

# AMERISAFE, Inc.

## First-Quarter Review: No Surprises

- AMERISAFE's first-quarter operating EPS based on a full converted share count decreased 8%, to \$0.54, compared with our \$0.51 estimate and in line with consensus. Upside relative to our estimate was driven by roughly \$0.04 per share of favorable loss reserve development. This was first quarter since the company's late-2005 IPO in which AMERISAFE has not exceeded the consensus EPS estimate.
- Gross written premium decreased 2%, to \$79.4 million, ahead of our estimate of a decline of 5%, reflecting lower audit adjustments for policies written in prior periods offset by an increase in underlying premiums. The weak economy continues to dampen demand, although AMERISAFE continues to see good new business growth from clients moving from AIG (AIG \$1.41). The competitive market continues to stabilize a bit, and we expect further improvements into 2010.
- The reported combined ratio was 88.6%, compared with our 90.3% estimate—favorable loss reserve development lowered the loss ratio by 1.7 percentage points—and the expense ratio was 21.1%, in line with our estimate. The accident-year loss ratio (losses estimated on business written in 2009) was booked at 69.0% in the first quarter, compared with the total year accident year 2008 loss ratio of 68.0%, in line with our estimate.
- On April 22, the company announced that A.M. Best reaffirmed AMERISAFE's A- (Excellent) rating and upgraded the company's outlook to positive from stable. AMERISAFE also announced on April 28 its board completed its corporate governance review announced in early February in response to concerns raised by a board member in conjunction with his declaration not to seek reelection. The results of the review were as expected; no significant issues were uncovered in the process of the review.
- Our rating remains Market Perform. We are increasing our 2009 EPS estimate to \$2.28 from \$2.25 given the outperformance this quarter; our 2010 EPS estimate remains \$2.10. We downgraded the stock from Outperform on February 24, 2009, given its high relative valuation and less confidence in the durability of significant favorable loss reserve development. Fully diluted book value per share ended the quarter at \$14.06. The shares trade at about 1.1 times diluted book of \$14.06 as of the end of the quarter, which is now just a modest premium to the overall commercial lines underwriting group, but remains reasonable on absolute basis.

## Financial | Commercial P/C Insurance

April 30, 2009

Stock Rating: **Market Perform**  
Company Profile: **Aggressive Growth**

Symbol: AMSF (NASDAQ)  
Price: \$15.74 (52-Wk.: \$13-\$22)  
Market Value (mil.): \$280  
Fiscal Year End: December  
Long-Term EPS Growth Rate: 12%  
Dividend/Yield: None

	2008A	2009E	2010E
<b>Estimates</b>			
EPS Q1	\$0.59	A\$0.54	NA
Q2	\$0.63	\$0.51	NA
Q3	\$0.75	\$0.62	NA
Q4	\$0.94	\$0.61	NA
FY	\$2.90	\$2.28	\$2.10
CY		\$2.28	\$2.10

### Valuation

FY P/E	5.4x	6.9x	7.5x
CY P/E		6.9x	7.5x

### Trading Data (Thomson Financial)

Shares Outstanding (mil.)	19
Float (mil.)	NA
Average Daily Volume	151,170

### Financial Data (Thomson Financial)

Long-Term Debt/Total Capital (MRQ)	12.9
Book Value Per Share (MRQ)	11.6
Enterprise Value (mil.)	262.8
EBITDA (TTM)	70.2
Enterprise Value/EBITDA (TTM)	3.7x
Return on Equity (TTM)	17.4

### Two-Year Price Performance Chart



Source: Thomson Financial, William Blair & Company estimates

**Mark Lane**  
312.364.8686  
mlane@williamblair.com

**Rachel Carter**  
312.364.8962  
rcarter@williamblair.com

## **No Surprises in Results; No Upside to Consensus—First Time as a Public Company**

AMERISAFE's first-quarter operating EPS based on a full converted share count decreased 8%, to \$0.54, compared with our \$0.51 estimate and in line with consensus. While profitability remains high, expectations have finally caught up with reality, as this marks the first quarter (IPO November 2005) in which the company did not exceed the consensus estimate. Upside relative to our estimate was principally driven by \$1.2 million (roughly \$0.04 per share) of favorable loss reserve development, compared with \$9.3 million (roughly \$0.30 per share) of favorable development last quarter. We had not included any favorable loss reserve development in our estimate given it is early in the year.

## **Modest Decline in Premium Growth—Relatively Aggressive on New Business**

Gross written premium decreased 2%, to \$79.4 million, ahead of our estimate of a decline of 5%, reflecting lower audit adjustments (\$1.4 million, accounting for the majority of the drop in production) written for policies in prior periods offset by an increase in underlying premiums. Voluntary workers' compensation business written increased 1.2%, offset by a decrease in the assigned risk business (allocated to insurers on an involuntary basis based on their market share in a respective state) as well as the abovementioned lower audit adjustment eventually accounting for the negative top-line growth in the quarter. While market pricing has stabilized a bit, the decline in growth this quarter was not a surprise given that prices have been declining for four years and recessionary pressures are dampening demand.

During the quarter, the company saw an increase in new business submissions of 4.3% (business seeking a quote) and an increase in new-bound policies of nearly 12.0% (signed policies), meaning that the company's hit ratio of closed business is up. Total premium bound was also up above 15%, signifying an increase in the average policy size. We are bit surprised by the higher hit ratio (new business to submissions) given that pricing has been down for about four years in the aggregate. However, AMERISAFE continues to see good new business growth from clients moving from AIG, and some of the growth can be seen as opportunistic, in our opinion. Last quarter management started tracking new business earned from AIG, and from mid-September through the end of 2008 AMERISAFE booked 142 new accounts totaling roughly \$7.3 million in premium—average policy size was over \$50,000, compared with AMERISAFE's average policy size for the balance of the year at \$36,600. In the first quarter, AMERISAFE secured 88 policies totaling roughly \$4.0 million in premium—average policy size was roughly \$45,500, compared with AMERISAFE's average policy size in the quarter of \$36,300.

For the company's in-force business, insured payrolls increased by 0.8% in the first quarter, while total in-force premium decreased by 0.2%, compared with a 0.3% increase last quarter. The company's average premium also declined in the quarter by 1.1%, to \$36,300. Management stated that the decrease in premium is consistent with the competitive environment and reflective of the soft pricing that has persisted over the past four years. That said, in the renewal business, voluntary workers' compensation count was down modestly, compared with a 1.5% increase last quarter; however, premium retention was up by 7 percentage points, implying retention was better on larger accounts.

## **Margins Remain Ahead of Expectations—Favorable Loss Reserve Development and Favorable Reinsurance Contracts Driving Benefit**

The reported combined ratio was 88.6%, compared with our 90.3% estimate, and benefited from 1.7 percentage points (\$1.2 million) of favorable loss reserve development in the quarter. The combined ratio was 73.7% last quarter, and benefited from 13.0 percentage points (\$9.3 million) of favorable loss reserve development, and in first quarter 2008 the combined ratio was 87.2%, and benefited from 2.3 percentage points (\$1.7 million) of favorable loss reserve development. The favorable loss reserve development in the quarter was attributed to accident years 2005 through 2007, offset somewhat by adverse development of \$5.3 million attributed to the 2008 accident year. Management stated that adjustments of this type from recent years are typical early in the year given that these are new claims. In its first two years as a public company (2006 and 2007), AMERISAFE only adjusted reserve from prior periods at the end of the year, but last year, given the degree of favorable development, management started recognizing favorable loss reserve development earlier in the year. Operating return on equity was 15.6% in the quarter, compared with 20.0% first quarter 2008.

The loss ratio was 67.2% in the quarter, and the accident-year loss ratio (losses estimated on business written in 2009) was booked at 69.0% in the first quarter, in line with our estimate, and compared with 64.8% last quarter (51.8% including favorable reserve development), and 69.5% in first quarter 2008 (67.2% including favorable reserve development). The company's expense ratio was 21.1% in the quarter, in line with our estimate despite a modest decline in net earned premiums. This is a reflection of the company's aggressive expense management, as well as the impact from AMERISAFE's 2009 \$5 million excess of \$5 million loss reinsurance treaty—through which the company has locked in the vast majority of its reinsurance costs in what will arguably be a period of rising prices, generating commissions that offset overall underwriting expenses; as long as the company does not penetrate the contract's \$20 million aggregate annual-rate deductible, if the deductible is reached, the benefit would transfer from the expense ratio to the loss ratio in the form of ceded losses; \$438,000 of commissions was received in the quarter offsetting expenses. The 2009 treaty is a three-year treaty, scheduled to expire January 1, 2012. The \$438,000 per quarter is in addition to the \$2.4 million quarterly commissions related to the 2008 \$4 million excess of \$1 million loss reinsurance treaty set to expire January 1, 2010. Excluding the aggregate benefit of approximately \$2.8 million, we estimate the fourth-quarter expense ratio would have been closer to 25.1% in the quarter.

The policyholder dividend ratio (premiums returned or credited to policyholders if certain levels of profitability are attained), which is the third component of the combined ratio, was 0.3%, a slight decrease from 0.4% in first quarter 2008, and compared with our 0.2% estimate. The majority of dividends are paid to policyholders in Florida under a state-specific statutory formula.

### **A Few Other Recent Positive Developments**

On April 22, the company announced that A.M. Best reaffirmed AMERISAFE's A- (Excellent) rating and upgraded the company's outlook to positive from stable. This will not have a material impact on AMERISAFE's business, but helps continue solidify its position as a stable competitor. Barring any unforeseen development, the outlook status should not come under formal review again for another 18 to 24 months in management's estimation. Importantly, AMERISAFE also announced on April 28 that the nominating and corporate governance committee of its board completed its corporate governance review announced in early February in response to concerns raised by the board member in conjunction with his declaration not to seek reelection. The results of the review were as expected; no significant issues were uncovered in the process of the review.

### **Maintaining Estimates and Rating**

Our rating remains Market Perform. We are increasing our 2009 EPS estimate to \$2.28 from \$2.25 given the outperformance this quarter; our 2010 EPS estimate remains \$2.10. We downgraded the stock from Outperform on February 24, 2009, given its high relative valuation and less confidence in the durability of significant favorable loss reserve development, which has been the major driver of earnings upside the past several quarters. Fully diluted book value per share ended the quarter at \$14.06. The shares trade at about 1.1 times diluted book, which is now just a modest premium to the overall commercial lines underwriting group, although there is probably not another publicly traded commercial underwriter that has matched AMERISAFE's financial performance relative to expectations over the past three years, and the company remains well managed. That said, we remain concerned about the negative impact on payroll growth (main driver of premiums) from the weaker economy and the underlying deterioration in profitability that will eventually catch up with underlying claims inflation.

**AMERISAFE, Inc.**  
**Condensed Income Statement Comparison**  
(\$ in millions, except per share data)

	1Q08	2Q08	3Q08	4Q08	2008 Actual	1Q09	2Q09E	3Q09E	4Q09E	2009 Estimate	2010 Estimate
<b>Gross premiums written</b>	<b>\$80,977</b>	<b>\$85,995</b>	<b>\$75,767</b>	<b>\$65,102</b>	<b>\$307,841</b>	<b>\$79,429</b>	<b>\$81,695</b>	<b>\$71,979</b>	<b>\$63,149</b>	<b>\$296,252</b>	<b>\$311,064</b>
% change annual	-11%	-9%	-7%	5%	-6%	-2%	-5%	-5%	-3%	-4%	5%
<b>Net premiums written</b>	<b>\$76,187</b>	<b>\$81,329</b>	<b>\$71,193</b>	<b>\$59,482</b>	<b>\$288,191</b>	<b>\$74,235</b>	<b>\$76,794</b>	<b>\$67,660</b>	<b>\$57,781</b>	<b>\$276,470</b>	<b>\$290,845</b>
% change annual	-11%	-9%	-6%	5%	-6%	-3%	-6%	-5%	-3%	-4%	5%
% gross premiums written	94.1%	94.6%	94.0%	91.4%	93.6%	93.5%	94.0%	94.0%	91.5%	93.3%	93.5%
Net premiums earned	\$74,300	\$72,143	\$71,284	\$71,766	\$289,493	\$70,001	\$70,966	\$70,008	\$69,445	\$280,420	\$283,657
% change annual	-2%	-6%	-10%	-3%	-6%	-6%	-2%	-2%	-3%	-3%	1%
Loss and loss expense	\$49,928	\$47,317	\$41,972	\$37,172	\$176,389	\$47,070	\$48,470	\$45,295	\$44,931	\$185,766	\$195,440
% premiums earned	67.2%	65.6%	58.9%	51.8%	60.9%	67.2%	68.3%	64.7%	64.7%	66.2%	68.9%
Reserve development	\$1,700	\$2,800	\$6,600	\$9,300	\$20,400	\$1,200	\$500	\$3,000	\$3,000	\$7,700	\$3,000
% premiums earned	2.3%	3.9%	9.3%	13.0%	7.0%	1.7%	0.7%	4.3%	4.3%	2.7%	1.1%
Total underwriting expenses	\$14,514	\$14,149	\$14,474	\$12,799	\$55,936	\$14,768	\$15,045	\$14,387	\$14,618	\$58,818	\$59,001
Expense ratio	19.5%	19.6%	20.3%	17.8%	19.3%	21.1%	21.2%	20.6%	21.1%	21.0%	20.8%
Policyholder dividends	\$316	\$122	\$125	\$2,941	\$3,504	\$181	\$170	\$168	\$139	\$658	\$567
Policyholder dividend ratio	0.4%	0.2%	0.2%	4.1%	1.2%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%
<b>Underwriting income</b>	<b>\$9,542</b>	<b>\$10,555</b>	<b>\$14,713</b>	<b>\$18,854</b>	<b>\$53,664</b>	<b>\$7,982</b>	<b>\$7,281</b>	<b>\$10,158</b>	<b>\$9,757</b>	<b>\$35,178</b>	<b>\$28,649</b>
% change annual	67%	18%	71%	-6%	24%	-16%	-31%	-31%	-48%	-34%	-19%
Combined ratio	87.2%	85.4%	79.4%	73.7%	81.5%	88.6%	89.7%	85.5%	86.0%	87.5%	89.9%
Fees and other income	\$141	\$229	\$200	\$172	\$742	\$136	\$200	\$200	\$200	\$736	\$800
% change annual	1%	66%	-6%	23%	-30%	-4%	-13%	0%	16%	-1%	9%
Net investment income	\$7,817	\$7,405	\$7,712	\$8,064	\$30,998	\$7,372	\$7,879	\$7,966	\$8,049	\$31,266	\$33,071
% change annual	13%	0%	-3%	2%	3%	-6%	6%	3%	0%	1%	6%
% of average invested assets	4.1%	3.8%	4.0%	4.1%	4.0%	3.7%	3.9%	3.8%	3.8%	3.8%	3.7%
Interest expense	\$769	\$657	\$654	\$380	\$2,460	\$611	\$575	\$575	\$575	\$2,336	\$2,000
Pretax operating income	\$16,731	\$17,532	\$21,971	\$26,710	\$82,944	\$14,879	\$14,785	\$17,749	\$17,431	\$64,844	\$60,520
% change annual	41%	12%	35%	-2%	17%	-11%	-16%	-19%	-35%	-22%	-7%
Net realized investment gains/(losses)	\$8	\$53	(\$2,921)	(\$15,996)	(\$18,856)	\$26	\$0	\$0	\$0	\$26	\$0
Income before taxes	\$16,739	\$17,585	\$19,050	\$10,714	\$64,088	\$14,905	\$14,785	\$17,749	\$17,431	\$64,870	\$60,520
% change annual	41%	13%	17%	-61%	-10%	-11%	-16%	-7%	63%	1%	-7%
Income tax expense	\$4,816	\$4,758	\$5,691	\$4,977	\$20,242	\$3,843	\$4,288	\$5,147	\$5,055	\$18,333	\$17,551
Effective tax rate	28.8%	27.1%	29.9%	46.5%	31.6%	25.8%	29.0%	29.0%	29.0%	28.3%	29.0%
Net income before preferred dividends	\$11,923	\$12,827	\$13,359	\$5,737	\$43,846	\$11,062	\$10,497	\$12,602	\$12,376	\$46,537	\$42,969
% change annual	42%	13%	13%	-69%	-13%	-7%	-18%	-6%	116%	6%	-8%
Preferred dividends	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Net income available to common shareholders	\$11,923	\$12,827	\$13,359	\$5,737	\$43,846	\$11,062	\$10,497	\$12,602	\$12,376	\$46,537	\$42,969
% change annual	42%	13%	13%	-69%	-13%	-7%	-18%	-6%	116%	6%	-8%
<b>Operating income<sup>1</sup></b>	<b>\$11,918</b>	<b>\$12,793</b>	<b>\$15,258</b>	<b>\$19,094</b>	<b>\$59,062</b>	<b>\$11,045</b>	<b>\$10,497</b>	<b>\$12,602</b>	<b>\$12,376</b>	<b>\$46,520</b>	<b>\$42,969</b>
% change annual	42%	13%	30%	3%	18%	-7%	-18%	-17%	-35%	-21%	-8%
<b>Diluted operating EPS</b>	<b>\$0.59</b>	<b>\$0.63</b>	<b>\$0.75</b>	<b>\$0.94</b>	<b>\$2.90</b>	<b>\$0.54</b>	<b>\$0.51</b>	<b>\$0.62</b>	<b>\$0.61</b>	<b>\$2.28</b>	<b>\$2.10</b>
% change annual	41%	13%	29%	2%	17%	-8%	-18%	-17%	-35%	-22%	-8%
Average diluted shares <sup>2</sup>	20,300	20,300	20,422	20,420	20,361	20,420	20,430	20,435	20,440	20,431	20,500
% change annual	0%	0%	1%	1%	0%	1%	1%	0%	0%	0%	0%
<b>Operating return on equity - diluted</b>	<b>20.0%</b>	<b>20.6%</b>	<b>23.4%</b>	<b>28.0%</b>	<b>23.1%</b>	<b>15.6%</b>	<b>14.4%</b>	<b>16.6%</b>	<b>15.6%</b>	<b>15.6%</b>	<b>12.5%</b>
100-basis-point change in combined ratio	\$0.03	\$0.03	\$0.02	\$0.02	\$0.10	\$0.03	\$0.02	\$0.02	\$0.02	\$0.10	\$0.10

<sup>1</sup>Income before the effects of net realized investment gains/losses.

<sup>2</sup>On a fully converted basis for Series C&D preferred stock and on a pro forma basis for the completion of the IPO in November, 2005.  
Source: Company reports and William Blair & Company L.L.C. estimates

William Blair & Company, L.L.C. is a market maker in the security of AMERISAFE, Inc. and may have a long or short position.

Additional information is available upon request.



**Current Rating Distribution (as of 03/31/09)**

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	55	Outperform (Buy)	3
Market Perform (Hold)	44	Market Perform (Hold)	1
Underperform (Sell)	1	Underperform (Sell)	1

\*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

Mark Lane attests that 1) all of the views expressed in this research report accurately reflect his/her personal views about any and all of the securities and companies covered by this report, and 2) no part of his/her compensation was, is, or will be related, directly or indirectly, to the specific recommendations or views expressed by him/her in this report.

Stock Rating: William Blair & Company, L.L.C. uses a three-point system to rate stocks. Individual ratings reflect the expected performance of the stock relative to the broader market over the next 12 months. The assessment of expected performance is a function of near-term company fundamentals, industry outlook, confidence in earnings estimates, valuation, and other factors. Outperform (O) – stock expected to outperform the broader market over the next 12 months; Market Perform (M) – stock expected to perform approximately in line with the broader market over the next 12 months; Underperform (U) – stock expected to underperform the broader market over the next 12 months; Not Rated (NR) – the stock is currently not rated.

Company Profile: The William Blair research philosophy is focused on quality growth companies. Growth companies by their nature tend to be more volatile than the overall stock market. Company profile is a fundamental assessment, over a longer-term horizon, of the business risk of the company relative to the broader William Blair universe. Factors assessed include: 1) durability and strength of franchise (management strength and track record, market leadership, distinctive capabilities); 2) financial profile (earnings growth rate/consistency, cash flow generation, return on investment, balance sheet, accounting); 3) other factors such as sector or industry conditions, economic environment, confidence in long-term growth prospects, etc. Established Growth (E) – Fundamental risk is lower relative to the broader William Blair universe; Core Growth (C) – Fundamental risk is approximately in line with the broader William Blair universe; Aggressive Growth (A) – Fundamental risk is higher relative to the broader William Blair universe.

The ratings and company profile assessments reflect the opinion of the individual analyst and are subject to change at any time.

The compensation of the research analyst is based on a variety of factors, including performance of his or her stock recommendations; contributions to all of the firm's departments, including asset management, corporate finance, institutional sales, and retail brokerage; firm profitability; and competitive factors.

THIS IS NOT IN ANY SENSE A SOLICITATION OR OFFER OF THE PURCHASE OR SALE OF SECURITIES. THE FACTUAL STATEMENTS HEREIN HAVE BEEN TAKEN FROM SOURCES WE BELIEVE TO BE RELIABLE, BUT SUCH STATEMENTS ARE MADE WITHOUT ANY REPRESENTATION AS TO ACCURACY OR COMPLETENESS OR OTHERWISE. OPINIONS EXPRESSED ARE OUR OWN UNLESS OTHERWISE STATED. FROM TIME TO TIME, WILLIAM BLAIR & COMPANY, L.L.C. OR ITS AFFILIATES MAY BUY AND SELL THE SECURITIES REFERRED TO HEREIN, MAY MAKE A MARKET THEREIN, AND MAY HAVE A LONG OR SHORT POSITION THEREIN. PRICES SHOWN ARE APPROXIMATE. THIS MATERIAL HAS BEEN APPROVED FOR DISTRIBUTION IN THE UNITED KINGDOM BY WILLIAM BLAIR INTERNATIONAL, LIMITED, REGULATED BY THE FINANCIAL SERVICES AUTHORITY (FSA), AND IS DIRECTED ONLY AT, AND IS ONLY MADE AVAILABLE TO, PERSONS FALLING WITHIN COB 3.5 AND 3.6 OF THE FSA HANDBOOK (BEING "ELIGIBLE COUNTERPARTIES" AND "PROFESSIONAL CLIENTS"). THIS DOCUMENT IS NOT TO BE DISTRIBUTED OR PASSED ON TO ANY "RETAIL CLIENTS." NO PERSONS OTHER THAN PERSONS TO WHOM THIS DOCUMENT IS DIRECTED SHOULD RELY ON IT OR ITS CONTENTS OR USE IT AS THE BASIS TO MAKE AN INVESTMENT DECISION. "WILLIAM BLAIR & COMPANY" AND "WILLIAM BLAIR & COMPANY (SCRIPT)" ARE REGISTERED TRADEMARKS OF WILLIAM BLAIR & COMPANY, L.L.C. Copyright 2009, William Blair & Company, L.L.C.

Please contact us at 1-800-621-0687 or consult [http://www.williamblair.com/pages/eqresearch\\_coverage.asp](http://www.williamblair.com/pages/eqresearch_coverage.asp) for all disclosures.

*William Blair & Company*<sup>®</sup>

Investment Banking ■ Asset Management ■ Equity Research ■ Institutional & Private Brokerage ■ Private Capital

William Blair & Company, L.L.C. 222 West Adams Street Chicago, Illinois 60606 312.236.1600 [www.williamblair.com](http://www.williamblair.com)

CHICAGO BOSTON LONDON NEW YORK SAN FRANCISCO SHANGHAI TOKYO ZURICH