

EGI FINANCIAL HOLDINGS INC.

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

For the period ending September 30, 2006

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

The following discussion should be read in conjunction with EGI's unaudited interim consolidated financial statements for the third quarter of fiscal 2006 and 2005; with the notes to the interim unaudited consolidated financial statements for the third quarter of fiscal 2006; with the management discussion and analysis (MD&A) set out on pages 8 to 35 in the Company's 2005 Annual Report; and the notes to the audited consolidated financial statements for fiscal 2005 set out on pages 42 to 51 of the Company's 2005 Annual Report. The following commentary is current as of October 31, 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 analyzes performance based on underwriting ratios such as combined, expense and loss ratios.

The following discussion contains forward-looking information that involves risk and uncertainties based on current expectations. This information includes, but is not limited to, statements about the operations, business, financial condition, priorities, targets, ongoing objectives, strategies and outlook of EGI Financial for 2006 and subsequent periods.

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

EGI's actual results could differ materially from those anticipated in this forward-looking information as a result of various factors, including those discussed in this Management's Discussion and Analysis. Additional information about the risks and uncertainties about EGI Financial's business is provided in its disclosure materials, including its annual information form, filed with the securities regulatory authorities in Canada, available at www.sedar.com. EGI Financial does not undertake to update any forward-looking information.

Overall Performance

Total revenues for the three months ended September 30, 2006, increased \$8.2 million or 36.6% to \$30.6 million compared to \$22.4 million in the same period in 2005. This was primarily the result of an increase in net premiums earned of \$28.5 million compared to \$20.1 million in the third quarter of 2005. The increase in net premiums earned in the period is attributable to a modest increase in direct premiums written combined with significant reductions in premiums ceded pursuant to reinsurance arrangements. In 2006, the Company is placing less reliance on reinsurance programs than in prior years by putting the additional capital raised in the Company's IPO, in December 2005, to work.

Similarly, for the nine months ended September 30, 2006, total revenues rose 38.5% to \$86.3 million from \$62.3 million in the same period last year.

Net income of \$5.5 million for the three months ended September 30, 2006, represents an increase of \$3.8 million, or 223% compared to net income of \$1.7 million in the third quarter of 2005. The primary reason for this result is the significant improvement in the loss ratio in the quarter to 48.9% compared to 71.7% in 2005. Partially offsetting the significant improvement in underwriting income was a slight decline in investment income in the third quarter of 2006, to \$2.1 million compared to \$2.3 million in the third quarter of 2005 resulting from small realized losses on the disposal of investments. Despite the dilutive effect of additional shares issued through the IPO in December 2005, basic earnings per share for the third quarter of 2006 increased 171% to \$0.57 compared to \$0.21 for the same period in 2005. Fully diluted earnings per share increased 170% to \$0.54 compared to \$0.20 for the third quarter of 2005.

For the nine months ended September 30, 2006, net income was \$11.8 million, representing an increase of \$3.6 million, or 43.9% compared to net income of \$8.2 million, excluding extraordinary gain, for the first nine months of 2005. The 2006 improvement over last year is due to a decrease in the year-to-date loss ratio to 56.1% in 2006 compared to 60.1% in 2005. Basic earnings per share for

the first nine months of 2006 were \$1.22 as compared to \$1.01 for the same period last year. Fully diluted earnings per share were \$1.16 as compared to \$0.96 for the first nine months of 2005.

Shareholders' equity increased to \$81.1 million as at September 30, 2006, an increase of \$5.1 million from June 30, 2006. Net income of \$5.5 million in the quarter was offset by quarterly dividends of \$0.4 million paid to common shareholders of record September 15, 2006.

For the nine months ended September 30, 2006, shareholders' equity increased \$8.5 million from \$72.6 million as at December 31, 2005. Net income of \$11.8 million in the period and the issuance of common shares of \$0.2 million were offset by the redemption of the Series F special shares of \$2.4 million and the payment of common share dividends of \$1.1 million in the first three quarters of 2006.

The summary of financial data set forth in the following tables has been prepared in accordance with Canadian GAAP and has been derived from our unaudited interim consolidated financial statements for the three and nine-month periods ended September 30, 2006 and 2005.

(in \$ thousands)	Quarter to September 30		9 months to September 30	
	2006	2005	2006	2005
Direct written premiums	29,184	28,466	91,898	88,925
Total revenue	30,633	22,420	86,331	62,332
Underwriting income	6,228	347	11,017	6,966
Net Income before extraordinary gain	5,489	1,728	11,780	8,151
Extraordinary gain	-	-	-	5,669
Net income	5,489	1,728	11,780	13,820
Earnings per share before extraordinary gain (in dollars)				
Basic	\$0.57	\$0.21	\$1.22	\$1.01
Diluted	\$0.54	\$0.20	\$1.16	\$0.96
ROE ⁽¹⁾			22.1%	30.6%

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

(in \$ thousands)	<u>As at September 30 2006</u>	<u>As at December 31 2005</u>
Investments (excluding premium finance receivables)	175,718	152,736
Premium finance receivables	20,117	18,800
Total assets	282,947	260,731
Total shareholders' equity	81,065	72,585
Book value per share ⁽¹⁾	\$8.44	\$6.75

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

Current Outlook

The above-average results which the Canadian P&C insurance industry has experienced over the past three years is leading into a more competitive market phase. The positive result is encouraging automobile insurers to implement rate reductions and loosen underwriting guidelines, thus creating competition for market share. As a result, we expect standard auto insurers to continue to pursue market share opportunities in traditionally non-standard auto areas, thereby reducing the near term opportunity for growth for non-standard auto insurers. The Company expects this to be a temporary situation for the non-standard market and the pendulum to swing back in the longer term, as standard insurers' margins erode on this higher risk business.

This competitive auto insurance market will create some challenges for EGI to grow its premium income in the non-standard auto line of business. However, the Company continues to pursue its diversification strategy to reduce its reliance on Ontario non-standard auto by growing its Niche Products Division and by pursuing other opportunities in new geographic markets and new vehicle types, such as motorcycles.

Through this market phase EGI will preserve its capital and is committed to focus on profitable lines of business even though this may, in the short term, limit growth in direct written premiums. Despite the pressure on growth, EGI expects to manage its reinsurance arrangements to increase its net retained business and thereby utilizing its capital more effectively. In 2006 EGI has eliminated its quota share reinsurance coverage on automobile business, resulting in significant growth in net written premiums in the quarter and year-to-date compared to the same period last year.

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)	Quarter to September 30		9 months to September 30	
	2006	2005	2006	2005
Gross written premiums	29,184	28,466	91,898	88,925
Net written premiums	26,635	20,070	83,098	63,030
Net earned premiums	28,490	20,060	79,753	56,500
Interest and dividends	2,149	1,530	6,130	4,588
Net realized gains (loss) on investments	(6)	766	447	1,124
Other revenue	-	64	1	120
Total revenue	30,633	22,420	86,331	62,332

For the three months ended September 30, 2006, total revenue increased to \$30.6 million, or 36.6%, compared to \$22.4 million for the same period in 2005. The significant increase is the result of increases in net premiums earned due to a combination of modest growth in direct written premiums and lower reinsurance costs and investment income.

Similarly, total revenue for the first nine months of 2006 increased 38.5% to \$86.3 million compared to \$62.3 million for the nine months ended September 30, 2005.

Expenses

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

(in \$ thousands)	Quarter to September 30		9 months to September 30	
	2006	2005	2006	2005
Incurred claims	13,945	14,386	44,737	33,972
Acquisition expense	5,891	3,294	15,810	8,633
Operating expense	2,426	2,097	8,190	7,049
	22,262	19,777	68,737	49,654

Selected Underwriting Ratios	Quarter to September 30		9 months to September 30	
	2006	2005	2006	2005
Incurring loss ratio	48.9%	71.7%	56.1%	60.1%
Acquisition expense ratio	20.7%	16.4%	19.8%	15.3%
Operating expense ratio	8.5%	10.5%	10.3%	12.5%
Combined ratio	78.1%	98.6%	86.2%	87.9%

The combined ratio for the Company was 78.1% for the three months ended September 30, 2006 compared to 98.6% in the third quarter of 2005. The decrease in the loss ratio to 48.9% in the third quarter of 2006 compared to 71.7% for the same period in 2005 was the primary reason for the improvement in the result. Our independent actuary performs a quarterly review of claims experience and reserves. As a result of this review, as at September 30, 2006, our independent actuary recommended a reduction to the ultimate loss ratio for the 2006 accident year, due to favorable claims experience in the quarter, and a further release of bulk reserves for prior years due to positive claims development related to prior years. The 2006 accident year loss ratio, which was impacted by an unusual number of large losses in the second quarter of 2006, improved to 64%, on a year-to-date basis, as at September 30, 2006. Also, in the third quarter of 2006 total prior year reserves of \$2.6 million were released due to positive claims development. This compares to \$1.2 million of prior year reserves released in the third quarter of 2005.

Acquisition costs increased to 20.7% of net earned premiums in the third quarter of 2006 compared to 16.4% for the same period in 2005. This was expected due to the withdrawal of the quota share treaty as at December 31, 2005, which resulted in no reinsurance commission being recorded as a reduction to the acquisition expense line in 2006. Offsetting the increase in the acquisition expense ratio, due to the withdrawal of quota share arrangements, was a decrease in the operating expense ratio. This occurs due to the reduction in ceded premiums which leads to an increase in net earned premiums, while the costs to run the business are largely unchanged, and results in an improved operating expense ratio. The overall increase in the acquisition and expense ratios combined was due to the increase in the proportion of Niche business in 2006, which generally has a higher acquisition ratio than the auto line of business.

For the nine months ended September 30, 2006, the combined ratio was 86.2% compared to 87.9% for the same period last year. The factors noted above related to the three months ended September 30, 2006, are also the primary factors causing the variance from last year for the first nine months of 2006.

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 of commissions and premium taxes which are directly related to the acquisition of premiums. Commissions, the amounts paid to producers for selling insurance policies, are generally a percentage of the insurance policy’s premium. 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. EGI pays premium taxes 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 are related to employee compensation and benefits. The effective control and management of these expenses can enhance the underwriting results from the operation.

Segmented Financial Information

(in \$ thousands)	Quarter to September 30			
	2006		2005	
	<u>Auto</u>	<u>Niche</u>	<u>Auto</u>	<u>Niche</u>
Underwriting revenue	24,404	4,086	18,190	1,934
Underwriting income (loss) (not including corporate expenses of \$179; 2005 - \$63)	6,470	(63)	155	255
Loss ratio	46.9%	61.3%	73.7%	52.2%
Expense ratio	26.6%	40.3%	25.4%	37.6%
Combined ratio	73.5%	101.6%	99.1%	89.8%

The segmented information for the third quarter of 2006 shows that the Auto line of business contributed \$6.5 million of underwriting income in the quarter while Niche products recorded an underwriting loss of \$0.1 million in the quarter. These results improved underwriting income for the Auto line of business to \$11.5 million for the first nine months of 2006 and reduced the Niche Products

Division underwriting income to \$0.3 million on a year-to-date basis.

The loss ratio in the Auto line of business was 46.9% for the quarter ended September 30, 2006, compared to 73.7% for the same period in 2005. As noted above, and as recommended by our independent actuary, this significant improvement was the result of a large reduction in the 2006 accident year loss ratio, during the third quarter of 2006, as compared to the first half of the year. In addition, the release of prior year reserves continued due to positive claims development in the quarter.

The Niche loss ratio increased to 61.3% in the third quarter of 2006 compared to 52.2% for the same period in 2005. This was primarily the result of an increase in the reserve for incurred but not reported claims (IBNR) of \$0.3 million related to general liability insurance programs. Our independent actuary felt that, due to premium growth in this relatively new line of business, it is prudent to increase IBNR to ensure adequate reserving for all known and as yet unreported claims.

The variance analysis of the expense ratios for the three months ended September 30, 2006, as compared to the same period in 2005 is similar to the nine month analysis noted below.

(in \$ thousands)	9 months to September 30			
	2006		2005	
	<u>Auto</u>	<u>Niche</u>	<u>Auto</u>	<u>Niche</u>
Underwriting revenue	70,284	9,470	51,983	4,637
Underwriting income (loss) (not including corporate expenses of \$733; 2005 - \$287)	11,461	289	6,898	355
Loss ratio	56.4%	53.6%	61.0%	50.4%
Expense ratio	27.2%	43.4%	25.8%	44.5%
Combined ratio	83.6%	97.0%	86.8%	94.9%

The above table shows that the loss ratio for the Auto line of business for the nine months ended September 30, 2006, of 56.4%, is lower than the loss ratio of 61.0% for the same period last year. This also reflects the improvement in the 2006 accident year loss ratio as well as the release of prior year loss reserves in the amount of \$8.4 million in 2006 compared to a release of \$5.1 million in the first nine months of 2005.

The Niche loss ratio increased to 53.6% for the first three quarters of 2006, compared to 50.4% in the same period last year, due to the occurrence of one large claim as noted in our first quarter MD&A, and the increase in IBNR in the Liability line of business, as noted above, in the third quarter of 2006.

The expense ratio increased slightly for the Auto line of business compared to 2005. This ratio is

the combination of the acquisition expense ratio and the operating expense ratio. While the operating expense ratio decreased due to the increase in net earned premiums, the acquisition expense ratio increased as a result of a reduction in reinsurance commission revenue, due to the elimination of the quota share arrangements. The Niche division expense ratio decreased in 2006 compared to 2005 reflecting the growth in this area of our business and the impact of cost containment. The Niche expense ratio, while lower than in 2005, is expected to decline further as this book of business matures. This will result from the earning of additional premium and the relative costs associated with the development of new programs will decline proportionately.

Critical Accounting Estimates and Assumptions

For a description of EGI's accounting policies refer to Note 3 in the 2005 audited financial statements as set out on pages 36 to 51 of the Company's 2005 Annual Report. A further description of EGI's critical accounting estimates and assumptions is also detailed on pages 17 and 18 of the 2005 Annual Report.

There have been no changes to the Company's accounting policies or assumptions made in critical accounting estimates in the third quarter of 2006.

For the nine and three months ended September 30, 2006 and 2005

Insurance Operation

Written Premiums

Direct written premiums increased \$3.0 million or 3.4% to \$91.9 million for the nine months ended September 30, 2006, compared to \$88.9 million for the first nine months of 2005. EGI has realized an increase in premiums despite current market conditions which resulted in a reduction of Ontario non-standard auto business. Despite the shrinkage in the Ontario non-standard auto, the growth overall was achieved due to the growth in Niche Products and the Quebec automobile business, and the addition of Ontario motorcycle business. Direct written premiums for Niche Products increased 98.6% to \$14.5 million for the nine months ended September 30, 2006, compared to \$7.3 million in the same period in 2005. Formed in 2003, the Niche Products Division had modest growth in 2004, and due to the continued marketing efforts to grow this division, it has experienced significant growth in 2005 and to date in 2006. Quebec automobile insurance premiums grew 20% to \$4.8 million for the first nine months of 2006, compared to \$4.0 million for the same period last year.

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. With an exclusive arrangement with a specialist broker, EGI began to write motorcycle business in Ontario during the first quarter of 2006; for the first nine months of 2006 direct premiums from this arrangement totaled \$7.1 million.

During the third quarter of 2006, direct written premiums increased \$0.7 million, or 2.5%, to \$29.2 million compared to \$28.5 million in the third quarter last year. This increase was achieved due to the growth in the motorcycle program and the Niche Products Division's direct premiums written, which more than offset the shrinkage in the Ontario non-standard auto line. In the most recent quarter Niche premiums written were \$5.1 million compared to \$3.0 million in the same period last year, representing an increase of 70%, and direct written premiums from the motorcycle program were \$2.2 million in the most recent quarter.

Despite the modest growth in direct written premiums, net written premiums increased \$20.1 million or 31.9% to \$83.1 million for the nine months ended September 30, 2006, compared to \$63.0 million for the same period last year. EGI has achieved this significant growth in net written premiums because of its ability to more effectively utilize its capital through managing its reinsurance arrangements. Net written premiums increased over 2005 because the Company terminated its quota share reinsurance arrangement effective December 31, 2005. Therefore, no quota share reinsurance arrangement was put in place for auto policies written in 2006. (See additional detail under "Reinsurance" on page 16.)

For the three months ended September 30, 2006, net written premiums increased \$6.6 million or 33% to \$26.6 million compared to \$20.0 million for the third quarter of 2006. As noted above, this significant increase was primarily achieved as a result of terminating quota share reinsurance arrangements effective December 31, 2005.

Earned Premiums

Net earned premiums for the nine months ended September 30, 2006, were \$79.8 million, an increase of \$23.3 million or 41.2% from the first nine months of 2005. The reduction in the amount of reinsurance purchased by EGI in 2006 compared to 2005 is the primary reason for the growth in net earned premiums. Third quarter revenue of 2006 was also positively impacted by the termination of the quota share reinsurance arrangement effective December 31, 2005.

For the quarter ended September 30, 2006, net earned premiums increased \$8.4 million or 42% to

\$28.5 million compared to \$20.1 million in the third quarter of 2005. This increase is consistent with the increase in net written premiums in the quarter compared to 2005.

Incurred Claims Expense

Net incurred claims expense increased \$10.8 million or 31.9% to \$44.7 million for the nine months ended September 30, 2006, compared to \$33.9 million for the same period in 2005. This is significantly lower than the 41.2% increase in net earned premiums, primarily due the improvement in the current accident year loss ratio and release of prior year reserves in 2006. As a result, the loss ratio decreased to 56.1% for the first nine months of 2006 compared to 60.1% for the same period in 2005.

For the quarter ended September 30, 2006, net claims expense decreased \$0.5 million or 3.5% to \$13.9 million compared to \$14.4 million for the third quarter of 2005. This resulted in a loss ratio of 48.9% for the three months ended September 30, 2006 compared to 71.7% for the same period in 2005. As noted earlier, the improvement in the 2006 accident year loss ratio and the release of prior year reserves were the primary factors causing the improvement.

Acquisition Costs

Net acquisition costs, which consist mainly of commissions and premium taxes, increased \$7.2 million or 83.7% to \$15.8 million for the nine months ended September 30, 2006, compared to \$8.6 million in the same period in 2005. In the third quarter of 2006 net acquisition costs totaled \$5.9 million compared to \$3.3 million in the third quarter of 2005, representing a 78.8% increase in the quarter compared to last year. It should be noted that the year over year variance is distorted by the effect of the withdrawal of quota share reinsurance arrangements at the end of 2005.

Increases to these costs in 2006 are primarily due to the withdrawal of quota share reinsurance effective December 31, 2005. In 2005, gross commissions paid to EGI's producers were offset by the commissions received from reinsurers on the portion of business that was ceded to them, on a quota share basis, to calculate the net commission. No reinsurance commission has been received or recorded in 2006 on the Auto line of business related to the 2005 or 2006 policy years, except for additional reinsurance commission occurring from swing rate arrangements for the 2004 policy year in the amount of \$1.4 million.

The resulting impact of the quota share withdrawal is an increase to acquisition costs, which is offset by a corresponding improvement in the operating expense ratio. This occurs because the reduction in ceded premiums leads to an increase in net earned premiums, resulting in an improved

operating expense ratio.

Operating Expenses

Operating expenses increased \$1.2 million or 17.1% to \$8.2 million for the nine months ended September 30, 2006, compared to \$7.0 million for the third quarter of 2005. This compared favourably to the 41.2% increase in net earned premiums. This is due to the quota share reinsurance reduction and the resulting increase in net earned premiums and expense controls, as noted above.

For the third quarter of 2006, operating expenses were \$2.4 million compared to \$2.1 million in 2005 or an increase of 14.3%.

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 2005, reflecting strong market conditions and a favourable claims environment. The overall underwriting income increased \$4.0 million to \$11.0 million for the first nine months of 2006, compared to \$7.0 million for the comparable period in 2005. The underwriting income for the first nine months of 2006 and 2005 is net of \$0.7 million and \$0.3 million of corporate and other expenses, respectively. In the third quarter of 2006, total underwriting income reached \$6.2 million compared to \$0.3 million in the third quarter of 2005.

Underwriting income from non-standard automobile and motorcycle program insurance for the nine months ended September 30, 2006, was \$11.5 million, an increase of \$4.6 million compared to an income of \$6.9 million for the first nine months of 2005. This increase was attributable to a decrease in the loss ratio to 56.4% in 2006 compared to 61.0% in the same period last year. In the third quarter of 2006, underwriting income in our Auto line of business was \$6.5 million compared to \$0.2 million in 2005, also attributable to a decrease in the loss ratio compared to the prior year.

The underwriting income from Niche Products for the nine months ended September 30, 2006, was \$0.3 million, a decrease of \$0.1 million compared to an income of \$0.4 million in the first nine months of 2005. This decrease was primarily the result of an increase in the loss ratio from Niche products to 53.6% compared to 50.4% in the first nine months of 2005. In the third quarter of 2006, an underwriting loss of \$0.1 million was recorded by the Niche Products Division compared to an underwriting income of \$0.3 million in the third quarter of 2005.

Investment Income

Investment income increased \$0.9 million, or 15.8%, to \$6.6 million for the nine months ended September 30, 2006, compared to \$5.7 million for the same period in 2005. In the third quarter of 2006 investment income decreased \$0.2 million, or 8.7%, to \$2.1 million compared to \$2.3 million in the third quarter of 2005. This third quarter decline, 2006 compared to 2005, was due to the realization of gains of \$0.8 million in the third quarter of 2005.

EGI's investment portfolio reflected a \$45.5 million or 27.8% increase in size as at September 30, 2006, compared to September 30, 2005, due to positive cash flows from operations during the period and the additional funds raised in our IPO which closed on December 8, 2005.

Net realized investment and other gains decreased \$0.7 million to \$0.4 million in the first nine months of 2006 compared to \$1.1 million for the same period last year. During the third quarter of 2006 net realized investment gains and losses were flat compared to net realized investment gains of \$0.8 million in the third quarter of 2005.

Net Income before Income Taxes

Net income before income taxes and extraordinary gain increased \$4.9 million, or 38.6%, to \$17.6 million for the nine months ended September 30, 2006, compared to \$12.7 million for the same period in 2005 due to a significant improvement in the loss ratio in 2006 and an increase in investment income compared to 2005.

For the nine months ended September 30, 2006, underwriting income of \$11.0 million plus investment income of \$6.6 million comprised net income before income taxes of \$17.6 million. This compares to an underwriting income of \$7.0 million, plus investment income of \$5.7 million, in the first nine months of 2005.

For the quarter ended September 30, 2006 net income before income taxes was \$8.3 million compared to \$2.6 million for the third quarter of 2005, resulting from the lower 2006 loss ratio. In the third quarter of 2006, underwriting income of \$6.2 million plus investment income of \$2.1 million comprised net income before income taxes of \$8.3 million. This compares to an underwriting income of \$0.3 million, plus investment income of \$2.3 million in the third quarter of 2005.

Income Taxes

The provision for income taxes for the quarter ended September 30, 2006, was \$2.9 million compared to \$0.9 million for the third quarter of 2005. This reflected higher pre-tax income as a result

of higher underwriting profits year over year for the quarter.

For the nine months ended September 30, 2006, the provision for income taxes was \$5.8 million compared to \$4.5 million for the same period last year. The approximate effective tax rate for both periods is 34%.

Extraordinary Gain

In the first nine months of 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. This gain was the result of the write-off of negative goodwill arising from the transaction. There were no extraordinary gains in the first nine months of 2006.

Summary of Quarterly Results

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

(Pro Forma 2004 results give effect to the acquisition of the remaining 50% of EGI Financial (2003) as if it had occurred at January 1, 2004.)

(\$ thousands except per share amounts)	2006			2005				Pro Forma 2004	
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Direct Written Premiums	29,184	36,622	26,092	28,081	28,466	34,528	25,931	26,864	27,380
Total Revenues (Excluding Investment Income)	28,490	26,189	25,075	19,950	20,124	19,840	16,656	16,697	16,889
Underwriting Income (loss)	6,228	3,859	930	2,452	347	6,214	405	3,585	172
Income (loss) before income taxes	8,371	5,660	3,563	4,267	2,643	7,733	2,303	5,644	1,306
Net Income before extraordinary gain	5,489	3,857	2,434	3,057	1,728	4,928	1,495	5,632	1,060
Extraordinary gain	-	-	-	-	-	-	5,669	-	-
Net income	5,489	3,857	2,434	3,057	1,728	4,928	7,164	5,632	1,060
Earnings per adjusted Share									
Basic	0.57	0.40	0.25	0.36	0.21	0.62	0.90	0.71	0.13
Diluted	0.54	0.38	0.24	0.35	0.20	0.58	0.85	0.69	0.13

Balance Sheet Analysis

Investments

The following table sets forth EGI's invested assets as at September 30, 2006, and December 31, 2005.

(\$ in thousands)	September 30, 2006			December 31, 2005		
	Carrying amount	Fair value	Unrealized gain (loss)	Carrying amount	Fair value	Unrealized gain (loss)
Bonds	138,810	140,622	1,812	122,677	123,633	956
Preferred shares	5,598	5,591	(7)	3,738	3,767	29
Common shares	29,656	35,632	5,976	25,563	31,735	6,172
Investment income due and accrued	1,654	1,654	-	758	758	-
	<u>175,718</u>	<u>183,499</u>	<u>7,781</u>	<u>152,736</u>	<u>159,893</u>	<u>7,157</u>

Included in the common shares held by the Company is an investment in the Gladiator Limited Partnership ("Gladiator LP") which is managed by Savoy Capital with a book value of \$8,367 and a market value of \$9,125. The Company has provided a notice of redemption to the Gladiator LP. The fund, as at September 30, 2006, primarily consists of cash, representing approximately 70% of total fund value. Therefore the risk exposure of this fund is limited to the remaining 30% of the fund which consists of private holdings.

Recoverable from Reinsurers

As at September 30, 2006, the recoverable from reinsurers decreased to \$55.4 million as compared to \$56.8 million as at December 31, 2005. The decrease is due to the withdrawal of quota share reinsurance arrangements as at December 31, 2005. This reduction occurs as prior year claims, subject to recovery from quota share reinsurers, are settled.

Accounts Receivable

Premium financing receivables are the largest component of this asset as at September 30, 2006, and represents approximately 82% or \$24.6 million of total receivables. Premium financing receivables increased \$1.3 million or 6.5% to \$20.1 million at September 30, 2006, from \$18.8 million at December 31, 2005. The majority of the automobile business is billed directly to policyholders and only a very small percentage is billed through brokers.

Increasingly, more of the direct-billed premium to policyholders is being financed at effective rates of interest between 6% and 14% depending on the jurisdiction.

Provision for Unpaid Claims

As recommended by our independent actuary, EGI establishes loss reserves to provide for future amounts required to pay claims related to insured events that have occurred and been reported but have not yet been settled, and related to events that have occurred but have not yet been reported to 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.

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.

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 four year period and for the nine months ended September 30, 2006.

(in \$ thousands)	Years ended December 31			
	2005	2004	2003	2002
Reserve Carried (actuarial present value basis) ⁽¹⁾	129,041	107,196	79,191	66,545
Reserve at December 31, 2003				43,754
Cumulative paid to December 31, 2003				24,122
Cumulative Redundancy (Deficiency)				(1,331)
Reserve at December 31, 2004			56,226	31,213
Cumulative paid to December 31, 2004			24,184	39,619
Cumulative Redundancy (Deficiency)			(1,220)	(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)
Reserve at September 30, 2006	99,018	57,368	30,315	17,970
Cumulative paid to September 30, 2006	19,458	36,239	45,951	52,376
Cumulative Redundancy (Deficiency)	10,565	13,589	2,925	(3,801)

1) Amounts include Provision for Adverse Deviation (PfAD) of \$11,619 - 2005, \$8,613 - 2004, \$6,137 - 2003 and \$5,226 - 2002.

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

months of 2006 the total prior year reserve redundancies released pursuant to the September 30, 2006, actuarial report were \$10,565. The prior year reserves released and recorded, in the interim financial statements for the nine months ended September 30, 2006, are on a net of reinsurance basis in the amount of \$8,401.

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

Reinsurance

EGI has reinsurance treaties with several unaffiliated reinsurers, all of whom are selected on the basis of their creditworthiness. EGI purchases reinsurance to reduce its exposure to the insurance risks that it assumes in writing business. For 2006 the maximum net retention on a single risk is \$0.95 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 September 30, 2006, EGI was the assigned beneficiary of such trust accounts totalling \$2.2 million (December 31, 2005 - \$2.3 million) in guarantees from unlicensed reinsurers.

EGI purchases renewable excess of loss and catastrophe reinsurance from third party reinsurers, covering its automobile and general liability business. In 2006, such coverage is for a total of \$19,100,000 and in 2005 is for \$14,425,000. In 2005 EGI purchased 25% quota share reinsurance coverage protecting its automobile and general liability businesses. This coverage was terminated and the portfolio of unexpired risks withdrawn effective December 31, 2005. Other than general liability, coverages for the programs of the Niche Products Division are reinsured on a program-by-program basis.

For 2005, EGI's liability after all excess of loss and quota share reinsurance recoveries is limited to a maximum of \$450,000 and, in 2006, \$950,000 on any one claim. Using reinsurance,

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

Share Capital

As of September 30, 2006, there were 9,607,152 common shares issued and outstanding. See Note 9 to our audited 2005 consolidated financial statements.

Liquidity and Capital Resources

The purpose of liquidity management is to ensure there is sufficient cash to meet all of EGI's financial commitments and obligations as they come due. EGI believes that it has the flexibility to obtain, from internal sources, the funds needed to fulfill its cash requirements during the following financial year and to satisfy regulatory capital requirements. EGI's principal sources of funds are premiums collected, investment income and proceeds from investments that have been sold or have matured. However, such funds may not provide sufficient capital to enable EGI to pursue additional market opportunities.

EGI's contractual obligations relating to operating leases are \$0.5 million due in less than a year and \$1.0 million due in the next two years. We have also entered into an agreement with our current Auto administration system provider to develop a new administration system that will provide enhanced efficiency and analytics. The capital cost commitment related to this agreement, over the next year, will be \$0.7 million.

Capital Resources

The total capitalization of EGI at September 30, 2006, is \$81.1 million compared to \$72.6 million at December 31, 2005. The increase was the result of net income in the period of \$11.8 million and the issuance of common shares of \$0.1 million. Offsetting these increases are the redemption of Series F special shares in the amount of \$2.3 million in January 2006, and the payment of common share dividends of \$1.1 million in the first three quarters of 2006.