

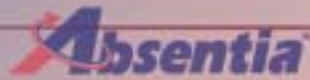


# 2005

ANNUAL REPORT

- Marketing
- Agency management
- Underwriting
- Loss prevention
- Policy issuance
- Pre-loss auditing
- Billing and collection
- Case and claims management
- Financial services

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



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## CORPORATE PROFILE

RTW, Inc. provides disability and absence management services to:

- (i) employers insured through our wholly-owned insurance subsidiaries, American Compensation Insurance Company and Bloomington Compensation Insurance Company; (ii) self-insured employers and employers with large deductibles; (iii) state assigned risk plans; (iv) other insurance companies; and (v) to agents and brokers on a consulting basis.



We developed two proprietary tools to increase productivity for employers:

- (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 who make it live.

# To The Shareholders of RTW, Inc.



RTW enters 2006 financially strong and well positioned for the future.

Early in 2004, we began to strategically reposition your Company, diversifying our revenue sources by focusing on opportunities that did not require an insurance solution. To increase intrinsic value to you, we looked for business that offered us strong operating margins, required little capital and provided significant growth potential. We

further understood the need to leverage our core competencies: **ID15<sup>®</sup>**, **The RTW Solution<sup>®</sup>**, proprietary technology and talented employees, to reduce workers' compensation and other disability costs and improve productivity for employers. We listened to customers and developed offerings that included insured solutions, third-party administration and customized solutions that range from pre-hire services to comprehensive absence management. We expected to learn quickly in 2004, and certainly did. In 2005 we positioned your Company to achieve sustainable, long-term growth and success. We refined our service offerings, created variable capacity, upgraded sales and marketing, enhanced our technology to support service and

insurance business, outsourced non-core processes and hired for the future. In short, we made significant progress, preparing RTW to grow in 2006 and beyond.

We reported strong earnings in 2005. Income before income taxes increased 24.9% to \$10.1 million from \$8.1 million in 2004. Net income totaled \$6.0 million or \$1.06 per fully diluted share. We grew net worth by \$5.0 million, increasing our book value per-share by 8.6%. Some other keys and successes in evaluating our 2005 performance:

- ◆ We focused on maintaining profit in our insurance operations and allowed gross earned premiums to decrease 5.5%. Competitors lowered rates seeking to increase volume and cash flow. Our insurance niche, with an average premium over \$90,000, is very competitive during a soft market cycle and it is not unusual to see competitors undercut our price by 20% or more. If we had chased premium growth by offering lower rates, our profit would have suffered significantly.
- ◆ While gross premiums earned decreased in 2005, we actually grew significantly. Service revenue grew 694% to \$4.4 million and contracts in place have an annualized run rate of \$6.6 million. If we had written the premiums underlying the service business we managed, gross premiums earned would have increased \$27.5 million which represents a 30% increase over 2004.
- ◆ We improved our ability to manage old claims and released \$5.5 million to income from previously recorded reserves. We continue to reserve conservatively. These results are a tribute to the incredible passion, attention and creativity of our employees.
- ◆ To compliment our primary insurance company, American Compensation Insurance Company (ACIC), we licensed and began writing in Bloomington Compensation Insurance Company (BCIC). BCIC provides us a competitive pricing tier to write ACIC customers whose lower workers' compensation costs merit lower rates.
- ◆ We grew policyholders' surplus in ACIC by \$5.1 million to \$43.6 million. ACIC continues to be a B+ rated carrier but was upgraded from a "stable" to a "positive" outlook by A.M. Best in 2005.

## Our View of Disability and Absence

Today, the direct expense of disability costs employers more than \$100 billion. This number is small in comparison to the less measured expense that absent employees cost the U.S. economy, estimated at \$260 billion. As a service provider and insurance carrier, we have proven our ability to reduce those numbers. We bring unique solutions to our customers to reduce their disability costs and improve their productivity. We transform long-standing paradigms and manage disability and absence differently by focusing on the person, not solely on the nature of the person's injury. Our key difference is identifying those people likely to become "inappropriately dependent on system benefits." Using **ID15<sup>®</sup>**, we identify early



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the psychosocial behaviors that exacerbate absence. Using **The RTW Solution®**, we intervene quickly to change outcomes. We have expanded beyond workers' compensation and are developing and adding skills that touch the entire absence spectrum to bring total value to our customers.

### **Service Business**

We grew our service business in 2005, positioning our people, partners and technology for the future. We continue to focus on those things that will further our progress along that path. The future is incredible and we are working to create new market space. We are excited and ready to seize the opportunity and are prepared for the challenges that lay ahead of us. Accomplishments in 2005 include:

Our **Absentia<sup>SM</sup>** service division has become more widely recognized. The services we provide are viewed as an added value and we are meeting more people that welcome our fresh approach.

We provide services today to: (i) employers insured through our wholly-owned insurance subsidiaries ACIC and BCIC; (ii) self-insured employers; (iii) state assigned risk plans; (iv) governmental entities; (v) other insurance companies; and (vi) agents and brokers.

We expanded our reach... in 2004 we serviced customers in 6 states. That count expanded to 18 by the end of 2005 and has grown to 24 today. We have 26 to go, but are well on our way.

### **Insurance Operations**

A substantial portion of our revenue is derived from premiums earned on our workers' compensation insurance products. We manage our insurance operations conservatively. Protecting surplus and our A.M. Best rating is paramount. We buy insurance from third parties to cover our claims that exceed \$200,000 and invest conservatively in high quality taxable and tax-exempt fixed income securities. We reserve consistently and conservatively.

Unlike other industries, neither size nor brand name determines our profitability. What counts is underwriting discipline and exceptional claim management. We operate our insurance companies for success over time, not for the moment. Success requires that we: (i) underwrite scientifically with unwavering discipline; (ii) manage claims exceptionally; (iii) reserve conservatively; and (iv) avoid inappropriate exposures.

We believe that the following strategies drive success in insurance:

- ◆ **Write for profit.** Insurers become irrational and competitors write at below-cost rates to chase cash flow. We write only business that gives us an appropriate chance at profit regardless of what our competitors do. "No" is an important word in our underwriting vocabulary. Underwriting to an expected profit does not ensure success – the 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 we understand.** In ACIC, we focus on employers with sub-par claim experience driven primarily by soft-tissue injuries. BCIC enables us to write transformed ACIC business at the right price. In 2006, we will add small accounts and association business, growing in historically dormant ACIC licensed states. Our ACIC experience provided invaluable ideas in launching the service side of our business and we are finding that our Absentia experience is fueling new opportunities in insurance.

- ◆ ***Understand the markets in which we operate.*** When we see the market changing, we will move quickly to take advantage of the new dynamics.
- ◆ ***Reserve conservatively and accurately.*** Understanding underlying loss cost is vital to pricing business correctly. Improper reserving promotes and prolongs incorrect pricing, more times negatively than not. We are committed to reserving appropriately and early to properly reflect cost in our business.

### Looking Forward to 2006

In 2006, we will grow both insurance and service revenue. We will execute on both fronts, growing the intrinsic value of your Company. We will continue to refine our sales and marketing strategy, further enhance our technology and hire and train to accommodate future growth. In addition, we will:

- ◆ Maintain profitability in our insurance operations writing policies at the right price.
- ◆ Grow service revenue as we continue to diversify our product offerings.
- ◆ Continue to identify and engage strategic partners who can expand our capabilities and help us access customers.

We add value; we improve our customer's bottom line; we make a difference. We made significant progress in the past two years transforming a static mono-line insurance operation to an agile, innovative company prepared to seize the opportunity we see in front of us today. We are proud of what we accomplished but are restless to do more. We have great energy driven by our vision of the future. We expect to face new unknowns, arrive with new ideas and will seek opportunities to further change the existing paradigm. We thrive on challenges, 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 2006.

In closing, I recognize that people drive our success. I am surrounded by exceptional executives and incredible employees that live our vision with passion and enthusiasm everyday. I appreciate all they contribute and thank them for the hard work and commitment they exhibit in driving RTW to success. Secondly, I thank each of the partners that we have grown with over the past two years – you have contributed greatly to our growth and learning. I thank the members of our Board for their continuing support of our vision and for their guidance and focus on the future.

Most importantly, thank you, our shareholders, for your ongoing-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  
866-940-0021

### 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 14, 2006 at 2:00 pm at the Crowne Plaza Hotel Minneapolis Airport West 5401 Green Valley Drive Bloomington, MN 55437

### 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](http://www.rtwi.com) or by writing to Alfred L. LaTendresse, Chief Financial Officer, P.O. Box 390327, Minneapolis, MN 55439-0327.

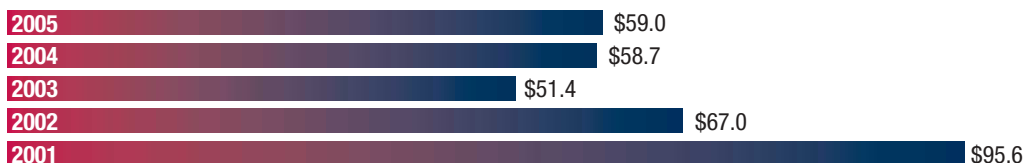
## FINANCIAL RESULTS

(Dollars in thousands, except per share data)

Fiscal year ended December 31,

	2005	2004	2003	2002	2001
Total revenues	\$59,011	\$58,687	\$51,383	\$67,023	\$95,570
Income (loss) from operations	10,079	8,072	6,635	10,325	(15,761)
Net income (loss)	5,998	9,941	6,999	14,319	(25,215)
Basic income (loss) per share	1.11	1.90	1.37	2.78	(4.89)
Diluted income (loss) per share	1.00	1.81	1.32	2.78	(4.89)
Total assets	228,471	220,507	202,168	223,834	218,307
Notes payable	—	—	—	1,250	4,500
Total shareholders' equity	50,578	45,531	35,587	29,810	14,222
Premiums in force	52,900	62,700	58,100	54,200	83,700

### REVENUE (in millions)



### PREMIUMS IN FORCE (in millions)



### ASSETS (in millions)



**CORPORATE HEADQUARTERS  
AND MINNESOTA REGIONAL OFFICE**

8500 Normandale Lake Boulevard  
Suite 1400  
Bloomington, MN 55437  
800-789-2242  
952-893-0403  
[www.rtwi.com](http://www.rtwi.com)

**DIRECTORS**

*(as of March 31, 2006)*

**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

**Thomas J. Byers**  
Executive Vice President –  
Sales and Marketing

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

**David M. Dietz**  
Vice President –  
Business Development

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



- Marketing
- Agency management
- Underwriting
- Loss prevention
- Policy issuance
- Premium auditing
- Bureau representation
- Premium collection
- Case and claims management
- Financial and statutory reporting



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