



# ArielHoldings

Annual Report  
2008



Valiant

ArielRe

Atrium

## Financial Highlights

(Expressed in thousands of US dollars, except per share data)

	2008	2007	2006	% Increase (Decrease)	% Increase (Decrease)
Gross premiums written	\$ 616,145	\$ 355,785	\$ 289,226	73.2%	23.0%
Net premiums earned	557,148	322,651	200,160	72.7%	61.2%
Net investment income	84,131	72,440	57,078	16.1%	26.9%
Net realized and unrealized losses on investments <sup>1</sup>	(89,737)	(14,936)	(5,669)	500.8%	163.5%
Other income (loss), net	28,149	(6,148)	1,854	557.9%	(431.6%)
Total revenue	579,691	374,007	253,423	55.0%	47.6%
Net (loss) income	(38,531)	233,118	156,280	(116.5%)	49.2%
Comprehensive (loss) income	(56,623)	241,361	158,588	(123.5%)	52.2%
<b>Diluted net (loss) income per share</b>	<b>\$ (3.69)</b>	<b>\$ 22.49</b>	<b>\$ 15.09</b>	<b>(116.4%)</b>	<b>49.0%</b>
Total assets	\$ 2,612,231	\$ 2,423,957	\$ 1,295,903	7.8%	87.1%
Shareholders' Equity	1,400,095	1,439,636	1,178,725	(2.8%)	22.1%
<b>Fully diluted book value per share</b>	<b>\$ 131.40</b>	<b>\$ 136.43</b>	<b>\$ 113.80</b>	<b>(3.7%)</b>	<b>19.9%</b>
Return on average equity	(2.7%)	17.8%	14.2%		

Note 1: In 2007 and 2006, net realized and unrealized losses on investments did not include unrealized losses/gains on investments.





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Donald Kramer  
Chairman

March 24, 2009

To Our Shareholders,

Last year we were truly tested under fire. We suffered one of the most expensive catastrophe events in history together with the worst meltdown in the financial system that any of us have ever experienced. While our total revenues rose 55%, principally as the result of our acquisition of Atrium, we nevertheless incurred a net loss for the year of \$38.5 million. This is in contrast to a \$233.1 million net income earned in the previous year. Our net loss per share for the year was (\$3.69) on a fully diluted basis compared with net income of \$22.49 per share for the prior year. Operating income, which is defined as income before realized and unrealized gains or losses and foreign exchange gains or losses, totaled a positive \$46.9 million. Total realized and unrealized losses on investments of \$89.7 million. Shareholders equity declined by 2.8% to \$1.4 billion. Our fully diluted Book value per share on December 31 2008 totaled \$131.40 per share compared with \$136.43 at the end of 2007 a decline of 3.7%.

We survived 2008 with both our capital and our financial strength rating intact and our infrastructure deeper and more diversified than ever before. Our capability to do new business today is stronger than ever and the outlook for the New Year is very positive. This is in sharp contrast to the banking and life insurance industries, who are suffering severely from the global recession.

The confluence of natural disasters and the financial meltdown destroyed insurance industry capital and left many primary insurers, particularly US mutual companies, with limited ability to retain risk. It also created a serious warning to insurance and reinsurance buyers to be mindful of excessive counter party exposure. The near demise of three of the largest property and liability insurers is helping to foster a hardening US market. In addition recent adverse developments within the leading Swiss and German reinsurers may also lead to a harder market in that sector. Previously we had seen limited profitable opportunities in the international reinsurance market and now it may be possible for us to expand our underwriting presence there.

Clearly there is far too much bad news on the economic front to expect a rapid turnaround. Consequently for the foreseeable future, there seems to be no respite, despite massive stimulus programs underway by the world's governments. In this global recession we may be one of the few industries to enjoy a positive outlook for 2009.

To take advantage of these improving business conditions in 2009, each of our three units have positioned themselves reasonably well during 2008.

Ariel Re continued to build its infrastructure. We added our Marine and Energy business to our portfolio pricing system, improved our pricing models and our portfolio analytics (ARPS...Ariel Re Portfolio System) and continued to deepen our broker relationships as a quoting market as opposed to simply providing capacity on risks submitted to us. We also moved to new quarters which has certainly uplifted morale and has allowed our staff to collaborate more efficiently on underwriting risk.



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Donald Kramer  
Chairman

At Atrium we have also made considerable progress. We have increased our forecast for volume and profits for 2009 and added several new lines of business. We also moved to establish a Singapore presence in line with Lloyd's entry into that market.

Valiant, our US start up, has actively recruited new talent and increased its underwriting capability, filing rates and forms in numerous jurisdictions. It is currently licensed as an admitted carrier in nearly every state of the United States. Valiant is also increasing its ability to write surplus lines both on its own paper and through a fronting arrangement with another carrier. We have been very encouraged by the broker market response to our presence and we expect to increase writing significantly in 2009.

Investment management is as important to us as insurance risk management. Last year despite the very severe financial meltdown our portfolio experienced a negative return of 0.29%. According to BlackRock the financial advisory firm, the Property and Casualty industry suffered negative total investment returns last year of between -6% to -10%. Certainly incurring losses is disappointing, but our results were clearly better than the market average. Fortunately we did not have any material exposure to the "headline" names and we avoided many sectors and issuers that suffered severely including subprime/alt-a mortgages, preferred stock, bank stocks, etc. Most of our losses were in mark to market reductions. Going forward we would expect to see some price recovery in many of our bonds because of their high quality and relatively short duration, averaging 1.75 years. In addition we have only 2% in equities and about 3% in hedge funds going forward into 2009.

On the negative side we find yields on our highest quality assets declining and we are taking steps to deploy funds opportunistically in selected higher yielding investments in order to sustain investment income levels without inordinately increasing our risk.

In summary, while we have been disappointed by the conditions which produced a net loss for us in 2008 we are very optimistic about 2009.

Attached is our audited financial report, together with a financial supplement covering various details on operations for 2008.

We thank you for your patience and support.

Yours Sincerely

A handwritten signature in black ink that reads 'Donald Kramer'.

Donald Kramer  
Chairman & CEO

## Cautionary Statement on Forward-Looking Statements

This report includes forward looking statements, both with respect to us and our industry. Statements that include the words “expect,” “intend,” “plan,” “believe,” “project,” “anticipate,” “will,” “may” and similar statements of a future or forward looking nature identify forward looking statements. All forward looking statements included in this report reflect our current views with respect to future events and our financial results and address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in such statements. We believe that the important factors for determining future events and our financial results include, but are not limited to, the following:

- our limited operating history;
- the cyclical nature of demand and pricing in the reinsurance and insurance markets;
- general economic and market conditions (including inflation, recessionary pressures, interest rates and foreign currency exchange rates) and their impact on access to capital in the financial markets and conditions specific to the reinsurance and insurance markets in which we expect to operate;
- our ability to successfully implement our business strategy during favorable and unfavorable market conditions;
- the extent and degree of competition on the basis of pricing, capacity, coverage or other terms, at any particular time or from time to time;
- the adequacy of our risk management and loss limitation methods and policies;
- the adequacy of our loss reserves against actual losses;
- the timing of required loss payments being faster or the actual receipt of reinsurance recoverables being slower than anticipated by us;
- the availability to us of retrocessions to manage our gross and net exposures and the cost of such retrocessions;
- the failure of retrocessionaires, producers or others to meet their obligations to us;
- our ability to obtain and, in the case of our principal operating subsidiaries, maintain credit ratings, which may be affected by our ability to raise additional equity and/or debt capital and other factors described herein;
- the acceptance of our business strategy and financial condition by rating agencies and regulators, as well as continued business from our insureds (including reinsurance and insurance companies) and insurance intermediaries;
- the amount of capital and scope of financing alternatives available to us on favorable terms, or at all;
- our ability to identify, hire and retain, on a timely and unimpeded basis and on favorable terms, experienced and capable senior management, as well as risk analysts, underwriters, claims professionals and support staff;
- our ability to implement, successfully, efficiently, and on a timely basis, complex infrastructure, distribution capabilities, systems, procedures and internal controls, and to develop accurate actuarial data to support the business and regulatory and reporting requirements;
- the successful integration of Atrium and Valiant, or other businesses we may acquire;
- accuracy of those estimates and judgments utilized in the preparation of our financial

statements, including those related to revenue recognition, insurance and other reserves, reinsurance recoverables, investment valuations, intangible assets, bad debts, income taxes, contingencies, litigation and any determination to use the deposit method of accounting, which, for a relatively new reinsurance and insurance company like our company, are even more difficult to make than those made in a mature company because of limited historical information;

- changes in accounting principles or the application of such principles by regulators;
- changes in domestic or foreign laws or regulations, or their interpretations;
- significant litigation or arbitration proceeding or developments that are unfavorable to reinsurance and/or insurance companies generally or to us specifically;
- statutory or regulatory or rating agency developments, including as to tax policy and matters and reinsurance and other regulatory matters such as the adoption of proposed legislation that would affect Bermuda headquartered companies and/or Bermuda based reinsurers or insurers;
- the unpredictable nature and severity of catastrophic events; and
- acts of terrorism, political unrest and other hostilities or other unforecasted and unpredictable events.

The foregoing list of important factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in this report. All of the forward looking statements made in this report are qualified by these cautionary statements, and there can be no assurance that the actual developments or events anticipated by us will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, us or our business or financial results. We undertake no obligation to update or revise any forward looking statement, whether as a result of new information, future developments or otherwise, except as required by applicable law.





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## REPORT OF INDEPENDENT AUDITORS

TO THE SHAREHOLDERS

ARIEL HOLDINGS LTD.

We have audited the accompanying consolidated balance sheets of Ariel Holdings Ltd. (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of operations and comprehensive income, changes in shareholders' equity, and cash flows for the three year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Ariel Holdings Ltd. at December 31, 2008 and 2007, and the consolidated results of its operations and comprehensive income, and its cash flows for the three year period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, with effect from January 1, 2008, the Company prospectively reclassified as trading, investments previously designated as available-for-sale and changed the manner in which movements in unrealized gains and losses on these investments are recognized.

A handwritten signature in cursive script that reads 'Ernst &amp; Young Ltd.'.

March 24, 2009

**ARIEL HOLDINGS LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the years ended December 31, 2008, 2007 and 2006**  
(Expressed in thousands of U.S. dollars, except share and per share amounts)

**CONSOLIDATED FINANCIAL STATEMENTS**

**For the year ended December 31, 2008**

**ARIEL HOLDINGS LTD.**

(Exact name as specified in its charter)

**Bermuda**  
(State or other jurisdiction of  
incorporation or organization)

**98-0486783**  
(I.R.S. Employer  
Identification No.)

**Victoria Place, 5th Floor, 31 Victoria Street, Hamilton HM10, Bermuda**  
(Address of principal executive offices and zip code)

**(441) 295 5485**  
(Telephone number, including area code)

As of February 20, 2009, there were 10,458,596 Common Shares, \$1.00 par value per share, of the Company outstanding.

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**ARIEL HOLDINGS LTD.**

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**Consolidated Financial Statements**

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**ARIEL HOLDINGS LTD.**  
**CONSOLIDATED BALANCE SHEETS**  
**As at December 31, 2008 and 2007**

(Expressed in thousands of US dollars, except share and per share amounts)

	<b>December 31, 2008</b>	<b>December 31, 2007</b>
<b>Assets</b>		
Investments		
Fixed maturities, at fair value <i>(amortized cost 2008: \$1,410,487; 2007: \$1,193,646)</i>	\$ 1,379,023	\$ 1,204,320
Other investments, at fair value	275,482	353,609
Short-term investments, at fair value	174,320	93,091
<b>Total investments</b>	<b>1,828,825</b>	<b>1,651,020</b>
Cash and cash equivalents	158,139	192,360
Accrued investment income	14,517	16,615
Deferred acquisition costs	35,471	14,954
Premiums receivable	187,788	178,341
Prepaid reinsurance premiums	13,440	21,995
Paid losses recoverable	5,294	11,355
Loss reserves recoverable	64,894	73,964
Goodwill and intangible assets	175,810	197,978
Other assets	41,381	55,994
Receivable for investments sold	86,672	9,381
<b>Total assets</b>	<b>\$ 2,612,231</b>	<b>\$ 2,423,957</b>
<b>Liabilities</b>		
Reserve for losses and loss adjustment expenses	650,189	478,240
Unearned premiums	210,917	221,122
Reinsurance premiums payable	26,235	27,160
Losses payable	22,718	20,001
Payable for investments purchased	120,304	30,802
Notes payable	2,147	8,264
Subordinated debentures payable	91,800	100,000
Deferred tax liabilities	38,547	46,880
Other liabilities	49,279	51,852
<b>Total liabilities</b>	<b>1,212,136</b>	<b>984,321</b>
<b>Shareholders' Equity</b>		
Common shares, <i>(par value \$1.00, authorized 100,000,000 shares, issued and outstanding 2008: 10,458,596; 2007: 10,450,806)</i>	10,459	10,451
Additional paid-in capital	1,045,981	1,028,907
Accumulated other comprehensive (loss) income	(18,092)	10,551
Retained earnings	361,747	389,727
<b>Total shareholders' equity</b>	<b>1,400,095</b>	<b>1,439,636</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 2,612,231</b>	<b>\$ 2,423,957</b>

See accompanying notes to consolidated financial statements

**ARIEL HOLDINGS LTD.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS) INCOME**

For the years ended December 31, 2008, 2007 and 2006  
(Expressed in thousands of US dollars, except share and per share amounts)

	December 31, 2008	December 31, 2007	December 31, 2006
<b>Revenues</b>			
Gross premiums written	\$ 616,145	\$ 355,785	\$ 289,226
Reinsurance premiums ceded	(74,869)	(9,241)	(2,907)
Net premiums written	541,276	346,544	286,319
Change in net unearned premiums	15,872	(23,893)	(86,159)
Net premiums earned	557,148	322,651	200,160
Other underwriting income	22,232	621	515
Gain on repurchase of subordinated debentures	1,520	-	-
Net investment income	84,131	72,440	57,078
Net realized losses on investments	(9,551)	(14,936)	(5,669)
Net unrealized losses on investments	(80,186)	-	-
Net foreign exchange gains (losses)	4,397	(6,769)	1,339
<b>Total revenues</b>	<b>579,691</b>	<b>374,007</b>	<b>253,423</b>
<b>Expenses</b>			
Net losses and loss adjustment expenses	387,591	37,463	21,819
Acquisition costs	108,509	39,827	22,469
General and administrative expenses	105,105	56,975	43,442
Interest expense	6,592	4,689	-
Amortization of intangible assets	1,647	1,993	9,396
<b>Total expenses</b>	<b>609,444</b>	<b>140,947</b>	<b>97,126</b>
<b>(Loss) income before income taxes</b>	<b>(29,753)</b>	<b>233,060</b>	<b>156,297</b>
Income tax expense (benefit)	8,778	(58)	17
<b>Net (loss) income</b>	<b>\$ (38,531)</b>	<b>\$ 233,118</b>	<b>\$ 156,280</b>
<b>Comprehensive (loss) income</b>			
Net unrealized investment loss arising during the year	\$ -	\$ (6,693)	\$ (3,361)
Adjustments for losses included in net income	-	14,936	5,669
Currency translation adjustments	(18,092)	-	-
<b>Comprehensive (loss) income</b>	<b>\$ (56,623)</b>	<b>\$ 241,361</b>	<b>\$ 158,588</b>
<b>Earnings per share</b>			
Weighted average number of common shares outstanding – basic	10,450,327	10,349,500	10,310,050
Weighted average number of common shares and common share equivalents outstanding- diluted	10,450,327	10,366,796	10,355,934
<b>Basic (loss) earnings per share</b>	<b>\$ (3.69)</b>	<b>\$ 22.52</b>	<b>\$ 15.16</b>
<b>Diluted (loss) earnings per share</b>	<b>\$ (3.69)</b>	<b>\$ 22.49</b>	<b>\$ 15.09</b>

See accompanying notes to consolidated financial statements

**ARIEL HOLDINGS LTD.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**For the years ended December 31, 2008, 2007 and 2006**  
(Expressed in thousands of US dollars)

	December 31, 2008	December 31, 2007	December 31, 2006
<b>Common shares</b>			
Balance, beginning of year	\$ 10,451	\$ 10,310	\$ 10,310
Issuance of common shares	25	141	-
Repurchase of common shares	(17)	-	-
<b>Balance, end of year</b>	<b>\$ 10,459</b>	<b>\$ 10,451</b>	<b>\$ 10,310</b>
<b>Additional paid-in capital</b>			
Balance, beginning of year	\$ 1,028,907	\$ 1,009,498	\$ 997,315
Issuance of common shares	2,607	8,950	-
Settlement of equity awards	(6,409)	-	-
Repurchase of common shares	(2,415)	-	-
Stock-based compensation expense	23,291	10,459	12,183
<b>Balance, end of year</b>	<b>\$ 1,045,981</b>	<b>\$ 1,028,907</b>	<b>\$ 1,009,498</b>
<b>Accumulated other comprehensive (loss) income</b>			
Balance, beginning of year	\$ 10,551	\$ 2,308	\$ -
Change in unrealized gains on investments	-	8,243	2,308
Currency translation adjustments	(18,092)	-	-
Cumulative effect of adoption of fair value option	(10,551)	-	-
<b>Balance, end of year</b>	<b>\$ (18,092)</b>	<b>\$ 10,551</b>	<b>\$ 2,308</b>
<b>Retained earnings</b>			
Balance, beginning of year	\$ 389,727	\$ 156,609	\$ 329
Cumulative effect of adoption of fair value option	10,551	-	-
Net (loss) income	(38,531)	233,118	156,280
<b>Balance, end of year</b>	<b>\$ 361,747</b>	<b>\$ 389,727</b>	<b>\$ 156,609</b>
<b>Total shareholders' equity</b>	<b>\$ 1,400,095</b>	<b>\$ 1,439,636</b>	<b>\$ 1,178,725</b>

See accompanying notes to consolidated financial statements

**ARIEL HOLDINGS LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the years ended December 31, 2008, 2007 and 2006**  
(Expressed in thousands of US dollars)

	December 31, 2008	December 31, 2007	December 31, 2006
<b>Cash flows provided by operating activities:</b>			
Net (loss) income	\$ (38,531)	\$ 233,118	\$ 156,280
<b>Adjustments to reconcile net (loss) income to net cash provided by operating activities:</b>			
Net realized losses on investments	9,551	14,936	5,669
Net amortization of premiums (discounts) of fixed maturities	1,216	(1,060)	(1,916)
Net unrealized losses on investments	80,186	-	-
Gain on repayment of subordinated debentures	(1,520)	-	-
Stock-based compensation expense	23,291	10,459	12,183
Amortization and depreciation	5,186	2,899	10,005
Change in value of other investments	-	(6,692)	(3,022)
Other items	4,235	5,618	232
<b>Change in:</b>			
Accrued investment income	2,098	(1,688)	(7,959)
Deferred acquisition costs	(17,266)	(3,565)	(11,389)
Premiums receivable	(9,447)	(23,668)	(45,650)
Prepaid reinsurance premiums	8,555	(629)	(815)
Paid losses recoverable	6,061	-	-
Loss reserves recoverable	9,824	(297)	(48)
Other assets	19,346	(8,195)	(1,580)
Reserve for losses and loss adjustment expenses	170,680	29,020	20,260
Unearned premiums	(13,456)	24,521	86,974
Reinsurance premiums payable	(925)	695	-
Losses payable	2,717	(11)	11
Deferred tax liabilities	(4,859)	-	-
Other liabilities	(2,573)	2,505	9,442
<b>Net cash provided by operating activities</b>	<b>254,369</b>	<b>277,966</b>	<b>228,677</b>
<b>Cash flows used in investing activities:</b>			
Purchases of fixed maturities	(4,708,349)	(1,416,535)	(2,246,014)
Proceeds for sales and maturities of fixed maturities	4,498,634	1,494,209	1,147,218
Net (purchases) sales of short-term investments	(93,810)	14,048	(13,314)
Net sales (purchases) of other investments	28,043	(96,417)	(86,000)
Change in payable for investments purchased	89,502	30,802	-
Change in receivable for investments sold	(77,291)	(8,535)	(371)
Purchase of subsidiaries, net of cash acquired	-	(229,996)	-
Purchases of fixed assets	(8,624)	(3,437)	(1,423)
<b>Net cash used in investing activities</b>	<b>(271,895)</b>	<b>(215,861)</b>	<b>(1,199,904)</b>
<b>Cash flows (used in) provided by financing activities:</b>			
Common share issuance expenses paid	-	-	(22,535)
Repurchase of common shares	(2,432)	-	-
Settlement of equity awards	(6,409)	-	-
Issuance of common shares	2,632	9,091	-
Repayment of notes payable	(4,200)	-	-
Proceeds from issuance of bridge loan	-	150,000	-
Repayment of bridge loan	-	(150,000)	-
Repayment of subordinated debentures	(6,680)	-	-
Proceeds from issuance of subordinated debentures	-	100,000	-
<b>Net cash (used in) provided by financing activities</b>	<b>(17,089)</b>	<b>109,091</b>	<b>(22,535)</b>
Effect of exchange rate changes on cash and cash equivalents	394	(3,733)	(50)
Net (decrease) increase in cash and cash equivalents	(34,221)	167,463	(993,812)
Cash and cash equivalents - beginning of year	192,360	24,897	1,018,709
<b>Cash and cash equivalents - end of year</b>	<b>\$ 158,139</b>	<b>\$ 192,360</b>	<b>\$ 24,897</b>

Supplemental disclosures of cash information:

Income taxes paid	\$ 15,796	\$ 10	\$ 8
Interest paid	\$ 6,720	\$ 2,991	\$ -

See accompanying notes to consolidated financial statements

**ARIEL HOLDINGS LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the years ended December 31, 2008, 2007 and 2006**  
(Expressed in thousands of U.S. dollars, except share and per share amounts)

**1. Organization**

Ariel Holdings Ltd. ("Ariel Holdings" or collectively with its subsidiaries, the "Company") was incorporated on October 21, 2005 under the laws of Bermuda. On December 16, 2005, Ariel Holdings completed a private offering of 10,310,050 common shares for gross proceeds of approximately \$1.0 billion. Ariel Holdings is owned by various private equity investors, none of which own a controlling interest. Ariel's objective is to operate a sustainable, diversified insurance and reinsurance operation.

Ariel Holdings has three wholly owned subsidiaries: Ariel Reinsurance Company Ltd. ("Ariel Re"), Atrium Underwriting Group Limited ("Atrium") and Valiant Insurance Group, Inc. ("VIG").

The Company's initial operations were conducted by Ariel Re and focused principally on catastrophe exposed property and marine reinsurance business. Catastrophe reinsurance covers unpredictable events such as hurricanes, windstorms, hailstorms, earthquakes, volcanic eruptions, fires, freezes, industrial explosions and other man-made or natural disasters. Loss experience associated with catastrophe reinsurance is characterized by infrequent events of high severity. Although catastrophe exposed business constitutes the majority of Ariel Re's business, Ariel Re also underwrites property and professional liability insurance on a direct basis.

The Company completed the acquisition of Atrium with an effective date of September 30, 2007. Atrium is a specialist insurer at Lloyd's of London that manages two syndicates (Syndicate 570, non-marine and Syndicate 609, marine) and participates in certain non-managed syndicates.

VIG was incorporated on May 14, 2007 as a wholly owned subsidiary of Ariel Holdings Ltd. On October 1, 2007, VIG acquired all of the outstanding shares of Valiant Insurance Company ("Valiant") from a wholly owned subsidiary of Zurich Insurance Company for \$26.0 million. Valiant is a Delaware-domiciled insurance corporation with admitted licenses in 47 states plus the District of Columbia. During 2008, Valiant Specialty Insurance Company ("Valiant Specialty") was formed as a wholly-owned subsidiary of Valiant and is expected to begin underwriting surplus lines in 2009. The Company's US-based activities are conducted through Valiant, which provides a US operating platform for specialty property and casualty insurance initiatives.

**2. Significant Accounting Policies**

**Basis of presentation and consolidation**

The consolidated financial statements include Ariel Holdings and its wholly owned subsidiaries, Ariel Re, Atrium, and VIG (collectively, the "Company"), and have been prepared in accordance with US Generally Accepted Accounting Principles ("US GAAP"). All intercompany accounts and transactions have been eliminated in preparing these consolidated financial statements.

For accounting purposes, the acquisition date of Atrium was September 30, 2007. The Company records its pro-rata share of syndicate assets, liabilities, revenues and expenses as a participant in the underwriting activities of Lloyd's syndicates. Due to the delay in receiving information from third parties relating to Atrium's participation in non-managed syndicates, the Company consolidates the results of Atrium on a three month lag in order for the Company to prepare more timely consolidated financial statements. In the event that material events occur during a given quarter, the impact is included in the current period. For the year ended December 31, 2007, the Company's consolidated statement of operations and comprehensive (loss) income did not include the results of operations from Atrium due to the three month lag in reporting.

Certain comparative financial information has been reclassified to conform to the current year presentation.

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**Use of estimates**

The preparation of the consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. While the estimates included in the consolidated financial statements reflect the Company's best estimates and assumptions, actual results could differ materially from these estimates. The significant estimates reflected in the Company's consolidated financial statements include the reserve for losses and loss adjustment expenses, premium estimates for business written, the valuation of goodwill and intangible assets, and the fair value measurement of certain fixed maturities and other investments. Estimates and assumptions are periodically reviewed and the effects of revisions are recorded in the consolidated financial statements in the periods in which they are determined.

**Premiums**

Premiums written are recorded in accordance with the terms of the underlying policies and contracts of insurance and reinsurance. Premiums written are recorded at the inception of the policy and are estimated based upon information received from insureds, ceding companies and their brokers. Subsequent differences arising on such estimates are recorded in the period in which they are determined. Premiums written are earned on a pro-rata basis over the period for which coverage is provided ("risk period"). The reserve for unearned premiums represents the portion of premiums written applicable to the unexpired risk period of policies and contracts of insurance and reinsurance in force.

For contracts and policies written on a losses occurring basis, the risk period is generally the same as the contract or policy term. For contracts written on a risks attaching basis, the risk period is based on the terms of the underlying contracts and policies.

Reinstatement premiums that reinstate coverage are estimated based on loss experience and are recorded in accordance with the contract terms based upon the ultimate loss estimate associated with each contract. Reinstatement premiums are generally written and earned at the time the associated loss event occurs.

A portion of the Company's assumed reinsurance agreements contain loss sensitive or loss limiting provisions, such as adjustable or sliding scale commissions or occurrence limitations, that may impact the ultimate amounts paid to or received from ceding companies. In some loss scenarios, these features would result in the ceding company's results not being proportional to the Company's results under the proportional reinsurance agreement, and such differences may be meaningful. The Company has recorded these agreements as deposits under the accounting provisions of the AICPA's Statement of Position 98-7, "*Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk*" ("SOP 98-7") and are included in Other liabilities on the consolidated balance sheets. These contracts were deemed as either transferring only significant timing risk or transferring only significant underwriting risk. During the years ended December 31, 2008 and 2007 the Company did not enter into any contracts that were accounted for as deposits under SOP 98-7.

**Deferred acquisition costs**

Acquisition expenses are costs that vary with, and are directly related to, the production of new and renewal business and consist principally of commissions and brokerage expenses incurred at the time a contract or policy is issued. These costs are deferred and amortized over the period in which the related premiums are earned. Deferred acquisition costs are limited to their estimated realizable value based on the related unearned premiums. Anticipated loss and loss adjustment expenses and anticipated investment income related to those premiums are considered in determining the recoverability of deferred acquisition costs.

**Reinsurance ceded**

In the normal course of business, the Company may seek to mitigate underwriting risk that could cause unfavorable results by reinsuring certain amounts of risk with other reinsurers. Reinsurance premiums ceded are expensed pro-rata over the period the reinsurance coverage is provided. Prepaid reinsurance premiums represent the portion of premiums ceded on the unexpired term of the policies purchased.

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Reinsurance recoverables are presented on the balance sheet net of any reserves for uncollectible reinsurance. The method for determining the reinsurance recoverable on unpaid losses and loss adjustment expenses involves actuarial estimates in a manner consistent with the determination of unpaid losses and loss adjustment expenses. Any reserve for uncollectible reinsurance is based on an estimate of the amount of the reinsurance recoverable balance that will ultimately not be recovered due to reinsurer insolvency, contractual dispute or other reason. The valuation of this reserve for uncollectible reinsurance includes several processes including a review of the credit ratings of the reinsurance recoverables by reinsurer, an analysis of default probabilities as well as coverage issues. These factors require considerable management judgment and the factors are reviewed in detail on a quarterly basis with any resulting adjustments recorded in earnings in the period that collection issues are identified.

**Reserve for losses and loss adjustment expenses**

The reserve for losses and loss adjustment expenses is established by management and includes estimates for unpaid claims and claim expenses on reported losses as well as an estimate of losses incurred but not reported. The reserve is based on individual claims, case reserves and other reserve estimates reported by insureds and ceding companies as well as management's estimate of ultimate losses. The reserve for incurred but not reported losses and loss expenses is established by management based on actuarially determined estimates of ultimate losses and loss expenses. Inherent in the estimate of ultimate losses are expected trends in claim severity and frequency and other factors which could vary significantly as claims are settled.

Ultimate losses and loss expenses may vary materially from the amounts provided in the consolidated financial statements. These estimates are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments, if any, are recorded in earnings in the period in which they become known and are accounted for as changes in estimates.

**Investments**

Effective January 1, 2008, the Company adopted Financial Accounting Standards Board ("FASB") Statement No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 defines fair value as the price received to transfer an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date reflecting the highest and best use valuation concepts. FAS 157 establishes a framework for measuring fair value in US GAAP by creating a hierarchy of fair value measurements that distinguishes market data between observable independent market inputs and unobservable market assumptions by the reporting entity. FAS 157 further expands disclosures about such fair value measurements. FAS 157 applies broadly to most existing accounting pronouncements that require or permit fair value measurements (including both financial and non-financial assets and liabilities) but does not require any new fair value measurements.

Effective January 1, 2008, the Company also adopted FASB Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115" ("FAS 159") and elected the fair value option for all of the Company's fixed maturity investments, short-term investments, and other investments. The Company believes that accounting for its fixed maturity investments as trading, with all changes in fair value included in earnings, reduces an element of management judgment as the Company is no longer required to perform an analysis of its investments for other-than-temporary impairment.

Following the adoption of FAS 159, all of the Company's fixed maturity investments, previously reported for as available-for-sale, are classified as trading securities and are carried at fair value with changes in fair value included in earnings in the consolidated statement of operations and comprehensive (loss) income. Prior to January 1, 2008, the Company's investments in fixed maturities were classified as available-for-sale and carried at fair value, with related net unrealized gains or losses excluded from earnings and included in shareholders' equity as a component of accumulated other comprehensive (loss) income. This resulted in a cumulative increase in retained earnings of \$10.6 million offset by a decrease in accumulated other comprehensive (loss) income, as described in the consolidated statement of shareholders' equity. The fair value of fixed maturity and short term investments is based upon quoted market values or industry standard models that consider only assumptions that are observable in the marketplace.

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Investment transactions are recorded on the trade date with balances pending settlement reflected separately in the balance sheet. Net investment income includes interest and dividend income together with amortization of market premiums and accretion of discounts and is recorded net of investment management fees. The amortization of premiums and accretion of discounts for fixed maturity investments is computed using the effective yield method. Premiums and discounts arising from the purchase of mortgage-backed securities are amortized using the effective yield method over the estimated remaining term of the securities, adjusted for anticipated prepayments.

Realized gains or losses on the sale of investments are determined on the basis of the first-in-first-out method and included in earnings when realized.

Short-term investments, which are managed as part of the Company's investment portfolio and have a maturity of one year or less when purchased, are carried at fair value, which approximates amortized cost.

The Company participates in a securities lending program whereby blocks of securities, which are included in fixed maturity investments, are loaned to third parties, primarily major brokerage firms. The Company retains all economic interest in the securities it lends, retains the earnings and cash flows associated with the loaned securities and receives a fee from the borrower for the temporary use of the securities. Collateral is required at a rate of 102% - 105% of the market value of the loaned securities and is monitored daily and maintained by the lending agent. The collateral has not been recorded on the balance sheet as the Company does not have the right to sell or repledge the collateral.

Other investments are carried at fair value with interest and dividend income and income distributions included in net investment income. The fair value of the hedge funds is generally established on the basis of the net valuation criteria established by the managers of the investments. These net valuations are determined based upon the valuation criteria established by the governing documents of such investments. The Company records the fair value of the hedge funds on a month lag as valuation information provided by the managers of the investments is not available on a timely basis. This lag in reporting is applied consistently until timely information becomes available. The fair value of catastrophe bonds are based on quoted market prices, or when such prices are not available, by reference to broker or underwriter bid indications. Such valuations may differ significantly from the values that would have been used had ready markets existed for the shares, partnership interests or notes of the other investments. Other investments also include the Company's pro-rata share of investments held by the non-managed Lloyd's syndicates in which the Company participates and that the Company does not manage nor control. These investments principally include fixed maturities, equities and short term investments.

The Company currently enters into derivative instruments such as swaps and forward contracts in order to manage its foreign currency exposure, obtain exposure to a particular financial market, for yield enhancement or for managing the duration of the fixed maturity investment portfolio. The Company accounts for its derivatives in accordance with FASB Statement No. 133, "*Accounting for Derivative Instruments and Hedging Activities*" ("FAS 133"), which requires all derivatives to be recorded at fair value on the Company's balance sheet as either assets or liabilities, depending on their rights or obligations, with changes in fair value included in unrealized gains (losses) on investments in the consolidated statement of operations and comprehensive (loss) income. The fair value of the Company's derivatives are estimated by reference to quoted prices or broker quotes, where available, or in the absence of quoted prices or broker quotes, by the use of industry or internal valuation models.

Prior to the adoption of FAS 159, net realized and net unrealized gains or losses relating to the Company's catastrophe bonds, equity funds and hedge funds were included in net investment income. Effective January 1, 2008, net realized and net unrealized gains or losses relating to fixed maturity and short-term investments and other investments are included in net realized gains or losses and net unrealized gains or losses in the consolidated statements of operations and comprehensive (loss) income.

**Cash and cash equivalents**

Cash and cash equivalents include highly liquid short-term deposits and securities with maturities of ninety days or less at the time of purchase.

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**Goodwill and intangible assets**

The Company accounts for intangible assets that arose from business combinations in accordance with FASB Statement No. 141 "*Business Combinations*". A purchase price paid that is in excess of net assets ("goodwill") arising from a business combination is recorded as an asset, and is not amortized. Intangible assets with a finite life are amortized on a straight-line basis over the estimated useful life of the asset. Intangible assets with an indefinite useful life are not amortized. Goodwill and intangible assets are tested for impairment on an annual basis or more frequently if events or changes in circumstances indicate that the carrying amount may not be recoverable. If the goodwill or intangible asset is impaired, it is written down to its realizable value with a corresponding expense charged to earnings in the consolidated statements of operations.

**Foreign exchange**

The Company's functional currency is the United States Dollar. The British pound is the functional currency of Atrium. Assets and liabilities of foreign operations whose functional currency is not the US dollar are translated at prevailing exchange rates in effect at the balance sheet dates. Revenues and expenses of such foreign operations are translated at average exchange rates for the year. The net effect of translation differences between functional and reporting currencies in foreign operations, net of applicable deferred income taxes, are included in accumulated other comprehensive (loss) income.

Monetary assets and liabilities denominated in foreign currencies are remeasured into the functional currency at the exchange rates in effect at the balance sheet dates and revenues and expenses denominated in foreign currencies are translated at the prevailing exchange rate on the transaction date, with the resulting foreign exchange gains and losses included in earnings.

**Earnings per share**

Basic earnings per common share is calculated by dividing net income by the weighted average common shares outstanding during the period. Diluted earnings per common share is computed by dividing net income by the weighted average number of common shares and common share equivalents outstanding during the period. Stock options and unvested stock grants are considered common share equivalents for the purposes of calculating diluted earnings per common share, and are included in the weighted average number of shares outstanding using the treasury stock method. In a period where there is a net loss, the dilutive effect of common share equivalents is not included in the weighted average number of shares, as this would be anti-dilutive.

**Stock based compensation plans**

The Company accounts for its share plans in accordance with the fair value recognition provisions of FASB Statement No. 123 ("revised"), "*Share-Based Payments*". Accordingly, the Company recognizes the compensation expense for stock options and restricted share grants based on the fair value of the award on the date of grant over the requisite service period.

**Taxation**

Income taxes have been provided in accordance with the provisions of FASB Statement No. 109, "*Accounting for Income Taxes*" ("FAS 109"), on those operations which are subject to income taxes. Under FAS 109, the Company records deferred income taxes which reflect the tax effect of the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their respective tax bases. A valuation allowance against a deferred tax asset is provided for if and when the Company believes that a portion or all of the deferred tax asset may not be realized in the near term.

The Company adopted FASB Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes*" ("FIN 48") on January 1, 2007 which requires the Company to recognize the tax benefits of uncertain tax positions only where the position is "more likely than not" to be sustained assuming examination by tax authorities. The Company did not recognize any liabilities for unrecognized tax benefits as a result of the implementation of FIN 48. The Company does not anticipate any significant changes to its total unrecognized tax benefits within the next twelve months and classifies all income tax associated with interest and penalties as income tax expense. During the year ended December 31, 2008, the Company paid interest of \$161 (2007 - \$nil).

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**Recent accounting pronouncements**

In March 2008, the FASB issued FAS No. 161, "*Disclosure About Derivative Instruments and Hedging Activities – an Amendment of FAS No. 133*" ("FAS 161"). FAS 161 requires enhanced disclosures about an entity's derivative and hedging activities, and is effective for financial statements issued for fiscal years beginning after November 15, 2008. FAS 161 will require the Company to make additional disclosures concerning the Company's derivatives and its adoption will not affect the Company's consolidated shareholders' equity or earnings.

In May 2008, the FASB issued FAS No. 162, "*The Hierarchy of Generally Accepted Accounting Principles*" ("FAS 162"). FAS 162 identifies the sources of accounting principles used and provides a framework for selecting the principles used in the preparation of the financial statements that are presented in conformity with US GAAP (the "GAAP hierarchy"). This Statement is effective 60 days following the approval by the Securities and Exchange Commission of the Public Company Accounting Oversight Board amendments to AU Section 411, "*The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*". The Company does not anticipate that the adoption of FAS 162 will have a material effect on the Company's financial position or results of operations.

**3. Investments**

Effective January 1, 2008, the Company adopted FAS 159 and FAS 157. Following the adoption of FAS 159, all of the Company's fixed maturities, previously reported for as available-for-sale, are reported as trading securities and are carried at fair value with changes in fair value included in earnings in the consolidated statement of operations and comprehensive (loss) income. Prior to January 1, 2008, the Company's investments in fixed maturities were classified as available-for-sale and carried at fair value, with related net unrealized gains or losses excluded from earnings and included in shareholders' equity as a component of accumulated other comprehensive (loss) income.

Under the provisions of FAS 157, the Company must determine the appropriate level in the fair value hierarchy for each financial instrument that it measures at fair value. The fair value hierarchy in FAS 157 prioritizes the inputs, which refer broadly to assumptions market participants would use in pricing an asset or liability, into three levels and gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The level in the fair value hierarchy within which a fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. The three levels are defined as follows:

Level 1 - Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 - Inputs are other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly. A significant adjustment to a Level 2 input could result in the Level 2 measurement becoming a Level 3 measurement.

Level 3 - Inputs are unobservable inputs for the asset or liability.

The Company uses quoted values and other data provided by an independent pricing service and its third-party investment managers in determining fair values for its fixed maturity investments. Each source has its own proprietary method for determining fair value that is not actively traded. In general, the methods involve the use of "matrix pricings" in which the independent pricing sources use observable market inputs including, but not limited to, yield curves, trade execution data, market spreads, cash flows, credit risks and benchmarking like securities to determine a reasonable fair value.

The Company reviews its investments measured at fair value and discusses the proper classification of such investments with its investment advisors. The Company's review process includes, but is not limited to, initial and ongoing evaluation of methodologies used by outside parties to calculate fair value and back testing, where information is available, which includes selecting securities sold and comparing to the executed prices to the fair values estimates from the pricing services. The Company determined that the securities classified as Level 1 would include highly liquid US Treasuries,

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European and Canadian Sovereign debt and certain highly liquid short-term investments where it believes that quoted prices are available in an active market. Where the Company believes that quoted market prices are not available or that the market is not active, fair values are estimated by using quoted prices of securities with similar characteristics, pricing models or matrix pricings that consider various assumptions, including time value, yield curves, interest rates, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. The Company determined that Level 2 securities include short-term and fixed maturity investments such as other governments, corporate bonds, US government agencies and non-US government agencies, mortgage-backed, commercial mortgage-backed and asset-backed securities.

Other investments include catastrophe bonds, hedge funds, derivatives and investments held by non-managed syndicates. All these investments are classified as Level 2, except for the hedge funds, which are classified as Level 3. Our estimate of the fair value of catastrophe bonds is based on quoted market prices or when such prices are not available, by reference to broker or underwriter bid indications. The fair values of the Company's over-the-counter derivatives such as swaps and forward contracts are estimated by reference to quoted prices or broker quotes, where available, or in the absence of quoted prices or broker quotes, the use of industry or internal valuation models used by an independent pricing service. Investments held by non-managed syndicates include the Company's pro-rata share of investments that the Company does not manage nor control. These investments principally include fixed maturities, equities and short-term investments. The fair value of these investments is provided by the non-managed syndicates' independent pricing service or investment managers utilizing observable data.

The Company's hedge funds have been classified as Level 3 due to the restrictions on redemptions and sale of these investments. The fair value of the hedge funds is generally determined on the basis of the net valuation criteria established by the managers of the investments. The Company believes the published net asset value represents the fair value that market participants would apply to an interest in the fund. Some of the hedge funds are subject to restrictions on redemptions and sale which are determined by the governing documents and limit our ability to liquidate these investments in the short-term. The Company obtains the audited financial statements for every hedge fund annually and regularly reviews and discusses fund performance with fund managers to corroborate the reasonableness of the published net asset value.

The adoption of FAS 157 did not have a material change on the Company's valuation techniques. In October 2008, FAS 157-3, "*Determining the Fair Value of a Financial Assets When Market for that Asset is not Active*", was issued, which provided further clarification on fair value measurement for financial assets in inactive markets. The adoption of this statement did not impact the Company's results of operations or financial position for the year ended December 31, 2008.

a) At December 31, 2008, the Company's investments were allocated between Levels 1, 2, and 3 as follows:

		<b>Level 1</b>		<b>Level 2</b>		<b>Level 3</b>		<b>Total</b>
US government and government agencies	\$	189,609	\$	128,600	\$	-	\$	318,209
Other governments		16,149		20,830		-		36,979
Corporate		-		403,054		-		403,054
Mortgage-backed securities		-		416,240		-		416,240
Asset-backed securities		-		99,134		-		99,134
Commercial mortgage-backed securities		-		105,407		-		105,407
Total fixed maturity investments	\$	205,758	\$	1,173,265	\$	-	\$	1,379,023
Other investments		-		227,239		48,243		275,482
Short-term investments		56,119		118,201		-		174,320
<b>Total</b>	<b>\$</b>	<b>261,877</b>	<b>\$</b>	<b>1,518,705</b>	<b>\$</b>	<b>48,243</b>	<b>\$</b>	<b>1,828,825</b>

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The following table presents a reconciliation of the beginning and ending balances for hedge funds, included in other investments that are measured at fair value using Level 3 inputs during the year ended December 31, 2008:

	<b>Other Investments</b>
Beginning balance at January 1, 2008	\$ -
Transfers in of Level 3 assets at fair value	62,226
Purchases, sales and issuances	-
Net unrealized losses included in earnings	(13,983)
Ending balance at December 31, 2008	<u>\$ 48,243</u>

Total net unrealized losses of \$18.4 million from the hedge funds were included in earnings for the year ended December 31, 2008.

- b) The amortized cost, gross unrealized gains and losses and fair value of fixed maturities by category at December 31, 2008 and 2007 are as follows:

	<b>December 31, 2008</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<b>Fixed maturity investments, trading:</b>				
US government and government agencies	\$ 307,084	\$ 14,571	\$ (3,446)	\$ 318,209
Other governments	36,767	237	(25)	36,979
Corporate	409,804	3,876	(10,626)	403,054
Mortgage-backed securities	422,978	10,816	(17,554)	416,240
Asset-backed securities	117,319	129	(18,314)	99,134
Commercial mortgage-backed securities	116,535	60	(11,188)	105,407
<b>Total</b>	<b>\$ 1,410,487</b>	<b>\$ 29,689</b>	<b>\$ (61,153)</b>	<b>\$ 1,379,023</b>

	<b>December 31, 2007</b>			
	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
<b>Fixed maturity investments, available-for-sale:</b>				
US government and government agencies	\$ 218,948	\$ 2,332	\$ -	\$ 221,280
Other governments	61,635	272	(8)	61,899
Corporate	304,457	3,263	-	307,720
Mortgage-backed securities	244,036	2,825	(1)	246,860
Asset-backed securities	235,741	1,070	(6)	236,805
Commercial mortgage-backed securities	128,829	932	(5)	129,756
<b>Total</b>	<b>\$ 1,193,646</b>	<b>\$ 10,694</b>	<b>\$ (20)</b>	<b>\$ 1,204,320</b>

During the year ended December 31, 2008, the Company recorded \$nil in other-than-temporary impairment charges. (2007 – \$11.9 million; 2006 - \$3.3 million)

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- c) The contractual maturity dates of fixed maturities, trading and fixed maturities, available-for-sale, at December 31, 2008 and 2007 are as follows:

	December 31, 2008		December 31, 2007	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year or less	\$ 127,320	\$ 127,570	\$ 113,537	\$ 113,696
Due after one year through five years	590,355	595,431	430,546	435,765
Due after five years through ten years	21,536	23,088	33,989	34,360
Due after ten years	14,444	12,153	6,968	7,078
Mortgage-backed securities	422,978	416,240	244,036	246,860
Asset-backed securities	117,319	99,134	235,741	236,805
Commercial mortgage-backed securities	116,535	105,407	128,829	129,756
<b>Total</b>	<b>\$ 1,410,487</b>	<b>\$ 1,379,023</b>	<b>\$ 1,193,646</b>	<b>\$ 1,204,320</b>

Actual maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

- d) The following table summarizes the composition of the fixed maturity portfolio by investment ratings assigned by rating agencies at December 31, 2008 and 2007:

	December 31, 2008		December 31, 2007	
	Fair Value	% of Total	Fair Value	% of Total
AAA/Aaa	\$ 1,051,956	76.3	\$ 924,675	76.8
AA/Aa	70,851	5.1	101,565	8.4
A/A	188,041	13.6	104,775	8.7
BBB/Baa	67,750	4.9	69,929	5.8
C	425	0.1	3,376	0.3
<b>Total</b>	<b>\$ 1,379,023</b>	<b>100.0</b>	<b>\$ 1,204,320</b>	<b>100.0</b>

The primary rating source is Standard & Poor's Corporation ("S&P").

- e) Certain of the Company's cash and fixed maturity investments are held in pledged accounts (see Note 12c).
- f) The following table reflects the Company's other investments, at fair value at December 31, 2008 and 2007:

	December 31, 2008	
	Cost	Fair Value
<b>Other investments:</b>		
Catastrophe bonds	\$ 93,663	\$ 86,065
Hedge funds	66,000	48,243
Derivative instruments	(9,342)	(10,978)
Investments held by non-managed syndicates	152,152	152,152
<b>Total</b>	<b>\$ 302,473</b>	<b>\$ 275,482</b>

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	December 31, 2007	
	Cost	Fair Value
<b>Other investments:</b>		
Catastrophe bonds	\$ 67,417	\$ 68,423
Equity fund	58,000	66,010
Hedge funds	57,000	57,668
Derivative instruments	-	544
Investments held by non-managed syndicates	160,964	160,964
<b>Total</b>	<b>\$ 343,381</b>	<b>\$ 353,609</b>

The catastrophe bonds are variable rate notes where the return is contingent upon certain climatic or geological events. The hedge funds include the Company's investment in credit, long and short equity, distressed capital, event-driven and other multi-strategy funds. These investments utilize a variety of different investment approaches, designed to maximize diversity. The fair values for the hedge funds are determined by management using the net asset values provided by the third party administrators of these funds. The equity fund and the hedge funds are subject to restrictions on redemptions which are determined by the governing documents and may limit the Company's ability to liquidate its investment in these funds. The investments held by non-managed syndicates is the portion of the Atrium portfolio that is administered by third parties and principally includes fixed maturities, equities and short term investments. The equity fund uses equity index futures and sometimes swaps to achieve non-leveraged passive stock market exposure that is indexed against the S&P 500 index. Further, the fund invests the cash collateral in an actively managed, one-to-six year duration, total return style core bond portfolio with the goal of outperforming the money market interest rate cost typically associated with equity index futures and swap collateral.

- g) The components of net investment income for the years ended December 31, 2008, 2007, 2006 and are as follows:

Year ended December 31,	2008	2007	2006
Fixed maturities and short-term investments	\$ 79,714	\$ 58,332	\$ 48,774
Cash and cash equivalents	5,132	3,509	5,606
Other investments	1,817	12,165	4,186
	86,663	74,006	58,566
Investment expenses	(2,532)	(1,566)	(1,488)
Net investment income	\$ 84,131	\$ 72,440	\$ 57,078

Prior to the adoption of FAS 159, net realized and net unrealized gains or losses relating to the Company's catastrophe bonds, equity funds and hedge funds were included in net investment income. Effective January 1, 2008, net realized and net unrealized gains or losses relating to fixed maturity and short-term investments and other investments are included in net realized gains or losses and net unrealized gains or losses in the consolidated statements of operations and comprehensive (loss) income.

- h) The analysis of realized gains and losses on investments for the years ended December 31, 2008, 2007 and 2006 is as follows:

Year ended December 31,	2008	2007	2006
Gross realized gains	\$ 51,569	\$ 3,577	\$ 382
Gross realized losses	(61,120)	(6,592)	(2,764)
Other-than-temporary impairments	-	(11,921)	(3,287)
Net realized losses on investments included in net (loss) income	\$ (9,551)	\$ (14,936)	\$ (5,669)

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**4. Reserve for losses and loss adjustment expenses**

The reserve for losses and loss adjustment expenses is an estimate which is subject to material variability. The variability arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Variability can be caused by the receipt of additional claim information, changes in judicial interpretation of contracts or significant differences in the severity or frequency of claims from historical trends. In addition, Ariel Re and VIG do not have the benefit of their own historical loss experience due to their short operating histories. Accordingly, the Company's reserves for losses and loss adjustments may be subject to greater variability than a more mature company.

Loss and loss adjustment expense reserve estimates are based on all relevant information available to the Company. The Company believes that the reserve for losses and loss adjustment expenses is sufficient to cover losses that fall within coverages assumed by the Company; however, there can be no assurance that actual losses will not exceed the Company's total reserves for losses and loss adjustment expenses.

Activity in the reserve for losses and loss adjustment expenses is summarized as follows for the years ended December 31, 2008 and 2007:

	<b>December 31 2008</b>	<b>December 31 2007</b>
Gross reserves for losses and loss expenses, beginning of year	\$ 478,240	\$ 20,260
Gross reserves for losses and loss expenses, acquired in purchase of Atrium	-	428,960
Total gross reserves for losses and loss expenses	478,240	449,220
Loss reserves recoverable, beginning of year	73,964	48
Loss reserves recoverable acquired in the purchase of Atrium	-	73,619
Total net reserves for losses and loss expenses	404,276	375,553
Net losses incurred related to:		
Current year	415,613	41,406
Prior years	(28,022)	(3,943)
Total net incurred losses	387,591	37,463
Net paid losses related to:		
Current year	(120,939)	(4,590)
Prior years	(84,910)	(5,596)
Total net paid losses	(205,849)	(10,186)
Loss portfolio transfer	(11,582)	-
Effect of foreign exchange movements	10,859	1,446
Total net reserves for losses and loss expenses, end of year	585,295	404,276
Loss reserves recoverable, end of year	64,894	73,964
Total gross reserves for losses and loss expenses, end of year	\$ 650,189	\$ 478,240

Our loss estimates for Hurricanes Ike and Gustav are subject to a high level of uncertainty due to the short period of time that has passed since the Hurricanes occurred. This may result in volatility in the Company's financial results. Current year net losses incurred of \$415.6 million include net incurred losses of \$247.8 million from Hurricanes Ike and Gustav.

During 2008, the Company experienced net favorable development on prior years of \$28.0 million consisting of net favorable development of \$31.6 million from the Lloyd's segment resulting from better than expected loss experience in prior underwriting years, which is partially offset by net adverse development of \$3.6 million from the Bermuda segment mainly due the marine and aviation lines.

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During 2007, the Company experienced favorable development of prior years of \$3.9 million due to the Bermuda segment which was primarily related to better than expected losses experience in all lines of business.

Atrium participated in seven syndicates for the 2005 Lloyd's underwriting year of account, which closed their 2005 underwriting year of account in 2007 by way of a Lloyd's reinsurance to close. In closing the 2005 year of accounting, all outstanding losses were transferred into the 2006 year of account, effective January 1, 2008. Atrium continued its participation in six of these syndicates for the 2006 underwriting year of account, but with changes in participation. Additionally, two syndicates which were in run-off closed into the 2006 year of account. This resulted in a decrease in loss reserves of \$11.6 million and has been treated as a ceded loss portfolio transfer. To the extent that the future run-off of the 2005 year of account differs from what has been estimated, that development will be recorded in earnings in the period that it is incurred.

**5. Reinsurance ceded**

- a) **Reinsurance premiums written and earned.** The effects of reinsurance ceded on premiums written, earned and on losses and loss adjustment expenses, during the years ended December 31, 2008 and 2007, are as follows:

	<b>2008</b>	<b>2007</b>
<b>Premiums written</b>		
Direct	\$ 283,945	\$ 39,012
Assumed	332,200	316,773
Ceded	(74,869)	(9,241)
<b>Net</b>	<b>\$ 541,276</b>	<b>\$ 346,544</b>
<b>Premiums earned</b>		
Direct	\$ 303,651	\$ 43,729
Assumed	335,310	288,403
Ceded	(81,813)	(9,481)
<b>Net</b>	<b>\$ 557,148</b>	<b>\$ 322,651</b>
<b>Losses and loss adjustment expenses</b>		
Gross losses and loss adjustment expenses	\$ 444,360	\$ 37,760
Losses and loss adjustment expenses recoverable	(56,769)	(297)
<b>Net losses and loss adjustment expenses</b>	<b>\$ 387,591</b>	<b>\$ 37,463</b>

The Company uses reinsurance ceded contracts to reduce its exposure to risk of loss on certain reinsurance contracts. Reinsurance ceded contracts do not relieve the Company from its obligations to policyholders. The Company remains primarily liable to its policyholders for the portion reinsured to the extent that any reinsurer does not meet the obligations assumed under the reinsurance agreements.

- b) **Credit Risk.** The Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk arising from its exposure to individual reinsurers. The reinsurance program is generally placed with reinsurers whose rating, at the time of placement, was A- ("Excellent") or better by A.M. Best or the equivalent with other rating agencies. Exposure to a single reinsurer is also controlled with restrictions dependent on rating. At December 31, 2008, the total reinsurance recoverable balance (which includes loss reserves recoverable and recoverables on paid losses) excluding non-managed syndicates was \$41.7 million (2007 - \$36.8 million). Reinsurance recoverables is analyzed as follows:

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	December 31, 2008		December 31, 2007	
	Reinsurance Recoverable	% of Total	Reinsurance Recoverable	% of Total
Top 10 reinsurers	\$ 29,603	42.2%	\$ 24,859	29.1%
Other reinsurers balances	12,133	17.3%	11,921	14.0%
Non-managed syndicates	28,452	40.5%	48,539	56.9%
<b>Total</b>	<b>\$ 70,188</b>	<b>100.0%</b>	<b>\$ 85,319</b>	<b>100.0%</b>

The Company estimates the provision for uncollectible reinsurance by applying specific percentages against each recovery based on the counterparty's credit rating. The percentages applied are based on historical industry default statistics developed by major rating agencies and are then adjusted based on industry knowledge and the Company's judgment and estimates. The Company then evaluates the overall adequacy of the provision for uncollectible reinsurance. At December 31, 2008 and 2007, the provision for uncollectible reinsurance relating to losses recoverable was \$1.0 million and \$1.5 million, respectively.

**6. Business combinations**

**a) Atrium Underwriting Plc**

The Company's acquisition of Atrium was completed with an effective date of September 30, 2007. Atrium provides the Company with significant benefits in both product line and geographic diversification while also offering access to underwriting expertise and business placed only in the Lloyd's of London marketplace. Atrium's business, written in two managed syndicates, Syndicates 570 and 609, includes professional liability insurance, casualty insurance and reinsurance, marine/aviation/transport insurance and other lines as well as property insurance and reinsurance. In addition, Atrium participates in certain non-managed syndicates that provide exposures to similarly diverse classes of business. Additional factors that added to the value of Atrium included its capital structure and workforce. These factors resulted in a purchase price greater than the fair value of Atrium's net assets.

The purchase price, including expenses, paid by the Company was \$398,057 and the fair value of the tangible net assets acquired was \$240,430, resulting in \$157,627 assigned to goodwill and intangible assets. Certain shareholders of Atrium elected to receive Ariel loan notes in lieu of cash, totaling \$8,264. At December 31, 2008 and 2007, the outstanding principal on these notes was \$2.1 million and \$8.3 million respectively.

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The fair value of net assets acquired and allocation of purchase price is summarized as follows:

<b>Total purchase price</b>		<b>\$ 398,057</b>
<b>Tangible assets acquired</b>		
Cash and investments	\$ 621,323	
Receivables and other assets	185,700	
Tangible assets acquired	<u>\$ 807,023</u>	
<b>Liabilities acquired</b>		
Net reserve for losses and loss adjustment expenses	\$ (355,342)	
Unearned premiums	(110,233)	
Tax liabilities	(27,305)	
Other net liabilities	(73,713)	
Tangible liabilities acquired	<u>\$ (566,593)</u>	
<b>Net tangible assets acquired</b>		<u>\$ 240,430</u>
<b>Excess of purchase price over net tangible assets acquired</b>		<u>\$ 157,627</u>
<b>Goodwill and other intangible assets acquired, net of taxation</b>		
Intangible asset — Management contract	\$ 35,251	
Intangible asset — Syndicate capacity	23,279	
Intangible asset – Distribution network	19,682	
Intangible asset – Trade name	279	
Total intangible assets	<u>78,491</u>	
Goodwill	79,136	
<b>Total goodwill and other intangible assets</b>		<u>\$ 157,627</u>

Syndicate capacity represents Atrium's authorized premium income limit to write insurance and reinsurance business in the Lloyd's of London market. The capacity is renewed annually at no cost to Atrium, but may be freely purchased or sold, subject to Lloyd's approval, during an annual auction process. The ability to write insurance business under the syndicate capacity is indefinite with a premium income limit being set during Atrium's annual business planning process, subject to Lloyd's approval. For the 2008 year of account, Atrium owns approximately 25% of the capacity of its managed Syndicates 570 and 609 and approximately 9% of the capacity of Syndicate 2791 which is managed by a third party managing agent.

The management contract governs the profit commission and management fee earned by Atrium for managing Syndicates 570 and 609. Profit commission is calculated based on the profit realized by the Syndicates during each year of account whilst management fee income is charged as a flat percentage of the Syndicates' capacity.

The fair value of the distribution network has been estimated using the excess earnings methodology, which present values all cash flows associated with the existing broker relationships, net of a fair return on the assets that contribute to these cash flows. These cash flows are discounted using a risk adjusted rate.

Part of the value of an operating entity may be contained in the value of the trade name. A trade name has a value for reasons such as its ability to generate sales or differentiate on price. The fair value of the trade name has been estimated using the relief-from-royalty methodology.

The fair values of the trade name and distribution network are estimated to have finite useful lives of 15 years and are amortized on a straight line basis. Syndicate capacity, the management contract and goodwill are estimated to have indefinite useful lives. Goodwill includes amounts related to the value of the workforce. The goodwill and intangibles are recorded entirely in the Company's Lloyd's segment. For accounting purposes, the acquisition date is September 30, 2007. Accordingly, for the year ended December 31, 2007, no operating results of Atrium have been included in the consolidated financial statements due to the quarter lag method of reporting Atrium's results as discussed in Note 2.

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The following unaudited pro forma financial information summarizes the combined results of operation of the Company and Atrium as though the companies had been combined as of the beginning of each of the periods presented. The unaudited pro forma information is not necessarily indicative of what would have occurred had the acquisition and related transactions been made on the dates indicated or of future results. The proforma financial information includes the results of Atrium for the nine-months ended September 30, 2008 and 2007 due to the three month lag in reporting.

<b>Year ended December 31,</b>	<b>2007</b>		<b>2006</b>	
Net premiums written	\$	613,020	\$	502,438
Total revenue		580,944		513,405
Total expenses		304,978		298,248
Net income	\$	259,678	\$	192,912
Basic earnings per share	\$	24.92	\$	18.56
Diluted earnings per share	\$	24.86	\$	18.48

**b) Valiant Insurance Group, Inc.**

Valiant Insurance Group, Inc (“VIG”) was incorporated on May 14, 2007 as a wholly owned subsidiary of Ariel Holdings. On October 1, 2007, VIG acquired all of the outstanding shares of Valiant Insurance Company (“Valiant”) from Maryland Casualty Company, a wholly owned subsidiary of Zurich Insurance Company (“Zurich”). Valiant is a Delaware-domiciled insurance corporation with admitted licenses in 47 states plus the District of Columbia. Valiant was acquired as a shell company, with no ongoing book of business, no workforce or other intangible assets as a result of an Assumption Reinsurance agreement pursuant to which Zurich assumed by novation all insurance-related obligations. An indemnification was also provided by the seller to the Company to protect against any other pre-acquisition liabilities. Valiant will serve as the Company’s US operating platform focused on specialty property and casualty insurance. The purchase price, including expenses, paid by the Company was \$26,035 and the fair value of the tangible net assets acquired was \$16,209, resulting in \$9,826 assigned to intangible assets.

The fair value of net assets acquired and allocation of purchase price is summarized as follows:

<b>Total purchase price</b>		\$	26,035
<b>Tangible assets acquired</b>			
Cash and investments	\$	15,618	
Receivables and other assets		591	
Tangible assets acquired	\$	16,209	
<b>Liabilities acquired</b>	\$	-	
<b>Net tangible assets acquired</b>			\$ 16,209
<b>Excess of purchase price over net tangible assets acquired</b>			<u>\$ 9,826</u>
<b>Goodwill and other intangible assets acquired, net of taxation</b>			
Intangible asset — state insurance licenses	\$	9,826	
Total intangible assets	\$	9,826	
Goodwill		-	
<b>Total goodwill and other intangible assets</b>			<u>\$ 9,826</u>

State insurance licenses are required in order to sell insurance in each state and the District of Columbia. To obtain these licenses, applications and procedures must be stringently followed according to state-specific rules. The state insurance licenses have value as they allow an insurance company, such as Valiant, to offer its products in markets that otherwise would not be immediately accessible. State insurance licenses are estimated to have indefinite useful lives.

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**7. Goodwill and intangible assets**

The following table shows an analysis of goodwill and other intangible assets for the years ended December 31, 2008 and 2007:

	<b>Goodwill</b>	<b>Intangible Assets - Indefinite Life</b>	<b>Intangible Assets - Finite Life</b>	<b>Total</b>
Balance at January 1, 2007	\$ -	\$ -	\$ 1,993	\$ 1,993
Amortization	-	-	(1,993)	(1,993)
Business combination	79,136	91,119	27,723	197,978
Balance at December 31, 2007	79,136	91,119	27,723	197,978
Amortization	-	-	(1,647)	(1,647)
Foreign exchange revaluation	(8,631)	(8,867)	(3,023)	(20,521)
Balance at December 31, 2008	\$ 70,505	\$ 82,252	\$ 23,053	\$ 175,810

Trade name and distribution network are estimated to have finite useful lives of 15 years and are amortized on a straight line basis. Syndicate capacity, the management contract and goodwill are estimated to have indefinite useful lives and as such are subject to annual impairment testing. The goodwill and intangibles are recorded entirely in the Company's Lloyd's segment.

No impairment of the Company's goodwill or intangible assets was noted following the annual impairment review for the years ended December 31, 2008 and 2007. The Company expects the amortization of the intangible assets with finite lives to approximate \$1.6 million in each of the years 2009 to 2012 and to be \$16.6 million in aggregate for all years thereafter.

**8. Segment Information**

The Company is currently organized into three segments: Bermuda, United States and Lloyd's operations. These segments form the basis of how the Company monitors the performance of its operations and the manner in which management makes strategic decisions. The Company evaluates the performance of its segments based on their individual operating results prior to any intercompany arrangements. General and administrative expenses relating to the holding company are included in "corporate and other reconciling items". The Company does not manage its assets by segment and therefore total assets are not allocated to the segments.

**Bermuda**

The Company's Bermuda segment provides both insurance and reinsurance coverage. The insurance sub-segment generally provides coverage to large multi-national companies on a worldwide basis. The principal lines are currently property and professional liability insurance. The reinsurance sub-segment provides treaty property, marine and aviation reinsurance to insurance companies on a worldwide basis.

**Lloyd's**

The Company's Lloyd's segment focuses on a diversified underwriting portfolio including non-marine physical damage, excess of loss reinsurance, energy, non-marine liability, aviation physical damage, marine, personal accident, motor and other.

**United States**

The Company's US segment focuses on new specialty property and casualty insurance. The segment focuses on management and professional lines, and excess of loss, umbrella and non-standard general liability insurance.

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The following tables summarize the underwriting income (loss), (loss) income before income taxes, net (loss) income, ratios and the reserves for losses and loss adjustment expenses for the years ended December 31, 2008, 2007 and 2006.

**Year ended December 31, 2008**

	Bermuda	Lloyd's	United States	Corporate & Other Reconciling Items (c)	Total
<b>Revenues:</b>					
Gross premiums written	\$ 357,507	\$ 233,733	\$ 24,905	\$ -	\$ 616,145
Net premiums written	347,435	169,205	24,636	-	541,276
Net premiums earned	356,609	191,591	8,948	-	557,148
Other underwriting income (loss)	(217)	22,449	-	-	22,232
<b>Expenses:</b>					
Net losses and loss adjustment expenses	(283,679)	(93,553)	(10,359)	-	(387,591)
Acquisition costs	(38,648)	(68,309)	(1,552)	-	(108,509)
General and administrative expenses	(32,084)	(40,103)	(13,143)	-	(85,330)
Amortization of intangible assets	-	(1,647)	-	-	(1,647)
<b>Underwriting income (loss) (a)</b>	<b>\$ 1,981</b>	<b>\$ 10,428</b>	<b>\$ (16,106)</b>	<b>\$ -</b>	<b>\$ (3,697)</b>
Gain on repurchase of subordinated debentures	-	-	-	1,520	1,520
Corporate expenses	-	-	-	(19,775)	(19,775)
Interest expense	-	-	-	(6,592)	(6,592)
Net investment income	61,886	17,053	2,160	3,032	84,131
Net realized investment (losses) gains	(11,527)	2,311	314	(649)	(9,551)
Net unrealized investment (losses) gains	(80,734)	(811)	(281)	1,640	(80,186)
Net foreign exchange gain (loss)	(4,561)	8,789	-	169	4,397
<b>(Loss) income before taxes</b>	<b>(32,955)</b>	<b>37,770</b>	<b>(13,913)</b>	<b>(20,655)</b>	<b>(29,753)</b>
Income tax expense	-	(8,733)	(45)	-	(8,778)
<b>Net (loss) income</b>	<b>\$ (32,955)</b>	<b>\$ 29,037</b>	<b>\$ (13,958)</b>	<b>\$ (20,655)</b>	<b>\$ (38,531)</b>
Net losses and loss expenses ratio	79.6%	48.8%	115.8%	n/a	69.6%
Acquisition cost ratio	10.8%	35.7%	17.3%	n/a	19.5%
General and administrative expense ratio (b)	9.0%	20.9%	146.9%	n/a	18.8%
Combined ratio (b)	99.4%	105.4%	280.0%	n/a	107.9%
Net reserve for losses and loss adjustment expenses	\$ 232,734	\$ 342,124	\$ 10,437	n/a	\$ 585,295

(a) The Company utilizes underwriting income (loss) as a measure of underwriting profitability as it evaluates profitability solely on underwriting related revenues and expenses. Items not considered to be part of underwriting include: corporate expenses, interest expense, net investment income, net realized (losses) gains on the sale of investments, net unrealized investment (losses) gains, net foreign exchange (losses) gains, and income tax expense. These items are evaluated separately from our underwriting income (loss). Underwriting income (loss) takes into account net premiums earned and other insurance related income as revenue and net losses and loss adjustment expenses, acquisition costs, underwriting related general and administrative expenses and amortization of intangible assets as expenses. Underwriting income (loss) is the difference between the revenue and expense items.

(b) The general and administrative expense ratio is calculated by dividing the sum of the general and administrative expenses and the corporate expenses by net premiums earned. It does not include the amortization of intangible assets, interest expense or net foreign exchange (losses) gains. The combined ratio is the sum of the net losses and loss expenses ratio, the acquisition cost ratio and the general and administrative expense ratio.

(c) Includes the general and administrative expenses of the holding Company and any other amounts required to reconcile the Company's underwriting results by segment to the Company's financial statement presentation.

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**Year ended December 31, 2007**

	Bermuda	Lloyd's	United States	Corporate & Other Reconciling Items (c)	Total
<b>Revenues:</b>					
Gross premiums written	\$ 354,632	\$ -	\$ 1,153	\$ -	\$ 355,785
Net premiums written	345,391	-	1,153	-	346,544
Net premiums earned	322,307	-	344	-	322,651
Other underwriting income	621	-	-	-	621
<b>Expenses:</b>					
Net losses and loss adjustment expenses	(37,239)	-	(224)	-	(37,463)
Acquisition costs	(39,736)	-	(91)	-	(39,827)
General and administrative expenses	(48,095)	-	(2,281)	-	(50,376)
Amortization of intangible assets	(1,993)	-	-	-	(1,993)
<b>Underwriting income (loss) (a)</b>	<b>\$ 195,865</b>	<b>\$ -</b>	<b>\$ (2,252)</b>	<b>\$ -</b>	<b>\$ 193,613</b>
Corporate expenses	-	-	-	(6,599)	(6,599)
Interest expense	-	-	-	(4,689)	(4,689)
Net investment income	70,311	-	343	1,786	72,440
Net realized investment losses	(14,911)	-	(25)	-	(14,936)
Net foreign exchange loss	(590)	-	-	(6,179)	(6,769)
<b>Income (loss) before taxes</b>	<b>250,675</b>	<b>-</b>	<b>(1,934)</b>	<b>(15,681)</b>	<b>233,060</b>
Income tax benefit (expense)	-	-	115	(57)	58
<b>Net income (loss)</b>	<b>\$ 250,675</b>	<b>\$ -</b>	<b>\$ (1,819)</b>	<b>\$ (15,738)</b>	<b>\$ 233,118</b>
Net losses and loss expenses ratio	11.6%	n/a	65.1%	n/a	11.6%
Acquisition cost ratio	12.3%	n/a	26.5%	n/a	12.3%
General and administrative expense ratio (b)	14.9%	n/a	663.1%	n/a	17.7%
Combined ratio (b)	38.8%	n/a	754.7%	n/a	41.6%
Net reserve for losses and loss adjustment expenses	\$ 48,711	\$ 355,341	\$ 224	\$ n/a	\$ 404,276

(a) The Company utilizes underwriting income (loss) as a measure of underwriting profitability as it evaluates profitability solely on underwriting related revenues and expenses. Items not considered to be part of underwriting include: corporate expenses, net investment income, net realized losses (gains) on the sale of investments, net foreign exchange, and income tax benefit (expense). These items are evaluated separately from our underwriting income (loss). Underwriting income (loss) takes into account net premiums earned and other insurance related income as revenue and net losses and loss adjustment expenses, acquisition costs, underwriting related general and administrative expenses and amortization of intangible assets as expenses. Underwriting income (loss) is the difference between the revenue and expense items.

(b) The general and administrative expense ratio is calculated by dividing the sum of the general and administrative expenses and the corporate expenses by net premiums earned. It does not include the amortization of intangible assets, interest expense or net foreign exchange losses. The combined ratio is the sum of the net losses and loss expenses ratio, the acquisition cost ratio and the general and administrative expense ratio.

(c) Includes the general and administrative expenses of the holding Company and any other amounts required to reconcile the Company's underwriting results by segment to the Company's financial statement presentation.

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**Year ended December 31, 2006**

	Bermuda	Lloyd's	United States	Corporate & Other Reconciling items (c)	Total
<b>Revenues:</b>					
Gross premiums written	\$ 289,226	\$ -	\$ -	\$ -	\$ 289,226
Net premiums written	286,319	-	-	-	286,319
Net premiums earned	200,160	-	-	-	200,160
Other underwriting income	515	-	-	-	515
<b>Expenses:</b>					
Net losses and loss adjustment expenses	(21,819)	-	-	-	(21,819)
Acquisition costs	(22,469)	-	-	-	(22,469)
General and administrative expenses	(42,225)	-	-	-	(42,225)
Amortization of intangible assets	(9,396)	-	-	-	(9,396)
<b>Underwriting income (a)</b>	<b>\$ 104,766</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>104,766</b>
Corporate expenses	-	-	-	(1,217)	(1,217)
Net investment income	56,721	-	-	357	57,078
Net realized investment losses	(5,669)	-	-	-	(5,669)
Net foreign exchange gain s (losses)	1,380	-	-	(41)	1,339
<b>Income (loss) before taxes</b>	<b>157,198</b>	<b>-</b>	<b>-</b>	<b>(901)</b>	<b>156,297</b>
Income tax expense	-	-	-	(17)	(17)
<b>Net (loss) income</b>	<b>\$ 157,198</b>	<b>\$ -</b>	<b>\$ -</b>	<b>(918)</b>	<b>\$ 156,280</b>
Net losses and loss expenses ratio	10.9%	-	-	n/a	10.9%
Acquisition cost ratio	11.2%	-	-	n/a	11.2%
General and administrative expense ratio (b)	21.1%	-	-	n/a	22.7%
Combined ratio (b)	43.2%	-	-	n/a	44.8%
Net reserve for losses and loss adjustment expenses	\$ 20,212	\$ -	\$ -	n/a	\$ 20,212

(a) The Company utilizes underwriting income (loss) as a measure of underwriting profitability as it evaluates profitability solely on underwriting related revenues and expenses. Items not considered to be part of underwriting include: corporate expenses, net investment income, net realized losses (gains) on the sale of investments, net foreign exchange, and income tax expense. These items are evaluated separately from our underwriting income (loss). Underwriting income (loss) takes into account net premiums earned and other insurance related income as revenue and net losses and loss adjustment expenses, acquisition costs, underwriting related general and administrative expenses and amortization of intangible assets as expenses. Underwriting income (loss) is the difference between the revenue and expense items.

(b) The general and administrative expense ratio is calculated by dividing the sum of the general and administrative expenses and the corporate expenses by net premiums earned. It does not include the amortization of intangible assets, interest expense or net foreign exchange losses. The combined ratio is the sum of the net losses and loss expenses ratio, the acquisition cost ratio and the general and administrative expense ratio.

(c) Includes the general and administrative expenses of the holding Company and any other amounts required to reconcile the Company's underwriting results by segment to the Company's financial statement presentation.

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The following tables summarize gross premiums written allocated by territory of coverage exposure for the years ended December 31, 2008, 2007 and 2006:

	December 31, 2008		December 31, 2007		December 31, 2006	
USA	\$ 342,242	55.6%	\$ 229,695	64.5 %	\$ 173,549	60.0 %
Worldwide, including USA (a)	11,428	1.9	3,912	1.1	7,148	2.4
Europe, excluding the United Kingdom	38,485	6.2	10,408	2.9	17,281	6.0
United Kingdom	9,363	1.5	19,830	5.6	13,250	4.6
Worldwide, excluding USA (b)	3,240	0.5	1,290	0.4	7,160	2.5
Others	61,522	10.0	17,944	5.0	20,203	7.0
Marine (c)	124,544	20.2	65,406	18.4	43,826	15.1
Aviation (c)	25,321	4.1	8,088	2.3	9,769	3.4
Deposit accounting (d)	-	-	(788)	(0.2)	(2,960)	(1.0)
<b>TOTAL</b>	<b>\$ 616,145</b>	<b>100.0%</b>	<b>\$ 355,785</b>	<b>100.0 %</b>	<b>\$ 289,226</b>	<b>100.0 %</b>

(a) For the year ended December 31, 2007, no data was included from Atrium due to the three month lag in the reporting of this segment.

(b) "Worldwide" comprises insurance and reinsurance contracts that insure or reinsure risks in more than one geographic area, including the United States.

(c) Not classified as a territory as Marine and Aviation risks can span multiple territories and are not fixed locations in some instances.

(d) Reconciles the Company's underwriting results by segment to the Company's financial statement presentation.

## 9. Earnings per share

The following table sets forth the calculation of basic and diluted (loss) earnings per share for the years ended December 31, 2008, 2007 and 2006:

	Year ended December 31, 2008	Year ended December 31, 2007	Year ended December 31, 2006
<b>Basic (loss) earnings per share</b>			
Net (loss) income available to common shareholders	\$ (38,531)	\$ 233,118	\$ 156,280
Weighted average common shares outstanding	10,450,327	10,349,500	10,310,050
Basic (loss) earnings per share	\$ (3.69)	\$ 22.52	\$ 15.16
<b>Diluted (loss) earnings per share</b>			
Net (loss) income	\$ (38,531)	\$ 233,118	\$ 156,280
Weighted average common shares outstanding	10,450,327	10,349,500	10,310,050
Share equivalents	-	-	-
Options	-	-	-
Restricted shares and restricted share units	-	17,296	45,884
Weighted average common shares and common share equivalents outstanding - diluted	10,450,327	10,366,796	10,355,934
Net (loss) income per share - diluted	\$ (3.69)	\$ 22.49	\$ 15.09

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**10. Stock-based compensation**

The Company's Private Placement Memorandum provided for grants of restricted stock and options to certain employees at the time of the Company's initial financing, as well as providing for future awards of stock-based compensation. All such awards are subject to, or operate under terms broadly similar to, the Company's Long Term Incentive Plan ("LTIP"). The LTIP provides the Compensation Committee of the Board of Directors with the sole discretion to grant awards to employees and to determine the exercise price, vesting period and other applicable terms of such awards. Under the terms of the LTIP a total of 1,570,200 common shares have been reserved for issuance of awards of all types. On exercise or vesting the awards will be fulfilled by the issuance of additional shares.

**a) Stock options**

The Company issued stock options to employees which vest over three or four years from the date of grant and have a maximum contractual term of 10 years.

A summary of option awards granted for the years ended December 31, 2008, 2007 and 2006 is presented in the table below:

	Number of options	Aggregate Fair Value
Options outstanding, December 31, 2005	630,000	\$ 24,667
Granted	208,500	8,383
Forfeited	(1,000)	(39)
Options outstanding, December 31, 2006	837,500	\$ 33,011
Granted	55,214	2,748
Forfeited	(1,375)	(61)
Exercised	(125)	(5)
Options outstanding, December 31, 2007	891,214	\$ 35,693
Granted	48,000	2,116
Forfeited	(215,000)	(8,418)
Exercised	-	-
Options outstanding, December 31, 2008	724,214	29,391
Options exercisable, December 31, 2008	432,290	\$ 17,179

The following table illustrates certain weighted average exercise price data for the year ended December 31, 2008, 2007 and 2006:

	2008	2007	2006
Weighted average exercise price of:			
Options outstanding, beginning of year	\$ 102.03	\$ 100.63	\$ 100.00
Granted during year	139.49	125.38	102.04
Forfeited during year	100.00	109.49	100.00
Exercised during year	-	105.07	-
Options outstanding, end of year	105.12	102.03	100.63
Options exercisable, end of year	\$ 101.29	\$ 100.28	\$ 100.00

The weighted average remaining contractual term of options outstanding and exercisable at December 31, 2008 was 7.33 years and 7.08 years, respectively (2007 - 8.13 years and 2006 - 8.00 years, respectively).

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The weighted average fair value of options granted during the year ended December 31, 2008 was \$2.2 million (2007 - \$2.7 million), with 48,000 options being granted (2007 - 55,214). The fair value of each option granted was estimated using the Black-Scholes-Merton option pricing model, using the following assumptions:

	<b>2008</b>		<b>2007</b>		<b>2006</b>	
Risk free rate	2.9 - 3.7	%	4.0 - 5.1	%	4.6 - 5.0	%
Expected term	7 years		7 years		7 years	
Expected volatility	18.1 - 27	%	27	%	27	%

The expected volatility is based on the historical volatility of the Dow Jones US Property & Casualty Index. The Company currently does not anticipate any dividends will be declared during the expected term of the options.

The expense recorded during the years ended December 31, 2008 and 2007 related to the options awarded amounted to \$9.1 million and \$7.8 million respectively. The total unamortized expense relating to non-vested option awards at December 31, 2008 and 2007 was \$9.8 million and \$19.2 million, respectively. The weighted average period over which the unamortized cost is expected to be recognized is 1.66 years (2007 - 2.19 years), assuming the employees complete their service period for the vesting of the options.

**b) Restricted stock and restricted stock units**

The Company also issues restricted shares and restricted share units awards to employees and certain non-employee directors. Restricted shares issued to employees vest pro rata from 18 months to four years. Restricted shares granted to non-employee directors vest twelve months following the date of grant. In addition, the Company maintains a restricted share matching plan for eligible employees. Under this plan, employees may purchase the Company's common shares up to a maximum amount and the Company awards each employee with an equivalent amount of restricted shares. The restricted shares issued under the restricted matching plan vest three years following the date of grant.

The restricted share units granted in 2007 and certain restricted share units granted in 2008 contain two components; one third of the grant will cliff vest three years from the date of grant and two thirds being performance based which will cliff vest three years from the date of grant provided that certain corporate performance conditions are met. In addition, certain restricted shares units granted in 2008 are performance based which will cliff vest over two to three years from the date of grant provided that certain corporate performance conditions are met.

A summary of unvested restricted stock awards and restricted stock units granted for the years ended December 31, 2008, 2007 and 2006 is presented in the table below:

	<b>Restricted stock</b>		<b>Restricted stock units</b>	
	<b>Number of shares</b>	<b>Aggregate Fair Value</b>	<b>Number of shares</b>	<b>Aggregate Fair Value</b>
Outstanding, December 31, 2005	53,700	\$ 5,370	-	\$ -
Granted	15,184	1,550	-	-
Vested	-	-	-	-
Outstanding, December 31, 2006	68,884	\$ 6,920	-	\$ -
Granted	2,805	344	22,718	2,600
Forfeited	-	-	(455)	-
Vested	(66,950)	(6,695)	-	-
Outstanding, December 31, 2007	4,739	\$ 569	22,263	\$ 2,600
Granted	6,205	848	239,585	32,260
Forfeited	-	-	(2,630)	(335)
Vested	(3,719)	(445)	-	-
Outstanding, December 31, 2008	7,225	\$ 972	259,218	\$ 34,525

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The following table illustrates certain weighted average fair values of the restricted stock and restricted stock units for the year ended December 31, 2008 and 2007:

	December 31, 2008		December 31, 2007	
	Restricted stock	Restricted stock units	Restricted stock	Restricted stock units
Outstanding, beginning of year	\$ 119.50	116.63	\$ 100.00	-
Granted	136.73	134.65	122.52	116.63
Forfeited	-	126.26	-	116.63
Issued	119.58	-	100.00	-
Outstanding, end of year	\$ 134.56	133.19	\$ 119.50	116.63

The expense recorded during the years ended December 31, 2008 and 2007 related to the awards of restricted stock and restricted stock units amounted to \$14.2 million and \$3.2 million respectively. The total unamortized expense relating to unvested restricted stock and restricted stock units was \$10.6 million at December 31, 2008 (2007 - \$2.1 million). The weighted average period over which the unamortized cost is expected to be recognized for the years ended December 31, 2008 and 2007 is 1.30 and 2.18 years respectively, assuming the employees complete their service period for the vesting of the restricted stock and restricted stock units. Certain restricted stock units issued during 2007 and 2008 have performance criteria which could limit the number of shares issued. At December 31, 2008, of the 259,218 units outstanding, the Company currently estimates that 177,168 units will vest at the end of the performance period (2007 – 22,263 units, 22,263 units)

#### 11. Pension plan

The Company provides pension benefits to eligible employees through defined contribution plans sponsored by the Company. Under the Company's defined contribution plans, the Company makes contributions to its employees' accounts in amounts ranging from between 3.0% to 20.0% of its employees' eligible earnings. The contributions in the defined contribution plans are to be invested at the election of each employee in one or more of several investment funds offered by third party investment advisors. Contributions for the years ended December 31, 2008, resulted in an expense of \$3.5 million, being recorded in earnings (2007 - \$1.5 million; 2006 -\$1.0 million).

#### 12. Commitments and contingencies

**a) Concentrations of credit risk.** As of December 31, 2008 and 2007 substantially all of the Company's cash and investments, other than those held in trust for the benefit of syndicate policyholders, were held by two custodians. Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of investments. The investment portfolio is managed by external advisors in accordance with prudent standards of diversification. Specific provisions limit the allowable holdings of a single issue and issuers. The Company did not have an aggregate exposure in a single entity, other than in US Government, US Government agency securities and US Government-sponsored enterprises, of more than 1.8% of shareholders' equity at December 31, 2008 (2007: 0.8%).

**b) Major production sources.** During the year ended December 31, 2008, the Company obtained 66% of its gross premiums written, excluding non-managed syndicate gross premiums written, through four brokers:

Aon Corporation*	35%
Marsh & McLennan Companies, Inc.	21%
Willis Companies	7%
CT Bowring	3%

\*Includes Benfield Group Limited following Aon's acquisition.

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**c) Investment commitments.** As of December 31, 2008, the Company has pledged \$152.5 million (\$19.6 million – 2007) of its fixed maturity investments and cash as collateral to secure \$121.7 million (2007 - \$17.5 million) of letters of credit outstanding under its credit facility.

As of December 31, 2008, the Company has also pledged \$61.7 million (2007 - \$109.9 million) of its cash and fixed maturity investments as collateral to secure a portion of the £60 million standby letter of credit (described in Note 13 below).

Invested assets with a carrying value of \$5.9 million (2007 - \$5.6 million) were held in trust for the benefit of Ariel Re's United States surplus line policyholders. In addition, invested assets in the amount of \$5.6 million were on deposit with various state insurance departments in order for Valiant to comply with insurance laws at December 31, 2008.

The Company had invested assets with a carrying value of \$116.7 million at December 31, 2008 (2007 – \$421.9 million) held in trust for the benefit of syndicate policyholders.

As of December 31, 2008, the Company has pledged \$2.2 million (2007 - \$7.7 million) of cash and cash equivalents as collateral to secure the notes payable issued in connection with the acquisition of Atrium.

**d) Employment agreements.** The Company has entered into employment agreements with certain officers that provide for option awards, executive benefits and severance payments under certain circumstances.

**e) Operating leases.** The Company leases office space and office equipment under operating leases. Future minimum lease commitments at December 31, 2008 are as follows:

<b>Year ending December 31</b>	<b>Amount</b>
2009	\$ 3,151
2010	3,350
2011	2,496
2012	441
2013 and thereafter	-

Total rent under operating leases for the year ended December 31, 2008 was \$1.6 million (2007 - \$0.9 million; 2006 - \$0.4 million).

**f) Securities lending.** As part of the Company's securities lending program the Company had \$97.9 million (2007 - \$64.6 million) of securities on loan at December 31, 2008 for which \$100.6 million (2007 - \$66.5 million) of collateral had been posted by the borrowers.

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**13. Debt and Financing Arrangements**

**(a) Junior subordinated deferrable debentures**

During September 2007, the Company issued \$100 million of junior subordinated deferrable interest debentures due 2037 (the "Junior Subordinated Deferrable Debentures") in a private placement. The Junior Subordinated Deferrable Debentures are redeemable by the Company at par beginning December 15, 2012 and require quarterly interest payments by the Company to the holders of the Junior Subordinated Deferrable Debentures. Interest was payable at 8.844% per annum from the date of issuance through December 15, 2007. Thereafter, interest is payable at a floating rate of three-month LIBOR plus 315 basis points, reset quarterly. The proceeds of \$100 million from the sale of the Junior Subordinated Deferrable Debentures, after the deduction of commissions paid to the placement agents in the transaction and other expenses, were used by the Company to repay the short term financing for the acquisition of Atrium and for general corporate purposes. Debt issuance costs relating to the Junior Subordinated Deferrable Debentures were capitalized and are amortized over the term to the earlier of maturity or redemption. At December 31, 2008, debt issuance costs in the amount of \$2.0 million were included in Other assets (2007- \$2.2 million).

During 2008, the Company repurchased \$8.2 million of the Junior Subordinated Deferrable Debentures and recognized a gain of \$1.5 million. At December 31, 2008, the carrying value of the Junior Subordinated Deferrable Debentures was \$91.8 million (2007 – \$100.0 million) and the fair value of these debentures was estimated to be \$62.4 million by reference to market valuations of similar securities (2007 - \$97.6 million).

**(b) Bridge loan**

On July 20, 2007, the Company entered into a \$150 million short term lending arrangement ("Bridge Loan") with HSBC Bank USA National Association ("HSBC") to finance the acquisition of Atrium. The Bridge Loan incurred interest at LIBOR plus 250 basis points, reset based on maturities elected by the Company. During the fourth quarter of 2007, the Company repaid the outstanding balance to HSBC in full.

**(c) Credit facilities**

On November 28, 2007, the Company entered into a £60 million standby letter of credit facility ("FALLOC") among the Company, Ariel Holdings, and Ariel Re ("the Borrowers") and ING Bank N.V., London Branch and Lloyds TSB plc (the "Lenders").

Proceeds of the FALLOC may be used by the Borrowers for the provision of Funds at Lloyd's to support the general business of the corporate members owned by Atrium, for the 2008, 2009 and prior years of account. The FALLOC may be utilized on either a secured or unsecured basis, provided that the secured portion is not less than 50% of the aggregate letters of credit issued. The collateral security will be provided from the invested assets of the Borrowers, subject to certain collateral advance rates. Ariel Re guarantees the obligations under the FALLOC.

For secured letters of credit, the Borrowers are required to pay a commission of 0.25% on the daily stated amount of such letters of credit from the date of issuance. For unsecured letters of credit, the Borrowers are required to pay a commission of 0.70% on the daily stated amount of such letters of credit from the date of issuance, provided Ariel Re maintains a financial strength rating from A.M. Best of A-. The Borrowers may, on a monthly basis, elect to increase or reduce the portion of letters of credit that are secured, subject to the minimum secured portion described above.

The FALLOC requires the Borrowers to pay the Lenders a commitment fee of 0.1% per annum of total commitments under the FALLOC. The Lenders were paid an arrangement fee of 0.25% on the total amount of the FALLOC. The arrangement fee, plus legal expenses, will be amortized over the availability period of two years.

The FALLOC requires the Company to comply with certain customary restrictive covenants. These include certain financial covenants, such as maintaining a maximum debt to capital ratio (no greater than 0.35:1.00 at any time), a consolidated tangible net worth (\$850,000,000, plus 50% of positive quarterly net income plus 70% of new equity raised) and a minimum amount of unencumbered investments (200% of amount of unsecured indebtedness). In addition, Ariel

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Re must maintain a financial strength rating from A.M. Best of at least B++ at all times.

The FALLOC also includes covenants restricting such activities as:

- incurring additional indebtedness;
- declaration or payment of dividends;
- merger with or acquisition of another entity;
- disposal of certain assets;
- transactions with affiliates and formation of subsidiaries; and
- changes in business.

It is an event of default under the FALLOC if, inter alia, any one of the following events occur:

- a failure of the Borrowers to pay principal when due, interest or fees within three business days or other amounts under the FALLOC following notice or demand;
- a representation, warranty or material statement made by the Borrowers in connection with the FALLOC is untrue in any material respect;
- a failure by the Borrowers to perform certain of the covenants made in connection with the FALLOC; and
- a change in control of the Company.

Upon the occurrence of an event of default under the FALLOC, the Lenders can give notice of termination of any outstanding letters of credit in accordance with their terms, require the delivery of cash collateral for outstanding letters of credit and foreclose on any security held by the Borrowers under the FALLOC.

On May 14, 2007, the Company replaced its \$350 million Credit Facility (the "Facility") among the Company and a syndicate of lending institutions (the "Lenders"). The transaction was led by HSBC and JP Morgan Securities Inc. ("JP Morgan").

Proceeds of the Facility may be used by the Company for general corporate and working capital purposes. The Facility comprises two tranches. The first tranche of \$100 million is available for three years on unsecured revolving loans or secured letters of credit. The second tranche of \$250 million is available for five years for the issuance of secured letters of credit. Collateral security will be provided from the invested assets of Ariel Re, subject to certain collateral advance rates. The Company guarantees the obligations of the Facility.

Depending on the type of revolving loans issued, the interest rate for revolving loans under the Facility is either (i) the higher of (a) the Federal Funds Effective Rate plus 0.5% and (b) the prime commercial lending rate of HSBC or (ii) the Eurodollar rate plus 0.625%. For secured letters of credit, the Company is required to pay a fee of 0.25% on the daily stated amount of such letters of credit from the date of issuance.

The Facility requires the Borrowers to pay the Lenders a facility fee of 0.08% of total commitments under the Facility. The Company must also pay the lenders a utilization fee of 0.125% of the total amount of revolving loans outstanding when the aggregate amount of revolving loans is greater than 50% of the \$100 million aggregate principal available under the unsecured tranche.

The Facility requires the Company to comply with certain customary restrictive covenants. These include certain financial covenants, such as maintaining a maximum debt to capital ratio (no greater than 0.35:1.00 at any time), a consolidated tangible net worth (70% of actual net worth at the date of closing, plus 50% of positive quarterly net income plus 70% of new equity raised) and a maximum amount of net premiums written to net equity of Ariel Re (no greater than 1.5 to 1.0). In addition, Ariel Re must maintain a financial strength rating from A.M. Best of at least B++ at all times.

The Facility also includes covenants and default provisions consistent with the FALLOC covenant and default provisions. Upon the occurrence of an event of default under the Facility, the Lenders can terminate their commitments under the revolving loans, require repayment of any outstanding revolving loans, give notice of termination of any outstanding letters

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of credit in accordance with their terms, require the delivery of cash collateral for outstanding letters of credit and foreclose on any security held by the Lenders under the Facility.

**(d) Atrium Loan Notes**

As discussed in Note 6, certain shareholders of Atrium elected to receive variable rate guaranteed unsecured loan notes ("loan notes") in lieu of cash, totaling \$8.3 million. At December 31, 2008, the outstanding principal on these notes was \$2.1 million (2007 - \$8.3 million). Unless previously redeemed by the holders, the Company shall redeem all of the loan notes on December 31, 2010. The loan notes require biannual interest payments at a floating rate of six-month sterling LIBOR less 75 basis points.

The financing structure at December 31, 2008 was:

	<b>Commitment</b>	<b>In Use / Outstanding</b>
Junior Subordinated Deferrable Debentures	\$ 100,000	\$ 91,800
\$350 million Credit Facility	350,000	121,700
£60 million FALLOC	93,180	87,279
Atrium Loan Notes Payable	2,147	2,147
<b>Total</b>	<b>\$ 545,327</b>	<b>\$ 303,726</b>

Finance expenses for the years ended December 31, 2008 and 2007 were \$7.1 million and \$4.7 million, respectively. Finance expenses consist of interest on the Junior Subordinated Deferrable debentures, the Bridge Loan and the Atrium Loan Notes, and the amortization of deferred costs relating to the debt issuance and our credit facilities.

**14. Statutory requirements and dividend restrictions**

As a holding company, Ariel Holdings relies on dividends from its subsidiaries to provide cash flows required to pay expenses and dividends to shareholders.

**(a) Bermuda**

Ariel Re's ability to pay dividends and make capital distributions is subject to certain regulatory restrictions. Under the Insurance Act 1978, amendments thereto and Related Regulations of Bermuda (the "Act"), Ariel Re is required to prepare statutory financial statements and to file in Bermuda a statutory financial return. The Act also requires Ariel Re to maintain certain measures of solvency and liquidity. At December 31, 2008, the statutory capital and surplus of Ariel Re was \$1,120.8 million (2007 - \$1,151.7 million) and the amount required to be maintained under the Act was \$214.0 million (2007 - \$173.5 million).

Under the Act, Ariel Re is classified as Class 4 insurer, and is therefore restricted as to the payment of dividends in the amount of 25% of the prior year's statutory capital and surplus, unless at least two members of the Board of Directors attest that a dividend in excess of this amount would not cause Ariel Re to fail to meet its relevant margins. During 2008, Ariel Re declared no dividends (2007 - \$200.0 million).

In 2008, new statutory legislation was enacted in Bermuda, which included, among other things, the Bermuda Solvency Capital Requirement ("BSCR") which is a standard mathematical model designed to give the Bermuda Monetary Authority ("BMA") more advanced methods for determining an insurer's capital adequacy. Underlying the BSCR is the belief that all insurers should operate on an ongoing basis with a view to maintaining their capital at a prudent level in excess of the minimum solvency margin otherwise prescribed under the Insurance Act. Effective December 31, 2008, the BMA will require all Class 4 insurers to maintain their capital at a target level which is set at 120% of the minimum amount calculated in accordance with the BSCR or an approved in-house model. Ariel Re is currently completing the 2008 BSCR and at this time believes that Ariel Re will exceed the target level of capital.

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**(b) Lloyds**

Atrium's ability to pay dividends is subject to certain regulatory restrictions on the payment of dividends by its subsidiaries. Certain of the UK subsidiaries are required under the statutory regulations of the jurisdictions in which they operate to maintain assets on deposit with various regulatory authorities to support their insurance and reinsurance operations and to hold trust funds for the benefit of ceding companies and insureds. In particular, Atrium is required to maintain Funds at Lloyd's amounting to \$74.3 million (2007 - \$112.3 million) and this is achieved through the provision of Letters of Credit that are guaranteed by the Ariel Holdings and Ariel Re.

**(c) United States**

Valiant and Valiant Specialty are subject to certain Risk-Based Capital ("RBC") requirements as specified by the National Association of Insurance Commissioners ("NAIC"). Under those requirements, the amount of capital and surplus maintained by a property/casualty company is determined based on the various risk factors related to the company. At December 31, 2008, Valiant and Valiant Specialty's RBC authorized control levels were \$13.0 million (2007 - \$10.5 million) and \$0.05 million, respectively. In addition, dividends may only be declared or distributed out of earned surplus.

At December 31, 2008, the maximum amount of dividends which can be paid by Valiant without the prior approval of the NAIC is limited to the greater of approximately \$5.1 million (2007 - \$5.0 million), which is 10% of statutory surplus of approximately \$51.1 million (2007 - \$50.5 million), or statutory net loss of approximately \$9.3 million (2007 - \$0.06 million), subject to the limitation of its earned surplus described above. Accordingly, as Valiant had no earned surplus, no dividend can be paid at December 31, 2008.

At December 31, 2008, the maximum amount of dividends which can be paid by Valiant Specialty is the greater of approximately \$1.6 million, which is 10% of its statutory surplus of approximately \$16.0 million, or statutory net income of approximately \$0.01 million, subject to the limitation of its earned surplus described above. Accordingly, the maximum dividend which can be paid at December 31, 2008 is approximately \$0.01 million.

Neither Valiant nor Valiant Specialty paid any dividends during 2008. During 2007, Valiant paid \$1.0 million in dividends prior to its acquisition by VIG.

**15. Taxation**

The Company provides for income taxes based upon amounts reported in the financial statements and the provisions of currently enacted tax laws. The Company is registered in Bermuda and is subject to Bermuda law with respect to taxation. Under current Bermuda law, the Company is not taxed on any Bermuda income or capital gains taxes and has received an undertaking from the Bermuda Minister of Finance that, in the event of any Bermuda income or capital gains taxes being imposed, the Company will be exempt from those taxes until March 2016.

The Company also has subsidiaries based in the United States of America that are subject to US tax laws and both US state and federal income taxes.

The Company also operates in the United Kingdom ("UK") through its UK subsidiaries and the income of the UK companies is subject to UK corporation taxes. Income from the Group's operations at Lloyd's is also subject to US income taxes. Under a Closing Agreement between Lloyd's and the Internal Revenue Service ('IRS'), Lloyd's Members pay US income tax on US-connected income written by Lloyd's Syndicates. US income tax due on this US-connected income is calculated by Lloyd's and remitted directly to the Internal Revenue Service and is charged by Lloyd's to Members in proportion to their participation on the relevant Syndicates. The Group's Corporate Members are all subject to this arrangement but, as UK tax residents, will receive UK corporation tax credits for any US income tax incurred up to the value of the equivalent UK corporation income tax charge on the US income.

**ARIEL HOLDINGS LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the years ended December 31, 2008, 2007 and 2006**  
(Expressed in thousands of U.S. dollars, except share and per share amounts)

Income tax expense (benefit) is comprised of current and deferred tax as follows:

	<b>Year ended December 31, 2008</b>	<b>Year ended December 31, 2007</b>	<b>Year ended December 31, 2006</b>
Current	\$ 13,834	\$ 61	\$ 17
Deferred	(5,056)	(119)	-
Income tax expense (benefit)	<u>\$ 8,778</u>	<u>\$ (58)</u>	<u>\$ 17</u>

(Loss) income before income taxes and income tax expense (benefit) attributable to that (loss) income consists of:

	<b>Year ended December 31, 2008</b>			
	<b>Income before tax</b>	<b>Current income taxes</b>	<b>Deferred income taxes</b>	<b>Total income taxes</b>
United States	\$ (10,064)	\$ 45	\$ -	\$ 45
United Kingdom	33,479	13,789	(5,056)	8,733
Bermuda	(53,168)	-	-	-
Total	<u>\$ (29,753)</u>	<u>\$ 13,834</u>	<u>\$ (5,056)</u>	<u>\$ 8,778</u>

	<b>Year ended December 31, 2007</b>			
	<b>Income before tax</b>	<b>Current income taxes</b>	<b>Deferred income taxes</b>	<b>Total income taxes</b>
United States	\$ (1,599)	\$ 61	\$ (119)	\$ (58)
United Kingdom	-	-	-	-
Bermuda	234,659	-	-	-
Total	<u>\$ 233,060</u>	<u>\$ 61</u>	<u>\$ (119)</u>	<u>\$ (58)</u>

	<b>Year ended December 31, 2006</b>			
	<b>Income before tax</b>	<b>Current income taxes</b>	<b>Deferred income taxes</b>	<b>Total income taxes</b>
United States	\$ 64	\$ 17	\$ -	\$ 17
United Kingdom	-	-	-	-
Bermuda	156,233	-	-	-
Total	<u>\$ 156,297</u>	<u>\$ 17</u>	<u>\$ -</u>	<u>\$ 17</u>

**ARIEL HOLDINGS LTD.**  
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A reconciliation between the expected tax provision at US Federal rate of tax of 35% and the actual tax charge per the financial statements is as follows:

	Year ended December 31, 2008	Year ended December 31, 2007	Year ended December 31, 2006
Computed expected tax (benefit) expense	\$ (10,414)	\$ 81,571	\$ 54,704
Foreign loss (income), not subject to US tax	18,609	(82,107)	(54,687)
Tax benefit effect of foreign taxes	(2,176)	-	-
Other	(755)	7	-
Effect of valuation allowance	3,514	471	-
Actual income tax expense (benefit)	<u>\$ 8,778</u>	<u>\$ (58)</u>	<u>\$ 17</u>

The deferred tax asset and liability consists of the following:

	December 31, 2008	December 31, 2007
<b>Deferred tax asset</b>		
Underwriting losses taxable in future periods	\$ 59	\$ 1,412
Present value of reinsurance recoverable balance	398	1,679
Cost of capital adjustment	2,598	6,241
Net operating loss carryforward	2,523	-
Other	4,536	330
Deferred tax asset	<u>\$ 10,114</u>	<u>\$ 9,662</u>
<b>Deferred tax liability</b>		
Underwriting profits taxable in future periods	(13,445)	(16,103)
Present value of losses and loss adjustment expenses	(3,918)	(9,245)
Intangible assets	(26,734)	(30,524)
Other timing differences	(362)	(670)
Deferred tax liability	<u>\$ (44,459)</u>	<u>\$ (56,542)</u>
Valuation allowance	(4,202)	-
<b>Net deferred tax liability</b>	<u>\$ (38,547)</u>	<u>\$ (46,880)</u>

Net deferred liabilities represent the tax effect of temporary differences between the value of assets and liabilities for financial statement purposes and such values as measured by US and UK tax laws and regulations.

VIG is a new company with a limited operating history. Accordingly, the realization of deferred tax assets from future taxable income and future reversals of existing taxable temporary differences is currently neither assured nor accurately determinable. Accordingly, the Company has recorded a valuation allowance of \$4.2 million as at December 31, 2008 (2007 - \$471).

In assessing whether deferred tax assets can be realized, management considers whether it is more likely than not that part, or all, of the deferred tax asset will not be realized. The realization of deferred tax assets is dependent upon the generation of future taxable income in the period during which those temporary differences and operating losses become deductible. Management considers the reversal of the deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. The amount of the deferred tax asset considered realizable could be reduced in the future if estimates of future taxable income are reduced.

At December 31, 2008, the Company has net operating loss carry forwards of approximately \$7.2 million relating to the Company's US subsidiaries which will expire in 2028.

**ARIEL HOLDINGS LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**For the years ended December 31, 2008, 2007 and 2006**  
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**16. Condensed unaudited quarterly financial data**

Quarterly results necessarily rely heavily on estimates. This and certain other factors, such as catastrophic losses, call for caution in drawing specific conclusions from quarterly results. The following is a summary of the unaudited quarterly data for the years ended December 31, 2008 and 2007:

	Quarter Ended			
	March 31, 2008	June 30, 2008	September 30, 2008	December 31, 2008
Gross premiums written	\$ 180,867	\$ 209,703	\$ 139,374	\$ 86,201
Net premiums written	165,995	170,751	129,175	75,355
Net premiums earned	149,294	130,757	143,752	133,345
Other underwriting income	7,378	4,554	2,324	7,976
Gain on repurchase of debentures	-	1,520		-
Net investment income	24,276	22,108	20,460	17,287
Net realized investment gains (losses)	9,901	(3,148)	(4,597)	(11,707)
Net unrealized investment losses	(13,641)	(8,044)	(35,286)	(23,215)
Net foreign exchange gains (losses)	3,575	1	(1,288)	2,109
Total revenue	180,783	147,748	125,365	125,795
Net losses and loss adjustment expenses	32,680	51,948	237,448	65,515
Acquisition costs	33,295	26,277	24,375	24,562
General and administrative expenses	33,411	30,277	23,876	17,541
Interest expense	2,007	1,559	1,518	1,508
Amortization of intangible assets	462	462	462	261
Income tax expense (benefit)	8,428	82	(588)	856
Net income (loss)	\$ 70,500	\$ 37,143	\$ (161,726)	\$ 15,552
Basic earnings (loss) per share	\$ 6.74	\$ 3.56	\$ (15.47)	\$ 1.49
Diluted earnings (loss) per share	\$ 6.65	\$ 3.50	\$ (15.47)	\$ 1.46

	Quarter Ended			
	March 31, 2007	June 30, 2007	September 30, 2007	December 31, 2007
Gross premiums written	\$ 133,967	\$ 137,748	\$ 71,756	\$ 12,314
Net premiums written	126,605	136,391	71,756	11,792
Net premiums earned	66,736	77,519	87,711	90,685
Other underwriting income	380	193	101	(53)
Net investment income	16,991	18,811	21,398	15,240
Net realized investment losses	(435)	(5,125)	(7,192)	(2,184)
Net foreign exchange (losses) gains	(305)	2	(6,212)	(254)
Total revenue	83,367	91,400	95,806	103,434
Net losses and loss adjustment expenses	14,470	17,606	617	4,770
Acquisition costs	8,051	9,909	10,900	10,967
General and administrative expenses	14,582	14,725	11,921	15,747
Interest expense	-	-	680	4,009
Amortization of intangible assets	1,139	854	-	-
Income tax expense (benefit)	8	14	34	(114)
Net income	\$ 45,117	\$ 48,292	\$ 71,654	\$ 68,055
Basic earnings per share	\$ 4.38	\$ 4.68	\$ 6.91	\$ 6.53
Diluted earnings per share	\$ 4.35	\$ 4.66	\$ 6.91	\$ 6.48





## Financial Supplement

December 31, 2008

This report is for informational purposes only. It should be read in conjunction with Ariel Holdings Ltd.'s consolidated financial statements

### Presentation Notes and Definitions

This report is for informational purposes. The financial information contained herein is unaudited and is supplemental to and not a substitute for GAAP financial statements. Unless otherwise noted, all data is in thousands except for per share, percentage and ratio information.

Measures used within this supplement include the following:

Loss Ratio is the ratio of losses and loss adjustment expenses to earned premiums.

Acquisition expense ratio is the ratio of acquisition costs, including commissions, premium taxes and other expenses associated with acquiring business, to earned premiums.

General expense ratio is the ratio of general and administrative expenses to earned premiums.

Expense ratio is the sum of the acquisition and general expense ratios, or the sum of acquisition and operating expenses to earned premiums.

Combined ratio is the sum of the loss ratio and the expense ratio. The combined ratio is a measure of underwriting profitability or margin in that this ratio presents the total costs of underwriting per dollar of earned premium, so that a combined ratio below 100% reflects an underwriting profit and a combined ratio above 100% indicates an underwriting loss.

Operating income (loss) excludes the impact of realized and unrealized gains or losses and foreign exchange gains or losses from net income (loss). Operating income (loss) is useful performance measure because the amounts that are excluded from net income (loss) to derive operating income (loss) are generally outside of the influence of management or fluctuate largely due to market opportunities and conditions and, therefore, may distort trends in operating results

Where used herein, "NM" means not meaningful, "LTM" means latest twelve months and "NA" means not applicable.

Ariel Holdings Ltd.  
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	Fourth Quarter 2008	Fourth Quarter 2007	% change	Twelve Months 2008	Twelve Months 2007	% change
<u>Key Financial Metrics - \$'000s</u>						
Net income (income)	15,552	68,054	(77.1%)	(38,531)	233,117	(116.5%)
Operating earnings <sup>1</sup>	48,365	70,491	(31.4%)	46,809	254,821	(81.6%)
Equity	1,400,095	1,439,636	(2.7%)	1,400,095	1,439,636	(2.7%)
Debt/total capital	6.2%	6.5%		6.2%	6.5%	
Annualized ROE <sup>2</sup>	4.5%	19.5%		(2.7%)	17.8%	
Annualized Operating ROE <sup>2</sup>	13.8%	20.2%		3.3%	19.5%	
Annualized Comprehensive ROE	0.8%	20.7%		(4.0%)	18.4%	
Combined ratio	80.9%	34.7%		107.9%	41.6%	
<u>Stockholder's Data - \$</u>						
Net income (loss) per share	1.49	6.53		(3.69)	22.52	
Operating earnings per share	4.62	6.76		4.48	24.62	
Book value per share	133.87	137.75	(2.8%)	133.87	137.75	(2.8%)
<u>Operating Leverage Ratios</u>						
Premium earned/equity	9.5%	6.5%		39.2%	24.6%	
Implied underwriting ROE <sup>3</sup>	1.8%	4.2%		(3.1%)	14.4%	
Invested assets/equity	140.9%	131.1%		134.0%	117.3%	
Return on Investments	(0.9%)	0.9%		(0.3%)	3.9%	
Implied investment ROE <sup>4</sup>	(1.3%)	1.1%		(0.4%)	4.6%	
Implied operating ROE	0.6%	5.4%		(3.5%)	19.0%	
Implied annualized operating ROE <sup>5</sup>	2.2%	21.5%		(3.5%)	19.0%	
<u>Combined Ratio Components</u>						
Loss & LAE - current AY	84.9%	5.8%		74.6%	12.8%	
Loss & LAE - prior years	(35.8%)	(0.6%)		(5.0%)	(1.2%)	
Loss & LAE - calendar year	49.1%	5.3%		69.6%	11.6%	
Expense ratio	31.8%	29.5%		38.3%	30.0%	
Combined ratio	80.9%	34.7%		107.9%	41.6%	

Notes

<sup>1</sup>operating earnings (loss) = net (loss) income excluding realized and unrealized investment gains or losses and FX gains or losses

<sup>2</sup>annualized by dividing (a) the ratio of net income (loss) or operating income, as applicable, during the period to average of beginning and ending equity by (b) the elapsed portion of the year

<sup>3</sup>= (1 - combined ratio) \* (premiums earned/equity)

<sup>4</sup>= (total investment return) \* (invested assets/equity)

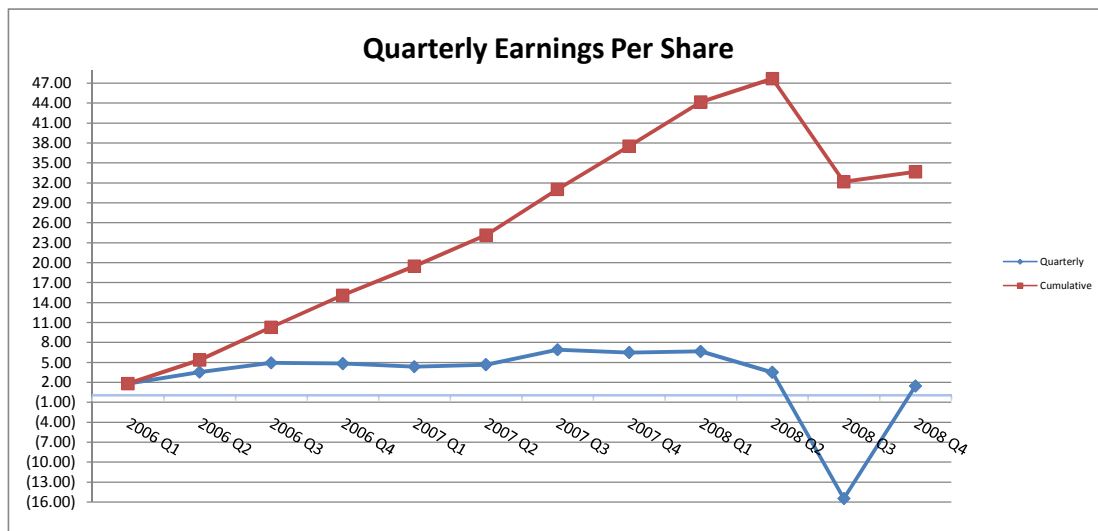
<sup>5</sup>sum of implied underwriting and investment ROE annualized by dividing by elapsed portion of the year

Summary Consolidated Income Statements (\$000's)	Fourth Quarter 2008	Fourth Quarter 2007	% Better (Worse)	Twelve Months 2008	Twelve Months 2007	% Better (Worse)
<b>Revenues</b>						
Gross premiums written	\$ 86,201	\$ 12,314	600.0%	\$ 616,145	\$ 355,785	73.2%
Net premiums written	75,355	11,791	539.1%	541,276	346,543	56.2%
Premiums earned	133,345	90,685	47.0%	557,148	322,651	72.7%
Other underwriting income	7,976	(54)		22,232	620	
Gain on repurchase of debt	-	-	NM	1,520	-	NM
Net investment income	17,287	15,239	13.4%	84,131	72,439	16.1%
Net foreign exchange (losses) gains	2,109	(254)	930.3%	4,397	(6,769)	165.0%
Net realized losses on investments	(11,707)	(2,183)	(636.3%)	(9,551)	(14,935)	36.0%
Net unrealized investment (losses) gains	(23,215)	-	NM	(80,186)	-	NM
Total Revenues	125,795	103,433	21.6%	579,691	374,006	55.0%
Losses and loss adjustment expenses	65,515	4,770	(1273.5%)	387,591	37,463	(934.6%)
Acquisition costs	24,562	10,968	(123.9%)	108,509	39,828	(172.4%)
General and administrative expenses	17,800	15,747	(13.0%)	105,105	56,975	(84.5%)
Interest expense	1,249	4,009	68.8%	6,592	4,689	40.6%
Amortization of intangible assets	261	-	NM	1,647	1,993	17.4%
Total Expenses	109,387	35,494	(208.2%)	609,444	140,948	(332.4%)
<b>Income before taxes</b>	16,408	67,939	(75.8%)	(29,753)	233,058	(112.8%)
Income tax (benefit) expense	856	(115)	(844.3%)	8,778	(59)	(14978.0%)
<b>Net (loss) income</b>	<b>\$ 15,552</b>	<b>\$ 68,054</b>	<b>(77.1%)</b>	<b>\$ (38,531)</b>	<b>\$ 233,117</b>	<b>(116.5%)</b>
Weighted average common shares outstanding - basic (000's)	10,459	10,420		10,450	10,350	
- diluted (000's)	10,663	10,500		10,450	10,367	
Basic earnings per share	\$1.49	\$6.53		(\$3.69)	\$22.52	
Diluted earnings per share	\$1.46	\$6.48		(\$3.69)	\$22.49	
Operating income (excluding realized and unrealized investment G/L and FX G/L)	48,365	70,491		46,809	254,821	
Operating basic earnings per share	\$4.62	\$6.76		\$4.48	\$24.62	

**Quarterly Summary Income Statements**

(\$000's)	<u>12/31/2008</u>	<u>9/30/2008</u>	<u>6/30/2008</u>	<u>3/31/2008</u>	<u>12/31/2007</u>
<b>Revenues</b>					
Gross premiums written	86,201	\$ 139,374	\$ 209,703	\$ 180,867	\$ 12,314
Net premiums written	<u>75,355</u>	<u>129,175</u>	<u>170,751</u>	<u>165,995</u>	<u>11,791</u>
Premiums earned	133,345	143,752	130,757	149,294	90,685
Other underwriting income	7,976	2,324	4,554	7,378	(54)
Gain on repurchase of debt	-	-	1,520	-	-
Net investment income	17,287	20,460	22,108	24,276	15,239
Net foreign exchange gains (losses)	2,109	(1,288)	1	3,575	(254)
Net realized (losses) gains on investments	(11,707)	(4,597)	(3,148)	9,901	(2,183)
Net unrealized investment (losses)	<u>(23,215)</u>	<u>(35,286)</u>	<u>(8,044)</u>	<u>(13,641)</u>	<u>-</u>
Total revenues	125,795	125,365	147,748	180,783	103,433
<b>Expenses</b>					
Losses and loss adjustment expenses	65,515	237,448	51,948	32,680	4,770
Acquisition costs	24,562	24,375	26,277	33,295	10,968
General and administrative expenses	17,800	23,757	30,240	33,308	15,747
Interest expense	1,249	1,637	1,596	2,110	4,009
Amortization of intangible assets	<u>261</u>	<u>462</u>	<u>462</u>	<u>462</u>	<u>-</u>
Total expenses	109,387	287,679	110,523	101,855	35,494
<b>Income (loss) before income taxes</b>	16,408	(162,314)	37,225	78,928	67,939
Income tax expense (benefit)	856	(588)	82	8,428	(115)
<b>Net income (loss)</b>	<u>\$ 15,552</u>	<u>\$ (161,726)</u>	<u>\$ 37,143</u>	<u>\$ 70,500</u>	<u>\$ 68,054</u>
Weighted average shares outstanding (000's)					
- basic	10,459	10,457	10,436	10,453	10,420
- diluted	10,663	10,457	10,560	10,605	10,500
Basic earnings per share	\$ 1.49	\$ (15.47)	\$ 3.56	\$ 6.74	\$ 6.53
Diluted earnings per share	\$ 1.46	\$ (15.47)	\$ 3.50	\$ 6.65	\$ 6.48

Ariel Holdings Ltd.  
Sequential Quarterly Results



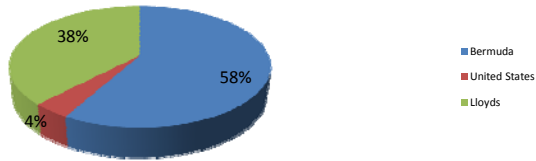
<b>Three months ending 12/31/08</b>					
	<u>Bermuda</u>	<u>Lloyd's</u>	<u>United States</u>	<u>Corporate &amp; Other Reconciling Items</u>	<u>Total</u>
<b>Revenues:</b>					
Gross premiums written	\$ 25,184	\$ 49,532	\$ 11,485	-	\$ 86,201
Net premiums written	24,794	39,235	11,326	-	75,355
Net premiums earned	87,868	40,762	4,715	-	133,345
Other underwriting income	(12)	7,988	-	-	7,976
<b>Expenses:</b>					
Net losses and loss adjustment expenses	(47,149)	(15,272)	(3,094)	-	(65,515)
Acquisition costs	(8,949)	(14,821)	(792)	-	(24,562)
General and administrative expenses	(4,030)	(8,892)	(3,907)	-	(16,829)
Amortization of intangible assets	-	(261)	-	-	(261)
<b>Underwriting result</b>	<b>27,728</b>	<b>9,504</b>	<b>(3,078)</b>	<b>-</b>	<b>34,154</b>
Corporate expenses	-	-	-	(971)	(971)
Interest expense	-	-	-	(1,249)	(1,249)
Net investment income	15,711	36	532	1,008	17,287
Net realized investment gains (losses)	(11,733)	(142)	117	51	(11,707)
Net unrealized investment gains (losses)	(25,330)	365	391	1,359	(23,215)
Net foreign exchange gains (losses)	(2,025)	4,544	-	(410)	2,109
Gain on repurchase of debt	-	-	-	-	-
<b>Income before taxes</b>	<b>4,351</b>	<b>14,307</b>	<b>(2,038)</b>	<b>(212)</b>	<b>16,408</b>
Income tax benefit	-	(816)	(40)	-	(856)
<b>Net Income</b>	<b>\$ 4,351</b>	<b>\$ 13,491</b>	<b>\$ (2,078)</b>	<b>\$ (212)</b>	<b>\$ 15,552</b>
<b>Three months ending 12/31/07</b>					
	<u>Bermuda</u>	<u>Lloyd's</u>	<u>United States</u>	<u>Corporate &amp; Other Reconciling Items</u>	<u>Total</u>
<b>Revenues:</b>					
Gross premiums written	\$ 11,161	\$ -	\$ 1,153	-	\$ 12,314
Net premiums written	1,639	-	1,153	-	2,792
Net premiums earned	90,341	-	344	-	90,685
Other underwriting income	(54)	-	-	-	(54)
<b>Expenses:</b>					
Net losses and loss adjustment expenses	(4,546)	-	(224)	-	(4,770)
Acquisition costs	(10,877)	-	(91)	-	(10,968)
General and administrative expenses	(12,364)	-	(2,281)	-	(14,645)
Amortization of intangible assets	-	-	-	-	-
<b>Underwriting result</b>	<b>62,500</b>	<b>-</b>	<b>(2,252)</b>	<b>-</b>	<b>60,248</b>
Corporate expenses	-	-	-	(1,102)	(1,102)
Interest expense	-	-	-	(4,009)	(4,009)
Net investment income	14,592	-	343	304	15,239
Net realized investment gains (losses)	(2,158)	-	(25)	-	(2,183)
Net unrealized investment gains (losses)	-	-	-	-	-
Net foreign exchange gains (losses)	(276)	-	-	22	(254)
<b>Income before taxes</b>	<b>74,658</b>	<b>-</b>	<b>(1,934)</b>	<b>(4,785)</b>	<b>67,939</b>
Income tax credit	-	-	115	-	115
<b>Net Income</b>	<b>\$ 74,658</b>	<b>\$ -</b>	<b>\$ (1,819)</b>	<b>\$ (4,785)</b>	<b>\$ 68,054</b>

<b>Operating Segment Results</b>		<b><u>Twelve months ending 12/31/08</u></b>				
		<u>Bermuda</u>	<u>Lloyd's</u>	<u>United States</u>	<u>Corporate &amp; Other Reconciling Items</u>	<u>Total</u>
<b>Revenues:</b>						
Gross premiums written	357,507	233,733	24,905	-	616,145	
Net premiums written	347,436	169,205	24,636	-	541,277	
Net premiums earned	356,609	191,591	8,948	-	557,148	
Other underwriting income	(217)	22,449	-	-	22,232	
<b>Expenses:</b>						
Net losses and loss adjustment expenses	(283,679)	(93,553)	(10,359)	-	(387,591)	
Acquisition costs	(38,648)	(68,309)	(1,552)	-	(108,509)	
General and administrative expenses	(32,084)	(40,103)	(13,143)	-	(85,330)	
<b>Underwriting result</b>	1,981	12,075	(16,106)	-	(2,050)	
-						
Corporate expenses	-	-	-	(19,775)	(19,775)	
Interest expense	-	-	-	(6,592)	(6,592)	
Net investment income	61,886	17,053	2,160	3,032	84,131	
Net realised investment gains (losses)	(11,527)	2,311	314	(649)	(9,551)	
Net unrealised investment gains (losses)	(80,734)	(811)	(281)	1,640	(80,186)	
Net foreign exchange gains (losses)	(4,561)	8,789	-	169	4,397	
Amortization of intangible assets	-	(1,647)	-	-	(1,647)	
Gain on repurchase of subordinated debentures	-	-	-	1,520	1,520	
<b>Income before taxes</b>	(32,955)	37,770	(13,913)	(20,655)	(29,753)	
Income tax expense	-	(8,733)	(45)	-	(8,778)	
<b>Net Income</b>	(32,955)	29,037	(13,958)	(20,655)	(38,531)	
		<b><u>Twelve months ending 12/31/07</u></b>				
		<u>Bermuda</u>	<u>Lloyd's</u>	<u>United States</u>	<u>Corporate &amp; Other Reconciling Items</u>	<u>Total</u>
<b>Revenues:</b>						
Gross premiums written	354,632	-	1,153	-	355,785	
Net premiums written	345,391	-	1,153	-	346,544	
Net premiums earned	322,307	-	344	-	322,651	
Other underwriting income	621	-	-	-	621	
<b>Expenses:</b>						
Net losses and loss adjustment expenses	(37,239)	-	(224)	-	(37,463)	
Acquisition costs	(39,736)	-	(91)	-	(39,827)	
General and administrative expenses	(48,095)	-	(2,281)	-	(50,376)	
Amortization of intangible assets	(1,993)	-	-	-	(1,993)	
<b>Underwriting result</b>	195,865	-	(2,252)	-	193,613	
Corporate expenses	-	-	-	(6,599)	(6,599)	
Interest expense	-	-	-	(4,689)	(4,689)	
Net investment income	70,311	-	343	1,786	72,440	
Net realised investment gains (losses)	(14,911)	-	(25)	-	(14,936)	
Net unrealised investment gains (losses)	-	-	-	-	-	
Net foreign exchange gains (losses)	(590)	-	-	(6,179)	(6,769)	
<b>Income before taxes</b>	250,675	-	(1,934)	(15,681)	233,060	
Income tax credit	-	-	115	(57)	58	
<b>Net Income</b>	250,675	-	(1,819)	(15,738)	233,118	

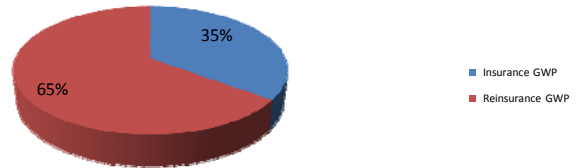
GWP by Segment (\$000's)	<u>4Q 2008</u>	<u>4Q 2007</u>	<u>% Change</u>	<u>YTD 2008</u>	<u>YTD 2007</u>	<u>% Change</u>
<b><u>Bermuda</u></b>						
<b>Total GWP</b>	\$ 25,184	\$ 11,161	126%	\$ 357,507	\$ 354,632	1%
Insurance GWP	8,325	6,610	26%	27,467	38,143	(28%)
Reinsurance GWP	16,859	4,551	270%	330,040	316,489	4%
<b><u>Insurance</u></b>						
Property	4,803	5,058	(5%)	19,472	32,873	(41%)
Professional Liability	3,522	1,552	127%	7,995	5,270	52%
<b><u>Reinsurance</u></b>						
Property cat	9,783	4,124	137%	245,727	224,642	9%
Property pro rata	(606)	(1,212)	(50%)	2,068	10,165	(80%)
Property per risk	(178)	71	(351%)	5,619	8,188	(31%)
Marine	7,860	1,568	401%	70,910	65,406	8%
Aviation	-	-	0%	5,716	8,088	(29%)
<b><u>United States</u></b>						
<b>Total GWP</b>	11,485	1,153	896.1%	24,905	1,153	2060.0%
Insurance GWP	11,485	1,153	896.1%	24,905	1,153	2060.0%
<b><u>Insurance</u></b>						
Professional Liability	9,074	1,153	687.0%	17,493	1,153	1417.2%
Marine, aviation and transport	2,411	-	NM	7,412	-	NM
<b><u>Lloyd's</u></b>						
<b>Total GWP</b>	49,532	-	NM	233,733	-	NM
Insurance GWP	37,406	-	NM	164,407	-	NM
Reinsurance GWP	12,125	-	NM	69,326	-	NM
<b><u>Insurance</u></b>						
Accident and health	2,961	-	NM	13,056	-	NM
Motor	729	-	NM	4,095	-	NM
Marine, aviation and transport	16,006	-	NM	65,827	-	NM
Fire and other damage to property	10,340	-	NM	47,297	-	NM
Third party liability	6,871	-	NM	31,422	-	NM
Pecuniary loss	499	-	NM	2,710	-	NM
<b>Reinsurance</b>	12,125	-	NM	69,326	-	NM
<b>Total</b>	<b>\$ 86,201</b>	<b>\$ 12,314</b>	<b>600%</b>	<b>\$ 616,145</b>	<b>\$ 355,785</b>	<b>73%</b>

Segment Premiums  
Twelve Months Ended December 31, 2008

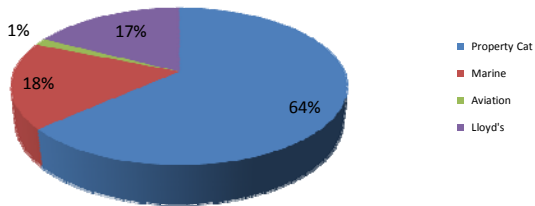
**Gross Written Premiums Reporting by Segment**



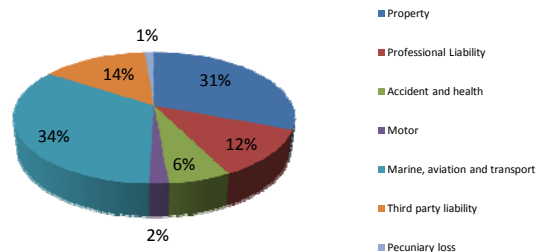
**Business Segments**



**Reinsurance Distribution by Type**



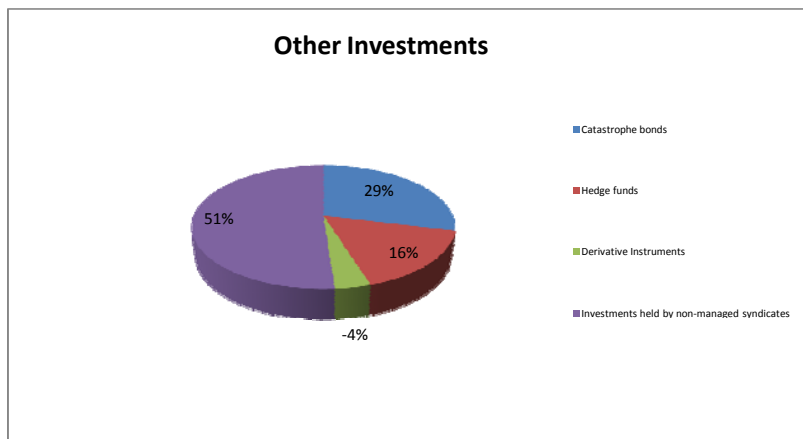
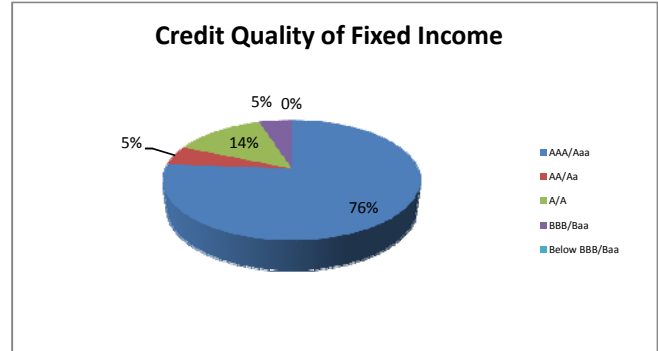
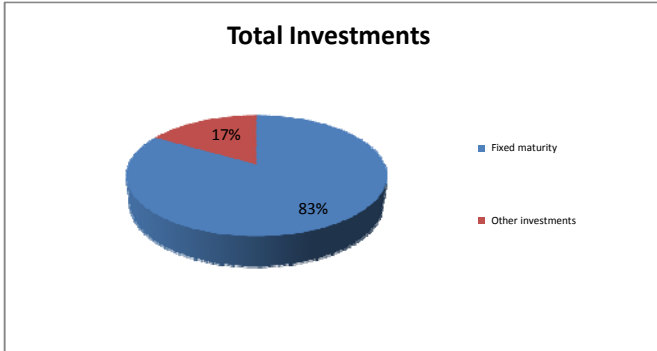
**Insurance by Type**



Summary Balance Sheets - \$'000's	<u>12/31/2008</u>	<u>9/30/2008</u>	<u>6/30/2008</u>	<u>3/31/2008</u>	<u>12/31/2007</u>
<b>Assets</b>					
Fixed maturity investments, at fair value	\$1,379,023	\$1,347,777	\$1,259,252	\$1,184,490	\$1,204,320
Other investments, at fair value	275,482	314,158	348,300	304,660	353,609
Short term investments, at fair value	174,320	101,891	213,715	119,798	93,091
Cash and cash equivalents	158,139	206,283	263,625	245,398	192,360
Total cash and investments	1,986,964	1,970,109	2,084,892	1,854,346	1,843,380
Premiums receivable	187,788	228,072	254,320	179,562	178,341
Accrued investment income	14,517	14,900	12,476	17,625	16,615
Deferred acquisition costs	35,471	43,394	41,009	29,380	14,954
Prepaid reinsurance	13,440	16,301	17,420	15,157	21,995
Paid losses recoverable	5,294	4,881	11,708	41,653	11,355
Loss reserves recoverable	64,894	61,689	79,034	68,865	73,964
Goodwill and intangible assets	175,810	196,591	197,054	197,515	197,978
Other assets	128,053	259,105	175,049	189,357	65,375
Total assets	<u>2,612,231</u>	<u>2,795,042</u>	<u>2,872,962</u>	<u>2,593,460</u>	<u>2,423,957</u>
<b>Liabilities</b>					
Reserve for losses and lae	650,189	659,849	520,249	471,142	478,240
Unearned premiums	210,917	286,666	301,890	245,666	221,122
Deposit liabilities	205	306	407	744	676
Reinsurance premiums payable	26,235	16,867	46,540	24,505	27,160
Losses payable	22,718	14,471	7,032	36,315	20,001
Bridge loan	-	-	-	-	-
Long-term debt	91,800	91,800	91,800	100,000	100,000
Deferred tax	38,547	44,086	42,773	51,316	46,880
Other Liabilities	171,525	287,168	313,787	156,086	90,242
Total liabilities	<u>1,212,136</u>	<u>1,401,213</u>	<u>1,324,478</u>	<u>1,085,774</u>	<u>984,321</u>
<b>Shareholders' equity</b>	<b>\$ 1,400,095</b>	<b>\$ 1,393,829</b>	<b>\$ 1,548,484</b>	<b>\$ 1,507,686</b>	<b>\$ 1,439,636</b>
<b>Weighted average shares outstanding ('000's)</b>					
Basic	10,459	10,436	10,436	10,453	10,451
Diluted	10,655	10,612	10,653	10,616	10,552
Basic book value per share	\$133.87	\$133.56	\$148.38	\$144.24	\$137.75
Diluted book value per share	\$131.40	\$131.34	\$145.36	\$142.02	\$136.43

Fixed Maturity Investments (in \$'000s)	12/31/2008		9/30/2008		6/30/2008		3/31/2008		12/31/2007		9/30/2007							
<b>Type of Investments</b>																		
US Government and government agencies	\$	318,209	23%	\$	317,870	24%	\$	216,060	17%	\$	227,708	19%	\$	221,280	18%	\$	100,577	11%
Other governments		36,979	3%		35,738	3%		32,707	3%		42,748	4%		61,898	5%		6,148	1%
Corporate		403,054	29%		335,067	25%		313,531	25%		255,786	22%		307,720	26%		230,231	24%
Mortgage-backed		416,240	30%		426,971	32%		360,023	29%		305,174	26%		246,861	20%		245,560	26%
Asset-backed		99,134	7%		120,844	9%		219,386	17%		222,526	19%		236,805	20%		236,978	25%
Commercial mortgage-backed		105,407	8%		111,287	8%		117,545	9%		130,548	11%		129,756	11%		131,510	14%
<b>Total</b>		<b>1,379,023</b>	<b>100%</b>		<b>1,347,777</b>	<b>100%</b>		<b>1,259,252</b>	<b>100%</b>		<b>1,184,490</b>	<b>100%</b>		<b>1,204,320</b>	<b>100%</b>		<b>951,004</b>	<b>100%</b>
<b>Credit Quality of Fixed Income</b>																		
AAA/Aaa		1,051,956	76%		1,026,000	76%		946,170	75%		925,918	78%		924,675	77%		682,001	72%
AA/Aa		70,851	5%		107,818	8%		100,623	8%		90,996	8%		101,565	8%		87,537	9%
A/A		188,041	14%		143,029	11%		140,700	11%		99,308	8%		104,775	9%		103,233	11%
BBB/Baa		67,750	5%		68,785	5%		68,192	5%		63,144	5%		69,929	6%		74,279	8%
BB/Ba		-	0%		-	0%		1,860	0%		1,872	0%		-	0%		2,271	0%
B/B		-	0%		1,718	0%		1,707	0%		3,252	0%		3,376	0%		1,683	0%
CCC/Caa		425	0%		427	0%		-	0%		-	0%		-	0%		-	0%
<b>Total</b>		<b>1,379,023</b>	<b>100%</b>		<b>1,347,777</b>	<b>100%</b>		<b>1,259,252</b>	<b>100%</b>		<b>1,184,490</b>	<b>100%</b>		<b>1,204,320</b>	<b>100%</b>		<b>951,004</b>	<b>100%</b>
<b>Maturity Profile of Fixed Income</b>																		
Due in one year or less		127,570	9%		118,455	9%		102,719	8%		137,460	12%		113,697	9%		39,713	4%
Due after one year through five years		595,431	43%		563,912	42%		461,471	37%		390,640	33%		435,765	36%		267,980	28%
Due after five years through ten years		23,088	2%		(4,762)	0%		(14,157)	-1%		(10,068)	-1%		34,360	3%		24,315	3%
Due after ten years		12,153	1%		11,070	1%		12,265	1%		8,210	1%		7,078	1%		4,948	1%
Mortgage-backed		416,240	30%		426,970	32%		360,023	29%		305,174	26%		246,859	20%		245,560	26%
Asset-backed		99,134	7%		120,845	9%		219,386	17%		222,526	19%		236,805	20%		236,978	25%
Commercial mortgage-backed		105,407	8%		111,287	8%		117,545	9%		130,548	11%		129,756	11%		131,510	14%
Investments held by non-managed syndicates		-	0%		-	0%		-	0%		-	0%		-	0%		-	0%
<b>Total</b>		<b>1,379,023</b>	<b>100%</b>		<b>1,347,777</b>	<b>100%</b>		<b>1,259,252</b>	<b>100%</b>		<b>1,184,490</b>	<b>100%</b>		<b>1,204,320</b>	<b>100%</b>		<b>951,004</b>	<b>100%</b>
<b>Effective Duration of Fixed Income (years)</b>		<b>1.74</b>		<b>2.13</b>		<b>1.72</b>		<b>1.72</b>			<b>1.66</b>			<b>1.58</b>				

Investments	12/31/2008		9/30/2008		6/30/2008		3/31/2008		12/31/2007		9/30/2007							
<b>Other investments:</b>																		
Catastrophe bonds		86,065	31%		98,957	31%		101,625	29%		80,257	26%		68,423	19%		59,469	11%
Equity fund		0	0%		0	0%		0	0%		0	0%		66,010	19%		66,580	12%
Hedge funds		48,243	18%		62,226	20%		65,117	19%		58,731	19%		57,668	16%		22,253	4%
Derivative Instruments		(10,978)	-4%		716	0%		125	0%		-437	0%		544	0%		224	0%
Investments held by non-managed syndicates		152,152	55%		152,259	48%		181,434	52%		166,109	55%		160,964	46%		411,503	73%
<b>Total</b>		<b>275,482</b>	<b>100%</b>		<b>314,158</b>	<b>100%</b>		<b>348,301</b>	<b>100%</b>		<b>304,660</b>	<b>100%</b>		<b>353,609</b>	<b>100%</b>		<b>560,029</b>	<b>100%</b>
<b>Grand Total Investments (excluding short term)</b>		<b>1,654,505</b>	<b>100%</b>		<b>1,661,935</b>	<b>100%</b>		<b>1,607,553</b>	<b>100%</b>		<b>1,489,150</b>	<b>100%</b>		<b>1,557,929</b>	<b>100%</b>		<b>1,511,033</b>	<b>100%</b>
Fixed maturity		1,379,023	83%		1,347,777	81%		1,259,252	78%		1,184,490	80%		1,204,320	77%		951,004	63%
Other investments		275,482	17%		314,158	19%		348,301	22%		304,660	20%		353,609	23%		560,029	37%



**Reserve for losses and loss adjustment expenses**

	<b>Twelve Months December 31, 2008 <u>2008</u></b>	<b>Year Ended December 31, 2007 <u>2007</u></b>
Gross reserves, beginning of period	\$ 478,240	\$ 20,260
Gross reserves acquired in purchase of Atrium	-	428,960
Total gross reserves	<u>478,240</u>	<u>449,220</u>
Losses recoverable, beginning of year/period	73,964	48
Losses recoverable acquired in purchase of Atrium	-	73,619
Total net reserves	<u>404,276</u>	<u>375,553</u>
Net losses incurred related to:		
Prior period	(28,022)	(3,943)
Current period	<u>415,613</u>	<u>41,406</u>
Total net incurred losses	<u>387,591</u>	<u>37,463</u>
Net paid losses related to:		
Prior period	(84,909)	(5,596)
Current period	<u>(120,940)</u>	<u>(4,590)</u>
Total net paid losses	<u>(205,849)</u>	<u>(10,186)</u>
Loss portfolio transfer	(11,582)	-
Effect of foreign exchange	<u>10,859</u>	<u>1,446</u>
Total net reserves, end of period	585,295	404,276
Losses recoverable, end of period	64,894	73,964
Total gross reserves, end of period	<u>\$ 650,189</u>	<u>\$ 478,240</u>

**Reserve for losses and loss adjustment expenses**  
**Twelve Months Ending December 31, 2008**

	<u>Bermuda</u>	<u>Lloyd's</u>	<u>United States</u>	<u>Total</u>
Gross reserves, beginning of period	\$ 49,056	\$ 428,960	\$ 224	\$ 478,240
Losses recoverable, beginning of year/period	\$ 345	73,619	-	73,964
Total net reserves	48,711	355,341	224	404,276
Net losses incurred related to:				
Prior period	3,632	(31,654)	-	(28,022)
Current period	280,047	125,207	10,359	415,613
Total net incurred losses	283,679	93,553	10,359	387,591
Net paid losses related to:				
Prior period	(17,619)	(67,226)	(64)	(84,909)
Current period	(80,827)	(40,032)	(81)	(120,940)
Total net paid losses	(98,446)	(107,258)	(145)	(205,849)
Loss portfolio transfer	-	(11,582)	-	(11,582)
Effect of foreign exchange	(1,213)	12,072	-	10,859
Total net reserves, end of period	232,731	342,126	10,438	585,295
Losses recoverable, end of period	858	64,036	-	64,894
Total gross reserves, end of period	\$ 233,589	\$ 406,162	\$ 10,438	\$ 650,189



**ArielHoldings**

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