Employers Holdings, Inc.
Form 10-Q
August 04, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

R QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____ to ____

Commission file number: 001-33245

EMPLOYERS HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

Nevada	04-3850065
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

10375 Professional Circle, Reno, Nevada 89521
(Address of principal executive offices and zip code)
(888) 682-6671
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes R No o

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

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

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

Class	July 29, 2011
Common Stock, $0.01 par value per share	37,855,399 shares outstanding

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PART I – FINANCIAL INFORMATION
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Employers Holdings, Inc. and Subsidiaries
Consolidated Balance Sheets
(in thousands, except share data)

Assets	As of June 30, 2011 (unaudited)	As of December 31, 2010
Available for sale:		
Fixed maturity securities at fair value (amortized cost $1,813,074 at June 30, 2011 and $1,901,778 at December 31, 2010)	$1,931,118	$2,000,364
Equity securities at fair value (amortized cost $49,748 at June 30, 2011 and $49,281 at December 31, 2010)	85,089	80,130
Total investments	2,016,207	2,080,494
Cash and cash equivalents	201,882	119,825
Restricted cash and cash equivalents	5,132	16,949
Accrued investment income	21,956	23,022
Premiums receivable, less bad debt allowance of $6,733 at June 30, 2011 and $7,603 at December 31, 2010	149,799	109,987
Reinsurance recoverable for:		
Paid losses	10,820	14,415
Unpaid losses	936,554	956,043
Funds held by or deposited with reinsureds	2,546	3,701
Deferred policy acquisition costs	37,025	32,239
Federal income taxes recoverable	6,392	4,048
Deferred income taxes, net	31,468	38,078
Property and equipment, net	11,656	11,712
Intangible assets, net	12,477	13,279
Goodwill	36,192	36,192
Other assets	17,936	20,136
Total assets	$3,498,042	$3,480,120
Liabilities and stockholders' equity		
Claims and policy liabilities:		
Unpaid losses and loss adjustment expenses	$2,255,531	$2,279,729
Unearned premiums	185,046	149,485
Policyholders' dividends accrued	4,394	5,218
Total claims and policy liabilities	2,444,971	2,434,432
Commissions and premium taxes payable	23,529	17,313
Accounts payable and accrued expenses	19,876	18,601
Deferred reinsurance gain—LPT Agreement	361,560	370,341
Notes payable	132,000	132,000
Other liabilities	17,393	17,317
Total liabilities	2,999,329	2,990,004
Commitments and contingencies		
Stockholders' equity:		

Common stock, $0.01 par value; 150,000,000 shares authorized; 53,930,227 and 53,779,118 shares issued and 37,855,399 and 38,965,126 shares outstanding at June 30, 2011 and December 31, 2010, respectively	539	538
Preferred stock, $0.01 par value; 25,000,000 shares authorized; none issued	—	—
Additional paid-in capital	316,739	314,212
Retained earnings	331,316	319,341
Accumulated other comprehensive income, net	99,287	84,133
Treasury stock, at cost (16,074,828 shares at June 30, 2011 and 14,813,992 shares at December 31, 2010)	(249,168)	(228,108)
Total stockholders' equity	498,713	490,116
Total liabilities and stockholders' equity	$3,498,042	$3,480,120

See accompanying unaudited notes to the consolidated financial statements.

Employers Holdings, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Revenues	(unaudited)			
Net premiums earned	$88,128	$78,235	$170,555	$157,526
Net investment income	20,306	20,648	40,799	41,903
Realized gains on investments, net	1,102	352	1,336	892
Other income	3	207	123	207
Total revenues	109,539	99,442	212,813	200,528
Expenses				
Losses and loss adjustment expenses	64,150	45,045	123,571	85,333
Commission expense	11,119	9,176	21,400	19,081
Dividends to policyholders	914	323	1,926	1,802
Underwriting and other operating expenses	26,200	25,143	51,878	57,410
Interest expense	908	1,620	1,825	3,200
Total expenses	103,291	81,307	200,600	166,826
Net income before income taxes	6,248	18,135	12,213	33,702
Income tax expense (benefit)	(2,003)	1,636	(4,383)	1,106
Net income	$8,251	$16,499	$16,596	$32,596
Comprehensive income				
Unrealized gains during the period, before taxes	$29,660	$23,318	$25,286	$28,526
Less: reclassification adjustment for realized gains in net income	1,102	352	1,336	892
Other comprehensive income, before tax	28,558	22,966	23,950	27,634
Income tax expense related to:				
Unrealized gains during the period	10,794	8,162	9,264	11,397
Realized gains in net income	386	123	468	312
Other comprehensive income, net of tax	18,150	14,927	15,154	16,549
Total comprehensive income	$26,401	$31,426	$31,750	$49,145
Earnings per common share (Note 10):				
Basic	$0.21	$0.39	$0.43	$0.76
Diluted	$0.21	$0.39	$0.43	$0.76
Cash dividends declared per common share	$0.06	$0.06	$0.12	$0.12
Realized gains on investments, net				
Net realized gains on investments before credit related impairments on fixed maturity securities	$1,102	$352	$1,336	$892
Other than temporary impairment, credit losses recognized in earnings	—	—	—	—
Portion of impairment recognized in other comprehensive income	—	—	—	—

Realized gains on investments, net	$1,102	$352	$1,336	$892

See accompanying unaudited notes to the consolidated financial statements.

Employers Holdings, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(in thousands)

	Six Months Ended June 30,	
	2011	2010
Operating activities	(unaudited)	
Net income	$16,596	$32,596
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,387	3,864
Stock-based compensation	1,756	1,950
Amortization of premium on investments, net	3,937	3,150
Allowance for doubtful accounts	(870)	(728)
Deferred income tax (benefit) expense	(2,186)	4,348
Realized gains on investments, net	(1,336)	(892)
Realized losses on retirement of assets	121	106
Change in operating assets and liabilities:		
Accrued investment income	1,066	520
Premiums receivable	(38,942)	11,261
Reinsurance recoverable on paid and unpaid losses	23,084	20,062
Funds held by or deposited with reinsureds	1,155	2,245
Federal income taxes recoverable	(2,344)	(4,397)
Unpaid losses and loss adjustment expenses	(24,198)	(66,296)
Unearned premiums	35,561	(3,917)
Accounts payable, accrued expenses and other liabilities	2,377	(3,241)
Deferred reinsurance gain – LPT Agreement	(8,781)	(8,722)
Other	2,329	(1,670)
Net cash provided by (used in) operating activities	12,712	(9,761)
Investing activities		
Purchase of fixed maturities	(61,495)	(63,285)
Purchase of equity securities	(2,096)	(455)
Proceeds from sale of fixed maturities	96,993	60,590
Proceeds from sale of equity securities	2,181	568
Proceeds from maturities and redemptions of investments	49,457	43,812
Capital expenditures and other	(2,603)	(1,661)
Restricted cash and cash equivalents provided by (used in) investing activities	11,817	(2,429)
Net cash provided by investing activities	94,254	37,140
Financing activities		
Acquisition of treasury stock	(21,060)	(21,892)
Cash transactions related to stock-based compensation	764	(1,229)
Dividends paid to stockholders	(4,613)	(5,110)
Net cash used in financing activities	(24,909)	(28,231)
Net increase (decrease) in cash and cash equivalents	82,057	(852)
Cash and cash equivalents at the beginning of the period	119,825	188,833
Cash and cash equivalents at the end of the period	$201,882	$187,981

See accompanying unaudited notes to the consolidated financial statements.

Employers Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

Employers Holdings, Inc. (EHI) is a Nevada holding company. Through its wholly owned insurance subsidiaries, Employers Insurance Company of Nevada (EICN), Employers Compensation Insurance Company (ECIC), Employers Preferred Insurance Company (EPIC), and Employers Assurance Company (EAC), EHI is engaged in the commercial property and casualty insurance industry, specializing in workers' compensation products and services. Unless otherwise indicated, all references to the "Company" refer to EHI, together with its subsidiaries.

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal, recurring adjustments) necessary for a fair presentation of the Company's consolidated financial position and results of operations for the periods presented have been included. The results of operations for an interim period are not necessarily indicative of the results for an entire year. These financial statements have been prepared consistent with the accounting policies described in the Company's 2010 Annual Report on Form 10-K for the year ended December 31, 2010.

The Company considers an operating segment to be any component of its business whose operating results are regularly reviewed by the Company's chief operating decision makers to make decisions about resources to be allocated to the segment and assess its performance based on discrete financial information. Currently, the Company has one operating segment, workers' compensation insurance and related services.

Use of Estimates

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

Reclassifications

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

2. New Accounting Standards

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) Number 2011-04, Fair Value Measurement. This update is a result of efforts by the FASB and the International Accounting Standards Board (IASB)to develop common requirements for measuring fair value and for disclosing information about fair value measurements in GAAP and International Financial Reporting Standards (IFRS). This update changes the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. The intent was to clarify existing fair value measurement and disclosure requirements and to ensure that GAAP and IFRS fair value measurements and disclosures are described in the same way. This update also requires additional disclosures related to valuation processes and the sensitivity of Level 3 financial assets and liabilities. It does not require additional fair value measures, nor does the FASB expect the amendment to affect current practice. This guidance becomes effective for interim and annual periods beginning after December 15, 2011 and early adoption is not permitted. The Company does not expect the adoption to have a material impact, if any, on its consolidated financial condition and results of operations.

In June 2011, the FASB issued ASU Number 2011-05, Comprehensive Income. This update requires all non-owner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. It also eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholder's equity. This guidance becomes effective for interim and annual periods beginning after December 15, 2011, and early adoption is permitted. The Company has elected early adoption of this update and has presented the required disclosures in single continuous consolidated statements of comprehensive income beginning with the interim period ended June 30, 2011.

3. Investments

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the Company's investments were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
At June 30, 2011	(in thousands)			
Fixed maturity securities				
U.S. Treasuries	$134,359	$11,000	$(29)	$145,330
U.S. Agencies	100,809	6,616	(15)	107,410
States and municipalities	877,435	55,231	(1,511)	931,155
Corporate	430,110	29,571	(1,686)	457,995
Residential mortgage-backed securities	237,496	17,775	(629)	254,642
Commercial mortgage-backed securities	20,856	1,077	(3)	21,930
Asset-backed securities	12,009	647	—	12,656
Total fixed maturity securities	1,813,074	121,917	(3,873)	1,931,118
Equity securities				
Consumer goods	19,325	9,365	(17)	28,673
Energy and utilities	4,769	6,088	—	10,857
Financial	6,627	2,731	(277)	9,081
Technology and communications	7,974	9,445	(52)	17,367
Industrial and other	11,053	8,065	(7)	19,111
Total equity securities	49,748	35,694	(353)	85,089
Total investments	$1,862,822	$157,611	$(4,226)	$2,016,207

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
At December 31, 2010	(in thousands)			
Fixed maturity securities				
U.S. Treasuries	$135,265	$9,619	$(159)	$144,725
U.S. Agencies	116,747	7,142	(87)	123,802
States and municipalities	927,668	43,054	(4,720)	966,002
Corporate	453,851	28,655	(3,082)	479,424
Residential mortgage-backed securities	230,518	16,926	(688)	246,756
Commercial mortgage-backed securities	23,877	1,201	(1)	25,077
Asset-backed securities	13,852	727	(1)	14,578
Total fixed maturity securities	1,901,778	107,324	(8,738)	2,000,364
Equity securities				
Consumer goods	19,141	7,550	(45)	26,646
Energy and utilities	5,106	5,160	(1)	10,265
Financial	6,603	2,916	(19)	9,500
Technology and communications	7,499	8,500	(9)	15,990
Industrial and other	10,932	6,841	(44)	17,729
Total equity securities	49,281	30,967	(118)	80,130
Total investments	$1,951,059	$138,291	$(8,856)	$2,080,494

The amortized cost and estimated fair value of fixed maturity securities at June 30, 2011, by contractual maturity, are shown below. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
	(in thousands)	
Due in one year or less	$110,995	$113,305
Due after one year through five years	515,501	551,231
Due after five years through ten years	610,456	656,023
Due after ten years	305,761	321,331
Mortgage and asset-backed securities	270,361	289,228
Total	$1,813,074	$1,931,118

The following is a summary of investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or greater as of June 30, 2011 and December 31, 2010.

	June 30, 2011					
	Less Than 12 Months		12 Months or Greater		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
	(in thousands)					
Fixed maturity securities						
U.S. Treasuries	$3,627	$(29)	$—	$—	$3,627	$(29)
U.S. Agencies	1,722	(15)	—	—	1,722	(15)
States and municipalities	52,240	(1,511)	—	—	52,240	(1,511)
Corporate	82,695	(1,686)	—	—	82,695	(1,686)
Residential mortgage-backed securities	29,186	(261)	3,262	(368)	32,448	(629)
Commercial mortgage-backed securities	2,283	(3)	—	—	2,283	(3)
Total fixed maturity securities	171,753	(3,505)	3,262	(368)	175,015	(3,873)
Equity securities						
Consumer goods	806	(17)	—	—	806	(17)
Financial	2,108	(247)	99	(30)	2,207	(277)
Technology and communications	848	(52)	—	—	848	(52)
Industrial and other	134	(7)	—	—	134	(7)
Total equity securities	3,896	(323)	99	(30)	3,995	(353)
Total investments	$175,649	$(3,828)	$3,361	$(398)	$179,010	$(4,226)

	December 31, 2010					
	Less Than 12 Months		12 Months or Greater		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
	(in thousands)					
Fixed maturity securities						
U.S. Treasuries	$4,548	$(159)	$—	$—	$4,548	$(159)
U.S. Agencies	14,500	(87)	—	—	14,500	(87)
States and municipalities	124,245	(4,720)	—	—	124,245	(4,720)
Corporate	123,216	(3,082)	—	—	123,216	(3,082)
Residential mortgage-backed securities	15,161	(304)	3,465	(384)	18,626	(688)
Commercial mortgage-backed securities	1,365	(1)	—	—	1,365	(1)
Asset-backed securities	923	(1)	—	—	923	(1)
Total fixed maturity securities	283,958	(8,354)	3,465	(384)	287,423	(8,738)
Equity securities						
Consumer goods	4,993	(45)	—	—	4,993	(45)
Energy and utilities	163	(1)	—	—	163	(1)
Financial	1,695	(16)	66	(3)	1,761	(19)
Technology and communications	801	(9)	—	—	801	(9)
Industrial and other	2,999	(44)	—	—	2,999	(44)
Total equity securities	10,651	(115)	66	(3)	10,717	(118)
Total investments	$294,609	$(8,469)	$3,531	$(387)	$298,140	$(8,856)

Based on reviews of the fixed maturity securities, the Company determined that unrealized losses as of June 30, 2011 and December 31, 2010 were primarily the result of changes in prevailing interest rates and not the credit quality of the issuers. The fixed maturity securities whose fair values were less than amortized cost were not determined to be other-than-temporarily impaired given the severity and duration of the impairment, the credit quality of the issuers, the Company’s intent on not selling the securities, and a determination made that it is not more likely than not that the Company will be required to sell the securities until fair value recovers above cost, or to maturity.

Based on reviews of the equity securities as of June 30, 2011 and December 31, 2010, the Company determined that the unrealized losses as of those dates were not considered to be other-than-temporary due to the financial condition and near term prospects of the issuers.

Realized gains on investments, net and the change in unrealized gains (losses) on fixed maturity and equity securities are determined on a specific-identification basis and were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands)			
Realized gains on investments, net				
Fixed maturity securities				
Gross gains from sales	$866	$353	$932	$873
Gross losses from sales	(55)	(1)	(148)	(261)
Realized gains on fixed maturity securities, net	$811	$352	$784	$612
Equity securities				
Gross gains from sales	$291	$—	$555	$280
Gross losses from sales	—	—	(3)	—
Realized gains on equity securities, net	$291	$—	$552	$280
Total	$1,102	$352	$1,336	$892
Change in unrealized gains (losses)				
Fixed maturity securities	$28,395	$29,951	$19,458	$31,120
Equity securities	163	(7,735)	4,492	(4,856)
Total	$28,558	$22,216	$23,950	$26,264

Net investment income was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands)			
Fixed maturity securities	$20,349	$20,998	$40,893	$42,358
Equity securities	469	348	918	681
Cash equivalents and restricted cash	91	(110)	196	66
	20,909	21,236	42,007	43,105
Investment expenses	(603)	(588)	(1,208)	(1,202)
Net investment income	$20,306	$20,648	$40,799	$41,903

The Company is required by various state laws and regulations to keep securities or letters of credit in depository accounts with the states in which it does business. As of June 30, 2011 and December 31, 2010, securities having a fair value of $571.0 million and $558.6 million, respectively, were on deposit. These laws and regulations govern not only the amount, but also the type of security that is eligible for deposit. The deposits are limited to fixed maturity securities in all states. Additionally, certain reinsurance contracts require Company funds to be held in trust for the benefit of the ceding reinsurer to secure the outstanding liabilities assumed by the Company. The fair value of securities held in trust for reinsurance at June 30, 2011 and December 31, 2010 was $40.7 million and $52.9 million, respectively. Additionally, the Company's debt was secured by fixed maturity securities and restricted cash and cash equivalents that had a fair value of $127.2 million and $131.0 million at June 30, 2011 and December 31, 2010, respectively.

4. Fair Value of Financial Instruments

The carrying value and the estimated fair value of the Company's financial instruments as of June 30, 2011, were as follows:

	Carrying Value	Estimated Fair Value
	(in thousands)	
Financial assets		
Investments	$2,016,207	$2,016,207
Cash and cash equivalents	201,882	201,882
Restricted cash and cash equivalents	5,132	5,132
Financial liabilities		
Notes payable	132,000	132,000

As of December 31, 2010, the estimated fair value of the Company's financial instruments was equal to the carrying value.

The Company's estimates of fair value for financial assets and liabilities are based on the inputs used in the valuation and give the highest priority to quoted prices in active markets and require that observable inputs be used in the valuations when available. The disclosure of fair value estimates is based on whether the significant inputs into the valuation are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company's significant market assumptions.

The three levels of the hierarchy are as follows:

- Level 1 - Valuations based on unadjusted quoted market prices for identical assets or liabilities in active markets. The Company uses the quoted market prices as fair value and includes these prices in the amounts disclosed in Level 1 of the hierarchy.
- Level 2 - Valuations based on observable inputs (other than Level 1 prices), such as quoted market prices for similar assets or liabilities at the measurement date; quoted prices in inactive markets; or other inputs that are observable, either directly or indirectly. When quoted market prices are unavailable, the Company estimates fair value based on objectively verifiable information, if available, and these estimates are included in the amount disclosed in Level 2 of the hierarchy.
- Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement and involve management judgment. The fair value of certain privately held or thinly traded securities is determined using internal analytical methods based on the best information available.

If quoted market prices and an estimate determined by using objectively verifiable information are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or Level 3. The Company bases all of its estimates of fair value for assets on the bid price as it represents what a third party market participant would be willing to pay in an arm's length transaction. The valuation methods used by the Company, by type of investment, are described below.

Equity Securities. The Company utilizes market quotations for equity securities that have quoted prices in active markets.

Fixed Maturity Securities, Short-Term Investments. Fair value measurements for these securities are estimated using relevant inputs, including available market information, benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. An Option Adjusted Spread model is also used to develop prepayment and interest rate scenarios. Industry standard models are used to analyze and value securities with embedded options or prepayment sensitivities.

Each asset class is evaluated based on relevant market information, credit information, perceived market movements, and sector news. The market inputs utilized in the pricing evaluation include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. The extent of the use of each market input depends on the asset class and the market conditions.

These methods of valuation will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. If objectively verifiable information is not available, the Company would be required to produce an estimate of fair value using some of the same methodologies, making assumptions for market based inputs that are unavailable.

Most estimates of fair value for fixed maturities are based on estimates using objectively verifiable information and are included in the amount disclosed in Level 2 of the hierarchy. The fair value estimates for determining Level 3 fair value include the Company's assumptions about risk assessments and market participant assumptions based on the best information available, including quotes from market makers and other broker/dealers recognized as market participants, using standard or trade derived inputs, new issue data, monthly payment information, cash flow generation, prepayment speeds, spread adjustments, or rating updates.

The following table presents the items on the accompanying consolidated balance sheets that are stated at fair value and the fair value measurements.

	Level 1	Level 2	Level 3
At June 30, 2011	(in thousands)		
Fixed maturity securities			
U.S. Treasuries	$—	$145,330	$—
U.S. Agencies	—	107,410	—
States and municipalities	—	931,155	—
Corporate	—	457,995	—
Residential mortgage-backed securities	—	254,642	—
Commercial mortgage-backed securities	—	21,930	—
Asset-backed securities	—	12,656	—
Total fixed maturity securities	$—	$1,931,118	$—
Equity securities			
Consumer goods	$28,673	$—	$—
Energy and utilities	10,857	—	—
Financial	9,081	—	—
Technology and communications	17,367	—	—
Industrial and other	19,111	—	—
Total equity securities	$85,089	$—	$—

	Level 1	Level 2	Level 3
At December 31, 2010	(in thousands)		
Fixed maturity securities			
U.S. Treasuries	$—	$144,725	$—
U.S. Agencies	—	123,802	—
States and municipalities	—	966,002	—
Corporate	—	479,424	—
Residential mortgage-backed securities	—	246,756	—
Commercial mortgage-backed securities	—	25,077	—
Asset-backed securities	—	14,578	—
Total fixed maturity securities	$—	$2,000,364	$—
Equity securities			
Consumer goods	$26,646	$—	$—
Energy and utilities	10,265	—	—
Financial	9,500	—	—
Technology and communications	15,990	—	—
Industrial and other	17,729	—	—
Total equity securities	$80,130	$—	$—

5. Income Taxes

Income tax expense for interim periods is measured using an estimated effective tax rate for the annual period. During the six months ended June 30, 2011 and 2010, the Company recognized net income before taxes of $12.2 million and $33.7 million and an income tax (benefit) expense of $(4.4) million and $1.1 million, yielding effective tax rates of (35.9)% and 3.3%, respectively.

The following is a reconciliation of the federal statutory income tax rate to the Company’s effective tax rates for the periods presented.

	Six Months Ended June 30, 2011	2010
Expense computed at statutory rate	35.0 %	35.0 %
Dividends received deduction and tax-exempt interest	(46.3)	(20.3)
LPT Agreement	(25.0)	(10.7)
Pre-privatization reserve adjustments	—	(2.3)
Stock based compensation	0.1	0.5
Other	0.3	1.1
	(35.9)%	3.3 %

6. Liability for Unpaid Losses and Loss Adjustment Expenses

The following table represents a reconciliation of changes in the liability for unpaid losses and LAE.

	Six Months Ended June 30, 2011	2010
	(in thousands)	
Unpaid losses and LAE, gross of reinsurance, at beginning of period	$2,279,729	$2,425,658
Less reinsurance recoverables, excluding bad debt allowance, on unpaid losses and LAE	956,043	1,052,505
Net unpaid losses and LAE at beginning of period	1,323,686	1,373,153
Losses and LAE, net of reinsurance, incurred in:		
Current period	131,885	110,697
Prior periods	467	(16,642)
Total net losses and LAE incurred during the period	132,352	94,055
Deduct payments for losses and LAE, net of reinsurance, related to:		
Current period	15,367	18,152
Prior periods	121,694	122,910
Total net payments for losses and LAE during the period	137,061	141,062
Ending unpaid losses and LAE, net of reinsurance	1,318,977	1,326,146
Reinsurance recoverable, excluding bad debt allowance in 2010, on unpaid losses and LAE	936,554	1,033,216
Unpaid losses and LAE, gross of reinsurance, at end of period	$2,255,531	$2,359,362

Total net losses and LAE included in the above table excludes the impact of the amortization of the deferred reinsurance gain—LPT Agreement (Deferred Gain) (Note 7).

The change in the liability for unpaid losses and LAE attributable to insured events for prior periods was $0.5 million and $(16.6) million for the six months ended June 30, 2011 and 2010, respectively. The increase in the first half of 2011 was related to the Company's assigned risk business, while the major sources of favorable development in the first half of 2010 were actual paid losses being less than expected and the impact of new information on selected claim payments and emergence patterns used in the projection of future loss payments.

7. LPT Agreement

The Company is party to a 100% quota share retroactive reinsurance agreement (LPT Agreement) under which $1.5 billion in liabilities for losses and LAE related to claims incurred by EICN prior to July 1, 1995 were reinsured for consideration of $775.0 million. The LPT Agreement provides coverage up to $2.0 billion. The initial Deferred Gain resulting from the LPT Agreement was recorded as a liability in the accompanying consolidated balance sheets and is being amortized using the recovery method, whereby the amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries. The Company amortized $4.3 million and $4.4 million of the Deferred Gain for the three months ended June 30, 2011 and 2010, respectively, and amortized $8.8 million and $8.7

million of the Deferred Gain for the six months ended June 30, 2011 and 2010, respectively. Any adjustments to the Deferred Gain are recorded in losses and LAE incurred in the accompanying consolidated statements of income. No adjustments occurred in the current period. The remaining Deferred Gain was $361.6 million and $370.3 million as of June 30, 2011 and December 31, 2010, respectively, and is included in the accompanying consolidated balance sheets.

8. Accumulated Other Comprehensive Income, net

Accumulated other comprehensive income is comprised of unrealized gains on investments classified as available-for-sale and unrealized losses on an interest rate swap, net of deferred tax expense. The following table summarizes the components of accumulated other comprehensive income, net:

	June 30,	
	2011	2010
	(in thousands)	
Net unrealized gain on investments, before taxes	$153,385	$156,814
Net unrealized loss on interest rate swap, before taxes	—	(810)
Deferred tax expense on net unrealized gains	(54,098)	(55,643)
Total accumulated other comprehensive income, net	$99,287	$100,361

9. Stock-Based Compensation

On March 16, 2011, 355,063 stock options and 126,975 restricted stock units (RSUs) were awarded to certain officers of the Company. The fair value of the RSUs on the grant date and the per share exercise price of the stock options was $19.81. The stock options have a service vesting period of four years and vest 25% on March 16, 2012, and 25% on each of the subsequent three anniversaries of such date. The stock options and RSUs are subject to accelerated vesting in circumstances of death or disability of the holder or in connection with a change of control of the Company and are subject to partial accelerated vesting in the case of retirement. The stock options expire seven years from the date of grant. The aggregate fair value of the stock options and RSUs on the date of grant was $2.5 million and $2.5 million, respectively.

On May 26, 2011, 29,440 RSUs were awarded to the directors of the Company. The fair value of the RSUs on the grant date was $16.30 per share and the total fair value on the date of grant was $0.5 million.

During the first quarter of 2010, the EHI Board of Directors certified the performance period results of the performance share units (PSUs) awarded in 2007, resulting in the vesting of 196,071 shares of common stock.

A total of 74,431 and 7,783 stock options were exercised during the six months ended June 30, 2011 and the year ended December 31, 2010, respectively.

10. Earnings Per Share

Basic earnings per share includes no dilution and is computed by dividing income applicable to stockholders by the weighted average number of shares outstanding for the period. Diluted earnings per share reflects the potential dilutive impact of all convertible securities on earnings per share. Diluted earnings per share includes shares assumed issued under the “treasury stock method,” which reflects the potential dilution that would occur if outstanding options were to be exercised.

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
	(in thousands, except share data)			
Net income available to stockholders—basic and diluted	$8,251	$16,499	$16,596	$32,596
Weighted average number of shares outstanding—basic	38,468,113	42,472,737	38,570,576	42,613,952
Effect of dilutive securities:				
Stock options	75,880	12,850	84,941	—
Restricted stock units	52,320	120,092	66,507	96,443
Dilutive potential shares	128,200	132,942	151,448	96,443
Weighted average number of shares outstanding—diluted	38,596,313	42,605,679	38,722,024	42,710,395

Diluted earnings per share exclude outstanding options and other common stock equivalents in periods where the inclusion of such potential common stock instruments would be anti-dilutive. For both the three and six months ended June 30, 2011, 1.0 million stock options were excluded from diluted earnings per share, as the options exercise price was greater than the average market price of the common stock during the period, compared to 0.7 million and 1.3 million for the corresponding periods of 2010. For both the three and six months ended June 30, 2011, 0.5 million outstanding RSUs and stock options were excluded from diluted earnings per share under the treasury method, as the potential proceeds on settlement or exercise was greater than the value of shares acquired, compared to 0.4 million and 0.5 million for the corresponding periods of 2010.

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

You should read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes thereto included in Item 1 of Part I. Unless otherwise indicated, all references to "we," "us," "our," "the Company" or similar terms refer to Employers Holdings, Inc. (EHI), together with its subsidiaries. The information contained in this quarterly report is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this quarterly report and in our other reports filed with the Securities and Exchange Commission (SEC), including our 2010 Annual Report on Form 10-K for the year ended December 31, 2010 (Annual Report).

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements if accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed. You should not place undue reliance on these statements, which speak only as of the date of this report. Forward-looking statements include those related to our expected financial position, business, financing plans, litigation, future premiums, revenues, earnings, pricing, investments, business relationships, expected losses, loss reserves, acquisitions, competition, and rate increases with respect to our business and the insurance industry in general. Statements including words such as "expect," "intend," "plan," "believe," "estimate," "may," "anticipate," "will" or similar statements of a future or forward-looking nature identify forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. All forward-looking statements address matters that involve risks and uncertainties that could cause actual results to differ materially from historical or anticipated results, depending on a number of factors. These risks and uncertainties include, but are not limited to, those described in our Annual Report and other documents that we have filed with the SEC.

Overview

We are a Nevada holding company. Through our insurance subsidiaries, we provide workers' compensation insurance coverage to select, small businesses in low to medium hazard industries. Workers' compensation insurance is provided under a statutory system wherein most employers are required to provide coverage for their employees' medical, disability, vocational rehabilitation, and/or death benefit costs for work-related injuries or illnesses. We provide workers' compensation insurance in 30 states and the District of Columbia, with a concentration in California. Our revenues are primarily comprised of net premiums earned, net investment income, and net realized gains (losses) on investments.

We target small businesses, as we believe that this market is traditionally characterized by fewer competitors, more attractive pricing, and stronger persistency when compared to the U.S. workers' compensation insurance industry in general. We believe we are able to price our policies at levels which are competitive and profitable over the long-term. Our underwriting approach is to consistently underwrite small business accounts at an appropriate and competitive price without sacrificing long-term profitability and stability for short-term top-line revenue growth.

We market and sell our workers' compensation insurance products through independent local, regional and national agents and brokers; through our strategic partnerships and alliances, including our principal partners ADP, Inc. and Anthem Blue Cross of California; and through relationships with professional trade groups and associations, including the National Federation of Independent Business (NFIB).

Results of Operations

Overall, net income was $8.3 million and $16.6 million for the three and six months ended June 30, 2011, respectively, compared to $16.5 million and $32.6 million for the corresponding periods of 2010. We recognized underwriting losses of $14.3 million and $28.2 million for the three and six months ended June 30, 2011, respectively, compared to underwriting losses of $1.5 million and $6.1 million for the same periods of 2010. Underwriting income or loss is determined by deducting losses and LAE, commission expense, dividends to policyholders, and underwriting and other operating expenses from net premiums earned. Key factors that effected our financial performance during the three and six months ended June 30, 2011, compared to the same periods of 2010, include:

- 41% increase in gross premiums written during the second quarter and 33% increase year-to-date (12.6% and 8.3% increase in net earned premium for the same periods);
-

42% increase in losses and LAE during the second quarter and 45% increase year-to-date (due to increased earned premium, favorable prior accident year loss development in 2010, and an increase in our current accident year loss estimate to 78.0% and 77.3% for the second quarter and year-to-date 2011, respectively);

- Income tax benefit of $2.0 million and $4.4 million for the second quarter and year-to-date 2011, respectively, compared to income tax expense of $1.6 million and $1.1 million.

We measure our performance by our ability to increase stockholders' equity, including the impact of the deferred reinsurance gain–LPT Agreement (Deferred Gain), over the long-term. Our stockholders' equity, including the Deferred Gain, was $860.3 million and $860.5 million at June 30, 2011 and December 31, 2010, respectively. Stockholders' equity, including the Deferred Gain, is a non-GAAP measure that is defined as total stockholders' equity plus the deferred reinsurance gain—LPT Agreement, which we believe is an important supplemental measure of our capital position. Stockholders' equity on a GAAP basis was $498.7 million and $490.1 million at June 30, 2011 and December 31, 2010, respectively. As a result of accretive share repurchases, shares outstanding declined to 37,855,399 from 38,965,126 in the first half of 2011. Additionally, we have returned $4.6 million to shareholders in 2011 through a $0.06 per share quarterly dividend.

Our goal is to maintain focus on disciplined underwriting and to continue to pursue profitable growth opportunities across market cycles; however, we continue to be affected by the impacts of the most recent economic recession. The pace of recovery remains uncertain and, although it appears to us that the declines in total employment and payroll may have leveled-off, we do not believe the situation will significantly improve in the near-term. We believe that we are positioned to continue to grow our business when the economy and employment trends improve.

The comparative components of net income are set forth in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands)			
Gross premiums written	$107,830	$76,421	$211,057	$158,798
Net premiums written	105,566	73,725	206,692	153,499
Net premiums earned	$88,128	$78,235	$170,555	$157,526
Net investment income	20,306	20,648	40,799	41,903
Realized gains on investments	1,102	352	1,336	892
Other income	3	207	123	207
Total revenues	109,539	99,442	212,813	200,528
Losses and LAE	64,150	45,045	123,571	85,333
Commission expense	11,119	9,176	21,400	19,081
Dividends to policyholders	914	323	1,926	1,802
Underwriting and other operating expenses	26,200	25,143	51,878	57,410
Interest expense	908	1,620	1,825	3,200
Income tax expense (benefit)	(2,003)	1,636	(4,383)	1,106
Total expenses	101,288	82,943	196,217	167,932
Net income	$8,251	$16,499	$16,596	$32,596
Less impact of the deferred reinsurance gain— LPT Agreement	$4,262	$4,371	$8,782	$8,722
Net income before impact of the deferred reinsurance gain— LPT Agreement(1)	$3,989	$12,128	$7,814	$23,874

(1) We define net income before impact of the deferred reinsurance gain—LPT Agreement as net income less: (a) amortization of deferred reinsurance gain—LPT Agreement and (b) adjustments to LPT Agreement ceded reserves. Deferred reinsurance gain—LPT Agreement reflects the unamortized gain from our LPT Agreement. Under GAAP, this gain is deferred and is being amortized using the recovery method, whereby the amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries, and the amortization is reflected in losses and LAE. We periodically reevaluate the remaining direct reserves subject to the LPT Agreement. Our reevaluation results in corresponding adjustments, if needed, to reserves, ceded reserves, reinsurance recoverable, and the deferred reinsurance gain, with the net effect being an increase or decrease, as the case may be, to net income. Net income before impact of the deferred reinsurance gain—LPT Agreement is not a measurement of financial performance under GAAP, but rather reflects the difference in accounting treatment between statutory

and GAAP, and should not be considered in isolation or as an alternative to net income before income taxes and net income or any other measure of performance derived in accordance with GAAP.

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

Net Premiums Earned

Net premiums earned increased 12.6% and 8.3% for the three and six months ended June 30, 2011, respectively, compared to the corresponding periods of 2010. The change in the accrual for final audit premium increased our net premiums earned by $4.5 million and $15.7 million for the three and six months ended June 30, 2011, respectively, compared to the corresponding periods of 2010. Changes in the accrual for final audit premium are driven by various factors, including general economic factors such as unemployment and payroll trends.

The following table shows the percentage change in our in-force premium, policy count, average policy size, and payroll exposure, upon which our premiums are based, and net rate.

	At June 30, 2011	
	Year-to-Date Percentage Increase (Decrease)	Year-Over-Year Percentage Increase (Decrease)
In-force premium	8.1 %	1.4 %
In-force policy count	16.8	20.1
Average in-force policy size	(7.4)	(15.6)
In-force payroll exposure	9.3	5.6
Net rate(1)	(1.1)	(4.0)

(1) Net rate, defined as total premium in-force divided by total insured payroll exposure, is a function of a variety of factors, including rate changes, underwriting risk profiles and pricing, and changes in business mix related to economic and competitive pressures.

Our total in-force premiums and number of policies in-force for our five largest states and all other states combined are shown in the table below as of the dates shown.

State	June 30, 2011		December 31, 2010		June 30, 2010		December 31, 2009	
	Premium In-force	Policies In-force	Premium In-force	Policies In-force	Premium In-force	Policies In-force	Premium In-force	Policies In-force
	(dollars in thousands)							
California	$191,684	32,987	$172,621	29,244	$176,073	28,337	$180,474	27,812
Illinois	22,690	1,574	18,617	932	18,678	812	19,389	801
Nevada	15,932	3,622	16,940	3,596	20,072	3,806	24,050	4,119
Florida	14,885	2,212	15,071	1,963	18,372	2,062	27,964	2,630
Georgia	12,915	1,387	10,773	757	11,677	538	12,744	539
Other	89,067	10,256	87,115	8,068	97,579	7,778	120,404	8,253
Total	$347,173	52,038	$321,137	44,560	$342,451	43,333	$385,025	44,154

Our strategic partnerships and alliances generated $80.5 million and $71.6 million, or 23.2% and 20.9%, of our in-force premiums as of June 30, 2011 and 2010, respectively. This percentage increase was primarily due to the higher retention rates for this business than for business produced by our independent agents. We believe that the bundling of products and services through these relationships has contributed to the higher retention rates. These relationships also allow us to access new customers that we may not have access to through our independent agent distribution channel. We continue to expand existing relationships and actively seek new partnerships and alliances.

Over one-half of our business is generated in California, where we continue to see a steady level of new business submittals and where our policy count has increased 12.8% during the first half of 2011.

In April 2011, the Workers' Compensation Insurance Rating Bureau (WCIRB) of California stated that it would not make a mid-year rate recommendation, but provided an informational filing highlighting the cost drivers that indicated a cumulative 39.8% increase in the claims cost benchmark since January 1, 2009 based on an analysis of December 31, 2010 loss experience. This includes deterioration of more than 12 percentage points in the claims cost benchmark since the WCIRB's previous recommendation for a 27.7% increase based on an analysis of June 30, 2010 loss experience. The WCIRB indicated that this further deterioration was due to: (a) continued adverse loss development on the 2009 accident year; (b) high emerging costs on the 2010 accident year, primarily due to increased claims frequency; (c) less optimistic forecasts for statewide wage growth in California; and (d) increased LAE that is likely as a result of certain Workers' Compensation Appeals Board decisions. The California Commissioner has not adjusted the claims cost benchmark since January 1, 2009.

We set our own premium rates in California based upon actuarial analyses of current and anticipated loss trends with a goal of maintaining underwriting profitability. Due to increasing loss costs, primarily medical cost inflation, we have increased our filed premium rates by a cumulative 33.3% since February 1, 2009.

The following table sets forth the percentage increases to our filed California rates effective for new and renewal policies incepting on or after the dates shown.

Effective Date	Premium Rate Change Filed in California	
February 1, 2009	10.0	%
August 15, 2009	10.5	
March 15, 2010	3.0	
March 15, 2011	2.5	
September 15, 2011	3.9	

We expect that premium revenues in 2011 will continue to reflect rate changes (increases and reductions) in the states in which we operate, increasing policy count as we continue to execute our growth strategy, lower average policy size, as well as competitive pressures and the residual effects of the recession.

Net Investment Income and Realized Gains on Investments.

We invest our holding company assets, statutory surplus, and the funds supporting our insurance liabilities, including unearned premiums and unpaid losses and LAE. We invest in fixed maturity securities, equity securities, short-term investments, and cash equivalents. Net investment income includes interest and dividends earned on our invested assets and amortization of premiums and discounts on our fixed maturity securities, less bank service charges and custodial and portfolio management fees.

We have established a high quality/short duration bias in our investment portfolio with high underlying credit quality of our municipal bond holdings. The performance of our investment portfolio, with its diversified structure and quality bias, has been exceptionally strong.

Net investment income decreased 1.7% and 2.6% for the three and six months ended June 30, 2011, respectively, compared to the corresponding periods of 2010. The decreases were primarily related to decreases in the average pre-tax book yield on invested assets to 4.1%, compared to 4.2% for the three months ended June 30, 2011, compared to same period of 2010, and to 4.1%, compared to 4.3% for the six months ended June 30, 2011, compared to the same period of 2010. The tax-equivalent yield on invested assets decreased to 5.2% at June 30, 2011, compared to 5.5% at June 30, 2010.

Realized gains and losses on our investments are reported separately from our net investment income. Realized gains and losses on investments include the gain or loss on a security at the time of sale compared to its original or adjusted cost (equity securities) or amortized cost (fixed maturity securities). Realized losses are also recognized when securities are written down as a result of an other-than-temporary impairment.

Net realized gains on investments were $1.1 million and $1.3 million for the three and six months ended June 30, 2011, respectively, compared to $0.4 million and $0.9 million for the corresponding periods of 2010. The increase in realized gains on investments for both periods was primarily due to the sale of equity securities, as we shifted to a high-yield equity securities portfolio.

Additional information regarding our Investments is set forth under "—Liquidity and Capital Resources—Investments."

Combined Ratio

The combined ratio, expressed as a percentage, is a key measurement of underwriting profitability. The combined ratio is the sum of the losses and LAE ratio, the commission expense ratio, dividends to policyholders' ratio, and underwriting and other operating expenses ratio. When the combined ratio is below 100%, we have recorded underwriting income, and conversely, when the combined ratio is greater than 100%, we cannot be profitable without investment income. Because we only have one operating segment, holding company expenses are included in our calculation of the combined ratio.

The following table provides the calculation of our calendar year combined ratios.