NAVIGATORS GROUP INC
Form 10-Q
May 03, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Under Section 13 or 15(d)

of the Securities Exchange Act of 1934

For the Quarterly Period Ended March 31, 2007

Commission file number 0-15886

The Navigators Group, Inc.

(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**13-3138397** (IRS Employer Identification No.)
One Penn Plaza, New York, New York (Address of principal executive offices)	**10119** (Zip Code)

(212) 244-2333

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report.)

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 x No o

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

Large Accelerated Filer o Accelerated Filer x Non-Accelerated Filer o

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

The number of common shares outstanding as of April 23, 2007 was 16,782,380.

THE NAVIGATORS GROUP, INC. AND SUBSIDIARIES

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Part 1. Financial Information

Item 1. Financial Statements

THE NAVIGATORS GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

($ in thousands, except share data)

ASSETS	**March 31, 2007 (Unaudited)**	**December 31, 2006**
Investments and cash:		
Fixed maturities, available-for-sale, at fair value (amortized cost: 2007, $1,331,069; 2006, $1,263,284)	$ 1,328,824	$ 1,258,717
Equity securities, available-for-sale, at fair value (cost: 2007, $39,484; 2006, $31,879)	45,380	37,828
Short-term investments, at cost which approximates fair value	130,202	176,961
Cash	1,628	2,404
Total investments and cash	1,506,034	1,475,910
Premiums in course of collection	225,797	163,309
Commissions receivable	3,351	3,647
Prepaid reinsurance premiums	199,544	179,493
Reinsurance receivable on paid losses	131,336	108,878
Reinsurance receivable on unpaid losses and loss adjustment expenses	872,436	911,439
Net deferred income tax benefit	29,502	30,422
Deferred policy acquisition costs	53,733	41,700
Accrued investment income	13,348	13,052
Goodwill and other intangible assets	8,040	8,012
Other assets	22,740	20,824
Total assets	$ 3,065,861	$ 2,956,686
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Reserves for losses and loss adjustment expenses	$ 1,606,283	$ 1,607,555
Unearned premium	469,269	415,096
Reinsurance balances payable	203,185	194,266
Senior notes	123,587	123,560
Federal income tax payable	11,394	3,934
Payable for securities purchased	9,089	166
Accounts payable and other liabilities	68,687	60,766
Total liabilities	2,491,494	2,405,343
Stockholders equity:		
Preferred stock, $.10 par value, authorized 1,000,000 shares, none issued		
Common stock, $.10 par value, shares authorized: 50,000,000 for 2007 and 50,000,000 for 2006; issued and outstanding: 16,781,583 for 2007 and 16,735,898 for 2006	1,678	1,674
Additional paid-in capital	288,479	286,732
Retained earnings	279,136	259,464
Accumulated other comprehensive income	5,074	3,473
Total stockholders equity	574,367	551,343
Total liabilities and stockholders equity	$ 3,065,861	$ 2,956,686

See accompanying notes to interim consolidated financial statements

THE NAVIGATORS GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

($ and shares in thousands, except net income per share)

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	Three Months Ended March 31, 2007 (Unaudited)	2006
Gross written premium	$ 300,861	$ 263,784
Revenues		
Net written premium	$ 173,019	143,426
(Increase) in unearned premium	(33,973)	(39,704)
Net earned premium	139,046	103,722
Commission income	408	1,286
Net investment income	16,216	12,550
Net realized capital gains (losses)	201	(424)
Other income (expense)	(71)	186
Total revenues	155,800	117,320
Operating expenses:		
Net losses and loss adjustment expenses incurred	81,192	62,117
Commission expense	17,099	13,705
Other operating expenses	26,289	18,408
Interest expense	2,215	
Total operating expenses	126,795	94,230
Income before income tax expense (benefit)	29,005	23,090
Income tax expense (benefit):		
Current	9,276	9,332
Deferred	57	(1,767)
Total income tax expense	9,333	7,565
Net income	$ 19,672	$ 15,525
Net income per common share:		
Basic	$ 1.17	$ 0.93
Diluted	$ 1.17	$ 0.93
Average common shares outstanding:		
Basic	16,756	16,639
Diluted	16,884	16,757

See accompanying notes to interim consolidated financial statements.

THE NAVIGATORS GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
($ in thousands)

	Three Months Ended March 31, 2007 (Unaudited)	2006
Preferred Stock		
Balance at beginning and end of period	$	$
Common stock		
Balance at beginning of year	$ 1,674	$ 1,662
Shares issued under stock plans	4	5
Balance at end of period	$ 1,678	$ 1,667
Additional paid-in capital		
Balance at beginning of year	$ 286,732	$ 282,463
Effect of SFAS 123 for stock options	159	240
Shares issued under stock plans	1,588	1,396
Balance at end of period	$ 288,479	$ 284,099
Retained earnings		
Balance at beginning of year	$ 259,464	$ 186,901
Net income	19,672	15,525
Balance at end of period	$ 279,136	$ 202,426
Accumulated other comprehensive income (loss)		
Net unrealized gains (losses) on securities, net of tax		
Balance at beginning of year	$ 849	$ (884)
Change in period	1,496	(9,330)
Balance at end of period	2,345	(10,214)
Cumulative translation adjustments, net of tax		
Balance at beginning of year	2,624	96
Net adjustment for period	105	242
Balance at end of period	2,729	338
Balance at end of period	$ 5,074	$ (9,876)
Total stockholders equity at end of period	$ 574,367	$ 478,316

See accompanying notes to interim consolidated financial statements.

THE NAVIGATORS GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
($ in thousands)

	Three Months Ended March 31, 2007 (Unaudited)	2006
Net income	$ 19,672	$ 15,525
Other comprehensive income (loss):		
Change in net unrealized gains (losses) on securities, net of tax expense (benefit) of $771 and ($5,024) in 2007 and 2006, respectively(1)	1,496	(9,330)
Change in foreign currency translation gains, net of tax expense of $56 and $130 in 2006 and 2005, respectively	105	242
Other comprehensive income (loss)	1,601	(9,088)
Comprehensive Income	$ 21,273	$ 6,437

(1)	Disclosure of reclassification amount, net of tax:		
	Unrealized holding gains (losses) arising during period	$ 1,625	$ (9,606)
	Less: reclassification adjustment for net gains (losses) included in net income	129	(276)
	Change in net unrealized gains (losses) on securities	$ 1,496	$ (9,330)

See accompanying notes to interim consolidated financial statements.

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THE NAVIGATORS GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
($ in thousands)

	Three Months Ended March 31, 2007 (Unaudited)	2006
Operating activities:		
Net income	$ 19,672	$ 15,525
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation & amortization	703	1,199
Net deferred income tax expense (benefit)	57	(1,767)
Net realized capital (gains) losses	(201)	424
Changes in assets and liabilities:		
Reinsurance receivable on paid and unpaid losses and loss adjustment expenses	18,344	(25,810)
Reserve for losses and loss adjustment expenses	(3,699)	44,092
Prepaid reinsurance premiums	(19,719)	(31,479)
Unearned premium	53,426	70,788
Premiums in course of collection	(61,862)	(53,362)
Commissions receivable	298	9
Deferred policy acquisition costs	(11,884)	(14,460)
Accrued investment income	(290)	(242)
Reinsurance balances payable	8,347	11,932
Federal income tax	7,400	5,470
Other	9,486	6,318
Net cash provided by operating activities	20,078	28,637
Investing activities:		
Fixed maturities, available-for-sale		
Redemptions and maturities	50,738	3,069
Sales	55,680	74,850
Purchases	(174,445)	(131,221)
Equity securities, available-for-sale		
Sales	4,464	2,205
Purchases	(11,877)	(5,762)
Change in payable for securities	8,863	(2,685)
Net change in short-term investments	47,079	32,108
Purchase of property and equipment	(1,898)	(878)
Net cash (used in) investing activities	(21,396)	(28,314)
Financing activities:		
Proceeds of stock issued from employee stock purchase plan	301	222
Proceeds of stock issued from exercise of stock options	241	353
Net cash provided by financing activities	542	575
Effect of exchange rate changes on foreign currency cash		6
Increase (decrease) in cash	(776)	904
Cash at beginning of year	2,404	13,165
Cash at end of period	$ 1,628	$ 14,069
Supplemental disclosures of cash flow information:		
Federal, state and local income tax paid	$ 1,712	$ 3,256
Issuance of stock to directors	181	140

See accompanying notes to interim consolidated financial statements.

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THE NAVIGATORS GROUP, INC. AND SUBSIDIARIES

Notes to Interim Consolidated Financial Statements
(Unaudited)

Note 1. Accounting Policies

The interim consolidated financial statements are unaudited but reflect all adjustments which, in the opinion of management, are necessary to provide a fair statement of the results of The Navigators Group, Inc. and its subsidiaries for the interim periods presented on the basis of accounting principles generally accepted in the United States of America (GAAP or U.S. GAAP). All such adjustments are of a normal recurring nature. All significant intercompany transactions and balances have been eliminated. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported revenues and expenses during the reporting periods. The results of operations for any interim period are not necessarily indicative of results for the full year. The terms we , us , our and the Company as used herein mean The Navigators Group, Inc. and its subsidiaries, unless the context otherwise requires. The term Parent or Parent Company is used to mean The Navigators Group, Inc. without its subsidiaries. These financial statements should be read in conjunction with the consolidated financial statements and notes contained in the Company s 2006 Annual Report on Form 10-K. Certain amounts for the prior year have been reclassified or restated to conform to the current year s presentation.

Note 2. Reinsurance Ceded

The Company s ceded earned premiums were $107.9 million and $88.9 million for the three months ended March 31, 2007 and 2006, respectively. The Company s ceded incurred losses were $63.6 million and $63.1 million for the three months ended March 31, 2007 and 2006, respectively.

Note 3. Segment Information

The Company s subsidiaries are primarily engaged in the underwriting and management of property and casualty insurance.

The Company classifies its business into two underwriting segments consisting of the Insurance Companies and the Lloyd s Operations, which are separately managed, and a Corporate segment. Segment data for each of the two underwriting segments include allocations of revenues and expenses of the Navigators Agencies and Parent Company s expenses and related income tax amounts.

We evaluate the performance of each segment based on its underwriting and net income results. The Insurance Companies and the Lloyd s Operations results are measured by taking into account net earned premiums, incurred losses and loss adjustment expenses, commission expense and other underwriting expenses. The Corporate segment consists of the Parent Company s investment income, interest expense and the related tax effect. Each segment also maintains its own investments, on which it earns income and realizes capital gains or losses. Our underwriting performance is evaluated separately from the performance of our investment portfolios.

Our Insurance Companies consist of Navigators Insurance Company, including its United Kingdom Branch (the U.K. Branch), and Navigators Specialty Insurance Company (formerly NIC Insurance Company). Navigators Insurance Company is our largest insurance subsidiary and has been active since 1983. It specializes principally in underwriting marine insurance and related lines of business, specialty liability insurance and professional liability insurance. Navigators Specialty Insurance Company, a wholly owned subsidiary of Navigators Insurance Company, began operations in 1990. It underwrites specialty and professional liability insurance on an excess and surplus lines basis fully reinsured by Navigators Insurance Company. The Lloyd s

Operations primarily underwrite marine and related lines of business at Lloyd s of London (Lloyd s) through Lloyd s Syndicate 1221 (Syndicate 1221). Our Lloyd s Operations include Navigators Underwriting Agency Ltd. (NUAL), a Lloyd s underwriting agency which manages Syndicate 1221. We participate in the capacity of Syndicate 1221 through two wholly-owned Lloyd s corporate members. The Navigators Agencies are wholly-owned insurance underwriting management companies which produce, manage and underwrite insurance and reinsurance for the Company. All segments are evaluated based on their GAAP results.

The Insurance Companies and the Lloyd s Operations underwriting results are measured based on underwriting profit or loss and the related combined ratio, which are both non-GAAP measures of underwriting profitability. Underwriting profit or loss is calculated from net earned premiums, less net losses and LAE, commission expense and other operating expenses related to underwriting activities. The combined ratio is derived by taking such net losses and LAE and operating expenses divided by net earned premiums. A combined ratio of less than 100% indicates an underwriting profit and over 100% indicates an underwriting loss.

Financial data by segment for the three months ended March 31, 2007 and 2006 were as follows:

	Three Months Ended March 31, 2007			
	Insurance Companies ($ in thousands)	**Lloyd s Operations**	**Corporate**	**Total**
Gross written premium	$ 208,874	$ 91,987		$ 300,861
Net written premium	122,048	50,971		173,019
Net earned premium	101,812	37,234		139,046
Net losses and loss adjustment expenses	(61,340)	(19,852)		(81,192)
Commission expense	(11,083)	(6,016)		(17,099)
Other operating expenses	(18,769)	(7,520)		(26,289)
Commission income and other income (expense)	489	(152)		337
Underwriting profit	11,109	3,694		14,803
Investment income	13,654	2,151	$ 411	16,216
Net realized capital gains (losses)	243	(42)		201
Interest expense			(2,215)	(2,215)
Income (loss) before income taxes	25,006	5,803	(1,804)	29,005
Income tax expense (benefit)	7,911	2,054	(632)	9,333
Net income (loss)	$ 17,095	$ 3,749	$ (1,172)	$ 19,672
Identifiable assets(1)	$ 2,166,439	$ 828,689	$ 65,240	$ 3,065,861
Loss and loss expenses ratio	60.2 %	53.3 %		58.4 %
Commission expense ratio	10.9 %	16.2 %		12.3 %
Other operating expense ratio(2)	18.0 %	20.6 %		18.7 %
Combined ratio	89.1 %	90.1 %		89.4 %

(1) Includes inter-segment transactions causing the row not to crossfoot.

(2) Includes *other operating expenses* and *commission income and other income (expense)*.

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	Three Months Ended March 31, 2006 Insurance Companies ($ in thousands)	Lloyd s Operations	Corporate	Total
Gross written premium(1)	$ 162,247	$ 101,748		$ 263,784
Net written premium	89,644	53,782		143,426
Net earned premium	67,352	36,370		103,722
Net losses and loss adjustment expenses	(39,954)	(22,163)		(62,117)
Commission expense	(7,124)	(6,581)		(13,705)
Other operating expenses	(13,433)	(4,975)		(18,408)
Commission income and other income (expense)	1,206	266		1,472
Underwriting profit	8,047	2,917		10,964
Investment income	10,410	2,007	$ 133	12,550
Net realized capital (losses)	(75)	(349)		(424)
Income before income taxes	18,382	4,575	133	23,090
Income tax expense	5,916	1,601	48	7,565
Net income	$ 12,466	$ 2,974	$ 85	$ 15,525
Identifiable assets(1)	$ 1,867,521	$ 848,132	$ 24,529	$ 2,740,313
Loss and loss expenses ratio	59.3 %	60.9 %		59.9 %
Commission expense ratio	10.6 %	18.1 %		13.2 %
Other operating expense ratio(2)	18.2 %	13.0 %		16.3 %
Combined ratio	88.1 %	92.0 %		89.4 %

(1) Includes inter-segment transactions causing the row not to crossfoot.

(2) Includes *other operating expenses* and *commission income and other income (expense)*.

The Insurance Companies net earned premium includes $15.4 million and $8.2 million of net earned premium from the U.K. Branch for the three months ended March 31, 2007 and 2006, respectively.

Note 4. Comprehensive Income

Comprehensive income encompasses net income, net unrealized capital gains and losses on available for sale securities, and foreign currency translation adjustments, all of which are net of tax. Please refer to the *Consolidated Statements of Stockholders Equity* and the *Consolidated Statements of Comprehensive Income*, included herein, for the components of *accumulated other comprehensive income (loss)* and of *comprehensive income (loss)*, respectively.

Note 5. Stock-Based Compensation

Stock based compensation is expensed as the stock awards vest with the expense being included in *other operating expenses* for the periods indicated. The amount charged to expense for stock grants was $1.2 million and $422,000 for the three months ended March 31, 2007 and 2006, respectively. The amount charged to expense for stock options was $159,000 and $240,000 for the three months ended March 31, 2007 and 2006, respectively. Stock appreciation rights resulted in an expense of $251,000 and $829,000 for the three months ended March 31, 2007 and 2006.

In addition, $50,000 and $35,000 was expensed in each of the three month periods ended March 31, 2007 and 2006 for stock issued annually to non-employee directors as part of their directors compensation for serving on the Company s Board of Directors.

Note 6. Application of New Accounting Standards

In February 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 155, *Accounting for Certain Hybrid Financial Instruments*. SFAS No. 155 amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and allows an entity to remeasure at fair value a hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation from the host, if the holder irrevocably elects to account for the whole instrument on a fair value basis. Subsequent changes in the fair value of the instrument would be recognized in earnings. SFAS No. 133 also removed an exception included in an interpretation of SFAS No. 133 (Implementation Issue No. B39) that kept holders of mortgage-backed securities from testing for the need to bifurcate the value embedded in mortgage-backed securities related to the ability to prepay. Such exception was subsequently reinstated. SFAS 155 is effective for financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. The Company s adoption of SFAS No. 155 at January 1, 2007 did not have a material effect on its financial condition or results of operations.

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), an interpretation of FASB Statement No. 109. FIN 48, which becomes effective in the first quarter of 2007, establishes the threshold for recognizing the benefits of tax-return positions in the financial statements as more-likely-than-not to be sustained by the taxing authorities, and prescribes a measurement methodology for those positions meeting the recognition threshold. The Company s adoption of FIN 48 at January 1, 2007 did not have a material effect on its financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP, and enhances disclosures about fair value measurements. SFAS No. 157, which becomes effective in the first quarter of 2008, applies when other accounting pronouncements require fair value measurements; it does not require new fair value measurements. The Company has not yet determined the estimated impact on its financial condition or results of operations, if any, of adopting SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which permits entities to choose to measure many financial instruments and certain warranty and insurance contracts at fair value on a contract-by-contract basis. SFAS No. 159 is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007 (January 1, 2008 for calendar-year-end companies). The Company has not yet determined the estimated impact on its financial condition or results of operations, if any, of adopting SFAS No. 159.

Note 7. Lloyd s Syndicate

We record our pro rata share of Syndicate 1221 s assets, liabilities, revenues and expenses, after making adjustments to convert Lloyd s accounting to U.S. GAAP. The most significant U.S. GAAP adjustments relate to income recognition. Lloyd s syndicates determine underwriting results by year of account at the end of three years. We record adjustments to recognize underwriting results as incurred, including the expected ultimate cost of losses incurred. These adjustments to losses are based on actuarial analysis of syndicate accounts, including forecasts of expected ultimate losses provided by Syndicate 1221. At the end of the Lloyd s three year period for determining underwriting results for an account year, Syndicate 1221 will close the account year by reinsuring outstanding claims on that account year with the participants for the account s next underwriting year. The amount to close an underwriting year into the next year is referred to as the reinsurance to close . The reinsurance to close transaction is recorded in the fourth quarter as additional written and earned premium, losses incurred, loss reserves and receivables, all in the same amount. No gain or loss is recorded on the reinsurance to close transaction.

Syndicate 1221 s stamp capacity is £140 million ($274 million) in 2007 compared to £123 million ($226 million) in 2006. Stamp capacity is a measure of the amount of premium a Lloyd s syndicate is authorized to write based on a business plan approved by the Council of Lloyd s. Syndicate 1221 s capacity is expressed net of commission (as is standard at Lloyd s) of approximately 22.5% for the 2007 underwriting year and 21% for the 2006 underwriting year. The Syndicate 1221 premium recorded in the Company s financial statements is gross of commission. The Company participates for 100% of Syndicate 1221 s capacity for both the 2007 and 2006 underwriting years. The Lloyd s Operations included in the consolidated financial statements represent the Company s participation in Syndicate 1221.

The Company provides letters of credit to Lloyd s to support its Syndicate 1221 capacity. If the Company increases its participation or if Lloyd s changes the capital requirements, the Company may be required to supply additional letters of credit or other collateral acceptable to Lloyd s, or reduce the capacity of Syndicate 1221. The letters of credit are provided through a credit facility with a consortium of banks which expires March 31, 2009. If the banks decide not to renew the credit facility, the Company will need to find other sources to provide the letters of credit or other collateral in order to continue to participate in Syndicate 1221. The bank facility is collateralized by all of the common stock of Navigators Insurance Company.

Note 8. Income Taxes

We are subject to the tax regulations of the United States and foreign countries in which we operate. The Company files a consolidated federal tax return, which includes all domestic subsidiaries and the U.K. Branch. The income from the foreign operations is designated as either U.S. connected income or non-U.S. connected income. Lloyd s is required to pay U.S. income tax on U.S. connected income (U.S. source income) written by Lloyd s syndicates. Lloyd s and the IRS have entered into an agreement whereby the amount of tax due on U.S. connected income is calculated by Lloyd s and remitted directly to the IRS. These amounts are then charged to the corporate members in proportion to their participation in the relevant syndicates. The Company s corporate members are subject to this agreement and will receive United Kingdom (U.K.) tax credits for any U.S. income tax incurred up to the U.K. income tax charged on the U.S. income. The non-U.S. connected insurance income would generally constitute taxable income under the Subpart F income section of the Internal Revenue Code since less than 50% of Syndicate 1221 s premium is derived within the U.K. and would therefore be subject to U.S. taxation when the Lloyd s year of account closes. Taxes are accrued at a 35% rate on our foreign source insurance income and foreign tax credits, where available, are utilized to offset U.S. tax as permitted. The Company s effective tax rate for Syndicate 1221 taxable income could substantially exceed 35% to the extent the Company is unable to offset U.S. taxes paid under Subpart F tax regulations with U.K. tax credits on future underwriting year distributions. U.S. taxes are not accrued on the earnings of the Company s foreign agencies as these earnings are not subject to the Subpart F tax regulations. These earnings are subject to taxes under U.K. tax regulations at a 30% rate.

As discussed in Note 6 to these Notes to Interim Consolidated Financial Statements, the Company adopted FIN 48 on January 1, 2007. FIN 48 applies to all tax positions accounted for under SFAS 109, *Accounting for Income Taxes*. FIN 48 defines the confidence level that a tax position must meet in order to be recognized in the financial statements. The tax position must be more-likely-than-not to be sustained by the relevant taxing authority which means a likelihood of more than 50%. If the more-likely-than-not threshold can not be reached, the benefit should not be reflected in the financial statements. However, a company should recognize the largest amount of the tax benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the taxing authorities. The determination of the 50% threshold is highly judgmental and depends on the individual facts and circumstances. A tax benefit taken in the tax return but not in the financial statements is known as an unrecognized tax benefit . The Company had no unrecognized tax benefits at either January 1, 2007 or at March 31, 2007 and does not anticipate any significant unrecognized tax benefits within the next twelve months.

The Company is currently not under examination by any major U.S. or foreign tax authority and is generally subject to U.S. Federal, state, local, or foreign tax examinations by tax authorities for years 2003 and subsequent. The Company s policy is to record interest and penalties related to unrecognized tax benefits to income tax expense. During the three months ended March 31, 2007 and 2006, the Company did not incur any interest or penalties related to unrecognized tax benefits.

The Company had state and local operating loss carryforwards amounting to potential future tax benefits of $6.8 million and $6.0 million at March 31, 2007 and December 31, 2006, respectively. A valuation allowance was established for the full amount of these potential future tax benefits due to the uncertainty associated with their realization.

Note 9. Commitments and Contingencies

a). Except as follows, the Company is not a party to, or the subject of, any material legal proceedings which depart from the ordinary routine litigation incident to the kinds of business it conducts.

At the end of April 2006, the Company was served as a defendant in an action in the United States District Court for the Northern District of Georgia captioned *New Cingular Wireless Headquarters, LLC, et al. v. Marsh & McLennan Companies, Inc., et al.*, along with approximately 100 other defendants. On May 31, 2006, this action, which involved allegations of contingent commissions and bid-rigging in the insurance industry, was conditionally transferred to the United States District Court for the District of New Jersey by the Judicial Panel on Multidistrict Litigation. On April 12, 2007, the Company entered into a Confidential Settlement and Release Agreement with the plaintiffs in this action, pursuant to which all claims against the Company have been dismissed with prejudice. The terms of this confidential settlement did not have a material impact upon the Company s results of operations or financial condition.

On November 22, 2006, the Company filed a demand for arbitration against Equitas, a lead reinsurer participating in excess of loss reinsurance agreements, with respect to unsatisfied loss payment recovery demands that the Company has previously presented to Equitas (the Equitas Arbitration). The recovery demands are for the 2005 settlement of two class action lawsuits involving large asbestos claims (together, the 2005 Settled Claims), which 2005 Settled Claims are being paid through 2007. Equitas has not indicated any dispute with respect to recoveries on related pro rata reinsurance agreements for such 2005 Settled Claims or with respect to excess of loss or pro rata reinsurance for the 2004 Settled Claim referred to below. The aggregate amount of excess of loss recoveries due from Equitas for ceded paid and unpaid losses on the 2005 Settled Claims is approximately $2.7 million.

On November 20, 2006, the Company also filed a demand for arbitration in New York against INA International Insurance Company, n/k/a Ace International (Ace International), a reinsurer participating in pro rata reinsurance agreements, with respect to unsatisfied loss payment recovery demands that the Company has previously presented to Ace International (the Ace International Arbitration). The recovery demands are for the 2005 Settled Claims and for the 2004 settlement of another class action lawsuit involving a third large asbestos claim (the 2004 Settled Claim and, together with the 2005 Settled Claims, the Settled Claims), which 2004 Settled Claim is being paid over seven years beginning in 2005. The aggregate amount of pro rata recoveries due from Ace International for ceded paid and unpaid losses on the Settled Claims is approximately $1.6 million.

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The Company has filed its demands for arbitration against Equitas and Ace International in accordance with the respective applicable provisions of the excess of loss reinsurance agreements and the pro rata reinsurance agreements. The Company believes that the refusal of Equitas and of Ace International to satisfy the Company s payment demands is without merit and it intends to vigorously pursue collection of its respective reinsurance recoveries. While it is too early to predict with any certainty the outcome of the Equitas Arbitration or the Ace International Arbitration, the Company believes that the ultimate outcomes would not be expected to have a significant adverse effect on its results of operations, financial condition or liquidity, although an unexpected adverse resolution of either or both of these arbitrations could have a material adverse effect on the Company s results of operations in a particular fiscal quarter or year.

b). Whenever a member of Lloyd s is unable to pay its debts to policyholders, such debts may be payable by the Lloyd s Central Fund. If Lloyd s determines that the Central Fund needs to be increased, it has the power to assess premium levies on current Lloyd s members up to 3% of a member s underwriting capacity in any one year. The Company does not believe that any assessment is likely in the foreseeable future and has not provided any allowance for such an assessment. However, based on the Company s 2007 capacity at Lloyd s of £140 million, the March 31, 2007 exchange rate of £1 equals $1.97 and assuming the maximum 3% assessment, the Company would be assessed approximately $8.3 million.

Note 10. Senior Notes due May 1, 2016

On April 17, 2006, the Company completed a public debt offering of $125 million principal amount of 7% senior unsecured notes due May 1, 2016 (the Senior Notes) and received net proceeds of $123.5 million. The Company contributed $100 million of the proceeds to the capital and surplus of Navigators Insurance Company and retained the remainder at the Parent Company for general corporate purposes. The interest payment dates on the Senior Notes are each May 1 and November 1. The effective interest rate related to the Senior Notes, based on the proceeds net of discount and all issuance costs, is approximately 7.17%.

The Senior Notes, the Company s only senior unsecured obligation, will rank equally with future senior unsecured indebtedness. The Company may redeem the Senior Notes at any time and from time to time, in whole or in part, at a make-whole redemption price. The terms of the Senior Notes contain various restrictive business and financial covenants typical for debt obligations of this type, including limitations on mergers, and liens or dispositions of the common stock of certain subsidiaries. As of March 31, 2007, the Company was in compliance with all such covenants.

The interest expense for the 2007 first quarter was $2.2 million. The fair value, which is based on the quoted market price at March 31, 2007, was $130.1 million.

Item 2. **Management s Discussion and Analysis of Financial Condition and Results of Operations**

Note on Forward-Looking Statements

Some of the statements in this Quarterly Report on Form 10-Q are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Whenever used in this report, the words estimate , expect , believe or similar expressions are intended to identify such forward-looking statements. Forward-looking statements are derived from information that we currently have and assumptions that we make. We cannot assure that anticipated results will be achieved, since results may differ materially because of both known and unknown risks and uncertainties which we face. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Factors that could cause actual results to differ materially from our forward-looking statements include, but are not limited to:

- the effects of domestic and foreign economic conditions, and conditions which affect the market for property and casualty insurance;

- changes in the laws, rules and regulations which apply to our insurance companies;

- the effects of emerging claim and coverage issues on our business, including adverse judicial or regulatory decisions and rulings;

- the effects of competition from banks and other insurers and the trend toward self-insurance;

- risks that we face in entering new markets and diversifying the products and services we offer;

- unexpected turnover of our professional staff;

- changing legal and social trends and inherent uncertainties in the loss estimation process that can adversely impact the adequacy of loss reserves and the allowance for reinsurance recoverables, including our estimates relating to ultimate asbestos liabilities and related reinsurance recoverables;

- risks inherent in the collection of reinsurance recoverable amounts from our reinsurers over many years into the future based on their financial ability and intent to meet such obligations to the Company;

- risks associated with our continuing ability to obtain reinsurance covering our exposures at appropriate prices and/or in sufficient amounts and the related recoverability of our reinsured losses;

- weather-related events and other catastrophes (including acts of terrorism) impacting our insureds and/or reinsurers, including, without limitation, the impact of Hurricanes Katrina, Rita, and Wilma and the possibility that our estimates of losses from Hurricanes Katrina, Rita and Wilma will prove to be materially inaccurate;

- our ability to attain adequate prices, obtain new business and retain existing business consistent with our expectations;

- the possibility of downgrades in our claims-paying and financial strength ratings significantly adversely affecting us, including reducing the number of insurance policies we write generally, or causing clients who require an insurer with a certain rating level to use higher-rated insurers;

- the inability of our internal control framework to provide absolute assurance that all incidents of fraud or unintended material errors will be detected and prevented;

- the risk that our investment portfolio suffers reduced returns or investment losses which could reduce our profitability; and

- other risks that we identify in future filings with the Securities and Exchange Commission (the SEC), including without limitation the risks described under the caption Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2006.

In light of these risks, uncertainties and assumptions, any forward-looking events discussed in this Form 10-Q may not occur. You are cautioned not to place undue reliance on any forward-looking statements, which speak only as of their respective dates.

The discussion and analysis of our financial condition and results of operations contained herein should be read in conjunction with our consolidated financial statements and accompanying notes which appear elsewhere in this Form 10-Q. It contains forward-looking statements that involve risks and uncertainties. Please see Note on Forward-Looking Statements for more information. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and elsewhere in this Form 10-Q.

Overview

We are an international insurance holding company focusing on specialty products for niches within the overall property/casualty insurance market. The Company s underwriting segments consists of insurance company operations and operations at Lloyd s of London. Our largest product line and most long-standing area of specialization is ocean marine insurance. We have also developed specialty niches in professional liability insurance and in specialty liability insurance primarily consisting of contractors liability and excess liability coverages. We conduct operations through our Insurance Companies and our Lloyd s Operations. The Insurance Companies consist of Navigators Insurance Company, which includes a United Kingdom Branch, and Navigators Specialty Insurance Company, which underwrites specialty and professional liability insurance on an excess and surplus lines basis fully reinsured by Navigators Insurance Company. Our Lloyd s Operations include NUAL, a Lloyd s underwriting agency which manages Syndicate 1221. We participate in the capacity of Syndicate 1221 through two wholly-owned Lloyd s corporate members.

While management takes into consideration a wide range of factors in planning the Company s business strategy and evaluating results of operations, there are certain factors that management believes are fundamental to understanding how the Company is managed. First, underwriting profit is consistently emphasized as a primary goal, above premium growth. Management s assessment of our trends and potential growth in underwriting profit is the dominant factor in its decisions with respect to whether or not to expand a business line, enter into a new niche, product or territory or, conversely, to contract capacity in any business line. In addition, management focuses on managing the costs of our operations. Management believes that careful monitoring of the costs of existing operations and assessment of costs of potential growth opportunities are important to our profitability. Access to capital also has a significant impact on management s outlook for our operations. The Insurance Companies operations and ability to grow their business and take advantage of market opportunities are particularly constrained by regulatory capital requirements and rating agency assessments of capital adequacy.

The discussions that follow include tables, which contain both our consolidated and segment operating results for the three month periods ended March 31, 2007 and 2006. In presenting our financial results we have discussed our performance with reference to underwriting profit or loss and the related combined ratio, both of which are non-GAAP measures of underwriting profitability. We consider such measures, which may be defined differently by other companies, to be important in the understanding of our overall results of operations. Underwriting profit or loss is calculated from premiums earned, less net losses and loss adjustment expenses (LAE), commission expense and other operating income and expenses related to underwriting activities. The combined ratio is derived by taking such net losses and LAE, commission expense and other income and expenses divided by earned premiums. A combined ratio of less than 100% indicates an underwriting profit and over 100% indicates an underwriting loss.

Although not a financial measure, management s decisions are also greatly influenced by access to specialized underwriting and claims expertise in our lines of business. We have chosen to operate in specialty niches with certain common characteristics which we believe provide us with the opportunity to use our technical underwriting expertise in order to realize underwriting profit. As a result, we have focused on underserved markets for businesses characterized by higher severity and lower frequency of loss where we believe our intellectual capital and financial strength bring meaningful value. In contrast, we have avoided niches that we believe have a high frequency of loss activity and/or are subject to a high level of regulatory coverage requirements, such as workers compensation and personal automobile insurance, because we do not believe our technical expertise is of as much value in these types of businesses. Examples of niches that have the characteristics we look for include bluewater hull which provides coverage for physical damage to, for example, highly valued cruise ships, and directors and officers liability insurance (D&O) which covers litigation exposure of a corporation s directors and officers. These types of exposures require substantial technical expertise. We attempt to mitigate the financial impact of severe claims on our results by conservative and detailed underwriting, prudent use of reinsurance and a balanced portfolio of risks.

Our revenue is primarily comprised of premiums and investment income. The Insurance Companies derive their premiums primarily from business written by the Navigators Agencies, which are wholly-owned insurance underwriting agencies of the Company. The Lloyd s Operations derive their premiums from business written by NUAL. Beginning in 2006, the Navigators Agencies produce and manage business only for the Insurance Companies and are reimbursed for actual costs. Prior to 2006, the Navigators Agencies received commissions and, in some cases, profit commissions on the business produced on behalf of the Insurance Companies and other unaffiliated insurers. NUAL is reimbursed for its actual costs and, where applicable, profit commissions on the business produced for Lloyd s Syndicate 1221.

Over the past several years, we have experienced generally beneficial market changes in our lines of business. As a result of several large industry losses in the second quarter of 2001, the marine insurance market began to experience diminished capacity and rate increases, initially in the offshore energy line of business. The marine rate increases began to level off in 2004 and into 2005. As a result of the substantial insurance industry losses resulting from Hurricanes Katrina and Rita, the marine insurance market experienced diminished capacity and rate increases through the end of 2006, particularly for the offshore energy risks located in the Gulf of Mexico. The 2007 first quarter average renewal rate increases for all marine lines of business including offshore energy approximated 2% for both the Insurance Companies and the Lloyd s Operations. Included in the marine renewal rate increases for the first quarter of 2007 are offshore energy rate increases of approximately 6% in the Insurance Companies and 2% in the Lloyd s Operations.

Specialty liability losses in 2001 to 2003, particularly for the construction liability business, also resulted in diminished capacity in the market in which we compete, as many former competitors who lacked the expertise to selectively underwrite this business have been forced to withdraw from the market resulting in approximate rate increases of 13% in 2004 and 49% in 2003. This was followed by a slight decline in rates of approximately 1% in 2005. The 2006 year average renewal rates for the construction liability business declined approximately 6%, primarily due to additional competition in the marketplace. This decline continued into the 2007 first quarter with average renewal rates declining approximately 9%. We expect these competitive conditions to continue during 2007 resulting in continuing moderate declines in pricing for construction liability and excess liability business.

In the professional liability market, the enactment of the Sarbanes-Oxley Act of 2002, together with financial and accounting scandals at publicly traded corporations and the increased frequency of securities-related class action litigation, has led to heightened interest in professional liability insurance generally. Average professional liability renewal premium rates decreased approximately 4% in the 2007 first quarter compared to relatively level renewal rates in 2006 and 2005 after decreasing of approximately 3% in 2004 which followed substantial renewal rate increases in 2003 and 2002, particularly for D&O insurance. The D&O insurance premium renewal rates decreased approximately 4% in the 2007 first quarter after decreases of approximately 2% in 2005 and 10% in 2004. We anticipate continuing moderate declines in 2007 pricing given the overall favorable industry underwriting results since 2002 for the professional liability lines of business.

Our business is cyclical and influenced by many factors. These factors include price competition, economic conditions, interest rates, weather-related events and other catastrophes including natural and man-made disasters (for example hurricanes and terrorism), state regulations, court decisions and changes in the law. The incidence and severity of catastrophes are inherently unpredictable. Although we will attempt to manage our exposure to such events, the frequency and severity of catastrophic events could exceed our estimates, which could have a material adverse effect on our financial condition. Additionally, because our insurance products must be priced, and premiums charged, before costs have fully developed, our liabilities are required to be estimated and recorded in recognition of future loss and settlement obligations. Due to the inherent uncertainty in estimating these liabilities, we cannot assure you that our actual liabilities will not exceed our recorded amounts.

Catastrophe Risk Management

Our Insurance Companies and Lloyd s Operations have exposure to losses caused by hurricanes and other natural and man-made catastrophic events. The frequency and severity of catastrophes are unpredictable.

The extent of losses from a catastrophe is a function of both the total amount of insured exposure in an area affected by the event and the severity of the event. We continually assess our concentration of underwriting exposures in catastrophe exposed areas globally and attempt to manage this exposure through individual risk selection and through the purchase of reinsurance. We also use modeling technologies and concentration management tools that allow us to better monitor and control our accumulations of potential losses from catastrophe exposures. Despite these efforts, there remains uncertainty about the characteristics, timing and extent of insured losses given the nature of catastrophes. The occurrence of one or more severe catastrophic events could have a material adverse effect on the Company s results of operations, financial condition or liquidity.

The Company has significant catastrophe exposures throughout the world with the largest catastrophe exposure for offshore energy risks due to hurricanes in the Gulf of Mexico. The Company believes that its estimated probable maximum pre-tax gross and net loss exposure in a one in two hundred and fifty year hurricane event in the Gulf of Mexico would approximate $168 million and $32 million, respectively, including the cost of reinsurance reinstatement premiums. There are a number of significant assumptions and related variables related to such an estimate including the size, force and path of the hurricane, the various types of the insured risks exposed to the event at the time the event occurs and the estimated costs or damages incurred for each insured risk. There can be no assurances that the gross and net loss amounts that the Company could incur in such an event or in any hurricanes that may occur in the Gulf of Mexico would not be materially higher than the estimates discussed above given the significant uncertainties with respect to such an estimate.

The occurrence of large loss events could reduce the reinsurance coverage that is available to us and could further weaken the financial condition of our reinsurers, which could have a material adverse effect on our results of operations. Although the reinsurance agreements make the reinsurers liable to us to the extent the risk is transferred or ceded to the reinsurer, ceded reinsurance arrangements do not eliminate our obligation to pay claims to our policyholders. Accordingly, we bear credit risk with respect to our reinsurers. Specifically, our reinsurers may not pay claims made by us on a timely basis, or they may not pay some or all of these claims. Either of these events would increase our costs and could have a material adverse effect on our business. We are required to pay the losses even if a reinsurer fails to meet its obligations under the reinsurance agreement.

Critical Accounting Policies

It is important to understand our accounting policies in order to understand our financial statements. Management considers certain of these policies to be critical to the presentation of the financial results, since they require management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosures at the financial reporting date and throughout the reporting period. Certain of the estimates result from judgments that can be subjective and complex and consequently actual results may differ from these estimates, which would be reflected in future periods.

Our most critical accounting policies involve the reporting of the reserves for losses and loss adjustment expenses (LAE) (including losses that have occurred but were not reported to us by the financial reporting date), reinsurance recoverables, written and unearned premium, the recoverability of deferred tax assets, the impairment of invested assets, accounting for Lloyd s results and the translation of foreign currencies.

Reserves for Losses and LAE. Reserves for losses and LAE represent an estimate of the expected cost of the ultimate settlement and administration of losses, based on facts and circumstances then known. Actuarial methodologies are employed to assist in establishing such estimates and include judgments relative to estimates of future claims severity and frequency, length of time to develop to ultimate, judicial theories of liability and other third party factors which are often beyond our control. Due to the inherent uncertainty associated with the reserving process, the ultimate liability may be different from the original estimate. Such estimates are regularly reviewed and updated and any resulting adjustments are included in the current year s results.

Reinsurance Recoverables. Reinsurance recoverables are established for the portion of the loss reserves that are ceded to reinsurers. Reinsurance recoverables are determined based upon the terms and conditions of reinsurance contracts which could be subject to interpretations that differ from our own based on judicial theories of liability. In addition, we bear credit risk with respect to our reinsurers which can be significant considering that certain of the reserves remain outstanding for an extended period of time. We are required to pay losses even if a reinsurer fails to meet its obligations under the applicable reinsurance agreement.

Written and Unearned Premium. Written premium is recorded based on the insurance policies that have been reported to us and the policies that have been written by agents but not yet reported to us. We must estimate the amount of written premium not yet reported based on judgments relative to current and historical trends of the business being written. Such estimates are regularly reviewed and updated and any resulting adjustments are included in the current year s results. An unearned premium reserve is established to reflect the unexpired portion of each policy at the financial reporting date.

Substantially all of our business is placed through agents and brokers. Since the vast majority of the Company s gross written premium is primary or direct as opposed to assumed, the delays in reporting assumed premium generally do not have a significant effect on the Company s financial statements, since we record estimates for both unreported direct and assumed premium. We also record the ceded portion of the estimated gross written premium and related acquisition costs. The earned gross, ceded and net premiums are calculated based on our earning methodology which is generally pro-rata over the policy period. Losses are also recorded in relation to the earned premium. The estimate for losses incurred on the estimated premium is based on an actuarial calculation consistent with the methodology used to determine incurred but not reported loss reserves for reported premiums.

A portion of the Company s premium is estimated for unreported premium, mostly for the marine business written by our U.K. Branch and Lloyd s Operations. We generally do not experience any significant backlog in processing premiums. Such premium estimates are generally based on submission data received from brokers and agents and recorded when the insurance policy or reinsurance contract is written or bound. The estimates are regularly reviewed and updated taking into account the premium received to date versus the estimate and the age of the estimate. To the extent that the actual premium varies from the estimates, the difference, along with the related loss reserves and underwriting expenses, is recorded in current operations.

Deferred Tax Assets. We apply the asset and liability method of accounting for income taxes whereby deferred 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 basis. In assessing the realization of deferred tax assets, management considers whether it is more likely than not that the deferred tax assets will be realized.

Impairment of Investment Securities. Impairment of investment securities results in a charge to operations when a market decline below cost is other-than-temporary. Management regularly reviews our fixed maturity and equity securities portfolios to evaluate the necessity of recording impairment losses for other-than-temporary declines in the fair value of investments. In general, we focus our attention on those securities whose market value was less than 80% of their cost or amortized cost, as appropriate, for six or more consecutive months. Factors considered in evaluating potential impairment include, but are not limited to, the current fair value as compared to cost or amortized cost of the security, as appropriate, the length of time the investment has been below cost or amortized cost and by how much, our intent and ability to retain the investment for a period of time sufficient to allow for an anticipated recovery in value, specific credit issues related to the issuer and current economic conditions. Other-than-temporary impairment losses result in a permanent reduction of the cost basis of the underlying investment. Significant changes in the factors we consider when evaluating investments for impairment losses could result in a significant change in impairment losses reported in the consolidated financial statements.

As mentioned above, the Company considers its intent and ability to hold a security until the value recovers as part of the process of evaluating whether a security s unrealized loss represents an other-than- temporary decline. The Company s ability to hold such securities is supported by sufficient cash flow from its operations and from maturities within its investment portfolio in order to meet its claims payment and other disbursement obligations arising from its underwriting operations without selling such investments. With respect to securities where the decline in value is determined to be temporary and the security s value is not written down, a subsequent decision may be made to sell that security and realize a loss. Subsequent decisions on security sales are made within the context of overall risk monitoring, changing information, market conditions and assessing value relative to other comparable securities. Management of the Company s investment portfolio is outsourced to third party investment managers. While these investment managers may, at a given point in time, believe that the preferred course of action is to hold securities with unrealized losses that are considered temporary until such losses are recovered, the dynamic nature of the portfolio management may result in a subsequent decision to sell the security and realize the loss, based upon a change in market and other factors described above. The Company believes that subsequent decisions to sell such securities are consistent with the classification of the Company s portfolio as available for sale.

Investment managers are required to notify management of rating agency downgrades of securities in their portfolios as well as any potential investment valuation issues at the end of each quarter. Investment managers are also required to notify management to the extent the investment manager is contemplating a transaction or transactions that may result in a realized loss above a certain threshold. Additionally, investment managers are required to notify management if they are contemplating a transaction or transactions that may result in any realized loss up until a certain period beyond the close of a quarterly accounting period.

Accounting for Lloyd s Results. We record our pro rata share of Syndicate 1221 s assets, liabilities, revenues and expenses, after making adjustments to convert Lloyd s accounting to U.S. GAAP. The most significant GAAP adjustments relate to income recognition. Lloyd s syndicates determine underwriting results by year of account at the end of three years. We record adjustments to recognize underwriting results as incurred, including the expected ultimate cost of losses incurred. These adjustments to losses are based on actuarial analysis of syndicate accounts, including forecasts of expected ultimate losses provided by the syndicate. At the

end of the Lloyd s three-year period for determining underwriting results for an account year, the syndicate will close the account year by reinsuring outstanding claims on that account year with the participants for the account s next underwriting year. The amount to close an underwriting year into the next year is referred to as the reinsurance to close (RITC). The RITC transaction is recorded in the fourth quarter as additional written and earned premium, losses incurred, loss reserves and receivables, all in the same amount. There are no gains or losses recorded on the RITC transaction.

Translation of Foreign Currencies. Financial statements of subsidiaries expressed in foreign currencies are translated into U.S. dollars in accordance with SFAS No. 52, *Foreign Currency Translation,* issued by the FASB. Under SFAS 52, functional currency assets and liabilities are translated into U.S. dollars using period end rates of exchange and the related translation adjustments are recorded as a separate component of *accumulated other comprehensive income*. Statement of income amounts expressed in functional currencies are translated using average exchange rates.

Results of Operations and Overview

The following is a discussion and analysis of our consolidated and segment results of operations for the three months ended March 31, 2007 and 2006. All earnings per share data is presented on a per diluted share basis.

Net income for the three month period ended March 31, 2007 was $19.7 million or $1.17 per share compared to $15.5 million or $0.93 per share for the three month period ended March 31, 2006. Included in these results were net realized capital gains (losses) of $0.01 per share and $(0.02) per share for the three months ended March 31, 2007 and 2006, respectively.

The combined loss and expense ratio (the combined ratio) for both the 2007 and 2006 first quarters was 89.4%. The combined ratio for the 2007 first quarter was reduced by 4.9 loss ratio points for a net loss reserve redundancy of $6.8 million relating to prior years. The combined ratio for the 2006 first quarter was reduced by 3.7 loss ratio points for a net loss reserve redundancy of $3.8 million relating to prior years. Net paid loss ratios for the 2007 and 2006 first quarters were 31.3% and 37.5%, respectively.

Cash flow from operations was $20.1 million for the first three months of 2007 compared to $28.6 million for the comparable period in 2006. The positive cash flow contributed to the growth in invested assets and net investment income. The 2007 and 2006 cash flow from operations were reduced by approximately $21.5 million and $4.4 million for 2005 hurricane loss reinsurance recoveries to be collected from reinsurers in subsequent accounting periods.

Consolidated stockholders equity increased 4% to $574 million or $34.23 per share at March 31, 2007 compared to $551 million or $32.94 per share at December 31, 2006. The increase was primarily due to net income of $19.7 million for the first quarter of 2007.

Revenues. Gross written premium increased 14% to $300.9 million in the first quarter of 2007 from $263.8 million in the first quarter of 2006. The growth in 2007 gross written premium generally reflects a combination of business expansion in both new and existing lines of business coupled with premium rate changes on renewal policies. As discussed below under *Lloyd s Operations Gross Written Premium*, the 2007 first quarter excludes advance premium, however advance premium was recorded as gross written premium in our Lloyd s Operations in the 2006 first quarter. The inclusion or exclusion of advance premium in gross written premium has no impact on revenues or net income for either accounting period since premiums are earned commencing with the effective date of an insurance policy.

The premium rate changes discussed above and below for marine, specialty and professional liability are calculated primarily by comparing premium amounts on policies that have renewed. The premiums are judgmentally adjusted for exposure factors when deemed significant and sometimes represent an aggregation of several lines of business. The rate change calculations provide an indicated pricing trend and are not meant to be a precise analysis of the numerous factors that affect premium rates or the adequacy of such rates to cover all underwriting costs and generate an underwriting profit. The calculation can also be affected quarter by quarter depending on the particular policies and the number of policies that renew during that period. Due to market conditions, these rate changes may or may not apply to new business which may be more competitively priced compared to renewal business. The following table sets forth our gross and net written premium and net earned premium by segment and line of business for the periods indicated:

	Three Months Ended March 31, 2007 Gross Written Premium ($ in thousands)	%		Net Written Premium	Net Earned Premium	2006 Gross Written Premium	%		Net Written Premium	Net Earned Premium
Insurance Companies:										
Marine	$ 84,369	28.0	%	$ 44,927	$ 33,318	$ 81,794	31.0	%	$ 41,515	$ 22,501
Specialty	95,720	31.8	%	58,554	53,612	62,131	23.5	%	40,519	36,134
Professional Liability	20,482	6.8	%	12,192	13,037	18,134	6.9	%	7,626	8,732
Other	8,303	2.8	%	6,375	1,845	188	0.1	%	(16)	(15)
Insurance Companies Total	208,874	69.4	%	122,048	101,812	162,247	61.5	%	89,644	67,352
Lloyd s Operations:										
Marine	77,679	25.8	%	45,488	32,341	90,855	34.4	%	51,403	35,716
Professional Liability	5,478	1.8	%	3,383	2,957	2,020	0.8	%	829	241
Other	8,830	3.0	%	2,100	1,936	8,873	3.4	%	1,550	413
Lloyd s Operations Total	91,987	30.6	%	50,971	37,234	101,748	38.6	%	53,782	36,370
Intercompany elimination		0.0	%			(211)	-0.1	%		
Total	$ 300,861	100.0	%	$ 173,019	$ 139,046	$ 263,784	100.0	%	$ 143,426	$ 103,722

Gross Written Premium

Insurance Companies Gross Written Premium

Marine Premium. The gross written premium for the 2007 first quarter consisted of 31% marine liability, 18% offshore energy, 9% cargo, 9% transport, 14% protection and indemnity (P&I) and 9% bluewater hull with the remainder in several other marine related classes of business.

The marine gross written premium for the 2007 first quarter increased 3% compared to the first quarter 2006 reflecting growth primarily from cargo and transport. The average renewal premium rates during the 2007 first quarter increased by approximately 2%. We expect overall flat to moderate declines in 2007 pricing for marine business, including offshore energy business, as additional capacity re-enters the marine market.

Specialty Premium. The gross written premium for the 2007 first quarter consisted of 53% general liability business for small general and artisan contractors, 17% excess casualty business, 6% primary casualty business, 13% commercial middle markets business, 8% personal umbrella business and 3% other targeted commercial risks.

The specialty gross written premium increased 54% for the 2007 first quarter compared to the same period in 2006 reflecting growth across all lines of business including premiums generated from our primary casualty business which started in the 2006 third quarter. The average renewal premium rates decreased by approximately 9% for the contractors liability business in the 2007 first quarter. The recent premium rate decreases for the construction liability business and generally for the specialty lines of business are reflective of softening market conditions which are expected to continue throughout 2007.

Professional Liability Premium. The gross written premium for the 2007 first quarter consisted of 60% D&O liability coverage for privately held and publicly traded corporations, 33% professional liability coverage for lawyers and other professionals and 7% professional liability coverage for architects and engineers.

The professional liability gross written premium for the 2007 first quarter increased 13%, compared to the same period in 2006. Average overall renewal premium rates for the professional liability business decreased by approximately 4% in the 2007 first quarter. D&O renewal premium rates, included in the overall professional liability rate change, also decreased by approximately 4% in the 2007 first quarter.

Other Premium. The gross written premium for the 2007 first quarter includes inland marine business and European property business which were started by the Company in 2006.

Lloyd s Operations Gross Written Premium

Our gross written premium is based on the amount of Syndicate 1221 s stamp capacity that we provide. Our percentage of participation in the stamp capacity is 100% for both 2007 and 2006. Stamp capacity is a measure of the amount of premium a Lloyd s syndicate is authorized to write based on a business plan approved by the Council of Lloyd s. Syndicate 1221 s stamp capacity is £140 million ($274 million) in 2007 compared to £123 million ($226.0 million) in 2006.

Gross written premium and net written premium decreased approximately 10% and 5% respectively, in the 2007 first quarter compared to the 2006 first quarter. Commencing in 2007, advance premium has been excluded from quarterly gross written premium of our Lloyd s Operations. Advance premium represents gross written premium on bound policies with effective dates subsequent to the end of the quarter. Such excluded amounts in the 2007 first quarter approximated $11 million and will be recorded as gross written premium in future quarterly periods based on their applicable effective dates. The 2006 first quarter gross written premium included $11 million of such advance premium.

The 2007 advance premium amounts have been included in other liabilities on the balance sheet at March 31, 2007. The inclusion of such amounts in gross written premium in 2006 and exclusion of such amounts in the 2007 gross written premium had no impact on revenues or net income for either accounting period since premiums are earned commencing with the effective date of an insurance policy.

Marine Premium. The gross written premium for the 2007 first quarter consisted of 38% cargo and specie, 18% offshore energy and 28% marine liability with the remainder in several other marine related classes of business.

The marine gross written premium for the 2007 first quarter decreased 15% compared to the same period in 2006 due to the timing in the recording of advance premium discussed above. The average renewal premium rates during the 2007 first quarter increased by approximately 2%.

Professional Liability Premium. The gross written premium for the 2007 first quarter consisted of 32% D&O liability coverage for privately held and publicly traded corporations and 68% professional liability coverage for lawyers and other professionals.

Other Premium. The gross written premium for the 2007 first quarter consisted of European property business, and engineering and construction business which provides coverage for construction projects including machinery, equipment and loss of use due to delays and of premium for onshore energy business which principally focuses on the oil and gas, chemical and petrochemical industries with coverages primarily for property damage and business interruption.

Ceded Written Premium. In the ordinary course of business, we reinsure certain insurance risks with unaffiliated insurance companies for the purpose of limiting our maximum loss exposure, protecting against catastrophic losses, and maintaining desired ratios of net premiums written to statutory surplus. The relationship of ceded to written premium varies based upon the types of business written and whether the business is written by the Insurance Companies or the Lloyd s Operations.

The following table sets forth our ceded written premium by segment and major line of business for the periods indicated:

	Three Months Ended March 31, 2007			2006			
	Ceded Written Premium ($ in thousands)	% of Gross Written Premium		Ceded Written Premium		% of Gross Written Premium	
Insurance Companies:							
Marine	$ 39,442	46.7	%	$ 40,279		49.2	%
Specialty	37,166	38.8	%	21,612		34.8	%
Professional Liability	8,290	40.5	%	10,508		57.9	%
Other	1,928	NM		204		NM	
Subtotal	86,826	41.6	%	72,603		44.7	%
Lloyd s Operations:							
Marine	32,191	41.4	%	39,452		43.4	%
Professional Liability	2,095	38.2	%	1,191		59.0	%
Other	6,730	76.2	%	7,323		82.5	%
Subtotal	41,016	44.6	%	47,966		47.1	%
Intercompany elimination		NM		(211	)	NM	
Total	$ 127,842	42.5	%	$ 120,358		45.6	%

NM = not meaningful

The increase in the total dollar amount ceded each year was primarily due to the increase in the gross written premium.

The ratio of total ceded written premium to gross written premium in the 2007 first quarter was 42.5% compared to the 2006 first quarter ratio of 45.6%. The decrease in the ratio of ceded written premium to gross written premium in the 2007 period compared to the same period in 2006 was due to a combination of the following factors:

• Modest reductions in the amounts of marine reinsurance ceded on a pro rata basis by the Insurance Companies and the Lloyd s Operations.

• An increase in the proportion of specialty gross premiums, in which we retain a higher proportion of premium relative to our other lines, to the overall total amount. However, the proportion of ceded premium compared to gross written premium for the specialty business has increased reflective of the growth in relatively new lines of business. Generally the Company reinsures a large percentage of its new lines of business and increases its retention as the business matures over time.

- Increases in our net retentions on the professional liability pro rata reinsurance treaty which renewed April 1, 2006. No changes to retentions occurred for the April 1, 2007 renewal.

Net Written Premium. Net written premium increased 21% in the 2007 first quarter compared to the same period in 2006. The increase in net written premium for the 2007 first quarter is principally due to business expansion in all of the Company s business units coupled with retaining more of the business written.

Net Earned Premium. Net earned premium, which generally lags the increase in net written premium, increased 34% in the 2007 first quarter compared to the same period in 2006 as a result of the increased net written premium discussed above.

Commission Income. Commission income from unaffiliated business was $0.4 million in the 2007 first quarter compared to $1.3 million in the 2006 first quarter. The decline reflects the elimination of the marine pool effective January 1, 2006.

Net Investment Income. Net investment income increased 29% in the 2007 first quarter compared to the same period in 2006 due to the increase in invested assets as a result of the positive cash flow from the increased premium volume, the $123.5 million of net proceeds from the April 2006 7% Senior Notes offering and the increase in the portfolio yield.

Net Realized Capital Gains and Losses. Pre-tax net income included a net realized capital gain of $201,000 for the three months ended March 31, 2007 compared to a net realized capital loss of $424,000 for the 2006 first quarter. On an after-tax basis, the 2007 first quarter net realized capital gain was $129,000 or $ 0.01 per share compared to a net realized capital loss of $276,000 or $0.02 per share for the 2006 first quarter.

Other Income/(Expense). Other income/(expense) for the first quarters of both 2007 and 2006 consisted primarily of foreign exchange gains and losses from our Lloyd s Operations and inspection fees related to the specialty insurance business.

Operating Expenses

Net Losses and Loss Adjustment Expenses Incurred. The ratios of net losses and loss adjustment expenses incurred to net earned premium (loss ratios) for the 2007 and 2006 first quarters were 58.4% and 59.9%. The 2007 and 2006 first quarter loss ratios were favorably impacted by 4.9 and 3.7 loss ratio points, respectively, resulting from a redundancy of prior year loss reserves.

The following tables set forth our net reported loss and LAE loss reserves and net IBNR reserves by segment and line of business as of March 31, 2007 and December 31, 2006:

	March 31, 2007 Net Reported Reserves ($ in thousands)	Net IBNR Reserves	Total Net Loss Reserves	% of IBNR to Total Net Loss Reserves
Insurance Companies:				
Marine	$ 81,546	$ 101,223	$ 182,769	55.4 %
Specialty				
Construction liability	45,283	173,318	218,601	79.3 %
All other liability	19,051	45,359	64,410	70.4 %
Total Specialty	64,334	218,677	283,011	77.3 %
Professional liability	14,690	42,855	57,545	74.5 %
Other (includes run-off business)	10,140	9,638	19,778	48.7 %
Total Insurance Companies	170,710	372,393	543,103	68.6 %
Lloyd s Operations				
Marine	84,347	89,831	174,178	51.6 %
Other	3,696	12,870	16,566	77.7 %
Total Lloyd s Operations	88,043	102,701	190,744	53.8 %
Total Company	$ 258,753	$ 475,094	$ 733,847	64.7 %

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	December 31, 2006 Net Reported Reserves ($ in thousands)	Net IBNR Reserves	Total Net Loss Reserves	% of IBNR to Total Net Loss Reserves
Insurance Companies:				
Marine	$ 83,295	$ 96,098	$ 179,393	53.6 %
Specialty				
Construction liability	40,070	166,179	206,249	80.6 %
All other liability	15,214	39,381	54,595	72.1 %
Total Specialty	55,284	205,560	260,844	78.8 %
Professional liability	14,013	37,558	51,571	72.8 %
Other (includes run-off business)	9,867	9,432	19,299	48.9 %
Total Insurance Companies	162,459	348,648	511,107	68.2 %
Lloyd s Operations				
Marine	77,621	95,876	173,497	55.3 %
Other	3,103	8,409	11,512	73.0 %
Total Lloyd s Operations	80,724	104,285	185,009	56.4 %
Total Company	$ 243,183	$ 452,933	$ 696,116	65.1 %

The above net loss and LAE reserves represent gross reserves for losses and LAE reduced for reinsurance receivable on such amounts as follows:

	March 31, 2007 ($ in thousands)	December 31, 2006
Total gross reserves for losses and LAE	$ 1,606,283	$ 1,607,555
Total reinsurance recoverable on unpaid losses and LAE reserves	872,436	911,439
Total net loss reserves	$ 733,847	$ 696,116

The recoverable amounts above do not include $131.3 million and $108.9 million of reinsurance recoverable for all paid losses at March 31, 2007 and December 31, 2006, respectively, of which $88.1 and $66.6 million, respectively, related to the gross loss payments for the 2005 Hurricanes. With the recording of gross losses, the Company assesses its reinsurance coverage, potential receivables, and the recoverability of the receivables. Losses incurred on business recently written are primarily covered by reinsurance agreements written by companies with whom the Company is currently doing reinsurance business and whose credit the Company continues to assess in the normal course of business.

Our reserving practices and the establishment of any particular reserve reflect management s judgment concerning sound financial practice and do not represent any admission of liability with respect to any claims made against us. No assurance can be given that actual claims made and related payments will not be in excess of the amounts reserved. During the loss settlement period, it often becomes necessary to refine and adjust the estimates of liability on a claim either upward or downward. Even after such adjustments, ultimate liability may exceed or be less than the revised estimates.

There are a number of factors that could cause actual losses and loss adjustment expenses to differ materially from the amount that we have reserved for losses and loss adjustment expenses.

The process of establishing loss reserves is complex and imprecise as it must take into account many variables that are subject to the outcome of future events. As a result, informed subjective judgments as to our ultimate exposure to losses are an integral component of our loss reserving process.

IBNR loss reserves are calculated by the Company s actuaries using several standard actuarial methodologies, including the paid and incurred loss development and the paid and incurred Bornheutter-Ferguson loss methods. Additional analyses, such as frequency/severity analyses, are performed for certain books of business.

While an annual loss reserve study is conducted for each line of business, the timing of such studies varies throughout the year. Additionally, a review of the emergence of actual losses relative to expectations for each line of business is conducted each quarter. A separate analysis of our asbestos and environmental liability exposures is also performed annually and updated quarterly. Any adjustments that result from this review are recorded in the quarter in which they are identified.

The actuarial methods generally utilize analysis of historical patterns of the development of paid and reported losses for each line of business by underwriting year. This process relies on the basic assumption that past experience, adjusted for the effects of current developments and likely trends, is an appropriate basis for predicting future outcomes. This basic assumption is particularly relevant for our marine and energy business written by our Insurance Companies and Lloyd s Operations where we generally rely on the substantial loss development data accumulated over many years to establish IBNR loss reserves for immature underwriting years.

For certain long tail classes of business where anticipated loss experience is less predictable because of the small number of claims and/or erratic claim severity patterns, estimates are based on both expected losses and actual reported losses. These classes include our California contractors liability business and directors and officers liability business, among others. For these classes, we set ultimate losses for each underwriting year reflecting several factors, including our evaluation of loss trends and the current risk environment. The expected ultimate losses are adjusted as the underwriting year matures.

While we have a significant amount of loss development data that is utilized by our actuaries to establish the IBNR loss reserves for our California contractors liability business, there have been significant changes relating to this product and its market that could affect the applicability of our data. For example, one factor that may affect reserves and claim frequency is legislation implemented in California, which generally provides consumers who experience construction defects a method other than litigation to obtain defect repairs. The law, which became effective July 1, 2002 with a sunset provision effective January 1, 2011, provides for an alternative dispute resolution system that attempts to involve all parties to the claim at an early stage. This legislation may impact claim severity, frequency and length of settlement assumptions underlying our reserves. Accordingly, our ultimate liability may exceed or be less than current estimates due to this variable, among others. There were approximately 1,129 specialty construction liability claims open at March 31, 2007 compared to 1,060 at December 31, 2006.

The professional liability business generates third-party claims which also are longer tail in nature. The professional liability policies mostly provide coverage on a claims-made basis, whereby coverage is generally provided only for those claims that are made during the policy period. These claims often involve a lengthy litigation period after being reported. Our professional liability business is relatively immature, as we first began writing the business in late 2001. Accordingly, it will take some time to better understand the reserve trends on this business. Given the limited history of this business, the actuaries generally utilize industry data to initially establish IBNR loss reserves, which are subsequently adjusted based on actual and expected claim emergence as each underwriting year matures. There were approximately 934 professional liability claims open at March 31, 2007 compared to 944 at December 31, 2006.

At the start of each underwriting year, our actuaries and management determine an initial selected ultimate loss ratio for each line of business. Management participation generally includes the underwriter for the particular line of business, executive management, and claims and finance personnel. Generally, such determinations are based on prior year history modified where deemed appropriate for observed changes in premium rates, terms, conditions, exposures, and loss trends. Industry data is generally utilized for new lines of business.

As underwriting years age, for each subsequent quarter and following years, our actuaries, with management, continue to update and refine their estimates of selected ultimate loss ratios for each line of business, by underwriting year, using the actuarial methods referred to above and incorporating relevant factors that generally include actual loss development, recent claims activity, number and dollar amount of open claims, risk characteristics of the particular line of business, the potential effects of changes in underwriting and claims procedures, historic performance relative to expectations and the relationship of the IBNR reserve levels across underwriting years and between similar lines of business. The output of this process results in refinements to the ultimate loss ratios. Such refinements to the ultimate loss ratios for the prior underwriting years generate prior year redundancies or deficiencies recorded in the year such refinements are made.

Asbestos Liability. Our exposure to asbestos liability principally stems from marine liability insurance written on an occurrence basis during the mid-1980s. In general, our participation on such risks is in the excess layers, which requires the underlying coverage to be exhausted prior to coverage being triggered in our layer. In many instances we are one of many insurers who participate in the defense and ultimate settlement of these claims, and we are generally a minor participant in the overall insurance coverage and settlement.

The reserves for asbestos exposures at March 31, 2007 and December 31, 2006 are for: (i) the 2005 fourth quarter settlements of two large claims aggregating approximately $28 million for excess insurance policy limits exposed to class action suits against two insureds involved in the manufacturing or distribution of asbestos products, each settlement is being paid over a two year period that started in 2006; (ii) the 2004 settlement of a large claim approximating $25 million exposed to a class action suit which settlement is being paid over a seven year period that started in June 2005; (iii) other insureds not directly involved in the manufacturing or distribution of asbestos products, but that have more than incidental asbestos exposure for their purchase or use of products that contained asbestos; and (iv) attritional asbestos claims that could be expected to occur over time. Substantially all of our asbestos liability reserves are included in our marine loss reserves.

The Company believes that there are no remaining known claims where it would suffer a material loss as a result of excess policy limits being exposed to class action suits for insureds involved in the manufacturing or distribution of asbestos products. There can be no assurances, however, that material loss development may not arise in the future from existing asbestos claims or new claims given the evolving and complex legal environment that may directly impact the outcome of the asbestos exposures of our insureds.

The following tables set forth our gross and net loss and LAE reserves for our asbestos exposures for the periods indicated, which we believe are subject to uncertainties greater than those presented by other types of claims:

	Three Months Ended March 31, 2007 ($ in thousands)	Year Ended December 31, 2006
Gross of Reinsurance		
Beginning gross reserves	$ 37,171	$ 56,838
Incurred losses & LAE	36	246
Calendar year payments	29	19,913
Ending gross reserves	$ 37,178	$ 37,171
Gross case loss reserves	$ 29,298	$ 29,291
Gross IBNR loss reserves	7,880	7,880
Ending gross reserves	$ 37,178	$ 37,171
Net of Reinsurance		
Beginning net reserves	$ 21,381	$ 30,372
Incurred losses & LAE	290	229
Calendar year payments	36	9,220
Ending net reserves	$ 21,635	$ 21,381
Net case loss reserves	$ 13,932	$ 13,678
Net IBNR loss reserves	7,703	7,703
Ending net reserves	$ 21,635	$ 21,381

To the extent the Company incurs additional gross loss development for its historic asbestos exposure; the Company s allowance for uncollectible reinsurance would increase for the reinsurers that are insolvent, in run-off or otherwise no longer active in the reinsurance business. The Company continues to believe that it will be able to collect reinsurance on the gross portion of its historic gross asbestos exposure in the above table. Net loss development for asbestos exposure was not significant in the 2007 first quarter or in 2006.

Loss reserves for environmental losses generally consist of oil spill claims on marine liability policies written in the ordinary course of business. Net loss reserves for such exposures are included in our marine loss reserves and are not separately identified.

Hurricanes Katrina and Rita. During the 2005 third quarter, the Company recorded gross and net loss estimates of $471 million and $22.3 million, respectively, exclusive of $14.5 million for the cost of excess of loss reinstatement premiums related to Hurricanes Katrina and Rita. Such estimates remain unchanged through December 31, 2006.

The following tables set forth our gross and net loss and LAE reserves, incurred loss and LAE, and payments for Hurricanes Katrina and Rita for the periods indicated:

	Three Months Ended March 31, 2007 ($ in thousands)	Year Ended December 31, 2006
Gross of Reinsurance		
Beginning gross reserves	$ 319,230	$ 465,728
Incurred loss & LAE		
Calendar year payments	64,794	146,498
Ending gross reserves	$ 254,436	$ 319,230
Gross case loss reserves	$ 114,666	$ 172,916
Gross IBNR loss reserves	139,770	146,314
Ending gross reserves	$ 254,436	$ 319,230
Net of Reinsurance		
Beginning net reserves	$ 10,003	$ 19,408
Incurred loss & LAE		
Calendar year payments	3,478	9,405
Ending net reserves	$ 6,525	$ 10,003
Net case loss reserves	$ 3,115	$ 3,628
Net IBNR loss reserves	3,410	6,375
Ending net reserves	$ 6,525	$ 10,003

Our management believes that the estimates for the reserves for losses and loss adjustment expenses are adequate to cover the ultimate cost of losses and loss adjustment expenses on reported and unreported claims. However, it is possible that the ultimate liability may exceed or be less than such estimates. To the extent that reserves are deficient or redundant, the amount of such deficiency or redundancy is treated as a charge or credit to earnings in the period in which the deficiency or redundancy is identified. We continue to review all of our loss reserves, including our asbestos reserves and Hurricanes Katrina and Rita reserves, on a regular basis.

Commission Expense. Commission expense paid to unaffiliated brokers and agents is generally based on a percentage of the gross written premium and is reduced by ceding commissions the Company may receive on the ceded written premium. Commissions are generally deferred and recorded as deferred policy acquisition costs to the extent that they relate to unearned premium. Commission expense as a percentage of net earned premiums in the 2007 first quarter was 12.3% compared to 13.2% for the 2006 comparable period.

Other Operating Expenses. The 43% increase in other operating expenses in the 2007 first quarter compared to the same period in 2006 was attributable primarily to employee-related expenses resulting from expansion of the business and investments in technology to support this growth. Included in the 2007 first quarter operating expenses were $1.6 million in the aggregate for employee stock options, stock grants and stock appreciation rights expense compared to $1.5 million for the same period in 2006.

Income Taxes. The income tax expense was $9.3 million and $7.6 million for the first quarters of 2007 and 2006, respectively. The effective tax rates for the 2007 and 2006 first quarters were 32.2% and 32.8%, respectively. The Company s effective tax rate is less than 35% due to permanent differences between book and tax return income, with the most significant item being tax exempt interest. As of March 31, 2007 and December 31, 2006, the net deferred Federal, foreign, state and local tax assets were $29.5 million and $30.4 million, respectively.

We are subject to the tax regulations of the United States and foreign countries in which we operate. The Company files a consolidated federal tax return, which includes all domestic subsidiaries and the U.K. Branch. The income from the foreign operations is designated as either U.S. connected income or non-U.S. connected income. Lloyd s is required to pay U.S. income tax on U.S. connected income (U.S. source income) written by Lloyd s syndicates. Lloyd s and the IRS have entered into an agreement whereby the amount of tax due on U.S. connected income is calculated by Lloyd s and remitted directly to the IRS. These amounts are then charged to the corporate members in proportion to their participation in the relevant syndicates. The Company s corporate members are subject to this agreement and will receive U.K. tax credits for any U.S. income tax incurred up to the U.K. income tax charge on the U.S. income. The non-U.S. connected insurance income would generally constitute taxable income under the Subpart F income section of the Internal Revenue Code since less than 50% of the Company s premium is derived within the U.K. and would therefore be subject to U.S. taxation when the Lloyd s year of account closes. Taxes are accrued at a 35% rate on our foreign source insurance income and foreign tax credits, where available, are utilized to offset U.S. tax as permitted. The Company s effective tax rate for Syndicate 1221 taxable income could substantially exceed 35% to the extent the Company is unable to offset U.S. taxes paid under Subpart F tax regulations with U.K. tax credits on future underwriting year distributions. U.S. taxes are not accrued on the earnings of the Company s foreign agencies as these earnings are not subject to the Subpart F tax regulations. These earnings are subject to taxes under U.K. tax regulations at a 30% rate.

We have not provided for U.S. deferred income taxes on the undistributed earnings of approximately $28.9 million of our non-U.S. subsidiaries since these earnings are intended to be permanently reinvested in the foreign subsidiary. However, in the future, if such earnings were distributed to the Company, taxes of approximately $1.0 million would be payable on such undistributed earnings and would be reflected in the tax provision for the year in which these earnings are no longer intended to be permanently reinvested in the foreign subsidiary assuming all foreign tax credits are realized.

The Company had net state and local operating loss carryforwards amounting to potential future tax benefits of $6.8 million and $6.0 million at March 31, 2007 and December 31, 2006, respectively. A valuation allowance was established for the full amount of these potential future tax benefits due to the uncertainty associated with their realization. The Company s state and local tax carryforwards at March 31, 2007 expire from 2019 to 2027.

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), an interpretation of FASB Statement No. 109. FIN 48, which becomes effective in 2007, establishes the threshold for recognizing the benefits of tax-return positions in the financial statements as more-likely-than-not to be sustained by the taxing authorities, and prescribes a measurement methodology for those positions meeting the recognition threshold. The Company s adoption of FIN 48 at January 1, 2007 did not have a material effect on its financial condition or results of operations.

Segment Information

The Company classifies its business into two underwriting segments consisting of the Insurance Companies and the Lloyd s Operations, which are separately managed, and a Corporate segment. Segment data for each of the two underwriting segments include allocations of revenues and expenses of the Navigators Agencies and the Parent Company s expenses and related income tax amounts previously reported separately.

The Corporate segment consists of the Parent Company s investment income, interest expense and the related tax effect.

We evaluate the performance of each segment based on its underwriting and net income results. The Insurance Companies and the Lloyd s Operations results are measured by taking into account net earned premiums, incurred losses and loss adjustment expenses, commission expense and other underwriting expenses. The Corporate segment consists of the Parent Company s investment income, interest expense and related tax effect. Each segment also maintains its own investments, on which it earns income and realizes capital gains or losses. Our underwriting performance is evaluated separately from the performance of our investment portfolios.

Following are the financial results of the Company s two underwriting segments.

Insurance Companies

Our Insurance Companies consist of Navigators Insurance Company, including its U.K. Branch, and Navigators Specialty Insurance Company. Navigators Insurance Company is our largest insurance subsidiary and has been active since 1983. It specializes principally in underwriting marine insurance and related lines of business, specialty liability insurance and professional liability insurance. Navigators Specialty Insurance Company, a wholly owned subsidiary of Navigators Insurance Company, began operations in 1990. It underwrites specialty and professional liability insurance on an excess and surplus lines basis fully reinsured by Navigators Insurance Company. The Navigators Agencies produce business for the Insurance Companies.

Following are the results of operations for the Insurance Companies for the three months ended March 31, 2007 and 2006:

	Three Months Ended March 31, 2007	**2006**
	($ in thousands)	
Gross written premium	$ 208,874	$ 162,247
Net written premium	122,048	89,644
Net earned premium	101,812	67,352
Net losses and LAE	(61,340)	(39,954)
Commission expense	(11,083)	(7,124)
Other operating expenses	(18,769)	(13,433)
Commission income and other income (expense)	489	1,206
Underwriting profit	11,109	8,047
Investment income	13,654	10,410
Net realized capital gains (losses)	243	(75)
Income before income taxes	25,006	18,382
Income tax expense	7,911	5,916
Net income	$ 17,095	$ 12,466
Loss and LAE ratio	60.2 %	59.3 %
Commission expense ratio	10.9 %	10.6 %
Other operating expense ratio(1)	18.0 %	18.2 %
Combined ratio	89.1 %	88.1 %

(1) Includes *other operating* expenses and *commission income and other income (expense).*

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Following are the underwriting results of the Insurance Companies for the three months ended March 31, 2007 and 2006:

	Three Months Ended March 31, 2007 ($ in thousands)						
	Net Earned Premium	Losses and LAE Incurred	Underwriting Expenses	Underwriting Profit/(Loss)	Combined Ratio Loss	Expense	Total
Marine	$ 33,318	$ 20,171	$ 7,113	$ 6,034	60.5 %	21.4 %	81.9 %
Specialty	53,612	31,766	16,492	5,354	59.3 %	30.7 %	90.0 %
Professional Liability	13,037	8,484	4,323	230	65.1 %	33.1 %	98.2 %
Other	1,845	919	1,435	(509)	NM	NM	NM
Total	$ 101,812	$ 61,340	$ 29,363	$ 11,109	60.2 %	28.9 %	89.1 %

	Three Months Ended March 31, 2006 ($ in thousands)						
	Net Earned Premium	Losses and LAE Incurred	Underwriting Expenses	Underwriting Profit/(Loss)	Combined Ratio Loss	Expense	Total
Marine	$ 22,501	$ 13,500	$ 6,046	$ 2,955	60.0 %	26.9 %	86.9 %
Specialty	36,134	21,157	10,524	4,453	58.6 %	29.1 %	87.7 %
Professional Liability	8,732	5,309	2,711	712	60.8 %	31.0 %	91.8 %
Other	(15)	(12)	70	(73)	NM	NM	NM
Total	$ 67,352	$ 39,954	$ 19,351	$ 8,047	59.3 %	28.8 %	88.1 %

Net earned premium of the Insurance Companies increased 51% in the 2007 first quarter compared to the same period last year reflective of business expansion in all business units coupled with increased retention of the business written.

Excluding the 2005 Hurricane Losses, underwriting results generally reflect the favorable industry market conditions over the last three to four years coupled with satisfactory loss trends in the aforementioned periods. The 2007 first quarter loss ratio was favorably impacted by prior year loss reserve redundancies of $5.7 million or 5.6 loss ratio points. The 2006 first quarter loss ratio was favorably impacted by prior year loss reserve redundancies of $3.8 million or 5.6 loss ratio points.

The approximate annualized pre-tax yields on the Insurance Companies investment portfolio, excluding net realized capital gains and losses, was 4.5% for both the 2007 and 2006 first quarters. The average duration of our Insurance Companies invested assets at March 31, 2007 was 4.5 years. Net investment income increased in the 2007 first quarter compared to the same period in 2006 primarily due to the positive cash flows resulting in a larger investment portfolio including the statutory surplus contribution of $100 million from the net proceeds of our April 2006 7% Senior Notes offering.

Lloyd s Operations

The Lloyd s Operations consist of NUAL, which manages Syndicate 1221, Millennium Underwriting Ltd. and Navigators Corporate Underwriters Ltd. Both Millennium Underwriting Ltd. and Navigators Corporate

Underwriters Ltd. are Lloyd s corporate members with limited liability and provide capacity to Syndicate 1221. NUAL owns Navigators Underwriting Ltd., an underwriting managing agency with its principal office in Manchester, England, which underwrites cargo and engineering business for Syndicate 1221. Navigators NV, a wholly owned subsidiary of NUAL located in Antwerp, Belgium, produces transport liability, cargo and marine liability premium on behalf of Syndicate 1221. The Lloyd s Operations and Navigators Management (UK) Limited, a Navigators Agency which produces business for the U.K. Branch, are subsidiaries of Navigators Holdings (UK) Limited located in the United Kingdom.

Syndicate 1221 has stamp capacity of £140 million ($274 million) in 2007 compared to £123 million ($226 million) in 2006. Stamp capacity is a measure of the amount of premium a Lloyd s syndicate is authorized to write based on a business plan approved by the Council of Lloyd s. The Company participates for 100% of Syndicate 1221 s capacity for both the 2007 and 2006 underwriting years.

Syndicate 1221 s stamp capacity is expressed net of commission (as is standard at Lloyd s) of approximately 22.5% for the 2007 underwriting year and 21% for the 2006 underwriting year. The Syndicate 1221 premium recorded in the Company s financial statements is gross of commission. Lloyd s presents its results on an underwriting year basis, generally closing each underwriting year after three years. We make estimates for each underwriting year and timely accrue the expected results. Our Lloyd s Operations included in the consolidated financial statements represent our participation in Syndicate 1221.

Lloyd s syndicates report the amounts of premiums, claims, and expenses recorded in an underwriting account for a particular year to the companies or individuals that participate in the syndicates. The syndicates generally keep accounts open for three years. Traditionally, three years have been necessary to report substantially all premiums associated with an underwriting year and to report most related claims, although claims may remain unsettled after the underwriting year is closed. A Lloyd s syndicate typically closes an underwriting year by reinsuring outstanding claims on that underwriting year with the participants for the next underwriting year. The ceding participants pay the assuming participants an amount based on the unearned premiums and outstanding claims in the underwriting year at the date of the assumption. Our participation in Syndicate 1221 is represented by and recorded as our proportionate share of the underlying assets and liabilities and results of operations of the syndicate since (i) we hold an undivided interest in each asset, (ii) we are proportionately liable for each liability and (iii) Syndicate 1221 is not a separate legal entity. At Lloyd s, the amount to close an underwriting year into the next year is referred to as the reinsurance to close (RITC) transaction. The RITC amounts represent the transfer of the assets and liabilities from the participants of a closing underwriting year to the participants of the next underwriting year. To the extent our participation in the syndicate changes, the RITC amounts vary accordingly. The RITC transaction is recorded in the fourth quarter as additional written and earned premium, losses incurred, loss reserves and receivables, all in the same amount. There are no gains or losses recorded on the RITC transaction.

We provide letters of credit to Lloyd s to support our participation in Syndicate 1221 s stamp capacity as discussed below under the caption *Liquidity and Capital Resources*.

Whenever a member of Lloyd s is unable to pay its debts to policyholders, such debts may be payable by the Lloyd s Central Fund. If Lloyd s determines that the Central Fund needs to be increased, it has the power to assess premium levies on current Lloyd s members up to 3% of a member s underwriting capacity in any one year. The Company does not believe that any assessment is likely in the foreseeable future and has not provided any allowance for such an assessment. However, based on the Company s 2007 capacity at Lloyd s of £140 million, the March 31, 2007 exchange rate of £1 equals $1.97 and in the event of a maximum 3% assessment, the Company would be assessed approximately $8.3 million. In addition, beginning with the 2005 underwriting year, Lloyd s added a second tier of assets to the existing central fund. This second tier is being built up through a compulsory interest bearing loan to the Society of Lloyd s from the Lloyd s members based on the stamp capacity of each syndicate for the respective underwriting year. The funds are invested in assets eligible for Society of Lloyd s solvency. The loans will be repaid on a rolling year basis as each year closes. At March 31, 2007, the Company had $3.8 million of assets loaned to this fund.

Following are the results of operations of the Lloyd s Operations for the three months ended March 31, 2007 and 2006:

	Three Months Ended March 31, 2007	2006
	($ in thousands)	
Gross written premium	$ 91,987	$ 101,748
Net written premium	50,971	53,782
Net earned premium	37,234	36,370
Net losses and LAE	(19,852)	(22,163)
Commission expense	(6,016)	(6,581)
Other operating expenses	(7,520)	(4,975)
Commission income and other income (expense)	(152)	266
Underwriting profit	3,694	2,917
Investment income	2,151	2,007
Net realized capital (losses)	(42)	(349)
Income before income taxes	5,803	4,575
Income tax expense	2,054	1,601
Net income	$ 3,749	$ 2,974
Loss and LAE ratio	53.3 %	60.9 %
Commission expense ratio	16.2 %	18.1 %
Other operating expense ratio (1)	20.6 %	13.0 %
Combined ratio	90.1 %	92.0 %

(1) Includes *other operating expenses* and *commission income and other income (expense).*

The Lloyd s Operations have been experiencing business expansion coupled with improving underwriting results as a result of the generally favorable market conditions for marine and energy business from late 2001 through 2003, and continuing to a lesser extent in 2004. Premium rate increases occurred in 2005 and continued into 2006 following Hurricanes Katrina and Rita, particularly in the offshore energy business.

The 2007 first quarter was favorably impacted by prior year loss reserve redundancies of $1.1 million or 3.0 loss ratio points. The 2006 first quarter was not impacted by prior year loss reserve redundancies.

The increase in other operating expenses was attributable primarily to the increase in employee-related expenses, investments in technology, the increase in the average exchange rate in the 2007 first quarter of $1.95 per £1 from $1.75 per £1 in the first quarter of 2006 and to the increase in the Lloyd s related expenses.

The approximate annualized pre-tax yields on the Lloyd s Operations investment portfolio, excluding net realized capital gains and losses, for the 2007 first quarter was 3.6% compared to 3.5% for the comparable 2006 period. Generally, funds invested at Lloyd s have been invested with a relatively short average duration, which is reflected in the yield, in order to meet liquidity needs. The average duration of our Lloyd s Operations invested assets at March 31, 2007 was 1.6 years. Such yields are net of interest credits to certain reinsurers for funds withheld by our Lloyd s Operations.

Off-Balance Sheet Transactions

There have been no material changes in the information concerning off-balance sheet transactions as stated in the Company s 2006 Annual Report on Form 10-K.

Tabular Disclosure of Contractual Obligations

There have been no material changes in the operating lease or capital lease information concerning contractual obligations as stated in the Company s 2006 Annual Report on Form 10-K. Total reserves for losses and LAE were $1.6 billion at both March 31, 2007 and December 31, 2006. There were no significant changes in the Company s lines of business or claims handling that would create a material change in the percentage relationship of the projected payments by period to the total reserves.

The following table sets forth our contractual obligations with respect to the 7% senior unsecured notes due May 1, 2016 discussed in Note 10 to the Notes to Interim Consolidated Financial Statements, included herein:

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
	($ in thousands)				
7% Senior Notes	$ 208,125	$ 8,750	$ 17,500	$ 17,500	$ 164,375

Investments

The objective of the Company s investment policy, guidelines and strategy is to maximize total investment return in the context of preserving and enhancing shareholder value and statutory surplus of the Insurance Companies. Secondarily, an important consideration is to optimize the after-tax book income.

The investments are managed by outside professional fixed-income and equity portfolio managers. The Company seeks to achieve its investment objectives by investing in cash equivalents and money market funds, municipal bonds, U.S. Government bonds, U.S. Government agency guaranteed and non-guaranteed securities, corporate bonds, mortgage-backed and asset-backed securities and common and preferred stocks. Our investment guidelines require that the amount of the consolidated fixed-income portfolio rated below A- but no lower than BBB- by Standard & Poor s (S&P) or below A3 but no lower than Baa3 by Moody s Investors Service (Moody s) shall not exceed 10% of the total of income and short-term investments. Securities rated below BBB- by S&P or below Baa3 by Moody s combined with any other investments not specifically permitted under the investment guidelines, can not exceed 5% of consolidated stockholders equity. Investments in equity securities that are actively traded on major U.S. stock exchanges can not exceed 20% of consolidated stockholders equity. Our investment guidelines prohibit investments in derivatives other than as a hedge against foreign currency exposures or the writing of covered call options on the equity portfolio.

The Insurance Companies investments are subject to the direction and control of their respective Board of Directors and our Finance Committee. The investment portfolio and the performance of the investment managers are reviewed quarterly. These investments must comply with the insurance laws of New York State, the domiciliary state of Navigators Insurance Company and Navigators Specialty Insurance Company. These laws prescribe the type, quality and concentration of investments which may be made by insurance companies.

In general, these laws permit investments, within specified limits and subject to certain qualifications, in Federal, state and municipal obligations, corporate bonds, preferred stocks, common stocks, mortgages and real estate.

The Lloyd s Operations investments are subject to the direction and control of the Board of Directors and the Investment Committee of NUAL, as well as the Company s Board of Directors and Finance Committee, and represent our share of the investments held by Syndicate 1221. These investments must comply with the rules and regulations imposed by Lloyd s and by certain overseas regulators. The investment portfolio and the performance of the investment managers are reviewed quarterly.

All fixed maturity and equity securities are carried at fair value. The fair value is based on quoted market prices or dealer quotes provided by independent pricing services.

The following tables show our cash and investments as of March 31, 2007 and December 31, 2006:

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March 31, 2007	Fair Value ($ in thousands)	Gross Unrealized Gains	Gross Unrealized (Losses)	Cost or Amortized Cost
Fixed maturities:				
U.S. Government Treasury Bonds, GNMAs and foreign government bonds	$ 201,371	$ 990	$ (1,685)	$ 202,066
States, municipalities and political subdivisions	388,024	2,426	(2,208)	387,806
Mortgage- and asset-backed securities (excluding GNMAs)	530,268	1,445	(3,764)	532,587
Corporate bonds	209,161	1,985	(1,434)	208,610
Total fixed maturities	1,328,824	6,846	(9,091)	1,331,069
Equity securities - common stocks	45,380	6,472	(576)	39,484
Cash	1,628			1,628
Short-term investments	130,202			130,202
Total	$ 1,506,034	$ 13,318	$ (9,667)	$ 1,502,383

December 31, 2006	Fair Value ($ in thousands)	Gross Unrealized Gains	Gross Unrealized (Losses)	Cost or Amortized Cost
Fixed maturities:				
U.S. Government Treasury Bonds, GNMAs and foreign government bonds	$ 206,214	$ 972	$ (2,086)	$ 207,328
States, municipalities and political subdivisions	361,859	2,719	(2,345)	361,485
Mortgage- and asset-backed securities (excluding GNMAs)	489,556	939	(4,488)	493,105
Corporate bonds	201,088	1,672	(1,950)	201,366
Total fixed maturities	1,258,717	6,302	(10,869)	1,263,284
Equity securities - common stocks	37,828	6,297	(348)	31,879
Cash	2,404			2,404
Short-term investments	176,961			176,961
Total	$ 1,475,910	$ 12,599	$ (11,217)	$ 1,474,528

At March 31, 2007 and December 31, 2006, all fixed-maturity and equity securities held by us were classified as available-for-sale.

We regularly review our fixed maturity and equity securities portfolios to evaluate the necessity of recording impairment losses for other-than-temporary declines in the fair value of investments. In general, we focus our attention on those securities whose market value was less than 80% of their cost or amortized cost, as appropriate, for six or more consecutive months. Other factors considered in evaluating potential impairment include the current fair value as compared to cost or amortized cost, as appropriate, our intent and ability to retain the investment for a period of time sufficient to allow for an anticipated recovery in value, specific credit issues related to the issuer and current economic conditions.

As mentioned above, the Company considers its intent and ability to hold a security until the value recovers as part of the process of evaluating whether a security s unrealized loss represents an other-than-temporary decline. The Company s ability to hold such securities is supported by sufficient cash flow from its operations and from maturities within its investment portfolio in order to meet its claims payment and other disbursement obligations arising from its underwriting operations without selling such investments. With respect to securities where the decline in value is determined to be temporary and the security s value is not written down, a subsequent decision may be made to sell that security and realize a loss. Subsequent decisions on security sales are made within the context of overall risk monitoring, changing information, market conditions and assessing value relative to other comparable securities. Management of the Company s investment portfolio is outsourced to third party investment managers. While these investment managers may, at a given point in time, believe that the preferred course of action is to hold securities with unrealized losses that are considered temporary until such losses are recovered, the dynamic nature of the portfolio management may result in a subsequent decision to sell the security and realize the loss, based upon a change in market and other factors described above. The Company believes that subsequent decisions to sell such securities are consistent with the classification of the Company s portfolio as available for sale.

When a security in our investment portfolio has an unrealized loss that is deemed to be other-than-temporary, we write the security down to fair value through a charge to operations. Significant changes in the factors we consider when evaluating investments for impairment losses could result in a significant change in impairment losses reported in the consolidated financial statements. There were no impairment losses recorded in our fixed maturity or equity securities portfolios in the first quarter of 2007 or 2006.

The following table summarizes all securities in an unrealized loss position at March 31, 2007 and December 31, 2006, showing the aggregate fair value and gross unrealized loss by the length of time those securities have continuously been in an unrealized loss position:

	March 31, 2007 Fair Value ($ in thousands)	Gross Unrealized Loss	December 31, 2006 Fair Value	Gross Unrealized Loss
Fixed Maturities:				
U.S. Government Treasury Bonds, GNMAs and foreign government bonds				
0-6 Months	$ 70,111	$ 437	$ 34,085	$ 586
7-12 Months	4,327	23	20,806	86
> 12 Months.	48,446	1,225	69,424	1,414
Subtotal	122,884	1,685	124,315	2,086
States, municipalities and political subdivisions				
0-6 Months	84,805	414	57,747	316
7-12 Months	2,450	36	6,661	80
> 12 Months.	120,780	1,758	118,917	1,949
Subtotal	208,035	2,208	183,325	2,345
Mortgage- and asset-backed securities (excluding GNMAs)				
0-6 Months	178,971	869	174,270	921
7-12 Months	679		10,444	65
> 12 Months.	181,587	2,895	184,515	3,502
Subtotal	361,237	3,764	369,229	4,488
Corporate bonds				
0-6 Months	28,529	188	27,719	185
7-12 Months	988	1	15,503	224
> 12 Months.	73,138	1,245	66,014	1,541
Subtotal	102,655	1,434	109,236	1,950
Total Fixed Maturities.	$ 794,811	$ 9,091	$ 786,105	$ 10,869
Equity securities - common stocks				
0-6 Months	$ 757	$ 91	$ 3,265	$ 158
7-12 Months	150	23	800	72
> 12 Months.	7,999	462	782	118
Total Equity Securities	$ 8,906	$ 576	$ 4,847	$ 348

We analyze the unrealized losses quarterly to determine if any are other-than-temporary. The above unrealized losses have been determined to be temporary and resulted from changes in market conditions.

The following table shows the composition by National Association of Insurance Commissioners (NAIC) rating and the generally equivalent S&P and Moody s ratings of the fixed maturity securities in our portfolio with gross unrealized losses at March 31, 2007. Not all of the securities are rated by S&P and/or Moody s.

NAIC Rating	Equivalent S&P Rating	Equivalent Moody s Rating	Gross Unrealized Loss Amount ($ in thousands)	Percent of Total		Fair Value Amount	Percent of Total	
1	AAA/AA/A	Aaa/Aa/A	$ 8,658	95	%	$ 767,917	97	%
2	BBB	Baa	433	5	%	26,894	3	%
3	BB	Ba						
4	B	B						
5	CCC or lower	Caa or lower						
6	N/A	N/A						
	Total		$ 9,091	100	%	$ 794,811	100	%

At March 31, 2007, the gross unrealized losses in the table directly above are related to fixed maturity securities that are rated investment grade. Investment grade is defined as a security having a NAIC rating of 1 or 2, an S&P rating of BBB- or higher, or a Moody s rating of Baa3 or higher. Unrealized losses on investment grade securities principally relate to changes in interest rates or changes in sector-related credit spreads since the securities were acquired. Any such unrealized losses are recognized in income, if the securities are sold, or if the decline in fair value is deemed other-than-temporary.

The scheduled maturity dates for fixed maturity securities in an unrealized loss position at March 31, 2007 are shown in the following table:

	Gross Unrealized Loss Amount ($ in thousands)	Percent of Total		Fair Value Amount	Percent of Total	
Due in one year or less	$ 244	3	%	$ 35,622	4	%
Due after one year through five years	2,090	23	%	194,868	25	%
Due after five years through ten years	1,175	13	%	121,340	15	%
Due after ten years	1,818	20	%	81,744	10	%
Mortgage- and asset-backed securities	3,764	41	%	361,237	46	%
Total fixed income securities	$ 9,091	100	%	$ 794,811	100	%

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Due to the periodic repayment of principal, the mortgage-backed and asset-backed securities are estimated to have an effective maturity of approximately 5.0 years.

Our realized capital gains and losses for the three months ended March 31, 2007 and 2006 were as follows:

	Three Months Ended March 31, 2007	2006
	($ in thousands)	
Fixed maturities:		
Gains	$ 450	$ 272
(Losses)	(438)	(1,166)
	12	(894)
Equity securities:		
Gains	250	481
(Losses)	(61)	(11)
	189	470
Net realized capital gains (losses)	$ 201	$ (424)

The following table details realized losses in excess of $250,000 from sales and impairments during the first three months of 2007 and 2006 and the related circumstances giving rise to the loss:

Description	Date of Sale	Proceeds from Sale	(Loss) on Sale	Impairment ($ in thousands)	Holdings at March 31, 2007	Net Unrealized (Loss)	# of Months Unrealized Loss Exceeded 20% of Cost or Amortized Cost
Three months ended March 31, 2007 and 2006:							
TIPS(1)	3/31/2007	$5,316	$(335)				
TIPS(1)	3/31/2006	$15,418	$(305)				

(1) Treasury inflation protection securities (TIPS) were sold during the 2007 and 2006 first quarters due to the widening breakeven yield spread between TIPS and Treasuries.

Reinsurance Recoverables

We utilize reinsurance principally to reduce our exposure on individual risks, to protect against catastrophic losses, and to stabilize loss ratios and underwriting results. Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred or ceded to the reinsurer, ceded reinsurance arrangements do not eliminate our obligation to pay claims to our policyholders. Accordingly, we bear credit risk with respect to our reinsurers. Specifically, our reinsurers may not pay claims made by us on a timely basis, or they may not pay some or all of these claims. Either of these events would increase our costs and could have a material adverse effect on our business. We are required to pay the losses even if the reinsurer fails to meet its obligations under the reinsurance agreement. Hurricanes Katrina and Rita increased our reinsurance recoverables significantly which increased our credit risk.

We are protected by various treaty and facultative reinsurance agreements. Our exposure to credit risk from any one reinsurer is managed through diversification by reinsuring with a number of different reinsurers, principally in the United States and European reinsurance markets. To meet our standards of acceptability, when the reinsurance is placed, a reinsurer generally must have an A.M. Best Company and/or Standard & Poor s rating of A or better, or equivalent financial strength if not rated, plus at least $250 million in policyholders surplus. Our Reinsurance Security Committee monitors the financial strength of our reinsurers and the related reinsurance receivables and periodically reviews the list of acceptable reinsurers. The reinsurance is placed either directly by us or through reinsurance intermediaries. The reinsurance intermediaries are compensated by the reinsurers.

The increase in *reinsurance receivable on paid losses* was primarily due to the ceded portion of paid losses resulting from Hurricanes Katrina and Rita which are in the process of being collected from various reinsurers.

The Company continues to periodically monitor the financial condition and ongoing activities of its reinsurers, in order to assess the adequacy of its allowance for uncollectible reinsurance.

Liquidity and Capital Resources

Cash flow provided by operations was $20.1 million and $28.6 million for the three months ended March 31, 2007 and 2006, respectively. The positive operating cash flow was primarily due to the increase in net written premium. Operating cash flow was used primarily to acquire additional investment assets. The 2007 and 2006 cash flow from operations were reduced by approximately $21.5 million and $4.4 million for 2005 hurricane loss reinsurance recoveries to be collected from reinsurers in subsequent accounting periods.

Beginning in 2006, the Company made certain adjustments to the Consolidated Statements of Cash Flows (Cash Flow Statements) to identify the impact of foreign exchange rate changes on each section of the Cash Flow Statement. The interim Cash Flow Statements for 2006 have been restated to reflect this change.

Investments and cash increased to $1,506 million at March 31, 2007 from $1,476 million at December 31, 2006. The increase was due to the positive cash flow from operations. Net investment income was $16.2 million and $12.6 million for the three months ended March 31, 2007 and 2006, respectively.

The approximate annualized pre-tax investment yields of the portfolio, excluding net realized capital gains and losses, was 4.4% for the 2007 first quarter compared to 4.3% for the 2006 first quarter. As of March 31, 2007 and December 31, 2006, all fixed maturity securities and equity securities held by us were classified as available-for-sale.

At March 31, 2007, the weighted average rating of our fixed maturity investments was AA by Standard & Poor s and Aa by Moody s. We believe that we have limited exposure to credit risk since the entire fixed maturity investment portfolio consists of investment-grade bonds. At March 31, 2007, our portfolio had an average maturity of 5.4 years and duration of 4.1 years. Management continually monitors the composition and cash flow of the investment portfolio in order to maintain the appropriate levels of liquidity in an effort to ensure our ability to satisfy claims.

We have a credit facility provided through a consortium of banks. The credit facility was amended in February 2007 to increase the letters of credit available under the facility from $115 million to $180 million and to increase the line of credit under the facility from $10 million to $20 million. Also, the expiration of the credit facility was extended from June 30, 2007 to March 31, 2009. If at that time, the bank consortium does not renew the credit facility, we will need to find other sources to provide the letters of credit or other collateral required to continue our participation in Syndicate 1221. The credit facility, which is denominated in U.S. dollars, is utilized primarily by Navigators Corporate Underwriters Ltd. and Millennium Underwriting Ltd. to fund our participation in Syndicate 1221 which is denominated in British pounds. At March 31, 2007, letters of credit with an aggregate face amount of $105.1 million were issued under the credit facility. The line of credit was unused at March 31, 2007.

The credit facility is collateralized by all of the common stock of Navigators Insurance Company. The credit agreement contains covenants common to transactions of this type, including restrictions on indebtedness and liens, limitations on dividends, stock buy backs, mergers and the sale of assets, maintaining certain consolidated tangible net worth, statutory surplus and other financial ratios. No dividends have been declared or paid by the Company through March 31, 2007. We were in compliance with all covenants at March 31, 2007.

An amendment to the credit facility was approved by the bank consortium in April 2006 for the primary purpose of permitting the Company to issue $125 million of senior unsecured notes. The public debt offering of the senior notes was completed on April 17, 2006.

Our reinsurance has been placed with various U.S. and foreign insurance companies and with selected syndicates at Lloyd s. Pursuant to the implementation of Lloyd s Plan of Reconstruction and Renewal, a portion of our recoverables are now reinsured by Equitas (a separate United Kingdom authorized reinsurance company established to reinsure outstanding liabilities of all Lloyd s members for all risks written in the 1992 or prior years of account).

Time lags do occur in the normal course of business between the time gross losses are paid by the Company and the time such gross losses are billed and collected from reinsurers. Recoverable amounts at March 31, 2007 are anticipated to be billed and collected over the next several years as gross losses are paid by the Company.

Generally, for pro-rata or quota share reinsurers, including pool participants, the Company issues quarterly settlement statements for premiums less commissions and paid loss activity, which are expected to be settled by the end of the subsequent quarter. The Company has the ability to issue cash calls requiring such reinsurers to pay losses whenever paid loss activity for a claim ceded to a particular reinsurance treaty exceeds a predetermined amount (generally $1 million) as set forth in the pro-rata treaty. For the Insurance Companies, cash calls must generally be paid within 30 calendar days. There is generally no specific settlement period for the Lloyd s Operations cash call provisions, but such billings are usually paid within 45 calendar days.

Generally, for excess of loss reinsurers the Company pays monthly or quarterly deposit premiums based on the estimated subject premiums over the contract period (usually one year) which are subsequently adjusted based on actual premiums determined after the expiration of the applicable reinsurance treaty. Paid losses subject to excess of loss recoveries are generally billed as they occur and are usually settled by reinsurers within 30 calendar days for the Insurance Companies and 30 business days for the Lloyd s Operations.

The Company sometimes withholds funds from reinsurers and may apply ceded loss billings against such funds in accordance with the applicable reinsurance agreements.

At March 31, 2007, ceded asbestos paid and unpaid losses recoverable were $21.2 million of which $11.4 million and $1.6 million were due from Equitas and Ace International, respectively. In November 2006, the Company filed arbitration demands against Equitas and Ace International for paid losses recoverable on settled asbestos claims. The approximate ceded paid and unpaid recoverable amounts relating to such arbitrations are $2.7 million for Equitas and $1.6 million for Ace International. For a discussion of our arbitration demands, see Part II Item 1 Legal Proceedings . The Company generally experiences significant collection delays for a large portion of reinsurance recoverable amounts for asbestos losses given that certain reinsurers are in run-off or otherwise no longer active in the reinsurance business. Such circumstances are considered in the Company s ongoing assessment of such reinsurance recoverables.

The Company believes that it has adequately managed its cash flow requirements related to reinsurance recoveries from its positive cash flows and the use of available short-term funds when applicable. However, there can be no assurances that the Company will be able to continue to adequately manage such recoveries in the future or that collection disputes or reinsurer insolvencies will not arise that could materially increase the collection time lags or result in recoverable write-offs causing additional incurred losses and liquidity constraints to the Company. The payment of gross claims and related collections from reinsurers with respect to 2005 Hurricanes could significantly impact the Company s liquidity needs. However, we expect to pay the 2005 Hurricane Losses over a period of years from cash flow and, if needed, short-term investments and expect to collect our paid reinsurance recoverables generally under the terms described above.

We believe that the cash flow generated by the operating activities of our subsidiaries will provide sufficient funds for us to meet our liquidity needs over the next twelve months. Beyond the next twelve months, cash flow available to us may be influenced by a variety of factors, including general economic conditions and conditions in the insurance and reinsurance markets, as well as fluctuations from year to year in claims experience.

Our capital resources consist of funds deployed or available to be deployed to support our business operations. At March 31, 2007 and December 31, 2006, our capital resources were as follows:

	March 31, 2007 ($ in thousands)	**December 31, 2006**
Senior debt	$ 123,587	$ 123,560
Stockholders equity	574,367	551,343
Total capitalization	$ 697,954	$ 674,903
Ratio of debt to total capitalization	17.7 %	18.3 %

The Company completed its public offering of senior debt on April 17, 2006 and received net proceeds of $123.5 million of which $100 million was contributed to the capital and surplus of Navigators Insurance Company. The increase in stockholders equity in 2006 was principally due to 2006 net income of $72.6 million.

We monitor our capital adequacy to support our business on a regular basis. The future capital requirements of our business will depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover losses. Our ability to underwrite is largely dependent upon the quality of our claims paying and financial strength ratings as evaluated by independent rating agencies. In particular, we require (1) sufficient capital to maintain our financial strength ratings, as issued by several ratings agencies, at a level considered necessary by management to enable our Insurance Companies to compete; (2) sufficient capital to enable our Insurance Companies to meet the capital adequacy tests performed by statutory agencies in the United States and the United Kingdom and (3) letters of credit and other forms of collateral that are necessary to support the business.

We primarily rely upon dividends from our subsidiaries to meet our holding company obligations. Since the issuance of the senior debt in April 2006, the holding company cash obligations primarily consist of semi-annual interest payments of $4.4 million. Going forward, the interest payments will be made from a combination of funds at the Parent Company and dividends from its subsidiaries. The dividends have historically been paid by Navigators Insurance Company. At March 31, 2007, the approximate maximum amount available for the payment of dividends by Navigators Insurance Company during 2007 without prior regulatory approval was

$53.6 million. Navigators Insurance Company declared a $2 million dividend in March 2007 which was paid to the Parent Company in April 2007. No dividends were paid by Navigators Insurance Company during 2006.

Condensed Parent Company balance sheets as of March 31, 2007 (unaudited) and December 31, 2006 are shown in the table below:

	March 31, 2007 ($ in thousands)	**December 31, 2006**
Cash and investments	$ 40,718	$ 32,308
Investments in subsidiaries	654,723	634,299
Goodwill and other intangible assets	2,534	2,534
Other assets	8,625	12,939
Total assets	$ 706,600	$ 682,080
Accounts payable and other liabilities	$ 1,048	$ 1,590
Accrued interest payable	3,646	1,458
Deferred compensation payable	3,952	4,129
7% Senior Notes due May 1, 2016	123,587	123,560
Total liabilities	132,233	130,737
Stockholders equity	574,367	551,343
Total liabilities and stockholders equity	$ 706,600	$ 682,080

At March 31, 2007 approximately $4.2 million of investments are held in a tax escrow account on behalf of Navigators Insurance Company until the two-year tax loss carryback period expires.

Deferred compensation payable represents accrued costs for employee stock appreciation rights which are paid by the operating subsidiaries when such stock appreciation rights are exercised.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes in the information concerning market risk as stated in the Company s 2006 Annual Report on Form 10-K.

Item 4. Controls and Procedures

(a) The Chief Executive Officer and Chief Financial Officer of the Company have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under of the Securities Exchange Act of 1934, as amended (the Exchange Act)), as of the end of the period covered by this quarterly report. Based on such evaluation, such officers have concluded that as of the end of such period the Company s disclosure controls and procedures are effective in identifying, on a timely basis, material information required to be disclosed in our reports filed or submitted under the Exchange Act.

(b) There have been no changes during our first fiscal quarter in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

Part II - Other Information

Item 1. **Legal Proceedings**

Except as described below, the Company is not a party to, or the subject of, any material pending legal proceedings which depart from the ordinary routine litigation incident to the kinds of business that it conducts.

At the end of April 2006, the Company was served as a defendant in an action in the United States District Court for the Northern District of Georgia captioned *New Cingular Wireless Headquarters, LLC, et al. v. Marsh & McLennan Companies, Inc., et al.*, along with approximately 100 other defendants. On May 31, 2006, this action, which involved allegations of contingent commissions and bid-rigging in the insurance industry, was conditionally transferred to the United States District Court for the District of New Jersey by the Judicial Panel on Multidistrict Litigation. On April 12, 2007, the Company entered into a Confidential Settlement and Release Agreement with the plaintiffs in this action, pursuant to which all claims against the Company have been dismissed with prejudice. The terms of this confidential settlement did not have a material impact upon the Company s results of operations or financial condition.

On November 22, 2006, the Company filed a demand for arbitration against Equitas, a lead reinsurer participating in excess of loss reinsurance agreements, with respect to unsatisfied loss payment recovery demands that the Company has previously presented to Equitas (the Equitas Arbitration). The recovery demands are for the 2005 settlement of two class action lawsuits involving large asbestos claims (together, the 2005 Settled Claims), which 2005 Settled Claims are being paid through 2007. Equitas has not indicated any dispute with respect to recoveries on related pro rata reinsurance agreements for such 2005 Settled Claims or with respect to excess of loss or pro rata reinsurance for the 2004 Settled Claim referred to below. The aggregate amount of excess of loss recoveries due from Equitas for ceded paid and unpaid losses on the 2005 Settled Claims is approximately $2.7 million.

On November 20, 2006, the Company also filed a demand for arbitration in New York against INA International Insurance Company, n/k/a Ace International (Ace International), a reinsurer participating in pro rata reinsurance agreements, with respect to unsatisfied loss payment recovery demands that the Company has previously presented to Ace International (the Ace International Arbitration). The recovery demands are for the 2005 Settled Claims and for the 2004 settlement of another class action lawsuit involving a third large asbestos claim (the 2004 Settled Claim and, together with the 2005 Settled Claims, the Settled Claims), which 2004 Settled Claim is being paid over seven years beginning in 2005. The aggregate amount of pro rata recoveries due from Ace International for ceded paid and unpaid losses on the Settled Claims is approximately $1.6 million.

The Company has filed its demands for arbitration against Equitas and Ace International in accordance with the respective applicable provisions of the excess of loss reinsurance agreements and the pro rata reinsurance agreements. The Company believes that the refusal of Equitas and of Ace International to satisfy the Company s payment demands is without merit and it intends to vigorously pursue collection of its respective reinsurance recoveries. While it is too early to predict with any certainty the outcome of the Equitas Arbitration or the Ace International Arbitration, the Company believes that the ultimate outcomes would not be expected to have a significant adverse effect on its results of operations, financial condition or liquidity, although an unexpected adverse resolution of either or both of these arbitrations could have a material adverse effect on the Company s results of operations in a particular fiscal quarter or year.

Item 1A. **Risk Factors**

There have been no material changes from the risk factors as previously disclosed in the Company s 2006 Annual Report on Form 10-K.

Item 2. **Unregistered Sales of Equity Securities and Use of Proceeds**

None.

Item 3. **Defaults Upon Senior Securities**

None.

Item 4. **Submissions of Matters to a Vote of Security Holders**

None.

Item 5. **Other Information**

None

Item 6. **Exhibits**

Exhibit No.	**Description of Exhibit**	
11-1	Statement re Computation of Per Share Earnings	*
31-1	Certification of CEO per Section 302 of the Sarbanes-Oxley Act	*
31-2	Certification of CFO per Section 302 of the Sarbanes-Oxley Act	*
32-1	Certification of CEO per Section 906 of the Sarbanes-Oxley Act (This exhibit is intended to be furnished in accordance with Regulation S-K item 601(b)(32)(ii) and shall not be deemed to be filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, or incorporated by reference into any filing under the Securities Act of 1933, except as shall be expressly set forth by specific reference).	*
32-2	Certification of CFO per Section 906 of the Sarbanes-Oxley Act (This exhibit is intended to be furnished in accordance with Regulation S-K item 601(b)(32)(ii) and shall not be deemed to be filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, or incorporated by reference into any filing under the Securities Act of 1933, except as shall be expressly set forth by specific reference).	*

* *Included herein.*

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

The Navigators Group, Inc.
(Registrant)

Date: May 3, 2007

/s / PAUL J. MALVASIO
Paul J. Malvasio
Executive Vice President
and Chief Financial Officer

INDEX OF EXHIBITS

Exhibit No.	**Description of Exhibit**	
11-1	Statement re Computation of Per Share Earnings	*
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