

# LANCASHIRE HOLDINGS LIMITED

Hamilton, Bermuda, 27 October 2008

Lancashire Holdings Limited (“Lancashire” or “the Company”) today announces its results for the third quarter of 2008 and the nine month period ended 30 September 2008.

As previously disclosed, Hurricanes Gustav and Ike, together with extremely difficult investment market conditions, have negatively impacted Lancashire’s results for the third quarter of 2008. At the same time, these two factors are expected to drive significantly improved trading conditions for 2009.

## **Financial highlights for the third quarter of 2008:**

- Fully converted book value per share of \$6.33 at 30 September 2008, compared to \$6.91 at 30 June 2008, a reduction of 8.4%;
- Gross written premiums of \$124.6 million. Net written premiums of \$120.3 million;
- Loss ratio of 152.5% and a combined ratio of 178.2%;
- Total annualised investment loss of 1.7%, including net investment income, realised gains and losses, impairments, and unrealised gains and losses;
- Net operating loss of \$105.7 million, or \$0.61 diluted operating loss per share; and
- Net loss after tax of \$119.4 million, or \$0.69 diluted loss per share.

## **Financial highlights for the nine months to 30 September 2008:**

- Fully converted book value per share of \$6.33 at 30 September 2008, compared to \$6.38 at 31 December 2007, a reduction of 0.8%. Compound annual return on equity since inception of 16.2%;
- Gross written premiums of \$508.0 million. Net written premiums of \$444.6 million;
- Loss ratio of 77.2% and a combined ratio of 101.9%;
- Total annualised investment return of 1.2% including net investment income, realised gains and losses, impairments, and unrealised gains and losses;
- Net operating profit of \$21.1 million, or \$0.11 diluted operating earnings per share; and
- Net income after tax of \$16.4 million, or \$0.09 diluted earnings per share.

## **Richard Brindle, Group Chief Executive Officer, commented:**

“As a result of summer hurricanes and financial market turmoil, Lancashire has experienced its first quarterly loss since inception. The total impact on our results from the hurricanes is approximately \$150 million. While this has negatively impacted our return on equity in the short-term, we believe these market events will better help us achieve our long-term aim of generating

a strong return for shareholders. The financial fallout from the credit crisis in particular is having a very significant impact on capacity in the industry as a whole. If the current malaise afflicting all financial markets continues throughout the fourth quarter, we can expect a sea of red ink for the industry's full year results.

There is now no question that the market has turned. In many areas of our portfolio, conditions could be similar, or even better, than what would have been in place in 2002 due in part to large improvements in terms and condition since that time. Our balance sheet is strong and we look forward with optimism."

**Neil McConachie, Chief Financial Officer and Chief Risk Officer, commented:**

"In some of the most challenging investment markets in recent memory, our highly conservative strategy helped Lancashire achieve a positive total investment return for the nine months through 30 September 2008, and to limit total investment losses in the third quarter to \$7.4 million. Our investment approach will remain very defensive throughout this difficult period.

As we look ahead to 2009, we are confident there are great opportunities to grow book value per share at an attractive rate and we plan to take full advantage of this."

**Underwriting results**

Gross written premiums decreased by 15.4% in the third quarter of 2008 compared to the same period in 2007. In 2008 to date, gross written premiums decreased by 15.2% compared to the first nine months of 2007.

The reduction in written premiums, both for the quarter and the year to date, is largely attributable to lower rates than in previous periods, and a corresponding greater proportion of submissions declined. Lancashire's Renewal Price Index, which considers both pricing and terms and conditions, shows the following renewal comparisons between the third quarter of 2008 and the same period in 2007: Property 88%; Energy 94%; Marine 104%; Aviation (AV52, aviation war and satellite only) 91%; Overall 92%.

We ceded less premium out in the third quarter of 2008 compared to the third quarter of 2007. Ceded premium fell from \$6.8 million in the third quarter of 2007 to \$4.3 million in the third quarter of 2008. Ceded premium fell from \$82.2 million in the nine months to 30 September 2007 to \$63.4 million for the same period in 2008. Contributing factors were lower rates, together with the reduction in the purchase of protection against natural catastrophes, including the commutation of the quota share cession to the Lancashire sponsored energy sidecar, Sirocco Re, at the end of 2007. This was partially offset by an increase in reinsurance purchased to mitigate losses from events other than natural disasters, most of which was purchased in the first quarter of 2008.

Net written premium decreased 14.4% and 13.9% for the quarter and year to date, respectively, compared to the same periods in 2007. This was chiefly due to lower gross written premiums, offset somewhat by lower purchases of reinsurance.

Net earned premiums as a proportion of net written premiums were 122.9% in the third quarter of 2008 compared to 114.2% in the same period in 2007. Net earned premiums as a proportion of net written premiums were 104.7% in the nine months to 30 September 2008 compared to 87.6% in the same period in 2007. The increases reflect that, after reaching its third year of operations,

Lancashire has built a mature portfolio of business, whereas in 2007 the portfolio was still in a growth phase.

The net loss ratios of 152.5% for the third quarter and 77.2% for the nine months to 30 September 2008 are largely driven by losses associated with Hurricane Ike. Estimated losses from Hurricane Gustav are immaterial at this time. Net reserve releases were \$9.6 million for the quarter and \$16.1 million in 2008 to date.

## **Investments**

Net investment income was \$15.5 million for the third quarter, a decrease of 25.8% from the third quarter of 2007. Net investment income was \$46.1 million in the nine months to 30 September 2008, a decrease of 18.0% over the same period in 2007. The decrease in net investment income is primarily due to lower yields on the bond portfolio. The lower yields were driven to a large extent by reductions in U.S. interest rates throughout 2008, together with the tactical decision to exit certain higher yielding fixed income classes, including all non-agency structured products, in the fourth quarter of 2007.

Total investment return, including net investment income, net realised gains and losses and net change in unrealised gains and losses, was a loss of \$7.4 million in the quarter and a positive return of \$17.0 million for the year to date. Total investment return was negatively impacted in the quarter by weak bond and equity markets. The limited loss in the third quarter, and the positive return in the nine months to date, was achieved by our strategy to hold an overweight position in cash and by maintaining a high quality, short duration bond portfolio with underweight allocations to structured products and the financial sector. It was also helped by maintaining only a modest allocation to equities.

At 30 September 2008 the fixed income portfolio plus managed cash had a duration of 1.6 years, a credit quality of AA+ and a market yield of 3.3%. Investment assets were comprised of 69.5% fixed income, 3.8% equities and 26.7% cash. Lancashire has no holdings in hedge funds or other alternative investments.

## **Capital**

At 30 September 2008, total capital was \$1.286 billion, comprising shareholders' equity of \$1.155 billion and \$131.7 million of long-term debt. Leverage was 10.2%. During the quarter Lancashire repurchased 3.75 million shares at an average cost of \$6.01 or approximately 312 pence.

## **Outlook**

Lancashire aims to achieve a cross-cycle return of 13% above a risk free rate. This is unchanged from previous guidance.

**Further detail of our 2008 third quarter results can be obtained from our Financial Supplement. This can be accessed via our website [www.lancashiregroup.com](http://www.lancashiregroup.com).**

## **Investor Presentation and Earnings Call**

There will be an investor conference call on the results at 1.00pm UK time / 9.00am EST on Monday 27 October 2008. This call will be hosted by Richard Brindle, Chief Executive Officer;

Simon Burton, Deputy Chief Executive Officer; and Neil McConachie, Chief Financial Officer and Chief Risk Officer.

The call can be accessed by dialing +44 (0)20 7806 1950 / +1 718 354 1387 with the passcode 3769284. The call can also be accessed via webcast, please go to our website ([www.lancashiregroup.com](http://www.lancashiregroup.com)) to access.

A replay facility will be available for two weeks until Monday 10 November 2008. The dial in number for the replay facility is +44 (0)20 7806 1970 / +1 718 354 1112 and the passcode is 3769284#. A replay facility can also be accessed at [www.lancashiregroup.com](http://www.lancashiregroup.com).

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Investor enquiries and questions can also be directed to [investors@lancashiregroup.com](mailto:investors@lancashiregroup.com) or by accessing the Company's website [www.lancashiregroup.com](http://www.lancashiregroup.com).

**consolidated balance sheet**

	<b>unaudited</b>	<b>audited</b>
	<b>september 30, 2008</b>	<b>december 31, 2007</b>
	\$m	\$m
<b>assets</b>		
cash and cash equivalents	567.5	737.3
accrued interest receivable	9.3	9.8
investments		
- fixed income securities		
- available for sale	1,292.5	1,069.7
- at fair value through income	18.0	23.5
- equity securities, available for sale	71.5	71.6
- other investments	3.5	4.4
reinsurance assets		
- unearned premium on premium ceded	26.2	19.6
- reinsurance recoveries	43.8	3.6
- other receivables	-	8.2
deferred acquisition costs	65.1	57.8
inwards premium receivable from insureds and cedants	154.8	198.2
investment in associate	-	22.9
other assets	47.5	8.1
<b>total assets</b>	<b>2,299.7</b>	<b>2,234.7</b>
<b>liabilities</b>		
insurance contracts		
- loss and loss adjustment expenses	545.5	179.6
- unearned premiums	367.6	381.8
- other payables	9.8	16.5
amounts payable to reinsurers	11.5	5.7
deferred acquisition costs ceded	3.7	3.1
other payables	75.2	300.1
long-term debt	131.7	132.3
<b>total liabilities</b>	<b>1,145.0</b>	<b>1,019.1</b>
<b>shareholders' equity</b>		
share capital	91.1	91.1
treasury shares	(58.0)	-
share premium	51.3	49.5
contributed surplus	754.8	754.8
fair value and other reserves	(0.5)	20.7
dividends	0.1	(239.1)
retained earnings	315.9	538.6
<b>total shareholders' equity attributable to equity shareholders</b>	<b>1,154.7</b>	<b>1,215.6</b>
<b>total liabilities and shareholders' equity</b>	<b>2,299.7</b>	<b>2,234.7</b>
basic book value per share	\$6.68	\$6.67
fully converted book value per share	\$6.33	\$6.38

## consolidated income statement

	unaudited quarter 3 2008 \$m	unaudited quarter 3 2007 \$m	unaudited ytd 2008 \$m	unaudited ytd 2007 \$m
gross premiums written	124.6	147.3	508.0	598.8
outwards reinsurance premiums	(4.3)	(6.8)	(63.4)	(82.2)
<b>net premiums written</b>	<u>120.3</u>	<u>140.5</u>	<u>444.6</u>	<u>516.6</u>
change in unearned premiums	40.0	35.5	14.2	(92.9)
change in unearned premiums on premium ceded	(12.4)	(15.5)	6.6	28.9
<b>net premiums earned</b>	<u>147.9</u>	<u>160.5</u>	<u>465.4</u>	<u>452.6</u>
net investment income	15.5	20.9	46.1	56.2
net realised gains (losses) and impairments	(13.1)	2.3	(7.0)	6.7
share of profit (loss) of associate	-	1.1	(0.2)	3.9
net foreign exchange gains (losses)	(4.5)	1.7	(4.2)	3.5
net other investment losses	(0.2)	(2.0)	(0.9)	(2.5)
<b>total net revenue</b>	<u>145.6</u>	<u>184.5</u>	<u>499.2</u>	<u>520.4</u>
insurance losses and loss adjustment expenses	260.4	38.1	400.4	122.9
insurance losses and loss adjustment expenses recoverable	(34.8)	(1.0)	(41.2)	(1.5)
net insurance acquisition expenses	23.9	21.2	74.4	62.4
equity based compensation	0.4	4.4	1.7	10.8
other operating expenses	14.0	12.3	40.7	39.1
<b>total expenses</b>	<u>263.9</u>	<u>75.0</u>	<u>476.0</u>	<u>233.7</u>
<b>profit (loss) before tax and finance costs</b>	<u>(118.3)</u>	<u>109.5</u>	<u>23.2</u>	<u>286.7</u>
finance costs	3.4	4.4	8.7	10.5
<b>profit (loss) before tax</b>	<u>(121.7)</u>	<u>105.1</u>	<u>14.5</u>	<u>276.2</u>
tax	2.3	0.1	1.9	(0.6)
<b>profit (loss) after tax</b>	<u>(119.4)</u>	<u>105.2</u>	<u>16.4</u>	<u>275.6</u>
net loss ratio	152.5%	23.1%	77.2%	26.8%
net acquisition cost ratio	16.2%	13.2%	16.0%	13.8%
administrative expense ratio	9.5%	7.7%	8.7%	8.6%
<b>combined ratio</b>	<u>178.2%</u>	<u>44.0%</u>	<u>101.9%</u>	<u>49.2%</u>
basic earnings (loss) per share	(0.69)	0.54	0.09	1.41
diluted earnings (loss) per share	(0.69)	0.51	0.09	1.34
change in fully converted book value per share	-8.4%	7.9%	-0.8%	22.0%

consolidated cash flow statement	unaudited nine months 2008 \$m	unaudited nine months 2007 \$m	audited twelve months 2007 \$m
<b>cash flows from operating activities</b>			
profit before tax	14.5	276.2	391.9
tax paid	(0.8)	(0.8)	(2.4)
depreciation	0.8	1.0	1.4
interest expense	7.6	8.5	11.6
interest and dividend income	(45.3)	(56.9)	(79.3)
amortisation of fixed income securities	(0.7)	(0.8)	(0.7)
employee benefit expense	1.7	10.8	14.4
foreign exchange	6.4	(2.4)	(3.1)
share of loss (profit) of associate	0.2	(3.9)	(6.2)
net unrealised losses (gains) on other investments	(0.2)	2.3	(9.1)
net realised losses (gains) and impairments on investments	7.0	(6.7)	3.3
net fair value losses (gains) on investments at fair value through income	1.1	0.2	(0.4)
unrealised loss on interest rate swaps	-	0.1	1.3
reinsurance assets			
- unearned premium on premium ceded	(6.6)	(28.9)	(0.5)
- reinsurance recoveries	(40.2)	(1.5)	(3.5)
- other receivables	8.1	(23.4)	(8.2)
deferred acquisition costs	(7.3)	(9.5)	(6.3)
other receivables	(38.7)	-	2.4
inwards premium receivable from insureds and cedants	41.2	(1.2)	(23.8)
insurance contracts			
- losses and loss adjustment expenses	368.1	118.7	140.0
- unearned premiums	(14.2)	92.9	56.2
- other payables	(7.3)	3.4	11.3
amounts payable to reinsurers	5.8	26.9	4.9
deferred acquisition costs ceded	0.6	4.1	0.5
other payables	25.3	45.4	25.8
<b>net cash flows from operating activities</b>	<b>327.1</b>	<b>454.5</b>	<b>521.5</b>
<b>cash flows used in investing activities</b>			
interest and dividends received	45.8	53.9	77.0
purchase of property, plant and equipment	(0.2)	(1.3)	(1.3)
dividends received from associate	22.7	5.4	6.5
purchase of fixed income securities	(2,601.8)	(1,628.7)	(2,143.3)
purchase of equity securities	(31.7)	(21.9)	(30.9)
proceeds on maturity and disposal of debt securities	2,373.5	1,252.4	1,960.4
proceeds on disposal of equity securities	13.5	26.3	36.9
net proceeds on other investments	1.4	3.3	5.1
<b>net cash flows used in investing activities</b>	<b>(176.8)</b>	<b>(310.6)</b>	<b>(89.6)</b>
<b>cash flows used in financing activities</b>			
interest paid	(7.7)	(8.5)	(11.6)
dividends paid	(238.2)	-	-
shares repurchased	(68.3)	-	(89.3)
<b>net cash flows used in financing activities</b>	<b>(314.2)</b>	<b>(8.5)</b>	<b>(100.9)</b>
<b>net decrease in cash and cash equivalents</b>	<b>(163.9)</b>	<b>135.4</b>	<b>331.0</b>
cash and cash equivalents at beginning of period	737.3	400.1	400.1
effect of exchange rate fluctuations on cash and cash equivalents	(5.9)	4.0	6.2
<b>cash and cash equivalents at end of period</b>	<b>567.5</b>	<b>539.5</b>	<b>737.3</b>

## About Lancashire

Lancashire, through its UK and Bermuda-based insurance subsidiaries, is a global provider of specialty insurance products. Its insurance subsidiaries carry the Lancashire group rating of A minus (Excellent) from A.M. Best with a stable outlook. Lancashire has capital in excess of \$1 billion and its Common Shares trade on AIM under the ticker symbol LRE. Lancashire is headquartered at Mintflower Place, 8 Par-La-Ville Road, Hamilton HM 08, Bermuda. The mailing address is Lancashire Holdings Limited, P.O. Box HM 2358, Hamilton HM HX, Bermuda. For more information on Lancashire, visit the company's website at [www.lancashiregroup.com](http://www.lancashiregroup.com)

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