



## 2006 Annual Report



Returns.

Many Happy



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

## 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) 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) **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 give it life.



# Letter to Shareholders



Dear Fellow Shareholders:

There is a single common thread that runs through our core ... a theme that permeates our organization and the people who make it great. Our message is consistent and clear:

***We transform people from absent or idle to present and productive.***

Productivity losses due to employee absences cost U.S. employers more than \$260 billion each year. The direct cost of disability and insurance programs related to these absences cost employers another \$100 billion. **We change those numbers!** Our unique solutions reduce the direct costs associated with disability and improve productivity.

Every day, we work with people who sustain injuries - injuries that have the potential to change lives. These people come from many different industries and from all walks of life. By focusing on the person, rather than solely on the nature of the person's injury, we transform outcomes. With ID15®, we identify psychosocial behaviors that are likely to exacerbate absence. Using the RTW Solution®, we intervene quickly to change outcomes. We care about the people we touch and are passionate about the difference

we make – we reduce costs, we increase productivity and **we save lives.**

## Our Experience in 2006

We began to diversify RTW in 2004 to avoid the experience we endured during the last soft insurance market cycle. We identified opportunities that reduce workers' compensation and other disability costs and improve productivity for our customers while leveraging our core competencies: ***ID15®, RTW Solution®, proprietary technology and talented employees.*** Since that time, we have added non-insurance revenues that offer us strong operating margins and provide significant growth potential while requiring little capital. We are pleased with our progress in transitioning RTW from being purely a mono-line workers' compensation insurance company to becoming a diversified service organization. We believe we have positioned RTW to achieve sustainable, long-term growth and success.

During 2006:

- ▀ We focused on writing **insurance business** at rates that provided us a reasonable opportunity for profit and declined business that we believed was unreasonably priced. We allowed gross earned premiums to decrease to maintain bottom-line profit. Competitors continued to lower their prices, 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; and
- ▀ We grew **service revenue** to \$5.9 million. Despite decreased service revenue from the Minnesota Assigned Risk Plan (ARP), 2006 service revenue grew over 35 percent year-over-year and 2006 non-ARP service revenue grew over 110 percent.

We expected to grow service revenue quickly enough in the short-term to offset anticipated declines in premiums earned and cost increases related to growth in infrastructure. We were disappointed that this did not happen late in 2006. We expect to return to profitability in 2007.

Net income in 2006 totaled \$3.3 million or \$0.60 per fully diluted share, down from 2005. We grew net worth by \$800,000, increasing our book value per-share by 6.5 percent even after repurchasing 319,000 shares of our common stock in 2006 for \$3.3 million. Other 2006 accomplishments include:

- ▀ We completed and rolled out the re-write of our case and claims technology in September 2006. This technology now enables us to provide insurance solutions to our customers while supporting our service solutions as well;
- ▀ We improved efficiency by adjusting workflow and the supporting technology, resulting in increased and added capacity to prepare us for growth in both service and insurance revenue in 2007 and beyond; and
- ▀ We maintained a very strong balance sheet as we positioned our technology, organization and people for the future.

## Service Business Accomplishments

Challenged by shrinking service revenues from the Minnesota Assigned Risk Plan, we successfully grew our service business in 2006. We developed relationships with partners that add variable capacity as we grow. We are excited by what we see happening in our service business:

- We continued to expand our reach, providing services to customers with operations in over 30 states, up from 18 states at the end of 2005;
- We penetrated the ranks of the Fortune 500, adding two new Fortune 500 customers; and
- We continue to grow our referral business by gaining recognition for the outcomes we deliver.

## Insurance Business Accomplishments

- We continued to improve our ability to manage claims and released \$1.8 million to income from previously recorded reserves;
- The A.M. Best rating for our insurance subsidiary, American Compensation Insurance Company (ACIC), was upgraded to B++ “positive” from B+ “positive” in April 2006. Our new insurance subsidiary, Bloomington Compensation Insurance Company (BCIC), also received that rating; and
- We again grew policyholders’ surplus for our insurance subsidiaries, growing by \$3.0 million in 2006 to \$46.6 million.

## Our View of the Industry

We believe that the existing age-old market models need significant change. Competitors continue to deliver commodity services at commodity prices with little improvement in cost or productivity to employers. With medical costs increasing at double digit rates and indemnity costs changing with wage inflation, it is more important than ever to find ways to transform outcomes. Our solutions change long-standing paradigms as we provide improved results to employers. What we do is very different and delivers incredible value, not just commodity results. **We are changing the way business is done and managing disability differently.** We focus on the key drivers of claim outcomes - people and their behaviors. We are changing that age-old way of doing business, one customer at a time!

## A Current Assessment

We are deep into a soft insurance market cycle. We believe some insurers are again chasing top line revenue and cash flow by writing business at what we believe to be below-cost prices. Writing profitable insurance business requires steadfast focus, disciplined underwriting and exceptional claim management. In light of the soft market cycle, growing service revenue is more important than ever.

## Growing Service Revenue

We deliver our services to employers through the Absentia® division of RTW. We create for employers “the absence of absence.” Our solutions dramatically reduce direct costs associated with workers’ compensation and disability while improving productivity. Our service business requires minimal capital and is expected to provide us strong operating margins as we grow. Absentia provides us incredible growth potential while decreasing our reliance on premiums earned from workers’ compensation insurance.

We have built a solid pipeline of service opportunities and are expanding our sales and marketing strategy beyond larger customers, who have much longer sales cycles. We are building sales and account management, adding the capability to sell customers regionally and increasing our focus on middle market employers where our experience shows the sales cycle to be shorter. We have worked diligently to seize the available market opportunity and are prepared for the challenges that lay ahead of us. We expect another year of double-digit service revenue growth in 2007.

to Work.

## Growing Premiums Earned

Our revenue continues to be dominated by premiums earned on our workers' compensation insurance products. We are committed to the profitability, health and long-term growth of our insurance operations. We manage our insurance operations conservatively, protecting surplus and our A.M. Best rating. 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 exercise discipline in underwriting, manage claims exceptionally, reserve conservatively and avoid inappropriate exposures.

We expect to experience challenges in insurance pricing in the near term and will be prudent in writing insurance business until we see strengthening in insurance rates. In our historical niche, top line insurance revenue will continue to be subject to pricing pressure in 2007. We expect to reverse the trend in our premiums by:

- ▀ Increasing agent submissions through new marketing efforts with existing agency partners and writing more business as a result, at appropriate prices and retaining business that might otherwise non-renew. Since January 1, 2007, we are seeing increased submission flow, higher retention rates and more new business opportunities; and
- ▀ Continuing to grow our small account book. Outside our traditional Minnesota, Michigan and Colorado markets, we have been writing small accounts and association business. With our business partners, we have expanded this business to ten states where we are licensed but had not been writing insurance business. We believe these niches are less vulnerable to below-market pricing during a "soft market" than our traditional niche markets and will provide us an opportunity to build a book of business that will provide a strong base in all market conditions.

## What You Can Expect in 2007

We are pleased with our progress and believe we have developed the platform for a great future; however, we cannot rest on our laurels. We will continually evaluate our progress, adjusting our approach as we go to ensure that we have the right people and processes at the right place and time. We will continue to grow geographically and add capability to touch more states. We will visit our vision religiously to help us drive change in the company today.

We are committed to growing service revenue in a very meaningful way in 2007 by expanding our sales and marketing strategy and leveraging our existing pipeline of opportunities. We are also committed to growing insurance - prudently, marketing more effectively with our existing agent plant and adding small account business at a growing rate. We will continue to improve our ability to deliver and provide services that differentiate RTW from the industry.

People are the key to ensuring our success. Today, I am pleased to report that I am surrounded by an exceptional executive management team whose dedication and loyalty to our mission and vision is unwavering and steadfast. We are, in turn further surrounded by enthusiastic and passionate employees that live our vision every day and make it a reality. I appreciate all they contribute and thank them for the hard work and commitment in driving RTW to success. I am pleased to have the opportunity work with such an incredible group of people and fortunate to lead an organization that makes the kind of difference we do each day.

I am excited about where we find ourselves and our company. In a short time, we have transformed RTW from being a mono-line workers' compensation insurance company to an agile, innovative forward-looking service organization. We are proud of our accomplishments but realize there is much more to do. We are energized and driven by our vision of the future. We expect new challenges and new unknowns. We will thrive by breaking from the past, arriving with new ideas and solutions that will further change the existing paradigm. We believe RTW is well-positioned for continued success. As more companies realize the savings they can capture by approaching an old problem with a new solution, our business will grow and prosper.

Thank you for your ongoing support of the Company.



Jeffrey B. Murphy  
President and Chief Executive Officer

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## 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 13, 2007 at 2:00 pm at the 8000 Building of Normandale Lake Office Park, Skyway Classroom, located at 8331 Norman Center 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,				
	2006	2005	2004	2003	2002
Total revenues	\$53,872	\$59,011	\$58,687	\$51,383	\$67,023
Income from operations	5,222	10,079	8,072	6,635	10,325
Net income	3,288	5,998	9,941	6,999	14,319
Basic income per share	0.62	1.11	1.90	1.37	2.78
Diluted income per share	0.60	1.06	1.81	1.32	2.78
Total assets	218,439	228,471	220,507	202,168	223,834
Notes payable	—	—	—	—	1,250
Total shareholders' equity	51,355	50,578	45,531	35,587	29,810
Premiums in force	47,500	52,900	62,700	58,100	54,200

### 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**

**Lyron L. Bentovim**

#### 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**  
Chief Operating Officer

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

**Patricia M. Sheveland**  
Vice President –  
Product Development,  
Quality and Compliance

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