



**HALLMARK**  
FINANCIAL SERVICES, INC.

Specialty Insurance Solutions

# 2018 Annual Shareholders Meeting

*May 31, 2018*

# Forward-Looking Statements

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## **Risks Associated with Forward-Looking Statements Included in this presentation:**

This presentation contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, which are intended to be covered by the safe harbors created thereby. Forward-looking statements include statements which are predictive in nature, which depend upon or refer to future events or conditions, or which include words such as “expect,” “anticipate,” “intend,” “plan,” “believe,” “estimate” or similar expressions. 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. Statements regarding the following subjects are forward-looking by their nature:

- our business and growth strategies;
- our performance goals;
- our projected financial condition and operating results;
- our understanding of our competition;
- industry and market trends;
- the impact of technology on our products, operations and business; and
- any other statements or assumptions that are not historical facts.

The forward-looking statements included in this presentation are based on current expectations that involve numerous risks and uncertainties. Assumptions relating to these forward-looking statements involve judgments with respect to, among other things, future economic, competitive and market conditions, legislative initiatives, 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 these 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 these forward-looking statements, the inclusion of such information should not be regarded as a representation 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. The Company does not undertake to update the forward-looking statements to reflect the impact of circumstances or events that may arise after the date of the forward-looking statements.

# Hallmark Financial Services (NASDAQ: HALL)

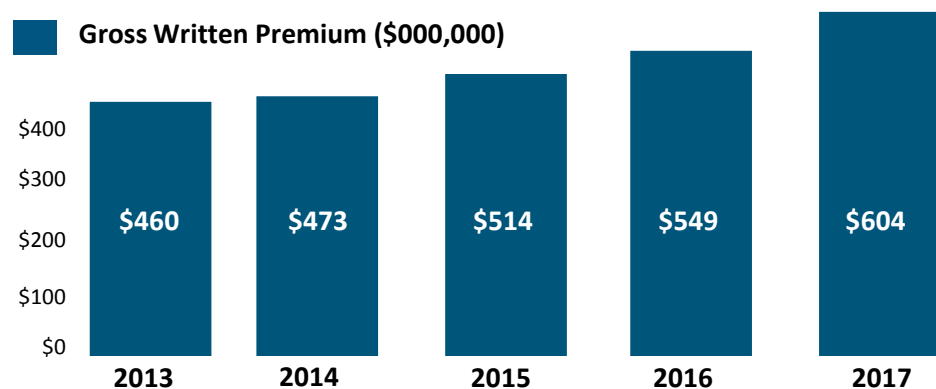
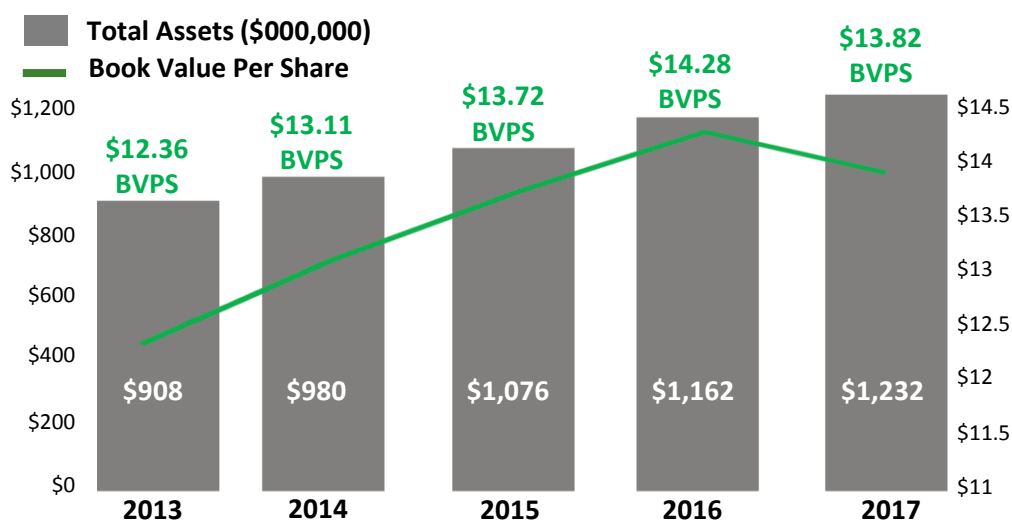
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- **Expertise-driven, diversified, niche specialty property/casualty insurer based in Dallas-Fort Worth, Texas**
- **Market, underwrite and service over \$600 million of commercial and personal insurance in selected markets**
  - Targeting U.S. focused, technical and SME risks
  - Focused on underserved sectors, mostly short-tailed lines
  - Operate in sustainable admitted and non-admitted niche markets
  - Diversification through multiple specialty lines of business
- **Deep distribution relationships, exquisite execution and scalable platform**
- **Demonstrated ability to identify and acquire profitable, niche businesses**
- **“A-” (Excellent) with a Stable Outlook - A.M. Best Financial Strength Rating.**

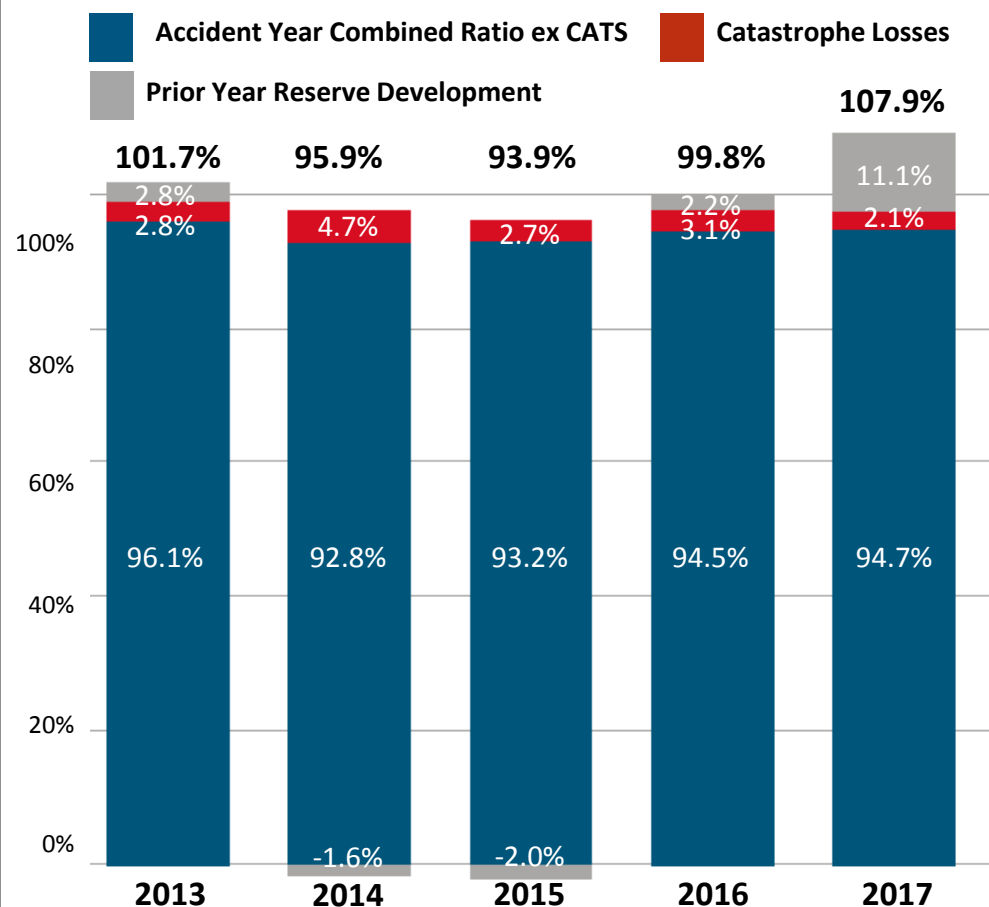


# Hallmark Financial Services (NASDAQ: HALL)

- **Market capitalization of \$189.5 million**, with 18.2 million shares outstanding (\$10.43 market value per share) as of December 31, 2017.
- **Consolidated Shareholders' Equity of \$251.1 million** as of December 31, 2017.
- **Total capitalization of \$336.9 million**



## Combined Loss Ratio Comparison



# 4th Quarter and 2017 Results Summary

		<u>4<sup>th</sup> Quarter 2017</u>	<u>4<sup>th</sup> Quarter 2016</u>		<u>2017</u>	<u>2016</u>
<b>Loss &amp; LAE Ratio <u>Excluding</u> PYD and Cat Losses</b>		67.3%	75.5%		66.7%	66.5%
<b>Prior Year Development</b>		21.5%	9.3%		11.1%	2.2%
<b>Catastrophe Losses</b>		1.5%	0.7%		2.1%	3.1%
<b>Loss &amp; LAE Ratio</b>		90.3%	85.5%		79.9%	71.8%
<b>Expense Ratio</b>		28.4%	25.5%		28%	28%
<b>Combined Ratio</b>		118.7%	111%		107.9%	99.8%

- Continued emergence of Commercial Auto frequency and severity trends in 2017 resulted in reserve strengthening at both the claim level and IBNR.
- The 2017 results reflect strengthening in Personal auto and run-off program as well
- Complete revamp of claims operations and case reserving practices for the group, particularly for the auto lines
- Personal Lines loss ratios improved by 31.5 points in the quarter and 14.7 points for the year
- Despite record breaking industry catastrophe losses, cat loss ratio was lower than last year and reflective of the actions taken to manage exposures

# Pro-forma Earnings excluding Impact of Catastrophe losses and Prior Year Development

	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Loss Ratio	68.4	66.9	62.3	65.2	66.5	66.7
Prior Year Development	-1.2	2.8	-1.6	-2	2.2	11.1
Catastrophe Loss Ratio	3.7	2.8	4.7	2.7	3.1	2.1
Expense Ratio	30.8	29.2	30.5	28.0	28.0	28.0
Combined Ratio	101.7	101.7	95.9	93.9	99.8	107.9
<b>Combined Ratio Ex Cat loss &amp; Prior Year</b>	<b>99.2</b>	<b>96.1</b>	<b>92.8</b>	<b>93.2</b>	<b>94.5</b>	<b>94.7</b>
<b>Diluted Earnings Per Share</b>	<b>\$0.18</b>	<b>\$0.43</b>	<b>\$0.69</b>	<b>\$1.13</b>	<b>\$0.34</b>	<b>-\$0.63</b>
<b>Pro-Forma Earnings per Share Ex CAT loss &amp; Prior Year Development*</b>	<b>\$0.45</b>	<b>\$1.10</b>	<b>\$1.02</b>	<b>\$1.20</b>	<b>\$0.98</b>	<b>\$1.07</b>

- Stable accident year loss ratios excluding prior year development
- Significant actions taken to address prior year development issues from older accident years
  - Completely revamped claims operations and conducted comprehensive review of outstanding claims
  - Strengthened reserves estimates focused on Commercial and Personal auto lines
  - Significant pricing and book management actions taken
  - Product and geographic diversification well underway and having the desired impact
  - Conservative initial accident year selections
- Improving CAT loss results driven by disciplined underwriting, 2017 was primarily impacted by Hurricanes Harvey and Irma as compared to hail and convective storm losses in past years
- Strong expense management discipline even with new teams and major infrastructure investments
- Underlying performance is strong and reflective of the strategy since 2015 to build out diversified specialty product lines and dampen the wheels impact in the organization



# The Hallmark Track Record

*Aggregates & Averages Through 2017 Highlight Hallmark's Successful Expansion and Diversification into Specialty Lines of Business.*

	Gross Premiums Produced	Investment Income	Operating Income	Operating Cash Flow	GAAP Equity		GAAP BVPS		Year-End Stock Price	
			(1)(3)		(3)	ROAE	(2)(3)	% Chg	(2)	% Chg
2004	\$ 119,305	\$ 1,386	\$ 8,602	\$ 7,339	\$ 32,656	20%	\$ 5.37		\$ 7.20	
2005	\$ 118,066	\$ 3,836	\$ 13,468	\$ 29,654	\$ 85,188	16%	\$ 5.89	10%	\$ 8.16	13%
2006	\$ 293,304	\$ 10,461	\$ 23,950	\$ 75,962	\$ 150,731	13%	\$ 7.26	23%	\$ 9.91	21%
2007	\$ 297,904	\$ 13,180	\$ 41,769	\$ 85,684	\$ 179,621	17%	\$ 8.65	19%	\$ 15.86	60%
2008	\$ 287,081	\$ 16,049	\$ 21,124	\$ 48,712	\$ 179,412	7%	\$ 8.61	0%	\$ 8.77	(45%)
2009	\$ 288,450	\$ 14,947	\$ 33,257	\$ 61,698	\$ 226,517	12%	\$ 11.26	31%	\$ 7.96	(9%)
2010	\$ 314,857	\$ 14,849	\$ 8,371	\$ 36,360	\$ 235,278	3%	\$ 11.69	4%	\$ 9.10	14%
2011	\$ 344,379	\$ 15,880	\$ (19,787)	\$ 24,610	\$ 215,572	(7%)	\$ 11.19	(4%)	\$ 6.99	(23%)
2012	\$ 384,231	\$ 15,293	\$ 3,374	\$ 33,682	\$ 220,537	2%	\$ 11.45	2%	\$ 9.39	34%
2013	\$ 454,981	\$ 12,884	\$ 11,080	\$ 68,338	\$ 238,118	4%	\$ 12.36	8%	\$ 8.89	(5%)
2014	\$ 468,442	\$ 12,383	\$ 18,782	\$ 33,684	\$ 252,037	5%	\$ 13.11	6%	\$ 12.09	36%
2015	\$ 509,188	\$ 13,969	\$ 31,886	\$ 52,936	\$ 262,026	9%	\$ 13.72	5%	\$ 11.69	(3%)
2016	\$ 544,968	\$ 16,342	\$ 8,478	\$ 30,854	\$ 265,736	2%	\$ 14.28	4%	\$ 11.63	(1%)
2017	\$ 600,243	\$ 18,874	\$ (16,572)	\$ 7,199	\$ 251,118	-4%	\$ 13.82	-3%	\$ 10.43	(10%)
<b>TOTAL</b>	<b>\$ 5,025,399</b>	<b>\$ 180,333</b>	<b>\$ 187,782</b>	<b>\$ 596,712</b>						

**Last 14 Years (2004-2017)**

<b>CAGR</b>	13%	22%	(205%)	0%	17%	8%	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. (3) FY2010 and FY2011 Operating income, equity and BVPS have been restated for change in accounting principal related to deferred acquisition costs.

# Strategic Focus

## 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

## 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 every year
- Total return approach values all components of investment return equally, whether reported as interest and dividends on the income statements 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



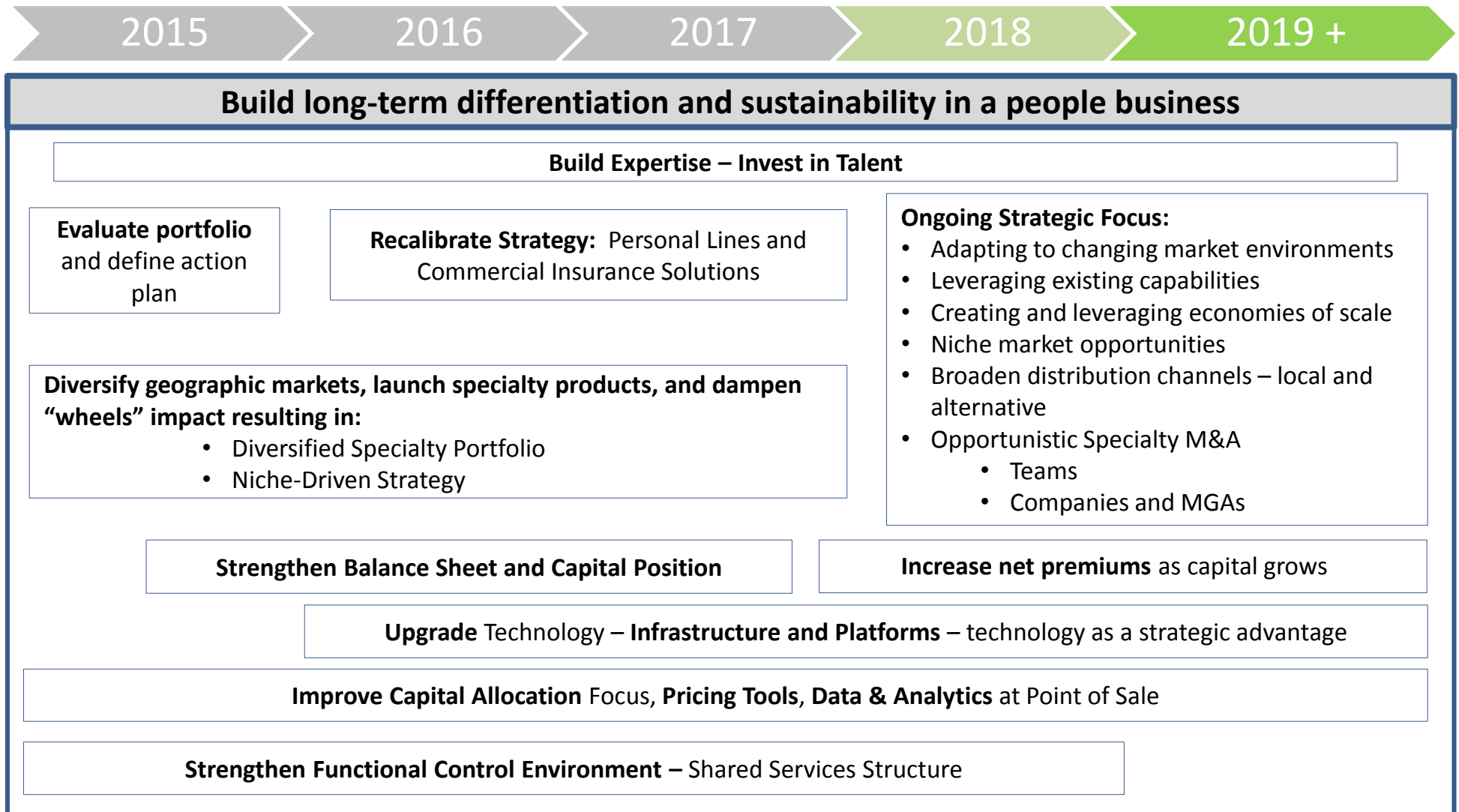
# Strategic Initiatives

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- **Investment in Talent**
- **Develop and Diversify Specialty Product Offerings**
- **Refocus Strategy for Standard Commercial P&C and Personal Lines Segments**
- **Grow and Diversify Geographic Reach**
- **Deepen Key Distribution Relationships**
- **Technology Upgrades**
- **Sharpen Pricing Tools and Capital Allocation Focus**
- **Improve Data and Analytics at the Point of Sale (POS)**
- **Strengthen Our Control Environment**
  - Claims, Operations, IT, Actuarial Departments
- **Engage External Capital Providers to support Product Expansion**

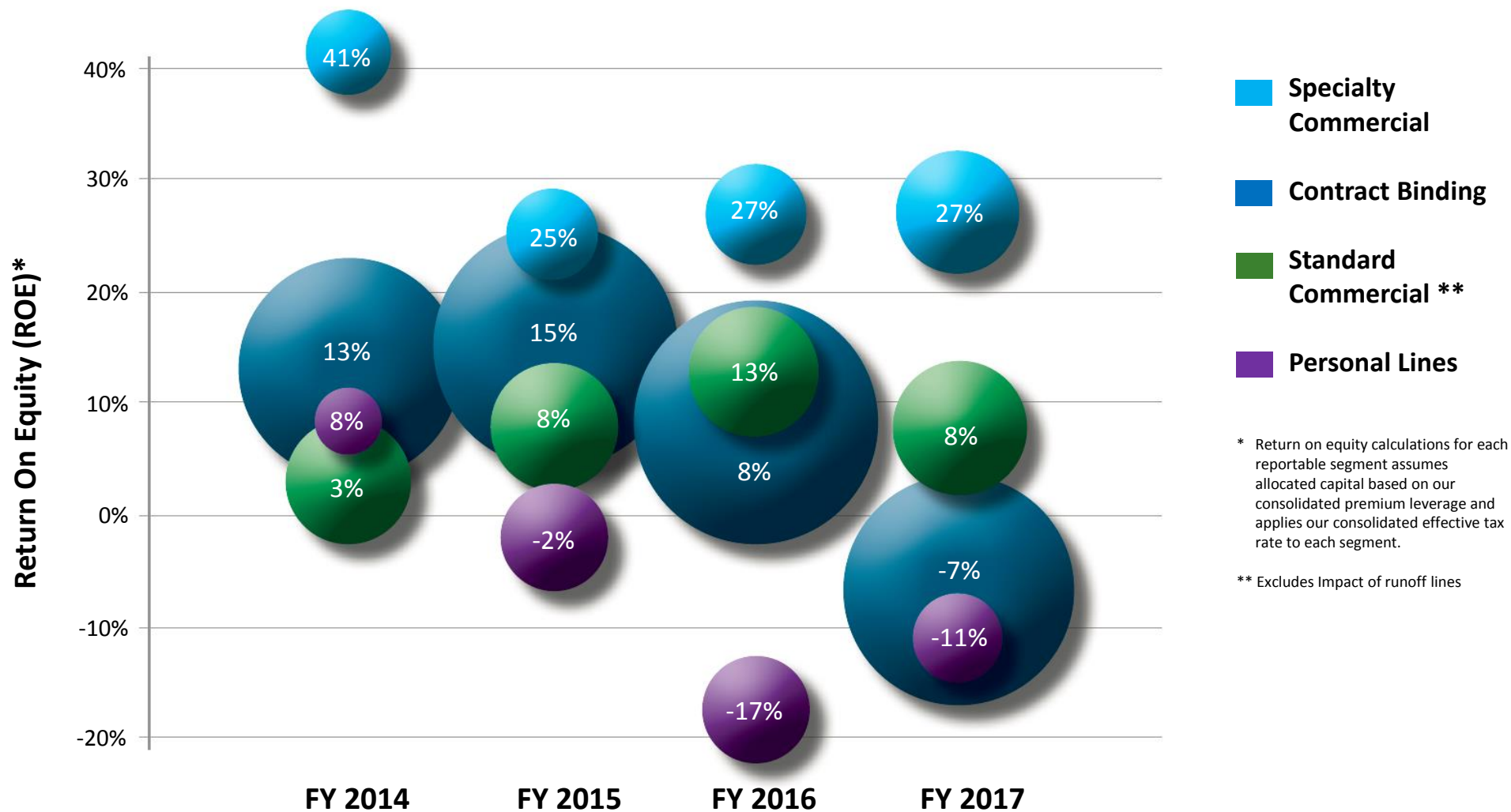
# Strategic Plan In Action

## Strategic Initiatives and Key Tactics



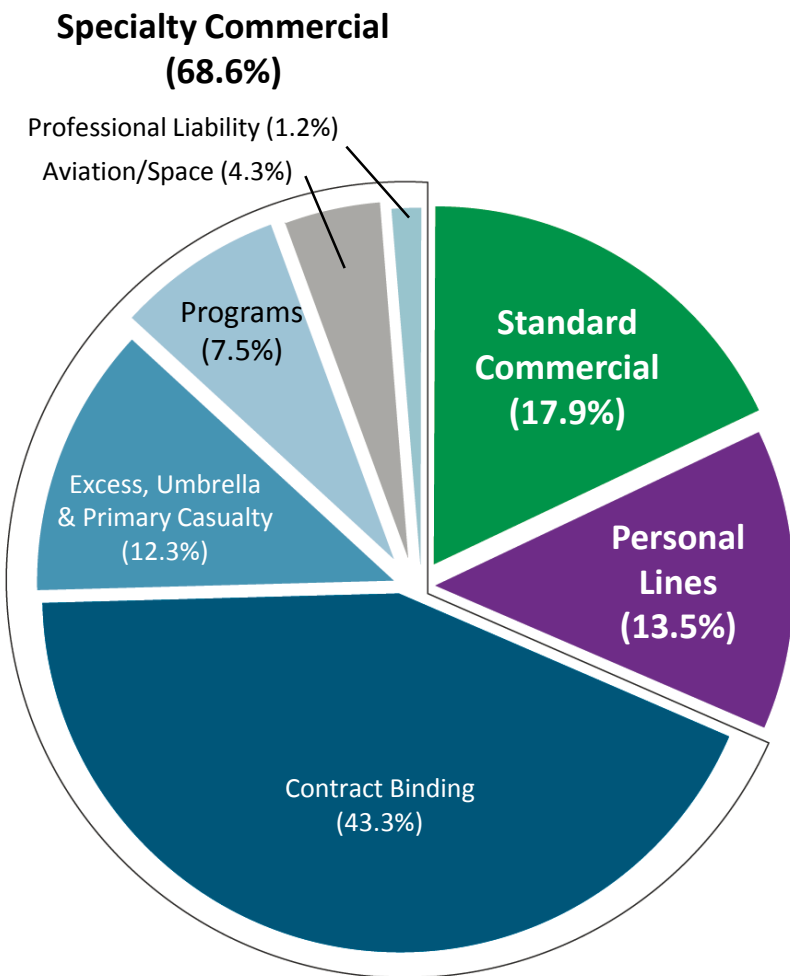
# ROE By Segment and Capital Allocation

- Capital is primarily allocated for the Specialty Commercial Segment which has consistently produced positive ROE for the past five years.



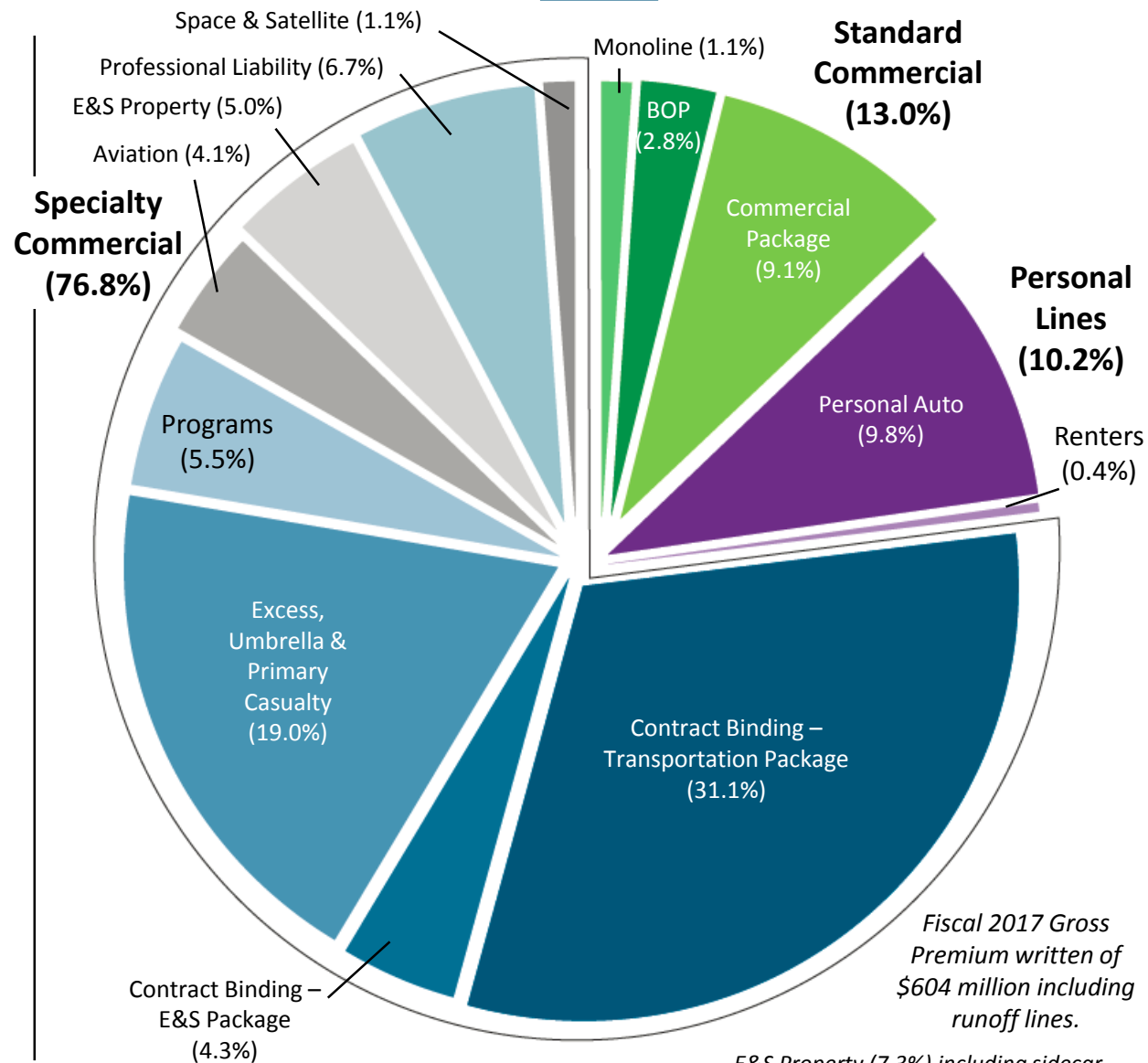
# Portfolio Diversification since 2014

**2014**



*Fiscal 2014 Gross Premium written of \$473 million*

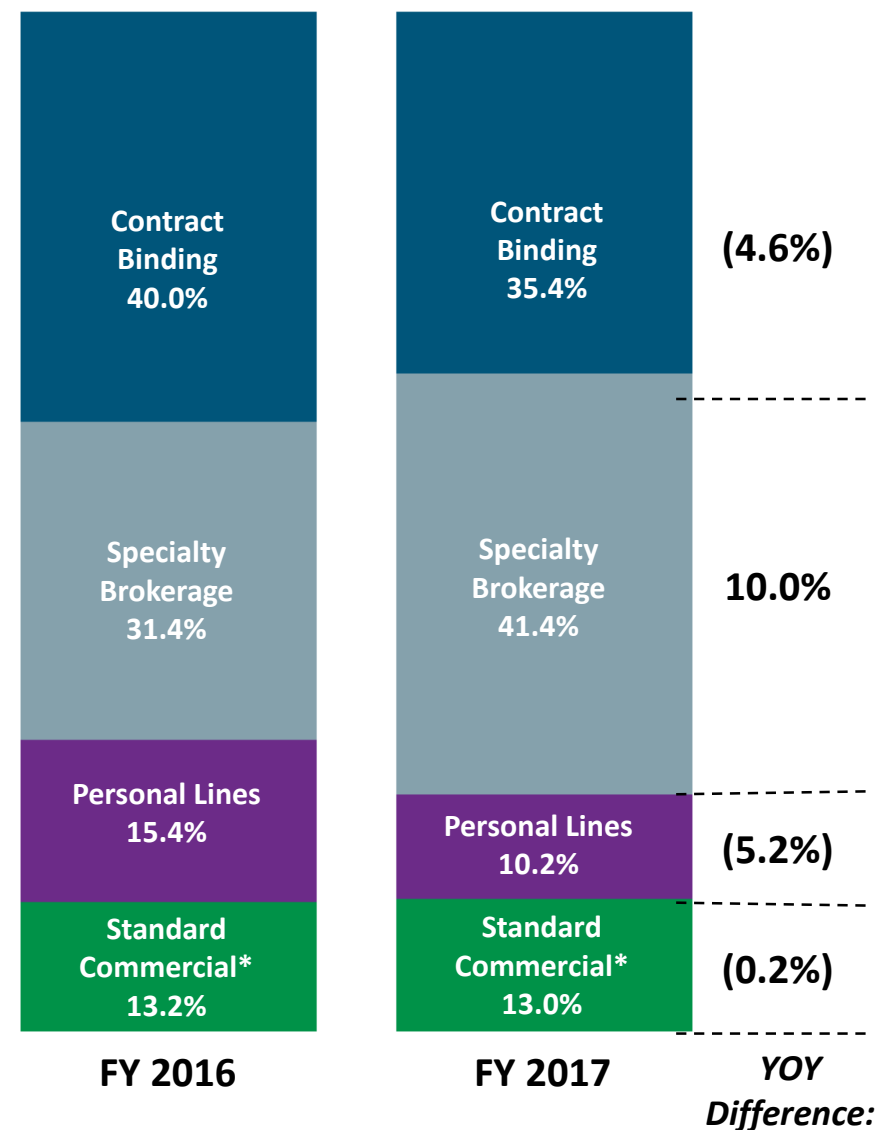
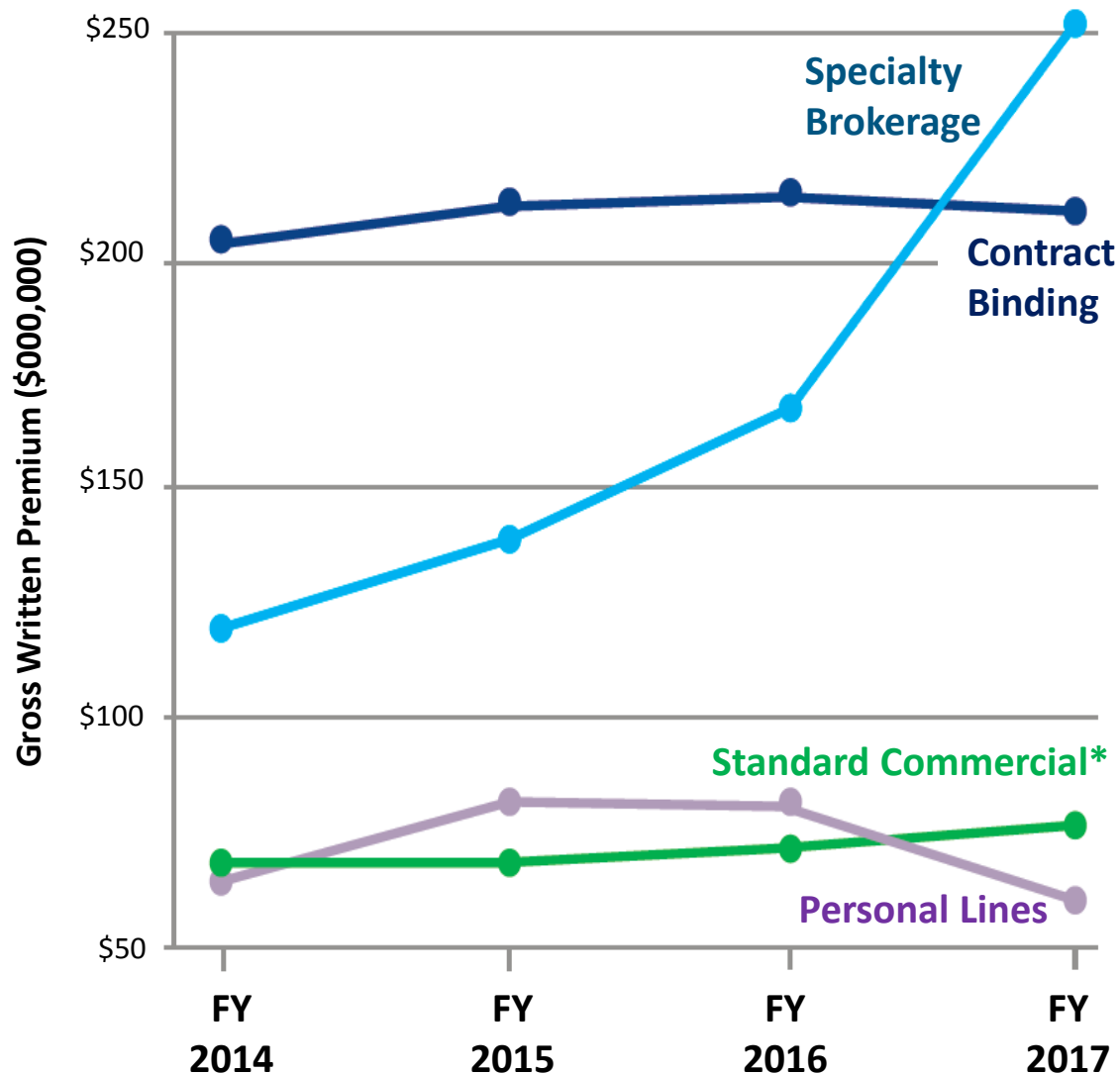
**2017**



*Fiscal 2017 Gross Premium written of \$604 million including runoff lines.*

*E&S Property (7.3%) including sidocar.*

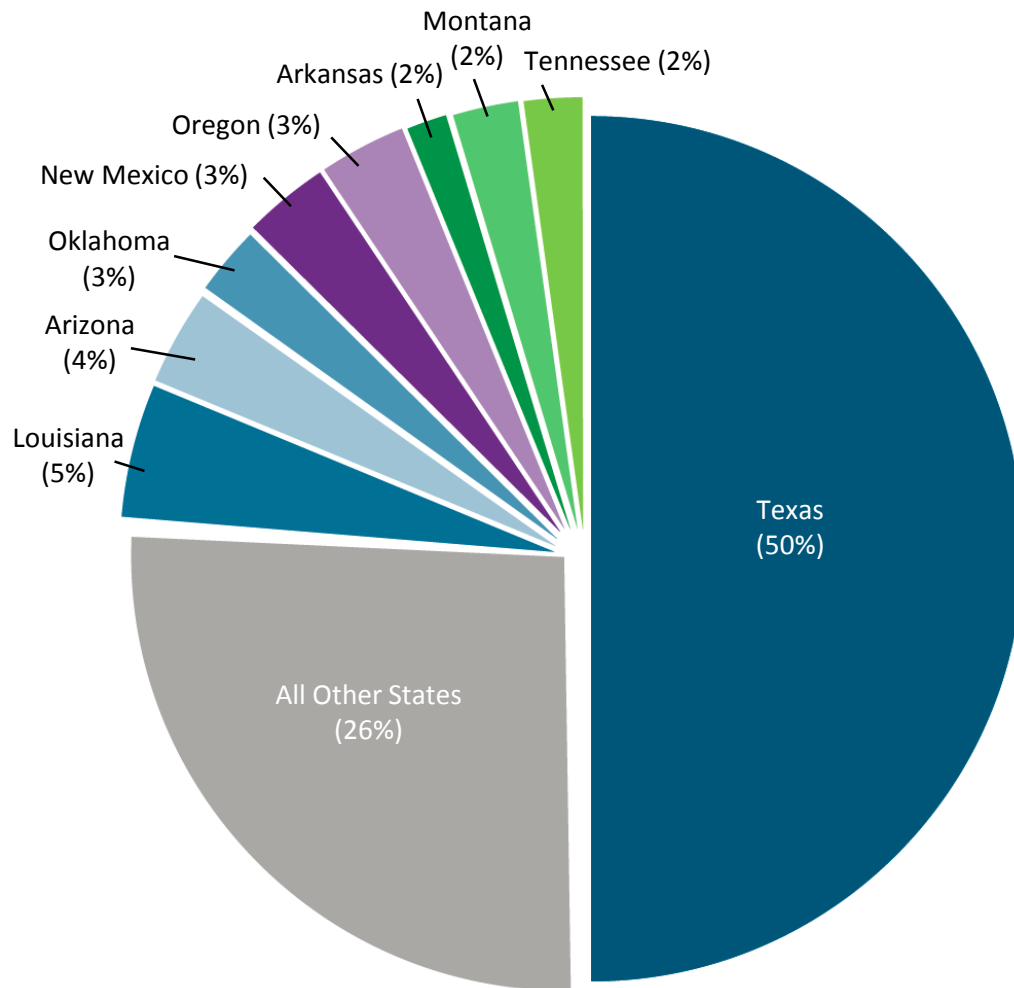
# Growth Focused on Specialty Brokerage Business



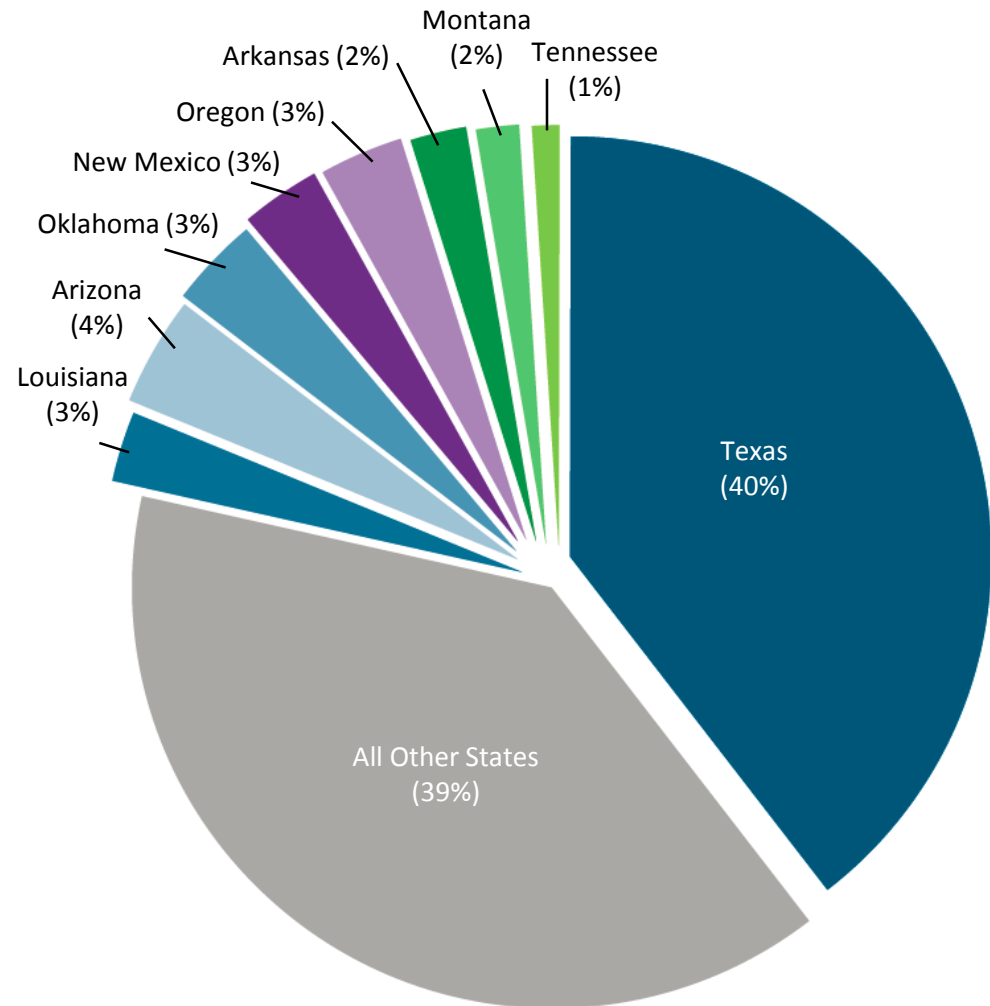
\*Standard Commercial excludes workers' compensation and non-subscription business that is in runoff.

# Geographic Diversification

**2014**



**2017**







## Operational Overview



# Specialty Commercial

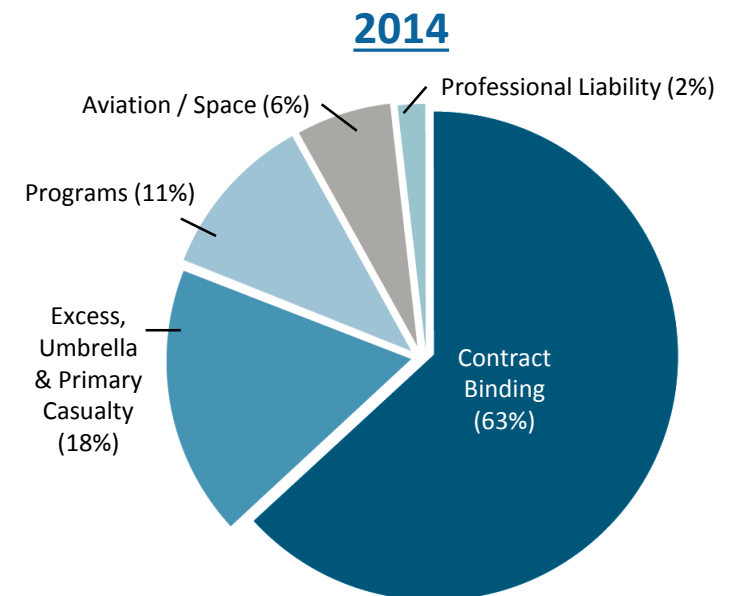
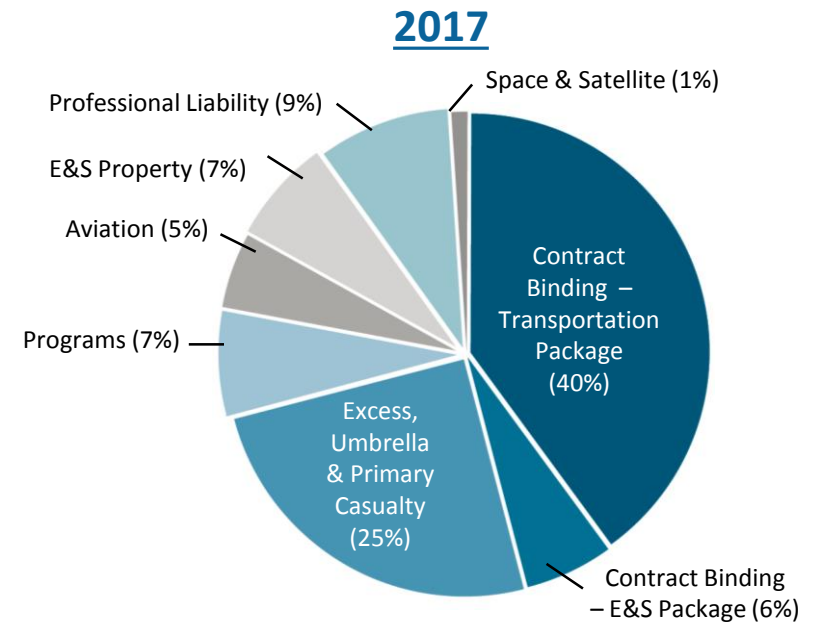
## Niche Specialty Commercial products in selected markets

2 major parts comprise the specialty commercial portfolio

1. **Specialty Brokerage**- Product expertise focused on niche specialty segments
2. **Contract Binding** focused on Commercial auto and E&S Package business targeted at SME risks

Specialty Commercial	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Gross Written	\$324,547	\$351,050	\$388,914	\$464,714
Net Written	\$230,638	\$241,775	\$249,072	\$265,022
Combined Ratio	91.1%	88.2%	95.2%	105.9%

- Premium growth driven by organic growth from new products and underwriting investments over the last 3 years
- 15.6% points of prior year development primarily in Commercial Auto



# Specialty Commercial – Specialty Brokerage

Specialty Brokerage	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Gross Written	\$119,689	\$138,615	\$173,045	\$252,233
Net Written	\$29,170	\$32,251	\$36,553	\$57,090
Combined Ratio	84.7%	88.2%	89.2%	83.4%

## Specialty Brokerage Characteristics

- Strong top and bottom line performance
- Earnings growth as we retain more of the premium on profitable specialty products lines going forward
- Focus of our investments in new product lines was done by deploying seasoned teams with strong track records as well as close relationships with our reinsurance and sidecar partners
- Focused on niche specialty markets and targeted distribution with opportunities for sustained profit and growth
- Requiring specialized underwriting skills and customer knowledge
- Small to large regional customer profile with a disciplined approach to limits management and capital deployment along with technical underwriting and pricing to ensure price adequacy for the long term

## Strategic Plan in Action

### **New Products introduced since 2015**

- Primary & Excess Casualty for select E&S classes
- Public Entity Excess Liability
- Professional Liability for Healthcare facilities
- Hospital Professional Liability
- Management Liability
- Errors & Omissions
- Shared & Layered Property
- Primary Property for select E&S classes

### **Complements established products:**

- Excess Transportation
- Medical Malpractice
- General Aviation
- Satellite launch and Orbit
- Affinity and Program Business

# Specialty Commercial – Contract Binding

Contract Binding	2014	2015	2016	2017
Gross Written	\$204,858	\$212,435	\$215,869	\$212,481
Net Written	\$201,468	\$209,524	\$212,519	\$207,932
Combined Ratio	93.1%	88.2%	96.3%	110.5%

## Contract Binding Characteristics

- Focuses on difficult to place accounts, primarily commercial auto, surplus lines general liability, package, supported excess umbrella and energy service contractors
- Prior year development driven by significant increase in underlying frequency and severity in commercial auto
- Diversifying with small E&S package business with launch of **HFSxpress** platform
- Business is derived from binding contract MGA's and wholesale brokers in 24 states with Texas accounting for significant amount of the premium

## Strategic Plan in Action

- Aggressively addressing elevated frequency, severity and litigation trends in commercial auto
- 18 points of impact from prior year development
- Exited 2 states due to price inadequacy
- Increased rates on all segments of commercial auto over the last 2 years and culled underperforming accounts and brokers
- Re-tooled claims operations to effect total claim outcome
- Developed our Package binding authority business to balance portfolio...**HFSxpress**
- New Platform launched with significant improvement in user experience
- New leadership in place

# Standard Commercial\*\*

Commercial Insurance Solutions	2014	2015	2016	2017
Gross Written	\$67,959	\$68,376	\$71,137	\$77,950
Net Written	\$61,159	\$61,085	\$63,473	\$69,028
Combined Ratio	101.9%	98.1%	95.7%	97.9%*

State expansion, along with broader distribution for targeted classes offers opportunity for profitable growth



\* 5.5 points of CAT loss impact primarily from Hurricane Harvey.

## Standard Commercial Characteristics

- Targeted, industry-focused property and casualty commercial insurance products to targeted small and medium-sized businesses
- Coverage is offered on Commercial Package Policy (CPP) or Business Owners Policy (BOP) forms
- Coverage includes general liability, property, auto, crime, inland marine, EPLI and cyber liability with industry specific solutions

## Strategic plan in Action:

- Experienced leadership in place to develop the portfolio
- Narrowed focus from a “generalist” to a “specialist”
- Sold WC renewal rights and put Occupational Accident business in run-off
- Revamped Underwriting guidelines and significantly improved catastrophe management
- New technology platform implemented
- Recent expansion into a new state and others to follow
- Targeted agents in each territory, rationally expanding distribution
- New industry focused products being developed and launched by region

# Specialty Personal Lines

Specialty Personal Lines	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>
Gross Written	\$63,992	\$81,281	\$83,272	\$61,214
Net Written	\$16,802	\$44,072	\$44,267	\$31,273
Combined Ratio	107.0%	107.6%	120.2%	113.3%

## Specialty Personal Lines Characteristics

- Personal Lines segment loss ratios improved by 31.5 points for the quarter and 14.7 points for year to date as compared to prior year periods.
- The expense ratio increased due to premium volume reduction, but we expect that to come in line over the course of 2018
- Focused distribution with industry specialists, consistent with Hallmark's niche strategy
- Provides minimum or financial responsibility limits for non-standard auto risks and companion renters coverage

## Strategic plan in Action:

- Narrowed focus from 33 States to current territory of 10 which offer sustained profitability and growth
- Put Homeowners, Dwelling and motorcycle/RV business in run off in 2014
- Seeing improvement from new platform launched in 2016 to support better underwriting decisions and pricing segmentation
- Significant rate increases taken and now being earned
- Improving mix of business is driving improved persistency
- Revamped claims organization and processes to drive better total claim outcome is having the expected impact
- Bent the curve on rising frequency and severity





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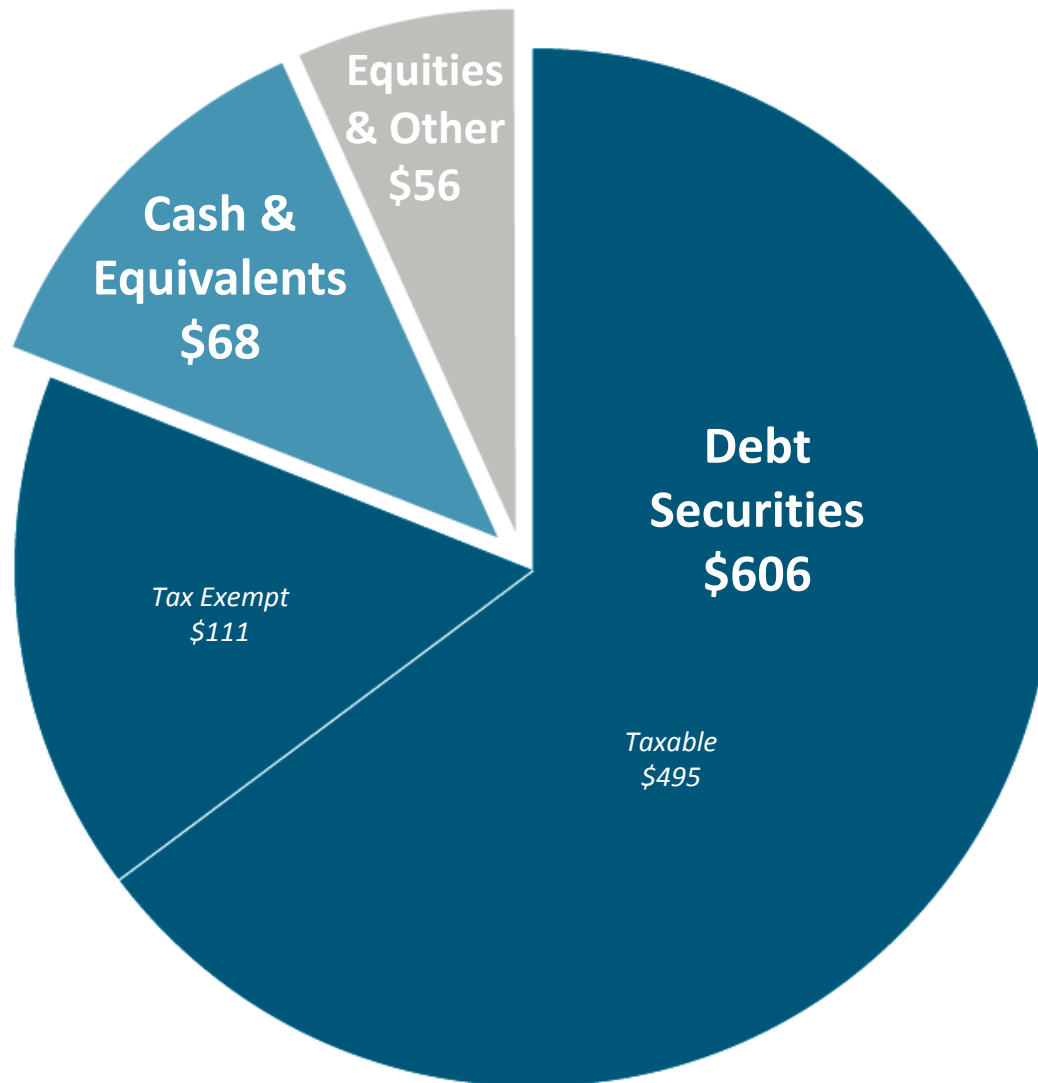
## Investment Overview



**HALLMARK**

# Investment Portfolio

**As of December 31, 2017**  
(*\$ in millions*)



***Total Cash & Investments of \$729 million, or approximately \$40.12 per share.***

- Investment portfolio of \$661 million
- 8% invested in equities
- Annualized tax equivalent yield of approximately 2.9%
- Weighted-average duration of 1.6 years
- Weighted-average credit rating of “BBB+”

# Key Characteristics of Hallmark Investment Portfolio

- Hallmark portfolio has significant liquidity
- \$128 million total cash and near cash:
  - \$68 million cash and cash equivalents
  - \$49 million short-term U.S. Government Treasury securities (cash substitute)
  - \$11 million performing auction rate securities (cash substitute)
- Hallmark portfolio has very short duration
  - Weighted average duration of 1.6 years
  - \$105 million forecasted portfolio maturities, redemptions and interest payments in the next 12 months
  - Only \$56 million of maturities greater than 10 years – many of these have an expected maturity less than 10 years
- Hallmark portfolio book yield compares favorably to Bloomberg Barclays U.S. Aggregate Index, with significantly shorter duration
  - Tax equivalent Book yield 2.9% vs. 2.7% for Barclays
  - Weighted average duration of 1.6 vs. 6.0 for Barclays Aggregate
- During rising interest rate environment this shorter duration portfolio should outperform the benchmark U.S. Aggregate Index
- Remain underweight equity allocation
- Protecting the balance sheet has been a priority in recent years = short duration and lower equity exposure
- 2017 Net investment income increased 15% to \$18.9 million, an all-time high, following increases of 17% and 13% in 2016 and 2015

# Transformed Specialty Insurer

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- Striving to be a “Best in Class” specialty property /casualty insurer focused on underserved sectors in sustainable “niche” markets
- Specialty product and geographic diversification well underway
- Built book value even during soft markets
- Continue to focus on profitability by mitigating risk
- Disciplined expense management while investing in our infrastructure, technology and talent
- Reserve volatility has masked progress
- Earned rate increases and underwriting actions are having the expected impact
- Economic growth and tax change impact is favorable to Hallmark
- Established underlying performance combined with net premium growth in profitable specialty lines and investment returns will support much improved ROE as we move forward

# Addendum

The Company's financial statements are prepared in accordance with United States generally accepted accounting principles ("GAAP"). However, the Company also presents and discusses certain non-GAAP financial measures that it believes are useful to investors as measures of operating performance. Management may also use such non-GAAP financial measures in evaluating the effectiveness of business strategies and for planning and budgeting purposes. However, these non-GAAP financial measures should not be viewed as an alternative or substitute for the results reflected in the Company's GAAP financial statements. In addition, our definitions of these items may not be comparable to the definitions used by other companies. Management believes disclosing results for the current accident year excluding catastrophe losses provides useful information for users to evaluate the Company's underwriting performance.

## Non-GAAP Measure Reconciliation

### Reported EPS to Pro-Forma EPS

<b>Reported:</b>	<b><u>2012</u></b>	<b><u>2013</u></b>	<b><u>2014</u></b>	<b><u>2015</u></b>	<b><u>2016</u></b>	<b><u>2017</u></b>
Net income	3,524	8,245	13,429	21,863	6,526	(11,553)
Diluted shares	19,269	19,361	19,366	19,405	18,941	18,343
<b>Diluted earnings per share</b>	<b>\$ 0.18</b>	<b>\$ 0.43</b>	<b>\$ 0.69</b>	<b>\$ 1.13</b>	<b>\$ 0.34</b>	<b>\$ (0.63)</b>
<b>Pro Forma Net Income Adjustments:</b>						
Reverse prior year net reserve development	(3,675)	9,954	(5,203)	(6,953)	7,608	40,105
Tax effect of prior year net reserve development	1,286	(3,484)	1,821	2,434	(2,663)	(14,037)
Reverse net incurred catastrophe losses	11,711	10,170	14,997	9,256	11,047	7,750
Tax effect of net incurred catastrophe losses	(4,099)	(3,560)	(5,249)	(3,240)	(3,866)	(2,713)
<b>Total pro forma net income adjustments</b>	<b>5,223</b>	<b>13,080</b>	<b>6,366</b>	<b>1,497</b>	<b>12,126</b>	<b>31,105</b>
<b>Pro Forma:</b>						
Net income excluding prior year net reserve development and net incurred catastrophe losses	8,747	21,325	19,795	23,360	18,652	19,552
Diluted shares	19,269	19,361	19,366	19,405	18,941	18,343
<b>Diluted earnings per share</b>	<b>\$ 0.45</b>	<b>\$ 1.10</b>	<b>\$ 1.02</b>	<b>\$ 1.20</b>	<b>\$ 0.98</b>	<b>\$ 1.07</b>



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