

## **EGI FINANCIAL HOLDINGS INC.**

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

**For the period ending September 30, 2007**

*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 third quarter of fiscal 2007 and 2006, with the notes to the interim unaudited consolidated financial statements for the third quarter of fiscal 2007, with management’s discussion and analysis (MD&A) set out on pages 8 to 40 of the Company’s 2006 Annual Report and the notes to the audited consolidated financial statements for fiscal 2006 set out on pages 48 to 58 of the Company’s 2006 Annual Report. The following commentary is current as of November 6, 2007. 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 2007 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 Management's Discussion and Analysis. Additional information about the risks and uncertainties about 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.

### **Impact of new financial instrument standards**

On January 1, 2007 the Company adopted, on a prospective basis, two new accounting standards related to financial instruments, which were issued by the Canadian Institute of Chartered Accountants (CICA). The new standards, as they apply to EGI, result in the recording of all investments at fair value in the Consolidated Balance Sheet as at September 30, 2007. In addition, cumulative changes in the fair value of investments are reported in Accumulated Other Comprehensive Income (AOCI), a new component of Shareholders' Equity.

Upon adoption of these standards, total assets of EGI increased by \$8.0 million to reflect the adjustment to fair value of investments as at January 1, 2007 previously measured at cost or amortized cost. Also on January 1, 2007, the AOCI was credited an amount of \$5.3 million representing the adjustment to fair value of investments, as noted above, net of income tax. For further details, refer to Note 2 of EGI's unaudited Interim Consolidated Financial Statements for the third quarter of fiscal 2007.

During the first nine months of 2007, due to the decline in fair value of investments designated as available-for-sale investments, Other Comprehensive Losses of \$0.3 million were incurred. This represented the net unrealized losses, net of income tax, associated with these investments.

## 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 and nine-months periods ended September 30, 2007 and 2006.

(in \$ thousands)	Quarter to September 30		9 months to September 30	
	2007	2006	2007	2006
Direct and assumed premiums written	42,343	29,184	114,837	91,898
Total revenue	34,083	30,633	93,350	86,331
Underwriting income	3,536	6,228	9,373	11,017
Net income	4,462	5,489	11,338	11,780
Earnings per share before extraordinary gain (in dollars)				
Basic	\$0.46	\$0.57	\$1.17	\$1.22
Diluted	\$0.44	\$0.54	\$1.10	\$1.16
ROE <sup>(1)</sup>			18.3%	22.1%

(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 September 30		9 months to September 30	
	2007	2006	2007	2006
Loss ratio	58.2%	48.9%	57.3%	56.1%
Expense ratio	30.3%	29.2%	31.7%	30.1%
Combined ratio	88.5%	78.1%	89.0%	86.2%

(in \$ thousands)	As at Sept 30 2007	As at Dec 31 2006
Investments (excluding premium finance receivables)	208,949	179,383
Premium finance receivables	20,139	18,621
Total assets	335,264	288,439
Total shareholders' equity	100,303	86,041
Book value per share <sup>(1)</sup>	\$10.39	\$8.93

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

Net income of \$4.5 million for the three months ended September 30, 2007, represents a decrease of \$1.0 million, or 18.1% compared to net income of \$5.5 million in the third quarter of 2006. The primary reason for this result is the increase in the loss ratio in the quarter to 58.2% compared to 48.9% in 2006. The loss ratio increased in the third quarter of 2007 as compared to the same period in 2006, due to the low reported claims experience in the third quarter of 2006 and a decline in the prior year reserve releases in the third quarter of 2007 to \$2.0 million compared to \$2.6 million in the same period last year. Also, although written premiums grew significantly in the third quarter of 2007, Personal Lines growth occurred in the motorcycle line of business and assumed premium from U.S. reinsurance arrangements. These lines are not yet contributing similar margins as earned in the Company's other lines of business. As premiums are earned over the next 12 months and these lines mature, it is expected these areas will contribute more to profitability. As a result underwriting income decreased to \$3.5 million compared to \$6.3 million in the third quarter of 2006. Total investment income, consisting of income from interest and dividends and realized gains (losses), for the quarter was \$3.2 million, compared to \$2.1 in the third quarter of 2006. Income from interest and dividends increased to \$2.5 million compared to \$2.1 million in the same period last year, due to the growth in the investment portfolio. The portfolio grew to a fair value of \$229.1 million as at September 30, 2007 compared to \$195.8 million as at September 30, 2006. Realized gains on sales of investments were \$0.8 million in the third quarter of 2007 compared to realized losses of \$0.1 million in the same period in 2006. Basic earnings per share for the third quarter of 2007 decreased 19.3% to \$0.46 compared to \$0.57 for the same period in 2006. Fully diluted earnings per share were \$0.44 in the third quarter of 2007, compared to \$0.54 for the third quarter of 2006, a decrease of 18.5%.

Direct written and assumed premiums increased \$13.1 million or 44.9% to \$42.3 million in the third quarter of 2007 compared to \$29.2 million in the same period in 2006. Premium growth was achieved in both the Personal Lines and Niche Products business segments. In EGI's Personal Lines division, growth in motorcycle premiums, in the quarter, and the introduction of assumed premiums from related reinsurance treaties with two U.S. domiciled insurance companies, effective January 1, 2007, contributed to the growth of 12.4% compared to the same period in 2006. The Company continues to achieve significant growth in its Niche Products business segment, recording direct and assumed premiums written of \$15.2 million in the third quarter of 2007, an increase of \$10.1 million or 198% over the same period in 2006.

The significant growth in premiums largely resulted from the Niche Products division's entry into the emergency travel health insurance market in the quarter, which generated \$8.1 million of premiums written in the period. Premium from this new line of business will be earned in the last quarter of 2007 and first quarter of 2008.

For the nine month period ended September 30, 2007 net income was \$11.3 million, representing a decrease of \$0.5 million or 4.2% compared to net income of \$11.8 for the first nine months of 2006. The slight decline as compared to 2006 is primarily due to an increase in the loss ratio to 57.3% in the first nine months of 2007 compared to 56.1% for the same period last year. This resulted in a decrease in underwriting income to \$9.4 million or 14.5% less than underwriting income of \$11.0 million in the same period in 2006. Investment income was \$7.9 million in the first three quarters of 2007 compared to \$6.6 million in 2006. This was the result of an increase in income from interest and dividends to \$7.0 million in 2007 compared to \$6.1 million in the corresponding period in 2006, due to the growth in EGI's investment portfolio as noted above. Total realized gains were \$0.8 million in the first three quarters of 2007 compared to \$0.4 million in the same period last year.

Direct written and assumed premiums increased \$22.9 million or 24.9% to \$114.8 million in the first nine months of 2007 compared to \$91.9 million in the same period in 2006. As noted above, premium growth was achieved in both the Personal Lines and Niche Products divisions. On a year-to-date basis Personal Lines written and assumed premiums increased to \$86.0 million, or 11.1% compared to \$77.4 million in the same period in 2006. Growth in motorcycle premium and the introduction of U.S. assumed business effective January 1, 2007 were the primary reasons for the increase. Niche premiums totaled \$28.8 million in the nine month period ending September 30, 2007 compared to \$14.5 million in the same period in 2006, an increase of 98.6%. This increase reflects the previously noted entry into the emergency travel health market in the third quarter of 2007, and EGI's ongoing efforts to grow the Niche Products business by continuing to develop relationships with distributors.

Shareholders' equity increased to \$100.3 million as at September 30, 2007, an increase of \$4.5 million from June 30, 2007. Net income of \$4.5 million in the quarter and Other Comprehensive Income of \$0.4 million, the result of an increase in the fair value of EGI's investment portfolio in the quarter, were offset by quarterly dividends paid to common shareholders of \$0.4 million.

For the nine months ended September 30, 2007 shareholders' equity increased \$14.3 million from \$86.0 million as at December 31, 2006. As noted in EGI's third quarter Shareholders' Report, this increase was impacted by the implementation of the new accounting policy regarding Financial Instruments as described in Note 2 of the interim financial statements. Effective January 1, 2007 a transition adjustment of \$5.3 million, reflecting the adjustment to increase the fair value of the Company's investments was recorded. This amount is offset by an Other Comprehensive Loss of \$1.1 million in the first nine months of 2007, reflecting a decline in fair value of bonds in the period. The net impact of adopting the new financial instrument standard for the first nine months of 2007 is an increase in shareholders' equity of \$4.2 million. Other components of the increase in shareholders' equity were net income of \$11.3 million in the period and the issuance of common shares of \$0.2 million, which were offset by the payment of dividends to common shareholders of \$1.4 million in the first nine months of 2007.

### **Current Outlook**

The above-average results which the Canadian P&C insurance industry has experienced over the past three years has led to a more competitive market phase. The positive results encouraged most automobile insurers to implement rate reductions and loosen underwriting guidelines, thus creating competition for market share. As a result, in the near term the Company expects standard auto insurers to continue to pursue market share opportunities in traditionally non-standard auto areas, thereby reducing the opportunity for growth for non-standard auto insurers. The Company expects this to be a temporary situation for the non-standard market and the pendulum to swing back in the longer term, as standard insurers' margins erode on this higher risk business. In fact, the industry has experienced generally higher loss ratios in the automobile line of business in the latter part of 2006 and the first half of 2007, which may indicate the first signs of a swing back to tighter pricing and risk selection by standard carriers. EGI expects the favourable automobile underwriting results experienced by the P&C insurance industry over the past three years to deteriorate toward the industry's historic norms.

Through this market phase EGI will preserve its capital and is committed to focus on profitable lines of business, even though this may, in the short term, limit growth in direct written premiums of its traditional non-standard auto business. Despite the pressure on growth, EGI has managed its reinsurance arrangements to increase its net retained business, thereby utilizing its capital more effectively. Beginning in 2006, EGI eliminated its quota share reinsurance coverage on automobile business and is retaining higher limits for niche and

automobile coverages, resulting in growth in net written premiums in 2007 to date compared to the same period last year.

As the competitive auto insurance market creates some challenges for EGI to grow its premium income in the non-standard auto line of business, the Company will continue to pursue its diversification strategy to reduce its reliance on Ontario non-standard auto by growing its Niche Products division and by pursuing other opportunities in new geographic markets and new vehicle types, such as motorcycles. EGI will also continue to seek out opportunities for profitable growth through expansion of its existing businesses, including additional reinsurance opportunities in the United States, and by carefully selecting acquisitions in Canada and the United States.

EGI has laid the groundwork over the past three years to aggressively expand the Niche lines of business. With the recent transition of the Automobile division into a multi-product, multi-line Personal Lines division, EGI will enhance its diversification strategy even further. To date in 2007, especially in the second and third quarters, this strategy has yielded significant positive results as EGI has experienced premium growth in both of its divisions. The addition of new products and lines of business has the objective of enabling EGI to continue to perform at its current level by keeping ahead of its competitors and the perceived market trends.

### **Critical Accounting Estimates and Assumptions**

For a description of EGI's accounting policies refer to Note 3 in the 2006 audited financial statements as set out on pages 42 to 58 of the Company's 2006 Annual Report. A further description of EGI's critical accounting estimates and assumptions is also detailed on pages 18 and 19 of the 2006 Annual Report.

There have been no changes to the Company's accounting policies or assumptions made in critical accounting estimates in the first three quarters of 2007, except as described in Note 2 and 3 of the interim financial statements for the quarter ended September 30, 2007 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)	2007			2006			2005	
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Direct written and assumed premiums	42,343	42,299	30,196	25,936	29,184	36,622	26,092	28,081
Total revenues (excluding investment income)	30,847	29,808	24,790	24,190	28,490	26,189	25,075	19,950
Underwriting income	3,536	4,533	1,304	3,493	6,228	3,859	930	2,452
Income (loss) before income taxes	6,772	6,601	3,905	7,949	8,371	5,660	3,563	4,267
Net income	4,462	4,349	2,527	5,200	5,489	3,857	2,434	3,057
Earnings per adjusted share								
Basic	0.46	0.45	0.26	0.54	0.57	0.40	0.25	0.36
Diluted	0.44	0.42	0.24	0.51	0.54	0.38	0.24	0.35
Selected Financial Ratios (%)								
Loss ratio	58.2	53.2	61.0	61.0	48.9	54.3	66.1	60.6
Expense ratio	30.3	31.6	33.7	24.6	29.2	31.0	30.2	27.6
Combined	88.5	84.8	94.7	85.6	78.1	85.3	96.3	88.2

## Quarter Ended September 30, 2007 Compared to Quarter Ended September, 2006

The following financial information compares the third quarter 2007 results with the third quarter of 2006.

	3rd Quarter 2007	3rd Quarter 2006	Variance \$	Variance %
Direct written and assumed premiums	42,343	29,184	13,159	45.1%
Net written and assumed premiums	39,624	26,635	12,989	48.8%
Net earned premiums	30,847	28,490	2,357	8.3%
Claims incurred	17,951	13,945	4,006	28.7%
Acquisition costs	6,512	5,891	621	10.5%
Operating expenses	2,848	2,426	422	17.4%
Underwriting income	3,536	6,228	(2,692)	(43.2%)
Investment income	3,236	2,143	1,093	51.0%
Net income before income taxes	6,772	8,371	(1,599)	(19.1%)
Income taxes	2,310	2,882	(572)	(19.8%)
Net income	4,462	5,489	(1,027)	(18.7%)

## **Insurance Operation**

### *Written and Assumed Premiums*

Direct written and assumed premiums increased \$13.1 million, or 45.1%, to \$42.3 million for the three months ended September 30, 2007, compared to \$29.2 million for the third quarter of 2006. EGI has realized an increase in premiums despite current market conditions which resulted in a reduction of its Ontario non-standard auto business. Despite the shrinkage in EGI's Ontario non-standard auto, the growth overall was achieved due to the growth in motorcycle premiums in Ontario, the introduction of two assumed reinsurance treaties with U.S. domiciled insurance companies in 2007 and continued significant growth in Niche Products. In EGI's Personal Lines division, direct written and assumed premiums increased 12.4% to \$27.1 million compared to \$24.1 million in the third quarter of 2006. Ontario motorcycle direct written premiums increased to \$3.2 million compared to \$2.4 million in the third quarter of 2006 and assumed premiums of \$2.9 million were recorded from the new U.S. reinsurance arrangements in the third quarter of 2007. Direct written premiums for Niche Products increased 198% to \$15.2 million for the three months ended September 30, 2007, compared to \$5.1 million in the same period in 2006. This significant increase is attributable to EGI's entry into the emergency travel health market in the third quarter of 2007. This new line of business will contribute to the continuing growth of the Niche Products division with most of the written premiums from these new programs being earned prior to the end of 2007 and during the first quarter of 2008.

Net written and assumed premiums increased \$13.0 million, or 48.8%, to \$39.6 million compared to \$26.6 in the same period last year. This represents a higher increase over the same period last year when compared to the increase in direct written and assumed premiums due to more effective utilization of the Company's capital, through less utilization of reinsurance and the greater retention of risk.

### *Earned Premiums*

Net earned premiums for the three months ended September 30, 2007, were \$30.8 million, an increase of \$2.4 million, or 8.3%, from the same period in 2006. The growth in earned premiums is significantly lower than the growth in net written premiums in 2007 compared to 2006. This is primarily due to the introduction of new premium from the Niche Products division's entry into the emergency travel health line of business. During the third quarter of

2007, new direct premiums of \$8.1 million were written for this line of business, which will be earned predominantly in the last quarter this year and the first quarter of 2008, when many Canadian policyholders will be traveling.

#### *Incurred Claims Expense*

Net incurred claims expense increased \$4.0 million, or 28.7%, to \$18.0 million for the three months ended September 30, 2007, compared to \$14.0 million for the same period in 2006. This increase is higher than the 8.3% increase in net earned premiums, reflecting an increase in the loss ratio compared to the same period in 2006. The loss ratio in the third quarter of 2007 is 58.2% compared to 48.9% in the third quarter of 2006. Positive development of prior year claims continued in the third quarter of 2007 resulting in a release of \$2.0 million of net reserves that were accrued for prior accident years. This release, however, was lower than the \$2.6 million of prior year reserves released in the third quarter of 2006. Also contributing to the lower loss ratio in the third quarter of 2006 was the significant improvement in the current year (2006) loss ratio. Offsetting these factors is the growth in Niche Products, which recorded a loss ratio of 42.3% in the third quarter of 2007, which positively contributed to the company's overall loss ratio in 2007.

#### *Acquisition Costs*

Net acquisition costs, which mainly consist of commissions and premium taxes, increased \$0.6 million, or 10.5%, to \$6.5 million for the three months ended September 30, 2007, compared to \$5.9 million in the same period in 2006. This increase is higher than the increase in earned premiums of 8.3%, as a result of the growth in Niche Products premiums in proportion to Personal Lines. Distribution costs related to Niche Products are expected to be higher than Personal Lines, which are expected to be offset by lower loss ratios in the Niche line of business.

#### *Operating Expenses*

Operating expenses increased \$0.4 million, or 17.4%, to \$2.8 million for the three months ended September 30, 2007, compared to \$2.4 million for the third quarter of 2006, due to an accrual of the senior management bonus of \$0.3 million in the third quarter of 2007. Growth in the Niche Products division also contributed to the increase.

### *Income (Loss)*

Underwriting results reflect the revenues from net earned premiums less claims and acquisition and operating expenses. In the quarter ended September 30, 2007 total underwriting income decreased \$2.7 million to \$3.5 million, compared to \$6.2 million for the third quarter of 2006.

Underwriting income from the Personal Lines division for the three months ended September 30, 2007, was \$2.9 million, a decrease of \$3.6 million, compared to an income of \$6.5 million for the same period in 2006. This decrease was primarily the result of a higher loss ratio in the quarter compared to the same period in 2006. Partially offsetting the increase in loss ratio, Personal Lines division expenses were reduced by \$0.2 million due to the reallocation of corporate expenses to the Niche Products division in the quarter (see below).

The underwriting income from the Niche Products division for the three months ended September 30, 2007, was \$0.7 million, an increase of \$0.8 million, after the allocation of corporate expenses of \$0.2 million, compared to an underwriting loss of \$0.1 million in the third quarter of 2006. Due to the continued growth of the Niche Products division, commencing in the second quarter of 2007, corporate expenses previously charged fully to the Personal Lines division have been allocated, quarterly, on the proportion of written premium to each division. As a result, in the third quarter of 2007 the Niche Products division has been allocated \$0.2 million of corporate expenses.

### *Investment Income*

Investment income for the three months ended September 30, 2007 was \$3.3 million compared to \$2.1 million for the same period in 2006. The increase in 2007 is the result of an increase in the investment portfolio as at September 30, 2007 compared to September 30, 2006. Also, realized gains in the period were \$0.8 million, compared to realized losses of \$0.1 million in the comparable period in 2006.

EGI's investment portfolio reflected a \$25.5 million, or 13.9%, increase in fair value as at September 30, 2007, compared to September 30, 2006, due to investment returns and positive cash flows from operations during the period.

### *Net Income before Income Taxes*

Net income before income taxes decreased \$1.6 million, or 19.1%, to \$6.8 million for the three months ended September 30, 2007, compared to \$8.4 million for the same period in 2006, due primarily to the increase in the loss ratio in 2007 as compared to 2006.

For the three months ended September 30, 2007, underwriting income of \$3.5 million plus investment income of \$3.3 million comprised net income before income taxes of \$6.8 million. This compares to an underwriting income of \$6.2 million, plus investment income of \$2.1 million, for the three months ended September 30, 2006.

### *Income Taxes*

The provision for income taxes for the quarter ended September 30, 2007, was \$2.3 million compared to \$2.9 million for the comparable period in 2006. This reflected lower pre-tax income as a result of lower underwriting profits year over year for the quarter.

## **Nine Months Ended September 30, 2007 Compared to Nine Months Ended September, 2006**

### *Written and Assumed Premiums*

Direct written and assumed premiums increased \$22.9 million, or 24.9%, to \$114.8 million for the nine months ended September 30, 2007, compared to \$91.9 million for the first three quarters of 2006. As noted above, EGI has realized an increase in premiums despite competitive market conditions in Ontario non-standard auto business. Offsetting the shrinkage in EGI's Ontario non-standard auto, was growth in motorcycle premiums in Ontario, assumed business from reinsurance arrangements with two U.S. domiciled insurance companies in 2007 and continued significant growth in Niche Products. In the Personal Lines division, direct written and assumed premiums increased 11.1% to \$86.0 million compared to \$77.4 million in the same period in 2006. Ontario motorcycle direct written premiums increased to \$13.2 million compared to \$8.2 million in the first three quarters of 2006 and assumed premiums of \$10.3 million were recorded from the U.S. reinsurance arrangements in the first nine months of 2007. Direct written premiums for Niche Products increased 98.6% to \$28.8 million for the nine months ended September 30, 2007, compared to \$14.5 million in the same period in 2006.

Net written and assumed premiums increased \$24.2 million, or 29.1%, to \$107.3 million compared to \$83.1 million in the same period last year. This represents a greater increase over the first nine months of last year, when compared to the increase in direct written and assumed premiums, due to more effective utilization of the Company's capital through greater retention of risk.

#### *Earned Premiums*

Net earned premiums for the nine months ended September 30, 2007, were \$85.4 million, an increase of \$5.4 million, or 6.8%, from the same period in 2006. The growth in earned premiums is lower than the increase in premiums written and assumed in 2007 compared to 2006 due to changes in the Company's mix of business, primarily Ontario motorcycle business and premiums written in the third quarter of 2007 from the new emergency travel health business. The additional written premiums in 2007 will earn over the term of the underlying policies predominantly through the last quarter of 2007 and the first quarter of 2008.

#### *Incurred Claims Expense*

Net incurred claims expense increased \$4.2 million, or 9.4%, to \$48.9 million for the nine months ended September 30, 2007, compared to \$44.7 million for the same period in 2006. This increase is higher than the 6.8% increase in net earned premiums, reflecting the slight increase in the loss ratio in 2007. The loss ratio in the first nine months of 2007 is 57.3% compared to 56.1% in the first nine months of 2006. This result is primarily due to an increase in the Personal Lines division loss ratio to 58.5% compared to 56.4% for the same period in 2006, caused by a higher loss ratio in the motorcycle line of business. Partially offsetting this increase is the improvement in Niche Products division loss ratio to 45.3% compared to 49.9% for the first three quarters of last year. Continued positive development of prior year claims in the first nine months of 2007 resulted in a release of \$9.8 million of net reserves that had been accrued for prior accident years. In the same period in 2006, favourable prior year claims development of \$9.5 million was recorded.

#### *Acquisition Costs*

Net acquisition costs, which mainly consist of commissions and premium taxes, increased \$2.9 million or 18.4% to \$18.7 million for the nine months ended September 30, 2007, compared to \$15.8 million in the same period in 2006. This increase is higher than the increase in earned

premiums of 6.8%, as a result of the growth in Niche Products premiums in proportion to Personal Lines. Distribution costs related to Niche Products are expected to be higher than Personal Lines, which costs are expected to be offset by lower loss ratios in the Niche line of business.

#### *Operating Expenses*

Operating expenses increased \$0.3 million, or 3.6%, to \$8.5 million for the nine months ended September 30, 2007, compared to \$8.2 million for the same period in 2006, reflecting continued careful operating expense control.

#### *Underwriting Income (Loss)*

Underwriting results reflect the revenues from net earned premiums less claims and acquisition and operating expenses. In the nine months ended September 30, 2007 total underwriting income decreased \$1.6 million to \$9.4 million, compared to \$11.0 million for the same period in 2006 as a result of a slightly higher loss and acquisition expense ratio.

Underwriting income from the Personal Lines division for the nine months ended September 30, 2007, was \$8.7 million, a decrease of \$2.8 million, compared to an income of \$11.5 million for the same period in 2006. This decrease was primarily the result of a higher loss ratio in the period compared to the same period in 2006, which was an exceptional year for the industry. Partially offsetting the higher loss ratio, Personal Lines division expenses were reduced by \$0.6 million due to the reallocation of corporate expenses to the Niche Products division in the second and third quarters of 2007.

Underwriting income from Niche Products for the nine months ended September 30, 2007, was \$1.3 million, an increase of \$1.0 million compared to an underwriting income of \$0.3 million in the same period in 2006, after the allocation of shared expenses of \$0.6 million. This result is primarily the result of a significant improvement in the Niche business loss ratio in 2007. As noted earlier, commencing in the second quarter of 2007, corporate expenses previously charged fully to the Personal Lines division have been allocated on the proportion of written premium to each division. As a result, in the first nine months of 2007 the Niche Products division has been allocated \$0.6 million of corporate expenses. Excluding this reallocation, underwriting income for the nine month period ending September 30, 2007 was \$1.9 million representing an increase of \$1.6 million compared to underwriting income of \$0.3 million in 2006. (See the segmented information analysis below.)

### *Investment Income*

Investment income for the nine months ended September 30, 2007 was \$7.9 million compared to \$6.6 million for the same period in 2006. The improvement in 2007 is the result of an increase in the investment portfolio as at September 30, 2007 compared to September 30, 2006. Interest and dividends increased by \$0.9 million compared to the same period in 2006 and net realized gains of \$0.9 million were recorded in the first nine months of 2007 compared to gains of \$0.4 million in the same period last year.

EGI's investment portfolio reflected a \$25.5 million, or 13.9%, increase in fair value as at September 30, 2007, compared to September 30, 2006, due to investment returns and positive cash flows from operations during the period.

### *Net Income before Income Taxes*

Net income before income taxes decreased \$0.3 million, or 1.7%, to \$17.3 million for the nine months ended September 30, 2007, compared to \$17.6 million for the same period in 2006.

For the nine months ended September 30, 2007, underwriting income of \$9.4 million plus investment income of \$7.9 million comprised net income before income taxes of \$17.3 million. This compares to an underwriting income of \$11.0 million, plus investment income of \$6.6 million for the nine months ended September 30, 2006.

### *Income Taxes*

The provision for income taxes for first nine months of 2007 was \$5.9 million compared to \$5.8 million for the comparable period in 2006. This occurred despite the decrease in pre-tax income due to one-time positive adjustments recorded in income tax expense in the first nine months of 2006.

## Segmented Financial Information

Three months ended September 30

(in \$ thousands)

	2007						2006	
	Personal Lines			Niche	Personal	Niche		
	Canada	U.S.	Total	Products Canada	Lines Canada	Products Canada		
Underwriting revenue	22,654	2,584	25,238	5,609	24,404	4,086		
Underwriting income (loss)	2,877	31	2,908	711	6,470	(63)		
Loss ratio	60.3%	74.5%	61.7%	42.3%	46.9%	61.3%		
Expense ratio	27.0%	24.2%	26.7%	45.0%	26.6%	40.3%		
Combined ratio	87.3%	98.7%	88.4%	87.3%	73.5%	101.6%		

The segmented information, for the third quarter of 2007, shows that the Personal Lines division recorded an underwriting income of \$2.9 million, while the Niche Products division showed an underwriting income of \$0.7 million. Personal Lines includes business assumed from two U.S. domiciled insurance companies.

The loss ratio in Personal Lines was 61.7% for the quarter ended September 30, 2007, compared to 46.9% for the same period in 2006. This increase was the result of a decline in prior year reserve releases recorded in the third quarter of 2007 as compared to the same period in 2006. In the quarter ended September 30, 2007, prior year reserve releases were \$1.8 million for the Personal Lines division compared to \$2.5 million in the third quarter of 2006.

The Niche Products division loss ratio decreased to 42.3% in the third quarter of 2007 compared to 61.3% for the same period in 2006. The improvement reflects excellent claims experience in the third quarter of 2007.

The expense ratio for Personal Lines in the third quarter of 2007 was 26.7% compared to 26.6% for the same period in 2006. This ratio is expected to decline during the remainder of 2007 as premiums generated from the motorcycle and U.S. assumed businesses are earned during the balance of the year. The Niche Products division expense ratio has increased to 45% in 2007 compared to 40.3% for the third quarter of 2006 due primarily to the allocation of corporate (shared) expenses to this division. Excluding this allocation, the Niche Products division expense ratio is 40.7% and in line with the 2006 third quarter expense ratio. As this division's book of business grows, increased premiums will better absorb the relatively fixed corporate expense allocation, thereby reducing this expense ratio in the future.

**Nine months ended September 30**

(in \$ thousands)	<b>2007</b>						<b>2006</b>	
	Personal Lines			Niche Products	Personal Lines	Niche Products		
	Canada	U.S.	Total	Canada	Canada	Canada		
Underwriting revenue	65,164	5,573	70,737	14,708	70,284	9,470		
Underwriting income (loss)	8,610	56	8,666	1,263	11,461	289		
Loss ratio	58.5%	74.7%	59.7%	45.3%	56.4%	49.9%		
Expense ratio	28.3%	24.3%	28.0%	46.1%	27.2%	44.3%		
Combined ratio	86.8%	99.0%	87.7%	91.4%	83.6%	94.2%		

On a year to date basis, both business segments have contributed underwriting income. Personal Lines recorded an underwriting income of \$8.7 million for the first nine months of 2007, a decrease of \$2.8 million, or 24.3% compared to the same period in 2006. The decrease was primarily the result of the increase in loss ratio in 2007. The Niche Products division showed an underwriting income of \$1.3 million compared to a gain of \$0.3 million for the same period last year. The primary reason for the improvement was the decline in the Niche loss ratio compared to 2006 due to improved claims experience in 2007.

## Balance Sheet Analysis

### Investments

The following table sets forth EGI's invested assets as at September 30, 2007, and December 31, 2006.

	September 30 2007	December 31, 2006	
	Fair value and carrying amount	Fair value	Carrying amount
Bonds			
Canadian			
Federal	\$76,895	\$65,928	\$65,918
Provincial	27,720	27,883	27,249
Municipal	3,871	3,954	3,914
Corporate	48,823	49,525	49,236
	<u>\$157,309</u>	<u>\$147,290</u>	<u>\$146,317</u>
United States			
Federal	860	-	-
Corporate	558	-	-
	<u>1,418</u>	<u>-</u>	<u>-</u>
Total Bonds	<u>158,727</u>	<u>147,290</u>	<u>146,317</u>
Preferred shares	<u>\$6,362</u>	<u>\$6,369</u>	<u>\$6,277</u>
Common shares			
Canadian	39,425	28,374	21,574
United States	2,442	4,183	3,883
	<u>\$41,867</u>	<u>\$32,557</u>	<u>\$25,457</u>
Investment income due and accrued	1,993	1,332	1,332
	<u>\$208,949</u>	<u>\$187,548</u>	<u>\$179,383</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 \$1.3 million and a market value of \$1.8 million at September 30, 2007. 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.

As part of the process to wind up the fund, in November 2006, Savoy redeemed EGI's cash position of the fund thereby lowering EGI's cost value to \$1.9 million as at December 31, 2006. Savoy has advised EGI of its intention to implement prudent and orderly monetization strategies in 2007 with the aim of preserving value. In July, 2007 Savoy issued a cash redemption to EGI in the amount of \$0.4 million representing EGI's share of cash held in the fund as at June 30, 2007, which was primarily generated from the sale of four private holdings in the second quarter of 2007. EGI continues to work with Savoy to secure an effective monetization of the fund and in October, 2007 Savoy has advised that it may be necessary to extend the monetization period to after December 31, 2007.

EGI does not currently hold any non-bank asset backed commercial paper (ABCP) in its investment portfolio.

### **Recoverable from Reinsurers**

As at September 30, 2007, the recoverable from reinsurers increased to \$52.7 million as compared to \$52.2 million as at December 31, 2006. This recoverable can be expected to decrease due to the withdrawal of quota share reinsurance arrangements as at December 31, 2005. However, the increase associated with the recovery of direct claims covered by excess loss reinsurance incurred in the first nine months of 2007 has more than offset the reduction from the settlement of prior year quota share claims.

### **Accounts Receivable**

Premium financing receivables are the largest component of this asset as at September 30, 2007, and represents approximately 73% or \$20.1 million of total receivables. Premium financing receivables increased to \$20.1 million from \$18.6 million at December 31, 2006. This increase is primarily due to the growth in motorcycle business, especially in the second and third quarters of 2007.

Also included in the Accounts Receivable balance are current net outstanding balances related to the Company's U.S. based reinsurance and current premiums receivable from the Niche distributors.

## Provision for Unpaid Claims

As recommended by the Company's 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 periods and for the nine months ended September 30, 2007.

(in \$ thousands)	Years ended December 31				
	2006	2005	2004	2003	2002
Reserve Carried (actuarial present value basis) <sup>(1)</sup>	145,691	129,041	107,196	79,191	66,545
Reserve at December 31, 2003					43,754
Cumulative paid to December 31, 2003					24,122
Cumulative Redundancy (Deficiency)					(1,331)
Reserve at December 31, 2004				56,226	31,213
Cumulative paid to December 31, 2004				24,184	39,619
Cumulative Redundancy (Deficiency)				(1,219)	(4,287)
Reserve at December 31, 2005			70,620	37,802	21,682
Cumulative paid to December 31, 2005			24,922	38,802	48,033
Cumulative Redundancy (Deficiency)			11,654	2,587	(3,170)
Reserve at December 31, 2006		88,029	49,557	25,214	14,964
Cumulative paid to December 31, 2006		25,817	41,158	49,592	54,050
Cumulative Redundancy (Deficiency)		15,195	16,481	4,385	(2,469)
Reserve at September 30, 2007	117,783	75,008	40,618	19,515	11,698
Cumulative paid to September 30, 2007	22,223	39,624	50,955	55,958	58,451
Cumulative Redundancy (Deficiency)	5,685	14,409	15,623	3,718	(3,604)

1) Amounts include Provision for Adverse Deviation (PfAD) of \$14,756 for 2006, \$12,473 for 2005, \$8,613 for 2004, \$6,137 for 2003, and \$5,226 for 2002.

The table above, which is reflected on a gross basis for all years, shows that for the nine

months ended September 30, 2007 the total prior year reserve redundancies released pursuant to the September 30, 2007 actuarial report, were \$5.7 million. For the three months ended September 30, 2007 total prior year reserve redundancies released were \$0.9 million.

On a net of reinsurance basis, for the first nine months of 2007 total prior year reserve releases were \$9.8 million. This result is greater than the release noted on a gross basis due to specific adverse development in the first nine months of 2007 related to large claims (covered by reinsurance) incurred in prior years. This adverse development, which is included in the total gross reserve development shown in the table above, is absorbed by reinsurers and does not impact EGI on a net basis.

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 2007 the maximum net retention on a single risk is \$1.15 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 September 30, 2007, EGI was the assigned beneficiary of such trust accounts totalling \$2.4 million (December 31, 2006 - \$2.2 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 2007, such coverage is for a total of \$13,850,000 and in 2006 was for \$19,050,000. Other than general liability, coverages comprising the programs of the Niche Products division are reinsured on a program-by-program basis.

In 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 November 6, 2007, there were 9,655,152 common shares issued and outstanding.

### **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.

EGI's contractual obligations relating to operating leases are \$0.5 million due in less than a year and \$1.0 million due in the next two years.

### **Capital Resources**

Shareholders' equity as at September 30, 2007 was \$100.3 million. For the nine months ended September 30, 2007 shareholders' equity increased \$14.3 million from \$86.0 million as at December 31, 2006. As noted in EGI's third quarter Shareholders' Report, this increase was impacted by the implementation of the new accounting policy regarding Financial Instruments as described in Note 2 of the interim financial statements. Effective January 1, 2007 a transition adjustment of \$5.3 million, reflecting the adjustment to fair value of EGI's investments was recorded. This amount is offset by an Other Comprehensive Loss of \$1.1 million in the first nine months of 2007, reflecting a decline in fair value of bonds in the period. The net impact of adopting the new financial instrument standard for the first nine months of 2007 is an increase in shareholders' equity of \$4.2 million. Other components of the increase in shareholders' equity were net income of \$11.3 million in the period and the issuance of common shares of \$0.2 million, which were offset by the payment of dividends to common shareholders of \$1.4 million in the first nine months of 2007.