QUANTA CAPITAL HOLDINGS LTD
Form 10-Q
November 09, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2007

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 000-50885

QUANTA CAPITAL HOLDINGS LTD.

(Exact name of registrant as specified in its charter)

Bermuda N/A (State or other jurisdiction of
incorporation or organization) (I.R.S. Employer
Identification No.)
1 Victoria Street, Second Floor
Hamilton HM11
Bermuda

(Address of principal executive offices and zip code)

441-294-6350

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of ''accelerated and large accelerated filer'' in Rule 12b-2 of the Exchange Act. (Check one).

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes No

As of November 1, 2007 there were 70,133,499 common shares, $0.01 par value per share, outstanding.

QUANTA CAPITAL HOLDINGS LTD.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

QUANTA CAPITAL HOLDINGS LTD.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Expressed in thousands of U.S. dollars except for share and per share amounts)

	September 30, 2007 (Unaudited)	December 31, 2006
Assets		
Investments at fair value (amortized cost: September 30, 2007, $645,860; December 31, 2006, $838,096)		
Trading investments	$ 643,316	$ 37,273
Available for sale investments	—	809,902
	643,316	847,175
Cash and cash equivalents	32,994	32,894
Restricted cash and cash equivalents	141,587	68,143
Accrued investment income	3,946	6,833
Premiums receivable	41,401	34,587
Funds withheld by cedants	6,548	25,204
Losses and loss adjustment expenses recoverable	149,258	221,228
Other accounts receivable	2,337	481
Net receivable for investments sold	300	134
Deferred acquisition costs, net	11,428	12,124
Deferred reinsurance premiums	19,465	35,259
Software, property and equipment, net of accumulated depreciation of $7,688 (December 31, 2006: $7,208)	535	1,112
Other intangible assets	7,175	7,350
Other assets	26,078	36,702
Total assets	$ 1,086,368	$ 1,329,226
Liabilities		
Reserve for losses and loss expenses	$ 563,067	$ 623,618
Unearned premiums	87,587	119,197
Environmental liabilities assumed	1,774	3,346
Reinsurance balances payable	30,056	37,070
Accounts payable and accrued expenses	20,736	38,511
Deposit liabilities	36,586	37,014
Deferred income and other liabilities	1,796	5,279
Junior subordinated debentures	—	61,857
Total liabilities	741,602	925,892
Mandatorily redeemable preferred shares ($0.01 par value; 25,000,000 shares authorized; 0 issued and outstanding at September 30, 2007 and 3,130,225 issued and outstanding at December 31, 2006)	—	74,998
Commitments and contingencies (Note 8)	—	—
Shareholders' equity		
Common shares ($0.01 par value; 200,000,000 shares authorized; 70,107,238 and 70,008,185 issued and outstanding at September 30, 2007 and December 31, 2006)	701	700
Additional paid-in capital	582,819	582,578
Accumulated deficit	(236,829)	(263,830)
Accumulated other comprehensive (loss) income	(1,925)	8,888
Total shareholders' equity	344,766	328,336
Total liabilities, redeemable preferred shares and shareholders' equity	$ 1,086,368	$ 1,329,226

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

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QUANTA CAPITAL HOLDINGS LTD.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Expressed in thousands of U.S. dollars except for share and per share amounts)

	For the three months ended		For the nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Revenues				
Gross premiums written	$ 22,494	$ (6,693)	$ 70,717	$ 141,075
Premiums ceded	(4,085)	1,276	(20,206)	(73,633)
Net premiums written	18,409	(5,417)	50,511	67,442
Change in net unearned premiums	3,967	54,619	17,366	121,733
Net premiums earned	22,376	49,202	67,877	189,175
Technical services revenues	713	752	1,706	2,947
Net investment income	11,306	12,821	33,835	35,350
Net gains (losses) on investments	3,379	906	(387)	(14,142)
Net foreign exchange (losses) gains	(184)	(257)	803	(1,951)
Gain on repurchase of junior subordinated debentures	4,421	—	4,421	—
Other income	375	1,174	4,140	2,692
Total revenues	42,386	64,598	112,395	214,071
Expenses				
Net losses and loss expenses	3,156	30,153	30,612	134,178
Acquisition expenses	5,517	8,415	15,980	32,608
General and administrative expenses	14,772	20,578	46,694	84,048
Interest expense	797	1,430	3,632	4,036
Depreciation of fixed assets and amortization and impairment of intangible assets	115	715	870	1,983
Total expenses	24,357	61,291	97,788	256,853
Income (loss) from continuing operations before income taxes	18,029	3,307	14,607	(42,782)
Income tax expense (benefit)	2	—	(14)	47
Net income (loss) from continuing operations	18,027	3,307	14,621	(42,829)
Discontinued operations:				
Loss from operations of discontinued operations	—	(936)	—	(12,953)
Income on disposal of discontinued operations	—	704	—	704
Net loss from discontinued operations	—	(232)	—	(12,249)
Net income (loss)	18,027	3,075	14,621	(55,078)
Gain on repurchase of Series A preferred shares	2,364	—	2,364	—
Dividends on preferred shares	—	—	—	(1,916)
Net income (loss) to common shareholders	$ 20,391	$ 3,075	$ 16,985	$ (56,994)
Weighted average common share and common share equivalents:				
Basic	70,106,237	69,981,925	70,053,443	69,970,237
Diluted	70,224,287	69,984,614	70,164,777	69,970,237
Basic income (loss) from continuing operations per common share	$ 0.26	$ 0.04	$ 0.21	$ (0.61)
Basic net loss from discontinued operations per common share	—	(0.00)	—	(0.17)
Basic gain on repurchase of preferred shares per common share	0.03	—	0.03	—
Basic dividends on preferred shares per common share	—	—	—	(0.03)
Basic income (loss) per common share	$ 0.29	$ 0.04	$ 0.24	$ (0.81)
Diluted income (loss) from continuing operations per common share	$ 0.26	$ 0.04	$ 0.21	$ (0.61)
Diluted net loss from discontinued operations per common share	—	(0.00)	—	(0.17)
Diluted gain on repurchase of preferred shares per common share	0.03	—	0.03	—
Diluted dividends on preferred shares per common share	—	—	—	(0.03)
Diluted income (loss) per common share	$ 0.29	$ 0.04	$ 0.24	$ (0.81)

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

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QUANTA CAPITAL HOLDINGS LTD.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Expressed in thousands of U.S. dollars except for share and per share amounts)

	For the three months ended		For the nine months ended	
	September 30, 2007	September 30, 2006	September 30, 2007	September 30, 2006
Net income (loss)	$ 18,027	$ 3,075	$ 14,621	$ (55,078)
Other comprehensive (loss) income				
Net unrealized investment gains (losses) arising during the period, net of income taxes	—	9,606	—	(5,785)
Foreign currency translation adjustments	(165)	(160)	(797)	(599)
Reclassification of net realized (gains) losses on available for sale investments included in net income (loss), net of income taxes	—	(906)	—	14,142
Other comprehensive (loss) income	(165)	8,540	(797)	7,758
Comprehensive income (loss)	$ 17,862	$ 11,615	$ 13,824	$ (47,320)

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

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QUANTA CAPITAL HOLDINGS LTD.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Expressed in thousands of U.S. dollars except for share and per share amounts)

For the nine months ended September 30,	2007	2006
Share capital – common shares of par value $0.01 each		
Balance at beginning of period	$ 700	$ 699
Issued during period	1	1
Balance at end of period	701	700
Additional paid-in capital		
Balance at beginning of period	582,578	581,929
Non-cash stock compensation expense	241	487
Balance at end of period	582,819	582,416
Accumulated deficit		
Balance at beginning of period	(263,830)	(199,010)
Cumulative effect adjustment resulting from the adoption of SFAS 159	10,016	—
Net income (loss)	14,621	(55,078)
Gain on repurchase of Series A preferred shares	2,364	—
Dividends on preferred shares	—	(1,916)
Balance at end of period	(236,829)	(256,004)
Accumulated other comprehensive income (loss)		
Balance at beginning of period	8,888	546
Cumulative effect adjustment resulting from the adoption of SFAS 159	(10,016)	—
Net change in unrealized losses on investments, net of income taxes	—	8,357
Foreign currency translation adjustments	(797)	(599)
Balance at end of period	(1,925)	8,304
Total shareholders' equity	$ 344,766	$ 335,416

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

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QUANTA CAPITAL HOLDINGS LTD.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in thousands of U.S. dollars)

	For the nine months ended September 30, 2007	2006
Cash flows from continuing operating activities		
Net income (loss) from continuing operations	$ 14,621	$ (42,829)
Adjustments to reconcile net income (loss) to net cash used in continuing operating activities		
Depreciation of property and equipment	695	1,811
Impairment of intangible assets	175	172
Amortization of net discounts on investments	(4,916)	(5,843)
Net realized (gains) losses on investments	(1,862)	13,438
Net change in fair value of investments	2,249	—
Net change in fair value of derivative instruments	—	696
Gain on repurchase of junior subordinated debentures	(4,421)	—
Gain on foreign exchange translation	(803)	—
Loss (gain) on sale of property and equipment	105	(47)
Non-cash stock compensation expense	241	488
Changes in assets and liabilities:		
Restricted cash and cash equivalents	(73,444)	(21,425)
Accrued investment income	2,887	26
Premiums receivable	(6,814)	83,481
Losses and loss adjustment expenses recoverable	90,626	(28,646)
Deferred acquisition costs, net	696	19,885
Deferred reinsurance premiums	15,794	58,015
Other accounts receivable	(2,022)	—
Other assets	7,246	(26,778)
Reserve for losses and loss adjustment expenses	(60,551)	84,677
Unearned premiums	(31,610)	(176,928)
Environmental liabilities assumed	(1,572)	(2,410)
Reinsurance balances payable	(7,014)	(12,906)
Accounts payable and accrued expenses	(17,213)	13,248
Deposit liabilities	(428)	(13,268)
Deferred income and other liabilities	(3,483)	(5,703)
Net cash used in continuing operating activities	(80,818)	(60,846)
Cash flows from discontinued operations		
Net loss from discontinued operations	—	(12,249)
Adjustments to reconcile net loss from discontinued operations to net cash provided by discontinued operations		
Depreciation of property and equipment	—	131
Amortization of intangible assets	—	516
Impairment of goodwill	—	12,561
Income on disposal of discontinued operations	—	(704)
Changes in assets and liabilities of discontinued operations	—	6,804
Purchase of property and equipment	—	(70)
Net cash provided by discontinued operations	—	6,989
Net cash used in operating activities	(80,818)	(53,857)

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For the nine months ended September 30,	2007	2006
Cash flows provided by (used in) investing activities		
Investment in equity investment, recorded at cost in other assets	(118)	—
Purchases of fixed maturities and short-term investments	(758,226)	(2,418,736)
Proceeds from sale of fixed maturities and short-term investments	966,620	2,335,047
Contingent consideration paid on acquisition of subsidiary	—	(5,000)
Proceeds from disposal of discontinued activities, net of costs and net of cash disposed of	—	9,317
Proceeds from sale of property and equipment	60	232
Purchases of property and equipment	(283)	(215)
Net cash provided by (used in) investing activities	208,053	(79,355)
Cash flows (used in) provided by financing activities		
Proceeds from issuance of preferred shares, net of offering costs	—	3,160
Repurchase of junior subordinated debentures	(54,501)	—
Repurchase of preferred shares	(72,634)	—
Dividends on preferred shares	—	(1,916)
Net cash (used in) provided by financing activities	(127,135)	1,244
Increase (decrease) in cash and cash equivalents	100	(131,968)
Cash and cash equivalents at beginning of period	32,894	178,135
Cash and cash equivalents at end of period	$ 32,994	$ 46,167
Supplemental information		
Interest paid	$ 4,823	$ —

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements

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QUANTA CAPITAL HOLDINGS LTD.
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of U.S. dollars except for share amounts, or as otherwise stated)

1.
Description of business and basis of presentation

Quanta Capital Holdings Ltd. (‘‘Quanta Holdings’’), incorporated on May 23, 2003, is a holding company organized under the laws of Bermuda. Quanta Holdings and its subsidiaries, collectively referred to as the ‘‘Company’’ were formed to provide specialty insurance, reinsurance, risk assessment and risk technical services and products on a global basis. Quanta Holdings participates in the Lloyd’s market through Syndicate 4000 and, following losses in the 2005 hurricane season and the resulting A.M. Best rating downgrading, is now actively running off its remaining business lines. The Company maintains offices in Bermuda, the United Kingdom, Ireland and the United States of America (the ‘‘U.S.’’).

On May 28, 2007, Quanta Holdings created QCH Acquisition Ltd., a wholly-owned subsidiary as an exempted company limited by shares in Bermuda. QCH Acquisition Ltd. was formed to purchase any and all of Quanta’s 10.25% Series A Preferred Shares (‘‘Series A Preferred Shares’’) pursuant to the terms of a tender offer which was commenced on July 11, 2007. The tender offer expired on August 10, 2007 and more than 96% of the outstanding Series A Preferred Shares were repurchased. On September 25, 2007, the Company repurchased all of the remaining Series A Preferred Shares and on September 29, 2007, the Series A Preferred Shares were cancelled. The Series A Preferred Shares were repurchased for an aggregate price of $72.6 million, including costs, resulting in a gain of $2.4 million, net of repurchase costs and the write off of original deferred issuance costs. Please see Note 11 regarding further information relating to the repurchase of the Series A Preferred Shares.

On August 22, 2007, the Company purchased all of the outstanding junior subordinated debentures (the ‘‘Trust Preferred Securities’’) of (i) Quanta Capital Statutory Trust I, an affiliated Delaware trust formed on December 21, 2004 (the ‘‘Trust I’’), and (ii) Quanta Capital Statutory Trust II, an affiliated Delaware trust formed on February 22, 2005 (the ‘‘Trust II’’ and together with Trust I, the ‘‘Trusts’’), for an aggregate purchase price of $54.5 million, including costs, resulting in a gain of $4.4 million, net of repurchase costs and the write off of original deferred issuance costs. The Company originally issued and sold $60 million of the Trust Preferred Securities in private placements. Following the purchase of the Trust Preferred Securities, the Company cancelled the Trust Preferred Securities, dissolved the Trusts and terminated the Declarations, the Guarantees, the Debentures and the Indentures. Please see Note 10 regarding further information relating to the repurchase of the Trust Preferred Securities.

Interim financial information

These unaudited condensed consolidated financial statements include the accounts of the Company and have been prepared in conformity with generally accepted accounting principles in the U.S. (‘‘GAAP’’) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed, or omitted, pursuant to the rules and regulations of the Securities and Exchange Commission (the ‘‘SEC’’). In the opinion of management, the condensed consolidated financial statements include all adjustments, consisting of normal recurring accruals, which, in the opinion of management, are necessary for a fair statement of the financial position and results of operations as at the end of and for the interim periods presented. The results of operations for any interim period are not necessarily indicative of the results that may be expected for any other interim period or for a full year. All significant inter-company balances and transactions have been eliminated on consolidation.

These unaudited condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements for the year ended December 31, 2006, included in the Form 10-K filed by the Company with the SEC on March 15, 2007.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of

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contingent assets and liabilities reported at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. While management believes the amounts included in the unaudited condensed consolidated financial statements reflect management's best estimates and assumptions, the actual results could ultimately be materially different from the amounts currently provided for in the unaudited condensed consolidated financial statements. The Company's principal estimates and assumptions relate to the development and determination of the following:

- reserves for losses and loss adjustment expenses;
- reinsurance balances recoverable and payable;
- deposit liabilities;
- certain estimated premiums written, unearned premiums and receivables;
- contingent commissions receivable and payable;
- provision for non-collectible reinsurance balances recoverable and premiums receivable;
- the valuation of investments;
- the valuation of intangible assets;
- annual incentive plan provisions and severance accruals;
- environmental liabilities assumed;
- deferred income taxes and liabilities; and
- litigation and other contingent liabilities.

Syndicate 4000

We participate in the Lloyd's of London insurance market through our investment in Syndicate 4000, which is managed by Pembroke Managing Agency Limited (''Pembroke''). Since March 2, 2007, when we restructured our investment in Lloyd's of London, we have owned 15% in Pembroke's parent, Pembroke JV. Pembroke provides technical and administrative support and oversight to Syndicate 4000 and is a joint venture among Quanta Holdings, Chaucer Holdings PLC (''Chaucer''), the specialist Lloyd's insurer, and the Syndicate 4000 underwriting team.

The Company has committed to support 90% of the stamp capacity (approximately £65.7 million or $132.0 million) required by Syndicate 4000 for the 2007 underwriting year. The remaining 10% of Syndicate 4000's capacity commitment was provided by Chaucer. The Company committed all of Syndicate 4000's capacity from its inception in 2004 through the 2006 underwriting years. Syndicate 4000's stamp capacity for 2007 is £73 million (equivalent to $147 million based on exchange rates at the commencement of the 2007 underwriting year) and was £82 million ($160 million) for 2006. Stamp capacity is a measure of the amount of gross premium a Lloyd's syndicate is authorized to write based on a business plan approved by the Council of Lloyd's and on the funds that have been committed to a syndicate by its capital providers. Syndicate 4000's capacity is expressed net of acquisition expenses (as is standard at Lloyd’s).

For the 2005 and 2006 underwriting years, the Company included all of Syndicate 4000’s results in its financial statements, after making adjustments to convert Lloyd’s accounting to U.S. GAAP. For the 2007 underwriting year and balances related to that year, the Company only records its 90% pro rata share of Syndicate 4000’s assets, liabilities, revenues and expenses, plus 100% of similar assets, liabilities, revenues and expenses for prior underwriting years, after making adjustments to convert the Lloyd’s accounting to U.S. GAAP. Lloyd’s determines the underwriting results for a particular underwriting year at the end of a three year period. The syndicate closes the underwriting year by purchasing reinsurance to cover the cost of settling all current and future claims related to that underwriting year. The cost to purchase this reinsurance to close an underwriting year into the next year is referred to as ‘‘reinsurance to close.’’

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Beginning in 2007, Syndicate 4000's reported gross written premiums to the Company included estimates of unreported premiums and premiums received but not yet processed at Lloyd's because of time delays between underlying policies being written or adjusted and the inclusion of those policies or policy adjustments in the Lloyd's underwriting systems. Policy adjustments typically include reinstatement premiums or adjustment premiums related to underwriting experience or the volume of underlying insurance business. During the nine months ended September 30, 2007, of the $86.4 million of gross premiums written in our Lloyd's segment (representing our share of Syndicate 4000's total gross written premium), $4.6 million was estimated. Generally, these premium estimates are based on the syndicate's estimates of ultimate premium written in a reporting period using submission data combined with the underwriters' historical experience and projection techniques. These premium estimates are regularly reviewed and updated taking into account comparisons of actual reported or received premium and estimated premiums. Similarly, also starting from the beginning of 2007, Syndicate 4000's results from operations include associated estimates of ceded premiums, acquisition expenses, losses and loss adjustment expenses related to estimated premiums. To the extent that actual premium varies from the estimates, the difference, along with the related losses and loss adjustment expenses and acquisition expenses, is recorded in current operations.

2. Summary of Significant Accounting Policies

A detailed discussion and analysis of the Company's significant accounting policies is provided in the notes to the Company's audited consolidated financial statements as of and for the year ended December 31, 2006 included in its Form 10-K.

The Company has made certain changes in the presentation of its financial statements starting in the first quarter of 2007. Certain 2006 disclosures and balances have been reclassified to conform to the 2007 presentation.

New Accounting Standards

Accounting for Investments

Effective January 1, 2007, the Company adopted FASB Statement No. 159, ''The Fair Value Option for Financial Assets and Financial Liabilities'' (''SFAS 159''). SFAS 159 permits an entity to choose to measure eligible financial instruments and certain other items at fair value that were not previously required to be measured at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in the statements of operations at each reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in the statements of operations as incurred and not deferred. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The Company elected to adopt the provisions of SFAS 159 for its entire investment portfolio. Accordingly effective January 1, 2007 investments which were previously reported as available for sale are now reported as trading securities. Upon adoption, on January 1, 2007, $10.0 million of unrecognized gains were reclassified from accumulated other comprehensive loss to accumulated deficit. The Company believes that by reporting its investment portfolio as trading securities its accounting has been simplified, as this election reduces the burden of the monitoring of differences between the cost and fair value of our investments, including the assessment as to whether declines in value are temporary in nature, mitigates a potential volatility in earnings and further removes an element of management judgment. SFAS 159 has not been applied to any other assets or liabilities. SFAS 159 has been prospectively applied on January 1, 2007 to all securities in the investment portfolio, and the Company intends to continue to apply it to all investments acquired in future periods as well.

Effective January 1, 2007, the Company adopted SFAS 157, ‘‘Fair Value Measurements’’ (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and enhances disclosures about fair value measurements. SFAS 157 applies when other accounting pronouncements require fair value measurements but it does not require new fair value

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measurements. SFAS 157 has been applied to the Company's entire investment portfolio but not to any other assets or liabilities. Implementing SFAS 157 has had no material effect on the way the Company records the fair market value of its securities, however, it has resulted in additional disclosure requirements about its investment portfolio.

Beginning in 2007, net gains and losses on investments as disclosed in the statement of operations consist of realized gains and losses and net change in fair market value of our investments.

Uncertain tax positions

As described in Note 12, the Company adopted the provisions of FASB Interpretation No. 48, ''Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109'' (''FIN 48'') on January 1, 2007.

During May 2007, the FASB issued FASB Staff Position No. FIN 48-1, ''Definition of Settlement in FASB Interpretation No. 48'' (''FSP FIN 48-1''). FSP FIN 48-1 amends FIN 48 to provide guidance on how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. The adoption of FSP FIN48-1 has not affected our financial position or results of operations.

Hybrid financial instruments

In September 2006, the FASB issued FASB Statement No. 155, ''Accounting for certain hybrid financial instruments'' (''SFAS 155''). SFAS 155 amends FASB Statements No. 133,'' Accounting for Derivative Instruments and Hedging Activities,'' and No. 140, ''Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities''. SFAS 155 was effective for financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of SFAS 155 on January 1, 2007 has not affected our financial position or results of operations.

3. Disposal of ESC

On September 15, 2006, the Company sold all of the equity interests in Environmental Strategies Consulting LLC (''ESC''), a wholly owned subsidiary of Quanta Holdings. The Company presented the disposal of ESC as a discontinued operation. For the three months ended September 30, 2006, the Company has reclassified the results of operations related to ESC from its continuing operations to discontinued operations. These results are reflected in the condensed consolidated statement of operations as (loss) income from operations of discontinued operations. The presentation of the reclassified segmental footnote and the reclassified statements of operations includes the previously eliminated inter-company transactions between ESC and the Company. The Company has separately disclosed the operating, investing and financing portions of the cash flows attributable to its discontinued operations.

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Following the sale of ESC, the Company has not reported any income from discontinued operations and, as a result, we are not presenting any financial results for the three and nine months ended September 30, 2007 in this report. The Company's net loss from discontinued operations generated by ESC, previously included in the technical services segment and now reported in discontinued operations, was as follows:

	Period from July 1, 2006 to September 15, 2006	Period from January 1, 2006 to September 15, 2006
Technical services revenues	$ 5,769	$ 21,954
Other income	3	14
Direct technical services costs	(3,743)	(13,968)
General and administrative expenses	(2,790)	(7,725)
Loss on impairment	—	(12,561)
Depreciation of fixed assets and amortization of intangible assets	(173)	(647)
Income tax expense	(2)	(20)
Net loss from discontinued operations	$ (936)	$ (12,953)

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4. Segment information

The following tables summarize the Company's results before income taxes for each reportable segment for the three and nine months ended September 30, 2007 and 2006 based on the reportable segments in effect during the quarter ended September 30, 2007. The three and nine months ended September 30, 2006 comparatives have been restated to conform to the presentation for the three and nine months ended September 30, 2007.

Three months ended September 30, 2007 Statement of operations by segment	Specialty insurance run-off	Specialty reinsurance run-off	Lloyd's	Underwriting total	Technical services	Consolidated
Direct insurance	$ (3,663)	$ —	$ 25,413	$ 21,750	$ —	$ 21,750
Reinsurance assumed	607	137	—	744	—	744
Total gross premiums written	(3,056)	137	25,413	22,494	—	22,494
Premiums ceded	1,195	(113)	(5,167)	(4,085)	—	(4,085)
Net premiums written	$ (1,861)	$ 24	$ 20,246	$ 18,409	$ —	$ 18,409
Net premiums earned	$ 566	$ 24	$ 21,786	$ 22,376	$ —	$ 22,376
Technical services revenues	—	—	—	—	713	713
Other income	474	—	—	474	—	474
Net losses and loss expenses	6,674	2,408	(12,238)	(3,156)	—	(3,156)
Acquisition expenses	(509)	(43)	(4,965)	(5,517)	—	(5,517)
General and administrative expenses	(2,737)	(198)	(3,339)	(6,274)	(1,003)	(7,277)
Segment income (loss)	$ 4,468	$ 2,191	$ 1,244	$ 7,903	$ (290)	$ 7,613
Depreciation of fixed assets and amortization and impairment of intangibles						$ (115)
Interest expense						(797)
Net investment income						11,306
Net gains on investments						3,379
Corporate general and administrative expenses						(7,495)
Gain on repurchase of junior subordinated debentures						4,421
Other expenses						(99)
Net foreign exchange losses						(184)
Income from continuing operations before income taxes						$ 18,029

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Three months ended September 30, 2006 Statement of operations by segment	Specialty insurance run-off	Specialty reinsurance run-off	Lloyd's	Underwriting total	Technical services	Consolidated
Direct insurance	$ (9,877)	$ —	$ 22,063	$ 12,186	$ —	$ 12,186
Reinsurance assumed	(68)	(18,811)	—	(18,879)	—	(18,879)
Total gross premiums written	(9,945)	(18,811)	22,063	(6,693)	—	(6,693)
Premiums ceded	665	10,243	(9,632)	1,276	—	1,276
Net premiums written	$ (9,280)	$ (8,568)	$ 12,431	$ (5,417)	$ —	$ (5,417)
Net premiums earned	$ 25,172	$ 8,565	$ 15,465	$ 49,202	$ —	$ 49,202
Technical services revenues	—	—	—	—	752	752
Other income	940	161	—	1,101	58	1,159
Net losses and loss expenses	(13,660)	(4,641)	(11,852)	(30,153)	—	(30,153)
Acquisition expenses	(3,583)	(1,708)	(3,124)	(8,415)	—	(8,415)
General and administrative expenses	(3,482)	(1,159)	(3,468)	(8,109)	(865)	(8,974)
Segment income (loss)	$ 5,387	$ 1,218	$ (2,979)	$ 3,626	$ (55)	$ 3,571
Depreciation of fixed assets and amortization and impairment of intangibles						$ (715)
Interest expense						(1,430)
Net investment income						12,821
Net gains on investments						906
Corporate general and administrative expenses						(11,604)
Other income						15
Net foreign exchange losses						(257)
Income from continuing operations before income taxes						$ 3,307

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Nine months ended September 30, 2007 Statement of operations by segment	Specialty insurance run-off	Specialty reinsurance run-off	Lloyd's	Underwriting total	Technical services	Consolidated
Direct insurance	$ (18,047)	$ —	$ 86,446	$ 68,399	$ —	$ 68,399
Reinsurance assumed	(95)	2,413	—	2,318	—	2,318
Total gross premiums written	(18,142)	2,413	86,446	70,717	—	70,717
Premiums ceded	1,303	(4,295)	(17,214)	(20,206)	—	(20,206)
Net premiums written	$ (16,839)	$ (1,882)	$ 69,232	$ 50,511	$ —	$ 50,511
Net premiums earned	$ 4,518	$ (509)	$ 63,868	$ 67,877	$ —	$ 67,877
Technical services revenues	—	—	—	—	1,706	1,706
Other income	1,959	2,242	—	4,201	—	4,201
Net losses and loss expenses	3,423	5,174	(39,209)	(30,612)	—	(30,612)
Acquisition expenses	(972)	736	(15,744)	(15,980)	—	(15,980)
General and administrative expenses	(8,043)	(1,223)	(10,281)	(19,547)	(1,732)	(21,279)
Segment income (loss)	$ 885	$ 6,420	$ (1,366)	$ 5,939	$ (26)	$ 5,913
Depreciation of fixed assets and impairment of intangibles						$ (870)
Interest expense						(3,632)
Net investment income						33,835
Net losses on investments						(387)
Corporate general and administrative expenses						(25,415)
Gain on repurchase of junior subordinated debentures						4,421
Other expenses						(61)
Net foreign exchange gain						803
Income from continuing operations before income taxes						$ 14,607

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Nine months ended September 30, 2006 Statement of operations by segment	Specialty insurance run-off	Specialty reinsurance run-off	Lloyd's	Underwriting total	Technical services	Consolidated
Direct insurance	$ 61,386	$ —	$ 64,608	$ 125,994	$ —	$ 125,994
Reinsurance assumed	11,818	3,263	—	15,081	—	15,081
Total gross premiums written	73,204	3,263	64,608	141,075	—	141,075
Premiums ceded	(38,396)	(13,650)	(21,587)	(73,633)	—	(73,633)
Net premiums written	$ 34,808	$ (10,387)	$ 43,021	$ 67,442	$ —	$ 67,442
Net premiums earned	$ 101,688	$ 39,317	$ 48,170	$ 189,175	$ —	$ 189,175
Technical services revenues	—	—	—	—	2,947	2,947
Other income	2,393	620	—	3,013	215	3,228
Net losses and loss expenses	(63,632)	(32,768)	(37,778)	(134,178)	—	(134,178)
Acquisition expenses	(14,156)	(9,552)	(8,900)	(32,608)	—	(32,608)
General and administrative expenses	(19,005)	(6,240)	(9,016)	(34,261)	(4,250)	(38,511)
Segment income (loss)	$ 7,288	$ (8,623)	$ (7,524)	$ (8,859)	$ (1,088)	$ (9,947)
Depreciation of fixed assets and amortization and impairment of intangibles						$ (1,983)
Interest expense						(4,036)
Net investment income						35,350
Net losses on investments						(14,142)
Corporate general and administrative expenses						(45,537)
Other expenses						(536)
Net foreign exchange losses						(1,951)
Loss from continuing operations before income taxes						$ (42,782)

During the three and nine months ended September 30, 2007, the Company returned approximately $4.7 million and $20.2 million in gross written premium due to cancellations as compared to approximately $32.9 million and $74.6 million in gross written premium due to cancellations during the three and nine months ended September 30, 2006. These premiums returned in connection with cancellations do not include premiums returned in connection with commutations.

For the three and nine months ended September 30, 2007, total favorable loss development was approximately $11.4 million and $17.2 million. The Company recorded net favorable development of approximately $1.8 million and $4.2 million in relation to hurricanes Charley, Frances, Ivan and Jeanne (the ''2004 hurricanes'') and hurricanes Katrina, Rita and Wilma (the ''2005 hurricanes'') and net favorable development of approximately $9.6 million and $13.0 million primarily arising in its more mature accident periods where actual loss experience has been better than expected, commutation activities and loss selections in our Lloyd's segment where actual loss experience, particularly the 2005 year of account, has been better than expected.

The Company completed several commutation transactions with certain of its cedants in the specialty reinsurance run-off segment resulting in aggregate net cash payments to those cedants in the amount of $2.7 million and $1.7 million for the three and nine months ended September 30, 2007, which represents full and final settlement and release from all current and future obligations under those reinsurance contracts. At September 30, 2007, an amount of $8.2 million is included in reinsurance balances payable representing the full and final settlement of one of the commutations. The net commutation payments reduced net premiums receivable and gross loss reserves by $3.4 million and $16.0 million for the three months ended September 30, 2007 and by $16.0 million and $31.9 million for the nine months ended September 30, 2007. The Company recognized a gain on

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commutations of $1.6 million during the three months ended September 30, 2007 which consisted of net favorable loss development of $1.7 million offset by returned earned premium of $0.1 million. For the nine months ended September 30, 2007, the Company recognized a gain on commutations of $5.0 million which consisted of net favorable loss development of $4.8 million and other income of $1.9 million offset by returned earned premium of $1.7 million.

5. Income (loss) per share

The following table sets forth the computation of basic and diluted loss and income per share:

	Three months ended September 30, 2007	September 30, 2006	Nine months ended September 30, 2007	September 30, 2006
Income (loss) from continuing operations prior to effects of SFAS 159	$ 14,416	$ 3,307	$ 16,870	$ (42,829)
Effect of adopting SFAS 159	3,611	—	(2,249)	—
Net income (loss) from continuing operations to common shareholder after effects of SFAS 159	$ 18,027	$ 3,307	$ 14,621	$ (42,829)
Net loss from discontinued operations	—	(232)	—	(12,249)
Net income (loss)	$ 18,027	$ 3,075	$ 14,621	$ (55,078)
Gain on repurchase of preferred shares	2,364	—	2,364	—
Dividends on preferred shares	—	—	—	(1,916)
Net income (loss) to common shareholder	$ 20,391	$ 3,075	$ 16,985	$ (56,994)
Weighted average common shares outstanding – basic	70,106,237	69,981,925	70,053,443	69,951,536
Weighted average common shares outstanding – diluted	70,224,287	69,984,614	70,164,777	69,951,536
Basic income (loss) per common share:				
Basic income (loss) from continuing operations prior to effects of SFAS 159 per common share	$ 0.21	$ 0.04	$ 0.24	$ (0.61)
Basic income (loss) from effects of SFAS 159 per common share	0.05	—	(0.03)	—
Basic net loss from discontinued operations per common share	—	(0.00)	—	(0.17)
Basic gain on repurchase of preferred shares per common share	0.03	—	0.03	—
Basic dividends on preferred shares per common share	—	—	—	(0.03)
Basic income (loss) per common share	$ 0.29	$ 0.04	$ 0.24	$ (0.81)
Diluted income (loss) per common share:				
Diluted income (loss) from continuing operations prior to effects of SFAS 159 per common share	$ 0.21	$ 0.04	$ 0.24	$ (0.61)
Diluted income (loss) from effects of SFAS 159 per common share	0.05	—	(0.03)	—
Diluted net loss from discontinued operations per common share	—	(0.00)	—	(0.17)
Diluted gain on repurchase of preferred shares per common share	0.03	—	0.03	—
Diluted dividends on preferred shares per common share	—	—	—	(0.03)
Diluted income (loss) per common share	$ 0.29	$ 0.04	$ 0.24	$ (0.81)

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For the nine months ended September 30, 2006, due to a net loss for the period presented, the assumed net exercise of options, warrants and restricted shares under the treasury stock method has been excluded, as the effect would have been anti-dilutive. Accordingly, for the nine months ended September 30, 2006, the calculation of weighted average common shares outstanding on a diluted basis excludes 1,468,224 options, 2,542,813 warrants and 182,127 restricted shares.

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6. Investments

The fair value of fixed maturity and short-term investments as of September 30, 2007 and December 31, 2006 as determined by the quoted market price of these securities provided by independent pricing services, defined as level 1 per SFAS 157, are as follows:

	September 30, 2007	December 31, 2006
Trading:		
Fixed maturities:		
U.S. government and government agencies	$ 246,145	$ 4,380
Foreign governments	20,737	—
Tax-exempt municipal	1,033	—
Corporate	69,805	18,736
Asset-backed securities	55,416	4,555
Mortgage-backed securities	166,605	9,169
Total fixed maturities	559,741	36,840
Short-term investments	83,575	433
Total trading investments	643,316	37,273
Available for sale securities:		
Fixed maturities:		
U.S. government and government agencies	—	366,861