Employers Holdings, Inc.
Form 10-Q
November 14, 2007

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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 September 30, 2007

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 of Incorporation) 04-3850065
(I.R.S. Employer Identification Number) 9790 Gateway Drive, Reno, Nevada
(Address of Principal Executive Offices) 89521
(Zip Code)
Registrant's telephone number, including area code: (888) 682-6671

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, or a non-accelerated filer. See definition of ''accelerated filer and large accelerated filer'' in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

As of November 9, 2007, there were 49,616,635 shares of the Registrant's common stock, par value $.01 per share, outstanding.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

EMPLOYERS HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	As of September 30, 2007 (unaudited)	As of December 31, 2006
Assets		
Available for Sale:		
Fixed maturity investments at fair value (amortized cost $1,619,110 at September 30, 2007 and $1,599,321 at December 31, 2006)	$ 1,621,148	$ 1,605,395
Equity securities at fair value (cost $61,861 at September 30, 2007 and $63,478 at December 31, 2006)	109,776	102,289
Short-term investments (at cost or amortized cost, which approximates fair value)	—	7,989
Total investments	1,730,924	1,715,673
Cash and cash equivalents	93,168	79,984
Accrued investment income	18,741	18,431
Premiums receivable, less bad debt allowance of $7,691 at September 30, 2007 and $6,911 at December 31, 2006	44,778	51,311
Reinsurance recoverable for:		
Paid losses	10,678	11,073
Unpaid losses, less allowance of $1,276 at each period	1,060,474	1,096,827
Funds held by or deposited with reinsureds	97,672	102,955
Deferred policy acquisition costs	15,268	13,767
Deferred income taxes, net	66,915	73,849
Property and equipment, net	15,074	15,598
Other assets	15,564	16,257
Total assets	$ 3,169,256	$ 3,195,725
Liabilities and stockholders' equity		
Claims and policy liabilities:		
Unpaid losses and loss adjustment expenses	$ 2,282,491	$ 2,307,755
Unearned premiums	70,813	73,255
Policyholders' dividends accrued	302	506
Total claims and policy liabilities	2,353,606	2,381,516
Commissions and premium taxes payable	8,674	6,776
Federal income taxes payable	10,017	24,262
Accounts payable and accrued expenses	12,063	22,178
Deferred reinsurance gain – LPT Agreement	429,342	443,036
Other liabilities	13,800	14,180
Total liabilities	2,827,502	2,891,948

See accompanying unaudited notes to consolidated financial statements.

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EMPLOYERS HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

As
of
September 30,
2007 As of
December 31,
2006 (unaudited) Commitments and contingencies Stockholders' equity: Common stock,
$0.01 par value; 150,000,000 shares authorized;
53,527,907 and 0 shares issued and 49,902,386 and 0 shares outstanding at September 30, 2007 and
December 31, 2006,
respectively 535 — Preferred stock, $0.01 par value; 25,000,000 shares authorized;
none issued — — Additional paid-in capital 302,044 — Retained earnings 75,749 274,602
Accumulated other comprehensive income, net 32,469 29,175 Treasury stock, at cost (3,625,521 shares at
September 30, 2007
and 0 shares at December 31, 2006) (69,043) — Total stockholders' equity 341,754 303,777 Total
liabilities and stockholders' equity $ 3,169,256 $ 3,195,725
See accompanying unaudited notes to consolidated financial statements.

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EMPLOYERS HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
	(unaudited)			
Revenues				
Net premiums earned	$ 88,527	$ 95,990	$ 262,436	$ 300,137
Net investment income	19,246	17,237	59,386	49,715
Realized (losses) gains on investments, net	146	2,758	(322)	5,660
Other income	861	1,451	3,047	3,694
Total revenues	108,780	117,436	324,547	359,206
Expenses				
Losses and loss adjustment expenses	40,867	(34,753)	111,336	95,745
Commission expense	12,411	11,878	35,797	36,762
Underwriting and other operating expense	21,726	22,637	67,778	59,151
Total expenses	75,004	(238)	214,911	191,658
Net income before income taxes	33,776	117,674	109,636	167,548
Income taxes	3,896	40,682	21,117	51,060
Net income	$ 29,880	$ 76,992	$ 88,519	$ 116,488
Net income after date of conversion (Note 2)			$ 82,048	

Earnings per common share for the periods (Note 9):

	For the Three Months Ended September 30, 2007	For the period February 5 through September 30, 2007
Basic	$ 0.58	$ 1.55
Diluted	$ 0.58	$ 1.55

	Pro forma for the three months ended September 30, 2006	Pro forma for the nine months ended September 30, 2007	Pro forma for the nine months ended September 30, 2006
Basic	$ 1.54	$ 1.69	$ 2.33
Diluted	$ 1.54	$ 1.69	$ 2.33

Cash dividends declared per common share	$ 0.06	$ —	$ 0.12	$ —

See accompanying unaudited notes to consolidated financial statements.

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EMPLOYERS HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EQUITY (unaudited)
(in thousands, except share data)

	Common stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income, net	Treasury stock, at cost	Total Stockholders' equity
	Shares	Amount					
Balance, January 1, 2006	—	$ —	$ —	$ 103,032	$ 41,575	$ —	$ 144,607
Comprehensive income:							
Net income for the period	—	—	—	116,488	—	—	116,488
Change in net unrealized gains on investments, net of taxes	—	—	—	—	11,960	—	11,960
Comprehensive income							128,448
Balance, September 30, 2006	—	$ —	$ —	$ 219,520	$ 53,535	$ —	$ 273,055
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 (Note 8)	—	—	902	—	—	—	902
Acquisition of treasury stock (Note 7)	—	—	—	—	—	(69,043)	(69,043)
Dividend to common stockholders	—	—	—	(6,299)	—	—	(6,299)
Comprehensive income:							
Net income before conversion	—	—	—	6,471	—	—	6,471
Net income after conversion	—	—	—	82,048	—	—	82,048
Net income for the period	—	—	—	88,519	—	—	88,519
Change in net unrealized gains on investments, net of taxes	—	—	—	—	3,294	—	3,294
Comprehensive income							91,813
Balance, September 30, 2007	53,527,907	$ 535	$ 302,044	$ 75,749	$ 32,469	$ (69,043)	$ 341,754

See accompanying unaudited notes to consolidated financial statements.

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EMPLOYERS HOLDINGS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended September 30,	
	2007	2006
	(unaudited)	
Operating activities		
Net income	$ 88,519	$ 116,488
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,517	2,726
Stock based compensation	902	—
Amortization of premium on investments, net	4,848	4,072
Allowance for doubtful accounts – premiums receivable	780	1,910
Deferred income tax expense	5,160	2,445
Realized losses (gains) on investments, net	322	(5,660)
Change in operating assets and liabilities:		
Accrued investment income	(310)	(2,291)
Premiums receivable	5,753	6,861
Reinsurance recoverable on paid and unpaid losses	36,748	34,832
Funds held by or deposited with reinsureds	5,283	9,315
Unpaid losses and loss adjustment expenses	(25,264)	(34,422)
Unearned premiums	(2,442)	(2,405)
Federal income taxes payable	(14,245)	21,839
Accounts payable, accrued expenses and other liabilities	(11,400)	—
Deferred reinsurance gain – LPT Agreement	(13,694)	(14,614)
Other	(3,041)	(15,233)
Net cash provided by operating activities	82,436	125,863
Investing activities		
Purchase of fixed maturities	(214,197)	(381,350)
Purchase of equity securities	(1,021)	(11,054)
Proceeds from sale of fixed maturities	156,471	131,141
Proceeds from sale of equity securities	2,744	18,489
Proceeds from maturities and redemptions of investments	40,650	127,521
Capital expenditures and other, net	(3,993)	(4,929)
Net cash used in investing activities	(19,346)	(120,182)
Financing activities		
Issuance of common stock, net	486,670	(799)
Cash paid to eligible policyholders under plan of conversion	(462,989)	—
Acquisition of treasury stock	(67,288)	—
Dividend paid to stockholders	(6,299)	—
Net cash used by financing activities	(49,906)	(799)
Net increase in cash and cash equivalents	13,184	4,882
Cash and cash equivalents at the beginning of the period	79,984	61,083
Cash and cash equivalents at the end of the period	$ 93,168	$ 65,965
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 and Principles of Consolidation

Employers Holdings, Inc. (EHI) is a holding company and is the successor to EIG Mutual Holding Company (EIG), which was incorporated in Nevada in 2005. The Company's two wholly-owned insurance subsidiaries, Employers Insurance Company of Nevada (EICN) and Employers Compensation Insurance Company (ECIC) 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 of the Company 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 2006 Annual Report on Form 10-K (Annual Report) for the year ended December 31, 2006, filed with the Securities and Exchange Commission (SEC) on March 30, 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 of the Company 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 September 2006, the Financial Accounting Standards Board (FASB) issued 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. SFAS No. 157 also requires expanded disclosures about (1) the extent to which companies measure assets and liabilities at fair value, (2) the methods and assumptions used to measure fair value, and (3) the effect of fair value measures on earnings. The Company will adopt SFAS No. 157 on January 1, 2008, and is currently evaluating the impact that the adoption of SFAS No. 157 will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115, Accounting for Certain

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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 objective of this standard is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reporting earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 permits all entities to choose to measure eligible items at fair value at specified election dates. Entities will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option: (1) may be applied instrument by instrument, with a few exceptions, such as investments accounted for by the equity method; (2) is irrevocable (unless a new election date occurs); and (3) is applied only to entire instruments and not to portions of instruments. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007, which for the Company would be the fiscal year beginning January 1, 2008. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply FASB Statement No. 157, Fair Value Measurements. The Company did not make such an election. The Company is currently evaluating the impact that the adoption of SFAS No. 159 will have on its consolidated financial statements.

Reclassifications

Certain prior year information has been reclassified to conform to the current period presentation.

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. 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 an 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, of which $0.9 million was incurred in the period from January 1, 2007 through February 5, 2007 and $3.5 million was incurred during the nine months ended September 30, 2006. 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 have no tax benefit and were expensed as incurred and are included in the underwriting and other operating expense in the accompanying consolidated statement of income for the nine months ended September 30, 2007.

3. Income Taxes

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes and Interpretation of FASB Statement No. 109 (FIN 48), effective January 1, 2007.

As of December 31, 2006, the Company had recorded, as a liability for tax contingencies, $14.9 million (including interest of $1.6 million). The adoption of FIN 48 did not result in any change in the amount of the unrecognized tax benefit. The Company elected to continue to record both interest and penalties related to any unrecognized tax benefits as a component of income tax expense.

During the three months ended September 30, 2007, the Company reversed $5.8 million of liabilities for previously unrecognized tax benefits which includes $0.7 million of related accrued interest, as a result of certain statutory periods expiring. The reversal decreased the Company’s three and nine months ended

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September 30, 2007, effective tax rate by 14.5 and 4.3 percentage points, respectively. There were no adjustments to the unrecognized tax benefit liability during the first six months of fiscal 2007. It is reasonably possible that the remaining balance of the unrecognized tax benefits of $10.1 million (including interest of $1.8 million), will be recognized during the second half of fiscal 2008 as statutory periods expire.

Tax years 2004 through 2006 are subject to examination by the federal taxing authority. There are no income tax examinations currently in progress.

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:

Nine Months Ended September 30,	2007	2006
	(in thousands)	
Beginning of the period	$ 2,307,755	$ 2,349,981
Reinsurance recoverable for incurred but unpaid losses and LAE	(1,098,103)	(1,141,500)
Beginning balance, net of reinsurance	1,209,652	1,208,481
Incurred losses and LAE, net of reinsurance related to:		
Current period	168,481	192,080
Prior period	(43,451)	(81,721)
Total incurred losses and LAE, net of reinsurance	125,030	110,359
Losses and LAE payments, net of reinsurance, related to:		
Current period	26,702	25,556
Prior period	87,239	83,796
Total losses and LAE payments, net of reinsurance	113,941	109,352
Balance, net of reinsurance, September 30	1,220,741	1,209,488
Reinsurance recoverable for incurred but unpaid losses and LAE	1,061,750	1,106,071
Balance, September 30	$ 2,282,491	$ 2,315,559

The above table excludes the impact of the amortization of the deferred gain – LPT Agreement and the reduction of the ceded reserves on the LPT Agreement (Note 5). The Company amortized $13.7 million and $14.6 million of the deferred gain for the nine months ended September 30, 2007 and 2006, respectively, which are reflected in losses and LAE incurred in the consolidated statements of income.

Estimates of incurred losses and LAE attributable to insured events of prior periods decreased due to continued favorable development in losses for such prior accident years (actual losses paid and current projections of unpaid losses were less than the Company originally anticipated). The reduction in the liability for unpaid losses and LAE was $43.4 million and $81.7 million for the nine months ended September 30, 2007 and 2006, respectively, which includes $7.4 million and $68.9 million in reductions during the three months ended September 30, 2007 and 2006, respectively. The $7.4 million and $43.4 million include an offset of $1.6 million related to the impact of a commutation of excess loss reinsurance agreements covering the periods July 1, 2000 to June 30, 2002. The major sources of this favorable development are attributable to actual paid losses being less than expected and the continued recalibration of selected patterns of claim emergence and claim payment 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 initial deferred gain resulting from the LPT Agreement was recorded as a liability in the accompanying consolidated balance sheets and is being amortized using the recovery method over the

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period the underlying reinsured claims are paid. The Company amortized $4.6 million and $13.7 million of the deferred gain for the three months and nine months ended September 30, 2007, respectively, and $5.0 million and $14.6 million of the deferred gain for the three months and nine months ended September 30, 2006, respectively. The adjustments to the deferred gain are recorded in losses and LAE incurred in the accompanying consolidated statements of income. The remaining deferred gain was $429.3 million and $443.0 million as of September 30, 2007 and December 31, 2006, respectively, which is included in the accompanying consolidated balance sheets as deferred reinsurance gain – LPT Agreement.

6. Other Comprehensive Income

Comprehensive income encompasses all changes in equity (except those arising from transactions with stockholders) and includes net income and changes in net unrealized investment gains and losses on investment securities available for sale, net of taxes. The following table summarizes the components of accumulated other comprehensive income as of September 30:

	2007	2006
(in thousands)		
Net unrealized gain on investment, before taxes	$ 49,953	$ 82,135
Deferred tax expense	(17,484)	(28,600)
Total accumulated other comprehensive income, net of taxes	$ 32,469	$ 53,535

The following table summarizes the change in the components of total comprehensive income for three months and nine months ended September 30, 2007 and 2006:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
(in thousands)				
Unrealized gains arising during the period, before taxes	$ 29,059	$ 51,062	$ 4,746	$ 23,833
Less: income tax expense	10,131	17,724	1,661	8,194
Unrealized gains arising during the period, net of taxes	18,928	33,338	3,085	15,639
Less: reclassification adjustment:				
Realized gains (losses) realized in net income	146	2,758	(322)	5,660
Income tax expense (benefit)	51	965	(113)	1,981
Reclassification adjustment for realized gains (losses) in net income	95	1,793	(209)	3,679
Other comprehensive income	18,833			