

Consolidated Financial Statements of

EGI FINANCIAL HOLDINGS INC.

June 30, 2009

EGI FINANCIAL HOLDINGS INC.
Consolidated Balance Sheets
(unaudited, in \$ thousands)

Assets	June 30 2009	December 31 2008
Cash and short-term deposits	\$ 59,675	\$ 29,111
Investments (note 3)	251,784	259,774
Reinsurers' share – unearned premiums	4,659	3,712
– provision for unpaid claims (note 4)	39,758	41,901
Accounts receivable	33,008	27,565
Income taxes recoverable	4,058	7,202
Due from insurance companies	4,244	9,063
Deferred policy acquisition costs	13,389	14,703
Property and equipment	939	1,182
Intangible assets	1,701	1,190
Future income taxes	3,341	3,172
Prepaid expenses and other assets	2,429	4,205
	<u>\$418,985</u>	<u>\$402,780</u>
 Liabilities		
Bank indebtedness (note 8)	\$ 19,550	\$ 19,550
Provision for unpaid claims (note 4)	193,024	185,255
Unearned premiums	68,190	71,154
Unearned commission	387	363
Income Taxes payable	120	429
Accounts payable and accrued liabilities	5,281	4,291
Payable to insurance companies	2,051	2,460
Other liabilities	634	674
	<u>289,237</u>	<u>284,176</u>
 Shareholders' Equity		
Share capital (note 7)	67,747	67,056
Contributed surplus	422	403
Retained earnings	60,387	56,605
Accumulated other comprehensive income (loss)	1,192	(5,460)
	<u>129,748</u>	<u>118,604</u>
	<u>\$418,985</u>	<u>\$402,780</u>

EGI FINANCIAL HOLDINGS INC.
Consolidated Statements of Income
(unaudited, in \$ thousands, except per share amounts)

	Quarter to June 30		6 months to June 30	
	2009	Restated (note 2) 2008	2009	Restated (note 2) 2008
Revenue				
Direct written and assumed premiums	\$48,487	\$49,784	\$80,103	\$84,720
Net written and assumed premiums	44,121	45,975	73,179	78,397
Net earned premiums	35,486	35,999	77,059	81,558
Investment income (note 3)	6,017	4,718	7,891	9,305
	<u>\$41,503</u>	<u>\$40,717</u>	<u>\$84,950</u>	<u>\$90,863</u>
Expenses				
Incurred claims	21,931	23,873	51,821	56,904
Acquisition costs	8,078	8,562	18,038	20,150
Operating costs	3,774	3,542	7,369	6,747
Interest expense	305	306	604	608
	<u>34,088</u>	<u>36,283</u>	<u>77,832</u>	<u>84,409</u>
Income before income taxes	7,415	4,434	7,118	6,454
Income tax expense	2,584	1,415	2,517	2,110
	<u>4,831</u>	<u>3,019</u>	<u>4,601</u>	<u>4,344</u>
Net income	<u>\$ 4,831</u>	<u>\$ 3,019</u>	<u>\$ 4,601</u>	<u>\$ 4,344</u>
Earnings per share (note 9)				
Net income per share – basic	\$0.41	\$0.31	\$0.39	\$0.45
Net income per share – diluted	\$0.38	\$0.28	\$0.36	\$0.41

EGI FINANCIAL HOLDINGS INC.
Consolidated Statements of Changes in Shareholders' Equity
and Comprehensive Income
(unaudited, in \$ thousands)

	Quarter to June 30		6 months to June 30	
	2009	Restated (note 2) 2008	2009	Restated (note 2) 2008
Share capital				
Balance, beginning of period	\$ 67,221	\$ 46,170	\$ 67,056	\$ 46,040
Common shares issued	526	71	691	201
Balance, end of period	<u>67,747</u>	<u>46,241</u>	<u>67,747</u>	<u>46,241</u>
Contributed surplus				
Balance, beginning of period	433	274	403	247
Stock options – granted	53	43	103	86
– exercised	(64)	(8)	(84)	(24)
Balance, end of period	<u>422</u>	<u>309</u>	<u>422</u>	<u>309</u>
Retained earnings				
Balance, beginning of period	55,556	53,936	56,605	53,193
Net income	4,831	3,019	4,601	4,344
Dividends – Common shares	–	(584)	(819)	(1,166)
Balance, end of period	<u>60,387</u>	<u>56,371</u>	<u>60,387</u>	<u>56,371</u>
Accumulated other comprehensive income (loss)				
Balance beginning of period	(3,624)	2,669	(5,460)	2,191
Other comprehensive income (loss)	4,816	(3,243)	6,652	(2,765)
Balance, end of period	<u>1,192</u>	<u>(574)</u>	<u>1,192</u>	<u>(574)</u>
Shareholders' equity, end of period	<u>\$129,748</u>	<u>\$102,347</u>	<u>\$129,748</u>	<u>\$102,347</u>
Comprehensive income				
Net income	<u>4,831</u>	<u>3,019</u>	<u>4,601</u>	<u>4,344</u>
Other comprehensive income, net of income taxes				
Change in unrealized gains on available-for-sale securities:				
Net unrealized gains (losses) on available-for-sale securities	6,913	(1,938)	7,463	(947)
Reclassification of net realized gains to net income	(2,205)	(1,023)	(884)	(1,809)
Unrealized gains (losses) on translation of financial statements of self-sustaining foreign operations	<u>108</u>	<u>(282)</u>	<u>73</u>	<u>(9)</u>
Other comprehensive income (loss)	<u>4,816</u>	<u>(3,243)</u>	<u>6,652</u>	<u>(2,765)</u>
Total comprehensive income (loss)	<u>\$ 9,647</u>	<u>\$ (224)</u>	<u>\$ 11,253</u>	<u>\$ 1,579</u>

EGI FINANCIAL HOLDINGS INC.
Consolidated Statements of Cash Flows
(unaudited, in \$ thousands)

	Quarter to June 30		6 months to June 30	
	2009	Restated (note 2) 2008	2009	Restated (note 2) 2008
Cash provided by (used in):				
Operating activities:				
Net income	\$ 4,831	\$ 3,019	\$ 4,601	\$ 4,344
Items not involving cash:				
Amortization of property and equipment and intangible assets	191	136	414	275
Amortization of premiums on bonds	216	70	317	152
Realized gains on investments	(3,243)	(2,032)	(1,678)	(3,215)
	1,995	1,193	3,654	1,556
Net change in other non-cash balances	8,799	6,427	9,282	7,628
	10,794	7,620	12,936	9,184
Financing activities:				
Issue of common shares	460	63	606	177
Common share dividends	-	(584)	(819)	(1,166)
	460	(521)	(213)	(989)
Investing activities:				
Purchase of property and equipment and intangible assets	(487)	(863)	(682)	(1,170)
Purchase of investments	(58,169)	(67,652)	(100,345)	(128,770)
Sale/maturity of investments	79,272	62,963	118,868	120,723
	20,616	(5,552)	17,841	(9,217)
Increase (decrease) in cash and short-term deposits	31,870	1,547	30,564	(1,022)
Cash and short-term deposits, beginning of period	27,805	20,216	29,111	22,785
Cash and short-term deposits, end of period	\$59,675	\$21,763	\$59,675	\$21,763
Supplementary information				
Income taxes paid	\$ 878	\$ 1,287	\$ 2,712	\$ 5,614
Interest paid	\$ 302	\$ 302	\$ 604	\$ 604

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements
(unaudited, in \$ thousands except per share amounts)

1 Organization and basis of presentation

These interim consolidated financial statements include the accounts of EGI Financial Holdings Inc. and its subsidiaries (the Company or EGI) and have not been reviewed by the Company's external auditors. They do not include all disclosures required by Canadian generally accepted accounting principles for annual financial statements, and accordingly, should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2008 as set out on pages 54 to 78 of the Company's 2008 Annual Report. These interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles using the same accounting policies, except as described in note 2 below, as were used for the Company's consolidated financial statements for the year ended December 31, 2008.

The Company was incorporated on August 18, 1997 under the Business Corporations Act (Ontario). The Company is principally engaged, through its subsidiaries, in property and casualty insurance in Canada and the U.S.

The Company's wholly-owned subsidiaries are EGI Insurance Managers Inc., Echelon General Insurance Company (Echelon), EGI Insurance Services, Inc., and CIM Reinsurance Company Ltd. (CIM Re).

The Company's Barbados based subsidiary, CIM Re changed its functional currency to U.S. dollars effective January 1, 2008. CIM Re is operating as a self-sustaining foreign subsidiary and is therefore subject to foreign currency translation adjustments upon consolidation.

2 Significant accounting changes

Provision for unpaid claims

As at January 1, 2009, the Company changed the methodology used to estimate incurred but not reported (IBNR) reserves for motorcycle business. The purpose of the change was to more accurately match incurred claims to earned premiums which are recognized into income pro rata over the terms of the underlying policies. This objective was achieved by determining IBNR based on an annualized loss ratio instead of a quarterly loss ratio which was previously used. The methodology change represents a change in accounting policy which management believes provides more relevant information because it more accurately reflects the claims costs associated with the pro-rata earned premiums recorded in the quarter.

This change in accounting policy has been accounted for retrospectively, and the comparative statements for the quarter and the six months ended June 30, 2008 have been restated. The effect of the change on the quarter ended June 30, 2008 and the six months ended June 30, 2008 is as follows:

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(unaudited, in \$ thousands except per share amounts)

For the six months ended June 30, 2008	Previously Reported	Adjustment	Restated
Incurring claims	\$ 55,523	\$ 1,381	\$ 56,904
Income tax expense	2,559	(449)	2,110
Net income	5,276	(932)	4,344
Shareholders' equity	103,279	(932)	102,347
Net income per share – basic	\$0.54	\$(0.09)	\$0.45
Net income per share – diluted	\$0.50	\$(0.09)	\$0.41

For the quarter ended June 30, 2008	Previously Reported	Adjustment	Restated
Incurring claims	\$ 24,360	\$ (487)	\$ 23,873
Income tax expense	1,257	158	1,415
Net income	2,690	329	3,019
Net income per share – basic	\$0.27	\$0.04	\$0.31
Net income per share – diluted	\$0.25	\$0.03	\$0.28

Intangible assets

On January 1, 2009, the Company adopted Handbook section 3064, Goodwill and Intangible Assets, issued by the Canadian Institute of Chartered Accountants (CICA). Section 3064, which replaces Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs, provides clarifying guidance on the criteria that must be satisfied in order for an intangible asset to be recognized, including internally developed intangible assets. As a result of adopting Section 3064, the Company has reclassified \$1,701 of computer software from Property and Equipment to Intangible Assets on the Consolidated Balance Sheet. Amounts for prior periods have also been reclassified.

Intangible assets are recorded at cost less accumulated amortization. Amortization is provided over the estimated useful life of the asset (2 years) using the straight line method.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(unaudited, in \$ thousands except per share amounts)

3 Investments

Investments are carried at fair value, which is the amount of consideration that would be agreed upon in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. Fair values are determined by reference to quoted bid or asking prices, as appropriate, in the most advantageous active market available. All financial assets are non-derivatives and have been classified as available-for-sale (AFS) investments.

Any change during the period in the fair values of investments classified as AFS are recognized in Other Comprehensive Income (OCI). The cumulative change in the fair values of investments previously recognized in Accumulated Other Comprehensive Income (AOCI) are reclassified to Net Income when they are realized or the decline in value is considered to be other than temporary.

Transaction costs related to AFS financial assets are capitalized on initial recognition and, where applicable, are amortized to interest income using the effective yield method.

Investment income is recorded as it accrues. Dividend income on shares is accrued on the ex-dividend date. Gains and losses on disposal of investments are determined and recorded as at the transaction date and are calculated on the basis of the average cost of the investments held.

Fair value of Investments

The following table provides a comparison as at June 30, 2009 and December 31, 2008:

	June 30 2009	December 31 2008
Available for sale	Fair value	Fair value
Bonds		
Canadian		
Federal	\$ 68,071	\$ 82,078
Provincial	42,144	45,162
Municipal	6,956	6,935
Corporate	85,128	86,570
	<u>202,299</u>	<u>220,745</u>
United States		
Corporate	2,975	2,717
	<u>205,274</u>	<u>223,462</u>
Total Bonds	<u>205,274</u>	<u>223,462</u>
Preferred shares	<u>5,052</u>	<u>4,042</u>
Common shares		
Canadian	38,716	29,049
United States	1,079	1,178
	<u>39,795</u>	<u>30,227</u>
Investment income due and accrued	<u>1,663</u>	<u>2,043</u>
	<u>\$251,784</u>	<u>\$259,774</u>

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
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Impaired assets and provisions for losses

The Board of Directors has established a policy to write down or make a provision for any investment with “other than temporary” impairment.

Management has reviewed currently available information regarding those investments whose estimated fair value is less than carrying value. For those securities whose decline in fair value was other than temporary, the Company has recorded the difference between the cost of the investment and its fair value as an impairment which reduces investment income in the year recorded.

The Company considers an impairment as other than temporary if it is unlikely the Company will recover an investment’s amortized cost in a reasonable period of time. Factors considered by the Company include but are not limited to the impact of issuer specific events, industry specific events, current and expected future market and economic conditions, the nature of the investment and the severity and duration of the fair value deficiency.

There were no impairment provisions recorded in the second quarter of 2009. An impairment loss of \$2,023, related to common shares, that was recognized in net income in the first quarter of 2009, has been reversed in the second quarter as a result of the disposal of the related investments in the period.

A gross unrealized loss of \$6,826 on investments held as at June 30, 2009, is recorded, net of tax, in the amount of \$4,596 as AOCI. The Company has concluded during its review, that these fair value deficiencies are considered temporary in nature.

Investment income

Investment income was derived from the following:

	Quarter to June 30		6 months to June 30	
	2009	2008	2009	2008
Interest income	\$2,939	\$2,809	\$5,882	\$5,542
Dividend income	345	282	667	976
Net realized gains and impairments	3,243	2,032	1,678	3,215
Foreign exchange gain (loss) ⁽¹⁾	(283)	(2)	131	230
Investment expenses	(227)	(403)	(467)	(658)
	\$6,017	\$4,718	\$7,891	\$9,305

(1) The foreign exchange gain for the six months ended June 30, 2009 of \$131 (2008 – \$230) arises primarily from cash balances held, denominated in U.S. dollars, used to fund claims liabilities denominated in U.S. dollars. For the quarter ended June 30, 2009, the foreign exchange loss was \$(283) (2008 – \$(2)).

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(unaudited, in \$ thousands except per share amounts)

4 Provision for unpaid claims

The determination of the provision for unpaid claims and adjustment expenses and the related reinsurers' share requires the estimation of three major variables or quanta, being development of claims, reinsurance recoveries and the effects of discounting, to establish a best estimate of the value of the respective liability or asset.

The provision for unpaid claims and adjustment expenses is an estimate subject to variability and the variability could be material in the near term. The variability arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Variability can be caused by receipt of additional claim information, changes in judicial interpretation of contracts, significant changes in the severity or frequency of claims for historical trends, the timing of claim payments, recoverability of reinsurance and future rates of investment return. The estimates are principally based on the Company's historical experience. Methods of estimation have been used, which the Company believes produce reasonable results given current information.

All provisions are periodically reviewed and evaluated considering emerging claims experience and changing circumstances. The process of determining the provisions necessarily involves risks that actual results may differ, perhaps materially, from the best estimates made. The resulting changes in estimates of the ultimate liability are recorded as incurred claims in the current year.

The fair value of the provision for unpaid claims approximates carrying value determined in accordance with generally accepted actuarial methods in Canada, which discount estimated future cash flows and include a margin for adverse deviation.

The Company discounts its best estimate of claim provisions at a rate of interest of 2.3% for 2009 (2008 – 2.8%) for all lines of business. The Company determines the discount rate based on the expected return on its investment portfolio of assets with appropriate assumptions for interest rates relating to reinvestment of maturing investments.

For the six months ended June 30, 2009, the Company has recorded a \$2,239 (2008 – \$3,435) reduction to the net provision for unpaid claims relating to redundancies in prior year estimates. For the quarter ended June 30, 2009, the redundancy recorded related to prior year estimates was \$817 (2008 – \$259).

To recognize the uncertainty in establishing these best estimates, to allow for possible deterioration in experience, and to provide greater comfort that the actuarial liabilities are adequate to pay future claims, the Company includes provisions for adverse deviations (PFADs) in some assumptions relating to claim development, reinsurance recoveries and future investment income. The PFADs selected are in the mid-range of those recommended by the Canadian Institute of Actuaries. The aggregate impact of the provision for adverse deviation is to increase the provision for unpaid claims on a gross basis by \$22,186 as at June 30, 2009 (December 31, 2008 – \$20,102).

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
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The provision for unpaid claims on an actuarial present value (APV) gross and ceded basis by line of business is as follows:

APV basis	<u>June 30, 2009</u>		<u>December 31, 2008</u>	
	Gross	Ceded	Gross	Ceded
Personal lines:				
Accident benefits	\$ 72,963	\$19,692	\$ 72,008	\$21,396
Liability	96,348	17,405	91,555	17,218
Other	3,688	662	4,336	656
Total Personal lines	<u>172,999</u>	<u>37,759</u>	<u>167,899</u>	<u>39,270</u>
Niche:				
Property				
Commercial	3,480	281	3,273	247
Personal	175	37	332	20
Liability	10,908	1,345	8,377	1,960
Accident and sickness	4,656	336	4,728	404
Other	806	–	646	–
Total Niche	<u>20,025</u>	<u>1,999</u>	<u>17,356</u>	<u>2,631</u>
	<u>\$193,024</u>	<u>\$39,758</u>	<u>\$185,255</u>	<u>\$41,901</u>

5 Underwriting policy and reinsurance ceded

In the normal course of business, the Company seeks to reduce the loss that may arise from catastrophes or other events that cause unfavourable underwriting results by purchasing reinsurance to share all or part of the insurance risks originally accepted by the Company in writing premiums. This reinsurance does not relieve the Company of its primary obligation to policyholders.

During 2009, the Company followed the policy of underwriting and reinsuring contracts of insurance, which limits the net exposure of the Company to a maximum amount on any one loss to \$1,500 (2008 – \$1,500). In addition, the Company obtained catastrophe reinsurance which limits the loss from a series of claims arising from a single occurrence to \$2,000 (2008 – \$2,000) to a maximum coverage of \$23,000 (2008 – \$18,000).

The Company places all its automobile reinsurance with Canadian registered reinsurers. There are non-registered reinsurers participating on the specialty property and casualty program business. The Company has access to trust funds that, in the Company's judgement, are adequate to secure the liabilities that the Company has ceded to non-registered reinsurers.

Failure of reinsurers to honour their obligations could result in losses to the Company. Consequently, the Company continually evaluates the financial condition of its reinsurers and monitors concentrations of credit risk to minimize its exposure to significant losses. There have been no defaults and no provision made in the accounts for defaults based on management's review of the creditworthiness of its reinsurers.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(unaudited, in \$ thousands except per share amounts)

6 Risk Management

As a provider of insurance products, effective risk management is fundamental to EGI's ability to protect the interests of EGI's customers and shareholders. EGI is exposed to risks of loss pertaining to insurance products. These include risks surrounding product and pricing, underwriting and claims, catastrophic exposure, and matching of assets and liabilities. EGI is also exposed to potential loss from various risks, including interest rate risk and equity market fluctuation risk, credit risk, liquidity risk, and to a lesser extent foreign exchange risk.

Product and pricing

EGI prices its products taking into account numerous factors, including claims frequency and severity trends, product line expense ratios, special risk factors, the capital required to support the product line, and the investment income earned on that capital. EGI's pricing process is designed to ensure an appropriate return on capital and long-term rate stability, avoiding wide fluctuations in rates unless necessary. These factors are reviewed and adjusted periodically to ensure they reflect the current environment.

Pricing for automobile insurance must be submitted to each provincial government regulator and, in certain provinces, pre-approved by the regulator. Regulatory decisions may impede automobile rate increases or other actions that EGI may wish to take. Also, during periods of intense competition for any product line, to gain market share, EGI's competitors may price their products below the rates EGI considers acceptable. Although EGI may adjust its pricing up or down to maintain EGI's competitive position, EGI strives to ensure its pricing will produce an appropriate return on invested capital. There is no assurance that EGI will not lose market share during periods of pricing competition.

Underwriting and claims

EGI is exposed to loss resulting from the underwriting of risks being insured and the exposure to financial loss resulting from greater than anticipated adjudication, settlement and claims costs.

EGI's underwriting objectives are to develop business within EGI's target markets on a prudent and diversified basis and to achieve profitable underwriting results. EGI underwrites automobile business after a review of the applicant's driving record reports and claims experience. Specialty commercial and personal risks are selected by EGI, working with its external brokers, after consideration of various risk factors associated with these lines of business. Despite its best efforts, and consideration of all known risk factors, there can be no assurance that all risks associated with the insurance policies that it writes can be identified and assessed, and EGI may, therefore, experience increased adjudication, settlement and claims costs.

EGI estimates its claims reserves on a quarterly basis and this is supported by quarterly assessments by the independent consulting actuary. Every quarter, for each line of business, EGI compares actual and expected claims development. To the extent that actual results differ from expected development, assumptions are re-evaluated and new estimates are derived. Although EGI believes its overall provision levels to be adequate to satisfy its obligations under existing policies, actual losses may deviate, perhaps substantially, from the amounts reflected in EGI's financial statements. To the extent provisions prove to be inadequate, EGI would have to re-evaluate such provisions and may incur a charge to earnings in the future.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
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Unpredictable catastrophic events

Catastrophes can be caused by various natural and unnatural events. Natural catastrophic events include hurricanes, windstorms, earthquakes, hailstorms, explosions, severe winter weather and fires. Unnatural catastrophic events include hostilities, terrorist acts, riots, crashes and derailments. The incidence and severity of catastrophes are inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Most catastrophes are restricted to small geographic areas; however, hurricanes, windstorms and earthquakes may produce significant damage in large, heavily populated areas.

Catastrophes can cause losses in a variety of business lines. Claims resulting from natural or unnatural catastrophic events could cause substantial volatility in EGI's financial results and could materially reduce EGI's profitability or harm EGI's financial condition. The Company manages the impact of losses which may result from catastrophic events by purchasing excess of loss and catastrophe reinsurance to share all or part of the insurance risks originally accepted by the Company.

EGI's ability to write new business also could be affected. EGI may experience an abrupt interruption of activities caused by unforeseeable and/or catastrophic events. EGI's operations may be subject to losses resulting from such disruptions. Losses can relate to property, financial assets, trading positions and also to key personnel. EGI has developed business continuity plans designed to allow the Company to continue operations in case of a catastrophic event, however if these plans cannot be put into action or do not take such events into account, losses may further increase.

Asset and liability matching

The Company is exposed to:

- changes in the value of its fixed income securities and policy liabilities to the extent that market interest rates change;
- equity price fluctuations which affect the fair values of equities held by the Company.
- the risk of losses to the extent that the sale of a security prior to its maturity is required to provide liquidity to satisfy policyholder and other cash outflows;
- the risk that future inflation of policyholder cash flows exceed returns on long-term investment securities; and
- foreign exchange risks with respect to investments, receivables and policy liabilities denominated in foreign currencies.

To mitigate these risks, the Company has policies to ensure that assets and liabilities are broadly matched in terms of their duration and currency. The Company's exposures are monitored on a regular basis and actions are taken to balance investment positions when approved risk tolerance limits are exceeded.

Risk management is carried out by the Investment Committee under policies approved by the Board of Directors.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
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Market risk

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, equity market fluctuations, foreign exchange rates, and other relevant market rate or price changes. Market risk is directly influenced by the volatility and liquidity in the markets in which the related underlying financial assets are traded. Below is a discussion of the Company's primary market risk exposures and how these exposures are currently managed.

Interest rate risk

Fluctuations in interest rates have a direct impact on the fair valuation and future cash flows of the Company's fixed income securities portfolio. Generally, the Company's investment income will be reduced during sustained periods of lower interest rates as higher yielding fixed income securities mature or are sold and the proceeds are reinvested at lower rates. During periods of rising interest rates, the fair value of the Company's existing fixed income securities will generally decrease and gains on fixed income securities will likely be reduced.

The sensitivity analysis for interest rate risk as set out in the table below illustrates the impact of changes in interest rates on OCI relating to the fixed income securities portfolio as at June 30, 2009 and December 31, 2008, based on parallel 200 basis point shifts in interest rates up and down in 100 basis point increments.

	As at June 30, 2009			As at December 31, 2008		
	Fair value of fixed income portfolio	Hypothetical % change on fair value	2009 Effect on OCI	Fair value of fixed income portfolio	Hypothetical % change on fair value	2008 Effect on OCI
Change in interest rates						
200 basis point rise	\$184,437	(10%)	\$(13,961)	\$202,324	(9%)	\$(14,162)
100 basis point rise	194,360	(5%)	(7,312)	212,438	(5%)	(7,386)
No change	205,274	—	—	223,462	—	—
100 basis point decline	217,340	6%	8,084	235,533	5%	8,087
200 basis point decline	230,630	12%	16,988	248,463	11%	16,751

Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet cash flow requirements associated with financial instruments. The purpose of liquidity management is to ensure that there is sufficient cash to meet all financial commitments and obligations as they fall due. To manage cash flow requirements, the Company maintains a portion of invested assets in liquid securities.

EGI FINANCIAL HOLDINGS INC.
Notes to Consolidated Financial Statements (continued)
(unaudited, in \$ thousands except per share amounts)

The maturity profile of bonds as at June 30, 2009, is as follows:

	<u>Less than 1 year</u>	<u>1 – 3 years</u>	<u>3 – 5 years</u>	<u>Greater than 5 years</u>	<u>Total</u>
Bonds	\$3,156	\$35,211	\$56,860	\$110,047	\$205,274
Percentage of total	1.5%	17.2%	27.7%	53.6%	100%

Future cash flows

The following table summarizes the expected timing of cash flows arising from insurance obligations, on an undiscounted basis (note 4), as at June 30, 2009:

	<u>Less than 1 year</u>	<u>1 – 3 years</u>	<u>3 – 5 years</u>	<u>Greater than 5 years</u>	<u>Total</u>
Actuarial liabilities (undiscounted)	\$58,293	\$67,565	\$36,296	\$24,534	\$186,688
Less: Reinsurance recoverable	<u>13,760</u>	<u>13,852</u>	<u>6,312</u>	<u>3,584</u>	<u>37,508</u>
Net actuarial liabilities	<u>\$44,533</u>	<u>\$53,713</u>	<u>\$29,984</u>	<u>\$20,950</u>	<u>\$149,180</u>

Equity price risk

Fluctuations in the value of equity securities affect the level and timing of recognition of gains and losses on securities held, and causes changes in realized and unrealized gains and losses. General economic conditions, political conditions and many other factors can also adversely affect the stock and bond markets and, consequently, the value of the equity and fixed income securities held.

The Company has policies to limit and monitor its exposure to individual issuers and classes of issuers of equity securities.

The table below summarizes the potential impact of a 20% change in the value of the equity securities (common and preferred shares) on OCI for the six months ended June 30, 2009. Certain shortcomings are inherent in the method of analysis presented, as the analysis is based on the assumptions that all equity holdings increased/decreased by 20% with all other variables held constant.

<u>Change in equity holdings</u>	<u>Effect on OCI</u>
20% rise	\$ 6,009
20% decline	\$(6,009)

Credit risk

The Company is exposed to credit risk principally through its investment securities and balances receivable from policyholders and reinsurers. The Company has policies to limit and monitor its exposure to individual issuers and classes of issuers of investment securities which do not carry the guarantee of a national or Canadian provincial government. EGI's credit exposure to any one individual policyholder is not material. The Company has policies which limit its exposure to individual

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reinsurers and regular review processes to assess the creditworthiness of reinsurers with whom it transacts business.

The following table sets forth EGI's fixed income securities portfolio by credit quality according to DBRS as at June 30, 2009 and December 31, 2008.

Fixed income portfolio

	As at June 30, 2009		As at December 31, 2008	
	Fair value	Fair value	Fair value	Fair value
AAA	\$ 90,276	44%	\$107,830	48%
AA	61,699	30%	60,713	27%
A	45,780	22%	48,080	22%
BBB	6,754	3%	6,765	3%
BB	256	-	-	-
CCC	509	1%	74	-
Total	<u>\$205,274</u>	<u>100%</u>	<u>\$223,462</u>	<u>100%</u>

Foreign exchange risk

Foreign exchange risk is the possibility that changes in foreign exchange rates produce an unintended effect on earnings and equity when measured in domestic currency.

A portion of the Company's premiums are written in U.S. dollars and a portion of loss reserves are also in U.S. dollars. In addition, premiums relating to the Emergency Travel Health line of business are remitted in Canadian dollars but a significant portion of the claims incurred for this line of business are in U.S. dollars. A portion of the Company's cash and investments are also held in U.S. dollars.

In general, the Company attempts to manage foreign exchange risk on liabilities by investing in financial instruments denominated in the same currency as the financial liabilities which they back. The Company may nevertheless, from time to time, experience losses resulting from fluctuations in the value of the U.S. dollar, which could adversely affect operating results.

The table below illustrates the expected impact on net income and OCI of a 10% change in the Canadian dollar ("CAD") compared to the U.S. dollar ("USD") as at June 30, 2009. Computations of the prospective effects of hypothetical foreign exchange changes are based on numerous assumptions, including the maintenance of the existing level and composition of assets and financial liabilities, and should not be relied on as indicative of actual or future results.

Change in CAD/ USD rate	Effect on Net Income	Effect on OCI
10% rise	\$(1,220)	\$ 732
10% decline	\$ 1,220	\$(477)

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Reinsurance recoverables

The following table summarizes the balances outstanding from reinsurers as at June 30, 2009 by risk rating:

<u>Credit rating</u>	<u>Gross reinsurance recoverable</u>	<u>Less: Provisions and securities held</u>	<u>Net reinsurance recoverable</u>
A	\$47,706	\$ –	\$47,706
Not rated	266	\$2,434	–
	<u>\$47,972</u>	<u>\$2,434</u>	<u>\$47,706</u>

Included in gross reinsurance recoverable is reinsurers' share of unearned premiums of \$4,659, reinsurers' share of provision for unpaid claims of \$39,758 and receivables from reinsurers presented as due from insurance companies of \$3,375.

No balances due from reinsurers are considered past due as at June 30, 2009.

Capital management

Capital is comprised of the Company's shareholders' equity and bank indebtedness. As at June 30, 2009 the Company's shareholders' equity was \$129,748 and bank indebtedness was \$19,550. The Company's objectives when managing capital are to maintain financial strength and protect its claims paying abilities, to maintain creditworthiness and to maximize returns to shareholders over the long term.

A common measure of capital adequacy in the property and casualty industry used by management is the ratio of premiums to surplus (or shareholders' equity). A lower ratio implies a higher measure of capital adequacy. The Company's ratio as at June 30, 2009 is 1.2:1. This level is well below the 2.5:1 ratio considered by management to be the maximum acceptable ratio.

The Company's Canadian insurance subsidiary, Echelon, is required to maintain minimum capital levels as required by the Office of the Superintendent of Financial Institutions. At June 30, 2009 and December 31, 2008, the Company exceeded the minimum regulatory capital requirement. Legislation applicable to insurance companies imposes certain restrictions on the Company's ability to pay dividends.

7 Share capital

	<u>June 30 2009</u>	<u>December 31 2008</u>
Authorized:		
Unlimited common shares		
Issued:		
11,819,582 common shares		
(2008 – 11,676,282 common shares)	<u>\$67,747</u>	<u>\$67,056</u>

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On March 27, 2009, common share dividends of \$819 or \$0.07 per share were paid to common shareholders of record March 13, 2009. No dividends were declared or paid in the second quarter of 2009.

During 2009, 143,500 common shares were issued pursuant to the exercise of options under the employee stock option plan.

During the first quarter of 2009, the Company, pursuant to its normal course issuer bid, purchased and cancelled 200 shares.

8 Bank indebtedness

On October 11, 2007, the Company entered into a non-revolving term loan facility with a major Canadian bank in the amount of \$19,550. The facility has a term of three years, bearing an interest rate of 6.20%. During the term of the loan, monthly payments will include interest only and on maturity a balloon payment of \$19,550 will be made to settle the principal amount.

9 Income per share

	Quarter to June 30		6 months to June 30	
	2009	Restated (note 2) 2008	2009	Restated (note 2) 2008
Basic income per share:				
Net income available to common shareholders	\$4,831	\$3,019	\$4,601	\$4,344
Average number of common shares (in thousands)	11,765	9,716	11,765	9,716
Basic income per share	<u>\$ 0.41</u>	<u>\$ 0.31</u>	<u>\$ 0.39</u>	<u>\$ 0.45</u>
Diluted income per share:				
Average number of common shares (in thousands)	11,765	9,716	11,765	9,716
Average number of common shares obligation under employee stock option plan (in thousands)	840	805	840	805
Average number of diluted common shares (in thousands)	<u>12,605</u>	<u>10,521</u>	<u>12,605</u>	<u>10,521</u>
Diluted income per share	<u>\$ 0.38</u>	<u>\$ 0.28</u>	<u>\$ 0.36</u>	<u>\$ 0.41</u>

10 Segmented information

The Company operates through three divisions. The Personal Lines and Niche Products divisions operate in Canada while the International division assumes premiums from U.S resident companies that specialize in the non-standard automobile market. Through its Personal Lines division, the Company is engaged primarily in the underwriting of high premium, non-standard automobile insurance. Through its Niche Products division, the Company designs and underwrites specialized non-auto insurance programs, such as higher premium property, primary and excess liability, legal expense, accident and health insurance and warranty coverage.

The effect of reinsurance is reflected in the revenue and results of the three divisions. The investment activities consist of managing the investment portfolio for the Company as a whole. Investment income is shown net of investment expenses. The corporate and other activities include holding

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company expenses not attributable to a division. Interest expense represents interest on bank indebtedness.

	Quarter to June 30		6 months to June 30	
	2009	Restated (note 2) 2008	2009	Restated (note 2) 2008
Revenue				
Earned premiums and other revenue				
Property and casualty insurance				
Canada – Personal Lines	\$25,080	\$24,505	\$50,256	\$47,586
– Niche Products	8,743	8,705	22,245	28,400
	33,823	33,210	72,501	75,986
International (United States)	1,663	2,789	4,558	5,572
	35,486	35,999	77,059	81,558
Interest and dividends, net of investment expenses	3,057	2,688	6,082	5,860
Realized investment gains	3,243	2,032	1,678	3,215
Foreign exchange gains (losses)	(283)	(2)	131	230
Total revenue	41,503	40,717	84,950	90,863
Income (loss) before income taxes				
Property and casualty insurance				
Canada – Personal lines	2,588	4,973	2,994	3,939
– Niche Products	1,003	(3,736)	(269)	(4,414)
	3,591	1,237	2,725	(475)
International (United States)	(1,436)	(805)	(2,185)	(1,082)
Corporate and other	(452)	(410)	(709)	(686)
Underwriting income (loss)	1,703	22	(169)	(2,243)
Interest and dividends, net of investment expenses	3,057	2,688	6,082	5,860
Realized investment gains	3,243	2,032	1,678	3,215
Foreign exchange gains (losses)	(283)	(2)	131	230
Interest expense	(305)	(306)	(604)	(608)
Total income before income taxes	\$7,415	\$4,434	\$7,118	\$6,454