AFFORDABLE RESIDENTIAL COMMUNITIES INC
Form 424B3
December 27, 2006
Filed Pursuant to Rule 424(b)(3)
Registration No. 333-139237

PROSPECTUS

AFFORDABLE RESIDENTIAL COMMUNITIES INC.

1,950,000 SHARES OF COMMON STOCK

This prospectus relates to the possible issuance by us from time to time of up to 1,950,000 shares of our common stock in exchange for Series C preferred partnership interests (the Series C Preferred Units) in Affordable Residential Communities LP, our operating partnership, if and to the extent that one or more of the holders of Series C Preferred Units tenders such units for redemption pursuant to their contractual rights. We are registering the shares of our common stock to provide the holders of Series C Preferred Units with freely tradable securities in the event we elect to make such an exchange. The registration of the shares of our common stock covered by this prospectus does not necessarily mean that any of the holders of Series C Preferred Units will exercise their redemption rights or that upon any such redemption we will elect, in our sole and absolute discretion, to exchange some or all of the Series C Preferred Units for shares of our common stock.

We will receive no proceeds from any issuance of the shares of our common stock covered by this prospectus, but we will pay all registration expenses.

Our common stock is listed on the New York Stock Exchange under the symbol ARC. The last reported sale price of our common stock on the New York Stock Exchange on December 20, 2006 was $11.00 per share.

INVESTING IN OUR COMMON STOCK INVOLVES RISKS. YOU SHOULD CAREFULLY CONSIDER THE RISK FACTORS BEGINNING ON PAGE 6 OF THIS PROSPECTUS BEFORE YOU MAKE AN INVESTMENT IN OUR COMMON STOCK.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is December 27, 2006

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement which we filed with the Securities and Exchange Commission, or SEC, using a shelf registration process. Under this shelf process, the Company may from time to time issue shares of our common stock, as described in this prospectus. We will not receive any proceeds from the issuance of shares of our common stock pursuant to this prospectus. This prospectus provides you with a general description of the securities the Company may issue. You should read both this prospectus and the additional information described under the heading Where You Can Find More Information beginning on page 58.

Unless the context otherwise requires, in this prospectus the terms ARC, the Company, we, us or our refer to Affordable Residential Communities Inc. and its consolidated subsidiaries. OP or operating partnership refers to Affordable Residential Communities LP, our operating partnership subsidiary. The term NLASCO refers to the business of NLASCO, Inc. and its consolidated subsidiaries and controlled affiliates.

You should rely only on the information contained in or incorporated by reference in this prospectus. We have not authorized anyone to provide you with information different from that contained in or incorporated by reference in this prospectus. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our common stock.

PROSPECTUS SUMMARY

The following summary highlights selected information contained elsewhere in this prospectus and may not contain all of the information that is important to you. We encourage you to read this prospectus together with additional information described under the heading Where You Can Find More Information in its entirety. You should pay special attention to the Risk Factors section of this prospectus.

The Company

Affordable Residential Communities Inc., also referred to as ARC or the Company, is a Maryland corporation that is engaged in the acquisition, renovation, repositioning and operation of primarily all-age manufactured home communities, the retail sale and financing of manufactured homes, the rental of manufactured homes and other related businesses, including acting as agent in the sale of homeowners insurance and related products, primarily to residents or prospective residents of ARC communities. ARC was organized in July 1998 and operates primarily through Affordable Residential Communities LP, or the OP, and its subsidiaries, of which ARC is the sole general partner and owned 96.5% as of September 30, 2006. Through the years ended December 31, 2005, ARC was organized as a fully integrated, self-administered and self-managed real estate investment trust, or REIT, for U.S. federal income tax purposes. In March 2006, ARC s board of directors decided to revoke the Company s election as a REIT for U.S. federal income tax purposes.

As of September 30, 2006, ARC owned and operated 276 communities (excluding one community classified as discontinued operations) consisting of 57,375 homesites in 24 states with occupancy of 83.3%. ARC s five largest markets are: Dallas-Fort Worth, Texas, with 12.5% of total homesites; Atlanta, Georgia, with 8.7% of total homesites; Salt Lake City, Utah, with 6.6% of total homesites; the Front Range of Colorado, with 5.7% of total homesites; and Kansas City-Lawrence-Topeka, with 4.2% of total homesites. ARC also conducts a retail home sales business.

ARC s common stock is traded on the New York Stock Exchange under the symbol ARC. ARC s Series A Cumulative Redeemable Preferred Stock is traded on the New York Stock Exchange under the symbol ARC-PA. ARC has no public trading history prior to February 12, 2004.

ARC s principal executive, corporate and property management offices are located at 7887 E. Belleview Avenue, Suite 200, Englewood, Colorado 80111, and ARC s telephone number is (303) 383-7500. ARC s Internet address is www.aboutarc.com. The information contained on ARC s website is not part of this prospectus.

Recent Developments

Acquisition of NLASCO, Inc.

ARC and ARC Insurance Holdings Inc., a subsidiary of ARC, which we refer to as Buyer, on the one hand, and C. Clifton Robinson, C.C. Robinson Property Company, Ltd. and The Robinson Charitable Remainder Unitrust, which we refer to as the Sellers, on the other hand, have entered into the Stock Purchase Agreement, dated as of October 6, 2006, which we refer to as the NLASCO Agreement. Subject to the terms and conditions of the NLASCO Agreement, at the closing we will purchase from Sellers all of the outstanding shares of capital stock of NLASCO in exchange for cash in the amount of $105,750,000 and 1,218,880 shares of our common stock, which shares will be issued to Mr. Robinson and will be placed into escrow pursuant to an escrow agreement. We refer to this transaction as the NLASCO acquisition. The purchase price will be subject to adjustments based on (1) the GAAP stockholders equity of NLASCO as of the closing date as finally determined by the parties and (2) the amount of actual losses as of the 36-month anniversary of the closing date for claims arising out of events or circumstances that occurred or existed on or prior to the closing date, compared to the reserves for losses as reflected on the closing balance sheet for both reported claims and for incurred but not reported claims.

Prior to the closing, and subject to any necessary regulatory approvals or third party consents, Sellers will cause NLASCO to make a dividend or distribution to Sellers in an aggregate amount equal to the excess of (1) the estimated date stockholders equity over (2) $71,009,382. At closing, NLASCO will repay approximately $5.6 million aggregate principal amount of outstanding debt.

NLASCO is a Delaware corporation that specializes in providing fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the south, southeastern and southwestern United States. NLASCO operates two insurance subsidiaries, National Lloyds Insurance Company, which we refer to as NLIC, and American Summit Insurance Company, which we refer to as ASIC. NLIC is rated A (Excellent) by A.M. Best Company, and ASIC is rated B++ (Very Good) by A.M. Best. NLIC, chartered in 1948 and licensed in 18 states, is an insurance company on the Lloyd s plan domiciled in Texas. NLIC underwrites fire and limited homeowner s insurance through approximately 4,800 independent agents. Through approximately 1,800 independent agents and selected managing general agents, which we refer to as MGAs, ASIC offers homeowners and property and casualty insurance primarily to manufactured home owners. NLASCO s policies are typically written for actual cash value of up to $250,000 in the low value dwelling market and replacement cost of up to $125,000 in the manufactured home market. Liability on a homeowners policy typically provides coverage up to $100,000 with a maximum of $300,000 issued by a few select agents. The vast majority of NLASCO s property policies currently exclude coverage for water and mold and provide actual cash value payments as opposed to replacement costs. NLASCO has an experienced management team, a high quality agency force and an established track record of growth and underwriting profitability.

Investment by Flexpoint Fund, L.P.

On October 6, 2006, ARC and Flexpoint Fund, L.P., or Flexpoint, which is managed by Flexpoint Partners, LLC, entered into a stock purchase agreement, which we refer to as the Flexpoint Agreement. Flexpoint Partners, LLC, or Flexpoint Partners, is an equity investment firm based in Chicago, Illinois that focuses on the financial services and healthcare industries. Donald Edwards, the Managing Principal of Flexpoint Partners, is the former Chief Executive Officer of First Acceptance Corporation, a non-standard auto insurance company, and is experienced in insurance company operations and related matters. Under the terms of the Flexpoint Agreement, Flexpoint has agreed to purchase 2,087,683 shares of our common stock for $9.58 per share, subject to certain anti-dilution provisions, for aggregate proceeds of approximately $20 million. The per share purchase price of $9.58 is based on the volume-weighted average sale price of ARC shares for the period September 21, 2006 to October 4, 2006, the ten day period immediately preceding our board of directors meeting on October 5, 2006. Flexpoint s commitment to this purchase is conditioned upon the closing of the NLASCO acquisition and stockholder approval, as well as certain other conditions set forth in the Flexpoint Agreement. The Company will also reimburse Flexpoint Partners for its costs and expenses associated with the due diligence and negotiation of the NLASCO Agreement. Flexpoint Partners assisted the Company in the sourcing, due diligence and negotiation of the NLASCO acquisition and the NLASCO Agreement on a non-compensated basis. Gerald J. Ford, who is one of our directors and the beneficial owner of 17.6% of our common stock and who has entered into the Investment Agreement, is a limited partner of Flexpoint, having committed $50 million of total committed funding of $225 million. As a limited partner of Flexpoint, Mr. Ford is pari passu with all other limited partners of Flexpoint and has no financial interest in, or management authority of, Flexpoint Partners, which manages Flexpoint. Upon the closing under the Flexpoint Agreement, Flexpoint will have the right to appoint an observer to ARC s board of directors. It is anticipated that Flexpoint Partners will continue to assist the Company in the future regarding the Company s insurance-related operations.

Stockholder Rights Plan

On July 11, 2006, we entered into the Stockholder Rights Plan, or Rights Plan, under which one right was distributed as a dividend for each share of our common stock held by stockholders of record as of the close of business on July 17, 2006. The Rights Plan was adopted as a means to preserve the use of previously accumulated net operating losses and other carryovers, or NOLs, as described below. Effective with the revocation of our REIT election in March 2006, we have been taxed as a corporation for U.S. federal income tax purposes and our net income has been subject to taxation at regular (or alternative minimum) corporate rates without the benefit of a dividends paid deduction. We have NOLs from prior years that are expected to offset substantially our taxable income, if any. Therefore, the preservation of such NOLs is the key to minimizing our U.S. federal income tax liability. U.S. federal income tax law imposes significant limitations on the ability of a corporation to use its NOLs to offset income in circumstances where such corporation has experienced a change in ownership. Generally, there is a change in ownership if, at any time, one or more 5% stockholders have aggregate increases in their ownership in the corporation of more than 50 percentage points looking back over the prior three year period. One of the principal reasons for adopting the Rights Plan is to preserve the use of our NOLs by dissuading investors from aggregating ownership in ARC and triggering such a change in ownership. The Rights Plan is designed to reduce the likelihood of a change in ownership by, among other things, discouraging any person or group from acquiring additional shares such that they would beneficially own 5% or more of the outstanding shares of our common stock. The Rights Plan was not adopted in response to any effort of which we are aware to acquire control of the Company. Under the Rights Plan, each right initially will entitle stockholders to purchase a fraction of a share of preferred stock at a purchase price of $50.00, subject to adjustment as provided in the Rights Plan. Subject to the exceptions and limitations contained in the Rights Plan, the rights generally will be exercisable only if a person or group acquires beneficial ownership of 5% or more of our common stock or commences a tender or exchange offer upon consummation of which such person or group would beneficially own 5% or more of our common stock. Unless earlier terminated, the Rights Plan will expire on July 17, 2016. At a special meeting to be held on January 23, 2007, the Company s stockholders will vote on whether to approve an amendment to the Company s charter to restrict certain acquisitions of the Company s securities in order to preserve the benefits of the Company s NOLs for tax purposes. The Company s board of directors intends to terminate the Rights Plan if the charter amendment is approved.

Rights Offering

On December 8, 2006, in connection with our previously announced $80 million rights offering, our board of directors authorized a special dividend consisting of rights to purchase 10 million shares of our common stock to all holders of record of our common stock as of 5:00 p.m., New York City time, on December 19, 2006, the record date. In the rights offering, we will distribute to each holder of record of our common stock on the record date, at no charge, one non-transferable subscription right for each share of common stock they own. Each right will entitle a holder to purchase 0.242 shares of our common stock at the subscription price of $8.00 per share. As fractional shares of our common stock will not be issued, in order to acquire one share of our common stock in the rights offering, a rights holder will need to hold at least five rights. The rights offering will expire at 5:00 p.m., New York City time, on January 23, 2007, unless extended by our board of directors.

Investment Agreement

On October 13, 2006, we entered into the Investment Agreement, which we refer to as the Investment Agreement, with Gerald J. Ford, one of our directors and the beneficial owner of approximately 17.6% of our common stock, ARC Diamond, LP, or ARC Diamond, an affiliate of Mr. Ford, and Hunter s Glen/Ford, Ltd., or Hunter s Glen/Ford, also an affiliate of Mr. Ford, pursuant to which Mr. Ford and

ARC Diamond, who are currently ARC stockholders, have agreed not to exercise their subscription rights to purchase 1,760,000 shares of our common stock that they will receive in the rights offering. Instead, Mr. Ford and ARC Diamond have agreed to purchase the shares of our common stock that they otherwise would have been entitled to subscribe for in the rights offering in a private placement directly from us at the same price per share as in the rights offering. Pursuant to the Investment Agreement, Hunter s Glen/Ford has agreed to backstop the rights offering, meaning it has agreed to purchase all shares of common stock that remain unsubscribed for in the rights offering, other than shares which are covered by rights distributed to Mr. Ford and ARC Diamond, at the same price per share as in the rights offering. At a special meeting of the Company s stockholders to be held on January 23, 2007, our stockholders will vote on whether to approve the issuance and sale of our common stock under the Investment Agreement. If the issuance and sale of our common stock under the Investment Agreement is not approved at the special meeting, then the rights offering will be cancelled. The rights offering is not conditioned upon the consummation of the NLASCO acquisition. Any shares purchased by Mr. Ford, ARC Diamond and Hunter s Glen/Ford pursuant to the Investment Agreement, which are included in the 10 million shares, will not be covered by the registration statement and will be acquired in a private placement.

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The Offering

Securities offered	Up to 1,950,000 shares of our common stock that may be issued from time to time at our election to holders of Series C Preferred Units of our operating partnership, or OP, upon redemption of such Series C Preferred Units Affordable Residential Communities LP issued such Series C Preferred Units on June 30, 2004 in connection with its acquisition of 36 manufactured home communities from D.A.M. Master Entity, L.P. Holders of Series C Preferred Units have the right to have their units redeemed for a combination of cash and a note, as more fully described in Redemption of Units beginning on page 45 of this prospectus, at any time after January 1, 2007, subject to our prior and independent right to acquire some or all of such units tendered for redemption in exchange for a number of shares of our common stock equal to the aggregate liquidation value of such units divided by the average closing market price of a share of our common stock for the ten consecutive trading days immediately preceding the date of redemption, with cash paid in lieu of any fractional share.
Use of proceeds	We will not receive any proceeds upon any issuance of shares of our common stock pursuant to this prospectus.
New York Stock Exchange symbol	ARC
Risk factors	Before investing in our common stock, you should carefully read and consider the information set forth in Risk Factors beginning on page 6 of this prospectus and all other information appearing elsewhere and incorporated by reference in this prospectus and any accompanying prospectus supplement.

RISK FACTORS

Before you invest in our common stock, you should be aware that there are various risks, including those described below. You should consider carefully these risk factors together with all of the other information included or incorporated by reference in this prospectus before you decide to redeem your Series C Preferred Units. The following Risk Factors could adversely affect our revenue, expenses, net income, cash flow, ability to pay or refinance our debt obligations, ability to make distributions to our stockholders, and/or the per share trading price of our common stock.

Risks Related to the Redemption of your Series C Preferred Units

The exchange of Series C Preferred Units for our common stock is a taxable transaction. In general, if you tender all of your Series C Preferred Units for redemption, you will recognize taxable gain or loss in an amount equal to the difference between the amount realized on the transaction and your adjusted tax basis in your tendered units. The amount realized will be an amount equal to the sum of any cash, the fair market value of any note and any shares of common stock you receive plus the allocable share of the operating partnership s liabilities allocated to your tendered Series C Preferred Units. Any tax liability resulting from such gain could exceed the amount of cash and the fair market value of any note and any shares of common stock received by you. In addition, if you tender less than all of your Series C Preferred Units and the operating partnership redeems such tendered units with cash (which is not contributed by ARC to effect the redemption), you will not recognize any taxable loss. If you exercise your redemption right with respect to Series C Preferred Units within 2 years of the date that you transferred property to the operating partnership in exchange for such units, your exchange of property for Series C Preferred Units could be treated, in whole or in part, as a disguised sale of your property to the operating partnership in the year of such transfer and must be reported to the Internal Revenue Service, or the IRS. In such a case, you would be required to recognize gain or loss on such disguised sale in the year that you transferred property to the operating partnership. In addition, if you receive shares of our common stock in exchange for tendered Series C Preferred Units, you will not be able to use income and loss from your investment in our common stock to offset passive income and losses from other investments, and distributions with respect to common stock will constitute taxable income to the extent of ARC s earnings and profits.

The particular tax consequences to you of a redemption will depend upon a number of factors related to your individual tax situation, including your tax basis in your Series C Preferred Units, whether you dispose of all of your units, and whether the passive loss rules apply to your investments. Because the income tax consequences of tendering Series C Preferred Units will not be the same for everyone, you should consult your tax advisor before determining whether to tender your units for redemption.

The exchange of Series C Preferred Units for our common stock may potentially change your investment. If you exercise your Series C Preferred Unit redemption right, we will determine whether you receive cash, cash and a note, or common stock in exchange for your units. If you receive common stock, you will become a stockholder of ARC rather than a Series C Preferred Unit holder in the operating partnership. There are some differences between the ownership of Series C Preferred Units and ownership of shares of our common stock. See Comparison of Series C Preferred Units and Common Stock. Further, since the price of the common stock fluctuates, the price you receive when you sell your common stock may not equal the value of the Series C Preferred Units at the time of the redemption.

Risks Related to the Securities Markets and Ownership of ARC s Common Stock

Additional issuances of equity securities and exchange of our Senior Exchangeable Notes, or Notes, for our common stock will dilute the ownership interest of our existing stockholders, including former Note holders who had previously exchanged their Notes for common stock.

The exchange of some or all of the Notes will dilute the ownership interests of our existing stockholders, including former Note holders who had previously exchanged their Notes for common stock. Any sales in the public market of our common stock to be issued upon such exchange of Notes could adversely affect the prevailing trading price of our common stock. In addition, the existence of the Notes may encourage short selling by market participants because the exchange of the Notes could depress the price of our common stock. We anticipate issuing equity in the future in connection with the rights offering, the Investment Agreement, the Flexpoint Agreement and the NLASCO Agreement. We also may issue equity in the future in connection with strategic transactions, including acquisitions, to adjust our ratio of debt-to-equity, including through repayment of outstanding debt, to fund expansion of our operations, upon exchange of the Notes, or for other purposes.

Our historic cash distributions to our common and preferred stockholders have exceeded our operating cash flows.

For the 24 months ended December 31, 2005, our annual cash distribution to common stockholders and quarterly distributions to preferred stockholders and the Operating Partnership s distributions to its limited partners have exceeded our operating cash flows. We funded these distributions from a combination of operating cash flows, cash generated from senior fixed and variable rate mortgage debt incurred in connection with the completion our IPO in February 2004, other borrowings, and sales of assets. On September 21, 2005, the board of directors announced that it had eliminated the quarterly dividend on our common stock and units in the OP units for the quarter ending September 30, 2005 and no common stock dividend was declared for the quarters ended December 31, 2005, March 31, 2006, June 30, 2006 and September 30, 2006. Unless operating cash flows increase substantially, we may be required to (1) continue to eliminate cash distributions or (2) fund future cash distributions to our stockholders or the OP s limited partners from other borrowings, sales of some of our properties, and/or other available financing sources or we will have to reduce such distributions. If we use working capital or proceeds from such other borrowings, sales of some of our properties, or other available financing sources to fund these distributions, this will reduce the availability of these funds for other purposes, including repurchase of the notes and the purchase of homes necessary to implement our programs for increasing occupancy. This could adversely affect our financial condition and results from operations and ability to expand our business and further fund our operating and growth initiatives, any of which could adversely affect the market price of the Notes and our common stock.

Our common stock price may experience substantial volatility, which may affect your ability, following any exchange, to sell our common stock at an advantageous price.

The market price of our common stock has been and may continue to be volatile. For example, the market price of our common stock on the NYSE has fluctuated for the period from January 1, 2006 to September 30, 2006 between $8.83 per share and $11.16 per share and may continue to fluctuate. Therefore, the volatility may affect your ability to sell our common stock at an advantageous price. Market price fluctuations in our common stock may be due to acquisitions, dispositions or other material public announcements, including those regarding dividends or changes in management, along with a variety of additional factors including, without limitation, other risks identified in Risk Factors and Forward Looking Statements. In addition, the stock markets in general, including the NYSE, recently have experienced extreme price and trading fluctuations. These fluctuations have resulted in volatility in the market prices of securities that often have been unrelated or disproportionate to changes in operating performance. These broad market fluctuations may adversely affect the market price of our common stock.

Risks Related to the Rights Offering, the Investment Agreement and the Flexpoint Agreement

The subscription price determined for the rights offering may not be indicative of the fair value of our common stock.

The subscription price for our common stock in the rights offering was set by our board of directors. In determining the subscription price, our board of directors considered a number of factors, including: our need for capital to complete the NLASCO acquisition; our business prospects; the need to offer shares of common stock at a price that would be attractive to our stockholders relative to the current trading price of our common stock; the historic and current market price of our common stock; general conditions in the securities market and any difficulty in market conditions prevailing for the raising of equity capital; the likely cost of capital from other sources; our operating history; and the liquidity of our common stock. In conjunction with its review of these factors, our board of directors also reviewed analyses of prior rights offerings by other public companies, including the range of discounts to market value represented by the subscription prices in those rights offerings. The subscription price does not necessarily bear any relationship to the book value of our assets, net worth, past operations, cash flows, losses, financial condition or any other established criteria for fair value. You should not consider the subscription price as an indication of the fair value of our common stock. After the date of this prospectus, our common stock may trade at prices above or below the subscription price.

Stockholders who do not exercise their subscription rights will experience a dilution of their relative ownership interests.

The rights offering is designed to enable us to raise capital while allowing the holders of our common stock on the record date for the rights offering to maintain their relative proportionate voting and economic interests in the Company, before giving effect to the NLASCO acquisition and the Flexpoint transaction. Gerald J. Ford, one of our directors and the beneficial owner of approximately 17.6% of our outstanding common stock, and ARC Diamond, one of Mr. Ford s affiliates, have agreed to purchase the shares of our common stock that they would otherwise have been entitled to receive pursuant to the subscription privilege in the rights offering in a private placement directly from us and not to exercise the subscription rights to purchase 1,760,000 shares of our common stock that they receive in the rights offering. In addition, Hunter s Glen/Ford has agreed to backstop the rights offering, meaning that it will purchase any shares of common stock that remain unsold in the rights offering, other than shares issuable under the subscription rights of Mr. Ford and ARC Diamond, at $8.00, the subscription price per share for the rights offering. To the extent that a stockholder does not exercise its rights and shares of common stock are purchased by other stockholders in the rights offering, such non-participating stockholders proportionate voting interest will be reduced, and the percentage that such stockholders original shares of common stock represent of our expanded equity after the rights offering will be diluted, before giving effect to the NLASCO acquisition or the Flexpoint Agreement. If Mr. Ford and ARC Diamond purchase the shares of our common stock under the Investment Agreement, no stockholders exercise their subscription rights and Hunter s Glen/Ford backstops the rights offering in full and the issuance and sale of our common stock under the NLASCO Agreement and the Flexpoint Agreement are completed, then Gerald J. Ford s beneficial ownership interest in ARC will increase to approximately 31.6% from approximately 17.6%, and the ownership interest of the remaining current stockholders, who currently own in the aggregate approximately 82.4% of our common stock, will decrease to approximately 62.3%. In the event that Mr. Ford and ARC Diamond purchase the shares of our common stock under the Investment Agreement, no stockholders exercise their subscription rights and Hunter s Glen/Ford backstops the rights offering in full but the issuance and sale of our common stock under the NLASCO Agreement and the

Flexpoint Agreement are not completed, then Gerald J. Ford s beneficial ownership interest in our common stock will increase to approximately 33.6%, and the remaining current stockholders ownership interest will decrease to approximately 66.4%.

The issuance and sale of our common stock pursuant to the Flexpoint Agreement and the NLASCO Agreement will result in the dilution of the relative ownership interests of our other stockholders.

Pursuant to the Flexpoint Agreement, Flexpoint has agreed to purchase 2,087,683 shares of our common stock for $9.58 per share, subject to certain anti-dilution provisions. In addition, we will issue approximately 1,218,880 shares of our common stock to C. Clifton Robinson pursuant to the NLASCO Agreement upon the closing of the NLASCO acquisition. After giving effect to the issuance and sale of our common stock in the rights offering (and assuming pro rata exercise of our stockholders in the rights offering) and under the Investment Agreement and the issuance and sale of shares of our common stock under the Flexpoint Agreement and the NLASCO Agreement, Flexpoint will beneficially own approximately 3.9% of our outstanding common stock and Mr. Robinson will beneficially own approximately 2.2% of our outstanding common stock. As a result, the ownership interest of our other common stockholders, other than Mr. Ford and his affiliates, who currently own in the aggregate approximately 82.4% of our common stock, will decrease to approximately 77.4%.

If we are unable to obtain the approval of our stockholders for the Investment Agreement or the Flexpoint Agreement, we will be required to obtain alternative sources of financing for our acquisition of NLASCO, and if we cannot obtain alternate financing, we could be unable to close the NLASCO acquisition or be in breach of the NLASCO Agreement.

The Investment Agreement will ensure that ARC receives the full proceeds contemplated by the rights offering. If the issuance and sale of our common stock under the Investment Agreement is not approved, we do not plan to complete the rights offering. The purpose of the rights offering is to raise capital to fund a portion of the purchase price of NLASCO, and it is intended that the issuance and sale of our common stock pursuant to the Flexpoint Agreement will fund an additional portion of the purchase price of NLASCO. Under the terms of the NLASCO Agreement, our obligation to consummate the NLASCO acquisition is not conditioned on the completion of the rights offering or the issuance and sale of shares of our common stock under the Investment Agreement or the Flexpoint Agreement or on our ability to obtain alternative financing. If the NLASCO acquisition is not consummated and it is determined, pursuant to the terms of the NLASCO Agreement, that we did not use our reasonable best efforts to obtain sufficient financing to consummate the NLASCO acquisition, then we will have breached the NLASCO Agreement and may be required to pay damages, up to specified maximum amounts, to the Sellers. In addition, we will have diverted significant financial and management resources in an effort to complete the NLASCO acquisition, for which we will have received little or no benefit. We are required to use our reasonable best efforts to obtain sufficient financing in order to avoid a breach of the NLASCO Agreement and, if the issuance and sale of our common stock under the Investment Agreement or the Flexpoint Agreement is not approved, we will have to seek alternative sources of financing. Alternative sources of financing may not be available at all or may be available only on unfavorable terms and the process of seeking alternative sources of financing could divert the attention of our management from day-to-day business operations. If we are determined to have breached the NLASCO Agreement, our business, financial condition and results of operations could be materially adversely affected.

If Gerald J. Ford significantly increases his beneficial ownership percentage in the Company as a result of the rights offering, such increase could impact our board s determination that he is independent .

In accordance with the definitional criteria of the Sarbanes-Oxley Act of 2002, which we refer to as SOX, and the rules and regulations of the New York Stock Exchange, which we refer to as the NYSE, a majority of our directors on our nine-director board are deemed to be independent. Failure to maintain an independent board of directors could result in the delisting of our common stock from the NYSE, which could result in there being no public market for shares of our common stock. In as much as Mr. Ford and ARC Diamond have agreed to purchase shares of our common stock under the Investment Agreement and Hunter s Glen/Ford has agreed to backstop the rights offering (meaning that it would purchase any shares of common stock that remain unsold in the rights offering at the same subscription price per share), Mr. Ford may significantly increase his beneficial ownership in the Company. A significant increase in Mr. Ford s beneficial ownership could impact our board s determination as to whether he is an independent director. In addition, Mr. Ford s affiliation with other independent directors Carl B. Webb and James R. Randy Staff could impact our board s determination that they are independent. If our board determines that Messrs. Ford, Webb and Staff are not independent, then we would have to increase the number of independent directors on our board in order to remain compliant with NYSE listing requirements, or we would not meet the same and could be subject to delisting. Recruiting independent directors could require the dedication of significant management resources, which may temporarily distract management s attention from our day-to-day business. In addition, adding directors to our board would make it more difficult and more expensive for us to maintain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to maintain coverage. If we are unable to maintain adequate director and officer insurance, our ability to recruit and retain qualified officers and directors, especially those directors who may be deemed independent for purposes of the rules and regulations of SOX and the NYSE, will be significantly curtailed.

Risks Related to the NLASCO Acquisition

Our management has limited prior experience operating an insurance company like NLASCO and therefore may have difficulty in successfully and profitably operating NLASCO or complying with regulatory requirements applicable to insurance companies.

Our management has limited experience operating an insurance company like NLASCO or complying with regulatory requirements applicable to insurance companies like NLASCO. Operating an insurance company is complex. The insurance industry is highly competitive and has historically been characterized by periods of significant price competition, alternating with periods of greater pricing discipline during which competitors focus on other factors. In addition, insurance companies are subject to comprehensive regulation and supervision in those states in which they write insurance policies and in which they are domiciled. Significant changes in the political and regulatory climate could result in changes in these laws and regulations and could make it more expensive or less profitable for us to manage an insurance company. Because we could encounter difficulties in operating an insurance company and complying with regulatory requirements applicable to insurance companies, you should be especially cautious in drawing conclusions about the ability of our management team to execute its business strategies as they relate to this acquisition.

We may fail to realize many of the anticipated potential benefits of the NLASCO acquisition.

We will not receive any anticipated benefits of the NLASCO acquisition if it does not close, and achieving the anticipated benefits of the acquisition will depend in part upon whether we can integrate NLASCO s operations into our own in an efficient and effective manner. We may not be able to accomplish this integration process smoothly or successfully. The necessity of coordinating geographically separated organizations and addressing possible differences in corporate cultures and management philosophies may increase the difficulties of integration. The integration of certain operations following the acquisition will require the dedication of significant management resources, which may temporarily distract management s attention from day-to-day business. Employee uncertainty and/or lack of management focus during the integration process may also disrupt our business and NLASCO s business.

Any inability of our management to integrate successfully NLASCO s operations into our own could have a material adverse effect on our business and results of our operations. We may not be able to achieve the anticipated cross-selling opportunities, the development and marketing of more comprehensive insurance product offerings, cost savings, revenue growth or the consistent use of our best practices. A failure of our due diligence process to identify significant issues with respect to product quality and development, information technology, and legal and financial contingencies or other liabilities could lead to unanticipated complications. Such complications could result in significant losses since the acquisition is structured as a stock purchase in which we will assume substantially all of the liabilities of NLASCO. An inability to realize the full extent of, or any of, the anticipated benefits of the acquisition, as well as any delays encountered in the integration and transition process, could have an adverse effect upon our revenues, level of expenses and operating results, which may affect the value of our common stock after the closing of the acquisition.

Our ability to use net operating loss carryovers to reduce future tax payments may be limited.

Our NOLs may be limited if the Company undergoes an ownership change. Generally, an ownership change occurs if certain persons or groups increase their aggregate ownership in the Company by more than 50 percentage points looking back over the prior three-year period. If an ownership change occurs, our ability to use our NOLs to reduce income taxes is limited to an annual amount (Section 382 limitation) equal to the fair market value of our common stock immediately prior to the ownership change multiplied by the long term tax-exempt interest rate, which is published monthly by the Internal Revenue Service, or IRS. In the event of an ownership change, NOLs that exceed the Section 382 limitation in any year will continue to be allowed as carryforwards for the remainder of the carryforward period and such excess NOLs can be used to offset taxable income for years within the carryforward period subject to the Section 382 limitation in each year. Whether or not an ownership change occurs, the carryforward period for NOLs is either 15 or 20 years from the year in which the losses giving rise to the NOLs were incurred. If the carryforward period for any NOL were to expire before that NOL had been fully utilized, the unused portion of that NOL would be lost. Our use of new NOLs arising after the date of an ownership change would not be affected by the Section 382 limitation (unless there were another ownership change after those new NOLs arose).

Based on our knowledge of shareholder ownership of ARC, we do not believe that an ownership change has occurred since our IPO that would limit our post-IPO NOLs. Accordingly we believe that there is no annual limitation under Section 382 of the Internal Revenue Code of 1986, or the Internal Revenue Code, imposed on our use of post-IPO NOLs to reduce future taxable income. Our pre-IPO NOLs are subject to an annual limitation of approximately $17 million annually. This annual limitation may cause $12 million of our pre-IPO NOLs not to be used before the pre-IPO NOLs expire. In addition, we believe that the consummation of the rights offering and/or the acquisition will not result in an ownership change.

Nevertheless, if (i) Mr. Ford and ARC Diamond purchase the shares of our common stock under the Investment Agreement, (ii) no stockholders exercise their subscription rights and Hunter s Glen/Ford backstops the rights offering in full, (iii) the transactions contemplated by the NLASCO Agreement are consummated and (iv) the transactions contemplated by the Flexpoint Agreement are consummated, there is an increased likelihood that we will experience an ownership change in the future. In that case, Mr. Ford s beneficial ownership interest in our common stock will increase to approximately 31.6% from approximately 17.6%, and the ownership interest of the remaining current common stockholders, who currently own in the aggregate approximately 82.4% of our common stock, will decrease to approximately 62.3%. As a result, there would be a substantial increase in the aggregate ownership of the Company of 43.7 percentage points looking back over the prior three year period. While this is below the 50 percentage points threshold required by Section 382 of the Internal Revenue Code in order for the Company to experience an ownership change, the consummation of the transactions described above would increase the likelihood of an ownership change in the future. As of December 31, 2006, we estimate that we will have $194 million of post-IPO NOLs. If an ownership change were to occur, such post-IPO NOLs would be subject to an annual limitation of $19 million based upon a fair market value of $454 million of our common stock and using the long term tax-exempt interest rate of 4.22% in effect for December 2006.

The determination of whether an ownership change has occurred or will occur as a result of such transactions is complicated and may also depend on other changes in percentage stock ownership among stockholders not related to the transactions described above. Therefore, no assurance can be provided as to whether an ownership change has occurred or will occur in whole or in part as a result of such transactions. We have not obtained, and currently do not plan to obtain, an IRS ruling or opinion of counsel regarding our conclusions as to whether the pre-IPO NOLs or post-IPO NOLs are subject to any such limitations. In addition, limitations imposed by Section 382 may prevent us from issuing additional common stock to raise capital or to acquire businesses or properties. To the extent not prohibited by our certificate of incorporation, we may decide in the future that it is necessary or in our interest to take certain actions that could result in an ownership change.

In order to avoid an ownership change and preserve the benefits of the Company s NOLs, on July 11, 2006, the Company entered into a Stockholder Rights Plan, or Rights Plan, which will be exercisable if a person or group acquires beneficial ownership of 5% or more of our common stock or commences a tender or exchange offer upon consummation of which such person or group would beneficially own 5% or more of our common stock. At a special meeting to be held on January 23, 2007, the Company s stockholders will vote on whether to approve an amendment to the Company s charter to restrict certain acquisitions of the Company s securities in order to preserve the benefit of the Company s NOLs. The Company s board of directors intends to terminate the Rights Plan if the charter amendment is approved. If any of our stockholders increases its beneficial ownership percentage in our common stock through future acquisitions, there is an increased possibility that the provisions under the Rights Plan or the charter amendment, as applicable, may be triggered.

We must obtain governmental and other regulatory consents to complete the NLASCO acquisition, which, if delayed, not granted or granted with unacceptable conditions, may jeopardize or postpone the completion of the acquisition, result in additional expenditures of money and resources and/or reduce the anticipated benefits of the acquisition.

We must obtain certain approvals and consents in a timely manner from Federal and state regulatory agencies prior to the completion of the acquisition. If we do not receive these approvals, or do not receive them on a timely basis or on terms that satisfy the conditions set forth in the NLASCO Agreement, then we will not be obligated to complete the NLASCO acquisition. The governmental agencies from which we will seek these approvals have broad discretion in administering the governing regulations. As a condition to approval of the NLASCO acquisition, agencies may impose requirements, limitations or costs that could negatively affect the way that we conduct business after the acquisition. These requirements, limitations or costs could jeopardize or delay the completion of the acquisition. If we agree to any material requirements, limitations or costs in order to obtain any approvals required to complete the acquisition, these requirements, limitations or additional costs could adversely affect our ability to integrate NLASCO s operations into our own and reduce the anticipated benefits of the acquisition. This could result in a material adverse effect on our business and results of operations, or cause us to be unable to complete the acquisition.

NLASCO must obtain certain third party consents in order for us to be able to maintain certain loans and reinsurance contracts following the closing.

Certain of the existing loan agreements and reinsurance contracts that NLASCO currently has in place, and which we want to keep in place as part of this transaction, require the consent of the lender or reinsurer in the event of a change of control of NLASCO. This transaction will result in a change of control, and NLASCO will need to obtain consents in order to maintain these agreements and contracts. If NLASCO does not receive these consents, then we will not be obligated to complete the NLASCO acquisition.

The integration of NLASCO s information systems into our own may be more costly than we anticipate, may not be completed on time or the integrated systems may not function properly.

Our success after the acquisition will depend in part on our ability to efficiently integrate NLASCO s information systems with our information systems. Our business and NLASCO s business depend upon numerous information systems for operational and financial information. We may not be able to integrate NLASCO s systems into our own or implement new information systems that can integrate successfully the disparate operational and financial information systems. Furthermore, we may experience unanticipated delays, complications and expenses in implementing, integrating and operating our systems. In addition, the integration of information systems may require modifications, improvements or replacements that may require substantial expenditures and may require interruptions in operations during the integration period. Integration of these systems is further subject to the availability of information technology and skilled personnel to assist us in creating and integrating the systems. If the integration takes longer or is more expensive than anticipated, or if we fail to successfully complete the integration or if the integrated information systems fail to perform as expected, our operations may be disrupted and we may not comply with the requirements of Section 404 of SOX. This may increase our costs, reduce our revenue and/or harm our business.

If we acquire NLASCO, we may need to incur significant costs to ensure that NLASCO is in compliance with SOX, which may increase the time and costs of completing the acquisition and, even after making such expenditures, we may not be able to achieve compliance.

NLASCO is not currently required to be in compliance with the provisions of SOX regarding the adequacy of its internal controls. Since ARC affiliated entities are required to comply with SOX, we could incur substantial costs and use a substantial amount of our management s time to develop the internal controls of NLASCO to achieve compliance with SOX. The incurrence of substantial costs to achieve compliance could adversely affect our financial condition. If we fail to implement, achieve or maintain an effective system of internal controls or to prevent fraud, such failures would require additional disclosures in certain of our filings and we could suffer losses and could be subject to costly litigation. In addition, if we would be required to make additional disclosures in our SEC filings, investors could lose confidence in our reported financial information, and our image and operating results could be harmed, which could have a negative effect on the trading price of our common stock.

If the acquisition s benefits do not meet the expectations of our stockholders or financial or industry analysts, the market price of our common stock may decline.

The market price of our common stock may decline as a result of the acquisition if:

- we do not achieve the perceived benefits of the acquisition as rapidly as, or to the extent anticipated by, our stockholders or financial or industry analysts; or

- the effect of the acquisition on our financial results is not consistent with the expectations of our stockholders or financial or industry analysts.

Accordingly, our stockholders may experience a loss as a result of a decrease in the price of our common stock.

We may experience difficulties in retaining NLASCO s current employees after the acquisition and during integration which could cause us to fail to realize the anticipated potential benefits of the acquisition.

Our success in integrating the NLASCO acquisition will depend in part upon our ability to retain the key employees of NLASCO. Competition for qualified personnel can be very intense. In addition, key employees may depart because of issues relating to the uncertainty or difficulty of integration or a desire not to remain with us or NLASCO after integration. Accordingly, we may not be able to retain key employees to the same extent that we and/or NLASCO have been able to do so in the past.

We may experience difficulties in retaining NLASCO s current agents after the acquisition which could cause us to fail to realize the anticipated potential benefits of the acquisition.

Our success in integrating the NLASCO acquisition also will depend in part on our ability to retain NLASCO s current agents who write business with NLIC and ASIC. Our inability to retain these agents could have an adverse impact on our business.

Under the NLASCO Agreement, we are required to indemnify the Sellers against certain matters.

Under the NLASCO Agreement, we have agreed, subject to certain minimum and maximum thresholds and other limitations, to indemnify the Sellers against any breach of any representation, warranty or covenant made in connection with the acquisition. These indemnification obligations generally survive closing of the acquisition. Any indemnity payment that we may be required to make to the Sellers could harm our financial results and/or adversely affect our business.

Risks Related to NLASCO s Business and NLASCO s Industry

The occurrence of severe catastrophic events may have a material adverse effect on NLASCO, particularly because NLASCO conducts business in a concentrated geographic area.

NLASCO expects to have large aggregate exposures to natural and man-made disasters, such as hurricanes, hail, tornados, windstorms, floods, wildfires and acts of terrorism. NLASCO expects that its loss experience generally will include infrequent events of great severity. Hurricanes Katrina and Rita, which occurred on August 29 and September 24, 2005, respectively, are such examples. The risks associated with natural and man-made disasters are inherently unpredictable, and it is difficult to predict the timing of these events with statistical certainty or estimate the amount of loss any given occurrence will generate. Although NLASCO may attempt to exclude certain losses such as terrorism and other similar risks from some coverages NLASCO writes, it may not be successful in doing so. The extent of losses from a catastrophe is a function of both the total amount of policyholder exposure in the geographic area affected by the event and the severity of the event. The occurrence of losses from catastrophic events may have a material adverse effect on NLASCO s ability to write new business and on its financial condition and results of operations. Increases in the values and geographic concentrations of policyholder property and the effects of inflation have resulted in increased severity of industry losses in recent years, and NLASCO expects that these factors will increase the severity of losses in the future. Factors that may influence NLASCO s exposure to losses from these types of events in addition to the routine adjustment of losses include: exhaustion of reinsurance coverage; increases in reinsurance rates; unanticipated litigation expenses; unrecoverability of ceded losses; impact on independent agent operations and future premium income in areas affected by catastrophic events; unanticipated expansion of policy coverage or reduction of premium due to regulatory, legislative and/or judicial action following a catastrophic event; and unanticipated demand surge related to other recent catastrophic events, among others.

NLASCO writes insurance primarily in the states of Texas, Arizona, Tennessee, Oklahoma and Louisiana. In 2005, premiums written in Texas accounted for 70% of direct written premiums. As a result, a single catastrophe, destructive weather pattern, wildfire, terrorist attack, regulatory development or other condition or general economic trend affecting this region or significant portions of this region could adversely affect NLASCO s financial condition and results of operations more significantly than other insurance companies that conduct business across a broader geographic area. Although NLASCO purchases catastrophe reinsurance to limit its exposure to these types of catastrophes, in the event of one or more major catastrophes resulting in losses to it in excess of $150 million, NLASCO s losses would exceed the limits of its reinsurance coverage.

NLASCO is exposed to claims related to severe weather and the occurrence of severe weather may result in an increase in claims frequency and exposure amount and could materially adversely affect its financial condition.

NLASCO is subject to claims arising out of severe weather, such as hurricanes, tornados, rainstorms, snowstorms, hailstorms, windstorms and ice storms that may have a significant effect on its financial condition and results of operations. The majority of its business is written in Texas, Arizona and Oklahoma, which have been experiencing extreme drought conditions, making the risk of loss from wildfires more prevalent. The incidence and severity of weather conditions are inherently unpredictable.

Some forecasters predict that the world is currently in a cycle of more numerous and more severe hurricanes.

NLASCO s insured risks generally exhibit higher losses in the second and third quarters of the year due to a seasonal concentration of weather-related events in its primary geographic markets. Although weather-related losses (including hail, high winds, tornadoes and hurricanes) can occur in any calendar quarter, the second quarter historically has experienced the highest frequency of losses associated with these events. For example, for the last five years, the contribution of weather-related catastrophes to the consolidated second quarter net loss ratio was on average approximately four points greater than the average contribution of such catastrophes in the other three quarters. Hurricanes are more likely to occur in the third quarter.

From 2001 through 2005, NLASCO s average annual net catastrophe losses after reinsurance recoveries were $5.0 million, with an average of two catastrophic events in excess of $1.0 million in losses per year. During this period, the year least impacted by catastrophes (2001) experienced no catastrophic events while the year most impacted (2005) experienced $12.5 million in such losses with two events exceeding $1.0 million. Before reinsurance recoveries, NLASCO incurred $116.5 million (including loss adjustment expenses) in catastrophe related losses in 2005, primarily related to hurricane losses from Katrina and Rita. However, NLASCO s net loss after reinsurance for the two hurricanes was $12.5 million. NLASCO incurred $5.9 million (including loss adjustment expenses) in catastrophe related losses for the nine months ended September 30, 2006. For the nine months ended September 30, 2006, NLASCO s net catastrophe loss experience was $4.5 million after reinsurance. In addition, NLASCO is exposed to an increase in claims frequency and exposure amount under the homeowners and dwelling fire insurance it writes because property damage may result from severe weather conditions.

Due to the inherent inability to accurately predict the severity and frequency of catastrophe losses, higher than expected catastrophe losses could materially adversely affect NLASCO s financial condition.

NLASCO utilizes catastrophe modeling to assess its probable maximum insurance losses from hurricane and other wind/hail perils and to structure its catastrophe reinsurance program to minimize its exposure to high severity/high frequency types of losses. Hurricane Katrina highlighted the challenges inherent in predicting the impact of catastrophic events, such as a severe hurricane. The catastrophe models generally failed to adequately project the financial impact of Hurricane Katrina. This experience highlights the limitations inherent in the use of modeling as a means of risk assessment/abatement. If the exposure amount and frequency of catastrophe losses are higher than predicted under NLASCO s modeling, NLASCO s financial condition may be materially adversely affected.

If NLASCO cannot price its business accurately, its profitability and the profitability of its insurance companies could be materially adversely affected.

NLASCO s results of operations and financial condition depend on its ability to underwrite and set premium rates accurately for a wide variety of risks. Adequate rates are necessary to generate premiums sufficient to pay losses, loss adjustment expenses and underwriting expenses and to earn a profit. To price its products accurately, NLASCO must (1) collect and properly analyze a substantial amount of data, (2) develop, test and apply appropriate pricing techniques, (3) closely monitor and recognize changes in trends in a timely manner and (4) project both severity and frequency of losses with reasonable accuracy. NLASCO s ability to undertake these efforts successfully and price its products accurately is subject to a number of risks and uncertainties, some of which are outside its control, including:

- the availability of sufficient reliable data and NLASCO s ability to properly analyze available data;
- changes in applicable legal liability standards and in the civil litigation system generally;
- NLASCO s selection and application of appropriate pricing techniques;
- NLASCO s ability to obtain regulatory approval, where necessary;
- the uncertainties that inherently characterize estimates and assumptions; and
- NLASCO s ability to obtain adequate premium rates to offset higher reinsurance costs.

Consequently, NLASCO could underprice risks, which would adversely affect its profit margins, or it could overprice risks, which could reduce its competitiveness and sales volume. In either case, its profitability and the profitability of its insurance companies could be materially adversely affected.

If NLASCO s actual losses and loss adjustment expenses exceed its loss and expense estimates, its financial condition and results of operations could be materially adversely affected.

NLASCO s financial condition and results of operations depend upon its ability to assess accurately the potential losses associated with the risks that it insures. NLASCO establishes reserve liabilities to cover the payment of all losses and loss adjustment expenses incurred under the policies that it writes. Such liability estimates include case estimates, which are established for specific claims that have been reported to NLASCO, and liabilities for claims that have been incurred but not reported, or IBNR. Loss adjustment expenses represent expenses incurred to investigate and settle claims. To the extent that losses and loss adjustment expenses exceed estimates, NLIC and ASIC will be required to increase their reserve liabilities and reduce their income before income taxes in the period in which the deficiency is identified. In addition, increasing reserves causes a reduction in policyholders surplus and could cause a downgrading of the ratings of NLIC and ASIC. This in turn could hurt the ability to sell insurance policies.

The liability estimation process for NLASCO s casualty insurance coverage possesses characteristics that make case and IBNR reserving inherently less susceptible to accurate actuarial estimation than is the case with property coverages. Unlike property losses, casualty losses are claims made by third parties of which the policyholder may not be aware and therefore may be reported a significant time after the occurrence, sometimes years later. As casualty claims most often involve claims of bodily injury, assessment of the proper case estimates is a far more subjective process than claims involving property damage. In addition, in determining the case estimate for a casualty claim, information develops slowly over the life of the claim and can subject the case estimation to substantial modification well after the claim was first reported. Numerous factors impact the casualty case reserving process, such as venue, the amount of monetary damage, legislative activity, the permanence of the injury and the age of the claimant.

The effects of inflation could cause the severity of claims from catastrophes or other events to rise in the future. Increases in the values and geographic concentrations of policyholder property and the effects of inflation have resulted in increased severity of industry losses in recent years, and NLASCO expects that these factors will increase the severity of losses in the future. As NLASCO observed in 2005, the severity of some catastrophic weather events, including the scope and extent of damage and the inability to gain access to damaged properties, and the ensuing shortages of labor and materials and resulting demand surge, provide additional challenges to estimating ultimate losses. NLASCO s liabilities for losses and loss adjustment expenses include assumptions about future payments for settlement of claims and claims handling expenses, such as medical treatments and litigation costs. To the extent inflation causes these costs to increase above liabilities established for these costs, NLASCO expects to be required to increase its liabilities with a corresponding reduction in its net income in the period in which the deficiency is identified.

Estimating an appropriate level of liabilities for losses and loss adjustment expenses is an inherently uncertain process. Accordingly, actual loss and loss adjustment expenses paid will likely deviate, perhaps substantially, from the liability estimates reflected in NLASCO s consolidated and combined financial statements. Claims could exceed NLASCO s estimate for liabilities for losses and loss adjustment expenses, which could have a material adverse effect on its financial condition and results of operations.

If NLASCO cannot obtain adequate reinsurance protection for the risks it underwrites, NLASCO may be exposed to greater losses from these risks or may reduce the amount of business it underwrites, which may materially adversely affect its financial condition and results of operations.

NLASCO uses reinsurance to protect itself from certain risks and to share certain risks it underwrites. During 2005, NLASCO s personal lines ceded 21% of its direct premiums written (primarily through excess of loss, quota share and catastrophe reinsurance treaties) and its commercial lines ceded 4% of its direct premiums written (primarily through excess of loss and catastrophe reinsurance treaties). The total cost of reinsurance inclusive of per risk excess and catastrophe has increased 73.3% in 2006. This includes additional catastrophe limits purchased. Reinsurance cost will likely increase for 2007, in part due to the frequency and severity of hurricanes and/or the lack of capacity in the reinsurance market.

From time to time, market conditions have limited, and in some cases have prevented, insurers from obtaining the types and amounts of reinsurance that they have considered adequate for their business needs. Accordingly, NLASCO may not be able to obtain desired amounts of reinsurance. Even if NLASCO is able to obtain adequate reinsurance, it may not be able to obtain it from entities with satisfactory creditworthiness or negotiate terms that it deems appropriate or acceptable. Although the cost of reinsurance is, in some cases, reflected in NLASCO s premium rates, NLASCO may have guaranteed certain premium rates to its policyholders. Under these circumstances, if the cost of reinsurance were to increase with respect to policies for which NLASCO guaranteed the rates, NLASCO would be adversely affected. In addition, if NLASCO cannot obtain adequate reinsurance protection for the risks it underwrites, it may be exposed to greater losses from these risks or it may be forced to reduce the amount of business that it underwrites for such risks, which will reduce NLASCO s revenue and may have a material adverse effect on its results of operations and financial condition.

NLASCO could face unanticipated losses from war, terrorism and political unrest, and these or other unanticipated losses could have a material adverse effect on NLASCO s financial condition and results of operations.

Although NLASCO believes that it does not have exposure to the events of September 11, 2001 because it did not have insurance in-force at that time with respect to exposure to such events, NLASCO has exposure to unexpected losses resulting from future man-made catastrophic events, such as acts of terrorism and political instability. These risks are inherently unpredictable. It is difficult to predict the timing of such events with statistical certainty or to estimate the amount of loss that any given occurrence will generate. In certain instances, NLASCO specifically insures risks resulting from acts of terrorism. Even in cases where NLASCO attempts to exclude losses from terrorism and certain other similar risks from some coverages it writes, NLASCO may not be successful in doing so. Irrespective of the clarity and inclusiveness of policy language, a court or arbitration panel may limit enforceability of policy language or otherwise issue a ruling adverse to NLASCO. Accordingly, while NLASCO believes its reinsurance programs, together with the coverage provided under the Terrorism Act and the Terrorism Extension Act, are sufficient to reasonably limit its net losses relating to potential future terrorist attacks, its reserves may not be adequate to cover losses when they materialize. Under the Terrorism Act, after an act of terrorism is certified by the Secretary of the Treasury, NLASCO may be entitled to be reimbursed by the Federal Government for a percentage of subject losses, after an insurer deductible and subject to an annual cap. The Terrorism Act covers an insurance company s operations for up to 90% of its losses for 2005 and 2006 and for up to 85% of its losses for 2007, in each case subject to certain mandatory deductibles. The deductible is calculated by applying the deductible percentage to the insurer s direct earned premiums for covered lines from the calendar year immediately preceding the applicable year. Although the Terrorism Act and the Terrorism Extension Act provide benefits in the event of certain acts of terrorism, such acts may not be extended beyond 2007 or their benefits may be reduced. It is not possible to eliminate completely NLASCO s exposure to unforecasted or unpredictable events, and to the extent that losses from such risks occur, NLASCO s financial condition and results of operations could be materially adversely affected.

If NLASCO s reinsurers do not pay losses in a timely fashion, or at all, NLASCO may incur substantial losses that could materially adversely affect its financial condition and results of operations.

As of December 31, 2005 and 2004, NLASCO had $36.2 million and $33.7 million, respectively, in reinsurance recoverables, including ceded paid loss recoverables, ceded losses and loss adjustment expense recoverables and ceded unearned premiums. At September 30, 2006, NLASCO had $10.0 million in reinsurance recoverables, including ceded paid loss recoverables, ceded losses and loss adjustment expense recoverables and ceded unearned premiums. NLASCO expects to continue to purchase substantial reinsurance coverage in the foreseeable future. Since NLASCO remains primarily liable to its policyholders for the payment of their claims, regardless of the reinsurance it has purchased relating to those claims, in the event that one of its reinsurers becomes insolvent or otherwise refuses to reimburse NLASCO for losses paid, or delays in reimbursing NLASCO for losses paid, its liability for these claims could materially and adversely affect its financial condition and results of operations. As an example, if one of NLASCO s catastrophe reinsurers experienced financial difficulties following one of the major hurricanes in 2005 and had been unable to meet its obligations to NLASCO, NLASCO could have experienced difficulty meeting its obligations to its policyholders. However, all of NLASCO s reinsurers responded in a timely fashion and NLASCO did not have any liquidity issues.

NLASCO relies on independent insurance agents to distribute its products, and if the agents do not promote NLASCO s products successfully, NLASCO s results of operations and financial condition could be adversely affected.

NLASCO s business depends in large part on the efforts of independent insurance agents to market its insurance products and on its ability to offer insurance products and services that meet the requirements of the customers. While NLASCO strives to offer products its agents require, NLASCO competes for business with other carriers based on the scope of coverage provided in its products, services, commissions and rates. NLASCO s competitors may offer coverage that is more attractive to particular customers than they offer for a specific product, may price their insurance products more aggressively, may offer higher agent commissions and may devote additional resources to improve their services. Accordingly, NLASCO s agents may find it easier to promote the programs of NLASCO s competitors rather than NLASCO s. If NLASCO s agents fail or choose not to market its insurance products successfully, its growth may be limited and its financial condition and results of operations may be adversely affected. Additionally, rather than utilizing an independent agent to buy their insurance, consumers may elect to deal with direct-writers or mass marketers who utilize the Internet to advertise and/or underwrite their business. Industry developments that centralize and commoditize insurance products could be detrimental to NLASCO s agency distribution model of doing business.

Because NLASCO relies on managing general agents, referred to as MGAs, to underwrite some of its products and to administer claims, such managing general agents could expose NLASCO to liability or allocate business away from NLASCO, which could cause NLASCO s financial condition and results of operations to be adversely affected.

NLASCO has developed programs with MGAs whereby the MGA will, within the guidelines NLASCO establishes, underwrite insurance policies on NLASCO s insurance subsidiaries behalf with oversight by NLASCO. An MGA is a person, firm or corporation that has supervisory responsibility for the local agency and field operations of an insurer in the state where it is organized or that is authorized by an insurer to accept or process on the insurer s behalf insurance policies produced and sold by other agents. While NLASCO exercises care in the selection of its MGA relationships and regularly audits the performance of its MGAs, NLASCO is at risk for their conduct as a result of the authority it has delegated to them. If one of NLASCO s MGAs binds NLASCO s insurance subsidiaries to policies that expose it to unexpected losses or fails to appropriately report claims, NLASCO s financial condition and results of operations could be adversely affected. For example, if a terminated MGA fails to continue to appropriately report claims during the runoff period, then liabilities for losses and loss adjusted expenses could be deficient, which would impact NLASCO s results of operations in future periods. Furthermore, subject to contractual limitations, MGAs have the ability to change carriers or increase or decrease the allocation to a particular carrier. An MGA might choose to change carriers or allocations for reasons such as pricing, service, conditions in the reinsurance market or a change in ownership of an MGA.

NLASCO s success depends in substantial part upon its key employees who have knowledge and experience in its target markets and lines of business.

In order to execute its business strategy successfully, NLASCO must attract and retain qualified executive officers, experienced underwriting and claims personnel and other skilled employees who are knowledgeable about its business. NLASCO relies substantially upon the services of its executive management team and the skilled underwriting, actuarial and claims management teams they supervise. While we anticipate that we will retain all of the key personnel in these areas, if NLASCO were to lose the services of certain members of its management team, its business could be adversely affected. ARC does not currently have any employment agreements with its employees, but upon consummation of the NLASCO acquisition, NLASCO will have employment agreements with Clifton Robinson, Gordon Robinson and Gregory Vanek. However, Clifton Robinson and Gordon Robinson will serve NLASCO in a reduced capacity following the acquisition, serving more in an advisory role as opposed to being in charge of day-to-day operations, and Gregory Vanek will assume additional responsibilities with respect to the operations of NLASCO. NLASCO does not currently maintain key man life insurance policies for any of its employees or employment agreements with any of its other employees.

NLASCO s future growth depends on its ability to hire additional underwriting and marketing personnel.

NLASCO s future growth will require it to hire additional underwriting and marketing talent as it expands its product offerings. NLASCO s underwriters manage and review all aspects of its commercial and personal insurance lines and personally underwrite all of its commercial lines policies, all of its personal lines policies that do not satisfy its established underwriting guidelines and a random sampling of those personal lines policies that otherwise do satisfy its established underwriting guidelines. As the underwriting function in many larger carriers becomes increasingly automated, there are fewer skilled underwriters of the type NLASCO requires. As a result, NLASCO may have difficulty finding talented replacements for members of its current underwriting team or additional underwriters that will enable its business to grow. If NLASCO is unable to find talented underwriters to meet the growing demand for its products, its business could be adversely affected.

A decline in NLIC s and/or ASIC s financial strength ratings by A.M. Best could cause either of their sales or earnings, or both, to decrease.

Ratings have become an increasingly important factor in establishing the competitive position of insurance companies. A.M. Best maintains a letter scale rating system ranging from A++ (Superior) to F (In Liquidation) to rate the financial strength of insurance enterprises. NLIC has been rated A (Excellent) by A.M. Best, which is the third highest of fifteen rating levels. ASIC has been rated B++ (Very Good) by A.M. Best, which is the fifth highest.

Each of NLIC s and ASIC s financial strength ratings is subject to periodic review by, and may remain the same, be revised downward, upward or revoked at the sole discretion of, A.M. Best. A decline in either NLIC s or ASIC s rating or an announced negative outlook on the rating can cause concern about their viability among agents, brokers and policyholders, resulting in a movement of business away from NLASCO and its insurance company subsidiaries to more highly-rated carriers. In addition, the errors and omissions insurance coverage of many of NLASCO s independent agents does not provide coverage if the covered agents sell policies from insurers with an A.M. Best financial strength rating of B+ (Very Good) or below. As a result, the loss of NLIC s or ASIC s A.M. Best financial strength rating, or a reduction to B+ (Very Go