

## **EGI FINANCIAL HOLDINGS INC.**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**For the period ending March 31, 2008**

*References to “EGI” or “Company” in this Management’s Discussion and Analysis of Financial Condition and Results of Operations refer to EGI Financial Holdings Inc. on a consolidated basis, both now and in its predecessor forms*

The following discussion should be read in conjunction with EGI’s unaudited interim consolidated financial statements for the first quarter of fiscal 2008 and 2007, with the notes to the interim unaudited consolidated financial statements for the first quarter of fiscal 2008, with the management’s discussion and analysis (MD&A) set out on pages 12 to 45 of the Company’s 2007 Annual Report and with the notes to the audited consolidated financial statements for fiscal 2007 set out on pages 52 to 66 of the Company’s 2007 Annual Report. The following commentary is current as of May 5, 2008. Additional information relating to EGI is available on SEDAR at [www.sedar.com](http://www.sedar.com). Certain totals, subtotals and percentages may not reconcile due to rounding.

EGI uses both Canadian generally accepted accounting principles (GAAP) and certain non-GAAP measures to assess performance. Securities regulators require that companies caution readers about non-GAAP measures that do not have a standardized meaning under GAAP and are unlikely to be comparable to similar measures used by other companies. EGI analyzes performance based on underwriting ratios such as combined, expense and loss ratios.

The following discussion contains forward-looking information that involves risk and uncertainties based on current expectations. This information includes, but is not limited to, statements about the operations, business, financial condition, priorities, targets, ongoing objectives, strategies and outlook of EGI for 2008 and subsequent periods.

This information is based upon certain material factors or assumptions that were applied in drawing a conclusion or making a projection as reflected in the forward-looking information. By its nature, this information is subject to inherent risks and uncertainties that may be general or specific. A variety of material factors, many of which are beyond EGI’s control, affect the operations, performance and results of EGI and its business, and could cause actual results to differ materially from the expectations expressed in any of this forward-looking information.

EGI's actual results could differ materially from those anticipated in this forward-looking information as a result of various factors, including those discussed in this MD&A. Additional information about the general risks and uncertainties regarding EGI's business is provided in its disclosure materials, including its annual information form, filed with the securities regulatory authorities in Canada, available at [www.sedar.com](http://www.sedar.com). EGI does not undertake to update any forward-looking information.

## Overall Performance

The summary of financial data set forth in the following tables has been prepared in accordance with Canadian GAAP and has been derived from the unaudited interim consolidated financial statements for the three month periods ended March 31, 2008 and 2007.

(in \$ thousands)	Quarter to March 31	
	2008	2007
Direct and assumed premiums written	34,936	30,196
Net earned premiums	45,559	24,790
Underwriting income	(397)	1,304
Investment income	4,587	2,601
Net income	2,586	2,527
Earnings per share before extraordinary gain (in dollars)		
Basic	0.27	0.26
Diluted	0.25	0.24
ROE <sup>(1)</sup>	15.3%	20.6%

(1) Represents EGI's net income for the twelve months ended on the date indicated, divided by the average shareholders' equity over the same twelve-month period.

	Quarter to March 31	
	2008	2007
Loss ratio	68.4%	61.0%
Expense ratio	32.4%	33.7%
Combined ratio	100.8%	94.7%

(in \$ thousands)	<u>As at March 31 2008</u>	<u>As at Dec 31 2007</u>
Investments (excluding premium finance receivables)	243,717	238,310
Premium finance receivables	18,453	19,569
Total assets	371,052	370,084
Total shareholders' equity	104,310	101,671
Book value per share <sup>(1)</sup>	10.74	10.50

(1) Shareholders' equity divided by the number of shares issued and outstanding.

Net income of \$2.6 million for the three months ended March 31, 2008, represents an increase of \$0.1 million, or 4% compared to net income of \$2.5 million in the first quarter of 2007. An underwriting loss of \$0.3 million was incurred in the first quarter of 2008 compared to an underwriting gain of \$1.3 million in the same period of 2007. Offsetting the shortfall in underwriting income in 2008, compared to 2007, is an increase in investment income of \$2.0 million to \$4.6 million in 2008 from \$2.6 million in the first three months of 2007.

The underwriting loss of \$0.3 million in 2008 is primarily attributable to an increase in the loss ratio to 68.4% as compared to 61.0% during the first three months of 2007. Both Canadian business segments experienced an increase in loss ratio in 2008 as compared to the same period in 2007. Personal Lines recorded a loss ratio of 68.8% in the first three months of 2008, as compared to 64.8% in 2007, primarily due to the longer duration of severe winter driving conditions during which the Company experienced a higher severity and frequency of claims. The Niche Products division loss ratio increased to 66.7% from 40.8% in the first quarter of 2007 primarily due to a higher than expected loss ratio incurred in the Emergency Travel Health (ETH) line of business. EGI's exposure to this line of business will be reduced in the next two quarters as the peak travel period for policyholders falls during the winter months. Excluding the unfavourable claims experience in this line of business, all other Niche Products programs recorded a loss ratio of 36.6%, exceeding expectations of management for the period. The Company's U.S. reinsurance business has been reorganized into the International division, consisting of the accounting consolidation of CIM Reinsurance Company Ltd. (CIM Re) and EGI Insurance Services, Inc. (For further discussion, refer to the Segmented Financial Information section on Page 13.)

Total investment income, consisting of income from interest and dividends and realized gains (losses), for the quarter was \$4.6 million, compared to \$2.6 for the first quarter of 2007. Income from interest and dividends increased to \$3.2 million compared to \$2.2 million in the same period last year, due primarily to growth in the investment portfolio. The portfolio grew to a fair value of \$262.2 million as at March 31, 2008 compared to \$216.0 million as at March 31, 2007. Realized gains on the sale of investments increased to \$1.4 million in the first three months of 2008 compared to \$0.4 million in the same period in 2007. Basic earnings per share for the first quarter of 2008 increased 4% to \$0.27 compared to \$0.26 for the same period in 2007. Fully diluted earnings per share were \$0.25 in the first quarter of 2008, an increase of \$0.01 or 4% from \$0.24 in the first quarter of 2007.

Direct written and assumed premiums increased \$4.7 million, or 15.6%, to \$34.9 million in the first quarter of 2008 compared to \$30.2 million in the first three months of 2007. Premium growth was achieved in both the Personal Lines and Niche Products business segments. In our Personal Lines division, direct premiums increased to \$22.5 million, an increase of 10.8% from 2007. Of this total increase, 8.8% is attributable to the non-standard auto line of business and 12.5% to the motorcycle line. We continue to achieve significant growth in our Niche Products business segment, recording direct and assumed premiums written of \$8.8 million in the first quarter of 2008, an increase of \$3.2 million or 57% over the same period in 2007.

Net earned premiums increased \$20.8 million, or 83.8%, to \$45.6 million in the first quarter of 2008 compared to \$24.8 million in the same period in 2007. This significant increase in net earned premiums compared to the 15.6% increase in direct and assumed premiums is primarily due to Emergency Travel Health premiums earned in the quarter. As noted in our year-end reports, the majority of premiums written in 2007 from this line of business is earned during the first and second quarters of 2008.

For the three months ended March 31, 2008 shareholders' equity increased to \$104.3 million, an increase of \$2.6 million from December 31, 2007. The increase in shareholders' equity consists of net income of \$2.6 million in the quarter, the issuance of common shares of \$0.1 million and other comprehensive income of \$0.5 million, which were offset by the payment of quarterly dividends of \$0.6 million to common shareholders of record on March 14, 2008.

## **Subsequent Developments**

The International division authorized two quota share reinsurance coverages, effective April 1, 2008, for Cornerstone National Insurance Company of Columbia, Missouri. Cornerstone underwrites non-standard auto insurance through managing general agents (MGAs). Under the treaties, CIM Re provides coverage for two of these MGAs, with an annual premium limit of US\$3,600,000. CIM Re is currently considering providing reinsurance coverage for certain of Cornerstone's other MGAs.

On April 18, 2008, the Financial Services Commission of Ontario approved Echelon's motorcycle rate filing which provides for a 17.9% average rate increase on Echelon's Ontario motorcycle business. The rate increase is effective May 15, 2008 for new business, June 15, 2008 for renewal business, and is expected by management to restore a reasonable profit margin on this business.

## **Critical Accounting Estimates and Assumptions**

For a description of EGI's accounting policies, refer to notes 2 and 3 in the 2007 audited financial statements as set out on pages 46 to 66 of the Company's 2007 Annual Report. A further description of EGI's critical accounting estimates and assumptions is also detailed on pages 23 and 24 of the 2007 Annual Report.

There have been no changes to the Company's accounting policies or assumptions made in critical accounting estimates in the first quarter of 2008, except as described in Note 2 of the interim financial statements for the quarter ended March 31, 2008, included in this report.

## Summary of Quarterly Results

A summary of the Company's last eight quarters is as follows:

(\$ thousands except per share amounts)	2008	2007				2006			
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2	
Direct written and assumed premiums	34,936	43,098	42,343	42,299	30,196	25,936	29,184	36,622	
Total revenues (excluding investment income)	45,559	34,161	30,847	29,808	24,790	24,190	28,490	26,189	
Underwriting income (loss)	(397)	609	3,536	4,533	1,304	3,493	6,228	3,859	
Income (loss) before income taxes	3,888	5,658	6,772	6,601	3,905	7,949	8,371	5,660	
Net income	2,586	3,727	4,462	4,349	2,527	5,200	5,489	3,857	
Earnings per adjusted share									
Basic	0.27	0.39	0.46	0.45	0.26	0.54	0.57	0.40	
Diluted	0.25	0.35	0.44	0.42	0.24	0.51	0.54	0.38	
Selected Financial Ratios (%)									
Loss ratio	68.4	65.1	58.2	53.2	61.0	61.0	48.9	54.3	
Expense ratio	32.4	33.1	30.3	31.6	33.7	24.6	29.2	31.0	
Combined	100.8	98.2	88.5	84.8	94.7	85.6	78.1	85.3	

## Quarter Ended March 31, 2008 Compared to Quarter Ended March 31, 2007

The following financial information compares the first quarter 2008 results with the first quarter of 2007.

	1st Quarter 2008	1st Quarter 2007	Variance \$	Variance %
Direct written and assumed premiums	34,936	30,196	4,740	15.6
Net written and assumed premiums	32,422	28,323	4,099	14.5
Net earned premiums	45,559	24,790	20,769	83.8
Claims incurred	31,163	15,131	16,032	105.9
Acquisition costs	11,588	5,630	5,958	105.8
Operating expenses	3,205	2,725	480	17.6
Underwriting income	(397)	1,304	(1,701)	(130.4)
Investment income	4,587	2,601	1,986	76.4
Interest expense	302	-	302	
Net income before income taxes	3,888	3,905	(17)	(0.4)
Income taxes	1,302	1,378	(76)	(5.5)
Net income	2,586	2,527	59	2.3

## **Insurance Operation**

### *Written and Assumed Premiums*

Direct written premiums increased \$4.7 million, or 15.6%, to \$34.9 million for the three months ended March 31, 2008, compared to \$30.2 million for the first three months of 2007. EGI has realized an increase in premiums in each of the Canadian business segments. Personal Lines premiums increased \$2.2 million to \$22.5 million in 2008 compared to \$20.3 million in the first quarter of 2007. Despite ongoing competitive conditions in the market, non-standard auto premiums increased to \$19.9 million, an increase of \$1.7 million or 9.3% compared to \$18.2 million in the first three months of 2007. Motorcycle direct written premiums increased to \$2.4 million compared to \$2.1 million in the first quarter of 2007, this growth being primarily derived from our exclusive arrangement with an Ontario based motorcycle insurance broker. Direct written premiums for the Niche Products division increased 57.1% to \$8.8 million for the three months ended March 31, 2008, compared to \$5.6 million in the same period in 2007. The increase is primarily attributable to ETH written premiums of \$2.6 million in the first quarter of 2008, a market which EGI entered in the third quarter of 2007. Premiums from the International division, consisting of assumed business from AAIC, a non-standard writer in southeastern United States, declined to \$3.6 million in the first quarter of 2008 from \$4.3 million in the same period in 2007.

Net written and assumed premiums increased \$4.1 million, or 14.5%, to \$32.4 million compared to \$28.3 in the same period last year. This increase is consistent with the increase in direct written and assumed premiums in the period compared to 2007.

### *Earned Premiums*

Net earned premiums for the three months ended March 31, 2008, totaled \$45.6 million, an increase of \$20.8 million, or 83.8%, as compared to \$24.8 million in the first three months of 2007. This significant increase is primarily due to the increase in net earned premiums of \$14.3 million from the Emergency Travel Health line of business. As noted in earlier reports, premiums from this line of business which was introduced in the third quarter of 2007, are earned primarily in the winter months, the peak period for policyholders travelling outside of Canada. Due to the seasonality of this business, a relatively low amount of unearned premiums, \$3.2 million, remains as at March 31, 2008 reflecting the limited exposure remaining in this line

of business related to the 2007-2008 travel period.

### *Incurred Claims Expense*

Net incurred claims expense increased \$16.1 million, or 106.6%, to \$31.2 million for the three months ended March 31, 2008, compared to \$15.1 million for the same period in 2007. This is significantly higher than the 83.8% increase in net earned premiums, primarily due to the higher than expected Niche Products loss ratio of 66.7% in the period, resulting from adverse claims experience incurred in the ETH line of business. In the first quarter of 2008, this line of business experienced a loss ratio of 78.2%, significantly above expectations. It is important to note that this experience relates to claims incurred in the first quarter of 2008, the majority of which have not yet been paid. As a result, claims incurred is primarily derived from the increase in outstanding case and bulk IBNR reserves as at March 31, 2008. Based on information available as at March 31, 2008, the reserves are based on conservative estimates which take into account a number of factors related to each claim including severity of policyholder illness, expected period of required hospital care and anticipated claim cost discounts to be achieved by our preferred providers. As noted above, exposure to claims related to this line of business is limited in the next two quarters due to travel seasonality. The first quarter experience from the Emergency Travel Health line of business significantly increased an otherwise profitable Niche Products division loss ratio in the period. Excluding this line of business, all other Niche Products programs experienced a superior loss ratio of 36.6%. This result compares to this division's loss ratio of 40.8% in the first three months of 2007, prior to the Company's entry into the ETH market.

Personal Lines products produced a loss ratio of 68.8% in the first quarter of 2008 compared to 64.9% in the same period in 2007. The increase in the loss ratio is primarily due to the longer than expected severe winter driving conditions experienced in the first quarter of 2008, which resulted in increased severity and frequency of reported claims. Partially offsetting the higher auto loss ratio in the quarter was a significantly improved loss ratio of 17% experienced from the motorcycle line of business. This positive result was anticipated as exposure to motorcycle claims is greatly reduced in the winter months. Positive development of Personal Lines prior year claims, of \$1.6 million was recorded in the first quarter of 2008. However, this positive development was lower than last year. During the same period in 2007, favourable prior year claims development of \$3.1 million was recorded for this division.

### *Acquisition Costs*

Net acquisition costs, which mainly consist of commissions and premium taxes, increased \$6.0 million, or 107%, to \$11.6 million for the three months ended March 31, 2008, compared to \$5.6 million in the same period in 2007. This relatively large increase, as compared to the increase of 83.8% in net earned premiums, is the result of the growth in Niche Products premiums in proportion to Personal Lines. Distribution costs related to Niche Products are higher than Personal Lines, which are expected to be offset by lower loss ratios in the Niche Line of business. As a percentage of net earned premiums, acquisition expenses increased to 25.4% in the first three months of 2008 compared to 22.7% in the same period last year.

### *Operating Expenses*

Operating expenses increased \$0.5 million, or 18.5%, to \$3.2 million for the three months ended March 31, 2008, compared to \$2.7 million for the first quarter of 2007. The increase is slightly higher than the 14.5% increase in net written premiums due to the start-up costs associated with our recently formed U.S. subsidiary, EGI Insurance Services, Inc. As noted in the Outlook section earlier in the report, this subsidiary, staffed with a small team of experts in U.S. niche and specialty lines of business, will perform the initial due diligence and ongoing monitoring of CIM Re's existing and potential reinsurance clients. EGI has not deferred any portion of these start-up costs to future periods.

### *Underwriting Income (Loss)*

Underwriting results reflect revenues from net earned premiums less claims, acquisition and operating expenses. In the quarter ended March 31, 2008 total underwriting contribution decreased \$1.7 million to an underwriting loss of \$0.4 million, compared to an underwriting gain of \$1.3 million for the comparable period in 2007. The underwriting result for 2008 and 2007 includes \$0.3 million and \$0.2 million of corporate and other expenses, respectively, which have not been allocated to the operating divisions.

Underwriting income from the Personal Lines division for the three months ended March 31, 2008, was \$0.8 million, a slight increase of \$0.1 million, compared to income of \$0.7 million for the first three months of 2007. This result was achieved despite a higher loss ratio due to a decline in the expense ratio incurred. The decline in the expense ratio is partially attributable to an allocation of shared expenses to the Niche Products division of \$0.3 million in the first

quarter of 2008. Allocation of shared expenses to the Niche Products division commenced in the second quarter of 2007.

The underwriting loss from Niche Products for the three months ended March 31, 2008, was \$0.7 million, a decrease of \$1.5 million compared to an underwriting gain of \$0.8 million in the first three months of 2007. As noted earlier, this decline is due to the unfavourable claims experience incurred in the ETH line of business. As noted above, this result compared to the same period in 2007 is also impacted by the allocation of shared expenses to the Niche Products division which did not commence until the second quarter of 2007.

The International division experienced an underwriting loss of \$0.3 million in the first quarter of 2008 due to a slightly higher than expected loss ratio and start up costs associated with EGI Insurance Services, Inc.

#### *Investment Income*

Investment income for the three months ended March 31, 2008 was \$4.6 million compared to \$2.6 million for the same period in 2007. Income from interest and dividends increased to \$3.2 million compared to \$2.2 million in the same period last year, due to the growth in the investment portfolio. Realized gains on the sale of investments increased to \$1.4 million in the first three months of 2008 compared to \$0.4 million in the same period in 2007.

EGI's investment portfolio reflected a \$46.2 million, or 21.4%, increase in fair value as at March 31, 2008, compared to March 31, 2007, due to investment returns and positive cash flows from operations during the period and bank indebtedness of \$19.5 million which funds were borrowed on October 1, 2007.

#### *Interest Expense*

During the first three months of 2008, interest expense related to bank indebtedness of \$0.3 million was incurred. No interest expense was incurred in the first quarter of 2007.

#### *Net Income before Income Taxes*

Net income before income taxes for the three months ended March 31, 2008, was \$3.9 million, unchanged as compared to the result for the three months ended March 31, 2007. The underwriting loss experienced in 2008 was offset by the increase in investment income in the period as compared to 2007.

For the three months ended March 31, 2008, an underwriting loss of \$0.4 million plus investment income of \$4.6 million, reduced by interest expense on bank indebtedness of \$0.3 million, comprised net income before income taxes of \$3.9 million. This compares to an underwriting income of \$1.3 million, plus investment income of \$2.6 million, in the first three months of 2007.

### *Income Taxes*

The provision for income taxes for the quarter ended March 31, 2008, was \$1.3 million compared to \$1.4 million for the first quarter of 2007. This decrease reflects a slightly lower effective tax rate achieved in 2008 as compared to the same period in 2007.

### **Segmented Financial Information**

	<b>Three months ended March 31</b>							
	<b>2008</b>				<b>2007</b>			
	<u>Personal Lines</u>	<u>Canada Niche</u>	<u>Total</u>	<u>International</u>	<u>Personal Lines</u>	<u>Canada Niche.</u>	<u>Total</u>	<u>International</u>
Underwriting revenue	23,081	19,695	42,776	2,783	19,531	4,383	23,914	876
Underwriting income (loss)	834	(678)	156	(277)	742	778	1,520	3
Loss ratio	68.8%	66.7%	67.8%	77.0%	64.9%	40.8%	60.5%	75.4%
Expense ratio	27.5%	36.7%	31.8%	32.9%	31.3%	41.4%	33.1%	24.2%
Combined ratio	96.3%	103.4%	99.6%	109.9%	96.2%	82.2%	93.6%	99.6%

The segmented information, for the first quarter of 2008, shows that Personal Lines contributed an underwriting income of \$0.8 million while the Niche Products division recorded an underwriting loss of \$0.7 million, resulting in an underwriting income of \$0.1 million for the Canadian business segments combined. The International division, consisting of assumed business from the U.S. insurer, recorded an underwriting loss of \$0.3 million.

The loss ratio in Personal Lines was 68.8% for the quarter ended March 31, 2008, compared to 64.9% for the same period in 2007. As noted above, the increase is primarily attributable to the severe winter driving conditions experienced in the first quarter of 2008 and a decrease in the positive development of prior year claims as compared to the same period in 2007.

The Niche Products division loss ratio was 66.7% in the first quarter of 2008 compared to

40.8% for the same period in 2007. As described above, the increase was the result of adverse loss experience in the ETH line of business of 78.2%. All other programs in the Niche Products division experienced an improved loss ratio of 36.6% as compared to the Niche Products division loss ratio of 40.8% in the first quarter of 2007.

The International division incurred a loss ratio of 77.0% in the first three months of 2008 compared to 75.4% in the first quarter of 2007.

The expense ratio for Personal Lines, in the first quarter of 2008, decreased to 27.5% compared to 31.3% for the same period in 2007. This was the result of the proportionally higher increase in net earned premiums as compared to operating expenses. The Niche Products division expense ratio also improved to 36.7% in 2008 compared to 41.4% for the first quarter of 2007 due to improved economies of scale resulting from the significant increase in net earned premiums for this business segment in 2008. A significant portion of the first quarter net earned premium increase was generated from the ETH line of business, which as noted above, is earned primarily during the winter months.

## Balance Sheet Analysis

*The Balance Sheet analysis that follows should be read in conjunction with the unaudited interim consolidated first quarter 2008 financial statements and notes therein, which include additional disclosures related to balance sheet risk management.*

### Investments

The following table sets forth EGI's invested assets as at March 31, 2008, and December 31, 2007.

	<b>March 31 2008</b>	<b>December 31 2007</b>
	<b>Fair value</b>	<b>Fair value</b>
Bonds		
Canadian		
Federal	\$71,731	\$ 80,378
Provincial	36,202	30,948
Municipal	6,061	3,908
Corporate	75,949	67,864
	<u>189,943</u>	<u>183,098</u>
United States		
Federal	3,225	2,288
Corporate	701	666
	<u>3,926</u>	<u>2,954</u>
Total Bonds	193,869	<u>186,052</u>
Preferred shares	<u>\$6,480</u>	<u>6,106</u>
Common shares		
Canadian	39,295	42,150
United States	1,734	2,244
	<u>41,029</u>	<u>44,394</u>
Investment income due and accrued	2,399	1,758
	<u>\$243,717</u>	<u>\$238,310</u>

Included in the common shares held by the Company is an investment in the Gladiator Limited Partnership (Gladiator LP) which is managed by Savoy Capital with a cost of \$0.2 million and a market value of \$0.2 million, at March 31, 2008. As noted in our 2007 interim and annual reports, in August 2006, subsequent to a notice provided by Savoy to terminate the investment management services agreement with the Gladiator fund, Savoy ceased actively investing in the fund and immediately began to employ a defensive position. Equity exposures were reduced significantly and the cash position increased.

Since that time, the process to wind up the fund has been substantially completed resulting in total cash redemptions received by EGI of \$7.8 million, of which \$1.0 million was received in the first quarter of 2008, further lowering the fair value of EGI's investment to \$0.2 million as at March 31, 2008. EGI expects the remaining holdings to be monetized during 2008.

### **Recoverable from Reinsurers**

As at March 31, 2008, the recoverable from reinsurers increased to \$52.6 million as compared to \$52.0 million as at December 31, 2007. This nominal increase represents an increase in claims recoverable from reinsurers related to claims incurred in the first quarter of 2008, covered by excess of loss reinsurance arrangements.

### **Accounts Receivable**

Premium financing receivables are the largest component of this asset as at March 31, 2008, and represents approximately 80% or \$18.4 million of total receivables. During the first quarter of 2008 premium financing receivables decreased \$1.2 million from \$19.6 million at December 31, 2007. These premiums are primarily billed directly to policyholders who are provided with a monthly payment financing option.

### **Provision for Unpaid Claims**

As recommended by our independent actuary, EGI establishes loss reserves to provide for future amounts required to pay claims related to insured events, that have occurred and been reported but have not yet been settled, and related to events that have occurred but have not yet been reported to EGI. Claims provisions (i.e., reserves for claims liability) are established at the individual file level by the "case method" as claims are reported.

Provision for unpaid claims consists of the aggregate amount of individual case reserves

established and management's estimate of claims incurred but not reported based on the volume of business currently in force and historical claims experience. In order to ensure as far as possible that EGI's provision for unpaid claims (often called "reserves") is adequate, management has retained the services of an independent actuary. EGI strives to establish adequate provisions at each quarter end.

The table below shows the development of the provision for claims reserves, including loss adjustment expenses as at December 31 in each year of the five year period and for the three months ended March 31, 2008.

(in \$ thousands)	Years ended December 31				
	2007	2006	2005	2004	2003
Reserve Carried (actuarial present value basis) <sup>(1)</sup>	161,526	145,691	129,041	107,196	79,191
Reserve at December 31, 2003					
Cumulative paid to December 31, 2003					
Cumulative Redundancy (Deficiency)					
Reserve at December 31, 2004					56,226
Cumulative paid to December 31, 2004					24,184
Cumulative Redundancy (Deficiency)					(1,219)
Reserve at December 31, 2005				70,620	37,802
Cumulative paid to December 31, 2005				24,922	38,802
Cumulative Redundancy (Deficiency)				11,654	2,587
Reserve at December 31, 2006			88,029	49,557	25,214
Cumulative paid to December 31, 2006			25,817	41,158	49,592
Cumulative Redundancy (Deficiency)			15,195	16,481	4,385
Reserve at December 31, 2007		107,992	67,408	36,129	17,569
Cumulative paid to December 31, 2007		30,432	46,413	55,306	58,217
Cumulative Redundancy (Deficiency)		7,267	15,220	15,761	3,405
Reserve at March 31, 2008	153,449	103,107	64,392	35,096	16,809
Cumulative paid to March 31, 2008	11,966	34,029	49,086	56,799	59,270
Cumulative Redundancy (Deficiency)	2,872	8,555	15,563	15,341	3,112

1) Amounts include Provision for Adverse Deviation (PfAD) of \$17,401; \$14,756 for 2006; \$12,473 for 2005; \$8,613 for 2004 and \$6,137 for 2003.

The table above, which is reflected on a gross basis for all years, shows that for the first three months of 2008 the total prior year reserve redundancies released pursuant to the March 31, 2008 actuarial report, were \$3.8 million.

The uncertainties regarding EGI's reserves could result in a liability exceeding the reserves by an amount that would be material to EGI's financial condition or results of operations in a future period. Future development could be significantly different from the past, due to many unknown factors.

## **Reinsurance**

EGI has reinsurance treaties with several unaffiliated reinsurers, all of whom are selected on the basis of their creditworthiness. EGI purchases reinsurance to reduce its exposure to the insurance risks that it assumes in writing business. For 2008 the maximum net retention on a single risk is \$1.5 million.

In accordance with industry practice, EGI's reinsurance recoverables with licensed Canadian reinsurers are generally unsecured, because Canadian regulations require these reinsurers to maintain minimum asset and capital balances in Canada to meet their Canadian obligations. Policy liabilities rank in priority to any subordinate creditors a reinsurer may have. For reinsurance recoverables with non-licensed reinsurers, EGI maintains security against reinsurance recoverables in the form of cash, letters of credit and/or assets held in trust accounts. At March 31, 2008, EGI was the assigned beneficiary of such trust accounts totalling \$2.4 million (December 31, 2007 - \$2.4 million) in guarantees from unlicensed reinsurers.

EGI purchases renewable excess of loss and catastrophe reinsurance from third party reinsurers, covering its automobile and general liability business. In 2008, excess of loss coverage on a single occurrence is for a total of \$18,500,000 and in 2007 it was for \$13,850,000. Total catastrophic coverage is \$18,000,000 in 2008 and \$13,850,000 in 2007. Other than general liability, coverages comprised by the programs of the Niche Products division are reinsured on a program-by-program basis.

Using reinsurance, EGI's policy is to limit its loss exposure on any one claim to not more than 2% of its shareholders' equity.

## **Share Capital**

As of May 5, 2008, there were 9,709,152 common shares issued and outstanding. (See Note 7 to the interim unaudited 2008 consolidated financial statements.)

## **Liquidity and Capital Resources**

The purpose of liquidity management is to ensure there is sufficient cash to meet all of EGI's financial commitments and obligations as they come due. EGI believes that it has the flexibility to obtain, from internal sources, the funds needed to fulfill its cash requirements during the following financial year and to satisfy regulatory capital requirements. EGI's principal sources of funds are premiums collected, investment income and proceeds from investments that have

been sold or have matured. However, such funds may not provide sufficient capital to enable EGI to pursue additional market opportunities.

In October 2007, EGI entered into a non-revolving term credit facility with a major Canadian bank in the amount of US\$20 million, converted to CDN\$19.55 million, the equivalent Canadian dollar amount as of the closing date. The aggregate commitments under the credit facility may be increased to an aggregate amount of up to US\$40 million, subject to certain conditions. The facility bears interest of 6.2% which is payable monthly over the 3 year term of the agreement. After 3 years EGI is obligated to repay the amounts drawn as at the termination of the agreement. Pursuant to the credit facility agreement EGI is required to comply with various financial covenants and financial information reporting requirements.

During the three year term, EGI has agreed to financial covenants which require EGI to maintain a minimum tangible net worth of \$80.0 million and a maximum debt to capital ratio of 0.30:1.00.

The initial drawdown of US\$20 million or CDN\$19.55 million was used to increase the capital of CIM Re, EGI's Barbados based reinsurance company, which will be used to reinsure selected niche and specialty line insurers which underwrite business in the U.S.

EGI's contractual obligations relating to operating leases are \$1.0 million due in less than a year and \$4.1 million due in the next five years.

## **Capital Resources**

For the three months ended March 31, 2008 shareholders' equity increased to \$104.3 million, an increase of \$2.6 million from December 31, 2007. The increase in shareholders' equity consists of net income of \$2.6 million in the quarter, the issuance of common shares of \$0.1 million, a transitional adjustment to AOCI as at January 1, 2008 related to an unrealized foreign exchange gain from a self-sustaining foreign operation (CIM Re) of \$0.2 million and other comprehensive income of \$0.3 million, which were offset by the payment of quarterly dividends of \$0.6 million to common shareholders of record on March 14, 2008.