



# Hallmark Financial Services, Inc.

*presentation for*

## Southwest IDEAS Investor Conference

*November 21, 2013*

# Forward-Looking Statements

This presentation contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created thereby. These statements include the plans and objectives of management for future operations, including plans and objectives relating to future growth of our business activities and availability of funds.

The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions, regulatory framework, weather-related events and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this presentation will prove to be accurate.

In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by any person that our objectives and plans will be achieved.

More information about forward-looking statements and the risk factors associated with our company are included in our annual, quarterly and other reports filed with the Securities and Exchange Commission.



# Strategic Overview

**Mark Schwarz**

Executive Chairman



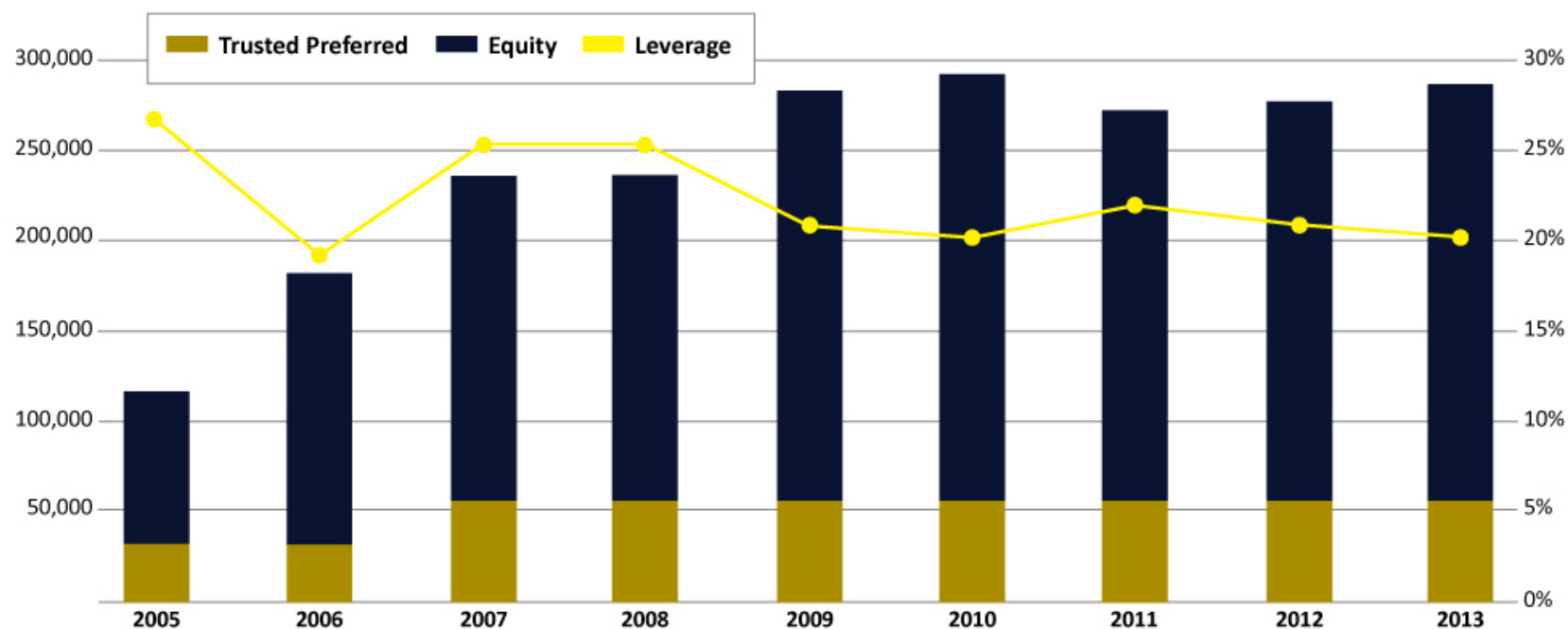
# Hallmark Financial Services (NASDAQ: HALL)

- ✓ Diversified specialty property/casualty insurer with operating units in Dallas-Fort Worth, Austin and San Antonio, Texas.
- ✓ Market, underwrite and service over \$400 million of commercial and personal insurance in selected markets.
  - Focused on underserved sectors, mostly short-tailed lines.
  - Operate in diversified, sustainable niche markets.
- ✓ Focus on disciplined underwriting and bottom line profitability.
- ✓ Proven track record of strong underwriting performance.
- ✓ Demonstrated ability to identify and acquire profitable, niche businesses.
- ✓ “A-” (Excellent) A.M. Best Financial Strength Rating.
- ✓ Combined Statutory Surplus of \$190 million as of September 2013.



# Hallmark Financial Services (NASDAQ: HALL)

- ✓ **Market capitalization of \$174 million**, with 19.3 million shares outstanding (\$9.02 market value per share) as of November 8, 2013.
- ✓ **Consolidated Shareholders' Equity of \$230 million** as of September 30, 2013 (\$11.94 per share).
- ✓ **Total capitalization of \$288 million** as of September 30, 2013, including \$57 million of subordinated trust preferred debt securities that mature in 2035.



# Our Corporate Strategy

***To be a “Best in Class” Specialty Insurance Company Focused on: (1) Underwriting Profitability; and (2) Superior Investment Returns***

- ✓ Strong management team has interests aligned with shareholders
- ✓ Focus on specialty insurance niches with customized products by competing on service and coverage, not price
- ✓ Diversification through multiple business lines
- ✓ Selectively and opportunistically acquire well positioned businesses with strong underwriting and operating management
- ✓ Maintain a Balance Sheet based on strong investment, reinsurance and reserving practices
- ✓ Performance measurement based on long-term growth in book value per share



# The Hallmark Track Record

**Aggregates & Averages Through 2012 Highlight Hallmark's Successful Expansion and Diversification into Specialty Lines of Business.**

	Gross Premiums Produced	Investment Income	Operating Income	GAAP Equity		GAAP BVPS		Year End Stock Price	
			(1)(3)	(3)	ROAE	(2)(3)	% Chg	(2)	% Chg
2004	\$ 119,305	\$ 1,386	\$ 8,602	\$ 32,656	20%	\$ 5.37		\$ 7.20	
2005	\$ 118,066	\$ 3,836	\$ 13,468	\$ 85,188	16%	\$ 5.89	10%	\$ 8.16	13%
2006	\$ 293,304	\$ 10,461	\$ 23,950	\$ 150,731	13%	\$ 7.26	23%	\$ 9.91	21%
2007	\$ 297,904	\$ 13,180	\$ 41,769	\$ 179,621	17%	\$ 8.65	19%	\$ 15.86	60%
2008	\$ 287,081	\$ 16,049	\$ 21,124	\$ 179,412	7%	\$ 8.61	0%	\$ 8.77	-45%
2009	\$ 288,450	\$ 14,947	\$ 33,257	\$ 226,517	12%	\$ 11.26	31%	\$ 7.96	-9%
2010	\$ 314,857	\$ 14,849	\$ 8,371	\$ 235,278	3%	\$ 11.69	4%	\$ 9.10	14%
2011	\$ 344,379	\$ 15,880	\$ (19,787)	\$ 215,572	-7%	\$ 11.19	-4%	\$ 6.99	-23%
2012	\$ 384,231	\$ 15,293	\$ 3,374	\$ 220,537	2%	\$ 11.45	2%	\$ 9.39	34%
YTD 2013	\$ 347,462	\$ 9,871	\$ 6,318	\$ 230,078		\$ 11.94		\$ 8.87	
Last 9 Years (2004-2012).....									
TOTAL	\$ 2,447,577	\$ 105,881	\$ 134,128						

CAGR	16%	35%	NM	27%	10%	3%
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(1) Operating income is income before noncash interest expense from amortization of deemed discount on convertible notes, income tax and non-controlling interest.

(2) Stock prices and BVPS prior to 2006 have been adjusted for the one for six stock split which took place during the Q3 2006. YTD 2013 stock price is as of September 30, 2013.

(3) FY2010 and FY2011 Operating income, equity and BVPS have been restated for change in accounting principal related to deferred acquisition costs.

# Performance Measured on Growth in Book Value

## *Why measure an Insurance Company's Performance on its Growth in Book Value per Share?*

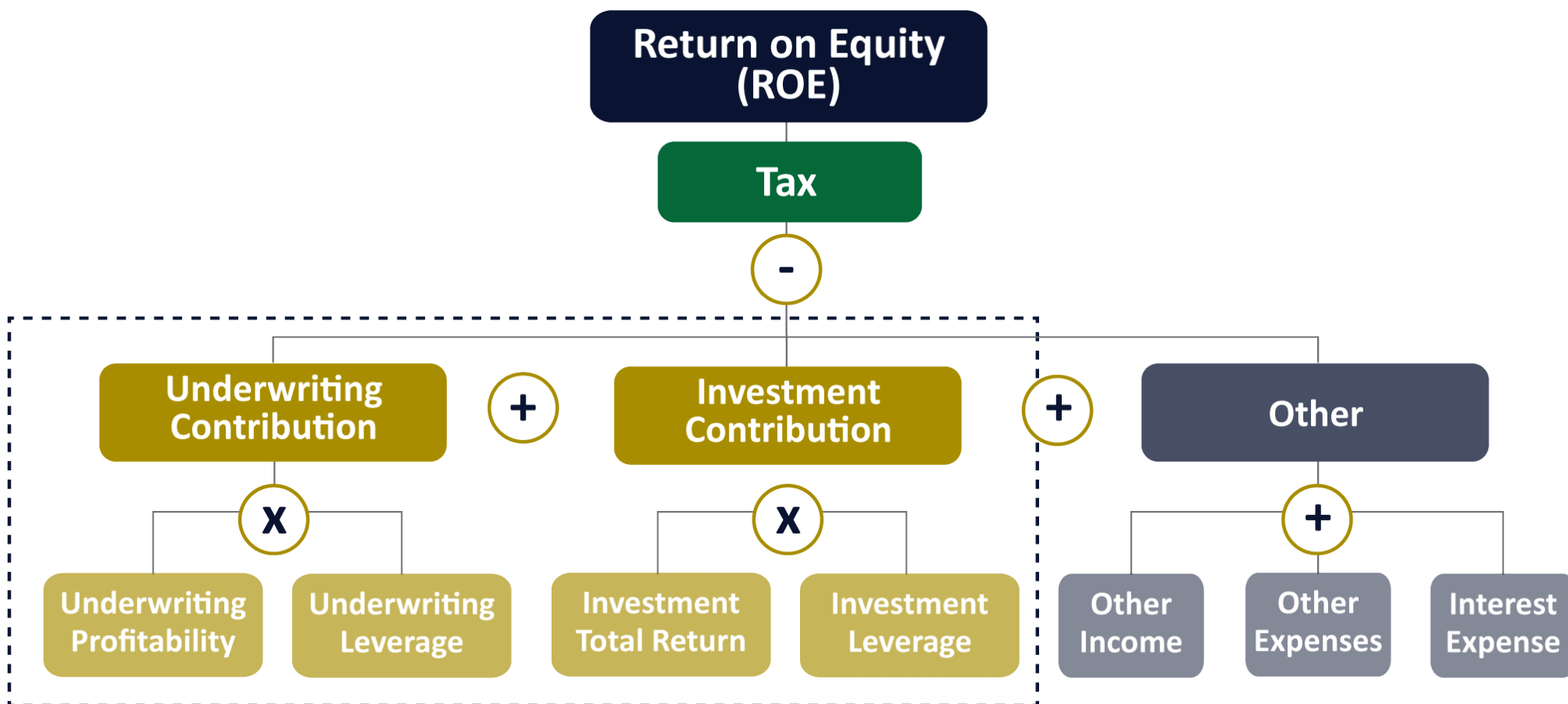
- ✓ Standard ROE calculation fails to capture Total Return on Investment - an important component on insurance company profitability:
  - Standard ROE calculation excludes changes in unrealized gains or losses.
  - Analysts typically adjust ROE calculation to further exclude realized gains.
- ✓ The period-to-period change in Book Value per Share captures all elements of insurance company profitability:
  - Underwriting Income.
  - Total Investment Return.
  - Changes in share capitalization and other items



# ROE Decomposition & Summary Analysis

*Return on Equity (ROE) and Growth in Book Value per Share are Primarily Driven by Two Major Elements:*

- Underwriting Income
- Total Investment Return



# Underwriting Contribution to ROE

## *Low Loss Ratios and Expense Management Drive Strong Underwriting Contribution to ROE.*

- ✓ Profitable underwriting produces significant ROE contribution
- ✓ Softening market conditions since 2006 have caused margin pressure across most all lines of business
- ✓ Personal Lines losses in Florida and other expansion states have severely impacted recent underwriting results

	Loss Ratio	Expense Ratio	Combined Ratio	(1 - CR%) Underwriting Margin	Underwriting Leverage	Underwriting Contribution
2005	57.1%	30.8%	87.9%	12.1%	1.8	21.9%
2006	57.3%	28.7%	86.0%	14.0%	1.8	25.0%
2007	58.8%	29.1%	87.9%	12.1%	1.5	18.1%
2008	61.0%	30.6%	91.6%	8.4%	1.3	11.1%
2009	61.2%	30.5%	91.7%	8.3%	1.4	11.6%
2010	72.8%	29.6%	102.4%	-2.4%	1.2	-2.9%
2011	81.6%	30.8%	112.4%	-12.4%	1.2	-15.4%
2012	70.9%	30.8%	101.7%	-1.7%	1.5	-2.5%
<b>8-YR Avg</b>	<b>65.1%</b>	<b>30.1%</b>	<b>95.2%</b>	<b>4.8%</b>	<b>1.5</b>	<b>8.4%</b>

# Investment Contribution to ROE

*Total Investment Return includes Interest, Dividends, Realized and Unrealized Gains.*

- ✓ Superior total returns: Outperform market averages
- ✓ Significant outperformance since 2008
- ✓ Increasing investment leverage magnifies contribution to ROE

	Total Investment Return	Beginning Invested Assets	Investment Leverage	Investment Contribution
2005	3.6%	51,531	1.6	5.7%
2006	6.2%	153,374	1.8	11.3%
2007	5.7%	268,000	1.8	10.1%
2008	-2.8%	427,787	2.4	-6.6%
2009	15.7%	360,683	2.0	31.6%
2010	7.7%	327,677	1.4	11.1%
2011	3.7%	432,441	1.8	6.8%
2012	4.6%	424,628	2.0	9.0%
<i>8-YR Avg</i>	<i>5.6%</i>	<i>305,765</i>	<i>1.9</i>	<i>9.9%</i>

# ROE Decomposition: An Eight-Year Track Record

*ROE Calculation Utilizing Comprehensive Income is Equivalent to Change in Book Value per Share (after adjustment for changes in equity capitalization)*

- ✓ Hallmark's objective is to produce significant contribution to ROE from both Underwriting and Investments activities

	Underwriting	Investment	Debt	Other	Comprehensive Pre-Tax ROBE	Tax	Comprehensive After-Tax ROBE	Treasury Repurchase	Stock Compensation	Stock Issuances	Minority Interest	BVPS Growth
2005	22%	6%	-4%	9%	33%	31%	22%	NA	0.4%	-13%	NA	10%
2006	25%	11%	-7%	-12%	17%	36%	11%	NA	0.2%	12%	NA	23%
2007	18%	10%	-3%	3%	28%	33%	19%	NA	0.2%	NA	NA	19%
2008	11%	-7%	-3%	-1%	1%	268%	-1%	NA	0.6%	NA	-0.1%	-1%
2009	12%	32%	-3%	1%	41%	31%	29%	2%	0.8%	NA	-0.2%	31%
2010	-3%	11%	-2%	-2%	4%	14%	4%	NA	0.5%	NA	-0.1%	4%
2011	-15%	7%	-2%	0%	-10%	43%	-6%	1%	0.4%	NA	0.0%	-4%
2012	-3%	9%	-2%	-2%	2%	6%	2%	0%	0.2%	NA	-0.2%	2%
8-YR Avg	8%	10%	-3%	-1%	15%	29%	10%	NM	0.4%	NM	NM	11%

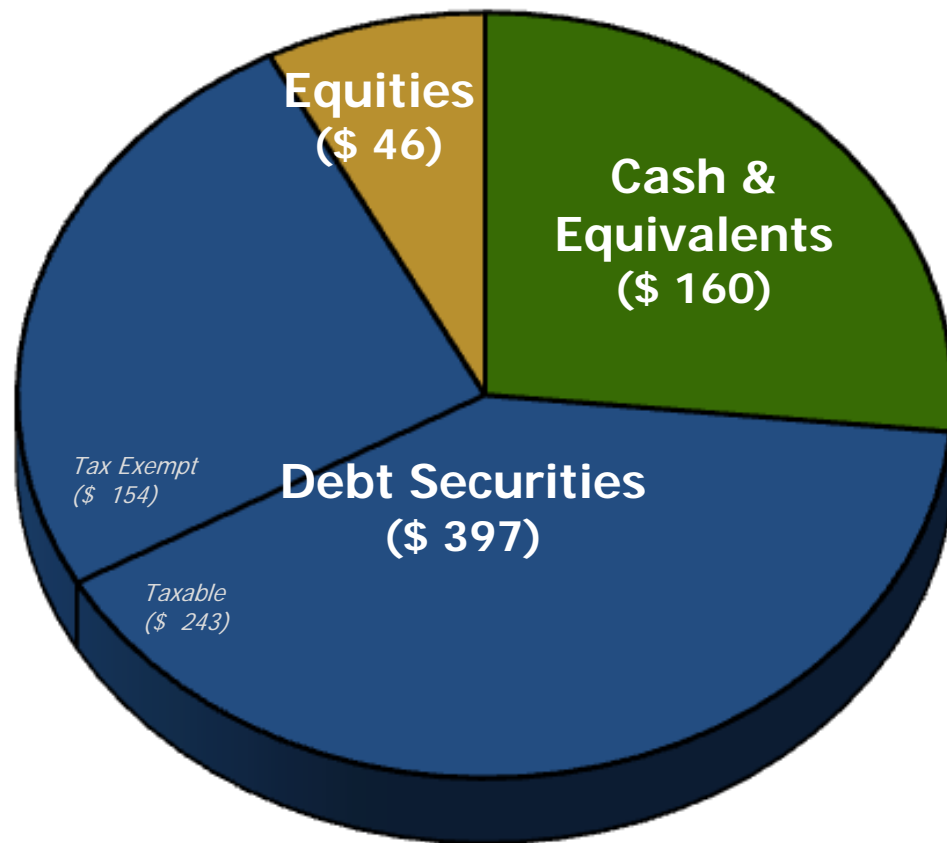
# Investment Strategy

*Hallmark views Investment Operations as a Core Competency.  
Hallmark has achieved above average results and expense savings  
through internal management of its investments.*

- ✓ Employ a disciplined, value-based investment strategy
- ✓ Investment process focuses on individual security selection
- ✓ Seek to outperform market benchmarks on average vs. consistently beating the market ever year
- ✓ Total return approach values all components of investment return equally, whether reported as interest and dividends on the income statement or recognized as comprehensive income on the balance sheet
- ✓ Seek to maximize total return on an after-tax basis through investment in tax-exempt securities and compounding of unrealized gains.

# Investment Portfolio

**As of September 30, 2013**  
*(\$ in millions)*



***Total Cash & Investments of \$603 million, or approximately \$31 per share.***

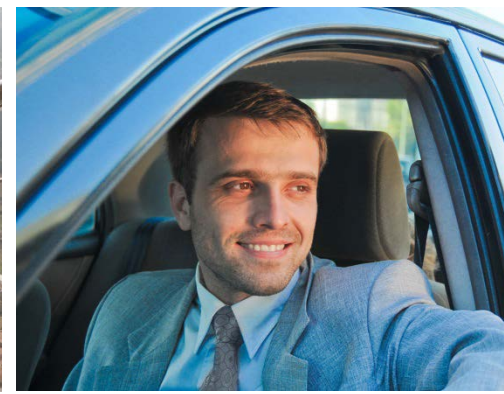
- ✓ Investment portfolio of \$443 million
- ✓ 10% invested in equities
- ✓ Annualized tax equivalent yield of approximately 4.0%
- ✓ Weighted-average duration of 2.8 years
- ✓ Weighted-average credit rating of “BBB+”



# Operational Overview

**Mark Morrison**

President & Chief Executive Officer





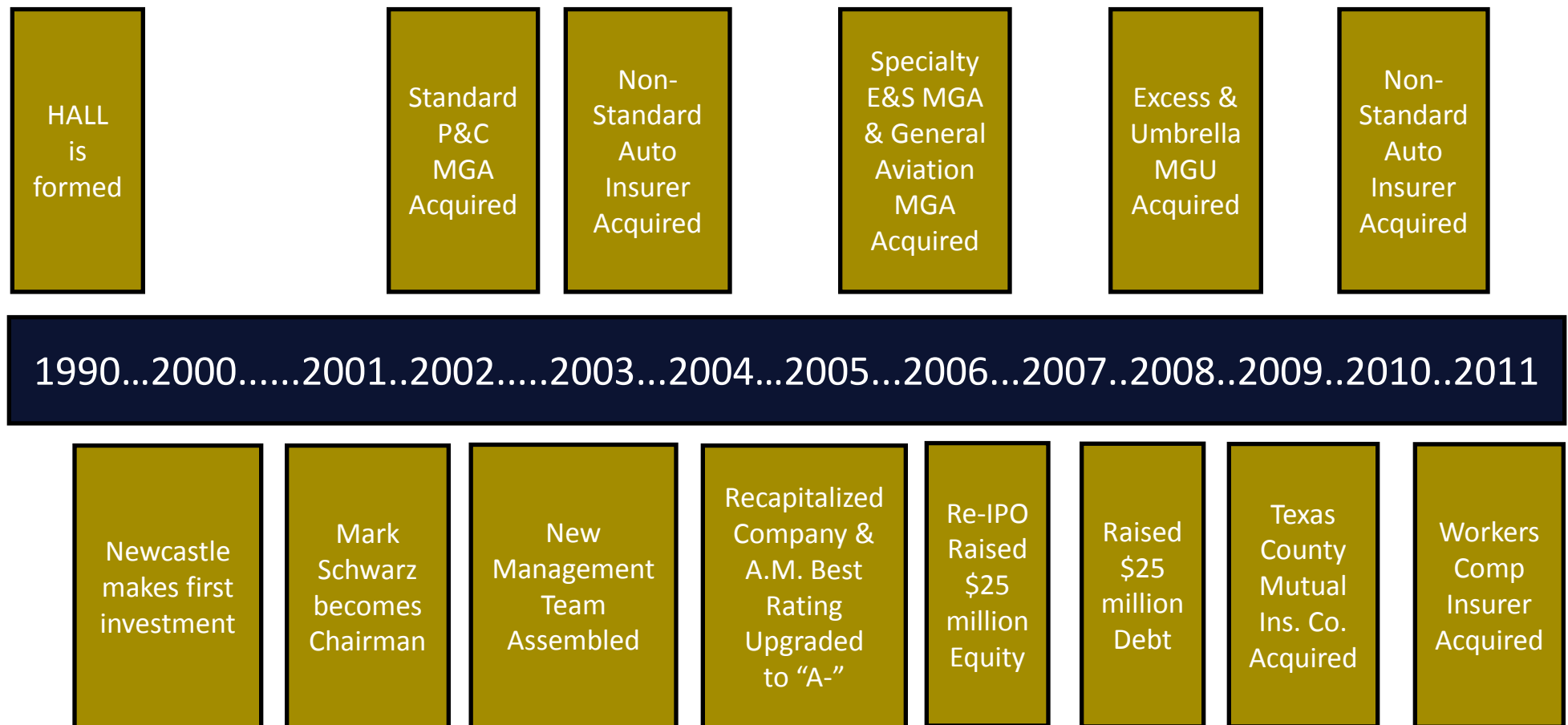
# Underwriting Strategy

## Disciplined Underwriting Strategy in Specialty Niche Market Segments.

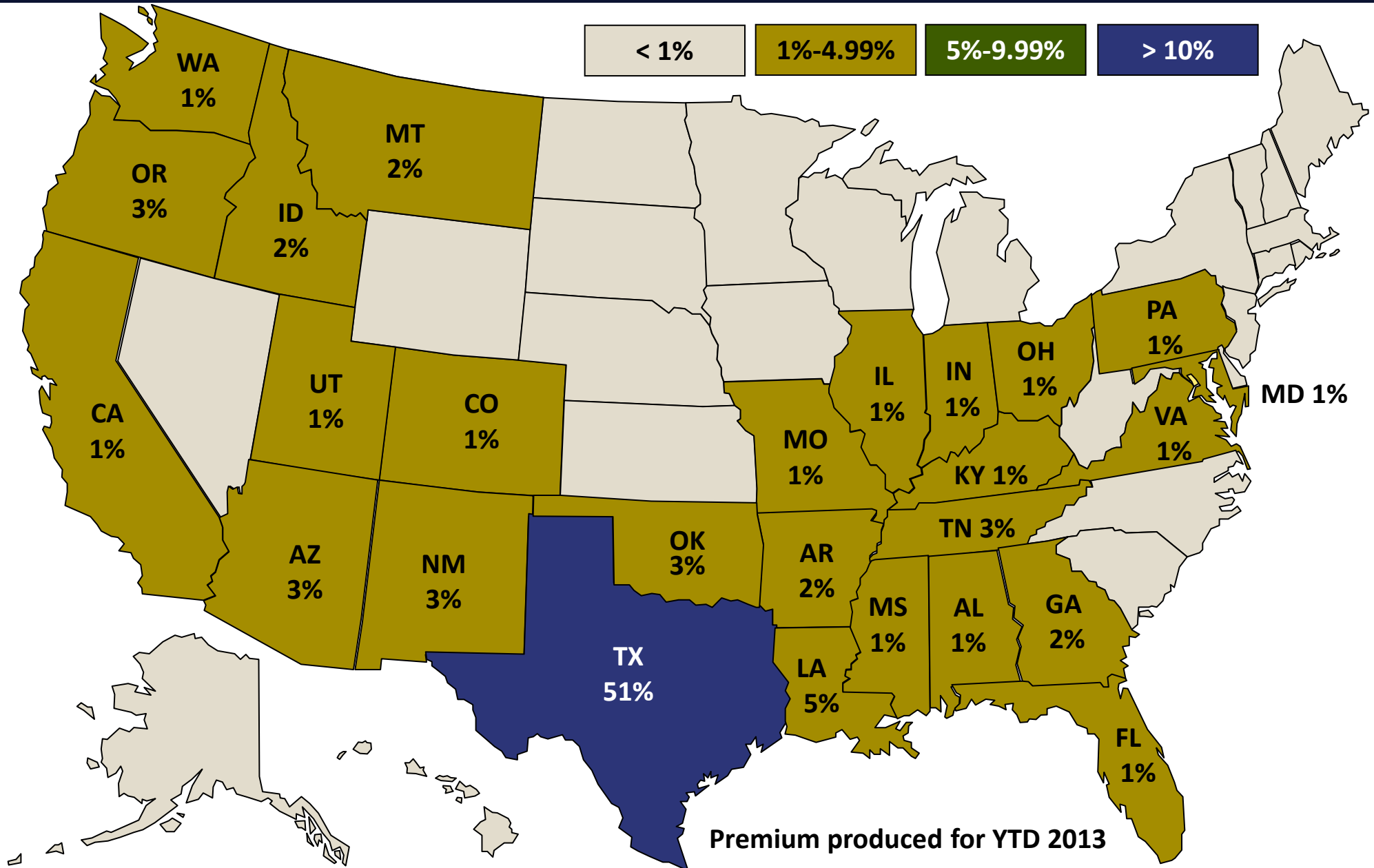
- ✓ Underserved markets – limited competition
- ✓ Highly customized products to meet unique needs of insureds
- ✓ Low price sensitivity
- ✓ Mostly low-severity and/or short-tailed exposures
- ✓ Underwriting expertise critical: Underwriters have an average of 15 years of experience
- ✓ Underwriters' bonuses based on underwriting performance—emphasizes bottom-line profitability over top-line growth
- ✓ Sustain strong, consistent underwriting performance
- ✓ Reinsurance used to reduce operating volatility and to protect shareholders capital

# How We Got to Where We Are Today

***Hallmark Began in 1990 as a Texas-only, Mono-line Company. In 2002, New Management Begins Transformation into a Diversified, Specialty Lines Focused Property/Casualty Insurer.***

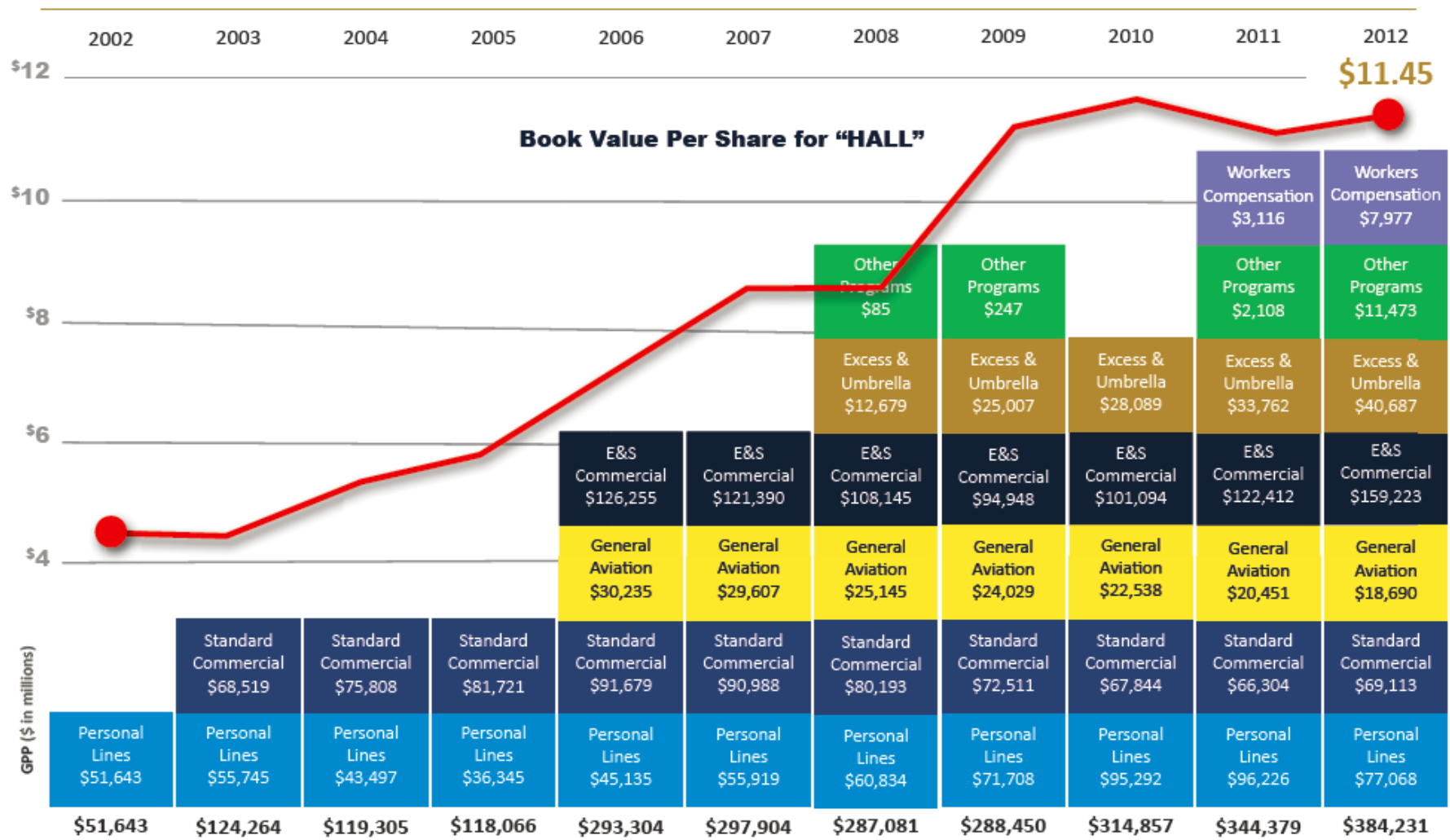


# Geographic Spread of Premium



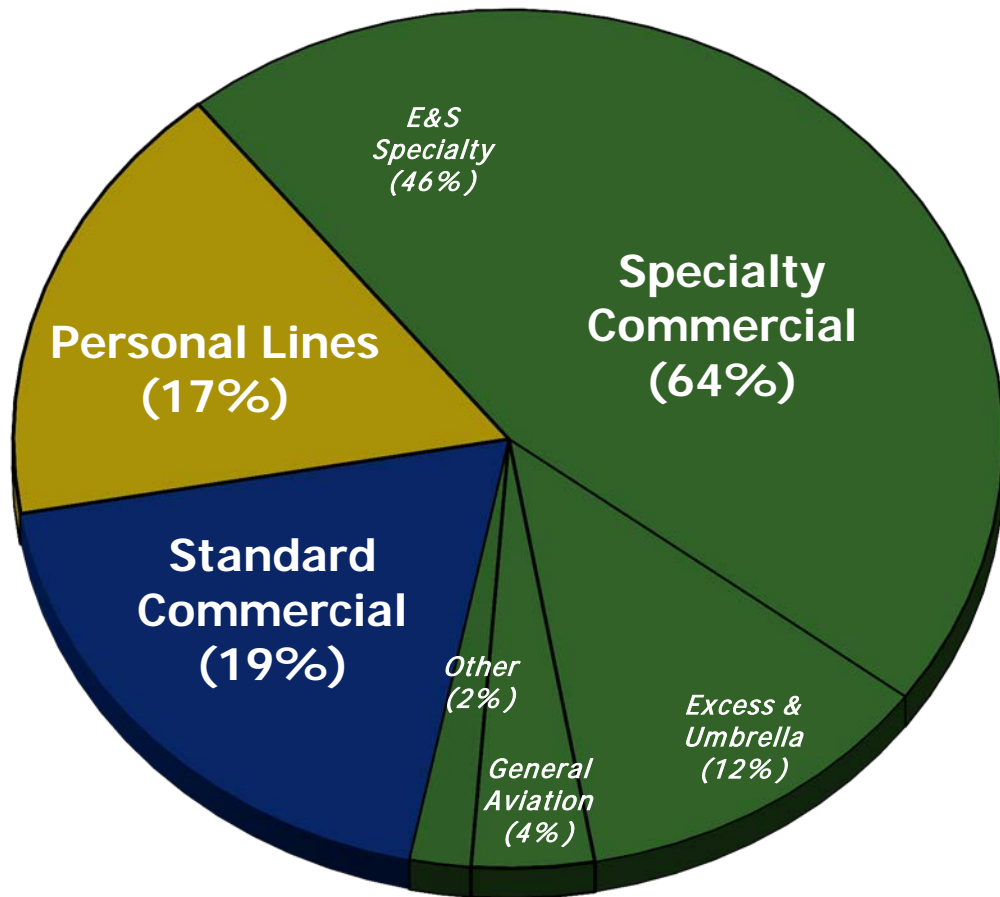
# Premium Diversity

*By Diversifying our Insurance Offerings, Hallmark has been able to Generate Premium Production during the Soft Market while Growing Book Value per Share.*



# Hallmark Operations Overview

## Gross Premiums Produced *By Operating Unit*



*YTD 2013 Gross Premium Produced of \$347 million*

## Three Reporting Segments:

### ■ Specialty Commercial:

- ✓ E&S Specialty: Difficult-to-place accounts, primarily commercial auto and small, stand-alone general liability policies.
- ✓ Hallmark Select: Excess middle market, mostly transportation fleet accounts, small airports, small planes focused on new/old/transitional pilots and older aircraft, and professional liability.

### ■ Standard Commercial:

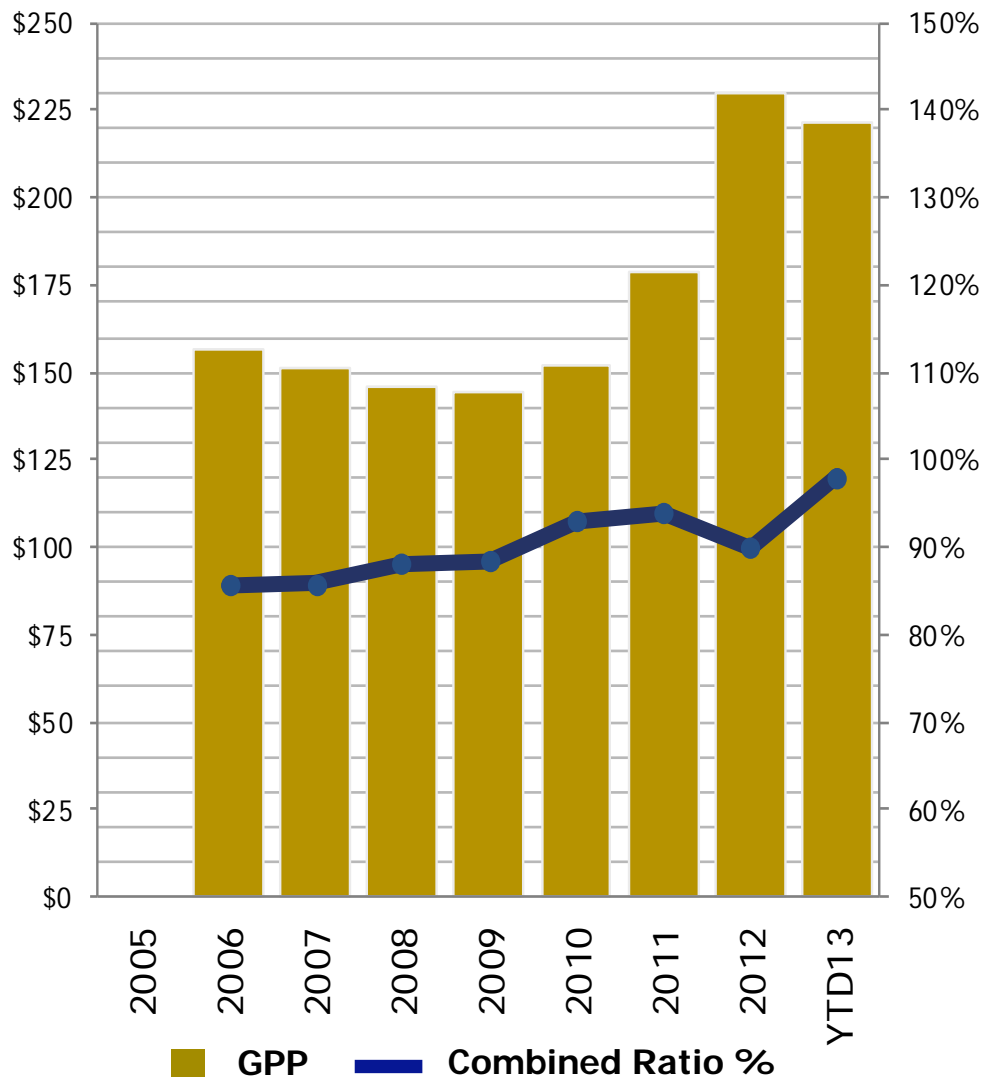
- ✓ Small accounts, low hazard standard commercial package policies.
- ✓ Since 2011, Workers Comp and A&H coverages added through independent agents in Texas.

### ■ Personal Lines:

- ✓ Non-standard automobile coupled with other niche personal line products.

# Specialty Commercial Operating Trends

**Gross Premiums Produced**  
(*\$ in millions*)



**Starting in late 2011, Market Conditions began to Improve, Allowing for Meaningful Rate Increases since 2012.**

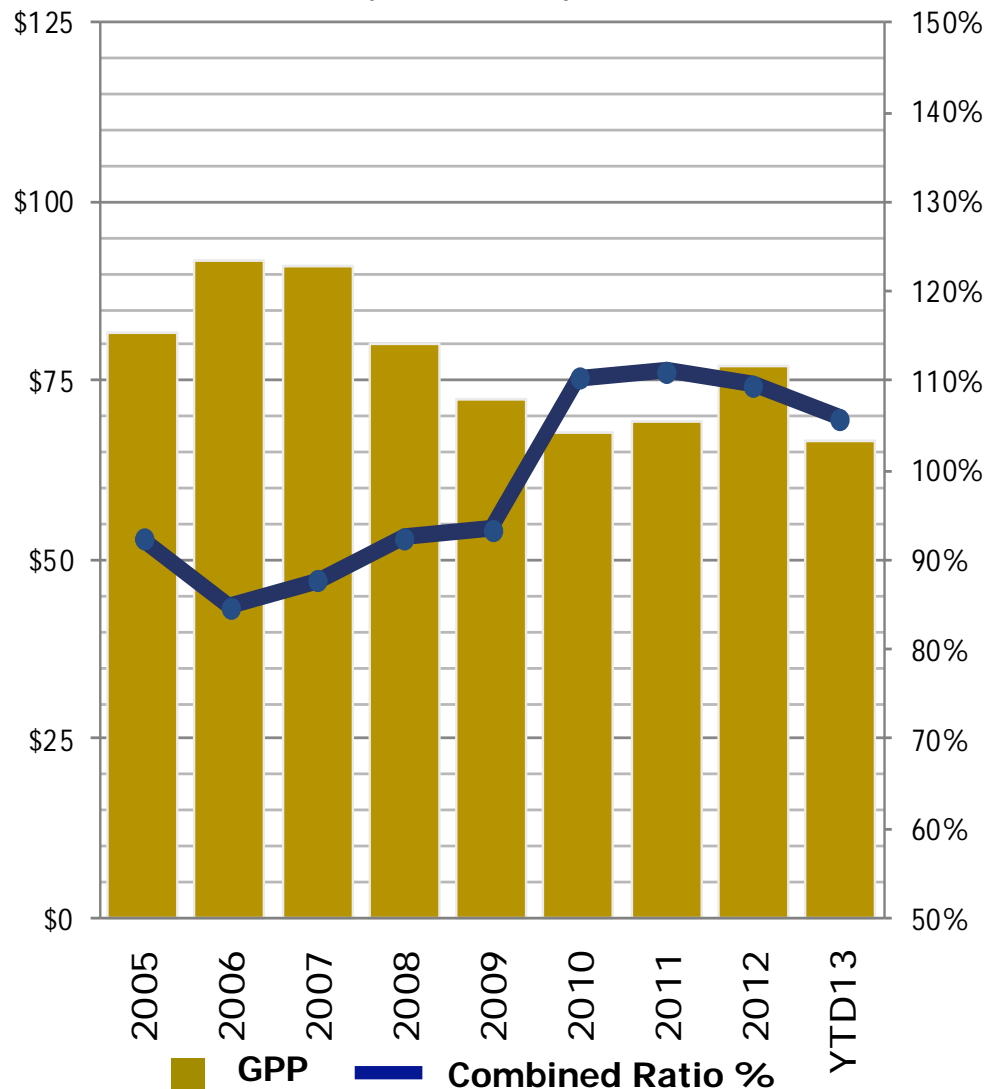
- ✓ Standard markets have become more selective in writing marginal risks and classes of business
- ✓ Increases in insured exposures suggest a stabilizing economy
- ✓ Trucking rates increased over 10% in 2013 while non-trucking liability rates increased 17% in 2013
- ✓ Excess & Umbrella achieved 4% rate increases in 2013

**Recent Additions of Specialty Underwriting Teams to Provide Product Expansion.**

- ✓ Experienced underwriters in Medical Professional Liability, Space & Satellite, Oil & Gas and Occupational Accident added since 2010

# Standard Commercial Operating Trends

## Gross Premiums Produced (*\$ in millions*)



### Our Disciplined Underwriting in the Prolonged Soft Market Significantly Reduced Size of our Book of Business.

- ✓ Reduced book increases underwriting volatility driven by large losses

### Results since 2010 have been Adversely Impacted by High Level of Large Property Losses.

- ✓ Despite consistent underwriting, an unprecedented level of large property losses incurred as a result of natural catastrophes and arson related losses
- ✓ Catastrophe losses (net) in YTD2013 was \$5.7 million (9.7% LR%); FY2012 was \$9.5 million (13.7% LR%)

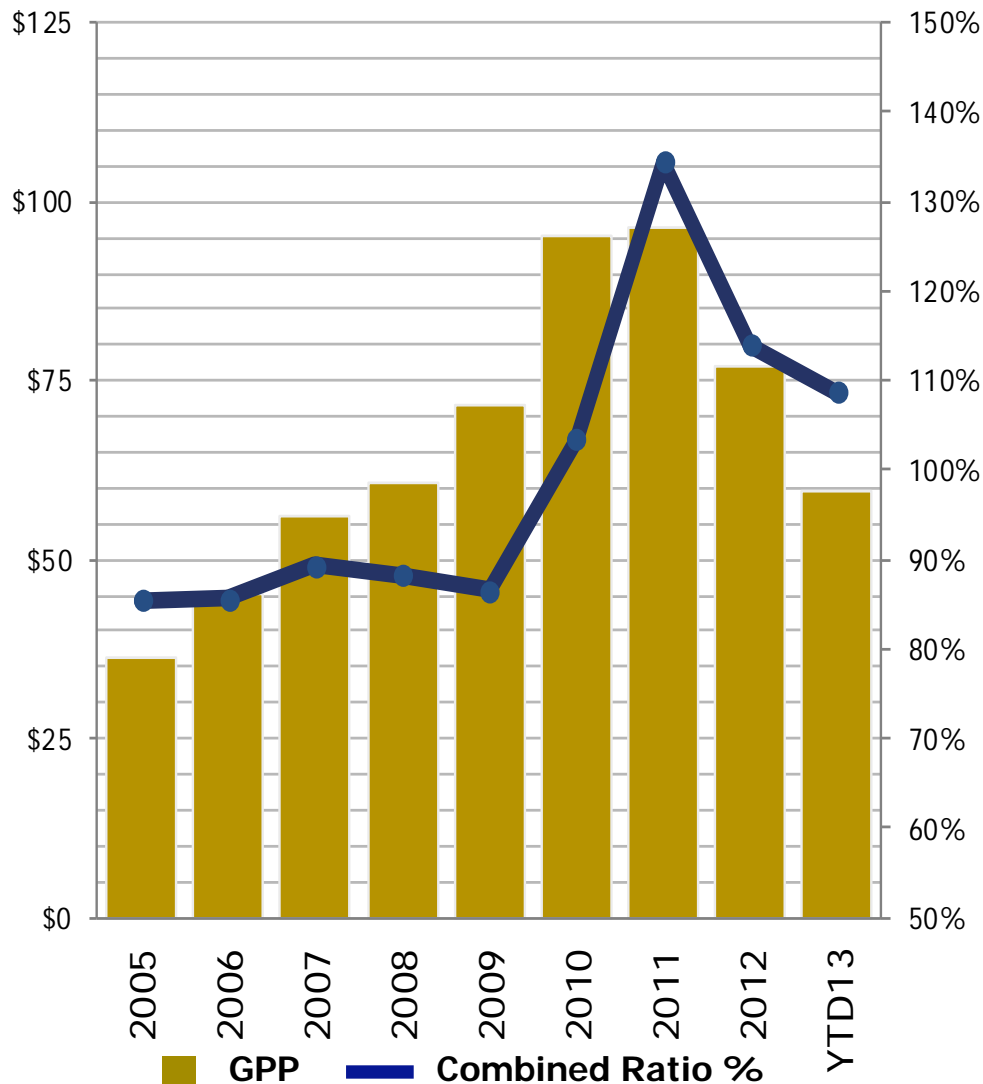
### Renewal Rates for Standard P&C Business increased 7% in 2012, and 9% for YTD 2013



# Personal Lines Operating Trends

## Gross Premiums Produced

(\$ in millions)



## Loss Ratio Slammed by PIP Fraud with 2009 Expansion into Florida Personal Auto Market.

- ✓ Aggressive measures taken in 2011 to mitigate losses and exit Florida

## Re-Focused Business in 2012 to Target Mature, less Volatile States and Simplified Product Lines.

- ✓ Exited 18 unprofitable states and streamlined product offerings
- ✓ Significant rate increases taken in underperforming markets/products
- ✓ Focused resources towards 15 ongoing states
- ✓ Increased use of point of sale underwriting and underwriting tools

**Achieved over 5% rate increase on automobile and over 9% on property business through September 2013**

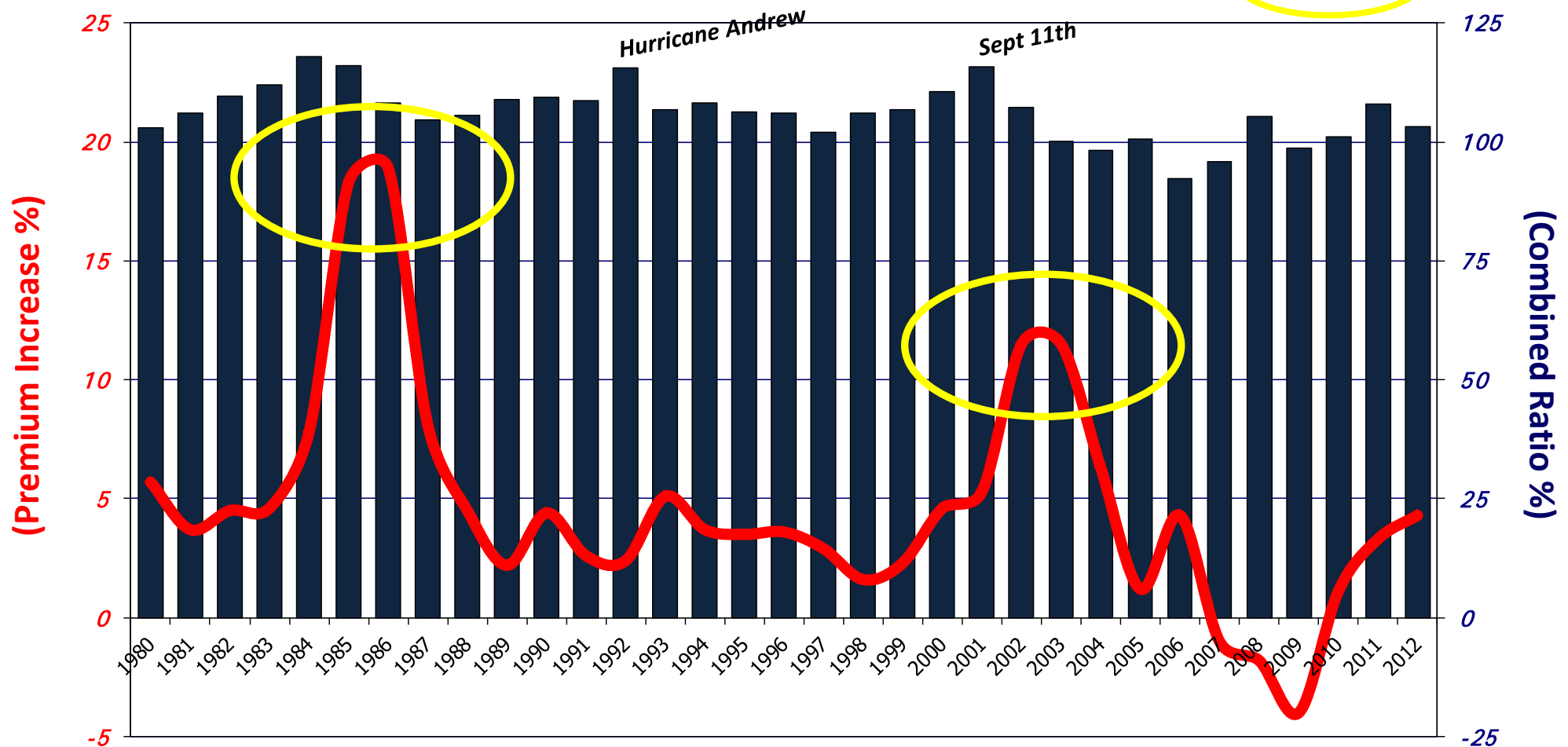


# Market & Underwriting Trends



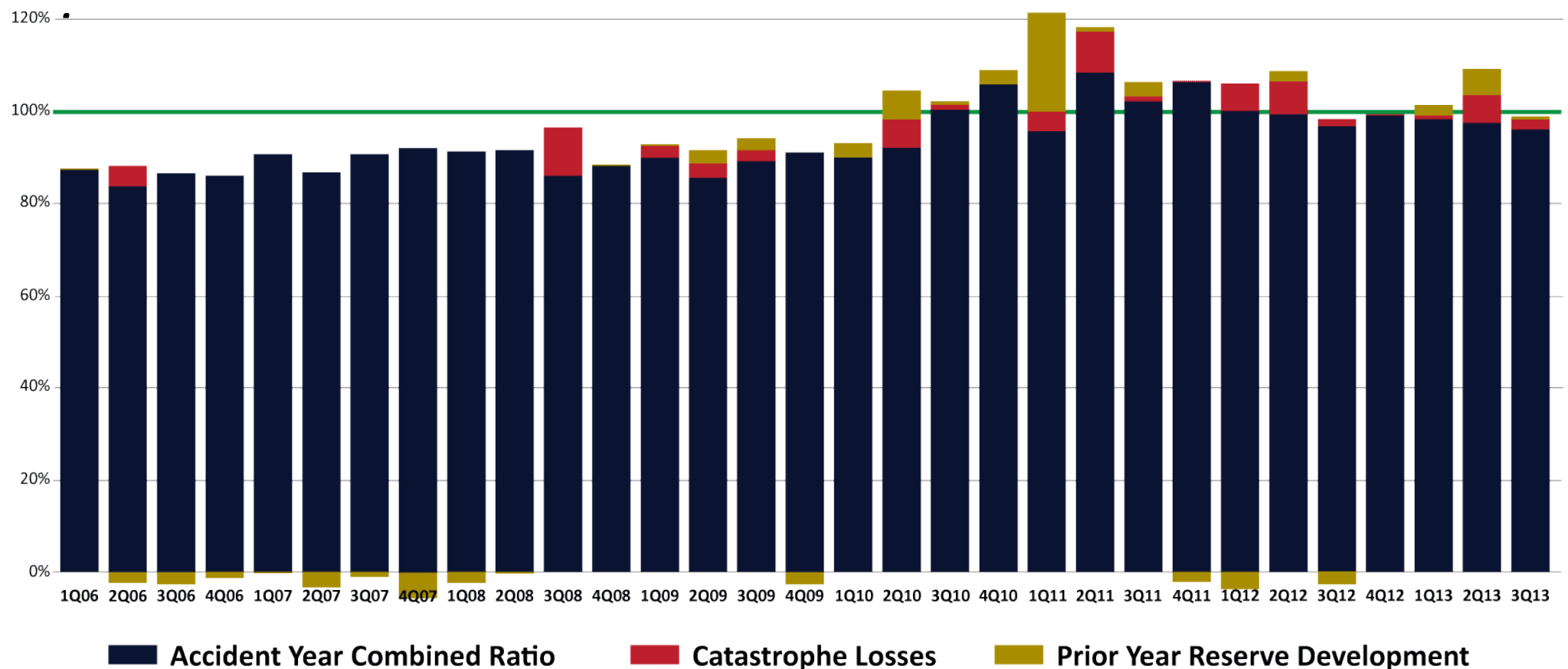
# P&C Industry Underwriting Trend

*After September 11, 2001, the P&C industry premium benefited from a strong hard market cycle. Since 2003 premium growth has been impacted by softening rates, coupled with the contraction in the economy beginning in 2007. However, the market cycle appears to have turned beginning in 2011.*



# Hallmark's Underwriting Trend

*Hallmark's Specialty Focus, Underwriting Discipline and Opportunistic Acquisitions since 2003 have diversified revenue streams and driven strong operating results. However, Personal Lines losses due largely to Florida PIP Fraud and significantly higher occurrences of catastrophe events in Standard Commercial have adversely impacted recent results.*





**NASDAQ: HALL**

For more information, visit [www.hallmarkgrp.com](http://www.hallmarkgrp.com).