2004 ANNUAL REPORT

EMC® Insurance Group Inc.

growth

Tall as the eye can see. From tiny seeds they grow. It doesn't just happen overnight. It takes a combination of nurturing and nourishment over time.

strength

It comes from deep within. The strength to support more weight than yours alone. The ability to weather the storms while continually reaching for the top.

maturity

You don't stand for nearly a century without earning your stripes. Maturity brings about a unique knowledge and wisdom that only time can teach.

success

There are numerous ways to measure success. The peace of mind of our shareholders, customers, agents and employees is the ultimate gauge.

Left to right: Ronald W. Jean, William A. Murray and Bruce G. Kelley

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Dear Shareholders:

Our 2004 corporate objectives included achieving a combined ratio of 98.0 or less, net written premium growth between 4 and 7 percent, an increase in the overall effectiveness of our employees, providing superior service to our customers, and enhancing shareholder value. The final combined ratio of 104.7 was not what we expected. Net income was significantly impacted by two factors – catastrophe and storm losses that remained at an unusually high level due to the active hurricane season and significant strengthening of direct loss and settlement expense reserves.

But by any number of measures, 2004 was a successful and productive year. For example, we achieved:

- *Net income of $13.2 million or $1.10 per share.*
- *Operating income of $10.3 million or $0.87 per share.*
- *Total assets of $934.8 million, an increase of 3.2 percent.*
- *Total revenues of $376.0 million, an increase of 4.1 percent.*
- *Total shareholders' equity of $228.5 million, an increase of 26.4 percent.*

Count on EMC represents the core values upon which EMC Insurance Companies has built its reputation. Since 1911, policyholders, agents and employees have come to *Count on EMC* for comprehensive protection, superior service and financial stability.

- *Net written premium of $351.9 million, an increase of 3.6 percent.*
- *Total invested assets of $779.3 million, an increase of 12.8 percent.*
- *Rate adequacy (either maintained or increased) in most lines of business.*
- *Significantly increased reserve adequacy due to reserve strengthening throughout 2004.*

Total shareholder value was again enhanced through an annual dividend distribution of $0.60 per share and our closing stock price as of December 31, 2004, increased to $21.64 per share.

Highlights of the year included the completion of a successful stock offering, unusually good results in our reinsurance segment, continued refinement of our underwriting standards and the implementation of additional rate increases where warranted.

No, we did not fully meet our objectives in 2004, but we did succeed in creating additional shareholder value as well as building a financial foundation that will accentuate our success in 2005 and beyond.

For 2005, our objective, once again, is to obtain a combined ratio of 98.0. With a balance sheet bolstered by strong reserves and increased capital, we are well positioned for success. On a countrywide basis, rate levels for most lines of business are adequate and provide the potential for profitable growth when combined with disciplined underwriting and marketing efforts. Our employees have a good understanding of company objectives and their individual roles in achieving those objectives. We look forward to the coming year.

Thank you for your continued interest in EMC Insurance Group Inc.

Bruce G. Kelley, CPCU, CLU
President & Chief Executive Officer

William A. Murray, CIC, AU
Executive Vice President & Chief Operating Officer

Ronald W. Jean, FCAS, MAAA
Executive Vice President for Corporate Development

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS
The Private Securities Litigation Reform Act of 1995 provides issuers the opportunity to make cautionary statements regarding forward-looking statements. Accordingly, any forward-looking statement contained in this report is based on management's current beliefs, assumptions and expectations of the Company's future performance, taking into account all information currently available to management. These beliefs, assumptions and expectations can change as the result of many possible events or factors, not all of which are known to management. If a change occurs, the Company's business, financial condition, liquidity, results of operations, plans and objectives may vary materially from those expressed in the forward-looking statements. The risks and uncertainties that may affect the actual results of the Company include, but are not limited to, the following: catastrophic events and the occurrence of significant severe weather conditions; the adequacy of loss and settlement expense reserves; state and federal legislation and regulations; changes in our industry, interest rates or the performance of financial markets and the general economy; rating agency actions and other risks and uncertainties inherent to the Company's business. When we use the words "believe," "expect," "anticipate," "estimate," or similar expressions, we intend to identify forward-looking statements. You should not place undue reliance on these forward-looking statements.

2004 Financial Highlights

($ in thousands, except per share data)

FOR THE YEAR	2004	2003	% CHANGE
Total revenues	$375,980	$361,187	4.1 %
Income (loss) before income taxes	15,571	27,982	(44.4)%
Net income (loss)	13,185	20,349	(35.2)%

PER SHARE	2004	2003	% CHANGE
Net income (loss)	$ 1.10	$ 1.78	(38.2)%
Catastrophe and storm losses	1.01	1.19	(15.1)%
Dividend paid	0.60	0.60	0.0 %
Book value per share	16.84	15.72	7.1 %

MARKET PRICE	2004	2003	% CHANGE
High	$ 25.51	$ 22.10	15.4 %
Low	18.02	15.50	16.3 %
Close on December 31	21.64	21.14	2.4 %

AT YEAR END	2004	2003	% CHANGE
Average return on equity (ROE)	6.4%	12.0%	(46.7)%
Total assets	$934,816	$899,712	3.9 %
Shareholders' equity	$228,473	$180,751	26.4 %
Price to book value	1.29x	1.35x	(4.4)%
Number of shares outstanding	13,568,945	11,501,065	18.0 %
Number of registered shareholders	1,201	1,188	1.1 %
Number of independent insurance agencies	3,100	3,200	(3.1)%

Count on EMC®

2004 Highlights

SHAREHOLDER VALUE

We strive to provide superior service and protection for our policyholders while producing consistent, long-term growth and value for our shareholders. In 2004, our net income per share was $1.10. Quarterly dividends totaling $0.60 per share were paid to shareholders. This equates to a dividend yield of 2.8 percent and a dividend payout of 54.5 percent for the year. The ending stock price for 2004 increased 2.4 percent to $21.64. The Company has paid a dividend each quarter since it became publicly traded in 1982. Historically, our dividend payout ratio equates to 66 percent of net income.

Net book value of our stock increased 7.1 percent to $16.84 per share.

We continue to believe shareholder value is created through a commitment to underwriting excellence and a philosophy of profitability over production.

STOCK OFFERING

Shareholders' equity increased 26.4 percent in 2004. This increase is a direct result of a successful secondary offering which was completed in October. The company issued two million new shares of its common stock at a price of $18.75 per share. Net proceeds from the sale of common stock totaled $34.9 million. The proceeds were contributed to three of the Company's subsidiaries to facilitate a planned increase in the Company's aggregate participation in the pooling agreement effective January 1, 2005.

In addition, Employers Mutual Casualty Company, our parent organization and largest shareholder, sold an additional 2.1 million shares of common stock. The additional 4.1 million shares more than tripled the Company's public float.

REFINED UNDERWRITING STANDARDS

The products we offer must be priced so that they are competitive in the marketplace, yet offer the prospect of producing an underwriting profit. This is even more critical in today's economic environment of low interest rates. Therefore, we have implemented focused underwriting initiatives that stress profitability over production. These initiatives include maintaining premium rate adequacy and the quality of risks we insure as well as diligent claim management. We continue to seek those risks and to write business in those territories where we believe an underwriting profit can be achieved.

REINSURANCE SEGMENT RESULTS

In 2004, the reinsurance segment generated 8.4 percent growth in net premiums written, but the majority of the growth was attributed to increased participation in the Mutual Reinsurance Bureau (MRB) pool. The segment experienced very good results in 2004 with a GAAP combined ratio of 84.0 percent. These results were a significant factor in our net income for 2004. The unusually good results benefited from the $1.5 million occurrence cap protection provided under the quota share agreement with Employers Mutual Casualty Company; very few large losses on excess business; favorable development on reserves; an excellent year for crop business; and continued improvements in premium rate adequacy.

REGIONAL PRESENCE

Our industry builds value on personal relationships. As an organization that firmly believes in and strictly adheres to the independent insurance agent structure, we not only encourage, but rely on personal relationships. With 16 branch offices and 6 service centers strategically located throughout the United States, we believe we have placed talented and well-trained underwriters, claims professionals, marketing professionals and sales support staff in communities where profitable and long-term relationships can grow and expand. Our decentralized structure and local focus allows us to react quickly to regional changes in market conditions. Our strong, stable relationships with agency partners add significant value to the insurance process. Through a local focus, we gain a keen understanding of the unique needs, expectations and regional nuances of our customers.

GROWTH THROUGH TECHNOLOGY

Despite the diversity that exists within each branch, great efforts have been made to initiate as many similarities among the branches as possible in order to benefit from economies of scale and technological development. We successfully launched real-time interface technology more than a year ago, giving agents quick and secure access to policyholder information. In addition, improvements to our web-based services provide agents with an enhanced ability to access claims, billing and policy information instantaneously. Quotes are now provided on a per-account basis and there is easy and immediate access to coverage forms. Complete proposals are downloadable and ready for print. Our ongoing efforts are centered on branch and agency efficiency. We recognize that independent agents have a choice of partnering relationships and we make every attempt to be their first choice.

EFFECTIVENESS OF OUR EMPLOYEES

Major advances were undertaken in 2004 to increase the overall effectiveness of our employees. These initiatives included enhancements in education and training, performance management, and leadership practices.

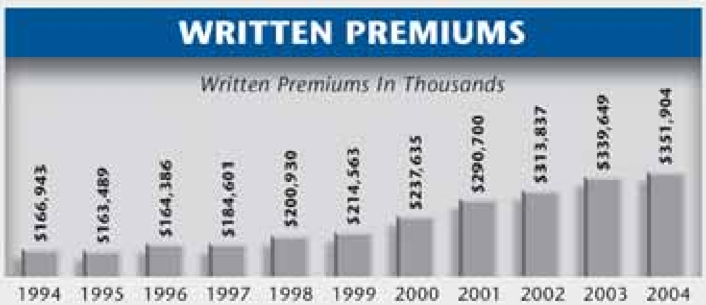
We continue to emphasize superior customer service, both internally and externally. Heavy emphasis remains on establishing communication flow not only from within specialized departments, but throughout our organizational structure, which includes information flow from subordinate levels to top management and vice versa.

Externally, customer service includes such practices as our loss control services. With the support of leading-edge technology, we have one of the most sophisticated loss control teams in the industry. Our experts work with policyholders to provide services that can result in meaningful loss control, which in turn, equates to cost control.

BRIGHT OUTLOOK FOR 2005

Once again, our 2005 corporate objective will be to achieve a combined ratio of 98.0 or less. With a balance sheet bolstered by strong reserves and increased capital, we are well positioned for success. On a countrywide basis, rate levels for most lines of business are adequate and provide the potential for profitable growth when combined with disciplined underwriting and marketing efforts. We believe we have successfully identified potential challenges and developed focused action plans to address those challenges, which are in the implementation process. Through the corporate planning process and the performance management system, employees have a good understanding of company objectives and their individual roles in achieving those objectives.

Historical Financials



EMC Insurance Group Inc.

Corporate Profile

EMC Insurance Group Inc. (Group) is a holding company with operations in property and casualty insurance and reinsurance. Group, formed in 1974, became publicly held in 1982.

Employers Mutual Casualty Company (EMCC) owns 53.7 percent of Group's stock. EMCC, its affiliates and its subsidiaries operate under the trade name of EMC Insurance Companies (EMC). Headquartered in Des Moines, Iowa, EMC provides insurance coverage and services through 16 branch offices throughout the country.

EMC Insurance Group Inc.'s common stock trades on the NASDAQ National Market tier of the NASDAQ Stock Market under the symbol EMCI.

Market Territories

We market our products and services to our agency partners and insurance customers through local branch offices and various service offices located strategically throughout the country. We feel it is important to our success to provide a local presence, especially in the areas of underwriting, claims, marketing and risk improvement.

The short chain of command and the decentralized structure of the branch office system allows us to fine-tune marketing strategies, products and pricing to meet the needs of individual marketing territories and to take advantage of different opportunities for profit in each market.

EMC BRANCH OFFICES

Birmingham, AL
Bismarck, ND
Charlotte, NC
Chicago, IL
Cincinnati, OH
Denver, CO
Des Moines, IA
Jackson, MS
Kansas City, MO
Lansing, MI
Milwaukee, WI
Minneapolis, MN
Omaha, NE
Phoenix, AZ
Providence, RI
Wichita, KS

EMC SERVICE OFFICES

Dallas, TX
Davenport, IA
Irvine, CA
Little Rock, AR
St. Louis, MO
Valley Forge, PA

Count on EMC

Shareholder Information

PRICES AND DIVIDENDS PAID
by quarters as reported by NASDAQ

	2004			2003		
	High	Low	Dividend	High	Low	Dividend
1st Quarter	$24.60	$20.00	$0.15	$19.45	$15.50	$0.15
2nd Quarter	$25.51	$19.11	$0.15	$20.85	$18.00	$0.15
3rd Quarter	$24.00	$18.65	$0.15	$21.64	$17.52	$0.15
4th Quarter	$22.50	$19.74	$0.15	$22.10	$16.40	$0.15
Close on Dec. 31	$21.64			$21.14		

COMMON STOCK

EMC Insurance Group Inc.'s common stock trades on the NASDAQ National Market tier of the NASDAQ Stock Market under the symbol EMCI. As of February 24, 2005, the number of registered shareholders was 1,150.

There are certain regulatory restrictions relating to the payment of dividends by Group's insurance subsidiaries (See Note 6 of Consolidated Financial Statements). It is the present intention of Group's Board of Directors to declare quarterly cash dividends, but the amount and timing thereof, if any, is to be determined by the Board of Directors at its discretion.

DIVIDEND REINVESTMENT AND COMMON STOCK PURCHASE PLAN

A dividend reinvestment and common stock purchase plan provides shareholders with the option of receiving additional shares of common stock instead of cash dividends. Participants may also purchase additional shares of common stock without incurring broker commissions by making optional cash contributions to the plan and may sell shares of common stock through the plan (See Note 12 of Notes to Consolidated Financial Statements). Employers Mutual Casualty Company (EMCC) participated in the Dividend Reinvestment Plan in 2002, 2003 and the first two quarters of 2004, reinvesting 50 percent of its dividends in additional shares of the Company's common stock in all but the second and third quarters of 2003, when it reinvested 75 percent and 25 percent, respectively, and in 2002, when it reinvested 25 percent. Due to its participation in the Company's recent stock offering, EMCC discontinued its participation in the plan for the third and fourth quarters of 2004 and has indicated that it will likely not participate in the plan in 2005. More information about the plan can be obtained by calling UMB Bank, n.a., the stock transfer agent and plan administrator.

Board Of Directors

Front Row Left to Right:

Margaret A. Ball, 67
Retired Senior Vice President
Employers Mutual Casualty Company

Joanne L. Stockdale, 58, **A**
President & Owner
Northern Iowa Die Casting, Inc.

George W. Kochheiser, 79, **E**
Chairman of the Board
Retired President
Employers Mutual Casualty Company

Back Row Left to Right:

Fredrick A. Schiek, 70, **E**
Retired Executive Vice President &
Chief Operating Officer
Employers Mutual Casualty Company

David J. Fisher, 68, **A**, **I**
Chairman of the Board & President
Onthank Company
(wholesale distributor)

Bruce G. Kelley, 51, **E**
President & Chief Executive Officer
Employers Mutual Casualty Company

George C. Carpenter III, 77, **A**, **I**
Retired Executive Director
Iowa Public Television
(broadcasting)

Raymond A. Michel, 79, **I**
Director &
Retired Chief Executive Officer
Koss Construction Company
(road construction)

COMMITTEE MEMBERS

E Member of Executive Committee
A Member of Audit Committee
I Member of Inter-Company Committee

INDEPENDENT DIRECTORS

Margaret A. Ball
George C. Carpenter III
David J. Fisher
Raymond A. Michel

Corporate Governance: Charters of the Audit and Nominating committees as well as the Code of Conduct, Code of Ethics for CEO and Senior Financial Officers, and Corporate Governance Guidelines can be found on the Investor Relations link of the Company's website www.emcinsurance.com.

Executive Officers

Raymond W. Davis
Senior Vice President/
Investments & Treasurer

Richard L. Gass
Senior Vice President/Technology

Richard W. Hoffmann
Vice President & General Counsel

Kevin J. Hovick
Senior Vice President/
Business Development

Ronald W. Jean
Executive Vice President
for Corporate Development

Bruce G. Kelley
President & Chief Executive Officer

Donald D. Klemme
Senior Vice President/
Administration & Secretary

Robert L. Link
Assistant Vice President
& Assistant Secretary

William A. Murray
Executive Vice President
& Chief Operating Officer

David O. Narigon
Senior Vice President/Claims

Ronald A. Paine
Vice President/Internal Audit

Steven C. Peck
Senior Vice President/Actuarial

Carla A. Prather
Assistant Vice President/
Accounting & Controller

Mark E. Reese
Senior Vice President/
Accounting & Chief Financial Officer

Count on EMC®

Shareholder Services

CORPORATE HEADQUARTERS

717 Mulberry Street
Des Moines, IA 50309
515-280-2511
EMCIns.Group@EMCIns.com

TRANSFER AGENT

UMB Bank, n.a.
Securities Transfer Division
P.O. Box 410064
Kansas City, MO 64141-0064
800-884-4225

AUDITORS

Ernst & Young LLP
801 Grand Avenue, Suite 3400
Des Moines, IA 50309

SEC COUNSEL

Nyemaster, Goode, Voigts,
West, Hansell & O'Brien, P.C.
700 Walnut Street, Suite 1600
Des Moines, IA 50309

INSURANCE COUNSEL

Bradshaw, Fowler, Proctor and Fairgrave
801 Grand Avenue, Suite 3700
Des Moines, IA 50309

ANNUAL MEETING

We welcome attendance at our annual meeting on May 26, 2005, at 1:30 p.m. CDT.

EMC Insurance Companies
700 Walnut Street
Des Moines, IA 50309

INFORMATION AVAILABILITY

Anyone interested in EMC Insurance Group Inc. can request news releases, annual reports, Forms 10-Q and 10-K, quarterly financial statements and other information at no cost by contacting:

Investor Relations
Anita Lake Novak
EMC Insurance Group Inc.
717 Mulberry Street
Des Moines, IA 50309
phone: 515-280-2515
fax: 515-237-2152
email: EMCIns.Group@EMCIns.com
website: www.emcinsurance.com

2004

FINANCIAL INFORMATION

EMC
EMC Insurance Group Inc.

Contents

SELECTED FINANCIAL DATA.

	Year ended December 31,										
	2004	2003	2002	2001	2000	1999	1998	1997	1996	1995	1994
	($ in thousands, except per share amounts)										
INCOME STATEMENT DATA											
Insurance premiums earned	$345,478	$330,623	$297,043	$265,280	$231,459	$211,098	$194,244	$177,218	$165,191	$162,266	$164,829
Investment income, net	29,900	29,702	32,778	30,970	29,006	25,761	24,859	23,780	24,007	23,204	21,042
Realized investment gains (losses)	4,379	1,170	(3,159)	800	1,558	277	5,901	4,100	1,891	1,043	520
Other income	602	862	866	774	1,473	2,194	1,701	1,023	904	1,005	1,128
Total revenues	380,359	362,357	327,528	297,824	263,496	239,330	226,705	206,121	191,993	187,518	187,519
Losses and expenses	364,788	334,375	305,636	303,366	262,431	245,321	223,031	189,318	171,324	163,202	168,842
Income (loss) before income tax expense (benefit)	15,571	27,982	21,892	(5,542)	1,065	(5,991)	3,674	16,803	20,669	24,316	18,677
Income tax expense (benefit)	2,386	7,633	5,790	(3,436)	(1,264)	(5,187)	(2,339)	3,586	5,635	6,967	5,171
Net income (loss)	$ 13,185	$ 20,349	$ 16,102	$ (2,106)	$ 2,329	$ (804)	$ 6,013	$ 13,217	$ 15,034	$ 17,349	$ 13,506
Net income (loss) per common share - basic and diluted:	$ 1.10	$ 1.78	$ 1.42	$ (.19)	$ .21	$ (.07)	$ .53	$ 1.18	$ 1.37	$ 1.62	$ 1.29
Premiums earned by segment:											
Property and casualty insurance	$250,034	$241,237	$225,013	$203,393	$184,986	$167,265	$155,523	$143,113	$128,516	$126,440	$127,573
Reinsurance	95,444	89,386	72,030	61,887	46,473	43,833	38,721	34,105	36,675	35,826	37,256
Total	$345,478	$330,623	$297,043	$265,280	$231,459	$211,098	$194,244	$177,218	$165,191	$162,266	$164,829
Balance Sheet Data											
Total assets	$934,816	$899,712	$674,864	$671,565	$587,676	$542,395	$496,046	$459,110	$430,328	$412,881	$387,370
Stockholders' equity	$228,473	$180,751	$157,768	$140,458	$148,393	$141,916	$163,938	$162,346	$148,729	$136,889	$116,727
OTHER DATA											
Average return on equity	6.4%	12.0%	10.8%	(1.5)%	1.6%	(.5)%	3.7%	8.5%	10.5%	13.7%	11.9%
Book value per share	$ 16.84	$ 15.72	$ 13.84	$ 12.40	$ 13.14	$ 12.60	$ 14.26	$ 14.30	$ 13.42	$ 12.66	$ 11.03
Dividends paid per share	$ .60	$ .60	$ .60	$ .60	$ .60	$ .60	$ .60	$ .60	$ .57	$ .53	$ .52
Property and casualty insurance subsidiaries aggregate pool percentage	23.5%	23.5%	23.5%	23.5%	23.5%	23.5%	23.5%	22%	22%	22%	22%
Reinsurance subsidiary quota share percentage	100%	100%	100%	100%	100%	100%	100%	100%	95%	95%	95%
Closing stock price	$ 21.64	$ 21.14	$ 17.87	$ 17.15	$ 11.75	$ 9.13	$ 12.75	$ 13.25	$ 12.00	$ 13.75	$ 9.50
Net investment yield (pre-tax) ...	4.33%	4.81%	5.92%	6.31%	6.47%	5.96%	6.02%	6.15%	6.54%	6.65%	6.59%
Cash dividends to closing stock price	2.8%	2.8%	3.4%	3.5%	5.1%	6.6%	4.7%	4.5%	4.8%	3.9%	5.5%
Common shares outstanding	13,569	11,501	11,399	11,330	11,294	11,265	11,496	11,351	11,084	10,814	10,577
Statutory trade combined ratio ...	104.2%	99.8%	101.3%	112.4%	113.5%	115.2%	114.8%	106.2%	103.6%	99.6%	101.3%

Amounts previously reported in prior consolidated financial statements have been reclassified to conform to current presentation.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of EMC Insurance Group Inc. and its subsidiaries' financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements included elsewhere herein.

COMPANY OVERVIEW

EMC Insurance Group Inc., a 53.7 percent owned subsidiary of Employers Mutual Casualty Company (Employers Mutual), is an insurance holding company with operations in property and casualty insurance and reinsurance. Property and casualty insurance is the most significant segment, representing 72.4 percent of consolidated premiums earned in 2004. For purposes of this discussion, the term "Company" is used interchangeably to describe EMC Insurance Group Inc. (Parent Company only) and EMC Insurance Group Inc. and its subsidiaries. Employers Mutual and all of its subsidiaries (including the Company) and an affiliate are referred to as the "EMC Insurance Companies."

The Company's four property and casualty insurance subsidiaries and two subsidiaries and an affiliate of Employers Mutual are parties to reinsurance pooling agreements with Employers Mutual (collectively the "pooling agreement"). Under the terms of the pooling agreement, each company cedes to Employers Mutual all of its insurance business, with the exception of any voluntary reinsurance business assumed from nonaffiliated insurance companies, and assumes from Employers Mutual an amount equal to its participation in the pool. All premiums, losses, settlement expenses and other underwriting and administrative expenses, excluding the voluntary reinsurance business assumed by Employers Mutual from nonaffiliated insurance companies, are prorated among the parties on the basis of participation in the pool. The aggregate participation of the Company's property and casualty insurance subsidiaries is 23.5 percent. Employers Mutual negotiates reinsurance agreements that provide protection to the pool and each of its participants, including protection against losses arising from catastrophic events.

Operations of the pool give rise to inter-company balances with Employers Mutual, which are settled on a quarterly basis. The investment and income tax activities of the pool participants are not subject to the pooling agreement. Effective December 31, 2003, the pooling agreement was amended to provide that Employers Mutual will make up any shortfall or difference resulting from an error in its systems and/or computational processes that would otherwise result in the required restatement of the pool participants' financial statements.

The purpose of the pooling agreement is to spread the risk of an exposure insured by any of the pool participants among all the companies. The pooling agreement produces a more uniform and stable underwriting result from year to year for all companies in the pool than might be experienced individually. In addition, each company benefits from the capacity of the entire pool, rather than being limited to policy exposures of a size commensurate with its own assets, and from the wide range of policy forms, lines of insurance written, rate filings and commission plans offered by each of the companies.

The Company's reinsurance subsidiary assumes a 100 percent quota share portion of Employers Mutual's assumed reinsurance business, exclusive of certain reinsurance contracts. This includes all premiums and related losses and settlement expenses of this business, subject to a maximum loss of $1,500,000 per event. The reinsurance subsidiary does not directly reinsure any of the insurance business written by Employers Mutual; however, the reinsurance subsidiary assumes reinsurance business from the Mutual Reinsurance Bureau pool and this pool provides a very small amount of reinsurance protection to the EMC Insurance Companies. As a result, the reinsurance subsidiary's assumed exposures include a very small portion of the EMC Insurance Companies direct business, after ceded reinsurance protections purchased by the Mutual Reinsurance Bureau pool are applied. In addition, reinsurance subsidiary does not reinsure any "involuntary" facility or pool business that Employers Mutual assumes pursuant to state law. Operations of the quota share agreement give rise to inter-company balances with Employers Mutual, which are settled on a quarterly basis. The investment and income tax activities of the reinsurance subsidiary are not subject to the quota share agreement.

The reinsurance subsidiary pays an annual override commission to Employers Mutual in connection with the $1,500,000 cap on losses assumed per event. The override commission rate is charged at 4.50 percent of written premiums. The reinsurance subsidiary also pays for 100 percent of the outside reinsurance protection Employers Mutual purchases to protect itself from catastrophic losses on the assumed reinsurance business, excluding reinstatement premiums. This cost is recorded as a reduction to the premiums received by the reinsurance subsidiary.

Changes for 2005

On October 20, 2004, the Company successfully completed a follow-on stock offering and sold 2.0 million new shares of its common stock to the public at a price of $18.75 per share. Employers Mutual participated in the stock offering as a selling shareholder and sold 2.1 million shares of the Company's common stock that it previously owned. As a result of these transactions, Employers Mutual's ownership of the Company was reduced from approximately 80.9 percent to 53.7 percent.

Net proceeds from the follow-on stock offering totaled $34,890,000. These proceeds were contributed to three of the Company's property and casualty insurance subsidiaries in late December to support a planned 6.5 percentage point increase in the Company's aggregate participation in the pooling agreement effective January 1, 2005. As a result of this change, the Company's aggregate participation in the pooling agreement will increase from the current 23.5 percent to 30.0 percent and Employers Mutual's participation will decrease from the current 65.5 percent to 59.0 percent. In connection with this change in the pooling agreement, the Company's liabilities will increase $115,042,000 and assets will increase $108,798,000. The Company will reimburse Employers Mutual $6,519,000 for expenses that were incurred to generate the additional business assumed by the Company, but this expense will be offset by an increase in deferred policy acquisition costs. The Company will also receive $275,000 in interest income from Employers Mutual as the actual cash transfer did not occur until February 15, 2005.

In addition to changing the individual pool participation percentages of Employers Mutual and three of the Company's property and casualty insurance subsidiaries, the pooling agreement has been amended effective January 1, 2005 to comply with certain conditions established by the Iowa Insurance Department and A.M. Best Company. These amendments: (1) provide for a fixed term of three years commencing January 1, 2005 and continuing until December 31, 2007, during which period the pooling agreement may not be terminated and the revised participation interests will not be further amended, absent the occurrence of a material event not in the ordinary course of business that could reasonably be expected to impact the appropriateness of the participation interests in the pool; (2) provide that if a pool participant becomes insolvent, or is otherwise subject to liquidation or receivership proceedings, each of the other participants will, on a pro rata basis, adjust their assumed portions of the pool liabilities in order to assume in full the liabilities of the impaired participant, subject to compliance with all regulatory requirements applicable to such adjustment under the laws of all states in which the participants are domiciled; (3) clarify that all development on prior years' outstanding losses and settlement expenses of the participants will remain in the pool and be pro rated pursuant to the pooling agreement; and (4) clarify that all liabilities incurred prior to a participant withdrawing from the pool, and associated with such withdrawing participant, shall remain a part of the pool and subject to the pooling agreement.

As a result of the planned change in aggregate pool participation, the reinsurance segment will have slightly less impact on the Company's financial results in 2005 and beyond. For example, the reinsurance segment represented approximately 28 percent of total premiums earned in 2004. Had the new 30 percent aggregate pool participation been in effect in 2004, the reinsurance segment would have represented approximately 23 percent of total premiums earned.

The successful completion of the follow-on stock offering will result in the Company surpassing the Securities and Exchange Commission's market value threshold for determination of accelerated filer status when the test is performed at June 30, 2005. As a result, the Company will become subject to accelerated filing deadlines beginning with the December 31, 2005 Annual Report on Form 10-K.

INDUSTRY OVERVIEW

An insurance company's underwriting results reflect the profitability of its insurance operations, excluding investment income. Underwriting results are calculated by subtracting losses and expenses incurred from premiums earned. An underwriting profit indicates that a sufficient amount of premium income was received to cover the risks insured. An underwriting loss indicates that premium income was not adequate. The combined ratio is a measure utilized by insurance companies to gauge underwriting profitability and is calculated by dividing losses and expenses incurred by premiums earned. A number less than 100 generally indicates an underwriting gain; a number greater than 100 generally indicates an underwriting loss.

Insurance pricing has historically been cyclical in nature. Periods of excess capital and increased competition encourage price cutting and liberal underwriting practices (referred to as a soft market) as insurance companies compete for market share, while attempting to cover the inevitable underwriting losses from these actions with investment income. As capital decreases and competition begins to subside in the interest of strengthening the balance sheet, premium pricing rises, sometimes dramatically, and underwriting practices are tightened (referred to as a hard market). During the late 1990's the insurance industry had hit the depths of an extremely long soft market. High interest rates and a strong stock market allowed insurers to cover ever growing underwriting losses with investment income. As the year 2000 approached, declining interest rates and a weakening stock market prompted the insurance industry to begin a movement toward increased pricing. This movement was dramatically accelerated by the terrorist attacks of September 11, 2001, pushing the industry toward a hard market. The ensuing plunge in the stock market, a further decline in interest rates, high profile bankruptcies and rising concerns about reserve deficiencies lead the insurance industry to implement large premium rate increases in an effort to improve capitalization. This hard market continued through 2002, but began to level off somewhat during 2003 as premium rate increases slowed, or even flattened, in most lines of business. Premium rates were fairly stable during 2004, but moderated slightly in certain lines of business and select territories due to an increase in price competition. Overall premium rate levels for 2005 are expected to remain steady or decline slightly due to improved industry capitalization and continued price competition.

A substantial determinant of an insurance company's underwriting results is its loss and settlement expense reserving. Insurance companies must estimate the amount of losses and settlement expenses that will ultimately be paid to settle claims that have occurred to date (loss and settlement expense reserves). This estimation process is inherently subjective with the possibility of widely varying results, particularly for certain highly volatile types of claims (asbestos, environmental, and various casualty exposures, such as products liability, where the loss amount and the parties responsible are difficult to determine). During a soft market, inadequate premium rates put pressure on insurance companies to under-estimate their loss and settlement expense reserves in order to show a profit. Correspondingly, inadequate reserves play an integral part in bringing about a hard market, because increased profitability from higher premium rate levels can be used to strengthen an insurance company's loss and settlement expense reserves. Despite large reserve strengthening actions taken by the insurance industry during 2003 and 2004, there continues to be concern about the magnitude of potential reserve deficiencies, particularly for asbestos and pollution exposures.

Insurance companies collect cash in the form of insurance premiums and pay out cash in the form of loss and settlement expense payments. Additional cash outflows occur through the payment of acquisition and underwriting costs such as commissions, premium taxes, salaries and general overhead. During the loss settlement period, which varies by line of business and by the circumstances surrounding each claim and may cover several years, insurance companies invest the cash premiums and earn interest and dividend income. This investment income supplements underwriting results and contributes to net earnings. The weakening economy during the period 2000 through 2002 prompted the Federal Reserve Bank to reduce interest rates several times, to the point of historic lows. As a result, called and matured fixed maturity securities have been reissued at much lower interest rates, which has had a negative impact on the insurance industry's investment income. Interest rates generally trended upward in 2004, but are still significantly lower than historic levels.

Recent actions by New York Attorney General Eliot Spitzer have raised questions concerning the use of contingent commission arrangements whereby insurance companies provide agents with financial incentives in addition to the traditional commission structure. The arrangements targeted by Attorney General Spitzer are variously referred to as "placement service agreements" or "market service agreements" and, in essence, compensate an agent for directing business to a particular insurance company. The Company, like many others in the insurance industry, uses contingent compensation arrangements to compensate independent agents for the valuable services they provide to their clients.

Determination of the legality and propriety of the compensation arrangements targeted by Attorney General Spitzer will take time to resolve through the investigative and judicial processes. The Company intends to closely monitor these developments and will be diligent in reviewing and assessing its internal practices, as well as its contingent compensation arrangements, with a goal of ensuring that they are in compliance with all legal requirements.

Attorney General Spitzer has also alleged the use of bid-rigging practices by some in the insurance industry. Bid-rigging constitutes a violation of federal and state laws and is strictly prohibited by the Company's Code of Corporate Conduct.

The United States Congress is currently studying, or has placed on their agenda, several issues of critical importance to the Company and the insurance industry. These issues include Federal regulation on top of or in place of current state-run regulation, tort and class-action reform, extension for an additional year of the federal back-stop for terrorism losses contained in TRIA, and asbestos liability determination and funding. The Company is closely monitoring activities by the United States Congress on these issues through its membership in various trade organizations.

MANAGEMENT ISSUES AND PERSPECTIVES

The insurance industry is highly regulated and very competitive, and its operations are impacted by many economic and social factors. In order to be a viable source of insurance protection in today's marketplace, an insurance company must be strongly capitalized, carry a secure rating from A.M. Best Company (which is considered to be the leading insurance rating agency), and offer competitive products and excellent service. Management recognizes that insurance agents and their customers have many options to choose from when selecting an insurance carrier and continually emphasizes the need to meet and exceed their expectations in these areas.

Management has long recognized the importance of adequate capitalization for its insurance subsidiaries and has strived to maintain a strong capital position by investing their assets conservatively and, more importantly, maintaining a consistent level of loss and settlement expense reserve adequacy. Carried reserves are analyzed on a regular basis and adjustments, if necessary, are implemented on a timely basis. This procedure not only assures a consistent level of reserve adequacy, it also minimizes the impact that any required adjustment will have on current operations. This dedication to reserve adequacy was demonstrated during 2003 and again during 2004 as the Company strengthened loss and settlement reserves in the property and casualty insurance segment in response to the findings of regularly-scheduled actuarial evaluations.

In addition to an ongoing review of claim files in the normal course of business, the Company has for many years required each of its 16 branch offices to perform a complete inventory of its open claim files during the fourth quarter of each year and to review the adequacy of each carried reserve based on current information. This fourth quarter review process has not historically resulted in a significant increase in carried reserves; however, because of heightened emphasis placed on case reserve adequacy during 2004, the review performed in the fourth quarter of 2004 generated a significant and unanticipated increase in carried reserves and a corresponding increase in settlement expense reserves. In an effort to minimize the likelihood of this occurring in the future, beginning in the 2005 the branch offices will be required to perform a complete inventory and review of their open claim files semi-annually rather than annually as previously required. The first review is to be completed by the end of June and the second review is to be completed by the end of November each year. This new procedure is designed to help assure that necessary reserve adjustments are implemented on a timely basis.

In addition to the recent actions taken to improve reserve adequacy, effective March 1, 2005, Richard K. Schulz, a current employee of Employers Mutual, became the senior claims executive officer. Mr. Schulz has been the claims manager at the Chicago branch office for the last five years and has over ten years of prior insurance industry experience. Mr. Schulz will report to William A. Murray, Executive Vice President and Chief Operating Officer.

The participants in the EMC Insurance Companies pooling agreement currently carry an "A-" (Excellent) rating from A.M. Best Company. Management has worked diligently over the last several years to improve profitability through a combination of adequate pricing and focused underwriting practices. Maintaining a consistent level of profitability is a primary goal of management that will assist the Company in its quest to achieve an even higher rating from A.M. Best Company.

The products offered by an insurance company must be priced so that they are competitive in the marketplace, yet offer the prospect of producing an underwriting profit. Management is keenly aware of the need to achieve an underwriting profit in today's marketplace and has implemented focused underwriting initiatives that stress profitability over production. Achieving an underwriting profit has become increasingly important during the last several years as investment income, which is used to supplement underwriting results and contribute to net earnings, has been negatively impacted by the lingering low interest rate environment.

Catastrophe and storm losses are unpredictable and can vary significantly from year to year. Management uses modeling software to help identify and estimate its potential loss exposure to a variety of events, both natural and manmade. Natural events that are modeled include hurricanes, tornados and windstorms, and earthquakes. Modeling activities for manmade events are primarily directed toward identifying concentrations of risk, such as workers' compensation coverage for a business or property that is subject to a terrorist attack or other manmade event. Management purchases reinsurance protection to mitigate the Company's loss potential to these types of exposures.

The Company has completed the majority of the documentation of its work flow and internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act of 2002. Efforts during 2005 will focus on remediation of any identified gaps in existing controls, testing of the documented controls, remediation of any controls that are found to be not working as designed and the establishment of a maintenance process. Management expects to complete its evaluation of the Company's internal controls over financial reporting by mid July, which will allow sufficient time for the Company's independent auditors to perform their analysis and testing procedures and issue their audit report on the Company's internal controls over financial reporting as of December 31, 2005.

MEASUREMENT OF RESULTS

The Company's consolidated financial statements are prepared on the basis of accounting principles generally accepted in the United States (also known as "GAAP"). The Company also prepares financial statements for each of its insurance subsidiaries based on statutory accounting principles that are filed with insurance regulatory authorities in the states in which they do business. Statutory accounting principles are designed to address the concerns of state regulators and stress the measurement of the insurer's ability to satisfy its obligations to its policyholders and creditors.

Management evaluates the Company's operations by monitoring key measures of growth and profitability. Management measures the Company's growth by examining direct premiums written and, perhaps more importantly, premiums written assumed from affiliates. Management generally measures the Company's operating results by examining the Company's net income, return on equity, and the loss and settlement expense, acquisition expense and combined ratios. The following provides further explanation of the key measures management uses to evaluate the Company's results:

Direct Premiums Written. Direct premiums written is the sum of the total policy premiums, net of cancellations, associated with policies underwritten and issued by the Company's property and casualty insurance subsidiaries. These direct premiums written are transferred to Employers Mutual under the terms of the pooling agreement and are reflected in the Company's consolidated financial statements as premiums written ceded to affiliates. See note 3 of Notes to Consolidated Financial Statements.

Premiums Written Assumed From Affiliates. Premiums written assumed from affiliates reflects the Company's property and casualty insurance subsidiaries' 23.5 percent aggregate participation interest in the total direct premiums written by all the participants in the pooling arrangement and the premiums written assumed by the Company's reinsurance subsidiary from Employers Mutual under the quota share agreement. See note 3 of Notes to Consolidated Financial Statements. Management uses premiums written assumed from affiliates and non-affiliates, which excludes the impact of written premiums ceded to reinsurers, as a measure of the underlying growth of the Company's insurance business from period to period.

Net Premiums Written. Net premiums written is the sum of the premiums written assumed from affiliates plus premiums written assumed from non-affiliates less premiums written ceded to non-affiliates. Premiums written ceded to non-affiliates is the portion of the Company's direct and assumed premiums written that is transferred to reinsurers in accordance with the terms of the reinsurance contracts and based upon the risks they accept. See note 3 of Notes to Consolidated Financial Statements. Management uses net premiums written to measure the amount of business retained after cessions to reinsurers.

Loss and Settlement Expense Ratio. The loss and settlement expense ratio is the ratio (expressed as a percentage) of losses and settlement expenses to premiums earned and measures the underwriting profitability of a company's insurance business. The loss and settlement expense ratio is generally measured on both a gross (direct and assumed) and net (gross less ceded) basis. Management uses the gross loss and settlement expense ratio as a measure of the Company's overall underwriting profitability of the insurance business it writes and to assess the adequacy of the Company's pricing. The net loss and settlement expense ratio is meaningful in evaluating the Company's financial results, which are net of ceded reinsurance, as reflected in the consolidated financial statements. The loss and settlement expense ratios are generally calculated in the same way for GAAP and statutory accounting purposes.

Acquisition Expense Ratio. The acquisition expense ratio is the ratio (expressed as a percentage) of net acquisition and other expenses to premiums earned and measures a company's operational efficiency in producing, underwriting and administering its insurance business. For statutory accounting purposes, acquisition and other expenses of an insurance company exclude investment expenses. There is no such industry definition for determining an acquisition expense ratio for GAAP purposes. As a result, management applies the statutory definition to calculate the Company's acquisition expense ratio on a GAAP basis. The net acquisition expense ratio is meaningful in evaluating the Company's financial results, which are net of ceded reinsurance, as reflected in the consolidated financial statements.

GAAP Combined Ratio. The combined ratio is the sum of the loss and settlement expense ratio and the acquisition expense ratio and measures a company's overall underwriting profit. If the combined ratio is at or above 100, an insurance company cannot be profitable without investment income (and may not be profitable if investment income is insufficient). Management uses the GAAP combined ratio in evaluating the Company's overall underwriting profitability and as a measure for comparison of the Company's profitability relative to the profitability of its competitors who prepare GAAP-basis financial statements.

Statutory Combined Ratio. The statutory combined ratio is calculated in the same manner as the GAAP combined ratio, but is based on results determined pursuant to statutory accounting rules and regulations. The statutory "trade combined ratio" differs from the statutory combined ratio in that the acquisition expense ratio is based on net premiums written rather than premiums earned. Management uses the statutory trade combined ratio as a measure for comparison of the Company's profitability relative to the profitability of its competitors, all of whom must file statutory-basis financial statements with insurance regulatory authorities.

CRITICAL ACCOUNTING POLICIES

The following accounting policies are considered by management to be critically important in the preparation and understanding of the Company's financial statements and related disclosures. The assumptions utilized in the application of these accounting policies are complex and require subjective judgment.

Loss and settlement expense reserves

Processes and assumptions for establishing loss and settlement expense reserves

Liabilities for losses are based upon case-basis estimates of reported losses and estimates of incurred but not reported ("IBNR") losses. For direct insurance business, the Company's IBNR reserves are estimates of liability for accidents that have occurred, but have not yet been reported to the Company. For assumed reinsurance business, IBNR reserves are also used to record anticipated increases in reserves for claims that have previously been reported. An estimate of the expected expenses to be incurred in the settlement of the claims provided for in the loss reserves is established as the liability for settlement expenses.

Property and Casualty Insurance Segment

The Company's claims department establishes case loss reserves for direct business. Branch claims personnel establish case reserves for individual claims, with mandatory home office claims department review of reserves that exceed a specified threshold. This reserving process implicitly assumes a stable inflationary and legal environment. The Company's case loss reserve philosophy is exposure based and implicitly assumes a stable inflationary and legal environment. When claims department personnel establish loss reserves they take into account various factors that influence the potential exposure, such as the types of injuries being claimed, whether the insured is a target defendant, the jurisdiction in which a potential court case would be litigated and negligence of other parties. The goal of the claims department is to establish and maintain loss reserves that are sufficient, but not excessive. Most of the IBNR reserves for direct business are established through an actuarial analysis of IBNR claims that have emerged after the end of recent calendar years compared to the corresponding calendar year earned premiums (adjusted for changes in rate level adequacy). The methodology used in estimating these formula IBNR reserves assumes consistency in claims reporting patterns and immaterial changes in loss development patterns due to loss cost trends. From this analysis, IBNR factors are derived for each line of business and are applied to the latest twelve months of earned premiums to generate the formula IBNR reserves.

Ceded reserves are derived by applying the ceded contract terms to the direct reserves. For excess of loss contracts (excluding the catastrophe contract), this is accomplished by applying the ceded contract terms to the case reserves of the ceded claims. For the catastrophe excess of loss contract, ceded reserves are calculated by applying the contract terms to both the aggregate case reserves on claims stemming from catastrophes and the estimate of IBNR reserves developed for each individual catastrophe. For quota share contracts, ceded reserves are calculated as the quota share percentage multiplied by both case and IBNR reserves on the direct business.

The methodology used for reserving settlement expenses is based on an analysis of historical ratios of paid expenses to paid losses. Assumptions underlying this methodology include stability in the mix of business, consistent claims processing procedures, immaterial impact of loss cost trends on development patterns, and a consistent philosophy regarding the defense of lawsuits. Based on this actuarial analysis, factors are derived for each line of business, which are applied to loss reserves to generate the settlement expense reserves.

As of December 31, 2004, IBNR loss reserves accounted for $55,720,000, or 18.0 percent, of the property and casualty insurance segment's total loss and settlement expense reserves, compared to $49,259,000, or 19.6 percent at December 31, 2003. IBNR reserves are, by nature, less precise than case reserves. A five percent change in IBNR reserves at December 31, 2004 would equate to a $2,786,000 change in loss reserves, which would represent 13.7 percent of net income and 0.8 percent of stockholders' equity.

The Company's direct IBNR reserves are established by applying factors to the latest twelve months premiums earned. These factors are developed using a methodology that compares (1) IBNR claims that have emerged after prior year-ends to (2) corresponding prior years' premiums earned that have been adjusted to the current level of rate adequacy. Included in the rate adequacy adjustment is consideration of current frequency and severity trends compared to the trends underlying prior years' calculations. The selected trends are based on an analysis of industry and Company loss data. This methodology assumes that future emerged IBNR claims relative to IBNR claims that have emerged after prior year-ends will reflect the change in frequency and severity trends underlying the rate adequacy adjustments. If this projected relationship proves to be inaccurate, future IBNR claims may differ substantially from the estimated IBNR reserves.

Following is a summary of the carried loss and settlement expense reserves for the property and casualty insurance segment at December 31, 2004 and 2003.

	December 31, 2004			
Line of Business	Case	IBNR	Settlement Expense	Total
	($ in thousands)			
Commercial lines:				
Automobile	$ 31,139	$ 5,798	$ 6,987	$ 43,924
Property	8,339	2,468	1,816	12,623
Workers compensation	80,615	16,928	13,315	110,858
Liability	50,561	25,631	34,055	110,247
Bonds	1,028	731	613	2,372
Total commercial lines	171,682	51,556	56,786	280,024
Personal lines:				
Automobile	17,271	2,275	2,339	21,885
Property	5,019	1,889	1,155	8,063
Total personal lines	22,290	4,164	3,494	29,948
Total property and casualty insurance segment	$193,972	$55,720	$60,280	$309,972

	December 31, 2003			
Line of Business	Case	IBNR	Settlement Expense	Total
	($ in thousands)			
Commercial lines:				
Automobile	$ 27,807	$ 5,784	$ 6,427	$ 40,018
Property	7,582	2,372	1,690	11,644
Workers compensation	63,275	13,348	10,220	86,843
Liability	38,241	22,457	25,542	86,240
Other	889	656	436	1,981
Total commercial lines	137,794	44,617	44,315	226,726
Personal lines:				
Automobile	11,968	2,468	2,260	16,696
Property	4,566	2,174	1,098	7,838
Total personal lines	16,534	4,642	3,358	24,534
Total property and casualty insurance segment	$154,328	$49,259	$47,673	$251,260

Internal actuarial evaluations of overall loss reserve levels are performed quarterly for all direct lines of business. There is a certain amount of random variation in loss development patterns, which results in some uncertainty regarding projected ultimate losses, particularly for longer tail lines such as workers' compensation, other liability and commercial auto liability. Therefore, the reasonability of the actuarial projections is regularly monitored through an examination of loss ratio and claims severity trends implied by these projections.

Historically, individual case reserves established by the claims department have been adequate. However, actuarial analyses performed during 2003 indicated that overall case reserves appeared to be somewhat inadequate. This apparent inadequacy was driven by the workers' compensation line of business, where adverse development more than offset the favorable development experienced on all other lines of business combined. Further analysis revealed that recent adverse development experienced in the workers' compensation line of business was arising from both the indemnity and medical portion of the claims. The underlying data indicated that the aggregate liability associated with time away from work was somewhat underestimated and that permanent injury awards were somewhat underestimated and/or not anticipated when the reserves were established. In response to these findings, the Company established a bulk case reserve for the workers' compensation line of business to supplement the individual case reserves. An actuarial evaluation of case reserve adequacy is now performed each quarter, which resulted in additional increases in the bulk case reserve during 2004.

To address the underlying cause of the indicated deficiency in case reserves, the home office claims department in early 2004 instructed each of the 16 branch offices to review and carefully reevaluate all claim reserves for adequacy. As a result of these reviews, case reserves were strengthened significantly in both the second and third quarters of 2004 and the third quarter actuarial review indicated that case reserves, as well as total loss and settlement expense reserves, were adequate. However, during the required fourth quarter inventory and review process, the branch offices further strengthened their case reserves, generating a significant amount of adverse development on prior years' reserves. With this additional strengthening, carried loss and settlement expense reserves are toward the high end of the range of actuarial reserve indications at December 31, 2004.

One of the variables impacting the estimation of IBNR reserves is the assumption that the vast majority of future construction defect losses will continue to occur in those states in which most construction defect claims have historically arisen. Since the vast majority of these losses have been confined to a relatively small number of states, which is consistent with industry experience, there is no provision in the IBNR reserve for a significant spread of construction defect claims to other states. It is also assumed that various underwriting initiatives implemented in recent years will gradually mitigate the amount of construction defect losses experienced. These initiatives include exclusionary endorsements, increased care regarding additional insured endorsements, a general reduction in the amount of contractor business written relative to the total commercial lines book of business and underwriting restrictions on the writing of residential contractors. The estimation of the Company's IBNR reserves also does not contemplate substantial losses from potential mass torts such as Methyl Tertiary Butyl Ether (a gasoline additive that reduces emissions, but causes pollution), tobacco, silicosis, cell phones and lead. Further, consistent with general industry practice, the IBNR reserve for all liability lines does not provide for any significant retroactive expansion of coverage through judicial interpretation. If these assumptions prove to be incorrect, ultimate paid amounts on emerged IBNR claims may differ substantially from the carried IBNR reserves.

As previously noted, the estimation of settlement expense reserves assumes a consistent claims department philosophy regarding the defense of lawsuits. If the Company should in the future take a more aggressive defense posture, defense costs would increase and it is likely that carried settlement expense reserves would be deficient. However, such a change in philosophy could be expected to reduce losses, generating some offsetting redundancy in the loss reserves.

An important assumption underlying aggregate reserve estimation methods is that the claims inflation trends implicitly built into the loss and settlement expense development patterns will continue into the future. To estimate the sensitivity of the estimated ultimate loss and settlement expense payments to an unexpected change in inflationary trends, the actuarial department derived expected payment patterns separately for each major line of business. These patterns were applied to the December 31, 2004 loss and settlement expense reserves to generate estimated annual incremental loss and settlement expense payments for each subsequent calendar year. Then, for the purpose of sensitivity testing, an explicit annual inflationary trend of one percent was added to the inflationary trend that is implicitly embedded in the estimated payment pattern, and revised incremental loss and settlement expense payments were calculated. This additional unexpected claims inflation trend could arise from a variety of sources including a general increase in economic inflation, social inflation and, especially for the workers' compensation line of business, the introduction of new medical technologies and procedures, changes in the utilization of procedures and changes in life expectancy. The estimated cumulative impact that this additional unexpected one percent increase in the inflationary trend would have on the Company's results of operations over the lifetime of the underlying claims is shown below.

Line of business	After-tax impact on earnings ($ in thousands)
Personal auto liability	$ 149
Commercial auto liability	511
Auto physical damage	15
Workers' compensation	3,357
Other liability	2,879
Property	82
Homeowners	44

The property and casualty insurance companies have exposure to environmental and asbestos claims arising primarily from the other liability line of business. This exposure is closely monitored by management, and the Company has established IBNR reserves to cover estimated ultimate losses. Currently, asbestos reserves are based on the results of an independent consultant's ground-up study of the Company's asbestos exposures, which was completed in early 2003. Environmental reserves are established with consideration to the implied three-year survival ratio (ratio of loss reserves to the three-year average of loss payments). Estimation of ultimate liabilities for these exposures is unusually difficult due to unresolved issues such as whether coverage exists, the definition of an occurrence, the determination of ultimate damages and the allocation of such damages to financially responsible parties. Therefore, any estimation of these liabilities is subject to greater than normal variation and uncertainty, and ultimate payments for losses and settlement expenses for these exposures may differ significantly from the carried reserves.

Reinsurance Segment

The reinsurance book of business is comprised of two major components. The first is Home Office Reinsurance Assumed Department ("HORAD"), which is the reinsurance business that is underwritten by Employers Mutual. The second is the Mutual Reinsurance Bureau pool ("MRB"), which is a voluntary reinsurance pool in which Employers Mutual participates with other unaffiliated insurers.

The primary actuarial methods used to project ultimate policy year losses on the assumed reinsurance business are paid development, incurred development and Bornhuetter-Ferguson, a recognized actuarial methodology. The assumptions underlying the various projection methods include stability in the mix of business, consistent claims processing procedures, immaterial impact of loss cost trends on development patterns, consistent case reserving practices and appropriate Bornhuetter-Ferguson expected loss ratio selections.

For the HORAD component, Employers Mutual records the case and IBNR reserves reported by the ceding companies. Since many ceding companies in the HORAD book of business do not report IBNR reserves, Employers Mutual establishes a bulk IBNR reserve, which is based on an actuarial reserve analysis, to cover the lag in reporting. For MRB, Employers Mutual records the case and IBNR reserves reported to it by the management of the pool, along with a relatively small IBNR reserve to cover a one month reporting lag. To verify the adequacy of the reported reserves, an actuarial evaluation of MRB's reserves is performed at each year-end.

Settlement expense reserves for both the HORAD and MRB books of business are developed through the application of factors to carried loss reserves. The factors are derived from an analysis of paid settlement expenses to paid losses. The assumptions described for the property and casualty insurance segment also apply to the reinsurance segment settlement expense reserving process.

At December 31, 2004, the carried reserves for HORAD and MRB combined were in the upper quarter of the range of actuarial reserve indications. This conservative selection reflects the fact that there are inherent uncertainties involved in establishing reserves for assumed reinsurance business. Such uncertainties include the fact that a reinsurance company generally has less knowledge than the ceding company about the underlying book of business and the ceding company's reserving practices. Because of these uncertainties, there is a risk that the reinsurance segment's reserves for losses and settlement expenses could prove to be inadequate, with a consequent adverse impact on the Company's future earnings and stockholders' equity.

At December 31, 2004, there was no backlog in the processing of assumed reinsurance information. Approximately $72,525,000 or 61 percent of the reinsurance segment's carried reserves were reported by the ceding companies. Employers Mutual receives loss reserve and paid loss data from the ceding companies on individual excess-of-loss business. If a claim involves a single or small group of claimants, a summary of the loss and claim outlook is normally provided. Summarized data is provided for catastrophe claims and pro rata business, which is subject to closer review if inconsistencies are suspected. Unearned premiums are generally reported on pro rata accounts, but are usually calculated by Employers Mutual on excess-of-loss business.

Carried reserves established in addition to those reported by the ceding companies totaled approximately $47,196,000 at December 31, 2004. Since many ceding companies in the HORAD book of business do not report IBNR reserves, Employers Mutual establishes a bulk IBNR reserve to cover the lag in reporting. For the few ceding companies that do report IBNR reserves, Employers Mutual carries them as reported. These reported IBNR reserves are subtracted from the total IBNR reserve calculated by Employers Mutual's actuaries, with the difference carried as bulk IBNR reserves. Except for a small IBNR reserve established to cover a one-month lag in reporting, the MRB IBNR reserve is established by the management of MRB. Employers Mutual rarely records additional case reserves.

Assumed reinsurance losses tend to be reported later than direct losses. This lag is reflected in loss projection factors for assumed reinsurance that tend to be higher than for direct business. The result is that assumed reinsurance IBNR reserves as a percentage of total reserves tend to be higher than for direct reserves. IBNR reserves totaled $66,092,000 and $58,427,000 at December 31, 2004 and 2003, respectively, and accounted for approximately 55% and 50% percent, respectively, of the reinsurance segment's total loss reserves. IBNR reserves are, by nature, less precise than case reserves. A five percent change in IBNR reserves at December 31, 2004 would equate to a $3,305,000 change in loss reserves, which would represent 16.3 percent of net income and 0.9 percent of stockholders' equity.

Following is a summary of the carried loss and settlement expense reserves for the reinsurance segment at December 31, 2004 and 2003.

	December 31, 2004			
Line of Business	Case	IBNR	Settlement Expense	Total
	($ in thousands)			
Pro Rata Reinsurance:				
Property and casualty	$ 3,125	$ 2,899	$ 237	$ 6,261
Property	6,097	7,127	335	13,559
Crop	1,034	36	54	1,124
Casualty	2,267	4,418	296	6,981
Marine/Aviation	9,187	7,802	890	17,879
Total pro rata reinsurance	21,710	22,282	1,812	45,804
Excess Reinsurance:				
Excess per risk reinsurance:				
Property	9,961	11,805	475	22,241
Casualty	16,436	31,050	1,719	49,205
Surety	1,440	955	60	2,455
Total excess per risk reinsurance	27,837	43,810	2,254	73,901
Total reinsurance segment ..	$ 49,547	$66,092	$ 4,066	$119,705

Line of Business	December 31, 2003 Case	IBNR	Settlement Expense	Total
	($ in thousands)			
Pro Rata Reinsurance:				
Property and casualty	$ 3,881	$ 2,564	$ 206	$ 6,651
Property	6,824	9,031	276	16,131
Crop	683	35	18	736
Casualty	2,703	4,714	237	7,654
Marine/Aviation	8,273	5,599	1,049	14,921
Total pro rata reinsurance	22,364	21,943	1,786	46,093
Excess Reinsurance:				
Excess per risk reinsurance:				
Property	11,190	10,695	373	22,258
Casualty	18,959	24,835	1,859	45,653
Surety	1,690	954	16	2,660
Total excess per risk reinsurance	31,839	36,484	2,248	70,571
Total reinsurance segment ..	$ 54,203	$58,427	$ 4,034	$116,664

To ensure the accuracy and completeness of the information received from the ceding companies, the actuarial department carefully reviews the latest four HORAD policy years on a quarterly basis, and all policy years on an annual basis. Any significant departures from historical reporting patterns are brought to the attention of the reinsurance department staff, who check the bookings for accuracy and, if necessary, contact the ceding company or broker for clarification.

Employers Mutual's actuarial department annually reviews the MRB reserves for reasonableness. These analyses use a variety of actuarial techniques, which are applied at a line-of-business level. MRB staff supplies the reserve analysis data, which is verified for accuracy by Employers Mutual's actuaries. This review process is replicated by certain other MRB member companies, using actuarial techniques they deem appropriate. Based on these reviews, Employers Mutual and the other MRB member companies have consistently found the MRB reserves to be appropriate.

For the HORAD book of business, paid and incurred loss development patterns for relatively short-tail lines of business (property and marine) are based on data reported by the ceding companies. Employers Mutual has determined that there is sufficient volume and stability in the reported losses to base projections of ultimate losses on these patterns. For longer tail lines of business (casualty), industry incurred development patterns are referenced due to the instability of development patterns based on reported historical losses.

For long-tail lines of business, unreliable estimates of unreported losses can result from the application of loss projection factors to reported losses. To some extent, this is also true for short-tail lines of business in the early stages of a policy year's development. Therefore, in addition to loss-based projections, we generate estimates of unreported losses based on earned premiums. The latter estimates are sometimes more stable and reliable than projections based on losses.

Disputes with ceding companies do not occur often. Employers Mutual performs claims audits and reviews claim reports for accuracy, completeness and adequate reserving. Most reinsurance contracts contain arbitration clauses to resolve disputes, but such disputes are generally resolved without arbitration due to the long-term and ongoing relationships that exist with those companies. There were no matters in dispute at December 31, 2004.

Toxic tort (primarily asbestos), environmental and other uncertain exposures

Toxic tort claims include those claims where the claimant seeks compensation for harm allegedly caused by exposure to a toxic substance or substance that increases the risk of contracting a serious disease, such as cancer. Typically the injury is caused by latent effects of direct or indirect exposure to a substance or combination of substances through absorption, contact, ingestion, inhalation, implantation or injection. Examples of toxic tort claims include injuries arising out of exposure to asbestos, silica, mold, drugs, carbon monoxide, chemicals or lead.

Asbestos and environmental losses paid by the Company have averaged only $244,000 per year over the past five years. During 2002, the Company re-evaluated the estimated ultimate loss projections for asbestos exposures. Based on this re-evaluation, the Company reallocated $176,000 of bulk IBNR reserves and $74,000 of settlement expense reserves to direct asbestos exposures. In addition, the Company diligently evaluated the adequacy of its asbestos reserves by commissioning a "ground-up" study to better quantify its exposure to asbestos liabilities. This study concluded that the Company's exposure for direct asbestos claims ranged from $1,100,000 to $5,100,000, with a point estimate of $3,000,000. Based on the results of this study, the Company elected to increase the IBNR and settlement expense reserves carried for direct asbestos exposures by $2,069,000 at December 31, 2002, to $2,985,000. The study's results for asbestos exposures on assumed reinsurance business were received during 2003, and the Company elected to increase its IBNR reserves carried for assumed asbestos exposures by $326,000 to the study's point estimate. The study and its results assume no improvement in the current asbestos litigation environment; however, continued efforts for federal legislation could reduce the ultimate loss projections for asbestos litigation below the levels currently projected for the industry.

Since 1989, the Company has included an asbestos exclusion in liability policies issued for most lines of business. The exclusion prohibits liability coverage for "bodily injury", "personal injury" or "property damage" (including any associated clean-up obligations) arising out of the installation, existence, removal or disposal of asbestos or any substance containing asbestos fibers. Therefore, the Company's present asbestos exposures are primarily limited to commercial policies issued prior to 1989. At present, the Company is defending approximately 500 asbestos bodily injury lawsuits. Most of these defenses are subject to express reservation of rights based upon the lack of an injury within the Company's policy periods because many asbestos lawsuits do not specifically allege dates of asbestos exposure or dates of injury. The Company's policyholders that have been named as defendants in these asbestos lawsuits are peripheral defendants who have had little or no exposure and are routinely dismissed from asbestos litigation with nominal or no payment at all (i.e., small contractors, insulators, electrical welding supply, furnace manufacturers, gasket, and building supply companies).

During 2003, as a direct result of proposed federal legislation in the areas of asbestos and class action reform, the Company was presented with several hundred additional lawsuits filed against three former policyholders representing approximately 40,500 claims related to exposure to asbestos or asbestos containing products. These claims are based upon nonspecific asbestos exposure and nonspecific injuries. As a result, management did not establish a significant amount of loss reserves associated with these claims. The vast majority of the 40,500 claims are multi-plaintiff suits filed in Mississippi. One lawsuit lists multiple named plaintiffs of approximately 2,000 individuals. While the expense of handling these lawsuits is higher than what the Company has averaged in the past, it is not proportional based upon the number of plaintiffs, and is mitigated to some extent through cost sharing agreements reached with other insurance companies. The Company believes its settlement expense reserve adequately accounts for these additional expenses.

The Company has denied coverage to one of the former policyholders, representing approximately 10,000 claims, because of express asbestos exclusion language contained in the policy. Minimal expense payments have been made to date on the lawsuits related to the other two former policyholders and no payments have been made for either defense or indemnity. Four former policyholders and one current policyholder dominate the Company's asbestos claims. To date, actual losses paid have been minimal due to the plaintiffs' failure to identify an asbestos-containing product to which they were exposed that is associated with the Company's policyholders. Defense costs, on the other hand, have typically increased due to the increased number of parties involved in the litigation and the length of time required to obtain a favorable judgment. Whenever possible, the Company has participated in cost sharing agreements with other insurance companies to reduce overall asbestos claim expenses.

While proposed federal asbestos legislation was not successful in 2004, plaintiffs' attorneys have already altered their pleadings across the country to anticipate the enactment of federal legislation. Specifically, asbestos plaintiffs' attorneys are pleading "silica" and "pnuemoconisis dust" exposure for new clients, as well as former asbestos plaintiffs. The Company is defending approximately 200 such claims in Texas and Mississippi jurisdictions, some of which involve multiple plaintiffs. The plaintiffs allege employment exposure to "airborne respirable silica dust," causing "serious and permanent lung injuries," i.e., silicosis. Silicosis injuries are identified in the upper lobes of the lungs while asbestos injuries are localized in the lower lobes.

The plaintiffs in the silicosis lawsuits are sandblasters, gravel and concrete workers, ceramic workers and road construction workers. All of these defenses are subject to express reservation of rights based upon the lack of an injury within the Company's policy periods because many silica lawsuits, like asbestos lawsuits, do not specifically allege dates of exposure or dates of injury. The Company's policyholders (a refractory product manufacturer, small local concrete and gravel companies and a concrete cutting machine manufacturer) that have been named as defendants in these silica lawsuits have had little or no exposure and are routinely dismissed from silica litigation with nominal, or no, payment. While the expense of handling these lawsuits is high, it is not proportional based upon the number of plaintiffs, and is mitigated to some extent through cost sharing agreements reached with other insurance companies.

In 2004, the Company developed, filed and attached "pneumoconiosis dust exclusions" in the majority of jurisdictions where such action was warranted. "Mixed dust" is defined as dust, or a mixture of dusts, composed of one or more of the following: asbestos, silica, fiberglass, iron, tin, coal, cement, cadminium, carbon, mica, cobalt, barium, tungsten, kaolin, graphite, clay, ceramic, talc, vitallium, beryllium, zinc, cotton, hemp, flax or grain. This exclusion precludes liability coverage for "any injury, damage, expense, cost, loss, liability, defense or legal obligation arising out of, resulting from or in any way related to, in whole or in part "mixed dust" pneumoconiosis, pleural plaques, pleural effusion, mesothelioma, lung cancer, emphysema, bronchitis, tuberculosis or pleural thickening, or other pneumoconiosis-related ailments such as arthritis, cancer (other than lung), lupus, heart, kidney or gallbladder disease. It is anticipated that this mixed dust exclusion will further limit the Company's exposure in silica claims, and may be broad enough to limit exposure in other dust claims.

The Company's environmental claims are defined as 1) claims for bodily injury, personal injury, property damage, loss of use of property, diminution of property value, etc., allegedly due to contamination of air, and/or contamination of surface soil or surface water, and/or contamination of ground water, aquifers, wells, etc.; or 2) any/all claims for remediation or clean up of hazardous waste sites by the United States Environmental Protection Agency, or similar state and local environmental or government agencies, usually presented in conjunction with federal or local clean up statutes (i.e., CERCLA, RCRA, etc.).

Examples include, but are not limited to: chemical waste; hazardous waste treatment, storage and/or disposal facilities; industrial waste disposal facilities; landfills; superfund sites; toxic waste spills; and underground storage tanks. Widespread use of pollution exclusions since 1970 in virtually all lines of business, except personal lines, has resulted in limited exposure to environmental claims. Absolute pollution exclusions have been used since the 1980's. The Company's exposure to environmental claims is therefore limited primarily to accident years preceding the 1980s. The pre-1980's exposures include municipality exposures for closed landfills, small commercial businesses involved with disposing waste at landfills or leaking underground storage tanks. During 2002, the Company re-evaluated the estimated ultimate losses for direct environmental exposures. Based on this re-evaluation, the Company reallocated $576,000 of bulk IBNR reserves and $191,000 of settlement expense reserves to direct environmental exposures. No additional IBNR reserves were established for these exposures.

In 2004, the Company was presented with eight contamination claims filed against four of its petroleum marketers in Iowa and Indiana. The claims arise out of alleged contamination of municipal public water systems by the gasoline additive Methyl Tertiary Butyl Ether ("MTBE"). All MTBE lawsuits initiated in California, Connecticut, Florida, Indiana, Iowa, Massachusetts, New Hampshire, New Jersey and New York were moved to their respective federal courts and were then transferred to the United States District Court for the Southern District of New York where they were consolidated under the caption, In re: Methyl Tertiary Butyl Ether ("MTBE") Products Liability Litigation. The Company is defending these claims under commercial auto policies which afford broadened pollution liability coverage for overfills. These defenses are subject to express reservations of rights based upon the lack of property damage within the policy periods because these lawsuits do not specifically allege dates of property damage or contamination or any contamination that is the result of an overfill.

The Company's exposure to asbestos and environmental claims through assumed reinsurance is very limited due to the fact that the Company's reinsurance subsidiary entered into the reinsurance marketplace in the early 1980s after much attention had already been brought to these issues. The Company took action to commute one reinsurance contract during the first quarter of 2003 that had some asbestos and environmental reserves associated with it.

At December 31, 2004, the Company carried asbestos and environmental reserves for direct insurance and assumed reinsurance business totaling $5,460,000, which represents 1.3% of total loss and settlement expense reserves. The asbestos and environmental reserves include $1,662,000 of case reserves, $2,836,000 of IBNR reserves and $962,000 of bulk settlement expense reserves.

The Company's non-asbestos direct product liability claims are considered to be highly uncertain exposures due to the many uncertainties inherent in determining the loss, and the significant periods of time that can elapse between the occurrence of the loss and the ultimate settlement of the claim. The majority of the Company's product liability claims arise from small to medium sized manufacturers, contractors, petroleum distributors, and mobile home and auto dealerships. No specific claim trends are evident from the Company's manufacturer policies, as the claims activity on these policies is generally isolated and can be severe. Specific product coverage is provided to the Company's mobile home and auto dealership policyholders, and the claims from these policies tend to be relatively small. Certain construction defect claims are reported under product liability coverage. During 2004, 67 of these claims were reported to the Company.

The Company's assumed casualty excess reinsurance is also considered to be a highly uncertain exposure due to the significant periods of time that can elapse during the settlement of the underlying claims and the fact that a reinsurance company generally has less knowledge than the ceding company about the underlying book of business and the ceding company's reserving practices. The Company attempts to account for this uncertainty by establishing bulk IBNR reserves, using conservative assumed treaty limits and, to a much lesser extent, booking of individual treaty IBNR (if reported by the ceding company) or establishing additional case reserves if the reported case reserves appear inadequate on an individual claim. While the Company's reinsurance subsidiary is predominantly a property reinsurer, it does write casualty excess business oriented mainly towards shorter tail casualty lines of coverage. The Company avoids reinsuring large company working layer casualty risks, and does not write risks with heavy product liability exposures, risks with obvious latent injury manifestation, medical malpractice, and "for profit" Directors and Officers coverage. A small amount of casualty excess business on large companies is written, but generally on a "clash" basis only (layers above the limits written for any individual policyholder).

The Company has exposure to construction defect claims arising from general liability policies issued to contractors. Most of the Company's construction defect claims are concentrated in a limited number of states, and the Company has taken steps to mitigate this exposure. Construction defect is a highly uncertain exposure due to such issues as whether coverage exists, definition of an occurrence, determination of ultimate damages, and allocation of such damages to financially responsible parties. The Company has recently implemented additional coding to identify and monitor construction defect claims. Newly reported construction defect claims numbered 685, 668, and 555 in 2004, 2003, and 2002, respectively, and produced incurred losses and paid settlement expenses of approximately $2,498,000, $3,200,000, and $1,913,000 in each respective period. Incurred losses and paid settlement expenses on all construction defect claims totaled approximately $3,895,000 in 2004. At year-end 2004, the Company carried case reserves of approximately $6,075,000 on 982 open construction defect claims.

Following is a schedule of claims activity for asbestos, environmental, products liability and casualty excess reinsurance for 2004, 2003 and 2002.

	Property and casualty insurance segment			Reinsurance segment		
($ in thousands)	Case	IBNR	Settlement expense	Case	IBNR	Settlement expense
Reserves at 12/31/04						
Asbestos	$ 1,395	$ 837	$ 651	$ 153	$ 515	$ –
Environmental	30	807	311	84	677	–
Products[1]	6,491	3,056	6,861	–	–	–
Casualty excess[2]	–	–	–	16,436	31,049	1,724
Reserves at 12/31/03						
Asbestos	$ 1,138	$ 991	$ 756	$ 86	$ 646	$ –
Environmental	13	836	316	52	750	–
Products[1]	4,235	2,557	4,657	–	–	–
Casualty excess[2]	–	–	–	18,959	24,834	1,866
Reserves at 12/31/02						
Asbestos	$ 451	$ 1,693	$ 839	$ 80	$ 454	$ –
Environmental	14	839	322	49	786	–
Products[1]	2,314	1,856	2,000	–	–	–
Casualty excess[2]	–	–	–	13,393	21,472	1,385
Paid during 2004						
Asbestos	$ 47		$ 141	$ 64		$ –
Environmental	11		11	40		–
Products[1]	1,079		1,401	–		–
Casualty excess[2]	–		–	7,911		916
Paid during 2003						
Asbestos	$ 14		$ 83	$ 93		$ 2
Environmental	5		6	33		–
Products[1]	705		959	–		–
Casualty excess[2]	–		–	4,523		386
Paid during 2002						
Asbestos	$ 18		$ 97	$ 8		$ –
Environmental	44		10	12		–
Products[1]	577		586	–		–
Casualty excess[2]	–		–	5,019		498

[1] Products includes the portion of asbestos and environmental claims reported above that are non-premises/operations claims.
[2] Casualty excess includes the asbestos and environmental claims reported above.

	Asbestos	Environmental	Products
Open claims, 12/31/04	39,738	6	1,721
Reported in 2004	9,655	2	295
Disposed of in 2004	10,993	3	358
Open claims, 12/31/03	41,076	7	1,784
Reported in 2003	40,893	7	1,008
Disposed of in 2003	123	6	304
Open claims, 12/31/02	306	6	1,080
Reported in 2002	123	–	781
Disposed of in 2002	83	3	260

Variability of loss and settlement expense reserves

The Company does not determine a range of estimates for all components of the loss and settlement expense reserves at the time those reserves are established. However, at each year-end an actuarially determined range of estimates is developed for the major components of the loss and settlement expense reserves. All reserves are reviewed, except for the involuntary workers' compensation pools, for which reliance is placed on a reserve opinion received from the National Council on Compensation Insurance certifying the reasonableness of those reserves. Shown below are the actuarially determined ranges of reserve estimates as of December 31, 2004, along with the carried reserves. The last two columns display the estimated after-tax impact on earnings if the reserves were moved to the high endpoint and the low endpoint of the ranges.

	Range of Reserve Estimates			After-Tax Impact on Earnings	
($ in thousands)	High	Low	Carried	Reserves at High	Reserves at Low
Property and casualty insurance segment	$294,723	$248,453	$285,962	$ (5,694)	$ 24,381
Reinsurance segment	119,880	102,484	119,721	(104)	11,204
	$414,603	$350,937	$405,683	$ (5,798)	$ 35,585

Changes in loss and settlement expense reserve estimates of prior periods

Loss and settlement expense reserves are estimates at a given time of what an insurer expects to pay on incurred losses, based on facts and circumstances then known. During the loss settlement period, which may be many years, additional facts regarding individual claims become known, and accordingly, it often becomes necessary to refine and adjust the estimates of liability on a claim. Such changes in reserves for losses and settlement expenses are reflected in operating results in the year such changes are recorded.

During the three years ended December 31, 2004, the Company has experienced adverse development in the provision for insured events of prior years. The majority of this adverse development has come from the property and casualty insurance segment, primarily in the workers' compensation and other liability lines of business. Following are the significant issues and trends that have been identified as contributors to this adverse development.

Workers' compensation claim severity has increased significantly over the past five years, with the projected ultimate average claim amount increasing approximately 72 percent over the five year period. An increase of this magnitude has made the establishment of adequate case reserves challenging. A review of claim data indicates that claims adjusters have recently underestimated medical costs and the length of time injured workers are away from work. In addition, partial disability benefits have been underestimated or unanticipated. Large increases in drug costs and the availability and utilization of new and costly medical procedures have contributed to rapidly escalating medical costs.

Construction defect claims arising from general liability policies issued to contractors have contributed to adverse reserve development. States with significant construction defect losses include Alabama, Arizona, California, Colorado, Nevada and Texas.

Large umbrella claims have recently contributed to the adverse development experienced in the other liability line of business. A pattern of increasing umbrella claims severity is believed to be generally consistent with industry umbrella severity trends. Also contributing to overall umbrella reserve development is an increase in claims arising from underlying general liability policies.

Legal expenses for the other liability line of business have also increased rapidly over the past three years, with defense costs increasing at an average rate of approximately 14 percent per year. This increase in legal expenses has occurred despite a reduction in the number of new lawsuits.

In response to an indicated deficiency in case reserves at December 31, 2004, the home office claims department in early 2004 instructed each of the 16 branch offices to review and carefully reevaluate all claim reserves for adequacy. As a result of these reviews, case reserves were strengthened in both the second and third quarters of 2004. However, during the required fourth quarter inventory and review process, the branch offices further strengthened their case reserves, generating a significant amount of adverse development on prior years' reserves.

For detailed discussion of the factors influencing the adverse development on prior years' reserves, see the discussion entitled "Loss and Settlement Expense Reserves" under the "Narrative Description of Business" heading in the Business Section under Item I of this Form 10-K.

Deferred policy acquisition costs and related amortization

Deferred policy acquisition costs are used to match the expenses incurred in the production of insurance business to the income earned on this business. This adjustment is necessary because statutory accounting principles require that expenses incurred in the production of insurance business be expensed immediately, while premium income is recognized ratably over the terms of the underlying insurance policies.

Amortization of deferred policy acquisition costs is calculated as the difference between the beginning and ending amounts of deferred policy acquisition costs plus the amount of costs deferred during the current year. Deferred policy acquisition costs and related amortization are calculated separately for the property and casualty insurance segment and the reinsurance segment. The method followed in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value, which gives effect to the premium to be earned, related investment income, losses and settlement expenses and certain other costs expected to be incurred as the premium is earned. Deferred policy acquisition costs were not subject to limitation at December 31, 2004, and management does not anticipate future limitations to be likely due to the improved premium rate environment in both the insurance and reinsurance marketplaces.

Deferred income taxes

The realization of the deferred income tax asset is based upon projections that indicate that a sufficient amount of future taxable income will be earned to utilize the tax deductions that will reverse in the future. These projections are based on the Company's history of producing significant amounts of taxable income, the improved premium rate environment for both the property and casualty insurance segment and the reinsurance segment and loss and expense control initiatives that have been implemented in recent years. In addition, management has formulated tax-planning strategies that could be implemented to generate taxable income if needed. Should the projected taxable income and tax planning strategies not provide sufficient taxable income to recover the deferred tax asset, a valuation allowance would be required.

RESULTS OF OPERATIONS

Segment information and consolidated net income for the three years ended December 31, 2004 are as follows:

($ in thousands)	**2004**	2003	2002
Property and Casualty Insurance			
Premiums earned	**$250,035**	$241,237	$225,013
Losses and settlement expenses	**196,460**	168,239	156,152
Acquisition and other expenses	**85,837**	80,493	72,483
Underwriting loss	**$(32,262)**	$ (7,495)	$ (3,622)
Loss and settlement expense ratio	**78.6%**	69.7%	69.4%
Acquisition expense ratio	**34.3**	33.4	32.2
Combined ratio	**112.9%**	103.1%	101.6%
Losses and settlement expenses:			
Insured events of current year	**$172,722**	$159,224	$151,507
Increase in provision for insured events of prior years	**23,738**	9,015	4,645
Total losses and settlement expenses	**$196,460**	$168,239	$156,152
Catastrophe and storm losses	**$ 13,481**	$ 17,531	$ 8,055
Reinsurance			
Premiums earned	**$ 95,444**	$ 89,386	$ 72,030
Losses and settlement expenses	**53,346**	58,266	50,906
Acquisition and other expenses	**26,870**	24,403	23,150
Underwriting income (loss)	**$ 15,228**	$ 6,717	$ (2,026)
Loss and settlement expense ratio	**55.9%**	65.2%	70.7%
Acquisition expense ratio	**28.1**	27.3	32.1
Combined ratio	**84.0%**	92.5%	102.8%
Losses and settlement expenses:			
Insured events of current year	**$ 56,946**	$ 59,805	$ 48,553
(Decrease) increase in provision for insured events of prior years	**(3,600)**	(1,539)	2,353
Total losses and settlement expenses	**$ 53,346**	$ 58,266	$ 50,906
Catastrophe and storm losses	**$ 5,011**	$ 3,411	$ 249

($ in thousands)	**2004**	2003	2002
Consolidated			
REVENUES			
Premiums earned	**$345,479**	$330,623	$297,043
Net investment income	**29,900**	29,702	32,778
Realized investment gains (losses)	**4,379**	1,170	(3,159)
Other income	**601**	862	866
	380,359	362,357	327,528
LOSSES AND EXPENSES			
Losses and settlement expenses	**249,806**	226,505	207,058
Acquisition and other expenses	**112,707**	104,896	95,633
Interest expense	**1,112**	1,320	1,639
Other expense	**1,163**	1,654	1,306
	364,788	334,375	305,636
Income before income tax expense	**15,571**	27,982	21,892
Income tax expense	**2,386**	7,633	5,790
Net income	**$ 13,185**	$ 20,349	$ 16,102
Earnings per share	**$ 1.10**	$ 1.78	$ 1.42
Loss and settlement expense ratio	**72.3%**	68.5%	69.7%
Acquisition expense ratio	**32.6**	31.7	32.2
Combined ratio	**104.9%**	100.2%	101.9%
Losses and settlement expenses:			
Insured events of current year	**$229,668**	$219,029	$200,060
Increase in provision for insured events of prior years	**20,138**	7,476	6,998
Total losses and settlement expenses	**$249,806**	$226,505	$207,058
Catastrophe and storm losses	**$ 18,492**	$ 20,942	$ 8,304

Year ended December 31, 2004 compared to year ended December 31, 2003

Net income decreased 35.2 percent to $13,185,000 ($1.10 per share) in 2004 from $20,349,000 ($1.78 per share) in 2003. This decrease is attributed to a significant increase in the amount of adverse development experienced on prior years' reserves. The majority of this adverse development occurred during the fourth quarter and is attributed to a diligent review and reevaluation of the individual case reserves carried by the property and casualty insurance segment. In addition to an ongoing review of claims files in the normal course of business, the Company has for many years required each of its 16 branch office to perform a complete inventory of its open claim files during the fourth quarter of each year and to review the adequacy of each carried reserve based on current information. This review process has not historically resulted in a significant increase in case reserves; however, because of heightened emphasis placed on case reserve adequacy during 2004, the review performed in the fourth quarter of 2004 generated a significant and unanticipated increase in carried reserves and a corresponding increase in settlement expense reserves. Catastrophe and storm losses declined 11.7 percent in 2004 but remained at an unusually high level due to the four hurricanes that hit the Southern United States in August and September.

To help assure that necessary case reserve adjustment are implemented on a timely basis in the future, beginning in 2005 the branch offices will be required to perform a complete inventory and review of their case reserves semi-annually, rather than annually as previously required. The first review is to be completed by the end of June and the second review is to be completed by the end of November each year.

The calculation of 2004 earning per share is impacted by the Company's recently completed follow-on stock offering in which 2.0 million new shares of common stock were issued on October 20, 2004. The Company earned approximately $170,000 of additional interest income on the net proceeds of the stock offering during the fourth quarter; however, this additional interest income was not sufficient to avoid an approximate 3.0 percent dilution in the 2004 earnings per share calculation.

Premium income

Premiums earned increased 4.5 percent to $345,479,000 in 2004 from $330,623,000 in 2003. This increase is primarily attributed to rate increases implemented during the last few years in the property and casualty insurance business as well as moderate growth and improved pricing in the assumed reinsurance business. The overall market for property and casualty insurance was stable during 2004, but moderated slightly in certain lines of business and select territories due to an increase in price competition. Price competition is expected to increase for most lines of business in 2005, but not to the extent seen in the last soft market. The Company will continue its efforts to maintain current pricing levels and will implement rate increases in those lines of business and/or territories where such action is warranted; however, the overall impact of these rate increases will continue to dissipate as the increases become smaller and less frequent.

Premiums earned for the property and casualty insurance segment increased 3.6 percent to $250,035,000 in 2004 from $241,237,000 in 2003. This increase is primarily the result of rate increases that were implemented during the prior two years. After the broad-based rate increases implemented during the peak of the hard market in 2001 and 2002, premium rate levels for most lines of business were considered to be at, or near, adequate levels at the end of 2002. Accordingly, moderate and more targeted rate increases were implemented during 2003 and 2004. This fine tuning of the Company's rate structure has been directed toward specific accounts, territories and lines of business where additional rate increases were warranted. Due to the timing of policy renewals and the earning of premiums ratably over the terms of the underlying policies, a time delay exists for implemented rate increases to have a noticeable impact on premiums earned. During 2004, premiums written increased only 1.9 percent due to a decline in policy count and an increase in ceded premiums. The decline in policy count is attributed to several factors, including the non-renewal of existing business that was under-priced and/or under-performing, a reluctance to accept new risks in under-priced lines of business and a decrease in new business associated with a moderate increase in price competition. The increase in ceded premiums primarily reflects an increase in the cost of the Company's reinsurance programs. Premium rate levels for most lines of business are not expected to change significantly in 2005. In light of the improvements that have been achieved in both the pricing and the quality of the Company's book of business, management has become more receptive to opportunities to write new business, but continues to stress profitability over production.

Premiums earned for the reinsurance segment increased 6.8 percent to $95,444,000 in 2004 from $89,386,000 in 2003 due to increased participation in the MRB reinsurance pool. For 2004, Employers Mutual's participation in the MRB reinsurance pool (which is ceded to the reinsurance segment under the terms of the quota share agreement) increased to 33 percent from 25 percent in 2003, producing $8,176,000 of additional premiums earned. The increase in the MRB premiums earned was partially offset by a decline in the HORAD book of business because Employers Mutual was unsuccessful in its attempt to renew several accounts during the January 1 and July 1, 2004 renewal seasons due to its current "A-" (Excellent) A.M. Best rating. Employers Mutual is attempting to replace this business with new accounts and increased participation on existing accounts. Following large across-the-board rate increases implemented in 2002, premium rate increases on excess-of-loss contracts moderated during 2003 and 2004 due to the influx of new capital into the reinsurance marketplace; however, contracts with poor loss experience continued to receive large rate increases. The rate increases implemented during the last several years have been realized in conjunction with moderate declines in the related exposure base due to increased retention levels and coverage exclusions for terrorist activities. In addition, both excess-of-loss and pro rata contracts have benefited from improved industry-wide rate levels at the primary company level. Premiums earned in 2004 reflect a decrease in the estimate of earned but not reported premiums of $190,000, compared to an increase of $3,575,000 in 2003.

The board of directors of the MRB reinsurance pool, of which Employers Mutual is a member, recently authorized management to pursue the addition of one or two new assuming companies to the pool. If additional assuming companies are added to the pool, Employers Mutual's participation would be reduced and the reinsurance segment's premium volume would decline in the short-term; however, this action will strengthen MRB's surplus base and should favorably impact their ability to attract new business.

Losses and settlement expenses

Losses and settlement expenses increased 10.3 percent to $249,806,000 in 2004 from $226,505,000 in 2003. The loss and settlement expense ratio increased to 72.3 percent in 2004 from 68.5 percent in 2003. The increase in the 2004 ratio is primarily attributed to a significant amount of adverse development on prior years' reserves in the property and casualty insurance segment, but was partially offset by a decline in reported losses in the reinsurance segment. Catastrophe and storm losses declined 11.7 percent in 2004, but remained at an unusually high level.

The loss and settlement expense ratio for the property and casualty insurance segment increased to 78.6 percent in 2004 from 69.7 percent in 2003. The increase in the 2004 ratio is primarily attributed to a significant increase in adverse development on prior years' reserves. The adverse development of 2004 reflects a combination of newly reported claims in excess of carried IBNR reserves ($14,758,000), development on case reserves of previously reported claims ($11,037,000), bulk reserve strengthening ($2,350,000), and settlement expense reserve increases resulting from increases in case reserves ($6,209,000). This adverse development was partially offset by $10,437,000 of reinsurance recoveries associated with the case reserve development and IBNR emergence. Substantial case reserve strengthening performed at the branch offices, primarily in the workers' compensation and other liability lines of business, is the underlying reason for the adverse reserve development that occurred during 2004. As discussed further under the "Critical Accounting Policies" heading of this discussion, the economic factors behind this case reserve strengthening include, most notably, an increase in workers' compensation claim severity, increases in construction defect claim activity, the recent occurrence of several large umbrella claims, and increasing legal expenses in the other liability line of business. Loss severity continued to trend upward during 2004 while overall loss frequency continued to trend downward; however, there are some indications that loss frequency may be leveling out. Catastrophe and storm losses for 2004 include $2,888,000 (net of reinsurance) from the four hurricanes that hit the Southern United States in August and September.

The loss and settlement expense ratio for the reinsurance segment decreased to 55.9 percent in 2004 from 65.2 percent in 2003, despite an increase in catastrophe and storm losses. The decline in the 2004 ratio reflects a decrease in the ratio of reported losses to premiums earned for 2004 policy year business, an increase in favorable development on prior years' reserves and continued improvement in overall premium rate adequacy. The favorable development experienced in 2004 is attributed to reported policy year 2003 losses for property, casualty and multi-line classes that are below 2003 implicit projections. Catastrophe and storm losses for 2004 include $4,830,000 associated with the four hurricanes that hit the Southern United States in August and September. The reinsurance segment had exposure to all four hurricanes and reached its $1,500,000 cap on losses assumed per occurrence on three of them. During 2003, two events (Midwest storms in the month of May and Hurricane Isabel) reached the $1,500,000 cap.

Acquisition and other expenses

Acquisition and other expenses increased 7.4 percent to $112,707,000 in 2004 from $104,896,000 in 2003. The expense ratio (acquisition and other expenses expressed as a percentage of premiums earned) increased to 32.6 percent in 2004 from 31.7 percent in 2003, primarily due to increases in contingent commission and policyholder dividend expenses.

For the property and casualty insurance segment, the acquisition expense ratio increased to 34.3 percent in 2004 from 33.4 percent in 2003. The rise in this ratio is primarily attributed to an increase in contingent commission expense from the Company's agent profit share program and an increase in policyholder dividend expense. The Company will be implementing a new agent profit share program, which is designed to better equate agent compensation with the quality and quantity of the insurance business produced, effective January 1, 2005. Under the new program, the Company's best performing agents will be rewarded with increased compensation while agents with marginal business will experience a decline in compensation. Total profit share expense under the new program is expected to decline slightly. The increase in contingent commission expense was partially offset by $387,000 of ceded contingent commission income recognized in the fourth quarter of 2004 related to a no-claims bonus on the terrorism reinsurance contract for years 2003 and 2004.

For the reinsurance segment, the acquisition expense ratio increased to 28.1 percent in 2004 from 27.3 percent in 2003. The increase is primarily attributed to a large amount of contingent commission expense reported by MRB during 2004, but was reduced by a $666,000 increase in contingent commission income from a retrocession contract on the HORAD book of business. Both increases are a reflection of recent favorable underwriting performance. The asset for deferred acquisitions costs increased in 2004 and 2003 in connection with the increased participation in the MRB pool. These increases offset commission expense of $1,033,000 and $782,000 recorded for statutory purposes in those respective years with the increased participation in the MRB pool.

Investment results

Net investment income remained relatively flat at $29,900,000 in 2004 compared to $29,702,000 in 2003, despite an increase in invested assets. This is primarily attributed to the lingering low interest rate environment, which has negatively impacted the rate of return earned on the Company's investments. During this prolonged period of low interest rates, many of the Company's higher yielding securities have been called. The proceeds from these called securities, and from maturing securities, have been reinvested at the current lower interest rates, resulting in less investment income. In addition, until the second quarter of 2004 the Company had been reluctant to invest in long-term securities due to the low interest rate environment, and had therefore accumulated a significant amount of short-term and cash equivalent investments. Since these investments carry lower interest rates than long-term securities, the decline in the Company's rate of return was magnified. However, during the second quarter of 2004 interest rates became more attractive and the Company began investing in long-term securities.

The Company reported net realized investment gains of $4,379,000 in 2004 and $1,170,000 in 2003. The large amount of realized investment gains in 2004 includes $2,558,000 of net gain recognized during the second quarter on the Company's investment in MCI Communications Corporation bonds in conjunction with a payout award received under a bankruptcy court approved "Plan of Reorganization." The MCI bonds had previously been determined to be other-than-temporarily impaired during the second quarter of 2002. The new MCI bonds were sold during the third quarter, resulting in an additional realized gain of $187,000. Reflected in the gains of 2003 are $1,567,000 of other-than-temporary impairment losses recognized in the Company's equity portfolio during the first quarter, $2,689,000 of net losses recognized by the Company's equity managers during the first quarter as they rebalanced the Company's portfolios to enhance future returns, and $4,342,000 of losses recognized on the sale of American Airlines and United Airlines bonds during the first quarter. These losses were more than offset by gains recognized on the sale of certain bond and equity investments during the remainder of 2003. The Company has not recognized any additional other-than-temporary impairment losses since the first quarter of 2003, and all the impaired equity securities were sold before year-end 2003, generating gross realized gains of $619,000 and gross realized losses of $48,000.

Other information

Income tax expense decreased 68.7 percent to $2,386,000 in 2004 from $7,633,000 in 2003. The effective tax rate declined to 15.3 percent in 2004 from 27.3 percent in 2003, primarily due to an increase in tax-exempt investment income and a decline in pre-tax income. Effective April 1, 2003, the Company was included in Employers Mutual's consolidated tax return due to the fact that Employers Mutual attained 80 percent ownership of the Company at the end of March. The Company filed a short-period tax return with its subsidiaries for the period January 1, 2003 through March 31, 2003. During October 2004 Employers Mutual's ownership of the Company fell below 80 percent upon successful completion of the follow-on stock offering. Accordingly, the Company will no longer be included in Employers Mutual's consolidated tax return effective October 1, 2004, and the Company will file a short-period tax return for the period October 1, 2004 through December 31, 2004.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was signed into law. The Act expanded Medicare to include, for the first time, coverage for prescription drugs. In January 2004, the Financial Accounting Standards Board (FASB) issued Staff Position FAS No. 106-1 "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." Because of various uncertainties, including Employers Mutual's response to this legislation and the appropriate accounting methodology for this event, the Company elected to defer financial recognition of this legislation as permitted under FAS 106-1. In May 2004, the FASB issued Staff Position FAS No. 106-2, which became effective for interim and annual periods beginning after June 15, 2004. FAS No. 106-2 provides accounting guidance and disclosure requirements for the prescription drug subsidy established under the Act. The effect of the subsidy on the measurement of the Employers Mutual postretirement benefit plan resulted in a decrease in the accumulated projected benefit obligation of $9,899,000 and the net periodic postretirement benefit cost for 2004 was reduced by $1,537,000. Adoption of FAS 106-2 resulted in a $344,000 reduction in the Company's share of the net periodic postretirement benefit cost for 2004.

Employers Mutual participated in the Company's Dividend Reinvestment and Common Stock Purchase Plan during the first two quarters of 2004 and reinvested 50 percent of its dividends in additional shares of the Company's common stock. Due to its participation in the Company's recent stock offering, Employers Mutual discontinued its participation in the plan for the third and fourth quarters of 2004 and has indicated that it will likely not participate in the plan in 2005.

On November 26, 2002, President Bush signed into law the Terrorism Risk Insurance Act of 2002 ("TRIA"). TRIA provides a temporary Federal backstop on losses from certified terrorism events from foreign sources and is effective until December 31, 2005. Coverage includes most direct commercial lines of business, including coverage for losses from nuclear, biological and chemical exposures. Each insurer has a deductible amount, which is calculated as a percentage of the prior year's direct earned commercial lines premium and a ten percent retention above the deductible. The percentage used in the deductible calculation increased from seven percent in 2003 to ten percent in 2004, and will increase to 15 percent in 2005. TRIA caps losses at $100 billion annually; no insurer that has met its deductible will be liable for payment of any portion above that amount. Congress is currently debating whether TRIA should be extended for one or possibly two years due to concerns that terrorism insurance may not be available in the private insurance market when TRIA expires; however, no action has yet been taken.

Year ended December 31, 2003 compared to year ended December 31, 2002

Net income increased 26.4 percent to a record $20,349,000 ($1.78 per share) in 2003 from $16,102,000 ($1.42 per share) in 2002. This increase was attributed to improved premium rate adequacy, an improvement in the quality of the Company's book of business and strong second half earnings in the reinsurance segment. The improvement in 2003 net income was achieved even though the Company experienced an unusually high level of catastrophe and storm losses and performed some necessary reserve strengthening in the property and casualty insurance segment.

Premium income

Premiums earned increased 11.3 percent to $330,623,000 in 2003 from $297,043,000 in 2002. This increase was attributed to rate increases that were implemented in the property and casualty insurance segment during the preceding two years as well as significant growth and improved pricing in the reinsurance segment. The market for property and casualty insurance softened somewhat during 2003 but was considered to be firm at year-end.

Premiums earned for the property and casualty insurance segment increased 7.2 percent to $241,237,000 in 2003 from $225,013,000 in 2002, primarily as a result of rate increases that were implemented during the preceding three years. The rate increases implemented in 2002 and 2001 were broad based in nature and resulted in premium rate levels for most lines of business that were considered to be at, or near, adequate levels at December 31, 2002. Accordingly, moderate and more targeted rate increases were implemented during 2003. This fine tuning of the Company's rate structure was directed toward specific accounts, territories and lines of business where additional rate increases were warranted. Due to the timing of policy renewals and the earning of premiums ratably over the terms of the underlying policies, a time delay exists for implemented rate increases to have a noticeable impact on premiums earned. Premiums earned for 2003 reflect this delay and continued to show strong growth as the rate increases obtained in 2002 became earned; however, the growth rate in 2003 was limited by a decline in policy count (overall approximately 5.8 percent from December 31, 2002) that resulted from a decrease in new business associated with a moderate increase in rate competition and a reluctance to accept new risks in under-priced lines of business, and the non-renewal of existing business that was under-priced and/or under-performing.

Premiums earned for the reinsurance segment increased 24.1 percent to $89,386,000 in 2003 from $72,030,000 in 2002, primarily as a result of improved premium rate levels and increased participation in the MRB reinsurance pool. Following the large across-the-board rate increases implemented in 2002, premium rate increases on excess of loss contracts moderated in 2003 due to the influx of new capital into the reinsurance marketplace; however, contracts with poor loss experience continued to receive exceptionally large rate increases. The rate increases implemented during 2003 and 2002 were realized in conjunction with moderate declines in the related exposure base due to increased retention levels and coverage exclusions for terrorist activities. In addition, both excess of loss and pro-rata contracts were benefiting from improved industry-wide rate levels at the primary company level. For 2003, Employers Mutual's participation in the MRB reinsurance pool increased to 25 percent from 20 percent in 2002, producing $7,262,000 of additional earned premium. In addition to these factors, the growth in earned premiums for 2003 reflected an increase in the estimate of earned but not reported premiums of $3,575,000, compared to a decrease in this estimate of approximately $1,135,000 in 2002.

Losses and settlement expenses

Losses and settlement expenses increased 9.4 percent to $226,505,000 in 2003 from $207,058,000 in 2002. The loss and settlement expense ratio (losses and settlement expenses expressed as a percentage of premiums earned) decreased to 68.5 percent in 2003 from 69.7 percent in 2002, despite an unusually high level of catastrophe and storm losses that was second only to the record amount reported in storm-plagued 2001, and some necessary reserve strengthening. This decline in the loss and settlement expense ratio was attributed to improved premium rate adequacy, an improvement in the quality of the Company's book of business and unusually good loss experience in the reinsurance segment during the second half of the year.

The loss and settlement expense ratio for the property and casualty segment increased slightly to 69.7 percent in 2003 from 69.4 percent in 2002. Despite an unusually high level of catastrophe and storm losses ($17,531,000 in 2003 compared to $8,055,000 in 2002) and some necessary reserve strengthening, the loss and settlement expense ratio did not increase appreciably during 2003. This is due to management's diligent efforts over the last several years to improve both premium rate adequacy and the quality of the risks insured. Loss frequency continued to trend downward in 2003 while loss severity continued to increase. The reserve strengthening performed in 2003 amounted to approximately $12,825,000, which represented only 5.6 percent of the property and casualty insurance segment's carried reserves at December 31, 2002.

The loss and settlement expense ratio for the reinsurance segment decreased to 65.2 percent in 2003 from 70.7 percent in 2002. This improvement was attributed to an unusually low level of reported loss activity from both proportional and excess of loss business, and from favorable development on prior years' reserves. However, this improvement was partially offset by a significant increase in catastrophe losses ($3,411,000 in 2003 compared to $249,000 in 2002). During 2003, two events (Midwest storms in the month of May and hurricane Isabel) reached the $1,500,000 cap on losses assumed per event from Employers Mutual. In addition, the reinsurance segment established $326,000 of additional IBNR reserves in 2003 in response to the findings of an independent study conducted on the Company's asbestos exposures.

Acquisition and other expenses

Acquisition and other expenses increased 9.7 percent to $104,896,000 in 2003 from $95,633,000 in 2002. The expense ratio (acquisition and other expenses expressed as a percentage of premiums earned) decreased to 31.7 percent in 2003 from 32.2 percent in 2002, primarily due to the improvement in premium rate adequacy achieved in 2003.

For the property and casualty insurance segment, the expense ratio increased to 33.4 percent in 2003 from 32.2 percent in 2002. This increase was primarily due to an increase in contingent commission expense and higher employee benefit costs. The increase in contingent commission expense was a direct result of the fundamental improvement achieved in underwriting results. The increase in employee benefit costs was associated with a 50 basis-point decrease in the discount rate and expected long-term rate of return on plan assets assumptions utilized in the pension plan and postretirement benefit plans actuarial valuations.

For the reinsurance segment, the expense ratio decreased to 27.3 percent in 2003 from 32.1 percent in 2002. The decrease in 2003 was attributed to a decline in contingent commission expense and a shift in the mix of business towards property excess, which carries a lower commission rate. The decline in contingent commission expense was attributed to several sources, including a decline of approximately $413,000 associated with the MRB pool and a marine syndicate account, a decline of approximately $400,000 associated with the commutation of a retrocession contract related to the World Trade Center catastrophe, and a general trend toward a reduction in the number of contracts with contingent commission provisions. The asset for deferred acquisitions costs increased in 2003 and 2002 in connection with the increased participation in the MRB pool. These increases offset commission expense of $782,000 and $379,000 recorded for statutory purposes in those respective years with the increased participation in the MRB pool.

Investment results

Net investment income decreased 9.4 percent to $29,702,000 in 2003 from $32,778,000 in 2002, despite an increase in invested assets. This decrease was primarily attributed to the lingering low interest rate environment, which negatively impacted the rate of return earned on the Company's investments, but also reflected an increase in investment expenses. During this period of low interest rates, many of the Company's higher yielding securities were called. The proceeds from those called securities, and from maturing securities, were reinvested at the current lower interest rates, resulting in less investment income. In addition, until the latter half of 2003 the Company was reluctant to invest in long-term securities in this current low interest rate environment and therefore had accumulated a significant amount of short-term and cash equivalent investments. Since these investments carry lower interest rates than long-term fixed maturity securities, the decline in the Company's rate of return was magnified.

Realized investment gains totaled $1,170,000 in 2003 compared to a loss of $3,159,000 in 2002. Reflected in the gains of 2003 were $1,567,000 of other-than-temporary impairment losses recognized in the Company's equity portfolio during the first quarter of 2003, $2,689,000 of net losses recognized by the Company's equity managers during the first quarter as they rebalanced the Company's portfolios to enhance future returns, and $4,342,000 of losses recognized on the sale of American Airlines and United Airlines bonds during the first quarter. These bonds were collateralized by aircraft with an appraised value sufficient to recover the Company's investment at December 31, 2002; however, during the first quarter of 2003 the value of the collateral declined below the Company's investment as a result of the war with Iraq, a significant decline in air travel, and the prospects of a bankruptcy filing by American Airlines and a liquidation of United Airlines. The losses recognized in the first quarter were more than offset by gains recognized on the sale of certain bond and equity investments during the remainder of 2003. The Company did not recognize any additional other-than-temporary impairment losses during 2003 and all the impaired equity securities were sold before year-end, generating gross realized gains of $619,000 and gross realized losses of $48,000. The realized investment loss for 2002 primarily reflected a $3,821,000 impairment loss on the Company's investment in MCI Communications Corporation bonds.

Other information

The Company refinanced its $36,000,000 of surplus notes with Employers Mutual effective April 1, 2003 at an interest rate of 3.09 percent, resulting in a 19.4 percent decline in interest expense in 2003.

Income tax expense increased 31.8 percent to $7,633,000 in 2003 from $5,790,000 in 2002. The effective tax rate increased slightly to 27.3 percent in 2003 from 26.4 percent in 2002.

In response to the declining interest rate environment, Employers Mutual changed several key assumptions utilized in the preparation of the actuarial valuation reports for its pension and postretirement benefit plans during 2003 and 2002. Key assumption changes include a reduction in the discount rate from 6.5 percent in 2002 to 6.0 percent in 2003 and a reduction in the expected long-term rate of return on plan assets for the pension plan from 8.0 percent in 2002 to 7.5 percent in 2003 and for the postretirement benefit plans from 6.0 percent in 2002 to 5.0 percent in 2003. In addition, the assumed health care cost trend rate utilized in the postretirement benefit plan valuation report was decreased from 12 percent in 2002 to 11 percent in 2003.

Prior to 2002, the Company had concluded that it was not subject to the accounting requirements of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations, since it received the current fair value for any common stock issued under Employers Mutual's stock option plans. As a result, the Company was recognizing as compensation expense its pool participation share of the stock option expense recorded by Employers Mutual for these plans. During 2002, the Company concluded that it was subject to the accounting requirements of APB 25 and, accordingly, should not be recognizing compensation expense from Employers Mutual's stock option plans since the exercise price of the options was equal to the fair value of the stock at the date of grant. Accordingly, during 2002 the Company reversed the accrual for stock option expense allocated to it by Employers Mutual, resulting in $349,000 of pre-tax income.

The Company's insurance subsidiaries reimburse Employers Mutual for their share of the statutory-basis compensation expense associated with stock option exercises under the terms of the pooling and quota share agreements. Beginning in 2003, the statutory-basis compensation expense that was paid by the Company's subsidiaries to Employers Mutual ($505,000 in 2003) was reclassified as a dividend payment to Employers Mutual in these GAAP-basis financial statements. Since the corresponding amounts for 2002 were not material, the financial statements for that year were not restated.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

Liquidity is a measure of a company's ability to generate sufficient cash to meet cash obligations as they come due. The Company generated positive cash flows from operations of $60,794,000 in 2004, $63,095,000 in 2003 and $56,566,000 in 2002. The Company typically generates substantial positive cash flows from operations because cash from premium payments is generally received in advance of cash payments made to settle claims. These positive cash flows provide the foundation of the Company's asset/liability management program and are the primary drivers of the Company's liquidity. When investing funds made available from operations, the Company invests in securities with maturities that approximate the anticipated liabilities of the insurance issued. In addition, the Company maintains a portion of its investment portfolio in relatively short-term and highly liquid assets as a secondary source of liquidity should net cash flows from operating activities prove inadequate to fund current operating needs. As of December 31, 2004, the Company did not have any significant variations between the maturity dates of its investments and the expected payment of its loss and settlement expense reserves.

The Company is a holding company whose principal assets are its investments in its insurance subsidiaries. As a holding company, the Company is dependent upon cash dividends from its insurance company subsidiaries to meet its obligations and to pay cash dividends to its stockholders. State insurance regulations restrict the maximum amount of dividends insurance companies can pay without prior regulatory approval. See note 6 of Notes to Consolidated Financial Statements for additional information regarding dividend restrictions. The maximum amount of dividends that the insurance company subsidiaries can pay to the Company in 2005 without prior regulatory approval is approximately $32.2 million. The Company received $7,029,000, $7,255,000 and $6,250,000 of dividends from its insurance company subsidiaries and paid cash dividends to its stockholders totaling $7,233,000, $6,874,000 and $6,828,000 in 2004, 2003 and 2002, respectively.

The Company's insurance company subsidiaries must have adequate liquidity to ensure that their cash obligations are met; however, because of their participation in the pooling agreement and the quota share agreement, they do not have the daily liquidity concerns normally associated with an insurance or reinsurance company. This is due to the fact that under the terms of the pooling and quota share agreements, Employers Mutual receives all premiums and pays all losses and expenses associated with the insurance business produced by the pool participants and the assumed reinsurance business ceded to the Company's reinsurance subsidiary, and then settles the inter-company balances generated by these transactions with the participating companies on a quarterly basis.

At the insurance company subsidiary level, the primary sources of cash are premium income, investment income and maturing investments. The principal outflows of cash are payments of claims, commissions, premium taxes, operating expenses, income taxes, dividends, interest and principal payments on debt, and investment purchases. Cash outflows can be variable because of uncertainties regarding settlement dates for unpaid losses and because of the potential for large losses, either individually or in the aggregate. Accordingly, the insurance company subsidiaries maintain investment and reinsurance programs generally intended to provide adequate funds to pay claims without forced sales of investments.

The Company maintains a portion of its investment portfolio in relatively short-term and highly liquid investments to ensure the availability of funds to pay claims and expenses. The remainder of the investment portfolio, excluding investments in equity securities, is invested in securities with maturities that approximate the anticipated liabilities of the insurance written. At December 31, 2004, approximately 27 percent of the Company's fixed maturity securities were in U.S. government or U.S. government agency issued securities. A variety of maturities are maintained in the Company's portfolio to assure adequate liquidity. The maturity structure of the fixed maturity investments is also established by the relative attractiveness of yields on short, intermediate and long-term securities. The Company does not invest in any high-yield debt investments (commonly referred to as junk bonds.)

The Company considers itself to be a long-term investor and generally purchases fixed maturity investments with the intent to hold them to maturity. Despite this intent, the Company has historically classified a portion of its fixed maturity investments as available-for-sale securities to provide flexibility in the management of the portfolio. Since the third quarter of 1999, all newly acquired fixed maturity investments have been classified as available-for-sale securities to provide increased management flexibility. The Company had unrealized holding gains, net of deferred taxes, on fixed maturity securities available-for-sale totaling $15,511,000 and $15,779,000 at December 31, 2004 and 2003, respectively. The fluctuation in the market value of these investments is primarily due to changes in the interest rate environment during this time period. Since the Company does not actively trade in the bond market, such fluctuations in the fair value of these investments are not expected to have a material impact on the operations of the Company, as forced liquidations of investments are not anticipated. The Company closely monitors the bond market and makes appropriate adjustments in its portfolio as changing conditions warrant.

The majority of the Company's assets are invested in fixed maturity securities. These investments provide a substantial amount of investment income that supplements underwriting results and contributes to net earnings. As these investments mature, or are called, the proceeds will be reinvested at current rates, which may be higher or lower than those now being earned; therefore, more or less investment income may be available to contribute to net earnings depending on the interest rate level.

The Company participates in a securities lending program administered by Mellon Bank, N.A. whereby certain fixed maturity securities from the investment portfolio are loaned to other institutions for short periods of time. The Company receives a fee for each security loaned out under this program and requires initial collateral, primarily cash, equal to 102 percent of the market value of the loaned securities. The cash collateral that secures the Company's loaned securities is invested in a Delaware statutory trust that is managed by Mellon Bank. The earnings from this trust are used, in part, to pay the fee the Company receives for each security loaned under the program.

The Company held $5,550,000 and $4,758,000 in minority ownership interests in limited partnerships and limited liability companies at December 31, 2004 and 2003, respectively. The Company does not hold any other unregistered securities.

The Company's cash balance was $61,000 and ($14,069,000) at December 31, 2004 and 2003, respectively. The balance at December 31, 2003 reflects a $14,346,000 transfer of funds out of the cash account on December 31, 2003 to purchase a fixed maturity security; however, due to timing, the account does not reflect the corresponding transfer of cash into the account to fund the purchase. This timing difference resulted in the negative balance in the account.

The Company carried a pension asset of $2,684,000 at December 31, 2004. At December 31, 2003 the Company reported a pension liability of $1,453,000 (including $1,016,000 of additional minimum liability). This change in the funded status of the pension plan was driven by a $5,236,000 pension plan contributions made during 2004. Along with the additional minimum liability reported on the Company's pension plan at December 31, 2003 was an intangible asset of $1,016,000. Postretirement benefit liabilities reflected in the Company's financial statements totaled $9,486,000 and $8,512,000 at December 31, 2004 and 2003, respectively.

Capital Resources

Capital resources consist of stockholders' equity and debt, representing funds deployed or available to be deployed to support business operations. For the Company's insurance subsidiaries, capital resources are required to support premium writings. Regulatory guidelines suggest that the ratio of a property and casualty insurer's annual net premiums written to its statutory surplus should not exceed 3 to 1. All of the Company's insurance subsidiaries were well under this guideline at December 31, 2004.

The Company's insurance subsidiaries are required to maintain certain minimum surplus on a statutory basis and are subject to regulations under which payment of dividends from statutory surplus is restricted and may require prior approval of their domiciliary insurance regulatory authorities. The Company's insurance subsidiaries are also subject to Risk Based Capital (RBC) requirements that may further impact their ability to pay dividends. RBC requirements attempt to measure minimum statutory capital needs based upon the risks in a company's mix of products and investment portfolio. At December 31, 2004, the Company's insurance subsidiaries had total adjusted statutory capital of $216,868,000, which is well in excess of the minimum RBC requirement of $43,485,000.

The Company had total cash and invested assets with a carrying value of $779.4 million and $676.9 million as of December 31, 2004 and December 31, 2003, respectively. The following table summarizes the Company's cash and invested assets as of the dates indicated:

	December 31, 2004		
($ in thousands)	Amortized cost	Fair value	Percent of total at fair value
Fixed maturities, held-to-maturity	$ 29,206	$ 30,594	3.9%
Fixed maturities, available-for-sale ..	595,791	619,654	79.4
Equity securities, available-for-sale	59,589	78,693	10.1
Cash	61	61	-
Short-term investments	46,239	46,239	5.9
Other long-term investments	5,550	5,550	0.7
	$736,436	$780,791	100.0%

	December 31, 2003		
($ in thousands)	Amortized cost	Fair value	Percent of total at fair value
Fixed maturities, held-to-maturity	$ 49,845	$ 53,854	7.9%
Fixed maturities, available-for-sale ..	499,511	523,786	76.9
Equity securities, available-for-sale	38,998	49,008	7.2
Cash	(14,069)	(14,069)	(2.0)
Short-term investments	63,568	63,568	9.3
Other long-term investments	4,758	4,758	0.7
	$642,611	$680,905	100.0%

The amortized cost and estimated fair value of fixed maturity and equity securities at December 31, 2004 were as follows:

($ in thousands)	Held-to maturity Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. treasury securities and obligations of U.S. government corporations and agencies	$ 28,037	$ 1,280	$ -	$ 29,317
Mortgage-backed securities	1,169	108	-	1,277
Total securities held-to-maturity	$ 29,206	$ 1,388	$ -	$ 30,594

($ in thousands)	Available-for sale Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
U.S. treasury securities and obligations of U.S. government corporations and agencies	$ 137,274	$ 413	$ 148	$ 137,539
Obligations of states and political subdivisions ...	257,483	10,329	136	267,676
Mortgage-backed securities	11,136	715	-	11,851
Public utilities	8,687	1,181	-	9,868
Debt securities issued by foreign governments	7,178	321	-	7,499
Corporate securities	174,033	11,226	38	185,221
Total fixed maturity securities	595,791	24,185	322	619,654
Equity securities	59,589	19,225	121	78,693
Total securities available-for-sale	$ 655,380	$ 43,410	$ 443	$ 698,347

In December 2001, three of the Company's property and casualty insurance subsidiaries issued surplus notes totaling $25 million to Employers Mutual at an annual interest rate of 5.38 percent. In June 2002, the Company's reinsurance subsidiary issued an $11.0 million surplus note to Employers Mutual at an annual interest rate of 5.25 percent. Effective April 1, 2003, these surplus notes were reissued at an annual interest rate of 3.09 percent. These notes do not have a maturity date. Payment of interest and repayment of principal can only be made out of the applicable subsidiary's statutory surplus and is subject to prior approval by the insurance commissioner of the respective state of domicile. The surplus notes are subordinate and junior in right of payment to all obligations or liabilities of the applicable insurance subsidiaries. The Company's subsidiaries incurred interest expense of $1,112,000, $1,320,000, and $1,639,000 in 2004, 2003, and 2002, respectively, on these surplus notes. The surplus notes were issued in response to statutory capital adequacy concerns raised by certain rating agencies because the statutory surplus position of the subsidiaries had declined over the preceding three years due to unfavorable operating results and the payment of dividends to the parent corporation. At December 31, 2004, the Company's subsidiaries had received approval for the payment of interest accrued on the surplus notes during 2004.

As of December 31, 2004, the Company had no material commitments for capital expenditures.

Off-Balance Sheet Arrangements

Employers Mutual receives all premiums and pays all losses and expenses associated with the assumed reinsurance business ceded to the reinsurance subsidiary and the insurance business produced by the pool participants, and then settles the inter-company balances generated by these transactions with the participating companies on a quarterly basis. When settling the inter-company balances, Employers Mutual provides the reinsurance subsidiary and the pool participants with full credit for the premiums written during the quarter and retains all receivable amounts. Any receivable amounts that are ultimately deemed to be uncollectible are charged-off by Employers Mutual and the expense is charged to the reinsurance subsidiary or allocated to the pool members on the basis of pool participation. As a result, the Company has an off-balance sheet arrangement with an unconsolidated entity that results in a credit-risk exposure that is not reflected in the Company's financial statements. Based on historical data, this credit-risk exposure is not considered to be material to the Company's results of operations or financial position.

Investment Impairments and Considerations

During 2004 the Company had one fixed maturity security series (MCI Communications Corporation) that was determined other-than-temporarily impaired. MCI Communications Corporation was owned by WorldCom Inc., whose corporate bonds were downgraded to junk status in May 2002 when it reported the detection of accounting irregularities. On June 30, 2002 the Company recognized $3,821,000 of realized loss when the carrying value of this investment was reduced from an aggregate book value of $5,604,000 to the then current fair value of $1,783,000. The fair value of the MCI bonds then partially recovered, resulting in pre-tax unrealized gains of $1,035,000 recognized during 2002 and $1,811,000 recognized during 2003. During the second quarter of 2004 the Company received three new series of fixed maturity securities (with impaired book values) issued by MCI Communications Corporation in conjunction with a payout award received under a bankruptcy court approved "Plan of Reorganization." This payout was recorded as a tax-free exchange and the new bonds were assigned a book value equal to the book value of the defaulted bonds that were replaced ($5,509,000). The par value of the new bonds reflected the settlement amount of 79.2 cents per dollar ($4,552,000) and the fair value of the new bonds was $4,241,000 at the time of the payout. Based on these facts, a realized investment gain of $3,826,000 was recognized in the second quarter of 2004 to offset the other-than-temporary impairment loss previously recognized in the second quarter of 2002 and an other-than-temporary impairment loss of $1,268,000 was recognized to reduce the book value of the new bonds to fair value at the time of the payout. The new bonds were sold during the third quarter of 2004, resulting in an additional realized gain of $187,000.

At December 31, 2004, the Company had unrealized losses on held-to-maturity and available-for-sale securities as presented in the table below. The estimated fair value is based on quoted market prices, where available, or on values obtained from independent pricing services. None of these securities are considered to be in concentrations by either security type or industry. The Company uses several factors to determine whether the carrying value of an individual security has been other-than-temporarily impaired. Such factors include, but are not limited to, the security's value and performance in the context of the overall markets, length of time and extent the security's fair value has been below carrying value, key corporate events and collateralization of fixed maturity securities. Based on these factors, and the Company's ability and intent to hold the fixed maturity securities until maturity, it was determined that the carrying value of these securities was not other-than-temporarily impaired at December 31, 2004. Risks and uncertainties inherent in the methodology utilized in this evaluation process include interest rate risk, equity price risk and the overall performance of the economy, all of which have the potential to adversely affect the value of the Company's investments. Should a determination be made at some point in the future that these unrealized losses are other-than-temporary, the Company's earnings would be reduced by approximately $288,000, net of tax; however, the Company's financial position would not be affected due to the fact that unrealized losses on available-for-sale securities are reflected in the Company's financial statements as a component of stockholders' equity, net of deferred taxes.

Following is a schedule of the length of time securities have continuously been in an unrealized loss position as of December 31, 2004.

Description of securities	Fair value	Unrealized losses
($ in thousands)		
Fixed maturity securities:		
Less than six months	$ 42,063	$ 183
Six to twelve months	6,829	13
Twelve months or longer	8,064	126
Total fixed maturity securities	56,956	322
Equity securities:		
Less than six months	7,061	111
Six to twelve months	334	10
Twelve months or longer	-	-
Total equity securities ...	7,395	121
Total temporarily impaired securities ...	$ 64,351	$ 443

Following is a schedule of the maturity dates of the fixed maturity securities presented in the above table. Note that this schedule includes only fixed maturity securities available-for-sale, as the Company does not have any fixed maturity securities held-to-maturity with unrealized losses.

($ in thousands)	Book value	Fair value	Gross unrealized loss
Due in one year or less	$ -	$ -	$ -
Due after one year through five years ...	2,000	1,990	10
Due after five years through ten years ..	27,491	27,384	107
Due after ten years	27,787	27,582	205
	$57,278	$56,956	$322

The Company has no fixed maturity securities available-for-sale that are non-investment grade and have unrealized losses at December 31, 2004. As previously noted, the Company does not invest in junk bonds. Any non-investment grade securities held by the Company are the result of rating downgrades that occurred subsequent to their purchase.

Following is a schedule of gross realized losses recognized in 2004 along with the associated book values and sales prices aged according to the length of time the underlying securities were in an unrealized loss position. This schedule does not include realized losses stemming from corporate actions such as calls, pay-downs, redemptions, etc. The Company's equity portfolio is managed on a "tax-aware" basis, which generally results in sales of securities at a loss to offset sales of securities at a gain, thus minimizing the Company's income tax expense. Fixed maturity securities are generally held until maturity.

($ in thousands)	Book value	Sales price	Gross realized loss
Fixed maturity securities available-for-sale:			
Three months or less	$ 5,509	$ 4,186	$ 1,323
Over three months to six months	14,202	14,000	202
Over six months to nine months	2,601	2,550	51
Over nine months to twelve months ..	-	-	-
Over twelve months	-	-	-
	$ 22,312	$ 20,736	$ 1,576
Equity securities:			
Three months or less	$ 10,309	$ 9,279	$ 1,030
Over three months to six months	2,262	1,935	327
Over six months to nine months	1,280	1,075	205
Over nine months to twelve months ..	1,018	712	306
Over twelve months	1,271	1,113	158
	$ 16,140	$ 14,114	$ 2,026

The realized losses recognized on fixed maturity securities that were in an unrealized loss position for three months or less reflects the $1,268,000 other-than-temporary impairment loss recognized during the second quarter of 2004 on a new series of bonds issued by MCI Communications Corporation in conjunction with a bankruptcy court approved payout award. The bonds were sold at a gain during the third quarter of 2004.

LEASES, COMMITMENTS AND CONTINGENT LIABILITIES

The following table reflects the contractual obligations of the Company as of December 31, 2004. Included in the table are the estimated payments that the Company expects to make in the settlement of its loss reserves and with respect to its long-term debt. One of the Company's property and casualty insurance subsidiaries leases office facilities in Bismarck, North Dakota with lease terms expiring in 2014. Hamilton Mutual Insurance Company, an affiliate of Employers Mutual and a pool participant, leases office facilities for the Cincinnati branch office with lease terms expiring in 2005. Employers Mutual has entered into various leases for branch and service office facilities with lease terms expiring through 2013. Employers Mutual also leases computer software under various operating lease agreements expiring through 2005. All lease costs are included as expenses under the pooling agreement after allocation of the portion of these expenses to the subsidiaries that do not participate in the pool. The table reflects the Company's current 23.5 percent aggregate participation in the pooling agreement. As discussed further under the caption "Company Overview," the Company's aggregate participation in the pooling agreement will increase to 30.0 percent effective January 1, 2005.

	Payments due by period				
	Total	Less than 1 year	1-3 years	4-5 years	More than 5 years
	($ in thousands)				
Contractual Obligations					
Loss and settlement expense reserves (1)	$429,677	$171,138	$157,146	$52,971	$ 48,422
Long-term debt (2)	36,000	-	-	-	36,000
Real estate operating leases	6,863	1,086	1,977	1,560	2,240
Software operating leases ..	375	375	-	-	-
Total	$472,915	$172,599	$159,123	$54,531	$ 86,662

(1) The amounts presented are estimates of the dollar amounts and time period in which the Company expects to pay out its gross loss and settlement expense reserves. These amounts are based on historical payment patterns and do not represent actual contractual obligations. The actual payment amounts and the related timing of those amounts could differ significantly from these estimates.

(2) Long-term debt reflects the surplus notes issued by the Company's insurance subsidiaries to Employer Mutual, which have no maturity date. Interest on the surplus notes amounts to $1,112,000 annually, and is subject to approval by the issuing company's state of domicile. Excluded from long-term debt are pension and other postretirement benefit obligations.

Estimated guaranty fund assessments of $1,207,000 and $1,253,000, which are used by states to pay claims of insolvent insurers domiciled in that state, have been accrued as of December 31, 2004 and 2003, respectively. The guaranty fund assessments are expected to be paid over the next two years with premium tax offsets of $1,544,000 expected to be realized within ten years of the payments. Estimated second injury fund assessments of $1,390,000 and $1,109,000, which are designed to encourage employers to employ a worker with a pre-existing disability, have been accrued as of December 31, 2004 and 2003, respectively. The second injury fund assessment accruals are based on projected loss payments. The periods over which the assessments will be paid is not known.

The participants in the pooling agreement have purchased annuities from life insurance companies, under which the claimant is payee, to fund future payments that are fixed pursuant to specific claim settlement provisions. The Company's share of loss reserves eliminated by the purchase of these annuities was $700,000 at December 31, 2004. The Company has a contingent liability of $700,000 should the issuers of these annuities fail to perform under the terms of the annuities. The Company's share of the amount due from any one life insurance company does not equal or exceed one percent of its subsidiaries' policyholders' surplus.

MARKET RISK

The main objectives in managing the investment portfolios of the Company are to maximize after-tax investment income and total investment return while minimizing credit risks, in order to provide maximum support for the underwriting operations. Investment strategies are developed based upon many factors including underwriting results and the Company's resulting tax position, regulatory requirements, fluctuations in interest rates and consideration of other market risks. Investment decisions are centrally managed by investment professionals and are supervised by the investment committees of the respective board of directors for each of the Company's subsidiaries.

Market risk represents the potential for loss due to adverse changes in the fair value of financial instruments. The market risks of the financial instruments of the Company relate to the investment portfolio, which exposes the Company to interest rate and equity price risk, and to a lesser extent credit quality and prepayment risk. Monitoring systems and analytical tools are in place to assess each of these elements of market risk.

Interest rate risk includes the price sensitivity of a fixed maturity security to changes in interest rates, and the affect on future earnings from short-term investments and maturing long-term investments given a change in interest rates. The following analysis illustrates the sensitivity of the Company's financial instruments to selected changes in market rates and prices. A hypothetical one percent increase in interest rates as of December 31, 2004 would result in a corresponding pre-tax decrease in the fair value of the fixed maturity portfolio of approximately $39,229,000, or 5.6 percent. In addition, a hypothetical one percent decrease in interest rates at December 31, 2004 would result in a corresponding decrease in pre-tax income over the next twelve months of approximately $1,463,000, assuming the current maturity and prepayment patterns. The Company monitors interest rate risk through the analysis of interest rate simulations, and adjusts the average duration of its fixed maturity portfolio by investing in either longer or shorter term instruments given the results of interest rate simulations and judgments of cash flow needs. The effective duration of the Company's fixed maturity portfolio at December 31, 2004 was 5.19 years.

The valuation of the Company's marketable equity portfolios is subject to equity price risk. In general, equities have more year-to-year price variability than bonds. However, returns from equity securities have been consistently higher over longer time frames. The Company invests in a diversified portfolio of readily marketable equity securities. A hypothetical 10 percent decrease in the S&P 500 index as of December 31, 2004 would result in a corresponding pre-tax decrease in the fair value of the Company's equity portfolio of approximately $8,980,000.

The Company invests in high quality fixed maturity securities, thus minimizing credit quality risk. At December 31, 2004, the portfolio of long-term fixed maturity securities consists of 12.2 percent U.S. Treasury, 14.4 percent government agency, 0.5 percent mortgage-backed, 41.1 percent municipal, and 31.8 percent corporate securities. At December 31, 2003, the portfolio of long-term fixed maturity securities consisted of 26.7 percent U.S. Treasury, 13.0 percent government agency, 2.8 percent mortgage-backed, 25.6 percent municipal, and 31.9 percent corporate securities.

Fixed maturity securities held by the Company generally have an investment quality rating of "A" or better by independent rating agencies. The following table shows the composition of the Company's fixed maturity securities, by rating, as of December 31, 2004.

	Securities held-to-maturity (at amortized cost)		Securities available-for-sale (at fair value)	
($ in thousands)	Amount	Percent	Amount	Percent
Rating:				
AAA	$ 29,206	100.0%	$349,176	56.3%
AA	-	-	90,847	14.7
A	-	-	134,837	21.7
BAA	-	-	40,046	6.5
B	-	-	4,748	0.8
Total fixed maturities	$ 29,206	100.0%	$619,654	100.0%

Ratings for preferred stocks and fixed maturity securities with initial maturities greater than one year are assigned by Moody's Investor's Services, Inc. Moody's rating process seeks to evaluate the quality of a security by examining the factors that affect returns to investors. Moody's ratings are based on quantitative and qualitative factors, as well as the economic, social and political environment in which the issuing entity exists. The quantitative factors include debt coverage, sales and income growth, cash flows and liquidity ratios. Qualitative factors include management quality, access to capital markets and the quality of earnings and balance sheet items. Ratings for securities with initial maturities less than one year are based on an evaluation of the underlying assets or the credit rating of the issuer's parent company.

Prepayment risk refers to the changes in prepayment patterns that can shorten or lengthen the expected timing of principal repayments and thus the average life and the effective yield of a security. Such risk exists primarily within the portfolio of mortgage-backed securities. The prepayment risk analysis is monitored regularly through the analysis of interest rate simulations. At December 31, 2004, the effective duration of the mortgage-backed securities is 1.7 years with an average life and current yield of 2.8 years and 7.1 percent, respectively. At December 31, 2003, the effective duration of the mortgage-backed securities was 1.6 years with an average life and current yield of 2.4 years and 7.0 percent, respectively.

IMPACT OF INFLATION

Inflation has a widespread effect on the Company's results of operations, primarily through increased losses and settlement expenses. The Company considers inflation, including social inflation that reflects an increasingly litigious society and increasing jury awards, when setting reserve amounts. Premiums are also affected by inflation, although they are often restricted or delayed by competition and the regulatory rate-setting environment.

NEW ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004) "Share-Based Payment," which is a revision of SFAS No. 123 "Accounting for Stock-Based Compensation" and supersedes Accounting Principles Board (APB) Opinion No. 25 "Accounting for Stock Issued to Employees." SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim and annual periods after June 15, 2005, with earlier adoption encouraged. The pro forma disclosures previously allowed under Statement No. 123 will no longer be an alternative to financial statement recognition. The transition methods for adoption include the modified-prospective and modified-retroactive methods. The modified-prospective method requires that compensation expense be recorded for all unvested stock options that exist upon the adoption of Statement 123(R). Under the modified-retroactive method, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The Company is currently evaluating the requirements of Statement 123(R), but does not expect adoption of this statement to have a material effect on the operating results of the Company.

In 2003, the Emerging Issues Task Force (EITF) of the FASB reached a consensus on certain disclosures required by EITF Issue 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," which was effective for fiscal years ending after December 15, 2003. The Company adopted this EITF in 2003, which only required additional disclosures and did not have any effect on the operating results of the Company. In March of 2004, the EITF reached a consensus on the guidance provided to determine whether an investment is within the scope of Issue 3-1. Under EITF Issue 03-1, an investment is impaired if the fair value of the investment is less than its cost including adjustments for amortization, accretion, foreign exchange and hedging. An impairment would be considered other-than-temporary unless a) the investor has the ability and intent to hold an investment for a reasonable period of time sufficient for the recovery of the fair value up to (or beyond) the cost of the investment, and b) evidence indicating that the cost of the investment is recoverable within a reasonable period of time outweighs evidence to the contrary. This new guidance for determining whether the decline in the fair value of the investment is other-than-temporary was to be effective for reporting periods beginning after June 15, 2004. On September 30, 2004, the FASB issued EITF Issue 03-1-1 "Effective Date of Paragraphs 10-20 of EITF Issue 3-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," which delayed the effective date for the measurement and recognition guidance included in EITF Issue 03-1 until additional implementation guidance is provided. Pending adoption of the final rule, the Company continues to apply existing accounting guidance for determining when a decline in fair value is other-than-temporary.

DEVELOPMENTS IN INSURANCE REGULATION

The NAIC has taken initial steps toward adopting selected provisions of the Sarbanes-Oxley Act of 2002 into its model audit rule. The provisions most likely to be adopted include the provisions on audit committees and auditor independence, as well as the requirements that insurers include in their annual statutory financial statements a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting, a report of management's assessment of the company's internal control over financial reporting, and an attestation report by the external auditor on the assessment. A working group is holding a series of meetings to further study the implications of revising the model audit rule to incorporate the Sarbanes-Oxley Act of 2002 Section 404-type requirements. Adoption of these requirements into the model audit rule is expected to have little consequence to either the Company or the EMC Insurance Companies, as the Company is already subject to the provisions of the Sarbanes-Oxley Act of 2002.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides issuers the opportunity to make cautionary statements regarding forward-looking statements. Accordingly, any forward-looking statement contained in this report is based on management's current beliefs, assumptions and expectations of the Company's future performance, taking into account all information currently available to management. These beliefs, assumptions and expectations can change as the result of many possible events or factors, not all of which are known to management. If a change occurs, the Company's business, financial condition, liquidity, results of operations, plans and objectives may vary materially from those expressed in the forward-looking statements. The risks and uncertainties that may affect the actual results of the Company include, but are not limited to, the following: catastrophic events and the occurrence of significant severe weather conditions; the adequacy of loss and settlement expense reserves; state and federal legislation and regulations; changes in the Company's industry, interest rates or the performance of financial markets and the general economy; rating agency actions and other risks and uncertainties inherent to the Company's business. When the Company uses the words "believe", "expect", "anticipate", "estimate" or similar expressions, the Company intends to identify forward-looking statements. You should not place undue reliance on these forward-looking statements.

Management's Responsibility for Financial Reporting

The management of EMC Insurance Group Inc. and Subsidiaries is responsible for the preparation, integrity and objectivity of the accompanying financial statements, as well as other financial information in this report. The financial statements have been prepared in accordance with U.S. generally accepted accounting principles and include amounts that are based on management's estimates and judgments where necessary.

The Company's financial statements have been audited by Ernst & Young LLP, Independent Registered Public Accounting Firm. Management has made available to Ernst & Young LLP all of the Company's financial records and related data, as well as the minutes of the stockholders' and directors' meetings. Furthermore, management believes that all representations made to Ernst & Young LLP during its audit were valid and appropriate. Their report appears elsewhere in this annual report.

Management of the Company has established and continues to maintain a system of internal controls that are designed to provide assurance as to the integrity and reliability of the financial statements, the protection of assets from unauthorized use or disposition, and the prevention and detection of fraudulent financial reporting. The system of internal controls provides for appropriate division of responsibility. Certain aspects of these systems and controls are tested periodically by the Company's internal auditors. Management considers the recommendations of its internal auditors and the independent auditors concerning the Company's internal controls and takes the necessary actions that are cost-effective in the circumstances to respond appropriately to the recommendations presented. Although management is not required to issue an annual report on internal control over financial reporting until December 31, 2005, management believes that as of December 31, 2004, the Company's system of internal controls was adequate to accomplish the above objectives.

The Audit Committee of the Board of Directors, composed solely of outside directors, met during the year with management and the independent auditors to review and discuss audit findings and other financial and accounting matters. The independent auditors and the internal auditors have free access to the Audit Committee, with and without management present, to discuss the results of their audit work.

Bruce G. Kelley
President and
Chief Executive Officer

Mark E. Reese
Senior Vice President and
Chief Financial Officer

Report of Ernst & Young LLP, Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
EMC Insurance Group Inc.

We have audited the accompanying consolidated balance sheets of EMC Insurance Group Inc. and Subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of EMC Insurance Group Inc. and Subsidiaries at December 31, 2004 and 2003 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 11, 2005
Des Moines, Iowa

EMC INSURANCE GROUP INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003
ASSETS		
Investments:		
Fixed maturities:		
Securities held-to-maturity, at amortized cost (fair value $16,908,726 and $21,167,655)	**$ 15,895,607**	$ 19,423,013
Securities available-for-sale, at fair value (amortized cost $541,401,950 and $382,326,388)	**565,000,931**	405,758,798
Fixed maturity securities on loan:		
Securities held-to-maturity, at amortized cost (fair value $13,684,880 and $32,686,769)	**13,310,264**	30,422,335
Securities available-for-sale, at fair value (amortized cost $54,389,046 and $117,184,150)	**54,653,472**	118,026,960
Equity securities available-for-sale, at fair value (cost $59,589,434 and $38,998,075)	**78,692,893**	49,008,498
Other long-term investments, at cost	**5,550,093**	4,758,019
Short-term investments, at cost	**46,238,853**	63,568,064
Total investments	**779,342,113**	690,965,687
Balances resulting from related party transactions with Employers Mutual:		
Reinsurance receivables	**26,316,358**	21,720,789
Prepaid reinsurance premiums	**3,682,676**	3,297,228
Deferred policy acquisition costs	**27,940,583**	26,737,784
Intangible asset, pension plan	**-**	1,016,492
Pension plan prepaid asset	**2,684,463**	-
Other assets	**1,877,564**	1,857,284
Cash	**61,088**	(14,069,102)
Accrued investment income	**8,726,292**	7,821,652
Accounts receivable (net of allowance for uncollectible accounts of $0 and $0)	**216,836**	379,423
Income taxes recoverable	**3,399,485**	-
Deferred income taxes	**9,504,193**	10,345,429
Goodwill, at cost less accumulated amortization of $2,616,234 and $2,616,234	**941,586**	941,586
Securities lending collateral	**70,122,695**	154,556,758
Total assets	**$934,815,932**	$905,571,010

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003
LIABILITIES		
Balances resulting from related party transactions with Employers Mutual:		
Losses and settlement expenses	**$429,677,302**	$373,782,916
Unearned premiums	**131,589,365**	124,832,607
Other policyholders' funds	**2,825,809**	1,390,594
Surplus notes payable	**36,000,000**	36,000,000
Indebtedness to related party	**6,058,848**	2,175,118
Employee retirement plans	**9,764,406**	9,965,600
Other liabilities	**20,304,475**	19,336,366
Income taxes payable	**-**	2,780,500
Securities lending obligation	**70,122,695**	154,556,758
Total liabilities	**706,342,900**	724,820,459
STOCKHOLDERS' EQUITY		
Common stock, $1 par value, authorized 20,000,000 shares; issued and outstanding, 13,568,945 shares in 2004 and 11,501,065 shares in 2003	**13,568,945**	11,501,065
Additional paid-in capital	**103,467,293**	69,113,228
Accumulated other comprehensive income	**27,928,463**	22,285,668
Retained earnings	**83,508,331**	77,850,590
Total stockholders' equity	**228,473,032**	180,750,551
Total liabilities and stockholders' equity	**$934,815,932**	$905,571,010

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF INCOME

All balances presented below, with the exception of investment income, realized investment gains (losses) and income tax expense (benefit), are the result of related party transactions with Employers Mutual.

	Year ended December 31,		
	2004	2003	2002
REVENUES			
Premiums earned	**$345,478,461**	$330,622,810	$297,043,033
Investment income, net	**29,900,203**	29,702,461	32,778,133
Realized investment gains (losses)	**4,379,314**	1,169,698	(3,159,201)
Other income	**600,732**	862,070	865,819
	380,358,710	362,357,039	327,527,784
LOSSES AND EXPENSES			
Losses and settlement expenses	**249,806,210**	226,504,550	207,057,856
Dividends to policyholders	**4,478,169**	3,011,433	2,977,154
Amortization of deferred policy acquisition costs	**75,444,837**	71,959,232	65,727,016
Other underwriting expenses	**32,783,686**	29,924,942	26,928,972
Interest expense	**1,112,400**	1,320,266	1,638,716
Other expenses	**1,162,411**	1,654,320	1,306,034
	364,787,713	334,374,743	305,635,748
Income before income tax expense (benefit)	**15,570,997**	27,982,296	21,892,036
INCOME TAX EXPENSE (BENEFIT)			
Current	**4,583,505**	8,336,381	5,061,093
Deferred	**(2,197,191)**	(703,208)	729,205
	2,386,314	7,633,173	5,790,298
Net income	**$ 13,184,683**	$ 20,349,123	$ 16,101,738
Net income per common share - basic and diluted	**$ 1.10**	$ 1.78	$ 1.42
Average number of shares outstanding - basic and diluted	**11,948,710**	11,453,324	11,375,779

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year ended December 31,		
	2004	2003	2002
Net income	**$ 13,184,683**	$ 20,349,123	$ 16,101,738
OTHER COMPREHENSIVE INCOME			
Unrealized holding gains arising during the period, before deferred income tax expense	**13,051,438**	13,290,568	7,454,522
Deferred income tax expense	**4,568,003**	4,651,699	2,609,079
	8,483,435	8,638,869	4,845,443
Reclassification adjustment for (gains) losses included in net income, before income tax expense (benefit)	**(4,370,215)**	(1,168,918)	3,159,201
Income tax expense (benefit)	**1,529,575**	409,121	(1,105,720)
	(2,840,640)	(759,797)	2,053,481
Adjustment for minimum liability associated with Employers Mutual's pension plan	**-**	289,639	(289,639)
Deferred income tax expense (benefit)	**-**	101,373	(101,373)
	-	188,266	(188,266)
Other comprehensive income ...	**5,642,795**	8,067,338	6,710,658
Total comprehensive income ...	**$ 18,827,478**	$ 28,416,461	$ 22,812,396

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Year ended December 31,		
	2004	2003	2002
COMMON STOCK			
Beginning of year	**$ 11,501,065**	$ 11,399,050	$ 11,329,987
Issuance of common stock through follow-on stock offering	**2,000,000**	-	-
Issuance of common stock through Employers Mutual's stock option plans	**67,880**	102,015	69,063
End of year	**13,568,945**	11,501,065	11,399,050
ADDITIONAL PAID-IN CAPITAL			
Beginning of year	**69,113,228**	67,270,591	66,013,203
Issuance of common stock through follow-on stock offering	**32,890,085**	-	-
Issuance of common stock through Employers Mutual's stock option plans	**1,463,980**	1,842,637	1,257,388
End of year	**103,467,293**	69,113,228	67,270,591
ACCUMULATED OTHER COMPREHENSIVE INCOME			
Beginning of year	**22,285,668**	14,218,330	7,507,672
Unrealized gains on available-for-sale securities	**5,642,795**	7,879,072	6,898,924
Minimum liability associated with Employers Mutual's pension plan ..	**-**	188,266	(188,266)
End of year	**27,928,463**	22,285,668	14,218,330
RETAINED EARNINGS			
Beginning of year	**77,850,590**	64,880,393	55,606,761
Net income	**13,184,683**	20,349,123	16,101,738
Dividends paid to public stockholders ($.60 per share in 2004, 2003 and 2002)	**(1,941,181)**	(1,350,736)	(1,405,064)
Dividends paid to Employers Mutual ($.60 per share in 2004, 2003 and 2002)	**(5,292,178)**	(5,522,994)	(5,423,042)
Dividends paid to Employers Mutual (reimbursement for non-GAAP expenses)	**(293,583)**	(505,196)	-
End of year	**83,508,331**	77,850,590	64,880,393
Total stockholders' equity	**$228,473,032**	$180,750,551	$157,768,364

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31,		
	2004	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	**$13,184,683**	$20,349,123	$16,101,738
Adjustments to reconcile net income to net cash provided by operating activities:			
Balances resulting from related party transactions with Employers Mutual:			
Losses and settlement expenses	**55,894,386**	42,556,163	16,708,165
Unearned premiums	**6,756,758**	9,085,793	16,364,638
Other policyholders' funds	**1,435,215**	354,972	562,670
Indebtedness of related party	**3,883,730**	(1,129,421)	620,121
Employee retirement plans	**(2,885,657)**	636,114	774,079
Reinsurance receivables	**(4,595,569)**	(10,138,653)	2,919,200
Prepaid reinsurance premiums	**(385,448)**	(854,329)	(167,668)
Commission payable	**2,594,243**	2,470,516	2,732,425
Interest payable	**278,100**	(1,003,066)	1,641,205
Prepaid assets	**8,029**	(87,676)	27,894
Deferred policy acquisition costs	**(1,202,799)**	(1,810,923)	(3,563,333)
Accrued investment income	**(904,640)**	1,357,903	(520,547)
Accrued income taxes:			
Current	**(6,179,985)**	2,994,004	(112,890)
Deferred	**(2,197,191)**	(703,208)	729,205
Realized investment (gains) losses	**(4,379,314)**	(1,169,698)	3,159,201
Accounts receivable	**162,587**	393,521	308,080
Other, net	**(672,675)**	(206,551)	(1,717,779)
	47,609,770	42,745,461	40,464,666
Net cash provided by operating activities	**$60,794,453**	$63,094,584	$56,566,404

CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED

	Year ended December 31, 2004	2003	2002
CASH FLOWS FROM INVESTING ACTIVITIES			
Maturities of fixed maturity securities held-to-maturity	**$ 20,635,775**	$ 5,293,717	$ 11,074,685
Purchases of fixed maturity securities available-for-sale ..	**(830,263,629)**	(791,156,969)	(229,504,732)
Disposals of fixed maturity securities available-for-sale ..	**737,364,629**	753,004,136	180,717,143
Purchases of equity securities available-for-sale	**(52,518,206)**	(34,283,972)	(43,930,432)
Disposals of equity securities available-for-sale	**32,685,028**	31,151,627	33,884,190
Purchase of other long-term investments	**(3,078,000)**	(2,040,000)	(4,057,004)
Disposals of other long-term investments	**2,285,926**	338,981	1,000,004
Net sales (purchases) of short-term investments	**17,329,211**	(33,917,835)	(11,925,773)
Net cash used in investing activities	**(75,559,266)**	(71,610,315)	(62,741,919)
CASH FLOWS FROM FINANCING ACTIVITIES			
Balances resulting from related party transactions with Employers Mutual:			
Issuance of common stock through Employers Mutual's stock option plans	**1,531,860**	1,944,652	1,326,451
Dividends paid to Employers Mutual	**(5,292,178)**	(5,522,994)	(5,423,042)
Dividends paid to Employers Mutual (reimbursement for non-GAAP expense)	**(293,583)**	(505,196)	-
Issuance of surplus notes	**-**	-	11,000,000
Issuance of common stock through follow-on stock offering	**34,890,085**	-	-
Dividends paid to public stockholders	**(1,941,181)**	(1,350,736)	(1,405,064)
Net cash provided by (used in) financing activities	**28,895,003**	(5,434,274)	5,498,345
Net increase (decrease) in cash	**14,130,190**	(13,950,005)	(677,170)
Cash at beginning of year	**(14,069,102)**	(119,097)	558,073
Cash at end of year	**$ 61,088**	$(14,069,102)	$ (119,097)
Income taxes paid	**$ 10,957,163**	$ 5,400,010	$ 4,755,010
Interest paid	**$ 884,310**	$ 615,709	$ 19,232

See accompanying Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Basis of Presentation

EMC Insurance Group Inc., a 53.7 percent owned subsidiary of Employers Mutual Casualty Company (Employers Mutual), is an insurance holding company with operations in property and casualty insurance and reinsurance. Both commercial and personal lines of insurance are written, with a focus on medium-sized commercial accounts. Approximately 38 percent of the premiums written are in Iowa and contiguous states. The term "Company" is used interchangeably to describe EMC Insurance Group Inc. (Parent Company only) and EMC Insurance Group Inc. and its subsidiaries.

The Company's subsidiaries include EMCASCO Insurance Company, Illinois EMCASCO Insurance Company, Dakota Fire Insurance Company, Farm and City Insurance Company, EMC Reinsurance Company and EMC Underwriters, LLC.

The consolidated financial statements have been prepared on the basis of U.S. generally accepted accounting principles (GAAP), which differ in some respects from those followed in reports to insurance regulatory authorities. All significant inter-company balances and transactions have been eliminated.

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 the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Property and Casualty Insurance and Reinsurance Operations

Property and casualty insurance premiums are recognized as revenue ratably over the terms of the respective policies. Unearned premiums are calculated on the daily pro rata method. Both domestic and foreign assumed reinsurance premiums are recognized as revenues ratably over the terms of the contract period. Amounts paid as ceded reinsurance premiums are reported as prepaid reinsurance premiums and are amortized over the remaining contract period in proportion to the amount of reinsurance protection provided. Reinsurance reinstatement premiums are recognized in the same period as the loss event that gave rise to the reinstatement premiums.

Certain costs of acquiring new business, principally commissions, premium taxes and other underwriting expenses that vary with and are directly related to the production of business have been deferred. Such deferred costs are being amortized as premium revenue is recognized. The method followed in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value, which gives effect to the premium to be earned, related investment income, losses and settlement expenses and certain other costs expected to be incurred as the premium is earned.

Certain commercial lines of business, primarily workers' compensation, are eligible for policyholder dividends in accordance with provisions of the underlying insurance policies. Net premiums written subject to policyholder dividends represented approximately 49 percent of the Company's total net premiums written in 2004. Policyholder dividends are accrued over the terms of the underlying policies.

Liabilities for losses are based upon case-basis estimates of reported losses, estimates of unreported losses based upon prior experience adjusted for current trends, and estimates of losses expected to be paid under assumed reinsurance contracts. Liabilities for settlement expenses are provided by estimating expenses expected to be incurred in settling the claims provided for in the loss reserves. Changes in estimates are reflected in current operating results (see note 4).

Ceded reinsurance amounts with nonaffiliated reinsurers relating to reinsurance receivables for paid and unpaid losses and settlement expenses and prepaid reinsurance are reported on the balance sheet on a gross basis. Amounts ceded to Employers Mutual relating to the affiliated reinsurance pooling agreement (see note 2) have not been grossed up because the contracts provide that receivables and payables may be offset upon settlement.

Based on current information, the liabilities for losses and settlement expenses are considered to be adequate. Since the provisions are necessarily based on estimates, the ultimate liability may be more or less than such provisions.

Investments

Securities classified as held-to-maturity are purchased with the intent and ability to be held to maturity and are carried at amortized cost. Unrealized holding gains and losses on securities held-to-maturity are not reflected in the financial statements. All other securities have been classified as securities available-for-sale and are carried at fair value, with unrealized holding gains and losses reported as accumulated other comprehensive income in stockholders' equity, net of deferred income taxes. Other long-term investments represent minor ownership interests in limited partnerships and limited liability companies and are carried at cost. Short-term investments represent money market funds and are carried at cost, which approximates fair value.

The Company's carrying value for investments is reduced to its estimated realizable value if a decline in the fair value is deemed other-than-temporary. Such reductions in carrying value are recognized as realized losses and are charged to income. Premiums and discounts on debt securities are amortized over the life of the security as an adjustment to yield using the effective interest method. Realized gains and losses on disposition of investments are included in net income. The cost of investments sold is determined on the specific identification method using the highest cost basis first. Included in investments at December 31, 2004 and 2003 are securities on deposit with various regulatory authorities as required by law amounting to $13,000,797 and $12,960,435, respectively.

The Company participates in a securities lending program whereby certain fixed maturity securities from the investment portfolio are loaned to other institutions for a short period of time. The Company requires initial collateral equal to 102 percent of the market value of the loaned securities. The collateral is invested by the lending agent, in accordance with the Company's guidelines, and generates fee income for the Company that is recognized ratably over the time period the security is on loan. The securities on loan to others are segregated from the other invested assets on the Company's balance sheet. In accordance with relevant accounting literature, the collateral held by the Company is accounted for as a secured borrowing and is recorded as an asset on the Company's balance sheet with a corresponding liability reflecting the Company's obligation to return this collateral upon the return of the loaned securities.

Income Taxes

Effective April 1, 2003, the Company was included in Employers Mutual's consolidated tax return due to the fact that Employers Mutual attained 80 percent ownership of the Company at the end of March. The Company filed a short-period tax return with its subsidiaries for the period January 1, 2003 through March 31, 2003. During October 2004, Employers Mutual's ownership of the Company fell below 80 percent upon successful completion of the follow-on stock offering. Accordingly, the Company is no longer included in Employers Mutual's consolidated tax return effective October 1, 2004, and the Company will file a short-period tax return for the period October 1, 2004 through December 31, 2004. Consolidated income taxes/benefits are allocated among the entities based upon separate tax liabilities.

Deferred income taxes are provided for temporary differences between the tax basis of assets and liabilities and the reported amounts of those assets and liabilities for financial reporting purposes. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Income tax expense provisions increase or decrease in the same period in which a change in tax rates is enacted. A valuation allowance is established to reduce deferred tax assets to their net realizable value if it is "more likely than not" that a tax benefit will not be realized.

Stock Based Compensation

The Company has no stock based compensation plans of its own; however, Employers Mutual has several stock plans that utilize the common stock of the Company. The Company receives the current fair value for any shares issued under these plans. Under the terms of the pooling and quota share agreements (see note 2), stock option expense is allocated to the Company as determined on a statutory basis of accounting; however, for these GAAP basis financial statements the Company accounts for the stock option plans using the intrinsic value method of accounting as prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Under the provisions of APB 25, no compensation expense is recognized from the operation of Employers Mutual's stock option plans since the exercise price of the options is equal to the fair value of the stock on the date of grant.

The Company's insurance subsidiaries reimburse Employers Mutual for their share of the statutory-basis compensation expense associated with stock option exercises under the terms of the pooling and quota share agreements. Beginning in 2003, the statutory-basis compensation expense that was paid by the Company's subsidiaries to Employers Mutual ($293,583 in 2004 and $505,196 in 2003) was reclassified as a dividend payment to Employers Mutual in these GAAP-basis financial statements. Since the corresponding amount for 2002 was not material, the financial statements for 2002 were not restated.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) SFAS No. 123 (as amended by SFAS No. 148) "Accounting for Stock-Based Compensation" to Employers Mutual's stock option plans:

	2004	2003	2002
Net income, as reported	**$13,184,683**	$20,349,123	$16,101,738
Deduct:			
Stock-based employee compensation expense determined under the fair value method for all awards, net of related tax effects	**32,373**	25,383	18,992
Pro forma net income	**$13,152,310**	$20,323,740	$16,082,746
Net income per share:			
Basic and diluted -			
As reported	**$1.10**	$1.78	$1.42
Pro forma	**$1.10**	$1.77	$1.41

The weighted average fair value of options granted amounted to $4.44, $2.93 and $3.28 for 2004, 2003 and 2002, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes-Merton option-pricing model with the following weighted-average assumptions used for the grants:

	2004	2003	2002
Dividend yield	**2.69%**	3.56%	3.28%
Expected volatility	**.239**	.247	.218
Risk-free interest rate	**3.12%**	2.99%	4.37%
Expected term (years)	**5.75**	5.35	5.00

In December 2004, the FASB issued SFAS No. 123 (revised 2004) "Share-Based Payment," which is a revision of SFAS No. 123 and supersedes APB No. 25. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim and annual periods after June 15, 2005, with earlier adoption encouraged. The pro forma disclosures previously allowed under SFAS No. 123 will no longer be an alternative to financial statement recognition. The transition methods for adoption include the modified-prospective and modified-retroactive methods. The modified-prospective method requires that compensation expense be recorded for all unvested stock options that exist upon the adoption of Statement 123(R). Under the modified-retroactive method, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The Company is currently evaluating the requirements of Statement 123(R), but does not expect adoption of this statement to have a material effect on the financial position or the results of operations of the Company.

Net Income Per Share - Basic and Diluted

The Company's basic and diluted net income per share is computed by dividing net income by the weighted average number of common shares outstanding during each period. As previously noted, the Company receives the current fair value for any shares issued under Employers Mutual's stock plans. As a result, the Company had no potential common shares outstanding during 2004, 2003 and 2002 that would have been dilutive to net income per share.

Goodwill

Goodwill represents the excess of cost over the fair value of net assets of acquired subsidiaries. Goodwill is not amortized, but is subject to annual impairment testing to determine if the carrying value of the goodwill exceeds the estimated fair value of net assets. If the carrying amount of the subsidiary (including goodwill) exceeds the computed fair value, an impairment loss is recognized through earnings equal to the excess amount, but not greater then the balance of the goodwill. The annual impairment test is completed in the fourth quarter of each year and goodwill was not deemed to be impaired in 2004, 2003 or 2002.

Reclassifications

Certain amounts previously reported in prior years' consolidated financial statements have been reclassified to conform to current year presentation.

2. AFFILIATION AND TRANSACTIONS WITH AFFILIATES

Property and Casualty Insurance Subsidiaries

The Company's four property and casualty insurance subsidiaries and two subsidiaries and an affiliate of Employers Mutual are parties to reinsurance pooling agreements with Employers Mutual (collectively the "pooling agreement"). Under the terms of the pooling agreement, each company cedes to Employers Mutual all of its insurance business, with the exception of any voluntary reinsurance business assumed from nonaffiliated insurance companies, and assumes from Employers Mutual an amount equal to its participation in the pool. All premiums, losses, settlement expenses and other underwriting and administrative expenses, excluding the voluntary reinsurance business assumed by Employers Mutual from nonaffiliated insurance companies, are prorated among the parties on the basis of participation in the pool. The aggregate participation of the Company's property and casualty insurance subsidiaries is 23.5 percent. Employers Mutual negotiates reinsurance agreements that provide protection to the pool and each of its participants, including protection against losses arising from catastrophic events.

Operations of the pool give rise to inter-company balances with Employers Mutual, which are settled on a quarterly basis. The investment and income tax activities of the pool participants are not subject to the pooling agreement. Effective December 31, 2003, the pooling agreement was amended to provide that Employers Mutual will make up any shortfall or difference resulting from an error in its systems and/or computational processes that would otherwise result in the required restatement of the pool participants' financial statements.

The purpose of the pooling agreement is to spread the risk of an exposure insured by any of the pool participants among all the companies. The pooling agreement produces a more uniform and stable underwriting result from year to year for all companies in the pool than might be experienced individually. In addition, each company benefits from the capacity of the entire pool, rather than being limited to policy exposures of a size commensurate with its own assets, and from the wide range of policy forms, lines of insurance written, rate filings and commission plans offered by each of the companies.

On October 20, 2004, the Company successfully completed a follow-on stock offering and sold 2.0 million new shares of its common stock to the public at a price of $18.75 per share. Employers Mutual participated in the stock offering as a selling shareholder and sold 2.1 million shares of the Company's common stock that it previously owned. As a result of these transactions, Employers Mutual's ownership of the Company was reduced from approximately 80.9 percent to approximately 53.7 percent.

Net proceeds from the follow-on stock offering totaled $34,890,085. These proceeds were contributed to three of the Company's property and casualty insurance subsidiaries in late December to support a planned 6.5 percentage point increase in the Company's aggregate participation in the pooling agreement effective January 1, 2005. As a result of this change, the Company's aggregate participation in the pooling agreement will increase from the current 23.5 percent to 30.0 percent and Employers Mutual's participation will decrease from the current 65.5 percent to 59.0 percent. In connection with this change in the pooling agreement, the Company's liabilities will increase $115,042,355 and invested assets will increase $108,798,583. The Company will reimburse Employers Mutual $6,518,735 for expenses that were incurred to generate the additional business assumed by the Company, but this expense will be offset by an increase in deferred policy acquisition costs. The Company will also receive $274,963 in interest income from Employers Mutual as the actual cash transfer did not occur until February 15, 2005.

In addition to changing the individual pool participation percentages of Employers Mutual and three of the Company's property and casualty insurance subsidiaries, the pooling agreement has been amended effective January 1, 2005 to comply with certain conditions established by the Iowa Insurance Department and A.M. Best Company. These amendments: (1) provide for a fixed term of three years commencing January 1, 2005 and continuing until December 31, 2007, during which period the pooling agreement may not be terminated and the revised participation interests will not be further amended, absent the occurrence of a material event not in the ordinary course of business that could reasonably be expected to impact the appropriateness of the participation interests in the pool; (2) provide that if a pool participant becomes insolvent, or is otherwise subject to liquidation or receivership proceedings, each of the other participants will, on a pro rata basis, adjust their assumed portions of the pool liabilities in order to assume in full the liabilities of the impaired participant, subject to compliance with all regulatory requirements applicable to such adjustment under the laws of all states in which the participants are domiciled; (3) clarify that all development on prior years' outstanding losses and settlement expenses of the participants will remain in the pool and be pro rated pursuant to the pooling agreement; and (4) clarify that all liabilities incurred prior to a participant withdrawing from the pool, and associated with such withdrawing participant, shall remain a part of the pool and subject to the pooling agreement.

During 2004, the Company's wholly-owned subsidiary, Farm and City Insurance Company, discontinued writing new nonstandard risk automobile insurance business and began instituting non-renewal procedures on all existing business. The effective dates for these actions were determined by the requirements of the six states in which it conducts business and the terms of the individual policies. Farm and City will continue to participate in the pooling agreement even though it will no longer write any direct insurance business. Discontinuance of the nonstandard risk automobile insurance business did not have a material impact on the results of operations of the Company. In 2004, Farm and City's direct premiums written declined to $1,553,000 from $9,849,000 in 2003. Under the terms of the pooling agreement, only 23.5 percent of this decline ($1,950,000) was assumed by the Company.

Reinsurance Subsidiary

The Company's reinsurance subsidiary assumes a 100 percent quota share portion of Employers Mutual's assumed reinsurance business, exclusive of certain reinsurance contracts. This includes all premiums and related losses and settlement expenses of this business, subject to a maximum loss of $1,500,000 per event. The reinsurance subsidiary does not directly reinsure any of the insurance business written by Employers Mutual; however, the reinsurance subsidiary assumes reinsurance business from the Mutual Reinsurance Bureau pool and this pool provides a very small amount of reinsurance protection to the EMC Insurance Companies. As a result, the reinsurance subsidiary's assumed exposures include a very small portion of the EMC Insurance Companies direct business, after ceded reinsurance protections purchased by the Mutual Reinsurance Bureau pool are applied. In addition, reinsurance subsidiary does not reinsure any "involuntary" facility or pool business that Employers Mutual assumes pursuant to state law. Operations of the quota share agreement give rise to inter-company balances with Employers Mutual, which are settled on a quarterly basis. The investment and income tax activities of the reinsurance subsidiary are not subject to the quota share agreement.

Premiums assumed by the reinsurance subsidiary from Employers Mutual amounted to $97,637,066, $90,057,773 and $76,203,278 in 2004, 2003 and 2002, respectively. It is customary in the reinsurance business for the assuming company to compensate the ceding company for the acquisition expenses incurred in the generation of the business. Commissions paid by the reinsurance subsidiary to Employers Mutual amounted to $20,621,898, $18,936,008 and $18,117,058 in 2004, 2003 and 2002, respectively.

The reinsurance subsidiary pays an annual override commission to Employers Mutual in connection with the $1,500,000 cap on losses assumed per event. The override commission rate is charged at 4.50 percent of written premiums. Total override commission paid to Employers Mutual amounted to $4,393,668, $4,052,600 and $3,429,148 in 2004, 2003 and 2002, respectively. Employers Mutual retained losses and settlement expenses under this agreement totaling $11,277,246 in 2004, $2,747,334 in 2003 and $1,186,598 in 2002. The reinsurance subsidiary also pays for 100 percent of the outside reinsurance protection Employers Mutual purchases to protect itself from catastrophic losses on the assumed reinsurance business, excluding reinstatement premiums. This cost is recorded as a reduction to the premiums received by the reinsurance subsidiary and amounted to $3,626,833, $3,802,878 and $3,247,969 in 2004, 2003 and 2002, respectively.

Services Provided by Employers Mutual

Employers Mutual provides various services to all of its subsidiaries and affiliates. Such services include data processing, claims, financial, actuarial, auditing, marketing and underwriting. Employers Mutual allocates a portion of the cost of these services to the subsidiaries that do not participate in the pooling agreement based upon a number of criteria, including usage and number of transactions. The remaining costs are charged to the pooling agreement and each pool participant shares in the total cost in accordance with its pool participation percentage. Costs allocated to the Company by Employers Mutual for services provided to the holding company and its subsidiaries that do not participate in the pooling agreement amounted to $2,300,700, $2,097,057 and $1,765,287 in 2004, 2003 and 2002, respectively. Costs allocated to the Company through the operation of the pooling agreement amounted to $73,305,162, $63,293,517 and $56,897,066 in 2004, 2003 and 2002, respectively.

Investment expenses are based on actual expenses incurred by the Company plus an allocation of other investment expenses incurred by Employers Mutual, which is based on a weighted average of total invested assets and number of investment transactions. Investment expenses allocated to the Company by Employers Mutual amounted to $699,807, $699,954 and $559,136 in 2004, 2003 and 2002, respectively.

3. REINSURANCE

The parties to the pooling agreement cede insurance business to other insurers in the ordinary course of business for the purpose of limiting their maximum loss exposure through diversification of their risks. In its consolidated financial statements, the Company treats risks to the extent they are reinsured as though they were risks for which the Company is not liable. Insurance ceded by the pool participants does not relieve their primary liability as the originating insurers. Employers Mutual evaluates the financial condition of the reinsurers of the parties to the pooling agreement and monitors concentrations of credit risk arising from similar geographic regions, activities or economic characteristics of the reinsurers to minimize exposure to significant losses from reinsurer insolvencies.

As of December 31, 2004, reinsurance ceded to two nonaffiliated reinsurers aggregated $12,495,837, which represents a significant portion of the total prepaid reinsurance premiums and reinsurance receivables for losses and settlement expenses. These amounts reflect the property and casualty insurance subsidiaries' aggregate pool participation percentage of amounts ceded by Employers Mutual to these organizations in connection with its role as "service carrier". Under these arrangements, Employers Mutual writes business for these organizations on a direct basis and then cedes 100 percent of this business to these organizations. Credit risk associated with these amounts is minimal, as all companies participating in these organizations are responsible for the liabilities of such organizations on a pro rata basis.

In 2004 the Company changed the recording of large no-fault auto claims associated with the Michigan Catastrophic Claims Association (MCCA) and began recording the reserves, which are ceded 100 percent to this association, on a gross basis. The 2003 consolidated balance sheet was restated for comparative purposes. As a result, the 2003 balances for "Reinsurance receivables" and "Losses and settlement expenses" were increased $5,859,035.

The effect of reinsurance on premiums written and earned, and losses and settlement expenses incurred, for the three years ended December 31, 2004 is presented below. The 2003 losses and settlement expenses incurred amounts for direct, assumed from affiliates, ceded to non-affiliates and ceded to affiliates amounts incurred have been restated to reflect change in recording claims associated with the MCCA. There was no effect on net losses and settlement expenses incurred.

	Year ended December 31,		
	2004	2003	2002
Premiums written			
Direct	**$191,823,068**	$220,741,419	$235,596,547
Assumed from nonaffiliates	**4,125,092**	3,816,789	3,985,370
Assumed from affiliates	**366,224,505**	351,641,368	320,940,551
Ceded to nonaffiliates	**(18,445,768)**	(15,808,709)	(11,089,041)
Ceded to affiliates	**(191,823,068)**	(220,741,419)	(235,596,547)
Net premiums written	**$351,903,829**	$339,649,448	$313,836,880
Premiums earned			
Direct	**$197,051,604**	$221,662,098	$241,939,466
Assumed from nonaffiliates	**3,933,665**	3,629,346	3,501,616
Assumed from affiliates	**359,605,116**	341,947,846	304,462,790
Ceded to nonaffiliates	**(18,060,320)**	(14,954,382)	(10,921,373)
Ceded to affiliates	**(197,051,604)**	(221,662,098)	(241,939,466)
Net premiums earned	**$345,478,461**	$330,622,810	$297,043,033
Losses and settlement expenses incurred			
Direct	**$132,616,303**	$176,461,490	$165,218,514
Assumed from nonaffiliates	**2,897,364**	3,270,406	2,876,808
Assumed from affiliates	**258,134,261**	239,682,836	206,614,356
Ceded to nonaffiliates	**(11,225,415)**	(16,448,692)	(2,433,308)
Ceded to affiliates	**(132,616,303)**	(176,461,490)	(165,218,514)
Net losses and settlement expenses incurred	**$249,806,210**	$226,504,550	$207,057,856

4. LIABILITY FOR LOSSES AND SETTLEMENT EXPENSES

The following table sets forth a reconciliation of beginning and ending reserves for losses and settlement expenses of the Company. Amounts presented are on a net basis, with a reconciliation of beginning and ending reserves to the gross amounts presented in the consolidated financial statements.

	Year ended December 31,		
	2004	2003	2002
Gross reserves at beginning of year	**$373,782,916**	$331,226,753	$314,518,588
Ceded reserves at beginning of year	**(20,666,429)**	(10,367,624)	(11,848,597)
Net reserves at beginning of year ..	**353,116,487**	320,859,129	302,669,991
Incurred losses and settlement expenses			
Provision for insured events of the current year	**229,667,776**	219,028,236	200,059,798
Increase in provision for insured events of prior years ..	**20,138,434**	7,476,314	6,998,058
Total incurred losses and settlement expenses	**249,806,210**	226,504,550	207,057,856
Payments			
Losses and settlement expenses attributable to insured events of the current year	**83,530,727**	86,072,127	81,124,276
Losses and settlement expenses attributable to insured events of prior years	**115,072,988**	108,175,065	107,744,442
Total payments	**198,603,715**	194,247,192	188,868,718
Net reserves at end of year	**404,318,982**	353,116,487	320,859,129
Ceded reserves at end of year	**25,358,320**	20,666,429	10,367,624
Gross reserves at end of year	**$429,677,302**	$373,782,916	$331,226,753

Underwriting results of the Company are significantly influenced by estimates of loss and settlement expense reserves. Changes in reserve estimates are reflected in operating results in the year such changes are recorded. The property and casualty insurance segment experienced adverse development on prior years' reserves for all three years presented, while the reinsurance segment experienced favorable development in the two most recent years and adverse development in 2002.

2004 Development

For the property and casualty insurance segment, the December 31, 2004 estimate of loss and settlement expense reserves for accident years 2003 and prior increased $23,738,375 from the estimate at December 31, 2003. This increase represents 9.4 percent of the December 31, 2003 carried reserves and is attributed to a combination of newly reported claims in excess of carried IBNR reserves ($14,758,000), development on case reserves of previously reported claims ($11,037,000), bulk reserve strengthening ($2,350,000), and settlement expense reserve increases resulting from increases in case reserves ($6,209,000). This adverse development was partially offset by $10,437,000 of reinsurance recoveries associated with the case reserve development and IBNR emergence. Substantial case reserve strengthening performed at the Company's branch offices, primarily in the workers' compensation and other liability lines of business, is the underlying reason for the adverse reserve development that occurred during 2004. The economic factors behind this case reserve strengthening include, most notably, an increase in workers' compensation claim severity, increases in construction defect claim activity, the recent occurrence of several large umbrella claims and increasing legal expenses in the other liability line of business.

For the reinsurance segment, the December 31, 2004 estimate of loss and settlement expense reserves for accident years 2003 and prior decreased $3,599,941 from the estimate at December 31, 2003. This decrease represents 3.1 percent of the December 31, 2003 carried reserves and is primarily from reported policy year 2003 losses for property, casualty and multi-line classes that were below 2003 implicit projections.

2003 Development

For the property and casualty insurance segment, the December 31, 2003 estimate of loss and settlement expense reserves for accident years 2002 and prior increased $9,014,984 from the estimate at December 31, 2002. This increase represents 3.9 percent of the December 31, 2002 carried reserves and is attributed to a combination of bulk reserve strengthening, development on case reserves of previously reported claims and newly reported claims in excess of carried incurred but not reported (IBNR) reserves. Included in the reserve strengthening actions taken during 2003 was an increase of approximately $6,055,000 in formula IBNR reserves, an increase of approximately $3,245,000 in settlement expense reserves and a $3,525,000 bulk reserve established for the workers' compensation line of business. The remaining adverse development of approximately $4,521,000 came from case reserve development and IBNR claim emergence.

For the reinsurance segment, the December 31, 2003 estimate of loss and settlement expense reserves for accident years 2002 and prior decreased $1,538,670 from the estimate at December 31, 2002. This decrease represents 1.5 percent of the December 31, 2002 carried reserves. This decrease is primarily from the 2002 accident year on the Home Office Reinsurance Assumed Department (HORAD) book of business, which has experienced very low reported loss activity. The favorable development was partially offset by $326,000 of asbestos reserve strengthening.

2002 Development

For the property and casualty insurance segment, the December 31, 2002 estimate of loss and settlement expense reserves for accident years 2001 and prior increased $4,645,194 from the estimate at December 31, 2001. This increase represents 2.1% of the December 31, 2001 carried reserves and is primarily attributable to three sources: direct IBNR reserves, involuntary pools and contingent salary plan reserves. With regard to direct IBNR reserves, the methodology utilized to establish these reserves assumes consistency in claims reporting patterns. However, in recent years emerged IBNR losses have increased as a percentage of earned premiums. As a result of these actuarial indications, the Company strengthened direct IBNR reserves by $3,564,000 in 2002, $1,697,000 of which was allocated to accident years 2001 and prior. In addition, the Company established $2,068,705 of additional IBNR asbestos reserves at December 31, 2002 based on the results of a recently completed study of the Company's asbestos exposures, all of which was allocated to accident years 2001 and prior. As previously noted, the Company books the reserves reported by the management of the involuntary pools and in 2002 these bookings resulted in modest upward development of $353,000. Finally, Employers Mutual implemented a contingent salary plan in 2002 and $376,000 of the reserve established for this plan at December 31, 2002 was allocated to settlement expenses for accident years 2001 and prior.

For the reinsurance segment, the December 31, 2002 estimate of loss and settlement expense reserves for accident years 2001 and prior increased $2,352,864 from the estimate at December 31, 2001. This increase represents 2.6% of the December 31, 2001 carried reserves. Virtually all of the increase arose from the MRB pool, for which the Company books the reserves established and reported by the pool. The carried MRB reserves at December 31, 2001 were above the midpoint of the actuarial range of estimates. However, reported losses and settlement expenses during pool year 2002 exceeded by approximately $1,249,792 the amounts predicted by the actuarial analysis. In addition, management of the MRB pool increased the IBNR reserves for prior years by $345,800. Finally, the losses and settlement expenses reported during January 2002 exceeded by $762,000 the IBNR reserve established at December 31, 2001 to cover the one-month reporting lag.

5. ASBESTOS AND ENVIRONMENTAL RELATED CLAIMS

The Company has exposure to asbestos and environmental related claims associated with the insurance business written by the parties to the pooling agreement and the reinsurance business assumed from Employers Mutual by the reinsurance subsidiary. These exposures are not considered to be significant. Asbestos and environmental losses paid by the Company have averaged only $244,000 per year over the past five years. During 2002, the Company re-evaluated the estimated ultimate losses for direct asbestos and environmental exposures. Based on this re-evaluation, the Company reallocated $752,000 of bulk IBNR reserves and $324,303 of settlement expense reserves to these exposures. In addition, the Company diligently evaluated the adequacy of its asbestos reserves by commissioning a "ground-up" study to better quantify its exposure to asbestos liabilities. This study concluded that the Company's exposure for direct asbestos claims ranged from $1,000,000 to $5,100,000, with a point estimate of $3,000,000. Based on the results of this study, the Company elected to increase the IBNR and settlement expense reserves carried for direct asbestos exposures by $2,068,705 at December 31, 2002, to $2,985,402. The study's results for asbestos exposures on assumed reinsurance business were received during 2003, and the Company elected to increase its IBNR reserves carried for assumed asbestos exposures by $326,000 to the study's point estimate. The study and its results assume no improvement in the current asbestos litigation environment; however, continued efforts for federal legislation could reduce the ultimate loss projections for asbestos litigation below the levels currently projected for the industry. Reserves for asbestos and environmental related claims for direct insurance and assumed reinsurance business totaled $5,459,912 and $5,584,196 at December 31, 2004 and 2003, respectively.

At present, the Company is defending approximately 500 asbestos bodily injury lawsuits. Most of these defenses are subject to express reservation of rights based upon the lack of an injury within the Company's policy periods, because many asbestos lawsuits do not specifically allege dates of asbestos exposure or dates of injury. During 2003, as a direct result of proposed federal legislation in the areas of asbestos and class action reform, the Company was presented with several hundred additional lawsuits filed against three former policyholders representing approximately 40,500 claims related to exposure to asbestos or asbestos containing products. These claims are based upon nonspecific asbestos exposure and nonspecific injuries. As a result, management did not establish a significant amount of loss reserves associated with these claims. The Company has denied coverage to one of the former policyholders, representing approximately 10,000 claims, because of express asbestos exclusion language contained in the policy. Minimal expense payments have been made to date on the lawsuits related to the other two former policyholders and no payments have been made for either defense or indemnity. Defense costs, on the other hand, have typically increased due to the increased number of parties involved in the litigation and the length of time required to obtain a favorable judgment. Whenever possible, the Company has participated in cost sharing agreements with other insurance companies to reduce overall asbestos claim expenses.

Estimating loss and settlement expense reserves for asbestos and environmental claims is very difficult due to the many uncertainties surrounding these types of claims. These uncertainties exist because the assignment of responsibility varies widely by state and claims often emerge long after the policy has expired, which makes assignment of damages to the appropriate party and to the time period covered by a particular policy difficult. In establishing reserves for these types of claims, management monitors the relevant facts concerning each claim, the current status of the legal environment, social and political conditions, and claim history and trends within the Company and the industry.

6. STATUTORY INFORMATION AND DIVIDEND RESTRICTIONS

The Company's insurance subsidiaries are required to file financial statements with state regulatory authorities. The accounting principles used to prepare these statutory financial statements follow prescribed or permitted accounting practices that differ from GAAP. Prescribed statutory accounting principles include state laws, regulations and general administrative rules issued by the state of domicile as well as a variety of publications and manuals of the National Association of Insurance Commissioners (NAIC). Permitted accounting practices encompass all accounting practices not prescribed, but allowed by the state of domicile. The Company's insurance subsidiaries had no permitted accounting practices during 2004, 2003 and 2002.

Statutory surplus of the Company's insurance subsidiaries was $216,868,207 and $170,232,871 at December 31, 2004 and 2003, respectively. Statutory net income of the Company's insurance subsidiaries was $11,878,844, $16,700,374 and $13,729,028 for 2004, 2003 and 2002, respectively.

The NAIC utilizes a risk-based capital model to help state regulators assess the capital adequacy of insurance companies and identify insurers that are in, or are perceived as approaching, financial difficulty. This model establishes minimum capital needs based on the risks applicable to the operations of the individual insurer. The risk-based capital requirements for property and casualty insurance companies measure three major areas of risk: asset risk, credit risk and underwriting risk. Companies having less statutory surplus than required by the risk-based capital requirements are subject to varying degrees of regulatory scrutiny and intervention, depending on the severity of the inadequacy. At December 31, 2004, the Company's insurance subsidiaries had total adjusted statutory capital of $216,868,207, which is well in excess of the minimum risk-based capital requirement of $43,484,541.

Retained earnings of the Company's insurance subsidiaries available for distribution as dividends are limited by law to the statutory unassigned surplus of each of the subsidiaries as of the previous December 31, as determined in accordance with accounting practices prescribed by insurance regulatory authorities of the state of domicile of each subsidiary. Subject to this limitation, the maximum dividend that may be paid within a 12 month period without prior approval of the insurance regulatory authorities is restricted to the greater of 10 percent of statutory surplus as regards policyholders as of the preceding December 31, or net income of the preceding calendar year on a statutory basis. At December 31, 2004, $32,232,101 was available for distribution to the Company in 2005 without prior approval.

7. SEGMENT INFORMATION

The Company's operations consist of a property and casualty insurance segment and a reinsurance segment. The property and casualty insurance segment writes both commercial and personal lines of insurance, with a focus on medium sized commercial accounts. The reinsurance segment provides reinsurance for other insurers and reinsurers. The segments are managed separately due to differences in the insurance products sold and the business environment in which they operate. The accounting policies of the segments are described in note 1, Summary of Significant Accounting Policies.

Summarized financial information for the Company's segments is as follows:

Year ended December 31, 2004	Property and casualty insurance	Reinsurance	Parent company	Consolidated
Premiums earned	**$250,034,561**	**$ 95,443,900**	**$ -**	**$ 345,478,461**
Underwriting gain (loss)	**(32,261,993)**	**15,227,552**	**-**	**(17,034,441)**
Net investment income	**20,236,342**	**9,498,925**	**164,936**	**29,900,203**
Realized gains	**3,270,862**	**1,108,452**	**-**	**4,379,314**
Interest expense	**772,500**	**339,900**	**-**	**1,112,400**
Other income	**600,732**	**-**	**-**	**600,732**
Other expenses	**495,783**	**-**	**666,628**	**1,162,411**
Income (loss) before income tax expense (benefit)	**$ (9,422,340)**	**$ 25,495,029**	**$ (501,692)**	**$ 15,570,997**
Assets	**$691,745,896**	**$242,694,389**	**$228,686,424**	**$1,163,126,709**
Eliminations	-	-	**(223,101,504)**	**(223,101,504)**
Reclassifications	**(62,040)**	**(5,147,233)**	**-**	**(5,209,273)**
Net assets	**$691,683,856**	**$237,547,156**	**$ 5,584,920**	**$ 934,815,932**

Year ended December 31, 2003	Property and casualty insurance	Reinsurance	Parent company	Consolidated
Premiums earned	$241,237,313	$ 89,385,497	$ -	$ 330,622,810
Underwriting gain (loss)	(7,493,703)	6,716,356	-	(777,347)
Net investment income	20,724,017	8,948,076	30,368	29,702,461
Realized gains (losses)	1,312,252	(142,554)	-	1,169,698
Interest expense	(919,362)	(400,904)	-	(1,320,266)
Other income	862,070	-	-	862,070
Other expenses	(1,044,757)	-	(609,563)	(1,654,320)
Income (loss) before income tax expense (benefit)	$ 13,440,517	$ 15,120,974	$ (579,195)	$ 27,982,296
Assets	$639,366,058	$256,579,831	$180,961,286	$1,076,907,175
Eliminations	-	-	(176,087,397)	(176,087,397)
Reclassifications	(896,043)	-	(211,760)	(1,107,803)
Net assets	$638,470,015	$256,579,831	$ 4,662,129	$ 899,711,975

Year ended December 31, 2002	Property and casualty insurance	Reinsurance	Parent company	Consolidated
Premiums earned	$225,013,076	$ 72,029,957	$ -	$297,043,033
Underwriting loss	(3,621,656)	(2,026,309)	-	(5,647,965)
Net investment income ...	23,517,163	9,147,127	113,843	32,778,133
Realized gains (losses)	(2,154,246)	(1,010,268)	5,313	(3,159,201)
Interest expense	(1,345,153)	(293,563)	-	(1,638,716)
Other income	865,819	-	-	865,819
Other expenses	(869,346)	-	(436,688)	(1,306,034)
Income (loss) before income tax expense (benefit)	$ 16,392,581	$ 5,816,987	$ (317,532)	$ 21,892,036

8. INVESTMENTS

Investments of the Company's insurance subsidiaries are subject to the insurance laws of the state of their incorporation. These laws prescribe the kind, quality and concentration of investments that may be made by insurance companies. In general, these laws permit investments, within specified limits and subject to certain qualifications, in federal, state and municipal obligations, corporate bonds, preferred and common stocks and real estate mortgages. The Company believes that it is in compliance with these laws.

The amortized cost and estimated fair value of securities held-to-maturity and available-for-sale as of December 31, 2004 and 2003 are as follows. The estimated fair value is based on quoted market prices, where available, or on values obtained from independent pricing services.

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
December 31, 2004				
Securities held-to-maturity:				
Fixed maturity securities:				
U.S. treasury securities and obligations of U.S. government corporations and agencies	**$ 28,037,203**	**$ 1,279,346**	**$ -**	**$ 29,316,549**
Mortgage-backed securities	**1,168,668**	**108,389**	**-**	**1,277,057**
Total securities held-to-maturity	**$ 29,205,871**	**$ 1,387,735**	**$ -**	**$ 30,593,606**
Securities available-for-sale:				
Fixed maturity securities:				
U.S. treasury securities and obligations of U.S. government corporations and agencies	**$137,273,717**	**$ 413,027**	**$ (148,047)**	**$137,538,697**
Obligations of states and political subdivisions	**257,483,428**	**10,329,065**	**(136,682)**	**267,675,811**
Mortgage-backed securities	**11,136,193**	**714,925**	**-**	**11,851,118**
Public utilities	**8,686,436**	**1,181,467**	**-**	**9,867,903**
Debt securities issued by foreign governments	**7,177,870**	**321,329**	**-**	**7,499,199**
Corporate securities ...	**174,033,352**	**11,225,843**	**(37,520)**	**185,221,675**
Total fixed maturity securities	**595,790,996**	**24,185,656**	**(322,249)**	**619,654,403**
Equity securities:				
Common stocks	**59,089,434**	**19,195,320**	**(120,861)**	**78,163,893**
Non-redeemable preferred stocks	**500,000**	**29,000**	**-**	**529,000**
Total equity securities	**59,589,434**	**19,224,320**	**(120,861)**	**78,692,893**
Total securities available-for-sale	**$655,380,430**	**$43,409,976**	**$ (443,110)**	**$698,347,296**

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
December 31, 2003				
Securities held-to-maturity:				
Fixed maturity securities:				
U.S. treasury securities and obligations of U.S. government corporations and agencies	$ 47,547,267	$ 3,780,331	$ -	$ 51,327,598
Mortgage-backed securities	2,298,081	228,745	-	2,526,826
Total securities held-to-maturity	$ 49,845,348	$ 4,009,076	$ -	$ 53,854,424
Securities available-for-sale:				
Fixed maturity securities:				
U.S. treasury securities and obligations of U.S. government corporations and agencies	$170,445,955	$ 703,239	$ -	$171,149,194
Obligations of states and political subdivisions	140,694,351	6,381,069	(300,188)	146,775,232
Mortgage-backed securities	19,311,455	1,967,145	-	21,278,600
Public utilities	20,171,434	1,714,421	(86,518)	21,799,337
Corporate securities ...	148,887,343	14,194,708	(298,656)	162,783,395
Total fixed maturity securities	499,510,538	24,960,582	(685,362)	523,785,758
Equity securities:				
Common stocks	38,498,075	10,188,751	(206,828)	48,479,998
Non-redeemable preferred stocks	500,000	28,500	-	528,500
Total equity securities	38,998,075	10,217,251	(206,828)	49,008,498
Total securities available-for-sale	$538,508,613	$35,177,833	$ (892,190)	$572,794,256

In 2003, the Emerging Issues Task Force (EITF) of the FASB reached a consensus on certain disclosures required by EITF Issue 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," which was effective for fiscal years ending after December 15, 2003. The Company adopted this EITF in 2003, which only required additional disclosures and did not have any effect on the results of operations of the Company. In March of 2004, the EITF reached a consensus on the guidance provided to determine whether an investment is within the scope of Issue 03-1. Under EITF Issue 03-1 an investment is impaired if the fair value of the investment is less than its cost including adjustments for amortization, accretion, foreign exchange and hedging. An impairment would be considered other-than-temporary unless a) the investor has the ability and intent to hold an investment for a reasonable period of time sufficient for the recovery of the fair value up to (or beyond) the cost of the investment, and b) evidence indicating that the cost of the investment is recoverable within a reasonable period of time outweighs evidence to the contrary. This new guidance for determining whether the decline in the fair value of the investment is other-than-temporary was to be effective for reporting periods beginning after June 15, 2004. On September 30, 2004, the FASB issued EITF Issue 03-1-1 "Effective Date of Paragraphs 10-20 of EITF Issue 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," which delayed the effective date for the measurement and recognition guidance included in EITF Issue 03-1 until additional implementation guidance is provided. Pending adoption of the final rule, the Company continues to apply existing accounting guidance for determining when a decline in fair value is other-than-temporary.

The following table sets forth the estimated fair value and unrealized losses of securities in an unrealized loss position as of December 31, 2004, listed by length of time the securities have been in an unrealized loss position.

	Less than twelve months		Twelve months or or longer		Total	
Description of securities	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. Treasury securities and obligations of U.S. government corporations and agencies	**$35,342,656**	**$148,047**	**$ -**	**$ -**	**$35,342,656**	**$148,047**
Obligations of states and political subdivisions	**11,962,755**	**35,038**	**7,241,675**	**101,644**	**19,204,430**	**136,682**
Corporate Securities	**1,587,243**	**13,245**	**821,546**	**24,275**	**2,408,789**	**37,520**
Subtotal, debt securities	**48,892,654**	**196,330**	**8,063,221**	**125,919**	**56,955,875**	**322,249**
Common stocks	**7,394,774**	**120,861**	**-**	**-**	**7,394,774**	**120,861**
Total temporarily impaired securities	**$56,287,428**	**$317,191**	**$8,063,221**	**$125,919**	**$64,350,649**	**$443,110**

The Company uses several factors to determine whether the carrying value of an individual security has been other-than-temporarily impaired. Such factors include, but are not limited to, the security's value and performance in the context of the overall markets, length of time and extent the security's fair value has been below carrying value, key corporate events and collateralization of fixed maturity securities. Based on these factors, and the Company's ability and intent to hold the fixed maturity securities until maturity, it was determined that the carrying value of these securities was not other-than-temporarily impaired at December 31, 2004.

The amortized cost and estimated fair value of fixed maturity securities at December 31, 2004, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized cost	Estimated fair value
Securities held-to-maturity:		
Due in one year or less	**$ 8,999,646**	**$ 9,059,063**
Due after one year through five years	**18,041,555**	**19,180,894**
Due after five years through ten years	**996,003**	**1,076,592**
Due after ten years	**-**	**-**
Mortgage-backed securities	**1,168,667**	**1,277,057**
Totals	**$ 29,205,871**	**$ 30,593,606**
Securities available-for-sale:		
Due in one year or less	**$ 90,137,120**	**$ 90,176,150**
Due after one year through five years	**52,831,899**	**56,265,211**
Due after five years through ten years	**118,069,601**	**125,200,014**
Due after ten years	**323,616,183**	**336,161,910**
Mortgage-backed securities	**11,136,193**	**11,851,118**
Totals	**$595,790,996**	**$619,654,403**

The mortgage-backed securities shown in the above table include $3,405,529 of securities issued by government corporations and agencies. Investment yields may vary from those anticipated due to changes in prepayment patterns of the underlying collateral.

A summary of realized investment gains and losses is as follows:

	Year ended December 31, 2004	2003	2002
Fixed maturity securities held-to-maturity: (1)			
Gross realized investment gains ..	**$ 9,099**	$ 781	$ -
Gross realized investment losses	**-**	-	-
Fixed maturity securities available-for-sale: (2)			
Gross realized investment gains ..	**5,188,496**	8,624,525	960,705
Gross realized investment losses	**(1,576,462)**	(4,877,307)	(3,831,374)
Equity securities available-for-sale: (3)			
Gross realized investment gains ..	**2,784,039**	2,885,412	4,654,622
Gross realized investment losses	**(2,025,858)**	(5,463,713)	(4,943,154)
Totals	**$ 4,379,314**	$ 1,169,698	$(3,159,201)

(1) Investment gains realized on fixed maturity securities held-to-maturity are the result of calls and prepayments.

(2) Investment losses realized on fixed maturity securities available-for-sale for the year ended December 31, 2004 and 2002 include other-than-temporary impairment write-downs totaling $1,323,475 and $3,821,466, respectively.

(3) Investment losses realized on equity securities for the year ended December 31, 2003 include other-than-temporary impairment write-downs totaling $1,566,985. All of the impaired equity securities were sold during 2003, generating gross realized gains of $619,069 and gross realized losses of $47,558.

A summary of net investment income is as follows:

	Year ended December 31, 2004	2003	2002
Interest on fixed maturities	**$28,305,693**	$29,027,370	$31,909,946
Dividends on equity securities	**827,112**	587,723	605,079
Interest on short-term investments	**985,105**	440,902	690,046
Interest on long-term investments	**518,793**	371,340	103,763
Fees from securities lending	**104,953**	92,671	120,489
Total investment income	**30,741,656**	30,520,006	33,429,323
Investment expenses	**(841,453)**	(817,545)	(651,190)
Net investment income	**$29,900,203**	$29,702,461	$32,778,133

A summary of net changes in unrealized holding gains (losses) on securities available-for-sale is as follows:

	Year ended December 31,		
	2004	2003	2002
Fixed maturity securities	**$ (411,813)**	$ (1,735,818)	$ 19,097,214
Applicable deferred income tax expense (benefit)	**(144,134)**	(607,536)	6,684,025
Total fixed maturity securities	**(267,679)**	(1,128,282)	12,413,189
Equity securities	**9,093,037**	13,857,468	(8,483,491)
Applicable deferred income tax expense (benefit)	**3,182,563**	4,850,114	(2,969,226)
Total equity securities	**5,910,474**	9,007,354	(5,514,265)
Total available-for-sale securities	**$ 5,642,795**	$ 7,879,072	$ 6,898,924

9. INCOME TAXES

Temporary differences between the consolidated financial statement carrying amount and tax basis of assets and liabilities that give rise to significant portions of the deferred income tax asset at December 31, 2004 and 2003 are as follows:

	Year ended December 31,	
	2004	2003
Loss reserve discounting	**$18,864,562**	$17,036,591
Unearned premium reserve limitation	**9,037,165**	8,592,924
Postretirement benefits	**3,007,951**	2,671,261
Other policyholders' funds payable	**989,033**	486,708
Net operating loss carry forward	**2,427,675**	-
Minimum tax credits	**954,953**	954,954
Other-than-temporary impairment losses on investments	**-**	1,337,513
Other, net	**1,135,774**	1,311,318
Total deferred income tax asset	**36,417,113**	32,391,269
Deferred policy acquisition costs	**(9,779,204)**	(9,358,224)
Net unrealized holding gains	**(15,038,403)**	(11,999,975)
Other, net	**(2,095,313)**	(687,641)
Total deferred income tax liability	**(26,912,920)**	(22,045,840)
Net deferred income tax asset	**$ 9,504,193**	$10,345,429

At December 31, 2004, the Company has $6,936,214 of net operating loss carry forwards which will expire, if unused, in 2024.

Based upon anticipated future taxable income and consideration of all other available evidence, management believes that it is "more likely than not" that the Company's net deferred income tax asset will be realized.

The actual income tax expense for the years ended December 31, 2004, 2003 and 2002 differed from the "expected" tax expense for those years (computed by applying the United States federal corporate tax rate of 35 percent to income before income tax expense) as follows:

	Year ended December 31,		
	2004	2003	2002
Computed "expected" tax expense	**$ 5,449,848**	$ 9,793,804	$ 7,662,213
Increases (decreases) in tax resulting from:			
Tax-exempt interest income	**(3,430,616)**	(2,079,465)	(1,441,502)
Pro-ration of tax-exempt interest and dividends received deduction	**544,317**	334,243	163,770
Other, net	**(177,235)**	(415,409)	(594,183)
Income tax expense	**$ 2,386,314**	$ 7,633,173	$ 5,790,298

Comprehensive income tax expense included in the consolidated financial statements for the years ended December 31, 2004, 2003 and 2002 is as follows:

	Year ended December 31,		
	2004	2003	2002
Income tax expense on:			
Operations	**$ 2,386,314**	$ 7,633,173	$ 5,790,298
Unrealized holding gains on revaluation of securities available-for-sale	**3,038,428**	4,242,578	3,714,799
Minimum pension liability	**-**	101,373	(101,373)
Comprehensive income tax expense	**$ 5,424,742**	$11,977,124	$ 9,403,724

10. SURPLUS NOTES

On December 28, 2001, three of the Company's property and casualty insurance subsidiaries issued surplus notes totaling $25,000,000 to Employers Mutual at an annual interest rate of 5.38 percent. On June 27, 2002, the Company's reinsurance subsidiary issued an $11,000,000 surplus note to Employers Mutual at an annual interest rate of 5.25 percent. These surplus notes do not have a maturity date. Effective April 1, 2003, the surplus notes were reissued at an annual interest rate of 3.09 percent. Payment of interest and repayment of principal can only be repaid out of the subsidiary's statutory surplus earnings and is subject to approval by the issuing company's state of domicile. The surplus notes are subordinate and junior in right of payment to all obligations or liabilities of the subsidiaries. Interest expense on surplus notes amounted to $1,112,400 for 2004, $1,320,266 for 2003 and $1,638,716 for 2002.

11. EMPLOYEE RETIREMENT PLANS

Employers Mutual has various employee benefit plans, including a defined benefit retirement plan (pension) and two postretirement benefit plans. Although the Company has no employees of its own, under the terms of the pooling agreement and the allocation of costs to the subsidiaries that do not participate in the pooling agreement (see note 2) the Company is responsible for its share of Employers Mutual's benefit plan expenses and related benefit plan prepaid assets and liabilities. Accordingly, the Company's consolidated balance sheets reflect the Company's share of the total plans' assets and liabilities.

Employers Mutual's pension plan covers substantially all of its employees. The plan is funded by employer contributions and provides benefits under two different formulas, depending on an employee's age and date of service. Benefits generally vest after five years of service. It is Employers Mutual's policy to fund pension costs according to regulations provided under the Internal Revenue Code.

Employers Mutual also offers postretirement benefit plans, which provide certain health care and life insurance benefits for retired employees. Substantially all of its employees may become eligible for those benefits if they reach normal retirement age and have attained the required length of service while working for Employers Mutual or its subsidiaries. The health care postretirement plan requires contributions from participants and contains certain cost sharing provisions such as coinsurance and deductibles. The life insurance plan is noncontributory. The benefits provided under both plans are subject to change.

Employers Mutual maintains two Voluntary Employee Beneficiary Association (VEBA) trusts, which accumulate funds for the payment of postretirement health care and life insurance benefits. Contributions to the VEBA trusts are used to fund the accumulated postretirement benefit obligation, as well as pay current year benefits.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") was signed into law. The Act expanded Medicare to include, for the first time, coverage for prescription drugs. In January 2004, the Financial Accounting Standards Board (FASB) issued Staff Position FAS No. 106-1 "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003", which permitted a sponsor of a postretirement health care plan that provides prescription drug benefits to make a one-time election to defer accounting for the effects of the Act. In May 2004, the FASB issued Staff Position FAS No. 106-2 which superseded FAS 106-1 and was effective for interim and annual periods beginning after June 15, 2004. FAS No. 106-2 provides accounting guidance and disclosure requirements for the prescription drug subsidy established under the Act.

The Company concluded that the accounting guidance provided by FAS 106-2 was applicable since the prescription drug benefit provided under Employers Mutual's postretirement benefit plan is actuarially equivalent to Medicare Part D. The expected subsidy reduced Employers Mutual's share of the cost of the underlying postretirement prescription drug coverage. The Company elected the retroactive method of transition to the date of the enactment of the Act.

The effect of the subsidy on the measurement of Employers Mutual's postretirement benefit plan resulted in a decrease in the accumulated projected benefit obligation of $9,899,120 and the net periodic postretirement benefit cost for 2004 was reduced by $1,536,635. The components of the reduction in the net periodic postretirement benefit cost for 2004 are as follows:

Postretirement benefit plans:	
Service cost	$ 580,952
Interest cost	494,956
Expected return on plan assets	-
Amortization of net loss	460,727
Total reduction in net periodic postretirement benefit cost	$1,536,635

Adoption of FAS 106-2 resulted in a $344,235 reduction in the Company's share of the net periodic postretirement benefit cost for the year ended December 31, 2004.

The following table sets forth the funded status of the Employers Mutual pension plan and postretirement benefit plans as of December 31, 2004 and 2003, based upon a measurement date of November 1, 2004 and 2003, respectively:

	Pension plan		Postretirement benefit plans	
	2004	2003	**2004**	2003
Change in projected benefit obligation:				
Benefit obligation at beginning of year ...	**$120,616,776**	$111,790,069	**$ 72,787,471**	$ 66,309,000
Service cost	**6,818,518**	6,161,019	**3,995,559**	4,401,000
Interest cost	**7,020,887**	6,992,656	**3,819,081**	4,263,000
Actuarial (gain) loss	**4,929,150**	5,316,003	**(10,254,086)**	(5,157,878)
Benefits paid	**(5,223,965)**	(9,642,971)	**(1,402,273)**	(1,481,498)
Acquisition	**-**	-	**-**	4,453,847
Projected benefit obligation at end of year	**134,161,366**	120,616,776	**68,945,752**	72,787,471
Change in plan assets:				
Fair value of plan assets at beginning of year	**93,676,748**	82,198,366	**15,974,241**	12,737,000
Actual return on plan assets	**9,897,006**	11,252,353	**1,047,459**	418,739
Employer contributions	**21,600,000**	9,869,000	**3,835,000**	4,300,000
Benefits paid	**(5,223,965)**	(9,642,971)	**(1,402,273)**	(1,481,498)
Fair value of plan assets at end of year	**119,949,789**	93,676,748	**19,454,427**	15,974,241
Funded status	**(14,211,577)**	(26,940,028)	**(49,491,325)**	(56,813,230)
Unrecognized net actuarial loss	**22,513,895**	21,576,909	**5,056,132**	15,587,383
Unrecognized prior service costs	**3,343,641**	4,109,466	**-**	-
Employer contributions	**-**	-	**610,000**	500,000
Net amount recognized	**$ 11,645,959**	$ (1,253,653)	**$(43,825,193)**	$(40,725,847)
Amounts recognized in EMC Insurance Companies balance sheets consist of:				
Accrued benefit liability	**$ -**	$ (4,831,428)	**$(43,825,193)**	$(40,725,847)
Prepaid pension asset	**11,645,959**	-	-	-
Intangible asset ..	**-**	3,577,775	**-**	-
Net amount recognized ..	**$ 11,645,959**	$ (1,253,653)	**$(43,825,193)**	$(40,725,847)

The accumulated benefit obligation for the pension plan amounted to $109,635,159 and $98,508,176 for the years ended December 31, 2004 and 2003, respectively.

During 2003, Employers Modern Life Company (EML), an affiliate of Employers Mutual, acquired National Travelers Life Company (NTL) and the company's name was changed to EMC National Life Company (EMCNL). EML participated in Employers Mutual's pension plan and postretirement benefit plans. As a result of the acquisition, EML pension plan participants were "spun-off" into a separate EMCNL pension plan. A payment of $2,567,367 was made from Employers Mutual's plan assets to the EMCNL pension plan, which is reflected as a benefit payment. The corresponding reduction in the benefit obligation is reflected as an actuarial gain of the plan. The employees and retirees of NTL were also granted benefits under the Employers Mutual postretirement benefit plans. As a result, an additional liability of $4,453,847 was recognized by the plans. EMCNL is responsible for the entire additional liability.

The components of net periodic benefit cost for the Employers Mutual pension plan and postretirement benefit plans is as follows:

	Year ended December 31,		
	2004	2003	2002
Pension plan:			
Service cost	**$ 6,818,518**	$ 6,161,019	$ 5,299,831
Interest cost	**7,020,887**	6,992,656	6,576,584
Expected return on plan assets	**(6,760,528)**	(6,516,913)	(6,744,907)
Recognized net actuarial loss	**855,686**	967,226	-
Amortization of prior service costs	**765,825**	789,648	784,219
Net periodic pension benefit cost	**$ 8,700,388**	$ 8,393,636	$ 5,915,727
Postretirement benefit plans:			
Service cost	**$ 3,995,555**	$ 4,401,000	$ 2,964,000
Interest cost	**3,819,081**	4,263,000	3,223,000
Expected return on assets	**(900,883)**	(737,000)	(518,000)
Amortization of net loss	**130,593**	1,011,000	150,000
Amortization of prior service costs	**-**	-	535,000
Net periodic postretirement benefit cost	**$ 7,044,346**	$ 8,938,000	$ 6,354,000

The weighted average assumptions used to measure the benefit obligations are as follows:

	Year ended December 31,	
	2004	2003
Pension plan:		
Discount rate	**6.00%**	6.00%
Rate of compensation increase	**4.81%**	4.82%
Postretirement benefit plans:		
Discount rate	**6.00%**	6.00%

The weighted average assumptions used to measure the net periodic benefit cost are as follows:

	Year ended December 31,		
	2004	2003	2002
Pension plan:			
Discount rate	**6.00%**	6.50%	7.00%
Expected long-term rate of return on plan assets	**7.50%**	8.00%	8.50%
Rate of compensation increase	**4.82%**	5.93%	5.96%
Postretirement benefit plans:			
Discount rate	**6.00%**	6.50%	7.00%
Expected long-term rate of return on plan assets	**5.00%**	5.00%	6.00%

The expected long-term rates of return on plan assets were developed considering actual historical results, current and expected market conditions, plan asset mix and management's investment strategy.

The assumed weighted average annual rate of increase in the per capita cost of covered health care benefits (i.e. the health care cost trend rate) for 2004 is 10 percent, and is assumed to decrease gradually to 5 percent in 2009 and remain at that level thereafter. The health care cost trend rates have a significant effect on the amounts reported for the health care plan. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	One-Percentage-Point	
	Increase	Decrease
Effect on total of service and interest cost ..	$ 1,628,900	($ 1,265,062)
Effect on postretirement benefit obligation ...	$11,146,706	($ 8,871,308)

The Company's financial statements reflect a pension asset of $2,684,463 in 2004 and a pension liability of $1,453,421 (including $1,016,492 of additional minimum liability) in 2003. The Company's financial statements also reflect an intangible asset associated with the pension plan of $0 in 2004 and $1,016,492 in 2003. Pension expense allocated to the Company amounted to $2,114,890, $2,023,292 and $1,406,306 in 2004, 2003 and 2002, respectively.

Postretirement benefit liabilities reflected in the Company's financial statements totaled $9,485,896 in 2004 and $8,512,179 in 2003. Net periodic postretirement benefit cost allocated to the Company for the years ended December 31, 2004, 2003 and 2002 was $1,583,172, $2,106,010 and $1,486,724, respectively.

The weighted average asset allocations of the Employers Mutual pension plan as of the measurement dates of November 1, 2004 and 2003 are as follows:

	Plan Assets at November 1,	
Asset Category	**2004**	2003
Equity securities	**56.0%**	51.0%
Debt securities	**32.0**	41.0
Real estate	**12.0**	8.0
Total	**100.0%**	100.0%

Employers Mutual has hired Principal Financial Advisors, Inc. to manage the asset allocation strategy for its pension plan (herein referred to as Fund Selection Service). The asset allocation strategy and process of the Fund Selection Service consists of a long-term, risk-controlled approach using diversified investment options with a minimal exposure to volatile investment options like derivatives. The long-term strategy of the Fund Selection Service is foremost preserving plan assets from downside market risk while secondarily out-performing its peers over a full market cycle. The investment process of Fund Selection Service uses a diversified allocation of equity, debt, and real estate exposures that are customized to each plan's cash flow needs.

The Fund Selection Service reviews a plan's assets and liabilities with an emphasis on forecasting a plan's cash flow needs. This forecast calculates the allocation percentage of fixed income assets needed to cover the liabilities of each plan. The model is quantitatively based and evaluates the plan's current assets plus five years of deposit projections and compares it to the current monthly benefit payments and the emerging benefit liabilities for the next ten years. The data for the deposits and emerging liabilities is provided from the plan's actuarial valuation while the current assets and monthly benefit payments data is provided from Principal Life Insurance Company's retirement plan account system.

The weighted average asset allocations of the Employers Mutual postretirement benefit plan as of the measurement dates of November 1, 2004 and 2003 are as follows:

	Plan Assets at November 1,	
Asset Category	**2004**	2003
Life insurance policies	**52.8%**	64.3%
Short-term investments	**13.8**	29.4
Real estate	**1.0**	-
Equity securities	**22.1**	-
Debt securities	**10.3**	6.3
Total	**100.0%**	100.0%

Plan assets for Employers Mutual's postretirement benefit plans are primarily invested in universal life insurance policies issued by EMCNL, an affiliate of Employers Mutual. The assets supporting these universal life insurance policies are invested in S&P 500 mutual funds and debt securities and have a guaranteed interest rate of 4.50 percent.

Employers Mutual plans to contribute approximately $2,500,000 to the pension plan and $3,800,000 to the postretirement benefit plans in 2005.

The Company participates in several other retirement plans sponsored by Employers Mutual, including a 401(k) Plan, an Executive Non-Qualified Excess Plan and a Supplemental Retirement Plan. The Supplemental Retirement Plan was effective October 1, 2004 and replaced the Excess Retirement Benefit Agreement and the Supplemental Executive Retirement Plan. The Company's share of expenses for these plans amounted to $1,139,411, $912,103 and $703,555 in 2004, 2003 and 2002, respectively.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid over the next ten years:

		Postretirement Benefits		
	Pension Benefits	Gross	Medicare Subsidy	Net
2005	$ 8,713,000	$ 2,056,651	$ -	$ 2,056,651
2006	8,284,000	2,334,266	254,146	2,080,120
2007	8,976,000	2,605,362	292,745	2,312,617
2008	10,220,000	2,888,512	340,904	2,547,608
2009	12,718,000	3,303,794	385,068	2,918,726
2010 - 2014 ..	105,127,000	23,222,122	3,011,185	20,210,937

12. STOCK PLANS

Stock Based Compensation

The Company has no stock based compensation plans of its own; however, Employers Mutual has several stock plans which utilize the common stock of the Company. Employers Mutual can provide the common stock required under its plans by: 1) using shares of common stock that it currently owns; 2) purchasing common stock on the open market; or 3) directly purchasing common stock from the Company at the current fair value. Employers Mutual has historically purchased common stock from the Company for use in its incentive stock option plans and its non-employee director stock purchase plan. Employers Mutual generally purchases common stock on the open market to fulfill its obligations under its employee stock purchase plan.

Incentive Stock Option Plans

Employers Mutual maintains two separate stock option plans for the benefit of officers and key employees of Employers Mutual and its subsidiaries. A total of 500,000 shares have been reserved for the 2003 Employers Mutual Casualty Company Incentive Stock Option Plan (2003 Plan) and a total of 1,000,000 shares have been reserved for issuance under the 1993 Employers Mutual Casualty Company Incentive Stock Option Plan (1993 Plan).

There is a ten year time limit for granting options under the plans. Options can no longer be granted under the 1993 Plan. Options granted under the plans have a vesting period of two, three, four or five years with options becoming exercisable in equal annual cumulative increments. Option prices cannot be less than the fair value of the stock on the date of grant.

The Senior Executive Compensation and Stock Option Committee (the "Committee") of Employers Mutual's Board of Directors (the "Board") is the administrator of the plans. Options granted are initially determined by the Committee and subsequently approved by the Board. In 2004, the Company's Board of Directors established its own Compensation Committee (the "Company Compensation Committee") and, commencing in 2005, the Company Compensation Committee will consider and approve all stock options granted to the Company's executive officers.

During 2004, 70,025 options were granted under the 2003 Plan to eligible participants at a price of $22.28 and 108,648 options were exercised under the plans at prices ranging from $19.71 to $24.95. A summary of the activity under Employers Mutual's incentive stock option plans for 2004, 2003 and 2002 is as follows:

	2004		2003		2002	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price`
Outstanding, beginning of year	**630,615**	**$12.86**	678,757	$11.65	723,378	$10.84
Granted	**70,025**	**22.28**	113,225	16.88	65,900	18.30
Exercised	**(108,648)**	**11.21**	(157,392)	10.50	(98,864)	10.26
Expired	**(8,454)**	**10.03**	(3,975)	13.96	(11,657)	10.88
Outstanding, end of year	**583,538**	**14.34**	630,615	12.86	678,757	11.65
Exercisable, end of year	**332,918**	**$12.33**	349,960	$11.85	404,807	$11.35

	December 31, 2004				
	Options Outstanding			Options Exercisable	
Range of option exercise prices	Number outstanding	Weighted-average exercise price	Weighted-average remaining contractual life	Number exercisable	Weighted-average exercise price
$ 9.25 - $12.69	253,359	$10.35	4.46	200,124	$10.59
13.25 - 16.88	198,414	15.41	5.61	109,034	14.21
18.30 - 22.28	131,765	20.42	8.16	23,760	18.30
	583,538	14.34	5.68	332,918	12.33

Employee Stock Purchase Plan

A total of 500,000 shares of the Company's common stock have been reserved for issuance under the Employers Mutual Casualty Company 1993 Employee Stock Purchase Plan. Any employee who is employed by Employers Mutual or its subsidiaries on the first day of the month immediately preceding any option period is eligible to participate in the plan. Participants pay 85 percent of the fair market value of the stock purchased, which is fully vested on the date purchased. The plan is administered by the Board of Employers Mutual and the Board has the right to amend or terminate the plan at any time; however, no such amendment or termination shall adversely affect the rights and privileges of participants with unexercised options. Expenses allocated to the Company in connection with this plan totaled $9,752, $13,214 and $6,817 in 2004, 2003 and 2002, respectively.

During 2004, a total of 13,531 options were exercised at prices of $20.06 and $18.46. Activity under the plan was as follows:

	Year ended December 31,		
	2004	2003	2002
Shares available for purchase, beginning of year	**288,322**	300,206	311,922
Shares purchased under plan	**(13,531)**	(11,884)	(11,716)
Shares available for purchase, end of year	**274,791**	288,322	300,206

Non-Employee Director Stock Purchase Plan

A total of 200,000 shares of the Company's common stock have been reserved for issuance under the 2003 Employers Mutual Casualty Company Non-Employee Director Stock Purchase Plan. All non-employee directors of Employers Mutual and its subsidiaries and affiliates who are not serving on the "Disinterested Director Committee" of the Board as of the beginning of the option period are eligible to participate in the plan. Each eligible director can purchase shares of common stock at 75 percent of the fair value of the stock in an amount equal to a minimum of 25 percent to a maximum of 100 percent of their annual cash retainer. The plan will continue through the option period for options granted at the 2012 annual meetings. The plan is administered by the Disinterested Director Committee of the Board. The Board may amend or terminate the plan at any time; however, no such amendment or termination shall adversely affect the rights and privileges of participants with unexercised options. The Employers Mutual Casualty Company Non-Employee Director Stock Purchase Plan previously in place expired on May 20, 2003 and the remaining 139,328 shares were deregistered. Expenses allocated to the Company in connection with these plans totaled $4,080, $1,878 and $0 in 2004, 2003 and 2002, respectively.

During 2004, a total of 1,359 options were exercised at prices ranging from $14.97 to $15.81. Activity under the plan was as follows:

	Year ended December 31,		
	2004	2003	2002
Shares available for purchase, beginning of year	**198,156**	141,197	143,158
Shares purchased under expired plan	**-**	(1,869)	-
Shares deregistered under expired plan ...	-	(139,328)	-
Shares registered for use in 2003 plan ...	-	200,000	-
Shares purchased under plans	**(1,359)**	(1,844)	(1,961)
Shares available for purchase, end of year	**196,797**	198,156	141,197

Dividend Reinvestment Plan

The Company maintains a dividend reinvestment and common stock purchase plan which provides stockholders with the option of reinvesting cash dividends in additional shares of the Company's common stock. Participants may also purchase additional shares of common stock without incurring broker commissions by making optional cash contributions to the plan and may sell shares of common stock through the plan. Since the third quarter of 1998, all shares of common stock issued under the plan have been purchased in the open market through the Company's transfer agent. Employers Mutual participated in the Dividend Reinvestment Plan in 2002, 2003 and the first two quarters of 2004, reinvesting 50 percent of its dividends in additional shares of the Company's common stock in all but the second and third quarters of 2003, when it reinvested 75 percent and 25 percent, respectively, and in 2002, when it reinvested 25 percent. Due to its participation in the Company's recent stock offering, Employers Mutual discontinued its participation in the plan for the third and fourth quarters of 2004 and has indicated that it will likely not participate in the plan in 2005. Activity under the plan was as follows:

	Year ended December 31,		
	2004	2003	2002
Shares available for purchase, beginning of year	**271,838**	416,899	501,230
Shares purchased under plan	**(63,018)**	(145,061)	(84,331)
Shares available for purchase, end of year	**208,820**	271,838	416,899
Range of purchase prices	**$18.75 to $24.97**	$16.98 to $21.32	$15.38 to $21.99

13. DISCLOSURES ABOUT THE FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value for fixed maturities, equity securities and short-term investments is based on quoted market prices, where available, or on values obtained from independent pricing services (see note 8).

The carrying value of the surplus notes approximates their estimated fair value since their interest rates approximate current interest rates and the companies' credit ratings have not changed.

Other long-term investments, consisting primarily of holdings in limited partnerships and limited liability companies, are valued by the various fund managers. In management's opinion, these values reflect fair value at December 31, 2004.

The estimated fair value of the Company's financial instruments is summarized below.

	Carrying amount	Estimated fair value
December 31, 2004		
Assets:		
Fixed maturity securities:		
Held-to-maturity	**$ 29,205,871**	**$ 30,593,606**
Available-for-sale	**619,654,403**	**619,654,403**
Equity securities available-for-sale	**78,692,893**	**78,692,893**
Short-term investments	**46,238,853**	**46,238,853**
Other long-term investments	**5,550,093**	**5,550,093**
Liabilities:		
Surplus notes	**36,000,000**	**36,000,000**
December 31, 2003		
Assets:		
Fixed maturity securities:		
Held-to-maturity	$ 49,845,348	$ 53,854,424
Available-for-sale	523,785,758	523,785,758
Equity securities available-for-sale	49,008,498	49,008,498
Short-term investments	63,568,064	63,568,064
Other long-term investments	4,758,019	4,758,019
Liabilities:		
Surplus notes	36,000,000	36,000,000

14. LEASES, COMMITMENTS AND CONTINGENT LIABILITIES

One of the Company's property and casualty insurance subsidiaries leases office facilities in Bismarck, North Dakota with lease terms expiring in 2014. Hamilton Mutual Insurance Company, an affiliate of Employers Mutual and a pool participant, leases office facilities for the Cincinnati branch office with lease terms expiring in 2005. Employers Mutual has entered into various leases for branch and service office facilities with lease terms expiring through 2013. Employers Mutual also leases computer software under various operating lease agreements expiring through 2005. All lease costs are included as expenses under the pooling agreement after allocation of the portion of these expenses to the subsidiaries that do not participate in the pool. The following table reflects the lease commitments of the Company as of December 31, 2004. The table reflects the Company's current 23.5 percent aggregate participation in the pooling agreement. As discussed further in note 2, the Company's aggregate participation in the pooling agreement will increase to 30.0 percent effective January 1, 2005.

	Payments due by period				
	Total	Less than 1 year	1-3 years	4-5 years	More than 5 years
Lease Commitments					
Real estate operating leases	$6,863,044	$1,086,053	$1,976,714	$1,559,701	$2,240,576
Software operating leases	375,363	375,363	-	-	-
Total	$7,238,407	$1,461,416	$1,976,714	$1,559,701	$2,240,576

Estimated guaranty fund assessments of $1,206,984 and $1,252,564, which are used by states to pay claims of insolvent insurers domiciled in that state, have been accrued as of December 31, 2004 and 2003, respectively. The guaranty fund assessments are expected to be paid over the next two years with premium tax offsets of $1,543,735 expected to be realized within ten years of the payments. Estimated second injury fund assessments of $1,389,590 and $1,108,605, which are designed to encourage employers to employ a worker with a pre-existing disability, have been accrued as of December 31, 2004 and 2003, respectively. The second injury fund assessment accruals are based on projected loss payments. The periods over which the assessments will be paid is not known.

The participants in the pooling agreement have purchased annuities from life insurance companies, under which the claimant is payee, to fund future payments that are fixed pursuant to specific claim settlement provisions. The Company's share of loss reserves eliminated by the purchase of these annuities was $699,913 at December 31, 2004. The Company has a contingent liability of $699,913 should the issuers of these annuities fail to perform under the terms of the annuities. The Company's share of the amount due from any one life insurance company does not equal or exceed one percent of its subsidiaries' policyholders' surplus.

The Company and Employers Mutual and its other subsidiaries are parties to numerous lawsuits arising in the normal course of the insurance business. The Company believes that the resolution of these lawsuits will not have a material adverse effect on its financial condition or its results of operations. The companies involved have reserves which are believed adequate to cover any potential liabilities arising out of all such pending or threatened proceedings.

15. UNAUDITED INTERIM FINANCIAL INFORMATION

	Three months ended,			
	March 31	June 30	September 30	December 31
2004				
Total revenues	**$91,209,265**	**$94,296,170**	**$96,455,388**	**$98,397,887**
Income (loss) before income tax expense (benefit)	**$12,363,360**	**$ 3,775,979**	**$ 1,641,750**	**$(2,210,092)**
Income tax expense (benefit)	**4,014,265**	**310,043**	**(216,710)**	**(1,721,284)**
Net income (loss)	**$ 8,349,095**	**$ 3,465,936**	**$ 1,858,460**	**$ (488,808)**
Net income (loss) per share - basic and diluted*	**$ .72**	**$ .30**	**$ .16**	**$ (.04)**
2003				
Total revenues	$86,646,867	$90,215,736	$92,594,260	$92,900,176
Income before income tax expense (benefit)	$ 9,543,476	$ 1,419,592	$ 8,922,814	$ 8,096,414
Income tax expense (benefit)	3,097,798	(10,600)	2,540,710	2,005,265
Net income	$ 6,445,678	$ 1,430,192	$ 6,382,104	$ 6,091,149
Net income per share - basic and diluted*	$ .57	$ .12	$ .56	$ .53

	Three months ended,			
	March 31	June 30	September 30	December 31
2002				
Total revenues	$77,157,134	$78,582,787	$81,763,105	$90,024,758
Income before income tax expense	$ 5,470,323	$ 3,518,303	$ 5,971,780	$ 6,931,630
Income tax expense	1,780,446	573,617	1,670,595	1,765,640
Net income	$ 3,689,877	$ 2,944,686	$ 4,301,185	$ 5,165,990
Net income per share – basic and diluted*	$ .33	$ .26	$ .38	$ .45

* Since the weighted average shares for the quarters are calculated independent of the weighted average shares for the year, quarterly net income (loss) per share may not total to annual net income (loss) per share.

GLOSSARY

Assumed Reinsurance – When one or more insurers, in exchange for a share of the premium, accepts responsibility to indemnify risk underwritten by another as reinsurance. See "Reinsurance."

Catastrophe and Storm Losses – Losses from the occurrence of an earthquake, hurricane, explosion, flood, hail storm or other similar event which results in substantial loss.

Ceded Reinsurance – The transfer of all or part of the risk of insurance loss from an insurer to another as reinsurance. See "Reinsurance."

Combined Ratio – A measure of property/casualty underwriting results. It is the ratio of claims, settlement and underwriting expenses to insurance premiums. When the combined ratio is under 100%, underwriting results are generally profitable; when the ratio is over 100%, underwriting results are generally unprofitable. Underwriting results do not include net investment income, which may make a significant contribution to overall profitability.

Deferred Policy Acquisition Costs – The capitalization of commissions, premium taxes and other expenses related to the production of insurance business. These costs are deferred and amortized in proportion to related premium revenue.

Excess of Loss Reinsurance – Coverage for the portion of losses which exceed predetermined retention limits.

Generally Accepted Accounting Principles (GAAP) – The set of practices and procedures that provides the framework for financial statement measurement and presentation. Financial statements in this report were prepared in accordance with U.S. GAAP.

Incurred But Not Reported (IBNR) – An estimate of liability for losses that have occurred but not yet been reported to the insurer. For reinsurance business IBNR may also include anticipated increases in reserves for claims that have previously been reported.

Incurred Losses and Settlement Expenses – Claims and settlement expenses paid or unpaid for which the Company has become liable for during a given reporting period.

Loss Reserve Development – A measure of how the latest estimate of an insurance company's claim obligations compares to an earlier projection. This is also referred to as the increase or decrease in the provision for insured events of prior years.

Net Investment Income – Dividends and interest earned during a specified period from cash and invested assets, reduced by related investment expenses.

Net Investment Yield – Net investment income divided by average invested assets.

Other-Than-Temporary Investment Impairment Loss – A realized investment loss that is recognized when an investment's fair value declines below its carrying value and the decline is deemed to be other-than-temporary.

Pooling Agreement – A joint underwriting operation in which the participants assume a predetermined and fixed interest in the premiums, losses, expenses and profits of insurance business.

Premiums – Amounts paid by policyholders to purchase insurance coverages.

Earned Premium – The recognition of the portion of written premiums directly related to the expired portion of an insurance policy for a given reporting period.

Net Written Premiums – Premiums written during a given reporting period, net of assumed and ceded reinsurance, which correlate directly to the insurance coverage provided.

Unearned Premium – The portion of written premium which would be returned to a policyholder upon cancellation.

Written Premium – The cost of insurance coverage. Written premiums refer to premiums for all policies sold during a specified accounting period.

Quota Share Reinsurance Agreement – A form of reinsurance in which the reinsurer assumes a stated percentage of all premiums, losses and related expenses in a given class of business.

Realized Investment Gains/Losses – The amount of net gains/losses realized when an investment is sold at a price higher or lower than its original cost or carrying amount. Also the amount of loss recognized when an investment's carrying value is reduced to fair value due to an impairment in the fair value of that investment.

Reinsurance – The contractual arrangement by which one or more insurers, called reinsurers, in exchange for premium payments, agree to assume all or part of a risk originally undertaken by another insurer. Reinsurance "spreads risk" among insurance enterprises, allowing individual companies to reduce exposure to losses and provide additional capacity to write insurance.

Reserves – The provision for the estimated future cost of all unpaid claims. The total includes known claims as well as amounts for claims that have occurred but have not been reported to the insurer (IBNR).

Return on Equity (ROE) – Net income divided by average stockholders' equity.

Risk-Based Capital – A model developed by the National Association of Insurance Commissioners which attempts to measure the minimum statutory capital needs of property and casualty insurance companies based upon the risks in a company's mix of products and investment portfolio.

Settlement Expenses – Expenses incurred in the process of investigating and settling claims.

Statutory Accounting – Accounting practices used by insurance companies to prepare financial statements submitted to state regulatory authorities. Statutory accounting differs from GAAP in that it stresses insurance company solvency rather than the matching of revenues and expenses.

Underwriting Gain/Loss – Represents insurance premium income less insurance claims, settlement and underwriting expenses.

Unrealized Holding Gains/Losses on Investments – Represents the difference between the current market value of investments and the basis at the end of a reporting period.

Our mission *is to create shareholder value through customer satisfaction and employee commitment to excellence, and is designed to directly coincide with our parent organization's mission – to grow profitably through partnership with independent insurance agents and to enhance the ability of our partners to deliver quality financial protection to the people and businesses we mutually serve.*

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