Western World Insurance Group

2004 Annual Report

Strength and security for the long-term.

Western World Insurance Group

2004 Annual Report

Binding Authority

Brokerage

Programs

Western World Insurance Company
A.M. Best A+ (Superior), Financial Size Category Class VIII

Tudor Insurance Company
A.M. Best A+ (Superior), Financial Size Category Class VIII

Stratford Insurance Company
A.M. Best A+ (Superior), Financial Size Category Class VIII

- General Liability
- Products Liability
- Professional Liability
- Commercial Automobile
- Property

www.westernworld.com

Message to the Shareholders

In 2004 the Western World Insurance Group achieved, by all financial measures, its most successful year. The Group's strong financial performance is matched by the quality of its business presence among its producer force. We admire, respect and appreciate our agents for the vital role they play in a very difficult environment, and we are pleased by the growing quality and size of our relationships with them.

In addition to successful marketing and underwriting of its products, the Group remains especially active in industry regulatory and legislative affairs. With change in the air, it is important that the Group be part of the process rather than simply react to the outcomes of government initiatives.

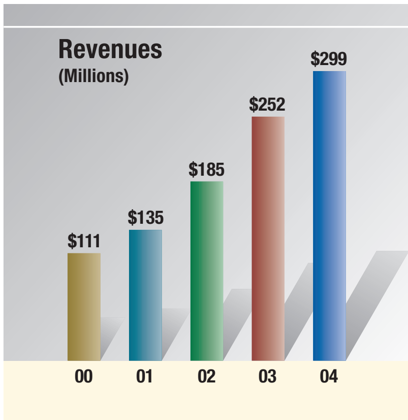
The strength, security and constancy achieved by the Group over the past four decades are rare assets in the specialty commercial insurance business. In the years ahead, they will serve us well and continue to benefit our shareholders and business partners.

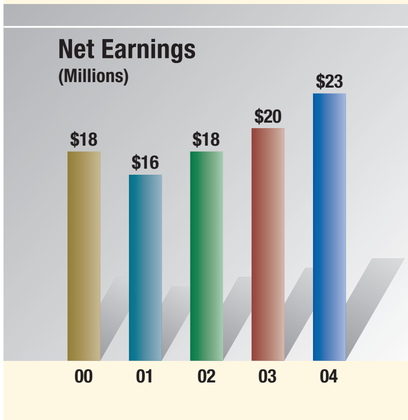
Group Results

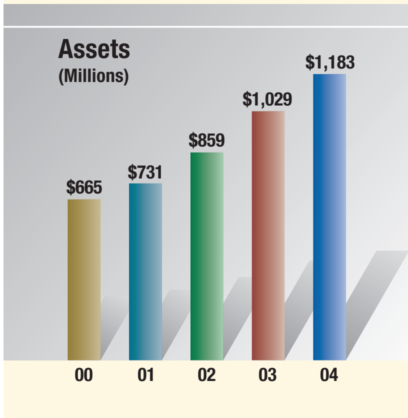
Group revenues, which include net earned premiums and investment income, increased 18% from $252 million in 2003 to $299 million in 2004. This revenue growth is largely attributable to continued growth in premiums in our insurance company subsidiaries. Investment income grew more than the year before, but still by a modest amount, as very low interest rates continue to hold the rate of growth of investment income significantly below the underlying growth of our insurance operations.

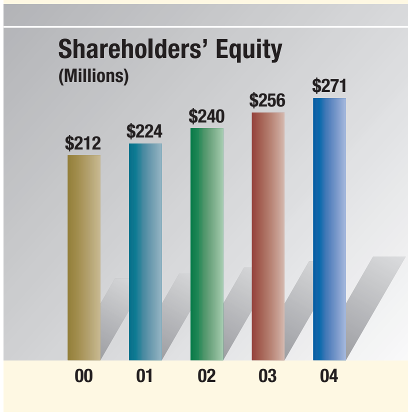
Group profits grew by 13% from $20.3 million in 2003 to $23.0 million in 2004. On a per share basis, profits improved from $454 to $513.

Group assets grew from $1.0 billion to $1.2 billion. These assets include an investment portfolio of $807 million plus substantial unrealized gains. In view of our perception of heightened interest rate risk as well as greater potential for event risk in the capital markets, our current investment policy is even more conservative than usual. Our investment portfolio is liquid, of the highest credit quality and positioned to gain from better investment opportunities in the future.









Shareholders' equity rose from $256 million in 2003 to $271 million in 2004, while book value per share increased from $5,704 to $6,034. Many observers of the insurance industry consider growth in tangible book value to be the best measure of long-term performance. Few insurance companies, let alone those operating in the volatile surplus lines sector, have consistently reported increases in tangible book value. Western World has achieved this every single year, for forty years.

Company Results

Direct premiums written for our three operating companies grew a combined 9% from $297 million to $325 million. All of our five underwriting departments grew in 2004, led by our core Contract Casualty department. Each department is featured later in this report.

Some financial analysts consider private ownership to be a barrier to competitive strength and success. Our experience is to the contrary—secure private ownership has allowed us to focus on long-term stability, without distraction from the quarterly financial reporting pressure brought to bear on publicly-held companies.

As a result, Western World was free to grow capital and not premiums during the soft market of the 1990s. This positioned Western World to respond to its agents in the following hard market with premium growth of more than 300% between the years 2000 and 2004.

Despite this rapid growth, Western World maintains the conservative capitalization ratio of 1.2 to 1 net premiums written to policyholders' surplus. This was achieved quietly without any need to replenish capital or externally fund hard market growth.

The consolidated statutory combined ratio improved to 99.4% in 2004 from 100.1% in 2003. This is the first year in more than a decade that our combined ratio was less than 100%. The recently improved environment for pricing and policy terms is now revealing itself in our statutory figures.

Even though pricing is better than it was a few years ago, the underwriting of U.S. casualty insurance remains a risky business and arguably grows riskier each year, regardless of pricing. Therefore, we are very cautious about declaring instant underwriting profits on long-tail casualty business written today when the true loss costs will not be known for years.

Other insurance companies are more optimistic about their current results and are reporting combined ratios on new business far below 99%. This may be perfectly justifiable for the moment, based upon the favorable pricing trends of the past few years. We hope that they are right.

However, at Western World we choose to take a more conservative approach and carry our reserves for losses at the high end of the range established by our outside actuaries, rather than the acceptable middle of the range. Moreover, our reserves for claims not yet reported to us approximate 80% of all loss reserves. Using this conservative approach, our reserves established in the past have developed favorably every year for almost two decades.

The statutory surplus of the Western World Insurance Company increased to $222 million in 2004 from $201 million in 2003. The statutory surpluses of Western World's two subsidiaries, Tudor and Stratford Insurance Companies, also grew in 2004.

All three companies share the A.M. Best group rating of A+ (Superior) Financial Size Category VIII. For the 10th consecutive year, the Group also achieved "Ward's 50" status as one of the nation's top performing property/casualty insurers.

Our conservative business practices, supported by our private ownership, lead to strength and security for our insureds, agents and shareholders. This approach has resulted in the strong financial foundation and industry recognition that make us a reliable business partner even in the most difficult times. This remains our strategy for the future.

Business Conditions and Outlook

Business conditions for the specialty commercial insurance industry remain favorable. The vast improvement in rates and policy terms that has occurred since the excessively competitive years of the late 1990s has been essential to preserve the long-term viability of the marketplace. Consumers, producers and underwriters all have a stake in this.

For the most part, the financial damage of the last soft market has been repaired, the weak competitors have withdrawn, and the survivors are strong. There is a reasonable equilibrium between healthy pricing and healthy competition.

However, equilibrium has never been a sustainable condition in our industry. There are signals everywhere that pricing is peaking sector by sector, and competition is on the rise. In our business, we see evidence of this in the larger premium accounts.

continued

In our view, there are three primary reasons why market conditions are turning softer so quickly after achieving a brief equilibrium:

Wall Street. The investing public favors companies exhibiting growth over those that are not. The short-term rewards for short-term growth can be substantial, and the short-term penalties for discipline can also be substantial. In an industry that once again is hardly growing overall, superior growth can only be achieved by gaining market share via lower prices. This is not to assign blame, it is just how the economics work.

New Capacity. In the post 9/11 hard market a good number of new, well-capitalized companies were formed—largely offshore. These companies have prospered in the latest hard market, have excess capital to put to work and are unencumbered with losses from the distant past. As a consequence, they appear more anxious to grow from this point forward than their more established domestic counterparts.

Prosperity. The companies with the staying power through the last soft market have prospered in the hard market since 2001. This is especially true of the specialty commercial sector. There is the natural tendency under such circumstances to compete a little harder, and that tendency may not be ill founded for the moment.

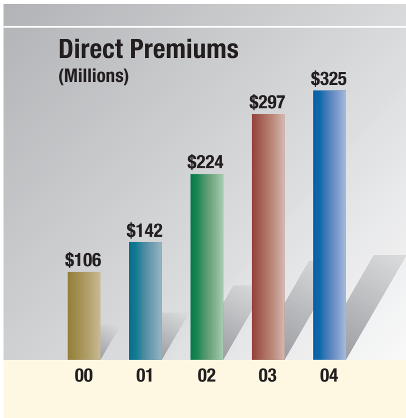
However, we believe that there are sound reasons that the return of competition will not lead to the destructive competition of the 1996–2000 years.

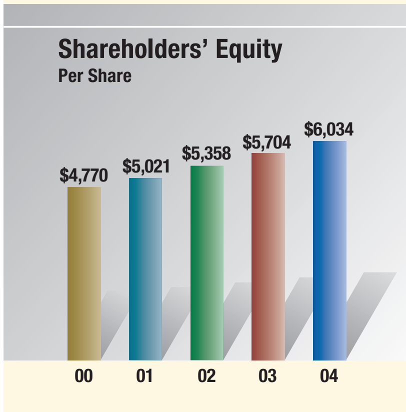
These are factors that should be considered:

New Accounting Standards. In the new world of Sarbanes-Oxley, all managements, directors and outside auditors are more focused than ever on accurate accounting. If future market conditions were to deteriorate significantly, companies would be more likely than before to post rising loss ratios in response. This would help the market correct itself sooner and before reaching the crisis conditions of the last soft market.

Lack of Prosperity. Industry underwriting results are the best in decades. Yet at this moment of peak prosperity, industry return on equity will not even exceed single digits, while many other industries achieve double digit ROEs on a regular basis. Under such circumstances, it is highly unlikely that a meaningful amount of new capital will be raised to further fuel competition.

Low Interest Rates. Despite the recent rise in short-term interest rates, intermediate and long-term interest rates—where companies invest—have not risen at all above historic lows. This contributes to the low industry ROE. More importantly, it highlights the fact that decent profits cannot be earned without decent underwriting results.





Diminished Reinsurance Market. The soft market of the late 1990's was especially damaging to reinsurers. This caused a number of significant reinsurers to withdraw from the market permanently. These business failures, combined with the rise in claims disputes, make for a very uneasy market. Reinsurance sellers remain wary, given their recent experience; reinsurance buyers are also wary and more suspicious of the value of the reinsurers' promise to pay. It is less likely than before that reinsurers will be enthusiastic enablers of excessive competition.

Memory of the Recent Past. The excessively competitive conditions of the recent past were ruinous for many companies. Memories are short, but not that short. Managements, investors and directors are all well aware of the consequences of straying too far from sound underwriting principles in an industry where risk is not always easy to identify.

Each of these factors involves motivation. We foresee ample industry motivation to keep the industry-competitive conditions far closer to equilibrium than was the case in the last soft market. The market of the next few years will present opportunity for companies that execute well.

No review of the overall business outlook is complete without a comment about the regulatory outlook. Less regulation and more uniform regulation are in the best interests of consumers, producers and insurance companies alike. There are many participants in the market who believe that increased involvement by the federal government in the regulation of insurance will lead to those dual results. As a practical matter, greater involvement of the federal government in the regulation of insurance business will most likely only lead to more regulation, not less. One must look no further than the current investigations of illegal behavior in the industry to conclude that for any movement toward federal regulation, the sentiment will be for more onerous regulation, not less.

The stakes are high, which is why Western World is especially active in each of the trade associations to which it belongs.

The breakout of the investigations of the insurance industry, and the facts revealed, led to a troubling end to 2004. However, a positive outcome is likely for the industry at large. An increased emphasis on integrity and fair dealing in this industry will be more than welcome by the public and will lead to a healthier industry over time.

Western World and the Future

Western World has five long-standing competitive advantages:

- Quality relationships with the best wholesale producers developed over 40 years;
- Financial strength, stability and consistency;
- Secure private ownership, free of demands for short-term results;
- Very long tenure of talented management and staff who share the same culture;
- A wide array of specialty commercial insurance products.

These competitive advantages are well suited for the market outlook that we anticipate, and we look forward to building our market presence further in the years ahead.

Forty years of successful experience in our market sector have equipped Western World to address the challenges and opportunities outlined here. The skill and dedication of our staff are our greatest assets, and we deeply appreciate their daily efforts. Our producers and reinsurers are our essential business partners; their success continues to be key to our success. Our directors and shareholders are remarkable in the value of their guidance and their consistent support.

With these resources at hand, we look forward to capitalizing on what has been achieved so far and meeting the challenges of the future.

Andrew S. Frazier
President and Chief Executive Officer

March 2005

Consolidated Balance Sheet*

Western World Insurance Group, Inc.

Assets

	2004	December 31, 2003
Bonds and Sinking Fund Preferred Stocks (Held to Maturity) — at Amortized Cost (Market Value $692,935,066 and $576,486,942)	**$ 676,714,948**	$ 554,610,815
Bonds and Sinking Fund Preferred Stocks (Available for Sale) — at Market Value (Amortized Cost $111,962,667 and $136,740,599)	**114,017,824**	141,356,461
Common and Other Preferred Stocks — at Market Value (Cost $14,824,338 and $11,358,782)	**16,004,679**	11,531,964
Total Investments	**806,737,451**	707,499,240
Cash	**489,866**	1,023,568
Uncollected Premiums	**39,184,151**	34,374,863
Deferred Policy Acquisition Costs	**34,029,759**	31,058,250
Deferred Federal Income Tax	**21,532,295**	19,035,278
Reinsurance Balances Recoverable	**267,836,903**	223,004,250
Other Assets	**12,841,495**	12,515,087
Total Assets	**$1,182,651,920**	$1,028,510,536

Financial Highlights*

	2004	2003	Change
Revenues	**$ 298,601,635**	$ 252,434,847	18.3%
Assets	**1,182,651,920**	1,028,510,536	15.0%
Shareholders' Equity	**271,291,788**	255,622,314	6.1%
Net Income	**23,029,738**	20,322,246	13.3%
Earnings Per Share	**513**	454	13.0%
Book Value Per Share	**6,034**	5,704	5.8%
Return on Equity	**9.0%**	8.5%	

*These GAAP statistics have been condensed from the Group's financial statements as audited by Ernst & Young LLP.

Liabilities

	2004	December 31, 2003
Losses and Loss Adjustment Expenses	**$666,727,541**	$548,948,138
Unearned Premiums	**139,585,262**	129,627,229
Funds Held Under Reinsurance Treaties	**69,875,780**	56,766,631
Other Liabilities	**35,171,549**	37,546,224
Total Liabilities	**$911,360,132**	$772,888,222

Shareholders' Equity

Common Stock	**$ 903,460**	$ 903,460
Paid-In Capital	**6,596,714**	6,270,207
Retained Earnings	**263,791,614**	248,448,647
Total Shareholders' Equity	**$ 271,291,788**	$ 255,622,314
Total Liabilities and Shareholders' Equity	**$1,182,651,920**	$1,028,510,536

Statutory Highlights**

	2004	2003	2002	2001	2000
Premiums Written	**$324,929,589**	$296,805,905	$223,675,731	$141,588,052	$105,664,048
Policyholders' Surplus	**222,113,355**	201,133,619	192,472,093	184,840,781	168,103,314
Assets	**859,190,021**	749,845,990	647,373,255	578,046,644	525,108,327
Combined Ratio	**99.4%**	100.1%	101.6%	106.5%	104.7%
Ratio of Net Premiums Written to Policyholders' Surplus	**1.2 to 1.0**	1.2 to 1.0	.9 to 1.0	.6 to 1.0	.5 to 1.0

*These GAAP statistics have been condensed from the Group's financial statements as audited by Ernst & Young LLP.

**These statistics were condensed from the Companies' Statutory Annual Statements as filed with the New Hampshire Insurance Department.

Policyholders' Rating A+ (Superior) Financial Size Category Class VIII by A.M. Best Company.

Products and services from the General Agency Division capitalize on specific market opportunities and challenges.

General Agency Division

Western World Contract Casualty

Stratford Transportation

The General Agency Division business is distributed through select general agents located throughout the United States. The Division is made up of distinct Underwriting Departments: **Western World Contract Casualty** and **Stratford Transportation**.

The cornerstone of the General Agency Division is the binding authority granted to our agents and the trust necessary for our partnerships to be successful. The Western World Insurance Group has been a leader in surplus lines binding authority distribution for most of our forty years.

Our products, authority and services can be tailored to the specific market opportunities and challenges presented to our agents as well as the marketing strengths of the agency itself. Our personalized service, unique range of products and favorable market conditions contributed to another year of premium volume increase in 2004.

The Contract Casualty Department offers general and professional liability on small-to-medium size commercial risks which can be packaged with property coverage. The Transportation Department offers commercial automobile liability, physical damage and cargo coverages. All contract agents with access to the General Agency Division also have access to our Specialty Brokerage Division and are encouraged to explore professional liability opportunities with Tudor Professional.

During 2004, we moved several technology projects forward, with specific emphasis on greater connectivity between the Company, our agents and brokers. Most notable are our enhanced website, which will be introduced shortly, and the electronic transfer of policy information, which will greatly improve the efficiency of all parties to the transaction.

The General Agency Division can provide a completely autonomous product line, or we can work in conjunction with other underwriting areas to fulfill several product needs for our select general agents. In our view, our success in distributing small-to-medium size commercial risks, on a binding authority basis, depends on our careful selection of classes, the management of our underwriting authority and aligning ourselves with the best possible business partners. We have made a commitment to enhance these business relationships by using all the tools available to us in underwriting, marketing, technology, claims and customer service.

Examples of general and professional liability classes underwritten are as follows:

- Alcohol/Drug Rehab Centers
- Ambulance Attendants
- Amusement Devices
- Apartments
- Athletic Events
- Buildings
- Clubs
- Contractors
- Day Care
- Dwellings
- Exercise or Health Studios
- Home Health Care
- Homeowners' Associations
- Janitorial
- Law Enforcement
- Nurses/Nurses' Registries
- Outpatient Clinics
- Pest Control
- Schools
- Social Workers
- Special Events
- Tanning Salons
- Therapists
- Volunteer Fire Fighters

The majority of classes offered can be packaged with property coverage.

In 2004, Western World Contract Casualty premium volume increased by 12.5% in both monoline (general liability) and package policies. This represents the fifth consecutive year of increased premium volume and policy count as well as a large number of referral submissions. With our enhancements in technology, as mentioned earlier, we will improve our service and efficiencies to our agents.

Examples of commercial auto classes underwritten are as follows:

- Bobtail/Deadhead
- Contractors/Artisans
- Day-Care Buses
- Dump Trucks
- Flatbeds
- Grain Haulers
- Limousines
- Loggers
- Social Service Agencies
- Taxis
- Truckers
- Wreckers

Coverages offered include liability, physical damage and cargo.

The growth in Commercial Auto that began in 1999 continued into 2004, albeit at a slower pace than in previous years. Terms and pricing stabilized, but at levels significantly higher than those of the soft market period of the 1990's. We expect the market to remain at this plateau through 2005.

The Commercial Automobile Department maintains a very selective distribution system of approximately 30 agents with commercial auto expertise.

We leverage our core competencies to provide tailored solutions for program administrators with unique liability exposures.

Westco Programs

Westco Programs capitalizes on the core competencies within the Western World Insurance Group. The year 2004 marked the fifth consecutive year of growth for Westco Programs with written premiums rising 16% through further diversification of supported programs.

Westco Programs caters to program administrators who place a high value on personalized attention and program protection and who add value to the distribution process through their own expertise in a specific class of business. The clients of Westco Programs focus on affinity group marketing, which often involves trade association ties and often requires tailored solutions for unique liability exposures.

In Westco Programs, we take the time necessary to completely understand the needs of an affinity group and the underwriting expertise of the agent. We serve a market niche where a lofty premium volume commitment is not essential to our business plan. All of our clients have the attention of senior management, receive our highest levels of service and have access to all areas of the Company.

In addition, Westco Programs offers exclusivity and program protection, where warranted. Westco Programs' customers usually have established books of business and are in search of a market that will be more protective and responsive to their needs. As a business practice, Westco provides greater access to management and demonstrates the value of the relationship through service, exclusivity and attention to detail. Westco Programs generally seeks programs that initially have production between $1 million and $5 million per year.

The Westco team takes pride in the number of unique programs successfully underwritten thus far and has applied its formula for success to such diverse affinity groups as:

- Crane Operators
- Equine Risk
- Fire Suppression Contractors
- Foster Care Services
- HVAC Contractors
- Hospitality
- Hot Air Balloons
- Janitorial Services
- Landscapers
- Property Recovery Agencies
- Psychologists
- Security Services
- Sports Camps
- Swim Clubs
- Whitewater Outfitters & Guides

The Westco Programs Underwriting Department designs tailored solutions for the following types of exposures:

- Professional and commercial general liability;
- Classes that are difficult to price and where published rates are not available;
- Clients needing manuscripted coverages;
- Unique risks that are typically recognized only in the Surplus Lines marketplace.

Westco Programs will provide tailored binding authority to qualified program managers (retail or wholesale) and can bring together the underwriting and claims expertise from all Divisions in the Group.

For the firms we insure, maintaining professional liability coverage is often vital to their continued operation.

Professional Liability Brokerage Division

Tudor Professional

The Western World Insurance Group has specialized in writing professional liability coverage for the majority of its forty-plus years of operation. **Tudor Professional** continues that tradition with a dedicated staff and high service standards.

The 2004 legal and social environment continued to challenge the insurance industry in several sectors, with the professional liability marketplace no exception. The liability faced by the professionals we insure is of a personal nature, and maintaining professional liability coverage is often vital to their continued operation.

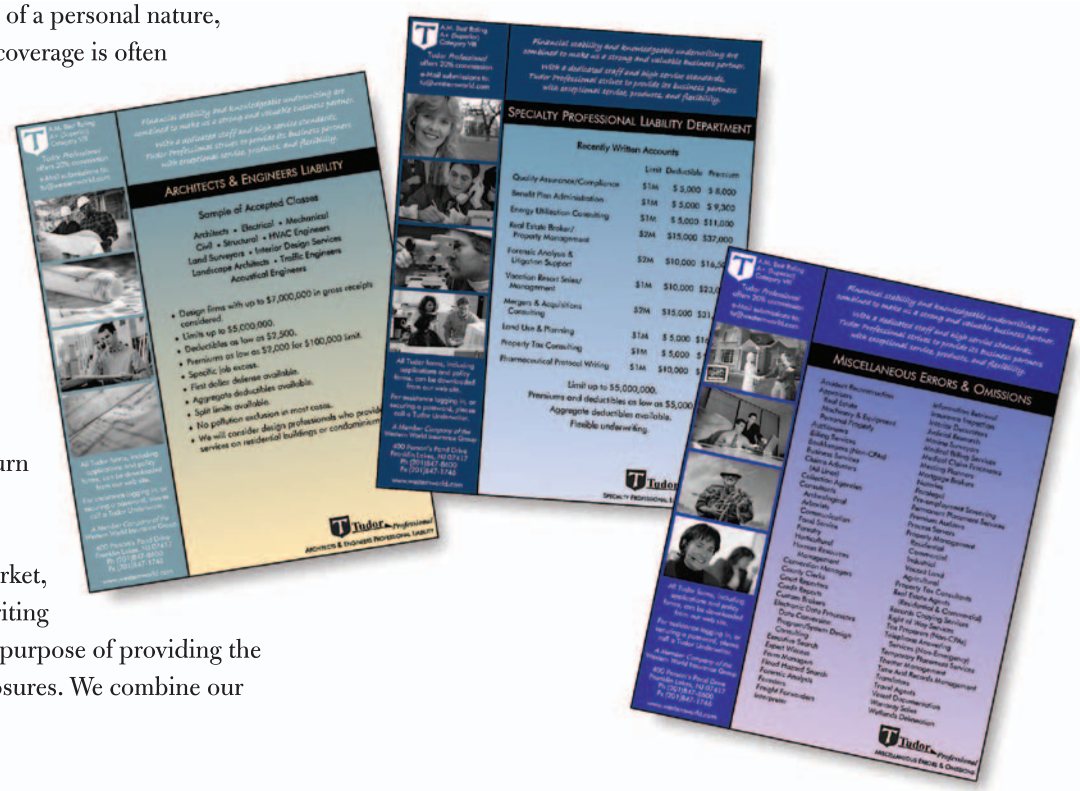
During 2004, we were able to maintain our underwriting principles, adjust our business mix for the best possible results and continue the moderate, but steady, annual growth that we have experienced for the past five years.

2004 will undoubtedly be looked upon as a transitional year for the property/casualty market with the return of increased competition, while others withdrew from unprofitable classes of business. With the volatility of this market, we constantly re-evaluate our underwriting guidelines and policy wording for the purpose of providing the proper coverage for the expected exposures. We combine our disciplined approach with the financial strength of the Western World Insurance Group to maintain our historically profitable book of business while achieving controlled growth.

Financial stability and knowledgeable underwriting combined to make us a strong and valuable business partner. In addition, our diverse and extensive menu of products meets the vast majority of our brokers' professional liability product needs. **Current products written by Tudor Professional include:**

- Specialty Professional Liability
- For-Profit Directors and Officers Liability
- Non-Profit Directors and Officers Liability
- Non-Profit Organization Professional Liability
- Fiduciary Liability
- Information Technology Professional Liability
- School Board Liability
- Public Officials Liability
- Miscellaneous Professional Liability
- Architects and Engineers Liability
- Business and Technical Consultants Errors and Omissions
- Real Estate Professional Liability

Tudor Professional is available to all appointed brokers.



Specialty Brokerage has the resources to analyze and write larger, more complex general liability and products liability policies.

Specialty Brokerage Division

Tudor Specialty Brokerage

Tudor Specialty Brokerage, formed in June of 1996, offers balance and diversification to the Group and our general agents. Specialty Brokerage writes larger, more complex general liability and product liability risks distributed through excess and surplus lines brokers.

Tudor Specialty Brokerage complements the Western World portfolio through:

- The utilization of a distinct distribution channel;
- A staff of seasoned underwriters dedicated to the service standards required to compete in the middle market segment;
- The resources to analyze intricate and hard-to-place primary business driven by the risk of severe loss.

The Division has an ample appetite for a broad spectrum of general liability risks such as large habitational risks, heavy equipment manufacturers, equipment rental and millwright contractors. Specialty's risk portfolio is divided between general liability and products liability exposures.

The long-term objective is to grow Tudor Specialty Brokerage profitably and to evolve into an increasingly influential player in the individual risk Surplus Lines casualty marketplace. To this end, the Division executes its focused marketing strategy by limiting the number of producers with access to the facility, allowing Specialty to offer the highest possible service standards. In addition, the Division also understands the culture of the Group's binding authority agents who have relationships with other underwriting divisions. This dual focus is unique to the Specialty Brokerage Division and will enable Specialty to achieve longer-term competitive advantages. In 2004, the Division added to staff to ensure that our underwriting and marketing goals could be achieved.

In order to make difficult risks acceptable or affordable, accounts can be written on either an occurrence or claims-made policy form. In addition, the Division makes extensive use of deductibles and unique forms.

The premiums typically range from $25,000 to $250,000 per policy, but vary depending on risk.

Examples of classes of business written by the Specialty Brokerage Division are as follows:

- Apartments
- Automobile Parts Manufacturers
- Boat Builders
- Furniture Manufacturers
- General Contractors (Commercial Construction)
- Riggers, Crane & Contractors Equipment Rental Companies
- Shopping Centers
- Sporting Goods Manufacturers
- Steel Erection & Fabrication
- Toy Manufacturers
- Trailer Manufacturers

The Division prides itself on a commitment to underwriting integrity. Advances in information technology enable us to make the most informed underwriting decisions. This facilitates the ability to provide superior service to our valued wholesale distribution partners.

Our enhanced website allows our Specialty Brokerage producers to access a secure area for viewing and printing policy forms and endorsements. A "What's New" section informs our producers of Division news and provides examples of recently bound accounts.

Western World Insurance Group

400 Parson's Pond Drive, Franklin Lakes, NJ 07417-2600 • 201-847-8600