GENERATING RESULTS THROUGH SPECIALIZATION

EGI FINANCIAL ANNUAL REPORT 2005

CORPORATE PROFILE

Through our subsidiary, Echelon General Insurance, EGI Financial Holdings provides a comprehensive, specialized insurance offering including:

NON-STANDARD AUTOMOBILE INSURANCE

90% of 2005 direct written premiums:

- Driving history includes claims/convictions
- Alternative to Facility insurance (Groupement in Quebec)
- Estimated 8%–10% of licensed drivers
- Focus on "Reformers" not "Repeaters"
- Individual risk assessment
- Few competitors = pricing power

NICHE-INSURANCE PRODUCTS

10% of 2005 direct written premiums including:

- Higher-premium property insurance
- Primary and excess liability coverage
- Legal expense insurance
- Accident and health insurance
- Extended warranty programs for homes and consumer purchases
- Specialized coverage, such as business interruption insurance for independent truckers

TABLE OF CONTENTS

1 Operational and Financial Highlights
2 Chairman's Message
3 Message to Shareholders
4 Q&A with CEO/CFO
8 MD&A
36 Management's Responsibility
38 Financials
52 Board of Directors/ Corporate Officers
Ibc Shareholder Information

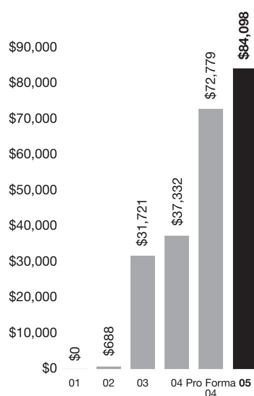
2005 was an excellent year for EGI Financial Holdings Inc., as illustrated by the financial highlights below. The Company enjoyed solid increases in revenue, earned premiums, net income and total assets. We also improved our internal operations, as evidenced by the improvement in our loss, expense and combined ratios. Our Automobile business had another year of solid performance while our Niche Products business generated significant growth, leading to an excellent return on equity of 30.1%.

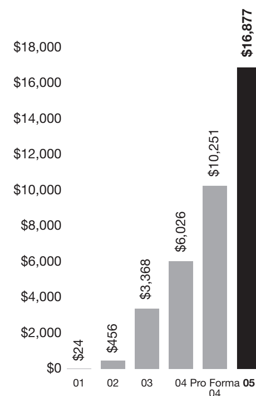
YEAR ENDED DECEMBER 31 (IN $ THOUSANDS, EXCEPT % AND PER SHARE DATA)	2005	2004[(1)] Pro forma	2004	2003	2002	2001
Gross written and assumed premiums	$ 117,006	$ 113,016	$ 57,240	$ 37,930	$ –	$ –
Net premiums earned	76,344	65,890	33,615	28,347	–	–
Total revenues	84,098	72,779	37,332	31,721	688	–
Total claims and operating expenses	67,153	62,669	32,544	30,053	556	–
Income from continuing operations	11,208	8,943	4,718	1,296	80	–
Net income	16,877	10,251	6,026	3,368	456	24
At end of period						
Total assets	260,731	217,567	110,737	93,959	95,265	2,433
Common shareholders' equity	70,213	41,529	23,082	19,283	15,915	1,073
Common shares outstanding	9,583,152	7,902,094	4,536,558	4,536,558	4,436,316	520,000
Earnings per common share						
– Basic	$ 2.09	$ 1.29	$ 1.31	$ 0.74	$ 0.16[(2)]	$ 0.05
– Fully diluted[(3)]	$ 1.96	$ 1.28	$ 1.30	$ 0.74	$ 0.16	$ 0.05
Key statistics						
Loss ratio	60.3%	66.9%	66.6%	75.8%	–	–
Expense ratio	27.7%	28.2%	30.2%	30.2%	–	–
Combined	88.0%	95.1%	96.8%	106.0%	–	–
Book value per common share ($)	7.33	5.26	5.08	4.25	3.59	2.06

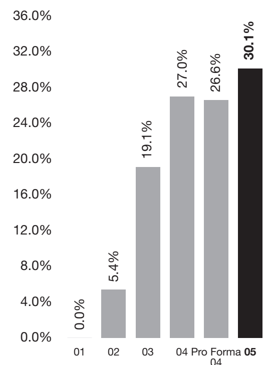
(1) The results for 2004 Pro forma reflect the Company's current structure. In January 2005, Canadian Insurance Marketing Inc. ("CIMI") fully acquired the 50% of EGIFH that it did not already own, issuing 3,365,536 shares (adjusted for share split) to Co-operators in exchange for Co-operators' EGIFH shares. In January 2005, EGIFH and CIMI were amalgamated and the Company now carries on business as EGIFH.

(2) The 2002 Earnings per Share calculation excludes the 1,583,872 CIMI shares issued to acquire EGI Investments Inc. ("EGII") on 31/12/02. CIMI issued an additional 100,242 shares during 2004 as an adjustment on the EGII acquisition.

(3) The Earnings per Share, fully diluted calculation reflects the impact of options issued to senior management to purchase the Company's share.







PAUL F. LITTLE
CHAIRMAN OF THE BOARD OF DIRECTORS

Dear Fellow Shareholders:

On behalf of your Board of Directors, it is my pleasure to present the first Annual Report for EGI Financial Holdings Inc. As you will read in the Message to Shareholders from Doug McIntyre, Chief Executive Officer of EGI Financial, 2005 was an excellent year for our Company, and was characterized by solid growth in both Non-Standard Auto and Niche Products. As a result of this success, the Directors were pleased to announce our initial quarterly dividend of $0.04 per share.

With the recent and welcomed addition of Mary Connolly, all but two of the EGI Financial directors are independent of management within the meaning of securities rules. More than half of the members have significant experience as a participant or investor in the insurance industry, providing an excellent sounding board for management. Many have investment management experience and expertise. All are committed to establishing and upholding the highest possible standards in accountability and corporate governance. As a result, we have been busy in the brief post-IPO period, putting in place appropriate governance measures, including best disclosure practices.

Your Directors are also strongly committed to aligning their interests with those of shareholders. As a result, we have instituted a mandatory share ownership condition as well as a policy under which at least 50% of Directors' fees are payable in deferred share units.

In closing, I would like to personally thank management and the entire EGI Financial team for their hard work and dedication in this transformative year for our Company. I would also like to acknowledge my fellow Directors – Katherine Bardswick, G. Mark Curry, Robert Purves, Scott Clark, Kevin Daniel, James E. Migliorini, Mary Connolly and of course our management Directors, Doug McIntyre and Mark Sylvia – whose guidance and support have been crucial in these early days as a public company. Finally, I would like to thank you, our shareholders, for your confidence in EGI Financial. I look forward to the opportunity to meet with many of you at our Annual Meeting on May 15.

PAUL F. LITTLE

DOUGLAS E. MCINTYRE
DIRECTOR AND CHIEF EXECUTIVE OFFICER

EGI Financial Holdings is generating results through specialization. Each of our two operating Divisions, Non-Standard Automobile and Niche Products, are positioned for success in their respective markets.

Our financial results for 2005 reflect the steady growth of EGI Financial's business, as well as the impact of the acquisition of the 50% of Echelon General not owned in 2004. Direct written premiums for 2005 were $117 million compared to $57.2 million in 2004. With Echelon on a 100%-owned basis, direct written premiums increased 3.5% from $113 million in 2004.

Underwriting profit for the year was $9.4 million compared with $1.4 million last year and $3.5 million with Echelon on a 100%-owned basis. Net income, including an extraordinary gain, was $16.9 million in 2005 compared with $6.0 million in 2004, or $10.3 million with 100% of Echelon. Fully diluted earnings per share, on the same basis, were $1.96 for 2005 compared to $1.30 in 2004. Excluding the extraordinary gain, net income was $11.2 million or $1.30 per share fully diluted.

In 2005, the Canadian P&C industry did well but EGI Financial did even better, with a return on equity of just over 30% for the year. The benefit of our two-division strategy – Non-Standard Automobile and Niche Products – was strongly evident in the year. While the current business appetite of standard insurers means that the non-standard auto segment is not expanding, demand for the products and services of our Niche Products Division has been outstripping available supply.

Despite a more competitive near-term market, EGI Financial's Automobile Division is expected to perform well going forward, fueled by broker and agent appointments in new territories and the addition of new vehicle types. By 2007, we expect the auto pendulum to swing back in favour of non-standard specialists like Echelon. Meanwhile, we continue to write profitable new business in Niche Products, the result of our professional staff's ability to properly screen submissions and to research and develop new programs. Our Niche Products Division is far less exposed to the cycles that typify the auto and standard P&C markets, due to limited competition and price insensitivity of product demand.

In 2006, we expect our business to continue to grow at an above average rate through greater retention of existing business, as a result of needing less reinsurance. We will remain focused on profitability, by providing customized solutions through innovative products and industry-leading service.

In closing, I would like to thank my fellow Directors for their strong counsel, and you, our shareholders, for your support. I also wish to recognize and congratulate the great team of EGI Financial employees who are building our business every day.

DOUGLAS E. MCINTYRE

EGI Financial Holdings Inc. completed its initial public offering (IPO) on December 8th, 2005, and the Company's shares were subsequently listed on the Toronto Stock Exchange under the symbol EFH. Founded in 1997, EGI Financial operates in the property and casualty (P&C) insurance industry in Canada, primarily focusing on non-standard automobile insurance and other niche and specialty general insurance products. Below, CEO Doug McIntyre and CFO Hemraj Singh answer some of the questions that have been most frequently asked of management since completion of the IPO.

Q: Where can investors expect to see the most growth in the Company's business, and how will you execute that growth?

A: **D.M.** In the short run, with large standard insurers encroaching on the non-standard auto sector, EGI's top-line growth will come mainly from our Niche Products business where we can meet our profitability targets through our new product and program initiatives. Medium- to longer-term, we will also grow our Automobile business, primarily through the acquisition of books of business from our competitors and through expansion to new geographic markets and vehicle types. We are buying less reinsurance and this will result in significant growth in our net retained business, profits on which flow to the bottom line.

Q: What is management's chief priority and how do you plan to achieve it?

A: **D.M.** Our priority can be described in three words: maximizing long-term profitability. We are not interested in top-line growth without acceptable bottom-line profitability. To achieve our objective, we expect to penetrate new markets, continue to introduce new, high-margin niche products and maintain a strict discipline in terms of costs.

Q: The insurance industry is highly regulated. Are there any upcoming regulatory issues that could impact your business that we need to discuss?

A: **H.S.** While there are no immediate issues that are commanding our attention, the industry is highly dynamic and the environment in which we operate is carefully monitored by provincial regulators. As such, the playing field changes frequently and our challenge is to constantly adapt to these changes.

Q: What differentiates EGI from its peers, enabling you to attract and retain business?

A: **D.M.** Our producers and policyholders are telling us that it's our service levels and independent surveys have confirmed that this is the case. As a matter of fact, our Non-Standard Auto business was ranked number one in claims satisfaction in the last survey taken by the Financial Services Commission of Ontario.

Q: Over 90% of the Company's earned premiums in 2005 came from non-standard automobile insurance in Ontario. What is EGI doing to diversify its dependency on this market.

A: **H.S.** First, of course, is to continue our momentum in the rapidly growing Niche Products segment, which we expect to comprise a much larger percentage of our business in 2006 than it did in 2005. Second, we are planning to expand the boundaries of our Automobile segment, taking advantage of our management team's successful past experience in select U.S. markets.

Q: How important is developing and implementing proprietary technology to EGI?

A: **D.M.** It's a critical component of our ongoing success. The dynamism of our proprietary ADAPT® system plays a central role in our ability to meet market needs by profitably rolling out new, tailored products in the Niche segment, then providing efficient ongoing administration and fast analysis of underwriting results.

Q: Why is EGI Financial's expense ratio so low when compared to the industry average?

A: **H.S.** For one thing, the ratio is held down by the fact that our auto products provide higher-than-average premium income per policy. Over and above this, we also have a strong focus on cost control, particularly variable costs. A third factor is our technology which, for example, provides us with the capacity to manage thousands of Niche program certificates without having to re-enter data. As Doug said earlier, our focus is bottom line profitability and all these factors are critical in achieving that objective.

Q: What is your loss reserve policy?

A: **H.S.** Simply put, it's to be conservative. The members of management at EGI, including in their predecessor companies, have a history of reserve redundancies, and this is the best proof that we are taking a very conservative approach to reserves.

Q: Why are you looking at markets outside Canada?

A: **D.M.** In the property and casualty insurance business, broad diversification of risk is critical. Certain states in the U.S. market have a history of consistent profitability in the non-standard auto segment. There are also numerous geographies where business and regulatory conditions are similar to ours, it's relatively easy to enter and we are confident in our ability to meet our profit criteria.

The preceding discussion contains forward-looking information that involves risk and uncertainties and must be read in conjunction with the detailed information and risk factors appearing elsewhere in this Annual Report.

References to EGI 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 audited consolidated financial statements as at December 31, 2005, and the related notes. The following commentary is current as of February 23, 2006. Additional information relating to EGI is available on SEDAR at 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 analyses performance based on underwriting ratios such as combined, expense and loss ratios.

The following discussion contains forward-looking statements that involve risk and uncertainties. EGI's actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and in EGI's other disclosures.

The following summary of financial information includes, for the year ended December 31, 2004, an unaudited pro forma income statement which gives effect to the acquisition of the remaining 50% of EGI Financial Holdings Inc. ["EGI Financial (2003)" which held 100% of Echelon General Insurance Company] as if it had occurred at January 1, 2004. Such pro forma information is provided for the sole purpose of providing a comparison to the financial information for the year ended December 31, 2005.

Years ended December 31

(IN $ THOUSANDS, EXCEPT PER SHARE AMOUNTS)	2005	Pro forma 2004	2004	2003	2002
Revenue					
Direct written premiums					
Auto	$ 105,567	$ 109,251	$ 54,626	$ 37,660	$ –
Niche products	11,439	3,765	2,614	270	–
Total direct written premiums	$ 117,006	$ 113,016	$ 57,240	$ 37,930	$ –
Net written premiums	$ 91,783	$ 69,230	$ 35,217	$ 28,208	$ –
Net earned premiums	76,344	65,890	33,615	28,347	–
Other revenue	227	298	298	154	512
Total underwriting revenue	$ 76,571	$ 66,188	$ 33,913	$ 28,501	$ 512
Underwriting expenses					
Incurred claims	45,997	44,075	22,400	21,490	–
Acquisition costs	12,073	10,832	5,638	4,320	–
Operating expenses	9,083	7,762	4,506	4,243	556
Total underwriting expense	$ 67,153	$ 62,669	$ 32,544	$ 30,053	$ 556
Underwriting income (loss)	9,418	3,519	1,369	(1,552)	(44)
Investment income	7,527	6,591	3,419	2,080	176
Income before the following:	16,945	10,110	4,788	528	132
Gain on reorganization	–	–	–	1,140	–
Income before income taxes	$ 16,945	$ 10,110	$ 4,788	$ 1,668	$ 132
Income tax expense (recovery)					
Current	7,505	2,310	1,155	227	52
Future	(1,768)	(1,143)	(1,085)	145	–
	$ 5,737	$ 1,167	$ 70	$ 372	$ 52
Income from continuing operations	11,208	8,943	4,718	1,296	80
Income from discontinued operations, net of income taxes	–	1,308	1,308	2,072	376
Extraordinary gain	$ 5,669	$ –	$ –	$ –	$ –
Net income	$ 16,877	$ 10,251	$ 6,026	$ 3,368	$ 456
Net income per share – Basic	$ 2.09	$ 1.29	$ 1.31	$ 0.74	$ 0.16
– Diluted	$ 1.96	$ 1.28	$ 1.30	$ 0.74	$ 0.16

	Years ended December 31		
(IN $ THOUSANDS)	2005	2004	2003
Balance sheet data			
Cash and cash equivalents	$ 15,899	$ 7,327	$ 7,712
Investments	152,736	57,098	49,711
Total assets	260,731	110,737	93,959
Provision for unpaid claims	129,173	54,149	42,890
Unearned premiums	39,973	17,933	16,214
Total shareholders' equity	72,585	25,309	19,283

The following table shows the Company's selected financial ratios and ROE data. These ratios are defined in the "Glossary of Selected Insurance Terms".

	2005	2004	2003	2002
Selected financial ratios[1] and ROE data (%)				
Loss ratio	60.3	66.6	75.8	N/A
Expense ratio	27.7	30.2	30.2	N/A
Combined ratio	88.0	96.8	106.0	N/A
ROE	30.1	27.0	19.1	5.4
Adjusted ROE[2]	25.9	23.0	13.1	12.9

(1) The underwriting ratios (the loss and expense ratios and the combined ratio) are all non-GAAP measures which are common insurance industry measures of performance.

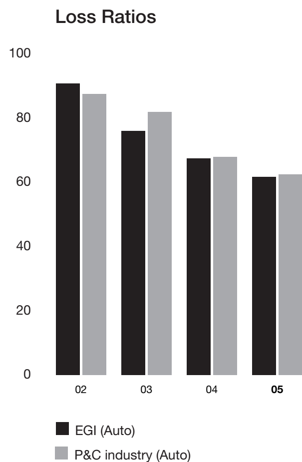
(2) Excludes the after tax effects resulting from acquisitions and divestitures including the corresponding adjustments to shareholders' equity. See "Significant Transactions".

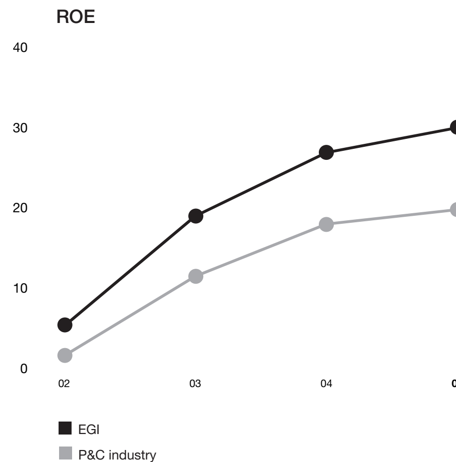
Overview of EGI

EGI operates in the property and casualty (P&C) insurance industry in Canada, primarily focusing on non-standard automobile insurance and other niche and specialty general insurance products. Founded in 1997 as an insurance and reinsurance broker and marketer, EGI has since developed its business to focus on underwriting opportunities not served by many of the larger, standard insurers.

EGI operates through two Divisions. Through its Automobile Division, EGI is engaged in the underwriting of high premium, non-standard automobile insurance. Through its recently established Niche Products Division, EGI designs and underwrites specialized non-auto insurance programs, such as higher premium property, primary and excess liability, legal expense and accident and health insurance for a variety of businesses and consumers and extended warranty coverage for homes and consumer products. By pursuing this focused strategy, EGI's objective is to produce a rate of return on equity (ROE) superior to the Canadian P&C insurance industry average. A key factor for EGI's ROE outperforming the industry is the fact that its loss ratio is below the industry average.

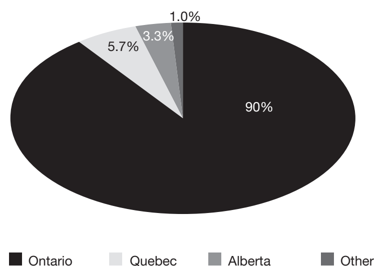
The charts illustrate EGI's and the P&C insurance industry's loss ratios and return on equity.

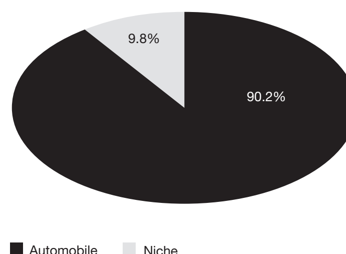




(1) Source for P&C industry data: OSFI website (federally regulated insurers as at September 30, 2005, representing approximately 64% of the P&C market).

Approximately 90% of EGI's premium revenue in 2005 was from its Automobile Division with approximately 90% of the total premiums written from Ontario. The breakdown of direct written premiums by category of business and by region during 2005 is illustrated below.





EGI's main source of revenue is net earned premiums from the sale of automobile insurance policies. One of EGI's diversification strategies is the growth of the non-auto business in the Niche Products Division, which currently accounts for approximately 10% of net earned premiums.

The financial performance of EGI is determined by two main factors: (i) the level of premiums earned in relation to claims and operating costs incurred; and (ii) the returns generated from the investment portfolio. Premiums collected are ultimately used to pay claims and operating expenses. However, there is a time lapse between the collection of premiums and the payment of claims and certain operating expenses. This allows EGI to invest premiums collected and earn an investment return until claims and operating expenses are paid. EGI also earns an investment return on invested capital.

EGI's results also include fees for consulting, income from one-time gains from acquisitions and divestitures and from corporate and other activities. The income from the non-operating transactions is discussed under "Extraordinary Gain" and "Income from Discontinued Operations".

Outlook

EGI's operating results for the years ending December 31, 2005 and 2004 were predominantly from Ontario automobile insurance. Continued regulatory changes to automobile insurance may impact the performance of the P&C insurance industry. EGI expects the favourable automobile underwriting results experienced by the P&C insurance industry over the past two years to trend down toward the industry's historic norms. The overall direction of EGI is to diversify from its heavy reliance on Ontario automobile insurance by more rapidly developing its automobile book of business in other jurisdictions and vehicle types, and by continuing to develop its niche products insurance business. EGI has already laid the groundwork in 2004 and 2005 to aggressively expand the niche line of business. EGI will also continue to seek out opportunities for profitable growth either through expansion of its existing business or by select acquisitions in Canada and the United States.

Strategy

EGI's objective is to continue to deliver an ROE superior to the average of the Canadian P&C insurance industry through a comprehensive specialized insurance offering. EGI's focus is on non-standard auto and targeted niches that are currently underserved by the market and which require the high level of underwriting and claims expertise of EGI's management team and staff.

In order to achieve this objective, EGI intends to:

Maintain and grow its core non-standard auto insurance offering. EGI concentrates on what it considers to be the best accounts from the non-standard segment, which has resulted in above average underwriting margins. EGI will continue to provide superior policy issuance and underwriting capabilities to its brokers and agents to support and expand its offering in this market segment. In addition, focusing primarily on return on equity, EGI will consider returning to markets which it previously exited if long-term profitable opportunities arise.

Introduce new and innovative specialized insurance products and programs. Working closely with Managing General Agents (MGAs) and other producers, EGI will continue to design niche and specialty programs that are not offered by traditional insurers. As many brokers need specialty insurers to cover all of their customers' insurance requirements, EGI's Niche Products Division continues to respond to this market opportunity.

Provide industry-leading service. EGI strives to provide optimum service to its policyholders and producers. EGI has created and implemented written service standards in all departments interfacing with policyholders or producers. Staff in these departments are thoroughly trained in the delivery of quality service, meeting these standards as a minimum. This service commitment ensures its policyholders and producers continue to be served by knowledgeable employees in a responsive manner.

Continue to invest in technology. EGI invests in technology where opportunities exist to enhance producers' ease of doing business, create operating efficiencies and improve EGI's data analysis capabilities. EGI developed and introduced its proprietary ADAPT® policy and claims management data processing system to streamline the management of its niche programs and will continue to employ leading technology solutions to serve its customers. With recent technological advancements, EGI has implemented a program to internalize its claims administration processes to enhance customer service and decrease administration costs. Claim forms are available to claimants immediately over the Internet from a computerized forms library that allows greater efficiencies in dealing with claimants directly. Much of the historical duplication of process and expense has been eliminated.

Pursue acquisitions. EGI intends to continue to grow its business by seeking attractively priced acquisitions of insurers or books of business in markets and business lines that are compatible with EGI's strategic objectives.

Competitive Strengths

EGI believes that it is uniquely positioned to compete in the P&C insurance industry for the following reasons:

Comprehensive specialized insurance offering. EGI offers its producers a comprehensive line of insurance products comprised of non-standard automobile insurance and specialized non-auto insurance products and programs. Responding to a market need, EGI thoroughly researches a product opportunity and develops underwriting procedures and ratings that will meet both the customers' requirements and earn an attractive ROE for EGI. EGI then arranges for distribution through its distribution channels.

Entrepreneurial culture. EGI fosters an entrepreneurial environment which encourages innovation in the development of new niche programs and the flexibility to allow for unique, tailor-made solutions to meet market demand.

Strong customer service focus. EGI believes that it has a strong reputation for customer service with its producers and policyholders from both an underwriting and claims standpoint. Policies are typically issued in five business days or less from receipt of the completed application. In the latest Automobile Claims Satisfaction Survey (2004) of insurers, EGI ranked highest among its non-standard auto competitors. Because of limited competition in niche markets, EGI believes that its strong customer service focus provides stability to the existing business and future growth opportunities with existing and new producers.

Financial strength. EGI has a strong capital base relative to its current underwriting commitments, as evidenced by its strong Minimum Capital Test ratio. EGI's Minimum Capital Test ratio as at December 31, 2005 is 368% compared to the P&C insurance industry average of 240% (as per OSFI third quarter information). EGI intends to preserve and grow its capital through appropriate pricing, underwriting discipline and conservative loss reserving practices.

Experienced management team. EGI has a seasoned group of owner-managers who have worked together successfully for years. With an average of over 19 years of experience in senior positions within the insurance industry, the executive management team has extensive knowledge in non-standard and niche insurance products together with an entrepreneurial thrust and a decisive, collegial management style.

Automobile Division

The market segment currently targeted by EGI's Automobile Division is high premium, non-standard automobile insurance for drivers who, because of inexperience or a poor driving record, are not able to obtain insurance from standard insurers. EGI provides coverage for private passenger vehicles as well as single commercial vehicles and small commercial fleets. Management believes that EGI's systems, underwriting and claims expertise and strict controls enable it to select those drivers in the higher premium categories who have a lower potential claims risk.

For those clients paying the higher premiums for non-standard automobile insurance, price is the single most important consideration. EGI provides these drivers with a lower premium option to the high premium coverage provided by the Facility Association and the Groupement. EGI targets drivers most likely to be "reformers" not "repeaters". These non-standard auto risks fall between Facility and the standard risks targeted by standard market insurers. The likely reformer expresses concern with respect to his or her poor driving record and will exhibit a sincere desire to improve (so as to re-enter the standard market). EGI utilizes brokers and agents to select qualifying risks. EGI then employs the experience of its underwriting personnel to ensure that complete and accurate underwriting and rating information has been developed.

In recent years, EGI has focused on appointing brokers and agents away from the major urban centers in its markets due to EGI's concerns regarding growth in the number of fraudulent claims. This strategy has resulted in marketing efficiencies and enhanced underwriting margins that on average exceed the industry average.

In July 2005, EGI withdrew from the Alberta personal lines automobile insurance market. The Alberta government's auto insurance reform package (introduced in October 2004) imposed a capping of insurance premiums, particularly those of inexperienced and other higher risk drivers, through the implementation of a mandated rating grid and clearly defined risk selection rules. The grid subsidizes the premiums of higher risk drivers and has resulted in the overcharging of lower-risk drivers in Alberta. The size of this subsidy is quite large, making it, in the opinion of management, uneconomical for a non-standard automobile insurer to underwrite the higher risk business for its own account. EGI continues to underwrite commercial, small fleet and farm vehicle insurance in Alberta.

In September 2005, EGI also withdrew from the Newfoundland automobile insurance market. This decision was made as a result of the introduction of Bill 26 which eliminated an insurer's ability to use statistically valid rating factors (such as "number of years licensed") which are essential to the proper underwriting of non-standard risks. The regulatory changes make it, in the opinion of management, uneconomical for a non-standard automobile insurer to underwrite the higher risk business for its own account in Newfoundland.

EGI will maintain and grow its automobile business by employing the following strategies:

- Expand in jurisdictions where EGI earlier withdrew or restricted its premium writing, such as New Brunswick and Nova Scotia, by filing new rates to reactivate distribution of EGI's automobile insurance products. EGI also intends to monitor and participate in the review of Alberta's grid rating system by the Alberta Automobile Insurance Rate Board, with a view to reactivating distribution of EGI's private passenger automobile insurance coverages in that province. In addition, EGI is monitoring the impact of recent government reforms in Ontario aimed at reducing fraudulent claims, which may allow EGI to increase its business activities in certain markets.
- Use EGI's non-standard automobile insurance expertise to add other lines of specialty auto insurance such as coverage for motorcycles, snowmobiles, all terrain vehicles, antique autos and recreational vehicles.
- Consider acquiring an existing non-standard automobile insurance company domiciled in the United States and licensed in one or more states which EGI believes constitutes attractive markets, which can contribute to EGI's goal of earning superior returns.

Niche Products Division

EGI's Niche Products Division, established in 2003, provides specialized non-auto insurance products and programs covering special risk lines of business. This Division has been specifically designed to respond to gaps in the P&C insurance market created by traditional insurers' focus on standardized coverage and the brokers' need to access customized insurance solutions in certain areas not provided by standard market insurers. Staffed with highly knowledgeable and experienced insurance professionals, the Division researches and designs programs of specialty insurance coverages in response to market demand. These programs are then distributed and administered by the initiating broker, MGA or other intermediary. EGI believes that the direct written premiums for its target specialized non-auto insurance segment is approximately 8% to 10% of the non-auto P&C insurance market.

There are four areas in niche markets which EGI has identified as offering opportunities for profitable growth: higher risk property insurance, umbrella and excess general liability, extended health insurance and warranty business. Within each of these areas, EGI concentrates its underwriting within the sub-segments where the risk characteristics of the business offer an opportunity to obtain a higher rate relative to the specific exposure than would be available within the broader segment of that niche market. This focus allows EGI to attain a per-risk margin that exceeds what is available in the standard market.

An important component of the niche products market is the degree to which significant expertise often resides at the MGA level. MGAs have highly specialized knowledge of the product and the market, and offer distribution capability for EGI's programs. The MGA's knowledge is used in product design and combined with EGI's expertise in pricing, underwriting structures and financial management, to create a sustainable product offering. MGAs are often interested in sharing in future underwriting profits through retention of risk. Accordingly, in certain circumstances, EGI will enter into a risk-sharing agreement with an MGA.

In response to the growth experienced in niche products, the ADAPT® system was developed by EGI to enable MGAs appointed by EGI to provide customer information in an electronic format on contracts and policies sold by the MGA. The ADAPT® system software uploads customer data provided by MGAs in preset formats supplied by EGI. The ability to export data avoids costly duplication and allows MGAs to use their own internal systems to supply the required information to EGI rather than being forced to re-enter data on EGI's systems. Once the data transfer is received from MGAs, EGI is able to immediately create customer policy records on the ADAPT® system and can use the claims portion of the ADAPT® system to manage claims and provide customer service.

EGI intends to maintain and grow the niche programs business by employing the following strategies:

- Continue to broaden market awareness of the existence and capabilities of EGI's Niche Products Division (including EGI's risk-retention structuring capabilities) through direct contact with qualified MGAs and through trade journal articles and advertising.
- Ensure that the Niche Products Division grows organically by continuing to provide unique expertise and superior service on all business inquiries.

- Seek opportunities for the Niche Products Division to grow through select acquisitions of books of business, MGAs or an insurance company.
- Attract business from MGAs by offering a unique opportunity for MGAs to enter into risk-sharing arrangements with EGI.

Segmented Financial Information

The segmented information shows the Auto line of business contributed $9.4 million or 96% of the total underwriting income while Niche products contributed $0.5 million or 4% of the total in 2005.

		2005		2004
(IN $ THOUSANDS)	Auto	Niche	Auto	Niche
Underwriting revenue	$ 69,644	$ 6,927	$ 31,836	$ 2,077
Underwriting income (loss)	9,372	467	1,920	(139)
Loss ratio	61.6%	46.1%	67.4%	53.3%
Expense ratio	24.9%	50.3%	26.6%	53.4%
Combined ratio	86.5%	96.4%	94.0%	106.7%

The table above illustrates the significant improvement in the loss and expense ratios for both business segments in 2005 as compared to 2004.

Revenue

Revenue reflected in the consolidated financial statements includes net earned premiums, investment income, realized gains and losses on the sale of investments and other revenue.

(IN $ THOUSANDS)	2005	2004
Gross premiums written	$ 117,006	$ 57,240
Net premiums written	91,783	35,217
Net premiums earned	76,344	33,615
Interest and dividends	6,306	2,500
Net realized gains on investments	1,221	919
Other revenue	227	298
Total revenue	$ 84,098	$ 37,332

The main source of revenue is earned premiums from the sale of insurance policies. In 2005, EGI experienced significant growth in gross written premiums, net written premiums and net earned premiums. For the year ended December 31, 2005, gross written premiums increased by $59,766 or 104% from December 31, 2004.

This growth was primarily due to the Echelon transaction that was completed in January 2005. On January 6, 2005, EGI acquired the 50% of Echelon that it did not already own from Co-operators in a share exchange transaction (refer to Acquisition of Echelon under “Significant Transaction”).

The second largest source of revenue is investment income which constituted approximately 9% of EGI’s total revenue in 2005. EGI recognizes revenue from interest, dividends and realized capital gains and losses on the invested assets. Market fluctuations in interest rates affect EGI’s returns on, and the market value of, fixed income and short-term investments. The fair market value of EGI’s exposure to preferred and common shares and other equity investments fluctuates as a result of changes in the overall level of the equity markets.

Expenses

EGI's expenses consist of incurred claims, acquisition costs and operating expenses.

(IN $ THOUSANDS)	2005	2004
Expenses		
Incurred claims	$ 45,997	$ 22,400
Acquisition expense	12,073	5,638
Operating expense	9,083	4,506
Total	$ 67,153	$ 32,544
Selected underwriting ratios		
Incurred claims ratio	60.3%	66.6%
Acquisition expense ratio	15.8%	16.8%
Operating expense ratio	11.9%	13.4%
Combined ratio	88.0%	96.8%

The combined ratio for EGI improved in 2005 to 88.0% from 96.8% in 2004.

Incurred claims, also referred to as losses, are the amounts payable under insurance policies relating to insured events. Loss adjustment expenses, also referred to as claim expenses, are the expenses of settling claims, including allocated (i.e., external) loss adjustment expenses and unallocated (i.e., internal) loss adjustment expenses (together, "LAE"). Achieving profitable results depends on EGI's ability to manage future claims and other costs through innovative product design, strict underwriting criteria and efficient claims management.

Acquisition costs consist mainly of commissions and premium taxes which are directly related to the acquisition of premiums. Commissions are the amounts paid to producers for selling insurance policies. The amount of commission is generally a percentage of the premium of the insurance policy sold. Contingent commissions are paid to brokers and MGAs on an annual basis if they meet certain targets. In general, these producers have to meet or exceed certain criteria, including written premium targets and profitability on average over three years to qualify for this compensation. Premium taxes are taxes paid by EGI to provincial governments calculated as a percentage of direct written premiums.

Operating expenses are the non-commission selling, underwriting and administrative expenses incurred to support EGI's business. A significant portion of these expenses is related to employee compensation and benefits. The effective control and management of these expenses can enhance the underwriting results from the operation.

Significant Transactions

Initial Public Offering

EGI completed an initial public offering (IPO) on December 8, 2005, pursuant to the filing of a prospectus dated November 30, 2005. As a result of the offering, 1.67 million common shares were issued at $10.50 per share for proceeds of $16.1 million net of underwriters' fees and other expenses.

Acquisition of Echelon

On January 5, 2005, EGI acquired the 50% of Echelon General Insurance Company ("Echelon") that it did not already own from Co-operators Group in a share exchange transaction (the "Echelon Transaction"). Since January 5, 2005, EGI includes 100% of Echelon's operating results. As a result of this transaction, EGI recognized an extraordinary gain of $5.7 million after tax, which is recorded in the results for the year ended December 31, 2005.

Divestiture of Trent Health and Trent Financial

In February 2004, EGI sold its 50% ownership in both Trent Health and Trent Financial (together, the "Trent Companies") to Co-operators Life Insurance Company. EGI's proportionate share of these companies' net results for the 2004 stub period and the after-tax gain of $1.3 million from the sale have been included in the financial statements as results from discontinued operations.

Regulation

The industry in which EGI operates is regulated for the sale of P&C insurance. Changes in these regulations may significantly affect the operations and financial results of EGI.

Critical Accounting Estimates and Assumptions

EGI's significant accounting policies are disclosed in Note 3 to the consolidated financial statements for the financial year ended December 31, 2005. The preparation of EGI's financial statements in accordance with Canadian GAAP requires EGI to make estimates and assumptions that affect the amounts reported in the financial statements. These estimates and assumptions principally relate to the establishment of reserves for claims and expenses, impairments of investment securities, amounts recoverable from reinsurers and certain other assets. As more information becomes known, these estimates and assumptions could change and impact future results. The most significant estimates and assumptions made in preparing the financial statements are in respect of policy liabilities, investments, reinsurance and income taxes.

Policy Liabilities

Policy liabilities consist of provisions for claim liabilities and premium liabilities.

Claim liabilities are maintained to cover EGI's estimated ultimate liability for unpaid losses and loss adjustment expenses with respect to reported and unreported claims incurred as of the end of each accounting period. The provision for unpaid claims and adjustment expenses is first determined on a case-by-case basis as claims are reported and then reassessed as additional information becomes known. The provision also accounts for the future development of these claims, including claims incurred but not reported. Reserves do not represent an exact calculation of liability, but instead represent estimates developed using projection techniques in accordance with Canadian accepted actuarial practice. These reserve estimates are expectations of the ultimate cost of settlement and administration of claims based on EGI's assessment of facts and circumstances then known, its review of historical settlement patterns, estimates of trends in claims severity and frequency, legal theories of liability and other factors.

Variables in the reserve estimation process can be affected by both internal and external events, such as changes in claims handling procedures, economic inflation, legal trends and legislative changes. Many of these items are not directly quantifiable, particularly on a prospective basis. Additionally, there may be significant reporting lags between the occurrence of the insured event and the time it is actually reported to the insurer. Reserve estimates are refined in a systematic ongoing process as historical loss experience develops and additional claims are reported and settled. Because the establishment of reserves is an inherently uncertain process involving estimates, current reserves may not be sufficient. Adjustments to reserves, both positive and negative, are reflected in the statement of income of the period in which such estimates are updated.

The provision for unpaid claims and adjustment expenses is discounted to take into account the time value of money. It also includes a provision for adverse deviation, as required by Canadian accepted actuarial practice. The appointed actuary of EGI's subsidiaries, using appropriate actuarial techniques, evaluates the adequacy of the policy liabilities.

Premium liabilities are considered adequate when the unearned premium reserve (after deducting any deferred acquisition cost asset) is at least equal to the present value, at the balance sheet date, of cash flow of the claims, expenses and taxes to be incurred after that date on account of the policies in force at that date or at an earlier date. Deferred acquisition costs are comprised of commissions, premium taxes and expenses directly related to the acquisition of premiums. They are deferred to the extent that they are recoverable from unearned premiums, after considering the related anticipated claims, expenses and investment income in respect of these premiums. Deferred acquisition costs are amortized on the same basis as the premiums are recognized in income.

A premium deficiency would be recognized immediately by a charge to the statement of income as a reduction of deferred acquisition costs to the extent that the unearned premium reserve, plus anticipated investment income, is not adequate to recover all deferred acquisition costs and related claims and expenses. If the premium deficiency was greater than unamortized deferred acquisition costs, a liability would be accrued for the excess deficiency.

Investments

EGI obtains values for all publicly traded securities in its investment portfolio from external pricing services.

Impairment of investment securities results in a charge to earnings when a market decline in the value of an investment to below cost is other than temporary. EGI's methodology to identify potential impairments requires professional judgement and places particular emphasis on those securities with unrealized losses of 10% or greater of the book value where the unrealized loss has been outstanding for more than six months. Assessment factors include, but are not limited to, the financial condition and rating of the issuer of the security, any collateral held and the length of time the market value of the security has been below cost. Any impairments are recognized when the assessment concludes that there is objective evidence of impairment. On a timely basis, any security with an unrealized loss that is determined to have been other than temporarily impaired is written down to its expected recoverable amount, with the amount of the write-down reflected in the statement of income for that period. Previously impaired securities continue to be monitored quarterly, with an additional write-down taken if necessary.

There are inherent risks and uncertainties involved in making these judgements. Changes in circumstances and critical assumptions such as a weak economy, a pronounced economic downturn or unforeseen events which affect one or more companies or industry sectors could result in additional write-downs in future periods for impairments that are deemed to be other than temporary. See also Note 4 to the consolidated financial statements for a description of the impairment policies.

Reinsurance

Reinsurance recoverables include amounts for expected recoveries related to claims liabilities as well as the portion of the reinsured premiums which has not yet been earned by the reinsurer. The cost of reinsurance is accounted for over the terms of the underlying reinsured policies using assumptions consistent with those used to account for the policies. Amounts recoverable from reinsurers are estimated in a manner consistent with claim and claim adjustment expense reserves and are reported in the consolidated balance sheet. The ceding of insurance to a reinsurer does not discharge EGI's primary liability to the insureds. The Company's policy is to record an estimated allowance for doubtful accounts on the basis of periodic evaluations of balances due from reinsurers, reinsurer solvency, management's experience and current economic conditions.

Income Taxes

EGI uses the liability method whereby income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of financial statement assets and liabilities compared with their respective tax bases. Accordingly, a future tax asset or liability is determined for each temporary difference, based on the income tax rates that are expected to be in effect when the underlying items of revenue and expenses are expected to be realized.

Future income taxes, accumulated as a result of temporary differences, are included in the consolidated balance sheet. In addition, the consolidated statement of income contains items that are non-taxable or non-deductible for income tax purposes, which cause the income tax provision to differ from what it would be if based on statutory rates.

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

The following financial information compares 2004 results with 2005. The 2004 comparative information is pre "Echelon Transaction" and therefore includes only 50% of Echelon.

Insurance Operation

Written Premiums

Direct written premiums increased $59.8 million or 104% to $117.0 million for the year ended December 31, 2005 compared to $57.2 million for 2004. The significant growth year over year for both direct and net written premiums was due primarily to the Echelon Transaction completed in January 2005. The 2004 direct and net written premiums only included 50% of Echelon's premiums while 2005 results include 100%. Echelon experienced a 3% decrease in automobile insurance direct written premiums in the year ended December 31, 2005 compared to 2004. This result was achieved despite EGI's decision to restrict writing of new business in the Atlantic provinces and Alberta, which resulted from government reforms to automobile insurance coverages in those provinces. Quebec automobile insurance premiums grew 40% to $4.9 million for the year ended December 31, 2005,

compared to $3.5 million for 2004. Quebec is viewed as a strategic growth area for geographic diversification and the focus there is on contracting new brokers and introducing new products such as the motorcycle program. These initiatives accounted for the significant growth in the Quebec business. Niche Products direct written premiums increased 338% to $11.4 million in 2005 compared to $2.6 million in 2004. The Niche Products Division started in 2003, with modest growth in 2004, and due to the continued marketing efforts to grow this Division, experienced significant growth in 2005.

Net written premiums increased $56.6 million or 160% to $91.8 million for the year ended December 31, 2005 compared to $35.2 million in 2004. In addition to the Echelon Transaction, the reduction in the auto quota share treaty cession in 2005 to 25% from 35% in 2004 also contributed to the year over year net written premium growth. Net written premiums also increased over 2004 because the Company arranged for a portfolio withdrawal of the unearned premiums from the 2005 quota share reinsurers. As a result of this withdrawal, the net written premiums increased in 2005 by $9.2 million.

Earned Premiums

Net earned premiums for the year ended December 31, 2005 were $76.3 million, an increase of $42.7 million or 127% from 2004. This increase reflects the impact of the Echelon Transaction. The reduction in the amount of reinsurance purchased by EGI in 2005 compared to 2004 is another key factor for the growth in net earned premiums. The revenue for 2005 was also positively impacted by the growth in premium volume generated from niche product programs.

Incurred Claims Expense

Net incurred claims expense increased $23.6 million or 105% to $46.0 million for the year ended December 31, 2005 compared to $22.4 million for 2004. This compares favourably to the 127% increase in net earned premiums, which indicates that the expense did not increase at the same rate as the revenue. One of the main reasons for this was that there was positive development in prior accident year claims reserve estimates as at December 31, 2005 as compared to a negative development during 2004. The positive development in 2005 resulted in a release of $6.5 million of net reserves that were accrued for the prior accident years. This favourable development at December 31, 2005 occurred because reported accident benefits and liability claims were lower than expected in both 2003 and 2004 accident years. The favourable development of $6.5 million can be distributed as $2.6 million for liability claims and $3.9 million for accident benefits claims.

The loss ratio of 60.3% in 2005 was a significant improvement over the loss ratio of 66.6% for 2004. The frequency of claims in 2005 decreased compared to 2004 largely in line with industry trends.

Acquisition Costs

Net acquisition costs, which consist mainly of commissions and premium taxes, increased $6.5 million or 116% to $12.1 million for the year ended December 31, 2005 compared to $5.6 million in 2004. Gross commissions paid to EGI's producers are offset by the commissions received from reinsurers on the portion of business that is ceded to them to develop the net commission. The amortization of the net commission costs is tied to the earning of the net written premiums, therefore there is a close correlation of net incurred acquisition expense to net earned premiums. The increase in earned premiums was 127% compared to an increase in acquisition expenses of 116%. This is due to the recording of additional reinsurance commission received from reinsurers in 2005 in the amount of $1.4 million relating to the positive sliding scale reinsurance commission adjustment for the 2003 and 2004 policy years.

Operating Expenses

Operating expenses increased $4.6 million or 102% to $9.1 million for the year ended December 31, 2005 compared to $4.5 million for 2004. The increase is due primarily to the Echelon Transaction in January 2005. In addition, operating expenses in 2005 include an accrual of $0.9 million for senior management bonuses, which the senior management group qualified for in 2005 as EGI's underwriting results exceeded budget by a significant amount. The accrual for senior management bonuses in 2004 was $0.2 million. Excluding this accrual, growth in expenses is at a lower rate than the growth of the business.

Underwriting Income (Loss)

Underwriting results reflect the revenues from net earned premiums less claims, acquisition and operating expenses. Industry underwriting profitability reached record levels in 2004, reflecting strong market conditions and a favourable claims environment. The overall underwriting income increased $8.0 million to $9.4 million for the year ended December 31, 2005 compared to $1.4 million for the comparative period in 2004. The underwriting income for 2005 and 2004 is net of $0.4 million of corporate and other expenses.

Underwriting income from non-standard automobile insurance for the year ended December 31, 2005 was $9.4 million, an improvement of $7.5 million compared to an income of $1.9 million for 2004. This improvement was attributable to a decrease in the loss ratio to 61.6% in 2005. The 2004 non-standard automobile underwriting result was impacted by deterioration in prior accident year claims of approximately $0.6 million.

The results for the year ended December 31, 2005 include the release of actuarial reserves for prior accident years' claims of $6.5 million. The combined underwriting ratio for non-standard auto for 2005 was 86.5% compared to 94.0% in 2004. The expense ratio, consisting of acquisition and operating expenses as compared to earned premiums, was 24.9% for 2005, compared to 26.6% for 2004. This slight decrease was achieved despite the accrual of senior management bonuses of $0.9 million in 2005, which was offset by the inclusion of additional reinsurance commission received of $1.4 million and an ongoing emphasis on expense control.

Underwriting income from Niche Products for the year ended December 31, 2005 was $0.5 million, an increase of $0.6 million compared to a loss of $0.1 million in 2004. This increase was primarily due to the controlled growth in this strategic line of business. The combined ratio for the Niche Products Division improved to 96.4% in 2005, compared to 106.7% in 2004.

Investment Income

Investment income increased $4.1 million, or 121%, to $7.5 million for the year ended December 31, 2005 compared to $3.4 million for 2004. This growth was due to the impact of the acquisition of the additional 50% of Echelon and the strong performance of Echelon's equity portfolio.

The investment income recorded in 2005 has been reduced by the realized portion of the fair value increment of 50% of the Echelon investment portfolio on acquisition. This increment was recognized in the purchase price equation in 2005 in the amount of $1.0 million; therefore investment income in 2005, excluding this adjustment, was $8.5 million.

EGI's investment portfolio reflected $115.2 million or a 160% increase in the investment portfolio in 2005, due to consolidation of the additional 50% of Echelon and positive cash flows from operations.

Before the elimination of realized gains of $1.0 million related to the fair value increment and included in gain on reorganization, realized investment and other gains increased $5.1 million to $8.5 million in 2005 compared to $3.4 million in 2004. The significant increase was primarily from the sale of invested assets of $39.6 million (2004 – $26.6 million).

Net Income Before Income Taxes

Net income before income taxes increased $12.1 million, or 252%, to $16.9 million for the year ended December 31, 2005 compared to $4.8 million for 2004 as a result of improved underwriting results, higher investment income and gains from non-operating transactions.

For the year ended December 31, 2005, underwriting income of $9.4 million plus investment income of $7.5 million comprises net income before income taxes of $16.9 million. This compares to an underwriting income of $1.4 million, plus investment income of $3.4 million in 2004.

Income Taxes

The provision for income taxes for the year ended December 31, 2005 was $5.7 million compared to $0.1 million for 2004. This reflected higher pre-tax income as a result of increased underwriting profits year over year.

Extraordinary Gain

In 2005 an extraordinary after-tax gain of $5.7 million arose due to the share exchange which formed part of the January 2005 Echelon Transaction. The gain was the result of the write-off of negative goodwill arising from the transaction.

Income from Discontinued Operations

In 2004, a gain on the sale of the travel health business in the amount of $1.3 million after income tax was recorded as income from discontinued operations. See "Significant Transactions" above. The sale of this business was finalized at the end of February 2004 which netted EGI a gain of $4.5 million, before legal expenses, on the sale of the shares of the Trent companies. This amount was reduced by the cumulative retained earnings of $2.3 million from this business consolidated by EGI prior to the sale and the legal expense for a residual income of $2.1 million before income tax. EGI has also recognized $6,000 of income from discontinued operations in January and February 2004.

Balance Sheet Analysis

Investments

EGI has an investment policy that seeks to provide a stable income base to support EGI's liabilities without incurring an undue level of investment risk. All investment decisions are made with this risk-return trade-off in mind. The two most important methods used to reduce the level of risk without reducing the rate of return in EGI's portfolio are diversification and the use of proven investment professionals.

EGI's Board of Directors has established an Investment Committee to develop and implement detailed strategies consistent with EGI's objectives and to report regularly to the Board of Directors on its activities. EGI has outsourced all buy/sell decisions on individual securities to a small number of reputable professional investment managers. Using the "prudent person" approach, the Committee monitors performance of each manager, measuring his or her performance against an appropriate market index benchmark.

Each of EGI's investment managers (with the exception of Savoy Capital Management Ltd.) operates under an investment management agreement which provides the investment manager with a discretionary mandate to hold one or more types of securities and/or cash. The investment manager receives an annual fee (payable quarterly) based on a negotiated percentage of the market value of the portfolio being managed. The investment manager's engagement is subject to immediate cancellation by EGI, without penalty, upon giving written notice. Savoy Capital Management Ltd. manages the Gladiator Limited Partnership, an equity investment currently held by EGI. See "Common Shares" below.

EGI's investment portfolio is invested in well-established, active and liquid markets in Canada and the United States. Fair value for most investments is determined by reference to quoted market prices. The external investment managers invest on a total return basis which views realized gains and losses as important and recurring components of the return on investments, and consequently, of income. The timing of the realization of gains and losses may be unpredictable and changes in the overall levels of fixed income or equity markets generally result in corresponding changes in realized gains and losses.

To assess impairments, the Investment Committee and management review all holdings with a fair value below their carrying values and, in consultation with the appropriate investment manager, ascertain whether the carrying amounts are expected to be recovered. EGI's investment managers provide advice as to whether the fair value of these securities is adversely affected other than on a temporary basis.

The following table sets forth EGI's invested assets as at December 31, 2005, and 2004.

Investment Portfolio

			2005			2004
(IN $ THOUSANDS)	Carrying amount	Fair value	Unrealized gain (loss)	Carrying amount	Fair value	Unrealized gain (loss)
Bonds						
Canadian						
Federal	$ 61,405	$ 61,267	$ (138)	$ 22,137	$ 22,458	$ 321
Provincial	21,366	22,307	941	8,676	9,011	335
Municipal	1,529	1,617	88	769	798	29
Corporate	38,377	38,442	65	15,783	16,225	442
	$ 122,677	$ 123,633	$ 956	$ 47,365	$ 48,492	$ 1,127
Preferred shares	$ 3,738	$ 3,767	$ 29	$ 650	$ 660	$ 10
Common shares						
Canadian	22,802	28,934	6,132	7,960	9,670	1,710
United States	2,761	2,801	40	830	868	38
	$ 25,563	$ 31,735	$ 6,172	$ 8,790	$ 10,538	$ 1,748
Investment income due and accrued	$ 758	$ 758	$ –	$ 293	$ 293	$ –
	$ 152,736	$ 159,893	$ 7,157	$ 57,098	$ 59,983	$ 2,885

EGI's portfolio is constructed in a manner which seeks to ensure that its objectives of producing a competitive rate of return while at the same time protecting and enhancing statutory underwriting capital on a long term basis are met. This is achieved through diversification principles to ensure each asset class has limited exposure by region, by industry, by issuer and by type of underlying security. Target ranges are set for each asset class and economic sector and are monitored by the Investment Committee to ensure that EGI's investment managers comply with these guidelines, and all regulatory requirements and liquidity needs are adhered to by each manager.

Fixed Income Securities

EGI holds fixed income securities to provide a steady, predictable level of income and reasonable liquidity with minimum risk of loss and a fixed sum at maturity. EGI's portfolio is diversified by selecting various types of government and corporate bonds. Constraints on types of issuers take liquidity, diversification and risk into account by limiting the portfolio mix by issuer.

EGI maintains a high overall credit quality level as measured by Dominion Bond Rating Service ("DBRS"). Constraints are placed on the percentage of bonds which can be held in the rating classes as follows: Class A or better – no maximum, Class BBB or lower – maximum 10%. EGI's policy is to purchase only corporate bond issues which are rated BBB or better at the time of purchase. In the event of subsequent downgrades, the Investment Committee will consider whether to continue to hold the bonds.

The following table sets forth EGI's fixed income portfolio by credit quality according to DBRS as at December 31, 2005 and 2004.

Fixed Income Portfolio

	As at December 31, 2005			As at December 31, 2004		
(IN $ THOUSANDS)	Carrying value	% of carrying value	Market value	Carrying value	% of carrying value	Market value
AAA	$ 69,166	56	$ 69,338	$ 27,209	57	$ 27,647
AA	15,852	13	16,460	5,198	11	5,336
A	29,782	24	30,289	10,953	23	11,449
BBB	7,877	7	7,546	1,847	4	1,902
BB	–	–	–	2,158	5	2,158
Total	$ 122,677	100	$ 123,633	$ 47,365	100	$ 48,492

Common Shares

Common shares are a key component of EGI's portfolio to enhance the capital appreciation opportunities of EGI's invested assets. EGI's investment managers, using a conservative approach to equity selection, ensure that equities of companies with a reputation for strong management and a proven track record of success are selected for EGI's portfolio. Diversification by country and industry sector also reduces the overall risk level inherent in EGI's common share portfolio.

EGI generally limits its total exposure to common shares at any one time to a maximum of 16% of the total of its invested assets and premium financing receivables, which is slightly below the average exposure to equities for Canadian-owned insurers.

Gladiator Limited Partnership ("Gladiator LP") is managed by Savoy Capital Management Ltd. Gladiator LP is an investment fund which attempts to maximize risk-adjusted absolute returns for investors through (i) the purchase of or selling short publicly traded Canadian and U.S. common equities, (ii) the limited use of leverage (maximum 50% of gross exposure, maintained between 90% and 140% [long and short positions] of portfolio value), and (iii) the limited use of derivatives and investment in private companies (maximum 10% each of the portfolio value). Total market exposure is maintained in a range between 30% net short and 120% net long positions. Savoy Capital Management Ltd. receives a management fee of 1.5% of asset value per annum plus 20% of profits over a 6% annual threshold return. Redemptions can be made monthly, subject to 30 days notice.

Restrictions as to the amount of common shares held in any industry sector are also part of EGI's risk diversification methodology. The following table outlines EGI's Canadian common share exposure to industry sectors as at December 31, 2005 and 2004.

Canadian Common Share Portfolio

	As at December 31, 2005			As at December 31, 2004		
(IN $ THOUSANDS)	Carrying value	% of carrying value	Market value	Carrying value	% of carrying value	Market value
Energy	$ 3,366	15	$ 5,122	$ 836	11	$ 1,068
Financial services	5,205	23	6,336	1,309	16	1,648
Materials	1,477	6	2,361	852	11	1,128
Gladiator LP	8,681	38	10,002	3,541	44	4,011
Other	4,073	18	5,113	1,422	18	1,815
Total	$ 22,802	100	$ 28,934	$ 7,960	100	$ 9,670

Recoverable from Reinsurers

	As at December 31	
(IN $ THOUSANDS)	2005	2004
Reinsurers' share of unpaid claims	$ 54,043	$ 24,978
Reinsurers' share of unearned premiums	2,761	6,871
Total	$ 56,804	$ 31,849

As at December 31, 2005, the amount recoverable from reinsurers increased $25.0 million or 79% to $56.8 million from $31.8 million at December 31, 2004. This significant growth can be explained for the most part by the Echelon Transaction in January 2005. There is also a natural tendency for reinsurers' share of unpaid claims to grow if there are more new claims than claims settled and the reinsurance program continues unchanged from one period to another. The impact from growth in reinsurers' share of unpaid claims accounts for the balance of growth in 2005. The decline in reinsurers' share of unearned premium is due to the withdrawal of the 2005 auto quota share treaty effective December 31, 2005. Due to the withdrawal of this reinsurance treaty, reinsurers' share of unearned premium was reduced by $9.2 million as at December 31, 2005.

Accounts Receivable

	As at December 31	
(IN $ THOUSANDS)	2005	2004
Premium financing receivables	$ 18,785	$ 7,726
Facility Association	765	1,532
Agents and brokers	2,247	961
Other	474	–
Total	$ 22,271	$ 10,219

Premium financing receivables is the largest component of this asset as at December 31, 2005 and represents approximately 84% or $18.8 million of total assets. Premium financing receivables increased $11.0 million or 143% to $18.8 million at December 31, 2005 from $7.7 million at December 31, 2004. There is a steady growth in premium financing receivables over the year from the growth in non-standard automobile business. The majority of the non-standard automobile business is billed directly to policyholders and only a very small percentage is billed through the broker. Increasingly, more of the direct billed premium to policyholders is being financed. As well, a significant portion of this growth is from the Echelon Transaction.

Facility Association receivable results reflect the pro rata sharing by Echelon of business written by the Facility. There is a reduction in 2005 from 2004 despite the fact that EGI now consolidates 100% of Echelon as compared to 50% in 2004. The reduction is due to Facility Association's decision to liquidate most of its investment portfolio and return the cash to its member companies. In the past, the Facility Association has maintained an investment portfolio, and therefore, its members carried a higher receivable.

Agents and brokers receivables grew significantly in 2005 compared to 2004 largely due to consolidating the additional 50% of Echelon in 2005. Echelon also experienced significant growth in business in Quebec where broker billing is offered as a mode of payment.

Provision for Unpaid Claims

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 the insurer. Claims provisions (i.e., reserves for claims liability) are established at the individual file level by the "case method" as claims are reported. The provisions are subsequently adjusted as additional information affecting the estimated amount of a claim becomes known during the course of its settlement. With the assistance of EGI's consulting actuary, a reserve provision is also made for management's calculation of factors affecting the future development of claims including a provision for claims incurred but not yet reported based on the volume of business currently in force and the historical experience on claims. Reserves are also established for the estimated internal and external loss adjustment expenses, which will be incurred during the claims settlement process.

The provision for unpaid claims and adjustment expenses is discounted to take into account the time value of money as required by EGI's primary insurance regulator. It also includes a provision for adverse deviation as required by accepted Canadian actuarial practice. EGI's consulting actuary reports on the adequacy of EGI's claims reserves as at June 30 and December 31 of each year. As time passes, more information about the claims becomes known and provisional estimates are appropriately adjusted upward or downward. Adjustments to reserves are reflected in the results of operations in the periods in which the estimates are changed.

The development of the provision for claims is shown by the difference between estimates of reserves as of the initial year-end and the re-estimated liability at each subsequent year-end. This is based on actual payments in full or partial settlement of claims, plus re-estimates of the reserves required for claims still open or claims still unreported. Favourable development means that the original reserve estimates were higher than subsequently indicated. Unfavourable development means that the original reserve estimates were lower than subsequently indicated.

For further discussion of EGI's reserving methods and underlying assumptions, see "Critical Accounting Estimates and Assumptions – Policy Liabilities".

Provision for unpaid claims consists of the gross 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.

EGI estimates its reserves on a quarterly basis and this is supported by a mid-year and an annual assessment by the independent 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 increase such provisions and incur a charge to earnings in the future.

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 three-year period and for the year ended December 31, 2005, for Echelon (on a 100% basis).

			As at December 31
(IN $ THOUSANDS)	2004	2003	2002
Reserve carried (actuarial present value basis) [1]	$ 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)		(1,220)	(4,286)
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)

(1) Amounts include Provision for Adverse Deviation (PfAD) of $8,613 – 2004, $6,137 – 2003 and $5,226 – 2002.

The following provides a reconciliation of claims reserve to EGI's consolidated balance sheet.

		As at December 31
(IN $ THOUSANDS)	2004	2003
Reserves as per table above	$ 107,196	$ 79,191
Echelon – 50% proportion	53,598	39,596
Other	551	3,294
Amount per balance sheet – EGI consolidated	$ 54,149	$ 42,890

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. See "Risk 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 2005 the maximum net retention on a single risk is $0.45 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. However, 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 December 31, 2005, EGI was the assigned beneficiary of such trust accounts totalling $2.3 million (December 31, 2004 – $0.3 million) in guarantees from unlicensed reinsurers.

Excess of loss and catastrophe reinsurance is used to limit an insurer's exposure to a maximum dollar value per claim and per occurrence. Quota share is a form of proportional reinsurance often used by an insurer to build a book of business larger than can be supported by the insurer's own capital. When used on established, profitable lines of business, quota share is an expensive substitute for equity capital. The insurer is essentially "borrowing" capital from the reinsurer by transferring unearned premium and claims liabilities from its books to the books of the reinsurer. Within the range of expected loss ratios, this transfer is done at a direct cost to the insurer, which happens through the ceding commission (expense allowance) paid by the reinsurer.

The ceding commission paid to the insurer by the reinsurer varies depending on the gross loss ratio. As the gross loss ratio increases, the amount of ceding commission decreases, subject to agreed limits. Above the maximum loss ratio on the ceding commission scale, there is full risk transfer (i.e., the potential to lose money) to the reinsurer. Below the minimum loss ratio on the ceding commission scale, the reinsurer's profit increases. The reinsurer also retains the investment income on the cash balances that develop between the dates premiums are received and the dates claims are paid.

EGI purchases renewable excess of loss and catastrophe reinsurance from third party reinsurers, covering its automobile and general liability business. In 2004, such coverage is for a total of $14.5 million and in 2005 $14.4 million. EGI has also purchased renewable quota share reinsurance from third party reinsurers. In 2004 EGI purchased a 35% and in 2005 a 25% quota share reinsurance coverage protecting its automobile and general liability businesses. Other than general liability, coverages for the programs of the Niche Products Division are reinsured on a program by program basis.

For 2004, EGI's liability after all excess of loss and quota share reinsurance recoveries is limited to a maximum of $325,000 and in 2005, $450,000 on any one claim. Using reinsurance, EGI's policy is to limit its loss exposure in any one claim to not more than 2% of its shareholders' equity.

EGI depends upon the financial stability of its reinsurers in the same way that EGI's insureds rely upon EGI. Accordingly, EGI carefully selects its reinsurers and only deals with creditworthy reinsurers. Reinsurers are selected based on their financial strength ratings, services, reputation and prices offered on the required reinsurance. As reported to EGI by AON Re Canada Inc., EGI's reinsurance broker, at December 2005, all reinsurers providing coverage under EGI's treaties were rated B++ or better by A.M. Best. EGI's Reinsurance Committee is responsible for evaluating and approving companies to which EGI cedes reinsurance. The committee consults with AON Re Canada Inc. regarding the financial ratings of EGI's reinsurers.

In 2005, EGI ceded $17.3 million of premiums under its automobile and general liability quota share reinsurance treaty. The terms of the quota share are such that the rate of ceding commission varies inversely with the loss ratio, but on average in a typical year EGI's cost to write the reinsured business is 27%, while the reinsurer allows EGI a 23% ceding commission. EGI's expense ratio would therefore improve by 4% on that portion of the reinsured business which EGI can retain for its own account. In addition, the reinsured business would have produced an average underwriting profit of 5% had the business been retained by EGI for its own account. Hence, the incremental income from this source would be 9% of the retained earned premium plus investment income earned by EGI.

As EGI's insurance and reinsurance Company subsidiaries increase their equity (and, therefore, regulatory capital), they can retain more insurance business for their own account and therefore purchase less quota share reinsurance. The marginal return on this new capital can be very substantial. Each dollar of new equity allows EGI to retain up to two and one-half dollars of additional premium (and the potential downside risk thereon) each year for its own account.

EGI believes that there is currently adequate reinsurance capacity in the marketplace for those classes of business which EGI underwrites, and management is not aware of any developments that might cause a serious shortage of capacity in the future. EGI believes that, through its reinsurance program, it is adequately protected against major underwriting losses arising from a large claim under a single policy or claims under a group of policies arising from a single event.

Share Capital

As of February 23, 2006, there were 9,583,152 common shares issued and outstanding. See Note 9 to the consolidated financial statements.

Liquidity and Capital Resources

The purpose of liquidity management is to ensure that 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.

At December 31, 2004, EGI had a $1.25 million principal debt obligation to Co-operators that was due in June 2006 with accrued interest. This obligation was paid in full on December 21, 2005 with a portion of the proceeds of the IPO. EGI also issued Series F special shares with a cumulative dividend feature in June 2004 and redeemed these shares at a cost of $2.4 million with a portion of the proceeds of the IPO on January 31, 2006.

The only contractual obligation that EGI has relates to operating leases for which $0.5 million is due in less than a year and $1.0 million is due in the next two years.

EGI is a holding company and, as such, has limited direct operations of its own. EGI's principal assets are the shares of its insurance, reinsurance and insurance management subsidiaries. Accordingly, its future cash flows depend in part upon the availability of dividends and other statutorily permissible distributions from the insurance subsidiaries. The ability to pay such dividends and to make such other distributions is limited by applicable laws and regulations of the jurisdictions in which the insurance subsidiaries are domiciled, which subject the insurance subsidiaries to significant regulatory restrictions. These laws and regulations require, among other things, that the insurance subsidiaries maintain minimum solvency requirements and may also limit the amount of dividends that the insurance subsidiaries can pay to EGI.

Transactions with Related Parties

EGI has entered into transactions with two related parties, Co-operators and Purves Redmond & Associates Limited ("Purves Redmond"). These transactions are carried out in the normal course of operation and are measured at cost which approximates fair value. The transactions involving Co-operators, which is a significant shareholder of EGI, consist principally of the agent channel of distribution, support services and investment management. Purves Redmond is involved in arranging insurance coverage for the companies within the EGI group. Robert Purves, a shareholder and Director of EGI, is also a shareholder and chairman of Purves Redmond.

Risk Management

EGI has developed a comprehensive process of risk management and internal control which emphasizes the proactive identification of risks facing the organization and the effective management and control of these risks. The foundation of the process is the ongoing thorough operational analysis by senior management committees and a structured oversight process undertaken by the Board of Directors and appointed committees. Underlying this structure are strong internal control procedures which are designed to safeguard EGI's assets and protect the organization and its stakeholders from risk.

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 potential loss from various market risks, including interest rate and equity market fluctuation risk, credit risk, liquidity risk, and to a lesser extent, foreign currency risk.

Market Risk

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, foreign currency 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 assets are traded.

The primary market risk to the investment portfolio is interest rate risk associated with investments in fixed income securities. EGI's exposure to foreign exchange risk is not significant and is limited to the common equity portfolio.

For EGI's investment portfolio, there were no significant changes in the primary market risk exposures or in how those exposures are managed compared to the year ended December 31, 2004. Management does not currently anticipate significant changes in EGI's primary market risk exposures or in how those exposures are managed in future reporting periods based upon what is known or expected to be in effect in future reporting periods.

Interest Rate and Equity Market Fluctuation

Movements in short- and long-term interest rates, as well as fluctuations in the value of equity securities, affect the level and timing of recognition of gains and losses on securities that EGI holds and cause changes in realized and unrealized gains and losses. Generally, EGI investment income will be reduced during sustained periods of lower interest rates as higher yielding fixed income securities are called, mature, or are sold and the proceeds are reinvested at lower rates. During periods of rising interest rates, the market value of EGI's existing fixed income securities will generally decrease and the realized gains on fixed income securities will likely be reduced. Realized losses will be incurred following significant increases in interest rates.

Generally, declining interest rates result in unrealized gains in the value of fixed income securities that EGI continues to hold, as well as realized gains, to the extent the relevant securities are sold. General economic conditions, political conditions and many other factors can also adversely affect the stock markets and, consequently, the value of the equity securities EGI owns.

Credit Risk

Credit risk is the possibility that counterparties may not be able to meet payment obligations when they become due. EGI assumes counterparty credit risk in many forms. A counterparty is any person or entity from which cash or other forms of consideration are expected to extinguish a liability or obligation to EGI. The credit risk exposure is concentrated primarily in the fixed income and preferred share investment portfolios and, to a lesser extent, in the reinsurance recoverables.

EGI's risk management strategy and investment policy is to invest in debt instruments of high credit quality issuers and to limit the amount of credit exposure with respect to any one issuer. EGI attempts to limit its credit exposure by imposing fixed income portfolio limits on individual corporate issuers based upon credit quality. See "Investments – Fixed Income Securities".

Foreign Exchange Risk

Foreign exchange risk is the possibility that changes in exchange rates produce an unintended effect on earnings and equity when measured in domestic currency. This risk is largest when assets backing liabilities are payable in one currency and are invested in financial instruments of another currency.

EGI is exposed to some foreign exchange risk arising from the investment in U.S. dollar denominated common shares. Total invested assets denominated in U.S. dollars were less than 1.5% of the total invested assets at December 31, 2005. EGI's general policy is to minimize foreign currency exposure.

Risk Factors

Careful consideration should be given to the following factors and must be read in conjunction with the detailed information appearing elsewhere in this Annual Report. Any of the matters highlighted in these risk factors could have a material adverse effect on EGI's results of operations, business prospects or financial condition.

Nature of Industry

The P&C insurance business in Canada is affected by many factors, which can cause fluctuations in the results of operations of EGI. Many of these factors are beyond EGI's control. An economic downturn in those jurisdictions in which EGI writes business could result in less demand for insurance and lower policy amounts. As a property and casualty insurer, EGI is subject to claims arising out of catastrophes, which may have a significant impact on its results of operations and financial condition. These factors, together with the industry's historically cyclical competitive pricing, could result in fluctuations in the underwriting results and net income of EGI. A significant portion of the earnings of insurance companies is derived from the income from their investment portfolios. Investment income will fluctuate depending on the returns and values of securities in EGI's investment portfolio.

Regulation

EGI is subject to the laws and regulations of the jurisdictions in which it carries on business. These laws and regulations cover many aspects of its business, including premium rates for automobile insurance; the assets in which it may invest; the levels of capital and surplus; the standards of solvency that it must maintain; and the amount of dividends which it may declare and pay.

Changes to laws or regulations are impossible to predict and could materially adversely affect EGI's business, results of operations and financial condition. Where the Office of the Superintendent of Financial Institutions (OSFI) is concerned about an unsafe course of conduct or an unsound practice in conducting of the business of a federally regulated insurance company, OSFI may direct the insurance company to refrain from a course of action or to perform acts necessary to remedy the situation. OSFI may, in certain circumstances, take control of the assets of an insurance company or take control of the company itself. More restrictive laws, rules or regulations may be adopted in the future that could make compliance more difficult and/or expensive. Specifically, recently adopted legislation addressing privacy issues, among other matters, is expected to lead to additional regulation of the insurance industry in the coming years, which could result in increased expenses or restrictions on EGI's operations.

Industry Growth

EGI is subject to, and dependent on, fluctuations within the P&C insurance industry. According to Canadian Underwriter, from 2001 to 2004 direct written premiums in the P&C insurance industry in Ontario, Alberta and Quebec grew at an abnormally high compound annual growth rate of 12.3%. EGI does not believe this growth rate is sustainable and believes that the performance of the P&C insurance industry will trend toward the industry's historic norms.

Competition

The P&C insurance business is highly competitive with pricing being a primary means of competition. Other elements of competition include availability and quality of products, quality and speed of service, financial strength, distribution systems and technical expertise.

EGI competes with many other insurance companies. Certain of these competitors are larger and have greater financial resources than EGI. In addition, certain competitors have from time to time decreased their prices in an apparent attempt to gain market share.

As competitors introduce new products and new competitors enter the market, the Company and its insurance subsidiaries may encounter additional and more intense competition. There can be no assurance that EGI will continue to increase revenues or be profitable. To a large degree, future revenues of EGI are dependent upon its ability to continue to develop and to market its products and to enhance the capabilities of its products to meet changes in customer needs.

EGI expects to encounter competition from other entities having a business objective similar to that of EGI. Many of these entities are well established and have extensive experience in connection with identifying and effecting business acquisitions directly or through affiliates. Many of these competitors possess greater financial, technical, personnel and other resources than EGI, and there can be no assurance that EGI will have the ability to compete successfully. EGI's financial resources will be relatively limited when contrasted with those of many of their competitors. Although EGI's business strategy assumes that the industry will generate competition, there can be no assurance on how any level of competition may impact the future revenues of EGI.

Cyclicality

Historically, the financial results of companies in the P&C insurance industry have been subject to significant fluctuations and uncertainties. The profitability of P&C insurers can be affected significantly by many factors, including regulatory regimes, developing trends in tort and class action litigation, adoption of consumer initiatives regarding rates or claims handling procedures, and privacy and consumer protection laws that prevent insurers from assessing risk or factors that have a high correlation with risks considered, such as credit scoring.

The financial performance of the P&C insurance industry has historically tended to fluctuate in cyclical patterns of "soft" markets characterized generally by increased competition resulting in lower premium rates and underwriting standards followed by "hard" markets characterized generally by lessening competition, stricter underwriting standards and increasing premiums rates. EGI's profitability tends to follow this cyclical market pattern with profitability generally increasing in hard market and decreasing in soft markets. These fluctuations in demand and competition could produce underwriting results that would have a negative impact on EGI's results of operations and financial condition.

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 P&C insurance lines. For example, the ice storm in eastern Canada in 1998 caused P&C insurance losses in several lines of business, including business interruption, personal property, automobile and commercial property. Claims resulting from natural or unnatural catastrophic events could cause substantial volatility in EGI's financial results for any fiscal quarter or year and could materially reduce EGI's profitability or harm EGI's financial condition. EGI's ability to write new business could also 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. If EGI's business continuity plans cannot be put into action or do not take such events into account, losses may further increase.

Interest Rates

An increase in interest rates may result in lower values for EGI's bond portfolio and increased costs of borrowing for EGI on future debt instruments or credit facilities. Such increased costs would negatively affect EGI's operating results.

Negative Publicity in Industry

EGI's products and services are ultimately distributed to individual consumers. From time to time, consumer advocacy groups or the media may focus attention on EGI's products and services, thereby subjecting its industry to periodic negative publicity. EGI also may be negatively impacted if its industry engages in practices resulting in increased public attention to its business. Negative publicity may also result in increased regulation and legislative scrutiny of practices in the P&C insurance industry as well as increased litigation. Such consequences may increase EGI's costs of doing business and adversely affect EGI's profitability by impeding its ability to market its products and services or increase the regulatory burdens under which EGI operates.

Reliance on Brokers

EGI distributes its products primarily through a network of brokers. These brokers sell EGI's competitors' products and may stop selling EGI products altogether. Strong competition exists among insurers for brokers with demonstrated ability to sell insurance products. Premium volume and profitability could be materially adversely affected if there is a material decrease in the number of brokers that choose to sell EGI products. In addition, some P&C insurance companies offer their products through dedicated, captive sales organizations. If the number of such P&C insurance companies increases, EGI's revenues may decrease, which could have a material adverse effect on EGI's business, financial condition and results of operations. EGI's strategy of distributing through Co-operators' agent channel may also adversely impact its relationship with brokers who distribute EGI products.

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 that they reflect the current environment.

However, pricing for automobile insurance must be submitted to each provincial government regulator and in certain provinces pre-approved by the regulator. It is possible that, in spite of EGI's best efforts, regulator 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 intense 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 success depends upon its ability to accurately assess the risks associated with the insurance policies that EGI writes.

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 (i.e., a combined ratio below 100%). EGI underwrites automobile business after a review of the applicant's driving record reports and claims experience. There can be no assurances that EGI will properly assess the risks associated with the insurance policies that it writes and may, therefore, experience increased adjudication, settlement and claims costs.

Loss Reserves and Claims Management

The amounts established and to be established by EGI for loss and loss adjustment expense reserves are estimates of future costs based on various assumptions, including actuarial projections of the cost of settlement and the administration of claims, estimates of future trends in claims severity and frequency, and the level of insurance fraud. Most or all of these factors are not directly quantifiable, particularly on a prospective basis, and the effects of these and unforeseen factors could negatively impact EGI's ability to accurately assess the risks of the policies that it writes. In addition, future adjustments to loss reserves and loss adjustment expenses that are unanticipated by management could have an adverse impact upon the financial condition and results of operations of EGI. Although EGI's management believes its overall reserve levels as at December 31, 2005 to be adequate to meet its obligations under existing policies, actual losses may deviate, perhaps substantially, from the reserves reflected in EGI's financial statements. To the extent reserves prove to be inadequate, EGI would have to increase such reserves and incur a charge to earnings.

Errors and Omissions Claims

Where EGI acts as a licensed insurance agency, it is subject to claims and litigation in the ordinary course of business resulting from alleged errors and omissions in placing insurance and handling claims. The placement of insurance and the handling of claims involve substantial amounts of money. Since errors and omissions claims against EGI may allege EGI's potential liability for all or part of the amounts in question, claimants may seek large damage awards and these claims can involve significant defence costs. Errors and omissions could include, for example, EGI's employees or sub-agents failing, whether negligently or intentionally, to place coverage or file claims on behalf of customers, to appropriately and adequately disclose insurer fee arrangements to its customers, to provide insurance providers with complete and accurate information relating to the risks being insured or to appropriately apply funds that it holds for its customers on a fiduciary basis. It is not always possible to prevent or detect errors and omissions, and the precautions EGI takes may not be effective in all cases.

EGI's business, financial condition and/or results may be negatively affected if in the future its errors and omissions insurance proves to be inadequate or unavailable. In addition, errors and omissions claims may harm EGI's reputation or divert management resources away from operating the business.

Investments

EGI's investment assets are exposed to any combination of risks related to interest rates, foreign exchange rates, and changing market values.

EGI's consolidated investment portfolio consists of diversified investments in fixed-income securities and preferred and common stocks. Investment returns and market values of investments fluctuate from time to time. A decline in returns could reduce the overall profitability of EGI. A change in interest rates, market values, or foreign exchange rates may affect Echelon's regulatory strength tests.

Reinsurance

Consistent with industry practice, EGI utilizes reinsurance to manage its claims exposure and diversifies its business by types of insurance and geographic area. The availability and cost of reinsurance are subject to prevailing market conditions that are generally beyond the control of EGI and may affect EGI's level of business and profitability. There can be no assurance that developments may not occur in the future, which might cause a shortage of reinsurance capacity in those classes of business

which EGI underwrites, which could result in curtailment of the issuing of policies in a certain line of business or containing limits above a certain size.

Reinsurer Credit Risk

EGI's reinsurance arrangements are with a limited number of reinsurers. This reinsurance may cause an adverse effect on EGI's results of operations if one or more of its reinsurers is unable to meet its financial obligations. Although all of its reinsurers were rated B++ or higher by A.M. Best at the time of entering into the reinsurance arrangements, these ratings are subject to change and may be lowered.

Although reinsurance makes the assuming reinsurers liable to EGI to the extent of the risk each reinsurer assumes, EGI, as the direct insurer, is not relieved of its primary liability to its insureds. As a result, EGI bears credit risk with respect to its reinsurers. EGI cannot ensure that its reinsurers will pay all reinsurance claims on a timely basis or at all. EGI evaluates each reinsurance claim based on the facts of the case, historical experience with the reinsurer on similar claims and existing law, and includes in its reserve for uncollectable reinsurance any amounts deemed uncollectable. The inability to collect amounts due to EGI under reinsurance arrangements would reduce EGI's net income and cash flow.

Technology

EGI is heavily dependent on systems technology to process large volumes of transactions, and there would be a risk if the technology employed is inadequate or inappropriate to support current and future business needs and objectives. EGI continues to implement new computer applications as part of a comprehensive approach to improve systems technology. EGI regularly tests and improves its Business Recovery Emergency Plan to protect itself, its producers and policyholders in the event of a technology failure; however, there is no assurance that EGI will be able to respond to technology failures effectively and with minimal disruption.

Liquidity

EGI manages its cash and liquid assets in an effort to ensure there is sufficient cash to meet all of EGI's financial obligations as they fall due. As a federally regulated insurance company, Echelon is required to maintain an asset base comprised of liquid securities that can be used to satisfy its ongoing commitments. EGI believes that internally generated funds provide the financial flexibility needed to fulfill cash commitments on an ongoing basis. EGI has no material commitments for capital expenditures. However, there can be no assurances that EGI's cash on hand and liquid assets will be sufficient to meet any future obligations that may come due.

Future Capital Requirements

EGI's future capital requirements will depend upon many factors, including the expansion of EGI's sales and marketing efforts and the status of competition. There can be no assurance that any additional financing will be available to EGI on acceptable terms, or at all. If additional funds are raised by issuing equity securities, further dilution to the existing stockholders will result. If adequate funds are not available, EGI may be required to delay, scale back or eliminate its programs. Accordingly, the inability to obtain such financing could have a material adverse effect on EGI's business, financial condition and results of operations.

Corporate Governance

EGI's Board of Directors has established the following committees to ensure that risks are effectively identified, monitored, controlled and reported on:

Audit Committee: This committee of Directors of the Company reviews all financial information, monitors internal controls and provides oversight of management's risk control processes specifically focusing on financial related risks. Echelon also has an Audit Committee of its Directors in accordance with requirements of the Insurance Companies Act (Canada).

Conduct Review & Compensation Committee: The Conduct Review & Compensation Committee of Directors of the Company monitors related party transactions affecting EGI and reviews and approves officer compensation and benefit plans. The Conduct Review Committee of Directors of Echelon is responsible for the identification and reporting of related party transactions to Echelon's Board of Directors and the monitoring of regulatory compliance and market conduct programs put in place by management to ensure their effectiveness.

Investment Committee: This committee, composed of Directors and supported by senior executives, ensures that risks associated with the investment of corporate and policyholder funds are effectively managed to accomplish EGI's investment objectives of prudent, conservative management of funds and compliance with regulatory restrictions while achieving competitive rates of return.

Reinsurance Committee: This committee of senior executives works closely with AON Re Canada Inc., EGI's reinsurance brokers, to ensure that effective reinsurance programs are in place which facilitate desired growth of EGI's business and provide EGI with protection against the occurrence of significant and unusual claims risk and development.

In addition to these committees, management has formed a number of working committees which have been assigned the responsibility of identifying and managing specific corporate risks, including (i) a strategic initiatives committee to consider the strategic risks faced by EGI, (ii) underwriting and claims committees to manage the risks associated with the development and pricing of EGI's products, claims adjudication and reserving, (iii) a technology committee and a system prioritization committee to implement effective technology solutions, and (iv) a regulatory committee to ensure that the appropriate processes and procedures are in place to ensure compliance with all applicable regulatory requirements. EGI has also established a Business Recovery Emergency Plan with the objectives of protecting life and securing critical infrastructure and facilities from a catastrophic event and resuming business operations in a timely effective manner, minimizing loss to the organization.

Except for May and June of 2005, when it self-insured, EGI has maintained liability insurance covering errors or omissions which may occur while acting in its role as an insurance consultant. The annual premium for this coverage during fiscal 2005 was $4,177. The coverage has an aggregate limit of liability of $2,000,000.

Disclosure Controls and Procedures

As of December 31, 2005 an evaluation was carried out, under the supervision of and with the participation of management including the President and Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures as defined under Multilateral Instrument 52-109. Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

Summary of Quarterly Results

				2005				Pro forma 2004
(IN $ THOUSANDS, EXCEPT PER SHARE DATA)	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Direct premium written	$ 28,081	$ 28,466	$ 34,528	$ 25,931	$ 26,864	$ 27,380	$ 34,106	$ 24,667
Total revenues	19,950	20,124	19,840	16,656	16,697	16,889	16,275	16,327
Underwriting income (loss)	2,452	347	6,214	405	3,585	172	(587)	349
Income (loss) before income taxes	4,267	2,643	7,732	2,303	5,644	1,306	795	2,365
Net income from continuing operations	3,057	1,728	4,928	1,495	5,632	1,060	1,102	1,149
Income from discontinued operations, net of income taxes	–	–	–	–	–	–	–	1,308
Extraordinary gain	–	–	–	5,669	–	–	–	–
Net income	3,057	1,728	4,928	7,164	5,632	1,060	1,102	2,457
Earnings per adjusted share								
– Basic	$ .36	$ .21	$ .62	$ .90	$ .71	$ .13	$ .14	$ 0.31
– Diluted	$ .35	$ .20	$ .58	$ .83	$ .70	$ .13	$ .14	$ 0.31

Direct written premiums in the fourth quarter of 2005 increased 4.5% compared to the pro forma fourth quarter of 2004, underwriting profit was $2.5 million compared to $3.6 million and net income was $3.1 million compared to pro forma net income of $5.6 million in 2004. An actuarial reserve release of $3.0 million occurred in the fourth quarter of 2004, compared to a release of $1.6 million in the fourth quarter of 2005. When these adjustments are excluded from the quarterly results, the fourth quarter 2005 underwriting result outperformed the same quarter in 2004. EGI Financial's reserves are reviewed and certified by its consulting actuary twice yearly, as at June 30 and December 31.

Capital Resources

The total capitalization of EGI at December 31, 2005 is $72.6 million compared to $26.9 million at December 31, 2004. The IPO transaction that closed December 8, 2005, the share for share transaction with The Co-operators Group and 2005 earnings are the contributing factors for this significant growth in capitalization.

This growth in capitalization reflects the strengthening of EGI's balance sheet and provides for better capital adequacy as a property and casualty insurance company. A common measure of capital adequacy is the net written premium ratio to surplus (or common shareholders' equity). This ratio improved from 1.30 at December 31, 2004 to 1.26 at December 31, 2005. This level of leverage is well below the 2.5:1 ratio which management feels is fully leveraged capital. Therefore EGI's current capitalization provides it with adequate financial resources for planned growth. The combined ratio for the Company improved in 2005 to 88.0% from 96.8% in 2004.

		As at December 31
(IN $ THOUSANDS)	2005	2004
Debt outstanding	$ –	$ 1,590
Shareholders' equity		
Series F special shares	2,155	2,155
	(2,268,279 shares)	(2,268,279 shares)
Common shares	45,505	15,186
	(9,583,152 shares)	(2,268,279 shares)
Retained earnings	24,845	7,968
Contributed surplus	80	–
Total capitalization	$ 72,585	$ 26,899

Future Adoption of New Accounting Policies

Financial Instruments – Recognition and Measurement, CICA Handbook Section 3855

Section 3855 prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the balance sheet and at what amount – sometimes using fair value, other times using cost-based measures. It also specifies how financial instrument gains and losses are to be presented.

Section 3855 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Earlier adoption is permitted only as of the beginning of a fiscal year ending on or after December 31, 2004. The Company will adopt this standard for its 2007 fiscal year. Transitional provisions for this section are complex and vary based on the type of financial instrument under consideration.

The effect on the Company's financial statements cannot be reasonably determined at this time.

Comprehensive Income, CICA Handbook Section 1530

Section 1530 introduces new standards for reporting and display of comprehensive income. Comprehensive income is the change in equity (net assets) of an enterprise during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners.

Section 1530 applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Earlier adoption is permitted only as of the beginning of a fiscal year ending on or after December 31, 2004. The Company will adopt this standard for its 2007 fiscal year. Financial statements of prior periods are required to be restated for certain comprehensive income items. In addition, an enterprise is encouraged, but not required, to present reclassification adjustments in comparative financial statements provided for earlier periods.

The effect on the Company's financial statements cannot be reasonably determined at this time.

Glossary of Selected Insurance Terms

Case method means establishing a reserve liability equal to the most probable expected outcome for an individual claim.

Cede means the act of an insurer transferring or assigning part or all of the risk on an insurance policy written by it to a reinsurer by purchasing insurance from such reinsurer to cover the risk or part thereof.

Combined ratio of an insurer for any period means the sum of the loss ratio and the expense ratio of the insurer for such period.

Direct written premiums of an insurer for any period means the total premiums on insurance, including assumed reinsurance, written by the insurer during such period.

Expense ratio for any period means the sum of expenses, including commissions, premium taxes and operating expenses incurred, expressed as a percentage of net earned premiums.

Facility Association or **Facility** refers to an organization of the Canadian automobile insurance industry which exists to ensure that all drivers can obtain basic insurance, even if their application fails to meet the criteria of individual insurance companies.

Groupement refers to a Quebec organization of the automobile insurance industry which exists to ensure that all drivers in Quebec can obtain basic insurance, even if their application fails to meet the criteria of individual insurance companies.

Loss adjustment expenses or **LAE** means the expense of settling claims, including certain legal and other fees, and the expense of administering the claims adjustment process.

Loss ratio for any period means the sum of claims and claims adjustment expenses incurred, net of reinsurance, expressed as a percentage of net earned premiums.

Minimum Capital Test means the OSFI's Minimum Capital Test Guideline under which a federally regulated insurer is measured for the adequacy of its capital.

Net earned premiums of an insurer means the portion of the written premium equal to the expired portion of the time for which insurance or reinsurance was in effect.

Net written premiums of an insurer means direct written premiums less amounts ceded to reinsurers.

Producers refers collectively to insurance brokers, agents and managing general agencies.

Quota share means a type of reinsurance where the reinsurer agrees to assume the risk on a fixed portion of a specified line of business in return for the same portion of the ceding company's premium for that line of business.

Reinsurance means an arrangement in which an insurance company, the reinsurer, agrees to indemnify another insurance or reinsurance company, the ceding company, against all or a portion of the insurance or reinsurance risks underwritten by the ceding company under one or more policies.

Retention means the amount of liability for which an insurance company will be responsible after it has completed its reinsurance arrangements.

Risk means a person or thing insured on an insurance policy.

Underwriting means the assumption of risk for designated loss or damage by issuing a policy of insurance in respect thereof.

Unearned premiums means the portion of premiums received relating to the period of risk in subsequent accounting periods and which is deferred to such subsequent accounting periods.

Role of Management, Board of Directors and Audit Committee

Management is responsible for the preparation and fair presentation of the consolidated financial statements, management's discussion and analysis and other information in this Annual Report. The consolidated financial statements of EGI Financial Holdings Inc. (EGI) were prepared in accordance with Canadian generally accepted accounting principles, including the accounting requirements of the Superintendent of Financial Institutions Canada. Where necessary, these statements reflect amounts based upon the best estimates and judgement of management.

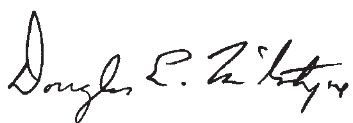
In meeting its responsibility for the reliability of the consolidated financial statements, management maintains the necessary system of internal controls. These controls are designed to provide management with reasonable assurance that the financial records are reliable for preparing financial statements and other financial information, and assets are safeguarded against unauthorized use or disposition and liabilities are recognized. The Audit Committee, comprised of Directors who are not officers or employees of the Company, meets, as required, with management, the appointed actuary and the external auditors to review actuarial, accounting, reporting and internal control matters. The Audit Committee is responsible for reviewing the consolidated financial statements and management's discussion and analysis and recommending them to the Board of Directors for approval.

Role of Appointed Actuary

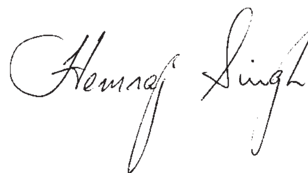
The actuary is appointed by the Board of Directors pursuant to the Insurance Companies Act (Canada). The appointed actuary is responsible for ensuring that the assumptions and methods used in the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation and associated regulations or directives. The actuary is also required to provide an opinion regarding the appropriateness of the policy liabilities at the balance sheet date to meet all policyholder obligations of the Company. Examination of supporting data for accuracy and completeness and consideration of Company assets are important elements of the work required to form this opinion. The actuary uses the work of the external auditors in verifying data used for valuation purposes.

Role of External Auditors

PricewaterhouseCoopers LLP, the external auditors, have been appointed by the shareholders to conduct an independent audit of the consolidated financial statements of EGI, in accordance with Canadian generally accepted auditing standards and report to the shareholders regarding the fairness of the financial reporting. The external auditors use the work of the appointed actuary in respect of policy liabilities included in the consolidated financial statements on which the appointed actuary has rendered an opinion.



DOUGLAS E. MCINTRYE,
CHIEF EXECUTIVE OFFICER



HEMRAJ SINGH,
CHIEF FINANCIAL OFFICER

APPOINTED ACTUARY'S REPORT

TO THE SHAREHOLDERS OF EGI FINANCIAL HOLDINGS INC.:

J. S. Cheng & Partners Inc. has valued the policy liabilities of the subsidiary insurance operations of EGI Financial Holdings Inc. in its consolidated balance sheets as at December 31, 2005 and 2004, in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion, the amount of policy liabilities makes appropriate provision for all policyholder obligations and the consolidated balance sheets fairly present the results of the valuation.

(SIGNED) JOE S. CHENG, FCIA
J. S. CHENG & PARTNERS INC.
Toronto, Ontario

February 17, 2006

AUDITORS' REPORT

TO THE SHAREHOLDERS OF EGI FINANCIAL HOLDINGS INC.

We have audited the consolidated balance sheets of EGI Financial Holdings Inc. as at December 31, 2005 and 2004 and the consolidated statements of income, changes in shareholders' equity and cash flows for each of the years in the two year period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a text basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for each of the years in the two year period ended December 31, 2005 in accordance with Canadian generally accepted accounting principles.

Chartered Accountants
Toronto, Canada

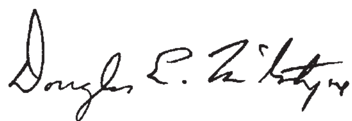
February 17, 2006

CONSOLIDATED BALANCE SHEETS

(in $ thousands, except share amounts)

AS AT DECEMBER 31, 2005		2005		2004
Assets				
Cash and short-term deposits	$	15,899	$	7,327
Investments (note 4)		152,736		57,098
Reinsurers' share – Unearned premiums (note 5)		2,761		6,871
– Unpaid claims (note 6)		54,043		24,978
Accounts receivable		22,271		10,219
Income taxes recoverable		273		–
Due from insurance companies		2,504		–
Deferred policy acquisition costs		6,289		2,733
Capital assets (note 8)		560		267
Future income taxes (note 12)		3,133		1,046
Prepaid expenses and other assets		262		198
	$	260,731	$	110,737
Liabilities				
Provision for unpaid claims (note 6)		129,173		54,149
Unearned premiums (note 5)		39,973		17,933
Unearned commission		1,261		1,368
Accounts payable and accrued liabilities		4,503		1,592
Payable to insurance companies		7,340		8,833
Income taxes payable		5,708		893
Other liabilities		188		660
		188,146		85,428
Shareholders' equity				
Share capital (note 9)		47,660		17,341
Contributed surplus (note 10)		80		–
Retained earnings		24,845		7,968
		72,585		25,309
	$	260,731	$	110,737

On behalf of the Board:



DOUGLAS E. MCINTYRE
DIRECTOR

MARK SYLVIA
DIRECTOR

CONSOLIDATED STATEMENTS OF INCOME

(in $ thousands, except share amounts)

FOR THE YEARS ENDED DECEMBER 31		2005		2004
Revenue				
Direct written premiums	$	117,006	$	57,240
Net written premiums		91,783		35,217
Net earned premiums		76,344		33,615
Investment income		7,527		3,419
Other revenue		227		298
	$	84,098	$	37,332
Expenses				
Incurred claims		45,997		22,400
Acquisition costs		12,073		5,638
Operating expenses		9,083		4,506
		67,153		32,544
Income before income taxes		16,945		4,788
Income tax expense (recovery) (note 12)				
Current		7,505		1,155
Future		(1,768)		(1,085)
		5,737		70
Income from continuing operations		11,208		4,718
Income from discontinued operations, net of income taxes (note 2)		–		1,308
Extraordinary gain, net of income taxes (note 2)		5,669		–
Net income	$	16,877	$	6,026
Earnings per share (note 18)				
Net income per share from continuing operations	$	1.38	$	1.02
Net income per share from discontinued operations	$	–	$	0.29
Net income per share from extraordinary gain	$	0.71	$	–
Net income per share	$	2.09	$	1.31
Net income per diluted share from continuing operations	$	1.30	$	1.01
Net income per diluted share from discontinued operations	$	–	$	0.29
Net income per diluted share from extraordinary gain	$	0.66	$	–
Net income per diluted share	$	1.96	$	1.30

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(in $ thousands, except share amounts)

FOR THE YEARS ENDED DECEMBER 31	2005	2004
Share capital		
Balance, beginning of year	$ 17,341	$ 15,186
Common shares issued	30,319	–
Stock dividend	–	2,155
Balance, end of year	47,660	17,341
Contributed surplus		
Stock options granted	80	–
Retained earnings		
Balance, beginning of year	7,968	4,097
Net income	16,877	6,026
Stock dividend	–	(2,155)
Balance, end of year	24,845	7,968
Total, end of year	$ 72,585	$ 25,309

CONSOLIDATED STATEMENTS OF CASH FLOW

(in $ thousands, except share amounts)

FOR THE YEARS ENDED DECEMBER 31		2005		2004
Cash provided by (used in):				
OPERATING ACTIVITIES				
Net income	$	16,877	$	6,026
Items not involving cash:				
Amortization of capital assets		448		187
Amortization of premium on bonds		177		(32)
Realized gains on investments		(1,221)		(907)
Extraordinary gain		(6,819)		–
Cash flow from change in:				
Reinsurers' share of unearned premiums		10,981		(4,081)
Reinsurers' share of unpaid claims		(4,087)		(3,622)
Accounts receivable		(2,190)		(4,348)
Income taxes recoverable		(273)		–
Due from insurance companies		(2,504)		–
Accounts payable and accrued liabilities		(15,564)		(2,259)
Provision for unpaid claims		21,426		11,259
Unearned premiums		4,445		1,719
Income taxes payable		3,749		747
Future income taxes		(1,267)		391
Deferred revenue		–		(714)
Other assets		(12)		294
Deferred acquisition cost		(884)		1,494
	$	23,282	$	6,154
FINANCING ACTIVITIES				
Issue of common shares	$	16,096	$	–
INVESTING ACTIVITIES				
Acquisition of subsidiary, net of cash acquired		5,646		–
Purchase of capital assets		(564)		(91)
Purchase of investments		(75,508)		(33,081)
Sale/maturity of investments		39,620		26,633
	$	(30,806)	$	(6,539)
Increase (decrease) in cash and short-term deposits		8,572		(385)
Cash and short-term deposits, beginning of year		7,327		7,712
Cash and short-term deposits, end of year	$	15,899	$	7,327
Supplementary information				
Income taxes paid	$	2,160	$	1,213

1. ORGANIZATION

EGI Financial Holdings Inc. ("the Company") was incorporated on August 18, 1997 under the Business Corporations Act (Ontario). The Company is a holding company which, through its subsidiaries, is involved primarily in the underwriting of non-standard automobile and other niche and specialty general insurance products and the management of investment funds derived from its insurance operations.

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

2. ACQUISITIONS AND DIVESTITURES

a) During January 2005, the Company issued shares to acquire an additional 50% ownership interest in the holding company that owned 100% of Echelon. The holding company, EGI Financial Holdings Inc. ("EGI Financial (2003)"), became a wholly owned subsidiary of the Company and amalgamated with the Company. The acquisition cost of $14,222 was paid with the issuance of 1,682,768 common shares and 1,682,768 Series B special shares of the Company. The price of the common shares was determined and agreed using the fair value of the net assets acquired as at December 31, 2003.

The purchase transaction was accounted for as a step acquisition which resulted in negative goodwill of $6,819 recognized in the consolidated statement of income. The Company's consolidated statements of income reflect the results of 100% of the operations for the acquired entity from the date of acquisition. Prior to this date, 50% was proportionally consolidated.

Assets and liabilities acquired at fair values:

(IN $ THOUSANDS)		
Cash and cash equivalents	$	5,646
Investments		58,625
Reinsurers' share of		
– Unpaid claims and adjustment expenses		24,978
– Unearned premiums		6,871
Deferred policy acquisition costs		2,672
Other assets		10,911
Provision for unpaid claims and adjustment expenses		(53,598)
Unearned premiums		(17,595)
Other liabilities		(17,469)
Net assets acquired		21,041
Consideration given:		
Common and Series B special shares		14,222
Negative goodwill	$	6,819

The negative goodwill was recorded as an extraordinary gain in 2005, net of income tax of $1,150.

The Company's 50% proportionate share in the assets, liabilities, revenues and expenses and cash flows of EGI Financial (2003) included by proportionate consolidation in 2004 is as follows:

(IN $ THOUSANDS)		
Assets	$	106,831
Liabilities		88,663
Revenue		35,447
Expenses		30,125
Cash flows from:		
Operating activities		11,576
Investing activities		(12,984)
Financing activities		3,500

b) During February 2004, the Company sold its 50% share in the Trent Health group of companies to Co-operators Life Insurance Company resulting in a gain of $2,102 before income taxes which is recorded as income from discontinued operations. The net income for the period from January 1, 2004 to February 26, 2004, date of disposition, was approximately $6 and was included in income from discontinued operations.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of income and expenses for the reporting period of the consolidated statement of income and retained earnings. Actual results could differ from those estimates.

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, except in 2004 a 50% proportionate share of the consolidated accounts of EGI Financial (2003) (Note 2) is included. All significant intercompany balances and transactions have been eliminated upon consolidation.

Cash and Short-term Deposits

Cash and short-term deposits include cash on hand, cash balances with banks and investments in money market instruments maturing in 90 days or less from the date of acquisition.

Investments

Bonds and debentures are stated at amortized cost. Premiums and discounts arising on the purchase of bonds and debentures are amortized to investment income on a yield-to-maturity basis. When the value of any bond, debenture or term deposit is identified as impaired, the carried amount is adjusted to an estimated realizable amount, and the adjustment is deducted from investment income.

Common shares are recorded at cost. Provision is made for any reductions in value of common shares that are considered other than temporary and any such amounts are deducted from investment income.

Investment income is recorded as it accrues. Dividend income on stocks 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.

Provision for Unpaid Claims

Provision for unpaid claims includes adjustment expenses which represent the estimated amounts required to settle all outstanding and unreported claims incurred to the end of the year. Unpaid claims liabilities are carried on a discounted basis. Expected reinsurance recoveries on unpaid claims and adjustment expenses, net of any required provision for doubtful amounts, are recognized as assets at the same time using principles consistent with the Company's method for establishing the related liability.

Reinsurance

The Company reflects third party reinsurance balances on the balance sheet on a gross basis to indicate the extent of credit risk related to third party reinsurance and its obligations to policyholders and on a net basis in the statement of income to indicate the results of the retention of premiums written.

Revenue Recognition

Premium income

Insurance premiums written are deferred as unearned premiums and taken into income pro rata over the terms of the underlying policies. The portion of the premium related to the unexpired term of the policy at the end of the fiscal year is reflected in unearned premiums.

Deferred Policy Acquisition Costs

Commissions and premium taxes incurred in the writing of premiums are deferred only to the extent that they are expected to be recovered from unearned premiums and are amortized to income over the terms of the related insurance policies. If unearned premiums are not sufficient to pay expected claims and expenses including policy maintenance expenses and unamortized policy acquisition costs, a premium deficiency is said to exist. Anticipated investment income is considered in determining whether a premium deficiency exists. Premium deficiencies are recognized initially by writing down deferred policy acquisition costs.

Capital Assets

Capital assets are recorded at cost less accumulated amortization. Amortization is provided over the estimated useful lives of the assets using the straight-line method over the following terms:

Furniture and equipment	3 years
Computer hardware	3 years
Computer software	2 years

Employee Benefits

The Company contributes to a Group Registered Savings Plan for employees as services are incurred. There are no other post-employment benefits.

Income Taxes

The Company follows the asset and liability method of accounting for income taxes, whereby future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Future tax assets and liabilities are measured using enacted or substantively enacted income tax rates expected to apply to taxable income in the periods in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in income tax rates is recognized in income in the period that includes the date of enactment or substantive enactment.

Foreign Currency Translation

Foreign currency transactions are translated into Canadian dollars using the exchange rates in effect at the time the transactions occurred. Monetary assets and liabilities are translated into Canadian dollars using the exchange rates in effect at the balance sheet date. Exchange gains and losses are included in income.

Stock Based Compensation

The Company has a stock option plan that is described in Note 10. Stock options granted under the plan are accounted for using the fair value method. Under this method, the compensation cost of stock options granted is measured at estimated fair value at the grant date and recognized over the vesting period.

4. INVESTMENTS

The Company utilizes the prudent person approach to asset management as required by the Insurance Companies Act (the “Act”). An investment policy is in place and its application is monitored by the Board of Directors. Diversification techniques are employed to minimize risk. Policies limit investments in any entity or group of related entities to a maximum of 5% of the Company’s assets. Limitations are also placed on the quality of investments, particularly relating to investment grade bonds.

(IN $ THOUSANDS)	Carrying amount 2005	Fair value 2005	Unrealized gain 2005	Unrealized loss 2005	Carrying amount 2004	Fair value 2004	Unrealized gain 2004	Unrealized loss 2004
Bonds								
Canadian								
Federal	$ 61,405	$ 61,267	$ 97	$ (235)	$ 22,137	$ 22,458	$ 324	$ (3)
Provincial	21,366	22,307	967	(26)	8,676	9,011	345	(10)
Municipal	1,529	1,617	88	–	769	798	29	–
Corporate	38,377	38,442	514	(449)	15,783	16,225	469	(27)
	$ 122,677	$ 123,633	$ 1,666	$ (710)	$ 47,365	$ 48,492	$ 1,167	$ (40)
Preferred shares	$ 3,738	$ 3,767	$ 58	$ (29)	$ 650	$ 660	$ 10	$ –
Common shares								
Canadian	22,802	28,934	6,185	(53)	7,960	9,670	1,730	(20)
United States	2,761	2,801	116	(76)	830	868	65	(27)
	$ 25,563	$ 31,735	$ 6,301	$ (129)	$ 8,790	$ 10,538	$ 1,795	$ (47)
Investment income due and accrued	758	758	–	–	293	293	–	–
	$ 152,736	$ 159,893	$ 8,025	$ (868)	$ 57,098	$ 59,983	$ 2,972	$ (87)

Fair values of bonds and stocks are determined based on quoted market prices. Bonds comprise Canadian government, provincial, municipal and corporate bonds.

The effective interest rate for bonds ranges from 3.8% to 4.5% in 2005 (2004 – 3.8% to 5.0%).

Impaired Assets and Provisions for Losses

The Board of Directors has established a policy to write down or make provision for any investment with “other than temporary” impairment. There was no investment provision recorded in 2005 and 2004.

Management has reviewed currently available information regarding those investments whose estimated fair value is less than carrying value. Debt securities whose carrying value exceeds market value can be held until maturity. All investments have been reviewed to ensure that corporate performance expectations have not changed significantly to adversely affect the market value of these investments other than on a temporary basis.

Securities Lending

Until April 2005 the Company participated in a securities lending program managed by a federally regulated financial institution whereby the Company lent securities it owned to other financial institutions to allow them to meet delivery commitments. The Company received securities of superior credit quality and value as collateral for securities loaned. As at December 31, 2004, securities with an estimated fair value of $6,116 had been loaned, and securities with an estimated fair value of $6,524 had been received as collateral.

Interest Rate and Liquidity Risk

Historical data and current information are used to profile the ultimate claims settlement pattern by class of insurance, which is then used in a broad sense to develop an investment policy and strategy. Fluctuations in interest rates could have a significant impact on the market value of the bond portfolio. Stock market values can be volatile. This could result in realized gains or losses if actual claims payment patterns require liquidation of investments.

Liquidity risk is the risk that an entity will encounter difficulty in raising funds to meet cash flow commitments associated with financial instruments. To manage its cash flow requirements, the Company maintains a portion of its invested assets in liquid securities.

The maturity profile of bonds as at December 31, 2005 is as follows:

(IN $ THOUSANDS)	1 year	1–3 years	3–5 years	Over 5 years	Total
Bonds	$ 1,401	$ 21,367	$ 24,721	$ 75,188	$ 122,677
Percentage of total	1.1%	17.4%	20.2%	61.3%	100.0%

Credit Risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the Company to incur a financial loss. Credit risk mostly arises from investments in bonds and preferred shares.

The Company's investment policy requires, at the time of the investment, that fixed income securities have a minimum credit rating of BBB and preferred shares have a minimum rating of P3. Management monitors subsequent rating changes on a regular basis.

5. UNEARNED PREMIUMS

		2005		2004
(IN $ THOUSANDS)	Gross	Ceded	Gross	Ceded
Automobile:				
– Accident benefits	$ 14,210	$ 1,025	$ 6,525	$ 2,576
– Liability	15,160	1,079	7129	2,790
– Other	7,770	94	3,686	1,357
Total Automobile	$ 37,140	$ 2,198	$ 17,340	$ 6,723
Niche Products:				
Property				
– Commercial	1,505	328	320	94
– Personal	43	–	24	7
Liability	883	230	–	–
Accident and sickness	34	5	41	7
Other	368	–	208	40
Total Niche Products	$ 2,833	$ 563	$ 593	$ 148
	$ 39,973	$ 2,761	$ 17,933	$ 6,871

6. 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, the 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.

Unpaid claims, adjustment expenses and unreported losses consist of (i) case reserves based on reports and estimates prepared by claims adjusters, and (ii) a reserve for incurred but unreported losses based on past experience. The provision for adjustment expenses reflects the estimated costs of investigating, settling and processing these claims. An actuary has been appointed by the Board of Directors of Echelon pursuant to the Act. With respect to the preparation of Echelon's financial statements, the actuary is required to carry out a valuation of Echelon's policy liabilities. The adequacy of these estimates is evaluated by the actuary using appropriate actuarial techniques based on prior experience. The actuary is responsible for ensuring that the assumptions and methods used for the valuation of policy liabilities are in accordance with Canadian accepted actuarial practices, applicable legislation and associated regulations and directives. In performing the valuations of Echelon's liabilities, which are by their nature inherently variable, assumptions are made as to the future loss ratios, trends, rates of claims frequency

and severity, inflation, reinsurance recoveries, investment rates of return and both internal and external adjustment expenses, taking into consideration the circumstances and the nature of the insurance policies in force.

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 provision for unpaid claims includes a provision for adverse deviation, as required by Canadian accepted actuarial practices. The aggregate impact of the provision for adverse deviation is to increase the provision for unpaid claims on a gross basis by $12,485 as at December 31, 2005 (2004 – $4,318).

		2005		2004
(IN $ THOUSANDS)	Gross	Ceded	Gross	Ceded
Automobile:				
– Accident benefits	$ 47,571	$ 21,668	$ 17,251	$ 8,028
– Liability	75,631	30,647	34,673	16,214
– Other	3,063	1,237	1,143	377
Total Automobile	$ 126,265	$ 53,552	$ 53,067	$ 24,619
Niche Products:				
Property				
– Commercial	1,590	411	785	264
– Personal	74	28	41	13
Liability	114	28	12	6
Accident and sickness	961	9	119	42
Other	169	15	125	34
Total Niche Products	$ 2,908	$ 491	$ 1,082	$ 359
	$ 129,173	$ 54,043	$ 54,149	$ 24,978

The Company discounts its best estimate of claim provisions at a rate of interest of 2.8% for 2005 (2004 – 3.5%) for all lines of business. The Company determines the discount rate based upon the expected return on its investment portfolio of assets with appropriate assumptions for interest rates relating to reinvestment of maturing investments.

7. 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.

The Company has entered into quota share reinsurance contracts with third party reinsurers ceding 25% (2004 – 35%) of all risks written. There were other specific reinsurance placements for the specialty property and casualty program business. At the end of 2005 the Company arranged for a portfolio withdrawal of the unearned premiums from the 2005 quota share reinsurers. As a result of this withdrawal, the reinsurers' share of unearned premiums has been reduced by $9,198 and unearned commission revenue has been reduced by $2,115 as at December 31, 2005.

During 2005, 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 $450 (2004 – $163). In addition, the Company obtained catastrophe reinsurance which limits the loss from a series of claims arising from a single occurrence to $750 (2004 – $325) to a maximum coverage of 75% of $15,000 (2004 – 65% of $7,500).

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.

8. CAPITAL ASSETS

			2005			2004
(IN $ THOUSANDS)	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Furniture and equipment	$ 425	$ 371	$ 54	$ 314	$ 232	$ 82
Computer hardware	131	65	66	241	233	8
Computer software	1,020	580	440	625	448	177
	$ 1,576	1,016	$ 560	$ 1,180	$ 913	$ 267

9. SHARE CAPITAL

(IN $ THOUSANDS)	2005	2004
Authorized:		
Unlimited common shares		
Unlimited special shares issuable in Series		
Issued:		
9,583,152 common shares post split (2004 – 2,268,279)	$ 45,505	$ 15,186
2,268,279 Series F special shares	2,155	2,155
	$ 47,660	$ 17,341

Series A and Series B special shares were issued as part of the January 2005 acquisition by the Company of 50% of EGI Financial (2003) (Note 2). Immediately prior to the acquisition, 2,268,279 Series A special shares were issued to the common shareholders of the Company and upon the acquisition, 1,682,768 Series B special shares were issued to the sellers of the 50% of EGI Financial (2003) as part of the purchase price along with 1,682,768 common shares. The Series B special shares were issued to effect any necessary adjustments in the exchange ratio based on development of claims. At a future date, any adjustment required to the ratio was to be determined and either the Series A or the Series B shares would be converted into additional common shares, and the other series of special shares would be redeemed for nominal consideration; no change in the aggregate amount of share capital would result. On September 29, 2005, the outstanding Series B special shares were converted to 11,058 additional common shares and the Series A special shares were redeemed for nominal consideration.

During 2004 the number of common shares of the Company was increased by 50,121 upon conversion of 791,936 Series E special shares.

During 2004 a stock dividend was declared to shareholders of record on May 13, 2004. One Series F special share with a nominal value of $0.95 was issued for each common share. These Series F special shares are entitled to cumulative dividends at the rate of $0.06365 per share per annum. This transaction resulted in a reduction to retained earnings and an increase in share capital of $2,155. As at December 31, 2005, there were unpaid cumulative dividends of $217 on these shares (2004 – $72). Subsequently, on January 31, 2006, the outstanding Series F special shares were redeemed for $2,384, including cumulative dividends.

On June 7, 2005, the existing 3,951,047 common shares were split 2-for-1.

Upon the closing of an initial public offering on December 8, 2005, 1,670,000 common shares were issued at a price of $10.50 per share. The net increase to share capital from this transaction was $16,096 comprising gross proceeds of $17,535 and expenses, net of taxes, of $1,439.

10. EMPLOYEE STOCK OPTION PLAN

The Company sponsors a stock option plan. The stock option plan provides for the issuance of shares of the Company's common stock not exceeding 10% of the total issued and outstanding shares (on a non-diluted basis) and shares reserved for issuance under employee stock option plans, options for services and employee stock purchase plans. The Board of Directors determines the terms and conditions of the awards under the plan as well as any award allocations.

For the year ended December 31, 2005, the Company recorded a compensation expense of $80 with an offsetting credit to contributed surplus. All stock options granted are for a term of five years. The stock options vest 20% on each anniversary of the grant date.

The following is a continuity schedule of stock options outstanding as at December 31, 2005 and 2004:

	Number of shares		Weighted average exercise price per share	
	2005	2004	2005	2004
Outstanding, beginning of year	470,000	–	$ 4.23	$ –
Granted	45,000	470,000	5.09	4.23
Outstanding, end of year	515,000	470,000	$ 4.30	$ 4.23

As at December 31, 2005, the outstanding stock options consist of the following:

Option price per share	Number	Remaining contractual life	Number of options exercisable
$4.23	470,000	3.8 years	94,000
$5.09	45,000	4.3 years	–

The fair value of the stock options issued was determined using the Black-Scholes option pricing model with the following assumptions: (i) risk-free rate of 3.75%, (ii) life expectancy of four years, (iii) estimated volatility of 0%, and (iv) dividend yield of 0%. The fair value of total options granted to date was estimated at $398. The weighted average grant-date fair value of options granted to date is $0.70.

11. RELATED PARTY TRANSACTIONS

The Co-operators Group Limited and Co-operators General Insurance Company, significant shareholders of the Company, provide services to the Company including but not limited to product distribution and investment management services. Direct written premiums derived from Co-operator's agents in 2005 was $27,217 (2004 – $15,394) and commissions paid in 2005 were $2,878 (2004 – $1,627).

The Company holds deposits of $5,996 at December 31, 2005 (2004 – $5,825) under the terms of a 2001 100% quota share reinsurance treaty with Co-operators General Insurance with income resulting from the investment of these deposits for the account of the Company. Reinsurers' share of unpaid claims includes a recoverable of $5,996 (2004 – $5,826) from Co-operators General Insurance. The 'due to insurance companies' balance includes amounts due to Co-operators General Insurance of $7,024 (2004 – $5,944).

Co-operators provided a loan of $2,000 to the Company in 2001 bearing interest at 7% to be paid semi-annually. During 2004, the Company repaid $945 to Co-operators. The balance of $1,702, including interest, owing to Co-operators was repaid on December 16, 2005.

12. INCOME TAXES

The provision for income taxes reflects an effective rate which differs from the corporate tax rate as follows:

(IN $ THOUSANDS)	2005	2004
Income tax expense at statutory rates	$ 6,100	$ 1,723
Permanent differences	(314)	(330)
Future income tax rate changes	1	3
Large Corporations tax	–	8
Recognition of income tax losses from prior years	–	(1,380)
Other	(50)	46
	$ 5,737	$ 70

Future income taxes are comprised of the following:

(IN $ THOUSANDS)	2005	2004
Income tax loss carryforward amounts	$ –	$ 226
Provision for unpaid claims	1,511	515
Investments	980	305
Deferred costs	647	–
Capital assets	(5)	–
	$ 3,133	$ 1,046

13. LEASE COMMITMENTS

The Company is committed under lease agreements for office premises and computer equipment with minimum lease payments of $1,474 as follows:

(IN $ THOUSANDS)	
2006	$ 498
2007	469
2008	412
2009	95

14. STRUCTURED SETTLEMENTS

In the normal course of claims adjudication, the Company may settle certain long-term losses through the purchase of annuities (structured settlements) from life insurance companies. The fair value of these annuity contracts amounts to $3,240 (2004 – $1,543) using a discount rate of 5% (2004 – 5%). It is the policy of the Company to purchase annuities from life insurers with proven financial stability. The net risk to the Company is the credit risk related to the life insurance companies and this risk is reduced to the extent of coverage provided by the life insurance compensation insurance plan (Assuris, formerly Comp Corp). The Company has determined that no credit risk provision is required.

15. FAIR VALUE DISCLOSURE

Fair value is an amount that represents the estimated exchange value of a financial instrument between willing parties.

The fair value of the investments is considered to be the market value, less transaction costs. The majority of the investment portfolio is fully invested in well-established, active, liquid markets. The fair value of investments is disclosed in Note 4.

The fair value of outstanding claims is reasonably considered to be the carrying value, as stated. Many claims are of short duration and the Company already discounts claims. There is not an active market for stand-alone policy liabilities, so a market value is not readily available. An actuarial approach to determine value is to discount estimated future cash flows and includes a margin called the 'provision for adverse deviation'. Both values are considered reasonable in the range of possible outcomes and the difference in the change year over year is not considered material.

The fair values of other financial assets and financial liabilities are considered to be the carrying values, as they are of short duration. The value of the Company as a whole on a going concern basis may be greater than the sum of the fair values of the individual assets and liabilities.

16. CONTINGENCIES

From time to time, in connection with its insurance operations, the Company is named a defendant in actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the outcome, such actions have generally been resolved with minimal damage or expense in excess of amounts provided as policy liabilities. The Company does not believe that it will incur any significant additional loss or expense in connection with such actions.

17. REGULATORY REQUIREMENTS

At December 31, 2005 and 2004, Echelon met the minimum regulatory capital requirement. In addition, legislation applicable to insurance companies imposes certain restrictions on an insurance Company's ability to pay dividends.

The Company writes business subject to rate regulation, including non-standard automobile insurance which comprises approximately 91% of net premiums written. The Company's automobile insurance premiums can be impacted by mandatory rate rollbacks and mandatory rate assessments as legislated by provincial law and by regulation in certain provinces. This could result in lower future premium rates or reductions to premium rates charged by the Company in prior periods. In addition, the Company is required, under certain provincial legislation, to participate in risk sharing pools, which may impact positively or negatively upon underwriting results. Certain benefit payments are also subject to provincial government regulation, including automobile accident benefits.

The Company currently has applications with Nova Scotia for an automobile premium rate increase of 10.6% in 2006. The Company is not aware of any proposed or pending rate rollbacks related to prior years.

18. EARNINGS PER SHARE

(IN $ THOUSANDS)	2005	2004
Basic earnings per share		
Net income from continuing operations	$ 11,208	$ 4,718
Dividends to Series F shareholders	(144)	(72)
Net income before discontinued operations and extraordinary items available to common shareholders	$ 11,064	$ 4,646
Average number of common shares (in thousands)	8,018	4,537
Diluted earnings per share		
Average number of common shares (in thousands)	8,018	4,537
Common shares obligation under employee stock option plan	515	470
Average number of diluted common shares	8,517	4,595

Earnings per share amounts for 2004 reflect the common stock split completed on June 7, 2005.

19. SEGMENTED INFORMATION

The Company operates through two Divisions. Through its Automobile Division, the Company is engaged in the underwriting of high premium, non-standard automobile insurance. Through its recently established 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 two Divisions. The investment activities consist of managing the investment portfolio for the Company as a whole. Investment income is shown net of investment expenses. Non property and casualty insurance segments include the corporate and other activities, as well as realized investment gains. The corporate and other activities include sources of income and non-recurring items such as acquisitions, divestitures and discontinued operations.

(IN $ THOUSANDS)	2005	2004
Revenue		
Earned premiums		
Property and casualty insurance		
Automobile	$ 69,644	$ 31,836
Niche	6,927	2,077
	76,571	33,913
Interest and dividends	6,306	2,500
Realized gains	1,221	919
Total revenue	$ 84,098	$ 37,332
Income (loss) before income taxes		
Property and casualty insurance		
Automobile	$ 9,372	$ 1,920
Niche	467	(139)
Corporate and other	(421)	(412)
Underwriting income	9,418	1,369
Interest and dividends	6,306	2,500
Realized investment and other gains	1,221	919
Total income before income taxes	$ 16,945	$ 4,788

20. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the current financial statement presentation.

DIRECTORS

Paul F. Little[(1)(3)]
Chairman

Douglas E. McIntyre[(3)]
Chief Executive Officer

Mark Sylvia
President and Chief Operating Officer

G. Mark Curry[(1)(2)(3)]
Chairman and President
Revmar Inc.

Robert Purves[(1)(2)]
Chairman
Purves Redmond & Associates Ltd.

Scott Clark[(2)(3)]
Senior Vice President – Investments
Covington Capital Corporation

Kevin Daniel
Chief Financial Officer
The Co-operators Group

Kathy Bardswick[(1)]
Chief Executive Officer
The Co-operators Group

James Migliorini[(3)]
Executive
Odyssey America Reinsurance Corporation

Mary G. Connolly
Management Consultant

1 Member of Audit Committee.
2 Member of Conduct Review & Compensation Committee.
3 Member of Investment Committee.

OTHER OFFICERS

Hemraj Singh
Chief Financial Officer

John Czerwinski
Vice President, Business Development

Head Office
1550 Enterprise Rd., Suite 310
Mississauga, ON L4W 4P4
Tel: (905) 564-9215
Fax: (905) 565-7992

Transfer Agent & Registrar
Computershare Trust Company of Canada
100 University Avenue, 9th Floor
Toronto, ON M5J 2Y1

Stock Exchange Listing
Toronto Stock Exchange
Trading Symbol "EFH"

Common Shares Outstanding
9,583,152 as at February 23, 2006

General Counsel
Blake, Cassels & Graydon LLP

Appointed Actuary
J. S. Cheng & Partners Inc.

Auditors
PricewaterhouseCoopers LLP

Investor Relations
Douglas E. McIntyre
Chief Executive Officer

Website: www.egi.ca

DESIGN: BRYAN MILLS GROUP WWW.BRYANMILLS.COM

VISION

> Echelon General Insurance strives to be the pre-eminent writer of specialized, niche insurance products in the Canadian market.

MISSION

> Echelon focuses on targeted niches that are currently underserved by the market and which require the high level of underwriting and claims expertise of our staff.

> Echelon will provide optimum service to its policyholders and intermediaries in a responsible, ethical manner, while producing a satisfactory return on shareholders' equity.

Head Office
1550 Enterprise Rd., Suite 310
Mississauga, ON L4W 4P4
Tel: (905) 564-9215
Fax: (905) 565-7992
Website: www.egi.ca