



Builders Mutual[®]
INSURANCE COMPANY

Where Builders Come First[®]

MESSAGE TO OUR POLICYHOLDERS.



BMIC Leadership Team:

President/CEO/General Counsel

John Q. Beard with Vice

Presidents John Boggs (CFO),

Steve Gregg (CIO), Mike Gerber

(CMO), and Don Johnson (COO).

» TO OUR POLICYHOLDERS

Two decades have passed since Builders Mutual began serving the residential building industry. Our third decade begins by strengthening our dedication to our agents and policyholders, new and old. The programs and policies we put in motion in 2003 were yielding tangible results throughout 2004. These efforts, known collectively as “Service Outside the Box,” will continue in the future and be refined as needed so that we never lose sight of why we’re in business: you, our customer.

Other insurance companies have come and gone over the years, but Builders Mutual will always be here for you. The competitive market place has become more crowded recently – all the more reason to emphasize and renew our special relationship with our policyholders and agents and our commitment to them.

- Our field personnel ratio is the highest in the industry. This hands-on, personal approach is unrivaled and greatly valued by our customers.
- We use technology not for its own sake, but to enhance our service to our customers. The improvements to Builders Online Business in 2004 illustrate how we anticipate developing technology to improve ease of doing business.

Additionally, Builders Mutual has a solid financial foundation, including a consistently high rating from A.M. Best, coupled with competitive rates. This results from our devoting more than two decades to a single mission – service to homebuilders.

We anticipate a strong, healthy future and look forward to serving you in the years to come.



Donald Betworth

DONALD BETSWORTH
Chairman of the Board



John Q. Beard

JOHN Q. BEARD
President/CEO/
General Counsel

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SERVICE IN A CLASS OF ITS OWN: THAT'S SERVICE OUTSIDE THE BOX.

This past year, Builders Mutual has spent a great deal of time and effort looking inward on behalf of our customers, assessing their needs and how we had been addressing them. Our recent efforts have been focused on improving our business processes and managing our extraordinary growth; 2004 became a year of self-evaluation, the results of which led to a company-wide initiative to deliver superior customer service across the board — and outside the box.

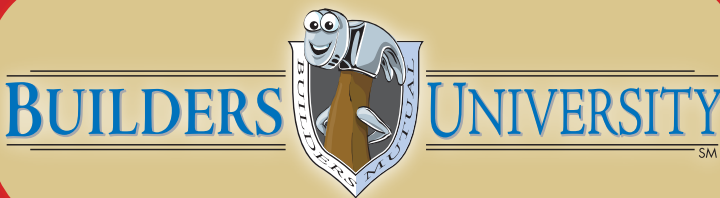


» BU OPENS DOORS TO EMPLOYEES

Builders University was established in 2003 as a resource to provide our agents and policyholders with ongoing education and training unique to the insurance industry. In 2004, its curriculum was expanded to include Builders University for Employees. In support of the Company's commitment to meeting our customers' needs, the initial focus of the curriculum was dedicated to enhancing our employees' customer service skills. Every Builders Mutual employee attended at least one of the six sessions; more than 81% achieved the designation of **Certified Customer Service Professional** by completing all six sessions. This specialized training was a critical component of the **Campaign '04 Customer Service**, conducted throughout much of the year. Designed to elicit feedback internally and from agents and policyholders, the campaign identified a number of areas that received an

unprecedented level of attention from employees and management. Only by dedicating all of our resources and energy to enhancing customer service could we hope to deliver **Service Outside the Box**.

"By establishing a standard to adhere to, the company will be better able to track and measure its performance," notes Vice President/Chief Marketing Officer Mike Gerber. "When we establish a relationship with a policyholder or agent, we take on a commitment from day one. 'Service Outside the Box' helps us define how we are living up to that commitment." An example of this commitment is a firm **24-Hour Callback Policy** now in place: calls placed to Builders Mutual before noon will be returned the same day, and calls placed after noon will be returned no later than noon the following business day.



The only school of its kind in the industry, Builders University provides education and training to our customers, agents and employees.

» BU FOR AGENTS AND POLICYHOLDERS

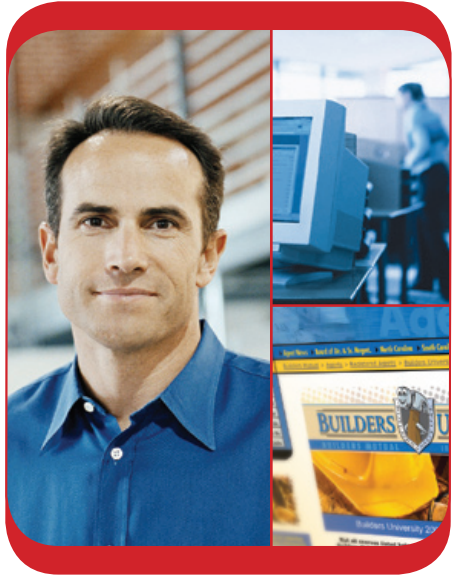
From its beginnings as a forum to provide education and training for our agency partners, Builders University for Agents illustrates how Builders Mutual remains dedicated to the independent agency system. Through the University, we are able to provide the tools and information necessary to help our agency partners attract and retain business. Attendance climbed to more than 1,000 at classes that were held in our four states; the first graduating class will earn Certified Builders Insurance Agent designations in 2005.

By extending this training to policyholders, Builders University now offers similar competitive advantages for our policyholders. Training in risk management and safety has always been a primary focus of our Company; now, Builders University incorporates much of the previous training and education efforts of the risk management program and enhances them with additional and frequently updated materials, in areas such as quality control, job site safety and OSHA compliance.

MEETING YOUR NEEDS FACE-TO-FACE: THAT'S SERVICE OUTSIDE THE BOX.

We believe that to best serve our unique niche market we must work with our agents and policyholders with a “hands-on” approach. By having staff geographically located near our customers, we understand their individual needs. From our Territory Managers who work daily with our agency partners to our Risk Management and Premium Audit teams who support our policyholders in managing their insurance exposures, Builders Mutual values the daily interaction that is centered around meeting the insurance needs of those in the residential building industry.

We depend on the input from our producers, customer service representatives and agency principals to meet customers’ needs. Our Agency Producers Councils meet throughout the year including an annual joint meeting where Builders Mutual’s senior leadership provides a forum for face-to-face discussion on critical issues. Armed with this information, Builders Mutual has been able to improve ease of doing business, enhance our product offerings and develop those important partner relationships.



Without agents like Jim, Builders Mutual would lack a critical connection to our core customer. Providing Service Outside the Box means we listen to Jim and respond to his needs and concerns with both face-to-face communication and business-enhancing training and technology. When he succeeds, so do we.

Input from our policyholders is just as important. “What better way to understand our customers than to meet with them face-to-face, in their own offices and on their own jobsites,” states Don Johnson, Vice President/Chief Operating Officer. “From Taylorstown, Virginia to Taylors, South Carolina, and from Jackson, Tennessee to Jacksonville, North Carolina, our Risk Management and Premium Audit teams are available and accessible at all times.”

From our agency partners to our policyholders, and from our employees who are serving customers from inside the Home Office to outside in the field, a hands-on approach furthers our Service Outside the Box.

» **20 YEARS OF CONTINUOUS DEDICATION: THAT'S SERVICE OUTSIDE THE BOX**

Builders Mutual reached a milestone in 2004: 20 years of providing uninterrupted coverage exclusively to the home building industry. "Where Builders Come First" has been the focus of our attention since 1984, when the company grew out of the North Carolina Home Builders Association to provide workers' compensation to eligible members. Since then, the coverage has expanded and the territory has broadened, but the focus has remained the same.

As always, we remain committed to the independent agency system and the exclusive relationships we have with our agents. Our agents have been a vital component of our growth and success since day one, providing valuable feedback on behalf of themselves and their customers through forums such as

Producers Councils. We credit this input with a number of improvements in how we do business through the years.

Builders Mutual's close ties to the Home Builders Association, in North Carolina and other states, is one of the reasons for our consistency and stability. As the mission of the Home Builders Association is to foster and promote a healthy home building economy and protect the interests of those in the industry, it benefits our company and our customers to align ourselves with such an influential organization. Through this long-term association, we are better able to ensure continuous financial stability and stick to our goal of providing superior coverage and customer service for the next 20, 40 or even 60 years.



Builders Online Business is another example of how we use technology to improve your ease of doing business.

» **USING TECHNOLOGY ON YOUR BEHALF: THAT'S SERVICE OUTSIDE THE BOX**

Builders Mutual believes it's not enough to stay current on technology; we must also anticipate the future technology and communication needs of our customers. To that end, we are constantly researching new ways to streamline, simplify and generally improve ease of doing business with and within Builders Mutual. It's one more facet of superior customer service.

Builders Online Business (BOB) was upgraded continuously throughout 2004. Originally designed to offer online quoting, BOB has received two significant enhancements: Client Look-Up and Builders Risk One-Shot. **Client Look-Up** allows agents to access their customers'

relevant data in an instant, from loss runs to payment history and claim information. **Builders Risk One-Shot** – inspired by the input from our Producers Councils – allows agents to process Builders Risk coverage for qualifying customers on the spot with unprecedented ease. "The agents on our Producers Councils told us what they wanted and we delivered," said Vice President/Chief Information Officer Steve Gregg. "In the past, 'outside the box' was another way of saying 'unexpected.' In the future, we want Builders Mutual customers to not only expect Service Outside the Box, but come to depend on it."

FINANCIAL SUMMARY

The following are statements of financial position and results of operations of Builders Mutual Insurance Company for the fiscal year ended December 31, 2004, assessed by management and supplementing the 2004 Annual Statement.

Builders Mutual has experienced significant growth the last several years and 2004 was no exception. Net premiums written grew by 9.2% in 2004, following growth of 25.2% and 69.0% in 2003 and 2002 respectively. Even with the pressures on operations associated with growth, the surplus of the Company grew by 5.9% before considering surplus notes issued by the Company in 2004. Management is committed to improving overall profitability to allow the Company to again return a dividend to its policyholders in a future period.

» FINANCIAL POSITION

ASSETS

Assets grew \$58.4 million due to increased premium volume, positive cash flows, issuing a surplus note, and investment returns. Virtually all asset growth is reflected in investments. The Company sold selected equities to reduce equity market volatility exposure and reinvested the proceeds in bonds.

LIABILITIES

Liabilities increased \$45.3 million. Loss and loss adjustment expense (LAE) reserves grew \$35.0 million due to losses related to the continued premium growth and due to the annual re-evaluation of losses from prior accident years. Reserve increases are net of \$4.6 million of favorable development on prior accident year loss and LAE reserves.

POLICYHOLDERS' SURPLUS

Policyholders' surplus growth of \$13.1 million is comprised primarily of net income of \$5.2 million combined with the issuance of an \$8.0 million surplus note. The current surplus note, along with a \$12.0 million surplus note issued in 2003, was issued to enhance our written premiums to surplus ratio. Several prior year adjustments result in a net decrease in surplus of \$2.4 million. The prior year adjustments were mostly offset by unrealized gains, change in net deferred income taxes, and change in non-admitted assets.



Surplus grew 34% over this four-year period (exclusive of surplus notes in 2003, 2004).

» RESULTS OF OPERATIONS

Premiums earned grew by \$15.7 million. The premiums earned growth, while significant, was less than the prior two years as the company strived to return to a more modest level of growth.

The Loss and LAE ratio (which encompasses all lines of business and all accident years) increased modestly in 2004. This reflects the continued maturation of business written during the Company's expansion (2001-2003). The expansion business has not contributed the same level of favorable development as pre-expansion (prior to 2001) business. The Company believes the 2004 business will ultimately out perform the 2001-2003 business based on implemented profitability measures.

Other underwriting expenses increased by \$8.1 million, or 1.7% of net premiums written. Several items contributed to the increase. Personnel necessary to support the company's expansion increased in 2003 and 2004 resulting in salary and benefit expenses increasing by \$1.8 million.

Commission expense increased \$1.8 million due to increased premium volume. The remainder of the increase was spread throughout multiple expense categories.

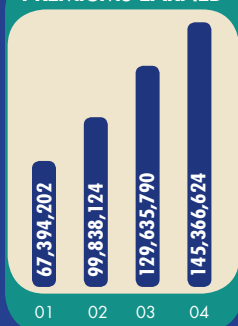
Net investment income increased by \$5.4 million of which \$4.9 million was net realized capital gains from the sale of equities.

No dividends were declared by the Board of Directors in 2004. The Board considers numerous factors when declaring a dividend including the quality and amount of surplus growth, underwriting gain or loss and net income. The majority of the Company's 2004 net income related to realized investment gains, which are reclassifications within surplus from unrealized gains, rather than true operating income to the company.

"The Company remains strong financially with a Risk-Based Capital ratio of 4.9 to 1," notes Vice President/Chief Financial Officer John Boggs. "Management has already taken steps to increase underwriting profits."

BALANCE SHEET

| | 2004 | 2003 |
|--|----------------------|----------------------|
| ASSETS | | |
| Bonds | \$265,320,641 | \$190,782,594 |
| Common and preferred Stocks | \$40,280,531 | \$52,579,023 |
| Cash and short-term Investments | \$27,552,733 | \$31,338,075 |
| Real estate | \$8,803,518 | \$9,155,450 |
| Premium balances | \$29,704,756 | \$26,316,794 |
| Other assets | \$14,510,020 | \$17,634,807 |
| TOTAL ASSETS | \$386,172,199 | \$327,806,743 |
| LIABILITIES AND POLICYHOLDERS SURPLUS | | |
| Unpaid Losses and Loss Adjustment expenses | \$209,319,981 | \$174,298,587 |
| Unearned Premiums | \$25,469,403 | \$22,633,488 |
| Other Liabilities | \$39,795,794 | \$32,395,090 |
| TOTAL LIABILITIES | \$274,585,178 | \$229,327,165 |
| TOTAL POLICYHOLDERS SURPLUS | \$111,587,021 | \$98,479,578 |
| TOTAL LIABILITIES AND POLICYHOLDERS SURPLUS | \$386,172,199 | \$327,806,743 |

PREMIUMS EARNED


Premiums earned increased by 115.7% over this four-year period, mostly due to expansion of product offerings and operating states.

STATEMENT OF INCOME

| | 2004 | 2003 |
|---|----------------------|---------------------|
| STATEMENT OF INCOME | | |
| Premiums earned | \$145,366,625 | \$129,635,790 |
| Losses and LAE incurred | \$99,478,591 | \$87,701,017 |
| Underwriting expenses | \$48,195,047 | \$40,050,930 |
| Underwriting gain | \$(2,307,013) | \$1,883,843 |
| INVESTMENT INCOME | | |
| Net investment gain | \$13,911,335 | \$8,508,446 |
| Other expenses | \$2,328,503 | \$3,773,779 |
| Surplus distribution expense | \$33,957 | \$2,387,745 |
| Income before income taxes | \$9,241,862 | \$4,230,765 |
| Federal income tax expense | \$3,997,486 | \$3,970,940 |
| NET INCOME | \$5,244,376 | \$259,825 |
| CHANGES IN POLICYHOLDERS SURPLUS | | |
| Unassigned surplus, beginning of year | \$98,479,578 | \$71,742,611 |
| Net income | \$5,244,376 | \$259,825 |
| Net unrealized capital gains (loss) | \$429,518 | \$11,128,197 |
| Change in net deferred income tax | \$1,065,298 | \$8,325,797 |
| Change in non-admitted assets | \$938,580 | \$(4,984,852) |
| Change in surplus notes | \$8,000,000 | \$12,000,000 |
| Other, including prior year adjustments | \$(2,570,327) | \$8,000 |
| UNASSIGNED SURPLUS, END OF YEAR | \$111,587,023 | \$98,479,578 |

PROFITABILITY ANALYSIS

| | 2004 | 2003 |
|--|-------|-------|
| Loss and LAE Ratio (Losses+LAE)/Net premiums earned | 68.4% | 67.7% |
| Underwriting Expense Ratio Underwriting expenses/Net premiums written | 31.2% | 29.5% |
| Dividend Ratio Policyholders dividends/Net premiums earned | 0.0% | 1.8% |
| Combined Ratio Loss & LAE Ratio + Underwriting Expense Ratio + Dividend Ratio | 99.7% | 99.0% |
| Operating Ratio (Net investment income earned/Net premiums earned) | 93.3% | 92.5% |

BOARD OF DIRECTORS & MANAGEMENT

» 2005 BOARD OF DIRECTORS

- Don Betsworth**, Chairman
Don Betsworth Homes, Inc.
Summerfield, NC
- Rick Judson**, Vice Chairman
Evergreen Home Builders
Charlotte, NC
- Greg Isenhour**, Secretary/Treasurer
Isenhour Enterprises
Chapel Hill, NC
- David Creech**
Creech Construction Co., Inc.
Raleigh, NC
- Jonathan Elliot**
Arran Realty
Fayetteville, NC
- George Henson**
Henson Construction, Inc.
Hickory, NC
- Willard "Buddy" Hughes**
Hughes Construction Co.
Lexington, NC
- Robert Ingraham**
Robert Ingraham Homes, Inc.
Charlotte, NC
- Herschel Redding**
D.J. Redding Co., Inc.
Rural Hall, NC
- David Stormont**
Stormont & Co., Inc.
Kitty Hawk, NC
- Carl "Pogie" Worsley**
Carl Worsley Company
Nags Head, NC

» SENIOR OFFICERS & DEPARTMENT DIRECTORS

- John Q. Beard**
President/Chief Executive Officer/
General Counsel
- John Boggs**, CPA
Vice President/Chief Financial Officer
- Michael Gerber**
Vice President/Chief Marketing Officer
- Don Johnson**, CPA
Vice President/Chief Operating Officer
- Steve Gregg**
Vice President/Chief Information Officer
- Kyle Bonestell**
Director - Information Services
- Charles Burton**, SPHR
Director - Human Resources
- Michael Carter**, CPCU, APA
Director - Premium Audit
- Dan Clark**, CIA
Director - Internal Audit
- Darcy Dye**
Director - Marketing
- Charmaine German**
Director - Product Development
- Allen Houck**, CPA
Controller
- John Parrish**
Director - Sales and Agency Relations
- Judy Rogers**, CPCU, CIC
Director - Underwriting
- Ken Shivar**
Director - Claims
- Laurie Trumbo**
Director - Premium Accounting
- Bill Walker**, CPEA
Director - Risk Management



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