COMMENTARY: OVERVIEW OF OUR RESULTS
JOHN K. SMITH, PRESIDENT & CEO

It has been awhile since I have focused my article solely on our financial results. I thought it would be appropriate to delve into that area since much of my previous commentaries have been focused on the PLM/ILM affiliation.

PLM/ILM finished nine months of 2014 with mixed results from a financial viewpoint. While our underwriting loss for the year is very bad -- perhaps the worst that we have endured over the last 15 years -- a significant portion of it stems from our decision to move more quickly than originally anticipated in our affiliation plan to strengthen our reserve position on a number of larger claims in the ILM portfolio. The fact of the matter is that our reserve decisions over the years have always been more conservatively positioned. As a mutual insurance company, we are able to do this since we are not concerned with reporting our results to Wall Street or stockholders. Our sole concern has been and always will be to maintain a strong, conservatively-positioned balance sheet for the benefit of our policyholders. So rather than delay any reserve actions, we felt it appropriate to act on the ILM reserves. In light of the strong results we have enjoyed from an investment standpoint, we decided to accelerate our actions in this area.

The heavy manufacturing arena was somewhat quiet in 2013, but in 2014 we had to deal with a number of significant setbacks. We recorded a number of major losses in the sawmill arena (see related comments in the Sawmills/Heavy Manufacturing article).

Some specifics are probably in order. From a reserve strengthening viewpoint, we have added on larger ILM casualty reserves, approximately $8 million in net loss to our 2014 underwriting results, due to reserve changes on less than a dozen major claims that we have identified as concerns in the ILM portfolio. This does not include the routine reserve adjustments that are occurring on a day-to-day basis or the reserves that were adjusted on smaller claims (claims under $100,000). Earlier this year, we encouraged the ILM claims staff to review each of their files and put through whatever reserve adjustment they felt might be appropriate to bring the reserve to a more conservative level. This is similar to what we have done for years in the PLM world. While we were not surprised with the overall amount of dollars involved in this activity to date from a casualty loss perspective, we were surprised that there were an additional $2 million on older property claims that we had to adjust reserves on accordingly.

Further, ILM's approach to reserves included a year-end review of all outstanding claims and a one-time adjustment to "load" those claims for loss adjustment expense and IBNR, etc. In the PLM world, this is an ongoing process which occurs every business day throughout the year. I am not suggesting that one approach is better than the other but in a larger organization, moving more rapidly in this area is a normal course of business. Hence, we implemented PLM's approach to loading loss adjustment and IBNR reserves on every claim. On ILM claims, we have accelerated the year-end loading forward. At this juncture, this adds another $1 million of net loss to our results.

I would like to comment that all of this activity was fully expected and should be thought of as a "one time charge" due to the affiliation. In other words, we should finish 2014 in a comfortable position from a reserving viewpoint on our entire book of business.

Also, weather has not been kind to us. To date, we have endured over 175 weather-related claims and recognized a catastrophe loss earlier in the year as a result of the weight of ice and snow. Due to the nature of last winter's events, our CAT reinsurance program could not contain all of the loss that we endured within the catastrophe time period that is included in that contract. This means that while we picked up some protection as a result of our reinsurance program, we exceeded our expected $2.5 million retention by just over $1 million as a result of the timing of the claims occurrences during late January and early February. Even considering this, we have seen more weather-related claims this year than we have in past years. One of the three major losses we suffered this year was a tornado-related loss in Missouri that, on a gross loss basis before reinsurance, was $9 million.

While I was happy to report earlier this year that we felt good about the progress we have made in the heavy manufacturing arena, I am now forced to report to you that we have had a significant setback on our heavy manufacturing book of business and have endured another extremely poor year. We will explore our options in this segment of the niche in a separate article accordingly.

From an expense standpoint, we are indeed pleased with our results. Our expense ratio has dropped dramatically on a year-over-year basis as a result of tightening expense controls while at the same time achieving our production objective -- both components of our expense ratio. The actions we have taken from a staffing standpoint are only now coming in line. Our thought is that we will see further improvement if our production holds through the fourth quarter. We have not been "penny wise and pound foolish" this past year as we have spent considerable funds in taking advantage of affiliated-related systems improvements, increased advertising of brand awareness and higher

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The Hardwood Forest Foundation is working tirelessly to ensure children are receiving true, scientific educational materials and curriculum pertaining to our industry. And we need your help more than ever.

No doubt about it, if you were to walk into any classroom in your area and ask, by a show of hands, how many students believed that harvesting trees was 'bad' for the environment—most every hand would be raised. And if you asked how many of the students had used a tree product that day, only a few hands would pop up.

Not only is this reality detrimental to a solid foundation of literacy about our forests, it is detrimental to YOUR reputation. Please donate to the Foundation today. Log onto www.hardwoodforest.org or call (901) 507-0312. All donations are 100 percent tax deductible.

This is the third consecutive year that the WBMA Safety Group has received a dividend. WBMA is a trade association serving building material dealers throughout the states of Alaska, Idaho, Montana, Oregon and Washington.

Congratulations to all participating members of the three dividend groups! If you have questions about any of our Safety Group Dividend Plans, please contact Susan Cho at (267) 825-9350 or at scho@plmins.com.
Pennsylvania and Indiana Lumbermens Mutual Insurance Companies celebrated the one year anniversary of its affiliation on October 25, 2014. We are proud of our progress over the past year and would like to take a moment to reflect on some of the improvements we have made as a company.

Since the affiliation began, PLM/ILM has been focused on determining best practices, streamlining processes, and developing quality products and services, all while maintaining and growing our relationships with insureds and producers. While many of our improvements have been made internally, we are proud of the new products and services we have made available to our insureds and producers.

**PLM/ILM WEBSITE**

The new PLM/ILM website, www.plmilm.com, was launched at the beginning of August. The site displays combined and updated information about doing business with both PLM and ILM. The new structure offers functional viewing on any device as well as easier navigation so insureds and producers can find the information they need, whenever and wherever they need it. We remain dedicated to providing world-class customer service. Our new website opens yet another avenue of communication for us to service your needs. Fillable PDFs and direct requests made through the website give current and potential insureds and producers multiple ways to connect with us.

**NEW BILLING SYSTEM**

PLM/ILM recently announced the introduction of the new PLM billing system for policies effective beginning January 1, 2015. The system was created internally and was developed largely from the suggestions of our insureds and producers. It will offer modernized and simplified billing options that will eliminate unnecessary time that insureds spend on premium payments. New payments types and payment options focus on what works best for insureds and will enhance the insurance buying experience for customers and producers.

The new billing system will offer multiple electronic payment methods in addition to the traditional check pay option. Insureds will have the option for hassle-free billing by signing up for Electronic Funds Transfer prior to their policy effective date. By returning a completed Authorization Agreement, insureds allow PLM/ILM to automatically deduct premium payments from their bank, eliminating the worry of late payments. For those that would prefer to manage their individual payments, the ePay option will allow insureds to create an account to make a one-time payment or to set up reoccurring payments. All electronic options eliminate the $9 service fee per installment incurred on check pay. PLM will move from policy billing to account billing, eliminating the confusion of multiple payments. Instead of payment coupons, insureds will simply receive a single invoice broken down by policy. Endorsement premiums will no longer be billed separately, but will instead be equally distributed among the remaining payments for the policy term.

The implementation of the new website and the new PLM billing system, as well as the introduction of the PLM producer portal last February, contribute to PLM/ILM accomplishing short-term affiliation goals of streamlining systems and processes. With the implementation of the new PLM billing system, PLM and ILM will now be providing similar products and services. These parallel business operations give us the opportunity to develop and delve into our Policy Movement Project that will focus on our long-term goals of best utilizing our two highly-respected brand names.

The Policy Movement Project will initially involve moving all policies onto a common rating platform. Instead of PLM and ILM providing similar products and services, we want to provide the best products and services across both brand names, tailored to the individual needs of our insureds. We have been dedicated to and actively involved in the lumber, woodworking, and building material industries for over 115 years and we are constantly developing our products and services to best suit the evolving needs of the industry. The policy movement project will occur over the next couple of years but will grow our relationships with insureds and producers long into the future.

As mutual companies, PLM and ILM have always remained dedicated to its insureds. Since the beginning, the affiliation of our two great companies has been focused on creating the best insurance buying experience for our insureds. With a shared purpose and mutual values, we believe the improvements we have made over the past year and will continue to make into the future will help develop and grow our relationship together and with our insureds and producers.

**HELP US, HELP YOU!**

A number of States require insurance carriers to regularly submit Proof of Policyholder Insurance Coverage to the Departments of Motor Vehicles to reduce the costs associated with uninsured motorists. Several states now require electronic Automobile Liability Insurance Reporting (ALIR), and many more states will join soon. The reporting requirements differ from state to state, making it difficult, time-consuming and costly to comply with.

Currently, PLM/ILM reports liability insurance to 12 states electronically: Alabama, Arizona, Arkansas, Florida, Georgia, Louisiana, Maryland, Massachusetts, Nevada, New Mexico, New York and North Carolina. By the end of this year, Texas anticipates that they will be ready for electronic commercial liability reporting as well.

In states where we are required to submit information electronically, the data reported must match the Registration Card exactly. Our proof of coverage is directly compared to the DMV registration records. This means that any variation, no matter how small, from what appears on the registration card can result in a rejection of our proof of coverage. When that occurs, states will issue Non-Compliance Notices to the insureds and without the correct response, could result in vehicle suspensions and/or sanctions. In order to correct any discrepancies, we need to request a copy of the insured’s registration card.

Help us, help you. Please ensure that the vehicle registration information contained in the original application is accurate. CONTINUED ON PAGE 6...
I have written many articles about the profitability problems in this segment of our book of business. Over the past couple of years we have taken what some would say “drastic actions” to return the segment to some semblance of profitability. To be honest we have not been successful in doing so. While we did break even last year in this segment, over the past five years we have collected almost $200 million in premium and paid out (before our expenses) just over $200 million in losses. If you add in our expenses, our underwriting loss on this business is in the range of $60 million dollars. This year we are once again experiencing poor results.

Historically this has been the most difficult area to produce an underwriting profit for both the reinsurers that we (and all the other major players left in the niche) work with and for us as a primary insurance company. 2014 has simply produced a plethora of claims activity that is important to consider as you read this.

Since 1/1, the industry has suffered the following losses that we are aware of:

- Plywood Operation - Pacific Northwest -- $75 million (this is the coverage limit; the losses are rumored to be just under $100 million)
- Plywood Operation - New England -- $20 million
- Sawmill Operation - Southeastern U.S. -- $19.5 million
- Sawmill Operation - Midwest U.S. -- $14.5 million
- Sawmill Operation - New York -- $9.5 million
- Sawmill Operation - Midwest U.S. -- $5 million

This doesn't include any losses below $5 million. It also doesn't include a loss that occurred just a couple of weeks ago in California which is rumored to be in excess of $10 million -- possibly closer to $20 million!

Totaling these up (and admittedly some of the numbers are not firm as we would like for this type of analysis) we know that the heavy manufacturing classes in the wood niche produced in excess of $130 million of losses in the first nine months of 2014. This is simply losses in excess of $5 million and doesn't include any smaller loss activity.

While only two of the above claims are PLM claims and our exposure on a net basis is limited and manageable on those two claims, the fact of the matter is the entire heavy manufacturing niche is not producing enough premium to entice most primary insurers (like PLM/ILM) or reinsurance companies to risk their capital by continuing to insure operations of this nature.

I have suggested before that the number of reinsurers, worldwide, interested in this segment of business has shrunk considerably in the 15 years that I have worked in the wood niche. We are down to only a handful and I would think that this handful will shrink further this year as we go into the marketplace looking to renew our reinsurance program solely due to the loss experience for the class of business outlined above.

A critical point to understand here is that most of these accounts or insureds that suffered these losses have never had a loss before. This is not unusual in a SEVERITY niche. I have insureds tell me all the time that they have never had a loss and don't understand why their premium is going up. The fact of the matter is that in a severity niche like property coverage on heavy wood manufacturers, past loss free experience really does not mean all that much from a pricing standpoint. From an insurance company viewpoint, it's about gathering a group of well run, high quality insureds in this segment and collecting enough premium from them all so that you can pay the loss that will inevitably occur within the group.

So, we have come to a crossroad with the return of significant unprofitability in this segment of our business.

What is disconcerting about our results is that we have focused a great deal of time and attention to understanding the loss drivers in this segment of the niche. We have gained an understanding of the hazards behind large losses and taken action -- aggressive action -- in order to put the problems behind us! Yet we have not been able to do so. What is truly frightening in our minds is that the losses we have endured this year involve top flight operations run by, in our estimation, excellent operators.

Some of the issues in the niche that we have identified this year include the following:

- We clearly recognize that the larger the operation, the more significant the exposure to loss. Simply put, once the fire gets started there is so much more fuel available that normal loss controls do not work.
- We have come to understand that the owner is not an on-site operator, the exposure to loss dramatically increases as the level of personal on-site involvement slips.
- We have identified that employee selection, training and control is increasingly important in this niche. Mistakes by individual employees, even when they have the best interest of their employers at heart, can and do lead to significant losses.
- We have come to understand that the welding program we have put in place, as tough as it is, needs to be tightened further. We are in the process of doing just that. This includes the production of a hot work video and a certification test for on-site welders. We have seen a dramatic reduction in the number of hot work/welding losses over the years and we believe it is because of the detailed, comprehensive program that we insist upon. We now recognize that if we are to stay in this segment of business, we need a detailed underwriting and loss control policy similar to welding that addresses the following areas of our insureds’ operations:
  - Housekeeping
  - Machine Maintenance
  - Electrical Maintenance
  - Fire Response
  - Catastrophe Planning

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SAWMILLS/HEAVY MANUFACTURING

Critically, after evaluating the potential impact of these new underwriting policies and programs, we have recognized that the pricing of some of our heavy manufacturing insureds -- particularly those with values over $10 million -- has to increase. The potential increase must be dramatic if we are to remain a viable player and attract the necessary reinsurance providers for this segment of our business.

The problem with this whole scenario is that even if we could achieve all these steps and turn the corner on our profitability, we are not sure that they are saleable in the marketplace. Even then, we are not absolutely, positively sure that it would result in profitability for both the reinsurers we require to maintain the marketplace and PLM/ILM.

If we were a stock insurance company as opposed to a mutual insurance company, the answer would be a simple one. We would non-renew the 500+ heavy manufacturing accounts that we insure and move on. They represent less than 15% of our insureds and only 20% of our premium! In order to be a viable long-term player in the niche -- which we have been for over a 100 years -- we need to step back and make some hard, short-term decisions that will benefit all in the long run.

We are aware that our major competitor in this niche has apparently begun to take aggressive actions as a result, we believe, of some of the losses that they have endured. These actions, as far as we are aware, have included midterm cancellations and decisions to non-renew certain segments of the heavy manufacturing niche as well as unprotected operations. Further, they are taking dramatic price increases and in some cases, not honoring sidebar, two-year rate guarantee agreements.

A smaller competitor that only 18 months ago sent out solicitations using some of our underwriting actions as a reason to get a quote with them, has recently started to dump its heavy manufacturing business due to losses.

A number of companies that picked up many of our pallet accounts are now limiting coverage, taking significant rate increases or non-renewing the businesses that they newly acquired in the last two years through aggressive pricing.

Whether all of this is accurate or not it is tough for us to tell, but what we do know is that we are being flooded with submissions on heavy manufacturing risks with requests for quotations in an extremely short time frame. In many cases, the insured is working on a short-term extension of coverage by the current carrier.

Further, we have received calls from several significant insurance brokers that have large volumes of business with the aforementioned competitors where they have expressed an interest in moving their entire book of business to us, or back to us, in some cases.

To be honest, we have not aggressively engaged in pursuing these "opportunities". To be blunt -- as many of you know I can be -- we have enough problems with the book of this business that we have without expanding it aggressively in the current market environment. This cannot work unless we can put the appropriate underwriting and loss controls in place and develop an adequate premium that would allow our reinsurers, and us, to make a profit on this business. That is not to say that we will not write any new heavy manufacturing business; we simply will not write all that many new accounts.

Now with that said, I have reviewed some of the "deals" that are coming into the marketplace for a number of friends that I have come to know over the years that for one reason or another are not PLM or ILM insureds.

I know a number of brokers are offering "excess and surplus" companies and/or "layered" approaches that on the surface may look like a good deal, but in reality are a problem. The first issue with this approach is the very nature of the companies offering them. Excess and surplus lines companies tend to jump into the market with a short-term view, hoping to take advantage of a market dislocation and the opportunity that may briefly exist as a result. There are a host of issues associated with excess and surplus lines coverage. My recommendation would be that any insured who perceives this to be a viable alternative should get in writing from the broker presenting these opportunities what the disadvantages are of dealing with excess and surplus lines carriers. If you are presented a "layered" approach, I would get a detailed explanation, in writing, on how a claim settlement is going to occur and understand who the companies involved are.

The point is, you need to be fully cognizant of the issues surrounding the purchase of these types of coverage and not simply look at the premium which all too many businesses use as their only decision point.

We are also aware that there are a couple of potential "newcomers" to the niche. In both cases, we know these carriers well. They are stock insurance companies and feel there is an opportunity to create value for their stockholders due to the significantly increased pricing that is quickly impacting this segment of the niche. While they look great now, I can assure you they will be gone as soon as the first seven (or eight) digit loss is ushered across their threshold and they start running Return on Revenue (ROR) and Return on Earnings (ROE) calculations!

As I write this, how PLM/ILM is going to shake out in this segment of the niche is still a bit blurry for me. To be totally transparent, unless we can convince ourselves that business operators in the heavy manufacturing segment are willing to aggressively manage their own loss control programs and broadly encourage a safety culture and pay what we believe is the exorbitant cost of reinsurance that we will be charged upon renewal, then our decision will be easily made.

We are at a crossroad. We will not jeopardize the future of PLM/ILM and the future of our financial stability as a result of a small segment of our policyholders.

I would think by the time you read this, the situation and marketplace will have clarified itself and we will be in a better position to answer our questions about the future. I can assure you that our answer will involve major changes in our approach to this limited segment of our operation.

As always, we welcome your thoughts and your comments.
HELP US, HELP YOU! ...CONTINUED FROM PAGE 3

Further, if you receive a request from us or your agent/broker asking for a copy of the registration card, please respond quickly. This will allow us to correct any discrepancies or errors with the DMV, thereby avoiding any potential non-compliance issues, suspensions and/or penalties that could be assessed against you.

If you have any questions regarding our liability reporting process, please contact Customer Service at 800.752.1895 or at custserv@plmins.com.

PLM/ILM WINS UNITED WAY “CULTURE OF CARING AWARD”

On June 19, 2014, the United Way of Greater Philadelphia and Southern New Jersey released its Campaign Award Winners for the 2013-14 campaign season, honoring Pennsylvania and Indiana Lumbermens Mutual Insurance Companies (PLM/ILM) as one of two recipients of the “Culture of Caring Award”.

United Way noted, “Our Culture of Caring Award recognizes organizations with outstanding employee participation. This has always been a strong point for Pennsylvania Lumbermens, and was highlighted this year with your new affiliation with Indiana Lumbermens.” Ultimately, over 90% of employees contributed to the Southeastern Pennsylvania and New Jersey or Indiana United Way campaigns in 2013-14.

We kicked off our 2014-15 United Way campaign drive on October 17, 2014 with a presentation of the “Culture of Caring Award” to PLM/ILM. As of early November, we are proud to say that the response to this year’s campaign has been overwhelming with 91.4% of PLM/ILM employees who are contributing to United Way. This is a testament to the commitment of our employees to their communities. The company plans to continue its campaign drive for 2014-15 through November and hopes to reach its goal of over 95% employee contributions to the United Way.