

AMERICAN SAFETY INSURANCE HOLDINGS LTD  
Form 10-Q  
August 16, 2004

**SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON D.C. 20549**

**FORM 10-Q**

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2004

Commission File Number 1-14795

**AMERICAN SAFETY INSURANCE HOLDINGS, LTD.**

(Exact name of Registrant as specified in its charter)

Commission File Number 1-14795

AMERICAN SAFETY INSURANCE HOLDINGS, LTD.  
(Exact name of Registrant as specified in its charter)

-----  
Bermuda  
(State or other jurisdiction  
of incorporation)

(  
Ide

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44 Church Street  
P.O. Box HM2064  
Hamilton HM HX, Bermuda  
(Address, zip code of principal executive offices)

(441) 296-8560  
(Registrant's telephone number, including area code)

Indicate by check mark whether 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 Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate number of shares outstanding of Registrant's common stock, \$.01 par value, on August 4, 2004 was 6,934,185.

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**AMERICAN SAFETY INSURANCE HOLDINGS, LTD.**

**FORM 10-Q**

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**PART I - FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**American Safety Insurance Holdings, Ltd. and Subsidiaries  
Consolidated Balance Sheets**

	December 31, <u>2003</u>	
<u>Assets</u>		
Investments:		
Fixed maturity securities available for sale	\$ 214,043,420	\$ 24
Common stock	2,694,736	
Investment in real estate	37,855,549	2
Short-term investments	<u>5,680,817</u>	<u>1</u>
Total investments	260,274,522	28
Cash and cash equivalents	32,153,379	3
Restricted cash	1,767,614	
Accrued investment income	2,771,691	
Notes receivable	1,435,000	
Premiums receivable	27,944,508	2
Ceded unearned premium	27,109,135	3
Reinsurance recoverable	126,986,307	13
Deferred income taxes	11,684,609	1
Deferred policy acquisition costs	11,960,495	1
Property, plant and equipment	4,094,763	
Other assets	<u>6,077,621</u>	
Total assets	\$ 514,259,644	\$ 55
	=====	==

December 31,  
2003

Liabilities and Shareholders' Equity

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Liabilities:		
Unpaid losses and loss adjustment expenses	\$ 230,103,754	\$ 27
Unearned premiums	99,938,562	10
Reinsurance on paid losses and loss adjustment expenses	6,486,149	
Ceded premiums payable	17,722,931	1
Escrow deposits	9,235,847	
Accounts payable and accrued expenses	14,260,809	1
Loan payable	30,441,348	2
Funds held	4,951,468	
Deferred revenue	1,817,775	
Minority Interest	<u>3,957,878</u>	
Total liabilities	418,916,521	45
Shareholders' equity:		
Preferred stock, \$0.01 par value; authorized 5,000,000 shares; no shares issued and outstanding	-	
Common stock, \$0.01 par value; authorized 15,000,000 shares; issued and outstanding at December 31, 2003, 6,910,766 and June 30, 2004, 6,934,185 shares	69,108	
Additional paid-in capital	52,744,720	5
Retained earnings	41,043,967	4
Accumulated other comprehensive income (loss), net	<u>1,485,328</u>	(
Total shareholders' equity	<u>95,343,123</u>	10
Total liabilities and shareholders' equity	\$ 514,259,644	\$55
	=====	==

See accompanying notes to consolidated financial statements (unaudited).

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**American Safety Insurance Holdings, Ltd. and Subsidiaries**  
**Consolidated Statements of Earnings**  
**(Unaudited)**

	Three Months Ended		Six M
	2003	2004	2003
		June 30,	J
Revenues:			
Direct premiums earned	\$ 40,697,010	\$ 53,093,944	\$ 80,069,51
Assumed premiums earned	444,873	1,588,554	3,881,26
Ceded premiums earned	<u>(16,653,065)</u>	<u>(22,592,774)</u>	<u>(36,649,97</u>
Net premiums earned	24,488,818	32,089,724	47,300,81
Net investment income	1,239,006	2,249,139	2,458,74
Net realized gains (losses)	2,951,280	(5,139)	3,101,99
Real estate income	17,167,373	20,176,157	22,597,22
Other income	<u>16,879</u>	<u>113,511</u>	<u>31,27</u>
Total revenues	45,863,356	54,623,392	75,490,05
Expenses:			
Losses and loss adjustment expenses	14,630,662	24,555,449	27,447,30
Acquisition expenses	4,805,213	6,513,912	9,482,43
Payroll and related expenses	2,099,339	2,705,771	4,321,25
Real estate expenses	16,714,993	16,993,188	22,876,63

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Other expenses	1,983,477	896,898	4,362,93
Minority interest	152,070	162,543	223,45
Expense due to rescission	<u>60,953</u>	<u>(1,745,544)</u>	<u>144,51</u>
Total expenses	<u>40,446,707</u>	<u>50,082,217</u>	<u>68,858,52</u>
Earnings before income taxes	5,416,649	4,541,175	6,631,52
Income taxes	<u>1,602,733</u>	<u>444,406</u>	<u>1,597,25</u>
Net earnings	\$ <u>3,813,916</u>	\$ <u>4,096,769</u>	\$ <u>5,034,26</u>
	=====	=====	=====
Net earnings per share:			
Basic	\$ <u>0.80</u>	\$ <u>0.59</u>	\$ <u>1.0</u>
Diluted	\$ <u>0.79</u>	\$ <u>0.55</u>	\$ <u>1.0</u>
Average number of shares outstanding:			
Basic	4,739,888	6,923,237	4,739,88
	=====	=====	=====
Diluted	4,814,216	7,447,155	4,802,12
	=====	=====	=====

See accompanying notes to consolidated financial statements (unaudited).

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**American Safety Insurance Holdings, Ltd. and Subsidiaries**  
**Consolidated Statements of Cash Flow>**  
**(Unaudited)**

	<u>2003</u>	Six Months <u>June 3</u>
Cash flow from operating activities:		
Net earnings	\$5,034,269	
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Realized gains on investments	(3,101,995)	
Depreciation expense	149,518	
Deferral of acquisition costs, net	(730,875)	
Accretion of discount	225,835	
Change in:		
Accrued investment income	478,531	
Premiums receivable	3,939,138	
Reinsurance recoverable and ceded unearned premiums	(12,753,129)	
Funds held	(41,508)	
Unpaid losses and loss adjustment expenses	28,783,529	
Unearned premiums	9,015,713	
Ceded premiums payable	3,215,229	
Accounts payable and accrued expenses	1,661,910	
Deferred revenue	1,151,889	
Other, net	<u>(1,454,002)</u>	
Net cash provided by operating activities	35,574,052	
Cash flow from investing activities:		
Purchases of fixed maturities	(60,305,410)	
Purchases of equity securities	-	
Proceeds from sale of fixed maturities	35,371,568	
Proceeds from sale of equity investments	-	
Increase in short-term investments	(2,355,284)	
Decrease in notes receivable	959,951	

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(Increase) decrease of investment in real estate	(5,893,473)
Purchase of fixed assets, net	<u>(1,068,179)</u>
Net cash used in investing activities	(33,290,827)

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**American Safety Insurance Holdings, Ltd. and Subsidiaries**  
**Consolidated Statements of Cash Flow (Continued)>**  
**(Unaudited)**

	Six Months June 30,	
	<u>2003</u>	
Cash flow from financing activities:		
Proceeds from issuance of common stock		51,799
Proceeds from (repayment of ) loan payable		8,902,064
Repayment of escrow deposits		(2,365,419)
Withdrawals of restricted cash		2,475,025
Dividends paid		<u>(570,113)</u>
Net cash (used in) provided by financing activities		<u>8,493,356</u>
Net increase in cash and cash equivalents		10,776,581
Cash and cash equivalents at beginning of period		<u>26,003,795</u>
Cash and cash equivalents at end of period		\$36,780,376 =====
Supplemental disclosure of cash flow:		
Income taxes paid	\$	4,004,441 =====
Interest paid	\$	453,826 =====

See accompanying notes to consolidated financial statements (unaudited).

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**American Safety Insurance Holdings, Ltd. and Subsidiaries**  
**Consolidated Statements of Comprehensive Earnings**  
**(Unaudited)**

	Three Months Ended		Si
	June 30,		
	<u>2003</u>	<u>2004</u>	<u>200</u>
Net earnings	\$ 3,813,916	\$ 4,096,769	\$ 5,034,
Other comprehensive income before income taxes:			
Unrealized gains and losses on securities available for sale, net of minority interest of \$306,131 and \$(435,113) for the three months ended June 30, 2003 and 2004, respectively, and \$314,608 and \$(294,027) for the six months ended June 30, 2003 and 2004, respectively.	2,348,132	(7,618,574)	2,945,
Unrealized gains and losses on hedging transactions	(100,958)	535,786	(100,

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Reclassification adjustment for realized gains and losses included in net earnings, net of minority interest of \$62,312 and \$(29,548) for the three months ended June 30, 2003 and 2004 respectively and \$62,312 and \$(29,548) for the six months ended June 30, 2003 and 2004, respectively.	<u>(2,888,968)</u>	<u>24,409</u>	<u>(3,039)</u>
Total other comprehensive income (loss) before taxes	(641,794)	(7,107,197)	(194,)
Income tax expense (benefit) related to items of other comprehensive income, net of minority interest of \$35,666 and \$(137,750) for the three months ended June 30, 2003 and 2004 respectively and \$43,311 and \$(33,689) for the six months ended June 30, 2003 and 2004, respectively.	<u>(361,059)</u>	<u>(1,571,065)</u>	<u>(262,</u>
Other comprehensive income (loss) net of income taxes	<u>(280,735)</u>	<u>(5,536,132)</u>	<u>68,</u>
Total comprehensive income (loss)	\$ 3,533,181 =====	\$ (1,439,363) =====	\$ 5,102 =====

See accompanying notes to consolidated financial statements (unaudited).

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**American Safety Insurance Holdings, Ltd. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

**Note 1 - Basis of Presentation**

The accompanying unaudited interim consolidated financial statements of American Safety Insurance Holdings, Ltd. ( American Safety ) and its subsidiaries and American Safety Risk Retention Group, Inc. ( American Safety RRG ), a non-subsidiary risk retention group affiliate (collectively the Company ) are prepared in accordance with accounting principles generally accepted in the United States of America and, in the opinion of management, reflect all normal, recurring adjustments considered necessary for a fair presentation of the interim period presented. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates, based on the best information available, in recording transactions resulting from business operations. The balance sheet amount that involves a greater extent of accounting estimates and actuarial determinations subject to future changes is the Company's liability for unpaid losses and loss adjustment expenses. As additional information becomes available (or actual amounts are determinable), the recorded estimates may be revised and reflected in operating results. While management believes that the liability for unpaid losses and loss adjustment expenses is adequate to cover the ultimate liability, such estimates may be more or less than the amounts actually paid when claims are settled.

The results of operations for the six months ended June 30, 2004 may not be indicative of the results that may be expected for the full year ending December 31, 2004. These unaudited interim consolidated financial statements and notes should be read in conjunction with the financial statements and notes included in the audited consolidated financial statements of American Safety and its subsidiaries for the year ended December 31, 2003.

The unaudited interim consolidated financial statements include the accounts of American Safety and each of its subsidiaries and American Safety RRG. All significant intercompany balances have been eliminated. Certain items from prior periods have been reclassified to conform with the 2004 presentation.

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**Note 2 - Accounting Pronouncements**

During the last two years, the Financial Accounting Standard Board (FASB) has issued a number of accounting pronouncements with various effective dates. Statement of Financial Accounting Standards (SFAS) No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections; SFAS No. 146, Accounting for Costs Associated with Exist or Disposal Activities; SFAS No. 147, Acquisitions of Certain Financial Institutions - an Amendment of FASB Statements No. 72 and 144; FASB Interpretation No. 9; FASB Statement No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure; FASB Statement No. 149, Amendment of Statement No. 133 on Derivative Instruments and Hedging Activities; FASB Statement No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity; and FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others. These pronouncements do not have a material effect on our financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46). This interpretation requires the consolidation of entities in which an enterprise absorbs a majority of the entity's expected losses, receives a majority of the expected residual gains, or both, as a result of ownership, contractual or other financial interests in the entity. In October 2003, FASB delayed the effective date of FIN 46 for variable interest entities (VIE) or potential VIE created before February 2003. In December 2003, the FASB issued a revised version of FIN 46, FIN 46(R), which finalized the accounting guidance for VIE. The Company adopted FIN 46(R) and has restated all prior year balances to conform to the new consolidation policies. As a result of adopting FIN 46(R), the Company consolidated its affiliate, American Safety RRG.

**Note 3 - Business Risks**

The following is a description of certain risks facing the Company:

Legal/Regulatory Risk is the risk that changes in the legal or regulatory environment in which an insurer operates will create additional expenses not anticipated by the insurer in pricing its products beyond those recorded in the financial statements. Regulatory initiatives designed to reduce insurer profits or otherwise affecting the industry in which the Company operates, new legal theories or insurance company insolvencies through guaranty fund assessments, may create costs for the Company beyond those recorded in the financial statements. The Company attempts to mitigate this risk by writing insurance business in several states, thereby spreading this risk over a large geographic area.

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The Potential Risk of United States Taxation of Bermuda Operations. Under current Bermuda law, American Safety is not required to pay any taxes in Bermuda on either income or capital gains. American Safety has received an undertaking from the Minister of Finance in Bermuda that will exempt American Safety from taxation until the year 2016 in the event of any such taxes being imposed. The Company, exclusive of its United States subsidiaries, does not consider itself to be engaged in a trade or business in the United States and accordingly does not expect to be subject to direct United States income taxation. The Company's U.S. subsidiaries are subject to taxation in the United States.

Whether a foreign corporation is engaged in a United States trade or business or is carrying on an insurance business in the United States depends upon the level of activities conducted in the United States. If the activities of a foreign company are continuous, regular, and considerable, the foreign company will be deemed to be engaged in a United States trade or business. Due to the fact that American Safety will continue to maintain an office in Bermuda and American Safety and its Bermuda insurance subsidiary's business is reinsuring contracts via treaty reinsurance agreements, which are all signed outside of the United States, American Safety does not consider itself to be engaged

in a trade or business in the United States and, accordingly, does not expect to be subject to United States income taxes. This position is consistent with the position taken by various other entities that have the same operational structure as American Safety.

However, Treasury Regulations, court decisions and the Internal Revenue Code of 1986, as amended, do not definitively identify activities that constitute being engaged in a United States trade or business, and because of the factual nature of the determination, there can be no assurance that the Internal Revenue Service will not contend that American Safety or its Bermuda insurance subsidiary are engaged in a United States trade or business. In general, if American Safety or its Bermuda insurance subsidiary are considered to be engaged in a United States trade or business, it would be subject to (i) United States Federal income tax on its taxable income that is effectively connected with a United States trade or business at graduated rates and (ii) the 30 percent branch profits tax on its effectively connected earnings and profits deemed repatriated from the United States.

Credit Risk is the risk that issuers of securities owned by the Company or secured notes receivable will default or that other parties, including reinsurers that have obligations to the insurer, will not pay or perform. The Company attempts to mitigate this risk by adhering to a conservative investment strategy, by obtaining sufficient collateral for secured note obligations and by maintaining sound reinsurance, credit and collection policies.

Interest Rate Risk is the risk that interest rates will change and cause a decrease in the value of an insurer's investments. The Company works to mitigate this risk by attempting to match the maturities of its assets with the expected payouts of its liabilities.

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**Note 4 - Investments**

	Amortized <u>cost</u>	Gross unrealized <u>gains</u>	Gross unrealized <u>losses</u>
December 31, 2003:			
Securities available for sale:			
Fixed maturities:			
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$ 59,335,374	\$1,340,823	\$ 319,700
States of the U.S. and political subdivisions of the States	22,343,998	346,245	119,788
Corporate securities	81,522,358	1,694,500	376,514
Mortgage-backed securities	<u>48,965,816</u>	<u>134,843</u>	<u>824,535</u>
Total fixed maturities:	\$212,167,546 =====	\$3,516,411 =====	\$1,640,537 =====
Common stock	\$ 2,520,930 =====	\$ 188,678 =====	\$ 14,872 =====
June 30, 2004:			
Securities available for sale:			
Fixed maturities:			
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$63,234,861	\$ 653,678	\$ 963,092
States of the U.S. and political subdivisions of the States	27,966,371	17,026	614,667
Corporate Securities	93,631,787	870,904	1,159,658



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Mortgage-backed securities	<u>65,787,248</u>	<u>45,250</u>	<u>1,771,550</u>
Total fixed maturities	\$250,620,267	\$1,586,858	\$ 4,508,967
	=====	=====	=====
Common stock	\$ 7,977,060	\$ 456,489	\$ 175,003
	=====	=====	=====

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**Note 5 - Segment Information**

The Company initially segregates its business into the following segments: Real Estate and Insurance Operations. The Insurance Operations segment is further classified into three reportable segments: Environmental, Excess and Surplus Lines (E&S) and Program Business.

Real estate consists of the Harbour Village project in Ponce Inlet, Florida, as discussed in Note 6. In our Insurance Operations segment, Environmental writes insurance coverages for the environmental remediation industry. Excess and Surplus Lines provides commercial casualty insurance coverages, generally in the area of construction and products liability. Program Business facilitates the offering of insurance to homogeneous niche groups of risks.

The Company measures the Real Estate and Insurance Operations segments using net earnings, total assets and total equity. The reportable Insurance Operations segments are measured by net premiums earned, incurred losses and loss adjustment expenses and acquisition expenses. Assets are not allocated to the reportable Insurance Operations segments. The following table presents key financial data by segment for the six months ended June 30, 2003 and June 30, 2004 (in thousands):

	June 30, 2003	Real Estate	Environmental	Insurance E&S	Insurance Programs	Other
Gross premiums written		-	18,139	33,935	36,610	4,228
Net Premiums written		-	13,207	28,993	7,308	3,178
Net premiums earned		-	10,064	23,654	10,545	3,038
Losses and loss adjustment expenses		-	4,299	13,490	6,909	2,749
Acquisition expenses		-	2,953	5,137	862	530
Underwriting profit/(loss)		-	2,812	5,027	2,774	(241)
Income tax/(benefit)		(105)		765		
Net earnings/(loss)		(174)		3,225		
Assets		59,068		385,795		
Equity		13,196		54,595		
	June 30, 2004	Real Estate	Environmental	Insurance E&S	Insurance Programs	Other
Gross premiums written		-	22,290	47,379	41,276	2,143
Net Premiums written		-	17,678	38,472	6,914	1,397
Net premiums earned		-	14,636	38,400	10,746	2,427
Losses and loss adjustment expenses		-	6,451	27,365	8,181	4,918
Acquisition expenses		-	3,778	8,098	442	806
Underwriting profit/(loss)		-	4,407	2,937	2,123	(3,297)
Income tax/(benefit)		2,122		(1,122)		
Net earnings/(loss)		3,518		420		
Assets		37,332		515,773		

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Equity 15,449 84,765

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Additionally the Company conducts business in the following geographic segments: United States and Bermuda. Significant differences exist in the regulatory environment in each country. Those differences include laws regarding the types of investments, capital requirements, solvency monitoring, pricing, corporate taxation, etc. The following provides key measurable information about the geographic segments for the six months ended June 30, 2003 and June 30, 2004 (in thousands):

June 30, 2003	United States	Bermuda
Income tax	1,597	-
Net earnings	3,223	1,811
Assets	382,347	62,593
Equity	48,567	18,987

  

June 30, 2004	United States	Bermuda
Income tax	1,606	-
Net earnings	2,830	4,917
Assets	421,205	132,160
Equity	51,458	48,626

The following table presents key financial data by segment for the three months ended June 30, 2003 and June 30, 2004 (in thousands):

June 30, 2003	Real Estate	Environmental	Insurance E&S	Insurance Programs	Other
Gross premiums written	-	9,027	16,995	19,973	1,445
Net Premiums written	-	6,248	14,667	3,357	920
Net premiums earned	-	5,418	12,712	4,847	1,512
Losses and loss adjustment expenses	-	2,214	7,474	3,445	1,498
Acquisition expenses	-	1,567	2,731	242	265
Underwriting profit/(loss)	-	1,637	2,507	1,160	(251)
Income tax/(benefit)	169		497		
Net earnings/(loss)	284		1,597		

  

June 30, 2004	Real Estate	Environmental	Insurance E&S	Insurance Programs	Other
Gross premiums written	-	13,131	19,482	20,735	386
Net Premiums written	-	10,606	14,685	4,536	78
Net premiums earned	-	7,720	18,560	4,590	1,220
Losses and loss adjustment expenses	-	3,587	14,130	4,161	2,677
Acquisition expenses	-	1,972	3,826	128	588
Underwriting profit/(loss)	-	2,161	604	302	(2,045)
Income tax/(benefit)	1,185		(1,350)		
Net earnings/(loss)	1,997		(1,691)		

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The following provides key measurable information about the geographic segments for the three months ended June 30, 2003 and June 30, 2004 (in thousands):

June 30, 2003 United States Bermuda Total

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Income tax	1,603	-	1,603
Net earnings	3,191	623	3,814
June 30, 2004	United States	Bermuda	Total
Income tax	444	-	444
Net earnings	751	3,346	4,097

**Note 6 - Investment in Real Estate**

The Company's investment in the development of the Harbour Village Golf and Yacht Club ( Harbour Village ) project is comprised of 173 acres of property in Ponce Inlet, Florida (the Property ) that was acquired through foreclosure on April 13, 1999. At the date of foreclosure, the Company evaluated the carrying value of its investment in real estate by comparing the fair value of the foreclosed collateral to the book value of the underlying loan and accrued interest. As the book value of the loan plus accrued interest was less than the fair value of the collateral, no loss was recognized on foreclosure; the book value of the loan plus accrued interest became the basis of the real estate.

As of December 31, 2003 and June 30, 2004, the investment in real estate for the Harbour Village project is as follows (in thousands):

	<u>December 31, 2003</u>	<u>June 30, 2004</u>
Land	\$1,587	\$ 816
Capitalized overhead, interest and taxes	2,254	1,199
Work in process	<u>34,015</u>	<u>18,450</u>
Total	\$37,856 =====	\$20,465 =====

During the quarter ended June 30, 2004, the Company closed 68 condominium units and 1 boat slip at Harbour Village and for the quarter ended June 30, 2003, the Company closed 67 condominium units and 5 boat slips. During the six months ended June 30, 2004, the Company closed 104 condominium units and 2 boat slips at Harbour Village and for the six months ended June 30, 2003, the Company closed 77 units and 12 boat slips. The Company recognizes revenue when title to each individual unit or boat slip passes to the purchaser. When title passes, the Company uses a percentage of completion method, based on actual costs to total estimated costs (including allocated common costs) to recognize revenue. The difference between total sales price and the revenue recognized is set up as deferred revenue and will be recognized as the additional costs of each building are incurred.

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**Note 7 - Income Taxes**

Total income tax expense for the periods ended June 30, 2003 and 2004 was allocated as follows:

	Three Months Ended June 30,		Six Months June
	<u>2003</u>	<u>2004</u>	<u>2003</u>
Tax expense attributable to:			
Income from continuing operations	\$ 1,602,733	\$ 444,406	\$ 1,597,258
Change in unrealized gains/losses on hedging transactions	(34,327)	182,167	(34,326)
Change in unrealized gains/losses on securities available for sale	<u>(291,066)</u>	<u>(1,890,982)</u>	<u>(185,255)</u>

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Total	\$ 1,277,340	\$ (1,264,409)	\$ 1,377,677
	=====	=====	=====

U.S. federal and state income tax expense (benefit) from continuing operations consists of the following components:

	<u>Current</u>	<u>Deferred</u>	<u>Total</u>
Three months ended:			
June 30, 2003	\$ 2,418,141	\$ (815,408)	\$ 1,602,733
June 30, 2004	\$ 68,751	\$ 375,655	\$ 444,406
Six months ended:			
June 30, 2003	\$ 3,494,933	\$ (1,897,675)	\$ 1,597,258
June 30, 2004	\$ 1,651,780	\$ (45,764)	\$ 1,606,016

The state income tax expense (benefit) aggregated \$(4,129) and \$318,542 for the six months ended June 30, 2003 and 2004, respectively, and \$27,606 and \$143,883 for the three months ended June 30, 2003 and 2004, respectively.

Income tax expense (benefit) for the periods ended June 30, 2003 and 2004 differed from the amount computed by applying the U.S. Federal income tax rate of 34% to earnings before Federal income taxes as a result of the following:

	Three Months Ended June 30,		Six Months E June 30,
	<u>2003</u>	<u>2004</u>	<u>2003</u>
Expected income tax expense	\$ 1,841,660	\$ 1,543,999	\$ 2,254,719
Foreign earned income not subject to U.S. taxation	(211,638)	(1,137,439)	(615,684)
State taxes and other	<u>(27,289)</u>	<u>37,846</u>	<u>(41,777)</u>
	\$ 1,602,733	\$ 444,406	\$ 1,597,258
	=====	=====	=====

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Deferred income taxes are based upon temporary differences between the financial statement and tax bases of assets and liabilities. The following deferred taxes are recorded:

	December 31, <u>2003</u>
Deferred tax assets:	
Loss reserve discounting	\$ 5,785,906
Unearned premium reserves	3,404,780
Difference between tax and GAAP basis of Harbour Village project.	1,153,901
Net unrealized losses	-
Difference between tax and GAAP method at Harbour Village project	3,087,152
Warranty reserve	1,407,578
NOL carry forward	<u>579,362</u>
Gross deferred tax assets	15,418,679
Valuation allowance	<u>(956,024)</u>
Gross deferred tax assets after valuation allowance	14,462,655
Deferred tax liabilities:	
Deferred acquisition costs	2,163,012
Net unrealized gains	315,012
Other	<u>300,022</u>
Gross deferred tax liabilities	<u>2,778,046</u>

Net deferred tax asset

\$11,684,609

=====

Except for the components of the deferred tax assets shown above that are associated with American Safety RRG, we believe it is more likely than not that we will realize the full benefit of our deferred tax assets; therefore, a valuation allowance has not been established against these assets. However, given the historical loss position of American Safety RRG, it has established a 100% valuation allowance on its net deferred tax assets totaling \$956,024, and \$722,219 at December 31, 2003 and June 30, 2004, respectively.

### Note 8 - Notes Receivable

At December 31, 2003, the Company recorded an impairment allowance of \$3,900,198. Of this amount, \$2,600,000 was recovered during the second quarter of 2004 and was recorded as a reduction of other expenses. This payment represents full and final payment under the settlement agreement.

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### Note 9 - Stock Options

The Company applied the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for the plan. No compensation expense is reflected in net earnings as all options granted under the plan have an exercise price equal to the market value of the underlying common stock on the date of grant. The majority of the options in the plan vest over a three year period. The following table illustrates the effect on net earnings and earnings per share, assuming we had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation.

	Three Months Ending June 30,		Six Months En June 30,
	<u>2003</u>	<u>2004</u>	<u>2003</u>
	(In thousands, except per share amounts)		
Net earnings:			
As reported	\$ 3,814	\$ 4,097	\$ 5,034
Effect of stock options	<u>(119)</u>	<u>13</u>	<u>(191)</u>
Pro forma net earnings	\$ 3,695	\$ 4,110	\$ 4,843
	=====	=====	=====
Net earnings per share:			
Basic - as reported	\$ 0.80	\$ 0.59	\$ 1.06
Basic - pro forma	\$ 0.78	\$ 0.59	\$ 1.02
Diluted - as reported	\$ 0.79	\$ 0.55	\$ 1.05
Diluted - pro forma	\$ 0.78	\$ 0.55	\$ 1.02

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### Note 10 - Loans Payable

#### Acquisition and Development Loan

In July 2000 the Company, through its subsidiary, Ponce Lighthouse Properties, Inc., initially closed a \$37,900,000 acquisition, development and construction loan facility with a commercial bank for the Harbour Village project. The current facility has been increased to \$57.0 million. As of December 31, 2003, and June 30, 2004, the Company had outstanding borrowings of \$17,561,122 and \$8,643,000. Interest only is due monthly until July 31, 2004, at which time all outstanding principal and interest is due. The term of this loan was extended until January 31, 2005. Partial repayments are required as residential condominium units and boat slips are sold. The loan bears interest at a variable

rate equal to 30 day LIBOR plus 2.25%, adjusted monthly. The loan is secured by a first mortgage on the real estate and a first priority security interest in all contracts for the sale of condominium units and boat slips, as well as all personal property used in the project. Both the Company and American Safety Holdings Corp., a subsidiary, have provided partial loan guarantees. The Company was in compliance with all debt covenants at December 31, 2003 and at June 30, 2004, and there were no defaults of events of default during 2003 and through June 30, 2004.

*Trust Preferred Offerings*

During 2003 American Safety Capital and American Safety Capital II, both non-consolidated, wholly-owned subsidiaries of the Company, issued \$8 million and \$5 million, respectively, of variable rate 30-year trust preferred securities. The proceeds are being used to support the growth of the Company's insurance business, to repay short term debt and for general corporate purposes. The securities require interest payments on a quarterly basis calculated at a floating rate of LIBOR + 4.2% and LIBOR + 3.95% for American Safety Capital and American Safety Capital II, respectively. The securities can be redeemed by the Company commencing in five years.

The underlying debt obligations between the Company and American Safety Capital and American Safety Capital II expose the Company to variability in interest payments due to changes in interest rates. Management entered into an interest rate swap for each trust preferred offering to manage that variability. Under each interest rate swap, the Company receives variable interest payments and makes fixed interest rate payments to the applicable capital trust entity, thereby creating fixed rate long-term debt. The overall effective fixed rate expense as a result of this hedge is 7.1% and 7.6% for American Safety Capital and American Safety Capital II, respectively, over the first five years of the obligation.

Interest expense for the twelve months ended December 31, 2003 and June 30, 2004 includes no gains or losses from the interest rate swaps. Changes in fair value of the interest rate swaps designated as hedging instruments of the variability of cash flow associated with a floating rate, long-term debt obligation is reported in accumulated other comprehensive income. The gross unrealized gains and (losses) on the interest rate swaps at December 31, 2003 and June 30, 2004 were \$135,558 and \$274,619 for American Safety Capital and (\$39,604) and \$68,316 for American Safety Capital II, respectively. The interest rate swaps are 100% effective at June 30, 2004.

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

The information in the following discussion should be read in conjunction with the Company's consolidated financial statements and notes thereto included elsewhere in this Report. All amounts and percentages are rounded.

The Company reported net earnings of \$4.1 million or \$0.55 per diluted share for the second quarter ended June 30, 2004, as compared to \$3.8 million or \$0.79 per diluted share for the second quarter of 2003. Net earnings for the six months ended June 30, 2004 are \$7.7 million or \$1.04 per diluted share, as compared to \$5.0 million or \$1.05 per diluted share for the same period in 2003. The following table sets forth the Company's net earnings (in thousands):

	Quarter Ended		Six Months Ended	
	<u>June 30,</u>		<u>June 30,</u>	
	2003	2004	2003	2004
Insurance Operations	\$1,597	\$(1,691)	\$3,225	\$2,000
Real Estate Operations	284	1,997	(174)	3,000
Other, including realized gains and (losses)	1,933	3,791	1,983	3,000
	=====	=====	=====	=====
Net Earnings	\$3,814	\$ 4,097	\$5,034	\$7,000
	=====	=====	=====	=====

The net loss from insurance operations for the second quarter of 2004 reflects a total of \$6.2 million of reserve strengthening as a result of adverse loss development that occurred during the period. Of this amount, \$3.0 million represents reserve increases for discontinued lines and the balance of \$3.2 million consists of reserve increases for excess and surplus business for accident year 2001 primarily attributable to certain New York commercial contracting risks (which represented 16% of the excess and surplus premium written in 2001). Premium written for New York commercial contracting risks has been reduced annually, and currently represents less than 2% of the Company's excess and surplus premium. Based on this development, the Company is evaluating its actuarial reserving assumptions for its excess and surplus business, which is expected to be completed during the third quarter of 2004. Given that approximately 50% of the reserve development was attributable to discontinued lines and the balance of the development related to its excess and surplus business, the Company does not believe that these reserve adjustments have any material implications with respect to the quality or profitability of the core business lines currently being written by the Company.

The increase in earnings for the second quarter of 2004 from real estate operations was due to increased profits from closings of condominium units at Harbour Village. Earnings from other items for the quarter include a \$2.6 million payment received by the Company in settlement of the impaired note receivable that was written off in the fourth quarter of 2003, which represents the final payment from the borrower. Other items also include a \$1.8 million payment received by the Company in settlement of professional liability claims against parties who are involved in the Principal Management rescission litigation.

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The decrease in insurance earnings for the six months ended June 30, 2004 reflects a total of \$9.0 million of reserve strengthening. Of this amount, \$4.7 million consists of reserve increases for excess and surplus business relating to accident year 2001 primarily attributable to certain New York commercial contracting risks, and the remaining \$4.3 million represents reserve increases for discontinued lines. The increase in earnings for the six months ended June 30, 2004 from real estate operations was due to increased profits from closings of condominium units at Harbour Village.

The following table sets forth the Company's consolidated revenues:

	Three Months Ended June 30,		Six Months Ended June 30,		Three Ende 3 200 2
	<u>2003</u>	<u>2004</u>	<u>2003</u>	<u>2004</u>	
			(Dollars in thousands)		
Net premiums written:					
Environmental	\$ 6,248	\$ 10,606	\$ 13,207	\$ 17,678	6
Excess and surplus Programs	14,667	14,685	28,993	38,472	3
Other	3,357	4,536	7,308	6,914	(9
	<u>920</u>	<u>78</u>	<u>3,178</u>	<u>1,397</u>	
Total net premiums written	\$ 25,192	\$ 29,905	\$ 52,686	\$ 64,461	1
	=====	=====	=====	=====	=
Net premiums earned:					
Environmental	\$ 5,418	\$ 7,720	\$ 10,064	\$ 14,636	4
Excess and surplus Programs	12,712	18,560	23,654	38,400	4
Other	4,847	4,590	10,545	10,746	(
	<u>1,512</u>	<u>1,220</u>	<u>3,038</u>	<u>2,427</u>	(1
Total net premiums earned	24,489	32,090	47,301	66,209	3
Net investment income	1,239	2,249	2,459	4,320	8

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Net realized gains (losses)	2,951	(5)	3,102	20	(10)
Real estate income	17,167	20,176	22,597	34,128	1
Other income	<u>17</u>	<u>113</u>	<u>31</u>	<u>145</u>	<u>57</u>
Total Revenues	\$ 45,863	\$ 54,623	\$ 75,490	\$ 104,822	1
	=====	=====	=====	=====	=====

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The following table sets forth the components of the Company's insurance operations GAAP combined ratio for the periods indicated:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2003	2004	2003	2004
Insurance operations:				
Loss and loss adjustment expense ratio	59.7%	76.5%	58.0%	70.9%
Expense ratio	36.8	37.5	37.9	34.8
	----	-----	----	-----
Combined ratio	96.5%	114.0%	95.9%	105.7%
	=====	=====	=====	=====

**Quarter Ended June 30, 2004 Compared to Quarter Ended June 30, 2003**

*Net Premiums Earned*

*Environmental.* Net earned premiums increased to \$7.7 million for the quarter ended June 30, 2004 compared to \$5.4 million in the same quarter in 2003. Net written premiums increased to \$10.6 million in the second quarter of 2004 compared to \$6.2 million in the same quarter of 2003. This increase was attributable to the Company's strategy of growing this line of business. The Company opened an office in Denver, Colorado in the second quarter of 2004 and our office in Cherry Hill, New Jersey began its third full year of operations and expanded its underwriting staff as compared to 2003. Our Atlanta, Georgia office also increased its underwriting staff and expanded its distribution of the ProStar online quoting system to qualified brokers.

*Excess and Surplus.* Net earned premiums increased to \$18.6 million in the second quarter of 2004 compared to \$12.7 million for the same quarter in 2003. Net written premiums remained consistent at \$14.7 million. The earned premium increase represents the continuing effects of the expansion of this line during 2003. While there have been signs of general market conditions softening, the Company continues to capitalize on favorable conditions, specifically the lack of insurance capacity for certain construction risks. Also, during the quarter ended June 30, 2004, the Company introduced a new excess coverage product designed to meet the market's need for higher limits of liability over the Company's current policies.

*Programs.* Net earned premiums decreased to \$4.5 million in the second quarter of 2004 compared to \$4.8 million in the same period of 2003. Net written premiums increased to \$4.5 million in the second quarter of 2004 compared to \$3.4 million in the same period of 2003. The increase was primarily due to additional writings of \$1.2 million in the Company's pest control program. In addition, the Company's assumed liability program, currently in runoff, had net return written premiums of \$639,000 in the quarter ended June 30, 2003 compared to net written premiums of \$26,000 in the quarter ended June 30, 2004. It is not unusual for the Company to experience quarter-to-quarter premium variances due to seasonal fluctuations on individual programs and the time it takes a program to become fully operational, coupled with the run-off of expiring programs. The Company has 12 active programs producing new business as of June 30, 2004 compared to 13 active programs for the same quarter in 2003.

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*Other.* Surety business net earned premium increased to \$368,000 in the second quarter of 2004 as compared to \$105,000 in the same quarter of 2003. Net written premium increased to \$327,000 in the second quarter of 2004 as compared to \$127,000 in the same quarter of 2003. The increase is attributed to the Company's efforts to grow its surety business. During the second quarter of 2004 the Company entered into a \$2 million per bond quota share reinsurance agreement to facilitate more underwriting opportunities. During 2002 and 2003 the Company did not have any reinsurance coverage and was limited in its underwriting opportunities.

Our workers' compensation business net earned premiums decreased from \$1.5 million in the second quarter of 2003 to \$851,000 in the second quarter of 2004. In the quarter ended June 30, 2004 the Company had net written premium returns of \$248,000 compared to \$793,000 of net written premium in the same quarter of 2003 as a result of the Company's decision to exit the workers' compensation line after the first quarter of 2004.

#### *Net Investment Income*

Net investment income increased to \$2.2 million in the quarter ended June 30, 2004 from \$1.2 million in the quarter ended June 30, 2003 due to higher levels of invested assets generated by positive cash flows from operations and the proceeds of our secondary offering in the fourth quarter of 2003. Average invested assets increased to \$266 million from \$120 million. The pre-tax investment yield decreased to 3.4% from 3.8% in the quarter ended June 30, 2004 and 2003, respectively, and the after-tax investment yield decreased to 2.7% from 3.0%, respectively. The decrease in pre-tax yield is due to the Company realizing gains on its bond portfolio in the second quarter of 2003, with the proceeds from those sales as well as the proceeds from the secondary offering being invested in bonds with shorter durations, and therefore lower yields, due to 2003 market conditions.

#### *Net Realized Gains and Losses*

Net realized gains and losses changed from a net gain of \$2.9 million in the quarter ended June 30, 2003 to a net loss of \$5,000 for the quarter ended June 30, 2004. During the second quarter of 2003, the Company decided to sell certain securities to maximize their total return as a result of an existing lower interest rate environment.

#### *Real Estate Income*

Real estate income at the Harbour Village project increased 17.5% to \$20.2 million in the quarter ended June 30, 2004 from \$17.2 million in the quarter ended June 30, 2003. This income was realized from the closing of 68 condominium units and 1 boat slip in the quarter ended June 30, 2004 as compared to the closing of 67 condominium units and 5 boat slips in the quarter ended June 30, 2003. More of the higher priced units closed during the second quarter of 2004; the average sales price of condominiums was \$283,000 for the quarter ended June 30, 2004 compared to \$234,000 for the same period of 2003. See Exhibit 99 included in this Report for further information regarding Harbour Village.

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#### *Losses and Loss Adjustment Expenses*

In the quarter ended June 30, 2004, our loss ratio increased 16.8 points from 59.7% to 76.5%, due to a combination of factors. The Company experienced adverse loss development of \$1.3 million on its program business and \$1.7 million on its other lines of business. Each component that experienced adverse development is not a continuing line for 2004. Our excess and surplus lines business experienced adverse loss development of \$3.2 million primarily attributable to certain New York commercial contracting risks written in 2001. Exposure to such New York commercial contracting risks was significantly reduced during 2002 and 2003.

*Acquisition Expenses*

Acquisition expenses are amounts that are paid to agents and brokers for the production of premium for the Company offset in part by the ceding commissions we retain from our reinsurers. For our program business, fees are typically earned through ceding commissions and have the effect of lowering our acquisition expenses. Acquisition expenses also include amounts paid for premium taxes to the states where we do business on an admitted basis. Acquisition expenses were \$6.5 million in the quarter ended June 30, 2004 compared to \$4.3 million in the quarter ended June 30, 2003. Acquisition expenses as a function of net earned premiums were 20.3% in the quarter ended June 30, 2004 and 19.6% in the quarter ended June 30, 2003. In the quarter, due to workers' compensation reserve strengthening, the Company had net impairments of \$200,000 on deferred acquisition costs.

*Real Estate Expenses*

Real estate expenses increased by \$294,000 for the quarter ended June 30, 2004 to \$17 million. The majority of real estate expenses (variable costs) are recognized at the same time as revenue is recognized. General and administrative expenses (fixed costs) are expensed as incurred once the project begins closing units. The following chart shows the cost components (in thousands).

	Quarter Ended June 30	
	<u>2003</u>	<u>2004</u>
Variable	\$ 15,463	\$ 16,147
Fixed	<u>1,252</u>	<u>846</u>
Total	\$ 16,715	\$ 16,993
	=====	=====

These variable costs, when applied to real estate revenue, produced gross margins of 16% for the quarter ended June 30, 2003, and 20% for the quarter ended June 30, 2004. The increase in gross margin was due to a higher average selling price on the Links in the quarter ended June 30, 2004 compared to the same period in 2003 and higher actual margins on the Links units in 2004 compared to the estimated margins recorded in 2003.

*Operations by Geographic Segment*

Net Income. For the three months ended June 30, 2004, net income from Bermuda operations increased by \$2.7 million compared to the same time period in 2003, primarily due to the Company collecting \$2.6 million as final settlement of a note receivable for which an allowance was previously established during the fourth quarter of 2003. Net income from United States operations for the quarter ended June 30, 2004 decreased by \$2.4 million compared to the same period in 2003, due to \$5.6 million (\$3.7 million, net of tax) of adverse insurance operations loss development offset by \$1.7 million of increased real estate net income. See previous discussion relating to real estate and insurance operations.

**Six months Ended June 30, 2004 Compared to Six months Ended June 30, 2003***Net Premiums Earned*

*Environmental.* Net earned premiums increased to \$14.6 million in the six months ended June 30, 2004 as compared to \$10.0 million in the first six months of 2003. Net written premiums increased to \$17.7 million in 2004 as compared to \$13.2 million in 2003. This increase was attributable to the Company's strategy of growing this line of business. The Company opened an office in Denver, Colorado in the second quarter of 2004 and our office in Cherry Hill, New Jersey began its third year of operations and expanded its underwriting staff as compared to 2003. Our Atlanta, Georgia office also increased its underwriting staff and expanded its distribution of the ProStar online quoting system to qualified brokers.

*Excess and Surplus.* Net earned premiums increased to \$38.4 million in the first six months of 2004 compared to \$23.7 million in 2003. Net written premiums increased to \$38.5 million compared to \$28.9 million for the same time period. The earned premiums increase represents the continuing efforts of the expansion of this line during 2003. While there have been signs of general market softening the Company continues to capitalize on favorable market conditions, specifically, the lack of insurance capacity for certain construction risks. Also, during the six months ended June 30, 2004, the Company introduced a new excess coverage product designed to meet the market's need for higher limits of liability over the Company's current policies.

*Programs.* Net earned premiums increased to \$10.7 million for the first six months of 2004 compared to \$10.5 million for the same period in 2003. Net written premiums decreased to \$6.9 million in the first six months of 2004 from \$7.3 million for 2003. Program net written premium business decreased primarily due to the run-off of our expiring assumed liability program. This program which had net return written premiums of \$670,000 for the six months ended June 30, 2004 compared to \$720,000 of net written premiums during the same period of 2003. It is not unusual for the Company to experience quarter-to-quarter premium variances due to seasonal fluctuations on individual programs and the time it takes a program to become fully operational, coupled with the run-off of expiring programs.

*Other.* Surety business net earned premiums increased to \$541,000 for the first six months of 2004 as compared to \$268,000 for the first six months of 2003. Net written premium increased to \$596,000 for the first six months of 2004 compared to \$284,000 for the same time period in 2003. The increase is attributed to the Company's efforts to grow its surety business. During the six months ended June 30, 2004 the Company entered into a \$2 million per bond quota share reinsurance agreement to facilitate more underwriting opportunities. During 2002 and 2003 the Company did not have any reinsurance coverage and was limited in its underwriting opportunities.

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Our workers' compensation net earned premiums decreased to \$1.9 million for the first six months of 2004 compared to \$2.8 million in 2003. Net written premiums for the first six months of 2004 were \$802,000 compared to \$2.9 million in 2003 as a result of the Company's decision to exit the workers' compensation line after the first quarter of 2004.

#### *Net Investment Income*

Net investment income increased to \$4.3 million in the six months ended June 30, 2004 from \$2.5 million in the six months ended June 30, 2003 due to higher levels of invested assets generated by positive cash flows from operations and the proceeds of our secondary offering in the fourth quarter of 2003. Average invested assets increased to \$244 million from \$116 million. The average pre-tax yield on investments was 4.3% in the six months ended June 30, 2003 and 3.5% in the six months ended June 30, 2004. The average after-tax yield on investments was 3.4% in the six months ended June 30, 2003 and 2.8% in the six months ended June 30, 2004. The decrease in the pre-tax yield is due to the Company realizing gains on its bond portfolio in the second quarter of 2003, with the proceeds from those sales as well as the proceeds from the secondary offering being invested in bonds with shorter durations, and therefore lower yields, due to 2003 market conditions.

#### *Net Realized Gains and Losses*

Net realized gains and losses changed from a net gain of \$3.1 million in the six months ended June 30, 2003 to \$20,000 for the six months ended June 30, 2004. During the second quarter of 2003, the Company determined it was beneficial to sell certain securities to maximize their total return as a result of an existing lower interest rate environment at that time.

#### *Real Estate Income*

Real estate income at the Harbour Village project increased 51% to \$34.1 million in the six months ended June 30, 2004 from \$22.5 million in the six months ended June 30, 2003. This income was realized from the closing of 104 condominium units and 2 boat slips in the six months ended June 30, 2004 as compared to the closing of 77 condominium units and 12 boat slips in the six months ended June 30, 2003. In addition to increased closings, more higher priced units closed during the second quarter of 2004; the average sales price of condominiums was \$295,000 for the six months ended June 30, 2004 compared to \$234,000 for the same period of 2003. See Exhibit 99 included in this Report for further information regarding Harbour Village.

*Losses and Loss Adjustment Expenses*

For the six months ended June 30, 2004, our loss ratio increased 12.9 points from 58.0% to 70.9%, due to a combination of factors. The Company experienced adverse loss development of \$1.3 million on its program business and \$3.0 million on its other lines of business. Each component that experienced adverse development is not a continuing line for 2004. Our excess and surplus line of business experienced adverse loss development of \$4.7 million primarily attributable to certain New York commercial contracting risks written in 2001. Exposure to New York contractor risks was significantly reduced during 2002 and 2003.

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*Acquisition Expenses*

Policy acquisition expenses increased to \$13.1 million for the six months ended June 30, 2004 from \$9.5 million for the six months ended June 30, 2003. Acquisition expenses as a function of net earned premiums were 19.8% for the six months ended June 30, 2004 compared to 20% for the six months ended June 30, 2003.

*Real Estate Expenses*

Real estate expenses associated with Harbour Village increased from \$22.9 million in the six months ended June 30, 2003 to \$28.5 million for the six months ended June 30, 2004. The majority of real estate expenses (variable costs) are recognized at the same time as revenue is recognized. General and administrative expenses (fixed costs) are expensed as incurred once the project begins closing units. The following chart shows the cost components (in thousands):

	Six Months Ended June 30	
	<u>2003</u>	<u>2004</u>
Variable	\$20,600	\$ 26,652
Fixed	<u>2,277</u>	<u>1,835</u>
Total	\$22,877	\$ 28,487
	=====	=====

These variable costs, when applied to real estate revenue, produced gross margins of 13% for the six months ended June 30, 2003 and 22% for the six months ended June 30, 2004. The increase in gross margin was due to a higher average selling price on the Links for the six months ended June 30, 2004 compared to the same period of 2003 and higher actual margins on the Links in 2004 compared to the estimated margins recorded in 2003.

*Operations by Geographic Segment*

Net Income. For the six months ended June 30, 2004, net income from Bermuda operations increased by \$3.1 million compared to the same time period in 2003. This increase was primarily due to the Company collecting \$2.6 million as final settlement of a note receivable for which an allowance was previously established during the fourth quarter of 2003. Net income from United States operations for the first six months of 2004 decreased by \$0.4 million compared to the same period of 2003. This decrease is a result of \$7.8 million (\$5.1 million, net of tax) adverse loss development during the first six months of 2004 offset by a \$3.6 million increase in net income from real estate

operations and a \$1.1 million increase in net income from insurance operations. See previous discussion relating to real estate and insurance operations.

**Assets.** Assets from Bermuda operations increased by \$69.6 million for the first six months of 2004 compared to the same period in 2003. This increase is a result of a secondary public offering in the fourth quarter of 2003 and an increase in premium writings assumed from United States operations. Assets from United States operations increased by \$38.9 million for the first six months of 2004 compared to the first six months of 2003. This is largely due to the expanded growth in the Company's premium writings.

**Equity.** Equity from Bermuda operations increased by \$29.6 million for the first six months of 2004 compared to the same period in 2003. This increase is largely due to the secondary public offering in the fourth quarter of 2003 raising \$27.2 million in new equity and higher net income offset by net unrealized losses on the Company's investment portfolio. Equity from United States operations increased by \$2.9 million. This increase was a result of higher net income offset by net unrealized losses on the Company's investment portfolio.

### **Liquidity and Capital Resources**

We meet our cash requirements and finance our growth principally through cash flows generated from operations. Since 2000 we have operated in a hardening market with increased insurance premium rates for general liability coverage and increased fees for program business opportunities. Our primary sources of short-term cash flow are premium writings, investment income and income from real estate development sales. Our short-term cash requirements relate to claims payments, reinsurance premiums, commissions, salaries, employee benefits, real estate development expenses, and other operating expenses. Due to the uncertainty regarding the timing and amount of settlements of unpaid claims, our future liquidity requirements may vary; therefore, we have structured our investment portfolio maturities to allow for variations in those factors. We believe our current cash flows are sufficient for the short-term needs of our insurance business and our invested assets are sufficient for the long-term needs of our insurance business.

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Consistent with the discussion above, net cash provided from operations was \$35.6 million for the six months ended June 30, 2003 and \$44 million for the six months ended June 30, 2004. During the second quarter of 2004, the Company also received \$2.6 million in final settlement of an impaired notes receivable.

Currently, our Board of Directors had decided not to pay dividends on the common shares so that we could expand our capital base. Our ability to pay future dividends to shareholders will depend, to a significant degree, on the ability of our subsidiaries to generate earnings from which to pay dividends to us. The jurisdictions in which our insurance and reinsurance subsidiaries are domiciled place limitations on the amount of dividends or other distributions payable by insurance companies in order to protect the solvency of insurers. Given our Company's growth and the capital requirements associated with that growth, we do not anticipate paying dividends on the common shares in the near future.

Harbour Village is being developed in three phases with projected completion in 2005. At June 30, 2004, the Company had outstanding borrowings of \$9 million, down from an initial \$37 million development and construction loan facility. The estimated completion cost for the remainder of Harbour Village is approximately \$3.5 million. Management believes that the bank credit facility, together with anticipated cash flows from marketing and sales operations, will meet the liquidity needs for the construction and development of Harbour Village. There can be no assurance, however, that the amounts available from our sources of liquidity, exclusive of the bank credit facility for the project, will be sufficient or available to meet our future capital needs for the project. See Exhibit 99 for further information regarding Harbour Village.

## Income Taxes

The Company is incorporated under the laws of Bermuda and, under current Bermuda law, is not obligated to pay any taxes in Bermuda based upon income or capital gains. The Company has received an undertaking from the Minister of Finance in Bermuda pursuant to the provisions of The Exempted Undertakings Tax Protection Act 1966, which exempts the Company and its shareholders, other than shareholders ordinarily resident in Bermuda, from any Bermuda taxes computed on profits, income or any capital asset, gain or appreciation, or any tax in the nature of estate, duty or inheritance until March 28, 2016. The Company, exclusive of its United States subsidiaries, does not consider itself to be engaged in a trade or business in the United States and accordingly does not expect to be subject to direct United States income taxation. The Company's U.S. subsidiaries are subject to taxation in the United States.

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## Impact of Inflation

Property and casualty insurance premiums are established before the amount of losses and loss adjustment expenses are known and therefore before the extent by which inflation may affect such expenses is known. Consequently, the Company attempts, in establishing its premiums, to anticipate the potential impact of inflation. However, for competitive and regulatory reasons, the Company may be limited in raising its premiums consistent with anticipated inflation, in which event the Company, rather than its insureds, would absorb inflation costs. Inflation also affects the rate of investment return on the Company's investment portfolio with a corresponding effect on the Company's investment income.

## Combined Ratio

The combined ratio of an insurance company measures only the underwriting results of insurance operations and not the profitability of the overall business. Our reported combined ratio for our insurance operations may not provide an accurate indication of our overall profitability. For instance, depending on our mix of business the combined ratio may not fluctuate consistently with the overall Company profitability.

## Reserves

Certain of our insurance policies and reinsurance assumed, including general and pollution liability policies covering environmental remediation, excess and surplus, and workers' compensation risks, may be subject to claims brought years after an incident has occurred or the policy period has ended. We are required to maintain loss reserves to cover the unpaid portion of the estimated liability for losses and loss adjustment expenses with respect to (i) reported claims and (ii) incurred-but-not-reported claims. A full actuarial analysis is performed to provide this estimate of all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements. In evaluating whether the reserves make a reasonable provision for unpaid loss and loss adjustment expenses, it is necessary to project future loss and loss adjustment expense payments. It is certain that the actual future losses and loss adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections.

With respect to reported claims, reserves are established on a case-by-case basis. The reserve amounts on each reported claim are determined by taking into account the circumstances surrounding each claim and policy provisions relating to the type of loss. Loss reserves are reviewed on a regular basis, and as new information becomes available, appropriate adjustments are made to reserves.

In establishing reserves, several methods are employed in determining ultimate losses: the expected loss ratio method; the Bornhuetter-Ferguson method based on expected loss ratios, paid losses and reported losses; and the loss development method based on paid and reported losses. The first method uses industry expected losses adjusted for

our actual experience, while the last method relies on industry payment and reporting patterns to develop our actual losses. The Bornhuetter-Ferguson method is a combination of the other two methods, using expected loss ratios produce expected losses, then applying loss payment and reporting patterns to the expected losses to produce the expected incurred-but-not-reported losses. We review the ultimate projections from all three methods and, based on the merits of each method, determine our estimated ultimate losses. However, the establishment of appropriate loss reserves is an inherently uncertain process, and there can be no assurance that such ultimate payments will not materially exceed our reserves.

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### **Forward Looking Statements**

This Report contains forward-looking statements within the meaning of United States securities laws that are intended to be covered by the safe harbors created thereby. Such statements include the Company's estimations of future insurance claims and losses, and the Company's expectations with respect to the outcome of the Principal Management acquisition rescission litigation, and the future profitability and value of the Harbour Village real estate project, as reflected in the Company's consolidated financial statements and Exhibit 99 to this Report. In addition, all statements, other than statements of historical facts, included or incorporated by reference in this Report that address activities, events or developments that the Company expects or anticipates will or may occur in the future constitute forward-looking statements.

Forward-looking statements involve risks and uncertainties which may cause actual results to differ materially, and are subject to change based on various insurance industry factors, including, without limitation, competitive conditions in the insurance industry, levels of new and renewal insurance business, unpredictable developments in loss trends, results of evaluating actuarial reserving assumptions, adequacy and changes in loss reserves, timing or collectibility of reinsurance receivables, market acceptance of new coverages and enhancements, changes in reinsurance costs and availability, potential adverse decisions in litigation and arbitration proceedings, and changes in levels of general business activity and economic conditions. With respect to the development of the Harbour Village project, such forward-looking statements involve risks and uncertainties which may cause actual results to differ materially, and are subject to change based on various real estate development industry factors, including competitive housing conditions in the local market area, risks inherent in real estate development and new construction, increases in construction costs, construction delays, weather, zoning, litigation, changes in interest rates and the availability of mortgage financing for prospective purchasers of condominium units and boat slips, and changes in local and national levels of general business activity and economic conditions. An adverse outcome of the Principal Management acquisition rescission litigation would have a material adverse effect on the financial condition of the Company. See discussion in Part II, Item 1 of this Report as to this material matter.

Although the Company believes that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could over time prove to be inaccurate and therefore, there can be no assurance that the forward-looking statements included in this Report will themselves prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by the Company or any other person that the objectives and plans of the Company will be achieved. The Company expressly disclaims any obligation to update any forward-looking statements except as required by law.

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### **Item 3. Quantitative and Qualitative Disclosures About Market Risks.**

The Company's market risk has not changed materially since December 31, 2003.

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this Report, concluded that, as of such date, the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company (including consolidated subsidiaries) would be made known to them.

#### **Changes in Internal Control**

There were no significant changes in the Company's internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) that could significantly affect the Company's disclosure controls and procedures subsequent to the date of such evaluation, nor were there any significant deficiencies or material weaknesses in the Company's internal control over financial reporting.

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## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

The Company, through its subsidiaries, is routinely a party to pending or threatened litigation or arbitration disputes in the normal course of or related to its business. Based upon information presently available, in view of legal and other defenses available to the Company's subsidiaries, management does not believe that any pending or threatened litigation or arbitration disputes will have any material adverse effect on the Company's financial condition or operating results, except for the following matter.

*Acquisition Rescission Litigation.* In April 2000, we filed a lawsuit in the U.S. District Court for the Northern District of Georgia for damages and, alternatively, to rescind the stock purchase of a Michigan insurance agency and two related insurance companies specializing in insurance program business based upon the sellers' breach of the representations and warranties made in the definitive agreements concerning the business affairs and financial condition of the acquired companies. The defendants filed several motions for summary judgment opposing our claims. In September 2002, the Court entered an order granting the defendants' motions for summary judgment. However, the Court did not rule that the representations and warranties of the defendant in the definitive agreements were correct. The Court also granted our motions on various counterclaims. We filed a motion for reconsideration with respect to the Court's order which the Court denied in November 2002. In August 2003, we filed a motion requesting the Court certify its previous order granting the defendants' motion for summary judgment as final so that we could appeal the adverse rulings. The Court denied our motion in December 2003 and the remaining issues in the case will now proceed to trial in late 2004. After the trial, we will have the right to appeal all adverse prior rulings in the case.



**Item 2. Changes in Securities and Use of Proceeds.**

Not applicable.

**Item 3. Defaults Upon Senior Securities.**

Not applicable.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

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**Item 5. Other Information.**

None.

**Item 6. Exhibits and Reports on Form 8-K.**

(a) The following exhibits are filed as part of this Report:

<u>Exhibit No.</u>	<u>Description</u>
11	Computation of Earnings Per Share
31.1	Certification Pursuant to § 302 of the Sarba
31.2	Certification Pursuant to § 302 of the Sarba
32.1	Certification Pursuant to § 906 of the Sarba
32.2	Certification Pursuant to § 906 of the Sarba
99	Harbour Village Development Status

(b) Reports on Form 8-K.

On May 12, 2004, the Company filed a report on Form 8-K with respect to the issuance of a press release reporting its financial results for the first quarter ended March 31, 2004.

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**SIGNATURES**

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 13<sup>th</sup> day of August 2004.

American Safety Insurance Holding

By: /s/ Stephen R. Crim  
 Stephen R. Crim  
 President and Chief Executive Officer

By: /s/ Steven B. Mathis  
 Steven B. Mathis  
 Chief Financial Officer  
 (Principal Financial Officer)

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**Exhibit 11**  
**American Safety Insurance Holdings, Ltd. and subsidiaries**  
**Computation of Earnings Per Share**

	<u>Three Months Ended</u>		<u>Six months</u>
	June 30, <u>2003</u>	June 30, <u>2004</u>	June 30, <u>2003</u>
Basic:			
Earnings available to common shareholders.....	\$ 3,813,916 =====	\$ 4,096,769 =====	\$ 5,034,269 =====
Weighted average common shares outstanding.....	4,739,888	6,923,237	4,739,888
Basic earnings per common shares ...	\$ 0.80 =====	\$ 0.59 =====	\$ 1.06 =====
Diluted:			
Earnings available to common shareholders.....	\$ 3,813,916 =====	\$ 4,096,769 =====	\$ 5,034,269 =====
Weighted average common shares outstanding.....	4,739,888	6,923,237	4,739,888
Weighted average common shares equivalents associated with options....	74,328	523,918	62,236
Total weighted average common shares	4,814,216 =====	7,447,155 =====	4,802,124 =====
Diluted earnings per common shares.....	\$ 0.79 =====	\$ 0.55 =====	\$ 1.05 =====

Exhibit 31.1

Exhibit 31.1

**Certification Pursuant to § 302 of the Sarbanes-Oxley Act of 2003**

I, Stephen R. Crim, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of American Safety Insurance Holdings, Ltd.;
2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and
  - c. designed in this Report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: August 13, 2004

/s/ Stephen R. Crim  
Stephen R. Crim  
Chief Executive Officer  
American Safety Insurance Holdings,

Exhibit 31.2

**Certification Pursuant to § 302 of the Sarbanes-Oxley Act of 2003**

I, Steven B. Mathis, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of American Safety Insurance Holdings, Ltd.;
2. Based on my knowledge, this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Report;
3. Based on my knowledge, the financial statements, and other financial information included in this Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this Report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - a. designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Report based on such evaluation; and
  - c. designed in this Report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an Annual Report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: August 13, 2004

/s/ Steven B. Mathis  
Steven B. Mathis  
Chief Financial Officer  
American Safety Insurance Holdings,

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Exhibit 32.1**Certification Pursuant to § 906 of the Sarbanes-Oxley Act of 2003**

The undersigned, as the Chief Executive Officer of American Safety Insurance Group, Ltd., certifies that, to the best of his knowledge and belief, the Quarterly Report on Form 10-Q for the period ended June 30, 2004, which accompanies this certification fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of American Safety Insurance Group, Ltd. at the dates and for the periods indicated. The foregoing certification is made pursuant to &#247; 906 of the Sarbanes-Oxley Act of 2003 (18 U.S.C. &#247;1350) and shall not be relied upon for any other purpose.

Date: August 13, 2004

/s/ Stephen R. Crim  
Stephen R. Crim  
Chief Executive Officer

A signed original of this written statement required by &#247; 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by &#247; 906, has been provided to American Safety Insurance Holdings, Ltd. and will be retained by American Safety Insurance Holdings, Ltd. and furnished to the Securities and Exchange Commission or its staff upon request.

The information in this Exhibit 32.1 shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, except as shall be expressly set forth by specific reference in such filing.

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Exhibit 32.2**Certification Pursuant to § 906 of the Sarbanes-Oxley Act of 2003**

The undersigned, as the Chief Financial Officer of American Safety Insurance Group, Ltd., certifies that, to the best of his knowledge and belief, the Quarterly Report on Form 10-Q for the period ended June 30, 2004, which accompanies this certification fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and the information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of American Safety Insurance Group, Ltd. at the dates and for the periods indicated. The foregoing certification is made pursuant to &#247; 906 of the Sarbanes-Oxley Act of 2003 (18 U.S.C. &#247; 1350) and shall not be relied upon for any other purpose.

Date: August 13, 2004

/s/ Steven B. Mathis  
Steven B. Mathis  
Chief Financial Officer

A signed original of this written statement required by &#247; 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by &#247; 906, has been provided to American Safety Insurance Holdings, Ltd. and will be retained by American Safety Insurance Holdings, Ltd. and furnished to the Securities and Exchange Commission or its staff upon request.

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The information in this Exhibit 32.2 shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, except as shall be expressly set forth by specific reference in such filing.

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Exhibit 99  
Harbour Village Development Stat  
(000)s except references to Condo  
(unaudited)  
Harbour Village Development

	Phase 1		
	Townhouses		
	Marina Condos	Oak Hammock	Riverwalk
6/30/2004			
Planned Number of Condo Units and Boat Slips	248	18	28
Condo Units and Boat Slips under Contract	248	17	27
Value of Pre-sale Contracts (Note 1)	62,892	7,931	10,462
Number of Buildings	8	4	6
Number of Closed Units	248	17	27
Number of Buildings Complete by Task			
Building Foundation	8	4	6
Vertical Building Completed	8	4	6
Interior Finish Completed	8	4	6
Certificate of Occupancy Received	8	4	6
2nd Quarter Actual			
Units Closed	-	-	1
Revenue Recognized			
Condos and Boat Slips	89	15	426
Land Sales and Other Revenue			
Total Revenue			
Gross Profit Recognized			
Condos and Boat Slips	35	12	(7)
Land Sales and Other Revenue			
Total Gross Profit			
Other Expense (Income) Items			
Pre-Tax Profit			

Outlook For 3rd Quarter of 2004

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Units Closed	-	1	-
Sales Value of Closed Units	-	750	-
Revenue Recognized			
Condos and Boat Slips	-	735	-
Land Sales and Other Revenue			
Total Revenue			
Gross Profit Recognized			
Condos and Boat Slips	-	(1)	-
Land Sales and Other Revenue			
Total Gross Profit			
Other Expense (Income) Items			
Pre-Tax Profit			

Note 1 - No assurance can be given that purchasers under binding pre-sale contracts with deposits will close each contemplated transaction .

Note 2 - Other includes net brokerage commissions, advertising, promotion, and other general and administrative costs. These items are not allocated to specific buildings.

The projected results contained above for unit closings, revenue, gross profit, fixed costs and pre-tax profit are forward looking statements. With respect to the Company's development of the Harbour Village property, such forward looking statements involve risks and uncertainties which may cause actual results to differ materially, and are subject to change based on various real estate development industry factors, including competitive housing conditions in the local market area, risks inherent in real estate development and new construction, increases in construction costs, construction delays, weather, litigation, changes in interest rates and the availability of mortgage financing for prospective purchasers of condominium units and boat slips and changes in local and national levels of general business activity and economic conditions.