

Employers Holdings, Inc.
Form 10-Q
August 08, 2008

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q

☐ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2008

OR

○ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: 001-33245

EMPLOYERS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

04-3850065
(I.R.S. Employer
Identification Number)

10375 Professional Circle, Reno, Nevada 89521
(Address of principal executive offices and zip code)

(888) 682-6671
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, non-accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Class

August 5, 2008

Common Stock, \$0.01 par value per share

49,006,640 shares outstanding

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****EMPLOYERS HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

	As of June 30, 2008	As of December 31, 2007
	(unaudited)	
Assets		
Available for sale:		
Fixed maturity investments at fair value (amortized cost \$1,547,613 at June 30, 2008 and \$1,594,159 at December 31, 2007)	\$ 1,550,700	\$ 1,618,903
Equity securities at fair value (cost \$57,787 at June 30, 2008 and \$60,551 at December 31, 2007)	91,398	107,377
Short-term investments at fair value (amortized cost \$65,309 at June 30, 2008)	65,238	
Total investments	1,707,336	1,726,280
Cash and cash equivalents	152,657	149,703
Accrued investment income	19,765	19,345
Premiums receivable, less bad debt allowance of \$6,458 at June 30, 2008 and \$6,037 at December 31, 2007	24,840	36,402
Reinsurance recoverable for:		
Paid losses	10,607	10,218
Unpaid losses, less allowance of \$1,308 at each period	1,030,632	1,051,333
Funds held by or deposited with reinsureds	92,309	95,884
Deferred policy acquisition costs	14,562	14,901
Deferred income taxes, net	66,604	59,730
Property and equipment, net	13,586	14,133
Other assets	15,119	13,299
Total assets	\$ 3,148,017	\$ 3,191,228
Liabilities and stockholders equity		
Claims and policy liabilities:		
Unpaid losses and loss adjustment expenses	\$ 2,231,247	\$ 2,269,710
Unearned premiums	59,899	63,924
Policyholders dividends accrued	158	386

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Total claims and policy liabilities	2,291,304	2,334,020
Commissions and premium taxes payable	5,633	7,493
Federal income taxes payable	10,387	13,884
Accounts payable and accrued expenses	15,850	20,682
Deferred reinsurance gain LPT Agreement	415,643	425,002
Other liabilities	11,047	10,694
 Total liabilities	 2,749,864	 2,811,775
 Commitments and contingencies		
 Stockholders' equity:		
Common stock, \$0.01 par value; 150,000,000 shares authorized; 53,528,007 and 53,527,907 shares issued and 49,241,435 and 49,616,635 shares outstanding at June 30, 2008, and at December 31, 2007, respectively	535	535
Preferred stock, \$0.01 par value; 25,000,000 shares authorized; none issued		
Additional paid-in capital	304,352	302,862
Retained earnings	151,454	104,536
Accumulated other comprehensive income, net	23,808	46,520
Treasury stock, at cost (4,286,572 shares at June 30, 2008 and 3,911,272 shares at December 31, 2007)	(81,996)	(75,000)
 Total stockholders' equity	 398,153	 379,453
 Total liabilities and stockholders' equity	 \$ 3,148,017	 \$ 3,191,228

See accompanying unaudited notes to consolidated financial statements.

Table of Contents**EMPLOYERS HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share data)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(unaudited)			
Revenues				
Net premiums earned	\$ 73,815	\$ 84,117	\$ 149,711	\$ 173,909
Net investment income	18,538	19,305	37,441	40,140
Realized losses on investments, net	(219)	(658)	(1,707)	(468)
Other income	422	1,046	860	2,186
Total revenues	92,556	103,810	186,305	215,767
Expenses				
Losses and loss adjustment expenses	24,142	28,802	54,756	70,469
Commission expense	9,721	11,665	20,344	23,386
Underwriting and other operating expense	22,981	22,752	44,707	46,052
Total expenses	56,844	63,219	119,807	139,907
Net income before income taxes	35,712	40,591	66,498	75,860
Income taxes	8,346	9,818	13,638	17,221
Net income	\$ 27,366	\$ 30,773	\$ 52,860	\$ 58,639
Net income after date of conversion (Note 2)				\$ 52,168

Earnings per common share for the periods (Note 10):

	For the three		For the period	
	months ended		February 5,	
	June 30,		2007	
	2008		through	
	2008	2007	For the six	June 30, 2007
			months	
			ended	
			June 30,	
			2008	
Basic	\$ 0.55	\$ 0.58	\$ 1.07	\$ 0.97
Diluted	\$ 0.55	\$ 0.58	\$ 1.07	\$ 0.97

					Pro forma for the six months ended June 30, 2007
Basic					\$ 1.11
Diluted					\$ 1.11
Cash dividends declared per common share	\$ 0.06	\$ 0.06	\$ 0.12		\$ 0.06

See accompanying unaudited notes to consolidated financial statements.

Table of Contents**EMPLOYERS HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

(in thousands, except share data)

	Common stock		Additional paid-in capital	Retained earnings (unaudited)	Accumulated other comprehensive income, net	Treasury stock, at cost	Total stockholders equity
	Shares	Amount					
Balance, January 1, 2007		\$	\$	\$ 274,602	\$ 29,175	\$	\$ 303,777
Conversion transaction (Note 2)	22,765,407	227	(182,143)	(281,073)			(462,989)
Initial public offering transaction (Note 2)	30,762,500	308	483,285				483,593
Stock-based compensation, net			206				206
Acquisition of treasury stock (Note 8)						(2,887)	(2,887)
Dividend to common stockholders				(3,212)			(3,212)
Comprehensive income:							
Net income before conversion				6,471			6,471
Net income after conversion				52,168			52,168
Net income for the period				58,639			58,639
Change in net unrealized gains on investments, net of taxes					(15,539)		(15,539)
Total comprehensive income							43,100
Balance, June 30, 2007	53,527,907	\$ 535	\$ 301,348	\$ 48,956	\$ 13,636	\$ (2,887)	\$ 361,588
Balance, January 1, 2008	53,527,907	\$ 535	\$ 302,862	\$ 104,536	\$ 46,520	\$ (75,000)	\$ 379,453
Stock-based compensation, net			1,487				1,487
Stock options exercised	100		2			(6,996)	2 (6,996)

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Acquisition of treasury stock (Note 8)								
Dividend to common stockholders	1			(5,942)				(5,941)
Comprehensive income:								
Net income for the period				52,860				52,860
Change in net unrealized gains on investments, net of taxes						(22,712)		(22,712)
Total comprehensive income								30,148
Balance, June 30, 2008	53,528,007	\$ 535	\$ 304,352	\$ 151,454	\$ 23,808	\$ (81,996)	\$	398,153

See accompanying unaudited notes to the consolidated financial statements.

Table of Contents**EMPLOYERS HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

	Six months ended	
	June 30,	
	2008	2007
	(unaudited)	
Operating activities		
Net income	\$ 52,860	\$ 58,639
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,317	2,892
Stock-based compensation	1,487	206
Amortization of premium on investments, net	3,226	3,301
Allowance for doubtful accounts premiums receivable	421	855
Deferred income tax expense	5,357	4,372
Realized losses on investments, net	1,707	468
Change in operating assets and liabilities:		
Accrued investment income	(420)	(702)
Premiums receivable	11,141	2,919
Reinsurance recoverable on paid and unpaid losses	20,312	16,457
Funds held by or deposited with reinsureds	3,575	3,665
Unpaid losses and loss adjustment expenses	(38,463)	(13,503)
Unearned premiums	(4,025)	219
Federal income taxes payable	(3,497)	(9,652)
Accounts payable, accrued expenses and other liabilities	(2,651)	(9,703)
Deferred reinsurance gain LPT Agreement	(9,359)	(9,137)
Other	(2,106)	1,778
Net cash provided by operating activities	42,882	53,074
Investing activities		
Purchase of fixed maturities	(152,424)	(135,033)
Purchase of equity securities	(1,063)	(833)
Proceeds from sale of fixed maturities	111,917	114,572
Proceeds from sale of equity securities	2,135	1,906
Proceeds from maturities and redemptions of investments	16,210	20,049
Capitalized acquisition costs	(959)	
Capital expenditures and other, net	(2,739)	(2,915)
Net cash used in investing activities	(26,923)	(2,254)
Financing activities		
Issuance of common stock, net		486,783

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Cash paid to eligible policyholders under plan of conversion		(462,989)
Proceeds from exercise of stock options	2	
Acquisition of treasury stock	(6,691)	(2,112)
Dividend paid to stockholders	(5,941)	(3,212)
Debt issuance costs	(375)	
Net cash (used in) provided by financing activities	(13,005)	18,470
Net increase in cash and cash equivalents	2,954	69,290
Cash and cash equivalents at the beginning of the period	149,703	79,984
Cash and cash equivalents at the end of the period	\$ 152,657	\$ 149,274
Schedule of noncash transactions		
Stock issued in exchange for membership interest	\$	\$ 281,073

See accompanying unaudited notes to consolidated financial statements.

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EMPLOYERS HOLDINGS, INC. AND SUBSIDIARIES

**Notes to Consolidated Financial Statements
(Unaudited)**

1. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

Employers Holdings, Inc. (EHI) is a holding company and successor to EIG Mutual Holding Company (EIG), which was incorporated in Nevada in 2005. EHI conducts substantially all its business through its two wholly-owned insurance subsidiaries, Employers Insurance Company of Nevada (EICN) and Employers Compensation Insurance Company (ECIC), which are domiciled in Nevada and California, respectively. Unless otherwise indicated, all references to the Company refer to EHI, together with its subsidiaries.

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal, recurring adjustments) necessary for a fair presentation of the Company's financial position and results of operations for the periods presented have been included. The results of operations for an interim period are not necessarily indicative of the results for an entire year. These financial statements have been prepared consistent with the accounting policies described in the Company's 2007 Annual Report on Form 10-K (Annual Report) for the year ended December 31, 2007, and should be read together with the Annual Report.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 131, *Disclosures About Segments of an Enterprise and Related Information*, the Company considers an operating segment to be any component of its business whose operating results are regularly reviewed by the Company's chief operating decision makers to make decisions about resources to be allocated to the segment and assess its performance based on discrete financial information. Currently, the Company has one operating segment: workers' compensation insurance and related services.

Estimates and Assumptions

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. As a result, actual results could differ from these estimates. The most significant areas that require management judgment are the estimate of unpaid losses and loss adjustment expenses (LAE), evaluation of reinsurance recoverables, recognition of premium revenue, deferred policy acquisition costs, deferred income taxes and the valuation of investments.

New Accounting Standards

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS No. 141(R)). SFAS No. 141(R) significantly changes the accounting for business combinations and requires the acquiring entity in the transaction to recognize the acquired assets and assumed liabilities at the acquisition-date fair value with limited exceptions. SFAS No. 141(R) is effective as of the beginning of an entity's first fiscal year that begins after December 15, 2008, which, for the Company, would include business combinations that are completed after January 1, 2009. Early adoption is prohibited. The adoption of

SFAS No. 141(R) will have an impact on the consolidated financial statements for any business combinations completed after January 1, 2009.

Table of Contents**2. Conversion and Initial Public Offering**

Effective February 5, 2007, under the terms of a plan of conversion, EIG converted from a mutual insurance holding company to a stock company (the Conversion). All membership interests in EIG were extinguished on that date and eligible members of EIG received, in aggregate, 22,765,407 shares of EHI's common stock and \$463.0 million of cash.

In addition, effective February 5, 2007, EHI completed its Initial Public Offering (IPO) in which it issued 30,762,500 shares of its common stock at a price of \$17.00 per share. The cash proceeds of the IPO, after underwriting discounts and commission of \$34.0 million and offering and conversion costs of \$16.3 million, were \$472.7 million, of which \$9.7 million was retained by EHI and was used for working capital, payment of dividends on common stock, repurchase of shares of common stock and other general corporate purposes.

Upon completion of EHI's IPO, the capitalized issuance costs related to the IPO of \$5.4 million were netted against the IPO proceeds in additional paid-in capital in the accompanying consolidated balance sheets. The costs related to the Conversion were \$10.9 million. Conversion expenses consisted primarily of printing and mailing costs and the aggregate cost of engaging independent accounting, actuarial, financial, investment banking, legal and other consultants. These costs had no tax benefit and were expensed as incurred.

3. Fair Value of Financial Instruments

On January 1, 2008, the Company adopted SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), which provides a common definition of fair value and establishes a framework to make the measurement of fair value more consistent and comparable. The Company's adoption of SFAS No. 157 did not have a material impact on its consolidated financial statements or results of operations.

Additionally on January 1, 2008, the Company adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities* (SFAS No. 159). SFAS No. 159 permits an entity to choose to measure many financial instruments and certain items at fair value. The Company's adoption of SFAS No. 159 did not have a material impact on its consolidated financial statements or results of operations.

The following table presents the items on the accompanying consolidated balance sheet that are stated at fair value and the fair value measurements used as of June 30, 2008:

	Fixed Maturities	Available for Sale Securities Equity Securities (in thousands)	Short-Term Investments
Level 1: Quoted prices in active markets for identical assets	\$	\$ 91,398	\$
Level 2: Significant other observable inputs	1,543,326		65,238
Level 3: Unobservable inputs	7,374		
Balance, June 30, 2008	\$ 1,550,700	\$ 91,398	\$ 65,238

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The following table provides a reconciliation of the beginning and ending balances, for the above items, that are measured using Level 3: Unobservable inputs, for the six months ended June 30, 2008:

	Fixed Maturities (in thousands)
Balance, January 1, 2008	\$ 7,384
Unrealized losses in other comprehensive income	(10)
Balance, June 30, 2008	\$ 7,374

Table of Contents**4. Liability for Unpaid Losses and Loss Adjustment Expenses**

The following table represents a reconciliation of changes in the liability for unpaid losses and LAE for the six months ended:

	June 30,	
	2008	2007
	(in thousands)	
Unpaid losses and LAE, gross of reinsurance, at beginning of period	\$ 2,269,710	\$ 2,307,755
Less reinsurance recoverables, excluding bad debt allowance, on unpaid losses and LAE	1,052,641	1,098,103
Net unpaid losses and LAE at beginning of period	1,217,069	1,209,652
Losses and LAE, net of reinsurance, incurred in:		
Current period	92,437	115,624
Prior periods	(28,322)	(36,018)
Total net losses and LAE incurred during the period	64,115	79,606
Deduct payments for losses and LAE, net of reinsurance, related to:		
Current period	12,629	12,365
Prior periods	69,248	64,599
Total net payments for losses and LAE during the period	81,877	76,964
Ending unpaid losses and LAE, net of reinsurance	1,199,307	1,212,294
Reinsurance recoverable, excluding bad debt allowance, on unpaid losses and LAE	1,031,940	1,081,958
Unpaid losses and LAE, gross of reinsurance, at end of period	\$ 2,231,247	\$ 2,294,252

The above table excludes the impact of the amortization of the deferred reinsurance gain LPT Agreement (Deferred Gain) and the reduction of the ceded reserves on the LPT Agreement (Note 5). The Company amortized \$9.4 million and \$9.1 million of the Deferred Gain for the six months ended June 30, 2008 and 2007, respectively, which are reflected in losses and LAE incurred in the consolidated statements of income.

The reduction in the liability for unpaid losses and LAE attributable to insured events of prior periods was \$28.3 million and \$36.0 million for the six months ended June 30, 2008 and 2007, respectively. The major sources of this favorable development are actual paid losses being less than expected and the impact from new information on selected claim payments and emergence patterns used in the projection of future loss payments in the Company's California and Nevada business as more information becomes known.

5. LPT Agreement

The Company is a party to a 100% quota share retroactive reinsurance agreement (LPT Agreement) under which \$1.5 billion in liabilities for losses and LAE related to claims incurred prior to July 1, 1995 were reinsured for

consideration of \$775.0 million. The LPT Agreement provides coverage up to \$2.0 billion. The Deferred Gain is recorded as a liability in the accompanying consolidated balance sheets and is being amortized using the recovery method, whereby the amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries. The Company amortized \$4.6 million and \$9.4 million of the Deferred Gain for the three and six months ended June 30, 2008, respectively, and \$4.6 million and \$9.1 million of the Deferred Gain for the three and six months ended June 30, 2007, respectively. The adjustments to the Deferred Gain are recorded in losses and LAE in the accompanying consolidated statements of income. The remaining Deferred Gain was \$415.6 million and \$425.0 million as of June 30, 2008 and December 31, 2007, respectively, and is included in the accompanying consolidated balance sheets as deferred reinsurance gain LPT Agreement.

Table of Contents**6. Credit Facility**

On May 23, 2008, EHI and Wells Fargo Bank, National Association (Wells Fargo) entered into an amended and restated Secured Revolving Credit Facility (Amended Credit Facility). The Amended Credit Facility provides the Company with a \$150.0 million line of credit through April 30, 2009, and a \$50.0 million line of credit thereafter. Any advances under the Amended Credit Facility in excess of \$50.0 million must be repaid by May 1, 2009, and all other amounts must be repaid by March 26, 2011. Amounts outstanding bear interest at a rate equal to, at the Company's option: (a) Wells Fargo's prime rate or (b) a fixed rate that until May 1, 2009 is 0.75% above the LIBOR rate then in effect and thereafter is 0.30% above the LIBOR rate then in effect. With the execution of the Amended Credit Facility, the Company paid a non-refundable commitment fee of \$375.0 thousand, which is being amortized over 12 months. In addition, the Company is required to pay a quarterly commitment fee equal to a per annum rate of 0.10% on any portion of the Amended Credit Facility that is unused.

The Amended Credit Facility is secured by fixed maturity securities which had a fair value of \$187.8 million at June 30, 2008. The Amended Credit Facility contains customary non-financial covenants and requires EHI to maintain \$7.5 million of cash and cash equivalents. As of June 30, 2008, EHI had no amounts borrowed under the Amended Credit Facility.

7. Accumulated Other Comprehensive Income

Accumulated other comprehensive income is comprised of unrealized appreciation on investments classified as available-for-sale. The following table summarizes the components of accumulated other comprehensive income:

	June 30,	
	2008	2007
	(in thousands)	
Net unrealized gain on investment, before taxes	\$ 36,627	\$ 21,040
Deferred tax expense	(12,819)	(7,404)
Total accumulated other comprehensive income, net of taxes	\$ 23,808	\$ 13,636

The following table summarizes changes in the components of total comprehensive income for the stated periods:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(in thousands)			
Unrealized losses arising during the period, before taxes	\$ (26,880)	\$ (23,870)	\$ (36,650)	\$ (24,313)
Less: income tax benefit	(9,408)	(8,315)	(12,828)	(8,470)
Unrealized losses arising during the period, net of taxes	(17,472)	(15,555)	(23,822)	(15,843)
Less reclassification adjustment:				

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Losses realized in net income	(219)	(658)	(1,707)	(468)
Income tax benefit	(76)	(231)	(597)	(164)
Reclassification adjustment for losses realized in net income	(143)	(427)	(1,110)	(304)
Other comprehensive loss	(17,329)	(15,128)	(22,712)	(15,539)
Net income	27,366	30,773	52,860	58,639
Total comprehensive income	\$ 10,037	\$ 15,645	\$ 30,148	\$ 43,100

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On February 21, 2008, the EHI Board of Directors authorized a stock repurchase program (the 2008 Program). The 2008 Program authorizes the Company to repurchase up to \$100.0 million of the Company's common stock through June 30, 2009. As of June 30, 2008, the Company repurchased 375,300 shares at a cost of \$7.0 million. EHI expects the shares to be repurchased from time to time at prevailing market prices in open market or private transactions. The repurchases may be commenced or suspended from time to time without prior notice.

9. Stock-Based Compensation

On October 3, 2006, the Company's Board of Directors approved the Employers Holdings, Inc. Equity and Incentive Plan (the Plan), effective as of the close of the Company's IPO. The Plan is administered by the Compensation Committee of the Board of Directors, which is authorized to grant, at its discretion, awards to officers, employees, non-employee directors, consultants and independent contractors. On May 29, 2008, the Company's stockholders approved an Amended and Restated Equity and Incentive Plan (the Amended Plan), resulting in an increase to the maximum number of common shares reserved for grants of awards to 3,605,838. The Amended Plan provides for the grant, in the sole discretion of the Compensation Committee, of stock options (including incentive stock options and nonqualified stock options), stock appreciation rights, restricted stock, restricted stock units, stock-based performance awards and other stock-based awards. In second quarter 2008, nonqualified stock options and restricted stock units were granted. As of June 30, 2008, nonqualified stock options, restricted stock units, and performance share awards have been granted.

The Company accounts for stock-based compensation according to the provisions of SFAS No. 123(R), *Share-Based Payment*. Net stock-based compensation expense recognized in the accompanying consolidated statements of income is as follows:

	Three months		Six months	
	ended		ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(in thousands)			
Stock-based compensation related to:				
Nonqualified stock options	\$ 249	\$ 66	\$ 503	\$ 206
Restricted stock units	180		300	
Performance shares	426		684	
Total	855	66	1,487	206
Less: related tax benefit	297	23	518	72
Net stock-based compensation expense	\$ 558	\$ 43	\$ 969	\$ 134

Nonqualified Stock Options

On May 29, 2008, the Company awarded 475,167 options to the officers of the Company. These options have a service vesting period of four years and vest 25% on May 29, 2009, and the subsequent three anniversaries of such date. The options are subject to accelerated vesting in certain limited circumstances, such as: death or disability of the holder, or in connection with a change of control of the Company. The options expire seven years from the date of grant. The per share exercise price of these options is equal to the fair value of the stock on the grant date, or \$19.21.

The fair value of the stock options granted is estimated using a Black-Scholes option pricing model that uses the assumptions noted in the following table. Due to the Company's limited public history, the expected stock price volatility was based on a weighted average of the Company's historical stock price volatility since the IPO of its common stock and the historical volatility of peer companies' stock for a period of time

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equal to the expected term of the options. The Company believes that the use of a weighted historical volatility of its common stock and of this peer group is currently the best estimate of expected volatility of the market price of its common stock. The expected term of the options granted is calculated using the plain-vanilla calculation provided in the guidance of the SEC's Staff Accounting Bulletin No. 107. The dividend yield was calculated using amounts authorized by the Board of Directors. The risk-free interest rate is the yield on the grant date of the options of U.S. Treasury zero coupon securities with a maturity comparable to the expected term of the options.

The fair value of the stock options was calculated using the following weighted average assumptions for the stated periods:

	Three and Six months ended June 30, 2008	Three and Six months ended June 30, 2007
Expected volatility	34.9%	32.7%
Expected life (in years)	4.8	4.5
Dividend yield	1.3%	1.4%
Risk-free interest rate	3.4%	4.8%
Weighted average grant date fair value of options granted per option	\$ 6.01	\$ 5.22

Changes in outstanding stock options for the six months ended June 30, 2008 were as follows:

	Number of options	Weighted average exercise price	Weighted average remaining contractual life (In years)
Options outstanding at January 1, 2008	584,850	\$ 18.29	6.4
Granted	475,167	19.21	6.9
Exercised	(100)	17.00	
Expired	(1,381)	17.00	
Forfeited	(28,843)	18.47	
Options outstanding at June 30, 2008	1,029,693	18.71	6.4
Exercisable at June 30, 2008	161,660	18.19	5.6

Restricted Stock Units

On May 29, 2008, 23,760 restricted stock units (RSUs), awarded to the non-employee members of the Board of Directors during 2007, vested in connection with the annual stockholders meeting. The vested RSUs will be settled in common stock six months following the awardee's termination of service from the Board of Directors. Prior to settlement, dividend equivalents are paid with respect to these vested RSUs and are credited as additional vested RSUs. On June 4, 2008, in connection with the Company's dividend to its stockholders, an additional 72 RSUs were

credited to vested RSU holders.

Additionally on May 29, 2008, the Company awarded the non-employee members of the Board of Directors, in aggregate, 24,984 RSUs. These RSUs vest on May 29, 2009, except for accelerated vesting in the case of death or disability of the Director or in connection with a change of control. Vested RSUs will be settled in common stock within 30 days after the vesting date or can be deferred until six months following the awardee's termination of service from the Board of Directors, at the awardee's election. In the event of a deferral election, dividend equivalents are paid with respect to vested RSUs and are credited as additional vested RSUs. The aggregate fair value of the RSUs on the date of grant was \$479.9 thousand.

On May 29, 2008, the Company awarded 152,564 RSUs to the officers of the Company. The RSUs have a service vesting period of four years and vest 25% on May 29, 2009, and the subsequent three anniversaries

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of such date. The RSUs are subject to accelerated vesting in certain limited circumstances, such as: death or disability of the holder, or in connection with a change of control of the company. The fair value of the RSUs on the date of grant was \$2.9 million.

Changes in outstanding RSUs for the six months ended June 30, 2008 were as follows:

	Number of RSUs		Weighted average grant date fair value
RSUs outstanding at January 1, 2008	23,760	\$	18.29
Granted	177,620		19.21
Forfeited	(1,667)		19.21
RSUs outstanding at June 30, 2008	199,713		18.93
Vested but unsettled RSUs at June 30, 2008	23,832		16.84

10. Earnings Per Share

SFAS No. 128, *Earnings per Share*, provides for the calculation of Basic and Diluted earnings per share. Basic earnings per share includes no dilution and is computed by dividing income applicable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of equity. Diluted earnings per common share includes common shares assumed issued under the treasury stock method, which reflects the potential dilution that would have occurred had shares been repurchased from the proceeds of potentially dilutive shares.

The following table presents the net income and the weighted average common shares outstanding used in the earnings per common share calculations for the periods presented:

	Three months ended June 30, 2008		Six months ended June 30, 2008		February 5, 2007 through June 30, 2007
	(in thousands, except share and per share data)				
Net income available to common stockholders basic and diluted	\$ 27,366	\$ 30,773	\$ 52,860	\$ 52,168	
Weighted average number of common shares outstanding basic	49,407,135	53,500,722	49,509,173	53,510,963	
Effect of dilutive securities:					
Performance share awards	50,470		36,091		

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Unvested restricted stock units	176				
Dilutive potential common shares	50,646			36,091	
Weighted average number of common shares outstanding	diluted	49,457,781	53,500,722	49,545,264	53,510,963

Earnings per common share:

Basic	\$	0.55	\$	0.58	\$	1.07	\$	0.97
Diluted	\$	0.55	\$	0.58	\$	1.07	\$	0.97

For the three months ended June 30, 2008 and 2007, earnings per common share basic was calculated using net income for the period and the weighted average common shares outstanding, including contingently issuable shares for which all necessary conditions for issuance have been met. Earnings per common

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share diluted is based on the basic weighted average common shares outstanding increased by the number of additional common shares that would have been outstanding had potentially dilutive common shares been issued and reduced by the number of common shares that could have been repurchased from the proceeds of the potentially dilutive shares. The Company's outstanding options have been excluded in computing the diluted earnings per share for the three months ended June 30, 2008 and 2007 because their inclusion would be anti-dilutive.

For the six months ended June 30, 2008, earnings per common share basic was calculated using net income for the period and the weighted average common shares outstanding including contingently issuable shares for which all necessary conditions for issuance have been met. Earnings per common share diluted is based on the basic weighted average common shares outstanding increased by the number of additional common shares that would have been outstanding had potentially dilutive common shares been issued and reduced by the number of common shares that could have been repurchased from the proceeds of the potentially dilutive shares. The Company's outstanding options have been excluded in computing the diluted earnings per share for the six months ended June 30, 2008 because their inclusion would be anti-dilutive.

The earnings per common share basic for the period February 5, 2007 through June 30, 2007 was calculated using only the net income available to common stockholders for the period after the IPO, as shown on the consolidated statements of income, and the weighted average common shares outstanding during the same period. Earnings per common share diluted is based on the basic weighted average common shares outstanding increased by the number of additional common shares that would have been outstanding had potentially dilutive common shares been issued and reduced by the number of common shares that could have been repurchased from the proceeds of the potentially dilutive shares. The Company's outstanding options have been excluded in computing the diluted earnings per share for the period February 5, 2007 through June 30, 2007 because their inclusion would be anti-dilutive.

The pro forma earnings per common share presented on the accompanying consolidated statements of income is intended to depict relative earnings per common share for 2007, irrespective of the impact of the Conversion because neither EHI, nor its predecessor, EIG, had, prior to the Conversion, any outstanding common shares. The weighted average common shares were 52,832,048 for the six months ended June 30, 2007. The weighted average common shares are calculated using the weighted average common shares outstanding of 50,000,002 for the period prior to the Conversion and 53,510,963 for the period after the Conversion through June 30, 2007. The Company's outstanding options have been excluded in computing the pro forma diluted earnings per share for the six months ended June 30, 2007 because their inclusion would be anti-dilutive.

11. Business Combination

Acquisition of AmCOMP Incorporated (AmCOMP)

On January 10, 2008, the Company announced its intended acquisition of AmCOMP Incorporated. The Company believes this acquisition will provide significant opportunity to accelerate the execution of its strategic goals and achieve its vision of being the leader in the property and casualty insurance industry specializing in workers compensation. As of January 10, 2008, the transaction had an aggregate purchase price of approximately \$230 million, including the assumption of \$37 million in debt. Under the terms of the merger agreement, which has been approved by the Boards of Directors of both companies, holders of AmCOMP's approximately 15 million outstanding common shares will receive \$12.50 in cash for each share of common stock. The Company expects to use available cash, including funds available through the Amended Credit Facility, to fund the acquisition of AmCOMP. The merger agreement expires on October 31, 2008, unless that date is extended by mutual agreement of the parties.

On May 23, 2008, AmCOMP announced that it had received a Notice of Intent to Issue Order to Return Excess Profit (the Notice) from the Florida Office of Insurance Regulation (the FOIR), indicating on a preliminary basis that,

following its review of data submitted by AmCOMP on June 22, 2007 for accident years 2003, 2004 and 2005, Florida excessive profits (as defined in Florida Statute Section 627.215) in the

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amount of approximately \$11.7 million had been realized by AmCOMP and are required to be returned to policyholders. On June 9, 2008, AmCOMP announced that its insurance subsidiaries, AmCOMP Assurance Corporation and AmCOMP Preferred Insurance Company filed a Petition For Administrative Hearing Involving Disputed Issues of Fact with FOIR, challenging the Notice. On June 29, 2008, AmCOMP made its annual filing related to Florida excessive profits with the FOIR for the accident years 2004, 2005 and 2006. Completion of the merger is subject to the satisfaction of certain conditions, including without limitation, the approval of the FOIR and the approval of AmCOMP's stockholders. The Company believes that FOIR approval of our acquisition will not occur unless AmCOMP and the FOIR reach agreement on the amounts, if any, of excessive profits realized by AmCOMP for some of all of the 2002-2006 accident years.

12. Subsequent Event

Stockholder Dividend

On August 7, 2008, the Board of Directors declared a \$0.06 dividend per share, payable September 4, 2008, to stockholders of record on August 21, 2008.

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Item 2. Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations

You should read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes thereto included in Item 1 of Part I. Unless otherwise indicated, all references to we, us, our, the Company or similar terms refer to Employers Holdings, Inc. (EHI), together with its subsidiaries. The information contained in this quarterly report is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this quarterly report and in our other reports filed with the Securities and Exchange Commission (SEC), including our 2007 Annual Report on Form 10-K for the year ended December 31, 2007 (Annual Report).

The discussion under the heading Risk Factors in our Annual Report, as updated by the discussion in Part II, Item 1A of this quarterly report and similar discussions in our other SEC filings, describe some of the important risk factors that may affect our business, results of operations and financial condition. You should carefully consider those risks in addition to the other information in this report and in our other filings with the SEC before deciding to purchase, hold, or sell our common stock.

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and 21E of the Securities Exchange Act of 1934. You should not place undue reliance on these statements. These forward-looking statements include those related to our expected financial position, business, financing plans, litigation, future premiums, revenues, earnings, pricing, investments, business relationships, expected losses, loss reserves, acquisitions, competition, and rate increases with respect to our business and the insurance industry in general. Statements that include the words expect, intend, plan, believe, project, estimate, may, should, potential, forecast, anticipate, will and similar statements of a future or forward-looking nature identify forward-looking statements.

All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause our actual results to differ materially from those indicated in these statements. We believe that these factors include, but are not limited to, the following:

- adequacy and accuracy of our pricing methodologies;
- our dependence on a concentrated geographic area and on the workers compensation industry;
- developments in the frequency or severity of claims and loss activity that our underwriting, reserving or investment practices do not anticipate based on historical experience or industry data;
- changes in rating agency policies or practices;
- negative developments in the workers compensation insurance industry;
- increased competition on the basis of coverage availability, claims management, safety services, payment terms, premium rates, policy terms, types of insurance offered, overall financial strength, financial ratings and reputation;
- changes in regulations or laws applicable to us, our policyholders or the agencies that sell our insurance;
- changes in legal theories of liability under our insurance policies;
- changes in general economic conditions, including interest rates, inflation and other factors;

effects of acts of war, terrorism, or natural or man-made catastrophes;

non-receipt of expected payments, including reinsurance receivables;

performance of the financial markets and their effects on investment income and the fair values of investments;

possible failure of our information technology or communication systems;

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adverse state and federal judicial decisions;

litigation and government proceedings;

possible loss of the services of any of our executive officers or other key personnel;

cyclical nature of the insurance industry;

investigations into issues and practices in the insurance industry;

changes in demand for our products;

the possibility that our business and the business of AmCOMP will not be integrated successfully; and

possible disruption from the AmCOMP transaction making it more difficult to maintain relationships with customers, employees, agents and producers.

The foregoing factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in this report.

These forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical or anticipated results, depending on a number of factors. These risks and uncertainties include, but are not limited to, those listed under the heading **Risk Factors** in our Annual Report, as updated by the discussion in Part II, Item 1A of this quarterly report. All subsequent written and oral forward-looking statements attributable to us or individuals acting on our behalf are expressly qualified in their entirety by these cautionary statements. We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. Before making an investment decision, you should carefully consider all of the factors identified in this report that could cause actual results to differ.

Overview

EHI is a Nevada holding company and is the successor to EIG Mutual Holding Company (EIG), which was incorporated in Nevada in 2005. EHI's principal executive offices are located at 10375 Professional Circle, Reno, Nevada. Our two insurance subsidiaries, Employers Insurance Company of Nevada (EICN) and Employers Compensation Insurance Company (ECIC), are domiciled in Nevada and California, respectively.

We are a specialty provider of workers' compensation insurance focused on select small businesses engaged in low to medium hazard industries. Workers' compensation is a statutory system under which an employer is required to provide coverage for its employees' medical, disability, vocational rehabilitation and death benefit costs for work-related injuries or illnesses. Our business has historically targeted small businesses located primarily in several western states, with a concentration in California and Nevada. We distribute our products almost exclusively through independent agents and brokers and our strategic distribution partners. We operate in a single reportable segment with 12 territorial offices serving 12 states in which we are currently doing business.

On January 10, 2008, we announced our intended acquisition of AmCOMP Incorporated (AmCOMP). We believe this acquisition will provide significant opportunity to accelerate the execution of our strategic goals and achieve our

vision of being the leader in the property and casualty insurance industry specializing in workers' compensation. As of January 10, 2008, the transaction had an aggregate purchase price of approximately \$230 million, including the assumption of approximately \$37 million in debt. Under the terms of the merger agreement, which has been approved by the Boards of Directors of both companies, holders of AmCOMP's approximately 15 million outstanding common shares will receive \$12.50 in cash for each share of common stock. We expect to use available cash, including funds available

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through the Amended Credit Facility, to fund the acquisition of AmCOMP. The merger agreement expires on October 31, 2008, unless that date is extended by mutual agreement of the parties.

On May 23, 2008, AmCOMP announced that it had received a Notice of Intent to Issue Order to Return Excess Profit (the Notice) from the Florida Office of Insurance Regulation (the FOIR), indicating on a preliminary basis that, following its review of data submitted by AmCOMP on June 22, 2007 for accident years 2003, 2004 and 2005,

Florida excessive profits (as defined in Florida Statute Section 627.215) in the amount of approximately \$11.7 million had been realized by AmCOMP and are required to be returned to policyholders. On June 9, 2008, AmCOMP announced that its insurance subsidiaries, AmCOMP Assurance Corporation and AmCOMP Preferred Insurance Company filed a Petition For Administrative Hearing Involving Disputed Issues of Fact with the FOIR, challenging the Notice. On June 29, 2008, AmCOMP made its annual filing related to Florida excessive profits with the FOIR for the accident years 2004, 2005 and 2006. Completion of the merger is subject to the satisfaction of certain conditions, including without limitation, the approval of AmCOMP's stockholders. We believe that FOIR approval of our acquisition will not occur unless AmCOMP and the FOIR reach agreement on the amounts, if any, of excessive profits realized by AmCOMP for some of all of the 2002-2006 accident years.

Revenues

We derive our revenues primarily from the following:

Net Premiums Earned. Our net premiums earned have historically been generated primarily in California and Nevada. In California, we have reduced our premium rates by 62.3% from September 2003 through June 30, 2008, including a decline of 38.1% since January 1, 2006. This compares with the recommendation of the California Workers' Compensation Insurance Rating Bureau (WCIRB) of a 45.0% rate decline since January 1, 2006. In November 2007, the California Commissioner of Insurance (California Commissioner) recommended that there be no overall change in pure premium rates for policies written on or after January 1, 2008. This was the first recommendation of no rate decrease by the California Commissioner since the adoption of the benefit reforms of 2003 and 2004. On May 9, 2008, the California Department of Insurance announced that stability in the workers compensation insurance marketplace had eliminated the immediate need for an interim pure premium rate advisory, noting that, WCIRB data indicated that insurer pay-outs for workers' compensation benefit costs had been relatively level since 2005.

Our last filed rates in California resulted in a 0.6% decrease in overall premium level due to a decrease in Terrorism Risk Insurance charges for policies incepting on or after August 1, 2008. Our previous rate change, a 4.5% decrease, was filed for new and renewal policies incepting on or after September 15, 2007.

Permanent Disability Rating Schedule changes may be adopted in California and if adopted, those changes would increase some benefit levels for injuries occurring after January 1, 2009, which may also increase rate levels.

On December 19, 2007, the Nevada Commissioner of Insurance (Nevada Commissioner) announced that the National Council on Compensation Insurance (NCCI) submitted a filing for an average voluntary loss cost decrease of 10.5% for new and renewal policies incepting on or after March 1, 2008. On February 6, 2008, the Nevada Commissioner approved the filing. The Nevada Commissioner cited decreasing claim frequency as the primary driver of the decrease, which more than offset increasing indemnity and medical costs per claim and cost of living benefit adjustments. In our last filed Nevada rate change, we adopted the approved loss costs effective for new and renewal policies incepting on or after March 1, 2008 with a revised loss cost modifier, the combination of which we expected would produce an average overall decrease of 5.0% on our rate level.

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The following table sets forth our direct premiums written by state and as a percentage of total direct premiums written for the periods presented:

State	Three months ended June 30,				Six months ended June 30,			
	2008	Percentage of 2008 Total	2007	Percentage of 2007 Total	2008	Percentage of 2008 Total	2007	Percentage of 2007 Total
(in thousands, except percentages)								
California	\$ 56,258	77.1%	\$ 62,617	73.4%	\$ 113,485	73.6%	\$ 125,491	69.8%
Nevada	7,671	10.5	13,813	16.2	21,365	13.9	37,290	20.7
Colorado	2,397	3.3	2,976	3.5	5,423	3.5	6,111	3.4
Utah	1,714	2.3	2,139	2.5	3,499	2.3	4,018	2.2
Idaho	1,577	2.2	1,860	2.2	3,171	2.1	3,354	1.9
Montana	701	1.0	676	0.8	2,045	1.3	1,680	0.9
Arizona	1,026	1.4	609	0.7	1,959	1.3	1,053	0.6
Illinois	838	1.1	311	0.4	1,593	1.0	265	0.2
Other	823	1.1	254	0.3	1,585	1.0	598	0.3
Total	\$ 73,005	100.0%	\$ 85,255	100.0%	\$ 154,125	100.0%	\$ 179,860	100.0%

The decline in our overall premium revenue in California and Nevada is reflective of the impact of rate reductions, increased price competition and economic conditions evidenced by slowing or declining employment and payroll in certain states in which we operate other than California. The decline was partially offset by the growth in premium volume in our seven smallest states, which nearly doubled during the last 12 months. We continue to operate in an increasingly competitive market. California and Nevada accounted for 87.5% of our direct premiums written for the six months ended June 30, 2008 compared to 90.5% of our direct premiums written for the six months ended June 30, 2007.

For the six months ended June 30, 2008, we wrote 73.6% and 13.9% of our direct premiums written in California and Nevada, respectively. We currently write business in ten other states (Arizona, Colorado, Florida, Idaho, Illinois, Montana, Oregon, Pennsylvania, Texas and Utah) and are licensed to write business in five additional states (Georgia, Maryland, Massachusetts, New Mexico and New York). We commenced writing business in Pennsylvania in April 2008. We also began writing business through Intego Insurance Services, LLC, a new strategic business partner, in April 2008.

The number of policies in force, at the specified dates, was as follows:

States	June 30, 2008	December 31, 2007	June 30, 2007
California	26,618	24,986	23,467
Nevada	5,761	6,147	6,307
Other	2,920	2,566	2,128

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Total	35,299	33,699	31,902
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During the six months ended June 30, 2008, we realized an increase of 1,600 policies, or 4.7%, over the total number of policies in force at December 31, 2007. For the same six month period, policies in California increased by 1,632, or 6.5%, and policies in states other than California and Nevada increased by 354, or 13.8%, which was offset by a decline in policies in Nevada of 386, or 6.3%.

During the 12 months ended June 30, 2008, our policies in force increased by 3,397 policies, or 10.6%, over the total number of policies in force at June 30, 2007. For the same 12 month period, policies in California increased by 3,151, or 13.4%, and policies in states other than California and Nevada increased by 792 or 37.2%, which was offset by a decline in policies in Nevada of 546, or 8.7%. We believe the decline in policy count in Nevada is a direct result of economic conditions and competitive pressures. We have not observed a similar impact on policy count in California.

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Rate changes have been adopted in other states in which we operate. We believe policy count in California and other states will continue to grow. However, that increase may not completely offset the decline in total premiums written. We cannot precisely determine how these trends will ultimately impact our financial position and results of operations.

Expenses

Our expenses consist of the following:

Losses and Loss Adjustment Expenses (LAE). Losses and LAE represent our largest expense item and include claim payments made, estimates for future claim payments and changes in those estimates for current and prior periods and costs associated with investigating, defending, and adjusting claims. The quality of our financial reporting depends in large part on accurately predicting our losses and LAE, which are inherently uncertain as they are estimates of the ultimate cost of individual claims based on actuarial estimation techniques. In states other than Nevada, we have a short operating history and must rely on a combination of industry experience and our specific experience to establish our best estimate of losses and LAE reserves. The interpretation of historical data can be impacted by external forces, principally legislative changes, economic fluctuations and legal trends. In recent years, we experienced lower losses and LAE in California than we anticipated due to factors such as regulatory reform designed to reduce loss costs in that market. As we continue to gain experience in the California market, we rely more on our own loss experience and place less reliance on industry experience.

Commission Expense. Commission expense includes direct commissions to our agents and brokers for the premiums that they produce for us. Also included in commission expense are incentive payments, other direct marketing costs and fees. Commission expense is net of contingent commission income related to the retroactive 100% quota share reinsurance agreement (LPT Agreement). Also, commissions paid to our agents and brokers are deferred and amortized to commission expense in our statement of income as the premiums generating these commissions are earned. We pay commissions that we believe are competitive with other workers' compensation insurers. We generally pay agents a direct commission between 10.0% and 12.5% on premiums written.

Underwriting and Other Operating Expense. Underwriting and other operating expense includes the costs to acquire and maintain an insurance policy (excluding commissions) consisting of premium taxes and certain other general expenses that vary with, and are primarily related to, producing new or renewal business. These acquisition costs are deferred and amortized to underwriting and other operating expense in the statement of income as the related premiums are earned. Other underwriting expenses consist of policyholder dividends and general administrative expenses such as salaries and benefits, rent, office supplies, depreciation and all other operating expenses not otherwise classified separately, and fees and assessments of boards, bureaus and statistical agencies for policy service and administration items such as manuals, rating plans and experience data. Our underwriting and other operating expense is a reflection of our operating efficiency in producing, underwriting and administering our business. Over recent periods, our underwriting and other operating expense has remained relatively flat in the face of increasing policy volume. We continue to pursue technological improvements that will, over time, reduce transaction costs and support future profitable growth.

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The following table summarizes our consolidated financial results for the three months ended June 30, 2008 and 2007:

	2008	2007	Increase (Decrease) 2008 Over 2007	Percentage Increase (Decrease) 2008 Over 2007
(in thousands, except for percentages)				
Selected Financial Data:				
Gross premiums written	\$ 73,152	\$ 84,596	\$ (11,444)	(13.5)%
Net premiums written	70,389	81,502	(11,113)	(13.6)
Net premiums earned	\$ 73,815	\$ 84,117	\$ (10,302)	(12.2)%
Net investment income	18,538	19,305	(767)	(4.0)
Realized losses on investments, net	(219)	(658)	439	n/a
Other income	422	1,046	(624)	(59.7)
Total revenues	92,556	103,810	(11,254)	(10.8)
Losses and LAE	24,142	28,802	(4,660)	(16.2)
Commission expense	9,721	11,665	(1,944)	(16.7)
Underwriting and other operating expense	22,981	22,752	229	1.0
Income taxes	8,346	9,818	(1,472)	(15.0)
Total expenses	65,190	73,037	(7,847)	(10.7)
Net income	\$ 27,366	\$ 30,773	\$ (3,407)	(11.1)%
Selected Operating Data:				
Combined ratio ⁽¹⁾	77.0%	75.2%	1.8%	n/a
Net income before impact of LPT Agreement ⁽²⁾	\$ 22,799	\$ 26,223	\$ (3,424)	(13.1)%

(1) The combined ratio is calculated by dividing the sum of losses and LAE, commission, underwriting and other operating expenses by net premiums earned.

(2) We define net income before impact of LPT Agreement as net income less: (a) amortization of deferred reinsurance gain LPT Agreement and (b) adjustments to LPT Agreement ceded reserves. Deferred reinsurance gain LPT Agreement reflects the unamortized gain from our LPT Agreement. Under GAAP, this gain is deferred and is being amortized using the recovery method, whereby the amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries, and the amortization is reflected in losses and LAE.

We periodically reevaluate the remaining direct reserves subject to the LPT Agreement. Our reevaluation results in corresponding adjustments, if needed, to reserves, ceded reserves, reinsurance recoverables and the deferred reinsurance gain, with the net effect being an increase or decrease, as the case may be, to net income. Net income before impact of LPT Agreement is not a measurement of financial performance under GAAP and should not be considered in isolation or as an alternative to net income before income taxes and net income or any other measure of performance derived in accordance with GAAP.

We present net income before impact of LPT Agreement because we believe that it is an important supplemental measure of operating performance to be used by analysts, investors and other interested parties in evaluating us. The LPT Agreement was a non-recurring transaction which does not result in ongoing cash benefits, and, consequently, we believe this presentation is useful in providing a meaningful understanding of our operating performance. In addition, we believe this non-GAAP measure, as we have defined it, is helpful to our management in identifying trends in our performance because the excluded item has limited significance in our current and ongoing operations.

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The table below shows the reconciliation of net income to net income before impact of LPT Agreement for the three months ended:

	June 30,	
	2008	2007
	(in thousands)	
Net income	\$ 27,366	\$ 30,773
Less impact of LPT Agreement:		
Amortization of deferred reinsurance gain LPT Agreement	4,567	4,550
Adjustment to LPT Agreement ceded reserves ^(a)		
Net income before impact of LPT Agreement	\$ 22,799	\$ 26,223

- (a) Any adjustment to the estimated direct reserves ceded under the LPT Agreement is reflected in losses and LAE for the period during which the adjustment is determined, with a corresponding increase or decrease in net income in the period. There is a corresponding change to the reinsurance recoverables on unpaid losses as well as the deferred reinsurance gain. A cumulative adjustment to the amortization of the deferred gain is also then recognized in earnings so that the deferred reinsurance gain reflects the balance that would have existed had the revised reserves been recognized at the inception of the LPT Agreement. See Note 5 in the notes to our consolidated financial statements which are included elsewhere in this report.

Gross Premiums Written. Gross premiums written decreased \$11.4 million, or 13.5%, to \$73.2 million for the three months ended June 30, 2008, from \$84.6 million for the three months ended June 30, 2007. The decrease in gross premiums written is primarily due to the overall reduction in our average policy size as a result of the impacts of rate reductions, the effects of increased competition and changes in economic and business conditions. Compared to the second quarter of 2007, the average rate level of premiums written during the second quarter of 2008 was 10.9% lower in California due to rate decreases in July 2006 of 12.7%, January 2007 of 9.9% and September 2007 of 4.5%. The average overall in force policy premium at June 30, 2008 decreased to \$8,464, or 20.9%, from \$10,702 at June 30, 2007. Total policy count, however, has increased 10.6% from June 30, 2007, mainly in California, lessening the impact of the change in policy size. The policy count increase was primarily attributable to sales and marketing efforts in our California market. The number of in force policies in California increased 13.4%, or 3,151 from June 30, 2007.

Net Premiums Written. Net premiums written decreased \$11.1 million, or 13.6%, to \$70.4 million for the three months ended June 30, 2008, from \$81.5 million for the three months ended June 30, 2007. The decrease was primarily attributable to an \$11.4 million decrease in gross premiums written for the same period. Ceded premiums were \$2.8 million and \$3.1 million, or 3.8% and 3.7%, of gross premiums written for the three months ended June 30, 2008 and June 30, 2007, respectively. The decrease in ceded premiums was primarily the result of the decrease in gross premiums written for the same periods.

Net Premiums Earned. Net premiums earned decreased \$10.3 million, or 12.2%, to \$73.8 million for the three months ended June 30, 2008, from \$84.1 million for the three months ended June 30, 2007. The decrease in net premiums earned for the three months ended June 30, 2008, as compared to the three months ended June 30, 2007, was primarily the result of the decrease in net premiums written.

Net Investment Income. Net investment income decreased \$0.8 million, or 4.0%, to \$18.5 million for the three months June 30, 2008, from \$19.3 million for the three months ended June 30, 2007. The \$0.8 million decrease was primarily attributable to a decrease in invested assets and a decrease in investment yield. The average pre-tax book yield on invested assets decreased approximately \$0.6 million, or approximately 14 basis points, to 4.26% at June 30, 2008, as compared to 4.40% at June 30, 2007. The tax equivalent yield on invested assets decreased to 5.16% at June 30, 2008, as compared to 5.31% at June 30, 2007.

Realized Losses on Investments. Realized losses on investments for the three months ended June 30, 2008, totaled \$0.2 million as compared to realized losses of \$0.7 million for the three months ended June 30, 2007. During the three months ended June 30, 2007, we sold \$55.0 million of fixed maturity securities to begin our share repurchase program which resulted in a realized loss of \$0.5 million.

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Losses and LAE. Losses and LAE decreased \$4.7 million, or 16.2%, to \$24.1 million for the three months ended June 30, 2008, from \$28.8 million for the three months ended June 30, 2007. The decrease was primarily due to the quarter over quarter change in net premiums earned which reduced losses and LAE by approximately \$6.6 million. The offsetting increase, of \$1.9 million, was primarily related to the following two factors impacting the losses and LAE ratio.

First, favorable prior accident year loss development was \$16.9 million for the three months ended June 30, 2008, compared with \$20.4 million for the three months ended June 30, 2007, a change of \$3.5 million. Second, this change in development was offset by a \$1.5 million reduction in the current year loss estimate, which is a result of the recognition of loss improvements in 2007. Our current accident year loss estimate was 61.9% for the three months ended June 30, 2008, as compared with 63.9% for the three months ended June 30, 2007.

The table below reflects the losses and LAE reserve adjustments for the three months ended:

	June 30,	
	2008	2007
	(in millions)	
Prior accident year favorable development, net	\$ 16.9	\$ 20.4
LPT reserve favorable change	\$	\$
LPT amortization of the deferred reinsurance gain	\$ 4.6	\$ 4.6

There was no adjustment in either period to the direct reserves subject to the LPT Agreement. Losses and LAE include amortization of deferred reinsurance gain-LPT Agreement of \$4.6 million in each of the three month periods ended June 30, 2008 and 2007. Excluding the impact from the LPT Agreement, losses and LAE would have been \$28.7 million and \$33.4 million, or 38.9% and 39.6%, of net premiums earned for the three months ended June 30, 2008 and 2007, respectively.

Commission Expense. Commission expense decreased \$2.0 million, or 16.7%, to \$9.7 million for the three months ended June 30, 2008, from \$11.7 million for the three months ended June 30, 2007. Commission expense was 13.2% and 13.9% of net premiums earned for the three months ended June 30, 2008 and 2007, respectively. Commission expense decreased approximately \$1.3 million due to a decrease in net premiums earned and agency incentive commissions.

Underwriting and Other Operating Expense. Underwriting and other operating expense increased \$0.2 million, or 1.0%, to \$23.0 million for the three months ended June 30, 2008, from \$22.8 million for the three months ended June 30, 2007. The increase was primarily due to a \$1.3 million increase in salaries and related benefits due to annual salary increases and increased benefit costs. Employee benefit increases included higher benefit costs for medical coverage and the Employers Holdings, Inc. Equity and Incentive Plan. This increase was partially offset by a \$0.6 million decrease in consulting and professional fees and a \$0.5 million decline in premium taxes attributable to lower net premiums earned. The decrease in our consulting and professional fees was primarily due to the reduction of one-time consulting costs incurred for Sarbanes-Oxley Act compliance and the conversion from a mutual holding company to a stock company in 2007.

Income Taxes. Income taxes decreased \$1.5 million, or 15.0%, to \$8.3 million for the three months ended June 30, 2008, from \$9.8 million for the three months ended June 30, 2007. The decrease in income taxes was primarily due to a \$4.9 million decrease in pre-tax income. The effective tax rate for the three months ended June 30, 2008, was 23.4%

compared to a 24.2% for the same period in 2007.

Net Income. Net income decreased \$3.4 million, or 11.1%, to \$27.4 million for the three months ended June 30, 2008, from \$30.8 million for the three months ended June 30, 2007. The decrease in net income was primarily due to lower net premiums earned, which was partially offset by reduced losses and LAE.

Net income includes amortization of deferred reinsurance gain LPT Agreement of \$4.6 million for each of the three month periods ended June 30, 2008 and 2007. Excluding the LPT Agreement items, net

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income would have been \$22.8 million and \$26.2 million for the three months ended June 30, 2008 and 2007, respectively.

Combined Ratio. The combined ratio increased 1.8 percentage points, to 77.0%, for the three months ended June 30, 2008, from 75.2% for the three months ended June 30, 2007. The change in combined ratio was primarily due to lower net premiums earned and the resulting impact on the underwriting and other operating expense ratio, which was partially offset by a decrease in the loss ratio.

Results of Operations**Six Months Ended June 30, 2008 and 2007**

The following table summarizes our consolidated financial results for the six months ended June 30, 2008 and 2007:

	2008	2007	Increase (Decrease) 2008 Over 2007	Percentage Increase (Decrease) 2008 Over 2007
(in thousands, except for percentages)				
Selected Financial Data:				
Gross premiums written	\$ 154,826	\$ 181,046	\$ (26,220)	(14.5)%
Net premiums written	149,493	174,713	(25,220)	(14.4)
Net premiums earned	\$ 149,711	\$ 173,909	\$ (24,198)	(13.9)%
Net investment income	37,441	40,140	(2,699)	(6.7)
Realized losses on investments, net	(1,707)	(468)	(1,239)	n/a
Other income	860	2,186	(1,326)	(60.7)
Total revenues	186,305	215,767	(29,462)	(13.7)
Losses and LAE	54,756	70,469	(15,713)	(22.3)
Commission expense	20,344	23,386	(3,042)	(13.0)
Underwriting and other operating expense	44,707	46,052	(1,345)	(2.9)
Income taxes	13,638	17,221	(3,583)	(20.8)
Total expenses	133,445	157,128	(23,683)	(15.1)
Net income	\$ 52,860	\$ 58,639	\$ (5,779)	(9.9)%
Selected Operating Data:				
Combined ratio ⁽¹⁾	80.0%	80.4%	(0.4)%	n/a
Net income before impact of LPT Agreement ⁽²⁾	\$ 43,501	\$ 49,502	\$ (6,001)	(12.1)%

(1)

The combined ratio is calculated by dividing the sum of losses and LAE, commission, underwriting and other operating expenses by net premiums earned.

- (2) We define net income before impact of LPT Agreement as net income less: (a) amortization of deferred reinsurance gain LPT Agreement and (b) adjustments to LPT Agreement ceded reserves. Deferred reinsurance gain LPT Agreement reflects the unamortized gain from our LPT Agreement. Under GAAP, this gain is deferred and is being amortized using the recovery method, whereby the amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries, and the amortization is reflected in losses and LAE. We periodically reevaluate the remaining direct reserves subject to the LPT Agreement. Our reevaluation results in corresponding adjustments, if needed, to reserves, ceded reserves, reinsurance recoverables and the deferred reinsurance gain, with the net effect being an increase or decrease, as the case may be, to net income. Net income before impact of LPT Agreement is not a measurement of financial performance under GAAP and should not be considered in isolation or as an alternative to net income before income taxes and net income or any other measure of performance derived in accordance with GAAP.

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We present net income before impact of LPT Agreement because we believe that it is an important supplemental measure of operating performance to be used by analysts, investors and other interested parties in evaluating us. The LPT Agreement was a non-recurring transaction which does not result in ongoing cash benefits, and, consequently, we believe this presentation is useful in providing a meaningful understanding of our operating performance. In addition, we believe this non-GAAP measure, as we have defined it, is helpful to our management in identifying trends in our performance because the excluded item has limited significance in our current and ongoing operations.

The table below shows the reconciliation of net income to net income before impact of LPT Agreement for the six months ended:

	June 30,	
	2008	2007
	(in thousands)	
Net income	\$ 52,860	\$ 58,639
Less impact of LPT Agreement:		
Amortization of deferred reinsurance gain LPT Agreement	9,359	9,137
Adjustment to LPT Agreement ceded reserves ^(a)		
Net income before impact of LPT Agreement	\$ 43,501	\$ 49,502

- (a) Any adjustment to the estimated direct reserves ceded under the LPT Agreement is reflected in losses and LAE for the period during which the adjustment is determined, with a corresponding increase or decrease in net income in the period. There is a corresponding change to the reinsurance recoverables on unpaid losses as well as the deferred reinsurance gain. A cumulative adjustment to the amortization of the deferred gain is also then recognized in earnings so that the deferred reinsurance gain reflects the balance that would have existed had the revised reserves been recognized at the inception of the LPT Agreement. See Note 5 in the notes to our consolidated financial statements which are included elsewhere in this report.

Gross Premiums Written. Gross premiums written decreased \$26.2 million, or 14.5%, to \$154.8 million for the six months ended June 30, 2008, from \$181.0 million for the six months ended June 30, 2007. The decrease in gross premiums written is primarily due to the overall reduction in our average policy size as a result of the impacts of rate reductions, the effects of increased competition and changes in economic and business conditions. Compared to the first six months of 2007, the average rate level of premiums written during the first six months of 2008 was 13.8% lower in California due to rate decreases in April 2006 of 10.5%, July 2006 of 12.7%, January 2007 of 9.9% and September 2007 of 4.5%. The average overall in force policy premium at June 30, 2008 decreased to \$8,464, or 20.9%, from \$10,702 at June 30, 2007. The policy count, however, has increased 10.6% from June 30, 2007, mainly in California, lessening the impact of the change in policy size. The policy count increase was primarily attributable to sales and marketing efforts in our California market. The number of in force policies in California increased 13.4%, or 3,151 from June 30, 2007.

Net Premiums Written. Net premiums written decreased \$25.2 million, or 14.4%, to \$149.5 million for the six months ended June 30, 2008, from \$174.7 million for the six months ended June 30, 2007. The decrease was primarily attributable to a \$26.2 million decrease in gross premiums written for the same period. Ceded premiums were

\$5.3 million and \$6.3 million, or 3.4% and 3.5%, of gross premiums written for the six months ended June 30, 2008 and June 30, 2007, respectively. The decrease in ceded premiums was primarily the result of the decrease in gross premiums written for the same period.

Net Premiums Earned. Net premiums earned decreased \$24.2 million, or 13.9%, to \$149.7 million for the six months ended June 30, 2008, from \$173.9 million for the six months ended June 30, 2007. The decrease in net premiums earned for the six months ended June 30, 2008, as compared to the six months ended June 30, 2007, was primarily the result of the decrease in net premiums written.

Net Investment Income. Net investment income decreased \$2.7 million, or 6.7%, to \$37.4 million for the six months ended June 30, 2008, from \$40.1 million for the six months ended June 30, 2007. The decrease was primarily attributable to: (a) one-time interest income from the net proceeds of EHI's IPO and (b) a slight decrease in investment yield on invested assets. The net proceeds from the IPO generated \$1.8 million

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of interest income prior to distribution to eligible members in 2007. The average pre-tax book yield on invested assets decreased approximately \$1.1 million, or approximately 13 basis points, to 4.27% at June 30, 2008, as compared to 4.40% at June 30, 2007.

Realized Losses on Investments. Realized losses on investment for the six months ended June 30, 2008, totaled \$1.7 million as compared to realized losses of \$0.5 million for the six months ended June 30, 2007. The increase is the result of other-than-temporary impairment on equity securities of \$1.7 million for the six months ended June 30, 2008. The impairment was primarily due to a decline in the fair value of equity securities in the financial services and telecommunications sectors.

Losses and LAE. Losses and LAE decreased \$15.7 million, or 22.3%, to \$54.8 million for the six months ended June 30, 2008, from \$70.5 million for the six months ended June 30, 2007. The decrease was primarily due to the period over period change in net premiums earned which reduced losses and LAE by approximately \$16.1 million. The offsetting increase of \$0.4 million was primarily related to the following two factors impacting the losses and LAE ratio.

First, favorable prior accident year loss development was \$28.3 million for the six months ended June 30, 2008, compared with \$36.0 million for the six months ended June 30, 2007, a change of \$7.7 million. Second, this change in development was offset by a \$7.0 million reduction in the current year loss estimate, which is a result of the recognition of loss improvements in 2007. Our current accident year loss estimate was 61.7% for the six months ended June 30, 2008, as compared with 66.5% for the six months ended June 30, 2007.

The table below reflects the losses and LAE reserve adjustments for the six months ended:

	June 30,	
	2008	2007
	(in millions)	
Prior accident year favorable development, net	\$ 28.3	\$ 36.0
LPT reserve favorable change	\$	\$
LPT amortization of the deferred reinsurance gain	\$ 9.4	\$ 9.1

There was no adjustment in either period to the direct reserves subject to the LPT Agreement. Losses and LAE include amortization of deferred reinsurance gain LPT Agreement of \$9.4 million and \$9.1 million for the six months ended June 30, 2008 and 2007, respectively. Excluding the impact from the LPT Agreement, losses and LAE would have been \$64.1 million and \$79.6 million, or 42.8% and 45.8%, of net premiums earned for the six months ended June 30, 2008 and 2007, respectively.

Commission Expense. Commission expense decreased \$3.1 million, or 13.0%, to \$20.3 million for the six months ended June 30, 2008, from \$23.4 million for the six months ended June 30, 2007. Commission expense was 13.6% and 13.4% of net premiums earned for the six months ended June 30, 2008 and 2007, respectively. The decrease in commission expense was primarily due to the decrease in net premiums earned.

Underwriting and Other Operating Expense. Underwriting and other operating expense decreased \$1.4 million, or 2.9%, to \$44.7 million for the six months ended June 30, 2008, from \$46.1 million for the six months ended June 30, 2007. The decrease was primarily due to a \$2.3 million reduction in one-time consulting and professional fees related to Sarbanes-Oxley Act compliance and the conversion from a mutual holding company to a stock company in 2007.

Additionally, premium taxes declined \$2.1 million as a result of lower net earned premiums earned and a favorable tax credit related to prior year's taxes. These decreases were partially offset by an increase of \$3.2 million in salaries and related benefits due to annual salary increases and increased benefit costs. Employee benefit increases included higher benefit costs for medical coverage and the Equity and Incentive Plan.

Income Taxes. Income taxes decreased \$3.6 million, or 20.8%, to \$13.6 million for the six months ended June 30, 2008, from \$17.2 million for the six months ended June 30, 2007. The decrease in income taxes was primarily due to a \$9.4 million decrease in pre-tax income. Also, the effective tax rate for the six months

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ended June 30, 2008, was 20.5% compared to a 22.7% for the same period in 2007. The effective tax rate was impacted by non-deductible expenses related to the conversion in the six months ended June 30, 2007 and the level of tax exempt interest and dividends for the same period in 2008.

Net Income. Net income decreased \$5.7 million, or 9.9%, to \$52.9 million for the six months ended June 30, 2008, from \$58.6 million for the six months ended June 30, 2007. The decrease in net income was primarily due to lower net premiums earned and investment income, partially offset by reduced losses and LAE.

Net income includes amortization of deferred reinsurance gain LPT Agreement of \$9.4 million and \$9.1 million for the six months ended June 30, 2008 and 2007, respectively. Excluding the LPT Agreement items, net income would have been \$43.5 million and \$49.5 million for the six months ended June 30, 2008 and 2007, respectively.

Combined Ratio. The combined ratio decreased 0.4 percentage points, to 80.0%, for the six months ended June 30, 2008, from 80.4% for the six months ended June 30, 2007. The change in combined ratio was primarily due to a decrease in the loss ratio, partially offset by lower net premiums earned and the resulting impact on the underwriting and other operating expense ratio.

Liquidity and Capital Resources

Parent Company. We are a holding company and substantially all of our operations are conducted through our insurance subsidiaries, EICN and ECIC. Dividends to EHI from our insurance subsidiaries are contingent upon our subsidiaries' earnings and subject to business considerations and regulatory requirements. The primary uses of cash are expected to continue to be stockholder dividends, repurchases of common stock, general operating expenses, as well as the acquisition of AmCOMP.

EHI received approval from the Nevada Commissioner on December 18, 2007, for a \$200.0 million extraordinary dividend from EICN special surplus to be paid in 2008. On May 15, 2008, EHI requested and received approval from the Nevada Commissioner to increase the \$200.0 million extraordinary dividend to \$275.0 million subject to maintaining the risk-based capital (RBC) total adjusted capital of EICN above a specified level on the date of payment after giving effect to such payment. As of June 30, 2008, the \$275.0 million extraordinary dividend has been paid to EHI.

On May 23, 2008, EHI and Wells Fargo Bank, National Association (Wells Fargo) entered into an amended and restated Secured Revolving Credit Facility (Amended Credit Facility). The Amended Credit Facility provides the Company with a \$150.0 million line of credit through April 30, 2009, and a \$50.0 million line of credit thereafter. Any advances under the Amended Credit Facility in excess of \$50.0 million must be repaid by May 1, 2009, and all other amounts must be repaid by March 26, 2011. Proceeds under the Amended Credit Facility can be used for general corporate purposes and the acquisition of AmCOMP. Amounts outstanding bear interest at a rate equal to, at EHI's option: (a) Wells Fargo's prime rate or (b) a fixed rate that until May 1, 2009 is 0.75% above the LIBOR rate then in effect and thereafter is 0.30% above the LIBOR rate then in effect. With the execution of the Amended Credit Facility, EHI paid a non-refundable commitment fee of \$375,000. In addition, EHI is required to pay a quarterly commitment fee equal to a per annum rate of 0.10% on any portion of the Amended Credit Facility that is unused.

The Amended Credit Facility is secured by fixed maturity securities which had a fair value of \$187.8 million at June 30, 2008. The Amended Credit Facility contains customary non-financial covenants and requires EHI to maintain \$7.5 million of cash and cash equivalents at all times. As of the date of this filing, EHI had no amounts borrowed under the Amended Credit Facility. We are currently in compliance with all applicable covenants.

On February 21, 2008, EHI's Board of Directors authorized a stock repurchase program (the 2008 Program). The 2008 Program authorizes us to repurchase up to \$100 million of our common stock through June 30, 2009. We expect the shares to be repurchased from time to time at prevailing market prices in open market or private transactions, in accordance with applicable laws and regulations, and subject to market conditions and other factors. The repurchases may be commenced or suspended from time to time without

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prior notice. There can be no assurance that we will continue to undertake any repurchase of our common stock pursuant to the 2008 Program. Through June 30, 2008, we have repurchased 375,300 shares of common stock, at the average price paid including commissions of \$18.61 per share, for a total of approximately \$7.0 million.

On August 7, 2008, the Board of Directors declared a \$0.06 dividend per share, payable September 4, 2008, to stockholders of record on August 21, 2008.

Operating Subsidiaries. The primary sources of cash for EICN and ECIC, our insurance operating subsidiaries, are funds generated from underwriting operations, asset maturities and income received from investments. We use trend and variance analyses to project future cash needs at both the consolidated and subsidiary levels. Cash provided from these sources has historically been used primarily for claims and loss adjustment expense payments and operating expenses. In the future, we also expect to have sufficient cash from these sources for the payment of dividends to parent holding companies to the extent permitted by law.

Our net cash flows are generally invested in marketable securities. We closely monitor the duration of our investments and investment purchases, and sales are executed with the objective of having adequate funds available for the payment of claims at the subsidiary level and for the subsidiaries to pay dividends to EHI. Because our investment strategy focuses on asset and liability durations, and not specific cash flows, asset sales may be required to satisfy obligations or rebalance asset portfolios. At June 30, 2008, 94.6% of our investment portfolio consisted of fixed maturity and short-term investments and 5.4% consisted of equity securities.

The ongoing availability of cash to pay claims is dependent upon our disciplined underwriting and pricing standards and the purchase of reinsurance to protect us against severe losses and catastrophic events. On July 1, 2008, we entered into a new reinsurance treaty program (Reinsurance Program) that is effective through July 1, 2009. The Reinsurance Program consists of three contracts, one excess of loss treaty agreement and two catastrophic loss treaty agreements. The Reinsurance Program provides coverage up to \$200.0 million per loss occurrence, subject to certain exclusions. Our loss retention for the treaty year beginning July 1, 2008, is \$5.0 million. The coverage is subject to an aggregate loss in the first layer (\$5.0 million in excess of our \$5.0 million retention) of \$20.0 million and is limited to \$10.0 million for any loss to a single individual involving the second through fifth layers of our Reinsurance Program. In our catastrophe excess of loss contracts we have one mandatory reinstatement for each contract and layer. We believe that we are sufficiently capitalized for the above described retention.

As of June 30, 2008 on a consolidated basis, we had investments, which will mature over the next 24 months, and cash of approximately \$300 million. We believe that our liquidity needs over the next 24 months, including the acquisition and integration of AmCOMP, the payment of future stockholder dividends, stock repurchases and other capital expenditures will be met from the above sources.

Cash Flows

We monitor cash flows at both the consolidated and subsidiary levels and project future cash needs using trend and variance analyses.

The table below shows our net cash flows for the six months ended:

June 30,
2008 2007
(in thousands)

Cash and cash equivalents provided by (used in):

Operating activities	\$ 42,882	\$ 53,074
Investing activities	(26,923)	(2,254)
Financing activities	(13,005)	18,470
Increase in cash and cash equivalents	\$ 2,954	\$ 69,290

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Net cash provided by operating activities was \$42.9 million for the six months ended June 30, 2008, as compared to \$53.1 million for the same period in 2007. The \$10.2 million decrease in net cash flow from operations for the six months ended June 30, 2008, compared to the same period in 2007, was due to: (a) a decrease of \$20.1 million in net premiums received; (b) an increase of \$5.7 million in losses and LAE paid; and (c) offsetting decreases of \$7.5 million in underwriting expenses paid and \$10.7 million in income taxes paid. The decrease in underwriting expenses paid was related to one-time incurred expenses paid for consulting and professional fees for the conversion during the six months ended June 30, 2007. The reduction in income taxes paid was primarily related to income taxes paid in 2007 for the realized gain of \$42.9 million that resulted from the equity sales of \$169.2 million in the fourth quarter 2006.

Net cash used by investing activities was \$26.9 million for the six months ended June 30, 2008, as compared to \$2.3 million net cash used for the same period in 2007. The difference between periods was primarily attributable to investment of cash from operating activities.

Net cash used by financing activities was \$13.0 million for the six months ended June 30, 2008, as compared to \$18.5 million net cash provided for the same period 2007. The cash was primarily used to repurchase our common stock and to pay stockholder dividends. For the six months ended June 30, 2007, the cash provided by financing activities was primarily related to our conversion from a mutual insurance company to a stock company.

Investments

We employ an investment strategy that emphasizes asset quality and the matching of maturities of fixed maturity securities against anticipated claim payments and expenditures, other liabilities and capital needs. Our investment portfolio is structured so that investments mature periodically over time in reasonable relation to current expectations of future claim payments. Currently, we make claim payments from positive cash flow from operations and use excess cash to invest in operations, invest in marketable securities, return capital to our stockholders and fund our acquisition of AmCOMP.

At June 30, 2008, our investment portfolio, which is classified as available-for-sale, was made up almost entirely of investment grade fixed maturity securities whose fair values may fluctuate due to interest rate changes. We strive to limit interest rate risk by managing the duration of our fixed maturity securities. As of June 30, 2008, our fixed maturity securities (excluding cash and cash equivalents) had a duration of 5.54. The duration reflects additional short-term investments in anticipation of our acquisition of AmCOMP. To minimize interest rate risk, our portfolio is weighted toward short-term and intermediate-term bonds; however, our investment strategy balances consideration of duration, yield and credit risk. Our current investment guidelines require that the minimum weighted average quality of our fixed maturity securities portfolio shall be AA. As of June 30, 2008, our fixed maturity securities portfolio had an average quality of AA+, with approximately 87.3% of the carrying value of our investment portfolio rated AA or better. Our investment portfolio is comprised of less than 0.02% of subprime mortgage debt securities or derivative securities relating thereto. Agency backed mortgage pass-throughs totaled \$164.5 million or 9.6% of the total portfolio.

We carry our portfolio of equity securities on our balance sheet at fair value. In order to minimize our exposure to equity price risk and the resulting increases and decreases to our assets, we invest primarily in equity securities of mid-to-large capitalization issuers and seek to diversify our equity holdings across several industry sectors.

Our overall investment philosophy is to maximize total investment returns within the constraints of prudent portfolio risk. We employ Conning Asset Management (Conning) to act as our independent investment advisor. Conning follows our written investment guidelines based upon strategies approved by the EHI Board of Directors. In addition to the construction and management of the portfolio, we utilize the investment advisory services of Conning. These services include investment accounting and company modeling using Dynamic Financial Analysis (DFA). The DFA

tool is utilized in developing a tailored set of portfolio targets and objectives that are used in constructing an optimal portfolio.

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The following table shows the fair values of various categories of invested assets, the percentage of the total fair value of our invested assets represented by each category and the tax equivalent yield based on the fair value of each category of invested assets as of June 30, 2008:

Category	Fair Value (in thousands, except percentages)	Percentage of Total	Yield
U.S. Treasury securities	\$ 149,771		