

James River Group, INC
Form 10-K
March 28, 2006
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2005

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
COMMISSION FILE NO. 000-51480

JAMES RIVER GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)
1414 Raleigh Rd., Suite 415
Chapel Hill, North Carolina

(Address of principal executive offices)

05-0539572
(I.R.S. Employer
Identification No.)

27517
(Zip Code)

(919) 883-4171

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common stock, par value \$.01 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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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.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

The initial public offering of the registrant’s common stock was effective on August 8, 2005, and the common stock began trading on the Nasdaq National Market on August 9, 2005, prior to which date there was no public market for the registrant’s common stock.

The number of shares of the registrant’s common stock outstanding on March 23, 2006 was 15,087,308.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive proxy statement for the 2006 Annual Meeting of Stockholders (the 2006 Proxy Statement) to be filed are incorporated by reference into Part III of this report.

FORWARD-LOOKING STATEMENTS

Some of the statements in this Form 10-K are forward-looking statements within the meaning of the Securities Litigation Reform Act of 1995. Forward-looking statements are derived from information that we currently have and assumptions that we make. Anticipated results may not be achieved, and actual results may differ materially, because of both known and unknown risks and uncertainties 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.

Forward-looking statements are identified by words such as “expect”, “intend”, “plan”, “believe”, “anticipate”, “seek” and words of a future or forward-looking nature. These statements relate to, among other things:

- Statements relating to our business and growth strategies, including plans for generating underwriting profits, potential for raising additional debt and opportunistically growing our business;
- Expectations regarding the payment of cash dividends;
- Expectations regarding cash flows related to the regulatory approvals required to transact insurance business;
- Expectations regarding the adequacy of our loss and loss adjustment expense reserves (LAE) and our expectations related to future claims from hurricanes and other severe weather and our ability to adequately reserve for potential catastrophes;
- Expectations regarding return on equity and growth of gross written premiums;
- Expectations that we can retain a greater percentage of our premiums in 2006 than in 2005;
- Belief that we are not exposed to any environmental liability claims other than those which we have specifically underwritten and priced as an environmental exposure;
- Belief that resolution of pending litigation will not have a material adverse effect on our financial position, results of operations or cash flows;
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Belief that we can successfully underwrite workers' compensation accounts in the residential construction industry;

- Expectation that our data warehouse and internal business processing systems will prove to be a competitive advantage for us;
- Belief that we will be able to manage our capital actively in response to changing market conditions;
- Belief that we offer more restrictive coverage than our competitors or standard markets and that we can effectively manage our claims costs through investigative and loss control initiatives;
- Belief that we are able to assertively manage our expenses, including commissions; and
- Any other statements or assumptions that are not historical facts.

Factors that could cause actual results to differ materially from our forward-looking statements include, but are not limited to, those described under “Item 1A. — Risk Factors” and the following:

- Increased competition on the basis of pricing, coverage or other factors may affect financial performance;
 - The cyclical nature of our industry and of our workers’ compensation market may affect our financial performance;
 - Developments in the financial or capital markets may adversely affect the performance of our investments or our ability to raise capital;
 - Effects of war or terrorism could adversely affect our business;
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- Changes in our relationships with the agencies, brokers or agents that distribute our products or our inability to recruit new agencies, brokers or agents may affect our ability to execute our business strategies;
 - Changes in rating agency policies or practices could result in changes in the way we conduct our business which could adversely affect our financial condition and results of operations;
 - A decline in our financial ratings may result in a reduction in new and renewal business;
 - Changes in regulations or laws applicable to our insurance subsidiaries could hinder our ability to execute our business strategies or result in penalties or suspensions that adversely affect our financial condition and results of operations;
 - Changes in the market for our common stock may make it more difficult for us to negotiate potential acquisitions in terms satisfactory to us;
 - Actual outcomes of pending litigation may vary from our expectations; and
 - Changes in legal theories of liability under our insurance policies could adversely affect our financial position and results of operations.
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PART I

Item 1. Business.

WHO WE ARE

James River is an insurance holding company that owns and manages specialty property/casualty insurance companies

with the objective of consistently earning underwriting profits. We currently underwrite in two specialty areas:

- excess and surplus lines in 48 states and the District of Columbia; and
- workers' compensation primarily for the residential construction industry in North Carolina.

Our underwriters evaluate and price each policy individually, and we do not extend underwriting or claims handling authority to third parties. For the year ended December 31, 2005, we wrote \$236.6 million in direct written premiums, earned net income of \$12.1 million and had a combined ratio of 91.6%. A combined ratio of less than 100% generally indicates profitable underwriting prior to the consideration of investment income.

The executives and professional investors who founded our company have significant experience managing, acquiring or investing in insurance operations. Key members of our management team, including J. Adam Abram, our President and Chief Executive Officer, five of our directors and a number of the managers in our excess and surplus lines business, were previously involved together at Front Royal, Inc., another insurance holding company with a similar business focus. Because we wrote our first policy in July 2003, we are not burdened by material loss exposures for years prior to 2003. We did not write any insurance during the 1990's when pricing was more competitive and policy terms were less restrictive than in the current environment. We craft our excess and surplus lines policy terms to manage our exposure to expanding theories of legal liability such as those which have given rise to claims from lead paint, asbestos, mold and construction defects.

We were incorporated in September 2002. In June 2003, we acquired Fidelity Excess and Surplus Insurance Company (Fidelity), which we renamed James River Insurance Company, from American Empire Surplus Lines Insurance Company (American Empire), a member of the American Financial Group. The purchase price totaled \$28.9 million. With the purchase of Fidelity, we acquired surplus lines approval in 40 states and the District of Columbia and insurance licenses in four states. We wrote our first insurance policy in July 2003. In November 2003, we formed Stonewood Insurance Company which wrote its first policy in January 2004.

OUR PRODUCTS

Our subsidiary James River Insurance Company (James River Insurance) writes excess and surplus lines insurance. Excess and surplus lines insurance covers risks that do not fit the underwriting criteria of standard carriers due, usually, to the perceived risk associated with aspects of the insured's business. In contrast to standard carriers that are required to be licensed in the state where the insurance is written, James River Insurance has significantly expanded regulatory freedom to craft policy terms and charge negotiated prices. Generally, James River Insurance offers more restrictive coverage at higher prices than would be offered by the standard market, which is necessary because insureds in the excess and surplus market are generally considered higher risk than those in the standard market. For the year ended December 31, 2005, James River Insurance had \$207.4 million in direct written premiums.

Our subsidiary Stonewood Insurance Company (Stonewood Insurance) writes workers' compensation insurance in North Carolina, primarily for the residential construction industry. Workers' compensation insurance provides coverage for the statutory obligations of employers to pay for medical care and lost wages for employees who are injured in the course of their employment. We focus on the residential construction industry because this hazardous class has relatively high premium rates and we believe we can successfully underwrite these accounts through proactive loss control. This approach requires us to rely on our underwriting and loss control staff to assess the risk of potential insureds. For the year ended December 31, 2005, Stonewood Insurance had \$29.2 million in direct written premiums.

Both James River Insurance and Stonewood Insurance are rated “A–” (Excellent) by A.M. Best. “A–” (Excellent) is the fourth highest of 16 A.M. Best ratings. These ratings are based on matters of concern to policyholders but are not designed or intended for use by investors in evaluating our securities.

OUR APPROACH TO OUR BUSINESS

We believe our approach will help us achieve our goal of delivering superior returns to our stockholders. This approach involves the following:

Generate Underwriting Profits

We intend to generate underwriting profits by minimizing our underwriting expenses and focusing on underwriting specialty insurance risks where we can use our expertise to price and structure policies to minimize our claims expenses.

Operate at a Lower Expense Ratio Than Many of Our Competitors. We believe that we are able to achieve a lower expense ratio than many of our competitors because of our assertive management of costs, including commissions. In 2005, our Excess and Surplus Insurance segment had a statutory expense ratio of 19.0% prior to the impact of an intercompany reinsurance pooling agreement. According to the 2005 edition of Best's Aggregates & Averages Property/Casualty, from 2000 through 2004, which we believe is the latest data available, the United States excess and surplus lines sector had an average statutory expense ratio of 30.9%.

Focus on Specialty Insurance Markets. By focusing on specialty markets in which our underwriters have particular expertise and in which we have fewer competitors than in standard markets, we have greater freedom to price and structure our products and to utilize loss control measures to target maximum profitability. For example, in our Excess and Surplus Insurance segment, we seek an underwriting profit by generally offering a combination of higher prices and more restrictive policy terms than standard carriers. Our insureds, on the other hand, generally present higher risk than that presented by the insureds of standard carriers.

Underwrite Each Risk Individually. We believe our goal of earning underwriting profits is best accomplished through careful risk selection combined with a thoughtful approach to setting the terms and conditions of the policies for these risks. We individually underwrite each risk and do not extend underwriting authority to brokers, agents or third parties. Our underwriting team leaders have an average of 28 years of industry experience. A substantial portion of our underwriters' compensation is linked to the underwriting profit produced by the policies they underwrite. This approach has the potential drawback of requiring us to rely heavily on experienced underwriters who can tailor coverages and to be particularly careful in selecting the policies we bind. Our underwriters regularly interact with our claims personnel to aid in underwriting decisions and policy form development. In our Workers' Compensation Insurance segment, we supplement the underwriting process through on-site inspection of insureds and proactive loss control measures.

Use Timely and Accurate Data. We design our internal processing and data collection systems to provide our management team with accurate and relevant information in real-time. Our data warehouse collects premium, commission and claims data, including detailed information regarding policy price, terms, conditions and the insured's business. This data allows us to analyze trends in our business, including results by individual agent or broker, underwriter and class of business. We rely on our technology systems in this process.

Actively Manage Claims. We believe that actively managing our claims is an important aspect of keeping loss and LAE low and accurately setting reserves. We attempt to investigate and settle all covered claims promptly and thoroughly generally through direct contact with the insured and other affected parties. When our investigation leads us to conclude that a claim or claims are not validly covered under the policy form, we vigorously contest payment and are willing to pursue prosecution for claims fraud.

Opportunistically Grow Our Business

We plan to grow our business opportunistically in markets where we can use our specialized expertise to generate consistent underwriting profits.

Expand Existing Operations. We intend to expand our existing insurance operations to increase our market share in our chosen markets. Both our Excess and Surplus Insurance and Workers' Compensation Insurance segments are relatively new, and we believe they can capture more market share. A potential drawback of our specialized approach is that we may be more vulnerable to adverse events that affect the excess and surplus lines and workers' compensation insurance business than companies which have more diversified business.

Excess and Surplus Insurance Segment. We seek to grow the business of our Excess and Surplus Insurance segment by taking advantage of opportunities for enhanced product offerings, additional coverages, geographic expansion and increased penetration in our existing markets. We have expanded the Excess and Surplus Insurance segment from seven underwriting divisions at inception to 12 at December 31, 2005. We continue to make selective broker appointments which helps drive our market penetration. In 2005, our Excess & Surplus Insurance segment wrote \$207.4 million in direct written premiums. A.M. Best estimated total premiums in this market to be \$33.0 billion in 2004.

Workers' Compensation Insurance Segment. We seek to expand our Workers' Compensation Insurance segment by adding selected agents and achieving greater market penetration. Our Workers' Compensation Insurance segment wrote \$29.2 million in direct written premium in 2005. We estimate, based in part on 2002 data (the latest we believe to be available) from the North Carolina Rate Bureau, that the North Carolina workers' compensation market for the portions of the construction industry in which we compete is approximately \$450.0 million in direct written premiums.

Acquire Additional Specialty Insurance Businesses. We intend to pursue acquisitions of specialty insurance businesses which have particular expertise in their markets. Our management team has significant industry experience in acquisitions of insurance companies and managing general agencies.

Manage Specialized Underwriting and Claims on a Decentralized Basis

Our holding company structure allows our specialized insurance operations to focus on achieving an underwriting profit in their markets. Our decentralized underwriting and claims handling personnel are able to respond effectively to changing conditions in the particular markets in which they operate. We handle capital raising, mergers and acquisitions, investor and rating agency relations, financial reporting and other support functions at the holding company level. This decentralized approach means management must make special efforts to ensure the Company is coordinated as a whole.

Manage Capital Actively

We intend to expand our business and capital base to capitalize on opportunities to earn an underwriting profit or to reduce our business and capital base if attractive underwriting opportunities are not available. We expect to finance our future operations with a combination of debt and equity and do not intend to seek to raise or retain more capital than we believe we can profitably deploy in a reasonable time frame. We may not, however, always be able to raise

capital when needed. Our ratings from A.M. Best are very important to us and maintaining them will be a principal consideration in our decisions regarding capital.

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Maintain a Strong Balance Sheet

We intend to set reserves conservatively and monitor reinsurance recoverables exposure carefully in order to maintain a strong balance sheet. We focus on making our profits from underwriting and do not expect above-market returns or risks in our investment portfolio. As a consequence, our investment returns may not be as high as those earned by some of our competitors. Our balance sheet is not burdened with material legacy liabilities related to loss exposures for years prior to 2003.

BUSINESS SEGMENTS

James River operates in two principal segments: Excess and Surplus Insurance (through our James River Insurance subsidiary) and Workers' Compensation Insurance (through our Stonewood Insurance subsidiary). The following table shows our premiums by segment:

	Excess and Surplus Insurance	Workers' Compensation Insurance (in millions)	Total
Year ended December 31, 2005:			
Direct written premiums	\$ 207.4	\$ 29.2	\$ 236.6
Gross written premiums	207.4	33.6	241.0
Net written premiums	111.1	29.5	140.6
Net earned premiums	91.4	26.1	117.5
Year ended December 31, 2004:			
Direct written premiums	\$ 133.4	\$ 9.2	\$ 142.6
Gross written premiums	133.4	9.2	142.6
Net written premiums	112.4	7.8	120.2
Net earned premiums	70.5	5.2	75.7
Year ended December 31, 2003:			
Direct written premiums	\$ 36.8	\$ —	\$ 36.8
Gross written premiums	36.8	—	36.8
Net written premiums	27.4	—	27.4
Net earned premiums	5.1	—	5.1

The amounts presented in this “Business” section do not reflect the impact of the intercompany reinsurance pooling arrangement that allocates our overall insurance results between our insurance companies. For 2004, James River Insurance had a 70% share, and Stonewood Insurance had a 30% share of the intercompany pool. For 2005 and 2006, James River Insurance has an 80% share, and Stonewood Insurance has a 20% share of the intercompany pool.

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Additional financial information regarding our segments is presented in Note 20 of the notes to our 2005 audited consolidated financial statements appearing elsewhere in this Form 10-K.

Excess and Surplus Insurance

Excess and surplus lines insurance focuses on insureds that generally cannot purchase insurance from standard lines insurers due typically to perceived risk related to their businesses. Our Excess and Surplus Insurance segment reflects the operations of James River Insurance. James River Insurance underwrites property/casualty insurance on an excess and surplus lines basis in 48 states and the District of Columbia. James River Insurance wrote its first policy effective July 1, 2003 and sells its policies through a network of independent wholesale and retail brokers throughout the United States.

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Products

James River Insurance's underwriting is organized in 12 underwriting divisions, each of which focuses on a specific industry group or coverage. Every policy issued by James River Insurance is produced by a surplus lines broker and individually underwritten by a James River Insurance underwriter.

Companies that underwrite on an excess and surplus lines basis operate under a different regulatory regime than standard market carriers. Excess and surplus lines carriers are generally permitted to craft the terms of the insurance contract to suit the particular risk they are assuming. Also, excess and surplus lines carriers are, for the most part, free of rate regulation. In contrast, licensed carriers are generally required to use approved insurance forms and to charge rates that have been authorized by or filed with state insurance departments.

James River Insurance writes insurance on both an "occurrence" form and a "claims made and reported" form. A policy written on an occurrence form provides coverage to the insured for all losses that occurred during the coverage period, regardless of when the loss is reported. A policy written on a claims made and reported form provides coverage to the insured only for losses that occurred during the coverage period and only if the claim was made and reported to us during a specified reporting period. While it may take many years for us to know the full extent of our loss under a claims made and reported form, that form does provide greater certainty and at an earlier time than alternative forms as to the number of claims to which we are exposed.

Below is a list of our 12 underwriting divisions with their 2005 direct written premiums, maximum policy limit, maximum retained policy limit and 2004 and 2003 direct written premiums. The Life Sciences division wrote its first policy in May 2005 and the Small Business division wrote its first policy in August 2005. In February 2006, we added a new division, Sports and Entertainment.

2005 Direct Written Premiums	2005 Maximum Policy Limit	2005 Maximum Retained Policy Limit (in millions)	2004 Direct Written Premiums	2003 Direct Written Premiums
\$ 37.6	\$ 2.0	\$ 1.0	\$ 21.5	\$ 5.3

Manufacturers and
Contractors

Excess Casualty	30.9	8.0	0.5	21.6	4.3
General Casualty	30.0	1.0	1.0	22.4	8.2
Allied Health	29.5	5.0	1.0	25.7	8.8
Professional Liability	23.0	5.0	1.0	16.8	4.9
Excess Property	20.1	25.0(a)	1.0	6.5	2.0
Primary Property	12.4	33.4(a)	1.0	10.4	2.5
Energy	12.2	5.0	1.0	5.7	0.8
Healthcare	5.1	3.0	1.0	1.6	—
Environmental	4.1	5.0	1.0	1.2	—
Life Sciences	2.3	2.0	1.0	—	—
Small Business	0.2	1.0	1.0	—	—
Total	\$ 207.4			\$ 133.4	\$ 36.8

(a) Individual policies may include multiple individually-scheduled properties. We purchase facultative reinsurance for per risk limits in excess of \$15.0 million.

Manufacturers and Contractors writes primary general liability coverage for a number of risk classes including manufacturers of consumer goods, industrial equipment manufacturers and distributors, contractors and commercial goods manufacturers and service providers. We typically issue a \$1.0 million per occurrence limit in this division and retain the entire risk. The individual overseeing this division has 37 years of industry experience. During 2005, we wrote \$37.6 million in direct written premiums in this division. Through 2005, less than 11% of the policy premium for this division came from accounts written on a claims made and reported form. Our average premium per policy in the manufacturers and contractors division was \$33,145 in 2005.

Excess Casualty underwrites excess liability coverage for a variety of risk classes including: manufacturers, contractors, distributors, habitational risks, restaurants, motels, amusement parks and recreational

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facilities. We typically provide between \$1.0 million and \$5.0 million per occurrence limits above a \$1.0 million attachment point. Of this amount, we retain up to \$500,000 of exposure per occurrence and cede the balance to our reinsurers. The underwriter who heads this division has 23 years of industry experience. In 2005, we wrote \$30.9 million in direct written premiums in this division with an average premium per policy of \$24,223.

General Casualty writes primary liability coverage on businesses exposed to premises liability type claims including: mercantile and retail operations, apartments and condominiums, daycare facilities and preschools, marinas and boatyards, janitorial service providers, manufactured home parks, hotels and motels, refuse and garbage collection companies, restaurants, bars, taverns, schools and vocational training centers and shopping centers. The head underwriter in this division has 28 years of experience. We generally write \$1.0 million per occurrence in limits, and we retain the entire \$1.0 million limit. Our General Casualty division generated \$30.0 million in direct written premiums in 2005. Our average premium per policy in this division was \$27,753 in 2005.

Allied Health underwrites casualty insurance for allied health and social service types of risks, such as long term care facilities, independent living apartments, group homes, half-way houses and shelters, drug rehab, home health care and medical staffing enterprises. Physicians are not covered under this division. The underwriter responsible for this unit has 23 years experience in the business. Over 95% of the premiums written by our Allied Health division from

inception through 2005 have been written on a claims made and reported form. We believe this policy form significantly reduces our long-term exposure in this complicated class of business. In 2005, the division wrote \$29.5 million in direct written premiums with an average premium per policy of \$24,368. Typical limits offered are \$1.0 million.

Professional Liability writes professional liability coverage for accountants, architects, engineers, lawyers and certain other professions. We retain \$1.0 million per occurrence in this division. The individual who directs our professional liability division has 35 years of industry experience. All of our professional liability coverage is written on a claims made and reported basis. In 2005, we wrote \$23.0 million in direct written premiums in the professional liability division. Our average premium per policy was \$12,724 in this division in 2005.

Excess Property writes property risks above the primary coverage layer for classes including apartments, condominiums, resorts, municipalities and school boards, retail chains and shopping centers, offices and general commercial properties and property managers. Typical limits offered are \$10.0 million or less. We retain 15% of the first \$5.0 million of limits offered. The underwriter leading our excess property division has 19 years experience in the industry. In 2005, we wrote \$20.1 million in direct written premiums in this division with an average premium per policy of \$30,668.

Primary Property writes classes including property risks of retail chains, shopping centers, offices, healthcare facilities, service and repair facilities, golf and country clubs, restaurants, vacant properties, recreational facilities, light manufacturing facilities, motels and distribution centers. Limits are generally \$5.0 million or less per risk, of which we retain the first \$1.0 million. The individual supervising this division has 19 years experience in the industry. In 2005, James River Insurance wrote \$12.4 million in direct written premium through this division. Our average premium per policy in the primary property division was \$14,613 in 2005.

Energy writes risks engaged in the business of energy production or distribution. Examples of classes underwritten by this division include: oil and gas exploration companies, oil or gas well drillers, oilfield consultants, oil or gas lease operators, oil well servicing companies, oil or gas pipeline construction companies, oil refining operations, petrochemical contractors and pipeline managers. The majority of policies written in this division are for limits of \$1.0 million per occurrence. The underwriter leading this division has 34 years experience in the business. In 2005, the division wrote \$12.2 million in direct written premiums with an average premium per policy of \$45,432.

Healthcare underwrites non-standard physicians' malpractice for individuals or small groups. Our healthcare business is a mix of both surgical and non surgical classes. The underwriter leading this division has 23 years of experience. This division wrote \$5.1 million in direct written premiums in 2005. Our average premium per policy in this division was \$35,716 in 2005. All of the policies written by this division have been issued on a claims made and reported basis. Typical limits offered are \$1.0 million.

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Environmental writes contractors' pollution liability, products pollution liability, site specific pollution liability and consultant's professional liability coverage on a stand alone basis and in conjunction with the general liability coverage. The underwriter heading our environmental division has 37 years experience in the business. Approximately 95% of our environmental policies written in 2005 carry \$1.0 million per occurrence limits. Approximately 32% of our environmental premiums written through 2005 were written on a claims made and reported basis. We generally write environmental coverage for contractors who are not engaged in environmental remediation work on an occurrence form. In 2005, the division wrote \$4.1 million in direct written premiums at an

average premium per policy of \$24,924.

Life Sciences underwrites general liability, products liability and/or professional liability coverage for manufacturers, distributors and developers of biologics (antibodies & vaccines used for the prevention of disease), nutraceuticals (health, nutrition and herbal supplements), human clinical trials and medical devices. Typical policy limits offered range between \$1.0 million to \$2.0 million. The underwriter at the head of this division has 23 years of experience in the industry. This division commenced underwriting in May 2005 and wrote \$2.3 million in direct written premiums in 2005. Our average premium per policy in this division for 2005 was \$41,723.

Small Business concentrates on accounts exposed to premises liability type claims with annual general liability insurance premiums of less than \$10,000. Except for a smaller average premium size, the Small Business division underwrites classes similar to the General Casualty division. All of our Small Business applications are submitted through our internet portal to facilitate quick turnaround and efficient processing. We generally write \$1.0 million per occurrence limits and retain the entire amount. The underwriter leading this division has 19 years of industry experience. Small Business commenced underwriting in August 2005 and wrote \$0.2 million in direct written premiums in 2005. Our average premium per policy in this division in 2005 was \$3,189.

James River Insurance sells policies in 48 states and the District of Columbia. The following table shows James River Insurance's 2005 direct written premiums by state.

State	2005	
	Direct Written Premiums	% of 2005 Direct Written Premiums
	(\$ in millions)	
California	\$ 32.8	15.8%
Florida	30.0	14.5%
Texas	25.0	12.0%
New York	10.2	4.9%
Illinois	7.4	3.6%
Arizona	7.2	3.5%
Georgia	6.9	3.3%
Louisiana	6.6	3.2%
New Jersey	6.0	2.9%
Pennsylvania	5.9	2.8%
All other states	69.4	33.5%
Total	\$ 207.4	100.0%

Marketing and Distribution

James River Insurance markets its products through a select group of licensed excess and surplus lines brokers that we believe can consistently produce reasonable volumes of quality business for James River Insurance. These brokers sell policies for us as well as for other insurance companies. For 2005, this group consisted of 209 retail and wholesale brokers. James River Insurance generally makes broker appointments by broker office and underwriting division. James River Insurance does not grant its brokers any underwriting or claims authority.

Most of our brokers are appointed only for selected classes. When James River Insurance appoints an agency, the appointment does not extend to all employees of the entity. James River Insurance selects its

brokers based upon management's review of the experience, knowledge and business plan of each broker. While many of James River Insurance's brokers have more than one office, we evaluate each office as if it were a separate agency. Often, James River Insurance appoints some but not all offices owned by an agency for specialized lines of business. James River Insurance may designate only a specific employee of the broker as having authority under the agreement. We seek brokers with plans that are consistent with our strategy and underwriting objectives. Brokers must be able to demonstrate an ability to competently produce both the quality and quantity of business sought by James River Insurance. For our more specialized divisions, we seek to appoint brokers that have a similar focus. Brokers who are unable to produce consistently profitable business, or who produce unacceptably low volumes of business, may be terminated. James River Insurance's underwriters regularly visit with brokers in their offices in order to review policies submitted by that agency, discuss products offered by the James River Insurance and market to these brokers.

James River Insurance's largest single broker, CRC Insurance Services, Inc., produced \$46.7 million, or 22.5%, of our Excess and Surplus Insurance segment's direct written premiums in 2005. James River Insurance has appointed 13 of CRC's offices as approved brokers. No other broker accounted for more than 10% of our direct written premiums in 2005. In 2005, we had 60 broker offices that each produced at least \$1 million of direct written premiums.

In 2005, our Excess and Surplus Insurance segment paid an average commission to producers of 14.1% of direct written premiums. We believe this is lower than the average commission paid by our competitors. We believe that our concentration on hard to place risks, combined with a high level of service permits us to manage our commission expense as part of our overall management of the underwriting process. It is important to us that we maintain excellent relationships with the excess and surplus lines brokers who present business to us. Commissions are an important part of that relationship, but not the sole determining factor in which company ultimately writes business for a broker. James River Insurance has not paid any contingent commission and has not entered into any contingent commission arrangements with any brokers.

Underwriting

James River Insurance's staff included 69 individuals directly employed in underwriting policies at February 15, 2006. We believe our internal business processing systems allow us to maintain a high ratio of underwriters to total employees. We believe our "paperless" environment allows us to engage fewer employees in policy administration.

We are very selective in the policies we bind. James River Insurance binds approximately one in every ten submissions. We realize all excess and surplus lines applications have already been rejected by the standard market. If our underwriters cannot reasonably expect to bind coverage at the combination of premium and coverage that meets our standards, they are encouraged to quickly move on to another prospective opportunity. For the year ended December 31, 2005, we received 87,970 submissions, quoted 32,040 policies and bound 8,909 policies for a policy to submission ratio of 10.1%. At December 31, 2005, we had 8,261 policies in force.

When we accept risk in our Excess and Surplus Insurance segment, we are careful to establish terms that are suited to the risk and the pricing. As an excess and surplus lines company, James River Insurance uses its freedom of rate and form assertively in order to make it possible to take on risks that have already been rejected by licensed carriers which have determined they cannot insure these risks on approved forms at filed rates.

We attempt to craft policies that offer affordable protection to insureds by tailoring coverages in ways that make potential losses more predictable and keep claims costs affordable. For example, the punitive damage exclusion,

which was applied to 76% of written premiums for primary casualty policies we wrote on an excess and surplus lines basis in 2005, reduces our exposure to large jury verdicts. Our “defense inside the limits” clause, which we applied to 44% of our primary casualty premiums written in 2005, means that funds we expend defending an insured against a claim are counted against the total policy limit. Our assault and battery exclusion, which we applied to 37% of our primary casualty premiums written in 2005, makes it more possible for us to quantify possible losses from policies where assault claims

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might make results highly unpredictable. Our class limitation endorsement, which we applied to 82% of our 2005 primary casualty written premiums, limits coverage to those risks disclosed on the policy application. We have no material exposure to claims from asbestos, lead paint, silica, mold or nuclear, biological or chemical terrorism.

Claims

James River Insurance's claims department consisted of nine claims professionals who have an average of 15 years of claims experience in the property/casualty industry as of February 15, 2006. The Senior Vice President of Claims is an attorney with 21 years of claims experience in large commercial and specialty insurance claims. Prior to joining James River Insurance, our head of the claims department was a senior officer in charge of claims for the United States division of a multi-national insurer.

James River Insurance's excess and surplus lines business generally results in claims from premises/operations liability, professional liability, first party property losses and products liability. We believe the key to effective claims management is timely and thorough claims investigation (which James River Insurance believes results in accurate reserves, improved defenses and proper settlements). We seek to complete all investigations and adjust reserves appropriately as soon as practicable after the receipt of a claim. We seek to manage the number of claims per adjuster to allow adjusters sufficient time to investigate and settle claims. Each quarter, senior management reviews each case to ensure that the front-line adjuster has recognized and is addressing the key issues in the case and has adjusted the reserve to the appropriate amount. James River Insurance keeps the settlement authority of its front-line adjusters low to ensure the practice of having two or more members of the department participate in the decision as to whether to settle or defend. In addition, cases with unusual damage, liability or policy interpretation issues are subjected to peer review on a weekly basis, and members of the underwriting staff participate in this process. Prior to any scheduled mediation or trial of a claim, claims personnel conduct further peer review to make sure all issues and exposures have been adequately analyzed. James River Insurance believes that effective management of litigation avoids delays and associated additional costs.

The claims staff also contributes to James River Insurance's underwriting operations through its interaction with the underwriting staff. The Senior Vice President for Claims heads the forms committee for James River Insurance which reviews and develops all policy forms and exclusions and is also a member of the underwriting review committee.

Workers' Compensation Insurance

Workers' compensation insurance provides coverage to employers to compensate for employees' medical costs, lost wages, vocational rehabilitation and death benefits for work related injuries or illness. The benefits payments and the duration of such benefits are set by statute and vary with the nature and severity of the injury or disease and the wages, occupation and age of the employee. Our Workers' Compensation Insurance segment provides workers' compensation insurance to narrowly-defined, high hazard employers. Our Workers' Compensation Insurance segment reflects the

operations of Stonewood Insurance. Stonewood Insurance was licensed to write insurance in North Carolina in November 2003 and wrote its first policy effective January 1, 2004. Stonewood Insurance sells its policies through a retail network of independent insurance agencies in North Carolina and is an admitted insurer there.

Target Markets

Stonewood Insurance writes workers' compensation insurance for construction industry accounts in North Carolina with a focus on residential construction. Additionally, Stonewood Insurance provides workers' compensation insurance to selected commercial construction and light manufacturing accounts in North Carolina. For 2005, approximately 78% of Stonewood Insurance's premiums were from customers in the residential construction industry. Examples of the types of risks written by Stonewood Insurance include: carpentry, electrical, painting, excavation, masonry, wallboard, plumbing and roofing. Stonewood Insurance's average annual premium per policy was approximately \$14,316 in 2005. Our senior management team has an average of 22 years of experience focused on workers' compensation for this sector in North Carolina.

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We focus on workers' compensation for the residential construction industry because our management team has extensive experience and expertise in this class of business in North Carolina. We believe that specialized knowledge in a focused geographic market improves our risk selection, loss control and claims management. This hazardous class of business has relatively high premium rates, and we believe we can successfully underwrite these accounts through proactive loss control. We believe that the fact that these operations are hazardous is balanced by the ability of Stonewood Insurance to charge premiums developed for the entire hazardous class while insuring operations we believe are safer than average.

Marketing and Distribution

Stonewood Insurance produced its business through 137 appointed independent agents as of December 31, 2005. These producers generally are selected on the basis of their ability to access profitable workers' compensation business in the construction industry in North Carolina. Stonewood Insurance focuses on high levels of service for its agents.

Approximately 65% of our workers' compensation policy applications through December 31, 2005 were received through our internet-based system. We respond to applications received through our internet-based system within 24 hours. Additionally, we do not have to re-enter data in our underwriting and policy issuance system which reduces our costs and minimizes errors.

Stonewood Insurance pays commissions which it believes are competitive with other insurance carriers offering similar products and also believes that it delivers prompt, efficient and professional support services. Our Workers' Compensation Insurance segment pays an 8% commission on new and renewal business. Stonewood Insurance has not paid any contingent commissions and has not entered into any contingent commission arrangements with any agent. Our senior management maintains personal contact with the agency force through regular visits to producer's offices. Approximately \$3.2 million (11.0%) of Stonewood Insurance's direct written premiums were derived from one agent, SIA Group, Inc., for the year ended December 31, 2005. Stonewood Insurance sets production goals for each agent and agents not making progress toward production targets can be terminated. Stonewood Insurance offers multiple payment plans for insureds including monthly self reporting, a ten payment plan and other installment payment options.

Underwriting

Stonewood Insurance had eight employees in its underwriting department with an average of 16 years of underwriting experience at February 15, 2006. These employees make all underwriting decisions. Our underwriters review each submission individually and develop rates based on our state filed rates and our customized rating model. None of our agents have underwriting or binding authority. Policy applications must include a loss history for all accounts. Our underwriting staff also determines which accounts require loss control inspections prior to binding. All underwriting is conducted in Stonewood Insurance's main office in Raleigh, North Carolina. During the year ended December 31, 2005, we received 5,384 submissions, quoted 2,780 policies and bound 1,328 policies for a policy to submission ratio of 24.7%.

We underwrite business on a guaranteed cost basis. Guaranteed cost plans allow for fixed premium rates for the term of the insurance policy. Although premium rates are fixed, the final premium on a guaranteed cost plan will vary based on the difference between the estimated payroll at the time the policy is written and the final audited payroll of the customer after the policy expires. It is our policy to audit the payroll for each expired policy. Stonewood Insurance does not offer any loss sensitive policies or policies providing for policyholder dividends. We underwrite workers' compensation insurance only on an occurrence form.

Loss Control

We place a strong emphasis on loss control as an integral part of the underwriting process. Stonewood Insurance has its own experienced loss control department which makes extensive evaluations of potential insureds. Many insureds are inspected prior to binding coverage. The majority of insureds are inspected within 60 days from the effective date of the policy, during which time we may cancel coverage in the

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event of an unsatisfactory inspection. Stonewood Insurance's management believes that its detailed knowledge of the residential construction industry, bolstered by these inspections, plays an important role in their ability to make informed underwriting decisions. A loss control inspection may result in termination of the policy within the first 60 days based on unsafe worksite practices, increased premium based on information collected in the inspection such as the number of employees or type of work being performed or safety recommendations for the contractor. Many loss control inspections generate follow-up inspections to insure that safety recommendations are implemented.

Our loss control department visits job sites to prepare individual evaluations for our underwriters with respect to the safety practices of our insureds or companies that have applied for coverage. Our staff serves as a resource for our insureds to support the promotion of a safe workplace. Our loss control staff has extensive experience developed from years of serving the construction industry. Our loss control staff consists of five employees with an average of 13 years of experience in the industry. We believe that this experience benefits us by allowing us to serve our insureds more efficiently and effectively. In 2005, our loss control staff conducted 1,375 inspections. Our loss control staff reviews a potential insured's safety and loss control procedures and provides direct feedback to our underwriting department. Our workers' compensation policies can be canceled within 60 days based on unsatisfactory loss control reports. Our loss control provides improvement recommendations to potential insureds. Whenever possible, our loss control staff conducts large loss investigation visits for traumatic or fatal incidents. Our loss control specialists are located throughout North Carolina.

Claims

Stonewood Insurance's claims staff, consisting of seven individuals who have an average of six years of claims management experience, retains complete authority for handling claims arising from policies issued by Stonewood Insurance. Stonewood Insurance believes that proper handling of workers' compensation claims includes at least three steps:

- determination of a claimant's eligibility for medical benefits and wage indemnity payments;
- ascertaining the appropriate medical treatment for an injured or ill claimant and providing appropriate, cost-effective treatment of covered medical expenses; and
- returning the claimant to work as soon as the claimant is medically capable of resuming work.

Stonewood Insurance has organized its claims handling process to effectively and efficiently address each of these tasks.

Stonewood Insurance's policy is to initiate an investigation of each claim within 48 business hours of receiving notice thereof. This review is conducted by a member of the claims staff, who develops basic information to determine whether the claim is covered under the policy terms. A typical investigation will include direct contact with the claimant, the claimant's employer and the medical service provider. If the adjuster develops information which suggests the claim may not be covered, additional investigation is commenced. This process may include ordering additional medical exams, surveillance, interviewing witnesses and reviewing police reports. Stonewood Insurance's policy is to promptly pay all sums due under its policies and to vigorously contest claims it judges to be unwarranted or not covered by its policies.

Medical cost containment is a key to Stonewood Insurance's success as a workers' compensation carrier. Under North Carolina law (where all of Stonewood Insurance's workers' compensation business is currently written), insurance companies have the right to direct medical treatment to the physicians of their choice. The North Carolina Industrial Commission sets a medical fee schedule applicable to workers' compensation related medical treatment. Stonewood Insurance reviews the treatment its claimants receive to assure they are being appropriately treated, consistent with the approach most likely to permit a rapid recovery and return to work. All medical bills are reviewed to assure that Stonewood Insurance has been billed the appropriate amount.

At the outset of each claim involving both medical and indemnity payments, Stonewood Insurance develops a strategy designed to chart a course to close the claim. To help implement these strategies,

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Stonewood Insurance remains in contact with injured or ill claimants and their medical providers during the entire period of their recovery and works with employers to modify the worker's duties during a period of convalescence.

In the event that a worker suffers a total disability, Stonewood Insurance's policy is to attempt to reach a total settlement of indemnity and medical claims associated with the claim. Final settlements permit Stonewood Insurance to eliminate the uncertainty associated with setting appropriate reserves for long-term medical care and indemnity payments. North Carolina law allows Stonewood Insurance to reach final settlements on workers' compensation cases.

The Director of Claims conducts a complete file review on each claim with reserves in excess of \$35,000 every quarter. This review process is designed to encourage progress on claims resolution, to assure that reserves set on open claims are appropriate and adequate and to review for appropriate medical treatment and return to work strategies.

RESERVES

Applicable insurance laws require us to maintain reserves to cover our estimated ultimate losses under insurance policies that we write and for LAE relating to the investigation and settlement of policy claims. The reserve for losses and LAE represents the estimated ultimate cost of all reported and unreported losses and LAE incurred and unpaid at the balance sheet date. We do not use discounting (recognition of the time value of money) in establishing our estimated reserve for losses and LAE.

When a claim is reported to one of our insurance subsidiaries, our subsidiary's claims department establishes a "case reserve" for the estimated amount of the ultimate payment as promptly as possible after receiving notice of the claim and developing sufficient information to form a judgment about the probable ultimate loss and LAE associated with that claim. The estimate of the amount of the ultimate loss is based upon various factors such as the type of loss, the severity of the injury or damage, our knowledge of the circumstances surrounding the claim, jurisdiction of the occurrence, policy provisions related to the claim and benefits defined by statute (for our workers' compensation insurance).

In addition to case reserves, we establish reserves on an aggregate basis to provide for losses and LAE that have been incurred but not reported, commonly referred to as "IBNR." Case reserves and IBNR together constitute the total reserve for losses and LAE.

The reserve for losses and LAE is estimated using individual case-basis valuations and statistical analyses. Those estimates are subject to the effects of trends in loss severity and frequency. We have limited historical loss information available in making loss reserve estimates. Several actuarial methods are utilized in the loss reserve estimates. For additional information on our reserving methodology, see "Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations".

Although many factors influence the actual cost of claims and our corresponding reserve estimates, we do not measure and estimate values for all of these variables individually. This is because many of the factors that are known to impact the cost of claims cannot be measured directly, such as the impact on claim costs due to economic inflation, coverage interpretations and jury determinations. In most instances, we rely on our historical experience or industry information to estimate values for the variables that are explicitly used in our reserve analyses. We assume that the historical effect of these unmeasured factors, which is embedded in our experience or industry experience, is representative of future effects of these factors. Where we have reason to expect a change in the effect of one of these factors, we will perform an analysis to quantify the necessary adjustments.

The establishment of loss and LAE reserves makes no provision for the broadening of coverage by legislative action or judicial interpretation or for the extraordinary future emergence of new types of losses not sufficiently represented in our historical experience or which cannot yet be quantified. We regularly analyze our reserves and review our pricing and reserving methodologies so that future adjustments to prior year reserves can be minimized. However, given the complexity of this process, reserves will require continual updates and the ultimate liability may be higher or lower than previously indicated. An independent actuarial consultant reviews our reserves annually.

Shown below is the loss development for business written each year from 2003 through 2005. The table portrays the changes in our loss and LAE reserves in subsequent years from the prior loss estimates based on experience as of the end of each succeeding year.

The first line of the table shows, for the years indicated, our net reserve liability including the reserve for IBNR losses as originally estimated. For example as of December 31, 2003, we estimated that \$3.183 million would be a sufficient reserve to settle all claims not already settled that had occurred prior to December 31, 2003, whether reported or unreported to us.

The next section of the table sets forth the re-estimates in later years of incurred losses, including payments for the years indicated. For example, as reflected in that section of the table, the original reserve of \$3.183 million was re-estimated to be \$3.027 million at December 31, 2004. An increase or decrease in the original estimate can generally be attributed to a combination of factors, including: (i) claims being settled for amounts different than originally estimated and (ii) reserves being increased or decreased for claims remaining open as more information becomes known about those individual claims.

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The net cumulative redundancy (deficiency) represents as of December 31, 2005, the difference between the latest re-estimated liability and the reserve as originally estimated. A redundancy means that the original estimate is higher than the current estimate. A deficiency means that the current estimate is higher than the original estimate. For example, as of December 31, 2005 and based on updated information, we re-estimated that the reserves which were established as of December 31, 2003 were \$753,000 redundant.

The next section of the table shows, by year, the cumulative amounts of losses and LAE paid as of the end of each succeeding year. For example, with respect to the net loss and LAE reserve of \$3.183 million as of December 31, 2003, by the end of 2004 (one year later) \$326,000, had actually been paid in settlement of the claims which pertain to the reserve as of December 31, 2003.

The bottom part of the table shows the impact of reinsurance and reconciles the net reserves shown in the upper portion of the table to gross reserves.

	Year ended December 31,		
	2003	2004	2005
	(in thousands)		
Net liability for losses and LAE as originally estimated:	\$ 3,183	\$ 47,043	\$ 115,979
Net liability estimated as of:			
One year later	3,027	42,135	
Two years later	2,430		
Net cumulative redundancy (deficiency)	753	4,908	
Net cumulative payments as of:			
One year later	326	7,335	
Two years later	402		
Gross liability for loss and LAE as originally estimated:			
Net liability for losses and LAE	\$ 3,183	\$ 47,043	\$ 115,979
Ceded liability for loss and LAE	14,234	15,200	110,514
Gross liability for losses and LAE	\$ 17,417	\$ 62,243	\$ 226,493

As re-estimated one year later:

Net liability for losses and LAE re-estimated	\$	3,027	\$	42,135
Ceded liability for losses and LAE re-estimated		10,477		16,374
Gross liability for losses and LAE re-estimated	\$	13,504	\$	58,509
Gross cumulative redundancy (deficiency)	\$	3,913	\$	3,734

As re-estimated two years later:

Net liability for losses and LAE re-estimated	\$	2,430
Ceded liability for losses and LAE re-estimated		14,147
Gross liability for losses and LAE re-estimated	\$	16,577
Gross cumulative redundancy (deficiency)	\$	840

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REINSURANCE

We enter into reinsurance contracts to limit our exposure to potential losses arising from large risks and to provide additional capacity for growth. Reinsurance involves an insurance company transferring, or “ceding,” a portion of its exposure on a risk to another insurer, the reinsurer. The reinsurer assumes the exposure in return for a portion of the premium. The ceding of liability to a reinsurer does not legally discharge the primary insurer from its liability for the full amount of the policies on which it obtains reinsurance. The primary insurer remains liable for the entire loss if the reinsurer fails to meet its obligations under the reinsurance agreement.

Our reinsurance is contracted under excess of loss and quota share reinsurance contracts. Through June 30, 2004, we retained approximately \$500,000 per risk for all coverages under our excess of loss reinsurance contracts except for primary casualty coverages, for which we retained \$405,000 per risk. Effective July 1, 2004, we increased the retention on our primary casualty excess of loss reinsurance treaty at James River Insurance to \$1.0 million. Effective July 1, 2005, we increased the retention on our property excess of loss reinsurance treaty at James River Insurance to \$1.0 million. Effective January 1, 2006, we increased our retention on our worker compensation excess of loss treaty at Stonewood Insurance Company to \$750,000. As of January 1, 2006, we retain up to \$1.0 million on all primary casualty and primary property business written in the Excess and Surplus Insurance Segment. We retain \$500,000 on excess casualty business and \$750,000 (15% of the first \$5.0 million) on excess property business.

The following is a summary of our casualty reinsurance in place at March 23, 2006:

Line of Business	Company Policy Limit	Reinsurance Coverage	Company Retention
Primary Casualty	Up to \$5.0 million per occurrence	\$4.0 million excess of \$1.0 million	\$1.0 million per occurrence
Excess Casualty	Up to \$8.0 million per occurrence	Variable quota share (1)	\$500,000 per occurrence
Workers' Compensation	Unlimited (benefits prescribed by statute)	\$19.25 million in excess of \$750,000 per occurrence with a maximum of \$9.25 million on any one	\$750,000 per occurrence and losses above \$20.0 million per occurrence and above \$10.0 million

injured worker on any one life

(1) For policies with an occurrence limit of \$1.0 million or higher, the quota share percentage is set such that our retention is \$1.0 million. For all excess casualty policy limits in excess of \$5.0 million, we purchase facultative reinsurance. For policies where we also write the underlying primary casualty limit, the quota share reduces our retention to \$0.1 million which results in a \$1.1 million retention for James River Insurance on that risk.

Our excess of loss property reinsurance treaties renewed on July 1, 2005, and our catastrophe reinsurance program renewed on June 1, 2005. For 2006, all property reinsurance renews on June 1.

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The following table is a summary of our property reinsurance in place as of March 23, 2006:

Line of Business	Company Per Risk Limit	Reinsurance Program	Company Retention
Primary Property	Generally up to \$15.0 million per risk (1)	\$14.0 million excess of \$1.0 million (2)	\$1.0 million per risk
Excess Property	Generally up to \$15.0 million per risk (1)	\$14.0 million excess of \$1.0 million (2) 85% quota share (3)	July 1, 2005 through October 31, 2005, \$1.0 million per risk November 1, 2005 through May 31, 2006, 15% of the first \$5 million per risk

(1) We purchase facultative reinsurance for per risk limits in excess of \$15.0 million.

(2) Primary property and excess property share the same reinsurance treaty for coverage of \$10.0 million excess of \$5.0 million. The \$10.0 million excess of \$5.0 million has maximum coverage for a single event of \$20.0 million and maximum coverage for the life of the treaty of \$20.0 million. For primary property, the reinsurance treaty for \$4.0 million excess of \$1.0 million has maximum coverage for a single event of \$8.0 million and maximum coverage for the life of the treaty of \$16.0 million. For excess property, the reinsurance treaty for \$4.0 million excess of \$1.0 million has maximum coverage for a single event of \$9.0 million and maximum coverage for the life of the treaty of \$12.0 million.

(3) The 85% quota share reinsurance treaty on excess property started November 1, 2005 and ends on May 31, 2006. The purchase of this coverage coincided with our resuming writing excess property coverage after a temporary suspension.

We have a property reinsurance treaty that covers our per occurrence exposure to terrorism as provided under the Terrorism Risk Insurance Act of 2002. The treaty covers \$13.0 million in excess of \$2.0 million per risk.

We monitor our aggregate property exposures by geographic area and use computer models to analyze the risk of severe losses from hurricanes and earthquakes. We measure exposure to these catastrophe losses in terms of probable maximum loss, which is an estimate of the highest amount we would expect to pay on our property portfolio in any one catastrophe event over a specified period of time (referred to as the return period). We manage this potential loss by purchasing catastrophe reinsurance coverage. Effective June 1, 2004, we purchased catastrophe reinsurance

coverage of \$5.0 million per event in excess of our \$2.0 million per event retention. Effective June 1, 2005, we increased our catastrophe reinsurance coverage to \$36.0 million per event in excess of our \$2.0 million per event retention. Our catastrophe reinsurance coverage in place effective June 1, 2005 had one reinstatement in the event we exhausted part or all of the \$36.0 million of coverage. Effective November 1, 2005, we purchased additional catastrophe reinsurance coverage which provides an additional \$6.5 million of coverage through May 31, 2005. At December 31, 2005 losses from Hurricane Katrina exceeded our catastrophe reinsurance coverage limit for a single event. Additionally, we ceded losses from Hurricane Wilma to our catastrophe reinsurance coverage. For our renewal in 2006, we intend to use our aggregate exposure by geographic area analysis to determine the amount of catastrophe reinsurance to purchase. Generally, our catastrophe reinsurance covers earned premium during the policy period. As a result, some premiums on the current in force property insurance policies will be earned during the period covered by catastrophe reinsurance that will be purchased at our next renewal date.

Our primary catastrophic risk is structural property exposures as a result of hurricanes, tornados, hail storms, winter storms and freezing rain. Generally, our strategy is to write hurricane exposed business on an excess basis over another carrier's primary policy, allowing us to avoid high frequency losses that do not exceed the insurance limits of the primary policy. We also wrote primary property insurance which was

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exposed to hurricanes. Effective November 2005, we revised our primary property underwriting guideline with an objective of moving our primary property geographic exposure further back from the coastline.

Reinsurance contracts do not relieve us from our obligations to policyholders. Failure of the reinsurer to honor its obligation could result in losses to us, and therefore, we establish allowances for amounts considered uncollectible. In formulating our reinsurance programs, we are selective in our choice of reinsurers and we consider numerous factors, the most important of which are the financial stability of the reinsurer, its history of responding to claims and its overall reputation. In an effort to minimize our exposure to the insolvency of our reinsurers, our security committee, consisting of our Chief Financial Officer and our corporate actuary, evaluates the acceptability and reviews the financial condition of each reinsurer annually. In addition, our security committee continually monitors rating downgrades involving any of our reinsurers. At December 31, 2005, all but one company on our reinsurance program had an A.M. Best rating of "A" (Excellent) or better or were collateralized with letters of credit or by the trust agreement with American Empire, as described below. At December 31, 2005, there was no allowance for uncollectible reinsurance.

At December 31, 2005, we had reinsurance recoverables on unpaid losses of \$110.5 million and recoverables on paid losses of \$11.5. The following is a summary of our largest reinsurers as of December 31, 2005:

Reinsurer	A.M. Best Rating	Recoverable		Prepaid	Recoverable	
		as of	Funds	Premiums	as a % of	Recoverable
		December	Held and	as of	Total	as a % of
		31,	Collateral	December	Reinsurance	Total Assets
		2005		31,	Recoverable	
				2005		

Hannover Reinsurance (Ireland) Ltd.						
Swiss Reinsurance America Corporation	A+	12.9	—	2.4	10.6%	2.1%
Berkley Insurance Company	A	8.1	0.3	5.4	6.6%	1.3%
Employers Reinsurance Corporation	A	7.9	—	2.4	6.5%	1.3%
Everest Reinsurance Company	A+	7.0	—	1.1	5.7%	1.2%
E&S Reinsurance (Ireland) Ltd.	A	6.0	6.6	—	4.9%	1.0%
Rosemont Reinsurance Limited	NR	5.6	3.5	—	4.6%	0.9%
Aspen Insurance UK Limited	A	4.7	—	2.7	3.8%	0.8%
Beazley Furlonge Limited	A	4.5	—	—	3.7%	0.8%
Quanta Reinsurance, Ltd	B++	4.5	5.0	—	3.7%	0.8%
XL Reinsurance America Inc.	A+	4.5	—	0.5	3.7%	0.8%
Other Reinsurers		32.4	7.2	11.4	26.5%	5.4%
Total		\$ 122.1	\$ 49.2	\$ 25.9	100.0%	20.4%

We did not have reinsurance recoverables greater than \$3.8 million at December 31, 2005 from any reinsurers other than those listed above.

At the time of our acquisition of Fidelity Excess and Surplus Insurance Company in June 2003, Fidelity had a reinsurance agreement with its parent, American Empire Surplus Lines Insurance Company. Under the reinsurance agreement, Fidelity ceded all of its liabilities on all insurance business it wrote or assumed through June 30, 2003 to American Empire. American Empire and Fidelity also entered into a trust agreement, under which American Empire established a trust account with Fidelity as the beneficiary. Under the trust agreement, American Empire must maintain assets with a current fair value greater than or equal to the ultimate net aggregate losses recoverable under the reinsurance agreement. At December 31, 2005, trust assets of \$4.1 million exceeded the ultimate net aggregate losses recoverable under the reinsurance agreement, as required by the trust agreement. The trust assets are limited to cash and investments permitted by Ohio insurance laws. None of the trust assets can be in capital stock or in fixed income securities that are below investment grade. As additional security, Great American

Insurance Company, an affiliate of American Empire, has irrevocably and unconditionally guaranteed the performance by American Empire of all of its obligations under the reinsurance agreement and trust agreement. American Empire and Great American Insurance Company are each rated “A” (Excellent) by A.M. Best.

Effective January 1, 2005, James River Insurance entered into a quota share reinsurance contract with Hannover Reinsurance (Ireland) Limited and E&S Reinsurance (Ireland) Ltd., each of which is rated “A” (Excellent) by A.M. Best. James River Insurance entered into the quota share reinsurance contract to transfer a portion of the risk related to certain lines of business. By transferring risk to the reinsurers, James River Insurance also reduced the amount of

capital required to support its operations. Under terms of the agreement, James River Insurance ceded a portion of its other liability occurrence and primary property lines of business, which includes business written by the General Casualty, Manufacturers and Contractors and Primary Property divisions. James River Insurance receives a commission equal to 25% of ceded earned premium and pays a reinsurer margin of 4.5% of ceded earned premium. The reinsurers do not receive a margin when they are in a loss position on the contract. James River Insurance maintains a funds held account which is credited interest at 3.75% annually. The contract has a loss ratio cap of 115%, which means that we could not cede any losses in excess of a 115% loss ratio to the reinsurers. The reinsurers do not receive a margin when they are in a loss position on the contract. The ceding commission cannot be reduced, but under certain circumstances, based on underwriting results, James River is entitled to an additional profit contingent commission up to an amount equal to all of the reinsurers' profits above the margin. We did not earn an additional profit contingent commission in 2005 based on the underwriting results of business ceded under the treaty. For the year ended December 31, 2005, ceded earned premium related to this quota share treaty were \$40.0 million, ceded loss and LAE was \$36.5 million, our reinsurance ceding commission was \$9.7 million and the reinsurers' margin was \$0. For 2006, James River Insurance did not renew the quota share reinsurance contract or purchase similar reinsurance coverage. As a result, we expect to retain a greater percentage of our premium in 2006 than in 2005.

INVESTMENTS

Investment income is an important component of our earnings. We collect premiums and hold a portion of these funds in reserves until claims are paid. We invest these reserves. In the years that we make an underwriting profit, we are able to retain all investment income. Underwriting losses require us to dedicate a portion of our investment income or capital to cover insurance claims and expenses associated with writing insurance.

Our policy is to invest primarily in high quality fixed maturity securities with a focus on preservation of capital and a secondary focus on maximizing our risk adjusted investment returns. Investment policy is set by the investment committee of the Board of Directors, subject to limits of applicable regulations. Our investment policy is designed to comply with the regulatory investment requirements and restrictions to which our insurance subsidiaries are subject. The policy imposes stringent diversification rules to minimize our potential exposure to any one business sector. The policy also imposes strict requirements for credit quality, as all securities must be investment grade securities when purchased, with a minimum of 90% of our fixed maturity securities being rated "A-" or higher by Standard & Poor's or the equivalent rating from another nationally recognized rating agency. Our investment portfolio is managed by two investment advisors, Earnest Partners LLC and General Re-New England Asset Management, Inc., which operate under guidelines approved by our investment committee. Our investment committee meets periodically and reports to our Board of Directors.

As of December 31, 2005, our fixed maturity security portfolio contained \$64.4 million of mortgage-backed securities representing 19.0% of the total fixed maturity security portfolio. All of these securities are rated Class I by the Securities Valuation Office of the National Association of Insurance Commissioners (NAIC) and are primarily issued by government and government-related agencies, are publicly traded and have market values obtained from an external pricing service. Changes in estimated cash flows due to changes in prepayment assumptions from the original purchase assumptions are revised based on current interest rates and the economic environment.

Mortgage-backed securities (MBSs), including collateralized mortgage obligations, are subject to prepayment risks that vary with, among other things, interest rates. During periods of declining interest

rates, MBSs generally prepay faster as the underlying mortgages are prepaid and refinanced by the borrowers in order to take advantage of the lower rates. As a result, during periods of falling interest rates, proceeds from such prepayments generally must be reinvested at lower prevailing yields. In addition, MBSs that have an amortized cost that is greater than par (i.e., purchased at a premium) may incur a reduction in yield or a loss as a result of such prepayments. Conversely, during periods of rising interest rates, the rate of prepayments generally slows. MBSs that have an amortized value that is less than par (i.e., purchased at a discount) may incur a decrease in yield as a result of a slower rate of prepayments. In order to mitigate these risks, approximately 65.7% of the MBSs we held at December 31, 2005 were either a category of MBSs known as planned amortization class bonds or agency pass-through certificates with 15-year or shorter final maturities, the average life of which is less sensitive to fluctuations in interest rates. The remainder of the MBSs we held was primarily agency pass-through certificates with 30-year final maturities. Our investment portfolio does not permit us to own, and we do not own, any interest only, principal only or residual tranches of MBSs.

The following table sets forth the composition of the Company's portfolio of fixed maturity securities by rating as of December 31, 2005:

Standard and Poor's or Equivalent Designation	Securities Valuation Office Designation	Fair Value (\$ in millions)	% of Fair Value
AAA	1	\$ 221.0	65.1%
AA	1	38.6	11.4%
A	1	72.0	21.2%
BBB	2	7.1	2.1%
BB	3	0.8	0.2%
		\$ 339.5	100.0%

At December 31, 2005, our portfolio of fixed maturity securities contained corporate fixed maturity securities with a fair value of \$95.9 million. The following is a summary of these securities by industry segment as of December 31, 2005:

Segment	Fair Value (\$ in millions)	% of Fair Value
Industrials and Other	\$ 43.3	45.2%
Financial	33.6	35.0%
Utilities	19.0	19.8%
Total	\$ 95.9	100.0%

INFORMATION TECHNOLOGY

As a new company, we had the opportunity to design the architecture for our information systems in a fashion that would allow us to reduce our administrative costs and provide us with useful, reliable, real-time information. Both of our insurance company subsidiaries operate in a "paperless" environment, which eliminates the costs of printing, storing and handling thousands of documents each week. Moreover, by maintaining electronic files on each account, we have been able to facilitate clear communication among personnel responsible for handling matters related to underwriting, servicing and claims, as each has access to full information regarding the account.

Our decentralized approach to managing our business allows us the flexibility to permit each business segment to acquire or construct its own policy management system. Consequently, our workers' compensation unit and our excess and surplus lines units, whose businesses are very different, each use policy management systems that permit them to tailor their work to the type of policies they underwrite. This approach promotes better service and more efficient underwriting. Both business segments have embraced a web-based platform approach to acquiring business. When a web-platform is utilized, an

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agent enters policy application information on a website controlled by one of our insurance company subsidiaries, and the information entered by the agent is automatically transferred to our underwriting system. This eliminates costly data-entry steps in our underwriting process and permits the underwriter to focus on underwriting the account accurately and rapidly.

From our inception, we have been intent on capturing and analyzing our data and building, over time, a robust repository of information we can continually use to improve our decision making. We refer to this repository as our data warehouse. At the same time, we recognize the importance of permitting the business segments to utilize policy management programs that are suited to their business and that no single policy management system is appropriate across specialty disciplines. Our approach is to place the data warehouse behind the policy management systems that are selected by our business segments. While we are still in the build-out phase of the data warehouse, our design permits us to capture all premium, claims and other policy information collected by the policy management systems at our subsidiaries. The data warehouse is easily searchable, collects and names information in a consistent format and will eventually contain most of underwriting or claims information we collect at every level. The data warehouse permits us flexibility with regard to analyzing our business by segment or in the aggregate. As we collect more information, we expect the data warehouse will prove to be a competitive advantage for us.

COMPETITION

The property/casualty insurance industry is highly competitive. We compete with domestic and international insurers, some of which have greater financial, marketing and management resources and experience than we do. We also may compete with new market entrants in the future. Competition is based on many factors, including the perceived market strength of the insurer, pricing and other terms and conditions, services provided, the speed of claims payment, the reputation and experience of the insurer and ratings assigned by independent rating organizations such as A.M. Best. James River Insurance and Stonewood Insurance each currently have a rating from A.M. Best of “A-” (Excellent). Ratings for an insurance company are based on its ability to pay policyholder obligations and are not directed toward the protection of investors.

Today, our primary competitors in the excess and surplus lines sector are Scottsdale Insurance Company (Nationwide Mutual Insurance Company), Markel Corporation, Burlington Insurance Group, Admiral Insurance Company (W. R. Berkley Corporation), Colony Insurance Company (The Argonaut Group) and RLI Corp.

We believe James River Insurance has several competitive advantages. We focus on individually underwritten risks which provide us with the ability to tailor coverage and pricing on each individual risk. We focus on data collection and analysis and benefit from having no material exposure to legacy insurance issues such as asbestos or construction defect coverage.

Our primary competitors in the workers' compensation insurance sector are Builders Mutual Insurance Company, Key Risk (W. R. Berkley Corporation) and Amerisure. We generally compete on the basis of service, as most market competitors have maintained both pricing and underwriting discipline.

We believe Stonewood Insurance has several competitive advantages. For policy applications completed through our internet-based portal, we can provide pricing indications within 24 hours. We believe this is significantly faster than our primary competitors. We are able to significantly improve our efficiency for applications submitted through this system because this data does not have to be re-entered into our underwriting system. In addition our system allows agents to automatically generate customized proposals for insureds. Each agent may also access web-based policy information for all of the business they place with Stonewood Insurance. In addition, unlike a major competitor, Stonewood Insurance does not require insureds to join the North Carolina Home Builders Association. We believe this represents a \$500 or greater average savings to our policyholders relative to that competitor.

REGULATION

We are regulated by insurance regulatory agencies in the states in which we conduct business. State insurance laws and regulations generally are designed to protect the interests of policyholders, consumers

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or claimants, rather than stockholders. The nature and extent of state regulation varies by jurisdiction, and state insurance regulators generally have broad administrative power relating to, among other matters, setting capital and surplus requirements, licensing of insurers and agents, establishing standards for reserve adequacy, prescribing statutory accounting methods and the form and content of statutory financial reports, regulating certain transactions with affiliates and prescribing the types and amounts of investments.

James River Insurance is licensed in Ohio. We must apply for and obtain appropriate new licenses before we can expand into a new state on an admitted basis or offer new lines of insurance that require separate or additional licensing. In most states, James River Insurance operates on a surplus lines basis. While James River Insurance does not have to apply for and maintain a license in those states, it is subject to maintaining suitability standards or approval under each particular state's surplus lines laws to be included as an approved surplus lines carrier.

Stonewood Insurance operates on an admitted basis in its home state of North Carolina. Insurers operating on an admitted basis must file premium rate schedules and policy or coverage forms for review and approval by the insurance regulators. In many states, including North Carolina, rates and policy forms must be approved prior to use, and insurance regulators have broad discretion in judging whether an insurer's rates are adequate, not excessive and not unfairly discriminatory.

We operate as an insurance holding company system and are subject to regulation in the jurisdictions in which our insurance subsidiaries conduct business. These statutes require that each insurance company in the system register with the insurance department of its state of domicile and furnish information concerning the operations of companies within the holding company system that may materially affect the operations, management or financial condition of the insurers within the system domiciled in that state. These statutes also provide that all transactions among members of a holding company system must be fair and reasonable. Transactions between insurance subsidiaries and their parents and affiliates generally must be disclosed to the state regulators, and notice to or prior approval of the applicable state insurance regulator generally is required for any material or extraordinary transaction.

As a holding company with no business operations of our own, our ability to pay dividends to stockholders and meet our debt payment obligations is largely dependent on dividends and other distributions from our insurance subsidiaries. State insurance laws restrict the ability of our insurance subsidiaries to declare stockholder dividends. State insurance regulators require insurance companies to maintain specified levels of statutory capital and surplus. Generally, dividends may only be paid out of earned surplus, and the amount of an insurer's surplus following payment of any dividends must be reasonable in relation to the insurer's outstanding liabilities and adequate to meet its financial needs. Further, prior approval from the insurance departments of our insurance subsidiaries' state of domicile generally is required in order for our insurance subsidiaries to declare and pay "extraordinary dividends" to us. The maximum amount of dividends our insurance subsidiaries can pay us during 2006 without regulatory approval is \$14.5 million.

RATINGS

A.M. Best, which rates insurance companies based on factors of concern to policyholders, rates each of our insurance subsidiaries. Our insurance subsidiaries have a rating of "A-" (Excellent) from A.M. Best. A.M. Best currently assigns 16 ratings to insurance companies, which currently range from "A++" (Superior) to "S" (Rating Suspended). "A-" (Excellent) is the fourth highest rating. In evaluating a company's financial and operating performance, A.M. Best reviews the company's profitability, leverage and liquidity, as well as its book of business, the adequacy and soundness of its reinsurance, the quality and estimated market value of its assets, the adequacy of its loss and LAE reserves, the adequacy of its surplus, its capital structure, the experience and competence of its management and its market presence. A.M. Best's ratings reflect its opinion of an insurance company's financial strength, operating performance and ability to meet its obligations to policyholders. These evaluations are not intended for use by investors in evaluating our securities.

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EMPLOYEES

As of February 15, 2006, we had 160 employees, six of whom were employed by James River, 122 of whom were employed by James River Insurance and 32 of whom were employed by Stonewood Insurance. All of the James River Insurance and Stonewood Insurance employees are employed through arrangements with James River Management Company, Inc. and Stonewood Insurance Management Company, Inc., respectively. We are not a party to any collective bargaining agreements, and we believe that our relations with employees are good.

AVAILABLE INFORMATION

We file reports, such as quarterly results on Form 10-Q, annual results on Form 10-K, ownership information on Forms 3 and 4 and other reports on our financial results, operations and ownership, with the Securities and Exchange Commission. The public may read and copy any materials we file with the Securities and Exchange Commission at their Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the Securities and Exchange Commission at (800) SEC-0330. The Securities and Exchange Commission maintains an internet site, www.sec.gov, which contains reports, proxy and information statements and other information regarding issuers that file electronically with the Securities and Exchange Commission. Copies of all of our filings are available free of charge through our website, www.james-river-group.com.

Item 1A. Risk Factors.

The following factors, as well as factors described elsewhere in this Form 10-K or in our other filings with the SEC, could adversely affect our business, financial condition or results of operations. Other factors not presently known to us or that we presently believe are not material could also affect our business and financial condition.

RISKS RELATED TO OUR BUSINESS

A decline in our financial strength rating may result in a reduction of new or renewal business.

Each of our insurance subsidiaries currently is rated “A-” (Excellent) by A.M. Best, which is the fourth highest of 16 A.M. Best ratings. A.M. Best assigns ratings that are intended to provide an independent opinion of an insurance company's ability to meet its obligations to policyholders and such ratings are not an evaluation directed to investors. A.M. Best focuses on balance sheet strength (including capital adequacy and loss and LAE reserve adequacy), operating performance and business profile. A reduction in our performance in these criteria could result in a downgrade of our rating. A downgrade of this rating could cause our current and future brokers and agents, retail brokers and insureds to choose other, more highly rated competitors. A downgrade of this rating could also increase the cost or reduce the availability of reinsurance to us.

The failure of any of the loss limitations or exclusions we employ, or changes in other claims or coverage issues, could have a material adverse effect on our financial condition or our results of operations.

Various provisions of our policies, such as limitations or exclusions from coverage or choice of forum, which have been negotiated to limit our risks, may not be enforceable in the manner we intend. At the present time, we employ a variety of endorsements to our policies that limit exposure to known risks. As industry practices and legal, judicial, social and other conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the size or number of claims.

In addition, we craft our excess and surplus lines policy terms to manage our exposure to expanding theories of legal liability like those which have given rise to claims for lead paint, asbestos, mold and construction defects. Many of the policies we issue also include conditions requiring the prompt reporting of claims to us and our right to decline coverage in the event of a violation of that condition. In addition, many of our policies limit the period during which a policyholder may bring a claim under the policy, which in many cases is shorter than the statutory period under which such claims can be brought against

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our policyholders. While these exclusions and limitations help us assess and reduce our loss exposure and help eliminate known exposures to certain risks, it is possible that a court or regulatory authority could nullify or void an exclusion or legislation could be enacted modifying or barring the use of such endorsements and limitations. This could result in higher than anticipated losses and LAE which could have a material adverse effect on our financial condition or results of operations. In some instances, these changes may not become apparent until some time after we have issued insurance policies that are affected by the changes. As a result, the full extent of liability under our insurance contracts may not be known for many years after a contract is issued.

We distribute our products through a select group of brokers and agents, two of which account for a significant portion of our business, and there can be no assurance that such relationships will continue.

We distribute our products through a select group of brokers and agents. For the year ended December 31, 2005, 22.5% of James River Insurance's direct written premiums were distributed through one broker, CRC Insurance Services, Inc. and approximately 11.0% of Stonewood Insurance's direct written premiums were distributed through one agent, SIA Group, Inc. Because our agreements with our agents and brokers do not require minimum premium volumes and are terminable upon 30 or 60 days notice, we cannot assure you that such relationships will continue. If they do continue, it is possible they may not be profitable for us. The termination of our relationship with one or more of these brokers or agents could result in lower direct written premiums and could have a material adverse effect on us.

We may not be successful in reducing our risk through reinsurance arrangements, and our reinsurers may not pay claims made by us in a timely fashion.

We purchase reinsurance by transferring part of the risk we have assumed (known as ceding) to reinsurers in exchange for part of the premium we receive in connection with the risk. Ceded written premiums amounted to 42.4% of our direct written premiums in 2005. The availability, cost and structure of reinsurance protection are subject to changing market conditions, which are outside our control. If we are not able to obtain reinsurance protection on favorable terms, or at all, our potential losses could exceed our ability to pay and our business, financial condition or results of operations could suffer. Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred or ceded to the reinsurer, it does not relieve us (the reinsured) of our liability to our policyholders. Accordingly, we bear risk with respect to our reinsurers. That is, 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. Since Hurricane Katrina, a number of our reinsurers have been downgraded or placed on negative watch by major ratings agencies, including two reinsurers who were downgraded to ratings below "A-" by A.M. Best. As of December 31, 2005, we had \$110.5 million of reinsurance recoverable on unpaid losses and \$11.5 million of reinsurance recoverable on paid losses.

If we lose key personnel or are unable to recruit qualified personnel, our ability to implement our business strategies could be delayed or hindered.

Our future success will depend, in part, upon the efforts of our executive officers and other key personnel, including J. Adam Abram, President and Chief Executive Officer; Michael T. Oakes, Executive Vice President and Chief Financial Officer; Michael E. Crow, Senior Vice President — Finance and Chief Accounting Officer; Michael P. Kehoe, President and Chief Executive Officer of James River Management Company, Inc.; and C. Kenneth Mitchell, President and Chief Executive Officer of Stonewood Insurance Management Company, Inc. The loss of any of these officers or other key personnel could prevent us from fully implementing our business strategies and materially and adversely affect our business, financial condition or results of operations. We have employment agreements with four of our executive officers. We do not have key person insurance on the lives of any of our key management personnel. As we continue to grow, we will need to recruit and retain additional qualified management personnel, but we may not be able to do so. Our ability to recruit and retain such personnel will depend upon a number of factors, such as our results of operations, prospects and the level of competition then prevailing in the market for qualified personnel.

Our actual incurred losses may be greater than our loss and LAE reserves which could have a material adverse effect on our financial condition and results of operations.

We are liable for losses and LAE under the terms of the insurance policies we underwrite. In many cases, several years may elapse between the occurrence of an insured loss, the reporting of the loss to us and our payment of the loss. We establish loss and LAE reserves for the ultimate payment of all losses and LAE incurred. We estimate the reserve for losses and LAE using individual case-basis valuations of reported claims. We also use statistical analyses to estimate the cost of losses that have been incurred but not reported to us. These estimates are based on historical information and on estimates of future trends that may affect the frequency of claims and changes in the average cost of claims that may arise in the future. They are by their nature imprecise, and our ultimate losses and LAE may vary from established reserves. If any of our reserves should prove to be inadequate, we will be required to increase reserves resulting in a reduction in our net income and stockholders' equity in the period in which the deficiency is identified. Future loss experience substantially in excess of established reserves could also have a material effect on future earnings and liquidity and our financial rating. Courts or other governmental authorities may interpret our insurance contracts so as to provide coverage for causes of loss we intended to exclude or limit. Such broadening of the coverage could expose us to greater losses than anticipated.

Furthermore, factors that are difficult to predict, such as: claims inflation, claims development patterns, legislative activity, social and economic patterns and litigation and regulatory trends may have a substantial impact on our future losses and LAE. As of December 31, 2005, unpaid loss and LAE reserves (net of reserves ceded to our reinsurers) were \$116.0 million.

Since we have a limited operating history, it is difficult to predict our future performance.

James River was organized in September 2002 and formed or acquired its two insurance subsidiaries in 2003. James River Insurance wrote its first policy effective July 1, 2003. Stonewood Insurance commenced writing insurance as of January 1, 2004. We therefore have limited operating and financial history. In addition, because we focus our efforts on certain specialized sectors of the insurance market, and because we do not have an extensive claims history to date, our limited historical financial results may not accurately predict our future performance. Moreover, companies in their initial stages of development present substantial business and financial risks and may suffer significant losses. They are not always able to find the necessary resources at a reasonable cost, or at all. As a result of the risks specific to our business and those associated with new companies in general, it is possible that we may not be successful in implementing our business strategy.

We are subject to extensive regulation, which may adversely affect our ability to achieve our business objectives. In addition, if we fail to comply with these regulations, we may be subject to penalties, including fines and suspensions, which may adversely affect our financial condition and results of operations.

Our subsidiaries are subject to extensive regulation, primarily by Ohio, the domiciliary state for James River Insurance, and North Carolina, the domiciliary state for Stonewood Insurance, and to a lesser degree, the other states in which we operate. Most insurance regulations are designed to protect the interests of insurance policyholders, as opposed to the interests of stockholders. These regulations generally are administered by a department of insurance in each state and relate to, among other things, authorizations to write certain lines of business, capital and surplus requirements, rate and form approvals, investment and underwriting limitations, affiliate transactions, dividend limitations, changes in control, solvency and a variety of other financial and non-financial aspects of our business. Significant changes in these laws and regulations could make it more expensive to conduct our business. State insurance departments also conduct periodic examinations of the affairs of insurance companies and require the filing of annual and other reports relating to financial condition, holding company issues and other matters. These regulatory requirements may impose timing and expense constraints that could adversely affect our ability to achieve some or all of our business objectives.

In addition, regulatory authorities have broad discretion to deny or revoke licenses for various reasons, including the violation of regulations. In some instances, where there is uncertainty as to applicability, we follow practices based on our interpretations of regulations or practices that we believe are generally

followed by the industry. These practices may turn out to be different from the interpretations of regulatory authorities. If we do not have the requisite licenses and approvals or do not comply with applicable regulatory requirements, insurance regulatory authorities could preclude or temporarily suspend us from carrying on some or all of our activities or otherwise penalize us. This could adversely affect our ability to operate our business. Further, changes in the level of regulation of the insurance industry or changes in laws or regulations themselves or interpretations by regulatory authorities could interfere with our operations and require us to bear additional costs of compliance, which could adversely affect our ability to operate our business.

The National Association of Insurance Commissioners has adopted a system to test the adequacy of statutory capital, known as “risk-based capital.” This system establishes the minimum amount of risk-based capital necessary for a company to support its overall business operations. It identifies property/casualty insurers that may be inadequately capitalized by looking at certain inherent risks of each insurer's assets and liabilities and its mix of net written premiums. Insurers falling below a calculated threshold may be subject to varying degrees of regulatory action, including supervision, rehabilitation or liquidation. Failure to maintain our risk-based capital at the required levels could adversely affect the ability of our insurance subsidiaries to maintain regulatory authority to conduct our business.

Stonewood Insurance’s business is heavily concentrated in workers’ compensation insurance for the residential construction industry in North Carolina.

Stonewood Insurance's business is heavily concentrated in workers' compensation insurance in North Carolina and is further concentrated in the residential construction business. This makes Stonewood Insurance vulnerable to changes affecting the economy of North Carolina and in particular the residential construction business in North Carolina. By concentrating a substantial portion of its business in construction operations, Stonewood Insurance is exposed to substantial losses due to accidents and occupational hazards. We attempt to moderate these risks by purchasing reinsurance and by underwriting and pricing accounts with these risks in mind. However, there can be no assurance that these precautions are adequate and that we will not be exposed to greater than anticipated losses arising from the hazardous nature of the business conducted by our insureds.

We may require additional capital in the future, which may not be available or may only be available on unfavorable terms.

Our future capital requirements 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. We may need to raise additional funds in the future through financings or be required to curtail our growth. Many factors will affect our capital needs and their amount and timing, including our growth and profitability, our claims experience and the availability of reinsurance, as well as possible acquisition opportunities, market disruptions and other unforeseeable developments. If we have to raise additional capital, equity or debt financing may not be available at all or may be available only on terms that are not favorable to us. In the case of equity financings, dilution to our stockholders could result. In the case of debt financings, we may be subject to covenants that restrict our ability to freely operate our business. If we cannot obtain adequate capital on favorable terms or at all, we may not have sufficient funds to implement our operating plans and our business, financial condition or results of operations could be materially adversely affected.

Our investment results and, therefore, our results of operations or financial condition may be impacted by changes in the business, financial condition or operating results of the entities in which we invest, as well as changes in interest

rates, government monetary policies, general economic conditions and overall capital market conditions.

Our results of operations depend, in part, on the performance of our invested assets. Fluctuations in interest rates affect our returns on, and the fair value of, fixed-income securities. Unrealized gains and losses on fixed-income securities are recognized in accumulated other comprehensive income, net of taxes, and increase or decrease our stockholders' equity. Interest rates in the United States are currently low relative to historical levels. An increase in interest rates could reduce the fair value of our investments in fixed-income securities. In addition, defaults by third parties who fail to pay or perform obligations could reduce our investment income and realized investment gains and could result in investment losses in our portfolio.

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We had fixed-income investments with a fair value of \$339.5 million as of December 31, 2005 that are subject to:

- credit risk, which is the risk that our invested assets will decrease in value due to unfavorable changes in the financial prospects or a downgrade in the credit rating of an entity in which we have invested; and
- interest rate risk, which is the risk that our invested assets may decrease in value due to changes in interest rates.

Our fixed-income investment portfolio includes mortgage-backed securities. As of December 31, 2005, mortgage-backed securities constituted 19.0% of our fixed maturity securities. As with other fixed-income securities, the fair value of these securities fluctuates depending on market and other general economic conditions and the interest rate environment. Changes in interest rates can expose us to prepayment risks on these investments. In periods of declining interest rates, mortgage prepayments generally increase and mortgage-backed securities and other asset-backed securities are paid more quickly, requiring us to reinvest the proceeds at the then current market rates. Conversely, during periods of rising interest rates, the rate of prepayment generally slows. Mortgage-backed securities that have an amortized cost that is less than par (i.e. purchased at a discount) may incur a decrease in yield as a result of a slower rate of prepayment.

Since the end of 2002, the United States financial markets have experienced volatile interest rates, which affect the value of our fixed-income securities. As of December 31, 2005, our investment portfolio had a net unrealized investment loss, before the effect of income taxes, of \$5.1 million.

We rely on information technology and telecommunications systems, and the failure of these systems could materially and adversely affect our business.

Our business is highly dependent upon the successful and uninterrupted functioning of our information technology and telecommunications systems. We rely on these systems to process new and renewal business, provide customer service, make claims payments and facilitate collections and cancellations. These systems also enable us to perform actuarial and other modeling functions necessary for underwriting and rate development. The failure of these systems, or the termination of a third-party software license upon which any of these systems is based, could interrupt our operations or materially impact our ability to evaluate and write new business. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If sustained or repeated, a system failure or service denial could result in a deterioration of our ability to write and process new and renewal business and provide customer service or compromise our ability to pay claims in a timely

manner. This could result in a material adverse effect on our business.

Our growth may be dependent upon our successful acquisitions of other insurance businesses.

We pursue acquisitions of specialty insurance businesses that can be acquired on acceptable terms. Some of these acquisitions could be material in size and scope. Our future growth may depend, in part, upon the successful implementation of this strategy. While we will continually be searching for acquisition opportunities, there can be no assurance that we will be successful in identifying suitable acquisitions. If any potential acquisition opportunities are identified, there can be no assurance that we will consummate such acquisitions, or, if any such acquisition does occur, that it will be successful in enhancing our business, be accretive to either our profitability or book value or generate an underwriting profit. We may in the future face increased competition for acquisition opportunities which may inhibit our ability to consummate suitable acquisitions. In addition, to the extent that our acquisition strategy results in the acquisition of businesses, such acquisitions could pose a number of special risks, including the diversion of management's attention, the unsuccessful integration of the operations and personnel of the acquired companies, adverse short-term effects on reported operating results, the impairment of acquired intangible assets and the loss of key employees.

We may, in the future, issue additional common stock in connection with one or more acquisitions, which may dilute our stockholders. Alternatively, we may issue debt, which could limit our future financial

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flexibility. Additionally, with respect to future acquisitions, our stockholders may not have an opportunity to review the financial statements of the entity being acquired or to vote on such acquisitions.

If North Carolina drastically increases the assessments Stonewood Insurance is required to pay, our results of operations and financial condition will suffer.

Stonewood Insurance, our admitted insurance subsidiary, is subject to assessments in North Carolina, its domiciliary state, for various purposes, including the provision of funds necessary to fund the operations of the North Carolina Department of Insurance, the state's workers compensation fund and the state fund that pays covered claims under certain policies provided by impaired, insolvent or failed insurance companies. These assessments are generally set based on an insurer's percentage of the total premiums written in the insurer's state within a particular line of business. As Stonewood Insurance grows, our share of any assessments may increase. However, we cannot predict with certainty the amount of future assessments because they depend on factors outside our control, such as insolvencies of other insurance companies. Significant assessments could result in higher than expected operating expenses and have a material adverse effect on our financial condition or results of operations.

Our reliance on brokers and agents subjects us to their credit risk.

With respect to the premiums produced by our brokers and agents, certain premiums from the policyholders are collected directly by the brokers or agents and forwarded to our insurance subsidiaries. In certain jurisdictions, when the insured pays premiums for these policies to brokers or agents for payment over to our insurance subsidiaries, the premiums might be considered to have been paid under applicable insurance laws and regulations and the insured will no longer be liable to us for those amounts, whether or not we have actually received the premiums from the broker or agent. Consequently, we assume a degree of credit risk associated with brokers and agents. Although brokers' and agents' failures to remit premiums to us have not had a material adverse effect on us to date, there may be instances

where brokers and agents collect premium but do not remit it to us and we may be nonetheless required under applicable law to provide the coverage set forth in the policy despite the absence of premium. Because the possibility of these events is dependent in large part upon the financial condition and internal operations of our brokers and agents, which in most cases are not public information, we are not able to quantify the exposure presented by this risk. If we are unable to collect premiums from our brokers and agents in the future, our underwriting profits may decline and our financial condition and results of operations could be materially and adversely affected.

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RISKS RELATED TO OUR INDUSTRY

Our business is cyclical in nature, which may affect our financial performance.

Historically, the financial performance of the property/casualty insurance industry has tended to fluctuate in cyclical periods of price competition and excess capacity (known as a soft market) followed by periods of high premium rates and shortages of underwriting capacity (known as a hard market). Although an individual insurance company's financial performance is dependent on its own specific business characteristics, the profitability of most property/casualty insurance companies tends to follow this cyclical market pattern. Further, this cyclical market pattern can be more pronounced in the excess and surplus market than in the standard insurance market. When the standard insurance market hardens, the excess and surplus market hardens, and growth in the excess and surplus market can be significantly more rapid than growth in the standard insurance market. Similarly, when conditions begin to soften, many customers that were previously driven into the excess and surplus market may return to the admitted market, exacerbating the effects of rate decreases. Beginning in 2000 and accelerating in 2001, the property/casualty insurance industry has been experiencing a market reflecting increasing rates, more restrictive coverage terms and more conservative risk selection. We believe these trends slowed beginning in 2004 and that the current insurance market is becoming generally more competitive in terms of pricing, policy terms and conditions, except for catastrophe-exposed property insurance where rates have increased as a result of significant hurricane losses in 2004 and 2005. Since this cyclical nature is due in large part to the actions of our competitors and general economic factors, we cannot predict the timing or duration of changes in the market cycle. These cyclical patterns cause our revenues and net income to fluctuate, which may cause the price of our common stock to be volatile.

If we are not able to renew our existing reinsurance or obtain new reinsurance, either our net exposure would increase or we would have to reduce the level of our underwriting commitment.

We currently purchase excess of loss reinsurance to stop our loss from a single occurrence on any one coverage part from any one policy. For our excess casualty and workers' compensation lines of business, we retained \$500,000 of loss for policies written through December 31, 2005. For 2006, we retain \$500,000 and \$750,000 of loss for our excess casualty and workers' compensation lines of business, respectively. For our workers' compensation line, we also retain the risk of loss for claims above a \$20.0 million limit and above \$10.0 million for any one life. For our primary property and primary casualty lines of business, we retain \$1.0 million in loss. We currently retain \$750,000 in loss for excess property. Further, we purchase catastrophe reinsurance to cover losses arising from any single occurrence above an amount retained by us. However, we may choose in the future to re-evaluate the use of reinsurance to increase, decrease or eliminate the amount of liability we cede to reinsurers, depending upon the cost and availability of reinsurance.

Market conditions beyond our control determine the availability and cost of the reinsurance protection that we purchase. The reinsurance market has changed dramatically over the past few years as a result of inadequate pricing,

poor underwriting and the significant losses incurred as a consequence of the terrorist attacks on September 11, 2001 and natural catastrophes occurring in 2004 and 2005. As a result, reinsurers have exited some lines of business, reduced available capacity and implemented provisions in their contracts designed to reduce their exposure to loss. In addition, the historical results of reinsurance programs and the availability of capital also affect the availability of reinsurance. Our reinsurance facilities generally are subject to annual renewal. We cannot provide any assurance that we will be able to maintain our current reinsurance facilities or that we will be able to obtain other reinsurance facilities in adequate amounts and at favorable rates. We have in force policies for which we will seek to renew reinsurance coverage mid-term. If we are unable to renew our expiring contracts or to make new arrangements, either our net exposures would increase, which could increase our costs, or, if we were unwilling to bear an increase in net exposures, we would have to reduce the level of our underwriting commitments, especially catastrophe exposed risks, which would reduce our revenues.

We compete with a large number of companies in the insurance industry for underwriting revenues.

We compete with a large number of other companies in our selected lines of business. Our principal competitors in the excess and surplus lines sector are Scottsdale Insurance Company (Nationwide Mutual

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Insurance Company), Markel Corporation, Burlington Insurance Group, Admiral Insurance Company (W. R. Berkley Corporation), Colony Insurance Company (The Argonaut Group) and RLI Corp., and in the workers' compensation insurance sector are Builders Mutual Insurance Company, Key Risk (W. R. Berkley Corporation) and Amerisure. We face competition both from specialty insurance companies, underwriting agencies and intermediaries, as well as diversified financial services companies that are significantly larger than we are and that have significantly greater financial, marketing, management and other resources than we do. Some of these competitors also have significantly greater experience and market recognition than we do. Larger carriers may have lower expense ratios, allowing them to price their products more competitively than us. We may incur increased costs in competing for underwriting revenues. If we are unable to compete effectively in the markets in which we operate or to expand our operations into new markets, our underwriting revenues and net income may decline.

A number of new, proposed or potential legislative and industry developments could further increase competition in our industry. These developments include:

- an increase in capital-raising by companies in our lines of business, which could result in new entrants to our markets and an excess of capital in the industry;
- programs in which state-sponsored entities provide property insurance in catastrophe prone areas or other "alternative markets" types of coverage;
- changing practices caused by the internet, which may lead to greater competition in the insurance business; and
- consolidation in the insurance industry, which could lead to lower margins for us.

New competition from these developments could cause the supply and/or demand for insurance or reinsurance to change, which could affect our ability to price our products at attractive rates and thereby affect our underwriting results. In addition, deregulation of commercial lines insurance has been adopted in many states and may be adopted in others. In some states, the deregulation of commercial lines generally enables admitted insurers to underwrite certain commercial property/casualty risks without the necessity of obtaining prior approval for rates and/or forms, although the content of policy forms is still regulated. In others states, the terms and conditions of commercial

insurance policy forms have been deregulated. The deregulation of commercial lines may permit risks that would not otherwise be considered attractive by standard market carriers to be underwritten by such carriers using forms and rates that are attractive to them. Although no assurance can be given that further deregulation will occur, the extent to which it may occur or the form it will take, it is possible that deregulation of commercial lines insurance will increase competition in our markets, which could reduce our written premiums or make our products less profitable to us and adversely affect our results of operations and financial position.

We also may compete with new entrants in the future. Competition is based on many factors, including:

- the perceived market strength of the insurer;
- pricing and other terms and conditions;
- services provided;
- the speed of claims payment;
- the reputation and experience of the insurer; and
- ratings assigned by independent rating organizations such as A.M. Best.

Ultimately, this competition could affect our ability to attract business at premium rates that are likely to generate underwriting profits.

As a holding company, we are dependent on the results of operations of our insurance subsidiaries and are likely to rely on the regulatory and financial capacity of our subsidiaries to pay dividends to us. The domiciliary states of our insurance subsidiaries limit the aggregate amount of dividends our subsidiaries may pay us in any 12 month period, thereby limiting our funds to pay expenses and dividends.

We are an insurance holding company and our principal asset is the shares we hold in our subsidiaries. Payments from our insurance company subsidiaries pursuant to management agreements and tax sharing

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agreements are our primary source of funds to pay holding company expenses. We anticipate that such payments, together with dividends paid to us by our subsidiaries and proceeds of financings held at the holding company, will be the primary source of funds for our holding company. The payment of dividends by our subsidiaries to us is limited by statute. In general, these restrictions limit the aggregate amount of dividends or other distributions that our subsidiaries may declare or pay within any 12 month period without advance regulatory approval. In Ohio, the domiciliary state of James River Insurance, this limitation is the greater of statutory net income for the preceding calendar year or 10% of the statutory surplus at the end of the preceding calendar year, and dividends may be paid only out of James River Insurance's earned surplus. In North Carolina, the domiciliary state of Stonewood Insurance, this limitation is the lesser of statutory net income excluding realized capital gains for the preceding calendar year or 10% of the statutory surplus at the end of the preceding calendar year. In addition, insurance regulators have broad powers to prevent reduction of statutory surplus to inadequate levels and could refuse to permit the payment of dividends calculated under any applicable formula. As a result, we may not be able to receive dividends from our subsidiaries at times and in amounts necessary to pay corporate expenses or meet other obligations. Subject to the foregoing, the maximum amount of dividends available to us from our insurance subsidiaries during 2006 without regulatory approval is \$14.5 million.

Litigation and legal proceedings against our insurance subsidiaries could have a material adverse effect on our business, results of operations and/or financial condition.

Our insurance subsidiaries have been named as defendants in various legal actions in the course of their insurance operations. Our subsidiaries have responded to the lawsuits, and we believe that there are meritorious defenses and intend to vigorously contest these claims. Adverse judgments in one or more of such lawsuits could require us to pay significant damage amounts or to change aspects of our operations, which could have a material adverse effect on our financial results.

Severe weather conditions and other catastrophes may result in an increase in the number and amount of claims filed against us.

Our business is exposed to the risk of severe weather conditions and other catastrophes. Catastrophes can be caused by various events, including natural events such as severe winter weather, hurricanes, tornadoes, windstorms, earthquakes, hailstorms, severe thunderstorms and fires and other events such as explosions, terrorist attacks and riots. The incidence and severity of catastrophes and severe weather conditions are inherently unpredictable. Severe weather conditions and catastrophes can cause losses in a variety of our property/casualty lines and generally result in an increase in the number of claims filed as well as the amount of compensation sought by claimants. It is possible that a catastrophic event or multiple catastrophic events could have a material adverse effect on our results of operations, liquidity and financial condition. At December 31, 2005, losses from Hurricane Katrina exceeded our catastrophe reinsurance coverage limit for a single event. Despite changes in our property underwriting strategy, there is no assurance that future catastrophe losses will not exceed our available reinsurance coverage.

RISKS RELATED TO OUR COMMON STOCK

Our directors, executive officers and principal stockholders own a large percentage of our common stock which allows them to control substantially all matters requiring shareholder approval.

Our directors, executive officers and principal stockholders beneficially own a large percentage of our outstanding common stock. Accordingly, these directors, executive officers and principal stockholders will have substantial influence, if they act as a group, over the election of directors and the outcome of other corporate actions requiring stockholder approval or may seek to arrange a sale of our Company at a time or under conditions that are not favorable to our other stockholders. These stockholders may also delay or prevent a change of control, even if such a change of control would benefit our other stockholders, if they act as a group. This significant concentration of stock ownership may adversely affect the trading price of our common stock due to investors' perception that conflicts of interest may exist or arise.

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Applicable insurance laws and certain provisions in our amended and restated certificate of incorporation make it difficult to effect a change of control.

Under applicable Ohio and North Carolina insurance laws and regulations, no person may acquire control of our company unless that person has filed a statement containing specified information with both the Ohio Department of Insurance and North Carolina Department of Insurance and obtains advance approval for such acquisition. Under applicable laws and regulations, any person acquiring, directly or indirectly (by revocable proxy or otherwise), 10% or more of the voting shares of any other person is presumed to have acquired control of such person, and a person who beneficially acquires 10% or more of our common shares without obtaining advance approval would be in violation of Ohio and North Carolina insurance laws and may be subject to injunctive action enjoining the acquisition and the voting of such shares, and seizure of the shares, as well as other action as determined by the Director of the Ohio

Department of Insurance and the Commissioner of the North Carolina Department of Insurance.

In addition, many state insurance laws require prior notification to the state insurance department of a change of control of a non-domiciliary insurance company licensed to transact insurance in that state. While these pre-notification statutes do not authorize the state insurance departments to disapprove the change of control, they authorize regulatory action (including a possible revocation of our authority to do business) in the affected state if particular conditions exist, such as undue market concentration. Any future transactions that would constitute a change of control of us may require prior notification in the states that have pre-acquisition notification laws.

Certain provisions of Delaware law and our certificate of incorporation make it more difficult to effect the acquisition of control of our company by means of a tender offer, open market purchase, proxy fight or otherwise. The provisions in our certificate of incorporation that will make it difficult to effect a change of control include the authority of our Board of Directors to issue series of preferred shares with such voting rights and other powers as the Board of Directors may determine and notice requirements in our by-laws relating to nominations to the Board of Directors and to the raising of business matters at stockholders' meetings.

We do not anticipate paying cash dividends, and, accordingly, stockholders must rely on stock appreciation for any return on their investment.

We do not expect to pay cash dividends on our common stock for the foreseeable future. We currently intend to retain any future earnings to finance our operations and growth. Any future determination to pay cash dividends will be at the discretion of our Board of Directors.

The market price of our common stock may be materially adversely affected by market volatility.

The market price of our common stock could be subject to significant fluctuations. Among the factors that could affect our stock price are:

- quarterly variations in our results of operations;
- changes in expectations as to our future results of operations, including financial estimates by securities analysts and investors;
- announcements by third parties of claims against us;
- changes in law and regulation;
- results of operations that vary from those expected by securities analysts and investors; and
- future sales of shares of our common stock.

Recently, stock prices of companies in the insurance industry have experienced some volatility as a result of ongoing regulatory investigations and significant losses related to hurricanes in 2005. The recent volatility in insurance industry stocks may continue for the foreseeable future and may affect the price of our common stock regardless of our practices.

Future sales of a substantial number of shares of our common stock in the public market, or the possibility or perception of such future sales, could adversely affect the market price of our common stock.

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The market price of our common stock could decline as a result of sales by our existing stockholders and optionholders in the future or the perception that these sales will occur. These sales also might make it difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

The Company leases or sub-leases all of the commercial office space in which it conducts its business. The following table summarizes the leased space out of which the Company and its subsidiaries operate as of March 23, 2006:

Operating Entity	Location	Square Footage	Expiration of Lease Term	Approximate Annual Rent
James River	Chapel Hill, NC	2,916	2008	\$ 71,000
James River Insurance	Richmond, VA	27,685	2008	\$ 471,000
Stonewood Insurance	Raleigh, NC	8,350	2009	\$ 148,000

The Stonewood Insurance lease is renewable at Stonewood Insurance's option for a period of up to three years. James River has entered into a lease agreement effective April 1, 2006 for the use of an additional 6,379 square feet of commercial office space in Chapel Hill, NC. The approximate annual rent under the lease totals \$159,000, and the lease expires in 2010. James River has entered into an agreement to sub-let its existing Chapel Hill, NC office space. We believe that our facilities are adequate for our current needs.

Item 3. Legal Proceedings.

We are party to lawsuits, arbitration and other proceedings that arise in the normal course of our business. Many of such lawsuits, arbitrations and other proceedings involve claims under policies that we underwrite as an insurer, the liabilities for which we believe have been adequately included in our loss and LAE reserves. Also, from time to time, we are party to lawsuits, arbitrations and other proceedings that relate to disputes over contractual relationships with third parties, or that involve alleged errors and omissions on the part of our insurance subsidiaries. We provide accruals for these items to the extent we deem the losses probable and reasonably estimable.

The outcome of litigation is subject to numerous uncertainties. Although the ultimate outcome of pending matters cannot be determined at this time, based on present information, we believe the resolution of these matters will not have a material adverse effect on our financial position, results of operations or cash flows.

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of security holders during the fourth quarter of 2005.

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Executive Officers of the Registrant

Set forth below, as of March 23, 2006, are the names, ages and current positions of our executive officers. Executive officers are appointed by, and hold office at, the discretion of our Board of Directors.

Name	Age	Position
J. Adam Abram	50	President and Chief Executive Officer since September 2002. In 1992, Mr. Abram founded Front Royal, Inc., an insurance holding company for which he served as Chief Executive Officer until it was sold in 2001. Prior to founding Front Royal, Inc., Mr. Abram founded and served as President of Adaron Group, Inc., a developer of approximately 2.0 million square feet of commercial property in North Carolina.
Michael T. Oakes	41	Executive Vice President and Chief Financial Officer since April 2004. From 1998 until joining James River, Mr. Oakes was a Managing Director in the Insurance Investment Banking Group at Keefe, Bruyette & Woods, Inc., an investment banking firm based in New York.
Michael E. Crow	41	Sr. Vice President — Finance and Chief Accounting Officer since April 2004. From May 2003 to March 2004, Mr. Crow served as our Chief Financial Officer. From October 2001 to May 2003, Mr. Crow served as Vice President, Controller and Principal Accounting Officer of Triad Guaranty Inc., a publicly traded mortgage insurance company. Prior to joining Triad, Mr. Crow was a senior manager with Ernst & Young LLP where he began working in 1987.
Michael P. Kehoe	40	President and Chief Executive Officer — James River Management Company, Inc. since November 2002. From 1994 until 2002, Mr. Kehoe held various positions at Colony Management Services, Inc. culminating as Vice President of Brokerage Underwriting. Colony Management Services, Inc. was part of the surplus lines operations of Front Royal, Inc. from 1994 to 2001 when it was sold to Argonaut Group, Inc.
C. Kenneth Mitchell	63	President and Chief Executive Officer — Stonewood Insurance Management Company, Inc. since October 2003. Prior to joining Stonewood Insurance Management Company, Inc., Mr. Mitchell served as President and Chief Executive Officer of Builders Mutual Insurance Company, a North Carolina based writer of workers' compensation insurance, from 1998 through 2002. From 1983 through 1999, Mr. Mitchell served as Executive Vice President of the North Carolina Home Builders Association.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

Our common stock trades on the Nasdaq National Market under the symbol "JRVR." The following table sets forth the range of the daily high and low sales prices as reported by Nasdaq for the quarterly periods from August 9, 2005, the date the Company first became publicly traded, through December 31, 2005:

	2005	
	High	Low
Third Quarter: August 9, 2005 through September 30, 2005	\$ 21.43	\$ 15.35
Fourth Quarter: October 1, 2005 through December 31, 2005	\$ 20.68	\$ 16.25

On March 23, 2006, the last reported sales price of our common stock was \$25.90 per share.

Shareholders

As of March 23, 2006, there were 15,087,308 shares of issued and outstanding common stock held by approximately 1,160 beneficial owners, including 36 holders of record.

Dividends

We have not paid in the past and do not anticipate paying in the near future any cash dividends on our common stock. We cannot assure you that we will declare and pay dividends in the future. Any future determination to pay dividends will be at the discretion of our board of directors and will depend upon our results of operations, financial condition, cash requirements, business prospects, regulatory and contractual restrictions on the payment of dividends by our subsidiaries and other factors our board of directors deems relevant. We currently intend to retain any future earnings to fund the development and growth of our business.

Our status as a holding company and a legal entity separate and distinct from our subsidiaries affects our ability to pay dividends and make other payments. As a holding company without significant operations of our own, the principal sources of our funds are dividends and other payments from our subsidiaries. The ability of our insurance subsidiaries to pay dividends to us is subject to limits under insurance laws of the states in which our insurance subsidiaries are domiciled. See "Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources" and "Item 1 — Business — Regulation".

Use of Proceeds

On May 3, 2005, we filed a registration statement on Form S-1 with the Securities Exchange Commission for an initial public offering of common stock. The offering was made through an underwriting syndicate led by book-running manager Keefe, Bruyette & Woods, Inc., and co-managers Bear, Stearns & Co., Inc., Friedman, Billings, Ramsey & Co., Inc. and Wachovia Capital Markets, LLC. Our registration statement was declared effective

on August 8, 2005. On August 9, 2005, we effected a 10 for 1 split of our common stock to shareholders of record on that date. Immediately prior to the closing of the initial public offering on August 12, 2005, all of our outstanding Series A Convertible Preferred Stock and Series B Convertible Preferred Stock including shares representing accrued but unpaid dividends, were converted into 9,956,413 shares of common stock. In addition, on that date we amended and restated our certificate of incorporation to increase the number of authorized shares of common stock to 100,000,000 and decrease the number of authorized shares of preferred stock to 5,000,000. Gross proceeds from the sale of 4,444,000 shares of common stock, at an initial public offering price per share of \$18.00, totaled \$80.0 million. Costs associated with the initial public offering included \$5.6 million of underwriting costs and \$995,000 of other issuance costs.

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On August 26, 2005, the underwriters of the initial public offering exercised their over-allotment option in which an additional 666,600 shares of common stock were issued and sold at the \$18.00 initial public offering price per share. Gross proceeds from this transaction were \$12.0 million and underwriting costs were \$840,000.

We contributed \$60.5 million of the proceeds from the offering to the capital of our insurance subsidiaries. We intend to use the remaining proceeds for general corporate purposes, which may include potential acquisitions of companies in the specialty insurance business.

Item 6. Selected Financial Data.

The information set forth in the following table, as of and for the period indicated, should be read in conjunction with “Item 7 — Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the accompanying Consolidated Financial Statements and Notes thereto.

	Year Ended December 31,			Period from
	2005	2004	2003	September 25,
	(\$ in thousands, except for share data)			2002
Operating Results:				Through
Direct written premiums (1)	\$ 236,617	\$ 142,539	\$ 36,764	December 31,—
Assumed written premiums (2)	4,400	—	—	2002 —
Ceded written premiums (3)	(100,427)	(22,361)	(9,339)	—
Net written premiums (4)	\$ 140,590	\$ 120,178	\$ 27,425	\$ —
Net earned premiums	\$ 117,500	\$ 75,763	\$ 5,087	\$ —
Net investment income	10,212	3,626	407	2
Realized investment losses	(252)	(71)	—	—
Other income	133	144	56	—
Total revenues	127,593	79,462	5,550	