

AMERICAN SAFETY INSURANCE HOLDINGS LTD  
Form 10-Q  
August 15, 2005

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

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**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, 2005**

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)  
Not Applicable (I.R.S. Employer Identification No.)

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)

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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, 2005 was 6,700,323.

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**AMERICAN SAFETY INSURANCE HOLDINGS, LTD.  
FORM 10-Q  
TABLE OF CONTENTS**

PART I - FINANCIAL INFORMATION	1
Item 1. Consolidated Financial Statements	1
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	19
Item 3. Quantitative and Qualitative Disclosures About Market Risk	31
Item 4. Controls and Procedures	31
PART II - OTHER INFORMATION	32
Item 1. Legal Proceedings	32
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	33
Item 3. Defaults Upon Senior Securities	33
Item 4. Submission of Matters to a Vote of Security Holders	34
Item 5. Other Information	34
Item 6. Exhibits	34

**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements**

American Safety Insurance Holdings, Ltd. and Subsidiaries

Consolidated Balance Sheets

	December 31,	
	<u>2004</u>	
Assets		(U)
Investments:		
Fixed maturity securities available for sale	\$ 286,057,489	\$ 32
Common stock	15,081,360	2
Investment in real estate	2,005,440	
Short-term investments	<u>25,898,131</u>	<u>1</u>
Total investments	329,042,420	35
Cash and cash equivalents	24,843,736	2
Restricted cash	144,500	
Accrued investment income	3,308,463	
Premiums receivable	21,093,810	2
Ceded unearned premium	25,454,691	2
Reinsurance recoverable	145,524,068	15
Deferred income taxes	9,080,990	
Deferred policy acquisition costs	11,559,188	1
Property, plant and equipment	3,900,473	
Other assets	<u>10,207,637</u>	<u>—</u>
Total assets	\$ 584,159,976	\$ 62
	=====	=====

See accompanying notes to consolidated financial statements (unaudited).

	December 31, <u>2004</u>	
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$ 321,623,730	\$ 35
Unearned premiums	93,798,378	9
Reinsurance on paid losses and loss adjustment expenses	6,486,149	
Ceded premiums payable	11,852,028	1
Escrow deposits	144,500	
Accounts payable and accrued expenses	15,370,443	1
Loan payable	13,019,489	1
Funds held	8,334,794	
Minority Interest	<u>4,750,782</u>	
Total liabilities	475,380,293	50
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, 2004, 6,781,721 and June 30, 2005, 6,700,323 shares	67,817	
Additional paid-in capital	51,067,506	4
Retained earnings	55,800,942	6
Accumulated other comprehensive income, net	<u>1,843,418</u>	
Total shareholders' equity	<u>108,779,683</u>	<u>11</u>
Total liabilities and shareholders' equity	\$ 584,159,976	\$62
	=====	=====

See accompanying notes to consolidated financial statements (unaudited).

American Safety Insurance Holdings, Ltd. and Subsidiaries

Consolidated Statements of Earnings  
(unaudited)

	<u>Three Months Ended</u>		<u>Six</u>
	June 30,		J
	<u>2004</u>	<u>2005</u>	<u>2004</u>
Revenues:			
Direct premiums earned	\$ 53,093,944	\$ 59,076,332	\$ 107,066,02
Assumed premiums earned	1,588,554	-	3,040,90
Ceded premiums earned	<u>(22,592,774)</u>	<u>(24,541,747)</u>	<u>(43,898,47</u>
Net premiums earned	32,089,724	34,534,585	66,208,46
Net investment income	2,249,139	3,427,475	4,320,25
Net realized gains (losses)	(5,139)	(96,697)	20,27
Real estate income	20,176,157	691,078	34,128,31

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Other income	<u>113,511</u>	<u>33,807</u>	<u>144,622</u>
Total revenues	54,623,392	38,590,248	104,821,910
Expenses:			
Losses and loss adjustment expenses	24,555,449	21,507,779	46,914,899
Acquisition expenses	6,513,912	6,883,652	13,124,133
Payroll and related expenses	2,705,771	3,181,498	5,329,144
Real estate expenses	16,993,188	423,933	28,487,022
Other expenses	896,898	3,199,767	2,993,444
Minority interest	162,543	(48,616)	336,655
Expense due to rescission	<u>(1,745,544)</u>	<u>11,561</u>	<u>(1,715,977)</u>
Total expenses	<u>50,082,217</u>	<u>35,159,574</u>	<u>95,469,311</u>
Earnings before income taxes	4,541,175	3,430,674	9,352,600
Income taxes	<u>444,406</u>	<u>291,920</u>	<u>1,606,010</u>
Net earnings	<u>\$ 4,096,769</u>	<u>\$ 3,138,754</u>	<u>\$ 7,746,588</u>
Net earnings per share:			
Basic	\$ 0.59	\$ 0.47	\$ 1.11
Diluted	\$ 0.55	\$ 0.44	\$ 1.00
Average number of shares outstanding:			
Basic	<u>6,923,237</u>	<u>6,718,269</u>	<u>6,919,660</u>
Diluted	<u>7,447,155</u>	<u>7,118,651</u>	<u>7,419,100</u>

See accompanying notes to consolidated financial statements (unaudited).

American Safety Insurance Holdings, Ltd. and Subsidiaries

Consolidated Statements of Cash Flow  
(unaudited)

	<u>2004</u>	Six Months <u>June 30</u>
Cash flow from operating activities:		
Net earnings	\$7,746,588	
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Realized gains/(losses) on investments	(20,272)	
Depreciation expense	427,157	
Deferral of acquisition costs, net	387,617	
Amortization of premium	1,182,156	
Change in:		
Accrued investment income	(604,960)	
Premiums receivable	7,725,881	
Reinsurance recoverable and ceded unearned premiums	(16,994,933)	
Funds held	360,676	
Deferred income taxes	(11,934)	
Unpaid losses and loss adjustment expenses	47,033,915	
Unearned premiums	3,132,615	
Ceded premiums payable	428,316	
Accounts payable and accrued expenses	(3,714,829)	
Deferred revenue	(41,437)	

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Other, net	<u>(3,044,159)</u>
Net cash provided by operating activities	43,992,397
Cash flow from investing activities:	
Purchases of fixed maturities	(51,298,446)
Purchases of equity securities	(5,577,948)
Proceeds from sale of fixed maturities	11,676,950
Proceeds from sale of equity investments	128,709
(Increase) decrease in short-term investments	(4,652,790)
Decrease in notes receivable	1,435,000
Decrease of investment in real estate	17,390,079
Purchase of fixed assets, net	<u>(341,248)</u>
Net cash used in investing activities	(31,239,694)

See accompanying notes to consolidated financial statements (unaudited).

American Safety Insurance Holdings, Ltd. and Subsidiaries

Consolidated Statements of Cash Flow (Continued)  
(unaudited)

	Six Months En <u>June 30,</u>
	<u>2004</u>
Cash flow from financing activities:	
Proceeds from issuance of common stock	247,771
Stock repurchase payments	-
Repayment of loan payable	(9,117,350)
Repayment of escrow deposits	(3,789,738)
Withdrawals of restricted cash	<u>17,815</u>
Net cash used in financing activities	<u>(12,641,502)</u>
Net increase (decrease) in cash and cash equivalents	111,201
Cash and cash equivalents at beginning of period	<u>32,153,379</u>
Cash and cash equivalents at end of period	\$32,264,580 =====
Supplemental disclosure of cash flow:	
Income taxes paid	\$ 1,925,270 =====
Interest paid	\$ 636,832 =====

See accompanying notes to consolidated financial statements (unaudited).

American Safety Insurance Holdings, Ltd. and Subsidiaries

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Consolidated Statements of Comprehensive Income  
(unaudited)

	Three Months Ended June 30,		Si
	<u>2004</u>	<u>2005</u>	<u>200</u>
Net earnings	\$ 4,096,769	\$ 3,138,754	\$ 7,746,
Other comprehensive income before income taxes:			
Unrealized gains (losses) on securities available for sale, net of minority interest of \$(435,113) and \$288,541 for the three months ended June 30, 2004 and 2005, respectively, and \$(294,027) and \$75,870 for the six months ended June 30, 2004 and 2005, respectively.	(7,618,574)	5,068,766	(4,376,
Unrealized gains (losses) on hedging transactions	535,786	(167,696)	246,
Reclassification adjustment for realized (gains) and losses included in net earnings, net of minority interest of \$(29,548) and \$0 for the three months ended June 30, 2004 and 2005 respectively and \$(29,548) and \$0 for the six months ended June 30, 2004 and 2005, respectively.	<u>(24,409)</u>	<u>96,697</u>	<u>(49,</u>
Total other comprehensive income (loss) before taxes	(7,107,197)	4,997,767	(4,178,
Income tax expense (benefit) related to items of other comprehensive income, net of minority interest of \$0 and \$109,733 for the three months ended June 30, 2004 and 2005 respectively and \$0 and \$108,370 for the six months ended June 30, 2004 and 2005, respectively.	<u>(1,571,065)</u>	<u>1,134,646</u>	<u>(925,</u>
Other comprehensive income (loss) net of income taxes	<u>(5,536,132)</u>	<u>3,863,121</u>	<u>(3,253,</u>
Total comprehensive income (loss)	\$ (1,439,363) =====	\$7,001,875 =====	\$ 4,493 =====

See accompanying notes to consolidated financial statements (unaudited).

American Safety Insurance Holdings, Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

June 30, 2005  
(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-sub 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, 2005 may not be indicative of the results that may be expected for the fiscal year ending December 31, 2005. 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 on Form 10-K of American Safety and its subsidiaries for the fiscal year ended December 31, 2004.

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 2005 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.

In December 2004, the FASB issued a revised version of SFAS 123, SFAS 123 (R), Share based payments, which finalizes the accounting for stock options. The statement requires that compensation related to share based payment transaction be recognized in the financial statements. The Company plans to adopt SFAS 123 (R) in the first quarter of 2006 and does not expect the adoption to have a material effect on earnings

**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 Company 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 as well as 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.

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 United States 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 maintain and 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.

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However, because the Internal Revenue Code of 1986, as amended, Treasury Regulations and court decisions 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, may 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 may change and cause a decrease in the value of an insurer's investments. The Company attempts to mitigate this risk by attempting to match the maturities of its assets with the expected payouts of its liabilities.

The Company's fixed maturity holdings are invested predominantly in high quality corporate, government and municipal bonds with relatively short durations. The fixed maturity portfolio is exposed to interest rate fluctuations; as interest rates rise, their fair values decline and as interest rates fall, their fair values rise. The changes in the fair market value of the fixed maturity portfolio are presented as a component of shareholders' equity in accumulated other comprehensive income, net of taxes.

We work to manage the impact of interest rate fluctuations on our fixed maturity portfolio. The effective duration of the fixed maturity portfolio is managed with consideration given to the estimated payout timing of our liabilities. We have investment policies which limit the maximum duration and maturity of individual securities within the portfolio and set target levels for average duration and maturity of the entire portfolio.

### Note 4 Investments

The amortized cost and estimated fair values of the Company's investments at December 31, 2004 and June 30, 2005 are as follows:

	<u>Amortized cost</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>
December 31, 2004:			
Securities available for sale:			
Fixed maturities:			
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$ 65,887,315	\$800,811	\$ 467,383
States of the U.S. and political subdivisions of the States	31,067,197	425,269	168,348
Corporate securities	90,742,305	1,618,821	650,822
Mortgage-backed securities	<u>97,243,632</u>	<u>306,453</u>	<u>747,761</u>
Total fixed maturities:	\$284,940,449 =====	\$3,151,354 =====	\$2,034,314 =====
Common stock	\$ 14,001,929 =====	\$1,455,131 =====	\$ 375,700 =====
June 30, 2005:			
Securities available for sale:			
Fixed maturities:			
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$76,989,187	\$ 1,060,739	\$ 372,202
States of the U.S. and political subdivisions of the States	39,614,763	789,556	79,841
Corporate Securities	91,375,682	1,530,617	799,527



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Mortgage-backed securities	<u>110,644,678</u>	<u>431,638</u>	<u>573,147</u>
Total fixed maturities	\$318,624,310	\$3,812,550	\$1,824,717
	=====	=====	=====
Common stock	\$ 20,027,052	\$1,508,623	\$ 770,969
	=====	=====	=====

**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. E&S 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, 2004 and June 30, 2005 (in thousands):

	<u>June 30,</u> <u>2004</u>	<u>Real</u> <u>Estate</u>	<u>Insurance</u>			
			<u>Environmental</u>	<u>E&amp;S</u>	<u>Programs</u>	<u>Other</u>
Gross premiums written	-	-	22,290	47,379	41,993	1,426
Net Premiums written	-	-	17,678	38,472	7,584	727
Net premiums earned	-	-	14,636	38,400	7,731	5,442
Losses and loss adjustment expenses	-	-	6,451	27,365	4,851	8,248
Acquisition expenses	-	-	3,778	8,098	101	1,147
Underwriting profit/(loss)	-	-	4,407	2,937	2,779	(3,953)
Income tax/(benefit)		2,122		(1,122)		
Net earnings		3,518		420		
Assets		37,332		515,773		
Equity		15,449		84,765		
	<u>June 30,</u> <u>2005</u>	<u>Real</u> <u>Estate</u>	<u>Environmental</u>	<u>E&amp;S</u>	<u>Programs</u>	<u>Other</u>
Gross premiums written	-	-	27,290	48,035	44,136	942
Net Premiums written	-	-	24,124	38,340	9,312	435
Net premiums earned	-	-	18,522	40,962	9,082	589
Losses and loss adjustment expenses	-	-	10,187	24,857	5,379	1,866
Acquisition expenses	-	-	4,637	9,300	254	(181)
Underwriting profit/(loss)	-	-	3,698	6,805	3,449	(1,096)
Income tax/(benefit)		118		445		
Net earnings/(loss)		193		6,654		
Assets		3,924		619,695		
Equity		2,740		111,334		

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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, 2004 and June 30, 2005 (in thousands):

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

  

<u>June 30, 2005</u>	<u>United States</u>	<u>Bermuda</u>
Income tax	543	-
Net earnings	2,381	4,404
Assets	474,185	149,371
Equity	58,902	55,071

The following table presents key financial data by segment for the three months ended June 30, 2004 and June 30, 2005 (in thousands):

<u>June 30, 2004</u>	<u>Real Estate</u>	<u>Insurance</u>			
		<u>Environmental</u>	<u>E&amp;S</u>	<u>Programs</u>	<u>Other</u>
Gross premiums written	-	13,131	19,482	20,745	376
Net Premiums written	-	10,606	14,685	4,510	103
Net premiums earned	-	7,720	18,559	3,033	2,778
Losses and loss adjustment expenses	-	3,587	14,130	1,798	5,040
Acquisition expenses	-	1,972	3,826	(51)	767
Underwriting profit/(loss)	-	2,161	604	1,286	(3,030)
Income tax/(benefit)	1,185		(1,350)		
Net earnings/(loss)	1,997		(1,691)		

  

<u>June 30, 2005</u>	<u>Real Estate</u>	<u>Insurance</u>			
		<u>Environmental</u>	<u>E&amp;S</u>	<u>Programs</u>	<u>Other</u>
Gross premiums written	-	13,696	20,982	21,076	438
Net Premiums written	-	13,157	16,155	5,909	220
Net premiums earned	-	9,777	19,858	4,684	215
Losses and loss adjustment expenses	-	5,378	11,969	2,926	1,235
Acquisition expenses	-	2,244	4,754	114	(288)
Underwriting profit/(loss)	-	2,155	3,135	1,644	(792)
Income tax/(benefit)	102		223		
Net earnings/(loss)	165		3,049		

The following provides key measurable information about the geographic segments for the three months ended June 30, 2004 and June 30, 2005 (in thousands):

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	<u>June 30, 2004</u>	<u>United States</u>	<u>Bermuda</u>
Income tax		444	-
Net earnings		751	3,346
	<u>June 30, 2005</u>	<u>United States</u>	<u>Bermuda</u>
Income tax		292	-
Net earnings		788	2,351

**Note 6 Investment in Real Estate**

The Company's investment in the development of the Harbour Village Golf and Yacht Club ( Harbour Village ) project was comprised of 173 acres of property in Ponce Inlet, Florida that was acquired through foreclosure in 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.

During the quarter ended June 30, 2005, the Company closed the final 2 condominium units at Harbour Village as compared to the quarter ended June 30, 2004, where the Company closed 68 condominium units and 1 boat slip. During the six months ended June 30, 2005, where the Company closed 9 condominium units at Harbour Village as compared to the six months ended June 30, 2004, the Company closed 104 units and 2 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.

The Harbour Village project is substantially complete as all units are sold and closed. The Company does not expect to engage in any further real estate activities in the future. No additional revenue from Harbour Village is expected. There will be some ongoing expenses for the project associated with legal, insurance and other matters.

**Note 7 Income Taxes**

Total income tax expense for the periods ended June 30, 2004 and 2005 was allocated as follows:

	Three Months Ended June 30,		Six Months June
	<u>2004</u>	<u>2005</u>	<u>2004</u>
Tax expense attributable to:			
Income from continuing operations	\$ 444,406	\$ 291,920	\$ 1,606,016
Change in unrealized gains/(losses) on hedging transactions	182,167	(57,018)	83,974
Change in unrealized gains/(losses) on securities available for sale	<u>(1,753,232)</u>	<u>1,301,397</u>	<u>(1,009,541)</u>
Total	<u>\$ (1,126,659)</u>	<u>\$ 1,536,299</u>	<u>\$ 680,449</u>

United States federal and state income tax expense (benefit) from continuing operations consists of the following components:

	<u>Current</u>	<u>Deferred</u>
Three months ended:		
June 30, 2004	\$ 68,751	\$ 375,655
June 30, 2005	\$ 422,259	\$ (130,339)

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Six months ended:

June 30, 2004	\$ 1,651,780	\$ (45,764)
June 30, 2005	\$ 997,185	\$ (454,458)

The state income tax expense aggregated \$318,542 and \$58,476 for the six months ended June 30, 2004 and 2005, respectively, and \$143,833 and \$16,250 for the three months ended June 30, 2004 and 2005, respectively, and is included in the current provision.

Income tax expense for the periods ended June 30, 2004 and 2005 differed from the amount computed by applying the United States 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,
	2004	2005	2004
Expected income tax expense	\$ 1,543,999	\$ 1,166,429	\$ 3,179,885
Foreign earned income not subject to U.S. taxation	(1,137,439)	(798,899)	(1,671,903)
Valuation allowance	-	-	-
State taxes and other	<u>37,846</u>	<u>(75,610)</u>	<u>98,034</u>
	\$444,406	\$ 291,920	\$ 1,606,016
	=====	=====	=====

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, 2004
Deferred tax assets:	
Loss reserve discounting	\$7,565,625
Unearned premium reserves	3,145,646
Difference between tax and GAAP basis of Harbour Village project	366,348
Difference between tax and GAAP method at Harbour Village project	146,738
Warranty reserve	282,556
NOL carry forward	88,443
Other	<u>611,443</u>
Gross deferred tax assets	12,206,799
Valuation allowance	<u>(554,515)</u>
Gross deferred tax assets after valuation allowance	11,652,284
Deferred tax liabilities:	
Deferred acquisition costs	2,033,536
Unrealized gains on securities	288,062
Other	<u>249,696</u>
Gross deferred tax liabilities	<u>2,571,294</u>
Net deferred tax asset	\$9,080,990
	=====

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 (RRG), it had established a 100% valuation allowance on its net deferred tax assets totaling \$554,515 at December 31, 2004. In the first quarter of 2005, RRG included as a reduction to income tax expense this valuation allowance as RRG's judgment about the realizability of the deferred tax assets changed due to

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RRG's profitability. This reduction in income tax expense was offset by an increase in minority interest expense and had no overall effect on the earnings or shareholders' equity of the Company.

### Note 8 Goodwill and Intangibles

Goodwill and indefinite-lived intangible assets are reviewed annually (or more frequently if impairment indicators arise) for impairment. Separable intangible assets that are not deemed to have an indefinite life are to be amortized over their useful lives (but with no maximum life). The recorded indefinite-lived intangibles at December 31, 2004 and June 30, 2005 were \$1,467,000.

In accordance with the disclosure requirements of SFAS No. 142, Goodwill and Other Intangibles, there were no effects of goodwill on the net earnings for the six months ended June 30, 2004 and 2005.

### 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,	2005	Six Months Ending June 30,
	<u>2004</u>	<u>2005</u>	<u>2004</u>
	(In thousands, except per share amounts)		
Net earnings:			
As reported	\$ 4,097	\$ 3,139	\$ 7,747
Effect of stock options	<u>13</u>	<u>26</u>	<u>(196)</u>
Pro forma net earnings	\$ 4,110	\$ 3,165	\$ 7,551
	=====	=====	=====
Net earnings per share:			
Basic - as reported	\$ 0.59	\$ 0.47	\$ 1.12
Basic - pro forma	\$ 0.59	\$ 0.47	\$ 1.09
Diluted - as reported	\$ 0.55	\$ 0.44	\$ 1.04
Diluted - pro forma	\$ 0.55	\$ 0.44	\$ 1.01

### Note 10 Loans Payable

#### *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 London Interbank Offering Rate (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 five years from the date of issue.

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 Trust II, respectively, over the first five years of the

obligation.

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 on the interest rate swaps at December 31, 2004 and June 30, 2005 were \$192,589 and \$238,826 for American Safety Capital and \$(14,724) and \$52,128 for American Safety Capital Trust II, respectively. The interest rate swaps are 100% effective.

#### Note 11 Stock Repurchase

On March 31, 2005, the Company's Board of Directors authorized a program to repurchase up to 200,000 shares of the Company's outstanding common stock. All 200,000 shares were repurchased during the second quarter of 2005, thus terminating the program. An additional 1,573 shares were also repurchased.

#### Note 12 Subsequent Event

On August 10, 2005, the Circuit Court, Seventh District, Volusia County, Florida entered an Order against the Company in the amount of \$3,426,703 stemming from a lawsuit associated with the Harbour Village real estate project. Seven plaintiffs filed suit against the Company and three of its subsidiaries seeking to recover a \$2,100,000 loan made by the plaintiffs in 1986 to Ponce Marina, Inc., the former owner of the Harbour Village property. The plaintiffs claimed that the Company was responsible for the repayment of the Loan, with interest. The plaintiffs propounded four theories of liability and the Court granted judgment for the Company on three of the theories. However, the Court entered judgment against the Company for \$3,426,703.50, which includes interest, on the remaining theory that various actions of the plaintiffs with regard to their loan benefited the Company. The Court found that these benefits created a quasi-contract between the plaintiffs and the Company that required the Company to repay the loan, with interest.

The Company has reviewed the decision of the Court with outside legal counsel and plans to vigorously pursue an appeal. Based on the merits of the case and the likelihood of ultimate payment, the Company has not established an accrual for the decision.

## 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's net earnings from insurance operations increased to \$3.0 million in the second quarter of 2005 from a loss of \$1.7 million for the same quarter in 2004. Net earnings for the second quarter were \$3.1 million, or \$0.44 per diluted share as compared to earnings of \$4.1 million, or \$0.55 per diluted share for the second quarter of 2004. Insurance earnings for the six months ended June 30, 2005 increased to \$6.7 million from \$420,000 for the six months ended June 30, 2004. Net earnings for the six months ended June 30, 2005 were \$6.8 million, or \$0.94 per diluted share as compared to \$7.7 million, or \$1.04 per diluted share for the six months ended June 30, 2004.

The following table sets forth the Company's net earnings (in thousands):

	Quarter Ended		Six Months Ended	
	June 30,		June 30,	
	2004	2005	2004	2005
Insurance Operations	\$ (1,691)	\$3,049	\$420	\$6,747
Real Estate Operations	1,997	165	3,518	3,518
Other, including realized gains and (losses)	<u>3,791</u>	<u>(75)</u>	<u>3,809</u>	<u>3,809</u>
Net Earnings	\$4,097	\$3,139	\$7,747	\$6,809
	=====	=====	=====	=====

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The increase in insurance earnings for the quarter and the six months ended June 30, 2005 was due to improved underwriting results combined with increased investment income. The underwriting results for the quarter and the six months ended June 30, 2005 were driven by an improved loss ratio, which for the quarter decreased to 62% from 77% and for the six months decreased to 61% from 71% for the same period of 2004. The combined ratio decreased for the quarter to 99% from 114% and for the six months decreased to 97% from 106% for the same period of 2004. The combined ratio was adversely impacted from \$1.1 million of reserve strengthening in discontinued lines and \$500,000 for Sarbanes-Oxley compliance and other regulatory expenses during the second quarter of 2005. The decrease in real estate earnings for the quarter and for the six months ended June 30, 2005 was due to the closing of the final remaining units of the Harbour Village project. This substantially completes the Company's real estate operations. Other items for the second quarter and for the six months of 2004 include non-recurring earnings of \$3.8 million, predominantly due to the recovery on an impaired note receivable.

Total revenues for the second quarter of 2005 decreased 29% to \$39 million compared to the same quarter of 2004 as a result of the expected decrease in real estate income. Net premiums earned for the second quarter of 2005 increased 8% to \$35 million compared to the same quarter of 2004 due to increases in the Company's core business lines. Net investment income for the quarter increased 52% to \$3.4 million from \$2.2 million in the second quarter of 2004 due to increased invested assets and an increase in the annualized yield to 3.9% from 3.4%.

Total revenues for the six months ended June 30, 2005 decreased 25% to \$79 million compared to the same period in 2004 as a result of the expected decrease in real estate income. Net premiums earned for the six months ended June 30, 2005 increased 4% to \$69 million from the same period of 2004 due to increases in the Company's core business lines. Net investment income for the six months ended June 30, 2005 increased 52% to \$6.6 million from \$4.3 million for the same period in 2004 due to increased invested assets and an increase in the annualized yield to 3.8% from 3.5%. Total invested assets increased 9% to \$358 million from \$327 million at December 31, 2004.

The Company's book value per share increased 6% to \$17.01 at June 30, 2005 from \$16.04 at December 31, 2004, due to the contribution of net earnings during the six months ended June 30, 2005. The Company completed its stock repurchase authorization with the repurchase of 201,573 shares of its common stock at an average price of \$14.79 per share during the quarter.

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

	Three Months Ended June 30,		Six Months Ended June 30,		Three Ende 3
	2004	2005	2004	2005	200 2
	(Dollars in thousands)				
Net premiums written:					
Environmental	\$ 10,606	\$ 13,157	\$ 17,678	\$ 24,124	2
Excess and surplus Programs	14,685	16,155	38,472	38,340	1
Other	4,510	5,909	7,584	9,312	3
	<u>103</u>	<u>220</u>	<u>727</u>	<u>435</u>	<u>11</u>
Total net premiums written	\$ 29,904	\$ 35,441	\$ 64,461	\$ 72,211	1
	=====	=====	=====	=====	=
Net premiums earned:					
Environmental	\$ 7,720	\$ 9,777	\$ 14,636	\$ 18,522	2
Excess and surplus Programs	18,559	19,858	38,400	40,962	1
Other	3,033	4,684	7,731	9,082	5
	<u>2,778</u>	<u>215</u>	<u>5,442</u>	<u>589</u>	<u>(9)</u>
Total net premiums earned	32,090	34,534	66,209	69,155	
Net investment income	2,249	3,427	4,320	6,584	5
Net realized gains (losses)	(5)	(96)	20	(44)	(1,82
Real estate income	20,176	691	34,128	3,000	(9
Other income	<u>113</u>	<u>34</u>	<u>145</u>	<u>36</u>	<u>(6</u>
Total Revenues	\$ 54,623	\$ 38,590	\$104,822	\$ 78,731	(2
	=====	=====	=====	=====	=

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	
	<u>June 30,</u>		<u>June 30,</u>	
	<u>2004</u>	<u>2005</u>	<u>2004</u>	<u>2005</u>
Insurance operations:				
Loss and loss adjustment expense ratio	76.5 %	62.3%	70.9%	61.2%
Expense ratio	<u>37.5</u>	<u>36.6</u>	<u>34.8</u>	<u>35.5</u>
Combined ratio.....	114.0%	98.9%	105.7%	96.7%
	=====	=====	=====	=====

**Quarter Ended June 30, 2005 Compared to Quarter Ended June 30, 2004**

*Net Premiums Earned*

**Environmental.** Net earned premiums increased to \$9.8 million in the second quarter of 2005 compared to \$7.7 million for the same quarter of 2004. Net written premiums increased to \$13.2 million in the second quarter of 2005 compared to \$10.6 million for the same quarter of 2004. Most of the growth in this segment for the quarter was attributable to increased production in the Company's Prostar online rating and quoting system, in addition to premium production in the Company's regional office in Denver, Colorado. During the quarter, the Company opened a new regional office in Cleveland, Ohio. This office is staffed with two experienced environmental underwriters and will enhance the future growth prospects by expanding the Company's regional presence into the Midwest region. The Company has experienced a slight decline in premium rates over 2004 due to increased competition and the overall change in pricing conditions in the marketplace.

As a result of the Company's continuous review of underwriting profitability, the Company noted a recent increase in the loss ratio from accounts written in certain areas of New York. The Company therefore initiated stricter underwriting criteria and policy terms for this business and expect this initiative to result in a reduction in the Company's premium writings. The overall ultimate loss ratio for the environmental business has not been adversely affected by the New York business. The Company believes that the initiatives it has undertaken will improve the ultimate profitability of the unit. These actions will have a short-term adverse impact on growth in this unit and the Company is anticipating flat to modest growth for 2005. Despite the short-term impact from this initiative the Company is still optimistic about the long-term growth opportunities in this unit.

**Excess and Surplus.** Net earned premiums increased to \$19.9 million in the second quarter of 2005 compared to \$18.6 million for the same quarter of 2004. Net written premiums increased to \$16.2 million in the second quarter of 2005 compared to \$14.7 million for the same quarter of 2004. Premium rates have leveled and in some cases have declined due to less business being shifted out of the standard markets and a softening of pricing in the marketplace. This has resulted in a reduction in the volume of new business and renewal retentions from 2004 levels. Despite the changing market, the Company has maintained its disciplined underwriting approach and policy terms and conditions have remained consistent. Construction risks make up a majority of the book of business written by the E&S unit and the insurance market for residential construction risks continues to offer modest growth opportunities. The Company's objective is to maintain underwriting and pricing discipline and monitor pricing conditions on an individual risk basis.

**Programs.** Net earned premiums increased to \$4.7 million in the second quarter of 2005 compared to \$3 million for the same quarter of 2004. Net written premiums increased to \$5.9 million in the second quarter of 2005 compared to \$4.5 million for the same quarter of 2004. One new program, a general liability program for small commercial artisan contractors, was added in the second quarter. The increase in net written premiums during the quarter was primarily attributable to growth in fully funded policies where the Company acts as the policy issuing carrier and the insured collateralizes the policy aggregate limit. Fee income earned in the second quarter from fully funded policies was \$250,000 as compared to \$26,000 for the second quarter of 2004. The Company's focus in the program business line is on insurance programs that allow the Company to participate in underwriting profits, while also earning fee income as the policy-issuing carrier.

**Other.** Net earned premiums decreased to \$0.2 million in the second quarter of 2005 compared to \$2.8 million for the same period of 2004. New written premiums increased to \$0.2 million in the second quarter of 2005 compared to \$0.1 million for the same period of 2005. Premiums from the Company's other lines of business decreased as the Company's assumed liability program and workers' compensation business were put



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in run-off in 2004. This decrease was coupled with an increase in the Company's surety business. The surety business grew as it was offered as a supporting product line to the environmental segment.

### *Net Investment Income*

Net investment income increased to \$3.4 million in the quarter ended June 30, 2005 from \$2.2 million in the quarter ended June 30, 2004 due to higher levels of invested assets generated by positive cash flows from operations and an increased investment yield. Average invested assets increased to \$349 million from \$266 million. The pre-tax investment yield increased to 3.9% from 3.4% in the quarter ended June 30, 2005 and June 30, 2004, respectively, and the after-tax investment yield increased to 3.2% from 2.7%, respectively. The increase in investment yield is consistent with the overall market rate increases.

### *Net Realized Gains and Losses*

Net realized losses increased to \$96,000 in the second quarter of 2005 compared to \$5,000 for the same period of 2004. Sales of investments are generally the result of changing investment strategies to maximize investment income.

### *Real Estate Income*

Real estate income at the Harbour Village project decreased to \$691,000 for the second quarter of 2005 compared to \$20.2 million for the same period of 2004. The final 2 condominium units were closed in the second quarter of 2005. The Company does not expect to engage in any further real estate activities in the future. The earnings and funds generated from Harbour Village have been redeployed into the Company's insurance operations.

### *Losses and Loss Adjustment Expenses*

In the quarter ended June 30, 2005, the Company's loss ratio decreased 14.2 points to 62.3% as compared to 76.5% for the same period of 2004. This decrease was attributable to lower loss reserve development. During the quarter ended June 30, 2005, adverse loss development decreased to \$1.1 million from \$6.2 million in the second quarter of 2004. The \$6.2 million adverse loss development for the second quarter of 2004 consisted of \$3.2 million on the excess and surplus lines of business and \$3 million on discontinued lines. For the second quarter of 2005, the \$1.1 million adverse loss development was on discontinued lines.

### *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 the Company does business on an admitted basis. Acquisition expenses were \$6.9 million in the quarter ended June 30, 2005 compared to \$6.5 million in the quarter ended June 30, 2004. Acquisition expenses as a function of net earned premiums were 19.9% in the quarter ended June 30, 2005 and 20.3% in the quarter ended June 30, 2004.

### *Real Estate Expenses*

Real estate expenses decreased to \$424,000 for the second quarter of 2005 compared to \$16.9 million for the same period of 2004. The final 2 condominium units were closed in the second quarter of 2005. The Company does not expect to engage in any further real estate activities in the future. The earnings and funds generated from Harbour Village have been redeployed into the Company's insurance operations.

### *Payroll and Other Expenses*

Payroll and other expenses increased to \$6.4 million in the second quarter of 2005 compared to \$3.6 million for the same period of 2004. The change was primarily due to increases in expenses associated with regulatory audits and with Sarbanes-Oxley implementation. For the

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quarter ended June 30, 2005 the Company incurred \$300,000 for the implementation of Sarbanes-Oxley. In addition, in the second quarter of 2004, the Company collected \$2.6 million as final settlement of a notes receivable. This receipt was applied as a reduction to other expenses as in the fourth quarter of 2003 the Company had established an allowance for doubtful accounts.

### *Expenses due to Rescission*

During the second quarter of 2004, the Company received \$1.8 million in settlement of professional liability claims against parties who were involved in the Principal Management rescission litigation, as discussed in Part II, Item 1, Principal Management Rescission Litigation.

## **Six months Ended June 30, 2005 Compared to Six months Ended June 30, 2004**

### *Net Premiums Earned*

**Environmental.** Net earned premiums increased to \$18.5 million in the first six months of 2005 as compared to \$14.6 million in 2004. Net written premiums increased to \$24.1 million compared to \$17.7 million for the same time period. Most of the growth in this segment for the first six months of 2005 was attributable to increased production in the Company's Prostar online rating and quoting system, in addition to premium production in the Company's regional office in Denver, Colorado. During the second quarter of 2005, the Company opened a new regional office in Cleveland, Ohio. This office is staffed with two experienced environmental underwriters and will enhance the future growth prospects by expanding the Company's regional presence into the Midwest region. The Company has experienced a slight decline in premium rates over 2004 due to increased competition and the overall change in pricing conditions in the marketplace.

As a result of the Company's continuous review of underwriting profitability, the Company noted a recent increase in the loss ratio from accounts written in certain areas of New York. The Company therefore initiated stricter underwriting criteria and policy terms for this business and expect this initiative to result in a reduction in the Company's premium writings. The overall ultimate loss ratio for the environmental business has not been adversely affected by the New York business. The Company believes that the initiatives it has undertaken will improve the ultimate profitability of the unit. These actions will have a short-term adverse impact on growth in this unit and the Company is anticipating flat to modest growth for 2005. Despite the short-term impact from this initiative the Company is still optimistic about the long-term growth opportunities in this unit.

**Excess and Surplus.** Net earned premiums increased to \$40.9 million in the first six months of 2005 as compared to \$38.4 million in 2004. Net written premiums decreased to \$38.3 million compared to \$38.5 million for the same time period. Premium rates have leveled and in some cases have declined due to less business being shifted out of the standard markets and a softening of pricing in the marketplace. This has resulted in a reduction in the volume of new business and renewal retentions from 2004 levels. Despite the changing market, the Company has maintained its disciplined underwriting approach and policy terms and conditions have remained consistent. Construction risks make up a majority of the book of business written by the E&S unit and the insurance market for residential construction risks continues to offer modest growth opportunities. The Company's objective is to maintain underwriting and pricing discipline and monitor pricing conditions on an individual risk basis.

**Programs.** Net earned premiums increased to \$9.1 million for the first six months of 2005 as compared to \$7.7 million in 2004. Net written premiums increased to \$9.3 million compared to \$7.6 million for the same time period. One new program, a general liability program for small commercial artisan contractors, was added in the second quarter of 2005. The increase in net written premiums for the first six months of 2005 was primarily attributable to growth in fully funded policies where the Company acts as the policy issuing carrier and the insured collateralizes the policy aggregate limit. Fee income earned for the first six months of 2005 from fully funded policies was \$411,000 as compared to \$56,000 for the first six months of 2004. The Company's focus in the program business line is on insurance programs that allow the Company to participate in underwriting profits, while also earning fee income as the policy-issuing carrier.

**Other.** Net earned premiums decreased to \$0.6 million for the first six months of 2005 as compared to \$5.4 million in 2004. Net written premiums decreased to \$0.4 million compared to \$0.7 million for the same period of 2004. Premiums from the Company's other lines of business decreased as the Company's assumed liability program and workers' compensation business were put in run-off in 2004. This decrease was coupled with an increase in the Company's surety business. The surety business grew as it was offered as a supporting product line to the environmental segment.

### *Net Investment Income*

Net investment income increased to \$6.6 million in the six months ended June 30, 2005 from \$4.3 million in the six months ended June 30, 2004 due to higher levels of invested assets generated by positive cash flows from operations and an increased investment yield. Average

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invested assets increased to \$342 million from \$244 million. The average pre-tax and after tax yields were 3.8% and 3.1% compared to 3.5% and 2.8% for the first six months of 2005 and 2004 respectively. The increase in yield is consistent with the overall market rate increases.

### *Net Realized Gains and Losses*

Net realized gains and losses changed from a net gain of \$20,000 in the six months ended June 30, 2004 to a net loss of \$44,000 for the six months ended June 30, 2005. Sales of investments are generally the result of changing investment strategies to maximize investment income.

### *Real Estate Income*

Real estate income decreased to \$3 million for the six months ended June 30, 2005 compared to \$34.1 million for the same period of 2004. During the six months ended June 30, 2005, the Company closed the remaining units at Harbour Village. The Company does not expect to engage in any further real estate activities in the future. The earnings and funds generated from Harbour Village have been redeployed into the Company's insurance operations.

### *Losses and Loss Adjustment Expenses*

For the six months ended June 30, 2005, the Company's loss ratio decreased 9.7 points from 70.9% to 61.2%. This decrease was attributable to lower loss reserve development. For the six months ended June 30, 2005, adverse loss development decreased to \$1.1 million from \$9 million for the same period of 2004. For the six months ended June 30, 2004 the \$9 million adverse loss development consisted of \$4.7 million on the excess and surplus lines and \$4.3 million on discontinued lines. For the six months ended June 30, 2005 the \$1.1 million adverse loss development was on discontinued lines.

### *Acquisition Expenses*

Policy acquisition expenses increased to \$14 million for the six months ended June 30, 2005 from \$13.1 million for the six months ended June 30, 2004. Acquisition expenses as a function of net earned premiums were 20.3% for the six months ended June 30, 2005 compared to 19.8% for the six months ended June 30, 2004.

### *Real Estate Expenses*

Real estate expenses associated with Harbour Village decreased to \$2.7 million in the six months ended June 30, 2005 from \$28.5 million for the six months ended June 30, 2004. During the six months ended June 30, 2005, the Company closed the remaining units at Harbour Village. The Company does not expect to engage in any further real estate activities in the future. The earnings and funds generated from Harbour Village have been redeployed into the Company's insurance operations.

### *Payroll and Other Expenses*

Payroll and other expenses increased to \$11.9 million in the first six months of 2005 compared to \$8.3 million for the same period of 2004. The change was primarily due to increases in expenses associated with regulatory audits and the Sarbanes-Oxley implementation. For the six months ended June 30, 2005 the Company incurred \$425,000 for the implementation of Sarbanes-Oxley. In addition, in the second quarter of 2004, the Company collected \$2.6 million as final settlement of a notes receivable. This receipt was applied as a reduction to other expenses as in the fourth quarter of 2003 the Company had established an allowance was doubtful accounts.

### *Expenses due to Rescission*

During the second quarter of 2004, the Company received \$1.8 million in settlement of professional liability claims against parties who were involved in the Principal Management rescission litigation, as discussed in Part II, Item 1, Principal Management Rescission Litigation.

### *Minority Interest Expense*

Minority interest expense is associated with our non-subsidiary affiliate, American Safety RRG. In the past, given the historical loss position of American Safety RRG(RRG), a valuation allowance on its net deferred tax assets had been established. In the first quarter of 2005, RRG included in income the reduction of this valuation allowance (totaling \$554,515) as management's judgment about the realizability of its deferred tax assets changed due to RRG's profitability. As a result, minority interest for the first six months of 2005 increased to \$539,000 as compared to \$337,000 for the same period of 2004.

### *Income taxes*

The effective tax rate, excluding the effects of RRG described above, were 14% for the first six months of 2005 as compared to 14% for the same period of 2004.

### **Liquidity and Capital Resources**

The Company meets its cash requirements and finances its growth principally through cash flows generated from operations. Since 2000 the Company has operated in a hardening market with increased insurance premium rates for general liability coverages and increased fees for program business opportunities. During 2004, the Company began to experience a leveling of premium rates due to entrance of new insurance competitors and overall market conditions. The Company's primary sources of short-term cash flow are premium writings and investment income. 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, the Company's future liquidity requirements may vary; therefore, the Company has structured its investment portfolio maturities to allow for variations in those factors. The Company believes its current cash flows are sufficient for the short-term needs of its business and its invested assets are sufficient for the long-term needs of its insurance business.

Net cash provided from operations was \$31 million for the six months ended June 30, 2005, and \$44 million for the six months ended June 30, 2004. This decrease was caused by increased loss payments, which increased to \$25 million from \$12 million in the same period of 2004.

The estimated completion cost for the remainder of Harbour Village is approximately \$2 million and represents amounts needed to construct a beach club. Management believes that cash on hand will meet the remaining liquidity needs of Harbour Village.

The Company's ability to pay future dividends to shareholders will depend, to a significant degree, on the ability of its subsidiaries to generate earnings from which to pay dividends. The jurisdictions in which the Company and its 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 the Company's growth and the capital requirements associated with that growth, the Company does not anticipate paying dividends on the common shares in the near future.

### **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 United States subsidiaries are subject to taxation in the United States.

### **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 reserves to cover the unpaid portion of our ultimate 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 expense, 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. If, the net loss reserves were to increase by 5% this would reduce pre-tax income by \$18 million. If, the net loss reserves were to decrease by 5% this would increase pre-tax income by \$18 million.

With respect to reported claims, case 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 product line incurred but not reported (IBNR) 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 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 to produce expected losses, then applying loss payment and reporting patterns to the expected losses to produce the expected IBNR. 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.

## 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. 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.

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.

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

The Company's market risk has not changed materially since December 31, 2004.

### **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, the company 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 company also sought to retain funds and company stock escrowed as part of the transaction. Over the past five years the court ruled on several motions and issues. The result of the pretrial motions were orders dismissing the company's claims and holding that company should release \$685,000 of the remaining amounts in an escrow account to the defendants. The court declined to rule on the disposition of escrowed shares of stock. The company has appealed all of the adverse orders and ruling. The defendants have filed a post appeal motion with the trial court seeking to have the court enter a judgment for the \$685,000. In 2004 the company accrued \$1.4 million of additional expense as a result of previous adverse rulings and currently maintains this amount.

*Assumed Reinsurance Litigation.* The Company is a defendant in numerous lawsuits arising from certain reinsurance agreements, for the years 2002 and 2003, with an automobile warranty insurer which is now in liquidation. The insurer provided coverage to dealerships and other providers who sold extended automobile warranty contracts to consumer purchasers. In these lawsuits, the consumer purchasers and automobile dealers have alleged various theories of liability against the Company. The Company believes it has several valid defenses and intends to vigorously contest these lawsuits.

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*Harbour Village.* Donald Griggs et al. v. American Safety Reinsurance Ltd. Et al., Case No 2003-31509, Circuit Court, Seventh District, Volusia County, Florida. Seven plaintiffs filed suit against the Company and three of its subsidiaries seeking to recover a \$2,100,000 loan made by the plaintiffs in 1986 to Ponce Marina, Inc., the former owner of the Harbour Village property. The plaintiffs claimed that the Company was responsible for the repayment of the Loan, with interest. The plaintiffs propounded four theories of liability and the Court granted judgment for the Company on three of the theories. However, the Court entered judgment on August 10, 2005 against the Company for \$3,426,703.50, which includes interest, on the remaining theory that various actions of the plaintiffs with regard to their loan benefited the Company. The Court found that these benefits created a quasi-contract between the plaintiffs and the Company that required the Company to repay the loan, with interest.

The Company has reviewed the decision of the Court with outside legal counsel and plans to vigorously pursue an appeal. Based on the merits of the case and the likelihood of ultimate payment, the Company has not established an accrual for the decision.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On March 31, 2005, the Company announced a plan to repurchase 200,000 shares of the Company's common stock. Subject to availability, the transactions were made from time to time on the open market or directly from shareholders at prevailing market prices. All 200,000 shares were repurchased during the second quarter of 2005, thus terminating the program. An additional 1,573 shares were also repurchased.

The Company may adopt additional repurchase plans in the future.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares that May Yet Be Purchased Under the Plans
April 1 30, 2005	74,973	\$14.84	74,973	25,027
May 1 31, 2005	126,600	14.56	126,600	0
June 1 2005	0	0	0	0
Total	<u>201,573</u>	<u>\$ 14.79</u>	<u>201,573</u>	<u>0</u>

### Item 3. Defaults Upon Senior Securities

Not applicable.

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

None.

### Item 5. Other Information

None.

### Item 6. Exhibits

The following exhibits are filed as part of this report:

<u>Exhibit No</u>	<u>Description</u>
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11	Computation of Earnings Per Share
31.1	Certification Pursuant to ss.302 of the Sarbanes-Oxley Act of 2002
31.2	Certification Pursuant to ss.302 of the Sarbanes-Oxley Act of 2002
32.1	Certification Pursuant to ss.906 of the Sarbanes-Oxley Act of 2002
32.2	Certification Pursuant to ss.906 of the Sarbanes-Oxley Act of 2002

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 15<sup>th</sup> day of August 2005.

American Safety Insurance Holdings

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)

Exhibit 11

American Safety Insurance Holdings, Ltd. and subsidiaries

Computation of Earnings Per Share

	Three Months Ended		Six Months Ended
	June 30, 2004	June 30, 2005	June 30, 2004
Earnings available to common shareholders.....	\$ 4,096,769 =====	\$ 3,138,754 =====	\$ 7,746,588 =====



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Weighted average common shares outstanding.....	6,923,237	6,718,269	6,919,668
Basic earnings per common shares ...	\$ 0.59 =====	\$ 0.47 =====	\$ 1.12 =====
Earnings available to common shareholders.....	\$ 4,096,769 =====	\$ 3,138,754 =====	\$ 7,746,588 =====
Weighted average common shares outstanding.....	6,923,237	6,718,269	6,919,668
Weighted average common shares equivalents associated with options....	523,918	400,382	499,436
Total weighted average common shares.....	7,447,155 =====	7,118,651 =====	7,419,104 =====
Diluted earnings per common shares.....	\$ 0.55 =====	\$ 0.44 =====	\$ 1.04 =====

Exhibit 31.1

**Certification Pursuant to § 302 of the Sarbanes-Oxley Act of 2002**

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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) 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

(d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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 15, 2005

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

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Exhibit 31.2

**Certification Pursuant to § 302 of the Sarbanes-Oxley Act of 2002**

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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) 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

(d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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 15, 2005

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

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Exhibit 32.1

**Certification Pursuant to § 906 of the**

**Sarbanes-Oxley Act of 2002**

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, 2005, 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 § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350) and shall not be relied upon for any other purpose.

Date: August 15, 2005

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

A signed original of this written statement required by § 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 § 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 2002**

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, 2005, 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 § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350) and shall not be relied upon for any other purpose.

Date: August 15, 2005

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

A signed original of this written statement required by § 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 § 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 32.2 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.