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

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**FORM 10-Q**

(Mark One)

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended June 30, 2007

or

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-51124

**SeaBright Insurance Holdings, Inc.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation  
or organization)

**56-2393241**

(IRS Employer Identification No.)

**2101 4<sup>th</sup> Avenue, Suite 1600  
Seattle, Washington 98121**

(Address of principal executive offices, including zip code)

**(206) 269-8500**

(Registrant's telephone number, including area code)

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

Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date:

**Class**  
Common Stock, \$0.01 Par Value

**Shares outstanding as of August 8, 2007**  
20,813,213

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**SeaBright Insurance Holdings, Inc.**

**Index to Form 10-Q**

	<u>Page</u>
<b>Part I. Financial Information</b>	
Item 1. Financial Statements (unaudited).....	2
Condensed Consolidated Balance Sheets as of June 30, 2007 and December 31, 2006.....	2
Condensed Consolidated Statements of Operations for the Three Months and Six Months Ended June 30, 2007 and 2006.....	3
Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2007 and 2006 .....	4
Notes to Unaudited Condensed Consolidated Financial Statements.....	5
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations .....	16
Item 3. Quantitative and Qualitative Disclosures About Market Risk .....	27
Item 4. Controls and Procedures .....	28
<b>Part II. Other Information</b>	
Item 1A. Risk Factors .....	28
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds .....	29
Item 4. Submission of Matters to a Vote of Security Holders.....	29
Item 6. Exhibits.....	29
Signatures .....	30

# PART I -- FINANCIAL INFORMATION

## Item 1. Financial Statements

### SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES

#### CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2007 (Unaudited)	December 31, 2006
	(in thousands)	
<b>ASSETS</b>		
Investment securities available for sale, at fair value (amortized cost \$428,696 in 2007 and \$399,433 in 2006) .....	\$ 421,695	\$ 399,119
Equity securities available for sale, at fair value (cost \$5,645 in 2007 and \$802 in 2006) .....	5,889	813
Cash and cash equivalents .....	23,034	20,412
Accrued investment income .....	4,636	4,208
Premiums receivable, net of allowance .....	7,897	8,877
Deferred premiums .....	135,791	118,788
Federal income tax recoverable .....	1,292	1,263
Service income receivable .....	262	792
Reinsurance recoverables .....	12,736	13,675
Receivable under adverse development cover .....	2,781	2,781
Prepaid reinsurance .....	2,039	1,917
Property and equipment, net .....	1,972	1,241
Deferred income taxes, net .....	15,390	12,198
Deferred policy acquisition costs, net .....	18,201	15,433
Intangible assets, net .....	1,212	1,217
Goodwill .....	1,527	1,527
Other assets .....	10,327	10,014
Total assets .....	<u>\$ 666,681</u>	<u>\$ 614,275</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Unpaid loss and loss adjustment expense .....	\$ 218,679	\$ 198,356
Unearned premiums .....	131,205	114,312
Reinsurance funds withheld and balances payable .....	306	309
Premiums payable .....	2,441	3,047
Accrued expenses and other liabilities .....	35,262	37,125
Surplus notes .....	12,000	12,000
Total liabilities .....	<u>399,893</u>	<u>365,149</u>
Commitments and contingencies		
Stockholders' equity:		
Series A preferred stock, \$0.01 par value; 750,000 shares authorized; no shares issued and outstanding .....	—	—
Undesignated preferred stock, \$0.01 par value; 10,000,000 shares authorized; no shares issued and outstanding .....	—	—
Common stock, \$0.01 par value; 75,000,000 shares authorized; issued and outstanding – 20,798,344 shares at June 30, 2007 and 20,553,400 shares at December 31, 2006 .....	208	205
Paid-in capital .....	192,170	190,593
Accumulated other comprehensive loss .....	(4,391)	(197)
Retained earnings .....	78,801	58,525
Total stockholders' equity .....	<u>266,788</u>	<u>249,126</u>
Total liabilities and stockholders' equity .....	<u>\$ 666,681</u>	<u>\$ 614,275</u>

*See accompanying notes to unaudited condensed consolidated financial statements.*

**SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	(in thousands, except income per share amounts)			
Revenue:				
Premiums earned .....	\$ 54,757	\$ 41,794	\$ 103,388	\$ 85,757
Claims service income.....	343	533	899	1,056
Other service income.....	25	19	49	47
Net investment income.....	4,854	3,741	9,612	6,866
Net realized loss .....	(8)	(88)	(60)	(315)
Other income .....	<u>685</u>	<u>869</u>	<u>1,642</u>	<u>1,625</u>
	<u>60,656</u>	<u>46,868</u>	<u>115,530</u>	<u>95,036</u>
Losses and expenses:				
Loss and loss adjustment expenses .....	29,012	22,065	54,930	50,528
Underwriting, acquisition and insurance expenses.....	14,692	9,761	27,323	19,497
Interest expense.....	284	272	565	528
Other expenses.....	<u>1,652</u>	<u>1,269</u>	<u>3,203</u>	<u>2,395</u>
	<u>45,640</u>	<u>33,367</u>	<u>86,021</u>	<u>72,948</u>
Income before taxes .....	<u>15,016</u>	<u>13,501</u>	<u>29,509</u>	<u>22,088</u>
Income tax expense (benefit):				
Current.....	5,692	4,770	10,166	9,234
Deferred .....	<u>(879)</u>	<u>(652)</u>	<u>(933)</u>	<u>(2,497)</u>
	<u>4,813</u>	<u>4,118</u>	<u>9,233</u>	<u>6,737</u>
Net income .....	<u>\$ 10,203</u>	<u>\$ 9,383</u>	<u>\$ 20,276</u>	<u>\$ 15,351</u>
Basic earnings per share .....	\$ 0.50	\$ 0.46	\$ 1.00	\$ 0.78
Diluted earnings per share .....	\$ 0.49	\$ 0.45	\$ 0.97	\$ 0.77
Weighted average basic shares outstanding.....	20,338,526	20,318,726	20,329,662	19,647,440
Weighted average diluted shares outstanding.....	20,960,268	20,750,605	20,913,518	20,045,091

*See accompanying notes to unaudited condensed consolidated financial statements.*

**SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	<u>Six Months Ended June 30,</u>	
	<u>2007</u>	<u>2006</u>
	(in thousands)	
Cash flows from operating activities:		
Net income.....	\$ 20,276	\$ 15,351
Adjustments to reconcile net income to cash provided by operating activities:		
Amortization of deferred policy acquisition costs .....	16,566	11,359
Policy acquisition costs deferred.....	(19,334)	(12,653)
Provision for depreciation and amortization.....	1,348	1,361
Compensation cost on restricted stock.....	935	387
Compensation cost on stock options.....	324	228
Net realized loss on investments.....	61	315
Gain on sale of fixed assets.....	(1)	—
Benefit for deferred federal income taxes.....	(933)	(2,497)
Changes in certain assets and liabilities:		
Unpaid loss and loss adjustment expense .....	20,323	27,124
Unearned premiums, net of deferred premiums and premiums receivable .....	870	2,149
Reinsurance recoverables, net of reinsurance withheld .....	(6)	(1,924)
Accrued investment income.....	(428)	(856)
Federal income tax recoverable .....	(596)	(322)
Other assets and other liabilities .....	(925)	(3,764)
Net cash provided by operating activities.....	<u>38,480</u>	<u>36,258</u>
Cash flows from investing activities:		
Purchases of investments.....	(71,101)	(229,804)
Sales of investments .....	10,565	122,758
Maturities and other.....	25,417	21,153
Purchases of property and equipment.....	(1,060)	(352)
Net cash used in investing activities.....	<u>(36,179)</u>	<u>(86,245)</u>
Cash flows from financing activities:		
Proceeds from exercise of stock options.....	239	32
Deferred tax benefit from disqualifying dispositions.....	77	—
Grant of restricted shares of common stock.....	5	—
Net proceeds from follow-on public offering of common stock.....	—	57,562
Net cash provided by financing activities.....	<u>321</u>	<u>57,594</u>
Net increase in cash and cash equivalents.....	2,622	7,607
Cash and cash equivalents at beginning of period .....	<u>20,412</u>	<u>12,135</u>
Cash and cash equivalents at end of period .....	<u>\$ 23,034</u>	<u>\$ 19,742</u>
Supplemental disclosures:		
Federal income taxes paid.....	\$ 10,000	\$ 9,250
Interest paid on surplus notes.....	565	518
Accrued expenses for purchases of investments.....	—	2,315

*See accompanying notes to unaudited condensed consolidated financial statements.*

## SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### 1. Organization

SeaBright Insurance Holdings, Inc. (“SIH” or the Company), a Delaware corporation, was formed in June 2003. On July 14, 2003, SIH entered into a purchase agreement, effective September 30, 2003, with Kemper Employers Group, Inc. (“KEG”), Eagle Pacific Insurance Company, Inc. and Pacific Eagle Insurance Company, Inc. (referred to collectively as “Eagle”), and Lumbermens Mutual Casualty Company (“LMC”), the ultimate owner of KEG and Eagle (the “Acquisition”). Under this agreement, SIH acquired Kemper Employers Insurance Company (“KEIC”), PointSure Insurance Services, Inc. (“PointSure”), and certain assets of Eagle, primarily renewal rights.

Prior to the Acquisition, beginning in 2000, KEIC wrote business only in California. In May 2002, KEIC ceased writing business and by December 31, 2003, all premiums related to business prior to the Acquisition were 100% earned. KEIC resumed writing business effective October 1, 2003, primarily targeting policy renewals for former Eagle business in the states of California, Hawaii and Alaska. In November 2003, permission was granted by the Illinois Department of Financial and Professional Regulation, Division of Insurance (the “Illinois Division of Insurance”) for KEIC to change its name to SeaBright Insurance Company (“SBIC”). As of June 30, 2007, SBIC is licensed to write workers’ compensation insurance in 45 states and the District of Columbia. PointSure is engaged primarily in administrative and wholesale insurance brokerage activities.

#### 2. Summary of Significant Accounting Policies

##### *a. Basis of Presentation*

The accompanying unaudited condensed consolidated financial statements include the accounts of SIH and its wholly owned subsidiaries, SBIC and PointSure (collectively, the “Company,” “we” or “us”). All significant intercompany transactions and amounts among these affiliated entities have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. The condensed consolidated balance sheet at December 31, 2006 has been derived from the audited financial statements at that date but does not include all of the information and notes required by GAAP for complete financial statements. These unaudited condensed consolidated financial statements and notes should be read in conjunction with the audited financial statements and accompanying notes as of and for the year ended December 31, 2006 included in the Company’s Annual Report on Form 10-K, which was filed with the U.S. Securities and Exchange Commission (the “SEC”) on March 16, 2007.

In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, necessary to state fairly the financial information set forth therein. Results of operations for the three month and six month periods ended June 30, 2007 are not necessarily indicative of the results expected for the full fiscal year or for any future period.

##### *b. Use of Estimates*

The preparation of the unaudited condensed consolidated financial statements in conformity with GAAP requires management of the Company to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. The Company has used significant estimates in determining fair value and impairment of investment securities, unpaid loss and loss adjustment expenses, goodwill and other intangibles, earned premiums on retrospectively rated policies, earned but unbilled premiums, deferred acquisition costs, federal income taxes and certain amounts related to reinsurance.

##### *c. Revenue Recognition*

Premiums for primary and reinsured risks are included in revenue over the lives of the contracts in proportion to the amount of insurance protection provided (i.e., ratably over the policy periods). The portions of premiums that are applicable to the unexpired periods of the policies in-force are not included in revenue but are deferred and recorded

## SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

as unearned premium in the liability section of the balance sheet. Deferred premiums represent the unbilled portion of annual premiums.

Earned premiums on retrospectively rated policies are based on the Company's estimate of loss experience as of the measurement date. Loss experience includes known losses specifically identifiable to a retrospective policy as well as provisions for future development on known losses and for losses incurred but not yet reported, which are developed using actuarial loss development factors that are consistent with how the Company projects losses in general. For retrospectively rated policies, the governing contractual minimum and maximum rates are established at policy inception and are made a part of the insurance contract. While the typical retrospectively rated policy has five annual adjustment or measurement periods, premium adjustments continue until mutual agreement to cease future adjustments is reached with the policyholder. For the three months ended June 30, 2007 and 2006, approximately 21.0% and 20.5%, respectively, of direct premiums written related to retrospectively rated policies. For the six months ended June 30, 2007 and 2006, approximately 17.0% and 23.9%, respectively, of direct premiums written related to retrospectively rated policies.

The Company estimates the amount of premiums that have been earned but unbilled at the end of the period by analyzing historical earned premium adjustments made and applying an adjustment percentage against premiums earned for the period. Included in deferred premiums is an accrual for earned but unbilled premiums of \$1.0 million at June 30, 2007 and \$1.5 million at December 31, 2006.

Service income generated from various underwriting and claims service agreements with third parties is recognized as income in the period in which services are performed.

#### *d. Unpaid Loss and Loss Adjustment Expense*

Unpaid loss and loss adjustment expense represents an estimate of the ultimate net cost of all unpaid losses incurred through the specified period. Loss adjustment expenses are estimates of unpaid expenses to be incurred in settlement of the claims included in the liability for unpaid losses. These liabilities, which anticipate salvage and subrogation recoveries and are presented gross of amounts recoverable from reinsurers, include estimates of future trends in claim severity and frequency and other factors that could vary as the losses are ultimately settled. Liabilities for unpaid loss and loss adjustment expenses are not discounted to account for the time value of money.

We used a consulting actuary to evaluate the reasonableness of our liability for unpaid loss and loss adjustment expense. In light of the Company's short operating history and uncertainties concerning the effects of legislative reform specifically as it relates to the Company's California workers' compensation class of business, actuarial techniques are applied that use the historical experience of the Company and the Company's predecessor as well as industry information in the analysis of unpaid loss and loss adjustment expense. These techniques recognize, among other factors:

- the Company's claims experience and that of its predecessor;
- the industry's claims experience;
- historical trends in reserving patterns and loss payments;
- the impact of claim inflation;
- the pending level of unpaid claims;
- the cost of claim settlements;
- legislative reforms affecting workers' compensation; and
- the environment in which insurance companies operate.

Although it is not possible to measure the degree of variability inherent in such estimates, management believes that the liability for unpaid loss and loss adjustment expense is reasonable. The estimates are reviewed quarterly and any necessary adjustment is included in the results of operations of the period in which the adjustment is determined.

## SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

#### *e. Reinsurance*

The Company protects itself from excessive losses by reinsuring certain levels of risk in various areas of exposure with nonaffiliated reinsurers. Reinsurance premiums, commissions, expense reimbursements and reserves related to ceded business are accounted for on a basis consistent with that used in accounting for original policies issued and the terms of the reinsurance contracts. The unpaid loss and loss adjustment expense subject to the adverse development cover with LMC is calculated periodically using generally accepted actuarial methodologies for estimating unpaid loss and loss adjustment expense liabilities, including incurred loss and paid loss development methods. Amounts recoverable in excess of acquired reserves at September 30, 2003 are recorded gross in unpaid loss and loss adjustment expense in accordance with Statement of Financial Accounting Standards ("SFAS") No. 141, *Business Combinations*, with a corresponding amount receivable from the seller. Amounts are shown net in the unaudited condensed consolidated statements of operations. Premiums ceded to other companies are reported as a reduction of premiums written and earned. Reinsurance recoverables are determined based on the terms and conditions of the reinsurance contracts.

Balances due from reinsurers on unpaid loss and loss adjustment expenses, including an estimate of such recoverables related to reserves for IBNR losses, are reported as assets and are included in reinsurance recoverables even though amounts due on unpaid loss and loss adjustment expenses are not recoverable from the reinsurer until such losses are paid. Should a reinsurer be unable or unwilling to pay such amounts to the Company when due, the Company would be liable for such obligations. The Company monitors the financial condition of its reinsurers and does not believe that it is currently exposed to any material credit risk through our reinsurance agreements because most of its reinsurance is recoverable from large, well-capitalized reinsurance companies. Historically, no amounts from reinsurers have been written-off as uncollectible.

#### *f. Income Taxes*

The asset and liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse, net of any applicable valuation allowances. The Company evaluates the necessity of a deferred tax asset valuation allowance by determining, based on the weight of available evidence, whether it is more likely than not that some portion or all of the deferred tax asset will not be realized. When necessary, a valuation allowance is recorded to reduce the deferred tax asset to the amount that is more likely than not to be realized.

The Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109* ("FIN 48") on January 1, 2007. At the date of adoption and as of June 30, 2007, the Company had no unrecognized tax benefits and no adjustments to liabilities or operations were required.

The Company recognizes interest on tax related matters as interest expense and penalties as income tax expense. As of June 30, 2007, the Company had no accrued interest or penalties related to uncertain tax positions.

The tax years 2003 through 2006 remain open to examination by the major taxing jurisdictions to which we are subject.

#### *g. Earnings Per Share*

The following table provides the reconciliation of basic and diluted weighted average shares outstanding used in calculating earnings per share for the three month and six month periods ended June 30, 2007 and 2006:



# SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	(in thousands)			
Basic weighted average shares outstanding...	20,339	20,319	20,330	19,647
Weighted average shares issuable upon exercise of outstanding stock options and vesting of restricted stock .....	<u>621</u>	<u>432</u>	<u>584</u>	<u>398</u>
Diluted weighted average shares outstanding .....	<u>20,960</u>	<u>20,751</u>	<u>20,914</u>	<u>20,045</u>

### *h. Stock-Based Compensation*

The Company accounts for awards of stock options and restricted stock according to the provisions of SFAS No. 123R, *Share-Based Payment*. The following table summarizes total stock-based compensation expense recognized in the unaudited condensed consolidated statements of operations for the three month and six month periods ended June 30, 2007 and 2006:

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	(in thousands)			
Stock option compensation expense related to:				
Restricted stock.....	\$ 581	\$ 329	\$ 935	\$ 387
Stock options .....	<u>176</u>	<u>126</u>	<u>324</u>	<u>228</u>
Total.....	<u>\$ 757</u>	<u>\$ 455</u>	<u>\$ 1,259</u>	<u>\$ 615</u>
Total related tax benefit.....	\$ 211	\$ 118	\$ 340	\$ 140

### *i. Comprehensive Income*

The following table summarizes the Company's comprehensive income for the three month and six month periods ended June 30, 2007 and 2006:

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	(in thousands)			
Net income.....	\$ 10,203	\$ 9,383	\$ 20,276	\$ 15,351
Reclassification adjustment for net realized losses recorded into income.....	(8)	(88)	(60)	(315)
Tax benefit related to reclassification adjustment .....	3	31	21	110
Increase in unrealized losses on investment securities available for sale.....	(6,655)	(3,476)	(6,393)	(7,120)
Tax benefit related to unrealized losses.....	<u>2,330</u>	<u>1,217</u>	<u>2,238</u>	<u>2,492</u>
Total comprehensive income.....	<u>\$ 5,873</u>	<u>\$ 7,067</u>	<u>\$ 16,082</u>	<u>\$ 10,518</u>

### *j. Recently Issued Accounting Pronouncements*

In September 2005, the American Institute of Certified Public Accountants ("AICPA") released Statement of Position 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts* ("SOP 05-1"). SOP 05-1 requires identification of transactions that result in a substantial change in an insurance contract. If it is determined that a substantial change to an insurance contract has occurred, the related unamortized deferred policy acquisition costs, unearned premiums and other related balances must be written off. SOP 05-1 is effective for fiscal years beginning after December 15, 2006. The Company adopted the provisions of SOP 05-1 as of January 1, 2007, which did not have a material effect on its consolidated financial condition or results of operations.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109* ("FIN 48"), which provides for the recognition, measurement, presentation and disclosure of uncertain tax positions. A tax benefit from an uncertain position may be recognized

# SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

only if it is more likely than not that the position is sustainable based on its technical merits. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. The Company adopted the provisions of FIN 48 as of January 1, 2007, which did not have a material effect on its consolidated financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value and establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. The provisions for SFAS No. 157 are effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. The Company must adopt these new requirements no later than its first fiscal quarter of 2008. The Company expects that SFAS No. 157 will not have a material effect on its consolidated financial condition or results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115*, which permits entities to choose to measure many financial instruments and certain other items at fair value in order to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently and without having to apply complex hedge accounting provisions. The provisions for SFAS No. 159 are effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. The Company must adopt these new requirements no later than its first fiscal quarter of 2008. The Company is currently evaluating the impact that adoption of SFAS No. 159 will have on its consolidated financial condition and results of operations.

### 3. Investments

The consolidated cost or amortized cost, gross unrealized gains and losses, and estimated fair value of investment securities available for sale at June 30, 2007 are as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Fixed income securities:				
U.S. Treasury securities.....	\$ 9,628	\$ —	\$ (222)	\$ 9,406
Government sponsored agency securities.....	41,600	—	(478)	41,122
Corporate securities.....	41,698	3	(1,079)	40,622
Tax-exempt municipal securities.....	217,121	79	(3,230)	213,970
Mortgage pass-through securities.....	68,680	28	(1,394)	67,314
Collateralized mortgage obligations.....	2,235	1	(34)	2,202
Asset-backed securities.....	47,734	5	(680)	47,059
Total fixed income securities.....	428,696	116	(7,117)	421,695
Equity securities.....	5,645	258	(14)	5,889
Total investment securities.....	<u>\$434,341</u>	<u>\$ 374</u>	<u>\$ (7,131)</u>	<u>\$427,584</u>

Equity securities consist of investments in exchange traded funds designed to correspond to the performance of certain indexes based on domestic or international stocks. The Company had no direct investments in equity securities at June 30, 2007. The unrealized loss on temporarily impaired investments totaled \$7.1 million at June 30, 2007 for investment securities available-for-sale with a fair value of \$384.0 million. Approximately \$6.7 million of total unrealized losses at June 30, 2007 were from securities that had been impaired for more than one year. At June 30, 2007, no unrealized loss exceeded 20% of the related security's book value at that date. The following table summarizes the fair value and gross unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss at June 30, 2007:

**SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

<u>Investment category</u>	<u>Less than 12 months</u>		<u>12 months or more</u>		<u>Total</u>	
	<u>Aggregate Fair Value</u>	<u>Aggregate Unrealized loss</u>	<u>Aggregate Fair Value</u>	<u>Aggregate Unrealized loss</u>	<u>Aggregate Fair Value</u>	<u>Aggregate Unrealized loss</u>
	<u>(in thousands)</u>					
U.S. Treasury securities.....	\$ 316	\$ (3)	\$ 9,090	\$ (219)	\$ 9,406	\$ (222)
Government sponsored agency securities.....	14,418	(50)	25,705	(428)	40,123	(478)
Corporate securities.....	3,661	(54)	32,871	(1,025)	36,532	(1,079)
Tax-exempt municipal securities.....	38,106	(156)	152,895	(3,074)	191,001	(3,230)
Mortgage pass-through securities.....	14,664	(97)	47,346	(1,297)	62,010	(1,394)
Collateralized mortgage obligations .....	—	—	1,832	(34)	1,832	(34)
Asset-backed securities .....	<u>3,559</u>	<u>(63)</u>	<u>39,554</u>	<u>(617)</u>	<u>43,113</u>	<u>(680)</u>
Total fixed income securities....	<u>\$ 74,724</u>	<u>\$ (423)</u>	<u>\$ 309,293</u>	<u>\$ (6,694)</u>	<u>\$ 384,017</u>	<u>\$ (7,117)</u>

The Company regularly reviews its fixed maturity portfolio to evaluate the necessity of recording impairment losses for other-than-temporary declines in the fair value of investments. A number of criteria are considered during this process, including, but not limited to, the following: the current fair value as compared to amortized cost or cost, as appropriate, of the security; the length of time the security's fair value has been below amortized cost; the Company's intent and ability to retain the investment for a period of time sufficient to allow for an anticipated recovery in value; specific credit issues related to the issuer; and current economic conditions. In general, the Company focuses on those securities whose fair values were less than 80% of their amortized cost or cost, as appropriate, for six or more consecutive months. Other-than-temporary impairment losses result in a permanent reduction of the carrying amount of the underlying investment. Significant changes in the factors considered when evaluating investments for impairment losses could result in a significant change in impairment losses reported in the financial statements. The Company evaluated investment securities with June 30, 2007 fair values less than amortized cost and has determined that the decline in value is temporary and is related primarily to the change in market interest rates since purchase. Furthermore, the Company has the ability to hold the impaired investments to maturity and the intent to hold them for a period of time sufficient for recovery of their carrying amount. Therefore, no other-than-temporary impairment losses were recorded in the six months ended June 30, 2007 and 2006.

The amortized cost and estimated fair value of fixed income securities available for sale at June 30, 2007, by contractual maturity, are set forth below. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

<u>Maturity</u>	<u>Cost or Amortized Cost</u>	<u>Estimated Fair Value</u>
	<u>(in thousands)</u>	
Due in one year or less .....	\$ 20,731	\$ 20,685
Due after one year through five years.....	93,185	91,803
Due after five years through ten years .....	171,552	168,500
Due after ten years.....	24,579	24,132
Securities not due at a single maturity date .....	<u>118,649</u>	<u>116,575</u>
Total investment securities available for sale .....	<u>\$ 428,696</u>	<u>\$ 421,695</u>

The amortized cost of investment securities available for sale deposited with various regulatory authorities at June 30, 2007 was \$180.3 million.

#### **4. Premiums**

Direct premiums written totaled \$65.2 million and \$48.6 million for the three month periods ended June 30, 2007 and 2006, respectively, and \$123.0 million and \$99.8 million for the six month periods then ended, respectively.

# SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Premiums receivable consisted of the following at June 30, 2007 and December 31, 2006:

	June 30, 2007	December 31, 2006
	(in thousands)	
Premiums receivable.....	\$ 9,203	\$ 9,986
Allowance for doubtful accounts.....	(1,306)	(1,109)
	<u>\$ 7,897</u>	<u>\$ 8,877</u>

### 5. Reinsurance

#### a. Reinsurance Ceded

Under reinsurance agreements, the Company cedes various amounts of risk to nonaffiliated insurance companies for the purpose of limiting the maximum potential loss arising from the underlying insurance risks.

On October 1, 2006, the Company entered into new reinsurance agreements with nonaffiliated reinsurers wherein it retains the first \$1.0 million of each loss occurrence. The new reinsurance program, which is effective through October 1, 2007, provides coverage up to \$75.0 million per loss occurrence as follows:

Layer	General Description
\$1.0 million excess of \$1.0 million each loss occurrence	Fully reinsured, subject to an aggregate annual limit of \$8.0 million
\$3.0 million excess of \$2.0 million each loss occurrence	Fully reinsured, subject to an aggregate annual limit of \$12.0 million
\$5.0 million excess of \$5.0 million each loss occurrence	Fully reinsured, subject to an aggregate annual limit of \$15.0 million
\$10.0 million excess of \$10.0 million each loss occurrence	Fully reinsured, subject to a limit of \$7.5 million maximum for any one life and an aggregate limit of \$20.0 million.
\$55.0 million excess of \$20.0 million each loss occurrence	Fully reinsured in two sub-layers. The first sub-layer affords coverage of up to \$30.0 million for each loss occurrence in excess of \$20.0 million, subject to an aggregate annual limit of \$60.0 million, and the second sub-layer affords coverage up to \$25.0 million for each loss occurrence in excess of \$50.0 million, subject to an annual aggregate limit of \$50.0 million. Both sub-layers are subject to a limit of \$5.0 million maximum for any one life.

The above coverage is subject to various additional limitations and exclusions as more fully described in the reinsurance agreements.

As part of the purchase of SBIC, SIH and LMC entered into an adverse development excess of loss reinsurance agreement (the "Agreement"). The Agreement, after taking into account any recoveries from third party reinsurers, requires LMC to reimburse SBIC 100% of the excess of the actual loss at December 31, 2011 over the initial insurance liabilities at September 30, 2003. The Agreement also requires SBIC to reimburse LMC 100% of the excess of the initial insurance liabilities at September 30, 2003 over the actual loss results at December 31, 2011. The amount of adverse loss development under the Agreement recorded in the accompanying unaudited consolidated balance sheets was \$2.8 million at June 30, 2007. Any increase or decrease in the amount due from LMC is included in loss and loss adjustment expenses in the unaudited consolidated statements of operations.

As part of the Agreement, LMC placed into trust (the "Trust") \$1.6 million, equal to 10% of the balance sheet reserves of SBIC on the date of sale. Thereafter, the Trust shall be adjusted each quarter, if warranted, to an amount equal to the greater of (a) \$1.6 million or (b) 102% of LMC's obligations under the Agreement. The balance of the Trust, including accumulated interest, was \$3.4 million at June 30, 2007 and \$5.2 million at December 31, 2006. In February 2007, LMC submitted a request to withdraw approximately \$1.8 million of excess funds on deposit in the

# SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

trust account. After due evaluation, the Company complied with LMC's request, resulting in a balance in the trust account of approximately \$3.4 million immediately following the withdrawal.

### *b. Reinsurance Assumed*

The Company involuntarily assumes residual market business either directly from various states that operate their own residual market programs or indirectly from the National Council for Compensation Insurance (the "NCCI"), which operates residual market programs on behalf of some states. The states in which we assumed residual market business at June 30, 2007 include the following: Alabama, Alaska, Arizona, Arkansas, Georgia, Idaho, Illinois, Iowa, Kansas, Michigan, Nevada, New Jersey, New Mexico, Oregon, South Carolina, South Dakota, and Virginia.

### *c. Reinsurance Recoverables and Income Statement Effects*

Balances affected by reinsurance transactions are reported gross of reinsurance in the accompanying unaudited condensed consolidated balance sheets. Reinsurance recoverables are comprised of the following amounts at June 30, 2007 and December 31, 2006:

	June 30, 2007	December 31, 2006
	(in thousands)	
Reinsurance recoverables on unpaid loss and loss adjustment expenses.....	\$ 12,648	\$ 13,504
Reinsurance recoverables on paid losses .....	88	171
Total reinsurance recoverables .....	<u>\$ 12,736</u>	<u>\$ 13,675</u>

The effects of reinsurance are as follows for the three month and six month periods ended June 30, 2007 and 2006:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(in thousands)			
Reinsurance assumed:				
Written premiums .....	\$ 2,343	\$ 3,702	\$ 4,452	\$ 7,246
Earned premiums .....	2,182	1,796	4,190	5,399
Losses and loss adjustment expenses				
incurred.....	1,375	1,212	2,644	3,251
Commission expenses incurred .....	772	605	1,539	1,958
Reinsurance ceded:				
Written premiums .....	\$ 3,914	\$ 4,230	\$ 7,580	\$ 8,099
Earned premiums .....	3,859	3,934	7,468	7,962
Losses and loss adjustment expenses				
incurred.....	706	346	(139)	833
Commission expenses incurred .....	315	454	565	910

## 6. Unpaid Loss and Loss Adjustment Expenses

The following table summarizes the activity in unpaid loss and loss adjustment expense for the three month and six month periods ended June 30, 2007 and 2006:

# SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	(in thousands)			
Beginning balance:				
Unpaid loss and loss adjustment expense .	\$ 206,463	\$ 160,063	\$ 198,356	\$ 142,211
Reinsurance recoverables .....	<u>(12,252)</u>	<u>(13,777)</u>	<u>(13,504)</u>	<u>(13,745)</u>
Net .....	<u>194,211</u>	<u>146,286</u>	<u>184,852</u>	<u>128,466</u>
Incurred related to:				
Current period.....	36,804	29,356	69,913	60,957
Prior periods .....	<u>(7,792)</u>	<u>(7,291)</u>	<u>(14,983)</u>	<u>(10,429)</u>
Total incurred .....	<u>29,012</u>	<u>22,065</u>	<u>54,930</u>	<u>50,528</u>
Paid related to:				
Current period.....	(8,153)	(4,141)	(12,641)	(5,502)
Prior periods .....	<u>(9,039)</u>	<u>(8,494)</u>	<u>(21,110)</u>	<u>(17,776)</u>
Total paid.....	<u>(17,192)</u>	<u>(12,635)</u>	<u>(33,751)</u>	<u>(23,278)</u>
Unpaid loss and loss adjustment expense, net of reinsurance recoverables	206,031	155,716	206,031	155,716
Reinsurance recoverables .....	<u>12,648</u>	<u>13,620</u>	<u>12,648</u>	<u>13,620</u>
Unpaid loss and loss adjustment expense .....	<u>\$ 218,679</u>	<u>\$ 169,336</u>	<u>\$ 218,679</u>	<u>\$ 169,336</u>

Loss and loss adjustment expenses are net of the release of loss reserves totaling approximately \$7.8 million and \$15.0 million in the three month and six month periods ended June 30, 2007, respectively, compared to \$7.3 million and \$10.4 million for the same periods in 2006. The majority of these reserve releases relate to the Company's California book of business and reflect a continuation of lower than anticipated patterns of loss payments in recent accident years as a result of reform legislation enacted there primarily in 2003 and 2004.

### 7. Surplus Notes

In a private placement on May 26, 2004, SBIC issued \$12.0 million in subordinated floating rate surplus notes due in 2034. Interest, paid quarterly in arrears, is calculated at the beginning of the interest payment period using the 3-month LIBOR rate plus 400 basis points, subject to certain limitations. Interest expense totaled \$284,000 and \$565,000 for the three month and six month periods ended June 30, 2007, respectively, and \$272,000 and \$528,000 for the three month and six month periods ended June 30, 2006, respectively.

The notes are redeemable prior to 2034 by the Company, in whole or in part, from time to time, on or after May 24, 2009 on an interest payment date or at any time prior to May 24, 2009, in whole but not in part, upon the occurrence and continuation of a tax event as defined in the agreement. The Company may not exercise its option to redeem with respect to a tax event unless it pays a premium in addition to the redemption price.

### 8. Contingencies

a. SBIC is subject to guaranty fund and other assessments by the states in which it writes business. Guaranty fund assessments are accrued at the time premiums are written. Other assessments are accrued either at the time of assessment or in the case of premium-based assessments, at the time the premiums are written, or in the case of loss-based assessments, at the time the losses are incurred. As of June 30, 2007, SBIC had a liability for guaranty fund and other assessments of \$2.9 million and a guaranty fund receivable of \$2.4 million. These amounts represent management's best estimate based on information received from the states in which it writes business and may change due to many factors, including the Company's share of the ultimate cost of current and future insolvencies. The majority of assessments are paid out in the year following the year in which the premium is written or the losses are paid. Guaranty fund receivables and other surcharge items are generally realized by a charge to new and renewing policyholders in the year following the year in which the related assessments were paid.

b. The Company is involved in various claims and lawsuits arising in the ordinary course of business. Management believes the outcome of these matters will not have a material adverse effect on the Company's consolidated financial position or results of operations.

# SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

### 9. Share-Based Payment Arrangements

At June 30, 2007, the Company had outstanding stock options and restricted stock granted according to the terms of two equity incentive plans. The stockholders and Board of Directors approved the 2003 Stock Option Plan (the “2003 Plan”) in September 2003, and amended and restated the 2003 Plan in February 2004, and approved the 2005 Long-Term Equity Incentive Plan (the “2005 Plan” and, together with the 2003 Plan, the “Stock Option Plans”) in December 2004. The Stock Option Plans were further amended and restated in April 2007.

As of June 30, 2007, options to purchase 483,855 shares of common stock were outstanding under the 2003 Plan, and no additional shares were reserved for issuance under the 2003 Plan. As of June 30, 2007, 450,229 shares of restricted stock were issued under the 2005 Plan, options to purchase 1,020,315 shares of common stock were outstanding under the 2005 Plan and 765,053 shares were reserved for issuance under the 2005 Plan.

#### a. Stock Options

The fair values of stock options granted during the three month and six month periods ended June 30, 2007 and 2006 were determined on the dates of grant using the Black-Scholes-Merton option valuation model with the following weighted average assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Expected term (years).....	6.3	6.2	6.3	6.2
Expected stock price volatility.....	26.1%	26.1%	26.2%	26.1%
Risk-free interest rate.....	4.62%	4.96%	4.58%	4.73%
Expected dividend yield .....	—	—	—	—
Estimated fair value per option.....	\$6.84	\$6.28	\$6.76	\$6.41

The following table summarizes stock option activity for the six months ended June 30, 2007:

	Shares Subject to Options	Weighted Average Exer- cise Price per Share	Weighted Average Re- maining Con- tractual Life (years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2006.....	918,154	\$ 9.39	7.6	\$ —
Granted .....	139,700	18.32	—	—
Forfeited .....	(8,949)	13.13	—	—
Exercised .....	(28,590)	8.36	—	—
Cancelled .....	—	—	—	—
Outstanding at June 30, 2007.....	<u>1,020,315</u>	10.61	7.5	7,012.4
Exercisable at June 30, 2007 .....	516,327	8.32	6.8	4,728.2

The aggregate intrinsic values in the table above are before applicable income taxes and are based on the Company’s closing stock price of \$17.48 on June 30, 2007. As of June 30, 2007, total unrecognized stock-based compensation cost related to nonvested stock options was approximately \$1.7 million, which is expected to be recognized over a weighted average period of approximately 34 months. Proceeds from the exercise of stock options totaled approximately \$239,100 for the six months ended June 30, 2007. The total intrinsic value of stock options exercised during the six months ended June 30, 2007 was approximately \$287,500.

**SEABRIGHT INSURANCE HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table presents additional information regarding options outstanding as of June 30, 2007:

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number Outstanding</u>	<u>Weighted- Average Remaining Contractual Life (years)</u>	<u>Weighted- Average Exercise Price</u>	<u>Number Outstanding</u>	<u>Weighted- Average Exercise Price</u>
\$ 6.54	459,928	6.3	\$ 6.54	339,447	\$ 6.54
10.50-12.54	303,874	7.6	10.61	148,913	10.64
15.44-18.68	256,513	9.3	17.90	27,967	17.64
	<u>1,020,315</u>	7.5	10.61	<u>516,327</u>	8.32

***b. Restricted Stock***

The following table summarizes restricted stock activity for the six months ended June 30, 2007:

	<u>Number of Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Outstanding at December 31, 2006.....	233,875	\$ 17.39
Granted .....	232,104	18.22
Vested.....	—	—
Forfeited .....	(15,750)	17.97
Outstanding at June 30, 2007.....	<u>450,229</u>	17.80

As of June 30, 2007, there was \$5.9 million of total unrecognized compensation cost related to restricted stock granted under the 2005 Plan. That cost is expected to be recognized over a weighted-average period of 28 months. No shares vested during the quarter ended June 30, 2007.



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

### **Cautionary Statement**

You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto included in Item 1 of this Part I. The information contained in this quarterly report is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this quarterly report and in our other reports filed with the U.S. Securities and Exchange Commission ("SEC"), including our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the SEC on March 16, 2007.

The discussion under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2006, as updated by the discussion in Part II, Item 1A of this quarterly report, and similar discussions in our other SEC filings, describe some of the important risk factors that may affect our business, results of operations and financial condition. You should carefully consider those risks, in addition to the other information in this report and in our other filings with the SEC, before deciding to purchase, hold or sell our common stock.

Some of the statements in this Item 2 and elsewhere in this quarterly report may include forward-looking statements that reflect our current views with respect to future events and financial performance. These statements include forward-looking statements both with respect to us specifically and the insurance sector in general. Statements that include the words "expect," "intend," "plan," "believe," "project," "estimate," "may," "should," "anticipate," "will" and similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise.

All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause our actual results to differ materially from those indicated in these statements. We believe that these factors include but are not limited to the following:

- ineffectiveness or obsolescence of our business strategy due to changes in current or future market conditions;
- increased competition on the basis of pricing, capacity, coverage terms or other factors;
- greater frequency or severity of claims and loss activity, including as a result of natural or man-made catastrophic events, than our underwriting, reserving or investment practices anticipate based on historical experience or industry data;
- the effects of acts of terrorism or war;
- developments in financial and capital markets that adversely affect the performance of our investments;
- changes in regulations or laws applicable to us, our subsidiaries, brokers or customers;
- our dependency on a concentrated geographic market;
- changes in the availability, cost or quality of reinsurance and failure of our reinsurers to pay claims timely or at all;
- decreased demand for our insurance products;
- loss of the services of any of our executive officers or other key personnel;
- the effects of mergers, acquisitions and divestitures that we may undertake;
- changes in rating agency policies or practices;
- changes in legal theories of liability under our insurance policies;
- changes in accounting policies or practices; and
- changes in general economic conditions, including inflation and other factors.

The foregoing factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in this quarterly report. We undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary materially from what we project. Any forward-looking statements you read in this quarterly report reflect our views as of the date of this quarterly report with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. Before making an investment decision, you should carefully consider all of the factors identified in this quarterly report that could cause actual results to differ.

Additional information concerning these and other factors is contained in our SEC filings, including, but not limited to, our 2006 Annual Report on Form 10-K.

## Overview

We are a specialty provider of multi-jurisdictional workers' compensation insurance. We are domiciled in Illinois, commercially domiciled in California and headquartered in Seattle, Washington. We are licensed in 45 states and the District of Columbia to write workers' compensation insurance. Traditional providers of workers' compensation insurance provide coverage to employers under one or more state workers' compensation laws, which prescribe benefits that employers are obligated to provide to their employees who are injured arising out of or in the course of employment. We focus on employers with complex workers' compensation exposures and provide coverage under multiple state and federal acts, applicable common law or negotiated agreements. We also provide traditional state act coverage in markets we believe are underserved. Our workers' compensation policies are issued to employers who also pay the premiums. The policies provide payments to covered, injured employees of the policyholder for, among other things, temporary or permanent disability benefits, death benefits and medical and hospital expenses. The benefits payable and the duration of such benefits are set by statute and vary by jurisdiction and with the nature and severity of the injury or disease and the wages, occupation and age of the employee.

SIH was formed in 2003 by members of our current management and entities affiliated with Summit Partners, a leading private equity and venture capital firm, for the purpose of the Acquisition. In the Acquisition, we acquired from LMC and certain of its affiliates the renewal rights and substantially all of the operating assets and employees of Eagle. Eagle began writing specialty workers' compensation insurance policies in the mid-1980's. The Acquisition gave us renewal rights to an existing portfolio of business, representing a valuable asset given the renewal nature of our business, and a fully operational infrastructure that would have taken many years to develop. These renewal rights gave us access to Eagle's customer lists and the right to seek to renew Eagle's continuing in-force insurance contracts.

In the Acquisition, we also acquired 100% of the issued and outstanding capital stock of KEIC and PointSure. We acquired KEIC, a shell company with no in-force policies or employees, solely for the purpose of acquiring its workers' compensation licenses in 43 states and the District of Columbia and for its certification with the United States Department of Labor. Subsequent to the Acquisition, KEIC was renamed "SeaBright Insurance Company." SeaBright Insurance Company received an "A-" (Excellent) rating from A.M. Best following the completion of the Acquisition.

To minimize our exposure to any past business underwritten by KEIC, we entered into an adverse development cover agreement in connection with the Acquisition. Under the terms of this agreement, we and LMC are required to indemnify each other with respect to developments in KEIC's insurance liabilities as they existed at the date of the Acquisition. Accordingly, if KEIC's insurance liabilities increase, LMC must indemnify us in the amount of the increase. If KEIC's insurance liabilities decrease, we must share with LMC the positive development of those reserves. To support LMC's obligations under the adverse development cover, LMC funded a trust account at the time of the Acquisition in the amount of \$1.6 million as collateral for LMC's potential future obligations to us under the adverse development cover. The minimum amount that must be maintained in the trust account is equal to the greater of (a) \$1.6 million or (b) 102% of the then existing quarterly estimate of LMC's total obligations under the adverse development cover. The amount on deposit in the trust account was approximately \$3.4 million at June 30, 2007 and \$5.2 million at December 31, 2006. In February 2007, LMC submitted a request to withdraw approximately \$1.8 million of excess funds on deposit in the Trust. After due evaluation, the Company complied with LMC's request, resulting in a balance in the trust account of approximately \$3.4 million immediately following the withdrawal. If LMC is placed into receivership and the amount held in the collateralized reinsurance trust is

inadequate to satisfy the obligations of LMC to us under the adverse development cover agreement, it is unlikely that we would recover any future amounts owing by LMC to us.

## Principal Revenue and Expense Items

We derive our revenue primarily from premiums earned, net investment income and net realized gains and losses from investments, and service income. We show certain non-GAAP financial measures that we believe are valuable in managing our business and evaluating our performance. These measures include gross premiums written, net premiums written, net loss ratios and net underwriting expense ratios.

### *Premiums Earned*

Gross premiums written is a non-GAAP financial measure representing all premiums billed and unbilled by an insurance company during a specified policy period. Premiums are earned over the terms of the related policies. At the end of each accounting period, the portions of premiums that are not yet earned are included in unearned premiums and are realized as revenue in subsequent periods over the remaining terms of the policies. Our policies typically have terms of 12 months. Thus, for example, for a policy that is written on July 1, 2006, one-half of the premiums would be earned in 2006 and the other half would be earned in 2007.

Premiums earned, the most comparable GAAP measure, represents the earned portion of our net premiums written. Net premiums written, another non-GAAP financial measure, is the difference between gross premiums written and premiums ceded or paid to reinsurers (ceded premiums written). Our gross premiums written is the sum of both direct premiums and assumed premiums before the effect of ceded reinsurance. Assumed premiums are premiums that we have received from an authorized state-mandated pool.

We earn our direct premiums written from our maritime, alternative dispute resolution (“ADR”) and state act customers. We also earn a small portion of our direct premiums written from employers who participate in the Washington State United States Longshore and Harbor Workers Compensation Act Assigned Risk Plan (the “Washington USL&H Assigned Risk Plan”). We immediately cede 100% of those premiums, net of our expenses, and 100% of the losses in connection with that business back to the USL&H Assigned Risk Plan. Premiums from the Washington USL&H Assigned Risk Plan are included in both direct premiums written and ceded premiums written.

We analyze our growth and earnings potential, in part, through the non-GAAP financial measures of gross premiums written, net premiums written and in-force premiums. In-force premiums refers to our current annual gross premiums written that have active or unexpired policies, excluding premiums received from the Washington USL&H Assigned Risk Plan, and represents premiums from our total customer base. In-force premiums as of June 30, 2007 and 2006 were \$242.1 million and \$186.4 million, respectively. The following table provides a reconciliation of gross premiums written and net premiums written to net premiums earned:

	<u>Three Months Ended June 30,</u>		<u>Six Months Ended June 30,</u>	
	<u>2007</u>	<u>2006</u>	<u>2007</u>	<u>2006</u>
	(in thousands)			
Direct premiums written .....	\$ 65,216	\$ 48,665	\$ 123,033	\$ 99,816
Assumed premiums written .....	<u>2,343</u>	<u>3,702</u>	<u>4,452</u>	<u>7,246</u>
Gross premiums written .....	67,559	52,367	127,485	107,062
Ceded premiums .....	<u>(3,914)</u>	<u>(4,213)</u>	<u>(7,580)</u>	<u>(8,099)</u>
Net premiums written .....	63,645	48,154	119,905	98,963
Change in unearned premiums, net of reinsurance .....	<u>(8,888)</u>	<u>(6,360)</u>	<u>(16,517)</u>	<u>(13,206)</u>
Premiums earned .....	<u>\$ 54,757</u>	<u>\$ 41,794</u>	<u>\$ 103,388</u>	<u>\$ 85,757</u>

### *Net Investment Income and Realized Gains and Losses on Investments*

We invest our statutory surplus and the funds supporting our insurance liabilities (including unearned premiums and unpaid loss and loss adjustment expense) in cash, cash equivalents, fixed income securities and, to a lesser degree, in equity securities. Our investment income includes interest earned on our invested assets. Realized gains and losses on invested assets are reported separately from net investment income. We earn realized gains when invested assets are sold for an amount greater than their amortized cost in the case of fixed maturity securities and recognize realized losses when investment securities are written down as a result of an other-than-temporary impairment or sold for an amount less than their carrying cost.

### ***Claims Service Income***

We receive claims service income in return for providing claims administration services for other companies. The claims service income we receive for providing these services approximates our costs. For the six months ended June 30, 2007 and 2006, approximately 51.1% and 70.4%, respectively, of our claims service income was generated by contracts we have with LMC to provide claims handling services for policies written by the Eagle Entities prior to the Acquisition. We expect income from these contracts to decrease substantially over the next several years as transactions related to the Eagle Entities diminish.

### ***Other Service Income***

Following the Acquisition, we entered into servicing arrangements with LMC to provide policy administration and accounting services for policies written by the Eagle Entities prior to the Acquisition. The fee income we receive for providing these services approximates our costs and will substantially decrease over the next several years as transactions related to the Eagle Entities diminish.

Our expenses consist primarily of:

### ***Loss and Loss Adjustment Expenses***

Loss and loss adjustment expenses represent our largest expense item and include (1) claim payments made, (2) estimates for future claim payments and changes in those estimates for current and prior periods and (3) costs associated with investigating, defending and adjusting claims.

The net loss ratio, expressed as a percentage, is a key non-GAAP financial measure that we use in monitoring our profitability. The net loss ratio is calculated by dividing loss and loss adjustment expenses for the period less claims service income by premiums earned for the period.

### ***Underwriting, Acquisition and Insurance Expenses***

In our insurance subsidiary, we refer to the expenses that we incur to underwrite risks as underwriting, acquisition and insurance expenses. Such expenses consist of commission expenses, premium taxes and fees and other underwriting expenses incurred in writing and maintaining our business. We pay commission expense in our insurance subsidiary to our brokers for the premiums that they produce for us. We pay state and local taxes based on premiums, as well as licenses, fees, assessments and contributions to workers' compensation security funds. Other underwriting expenses consist of general administrative expenses such as salaries and employee benefits, rent and all other operating expenses not otherwise classified separately, and boards, bureaus and assessments of statistical agencies for policy service and administration items such as rating manuals, rating plans and experience data.

The net underwriting expense ratio, expressed as a percentage, is a key non-GAAP financial measure that we use in monitoring our profitability. The net underwriting expense ratio is calculated by dividing underwriting, acquisition and insurance expenses for the period less other service income by premiums earned for the period.

### ***Interest Expense***

We incur interest expense on \$12.0 million in surplus notes that our insurance subsidiary issued in May 2004. The interest expense is paid quarterly in arrears. The interest expense for each interest payment period is based on the three-month LIBOR rate two London banking days prior to the interest payment period, plus 400 basis points.

## **Results of Operations**

### ***Three Month and Six Month Periods Ended June 30, 2007 and 2006***

**Gross Premiums Written.** Gross premiums written for the three months ended June 30, 2007 totaled \$67.6 million, an increase of \$15.2 million, or 29.0%, from \$52.4 million in the same period of 2006. For the six months ended June 30, 2007, gross premiums written totaled \$127.5 million, an increase of \$20.4 million, or 19.0%, from \$107.1 million in the same period of 2006 even though we continued to experience rate reductions in California, our largest market, as well as in other states. Excluding work we perform as the servicing carrier for the Washington USL&H Assigned Risk Plan, the number of customers we serviced increased 53.7% from 536 at June 30, 2006 to 824 at June 30, 2007 and in-force payrolls, one of the factors used in determining premium charges, increased 62.1% from \$2.9 billion at June 30, 2006 to \$4.7 billion one year later. California continues to be our largest market,

accounting for approximately \$111.4 million (46.0%) of our in-force premiums as of June 30, 2007 compared to \$112.7 million (60.5%) as of June 30, 2006, representing a decrease of \$1.3 million (1.2%). The decrease in California in-force premiums resulted primarily from rate reductions brought about by reform legislation enacted several years ago.

In December 2006, we announced the division of our Southern region into two markets, allowing us to devote greater focus and resources to further develop our key states in this region. Our new Southeast region is developing business in selected states, including Florida. This new region contributed approximately \$2.3 million and \$3.7 million to our direct premiums written in the three month and six month periods ended June 30, 2007, respectively. The Gulf region, which is based in Houston, Texas, now focuses primarily on developing business in the states of Texas and Louisiana. This new region contributed approximately \$11.8 million and \$17.9 million to our direct premiums written for the three month and six month periods ended June 30, 2007, respectively. Alaska continues to be our second largest market and accounted for approximately \$22.9 million (9.5%) of our in-force premiums as of June 30, 2007, representing an increase of \$0.9 million from \$22.0 million (11.8%) as of June 30, 2006. Illinois is our third largest market and accounted for approximately \$22.4 million (9.3%) of our in-force premiums as of June 30, 2007, representing an increase of \$14.8 million from \$7.6 million (4.0%) as of June 30, 2006. The remaining states in our top five markets were Louisiana and Hawaii, which accounted for approximately \$20.2 million (8.3%) and \$13.8 million (5.7%) of our in-force premiums as of June 30, 2007, respectively, compared to \$6.7 million (3.6%) and \$13.4 million (7.2%), respectively, of our in-force premiums as of June 30, 2006.

On March 30, 2007, the California Workers' Compensation Insurance Rating Bureau (the "WCIRB") submitted a filing with the California Insurance Commissioner to recommend an 11.3% decrease in advisory pure premium rates on new and renewal policies effective on or after July 1, 2007. The filing was based on a review of loss and loss adjustment experience through December 31, 2006 and was made in response to continued reductions in California workers' compensation claim costs. On May 29, 2007, the California Insurance Commissioner recommended a 14.2% decrease in rates effective July 1, 2007. On June 8, 2007, after completing a study of our California loss data, we filed with the California Insurance Commissioner our new rates reflecting an average reduction of 14.2% from prior rates for new and renewal workers' compensation insurance policies written in California on or after July 1, 2007. The filing was approved on June 12, 2007. This is the eighth California rate reduction we have filed since October 1, 2003, resulting in a net cumulative reduction of our California rates of approximately 54.8%.

Rate reductions have also been proposed in other states in which we operate. For example, effective January 1, 2007, we adopted the following rate decreases recommended by the National Council for Compensation Insurance (the "NCCI"): 10.5% in Alaska, 12.3% in Hawaii and 2.0% in Illinois. Effective July 1, we adopted a 15.8% reduction in Louisiana, which is 2.0% more than the 13.8% rate decrease recommended by the NCCI.

*Net Premiums Written.* Net premiums written for the three months ended June 30, 2007 totaled \$63.6 million, an increase of \$15.4 million, or 32.0%, from \$48.2 million in the same period of 2006. For the six months ended June 30, 2007, net premiums written totaled \$119.9 million, an increase of \$20.9 million, or 21.1%, from \$99.0 million in the same period of 2006. The increases in net premiums written for the three month and six month periods ended June 30, 2007 are reflective of similar increases in gross premiums written and reductions in premium rates on our ceded reinsurance contracts. Net premiums written are affected by premiums ceded under reinsurance agreements with external reinsurers. For the three months ended June 30, 2007, ceded written premiums totaled \$3.9 million (5.8% of gross premiums written) compared to \$4.2 million (8.0% of gross premiums written) in the same period of 2006. Ceded written premiums for the six months ended June 30, 2007 totaled \$7.6 million (6.0% of gross premiums written) compared to \$8.1 million (7.6% of gross premiums written) in the same period of 2006. The decrease in ceded premiums as a percentage of gross premiums written resulted primarily from the renewal of our excess of loss reinsurance program on October 1, 2006 at average rates that are approximately 16.8% lower than rates under the prior reinsurance program. We were able to achieve savings at the lower tiers of our program while increasing our catastrophe coverage from \$50.0 million to \$75.0 million.

*Net Premiums Earned.* Net premiums earned for the three months ended June 30, 2007 totaled \$54.8 million, an increase of \$13.0 million, or 31.1%, over \$41.8 million in the same period of 2006. For the six months ended June 30, 2007, net premiums earned totaled \$103.4 million, an increase of \$17.6 million, or 20.5%, from \$85.8 million in the same period of 2006. We record the entire annual policy premium as unearned premium when written and earn the premium over the life of the policy, which is generally twelve months. Consequently, the amount of premiums earned in any given year depends on when during the current or prior year the underlying policies were written. Our direct premiums earned for the three months ended June 30, 2007 increased \$12.5 million (28.5%) to \$56.4 million

from \$43.9 million in 2006. Our direct premiums earned for the six months ended June 30, 2007 increased \$18.4 million (20.8%) to \$106.7 million from \$88.3 million for the same period in 2006. The increase in our direct premiums earned is the result of our premium growth as described above.

Net premiums earned are also affected by premiums ceded under reinsurance agreements. Ceded premiums earned for the three month and six month periods ended June 30, 2007 were \$3.9 million and \$7.5 million, respectively. This represents no change from the three month period ended June 30, 2006 and a decrease of \$0.5 million (6.3%) from \$8.0 million in the six months ended June 30, 2006. A decrease in ceded premiums earned is an increase to our overall net premiums earned. Included in the net premiums earned for the three months ended June 30, 2007 is an increase of \$0.4 million (21.5%) in the amount of premiums we involuntarily assume on residual market business from the NCCI, which operates residual market programs on behalf of many states. For the six months ended June 30, 2007, assumed premiums earned decreased \$1.2 million (22.4%) to \$4.2 million from \$5.4 million in the same period of 2006.

*Net Investment Income.* Net investment income for the three months ended June 30, 2007 totaled \$4.9 million, an increase of \$1.2 million, or 32.4%, over \$3.7 million in the same period of 2006. For the six months ended June 30, 2006, net investment income totaled \$9.6 million, an increase of \$2.7 million, or 39.1%, from \$6.9 million in the same period of 2006. Average invested assets for the three months ended June 30 increased \$88.0 million (24.7%) from \$356.6 million in 2006 to \$444.6 million in 2007. For the six months ended June 30, average invested assets increased \$119.2 million (37.7%) from \$316.3 million in 2006 to \$435.5 million in 2007. This increase in our investment portfolio is due primarily to strong cash flow from operations of \$90.3 million for the year ended December 31, 2006 and \$38.5 million for the six months ended June 30, 2007 and, to a lesser degree, the \$57.6 million in proceeds from the follow-on offering of our common stock in February 2006. Our yield on average invested assets for the three months ended June 30, 2007 was approximately 4.4% compared to approximately 4.2% for the same period in 2006. For the six months ended June 30, 2007, our yield on average invested assets was 4.4% compared to approximately 4.3% for the same period in 2006.

*Service Income.* Service income for the three months ended June 30, 2007 totaled \$368,000, a decrease of \$184,000, or 33.3%, from \$552,000 in the same period of 2006. For the six months ended June 30, 2007, service income totaled \$0.9 million, a decrease of \$0.2 million, or 18.2%, from \$1.1 million in the same period of 2006. Our service income results primarily from service arrangements we have with LMC and other companies for claims processing, policy administration and administrative services that we perform for them. Average monthly fees from arrangements with LMC for services we provide in connection with the Eagle Entities' insurance policies are declining as the volume of work decreases due to the run off of our predecessor's business. Approximately 50.3% of our service income in the three-month period ended June 30, 2007 came from third party claims administration services that we provide to independent, unrelated companies and, to a lesser degree, administrative fees charged to our policyholders that have high deductible policies, compared to 30.9% in the same period of 2006. For the six-month period ended June 30, 2007, approximately 50.2% of our service income came from such services and fees, compared to approximately 28.4% in the same period of 2006.

*Other Income.* Other income for the three months ended June 30, 2007 totaled \$685,000, a decrease of \$184,000, or 21.2%, from \$869,000 in the same period of 2006. For the six months ended June 30, 2007 and 2006, other income totaled \$1.6 million. Other income is derived primarily from the operations of PointSure, our non-insurance subsidiary. PointSure represented 20 insurance companies as of June 30, 2007.

*Loss and Loss Adjustment Expenses.* Loss and loss adjustment expenses for the three months ended June 30, 2007 totaled \$29.0 million, an increase of \$6.9 million, or 31.2%, from \$22.1 million in the same period of 2006. For the six months ended June 30, 2006, loss and loss adjustment expenses totaled \$54.9 million, an increase of \$4.4 million, or 8.7%, from \$50.5 million in the same period of 2006. Our net loss ratio, which is calculated by dividing loss and loss adjustment expenses less claims service income by premiums earned, for the three months ended June 30, 2007 was 52.4% compared to 51.5% for the same period in 2006. Our net loss ratio for the six months ended June 30, 2007 was 52.3% compared to 57.7% for the same period in 2006. Included in the loss ratios for the three month and six month periods ended June 30, 2007 were reductions of approximately \$7.8 million and \$15.0 million, respectively, of previously recorded direct net loss reserves to reflect a continuation of lower than anticipated patterns of loss payments in recent accident years. Included in the loss ratios for the three month and six month periods ended June 30, 2006, were reductions of approximately \$7.3 million and \$10.4 million, respectively. Our direct net loss reserves are net of reinsurance and exclude reserves associated with KEIC and the business we involuntarily assume from the NCCI.

There is uncertainty about whether recent lower paid loss trends, which result primarily from California legislative reforms enacted primarily in 2003 and 2004, will be sustained, particularly in light of current efforts to change or repeal portions of the reforms. We will not know the full impact of these reforms with a high degree of confidence for several years. We have established loss reserves at June 30, 2007 that are based upon our current best estimate of loss costs, taking into consideration the recent lower paid loss claim data and incurred loss trends.

As of June 30, 2007, we had recorded a receivable of approximately \$2.8 million for adverse loss development of KEIC reserves since the date of the Acquisition. We do not expect this receivable to have any material adverse effect on our future cash flows if LMC fails to perform its obligations under the adverse development cover agreement. At June 30, 2007, we have access to approximately \$3.4 million under the collateralized reinsurance trust in the event that LMC fails to satisfy its obligations under the adverse development cover agreement. The balance of the Trust, including interest, was \$5.2 million at December 31, 2006. In February 2007, LMC submitted a request to withdraw approximately \$1.8 million of excess funds on deposit in the trust account. After due evaluation, we complied with LMC's request, resulting in a balance in the trust account of approximately \$3.4 million immediately following the withdrawal.

*Underwriting Expenses.* Underwriting expenses for the three months ended June 30, 2007 totaled \$14.7 million, an increase of \$4.9 million, or 50.0%, from \$9.8 million in the same period of 2006. For the six months ended June 30, 2007, underwriting expenses totaled \$27.3 million, an increase of \$7.8 million, or 40.0%, from \$19.5 million in the same period of 2006. Our net underwriting expense ratio for the three months ended June 30, 2007, which is calculated by dividing underwriting, acquisition and insurance expenses less other service income by premiums earned, was 26.8%, compared to 23.3% for the same period in 2006. For the six months ended June 30, 2007, our net underwriting expense ratio was 26.4%, compared to 22.7% for the same period of 2006. The increases in the net underwriting expense ratio for the three month and six month periods ended June 30, 2007 are primarily the result of increases in the number of staff, staffing related costs and other premium production-related expenses, including commission expense, as we continue to grow our business in existing offices and in new offices recently opened in Philadelphia, Atlanta, and Phoenix. These new offices have not yet reached the premium production levels required to contribute to earnings. The number of employees grew from 172 at June 30, 2006 to 210 at June 30, 2007, representing an increase of 22.1%. For the three month and six month periods ended June 30, 2007, the number of employees grew 6.7% and 18.0%, respectively.

Commission expense as a percentage of net earned premiums averaged 9.2% for the three months ended June 30, 2007 compared to 7.8% in the same period of 2006. Commission expense as a percentage of net earned premiums for the six months ended June 30, 2007 and 2006 averaged 9.2% and 8.3%, respectively. These increases are driven primarily by the California market as brokers try to maintain cash flow during a period of declining premium rates.

*Interest Expense.* Interest expense related to the surplus notes issued by our insurance subsidiary in May 2004 totaled \$284,000 for the three months ended June 30, 2007, compared to \$272,000 for the same period in 2006, representing an increase of \$12,000, or 4.4%. Interest expense for the six months ended June 30, 2007 totaled \$565,000, compared to \$528,000 for the same period in 2006, representing an increase of \$37,000, or 7.0%. The surplus notes interest rate, which is calculated at the beginning of each interest payment period using the 3-month LIBOR rate plus 400 basis points, increased from 9.21% at June 30, 2006 to 9.36% at June 30, 2007.

*Other Expenses.* Other expenses for the three months ended June 30, 2007 totaled \$1.7 million, an increase of \$0.4 million, or 30.8%, over \$1.3 million in the same period of 2006. For the six months ended June 30, 2007, other expenses totaled \$3.2 million, an increase of \$0.8 million, or 33.3%, from \$2.4 million in the same period of 2006. Other expenses result primarily from the operations of PointSure, our non-insurance subsidiary which continued to experience direct costs associated with the expansion of insurance products they offer. Other expenses for the three month and six month periods ended June 30, 2007 also included charges of \$650,000 and \$840,000, respectively, related to our annual report and annual shareholders meeting as well as other non-recurring expenses. Other expenses for the three month and six month periods ended June 30, 2006 included a one-time charge of \$305,000 related to a legal settlement.

*Federal Income Tax Expense.* The effective tax rate for the three months ended June 30, 2007 was 32.1%, compared to 30.5% for the same period in 2006. For the six months ended June 30, 2007 our effective tax rate was 31.3% compared to 30.5% in the same period of 2006. The increases in our effective tax rate are primarily attributable to a decrease in the proportion of tax-exempt municipal securities in our portfolio and an overall increase in taxable income as a result of our continued growth. At June 30, 2007, approximately 50.0% of our

investment portfolio was invested in tax-exempt municipal securities, compared to approximately 58.2% at June 30, 2006.

*Net Income.* Net income was \$10.2 million for the three months ended June 30, 2007, compared to \$9.4 million for the same period in 2006, representing an increase of \$0.8 million, or 8.5%. Net income for the six months ended June 30, 2007 totaled \$20.3 million, an increase of \$4.9 million, or 31.8%, from \$15.4 million in the same period of 2006. The increase in net income for the three and six months ended June 30, 2007 resulted primarily from increases in premiums earned and investment income and decreases in loss and loss adjustment expenses recognized in the period, offset by increases in underwriting, acquisition and insurance expenses, and other expenses.

## **Liquidity and Capital Resources**

Our principal sources of funds are underwriting operations, investment income and proceeds from sales and maturities of investments. Our primary use of funds is to pay claims and operating expenses and to purchase investments.

Our investment portfolio is structured so that investments mature periodically over time in reasonable relation to current expectations of future claim payments. Since we have a limited claims history, we have derived our expected future claim payments from industry and predecessor trends and included a provision for uncertainties. Our investment portfolio as of June 30, 2007 has an effective duration of 4.9 years with individual maturities extending out to 30 years. Currently, we make claim payments from positive cash flow from operations and invest excess cash in securities with appropriate maturity dates to balance against anticipated future claim payments. As these securities mature, we intend to invest any excess funds in investments with appropriate durations to match against expected future claim payments.

At June 30, 2007, our portfolio was made up almost entirely of investment grade fixed income securities with fair values subject to fluctuations in interest rates. Prior to March 2005, we did not invest in common equity securities and we had no exposure to foreign currency risk. In November 2006, our investment policy was revised to allow for investment in domestic and international equities of up to 4% and 1%, respectively, of our statutory consolidated capital and surplus. While we have structured our investment portfolio to provide an appropriate matching of maturities with anticipated claim payments, if we decide or are required in the future to sell securities in a rising interest environment, we would expect to incur losses from such sales.

Our ability to adequately provide funds to pay claims comes from our disciplined underwriting and pricing standards and the purchase of reinsurance to protect us against severe claims and catastrophic events. Effective October 1, 2006, our reinsurance program provides us with reinsurance protection for each loss occurrence in excess of \$1.0 million, up to \$75.0 million, subject to various additional limitations and exclusions as more fully described in Note 5.a. to our unaudited condensed consolidated financial statements in Part I, Item 1 of this quarterly report and in the reinsurance agreements. Given industry and predecessor trends, we believe that we are sufficiently capitalized to retain the losses described above.

Our insurance subsidiary is required by law to maintain a certain minimum level of surplus on a statutory basis. Surplus is calculated by subtracting total liabilities from total admitted assets. The National Association of Insurance Commissioners has a risk-based capital standard designed to identify property and casualty insurers that may be inadequately capitalized based on inherent risks of each insurer's assets and liabilities and its mix of net premiums written. Insurers falling below a calculated threshold may be subject to varying degrees of regulatory action. As of December 31, 2006, the last date that we were required to update the annual risk-based capital calculation, the statutory surplus of our insurance subsidiary was in excess of the prescribed risk-based capital requirements that correspond to any level of regulatory action.

SIH has minimal revenue and expenses. Currently, there are no plans to have SBIC or PointSure pay a dividend to SIH.

Our unaudited consolidated net cash provided by operating activities for the six months ended June 30, 2007 was \$38.5 million, compared to \$36.3 million for the same period in 2006. The increase resulted primarily from the increases in unpaid loss and loss adjustment expense and balances related to reinsurance recoverables, offset by decreases in other assets and liabilities, all as a result of the growth of our business.

We used net cash of \$36.2 million for investing activities in the six months ended June 30, 2007, compared to \$86.2 million for the same period in 2006. The difference between periods is primarily attributable to a reduction in



funds available for investing activities, offset by an increase in funds available for investment from operating activities. In February 2006, we invested net proceeds totaling approximately \$57.6 million resulting from a follow-on public offering of 3,910,000 shares of our common stock.

For the six months ended June 30, 2007, financing activities provided cash of \$321,000, compared to \$57.6 million in the same period in 2006. As described below, the majority of cash provided by financing activities resulted from the sale of our common stock and, to a much lesser degree, from the exercise of common stock options by our employees.

### Contractual Obligations and Commitments

The following table identifies our contractual obligations by payment due period as of June 30, 2007:

	Payments Due by Period				More than 5 Years
	Total	Less than 1 Year	1-3 Years (in thousands)	4-5 Years	
Long term debt obligations:					
Surplus notes.....	\$ 12,000	\$ —	\$ —	\$ —	\$ 12,000
Loss and loss adjustment expenses .....	218,679	72,164	94,251	20,118	32,146
Operating lease obligations .....	13,817	1,485	5,655	2,802	3,875
Total .....	<u>\$ 244,496</u>	<u>\$ 73,649</u>	<u>\$ 99,906</u>	<u>\$ 22,920</u>	<u>\$ 48,021</u>

The loss and loss adjustment expense payments due by period in the table above are based upon the loss and loss adjustment expense estimates as of June 30, 2007 and actuarial estimates of expected payout patterns and are not contractual liabilities as to time certain. Our contractual liability is to provide benefits under the policies. As a result, our calculation of loss and loss adjustment expense payments due by period is subject to the same uncertainties associated with determining the level of unpaid loss and loss adjustment expenses generally and to the additional uncertainties arising from the difficulty of predicting when claims (including claims that have not yet been reported to us) will be paid. Actual payments of loss and loss adjustment expenses by period will vary, perhaps materially, from the above table to the extent that current estimates of loss and loss adjustment expenses vary from actual ultimate claims amounts and as a result of variations between expected and actual payout patterns.

### Off-Balance Sheet Arrangements

As of June 30, 2007, we had no off-balance sheet arrangements that had or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

### Critical Accounting Policies, Estimates and Judgments

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

The most critical accounting policies involve the reporting of unpaid loss and loss adjustment expenses, including losses that have occurred but were not reported to us by the financial reporting date; the amount and recoverability of reinsurance recoverable balances; accounting for our adverse development cover; deferred policy acquisition costs; deferred taxes; goodwill and other intangible assets; retrospective premiums; earned but unbilled premiums; and the impairment of investment securities. The following should be read in conjunction with the notes to our financial statements.

#### *Unpaid Loss and Loss Adjustment Expenses*

Unpaid loss and loss adjustment expenses represent our estimate of the expected cost of the ultimate settlement and administration of losses, based on known facts and circumstances. Included in unpaid loss and loss adjustment expenses are amounts for case-based insurance liabilities, including estimates of future developments on these claims; claims incurred but not yet reported to us; second injury fund expenses; allocated claim adjustment expenses; and unallocated claim adjustment expenses. We use actuarial methodologies to assist us in establishing

these estimates, including judgments relative to estimates of future claims severity and frequency, length of time to achieve ultimate resolution, judicial theories of liability and other third-party factors that are often beyond our control. Due to the inherent uncertainty associated with the cost of unsettled and unreported claims, the ultimate liability may differ from the original estimates. These estimates are regularly reviewed and updated and any resulting adjustments are included in the current period's operating results. Because of the relative immaturity of our unpaid loss and loss adjustment expense data, actuarial techniques are applied that use the historical experience of our predecessor as well as industry information in the analysis of our unpaid loss and loss adjustment expenses.

#### ***Reinsurance Recoverables***

Reinsurance recoverables on paid and unpaid losses represent the portion of the loss and loss adjustment expenses that is assumed by reinsurers. These recoverables are reported on our unaudited condensed consolidated balance sheets separately as assets, as reinsurance does not relieve us of our legal liability to policyholders and ceding companies. We are required to pay losses even if a reinsurer fails to meet its obligations under the applicable reinsurance agreement. Reinsurance recoverables are determined based in part on the terms and conditions of reinsurance contracts, which could be subject to interpretations that differ from ours based on judicial theories of liability. In addition, we bear credit risk with respect to the reinsurers, which can be significant considering that some of the unpaid loss and loss adjustment expenses remain outstanding for an extended period of time.

#### ***Adverse Development Cover***

The unpaid loss and loss adjustment expense subject to the adverse development cover with LMC is calculated on a quarterly basis using generally accepted actuarial methodologies. Amounts recoverable in excess of acquired insurance liabilities at September 30, 2003 are recorded gross in unpaid loss and loss adjustment expense in accordance with SFAS No. 141, *Business Combinations*, with a corresponding amount receivable from the seller. Amounts are shown net in the statement of operations.

#### ***Deferred Policy Acquisition Costs***

We defer commissions, premium taxes and certain other costs that vary with and are primarily related to the acquisition of insurance contracts. These costs are capitalized and charged to expense in proportion to the recognition of premiums earned. The method followed in computing deferred policy acquisition costs limits the amount of these deferred costs to their estimated realizable value, which gives effect to the premium to be earned, related investment income, anticipated losses and settlement expenses and certain other costs that we expect to incur as the premium is earned. Judgments as to ultimate recoverability of these deferred costs are highly dependent upon estimated future loss costs associated with the premiums written.

#### ***Deferred Taxes***

We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of operations in the period that includes the enactment date.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. If necessary, we would establish a valuation allowance to reduce the deferred tax assets to the amounts more likely than not to be realized.

#### ***Goodwill and Other Intangible Assets***

Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill and other intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but are instead tested for impairment at least annually. Intangible assets with estimable useful lives

are amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*.

### ***Retrospective Premiums***

Retrospective premiums for primary and reinsured risks are included in income as earned on a pro rata basis over the effective period of the respective policies. Earned premiums on retrospectively rated policies are based on our estimate of loss experience as of the measurement date. Unearned premiums are deferred and include that portion of premiums written that is applicable to the unexpired period of the policies in force and estimated adjustments of premiums on policies that have retrospective rating endorsements. Retrospectively rated policies accounted for approximately 21.0% and 20.5% of direct premiums written in the three month periods ended June 30, 2007 and 2006, respectively, and 17.0% and 23.9% of direct premiums written for the six month periods then ended, respectively.

### ***Earned But Unbilled Premiums***

We estimate the amount of premiums that have been earned but are unbilled at the end of the period by analyzing historical earned premium adjustments made and applying an adjustment percentage against premiums earned for the period.

### ***Impairment of Investment Securities***

Impairment of investment securities results in a charge to operations when the fair value of a security declines to below our cost and is deemed to be other-than-temporary. We regularly review our fixed maturity portfolio to evaluate the necessity of recording impairment losses for other-than-temporary declines in the fair value of investments. A number of criteria are considered during this process, including, but not limited to, the following: the current fair value as compared to amortized cost or cost, as appropriate, of the security; the length of time the security's fair value has been below amortized cost; our intent and ability to retain the investment for a period of time sufficient to allow for an anticipated recovery in value; specific credit issues related to the issuer; and current economic conditions. In general, we focus on those securities whose fair values were less than 80% of their amortized cost or cost, as appropriate, for six or more consecutive months. We also analyze the entire portfolio for other factors that might indicate a risk of impairment. Other-than-temporary impairment losses result in a permanent reduction of the carrying amount of the underlying investment. Significant changes in the factors considered when evaluating investments for impairment losses could result in a significant change in impairment losses reported in the financial statements.

### **Recent Accounting Pronouncements**

In September 2005, the American Institute of Certified Public Accountants ("AICPA") released Statement of Position 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts* ("SOP 05-1"). SOP 05-1 requires identification of transactions that result in a substantial change in an insurance contract. If it is determined that a substantial change to an insurance contract has occurred, the related unamortized deferred policy acquisition costs, unearned premiums and other related balances must be written off. SOP 05-1 is effective for fiscal years beginning after December 15, 2006. We adopted the provisions of SOP 05-1 as of January 1, 2007, which did not have a material effect on our consolidated financial condition or results of operations.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109* ("FIN 48"), which provides for the recognition, measurement, presentation and disclosure of uncertain tax positions. A tax benefit from an uncertain position may be recognized only if it is more likely than not that the position is sustainable based on its technical merits. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006. We adopted the provisions of FIN 48 as of January 1, 2007, which did not have a material effect on our consolidated financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value and establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. The provisions for SFAS No. 157 are effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. We must adopt these new requirements no later than

our first fiscal quarter of 2008. We expect that SFAS No. 157 will not have a material effect on our consolidated financial condition or result of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115*, which permits entities to choose to measure many financial instruments and certain other items at fair value in order to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently and without having to apply complex hedge accounting provisions. The provisions for SFAS No. 157 are effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. We must adopt these new requirements no later than our first fiscal quarter of 2008. We are currently evaluating the impact that the adoption of SFAS No. 159 will have on our consolidated financial condition and results of operations.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the potential economic loss principally arising from adverse changes in the fair value of financial instruments. The major components of market risk affecting us are credit risk and interest rate risk.

#### Credit Risk

Credit risk is the potential economic loss principally arising from adverse changes in the financial condition of a specific debt issuer. We address this risk by investing primarily in fixed-income securities which are rated “A” or higher by Standard & Poor’s. We also independently, and through our outside investment manager, monitor the financial condition of all of the issuers of fixed-income securities in the portfolio. To limit our exposure to risk, we employ stringent diversification rules that limit the credit exposure to any single issuer or business sector.

#### Interest Rate Risk

We had fixed-income investments with a fair value of \$421.7 million at June 30, 2007 that are subject to interest rate risk, compared with \$339.6 million at June 30, 2006. We manage the exposure to interest rate risk through a disciplined asset/liability matching and capital management process. In the management of this risk, the characteristics of duration, credit and variability of cash flows are critical elements. These risks are assessed regularly and balanced within the context of the liability and capital position.

The table below summarizes our interest rate risk as of June 30, 2007 and 2006. It illustrates the sensitivity of the fair value of fixed-income investments to selected hypothetical changes in interest rates as of June 30, 2007 and 2006. The selected scenarios are not predictions of future events, but rather illustrate the effect that such events may have on the fair value of our fixed-income portfolio and shareholders’ equity.

#### Interest Rate Risk as of June 30, 2007

<u>Hypothetical Change in Interest Rates</u>	<u>Estimated Change in Fair Value</u>	<u>Fair Value (\$ in thousands)</u>	<u>Hypothetical Percentage Increase (Decrease) in Portfolio Value</u>
200 basis point increase .....	\$ (36,191)	\$ 385,504	(8.6)%
100 basis point increase .....	(18,124)	403,571	(4.3)%
No change .....	—	421,695	—
100 basis point decrease .....	18,182	439,877	4.3%
200 basis point decrease .....	36,421	458,116	8.6%

## Interest Rate Risk as of June 30, 2006

<u>Hypothetical Change in Interest Rates</u>	<u>Estimated Change in Fair Value</u>	<u>Fair Value (\$ in thousands)</u>	<u>Hypothetical Percentage Increase (Decrease) in Portfolio Value</u>
200 basis point increase .....	\$ (29,882)	\$ 309,761	(8.8)%
100 basis point increase .....	(15,123)	324,520	(4.5)%
No change .....	—	339,643	—
100 basis point decrease .....	15,487	355,130	4.6%
200 basis point decrease .....	31,338	370,981	9.2%

## Item 4. Controls and Procedures

Under the supervision and with the participation of management, including our Chief Executive Officer and our Chief Financial Officer, we have carried out an evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report to ensure that information we are required to disclose in reports that are filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms specified by the SEC and is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

### *Changes in Internal Control over Financial Reporting*

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our second fiscal quarter of 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II -- OTHER INFORMATION

### Item 1A. Risk Factors

*You should carefully consider the risks described below and in our Annual Report on Form 10-K filed with the SEC on March 16, 2007, together with all of the other information included in this quarterly report. Such risks and uncertainties are not the only ones facing us. If any such risks actually occur, our business, financial condition or operating results could be harmed. Any such risks could result in a significant or material adverse effect on our financial condition or results of operations, and a corresponding decline in the market price of our common stock. You could lose all or part of your investment. Such risks also include forward-looking statements and our actual results may differ substantially from those discussed in those forward-looking statements. Please refer to the discussion under the heading “Cautionary Statement” in Part I, Item 2.*

Under the heading “Item 1A. Risk Factors—Risk Related to Our Business—Intense competition could adversely affect our ability to sell policies at rates we deem adequate” in our Annual Report on Form 10-K filed with the SEC on March 16, 2007, we include a discussion about a series of recent filings from the WCIRB to the California Insurance Commissioner recommending decreases in advisory pure premium rates on new and renewal policies and subsequent rate reductions. We hereby update such discussion by adding that, on March 30, 2007, the WCIRB submitted an additional filing with the California Insurance Commissioner to recommend an 11.3% decrease in advisory pure premium rates on new and renewal policies effective on or after July 1, 2007. The filing was based on a review of loss and loss adjustment experience through December 31, 2006 and was made in response to continued reductions in California workers’ compensation claim costs. On May 29, 2007, the California Insurance Commissioner recommended a 14.2% decrease in rates effective July 1, 2007. On June 8, 2007, after completing a study of our California loss data, we filed with the California Insurance Commissioner our new rates reflecting an average reduction of 14.2% from prior rates for new and renewal workers’ compensation insurance policies written in California on or after July 1, 2007. The filing was approved on June 12, 2007.

As previously noted, we are unable to predict the impact that proposed rate reductions, if approved and adopted by us, might have on our future financial position and results of operations. If any of our competitors adopt premium

rate reductions that are greater than ours, we may be unable to compete effectively and our business, financial condition and results of operations could be materially adversely affected.

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

On January 19, 2005, the SEC declared effective our Registration Statement on Form S-1, as amended (Registration No. 333-119111), as filed with the SEC in connection with the initial public offering of 8,625,000 shares of our common stock. Our use of the proceeds from the offering does not represent a change in the use of proceeds described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 filed with the SEC on March 16, 2007.

We did not purchase any of our equity securities during the three months ended June 30, 2007.

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

The 2007 annual meeting of stockholders of SIH was held on May 15, 2007. At the annual meeting, our stockholders were asked to elect six directors to the Board of Directors and to ratify the Audit Committee's appointment of KPMG LLP as SIH's independent auditors for the year ending December 31, 2007. Following are the results of the election:

### **Proposal I: Election of six directors to the Board of Directors**

	<u><b>Votes For</b></u>	<u><b>Votes Withheld</b></u>
John G. Pasqualetto .....	18,178,881	968,964
Peter Y. Chung .....	18,857,360	290,485
Joseph A. Edwards .....	18,899,460	248,385
William M. Feldman .....	18,856,180	291,665
Mural R. Josephson .....	18,857,360	290,485
George M. Morvis .....	18,355,990	791,855

### **Proposal II: Ratification of the Audit Committee's appointment of KPMG LLP as independent auditor for the year ending December 31, 2007**

Votes for .....	19,088,837
Votes against .....	56,908
Abstentions .....	2,100

There were no broker non-votes in the election of directors since brokers who hold shares for the accounts of their clients have discretionary authority to vote such shares with respect to the election of directors.

## **Item 6. Exhibits**

The list of exhibits in the Exhibit Index to this quarterly report is incorporated herein by reference.

## **SIGNATURES**

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

SEABRIGHT INSURANCE HOLDINGS, INC.

Date: August 9, 2007

By: /s/ Joseph S. De Vita  
Joseph S. De Vita  
Senior Vice President, Chief Financial Officer and  
Assistant Secretary (Principal Financial Officer)

## EXHIBIT INDEX

The list of exhibits in the Exhibit Index to this quarterly report on Form 10-Q is incorporated herein by reference. Exhibits 31.1 and 31.2 are being filed as part of this quarterly report on Form 10-Q. Exhibits 32.1 and 32.2 are being furnished with this quarterly report on Form 10-Q.

<b>Exhibit Number</b>	<b>Description</b>
10.1	Second Amended and Restated 2003 Stock Option Plan (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K, filed April 3, 2007)
10.2	Amended and Restated 2005 Long-Term Equity Incentive Plan (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K, filed April 3, 2007)
31.1	Rule 13a-14(a) Certification (Chief Executive Officer)
31.2	Rule 13a-14(a) Certification (Chief Financial Officer)
32.1	Section 1350 Certification (Chief Executive Officer)
32.2	Section 1350 Certification (Chief Financial Officer)



## CHIEF EXECUTIVE OFFICER CERTIFICATION

I, John G. Pasqualetto, President and Chief Executive Officer of SeaBright Insurance Holdings, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of SeaBright Insurance Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2007

/s/ John G. Pasqualetto  
John G. Pasqualetto  
Chairman, President and Chief Executive Officer

## CHIEF FINANCIAL OFFICER CERTIFICATION

I, Joseph S. De Vita, Chief Financial Officer of SeaBright Insurance Holdings, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of SeaBright Insurance Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2007

/s/ Joseph S. De Vita  
Joseph S. De Vita  
Senior Vice President, Chief Financial Officer  
and Assistant Secretary

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of SeaBright Insurance Holdings, Inc. (the “Company”) on Form 10-Q for the period ended June 30, 2007, as filed with the Securities and Exchange Commission (the “Report”), I, John G. Pasqualetto, Chairman, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 9, 2007

/s/ John G. Pasqualetto  
John G. Pasqualetto  
Chairman, President and Chief Executive Officer

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to SeaBright Insurance Holdings, Inc. and will be retained by SeaBright Insurance Holdings, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of SeaBright Insurance Holdings, Inc. (the “Company”) on Form 10-Q for the period ended June 30, 2007, as filed with the Securities and Exchange Commission (the “Report”), I, Joseph S. De Vita, Senior Vice President, Chief Financial Officer and Assistant Secretary of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 9, 2007

/s/ Joseph S. De Vita  
Joseph S. De Vita  
Senior Vice President, Chief Financial Officer  
and Assistant Secretary

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to SeaBright Insurance Holdings, Inc. and will be retained by SeaBright Insurance Holdings, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.