

# AMTRUST FINANCIAL SERVICES, INC.

## FORM 8-K/A (Amended Current report filing)

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Address	59 MAIDEN LANE 6TH FLOOR NEW YORK, NY 10038
Telephone	(212) 220-7120
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 8-K/A

CURRENT REPORT

Pursuant to Section 13 OR 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of Earliest Event Reported) September 7, 2007

AmTrust Financial Services, Inc.  
(Exact name of registrant as specified in its charter)

<u>Delaware</u>	<u>001-33143</u>	<u>04-3106389</u>
(State or other jurisdiction of incorporation)	(Commission File Number)	IRS Employer Identification No.)

<u>59 Maiden Lane, 6<sup>th</sup> Floor, New York, New York</u>	<u>10038</u>
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (212) 220-7120

(Former name or former address, if changed since last report.)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions ( see General Instruction A.2. below):

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.133-4 (c))

Item 2.01 COMPLETION OF ACQUISITION OR DISPOSITION OF ASSETS.

As previously reported in the Current Report on Form 8-K dated September 7, 2007, AmTrust Financial Services, Inc. (the "Company") completed the acquisition of Associated Industries Insurance Services, Inc. ("Associated") and its wholly-owned subsidiary, Associated Industries Insurance Company, Inc. pursuant to the Stock Purchase Agreement (the "Agreement"), dated June 25, 2007, by and among the Company, Associated and the Sellers named therein. This Amendment No. 1 on Form 8-K/A amends and supplement the September 7, 2007 Form 8-K of the Company to include financial statements and pro forma financial information.

Item 9.01 FINANCIAL STATEMENTS AND EXHIBITS.

(a) Financial statements of business acquired.

The following financial statements required by Item 9.01(a) of form 8-K are attached hereto as Exhibit 99.1 and 99.2.

Exhibit 99.1

(i) Interim Unaudited Condensed Consolidated Financial Statements

Condensed Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006

Unaudited Condensed Consolidated Statements of Income and Comprehensive Net Income for the six months ended June 30, 2007 and June 30, 2006

Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2007 and June 30, 2006.

Notes to the Unaudited Condensed Consolidated Financial Statements

Exhibit 99.2

(ii) Annual Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheet as of December 31, 2006

Consolidated Statement of Income and Comprehensive Net Income for the year ended December 31, 2006

Consolidated Statement of Changes in Shareholders' Equity for the year ended December 31, 2006

Consolidated Statement of Cash Flows for the year ended December 31, 2006

Notes to Consolidated Financial Statements

(b) Pro Forma financial information

The following unaudited condensed consolidated pro forma financial information required by Item 9.01(b) of Form 8-K is attached as Exhibit 99.3.

Unaudited Pro Forma Financial Information

Unaudited Condensed Consolidated Pro Forma Balance Sheet as of June 30, 2007

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Unaudited Condensed Consolidated Pro Forma Statement of Income for the six months ended June 30, 2007  
Unaudited Condensed Consolidated Pro Forma Statement of Income for the year ended December 31, 2006  
Notes to Unaudited Condensed Consolidated Pro Forma Financial Statements

(c) Not applicable

(d) Exhibits.

Exhibit Number	Description
23.1	Consent of Johnson Lambert & Co. LLP
99.1	Condensed Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006; Unaudited Condensed Consolidated Statements of Income and Comprehensive Net Income for the six months ended June 30, 2007 and June 30, 2006; Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2007 and June 30, 2006; Notes to the Unaudited Condensed Consolidated Financial Statements
99.2	Report of Independent Registered Public Accounting Firm Consolidated Balance Sheet as of December 31, 2006; Consolidated Statement of Income and Comprehensive Net Income for the year ended December 31, 2006; Consolidated Statement of Changes in Shareholders' Equity for the year ended December 31, 2006; Consolidated Statement of Cash Flows for the year ended December 31, 2006; Notes to Consolidated Financial Statements
99.3	Unaudited Condensed Consolidated Pro Forma Balance Sheet as of June 30, 2007; Unaudited Condensed Consolidated Pro Forma Statement of Income for the six months ended June 30, 2007; Unaudited Condensed Consolidated Pro Forma Statement of Income for the year ended December 31, 2006; Notes to Unaudited Condensed Consolidated Pro Forma Financial Statements

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

AmTrust Financial Services, Inc.

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(Registrant)

Date: November 13, 2007

/s/ Ronald Pipoly

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Ronald Pipoly  
Chief Financial Officer

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Consent of Independent Registered Public Accounting Firm

AmTrust Financial Services, Inc.

We consent to the inclusion in this current report on Form 8-K/A and the incorporation by reference in the registration statement on Form S-1 (Registration No. 333-134960) of AmTrust Financial Services, Inc. of our report dated February 27, 2007 relating to the consolidated financial statements of Associated Industries Insurance Services, Inc. as of and for the year ended December 31, 2006.

We also consent to the reference to us under the caption "Experts" in the registration statement.

/s/ Johnson Lambert & Co., LLP

Jacksonville, Florida  
November 13, 2007

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Associated Industries Insurance Services, Inc.

Unaudited Condensed Consolidated Financial Statements  
and Consolidating Information

Six months ended June 30, 2007

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**Associated Industries Insurance Services, Inc.**  
**Condensed Consolidated Balance Sheets**

	June 30, 2007 (Unaudited)	December 31, 2006 (Audited)
<b>Assets</b>		
Fixed maturity securities, available for sale (amortized cost of \$134,379,688 and \$110,634,760)	\$ 131,438,901	\$ 109,014,317
Equity securities, available for sale (cost of \$5,272 and \$5,294)	2,512	2,409
Investment in real estate	1,240,490	1,267,213
Total investments	132,681,903	110,283,939
Cash and cash equivalents	10,647,634	31,305,724
Accrued investment income	1,482,842	1,185,991
Premiums receivable, net	35,285,453	30,441,329
Reinsurance recoverable	170,459,082	176,218,624
Prepaid reinsurance premiums	1,637,407	8,913,829
Deferred policy acquisition costs	5,412,487	1,956,101
Property and equipment, net	1,136,326	1,192,979
Net deferred tax asset	10,534,233	10,650,610
Other assets	9,725,130	10,889,314
Total assets	<u>\$ 379,002,497</u>	<u>\$ 383,038,440</u>
<b>Liabilities and shareholders' equity</b>		
<b>Liabilities:</b>		
Reserves for losses and loss adjustment expenses	\$ 300,851,273	\$ 304,174,672
Unearned premiums	33,151,457	28,661,391
Advance premiums	205,405	729,267
Reinsurance premiums payable	(1,773,034)	2,071,109
Accounts payable and accrued expenses	8,758,441	7,787,647
Federal income tax payable	281,853	2,889,071
Notes payable	4,155,075	4,162,602
Other liabilities	7,678,017	7,345,269
Deferred gain on retroactive reinsurance	181,084	452,448
Total liabilities	<u>353,489,571</u>	<u>358,273,476</u>
<b>Shareholders' equity:</b>		
Common stock, no par value; 20,000,000 shares authorized; 2,809,000 shares issued and outstanding	10,000	10,000
Accumulated other comprehensive loss	(1,835,890)	(1,012,464)
Retained earnings	27,338,816	25,767,428
Total shareholders' equity	<u>25,512,926</u>	<u>24,764,964</u>
Total liabilities and shareholders' equity	<u>\$ 379,002,497</u>	<u>\$ 383,038,440</u>

See accompanying notes to the unaudited condensed consolidated financial statements

**Associated Industries Insurance Services, Inc.**  
**Condensed Consolidated Statements of Income and Comprehensive Income**

	Six Months Ended June 30,	
	2007	2006
	<u>(unaudited)</u>	<u>(unaudited)</u>
<b>Revenues</b>		
Premium income		
Net premium written	\$ 39,831,151	\$ 29,176,485
Change in unearned premium	(11,766,488)	(8,244,818)
Net premiums earned	28,064,663	20,931,667
Administrative service fees	5,500,468	4,551,680
Net investment income	3,369,874	2,582,189
Net realized investment gains	80	164,749
Retroactive reinsurance gain	271,364	220,603
Other income	35,724	27,760
Total revenues	<u>37,242,173</u>	<u>28,478,648</u>
<b>Expenses</b>		
Losses and loss adjustment expenses	19,997,907	16,301,910
Policy acquisition expenses	5,186,524	3,486,311
Salaries and benefits	4,120,340	4,149,084
Other insurance general and administrative expenses	4,476,635	3,573,314
Interest expense	375,125	362,970
Total expenses	<u>34,156,531</u>	<u>27,873,589</u>
Income before income taxes	3,085,642	605,059
Federal income tax expense	1,514,253	408,388
Net income	<u>\$ 1,571,389</u>	<u>\$ 196,671</u>
<b>Comprehensive Net Income</b>		
Net income	\$ 1,571,389	\$ 196,671
Net unrealized holding losses arising during the period, net of income taxes of \$496,772 and \$169,995, respectively	(823,377)	(1,317,647)
Less: reclassification adjustment for realized gains included in net income, net of income taxes of \$(30) and \$(366,744), respectively	(50)	(102,754)
Other comprehensive loss, net of tax	<u>(823,427)</u>	<u>(1,420,401)</u>
Comprehensive net income (loss)	<u>\$ 747,962</u>	<u>\$ (1,223,730)</u>

See accompanying notes to the unaudited condensed consolidated financial statements

**Associated Industries Insurance Services, Inc.**  
**Condensed Consolidated Statements of Cash Flows**

	Six Months Ended June 30,	
	2007	2006
	(unaudited)	(unaudited)
<b>Cash from operations</b>		
Net income	\$ 1,571,389	\$ 196,671
Adjustments to reconcile net income to cash from operations:		
Depreciation and amortization	212,656	245,927
Net realized investment gains	(90)	(164,749)
Retroactive reinsurance gain	(271,364)	(220,603)
Changes in operating assets and liabilities:		
Accrued investment income	(296,851)	(107,225)
Premiums receivable	(4,844,124)	(8,205,608)
Reinsurance recoverable	5,759,542	7,467,810
Receivable for securities sold	-	(1,950)
Deferred policy acquisition costs	(3,456,386)	(684,766)
Prepaid reinsurance premium	7,276,422	(1,548,028)
Deferred income taxes	613,179	(229,040)
Other assets	1,164,184	99,374
Losses and loss adjustment expenses	(3,323,399)	(13,067,323)
Unearned premiums	4,490,066	9,792,846
Advance premiums	(523,862)	(540,664)
Reinsurance premiums payable	(3,844,143)	(3,030,232)
Accounts payable and accrued expenses	970,794	4,715,879
Federal income taxes receivable	(2,607,217)	538,718
Other liabilities	332,746	(571,764)
Net cash from operations	<u>3,223,542</u>	<u>(5,314,727)</u>
<b>Cash flows from investing activities</b>		
Proceeds from sales and maturities of investments	14,665,797	3,821,460
Cost of investments purchased	(38,498,966)	(6,831,973)
Cost of fixed assets purchased	(40,936)	(116,792)
Net cash from investments	<u>(23,874,105)</u>	<u>(3,127,305)</u>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of debt	-	148,478
Repayment of borrowed funds	(7,527)	(262,538)
Net cash from financing activities	<u>(7,527)</u>	<u>(114,060)</u>
Net change in cash and cash equivalents	(20,658,090)	(8,556,092)
Cash and cash equivalents, beginning of year	31,305,724	19,142,705
Cash and cash equivalents, end of period	<u>\$ 10,647,634</u>	<u>\$ 10,586,613</u>

See accompanying notes to the unaudited condensed consolidated financial statements

**Associated Industries Insurance Services, Inc.**  
**Notes to Unaudited Condensed Consolidated Financial Statements**  
**June 30, 2007**

1. Business

The condensed consolidated financial statements of Associated Industries Insurance Services, Inc. (the "Company") include its accounts and those of its wholly-owned subsidiary company, Associated Industries Insurance Company, Inc. ("AIIC").

The Company is a Florida corporation which owns AIIC. AIIC engages in property and casualty insurance, principally workers' compensation insurance produced by independent agents with approximately 99% of risks located in Florida. The Company generates substantially all of its revenues from its insurance operations.

2. Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the consolidated financial position, results of operations and cash flows for the periods presented.

These condensed consolidated financial statements are unaudited for the six months ended June 30, 2007 and should be read in conjunction with the audited consolidated financial statements of the Company for the year ended December 31, 2006. A summary of more significant accounting policies is set forth in the notes to those audited consolidated financial statements. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary.

All significant intercompany transactions and accounts have been eliminated in the consolidated financial statements.

### 3. Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP, and enhances disclosures about fair value measurements. SFAS No. 157 applies when other accounting pronouncements require fair value measurements; it does not require new fair value measurements. SFAS No. 157 is effective as of the beginning of the entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact that the adoption of SFAS No. 157 will have on its consolidated financial position and result of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of SFAS No. 115." This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. Most of the provisions in SFAS No. 159 are elective; however, the amendment to SFAS No. 115 applies to all entities with available-for-sale and trading securities. The FASB's stated objective in issuing this standard is as follows: "to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions." The fair value option: (a) may be applied instrument by instrument, with a few exceptions such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments. SFAS No. 159 is effective as of the beginning of the entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact that the adoption of SFAS No. 159 will have on its consolidated financial position and result of operations.

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes (an interpretation of FASB Statement No. 109)" (FIN 48) to be effective for fiscal years beginning after December 15, 2007 for private companies. FIN 48 sets forth criteria for recognition and measurement of tax positions taken or expected to be taken in a tax return. FIN 48 requires that companies recognize the impact of a tax position if that position is "more likely than not" of being sustained on audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest, penalties, accounting in interim periods and disclosure. Management is currently evaluating the impact of adopting this interpretation as the Company is currently involved in a tax dispute with the Internal Revenue Service (see Note 5. Income Taxes). The potential impact of adoption of the standard may require the Company to record a tax liability of approximately \$4 million.

#### 4. Investments

The Company evaluated the unrealized loss position for various securities and deemed them to be temporarily impaired. Positive evidence considered in reaching the Company's conclusion that the investments in an unrealized loss position are not other-than-temporarily impaired consisted of: (1) there were no specific events related to the credit risk of the issuer which caused concerns; (2) there were no past due interest payments; (3) the length of time and extent to which fair value has been below cost; (4) the Company's ability and intent to retain the investment for a sufficient amount of time to allow an anticipated recovery in the market value; and (5) the Company also determined that the changes in fair value were considered normal in relation to overall fluctuations in interest rates.

#### 5. Income Taxes

During 2006, the Internal Revenue Service completed its audit of AIC and AIS' 2002 and 2003 consolidated federal income tax return. The field examiner indicated that the Companies underpaid their liability by approximately \$3.2 million and assessed interest and penalties of \$0.6 million. Management disagrees with the majority of the positions taken by the examiner and has appealed the assessment. While management and its counsel are actively defending the Companies' position to the appeals agent, the ultimate outcome of these negotiations is uncertain. In addition, the resolution of the individual issues could result in additional taxes due for subsequent open tax years. During 2006, management accrued a liability for its best estimate of a settlement with the Service. Should the amount of the ultimate resolution differ from this amount, additional income tax expense or benefit will be recognized in future financial statement periods.

#### 6. Subsequent Event

On September 7, 2007 the Company was acquired by AmTrust Financial Services Inc. ("AmTrust"), a publicly held company traded on NASDAQ Global Markets, pursuant to the Stock Purchase Agreement ("Agreement"), dated as of June 25, 2007 by and among AmTrust, Associated and the Sellers named therein. The Agreement provides for a base purchase price of approximately \$40.0 million, subject to certain purchase price adjustments.

Associated Industries Insurance Services, Inc.

Audited Consolidated Financial Statements  
and Consolidating Information

*Year ended December 31, 2006*  
*with Report of Independent Auditors*

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Associated Industries Insurance Services, Inc.

Audited Consolidated Financial Statements  
and Consolidating Information

Year ended December 31, 2006

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## Report of Independent Auditors

Board of Directors  
Associated Industries Insurance Services, Inc.

We have audited the accompanying consolidated balance sheet of Associated Industries Insurance Services, Inc. ("the Company") as of December 31, 2006 and the related consolidated statements of income and comprehensive income, changes in shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Associated Industries Insurance Services, Inc. at December 31, 2006, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

/s/ Johnson Lambert & Co., LLP

Jacksonville, Florida  
February 27, 2007

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Associated Industries Insurance Services, Inc.

Consolidated Balance Sheet

	December 31, 2006
<b>Assets</b>	
Cash and cash equivalents	\$ 31,305,724
Fixed maturity securities, available for sale (amortized cost of \$110,634,760)	109,014,317
Equity securities, available for sale (cost of \$5,294)	2,409
Investment in real estate	1,267,213
Accrued investment income	1,185,991
Premiums receivable, net	30,441,329
Reinsurance recoverable	176,218,624
Prepaid reinsurance premiums	8,913,829
Deferred policy acquisition costs	1,956,101
Property and equipment, net	1,192,979
Net deferred tax asset	10,650,610
Other assets	10,889,314
	<u>383,038,440</u>
<b>Total assets</b>	<b>\$ 383,038,440</b>
<b>Liabilities and shareholders' equity</b>	
<b>Liabilities:</b>	
Reserves for losses and loss adjustment expenses	\$ 304,174,672
Unearned premiums	28,661,391
Advance premiums	729,267
Reinsurance premiums payable	2,071,109
Accounts payable and accrued expenses	7,787,647
Federal income tax payable	2,889,071
Notes payable	4,162,602
Other liabilities	7,345,269
Deferred gain on retroactive reinsurance	452,448
<b>Total liabilities</b>	<b><u>358,273,476</u></b>
<b>Shareholders' equity:</b>	
Common stock, no par value; 20,000,000 shares authorized; 2,809,000 shares issued and outstanding	10,000
Accumulated other comprehensive loss	(1,012,464)
Retained earnings	25,767,428
<b>Total shareholders' equity</b>	<b><u>24,764,964</u></b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ <u>383,038,440</u></b>

*See accompanying notes to the financial statements.*

Associated Industries Insurance Services, Inc.

Consolidated Statement of Income and Comprehensive Income

	Year ended December 31, 2006
<b>Revenues</b>	
Premiums earned	\$ 44,106,446
Administrative service fees	9,354,667
Net investment income	5,152,054
Net realized investment gains	974,605
Retroactive reinsurance gain	297,552
Other income	56,097
	<u>59,941,421</u>
<b>Expenses</b>	
Losses and loss adjustment expenses	33,294,164
Policyholder dividends	799,594
General and administrative expenses	17,112,269
	<u>51,206,027</u>
Total expenses	51,206,027
Income before income taxes	8,735,394
Federal income tax expense	(4,326,098)
Net income	<u>\$ 4,409,296</u>
<b>Comprehensive Net Income</b>	
Net income	\$ 4,409,296
Net unrealized holding gains arising during the period, net of income taxes of \$169,995	281,758
Less: reclassification adjustment for realized gains included in net income, net of income taxes of \$(366,744)	(607,861)
	<u>(326,103)</u>
Other comprehensive loss, net of tax	(326,103)
Comprehensive net income	<u>\$ 4,083,193</u>

*See accompanying notes to the financial statements.*

Associated Industries Insurance Services, Inc.

Consolidated Statement of Changes in Shareholders' Equity

	Common Stock		Retained	Accumulated Other Comprehensive	
	Shares	ParAmount	Earnings	Loss s	Total
Balance at December 31, 2005	2,809,000	\$ 10,000	\$21,358,132	\$ (686,361)	\$20,681,771
Change in net unrealized losses on securities available for sale, net of tax	-	-	-	(326,103)	(326,103)
Net income	-	-	4,409,296	-	4,409,296
Balance at December 31, 2006	<u>2,809,000</u>	<u>\$ 10,000</u>	<u>\$25,767,428</u>	<u>\$ (1,012,464)</u>	<u>\$24,764,964</u>

*See accompanying notes to the financial statements.*

Associated Industries Insurance Services, Inc.

Consolidated Statement of Cash Flows

	Year ended December 31, 2006
<b>Cash from operations</b>	
Net income	\$ 4,409,296
Adjustments to reconcile net income to cash from operations:	
Depreciation and amortization	576,274
Net realized investment gains	(974,605)
Loss on disposal of equipment	6,011
Retroactive reinsurance gain	(297,552)
Changes in operating assets and liabilities:	
Accrued investment income	(161,704)
Premiums receivable, net	(4,770,154)
Reinsurance recoverable	29,900,652
Deferred policy acquisition costs	(185,921)
Prepaid reinsurance premium	717,710
Deferred income taxes	(143,456)
Other assets	(1,450,885)
Losses and loss adjustment expenses	(17,236,804)
Unearned premiums	4,295,571
Advance premiums	(51,286)
Reinsurance premiums payable	(1,943,716)
Accounts payable and accrued expenses	911,324
Federal income taxes receivable	3,470,843
Other liabilities	(85,180)
Net cash from operations	<u>16,986,418</u>
<b>Cash flows from investing activities</b>	
Proceeds from sales and maturities of investments	34,768,020
Cost of investments purchased	(39,308,060)
Cost of fixed assets purchased	(169,381)
Proceeds from sale of fixed assets	<u>6,796</u>
Net cash from investments	<u>(4,702,625)</u>

-continued on next page-

*See accompanying notes to the financial statements*

Associated Industries Insurance Services, Inc.

Consolidated Statement of Cash Flows

Year ended  
December 31,  
2006

**Cash flows from financing activities**

Proceeds from issuance of debt	148,478
Repayment of borrowed funds	<u>(269,252)</u>

Net cash from financing activities (120,774)

Net change in cash and cash equivalents 12,163,019

Cash and cash equivalents, beginning of year 19,142,705

Cash and cash equivalents, end of year \$ 31,305,724

**Supplemental Disclosure of cash flow information**

Interest paid \$ 735,146

Income taxes paid \$ 1,000,000

*See accompanying notes to the financial statement*

# Associated Industries Insurance Services, Inc.

## Notes to Consolidated Financial Statements

Year ended December 31, 2006

### **Note A - Organization and Significant Accounting Policies**

#### *Organization*

Associated Industries Insurance Services, Inc. ("AIIS" or "the Company") was incorporated on March 15, 1993 for the purpose of providing insurance administration and management services for certain insurers and self-insurance funds. The Company is licensed by the Florida Department of Financial Services as a service company and licensed by the Florida Office of Insurance Regulation as a managing general agent. Operations commenced on January 1, 1995.

Effective January 1995, the Company purchased Southeast Title and Insurance Company, Inc., a stock insurance company licensed in the State of Florida, and changed its name to Associated Industries Insurance Company, Inc. ("AIIC"). The Company purchased AIIC for the purpose of providing an alternative workers' compensation market for the members of Associated Industries of Florida ("AIF"), a trade association representing business interests in the State of Florida.

In 1996, Associated Industries of Florida Property and Casualty Trust ("AIFPCT"), a commercial self-insurance fund, was converted to a Florida domestic insurance company and merged with AIIC pursuant to a Plan of Conversion in which AIIC was the surviving entity.

As of December 31, 2006, Associated Industries of Florida Holding Trust ("AIFHT") holds 49.98% of the stock of AIIS. AIFHT is a beneficiary trust that exercises all rights of ownership and is required to make distributions to AIF of all dividends and distributions received, after payment of all costs and expenses. The remaining stock of AIIS is owned by directors and key management personnel or is part of a stock option plan for directors and key management personnel (refer to Note N).

#### *Basis of Reporting*

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, AIIC. All inter-company accounts and transactions have been eliminated in the consolidation. Preparation of consolidated financial statements in accordance 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

**Note A - Organization and Significant Accounting Policies (continued)**

*Premiums*

Written premiums are recorded utilizing full annual amounts calculated by underwriters at the time of policy issuance based on rates established by the National Council on Compensation Insurance ("Standard Premium"). For those policies written under a retrospective rating plan, an estimated retrospective premium adjustment is recorded when the related Standard Premium is recorded. Standard Premium and the related accrued retrospective premium rating adjustments are recorded as earned on a daily pro rata basis over the policy period. The portion of premiums not earned at the end of the period is recorded as unearned premiums. During the policy period and until the final retrospective adjustment is determined, the Company calculates and records a monthly retrospective premium adjustment for each specific policy based upon the loss experience under that policy. Premiums ceded under prospective reinsurance contracts are recorded as a reduction of written and earned premiums over the related reinsurance contract period. The company anticipates investment income as a factor in the premium deficiency calculation. At December 31, 2006 no premium deficiency was reflected in the financial statement.

*Losses and Loss Adjustment Expense Reserves*

The liability for unpaid losses and loss adjustment expenses ("LAE") includes case basis estimates of reported losses, plus supplemental amounts for incurred but not reported losses ("IBNR") calculated based upon loss projections utilizing certain actuarial assumptions and studies of AIIC's historical loss experience and industry statistics. The Company does not discount liabilities for loss reserves except as described in Note D. Management believes that its aggregate liability for unpaid losses and LAE at year-end represents its best estimate of the amount necessary to cover the ultimate cost of losses based upon an actuarial analysis prepared by a consulting actuary. However, because of future events beyond the control of management, such as changes in approved benefit rates, changes in law, judicial interpretations of law, and acts of terrorism and inflation, actual loss experience may not conform to the assumptions used in determining the estimated amounts for such liability at the balance sheet date. Accordingly, the ultimate liability could be significantly in excess of or less than the amount indicated in the consolidated financial statements. As adjustments to these estimates become necessary, such adjustments are reflected in current operations.

*Reinsurance*

As described more fully in Note E, AIIC has entered into both prospective and retroactive reinsurance agreements. Pursuant to prospective reinsurance agreements, AIIC cedes to reinsurers portions of covered losses related to insured events that have not yet occurred at the inception of the reinsurance agreement. Pursuant to retroactive reinsurance agreements, AIIC cedes to reinsurers portions of covered losses related to insured events that have occurred at the inception of the reinsurance agreement but have not yet been paid. Amounts recoverable from reinsurers pursuant to prospective and retroactive reinsurance agreements have been estimated using actuarial assumptions consistent with those used in establishing the liability for losses and LAE described above.

## Associated Industries Insurance Services, Inc.

### Notes to Consolidated Financial Statements (continued)

#### **Note A - Organization and Significant Accounting Policies (continued)**

As described above, premiums ceded under prospective reinsurance agreements are recorded as a reduction of written and earned premiums over the related reinsurance contract period. For retroactive reinsurance agreements, the amount by which the loss and LAE liabilities associated with the retroactively reinsured policies exceed the amounts paid for the reinsurance is recorded as a deferred gain and recognized using the cash recovery method. The effects of subsequent changes in estimated or actual cash flows are accounted for by adjusting the deferred gain and related income in the period of the change.

Management believes that reinsurance recoverable as recorded represents its best estimate of such amounts; however, as changes in the estimated ultimate liability for losses and LAE are determined, the estimated ultimate amount recoverable from the reinsurer will also change. Accordingly, the ultimate recoverable could be significantly in excess of or less than the amount indicated in the consolidated financial statements. As adjustments to these estimates become necessary, such adjustments are reflected in current operations.

In entering into reinsurance agreements, management considers a variety of factors including the creditworthiness of reinsurers. In preparing financial statements, management makes estimates of amounts receivable from reinsurers estimated to be uncollectible based on an assessment of factors including an assessment of the creditworthiness of the reinsurers. Significant uncertainties are inherent in the assessment of the creditworthiness of reinsurers and estimates of any uncollectible amounts due from reinsurers. Any change in the ability of the AIIC's reinsurers to meet their contractual obligations could have a detrimental impact on AIIC's ability to meet its regulatory capital and surplus requirements. Reinsurance contracts do not relieve AIIC from its obligations to policyholders. Failure by the reinsurers to honor their obligations could result in losses to the Company. AIIC mitigates this risk by requiring collateral, in the form of letters of credit, for selected reinsurance recoverable amounts.

#### *Accrued Reinsurance Commissions Adjustments*

Commission income from the 2006 Excess of Loss Agreement (XOL) and the 2005, 2004, 2003 and 2002 Quota Share Agreements ("QSA") are subject to adjustment based on sliding scale and profit commission arrangements (see Note E). Any estimated payable or receivable is adjustable based on loss experience. For the 2006 XOL, any payable or receivable is settled annually beginning in 2007. For the 2005 QSA, any payable or receivable is settled annually beginning in 2006. For the 2004 QSA, any payable or receivable is settled annually beginning in 2005. For the 2003 QSA, any payable or receivable is settled annually beginning in 2004. For the 2002 QSA, any payable or receivable becomes payable over three years and as adjusted at each succeeding year-end beginning in 2006.

#### *Premiums Receivable*

Premiums receivable is presented net of an allowance for uncollectible accounts in the amount of \$300,000 at December 31, 2006. The allowance for uncollectible accounts is based on an analysis of premiums receivable and reflects an amount which, in management's judgment, is adequate to provide for uncollectible amounts.

In addition, accounts specifically identified as uncollectible are charged to expense in the year the determination is made.

## Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

### **Note A - Organization and Significant Accounting Policies (continued)**

#### *Deferred Policy Acquisition Costs*

Policy acquisition costs are expenses that vary with and are directly related to the production of new or renewal business, such as producer commissions, Florida Department of Labor administration fees, premium taxes and other costs. These costs are deferred, net of related ceding commissions, to the extent recoverable, and are amortized over the period during which the related premiums are earned. Amortization of acquisition costs, net of ceding commissions earned, amounted to \$185,921 for the year ending December 31, 2006.

#### *Cash and Cash Equivalents*

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. For the purpose of presentation in the Company's statements of cash flows, cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near to maturity that they present insignificant risk of changes in value due to changing interest rates. The Company maintains certain cash and cash equivalent balances that are not subject to FDIC insurance. Management does not believe these balances represent a significant credit risk to the Company.

#### *Investments*

The Company has designated its entire marketable security portfolio as available-for-sale at December 31, 2006. Accordingly, the Company reports these securities at their estimated fair values with unrealized holding gains and losses being reported as other comprehensive income, net of estimated tax. Realized investment gains and losses are determined using the specific identification method.

Effective January 1, 2003, the classification of real estate investments was changed from held for the production of income to held for sale and, accordingly, the Company stopped depreciating these investments. Investments in real estate held for sale are recorded at the lower of depreciated cost or fair value. During the year ended December 31, 2004 the Company recorded an impairment charge to write the investment in real estate down to its fair value less estimated costs to sell, based on an independent appraisal. The impairment charge, amounting to \$85,848, was reflected in the consolidated statements of income and comprehensive income as a realized loss. During 2006, the classification of real estate investments was changed to held for the production of income. Investments in real estate held for the production of income are carried at depreciated cost. During the year ended December 31, 2006 the Company recorded depreciation expense of \$137,287 to record the investment in real estate at depreciated cost. Depreciation was determined by calculating the difference between the appraised value less estimated costs to sell and the net book value using tax basis depreciation. Depreciation expense on investment real estate is included with investment expenses in the consolidated statements of income.

Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

**Note A - Organization and Significant Accounting Policies (continued)**

*Property and Equipment*

Property and equipment are carried at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of assets, which range from 3 to 39.5 years, or the MACRS method as directed by the IRS.

*Income Taxes*

The Company and AIIC file consolidated income tax returns. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and for operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

*Guaranty Fund Assessments*

Periodically, the Company may be assessed by a state guaranty fund as part of that fund's activities to collect funds from solvent insurance companies to cover certain losses to policyholders that result from the insolvency or rehabilitation of insurance companies. Because there are many uncertainties regarding the ultimate amount of assessments, the Company's policy is to recognize its obligation for guaranty fund assessments when it receives notice that an amount is payable to the guaranty fund. At December 31, 2006, the Company is not able to reasonably estimate the potential effects of any future assessments and, accordingly, the accompanying financial statements do not include any provision for such future assessments.

*Stock Option Plan*

The Company accounts for employee stock options in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock-Based Compensation* ("APB 25"). Under APB 25, because the exercise price of the Company's employee stock options equals the estimated fair value of the underlying stock at the date of the grant, no compensation expense is recognized. The effect of applying Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, ("FASB 123"), as amended by Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure*, ("FASB 148"), to employee stock options is addressed in Note N.

Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

**Note B - Investments**

The Company's investments in available-for-sale fixed maturity securities at December 31, 2006 are summarized as follows:

	Amortized Cost	Unrealized Gains	Unrealized Gains	Fair Value
U.S. Government bonds	\$ 26,253,059	\$ 99	\$ (418,348)	\$ 25,834,810
Agency bonds	530,602	-	(6,048)	524,554
Municipal bonds	1,874,254	8,276	(28,041)	1,854,489
Corporate bonds	49,087,291	100,777	(719,701)	48,468,367
Mortgage backed and asset backed securities	31,548,976	40,360	(597,817)	30,991,519
Annuity	1,340,578	-	-	1,340,578
<b>Totals</b>	<b>\$ 110,634,760</b>	<b>\$ 149,512</b>	<b>\$ (1,769,955)</b>	<b>\$ 109,014,317</b>

The amortized cost and estimated fair value of the Company's investments in fixed maturity securities at December 31, 2006 are summarized, by stated maturity, as follows. Actual maturities may differ for some securities because borrowers may have the right to call or prepay obligations.

Maturity:	Amortized Cost	Fair Value
In 2007	\$ 10,309,004	\$ 10,192,182
In 2008-2011	39,391,159	38,912,194
In 2012-2016	26,891,377	26,444,827
Due after 2016	2,494,244	2,473,595
Mortgage backed and asset backed securities	31,548,976	30,991,519
<b>Total</b>	<b>\$ 110,634,760</b>	<b>\$ 109,014,317</b>

Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

**Note B - Investments (continued)**

The cost and estimated fair value of investments in equity securities at December 31, 2006 are as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Common stocks	\$ 5,294	\$ 98	\$ (2,983)	\$ 2,409

At December 31, 2006 the aggregate amount of unrealized losses and the aggregate related fair values of investments with unrealized losses were segregated into the following time periods during which the investments had been in continuous unrealized loss positions:

	Less than Twelve Months		Twelve Months or Greater	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Government bonds	\$ 3,731,167	\$ (10,335)	\$ 21,927,429	\$ (408,013)
Agency bonds	-	-	524,554	(6,048)
Municipal bonds	-	-	1,320,703	(28,041)
Corporate bonds	4,990,050	(39,864)	30,456,105	(679,837)
Mortgage backed and asset backed securities	1,989,340	(18,696)	24,007,056	(579,121)
Common stocks	-	-	1,165	(2,983)
<b>Total</b>	<b>\$ 10,710,557</b>	<b>\$ (68,895)</b>	<b>\$ 78,237,012</b>	<b>\$ (1,704,043)</b>

The unrealized losses related to the Company's investments in fixed maturity securities are predominantly interest rate related. The Company has both the intent and ability to hold individual securities until their maturity, at which time management expects the fair value to approximate amortized cost. As such, management considers the impairments (i.e., excess of cost over fair value) to be temporary.

When, in the opinion of management, a decline in the estimated fair value of an investment is considered to be "other than temporary," the investment is written down to its estimated fair value. The determination of an "other than temporary" decline in estimated fair value includes, in addition to other relevant factors, consideration of the nature of the investments, the severity of the impairments, including the number of securities impaired and the duration of the impairment. Any such write-downs are reported as net realized losses on investments.

Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

**Note B - Investments (continued)**

There were no such write-downs during 2006. All of the fixed-maturity securities are meeting and are expected to continue to meet all contractual obligations for interest payments.

Major categories of the Company's net investment income are summarized as follows:

	<u>2006</u>
Investment income:	
Fixed maturity securities	\$ 4,857,084
Equity securities	73,002
Real estate	-
Cash and cash equivalents	666,175
Annuity	<u>103,524</u>
Gross investment income	5,699,785
Investment expense	<u>(547,731)</u>
Net investment income	<u><u>\$ 5,152,054</u></u>

The Company's realized gains and losses on fixed maturity and equity securities are summarized as follows:

	<u>2006</u>
Gross realized gains	\$ 1,097,397
Gross realized losses	<u>(122,792)</u>
Net realized gains	<u><u>\$ 974,605</u></u>

Investment in real estate consists of the following at December 31, 2006:

	<u>2006</u>
Land	\$ 217,000
Buildings	<u>1,893,405</u>
Total cost	2,110,405
Accumulated depreciation	<u>(843,192)</u>
Investment in real estate	<u><u>\$ 1,267,213</u></u>

Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

**Note C - Premiums and Related Commissions**

Premiums written, ceded and earned for the year ended December 31, 2006 are as follows:

	<u>Direct</u>	<u>Ceded</u>	<u>Net</u>
Premiums written	\$ 72,943,777	\$ (23,824,050)	\$ 49,119,727
Change in unearned premiums	(4,295,571)	(717,710)	(5,013,281)
Premiums earned	<u>\$ 68,648,206</u>	<u>\$ (24,541,760)</u>	<u>\$ 44,106,446</u>

Included in direct written premiums for the year ended December 31, 2006 are retrospective premium adjustments of \$2,595,148. Unearned premiums at December 31, 2006 are net of unearned retrospective premium adjustments of \$3,129.

Commissions on direct, retrospective and ceded premium for the year ended December 31, 2006 is as follows:

	<u>2006</u>
Commission expense on direct and retrospective premiums	\$ (6,079,879)
Contingent commissions on direct and retrospective premiums	(239,999)
Ceding commissions on premiums ceded to reinsurers	<u>14,300,074</u>
Commissions earned	<u>\$ 7,980,196</u>

Commissions earned are included in the consolidated statements of income and comprehensive income as an offset to general and administrative expenses. The maximum amount of return commission which would have been due to reinsurers if all reinsurance were cancelled with the return of the unearned premium reserve would have been \$3,119,840 as of December 31, 2006.

Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

**Note C - Premiums and Related Commissions (continued)**

Premiums receivable as of December 31, 2006 consist of the following:

	2006
Premium balances due, gross	\$ 27,149,977
Accrued retrospective premiums	603,802
Earned but unbilled premiums	2,987,550
Premiums receivable, gross	30,741,329
Allowance for uncollectible accounts	(300,000)
Premium receivable, net	\$ 30,441,329

Prior to 2004, all of the premiums written were subject to retrospective rating features. During 2004, AIIC began writing and renewing substantially all policies on a guaranteed cost basis, not subject to experience rating. Billed premium balances due include amounts due from insureds for billed premiums. Retrospective premium adjustments and earned but unbilled premiums are an estimate of the additional premiums to be billed upon expiration, audit and adjustment of the policy based on experience.

The components of bad debt expense, which is included in the consolidated statements of income and comprehensive income as a component of general and administrative expenses, are as follows:

	2006
Change in reserve allowance for bad debt	\$ (450,000)
Bad debt write-offs	438,050
Bad debt recoveries	(204,694)
Net bad debt expense	\$ (216,644)

**Note D - Loss and Loss Adjustment Expense Reserves**

The components of the liability for losses and loss adjustment expenses and related reinsurance receivable are as follows:

	2006	
	Gross Liability	Reinsurance Recoverable
Case-basis reserves	\$ 121,626,934	\$ 61,290,332
IBNR reserves	182,547,738	108,574,075
Recoverable on paid losses	-	6,354,217
Total	\$ 304,174,672	\$ 176,218,624

Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

**Note D - Loss and Loss Adjustment Expense Reserves (continued)**

Activity in loss and loss adjustment expense reserves, net of reinsurance recoverables, for the year ended December 31, 2006 is summarized as follows:

	2006
Gross balance, beginning of year	\$ 321,411,476
Less: reinsurance recoverables on unpaid losses	(198,397,920)
Net balance, beginning of year	123,013,556
<b>Incurred related to:</b>	
Current year	33,465,003
Prior years	(170,839)
Total incurred	33,294,164
Decrease in reserves ceded under loss portfolio transfer and retroactive reinsurance	258,506
<b>Paid related to:</b>	
Current year	(12,946,608)
Prior years	(9,309,353)
Total paid	(22,255,961)
Net balance, end of year	134,310,265
Plus: reinsurance recoverables on unpaid losses	169,864,407
Gross balance, end of year	\$ 304,174,672

The components of reinsurance recoverables on unpaid losses by reinsurance agreement type as of December 31, 2006 are as follows:

	2006
Excess of loss	\$ 129,327,666
Quota share	40,045,247
Retroactive reinsurance 1993-1994	491,494
Total reinsurance recoverable on unpaid losses	\$ 169,864,407

Net reserves for incurred losses and loss adjustment expenses attributable to insured events of prior years decreased by \$170,839 during 2006 as the result of the re-estimation of unpaid losses and loss adjustment expenses. The Company's management continually monitors claims activity to assess the appropriateness of carried case and IBNR reserves, giving consideration to the Company and industry trends. The above noted changes are the result of the ongoing analysis of recent loss development trends. Original estimates are increased or decreased as additional information becomes known regarding individual claims. During 2006, the Company commuted several reinsurance treaties. The amounts received from the reinsurers were recognized as paid loss and LAE with a corresponding reduction in the reserves ceded under the commuted treaties. As a result, the Company's net reserves for the time periods of the commuted treaties increased. Further discussion of the Company's reinsurance program is discussed in Note E.

Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

**Note D - Loss and Loss Adjustment Expense Reserves (continued)**

The Company obtained permission from the Florida Department of Financial Services Office of Insurance Regulation ("the Department") to discount one claim with a current reserve, before discounting, of \$916,950 at December 31, 2006. The amount of discount reported in these financial statements at December 31, 2006 is \$81,000. The discount was calculated using the statutory rate of 4% over the anticipated payout pattern of the claim.

The reserves for losses and loss adjustment expenses are recorded net of recoverables for subrogation of \$1,902,049 at December 31, 2006. Subrogation recoverables primarily relate to Special Disability Trust Fund ("SDTF") recoverables and are based on amounts requested by the Company and expected to be recovered. The SDTF was established pursuant to Florida Statutes Section 440.49 for the purpose of reducing an employer's workers' compensation insurance premium for the reemployment of an injured worker, to decrease litigation between carriers on apportionment issues, and to protect employers from excess liability for compensation relating to the reemployment of an injured employee. The SDTF provides coverage for claims incurred prior to January 1, 1998 and is funded through annual assessments upon the insurance companies and individual and group self-insurers writing workers' compensation insurance in the State of Florida (see Note F).

Management believes that trends based on the historical experience of the Company combined with industry statistics are a reasonable basis for estimating future losses. However, future events beyond the control of management, such as changes in approved rates, changes in law, judicial interpretations of law, acts of terrorism and inflation may favorably or unfavorably impact the Company's loss and loss adjustment expenses. Anticipated loss payouts are calculated using the payout patterns developed from the Company's loss portfolio as determined by the Company's independent actuary and industry statistics.

## Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

### Note E - Reinsurance

AIIC utilizes reinsurance agreements to reduce retention on larger risks, thereby reducing its overall net loss retention. AIIC also utilizes quota share reinsurance to maintain regulatory ratios generally within expected ranges used for regulatory oversight purposes. AIIC has entered into reinsurance arrangements as follows:

#### Prospective Reinsurance:

*Excess of Loss Reinsurance Treaties* - Effective January 1, 2006, the Company entered into a structured Excess of Loss Agreement ("XOL") with Swiss Reinsurance America Corporation, which reinsured losses on a per occurrence basis in excess of \$125,000 up to \$500,000. Effective January 1, 2006, the Company entered into separate XOL agreements with unaffiliated reinsurance companies, which reinsured losses on a per occurrence basis from \$500,000 up to \$40,000,000. During 2005 and 2004 AIIC maintained excess of loss reinsurance agreements with unaffiliated reinsurance companies, which reinsured losses on a per occurrence basis from \$500,000 up to \$40,000,000. Additionally, other agreements covering the periods from January 1, 1995 through December 31, 2003 remain in effect. Premiums ceded during 2006 related to these agreements amounted to \$23,569,739, and are included as a reduction to premiums earned in the accompanying consolidated statements of income and comprehensive income. During 2006, AIIC received \$14,987,181, in loss and LAE recoveries related to excess of loss agreements.

Effective December 31, 2006, the structured XOL agreement entered into with Swiss Reinsurance America Corporation allows the Company a provisional commission on premium ceded of 35% during the year. Such commissions are subject to a sliding scale commission adjustment and a profit commission arrangement which are individually dependent upon loss experience. At December 31, 2006, the Company had accrued \$626,765 of sliding scale ceding commissions payable under this treaty.

*Quota Share Agreements* - Effective January 1, 2005, the Company entered into a Quota Share Agreement ("QSA") with Swiss Reinsurance America Corporation, which applies to unearned premiums as of December 31, 2004 and premiums written and renewed during 2005. AIIC ceded 40% of its beginning unearned premiums under this agreement. In order to allow the Company to maintain a net written premium to surplus ratio of 3:1 or lower, this contract had an adjustable cession rate, with regards to new and renewal policies during the term of the treaty, subject to a minimum of 20% and a maximum of 40%. The Company ultimately ceded 35% of premium with regard to new and renewal policies. Effective January 1, 2004, AIIC entered into a Quota Share Agreement ("QSA") with a consortium of reinsurers, which applies to unearned premiums as of December 31, 2003 and premiums written and renewed during 2004. AIIC ceded 55% of its beginning unearned premiums under this agreement. In order to allow AIIC to maintain a net written premium to surplus ratio of 3:1 or lower, this contract had an adjustable cession rate, with regards to new and renewal policies during the term of the treaty, subject to a minimum of 20% and a maximum of 40%. The Company ultimately ceded 40% of premium with regard to new and renewal policies. Effective January 1, 2003, AIIC entered into a 55% QSA with a consortium of reinsurers, which applies to all new and renewal policies written during 2003. This QSA contains an excess of loss component described below.

## Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

### Note E - Reinsurance (continued)

Additionally, other agreements covering the period January 1, 1997 through December 31, 2003 remain in effect. During 2006, AIIC ceded premiums under QSAs to reinsurers of \$254,310 and received \$32,097,284 in loss and LAE recoveries.

The reinsurers allow AIIC a 35% provisional commission on premium ceded during the year ended December 31, 2005 and 33% during the years ended 2003 and 2002, respectively, to recover the cost of writing the premium and paying commissions and premium taxes. Such commissions are subject to a sliding scale commission adjustment and a profit commission arrangement that are each dependent upon loss experience. At December 31, 2006, the amounts accrued as a reduction in commission based on the sliding scale and profit commission arrangements is \$6,007,720.

#### Retroactive Reinsurance :

Effective December 31, 2002 AIIC entered into a retroactive reinsurance agreement with Eagle & Crown Limited ("EC Ltd.") in conjunction with a settlement agreement with AIIC's reinsurance broker. Under this agreement, the reinsurer assumed certain liabilities of AIIC related to nine claims occurring in 1993 and 1994. The gain on retroactive reinsurance transactions is deferred and recognized as income over the estimated remaining settlement period using the interest method.

#### Other :

At December 31, 2006, a portion of AIIC's reinsurance recoverables is secured with irrevocable letters of credit with U.S. banks in the amount of approximately \$12,676,000. Additionally, the EC Ltd. retroactive reinsurance agreement is secured by an irrevocable evergreen letter of credit in the amount of \$491,494 at December 31, 2006.

During 2006 the Company commuted various excess of loss reinsurance agreements with various Lloyds Syndicates. The excess of loss agreements commuted included accidents occurring from January 1, 1997 to December 31, 1997. Additionally, AIIC commuted its quota share reinsurance agreements with Scor Re, that included accidents occurring from January 1, 1998 through March 31, 1999, and Hannover Reinsurance and E&S Reinsurance, that included accidents occurring from January 1, 2004 through December 31, 2004. The Company recognized the amounts received from the reinsurers as a reduction of losses and LAE paid, thereby reducing losses and LAE incurred in 2006. The Company also increased its loss and LAE reserves to recognize the effect of releasing the reinsurers from their obligations under the treaties. The net effect of such commutations was an increase in losses and LAE incurred of \$59,067 for the year ended December 31, 2006.

## Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

### Note F - Assessments and Insurance Taxes

Pursuant to Florida Statutes Sections 440.49 and 440.50, AIIC is subject to assessments from the Department for the SDTF and the Workers' Compensation Administration Trust Fund. Pursuant to Florida Statutes Section 624.509, AIIC is required to pay to the Florida Department of Revenue a tax on insurance premiums, net of credits given for assessments paid to the Department, intangible taxes and state income taxes. Pursuant to Florida Statutes Section 631.914, AIIC is subject to assessments from the Florida Workers' Compensation Insurance Guaranty Association ("the FWCIGA"). AIIC records these assessments when it receives notice that an amount is payable to the guaranty fund. AIIC has received notification of several insolvencies in the states in which AIIC operates. It is expected that the insolvencies will result in a guaranty fund assessment against AIIC at some future date. At this time the Company is unable to estimate the possible amounts, if any, of such assessments.

Included in general and administrative expenses in the accompanying consolidated statements of income and comprehensive income are state and local insurance taxes amounting to \$3,664,257 for the year ended December 31, 2006, and FWCIGA assessments of \$15,833 for the year ended December 31, 2006.

### Note G - Property and Equipment

Property and equipment as of December 31, 2006 consists of the following:

	2006
Leasehold improvements	\$ 2,077,294
Software development costs	1,152,390
Furniture and fixtures	1,276,332
Office equipment	392,807
Computer equipment	1,766,962
Vehicles	313,167
Property and equipment, gross	6,978,952
Accumulated depreciation and amortization	(5,785,973)
Property and equipment, net	\$ 1,192,979

Depreciation and amortization expense related to property and equipment for the year ended December 31, 2006, was \$241,648.

## Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

### Note H - Accounts Payable and Accrued Expenses

The significant components of accounts payable and accrued expenses as of December 31, 2006 are as follows:

	2006
Accrued acquisition costs	\$ 3,277,112
Guaranty fund assessment payable	15,934
DOLES assessment payable	1,014,906
Agent's commissions payable	728,797
Payroll-related liabilities	1,591,158
Other liabilities	1,159,740
Accounts payable and accrued expenses	<u>\$ 7,787,647</u>

### Note I - Notes Payable

During 2004, the Company repurchased all of its outstanding shares owned by OPre. A portion of the funds for the repurchase were secured via six demand notes, amounting to \$1,300,000, issued to directors and general counsel of the Company. Interest expense accrues at a rate of 10% per annum, and interest expense incurred during each of the years ended December 31, 2006 amounted to \$131,444.

During 2005, the Company repurchased 1.1 million shares of AIIS common stock held by AIFHT for total consideration of \$2,880,000. In connection with this, AIIS executed a mortgage loan payable to First Community Bank ("FCB") in the amount of \$1,988,000. The loan is payable monthly over a term of 30-years and bears interest at FCB's prime rate plus 1%. The remaining \$900,000 of the purchase price was paid to AIFHT using the proceeds from a revolving line of credit. The line of credit is payable in monthly installments, due upon demand and bears interest at FCB's prime rate plus 1.25%. At December 31, 2006, the outstanding balance on the line of credit was \$900,000. These loans are collateralized by the AIF building.

## Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

### Note J - Income Taxes

The significant components of the Company's income tax expense for the year ended December 31, 2006 are as follows:

	Federal	State	Total
Current	\$ (3,712,556)	\$ (756,998)	\$ (4,469,554)
Deferred	132,277	11,179	143,456
<b>Total</b>	<b>\$ (3,580,279)</b>	<b>\$ (745,819)</b>	<b>\$ (4,326,098)</b>

Income tax expense differs from expected tax expense in 2006 due to the following significant components:

	2006
Expected income tax expense at 34%	\$ 2,970,034
Nondeductible contributions	204,758
Lobbying	97,127
Meals and entertainment	57,430
Prior year underaccrual	299,544
State income tax provision	571,744
Tax-exempt interest	-
Other	125,461
<b>Total</b>	<b>\$ 4,326,098</b>

The Company has recorded a deferred tax asset for the net deductible temporary differences. Deferred income tax amounts result from temporary differences between assets and liabilities for financial statement reporting and income tax purposes.

	2006
Deferred tax assets:	
Loss and loss adjustment expense reserves	\$ 6,501,293
Unearned premium	1,541,086
Bad debt reserve	112,890
LPT gain	170,256
Accrued vacation	341,413
Deferred compensation	2,458,426
Net unrealized loss on investments	610,855
Other	105,887
<b>Gross deferred tax assets</b>	<b>11,842,106</b>
Deferred tax liabilities:	
Deferred acquisition costs	736,081
Other	455,415
<b>Gross deferred tax liabilities</b>	<b>1,191,496</b>
<b>Net deferred tax asset</b>	<b>\$ 10,650,610</b>

## Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

### Note J - Income Taxes (continued)

The Company is required to establish a "valuation allowance" for any portion of the deferred tax asset that management believes will not be realized. The Company has historically been a taxpayer, and in the opinion of management, will continue to be subject to income taxes. Because management believes that it is more likely than not that the Company will realize the benefit of the deferred tax asset, no valuation allowance has been established.

### Note K - Lease Commitments

During the year ended December 31, 2006, the Company leased office space for its operations in Boca Raton, Florida; Sunrise, Florida; and Clearwater, Florida. The monthly rental payments include a base rate plus supplemental charges, which may vary. The rent expense related to these leases for the year ended December 31, 2006 was \$2,000,744.

Future minimum lease payments at December 31, 2006 are as follows:

2007	\$ 1,815,768
2008	1,763,318
2009	1,820,168
2010	1,891,867
2011	1,966,571
Thereafter	-
	<u>\$ 9,257,692</u>

The Company also leases equipment for its operations under various operating leases. The rent expense related to these leases for the year ended December 31, 2006 was \$77,924. Future minimum lease payments at December 31, 2006 are as follows:

2007	\$ 76,339
2008	46,069
2009	21,215
2010	21,215
2011	8,840
	<u>\$ 173,678</u>

## Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

### Note L - Shareholders Equity

AIIC is subject to minimum capital and surplus requirements and other regulatory measures of the adequacy of its capital and surplus. Those requirements include, but are not limited to the following:

- Florida Statutes Section 624.408 requires AIIC to maintain minimum capital and surplus of \$4,000,000 at December 31, 2006. At December 31, 2006, AIIC had capital and surplus of \$26,294,895. At December 31, 2006, AIIC had net income of \$6,100,087. Florida Statutes Section 624.4095 requires the AIIC to maintain a ratio of written premiums times 1.25 to surplus of no greater than 10 to 1 for gross written premiums and 4 to 1 for net written premiums.
- AIIC is subject to a Risk Based Capital ("RBC") requirement, which was developed by the NAIC and used by state insurance regulators to identify insurance companies that are at risk of inadequate capitalization. The RBC guidelines define minimum capital standards determined by a ratio of a company's regulatory Total Adjusted Capital to its Authorized Control Level RBC as defined by the NAIC. Companies below specific ratios may be subject to various levels of regulatory action or oversight by their domiciliary department.
- AIIC is subject to Insurance Regulatory Information System ("IRIS"). The IRIS was developed to assist the state insurance departments in monitoring financial conditions of property and liability insurance companies. The system uses financial ratios to identify companies that may be having financial difficulties.

At December 31, 2006 AIIC was in compliance with Florida Statute Section 624.4095 and AIIC's risk based capital ratio was above the regulatory no action level.

AIIC is subject to dividend restrictions under Section 628.371 of the Florida statutes which state that AIIC shall not pay any cash dividends to stockholders except out of the part of its available and accumulated surplus funds, which are derived from realized net operating profit on its business and realized capital gains. Such cash dividend shall not exceed 10% of such surplus in any one year unless otherwise approved by the Department. Additionally, AIIC has stipulated that it will give the Department 30 days prior notice before paying dividends in excess of 75% of net gains from operations. During 2006 no dividends were declared or paid.

### Note M - Retirement Plans

The Company maintains a 401(k) defined contribution plan that covers substantially all employees. The Company makes discretionary employer contributions on a variable matching basis. The Company contributes a dollar per employee dollar, up to a maximum contribution of the greater of 3% of an employee's annual wage or the total of \$600 plus 0.25% of an employee's annual wage. The contribution per employee is also limited to the greater of 100% of the employee contribution or \$6,600. Employer contributions charged to expense in 2006 was \$222,249.

## Associated Industries Insurance Services, Inc.

Notes to Consolidated Financial Statements (continued)

### Note M - Retirement Plans (continued)

The Company has implemented a deferred compensation plan for certain key officers and directors. Net deferred compensation expense was \$0 for 2006. Deferred compensation payable at December 31, 2006 is \$6,533,155. The Company has purchased life insurance policies to fund the deferred compensation liability. The cash surrender value of the Company-owned life insurance policies at December 31, 2006 is \$4,230,868, and is included in other assets. Such amount are pledged as collateral for a loan from Northwestern Mutual Life in the amount of \$3,700,990, and is reported as an offset to the cash surrender value of the underlying life insurance policies included in other assets. The Company paid \$78,115 in deferred compensation benefits during 2006. The Company incurred premium expense on key-person whole-life insurance policies of \$103,419 in 2006.

The Company also purchased split-dollar life insurance policies on certain key officers and directors. Under these policies, the officer or director owns the policy and the Company pays the premiums. However, the Company is to be reimbursed for all of the premiums paid on these policies by the covered insureds. The insureds have executed a collateral assignment to the Company of the policy's cash surrender value to secure the reimbursement of premiums paid.

The amount due the Company for cumulative premiums paid as of December 31, 2006 is \$2,239,906, and is included in other assets.

### Note N - Stock Option Plan

Under a Stock Option Plan (the "Plan") implemented in 1999, Associated Industries of Florida Holding Trust authorized a maximum of 1,405,000 shares of the Company's common stock to be issued under the Plan to directors and key employees. The options originally vested over a period of one to five years and expire in 2009. Effective October 24, 2002, the Board of Directors of AIIS approved an acceleration of the vesting schedule under the Plan such that all options became immediately exercisable. If employment or service is terminated, the options will expire and all shares held may be repurchased by AIFHT and/or other shareholders.

At each grant date, the option price is set at the estimated fair value as of the date of grant. The changes in outstanding shares under option are as follows:

	Shares Under Option	Weighted- Average Exercise Price Per Share
Balance at December 31, 2005	422,954	\$ 2.91
Issued	-	\$ -
Terminated	-	\$ -
Exercised	-	\$ -
Balance at December 31, 2006	<u>422,954</u>	<u>\$ 2.91</u>

## **Associated Industries Insurance Services, Inc.**

Notes to Consolidated Financial Statements (continued)

### **Note N - Stock Option Plan (continued)**

As discussed further in Note O, during 2004, the Company repurchased all of its outstanding shares owned by OPRé. In connection therewith, the 125,000 shares previously reserved for issuance to OPRé under the aforementioned performance covenant, for which the measurement date was June 29, 2004, became available for issuance under the Plan. Subsequently, AIFHT authorized the Company to grant options for the 125,000 shares to directors and key employees. In connection with the acceleration of the vesting schedule, all shares issued during 2004 were immediately exercisable.

AIFHT made approximately \$3.1 million in loans to stock option holders to facilitate the immediate exercise of stock options. The loans were made at market rates and are collateralized by a pledge of shares acquired.

The Company has elected to follow APB 25 and related interpretations in accounting for its employee stock options because the alternative fair value accounting provided for under FASB 123 requires the use of option valuation models that were not developed for use in valuing employee stock options. Specifically, the Black-Scholes option valuation model used by the Company for option valuation was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The fair value of the options was estimated at April 1, 1999 in preparation for the initial grant, with the following weighted average assumptions: risk free interest rate of 5.14%, dividend yield of 0%, volatility factors of the expected market price of the Company's common stock of 23.65%, and a weighted-average expected life of the options of 5 years.

Under APB 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock at the date of the grant, no compensation expense is recognized. The effect of applying FASB 123's fair value method to the Company's stock-based awards results in net income that is not materially different from amounts reported.

### **Note O - Related Party Transactions**

The Company has entered into a royalty agreement with AIF for the use of its name and logo for an annual fee of \$1,000,000. At December 31, 2006, no royalties were due to AIF. The royalty agreement remains in force until terminated by either party giving the proper notice as stated in the agreement.

## **Associated Industries Insurance Services, Inc.**

Notes to Consolidated Financial Statements (continued)

### **Note O - Related Party Transactions (continued)**

Pursuant to agreements, the Company provides managerial and support services to AIIC including, but not limited, to the following: underwriting, claims processing, premium collection, claims settlement, accounting, record keeping, investment management and maintenance of computer systems and other hardware. Pursuant to the agreements, the Company received from AIIC 15% of gross earned premiums during the years ended December 31, 2006. All of the inter-company administrative service fee income and expenses have been eliminated during consolidation. The agreement remains in force until terminated by either party giving the proper notice as stated in the agreement.

All of the Directors of AIIC are also Directors of the Company, and the majority is also Directors of AIF and AIFHT.

### **Note P - Commitments and Contingencies**

The Company is named as defendant in various legal actions arising in the normal course of business from claims made under insurance policies and contracts. These actions are considered by the Company in estimating the loss and loss adjustment expense reserves. The Company's management believes that the resolution of these actions will not have a material adverse effect on the Company's financial position or results of operations.

During 2006, the Internal Revenue Service completed its audit of AIIC and AIIS' 2002 and 2003 consolidated federal income tax return. The field examiner indicated that the Companies underpaid their liability by approximately \$3.2 million and assessed interest and penalties of \$0.6 million. Management disagrees with the majority of the positions taken by the examiner and has appealed the assessment. While management and its counsel are actively defending the Companies' position to the appeals agent, the ultimate outcome of these negotiations is uncertain. In addition, the resolution of the individual issues could result in additional taxes due for subsequent open tax years. During 2006, management accrued a liability for its best estimate of a settlement with the Service. Should the amount of the ultimate resolution differ from this amount, additional income tax expense or benefit will be recognized in future financial statement periods.

### **Note Q - Administrative Service Fees**

Pursuant to a Production and Administration Agreement, effective September 1, 2004, the Company formed a strategic alliance with AmTrust North America, Inc. ("AmTrust"), an unaffiliated Delaware insurance corporation representing insurers that offer workers' compensation coverage in the State of Florida and other states. Services provided by the Company under this agreement primarily include production and marketing, underwriting, claims administration and loss control. The agreement was amended on August 15, 2006 and expires in 2010, with a one-year renewal thereafter until terminated by either party in accordance with the terms of the underlying agreement.

In connection with the Production and Administration Agreement described above, the Company entered into a Renewal Rights Purchase Agreement, whereby the Company sold its renewal rights, title and interest in the renewals of policies generating annual premium of \$100,000 or less, which meet the underwriting guidelines established in the agreement.

## SELECTED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION

On September 7, 2007, Associated Industries Insurance Services, Inc. ("Associated") was acquired by AmTrust Financial Services, Inc. ("AmTrust"), pursuant to the Stock Purchase Agreement, dated as of June 25, 2007, by and among AmTrust, Associated and the Sellers named therein. The agreement provided for a base purchase price of approximately \$40.0 million. Pursuant to the agreement, certain offsets and adjustments were made whereby AmTrust withheld approximately \$5.4 million of the purchase price from certain of the Sellers to pay off certain debts of Associated and certain Sellers. At the date of acquisition, \$3.1 million of this amount was utilized to payoff the aforementioned debts. Additionally, Amtrust paid an additional \$0.7 million related to debts of selling shareholders. AmTrust incurred approximately \$0.6 million of transaction costs for a total purchase price of \$39.0 million.

The following unaudited condensed consolidated pro forma financial information consolidates the historical consolidated statements of income and consolidated balance sheet of AmTrust and the historical consolidated statements of income and consolidated balance sheet of Associated. Those historical financial statements were prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The unaudited condensed consolidated pro forma financial information has been prepared using the assumptions described in the notes thereto.

The unaudited condensed consolidated pro forma financial information below should be read in conjunction with the notes thereto and the historical consolidated financial statements of Associated, as well as in conjunction with the historical consolidated financial statements of AmTrust included in its Annual Report on Form 10-K for the year ended December 31, 2006 and Quarterly Report on Form 10-Q for the six months ended June 30, 2007. This unaudited condensed consolidated pro forma financial information is presented for informational purposes only and is not necessarily indicative of the financial position or results of operations of the consolidated company that would have actually occurred had the acquisition been effective during the periods presented or of the future financial position or future results of operations of the consolidated company. The consolidated financial information as June 30, 2007 and for the periods presented may have been different had the companies actually been consolidated as of that date or during those periods due to, among other factors, possible revenue enhancements, expense efficiencies and integration costs. Additionally, as discussed in Note 1, the actual allocation of the purchase price to the acquired assets and liabilities may vary materially from the assumptions used in preparing the unaudited condensed consolidated pro forma financial information.

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AmTrust Financial Services, Inc.  
Unaudited Condensed Consolidated Pro Forma Balance Sheet  
June 30, 2007

(\$ in thousands, except share amounts)

	Historical AmTrust Financial Services, Inc.	Historical Associated Industries Insurance Services, Inc.	Pro Forma Purchase Adjustments	Notes	Pro Forma Results
<b>Assets</b>					
Fixed maturities, held-to-maturity, at amortized cost	\$ 363,404	\$ -	\$ -		\$ 363,404
Fixed maturities, available-for-sale, at market value	318,583	131,439	-		450,022
Equity securities, available-for-sale, at market value	119,706	3	-		119,709
Short-term investments	95,513	-	-		95,513
Other investments	25,021	1,240	-		26,261
<b>Total investments</b>	<b>922,227</b>	<b>132,682</b>	<b>-</b>		<b>1,054,909</b>
Cash and cash equivalents	130,005	10,648			
			(40,028)	2, 3a	
			(3,805)	3a	
			5,397	3a	
			(599)	3a	101,618
Assets under management	25,495	-	-		25,495
Accrued interest and dividends	11,788	1,483	-		13,271
Premiums receivable, net	239,257	35,286	-		274,543
Note receivable - related party	20,336	-	-		20,336
Reinsurance recoverable	52,273	170,459	-		222,732
Funds held with reinsured companies	426	-	-		426
Prepaid reinsurance premiums	97,604	1,637	-		99,241
Federal tax receivable	2,532	-	-		2,532
Prepaid expenses and other assets	14,932	9,725	(2,554)	3b	22,103
Deferred policy acquisition costs	73,175	5,412	-		78,587
Deferred tax asset	12,074	10,534	-		22,608
Property and equipment, net	11,450	1,136	-		12,586
Goodwill	5,841	-	-		5,841
Intangible assets	34,535	-	9,067	3c	43,602
	<b>\$ 1,653,950</b>	<b>\$ 379,002</b>	<b>(32,522)</b>		<b>2,000,430</b>
<b>Liabilities and Stockholders' Equity</b>					
<b>Liabilities:</b>					
Loss and loss expense reserves	\$ 385,961	\$ 300,851	\$ -		686,812
Unearned premiums	451,995	33,152	-		485,147
Ceded reinsurance premiums payable	44,260	181	-		44,441
Reinsurance payable on paid losses	2,256	(1,773)	-		483
Federal income tax payable	-	282	-		282
Funds held under reinsurance treaties	9,853	205	-		10,058
Securities sold but not yet purchased, at market	36,502	-	-		36,502
Securities sold under agreements to repurchase, at contract value	86,075	-	-		86,075
Accrued expenses and other current liabilities	106,607	16,436			
			(300)	3a	
			(2,554)	3b	120,189
Other liabilities	2,045	-	-		2,045
Notes payable	-	4,155	(650)	3a	
			)		

			(650)	3d	
			(2,855)	3a	-
Junior subordinated debt	123,714	-	-		123,714
<b>Total liabilities</b>	<b>1,249,268</b>	<b>353,489</b>	<b>(7,009)</b>		<b>1,595,748</b>
<b>Commitments and contingencies</b>					
Minority Interest	25,495	-	-		25,495
<b>Stockholders' equity:</b>					
Common stock, \$.01 par value	600	10	(10)	3e	600
Additional paid-in capital	239,723	-			239,723
Accumulated other comprehensive income	1,446	(1,836)	1,836	3e	1,446
Retained earnings	137,418	27,339	(27,339)	3e	137,418
<b>Total stockholders' equity</b>	<b>379,187</b>	<b>25,513</b>	<b>(25,513)</b>		<b>379,187</b>
	<u>\$ 1,653,950</u>	<u>\$ 379,002</u>	<u>\$ (32,522)</u>		<u>\$ 2,000,430</u>

AMTRUST FINANCIAL SERVICES, INC.  
 UNAUDITED CONDENSED CONSOLIDATED PRO FORMA STATEMENT OF INCOME  
 FOR THE SIX MONTHS ENDED JUNE 30, 2007

(\$ in thousands, except share and per share amounts)

	Historical AmTrust Financial Services, Inc.	Historical Associated Industries Insurance Services, Inc.	Pro Forma Purchase Adjustments	Notes	Pro Forma Results
Gross premium written	\$ 399,693	\$ 41,041	-		\$ 440,734
Premium income					
Net premium written	324,141	39,831	-		363,972
Change in unearned premium	(75,029)	(11,766)	-		(86,795)
Net premium earned	249,112	28,065	-		277,177
Fee income	8,782	5,536	(5,536)	3f	8,782
Investment income, net	24,625	3,370	112	3g	28,107
Net realized gains	11,022	-	-		11,022
Retroactive reinsurance gain		271	-		271
Other investment gain on managed assets	1,901	-	-		1,901
Total other income	46,330	9,177	(5,424)		50,083
Total revenue	295,442	37,242	(5,424)		327,260
Loss and loss adjustment expense	159,556	19,998	(855)	3h	178,699
Policy acquisition expenses	32,030	5,187	(4,543)	3f, 3h	32,674
Salaries and benefits	18,933	4,120	-		23,053
Other insurance general and administrative expense	12,578	4,476	(1,349)	3i	15,705
Other underwriting expenses	6,540	-	-		6,540
	229,637	33,781	(6,747)		256,671
Income from continuing operations	65,805	3,461	1,323		70,589
Other income (expense)					
Foreign currency gain (loss)	119	-	-		119
Loss from equity investment	(215)	-	-		(215)
Interest expense	(4,335)	(375)	202	3j	(4,508)
	(4,431)	(375)	202		(4,604)

Income from continuing operations before provision for income taxes	61,374	3,086	1,525	65,985
Provision for income taxes	16,599	1,514	(227) 3k	17,886
Minority interest in net loss of subsidiary	1,901	-	-	1,901
Net income from continuing operations	<u>\$ 42,874</u>	<u>\$ 1,572</u>	<u>\$ 1,752</u>	<u>\$ 46,198</u>
Earnings per common share:				
Basic earnings per share	\$ 0.72			\$ 0.77
Diluted earnings per share	\$ 0.71			\$ 0.77
Weighted average number of basic shares outstanding				
	59,959			59,959
Weighted average number of diluted shares outstanding				
	60,297			60,297

AMTRUST FINANCIAL SERVICES, INC.  
 UNAUDITED CONDENSED CONSOLIDATED PRO FORMA STATEMENT OF INCOME  
 FOR THE YEAR ENDED DECEMBER 31, 2006

(\$ in thousands, except share and per share amounts)

	Historical AmTrust Financial Services, Inc.	Historical Associated Industries Insurance Services, Inc.	Pro Forma Purchase Adjustments	Notes	Pro Forma Results
Gross premium written	\$ 526,074	\$ 72,944	\$ -		\$ 599,018
<b>Premium income</b>					
Net premium written	\$ 436,314	\$ 49,119	\$ -		\$ 485,433
Change in unearned premium	(107,302)	(5,013)	-		(112,315)
Net premium earned	329,012	44,106	-		373,118
Fee income	12,403	9,355	(9,355)	3f	12,403
Investment income, net	27,583	5,207	224	3g	33,014
Net realized gains	14,783	975	-		15,758
Retroactive reinsurance gain	-	298	-		298
Other investment gain on managed assets	244	-	-		244
Total other income	55,013	15,835	(9,131)		61,717
Total revenue	384,025	59,941	(9,131)		434,835
Loss and loss adjustment expense	210,140	33,294	(1,507)	3h	241,927
Policy acquisition expenses	43,302	1,988	(7,530)	3f, 3h	37,760
Salaries and benefits	28,277	8,457	-		36,734
Other insurance general and administrative expense	20,804	6,721	(1,874)	3i	25,651
Other underwriting expenses	10,561	-	-		10,561
	313,084	50,460	(10,911)		352,633
Income from continuing operations	70,941	9,481	1,780		82,202
<b>Other income (expense)</b>					
Foreign currency gain (loss)	833	-	-		833
Interest expense	(5,326)	(746)	401	3j	(5,671)
	(4,493)	(746)	401		(4,838)
Income from continuing operations before provision for income taxes	66,448	8,735	2,181		77,364
Provision for income taxes	17,779	4,326	(1,416)	3k	20,689
Minority interest in net loss of subsidiary	244	-	-		244
Net income from continuing operations	\$ 48,425	\$ 4,409	\$ 3,597		\$ 56,431
<b>Earnings per common share:</b>					
Basic earnings per share	\$ 0.86				\$ 1.00
Diluted earnings per share	\$ 0.86				\$ 1.00

Weighted average number of basic shares

outstanding	56,315	56,315
Weighted average number of diluted shares outstanding	56,315	56,315

AmTrust Financial Services, Inc.  
Notes to Unaudited Condensed Consolidated Pro Forma Financial Statements

1. BASIS OF PRESENTATION

The unaudited condensed consolidated pro forma financial information gives effect to the acquisition as if it had occurred on June 30, 2007 for the purposes of the unaudited condensed consolidated pro forma balance sheet at June 30, 2007 and at January 1, 2006 for the purposes of the unaudited condensed consolidated pro forma statements of income for the six months ended June 30, 2007 and the year ended December 31, 2006. The unaudited condensed consolidated pro forma financial information has been prepared by AmTrust's management and is based on AmTrust's historical consolidated financial statements and Associated's historical consolidated financial statements, which have been prepared by Associated. Certain amounts from Associated's historical consolidated financial statements have been reclassified to conform to the AmTrust presentation.

This unaudited condensed consolidated pro forma financial information is prepared in conformity with GAAP. The unaudited condensed consolidated pro forma balance sheet as of June 30, 2007 and the unaudited condensed consolidated pro forma statements of income for the year ended December 31, 2006 and the six months ended June 30, 2007 have been prepared using the following information:

- (a) Unaudited historical consolidated financial statements of AmTrust as of June 30, 2007 and for the six months ended June 30, 2007;
- (b) Unaudited historical consolidated financial statements of Associated as of June 30, 2007 and for the six months ended June 30, 2007;
- (c) Audited historical consolidated financial statements of AmTrust for the year ended December 31, 2006;
- (d) Audited historical consolidated financial statements of Associated for the year ended December 31, 2006; and
- (e) Such other supplementary information as considered necessary to reflect the acquisition in the unaudited pro forma condensed consolidated financial information.

AmTrust Financial Services, Inc.  
Notes to Unaudited Condensed Consolidated Pro Forma  
Financial Statements (Continued)

The pro forma adjustments reflecting the acquisition of Associated under the purchase method of accounting are based on certain estimates and assumptions. The actual adjustments upon consummation of the acquisition and the allocation of the final purchase price of Associated will depend on a number of factors, including additional financial information available at such time, changes in values and changes in Associated's operating results between the date of preparation of this unaudited pro forma condensed consolidated financial information and the effective date of the acquisition. Therefore, it is likely that the actual adjustments will differ from the pro forma adjustments and it is possible the differences may be material. AmTrust's management believes that its assumptions provide a reasonable basis for presenting all of the significant effects of the transactions contemplated and that the pro forma adjustments give appropriate effect to those assumptions and are properly applied in the unaudited pro forma condensed consolidated financial information.

The unaudited condensed consolidated pro forma financial information does not include all the anticipated financial benefits or expenses from such items as expense efficiencies or revenue enhancements arising from the acquisition nor does the unaudited condensed consolidated pro forma financial information include restructuring and integration costs to be incurred by AmTrust. Interest expense, legal fees, director expenses, royalty fees to sellers and related party transactions have been eliminated as a consequence of the completion of the acquisition.

The unaudited condensed consolidated pro forma financial information is not intended to reflect the results of operations or the financial position that would have resulted had the acquisition been affected on the dates indicated and if the companies had been managed as one entity. The unaudited condensed consolidated pro forma financial information should be read in conjunction with the historical consolidated financial statements of AmTrust included in AmTrust's Annual Report on Form 10-K for the year ended December 31, 2006 and unaudited consolidated financial statements of AmTrust included in AmTrust's Quarterly Report on Form 10-Q for the six months ended June 30, 2007, as well as the historical consolidated financial statements of Associated.

2. PURCHASE PRICE CONSIDERATIONS

The agreement provided for a base purchase price of approximately \$40.0 million, subject to certain adjustments.

Pursuant to the agreement, certain offsets and adjustments were made whereby AmTrust withheld approximately \$5.4 million of the purchase price from certain of the Sellers to pay off certain debts of Associated and certain Sellers. At the date of acquisition, \$3.1 million of this amount was utilized to payoff the aforementioned debts. Additionally, AmTrust paid an additional \$0.7 million related to debts of selling shareholders. AmTrust incurred approximately \$0.6 million of transaction costs for a total purchase price of approximately \$39.0 million.

The determination of goodwill is based upon the following (\$ in thousands):

	Pro Forma Footnote	
<b>Purchase price:</b>		
Purchase of common stock	3a	\$ 40,028
<b>Adjustments:</b>		
Settlement of certain shareholder liabilities by AmTrust	3a	3,805
Proceeds withheld for certain Associated debt obligations	3a	(5,397)
Direct transaction costs	3a	599
<b>Total purchase price</b>		<b><u>39,035</u></b>
<b>Allocation of purchase price: (A)</b>		
Book value of Associated at 6/30/07		25,513
Associated loans and accrued interest repayments	3a	4,455
		<u>29,968</u>
<b>Intangible assets</b>		<b><u>\$ 9,067</u></b>

- A The purchase price is allocated to balance sheet assets acquired (including identifiable intangible assets arising from the acquisition) and liabilities assumed based on their estimated fair value. The pro forma adjustments to the Associated historical consolidated balance sheet in connection with the acquisition are described in Note 3.

### 3. PRO FORMA ADJUSTMENTS

As discussed above, these pro forma adjustments are based on certain estimates and assumptions made as of the date of the unaudited pro forma condensed consolidated financial information. The actual adjustments will depend on changes in the estimated fair values of net balance sheet assets and operating results of Associated between June 30, 2007 and the effective date of the acquisition. AmTrust expects to make such adjustments at the effective date of the acquisition. These adjustments may be different from the adjustments made to prepare the unaudited pro forma condensed consolidated financial information and such differences may be material.

- (a) Pursuant to the agreement, certain offsets and adjustments were made whereby AmTrust withheld approximately \$5.4 million of the purchase price from certain of the Sellers to pay off certain debts of Associated and certain Sellers. The \$5.4 million consisted of approximately \$2.0 million representing 50% of the balance (the remaining 50% or \$2.0 million was to be paid by Amtrust) arising from loans received by Associated against certain insurance policy issued to certain Sellers, \$2.8 million of bank debt arising out of a loan received by Associated for the benefit of the Sellers and \$0.5 million for repayment of loans made by Associated to one of the Sellers. Additionally, \$4.3 million was withheld from the proceeds at the transaction date for a potential tax liability, which, upon resolution of the pending tax contest, will be distributed to the Sellers and/or the Internal Revenue Service as determined therein. This amount has not been deducted from the purchase price as it will ultimately be paid upon resolution. Of the \$5.4 million withheld from the purchase price, AmTrust paid off \$3.1 million of these liabilities at closing, which consisted of \$2.8 million of the bank debt and \$0.3 million for certain of the insurance policy loans (this amount represented the 50% owed by Amtrust as well as the 50% owed by the sellers resulting in a remaining liability of \$3.7 million for insurance policy loans). Additionally, AmTrust paid approximately, \$0.7 million for 50% of an outstanding loan balance related to certain Sellers to Associated. In total, AmTrust paid off approximately \$3.8 million of debts for Associated and the at the transaction date. As part of the transaction, Amtrust incurred approximately \$0.6 million of transaction costs for a total purchase price of \$39.0 million.

- (b) Elimination of balances that relate to business conducted between AmTrust and Associated from a preexisting relationship related to the acquisition of certain distribution network and renewal rights for certain workers' compensation business prior to January 1, 2006.
- (c) Represents the recognition of approximately \$9.1 million of intangible assets, relating to trademarks, licenses, distribution networks and non-compete agreements.
- (d) Approximately \$0.7 million for 50% of an outstanding loan balance related to certain Sellers to Associated paid by majority shareholder at transaction date. The remaining 50% of the balance was paid by Amtrust (See note 3a).
- (e) Elimination of Associated's historical equity balance.
- (f) Elimination of balances between AmTrust and Associated for the period for an agreement entered into prior to January 1, 2006 related to the acquisition of certain distribution network and renewal rights for certain workers' compensation business. Commission and fee income recorded by Associated was approximately \$5.5 million for the pro forma six months ended June 30, 2007 and \$9.4 million for the year ended 2006. Expenses related to the commission and fee income were approximately \$0.9 million of loss and loss adjustment expenses and \$4.9 million of policy acquisition costs for the six months ended June 30, 2007 and \$1.5 million of loss and loss adjustment expenses and \$6.5 million of policy acquisition costs for the year ended December 31, 2006.
- (g) The approximate \$0.1 million and \$0.2 million increase to net investment income represents the purchase price of Associated's investments at a discount on the closing date of approximately \$1.7 million lower than amortized cost. The discount of \$1.7 million was amortized over an estimated eight year period.
- (h) Policy acquisition expenses decreased by approximately \$0.5 million and \$1.0 million, respectively, on the pro forma income statement for the six months ended June 30, 2007 and for the year ended December 31, 2006 resulting from reduction of royalty payments to its former majority shareholder.

- (i) Other insurance general and administrative expense decreased by approximately \$1.3 million and \$1.9 million, respectively, on the pro forma income statement for the six months ended June 30, 2007 and for the year ended December 31, 2006. For the six months ended June 30, 2007, the amount consisted of reductions in Associated's legal expenses of approximately \$0.8 million and director and officer related fees and expenses of approximately \$0.5 million. For the year ended 2006, the amount consisted of reductions in Associated's legal expenses of approximately \$0.5 million and director and officer related fees and expenses of approximately \$1.4 million.
- (j) Interest expense decreased by approximately \$0.2 million and \$0.4 million, respectively, on the pro forma income statement for the six months ended June 30, 2007 and for the year ended December 31, 2006 resulting from the repayment of Associated debt as disclosed in note 2.
- (k) Represents the income tax effect of all pro forma consolidated statement of income adjustments using the tax rate of 35%.