

*Transforming people from absent  
or idle to present and productive*



## CORPORATE PROFILE

RTW, Inc. provides disability management services to: (i) employers insured through our wholly-owned insurance subsidiary, American Compensation Insurance Company; (ii) self-insured employers; (iii) state assigned risk plans; (iv) other insurance companies; and (v) on a consulting basis to agents and brokers.

We developed two proprietary systems to manage disability: (i) **ID15®**, designed to quickly identify those injured employees who are likely to become inappropriately dependent on disability system benefits; and (ii) **The RTW Solution®**, rapid intervention in and intensive management of potentially high-cost injuries, designed to lower employers' disability costs and improve productivity by returning injured employees to work as soon as safely possible. We support these proprietary management systems with state-of-the-art technology and talented employees dedicated to our vision of transforming people from absent or idle to present and productive. During 2004, we operated primarily in Minnesota, Michigan and Colorado and began servicing non-insurance customers in California and Indiana.

I am pleased to be writing to you this year at the helm of a growing organization. In all respects, 2004 was an exciting year. Net income totaled \$9.9 million or \$1.81 per fully diluted share. We grew net worth by \$9.9 million as well, increasing our book value per-share 23%. Our market value followed the growth in book value increasing 50% to \$49.6 million (\$9.32 per share) at December 31, 2004 from \$33.0 million (\$6.44 per share) at December 31, 2003.

## To Our Shareholders



### Our Approach

We lower employers' disability costs and improve productivity by returning injured employees to work as soon as safely possible. Our approach reduces medical expense and wage-replacement cost including time away from the job. We have been successful by concentrating our efforts in three key areas:

- ◆ Focusing on the 15% of injured employees that drive 80% of the system costs;
- ◆ Actively managing all participants in the system, including employers, employees, medical care providers, attorneys and the legal system; and
- ◆ Returning employees to work as soon as safely possible.

We use two proprietary tools successfully. First, **ID15®** enables us to identify immediately those individuals likely to become inappropriately dependent on disability system benefits. Secondly, **The RTW Solution®** process enables us to rapidly intervene in and intensively manage potentially high-cost claims. We support these proprietary tools with state-of-the-art technology and talented employees dedicated to our vision of transforming people from absent or idle to present and productive.

### Service Business

A year ago, we told you that we would diversify our products and transform the Company from insurance to service. Today, I can unequivocally say that we have progressed nicely along that path. We are excited about our future and the opportunities ahead of us. Accomplishments for our service business include:

- ◆ We named our services division, **Absentia<sup>SM</sup>**, to begin differentiating our service offerings from our insurance products. Absentia, by our definition is simply, the absence of absence.
- ◆ Service revenue grew to \$633,000 in 2004 from \$109,000 in 2003. More importantly, our service revenue trajectory is strong, doubling in both the third and fourth quarters of 2004. At year-end, we had signed contracts representing over \$5.0 million in annualized service revenue in place. (Servicing \$5.0 million in annualized service revenue is equivalent to providing approximately \$30.0 million in insurance premiums - nearly half of our insurance premiums in force).
- ◆ We expanded our service offerings. A year ago we offered only guaranteed cost workers' compensation insurance. Today, we provide eight different service offerings built upon our core competencies: **ID15**, **The RTW Solution** and our proprietary technology. Not only did we expand our service offerings, but we moved outside of workers' compensation into disability management as well.
- ◆ We broadened our definition of customer and provide services today not only to employers insured through our wholly-owned insurance subsidiary, American Compensation Insurance Company (ACIC), but further added: (i) self-insured employers; (ii) state assigned risk plans; (iii) governmental entities; (iv) other insurance companies; and (v) agents and brokers to our customer list.
- ◆ We expanded our reach beyond Minnesota, Michigan and Colorado offering services through **Absentia<sup>SM</sup>** to customers in California and Indiana. We expect to continue to expand our services throughout the United States.

### Insurance Operation

While I am energized by our service business, our insurance results are important too. We derive a substantial portion of our revenue from premiums earned on our workers' compensation insurance product.



We manage our insurance subsidiary conservatively. Protecting surplus and our A.M. Best rating is paramount. We buy insurance to cover claims that exceed \$200,000 in cost (in certain of our markets, that insurance is capped at \$20.0 million). We invest conservatively in taxable and tax-exempt fixed income securities, nearly all of which are rated AAA. We strive for consistent and conservative reserving.

Our American Compensation Insurance Company (ACIC) insurance subsidiary had a great year:

- ▶ Gross earned premiums grew 16% to \$63.4 million. Rate increases on renewing policies were hard to come by, increasing by less than 1%. Our competitors are lowering rates seeking to increase volume and cash flow. We will continue to underwrite for profit, even if it means lower volume.
- ▶ We improved our ability to manage old claims and released another \$7.0 million to income from previously recorded reserves. We experienced favorable development for three consecutive years and continue to reserve conservatively. These results are a tribute to the incredible passion, attention and creativity of our case and claims management teams.
- ▶ We grew policyholders' surplus in ACIC to \$38.5 million.
- ▶ The A.M. Best rating for ACIC was upgraded to B+ in March 2004.

Unlike other industries, neither size nor brand name determines our profitability. What counts is underwriting discipline and exceptional claim management. We run our insurance company for success over time, not for the moment. Success requires that we: (i) underwrite scientifically with unwavering discipline (too many organizations lose this focus and get themselves into trouble); (ii) manage claims exceptionally (not enough companies do this well); (iii) reserve conservatively; and (iv) avoid inappropriate exposures.

We believe that the following areas drive success in insurance:

- ▶ *Write for profit.* We know that the insurance industry becomes irrational and that some competitors will write at below-cost rates to chase cash flow. We avoid the pricing game by sacrificing business that will not allow us an appropriate chance at profit. We played the wrong game in the past and we suffered financially. We intend to avoid that same mistake again. We do not use market-share as a benchmark for success. "No" is the most important word in our underwriter's vocabulary. We write to achieve an expected profit, no matter what the competition does. Underwriting to an expected profit does not ensure success. Only a combination of: (i) the right price; (ii) exceptional claim management; and (iii) fortune in the severity of reported losses, results in profit.
- ▶ *Accept only risks that are in our niche.* Our niche? Employers with sub-par workers' compensation experience driven primarily by soft-tissue injuries.
- ▶ *Understand the markets in which we operate,* then, when points of inflection are noted, change to reflect the new dynamics.
- ▶ *Reserve conservatively.* Understanding underlying loss cost is vital in getting rates right. In workers' compensation, improper reserving promotes and prolongs incorrect pricing, mostly in an unpleasant direction. We are committed to reserving appropriately and early to properly reflect cost in our business. The ability to do so with reasonable accuracy is vital so that we can compare actual loss costs to the premiums being charged.

## Development

The term "development" is widely used in insurance. We receive many questions about our development and whether it is appropriate to include or exclude it in determining our normalized income for the year. Let me help describe where it comes from so you can make a more informed decision.

Insurance reserves are a liability on our balance sheet that state the estimated amounts that we expect to pay for workers' compensation claims that occurred prior to the reporting date but that are as yet unpaid. This liability includes estimates for both reported and unreported claims. In workers' compensation, claims extend over many years and it is difficult to

determine the ultimate cost of these reported and unreported events.

When it becomes evident that recorded reserves differ from the liability currently estimated, “development” occurs. Development may be either favorable or unfavorable.

We have recognized favorable development in each of the last three years and continue to manage claims to their best possible outcome, focusing on closing open claims. There is no guarantee of favorable development in the future.

## 2005, Positioning for the Future

In 2005, we are positioning ourselves to achieve sustainable, long-term success. To achieve that end, we will need to refine our sales and marketing strategy for our service offerings, enhance our technology to encompass our service operation and build hiring and training to accommodate future growth. In addition, we will:

- ◆ Maintain profitability in our insurance operation by writing policies at the right price and non-renewing unprofitable business. Competitors are offering lower rates (many that we believe are inadequate) in our markets. We will not follow those rates down to retain the premium. To offset some of that pressure, we will expand our insurance product offerings in 2005.
- ◆ Grow service revenue as we continue to diversify our product offerings and further leverage **ID15** and **The RTW Solution**.
- ◆ Brand and position our service offerings under the **Absentia<sup>SM</sup>** name.
- ◆ Continue to identify and engage strategic partners who can help us access customers and achieve success.
- ◆ Accomplishing these initiatives will position us well for the future and create value for our shareholders.

We, as an organization, will not attempt to talk the stock up or down. I think it is dangerous to predict the future publicly, and while I am frequently asked to do so by analysts and shareholders, I resist. Too often, predictions spread unwarranted optimism and lead to trouble. (Do you remember the late 1990's?) We will tell our story with passion and continue to publicly express our future vision. We will, however, accompany any comments with sensible caution. Frankly, I want to focus on growing this business, and do not want to lose that focus by trumpeting RTW's expected value. Over time, we expect to provide you a fair return for your continued loyalty.

We provide services that make a difference – not only to our employers, but also to their employees and society as a whole. We are very proud of our progress; however, we are not satisfied. Instead, we are energized by opportunity and our vision of the future. We continue to approach each new challenge head on with optimism, creating success through our tenacity and dedication to excellence in our business. We are excited about our future and look forward to reporting our achievements to each of you throughout 2005.

It wouldn't be right to close without thanking the groups that made 2004 successful. First, I am fortunate to be surrounded by an exceptional executive management team. I appreciate and thank each for the commitment and passion they continually exhibit in driving RTW to success. Secondly, I thank the members of our board for their ongoing support of our initiatives, guidance and maintaining focus on what is important. Most importantly, I thank each of the employees of RTW. RTW owes its success to their drive, desire and persistence in achieving our vision.

Thank you for your continued support and interest in all we do.

Sincerely,



Jeffrey B. Murphy

President and Chief Executive Officer





## CORPORATE INFORMATION

### Headquarters and Minnesota Regional Office

8500 Normandale Lake Boulevard  
Suite 1400  
Bloomington, MN 55437  
800-789-2242  
952-893-0403

### Website

www.rtwi.com

### Other Regional Offices

#### Colorado

7400 East Orchard Road  
Suite 170 South  
Englewood, CO 80111  
800-203-2610

#### Michigan

4000 Town Center  
Suite 300  
Southfield, MI 48075  
800-809-4337

3033 Orchard Vista Drive S.E.  
Suite 101  
Grand Rapids, MI 49546  
866-942-0021

### Transfer Agent

Wells Fargo Bank, Minnesota, N.A.  
South St. Paul, Minnesota

### Auditors

Ernst & Young LLP  
Minneapolis, Minnesota

### Legal Counsel

Lindquist & Vennum P.L.L.P.  
Minneapolis, Minnesota

### Notice of Annual Meeting

The RTW, Inc. Annual Meeting of Shareholders will be held on June 15, 2005 at 2:00 pm at the 8000 Building Normandale Office Park 8331 Norman Center Drive Bloomington, MN 55439

### Form 10-K

The Annual Report on Form 10-K filed with the Securities and Exchange Commission is available to stockholders at no charge on the Company's website at www.rtwi.com or by writing to Alfred L. LaTendresse Chief Financial Officer P.O. Box 390327 Minneapolis, MN 55439-0327

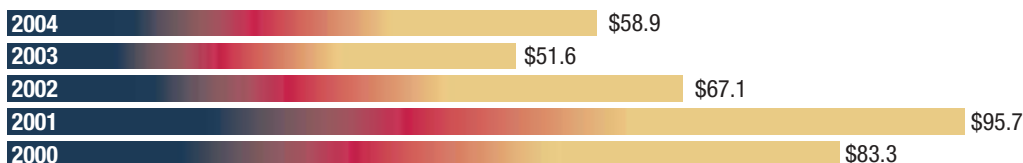
## FINANCIAL RESULTS

(Dollars in thousands, except per share data)

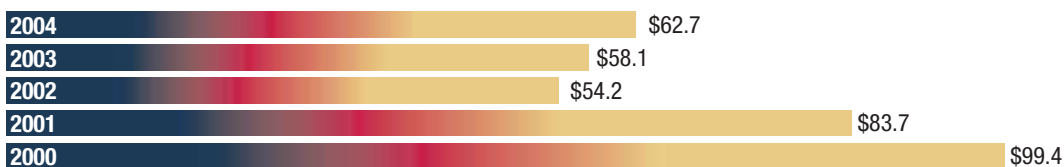
Fiscal year ended December 31,

|                                 | 2004     | 2003     | 2002     | 2001     | 2000     |
|---------------------------------|----------|----------|----------|----------|----------|
| Total revenues                  | \$58,857 | \$51,558 | \$67,146 | \$95,723 | \$83,299 |
| Income (loss) from operations   | 8,072    | 6,635    | 10,325   | (15,761) | (14,780) |
| Net income (loss)               | 9,941    | 6,999    | 14,319   | (25,215) | (9,708)  |
| Basic income (loss) per share   | 1.90     | 1.37     | 2.78     | (4.89)   | (1.79)   |
| Diluted income (loss) per share | 1.81     | 1.32     | 2.78     | (4.89)   | (1.79)   |
| Total assets                    | 220,507  | 202,168  | 223,834  | 218,307  | 194,535  |
| Notes payable                   | —        | —        | 1,250    | 4,500    | 7,000    |
| Total shareholders' equity      | 45,531   | 35,587   | 29,810   | 14,222   | 38,736   |
| Premiums in force               | 62,700   | 58,100   | 54,200   | 83,700   | 99,400   |

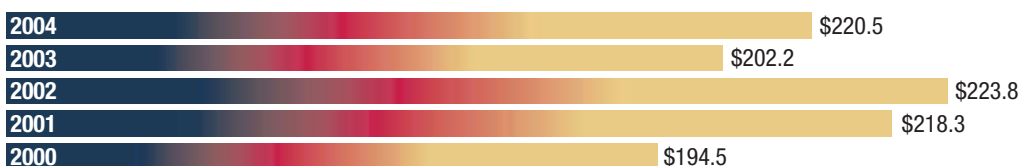
### REVENUE (in millions)



### PREMIUMS IN FORCE (in millions)



### ASSETS (in millions)



## DIRECTORS

**John O. Goodwyne**  
Chairman of the Board

**David C. Prosser**  
Chairman Emeritus

**Jeffrey B. Murphy**  
President and CEO

**William J. Deters**

**Gregory D. Koschinska**

**Vina L. Marquart**

**John W. Prosser**

## OFFICERS

**Jeffrey B. Murphy**  
President and CEO

**Alfred L. LaTendresse**  
Executive Vice President,  
Chief Financial Officer,  
Secretary and Treasurer

**Keith D. Krueger**  
Vice President –  
Insured Products

**David M. Dietz**  
Vice President –  
Absentia

**Patricia M. Sheveland**  
Vice President –  
Case and Claim Management

The RTW Solution®



## CORPORATE HEADQUARTERS AND MINNESOTA REGIONAL OFFICE

8500 Normandale Lake Boulevard  
Suite 1400  
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952-893-0403  
[www.rtwi.com](http://www.rtwi.com)



and staff physicians provide transitional job description restrictions. We train our customers' management return-to-work program.



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