

UNITED FIRE & CASUALTY CO  
Form 10-Q  
May 10, 2011  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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

for the quarterly period ended March 31, 2011

Commission File Number 001-34257

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

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Iowa  
(State of Incorporation)

42-0644327  
(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  NO

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  NO

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):

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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 May 5, 2011, 26,196,882 shares of common stock were outstanding.

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March 31, 2011

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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.”

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## PART I — FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## United Fire &amp; Casualty Company and Subsidiaries

## Consolidated Balance Sheets

(In Thousands, Except Per Share Data and Number of Shares)

	March 31, 2011 (unaudited)	December 31, 2010
<b>ASSETS</b>		
Investments		
Fixed maturities		
Held-to-maturity, at amortized cost (fair value \$5,936 in 2011 and \$6,422 in 2010)	\$5,859	\$6,364
Available-for-sale, at fair value (amortized cost \$2,529,946 in 2011 and \$2,178,666 in 2010)	2,619,909	2,278,429
Equity securities, at fair value (cost \$68,602 in 2011 and \$54,139 in 2010)	168,886	149,706
Trading securities, at fair value (amortized cost \$12,592 in 2011 and \$12,322 in 2010)	13,323	12,886
Mortgage loans	6,468	6,497
Policy loans	7,289	7,875
Other long-term investments	20,143	20,041
Short-term investments	1,100	1,100
	\$2,842,977	\$2,482,898
Cash and cash equivalents	\$165,772	\$180,057
Accrued investment income	32,318	28,977
Premiums receivable (net of allowance for doubtful accounts of \$581 in 2011 and \$1,001 in 2010)	168,728	124,459
Deferred policy acquisition costs	120,609	87,524
Property and equipment (primarily land and buildings, at cost, less accumulated depreciation of \$34,029 in 2011 and \$33,397 in 2010)	36,480	21,554
Reinsurance receivables and recoverables	104,094	46,731
Prepaid reinsurance premiums	8,009	1,586
Income taxes receivable	19,486	17,772
Goodwill and intangible assets	31,853	—
Other assets	19,203	15,881
<b>TOTAL ASSETS</b>	<b>\$3,549,529</b>	<b>\$3,007,439</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Future policy benefits and losses, claims and loss settlement expenses		
Property and casualty insurance	\$913,336	\$603,090
Life insurance	1,399,136	1,389,331
Unearned premiums	281,680	200,341
Accrued expenses and other liabilities	123,294	78,439
Deferred income taxes	15,179	19,814
Debt	82,900	—
Trust preferred securities	15,614	—
<b>TOTAL LIABILITIES</b>	<b>\$2,831,139</b>	<b>\$2,291,015</b>
Stockholders' Equity		

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Common stock, \$3.33 1/3 par value; authorized 75,000,000 shares; 26,195,552 shares issued and outstanding in both 2011 and 2010	\$87,318	\$87,318
Additional paid-in capital	136,622	136,147
Retained earnings	417,862	415,981
Accumulated other comprehensive income, net of tax	76,588	76,978
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>\$718,390</b>	<b>\$716,424</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$3,549,529</b>	<b>\$3,007,439</b>

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

Table of ContentsUnited Fire & Casualty Company and Subsidiaries  
Consolidated Statements of Income (Unaudited)

(In Thousands, Except Per Share Data and Number of Shares)	Three Months Ended March 31,	
	2011	2010
<b>Revenues</b>		
Net premiums earned	\$ 114,204	\$ 114,308
Investment income, net of investment expenses	27,063	27,968
Net realized investment gains		
Other-than-temporary impairment charges	—	(342
All other net realized gains	2,653	3,068
Total net realized investment gains	2,653	2,726
Other income	156	123
	\$ 144,076	\$ 145,125
<b>Benefits, Losses and Expenses</b>		
Losses and loss settlement expenses	\$ 76,182	\$ 68,363
Future policy benefits	8,182	6,390
Amortization of deferred policy acquisition costs	26,046	26,516
Other underwriting expenses	16,057	9,213
Interest on policyholders' accounts	10,670	10,801
	\$ 137,137	\$ 121,283
Income before income taxes	\$ 6,939	\$ 23,842
Federal income tax expense	1,129	4,729
Net Income	\$ 5,810	\$ 19,113
Weighted average common shares outstanding	26,195,552	26,435,269
Basic earnings per common share	0.22	0.72
Diluted earnings per common share	0.22	0.72
Cash dividends declared per common share	0.15	0.15

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



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Consolidated Statement of Stockholders' Equity (Unaudited)

(In Thousands, Except Per Share Data)	Three Months Ended March 31, 2011
Common stock	
Balance, beginning of year	\$87,318
Shares repurchased	—
Shares issued for stock-based awards	—
Balance, end of period	\$87,318
Additional paid-in capital	
Balance, beginning of year	\$136,147
Compensation expense and related tax benefit for stock-based award grants	475
Shares repurchased	—
Shares issued for stock-based awards	—
Balance, end of period	\$136,622
Retained earnings	
Balance, beginning of year	\$415,981
Net income	5,810
Dividends on common stock (\$0.15 per share)	(3,929) )
Balance, end of period	\$417,862
Accumulated other comprehensive income, net of tax	
Balance, beginning of year	\$76,978
Change in net unrealized appreciation <sup>(1)</sup>	(750) )
Change in underfunded status of employee benefit plans	360
Balance, end of period	\$76,588
Summary of changes	
Balance, beginning of year	\$716,424
Net income	5,810
All other changes in stockholders' equity accounts	(3,844) )
Balance, end of period	\$718,390

(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.

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United Fire & Casualty Company and Subsidiaries  
Consolidated Statements of Cash Flows (Unaudited)  
(In Thousands)

	Three Months Ended March 31,	
	2011	2010
<b>Cash Flows From Operating Activities</b>		
Net income	\$5,810	\$19,113
Adjustments to reconcile net income to net cash provided by operating activities		
Net accretion of bond premium	1,705	834
Depreciation and amortization	706	735
Stock-based compensation expense	489	447
Net realized investment gains	(2,653	) (2,726
Net cash flows from trading investments	(205	) 752
Deferred income tax expense	117	2,313
Changes in:		
Accrued investment income	400	(1,389
Premiums receivable	(8,447	) (4,153
Deferred policy acquisition costs	(1,719	) (2,935
Reinsurance receivables	830	1,352
Prepaid reinsurance premiums	(135	) (58
Income taxes receivable	1,018	17,435
Other assets	6,355	1,642
Future policy benefits and losses, claims and loss settlement expenses	7,146	3,480
Unearned premiums	9,090	5,186
Accrued expenses and other liabilities	11,507	(10,969
Deferred income taxes	2	(1,537
Other, net	(748	) 194
Total adjustments	\$25,458	\$10,603
Net cash provided by operating activities	\$31,268	\$29,716
<b>Cash Flows From Investing Activities</b>		
Proceeds from sale of available-for-sale investments	\$4,847	\$603
Proceeds from call and maturity of held-to-maturity investments	486	984
Proceeds from call and maturity of available-for-sale investments	197,447	86,868
Proceeds from short-term and other investments	1,548	2,781
Purchase of available-for-sale investments	(154,923	) (165,250
Purchase of short-term and other investments	(454	) (2,850
Change in securities lending collateral	—	(78,769
Net purchases and sales of property and equipment	(100	) (629
Acquisition of property and casualty company, net of cash acquired	(172,619	) —
Net cash used in investing activities	\$(123,768	) \$(156,262
<b>Cash Flows From Financing Activities</b>		
Policyholders' account balances		
Deposits to investment and universal life contracts	\$31,242	\$34,378
Withdrawals from investment and universal life contracts	(28,984	) (26,521
Borrowings of short-term debt	79,900	—
Change in securities lending payable	—	78,769
Payment of cash dividends	(3,929	) (3,955
Repurchase of common stock	—	(2,758
Issuance of common stock	—	1
Tax benefit from issuance of common stock	(14	) —

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Net cash provided by financing activities	\$78,215	\$79,914	
Net Change in Cash and Cash Equivalents	\$(14,285	) \$(46,632	)
Cash and Cash Equivalents at Beginning of Period	180,057	190,852	
Cash and Cash Equivalents at End of Period	\$165,772	\$144,220	

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

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United Fire & Casualty Company and Subsidiaries  
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 & Casualty Company or United Fire & Casualty Company and its consolidated subsidiaries and its affiliate, 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 29 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; 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 therein.

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, 2010. The review report of Ernst & Young LLP as of and for the three-month periods ended March 31, 2011, accompanies the unaudited Consolidated Financial Statements included in Part I, Item 1 “Financial Statements.”

Acquisition of Mercer Insurance Group

On March 28, 2011, we acquired 100 percent of the outstanding common stock of Mercer Insurance Group for cash consideration of \$191.5 million. Accordingly, the results of operations for Mercer Insurance Group have been included in the accompanying unaudited Consolidated Financial Statements from that date forward. After the acquisition, we market through over 1,000 independent agencies. The acquisition allows us to diversify our exposure to weather and other catastrophe risks across our geographic markets.

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This transaction was accounted for under the purchase method of accounting using Mercer Insurance Group historical financial information and applying fair value estimates to the acquired assets, liabilities and commitments as of the acquisition date. For additional information related to this acquisition, see Note 11, "Business Combinations."

In connection with this acquisition, we incurred \$5.5 million of expense related to change in control payments made to the former executive officers of Mercer Insurance Group.

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 three-month periods ended March 31, 2011 and 2010, we made no payments for income taxes. For the three-month period ended March 31, 2011, we received no tax refunds compared to tax refunds of \$13.5 million for the same period of 2010, due to the overpayment of prior year tax and operating loss carrybacks.

We made no significant payments of interest for the three-month periods ended March 31, 2011 and 2010, other than for interest credited to policyholders' accounts.

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 \$1.1 million (at an effective tax rate of 16.3 percent) and \$4.9 million (at an effective tax rate of 20.1 percent) for the three-month periods ended March 31, 2011 and 2010, respectively. Our effective tax rate is less 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 March 31, 2011 or December 31, 2010, or at any time during the three-month period ended March 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. There are ongoing examinations of income tax returns by the Internal Revenue Service of the 2008 tax year and by the State of Illinois of the 2007 and 2008 tax years.

Recently Issued Accounting Standards

Adopted Accounting Standards

Fair Value Measurements

In January 2010, the FASB issued revised accounting guidance that clarifies and provides additional disclosure requirements related to recurring and non-recurring fair value measurements. The guidance requires separate disclosures for the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements, along with an explanation for the transfers. Additionally, a separate disclosure is required for purchases, sales, issuances and settlements on a gross basis for Level 3 fair value measurements. The guidance also provides additional clarification for both the level of disaggregation reported for each class of assets or liabilities and disclosures of inputs and valuation techniques used to measure fair value for both recurring and non-recurring fair value

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measurements for assets and liabilities categorized as Level 2 or Level 3.

The new disclosures and clarifications of existing disclosures were effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010. Refer to Note 3 “Fair Value of Financial Instruments” for the information required to be disclosed upon our adoption of the guidance, effective January 1, 2011.

Pending Adoption of Accounting Standards

Policy Acquisition Costs

In October 2010, the FASB issued updated 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. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2011. We are currently evaluating the impact that our adoption of the guidance, effective January 1, 2012, will have on our Consolidated Financial Statements.

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 March 31, 2011 and December 31, 2010, is as follows:

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March 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				
General obligations	\$ 732	\$ 9	\$ —	\$ 741
Special revenue	4,655	96	104	4,647
Collateralized mortgage obligations	72	3	—	75
Mortgage-backed securities	400	73	—	473
Total Held-to-Maturity Fixed Maturities	\$ 5,859	\$ 181	\$ 104	\$ 5,936
<b>AVAILABLE-FOR-SALE</b>				
Fixed maturities				
Bonds				
U.S. government and government- sponsored enterprises				
U.S. Treasury	\$ 40,550	\$ 742	\$ 8	\$ 41,284
Agency	110,243	33	1,514	108,762
States, municipalities and political subdivisions				
General obligations	411,125	22,150	396	432,879
Special revenue	297,387	8,995	667	305,715
Foreign bonds				
Canadian	63,330	3,374	280	66,424
Other foreign	88,521	4,458	246	92,733
Public utilities				
Electric	221,575	9,457	941	230,091
Natural gas	46,824	2,195	328	48,691
Other	687	90	—	777
Corporate bonds				
Banks, trusts and insurance companies	343,522	12,849	2,228	354,143
Transportation	19,514	760	33	20,241
Energy	162,539	5,470	135	167,874
Technology	127,571	5,647	354	132,864
Basic industry	142,477	5,013	419	147,071
Pharmaceutical	41,112	1,284	42	42,354
Retail	31,521	1,548	130	32,939
Restaurants	12,464	381	162	12,683
Food and beverage	70,598	2,302	148	72,752
Other	202,147	9,793	707	211,233
Collateralized mortgage obligations	17,591	1,890	—	19,481
Mortgage-backed securities				
Government	53,938	—	—	53,938
Other	1,034	—	—	1,034
Asset-backed securities	23,215	469	199	23,485
Redeemable preferred stocks	461	—	—	461

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Total Available-For-Sale Fixed Maturities	\$2,529,946	\$ 98,900	\$ 8,937	\$2,619,909
Equity securities				
Common stocks				
Public utilities				
Electric	\$6,087	\$ 5,195	\$ 1	\$11,281
Natural gas	838	1,310	—	2,148
Banks, trusts and insurance companies				
Banks	11,479	33,856	57	45,278
Insurance	3,210	11,427	32	14,605
Other	1,621	1,917	—	3,538
All other common stocks				
Transportation	247	—	—	247
Energy	5,402	7,535	2	12,935
Technology	11,086	7,689	110	18,665
Basic industry	8,039	10,720	—	18,759
Pharmaceutical	8,789	6,941	36	15,694
Retail	2,847	—	—	2,847
Restaurants	380	—	—	380
Food and beverage	1,839	3,446	—	5,285
Other	4,584	10,626	50	15,160
Nonredeemable preferred stocks	2,154	2	92	2,064
Total Available-for-Sale Equity Securities	\$68,602	\$ 100,664	\$ 380	\$168,886
Total Available-for-Sale Securities	\$2,598,548	\$ 199,564	\$ 9,317	\$2,788,795



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December 31, 2010	(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				
General obligations	731	10	—	741
Special revenue	5,106	102	108	5,100
Collateralized mortgage obligations	83	4	—	87
Mortgage-backed securities	444	50	—	494
Total Held-to-Maturity Fixed Maturities	\$6,364	\$ 166	\$ 108	\$6,422
<b>AVAILABLE-FOR-SALE</b>				
Fixed maturities				
Bonds				
U.S. government and government- sponsored enterprises				
U.S. Treasury	38,133	943	—	39,076
Agency	104,049	96	1,014	103,131
States, municipalities and political subdivisions				
General obligations	371,788	22,327	338	393,777
Special revenue	216,245	9,782	594	225,433
Foreign bonds				
Canadian	69,209	3,908	194	72,923
Other	85,434	4,588	268	89,754
Public utilities				
Electric	203,405	11,247	519	214,133
Natural gas	56,873	2,560	359	59,074
Other	687	96	—	783
Corporate bonds				
Banks, trusts and insurance companies	291,953	13,621	2,891	302,683
Transportation	22,836	871	57	23,650
Energy	150,873	7,041	110	157,804
Technology	102,768	6,048	396	108,420
Basic industry	122,075	5,526	237	127,364
Pharmaceutical	18,087	1,446	—	19,533
Retail	22,338	1,662	148	23,852
Restaurants	11,493	418	182	11,729
Food and beverage	53,385	2,760	90	56,055
Other	212,715	10,508	873	222,350
Collateralized mortgage obligations	17,564	2,013	—	19,577
Mortgage-backed securities	2	—	—	2
Asset-backed securities	6,754	572	—	7,326
Total Available-For-Sale Fixed Maturities	\$2,178,666	\$ 108,033	\$ 8,270	\$2,278,429
Equity securities				
Common stocks				

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Public utilities				
Electric	\$6,011	\$ 4,751	\$ 1	\$10,761
Natural gas	838	1,159	—	1,997
Banks, trusts and insurance companies				
Banks	8,013	33,255	100	41,168
Insurance	3,129	11,320	41	14,408
Other	1,621	2,048	—	3,669
All other common stocks				
Transportation	1	—	—	1
Energy	5,211	6,235	2	11,444
Technology	8,100	6,692	139	14,653
Basic industry	7,789	9,116	—	16,905
Pharmaceutical	6,678	6,651	62	13,267
Food and beverage	668	3,428	—	4,096
Other	4,619	11,369	41	15,947
Nonredeemable preferred stocks	1,461	3	74	1,390
Total Available-for-Sale Equity Securities	\$54,139	\$ 96,027	\$ 460	\$149,706
Total Available-for-Sale Securities	\$2,232,805	\$ 204,060	\$ 8,730	\$2,428,135

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## Maturities

The amortized cost and fair value of held-to-maturity, available-for-sale and trading securities at March 31, 2011, 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
March 31, 2011						
Due in one year or less	\$230	\$239	\$240,102	\$246,093	\$2,768	\$2,741
Due after one year through five years	5,154	5,146	1,219,111	1,273,349	3,059	3,103
Due after five years through 10 years	3	3	915,756	941,930	—	—
Due after 10 years	—	—	59,199	60,599	6,765	7,479
Asset-backed securities	—	—	23,215	23,485	—	—
Mortgage-backed securities	400	473	54,972	54,972	—	—
Collateralized mortgage obligations	72	75	17,591	19,481	—	—
	\$5,859	\$5,936	\$2,529,946	\$2,619,909	\$12,592	\$13,323

## Net Realized Investment Gains and Losses

Net realized gains or losses on disposition of investments are computed using the specific identification method and are included in the computation of net income. A summary of realized investment gains resulting from investment sales, calls and other-than-temporary impairment (“OTTI”) charges are as follows:

(In Thousands)	Three Months Ended March 31,	
	2011	2010
Net realized investment gains (losses)		
Fixed maturities	\$1,386	\$489
Equity securities	1,116	2,344
Trading securities	316	(92 )
Other long-term investments	(165 )	(15 )
Total net realized investment gains	\$2,653	\$2,726

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

(In Thousands)	Three Months Ended March 31,	
	2011	2010
Proceeds from sales	\$4,847	\$602
Gross realized gains	90	402
Gross realized losses	516	—

There were no sales of held-to-maturity securities during the three-month periods ended March 31, 2011 and 2010. 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 realized investment gains and losses. Our portfolio of trading securities had a fair value of \$13.3 million and \$12.9 million at March 31, 2011 and December 31, 2010 respectively.

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The realized gains and losses attributable to the change in fair value during the reporting period of trading securities held at March 31, 2011 and 2010 were as follows:

(In Thousands)	Three Months Ended March 31,	
	2011	2010
Trading		
Realized gains	\$195	\$—
Realized losses	27	300

## Off-Balance Sheet Arrangements

Pursuant to an agreement with one of our limited liability partnership holdings, 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 \$11.0 million at March 31, 2011.

## Unrealized Appreciation and Depreciation

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

(In Thousands)	Three Months Ended March 31,	
	2011	2010
Change in net unrealized investment appreciation		
Available-for-sale fixed maturities and equity securities	\$(5,083 )	\$25,987
Deferred policy acquisition costs	3,930	(7,236 )
Income tax effect	403	(6,550 )
Total change in net unrealized appreciation, net of tax	\$(750 )	\$12,201

We continually monitor the difference between our cost basis and the estimated fair value of our investments. Our accounting policy for impairment recognition requires 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 March 31, 2011 and December 31, 2010. 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 March 31, 2011, 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 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 to our cost basis or the securities mature.

We have evaluated the unrealized losses reported for all of our equity securities at March 31, 2011, and have concluded that the duration and severity of these losses do not warrant the recognition of an OTTI charge at March 31, 2011. Our largest unrealized loss greater than 12 months on an individual equity security at March 31, 2011 was \$0.1 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.

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(In Thousands)

March 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								
Special revenue	—	\$—	\$—	2	\$595	\$ 104	\$595	\$ 104
Total Held-to-Maturity Fixed Maturities	—	\$—	\$—	2	\$595	\$ 104	\$595	\$ 104
<b>AVAILABLE-FOR-SALE</b>								
Fixed maturities								
Bonds								
U.S. government and government-sponsored enterprises								
U.S. Treasury	2	\$1,812	\$ 8	—	\$—	\$—	\$1,812	\$ 8
Agency	14	49,082	918	8	35,450	596	84,532	1,514
States, municipalities and political subdivisions								
General obligations	12	11,926	362	1	494	34	12,420	396
Special revenue	20	20,739	411	5	5,710	256	26,449	667
Foreign bonds								
Canadian	1	5,602	250	1	1,716	30	7,318	280
Other foreign	2	5,574	91	2	4,341	155	9,915	246
Public utilities								
Electric	5	12,021	69	7	21,446	872	33,467	941
Natural gas	1	1,102	65	2	4,740	263	5,842	328
Corporate bonds								
Banks, trusts and insurance companies	9	27,903	360	26	31,244	1,868	59,147	2,228
Transportation	2	4,165	33	—	—	—	4,165	33
Energy	1	3,324	109	2	3,636	26	6,960	135
Technology	4	6,867	117	2	6,226	237	13,093	354
Basic industry	2	4,599	77	5	17,974	342	22,573	419
Pharmaceutical	—	—	—	1	2,721	42	2,721	42
Retail	4	8,346	130	—	—	—	8,346	130
Restaurants	1	3,316	162	—	—	—	3,316	162
Food and beverage	1	1,997	20	3	11,603	128	13,600	148
Other	7	20,981	481	3	7,014	226	27,995	707
Asset-backed securities	1	486	199	—	—	—	486	199
Total Available-For-Sale Fixed Maturities	89	\$ 189,842	\$ 3,862	68	\$ 154,315	\$ 5,075	\$ 344,157	\$ 8,937
Equity securities								
Common stocks								
Public utilities								

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Electric	—	\$—	\$—	4	\$—	\$ 1	\$—	\$ 1
Banks, trusts and insurance companies								
Banks	—	—	—	1	499	57	499	57
Insurance	3	431	20	1	45	12	476	32
All other common stocks								
Energy	3	306	2	—	—	—	306	2
Technology	1	202	5	2	410	105	612	110
Pharmaceutical	2	1,472	28	3	90	8	1,562	36
Other	3	271	16	2	153	34	424	50
Nonredeemable preferred stocks	—	—	—	2	1,140	92	1,140	92
Total Available-for-Sale Equity Securities	12	\$2,682	\$ 71	16	\$2,337	\$ 309	\$5,019	\$ 380
Total Available-for-Sale Securities	101	\$192,524	\$ 3,933	84	\$156,652	\$ 5,384	\$349,176	\$ 9,317
Total	101	\$192,524	\$ 3,933	86	\$157,247	\$ 5,488	\$349,771	\$ 9,421

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(In Thousands)

December 31, 2010	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								
Special revenue	—	\$—	\$—	2	\$590	\$ 108	\$590	\$ 108
<b>Total Held-to-Maturity Fixed Maturities</b>	<b>—</b>	<b>\$—</b>	<b>\$—</b>	<b>2</b>	<b>\$590</b>	<b>\$ 108</b>	<b>\$590</b>	<b>\$ 108</b>
<b>AVAILABLE-FOR-SALE</b>								
Fixed maturities								
Bonds								
U.S. government and government-sponsored enterprises								
Agency States, municipalities and political subdivisions	12	\$41,374	\$ 626	7	\$30,661	\$ 388	\$72,035	\$ 1,014
General obligations	9	6,876	306	1	497	32	7,373	338
Special revenue	12	15,331	342	5	5,880	252	21,211	594
Foreign bonds								
Canadian	1	5,687	194	—	—	—	5,687	194
Other	2	6,634	235	2	2,873	33	9,507	268
Public utilities								
Electric	3	4,490	100	3	10,003	419	14,493	519
Natural gas	—	—	—	3	5,840	359	5,840	359
Corporate bonds								
Banks, trusts and insurance companies	6	22,451	355	32	38,821	2,536	61,272	2,891
Transportation	3	5,249	57	—	—	—	5,249	57
Energy	—	—	—	1	3,340	110	3,340	110
Technology	3	5,924	58	3	9,151	338	15,075	396
Basic industry	2	3,218	34	3	10,236	203	13,454	237
Retail	3	6,058	140	1	2,308	8	8,366	148
Restaurants	1	3,313	182	—	—	—	3,313	182
Food and beverage	1	2,006	12	1	3,009	78	5,015	90
Other	10	29,811	677	6	9,241	196	39,052	873
<b>Total Available-For-Sale Fixed Maturities</b>	<b>68</b>	<b>\$158,422</b>	<b>\$ 3,318</b>	<b>68</b>	<b>\$131,860</b>	<b>\$ 4,952</b>	<b>\$290,282</b>	<b>\$ 8,270</b>
Equity securities								
Common stocks								
Public utilities								
Electric	—	\$—	\$—	4	\$—	\$ 1	\$—	\$ 1
Banks, trusts and insurance companies								

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Banks	2	594	32	1	488	68	1,082	100
Insurance	1	260	28	1	43	13	303	41
All other common stock								
Energy	3	306	2	—	—	—	306	2
Technology	2	287	15	1	371	124	658	139
Pharmaceutical	2	1,437	62	—	—	—	1,437	62
Other	1	79	11	2	158	30	237	41
Nonredeemable preferred stocks	—	—	—	2	1,158	74	1,158	74
Total Available-for-Sale Equity Securities	11	\$2,963	\$ 150	11	\$2,218	\$ 310	\$5,181	\$ 460
Total Available-for-Sale Securities	79	\$161,385	\$ 3,468	79	\$134,078	\$ 5,262	\$295,463	\$ 8,730
Total	79	\$161,385	\$ 3,468	81	\$134,668	\$ 5,370	\$296,053	\$ 8,838



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## 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.

We base the estimated fair value of mortgage loans on discounted cash flows, utilizing the market rate of interest for similar loans in effect at the valuation date.

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 its short-term nature.

We calculate the fair value of the liabilities for all annuity products based upon the estimated value of the business, using current market rates and forecast assumptions and risk-adjusted discount rates, when relevant observable market data does not exist.

A summary of the carrying value and estimated fair value of our financial instruments at March 31, 2011 and December 31, 2010 is as follows:

(In Thousands)	March 31, 2011		December 31, 2010	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Assets				
Investments				
Held-to-maturity fixed maturities	\$5,936	\$5,859	\$6,422	\$6,364
Available-for-sale fixed maturities	2,619,909	2,619,909	2,278,429	2,278,429
Equity securities	168,886	168,886	149,706	149,706
Trading securities	13,323	13,323	12,886	12,886
Mortgage loans	7,490	6,468	7,658	6,497
Policy loans	7,289	7,289	7,875	7,875
Other long-term investments	20,143	20,143	20,041	20,041
Short-term investments	1,100	1,100	1,100	1,100
Cash and cash equivalents	165,772	165,772	180,057	180,057
Accrued investment income	32,318	32,318	28,977	28,977
Liabilities				
Policy reserves				
Annuity (accumulations) <sup>(1)</sup>	\$979,960	\$950,839	\$965,932	\$948,920
Annuity (benefit payments)	105,808	87,590	102,511	86,874

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

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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 (Level 1) and the lowest priority to unobservable inputs (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 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.

We validate the prices obtained from 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 March 31, 2011, 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 current 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 at March 31, 2011 and December 31, 2010:

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(In Thousands) Description	March 31, 2011	Fair Value Measurements		
		Level 1	Level 2	Level 3
<b>AVAILABLE-FOR-SALE</b>				
Fixed maturities				
Bonds				
U.S. government and government-sponsored enterprises				
U.S. Treasury	\$41,284	\$—	\$41,284	\$—
Agency	108,762	—	108,762	—
States, municipalities and political subdivisions				
General obligations	432,879	—	432,879	—
Special revenue	305,715	—	304,715	1,000
Foreign bonds				
Canadian	66,424	—	66,424	—
Other	92,733	—	91,618	1,115
Public utilities				
Electric	230,091	—	230,091	—
Natural gas	48,691	—	48,691	—
Other	777	—	777	—
Corporate bonds				
Banks, trusts and insurance companies	354,143	—	342,746	11,397
Transportation	20,241	—	20,241	—
Energy	167,874	—	167,874	—
Technology	132,864	—	132,864	—
Basic industry	147,071	—	141,697	5,374
Pharmaceutical	42,354	—	42,354	—
Retail	32,939	—	32,939	—
Restaurants	12,683	—	12,683	—
Food and beverage	72,752	—	72,752	—
Other	211,233	—	205,262	5,971
Collateralized mortgage obligations	19,481	—	19,481	—
Mortgage-backed securities				
Government	53,938	—	53,938	—
Other	1,034	—	1,034	—
Asset-backed securities	23,485	—	22,062	1,423
Redeemable preferred stocks	461	—	461	—
<b>Total Available-For-Sale Fixed Maturities</b>	<b>\$2,619,909</b>	<b>\$—</b>	<b>\$2,593,629</b>	<b>\$26,280</b>
Equity securities				
Common stocks				
Public utilities				
Electric	\$11,281	\$11,281	\$—	\$—
Natural gas	2,148	2,148	—	—
Banks, trusts and insurance companies				
Banks	45,278	40,475	—	4,803
Insurance	14,605	14,605	—	—
Other	3,538	3,538	—	—
All other common stocks				
Transportation	247	247	—	—

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Energy	12,935	12,935	—	—
Technology	18,665	18,632	33	—
Basic industry	18,759	18,759	—	—
Pharmaceutical	15,694	15,694	—	—
Retail	2,847	2,847	—	—
Restaurants	380	380	—	—
Food and beverage	5,285	5,285	—	—
Other	15,160	15,160	—	—
Nonredeemable preferred stocks	2,064	1,832	232	—
Total Available-for-Sale Equity Securities	\$ 168,886	\$ 163,818	\$ 265	\$ 4,803
Total Available-for-Sale Securities	\$ 2,788,795	\$ 163,818	\$ 2,593,894	\$ 31,083
<b>TRADING</b>				
Fixed maturities				
Bonds				
Foreign bonds	\$ 1,364	\$ —	\$ 1,364	\$ —
Corporate bonds				
Banks, trusts and insurance companies	1,194	—	1,194	—
Energy	3,007	—	3,007	—
Technology	3,367	—	3,367	—
Basic industry	1,348	—	1,348	—
Other	1,598	—	1,598	—
Redeemable preferred stocks	1,445	—	1,445	—
Total Trading Securities	\$ 13,323	\$ —	\$ 13,323	\$ —
Short-Term Investments	\$ 1,100	\$ 1,100	\$ —	\$ —
Money Market Accounts	\$ 67,734	\$ 67,734	\$ —	\$ —
Total	\$ 2,870,952	\$ 232,652	\$ 2,607,217	\$ 31,083

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(In Thousands) Description	December 31, 2010	Fair Value Measurements		
		Level 1	Level 2	Level 3
<b>AVAILABLE-FOR-SALE</b>				
Fixed maturities				
Bonds				
U.S. government and government-sponsored enterprises				
U.S. Treasury	\$39,076	\$—	\$39,076	\$—
Agency	103,131	—	103,131	—
States, municipalities and political subdivisions				
General obligations	393,777	—	393,777	—
Special revenue	225,433	—	224,432	1,001
Foreign bonds				
Canadian	72,923	—	72,923	—
Other	89,754	—	88,639	1,115
Public utilities				
Electric	214,133	—	214,098	35
Natural gas	59,074	—	59,074	—
Other	783	—	783	—
Corporate bonds				
Banks, trusts and insurance companies	302,683	—	290,625	12,058
Transportation	23,650	—	23,650	—
Energy	157,804	—	157,804	—
Technology	108,420	—	108,420	—
Basic industry	127,364	—	121,964	5,400
Pharmaceutical	19,533	—	19,533	—
Retail	23,852	—	23,852	—
Restaurants	11,729	—	11,729	—
Food and beverages	56,055	—	56,055	—
Other	222,350	—	216,329	6,021
Collateralized mortgage obligations	19,577	—	19,577	—
Mortgage-backed securities	2	—	2	—
Asset-backed securities	7,326	—	7,326	—
Total Available-For-Sale Fixed Maturities	\$2,278,429	\$—	\$2,252,799	\$25,630
Equity securities				
Common stocks				
Public utilities				
Electric	\$10,761	\$10,761	\$—	\$—
Natural gas	1,997	1,997	—	—
Banks, trusts and insurance companies				
Banks	41,168	39,633	—	1,535
Insurance	14,408	14,408	—	—
Other	3,669	3,669	—	—
All other common stocks				
Transportation	1	1	—	—
Energy	11,444	11,444	—	—
Technology	14,653	14,622	31	—
Basic industry	16,905	16,905	—	—

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Pharmaceutical	13,267	13,267	—	—
Food and beverage	4,096	4,096	—	—
Other	15,947	15,947	—	—
Nonredeemable preferred stocks	1,390	1,158	232	—
Total Available-for-Sale Equity Securities	\$ 149,706	\$ 147,908	\$ 263	\$ 1,535
Total Available-for-Sale Securities	\$ 2,428,135	\$ 147,908	\$ 2,253,062	\$ 27,165
TRADING				
Fixed maturities				
Bonds				
Foreign bonds	\$ 2,283	\$ —	\$ 2,283	\$ —
Corporate bonds				
Banks, trusts and insurance companies	1,198	—	1,198	—
Energy	3,311	—	3,311	—
Technology	2,844	—	2,844	—
Other	384	—	384	—
Redeemable preferred stocks	2,866	1,476	1,390	—
Total Trading Securities	\$ 12,886	\$ 1,476	\$ 11,410	\$ —
Short-Term Investments	\$ 1,100	\$ 1,100	\$ —	\$ —
Money Market Accounts	\$ 34,384	\$ 34,384	\$ —	\$ —
Total	\$ 2,476,505	\$ 184,868	\$ 2,264,472	\$ 27,165

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

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 three-month period ended March 31, 2011, the change in our available-for-sale securities categorized as Level 1 and Level 2 is the result of investment purchases made during the period, which were made from funds held in our money market accounts, and an increase in unrealized gains on both fixed maturities and equity securities. There were no significant transfers of securities in or out of Level 1 or Level 2 during the period.

Securities that may be 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.

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 a security does not have a market 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 March 31, 2011:

(In Thousands)	States, municipalities and political subdivisions	Foreign bonds	Public utilities	Corporate bonds	Asset-backed securities	Equities	Total	
Balance at January 1, 2011	\$ 1,001	\$ 1,115	\$ 35	\$ 23,479	\$ —	\$ 1,535	\$ 27,165	
Realized gains <sup>(1)</sup>	—	—	—	—	—	—	—	
Unrealized losses <sup>(1)</sup>	—	—	(2	) (465	) —	—	(467	)
Amortization	—	—	—	—	—	—	—	
Purchases	—	—	—	—	1,423	3,268	4,691	
Disposals	(1	) —	(33	) (272	) —	—	(306	)
Transfers in	—	—	—	—	—	—	—	
Transfers out	—	—	—	—	—	—	—	
Balance at March 31, 2011	\$ 1,000	\$ 1,115	\$ —	\$ 22,742	\$ 1,423	\$ 4,803	\$ 31,083	

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

As a result of our acquisition of Mercer Insurance Group, \$1.5 million in Level 3 securities are held by Mercer Insurance Group at the date of acquisition have been reported as "purchases." The reported "disposals" relates to the receipt of principal on calls or sink fund bonds, in accordance with the indentures.





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## NOTE 4. EMPLOYEE BENEFITS

## Pension and Postretirement Periodic Benefit Cost

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

(In Thousands)	Pension Plan		Postretirement Benefit Plan	
Three Months Ended March 31,	2011	2010	2011	2010
Net periodic benefit cost				
Service cost	\$713	\$687	\$379	\$337
Interest cost	1,143	1,054	356	305
Expected return on plan assets	(1,132 )	(1,001 )	—	—
Amortization of prior service cost	3	19	(14 )	(13 )
Amortization of net loss	545	603	20	—
Net periodic benefit cost	\$1,272	\$1,361	\$741	\$629

## Employer Contributions

We previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010 that we expected to contribute \$6.0 million to the pension plan for the 2011 plan year. For the three-month period ended March 31, 2011, we contributed \$0.8 million to the pension plan. We anticipate that the total contribution for the 2011 plan year will not vary significantly from our expected contribution.

## NOTE 5. STOCK-BASED COMPENSATION

## Non-qualified Employee Stock Award Plan

The United Fire & Casualty Company 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 659,258 authorized shares available for future issuance at March 31, 2011. 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 employees of United Fire or any of its affiliated companies who are in positions of substantial responsibility with United Fire.

Option awards 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 10.0 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 and fully vest after 5.0 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. Restricted and unrestricted stock awards are generally granted free of charge to the eligible employees of United Fire as designated by the Board of Directors.



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

Authorized Shares Available for Future Award Grants	Three Months Ended March 31, 2011	Inception to Date
Beginning balance	833,495	1,900,000
Number of awards granted	(174,737 )	(1,313,967 )
Number of awards forfeited or expired	500	73,225
Ending balance	659,258	659,258
Number of option awards exercised	—	167,292
Number of unrestricted stock awards vested	—	1,755
Number of restricted stock awards vested	—	—

#### Non-qualified Non-employee Director Stock Option and Restricted Stock Plan

We have a non-employee director stock option and restricted stock plan that authorizes United Fire to grant restricted and unrestricted stock and non-qualified stock options to purchase 150,000 shares of United Fire's common stock with 10,009 authorized shares available for future issuance at March 31, 2011. 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 plan.

The activity in our non-employee director stock option and restricted stock plan is displayed in the following table:

Authorized Shares Available for Future Award Grants	Three Months Ended March 31, 2011	Inception to Date
Beginning balance	37,003	150,000
Number of awards granted	(33,000 )	(152,000 )
Number of awards forfeited or expired	6,006	12,009
Ending balance	10,009	10,009
Number of awards exercised	—	—

#### Stock-Based Compensation Expense

For each of the three-month periods ended March 31, 2011 and 2010, we recognized stock-based compensation expense of \$0.5 million and \$0.4 million, respectively. As of March 31, 2011, we had \$5.1 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 2011 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)

2011	\$1,338
2012	1,432
2013	996
2014	765
2015	533
2016	58
Total	\$5,122



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## 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 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, 2010.

The following tables for the three-month periods ended March 31, 2011 and 2010, 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
Three Months Ended March 31, 2011			
Net premiums earned	\$ 101,764	\$ 12,532	\$ 114,296
Investment income, net of investment expenses	8,781	18,329	27,110
Net realized investment gains	1,208	1,445	2,653
Other income	8	148	156
Total reportable segment	\$ 111,761	\$ 32,454	\$ 144,215
Intersegment eliminations	(44	) (95	) (139
Total revenues	\$ 111,717	\$ 32,359	\$ 144,076
Net income	\$ 3,350	\$ 2,460	\$ 5,810
Assets	\$ 1,864,823	\$ 1,684,706	\$ 3,549,529
Invested assets	\$ 1,302,553	\$ 1,540,424	\$ 2,842,977
Three Months Ended March 31, 2010			
Net premiums earned	\$ 101,979	\$ 12,408	\$ 114,387
Investment income, net of investment expenses	8,682	19,331	28,013
Net realized investment gains	2,176	550	2,726
Other income	(58	) 181	123
Total reportable segment	\$ 112,779	\$ 32,470	\$ 145,249
Intersegment eliminations	(45	) (79	) (124
Total revenues	\$ 112,734	\$ 32,391	\$ 145,125
Net income	\$ 15,797	\$ 3,316	\$ 19,113
Assets	\$ 1,326,278	\$ 1,692,989	\$ 3,019,267
Invested assets	\$ 953,963	\$ 1,501,685	\$ 2,455,648

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## 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 fair 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 fair 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 March 31, 2011 and 2010:

(In Thousands Except Per Share Data)	Three Months Ended March 31,			
	2011		2010	
	Basic	Diluted	Basic	Diluted
Net income	\$5,810	\$5,810	\$19,113	\$19,113
Weighted-average common shares outstanding	26,196	26,196	26,435	26,435
Add dilutive effect of restricted stock awards	—	50	—	19
Add dilutive effect of stock options	—	6	—	—
Weighted-average common shares for EPS calculation	26,196	26,252	26,435	26,454
Earnings per common share	\$0.22	\$0.22	\$0.72	\$0.72
Awards excluded from diluted EPS calculation <sup>(1)</sup>	—	978	—	972

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

## NOTE 8. COMPREHENSIVE INCOME

Comprehensive income includes all changes in stockholders' equity during the reporting period except those resulting from investments by stockholders and dividends to stockholders.

The following table sets forth the components of our comprehensive income and the related tax effects for the three-month periods ended March 31, 2011 and 2010.

(In Thousands)	Three Months Ended March 31,	
	2011	2010
Net income	\$5,810	\$19,113
Other comprehensive income		
Change in net unrealized appreciation on investments	1,500	21,477
Adjustment for net realized gains included in income	(2,653)	(2,726)
Adjustment for costs included in employee benefit expense	554	615
Other comprehensive income (loss), before tax	(599)	19,366
Income tax effect	209	(6,765)
Other comprehensive income (loss), after tax	(390)	12,601

Comprehensive income	\$5,420	\$31,714
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NOTE 9. CONTINGENT LIABILITIES

Legal Proceedings

We have been named as a defendant in various lawsuits, including actions seeking certification from the court to proceed as a class action suit and actions filed by individual policyholders, relating to disputes arising from damages that occurred as a result of Hurricane Katrina in 2005. As of March 31, 2011, there were approximately 76 individual policyholder cases pending and four class action cases pending. These cases have been filed in Louisiana state courts and federal district courts and involve, among other claims, disputes as to the amount of reimbursable claims in particular cases, as well as the scope of insurance coverage under homeowners and commercial property policies due to flooding, civil authority actions, loss of use and business interruption. Certain of these cases also claim a breach of duty of good faith or violations of Louisiana insurance claims-handling laws or regulations and involve claims for punitive or exemplary damages. Other cases claim that under Louisiana's so-called "Valued Policy Law," the insurers must pay the total insured value of a home that is totally destroyed if any portion of such damage was caused by a covered peril, even if the principal cause of the loss was an excluded peril. Other cases challenge the scope or enforceability of the water damage exclusion in the policies.

Several actions pending against various insurers, including us, were consolidated for purposes of pre-trial discovery and motion practice under the caption *In re Katrina Canal Breaches Consolidated Litigation*, Civil Action No. 05-4182 in the United States District Court, Eastern District of Louisiana. In August 2009, the federal trial court ruled in that case that certification of policyholder claims as a class would be inappropriate. The Federal Fifth Circuit Court of Appeals affirmed the denial of class certification. Federal court rulings in that case are not binding on state courts, which do not have to follow the federal court ruling on class certification.

Following an April 2008 Louisiana Supreme Court decision finding that flood damage was clearly excluded from coverage, both state and federal courts have been reviewing pending lawsuits seeking class certification and other pending lawsuits in order to expedite pre-trial discovery and to move the cases towards trial. In the first three months of 2011, we concluded 14 of the approximately 90 lawsuits that were pending at December 31, 2010. Five new lawsuits were filed in 2010 against us, alleging entitlement to additional insurance recovery as a result of Katrina-related damage. We have asserted that these suits were not timely filed and should be dismissed, but the Louisiana Supreme Court issued an opinion on March 15, 2011 that appears to allow for filing of suit even at this late date by personal lines policyholders.

In July 2008, Lafayette Insurance Company participated in a hearing in St. Bernard Parish, Louisiana, after which the court entered an order certifying a class defined as all Lafayette Insurance Company personal lines policyholders within an eight parish area in and around New Orleans who sustained wind damage as a result of Hurricane Katrina and whose claims were at least partially denied or allegedly misadjusted. We appealed this order, and in a decision dated, November 30, 2010, the Louisiana Supreme Court ruled that certification of the class was improper and remanded the matter to the trial court for a determination of the merits of the claims of individually identified policyholders. In light of this decision, we believe it unlikely that class certification will be upheld in any of the other suits seeking class relief. As the claims of potential class members will likely not be addressed in class action litigation, the only recourse for policyholders dissatisfied with their insurance claim adjustment will be through litigation pursued by specifically named persons.

We intend to continue to defend the cases related to losses incurred as a consequence of Hurricane Katrina. We have established our loss and loss settlement expense reserves on the assumption that the application of the Valued Policy Law will not result in our having to pay damages for perils not otherwise covered. We believe that, in the aggregate, these reserves are adequate. Our evaluation of these claims and the adequacy of recorded reserves may change if we encounter adverse developments in the further defense of these claims. In the three-month periods ended March 31, 2011 and 2010, we incurred \$3.8 million and \$5.4 million in adverse development from our previous estimates for Hurricane Katrina claims litigation.

We are a defendant in two lawsuits filed in the Superior Court of New Jersey of Mercer County, Chancery Division, relating to our proposed merger with Mercer Insurance Group. Each of the lawsuits was filed as a class action on





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behalf of all of Mercer Insurance Group stockholders and alleges, among other things, that the consideration that stockholders will receive in connection with the merger is inadequate, that Mercer Insurance Group directors breached their fiduciary duties to stockholders in negotiating and approving the merger agreement, and that we aided and abetted the breach of fiduciary duty by Mercer Insurance Group's directors. Each of the complaints seeks various forms of relief, including injunctive relief that would have, if granted, prevented the merger from closing in accordance with the agreed-upon terms. We aggressively defended these cases and while we believe that the claims asserted against United Fire, Mercer Insurance Group, and its directors are without merit, we, along with Mercer Insurance Group, have negotiated a resolution of the suits. Court approval of the settlement is pending and is expected within the second or third quarter of 2011. The exposure under the terms of the negotiated resolution is not a material obligation of United Fire or Mercer Insurance Group. In the event that the court does not approve the negotiated resolution of the litigation, we believe that the exposure faced by United Fire and Mercer Insurance Group does not represent a material obligation.

We consider all of our other litigation pending as of March 31, 2011, to be ordinary, routine, and incidental to our business.

**NOTE 10. QUARTERLY SUPPLEMENTARY FINANCIAL INFORMATION (UNAUDITED)**

In the course of completing control procedures with respect to the accounting close for the three-month period ended March 31, 2011, management discovered an error in the information utilized in the calculation of deferrable acquisition costs for the property and casualty insurance segment throughout 2010. The use of the incorrect information did not impact the overall annual expense recognized for the year ended December 31, 2010; however it did have an impact of the pattern of expense recognition across quarters. The following table sets forth our selected 2010 unaudited quarterly financial information as originally presented in our Annual Report on Form 10-K that was filed on March 1, 2011 and as adjusted for the calculation error. The adjusted amounts have been used throughout this Form 10-Q for comparative purposes.

(In Thousands Except Per Share Data)

Quarters	First	Second	Third	Fourth	Total
As Originally Presented					
Year Ended December 31, 2010					
Total revenues	\$ 145,125	\$ 148,014	\$ 147,904	\$ 150,029	\$ 591,072
Income before income taxes	24,271	20,591	2,595	10,926	58,383
Net income	19,392	15,394	3,640	9,087	47,513
Basic earnings per share <sup>(1)</sup>	\$0.73	\$0.58	\$0.14	\$0.35	\$1.81
Diluted earnings per share <sup>(1)</sup>	0.73	0.58	0.14	0.35	1.80
As Adjusted					
Year Ended December 31, 2010					
Total revenues	\$ 145,125	\$ 148,014	\$ 147,904	\$ 150,029	\$ 591,072
Income before income taxes	23,842	18,340	1,492	14,709	58,383
Net income	19,113	13,931	2,923	11,546	47,513
Basic earnings per share <sup>(1)</sup>	\$0.72	\$0.53	\$0.11	\$0.44	\$1.81
Diluted earnings per share <sup>(1)</sup>	0.72	0.53	0.11	0.44	1.80

(1) The sum of the quarterly reported amounts may not equal the full year, as each is computed independently.

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## NOTE 11. BUSINESS COMBINATIONS

On March 28, 2011, we purchased 100.0 percent of the outstanding voting stock of Mercer Insurance Group, which was funded through a combination of cash and short-term debt. The excess of the purchase price over the estimated fair value of the tangible assets acquired and liabilities assumed at the acquisition date has been allocated to goodwill and other intangible assets of the property and casualty insurance segment.

Due to the short time frame since the acquisition date, our procedures to allocate the purchase price are not complete. We are in the process of completing valuation procedures of the separately identifiable intangible assets acquired and assessing the related useful lives of those assets. The purchase price allocations below have been established on a preliminary basis and may be subject to adjustment within one year from the acquisition date. We expect to continue to obtain further information during the measurement period to assist us in determining the fair value of certain of the assets acquired and liabilities assumed. Any adjustment to the fair values that have been preliminarily established will be recognized in the period that the adjustment is identified.

The following is a summary of the estimated fair value of the assets acquired and liabilities assumed of Mercer Insurance Group at the date of acquisition based on preliminary purchase price allocations:

(In Thousands) March 28, 2011

Assets	
Available-for-sale fixed maturity securities	\$401,548
Equity securities	10,666
Cash and cash equivalents	18,855
Accrued investment income	3,741
Premiums receivable	35,822
Value of business acquired	27,436
Property and equipment	15,516
Reinsurance receivables and recoverables	58,193
Prepaid reinsurance premiums	6,289
Income taxes receivable	2,732
Deferred income taxes	4,543
Goodwill and intangible assets	31,438
Other assets	10,107
Total assets	\$626,886
Liabilities	
Reserves for losses, claims and loss settlement expenses	\$310,647
Unearned premiums	72,249
Accrued expenses and other liabilities	33,902
Debt	3,000
Trust preferred securities	15,614
Total liabilities	\$435,412
Total net assets acquired	\$191,474

The fair value of available-for-sale fixed maturity securities is primarily based on quoted prices for similar financial instruments in markets that are not active or on inputs that are observable either directly or indirectly for the full term of the financial instrument. The fair value of equity securities is primarily based on unadjusted quoted prices in active markets for identical financial instruments that we have the ability to access.

The value of business acquired (“VOBA”) at the acquisition date is an intangible asset relating to the difference between the unearned premium reserves assumed in the transaction and the estimated fair value of the unexpired insurance policies, which consists of two components: (1) a provision for loss and loss settlement expenses that will be incurred

as the premium and exposure is earned and (2) a provision for policy maintenance costs related to

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servicing those policies until they expire. Loss and loss settlement expenses are valued in a manner identical to that used for loss reserve valuation. Policy maintenance costs are valued based on estimates of future cash flows that are discounted to present value using duration matched risk-free interest rates. VOBA is reported as a component of deferred policy acquisition costs in the accompanying unaudited Consolidated Balance Sheet and will be substantially amortized over a twelve-month period from the acquisition date in proportion to the timing of the estimated underwriting profit associated with the in-force business.

The fair value of reserves for losses, claims and loss settlement expenses related to incurred claims, and reinsurance receivables and recoverables is determined using a valuation model that is based on actuarial estimates of future cash flows for the underwriting liabilities. These future cash flows are adjusted for the time value of money using duration matched risk-free interest rates, which approximate current U.S. Treasury bill rates, and a risk margin to compensate the acquirer for the risk associated with these liabilities.

The fair value of all other tangible assets and liabilities approximated their carrying values at the acquisition date due to their short-term duration.

The following is a summary of our unaudited pro forma historical results, as if Mercer Insurance Group had been acquired on January 1, 2010:

(In Thousands)	Three Months Ended March 31,	
	2011	2010
Revenue	\$ 180,901	\$ 184,294
Net income <sup>(1)</sup>	1,902	22,864
Basic earnings per share	0.07	0.86
Diluted earnings per share	0.07	0.86

(1) The three-month period ended March 31, 2011, includes transaction related expenses incurred which reduced net income by \$11.4 million.

The unaudited pro forma results above have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had the acquisition occurred at January 1, 2010, nor are they necessarily indicative of future operating results. Annualized revenues of Mercer Insurance Group approximates \$147.3 million.

## NOTE 12. DEBT

As a result of our acquisition of Mercer Insurance Group, we have the following debt outstanding at March 31, 2011:  
(In Thousands)

	Repayment of Funds are Due on or Before	Amount Due
Federal Home Loan Bank	September 26, 2011	\$29,900
Bankers Trust Company	March 23, 2012 <sup>(1)</sup>	50,000
Union Bank of California	November 16, 2011	3,000
Total		\$82,900

(1) The borrowing under the line of credit is due on March 23, 2012; however, we have agreed to prepay to the lender the outstanding amount of any loan or loans, plus interest, on or before the nine-month anniversary of the loan issuance date, which was March 24, 2011.

In the first quarter of 2011, United Life Insurance Company borrowed \$29.9 million from the Federal Home Loan Bank. Under the terms of the loan, the effective interest rate is 0.37 percent and is calculated on a ratio of a 360 day year and the actual days. The loan agreement contains customary terms and conditions. Interest payments are due at maturity on this line. We deposited \$35.2 million in collateral with Federal Home Loan Bank to secure that loan. In the first quarter of 2011, we entered into a \$50.0 million line of credit with Bankers Trust Company. For the three-month period ended March 31, 2011, we utilized our entire line of credit to assist in the funding of our acquisition of Mercer Insurance Group. Under the terms of our credit agreement, interest on outstanding notes is adjusted monthly to the annual London Interbank Offered Rate ("LIBOR"), as published in the Wall Street Journal, plus 180 basis points, calculated using a 360 day year and the actual days of the month the principal is outstanding. In

addition,

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annually the line of credit incurs a facility charge of \$25,000. Interest payments are due monthly on this line. The line of credit contains certain financial covenants including covenants that require us to maintain our A.M. Best rating, a debt to capitalization ratio and minimum stockholders equity.

In addition, Mercer Insurance Group has the ability to borrow up to \$7.5 million on a bank line of credit with Union Bank of California. Under the terms of our credit agreement, the line of credit bears interest at the bank's base rate or an optional rate based on LIBOR. The effective annual interest rate as of March 31, 2011 was 3.25 percent. In addition, annually the line of credit incurs a facility charge of \$10,000. Interest payments are due monthly on this line. The line of credit contains certain financial covenants, including covenants that require Mercer Insurance Group to maintain a minimum statutory surplus and to distribute from subsidiaries no more than 50.0 percent of allowable dividends.

We were in compliance with all covenants for all credit agreements as of March 31, 2011.

**NOTE 13. TRUST PREFERRED SECURITIES**

In connection with our acquisition of Mercer Insurance Group, we acquired the following Trust Preferred Securities previously issued by a subsidiary of Mercer Insurance Group. The following Trust Preferred Securities were outstanding as of March 31, 2011:

	Issue Date	Amount	Interest Rate	Maturity Date
Financial Pacific Statutory Trust I	12/4/2002	\$5,028	LIBOR + 4.00%	12/4/2032
Financial Pacific Statutory Trust II	5/15/2003	3,015	LIBOR + 4.10%	5/15/2033
Financial Pacific Statutory Trust III	9/30/2003	7,571	LIBOR + 4.05%	9/30/2033
Total Trust Preferred Securities		\$15,614		

Mercer Insurance Group had previously formed three statutory business trusts for the purpose of issuing Floating Rate Capital Securities (Trust Preferred Securities) and investing the proceeds thereof in Junior Subordinated Debentures of Mercer Insurance Group. Mercer Insurance Group holds \$.5 million of equity securities to capitalize the Trusts. Trust Preferred Securities totaling \$15.5 million were issued to the public.

Financial Pacific Statutory Trust I (Trust I) is a Connecticut statutory business trust. The Trust issued 5.0 million shares of the Trust Preferred Securities at a price of \$1 per share for \$5.0 million. The Trust purchased \$5.0 million in Junior Subordinated Debentures from Mercer Insurance Group that mature on December 4, 2032. The annual effective rate of interest at March 31, 2011 is 8.74 percent.

Financial Pacific Statutory Trust II (Trust II) is a Connecticut statutory business trust. The Trust issued \$3.0 million shares of the Trust Preferred Securities at a price of \$1 per share for \$3.0 million. The Trust purchased \$3.0 million in Junior Subordinated Debentures from Mercer Insurance Group that mature on May 15, 2033. The annual effective rate of interest at March 31, 2011 is 8.9 percent.

Financial Pacific Statutory Trust III (Trust III) is a Delaware statutory business trust. The Trust issued 7.5 million shares of the Trust Preferred Securities at a price of \$1 per share for \$7.5 million. The Trust purchased \$7.6 million in Junior Subordinated Debentures from Mercer Insurance Group that mature on September 30, 2033. The annual effective rate of interest at March 31, 2011 is 8.89 percent.

Mercer Insurance Group has the right, at any time, so long as there are no continuing events of default, to defer payments of interest on the Junior Subordinated Debentures for a period not exceeding 20.0 consecutive quarters; but not beyond the stated maturity of the Junior Subordinated Debentures. To date no interest has been deferred. Mercer Insurance Group entered into three interest rate swap agreements to economically hedge the floating interest rate on the Junior Subordinated Debentures (see Note 14, "Derivative Instruments and Hedging Activities").

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The Trust Preferred Securities are subject to mandatory redemption, in whole or in part, upon repayment of the Junior Subordinated Debentures at maturity or their earlier redemption. Mercer Insurance Group has the right to redeem the Junior Subordinated Debentures after December 4, 2007 for Trust I, after May 15, 2008 for Trust II and after September 30, 2008 for Trust III. Mercer Insurance Group has not exercised these rights as of March 31, 2011.

## NOTE 14. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

Upon the acquisition of Mercer Insurance Group, we acquired three interest-rate swap agreements that hedge against interest rate risk on the trust preferred securities. The interest rate swaps are contracts to convert, for a period of time, the floating rate of the trust preferred securities issued by Mercer Insurance Group into a fixed rate without exchanging the instruments themselves. As of March 31, 2011, the interest-rate swap agreements had an aggregate notional principal amount of \$15.5 million.

The interest rate swaps are designated as non-hedge instruments. Accordingly, the fair value of the interest rate swaps is recognized as an asset or liability, with changes in fair value recognized in earnings. The estimated fair value of the interest rate swaps is based on the valuation received from the financial institution counterparty (“counterparty”).

By using financial instruments to manage exposure to changes in interest rates, we are exposed to market and credit risk. In this instance, market risk is the potential for loss due to a decrease in the fair value of securities resulting from uncontrollable fluctuations in interest rates. Credit risk is the potential failure of the counterparty to perform under the terms of the contract. If the fair value of a contract is positive, the counterparty would owe, therefore exposing us to credit risk. The credit risk inherent has been minimized by entering into transactions with high-quality counterparties, whose credit rating is higher than Aa, as rated by Moody's.

A summary of the fair value of interest rate swaps outstanding as of March 31, 2011, is as follows:

(In Thousands)	Three Months Ended March 31, 2011	
	Balance Sheet Location	Fair Value Liability
Interest rate swaps		
Union Bank of California (Trust I)	Accrued expenses and other liabilities	\$355
Union Bank of California (Trust II)	Accrued expenses and other liabilities	260
Union Bank of California (Trust III)	Accrued expenses and other liabilities	682
Total derivatives		\$1,297



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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders of  
United Fire & Casualty Company

We have reviewed the consolidated balance sheet of United Fire & Casualty Company as of March 31, 2011, and the related consolidated statements of income for the three-month periods ended March 31, 2011 and 2010, the consolidated statements of cash flows for the three-month periods ended March 31, 2011 and 2010, and the consolidated statement of stockholders' equity for the three-month period ended March 31, 2011. 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 & Casualty Company as of December 31, 2010, 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 February 28, 2011, 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, 2010, 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  
May 10, 2011

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

FORWARD-LOOKING STATEMENTS

This report may contain forward-looking statements about our operations, anticipated performance and other similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor under the Securities Act of 1933 and the Securities Exchange Act of 1934 for forward-looking statements. The forward-looking statements are not historical facts and involve risks and uncertainties that could cause actual results to differ materially from those expected and/or projected. Such forward-looking statements are based on current expectations, estimates, forecasts and projections about our company, the industry in which we operate, and beliefs and assumptions made by management. Words such as “expect(s),” “anticipate(s),” “intend(s),” “plan(s),” “believe(s),” “continue(s),” “seek(s),” “estimate(s),” “goal(s),” “target(s),” “forecast(s),” “project(s),” “predict(s),” “should,” “could,” “may,” “will continue,” “hope,” “can” and other words and terms of similar meaning or expression in connection with a discussion of future operations, financial performance or financial condition, are intended to identify forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed in such 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 II Item 1A, “Risk Factors” of this document. Among the factors that could cause our actual outcomes and results to differ are:

• The adequacy of our loss and loss settlement expense reserves established for Hurricane Katrina, which are based on management’s estimates.

• The frequency and severity of claims, including those related to catastrophe losses, and the impact those claims have on our loss reserve adequacy.

• Developments in the domestic and global financial markets that could affect our investment portfolio and financing plans.

• The calculation and recovery of deferred policy acquisition costs (“DAC”).

• The valuation of pension and other postretirement benefit obligations.

• Our relationship with our agents.

• Our relationship with our reinsurers.

• The financial strength rating of our reinsurers.

• Changes in industry trends and significant industry developments.

• The resolution of regulatory issues and litigation pertaining to and arising out of Hurricane Katrina.

Governmental actions, policies and regulations, including, but not limited to, domestic health care reform, financial services regulatory reform, corporate governance, new laws or regulations or court decisions interpreting existing laws and regulations or policy provisions.

• NASDAQ policies or regulations relating to corporate governance and the cost to comply.

These are representative of the risks, uncertainties, and assumptions that could cause actual outcomes and results to differ materially from what is expressed in forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report or as of the date they are made. Except as required under the federal securities laws and the rules and regulations of the Securities and

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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.

### 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; and 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; the valuation of reserves for future policy benefits; and the calculation of the deferred policy acquisition costs asset. 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, 2010.

### 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 the consolidated financial statements and related notes, including those in our Annual Report on Form 10-K for the year ended December 31, 2010. 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

Statutory Financial Measures

### OUR BUSINESS

Founded in 1946, United Fire & Casualty Company provides 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 1,000 independent agencies. Our life insurance subsidiary is licensed in 29 states and is represented by more than 900 independent agencies.

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.

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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 three months ended March 31, 2011, property and casualty business accounted for 89.1 percent of our net premiums earned, of which 90.1 percent was generated from commercial lines. Life insurance business made up 10.9 percent of our net premiums earned, of which 68.8 percent was generated from traditional life insurance products.

For the three months ended March 31, 2011, more than half of our property and casualty premiums were written in Iowa, Texas, Missouri, Louisiana, and Illinois, and over three-fourths of our life insurance premiums, which excludes annuities, were written in Iowa, Illinois, Wisconsin, Minnesota and Nebraska.

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 Consolidated Financial Statements.

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

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. Management believes that climate change considerations will not have a material impact on our profitability, unless a connection between future increased extreme weather events and climate change is ultimately proven true.

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.

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## CONSOLIDATED FINANCIAL HIGHLIGHTS

(In Thousands)	Three Months Ended March 31,		
	2011	2010	%
Revenues			
Net premiums earned	\$ 114,204	\$ 114,308	(0.1 )%
Investment income, net of investment expenses	27,063	27,968	(3.2 )
Net realized investment gains			
Other-than-temporary impairment charges	—	(342 )	—
All other net realized gains	2,653	3,068	(13.5 )
Total net realized investment gains	2,653	2,726	(2.7 )
Other income	156	123	26.8
	\$ 144,076	\$ 145,125	(0.7 )%
Benefits, Losses and Expenses			
Losses and loss settlement expenses	\$ 76,182	\$ 68,363	11.4
Increase in liability for future policy benefits	8,182	6,390	28.0
Amortization of deferred policy acquisition costs	26,046	26,516	(1.8 )
Other underwriting expenses	16,057	9,213	74.3
Interest on policyholders' accounts	10,670	10,801	(1.2 )
	\$ 137,137	\$ 121,283	13.1 %
Income before income taxes	\$ 6,939	\$ 23,842	(70.9 )%
Federal income tax expense	1,129	4,729	(76.1 )
Net Income	\$ 5,810	\$ 19,113	(69.6 )%

The following is a summary of our financial performance for the three-month periods ended March 31, 2011:

## Consolidated Results of Operations

Net income was \$5.8 million for the three-month period ended March 31, 2011, compared to \$19.1 million for the same period of 2010. The deterioration is largely attributable to the assumed reinsurance losses of \$10.0 million related to the New Zealand earthquake and the earthquake and tsunami in Japan. Also contributing were transaction costs totaling \$7.9 million related to our acquisition of Mercer Insurance Group, Inc.

Net premiums written for the property and casualty insurance segment increased 3.3 percent in the three-month period ended March 31, 2011, compared to the same period of 2010, reflecting an increase in new business being written and a slight increase in retention rates.

Deferred annuity deposits decreased 17.0 percent in the three-month period ended March 31, 2011, as compared to the same period of 2010. Deferred annuity sales continued to decline, as interest rates remain at historic lows and as some consumers with a greater tolerance for risk are choosing to surrender their annuities and place the funds in products with greater risk and potentially greater return. Deferred annuity deposits are not recorded as a component of net premiums written or net premiums earned; however, they do generate investment income.

Pre-tax catastrophe losses totaled \$12.4 million for the three-month period ended March 31, 2011 (compared to \$3.2 million in the same period of 2010) of which \$12.0 million was related to our assumed reinsurance portfolio, while the remaining \$.4 million in losses were the result of business written directly through agents.

Our combined ratio was affected by our assumed reinsurance losses and acquisition expenses for Mercer Insurance Group. It increased 14.3 percentage points to 106.5 percent in the three-month period ended March 31, 2011, from

92.2 percent in the same period of 2010.

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## Consolidated Financial Condition

Net cash outflow related to our annuity business was \$6.2 million in the three-month period ended March 31, 2011, compared to \$1.1 million in the same period of 2010. The decline is attributable to the decline in annuity deposits.

As of March 31, 2011, the book value per share of our common stock was \$27.42. Under our share repurchase program, which expires in August 2011, we are authorized to purchase an additional 172,826 shares of common stock. We did not purchase shares of our common stock in the first quarter of 2011.

Net unrealized investment gains totaled \$101.9 million as of March 31, 2011, a decrease of \$.8 million or 0.7 percent since December 31, 2010.

Our stockholders' equity increased to \$718.4 million at March 31, 2011, from \$716.4 million at December 31, 2010.

## RESULTS OF OPERATIONS

## Property and Casualty Insurance Segment Results

(In Thousands)	Three Months Ended March 31,			
	2011		2010	
Net premiums written <sup>(1)</sup>	\$110,726		\$107,124	
Net premiums earned	\$101,764		\$101,979	
Losses and loss settlement expenses	(71,665	)	(63,628	)
Amortization of deferred policy acquisition costs	(24,030	)	(24,043	)
Other underwriting expenses	(12,726	)	(6,360	)
Underwriting gain (loss) <sup>(1)</sup>	\$(6,657	)	\$7,948	
Investment income, net of investment expenses	8,737		8,637	
Net realized investment gains				
Other-than-temporary impairment charges	—		(36	)
All other net realized gains	1,208		2,212	
Total net realized investment gains	1,208		2,176	
Other income	8		(58	)
Income before income taxes	\$3,296		\$18,703	
GAAP Ratios:				
Net loss ratio	58.2	%	59.3	%
Catastrophes - effect on net loss ratio	12.2		3.1	
Net loss ratio	70.4	%	62.4	%
Expense ratio <sup>(2)</sup>	36.1		29.8	
Combined ratio	106.5	%	92.2	%

(1) The Statutory Financial Measures 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.

(2) Includes policyholder dividends.

Net premiums written increased in the first quarter of 2011, compared to the same period in 2010.

Commercial lines - We are encouraged by the increase in net premiums written, reflecting an increase in new business being written and a slight increase in policy retention rates. Overall, a sluggish economy continues to create

financial concerns for our insureds, and the competitive pricing environment continues to impact our business. During the first quarter of 2011, we slightly reduced our commercial lines renewal pricing levels to retain quality accounts, keeping

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approximately 80.0 percent of our accounts, which is in line with our retention goals. New business pricing remained unchanged.

Personal lines continues to provide positive growth in written premium, and we continue to be successful in obtaining increases in personal lines rates in certain states.

Federal income tax decreased \$3.1 million in the first quarter of 2011, as compared to the same period in 2010, due to lower pretax income in 2011, the effect of tax-exempt municipal bond interest income and non-taxable dividend income.

GAAP combined ratio increased by 14.3 percentage points compared to the first quarter of 2010, due primarily to the assumed reinsurance losses of \$10.0 million related to the New Zealand earthquake and the earthquake and tsunami in Japan. Also contributing to the increase were transaction costs totaling \$7.9 million related to our acquisition of Mercer Insurance Group.

Losses and loss settlement expenses increased 12.6 percent in the first quarter of 2011, as compared to the same period in 2010. The deterioration is primarily due to our assumed catastrophe losses during the quarter.

Noncatastrophe claims experience - overall claims frequency was relatively flat in the first quarter of 2011, while claims severity decreased slightly.

Other underwriting expenses increased 100.1 percent in the first quarter of 2011, primarily due to transaction costs of \$7.9 million related to our acquisition of Mercer Insurance Group that were incurred during the quarter.

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

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The following tables display our premiums earned, losses and loss settlement expenses and loss ratio by line of business for the three-month periods ended March 31, 2011 and 2010:

Three Months Ended March 31,

(In Thousands)	2011			2010			Loss Ratio	
	Premiums Earned	Losses and Loss Settlement Expenses Incurred	Loss Ratio	Premiums Earned	Losses and Loss Settlement Expenses Incurred	Loss Ratio		
Commercial lines								
Other liability <sup>(1)</sup>	\$27,929	\$11,181	40.0	% \$28,214	\$18,841	66.8	%	
Fire and allied lines <sup>(2)</sup>	23,898	19,668	82.3	24,384	19,799	81.2		
Automobile	22,694	13,658	60.2	23,010	13,830	60.1		
Workers' compensation	11,638	9,891	85.0	11,218	4,278	38.1		
Fidelity and surety	4,061	(9 )	(0.2 )	4,679	209	4.5		
Miscellaneous	203	217	106.9	202	36	17.8		
Total commercial lines	\$90,423	\$54,606	60.4	% \$91,707	\$56,993	62.1	%	
Personal lines								
Fire and allied lines <sup>(3)</sup>	\$6,247	\$2,199	35.2	% \$5,979	\$2,067	34.6	%	
Automobile	3,744	1,863	49.8	3,467	2,881	83.1		
Miscellaneous	123	2	1.6	87	(27 )	(31.0 )		
Total personal lines	\$10,114	\$4,064	40.2	% \$9,533	\$4,921	51.6	%	
Reinsurance assumed	\$1,227	\$12,995	N/A	\$739	\$1,714	231.9	%	
Total	\$101,764	\$71,665	70.5	% \$101,979	\$63,628	62.4	%	

(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.

Other liability - The loss ratio improved 26.8 percentage points to 40.0 percent in the three months ended March 31, 2011, from 66.8 percent in the three months ended March 31, 2010. The improvement in our loss ratio was due to an overall decline in severity quarter over quarter.

Workers' compensation - The loss ratio deteriorated 46.9 percentage points to 85.0 percent in the three months ended March 31, 2011, from 38.1 percent in the three months ended March 31, 2010. The deterioration in this line was due to an increase in severity, as the result of several large losses that occurred in the first quarter of 2011.

Fidelity and surety - In the three months ended March 31, 2011, we had favorable development of 0.2 percent compared to a loss ratio of 4.5 percent in the three months ended March 31, 2010. The favorable development in this line is due to minimal losses in the first quarter of 2011, along with recoveries from salvage and subrogation on prior year claims.

Personal lines automobile - The loss ratio improved 33.3 percentage points to 49.8 percent in the three months ended March 31, 2011, from 83.1 percent in the three months ended March 31, 2010. The improvement in our loss ratio was due to an increase in our premiums earned along with a slight decrease in frequency and a reduction in the average claim size.



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## Life Insurance Segment Results

(In Thousands)	Three Months Ended March 31,	
	2011	2010
Revenues		
Net premiums earned	\$12,440	\$12,329
Investment income, net	18,326	19,331
Net realized investment gains		
Other-than-temporary impairment charges	—	(306 )
All other net realized gains	1,445	856
Total net realized investment gains	1,445	550
Other income	148	181
Total Revenues	\$32,359	\$32,391
Benefits, Losses and Expenses		
Losses and loss settlement expenses	\$4,517	\$4,735
Increase in liability for future policy benefits	8,182	6,390
Amortization of deferred policy acquisition costs	2,016	2,473
Other underwriting expenses	3,331	2,853
Interest on policyholders' accounts	10,670	10,801
Total Benefits, Losses and Expenses	\$28,716	\$27,252
Income Before Income Taxes	\$3,643	\$5,139

Net premiums earned was flat in the first quarter of 2011, as compared to the same period of 2010, as we generally experience in the first quarter.

Investment income decreased 5.2 percent in the first quarter of 2011, compared to the same period of 2010; as our fixed maturity securities were called or matured, we were unable to obtain the same level of return on the reinvestment of these funds.

Increase in liability for future policy benefits increased 28.0 percent in the first quarter of 2011, compared to the same period of 2010. This reflects the impact on our reserves of the growth in the sale our single premium whole life insurance product and the demographics of insureds who purchased that product.

Interest on policyholders' accounts decreased 1.2 percent for the first quarter of 2011, as compared to the same period of 2010. As the guaranteed interest period on policies expires, the interest rate credited to the policies is lower due to market rates being lower than the rates at the inception of the policy.

Deferred annuity sales decreased 17.0 percent in the first quarter of 2011, as compared to the same period of 2010. Deferred annuity sales continued to decline, as interest rates remain at historic lows and as some consumers with a greater tolerance for risk are choosing to surrender their annuities and place the funds in products with greater risk and potentially greater return. Deferred annuity sales are not recorded as a component of net premiums written or net premiums earned; however, they do generate investment income.

Net cash outflow related to our annuity business was \$6.2 million in the first quarter of 2011, compared to \$1.1 million in the same period of 2010.

## Investment Portfolio

Our invested assets totaled \$2,843.0 million at March 31, 2011, compared to \$2,482.9 million at December 31, 2010. At March 31, 2011, fixed maturity securities comprised 92.4 percent of our investment portfolio, while equity securities accounted for 5.9 percent of the value of our portfolio. Because the primary purpose of our investment portfolio is to fund future claims payments, we follow a conservative investment philosophy, investing in a

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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 March 31, 2011, is presented at carrying value in the following table:

	Property & Casualty Insurance Segment		Life Insurance Segment		Total		
(Dollars in Thousands)		Percent of Total		Percent of Total		Percent of Total	
Fixed maturities <sup>(1)</sup>	\$ 1,124,211	86.4	% \$ 1,501,557	97.5	% \$ 2,625,768	92.4	%
Equity securities	147,670	11.3	21,216	1.4	168,886	5.9	
Trading securities	13,323	1.0	—	—	13,323	0.5	
Mortgage loans	—	—	6,468	0.4	6,468	0.2	
Policy loans	—	—	7,289	0.5	7,289	0.3	
Other long-term investments	16,249	1.2	3,894	0.2	20,143	0.7	
Short-term investments	1,100	0.1	—	—	1,100	—	
Total	\$ 1,302,553	100.0	% \$ 1,540,424	100.0	% \$ 2,842,977	100.0	%

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

At March 31, 2011, we classified \$2,619.9 million, or 99.8 percent, of our fixed maturities portfolio as available-for-sale, compared to \$2,278.4 million, or 99.7 percent, at December 31, 2010. 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 March 31, 2011 and December 31, 2010, we did not have direct exposure to investments in subprime mortgages or other credit enhancement vehicles. Our exposure to derivative instruments and hedging is described in detail in Note 14, "Derivative Instruments and Hedging Activities."

## 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 March 31, 2011 and December 31, 2010. 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.

(In Thousands)	March 31, 2011		December 31, 2010			
Rating	Carrying Value	% of Total		Carrying Value	% of Total	
AAA	\$392,289	14.9	%	\$279,009	12.1	%
AA	613,854	23.3		480,478	20.9	
A	591,780	22.4		476,044	20.7	
Baa/BBB	919,223	34.8		938,781	40.9	
Other/Not Rated	121,945	4.6		123,367	5.4	



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\$2,639,091	100.0	%	\$2,297,679	100.0	%
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Changes in the credit ratings of our fixed maturity securities portfolio at March 31, 2011, from December 31, 2010, is primarily due to the inclusion of Mercer Insurance Group's invested assets in our portfolio at March 31, 2011.

### Duration

Our investment portfolio comprises primarily 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 and opposite effect on these accounts. Mismatches in the duration of assets and liabilities can cause significant fluctuations in our results of operations. 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.

### Group

The weighted average duration of our portfolio of fixed maturity securities, at March 31, 2011, is 5.9 years compared to 5.2 years at December 31, 2010.

### Property and Casualty Insurance Segment

The weighted average duration of our portfolio of fixed maturity securities, at March 31, 2011, is 7.2 years compared to 6.5 years at December 31, 2010.

### Life Insurance Segment

The weighted average duration of our portfolio of fixed maturity securities, at both March 31, 2011 and December 31, 2010, is 3.6 years.

### Investment Results

We invest the premiums received from our policyholders and annuitants in order to generate investment income, which is an important component of our revenues and profitability. The amount of investment income that we are able to generate is affected by many factors, some of which are beyond our control. Some of these factors are: volatility in the financial markets, economic growth, inflation, interest rates, world political conditions, terrorism attacks or threats, adverse events affecting other companies in our industry or the industries in which we invest and other unpredictable national or world events.

Our net investment income decreased 3.2 percent in the first quarter of 2011, as compared to the same period of 2010, as interest rates remain at a historical low. Net realized investment gains were \$2.7 million in both the first quarter of 2011 and 2010. There were no other-than-temporary impairment charges in the first quarter of 2011 compared to \$0.3 million in the same period of 2010.

We continually monitor the difference between our cost basis and the estimated fair value of our investments. Our accounting policy for impairment recognition requires 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.

Changes in unrealized gains 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 March 31, 2011, are temporary based upon our current analysis of the issuers

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of the securities that we hold and current market events. It is possible that we could recognize impairment losses in future periods on securities that we own at March 31, 2011, 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 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 for loss and loss settlement expenses, payment of policyholder benefits under life insurance contracts; annuity withdrawals, operating expenses, dividends, pension plan contributions, and in recent years, common share 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 2011 and 2010.

Cash Flow Summary (In Thousands)	Three Months Ended March 31,	
	2011	2010
Cash provided provided by (used in)		
Operating activities	\$31,268	\$29,716
Investing activities	(123,768	) (156,262
Financing activities	78,215	79,914
Net decrease in cash and cash equivalents	\$(14,285	) \$(46,632

**Operating Activities**

Net cash flows provided by operating activities totaled \$31.3 million and \$29.7 million for the three-month periods ended March 31, 2011 and 2010, respectively. Cash flows for the three-month period ended March 31, 2011, reflected a higher level of: property and casualty insurance premiums collected; loss and loss settlement expense payments; and operating expenses paid, as compared to the same period of 2010. Additionally, we experienced a lower level of investment income received.

Our cash flows from operations were sufficient to meet our liquidity needs for the three-month periods ended March 31, 2011 and 2010.

**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, \$1.5 billion, or 56.1 percent of our fixed maturity portfolio will mature.

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We invest funds required for short-term cash needs primarily in money market accounts, which are classified as cash equivalents. At March 31, 2011, our cash and cash equivalents included \$67.7 million related to these money market accounts, compared to \$34.4 million at December 31, 2010.

Net cash flows used in investing activities totaled \$123.8 million and \$156.3 million for the three-month periods ended March 31, 2011 and 2010, respectively. In the three-month period ended March 31, 2011, we had cash inflows from sales of investments, scheduled and unscheduled investment maturities, redemptions and prepayments that totaled \$204.3 million compared to \$91.2 million for the same period in 2010.

Our cash outflows for investment purchases totaled \$155.4 million for the three-month period ended March 31, 2011, compared to \$168.1 million for the same period in 2010. In 2011, as in 2010, we have purchased a higher level of fixed maturity securities rather than other investment vehicles, such as short-term investments, which continue to be less profitable due to the lower market interest rates. In the three-month period ended March 31, 2011, we had cash outflows totaling \$172.6 million related to our acquisition of Mercer Insurance Group.

**Financing Activities**

Net cash flows provided by financing activities totaled \$78.2 million and \$79.9 million for the three-month periods ended March 31, 2011 and 2010, respectively. Included in our 2010 cash flows was \$78.8 million related to the change in our securities lending collateral for a program that was terminated in December 2010. Also impacting cash flows were borrowed funds totaling \$79.9 million related to our acquisition of Mercer Insurance Group. For further discussion of this, please see Note 12. "Debt."

In the three-month period ended March 31, 2011, net cash inflows from our life insurance segment's annuity and universal life deposits totaled \$2.3 million, compared to \$7.9 million for the same period of 2010, as interest rates continue to remain at historic lows and some consumers sought products with greater risk. In the three-month period ended March 31, 2011, we made no repurchases of our common stock, compared to \$2.8 million in the same period in 2010.

**Line of Credit**

In the first quarter of 2011, we entered into a \$50.0 million line of credit with Bankers Trust Company. This line of credit is available if our operating and investing cash flows are not sufficient to support our operations. For the three-month period ended March 31, 2011, we utilized our entire line of credit to assist in the funding of our acquisition of Mercer Insurance Group. For further discussion of the utilization of our line of credit, please see Note 12. "Debt."

Under the terms of our credit agreement, interest on outstanding notes is adjusted monthly to the annual London Interbank Offered Rate ("LIBOR"), as published in the Wall Street Journal, plus 180 basis points, calculated using a 360 day year and the actual days of the month the principal is outstanding. In addition, annually the line of credit incurs a facility charge of \$25,000. Interest payments are due monthly on this line. The line of credit contains certain financial covenants including covenants that require us to maintain our A.M. Best rating, a debt to capitalization ratio and minimum stockholders equity.

In addition, Mercer Insurance Group has the ability to borrow up to \$7.5 million on a bank line of credit with Union Bank of California. Under the terms of our credit agreement, the line of credit bears interest at the bank's base rate or an optional rate based on LIBOR. The effective annual interest rate as of March 31, 2011 was 3.25 percent. In addition, annually the line of credit incurs a facility charge of \$10,000. Interest payments are due monthly on this line. The line of credit contains certain financial covenants, including covenants that require Mercer Insurance Group to maintain a minimum statutory surplus and to distribute from subsidiaries no more than 50 percent of allowable dividends.

At the date of acquisition, Mercer Insurance Group had utilized \$3.0 million of the outstanding line of credit. We were in compliance with all covenants for all credit agreements as of March 31, 2011.

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## Stockholders' Equity

Stockholders' equity increased 0.3 percent to \$718.4 million at March 31, 2011, from \$716.4 million at December 31, 2010. The increase in our stockholders' equity was primarily attributable to net income of \$5.8 million. This was partially offset by stockholder dividends of \$3.9 million and net unrealized investment depreciation of \$0.8 million, net of tax. At March 31, 2011, book value per share was \$27.42 compared to \$27.35 at December 31, 2010.

## Off-Balance Sheet Arrangements

Pursuant to an agreement with one of our limited liability partnership holdings, we are contractually committed to make capital contributions up to \$15.0 million, upon request by the partnership, through December 31, 2017. As of March 31, 2011, our remaining potential contractual obligation was \$11.0 million.

## STATUTORY FINANCIAL MEASURES

United Fire and its subsidiaries are required to file financial statements based on statutory accounting principles in each of the states where our insurance companies are domiciled and licensed to conduct business. Management analyzes financial data and statements that are prepared in accordance with statutory accounting principles and GAAP. Regulation G promulgated by the Securities and Exchange Commission does not require reconciliation to GAAP of data prepared under a system of regulation of a government or governmental authority or self-regulatory organization that is applicable to the registrant.

The following definitions of key statutory financial measures are provided for our readers' convenience.

Premiums written is a measure of our overall business volume. 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, annuity deposits (i.e., sales) are included in direct statutory premiums written, whereas they are excluded 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. Premiums written is an important measure of business production for the period under review.

(In Thousands)	Three Months Ended March 31,	
	2011	2010
Net premiums written	\$123,159	\$119,436
Net change in unearned premium	(9,090 )	(5,186 )
Net change in prepaid reinsurance premium	135	58
Net premiums earned	\$114,204	\$114,308

Combined ratio is a commonly used statutory financial measure of underwriting performance. A combined ratio below 100.0 percent generally indicates a profitable book of business. 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").

When prepared in accordance with GAAP, the net loss ratio is calculated by dividing the sum of losses and loss settlement expenses by net premiums earned. The expense ratio is calculated by dividing nondeferred underwriting expenses and amortization of deferred policy acquisition costs by net premiums earned.

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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 premium earned; the expense ratio is calculated by dividing underwriting expenses by net premiums written.

Underwriting gain (loss) is the gain or loss by an insurance company from the business of insurance. Underwriting income is equal to net premiums earned less incurred losses and loss settlement expenses, amortization of deferred policy acquisition costs, and other underwriting expenses. We use this financial measure in evaluating the results of our operations and to analyze the profitability of our property and casualty insurance segment separately from our investment results.

Statutory surplus is the excess of admitted assets, those recognized and accepted by the state insurance laws to determine solvency, over liabilities.

**NON-GAAP FINANCIAL MEASURES**

We believe that disclosure of certain Non-GAAP financial measures enhances investor understanding of our financial performance. The following Non-GAAP financial measure is utilized in this filing:

Catastrophe losses 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, may determine for comparison purposes that it is more meaningful to exclude extraordinary catastrophe losses and resulting litigation, such as Hurricane Katrina. 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.

(In Thousands)	Three Months Ended March 31,	
	2011	2010
ISO catastrophes <sup>(1)</sup>	\$357	\$3,027
Non-ISO catastrophes <sup>(2)</sup>	12,065	129
Total catastrophes	\$12,422	\$3,156

(1) This number does not include development for Hurricane Katrina claims litigation totaling \$3.8 million and \$5.4 million for the three-month periods ended March 31, 2011 and 2010.

(2) 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 instrument 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. However, as a result of our acquisition of Mercer Insurance Group in 2011, our investment portfolio does utilize derivative instruments and hedges. Our exposure to derivative instruments and



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hedging is described in detail in Note 14, “Derivative Instruments and Hedging Activities.”

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 March 31, 2011, we did not hold investments in sub-prime mortgages, credit default swaps, or other credit-enhancement exposures.

While our primary market risk exposure is change 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 that reported in our Annual Report on Form 10-K for the year ended December 31, 2010.

## 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, have 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.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

For a detailed discussion of our legal proceedings, refer to Note 9. “Contingent Liabilities” in the Notes to Unaudited Consolidated Financial Statements of this Form 10-Q.

### ITEM 1A. RISK FACTORS

Our business is subject to a number of risks, including those identified in Part I, Item 1A of our 2010 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 1, 2011, 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.



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

Under our Share Repurchase Program, first announced in August 2007, we may purchase 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 company 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. It is currently set to expire in August 2011. For the three-month period ended March 31, 2011, we did not repurchase any shares of our common stock.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. (REMOVED AND RESERVED)

None.

## ITEM 5. OTHER INFORMATION

None.

## ITEM 6. EXHIBITS

Exhibit number	Exhibit description	Filed herewith
10.1	Loan Agreement, dated as of February 4, 2011, among United Life and Federal Home Loan Bank of Des Moines.	X
10.2	Terms of Agreement, dated as of March 24, 2011, between Federal Home Loan Bank and United Life Insurance Company	X
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

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SIGNATURES

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

UNITED FIRE & CASUALTY COMPANY  
(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

May 10, 2011  
(Date)

May 10, 2011  
(Date)