THE GRAY INSURANCE COMPANY
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Management's Discussion and Analysis for the Year Ended December 31, 2004

This discussion, presented by management, provides an assessment of the current financial position, results of operations, cash flow and liquidity, and changes in financial position for The Gray Insurance Company. Information presented in this discussion supplements the financial statements, schedules and exhibits in the Company's 2004 Annual Statement.

The Gray Insurance Company provides excess coverages for workers' compensation, general liability and commercial auto liability for insureds in energy production and heavy construction. During 2004, growth of the number of insureds leveled off at 193 from the 189 of the previous year. Growth in business outside of Louisiana rose to 42.8% for 2004, from the 41.5% for 2003. No additional states were added to the list of certificates of authority in 2004. The Company is admitted to a total of forty-three states.

The hard market that was signaled in 2000, by the exit of Reliance sponsored programs from workers' compensation, continued into 2004. While reinsurance markets were more organized for the 2004 anniversary, prices again remain high. The level of increased submissions received by the Company continued into 2004. As a result, both the number of insureds has increased as has the written premium. The year 2004, saw an increase of 31.74% in net written premiums.

	2004	2003
Insureds	193	189
Net Written Premium	$88,168,910	$66,927,244

In 2003, the Company expanded its surety business into construction bonds. The Company added Mr. Edmund Pixberg to the project who has over 40 years of experience as a surety underwriter. Additionally, the Company teamed with XL Reinsurance America Inc. on a 50% quota share reinsurance contract to limit exposure and bring additional expertise to the new venture. This contract was amended in 2004, lowering the XL Reinsurance America, Inc. participation to 40%. The Company initially wrote the business, but is in the process of transferring the operations to its subsidiary, The Gray Casualty & Surety Company. Combined premiums written totaled $120,903 for 2003. Premiums for 2004 for both Companies totaled $539,580, of which $323,462 was written by the Company.

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Financial Position

Assets:

	2004	2003
Bonds	$141,691,858	$104,466,344
Common stock – unaffiliated	13,448,776	11,639,398
Common stock – affiliates		
The Gray Casualty & Surety Co.	11,876,081	11,844,886
Collateral loans	10,762,663	9,293,503
Real estate – mortgages	1,554,054	1,580,750
Real estate – home office	2,447,041	2,459,152
Cash and certificates of deposit	21,539,775	20,404,854

The Company has historically invested in U.S. Treasury bonds and notes. The Company has identified solid local companies for acquisition of stock.

Investments in U.S. Treasury bonds increased for year 2004 over 2003. Increases in the U.S. Treasury portfolio are due to the increase in written premium. Cash inflows are outpacing claim payments and expenses. This continues the trend of recent periods.

Cash grew as a result of increased business. The Company retained the cash in short term investments while researching appropriate longer term investments.

In 1998, the Company created a new subsidiary, The Gray Oil & Gas Company, to own oil and gas royalty interests. Statutory accounting and limits were applied to the accounting of this subsidiary.

In October of 2001, The Board of Directors authorized the sale of The Gray Oil & Gas Company to Gray & Company, Inc. for its book value of $6,500,000. The prospects for the subsidiary would require growth to levels that would exceed statutory limits. The Company took a ten-year mortgage secured by the stock of the subsidiary. The Company receives interest and principal on the mortgage. During 2004, the parent paid $564,840 in principal payments reducing the balance due to $4,812,663.

During 2001, mortgages on oil & gas royalty properties owned by The Gray Oil & Gas Company in the amount of $2,500,000 were written by the Company. During 2003, additional royalty properties were mortgaged for $750,000 raising the total to $3,250,000 of mortgaged properties. An additional mortgage for $666,000 was placed with The Gray Exploration Company on oil properties placed into production in 2002. This mortgage for $666,000 was repaid in 2004. A new mortgage on oil royalty properties was placed with The Gray Exploration Company in 2004, for $2,300,000.

All mortgages were current as to principal and interest at year-end.

Liabilities

Loss reserves grew by 26.1% as a result of the growth in written premiums cited above. Loss reserves continue to be above actuary's best estimate and have been for the past 11 years.

Changes to other liabilities were minor in the aggregate.

Capital and Surplus Accounts

In 2004, the Company sought and received approval to issue a Surplus Note for $10,000,000 to its parent. The note was issued to increase surplus in support of the level of premiums developed over the past four years.

Operations

As indicated above, the hard market again continued into 2004. Economies and improved underwriting reduced the combined ratio to 92.8 from the 94.7 of the previous year. The Company maintained loss reserves at actuary's best estimate. Experience from prior years continues to have favorable development.

	2004	2003
Gross Written Premium	$90,959,054	$79,789,726
Earned Premium	87,138,381	63,839,020
Losses & LAE Incurred	56,472,045	39,577,400
Other underwriting expenses	24,394,976	20,387,058
Policyholders Surplus	74,602,941	58,630,129

For 2004, over 2003, gross written premium rose by 14% fueled by the traffic created by the reduced writings of others in the market. This again allowed the Company to adjust insureds with poor performance and the opportunity to write new business.

The increase to Policyholders' Surplus resulted from the investment income and an underwriting profit. Unrealized gains were again posted in 2004. The dividend to its parent was increased to $2,750,000 in 2004 versus $2,250,000 in 2003.

	2004	2003
Net underwriting income	$6,271,360	$3,371,462
Investment income	5,009,145	3,066,579
Capital gains/(loss)	(396,435)	2,147,114
Unrealized gain/(loss)	1,840,573	2,118,596
Federal income tax	(4,108,831)	(3,647,000)
Dividends to parent	(2,750,000)	(2,250,000)
Earnings change to policyholders' surplus	5,972,812	5,144,751

A capital loss of $396,435 was realized on the sale of U.S. Treasury bonds and notes to move the investment into higher return U.S. Treasury Bonds.

The growth of written premium and loss reserves resulted in an increase to the Risk Based Capital Authorized Control Level. The table below outlines the change. Policyholder's Surplus remains well above the Authorized Control Level.

	2004	2003
Policyholder's Surplus	$74,602,941	$58,630,130
RBC Authorized Control Level	16,812,770	15,328,263
Percent Policyholder's Surplus/RBCAL	444%	382%

The Company had unusual values on two IRIS ratios. For IRIS Ratio 6, "Investment Yield", the Company experienced a value of 2.6%, below the indicated value of 4.5%. This resulted from the increase in collections for new business that had to be invested at current depressed returns. The Company's investment philosophy prohibits chasing riskier investments for the higher returns. The Company will stay with U.S. Treasurys with shorter durations in anticipation of increased returns in the future.

For IRIS ratio 12, "Estimated Current Reserve Deficiency to Policyholder's Surplus", the Company scored a 34 versus the limit indicated of 25. The documentation supplied by NAIC indicates that this ratio is distorted if the Company experiences large growth. The Company discussed both of these ratios with actuaries and found no concerns. The Company and its actuaries continue to monitor this.

During 2004, the Company's book reserves held at the actuary's point estimate. The Company has increased loss and loss expenses in response to the new business written.

	2004	2003
Loss & LAE Reserves	142,490,895	112,537,216

As the Company enters its 28th year in business, the Company will continue focus on underwriting, expanding outside our base region and managing the current market. Growth outside Louisiana has been a result of the Company's current insured's expansion outside the state and the acceptance of insureds based in this region with operations outside the area. Superior loss control services, claims management and financial stability are at the heart of our customer loyalty and a 95% renewal rate this year.

Michael T. Gray, President
March 31, 2005