Darwin Professional Underwriters Inc
Form 10-Q
August 10, 2006

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended **June 30, 2006**
Commission file number: **001-32883**

Darwin Professional Underwriters, Inc.
(Exact name of registrant as specified in its charter)

Delaware	**03-0510450**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9 Farm Springs Road
Farmington, Connecticut 06032
(Address of principal executive offices) (Zip Code)
(860) 284-1300
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer	o	Accelerated filer	o	Non-accelerated filer	þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ
The number of shares of the Registrant s Common Stock, par value $0.01 per share, outstanding at August 7, 2006 was 17,042,496 shares.

Darwin Professional Underwriters, Inc.
Quarterly Report on Form 10-Q
For Quarterly Period Ended June 30, 2006
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Part I. Financial Information

Item 1. Financial Statements

DARWIN PROFESSIONAL UNDERWRITERS, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
June 30, 2006 and December 31, 2005
(Dollars in thousands, except per share amounts)

	June 30, 2006 (Unaudited)	December 31, 2005
ASSETS:		
Available for sale securities, at fair value:		
Fixed maturity securities (amortized cost: 2006, $260,278; 2005, $120,832)	$ 255,877	$ 120,770
Short-term investments, at cost which approximates fair value	81,940	184,088
Total investments	337,817	304,858
Cash	22,407	10,255
Premiums receivable (net of allowance for doubtful accounts of $50 as of June 30, 2006 and December 31, 2005)	23,932	22,090
Reinsurance recoverable on paid and unpaid losses	72,125	51,260
Ceded unearned reinsurance premiums	41,957	33,853
Deferred insurance acquisition costs	9,663	7,603
Property and equipment at cost, less accumulated depreciation of $878 and $599, respectively	1,940	1,880
Intangible assets	7,306	7,092
Net deferred income tax asset	9,471	6,278
Current income taxes receivable		283
Other assets	3,263	1,539
Total assets	$ 529,881	$ 446,991
LIABILITIES AND STOCKHOLDERS EQUITY:		
Loss and loss adjustment expense reserves	$ 195,914	$ 138,089
Unearned premium reserves	110,340	88,280
Reinsurance payable	13,305	10,628
Due to brokers for unsettled trades		2,216
Current income taxes payable	769	
Accrued expenses and other liabilities	6,413	8,255
Total liabilities	326,741	247,468
Series A Preferred Stock; $0.10 par value; (Redeemable at $20.00 per share); authorized 500,000 shares; issued and outstanding 0 shares at June 30, 2006 and 105,300 shares at December 31, 2005. Aggregate liquidation preference of $0 at June 30, 2006 and $2,106 at December 31, 2005		2,106
Stockholders equity:		
Common stock; $0.01 par value; authorized 50,000,000 shares; issued and outstanding 17,042,596 shares at June 30, 2006 and 8,105,625 shares at	170	81

December 31, 2005				
Additional paid-in capital		201,997		195,950
Retained earnings		3,748		1,425
Accumulated other comprehensive income (loss)		(2,775)		(39)
Total stockholders equity		203,140		197,417
Total liabilities and stockholders equity	$	529,881	$	446,991

See accompanying notes to Condensed Consolidated Financial Statements.

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DARWIN PROFESSIONAL UNDERWRITERS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
Three and Six Months Ended June 30, 2006 and 2005
(Unaudited)
(Dollars in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Revenues:				
Net premiums earned	$ 31,954	$ 19,945	$ 59,258	$ 38,689
Net investment income	3,763	931	7,123	1,563
Net realized investment gains (losses)	(3)		(13)	(60)
Total revenues	35,714	20,876	66,368	40,192
Costs and expenses:				
Losses and loss adjustment expenses	21,767	13,733	41,031	26,845
Commissions and brokerage expenses.	3,356	2,283	5,988	4,374
Other underwriting, acquisition and operating expenses	5,633	3,599	10,112	6,631
Other expenses	119	297	278	654
Total costs and expenses	30,875	19,912	57,409	38,504
Earnings before income taxes	4,839	964	8,959	1,688
Income tax expense	1,462	326	2,794	626
Net earnings	$ 3,377	$ 638	$ 6,165	$ 1,062
Basic earnings per share				
Net earnings per share	$ 0.13	$ 0.10	$ 1.04	$ 0.16
Weighted average shares outstanding	7,094,352	6,600,000	3,547,176	6,600,000
Diluted earnings per share:				
Net earnings per share	$ 0.10	$ 0.08	$ 0.37	$ 0.13
Weighted average shares outstanding	8,719,928	8,119,224	16,535,853	8,133,049

See accompanying notes to Condensed Consolidated Financial Statements.

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DARWIN PROFESSIONAL UNDERWRITERS, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
For The Six Months Ended June 30, 2006 and 2005
(Unaudited)
(Dollars in thousands)

	Six Months Ended June 30,	
	2006	**2005**
Cash flows provided by (used for) operating activities:		
Net earnings	$ 6,165	$ 1,062
Adjustments to reconcile net earnings to net cash provided by (used for) operating activities:		
Deferred insurance acquisition costs	(7,216)	(5,131)
Amortization of insurance acquisition costs	5,156	5,672
Deferred income taxes	(1,590)	(1,412)
Depreciation	279	180
Net realized investment (gains) losses	13	60
Amortization of investment discounts and premiums	(2,158)	(260)
Stock-based compensation expense	187	
Change in:		
Premiums receivable	(1,842)	(1,665)
Reinsurance recoverable on paid and unpaid losses	(20,865)	(20,000)
Ceded unearned reinsurance premiums	(8,104)	(10,130)
Current income taxes payable/receivable	1,052	(1,197)
Other assets	(1,724)	(27)
Loss and loss adjustment expense reserves	57,825	46,024
Unearned premium reserves	22,060	12,800
Reinsurance payable	2,677	4,387
Accrued expenses and other liabilities	(1,842)	(56)
Net cash provided by (used for) operating activities	50,073	30,307
Cash flows provided by (used for) investing activities:		
Proceeds from sales of available-for-sale securities	7,823	4,848
Proceeds from sales of short-term investments	300,191	189,618
Maturities of available-for-sale securities	3,953	88
Due to brokers for unsettled trades	(2,216)	
Purchases of available-for-sale securities	(151,551)	(15,268)
Purchases of short-term investments	(195,568)	(209,127)
Purchases of fixed assets	(339)	(842)
Acquisition of insurance company, net of cash acquired	(214)	(25,575)
Net cash provided by (used for) investing activities	(37,921)	(56,258)
Cash flows provided by (used for) financing activities:		
Proceeds from issuance of common stock	96,000	
Issuance costs	(9,712)	
Redemption of Series A Preferred Stock	(2,297)	
Redemption of Series C Preferred Stock	(2,465)	
Redemption of Series B Convertible Preferred Stock	(81,526)	

Proceeds from capital contribution				25,240
Net cash provided by (used for) financing activities				25,240
Net increase (decrease) in cash		12,152		(711)
Cash, beginning of period		10,255		5,032
Cash, end of period	$	22,407	$	4,321
Supplemental disclosures of cash flow information:				
Cash paid for federal and state income taxes	$	3,332	$	3,241

See accompanying notes to Condensed Consolidated Financial Statements.

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DARWIN PROFESSIONAL UNDERWRITERS, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Dollars in thousands, except per share amounts)

(1) Organization and Basis of Presentation

*(a) **Organization***

Darwin Professional Underwriters, Inc. (DPUI) was formed in March 2003 as an underwriting manager for certain insurance company subsidiaries of Alleghany Corporation (Alleghany), a publicly traded company, pending the establishment or acquisition of separate insurance companies for the DPUI business. Effective June 1, 2003, DPUI entered into underwriting management agreements with three wholly-owned subsidiaries of Alleghany, Capitol Indemnity Corporation, Capitol Specialty Insurance Corporation, and Platte River Insurance Company (collectively, the Capitol Companies), to underwrite and administer specialty liability insurance business. DPUI s specialty liability insurance business consists of directors and officers liability (D&O), errors and omissions liability (E&O) and medical malpractice liability insurance.

DPUI, located in Farmington, Connecticut, is a majority-owned publicly-traded insurance underwriting subsidiary of Alleghany Insurance Holdings, LLC (AIHL), which is a wholly-owned subsidiary of Alleghany. On May 19, 2006, DPUI had its initial public offering of its common shares (see Note 8). A minority interest in DPUI is owned by certain key employees of DPUI.

On February 3, 2004, Darwin Group, Inc. (Darwin Group), a wholly-owned subsidiary of AIHL, was formed as an insurance holding company for the purpose of acquiring Darwin National Assurance Company (DNA). DNA was acquired on May 3, 2004 as a wholly-owned subsidiary of Darwin Group. As of July 31, 2006, DNA is licensed to write property and casualty insurance on an admitted basis in 48 jurisdictions (including the District of Columbia) and is eligible to operate on an excess and surplus lines basis in one additional state (Arkansas). On May 2, 2005, DNA acquired Darwin Select Insurance Company (Darwin Select), as a wholly-owned insurance company subsidiary. As of July 31, 2006, Darwin Select is licensed to write property and casualty insurance on an admitted basis in Arkansas (its state of domicile) and is eligible to operate on an excess and surplus lines basis in 44 additional states. Effective as of January 1, 2006, Darwin Group was contributed by Alleghany to DPUI (see Note 1(b)).

The Capitol Companies are wholly-owned subsidiaries of AIHL and operate in 50 states and the District of Columbia. In addition to the business produced by DPUI and issued on policies of the Capitol Companies, the Capitol Companies have significant independent operations that are not included in these condensed consolidated financial statements. Alleghany acquired ownership of the Capitol Companies in January 2002. Prior to the formation of DPUI as an underwriting manager to underwrite professional liability coverages for the Capitol Companies in the directors and officers (D&O), errors and omissions (E&0) and medical malpractice lines, neither the Capitol Companies nor Alleghany wrote any of these lines of business.

DNA, Darwin Select and the Capitol Companies (in respect of the business produced by DPUI and issued on polices of the Capitol Companies) receive underwriting, claims, management, and administrative services from DPUI.

DPUI s products are marketed through independent producers located throughout the United States.

*(b) **Reorganization***

Effective October 1, 2005, Darwin Group, through its subsidiary DNA, entered into a series of reinsurance and commutation agreements with the Capitol Companies. Overall, these reinsurance agreements had the effect of transferring to DNA all of the in-force business produced by DPUI and issued on policies of the Capitol Companies, along with the corresponding financial statement effects of these policies. In addition, in November 2005, Alleghany made a capital contribution of $135,000 to Darwin Group, which subsequently contributed this capital to DNA.

Effective January 1, 2006, DPUI became the parent of Darwin Group and its subsidiaries, DNA and Darwin Select and, in connection therewith, DPUI issued to AIHL shares of Series B Convertible Preferred Stock with an aggregate liquidation preference of $197,178, equal to the book value of Darwin Group on December 31, 2005, in exchange for all of the outstanding common stock of Darwin Group held by AIHL. In addition, AIHL exchanged its 6,600,000 shares of common stock of DPUI, representing 80% of the issued and outstanding shares of DPUI, for 9,560 additional shares of Series A

Preferred Stock of DPUI having an additional aggregate liquidation preference of $200, representing 80% of the book value of DPUI on December 31, 2005. As a result of the reorganization, the only shares of common stock outstanding as of January 1, 2006 were unvested restricted shares.

The condensed consolidated financial statements give retroactive effect to both the transfer of the in-force business to Darwin Group from the Capitol Companies and the contribution of Darwin Group to DPUI as transactions between entities under common control, accounted for as a pooling of interests. This results in a presentation that reflects the actual business produced and managed by DPUI, regardless of the originating insurance carrier, with all periods presented as if DPUI and Darwin Group, including the transferred in-force business, had always been combined.

Collectively these operations are referred to as Darwin or the Company.

(c) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Darwin have been prepared in accordance with U.S. generally accepted accounting principles and with Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments and the elimination of intercompany transactions and balances) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2006. The financial information included in the accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and notes for the fiscal year ended December 31, 2005 included in Darwin s registration statement (Form S-1), as amended. The condensed consolidated balance sheet at December 31, 2005 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

On May 3, 2006, the Company s Board of Directors approved a 33-for-two stock split of the Company s shares of common stock, to be effected on the effective date of the Company s filing of a registration statement on Form S-1 in connection with its initial public offering, which occurred on May 19, 2006. In addition, the par value of the common stock has been adjusted to $0.01 per common share from $0.10 per common share. The resulting increase in common stock was offset by a decrease in additional paid-in capital.

All common stock and per share data included in these condensed consolidated financial statements, and the exchange ratios for the Series B Convertible Preferred Stock, have been retroactively adjusted to reflect the 33-for-two stock split and the change in par value for all periods presented.

(2) New Accounting Standards

In September 2005, the Accounting Standards Executive Committee issued Statement of Position 05-1, *Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts* (SOP 05-1). SOP 05-1 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in SFAS No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments.* SOP 05-1 defines internal replacement as a modification in product benefits, features, rights, or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature of coverage within a contract. SOP 05-1 is effective for Darwin in fiscal year 2007, with earlier adoption encouraged. The Company has evaluated the effect of SOP 05-1 and does not expect the impact to have a significant effect on the operations or financial condition of Darwin.

In March 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 155, *Accounting for certain Hybrid Instruments, an amendment to FASB Statement No. 133 and 140.* This statement permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. This Statement is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. The Company does not believe that this statement will have a material impact on its results of operations and financial condition.

In July 2006 FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes.* The Interpretation clarifies the accounting for income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes.* The Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Interpretation is effective for fiscal years beginning after December 15, 2006. The Company will adopt the provisions of this Interpretation in the first quarter of 2007, and does not anticipate that it will have any material impact on its results of operations and financial condition.

(3) Share-Based Compensation

The Company has four share-based payment plans for employees and non-employee directors: the 2003 Restricted Stock Plan (as amended November 2005), the 2006 Stock Incentive Plan, the 2006 Employees Restricted Stock Plan and the 2006 Stock and Unit Plan for Nonemployee Directors (Directors Plan), which are described below.

In December 2004, FASB issued SFAS 123(R), *Share-Based Payment (as amended)* (SFAS No. 123(R)). SFAS No. 123(R) eliminates the alternative to use the intrinsic value method of accounting that was provided in SFAS No. 123. SFAS No. 123(R) requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. SFAS No. 123(R) establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all companies to apply a fair-value based measurement method in accounting generally for all share-based payment transactions with employees.

On January 1, 2006, the Company adopted SFAS No. 123(R) using a modified prospective method. Under this application, Darwin is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption. The Company did not recognize any share-based compensation expense as a result of the adoption of SFAS No. 123(R) for periods prior to January 1, 2006.

Prior to the adoption of SFAS No. 123(R), the Company applied Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for the 2003 Restricted Stock Plan. Prior to January 1, 2006, the Company s share-based grants were restricted shares under the 2003 Restricted Stock Plan that had a nominal fair value at the date of grant. Darwin did not have any stock option or other share-based awards prior to January 1, 2006.

As a result of adopting SFAS No. 123(R) and the granting of shares under the plans at the time of the initial public offering on May 19, 2006, the Company recorded for the three months and six months ended June 30, 2006 total share-based compensation expense of $187. During the same periods, a deferred tax benefit of $75 related to the stock-based compensation expense was recorded. DPUI did not incur any stock-based compensation expense for the three and six months ended June 30, 2005.

(a) 2003 Restricted Stock Plan

The 2003 Restricted Stock Plan was adopted in July 2003 and was amended and restated in November 2005. The plan provides a means to attract, retain and motivate key employees with the granting of restricted stock. A maximum of 1,650,000 shares of common stock are reserved for issuance under the 2003 Restricted Stock Plan. The terms for awards of 1,546,875 restricted shares provide for vesting over a four-year period from the date of grant, with 50% of the restricted shares vesting on the third anniversary of the date of grant and the remaining 50% of the restricted shares vesting on the fourth anniversary of the date of grant. The terms for awards of the remaining 103,125 restricted shares provide for vesting over a three year period from the date of grant, with 50% of the restricted shares vesting on the second anniversary of the date of grant and the remaining 50% of the restricted shares vesting on the third anniversary of the date of grant.

As of December 31, 2005, 1,505,625 restricted shares were issued and outstanding under this plan, none of which had vested. The total fair value of the shares when granted in 2003 was $9, which was equal to the par value of the shares at the date of grant. On May 19, 2006, the remaining 144,375 restricted shares were granted at a fair value of $16.00 per share, the initial public offering price per share of the Company s common stock. In connection with the granting of these restricted shares, certain of the recipients received an additional cash payment calculated as a tax equalization payment (tax gross up). This tax gross up was paid to provide the recipients with a reduction in total tax expenses incurred or to be incurred in connection with the restricted share awards. The total amount of the tax gross up of $450 was expensed in May 2006, the period it was incurred and paid. The stock compensation expense for the restricted shares is based on the fair value when

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granted and is recognized ratably over the vesting period. For both the three months and six months ended June 30, 2006, the Company s stock-based compensation expense for the 2003 Restricted Stock Plan was $82. There was no forfeiture or vesting of shares during the three or six months ending June 30, 2006. As of June 30, 2006, 1,650,000 restricted shares were outstanding under the plan with 752,813 shares scheduled to vest in 2006, 804,375 shares scheduled to vest in 2007, 72,187 shares scheduled to vest in 2008 and 20,625 shares scheduled to vest in 2009.

(b) 2006 Stock Incentive Plan

The 2006 Stock Incentive Plan permits the Company to award a broad range of equity-based incentive compensation to key employees, including the types commonly known as restricted stock, stock options, stock appreciation rights and performance units, as well as any other types of equity-based incentive compensation awards. Under the terms of the plan, the exercise price of options and stock appreciation rights cannot be less than the fair market value of the common stock at the time of grant, and the term of options, stock appreciation rights and other awards under the 2006 Stock Incentive Plan can not exceed ten years. In addition, the plan permits the award of cash payments as a part of, or in addition to, an equity-based award. A maximum of 850,000 shares of common stock may be issued to participants under the plan, and awards of, or based upon, up to a maximum of 127,500 shares of common stock may be granted to any individual participant in any calendar year, in each case subject to anti-dilution and other adjustments in the case of certain events specified in the plan. The 2006 Stock Incentive Plan was adopted by the board of directors on May 17, 2006 and is subject to approval of the stockholders at the first annual meeting of shareholders following the initial public offering. If the shareholders do not approve the 2006 Stock Incentive Plan, the plan will terminate and all awards theretofore granted will be cancelled.

At the time of its initial public offering, the Company granted, under the terms of the 2006 Stock Incentive Plan, non-qualified stock options to purchase 170,060 shares of common stock to certain key employees at a price of $16.00 per share, the initial public offering price. The options are exercisable for ten years from the date of grant and vest at an annual rate of 25% on each anniversary of the grant date, provided that the option holder is still employed by DPUI.

The fair value of the option grant was estimated at $6.64 per share on the date of the grant using the Black-Scholes option pricing model. The expected term is based on the vesting period simplified method or 6.25 years. The stock price volatility for the award was 30.4 %, an estimate based on the average stock price volatility data for the expected term for similar property and casualty companies. The risk-free interest rate assumption is based on the 6.25 year U.S. Treasury for the expected term, which was 5.18%. The Company does not anticipate paying dividends for any of the years. The compensation expense is based on the fair value at grant and is recognized on a straight line basis over the vesting period. The Company s compensation expense for the options was $32 for both the three months and six months ended June 30, 2006. There was no forfeiture or exercised shares. As of June 30, 2006, 170,060 options were outstanding and not vested.

(c) 2006 Employees Restricted Stock Plan

The 2006 Employees Restricted Stock Plan, was adopted by the Board of Directors on May 17, 2006 to provide an opportunity for all employees of Darwin at the time of the initial public offering to be owners of common stock of Darwin. The Company granted an aggregate of 9,000 restricted shares of common stock under the 2006 Employees Restricted Stock Plan to employees who are not executive officers based upon the employee s length of service with the Company. The restricted shares had a fair value of $16.00 per share, the initial public offering price. No additional awards will be made under the 2006 Employees Restricted Stock Plan. Under the terms of the 2006 Employees Restricted Stock Plan, each grant of restricted stock will be forfeited if the employee s employment with the Company is terminated before the third anniversary of the date of grant for any reason other than death or disability, and during that period, the restricted shares may not be sold, assigned, pledged or transferred to any person. The related stock based compensation expense is based on the fair value of the restricted shares when granted and is recognized ratably over the three year vesting period. For both the three months and six months ended June 30, 2006, the Company s stock based compensation expense for the plan was $5. As of June 30, 2006, 9,000 restricted shares were outstanding under the plan.

(d) Directors Plan

The Directors Plan for non-employee directors (defined as a director who is not either an employee of the Company or an employee of any of our affiliates including Alleghany) is designed to align their interest with the stockholders interest through equity-based incentive compensation, including restricted stock and share unit accumulation. The Directors Plan provides for a maximum of 130,000 shares of common stock that may be issued to participants under the plan. As of June 30, 2006, the Company has made two awards to non-employee directors under the plan totaling 29,219 shares.

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Initial Public Offering Restricted Stock Grant In connection with the Company s initial public offering, each non-employee director received a grant of 2,500 restricted shares of common stock based upon the initial public offering price of $16.00 per share upon the completion of the offering. The restricted stock vests at the time of the Company s next annual meeting of stockholders and will be forfeited if the non-employee director resigns from the board of directors prior to the first meeting of the board of directors following the anniversary of the date of grant of the restricted common stock. The directors compensation expense is based on the fair value of $16.00 per share and is being recognized on a straight line basis over an estimated twelve month vesting period from the Company s initial public offering on May 19, 2006. There was no forfeiture or vesting of shares during the six months ending June 30, 2006. The Company s directors compensation expense for the restricted shares was $23 for both the three months and six months ended June 30, 2006. As of June 30, 2006, 12,500 restricted shares were outstanding under the Directors Plan.

Annual Non-Employee Directors Share Unit Award Annually, Darwin pays its non-employee directors board and committee fees in connection with their services to the Company. These fee agreements provide that a minimum of 50% of all fees earned by a non-employee director are paid through the issuance of a number of share units which is equal to the number of shares of our common stock that could have been purchased with such fees, based upon the initial public offering price of $16.00 per share, in the case of the first determination of unit shares, and thereafter, based upon the closing price of the shares of common stock on the day after the annual meeting of stockholders. The share units are earned on a pro rata basis over the twelve month period between annual meetings. In addition to the 50% mandatory conversion, each non-employee director may elect to have up to a total of 100% of their fees converted into share units. No shares of common stock are actually purchased in connection with the share units, but the number of the share units is dependent upon the market value of the Company s shares of common stock. A non-employee director will receive distributions in respect of share units following the expiration of five calendar years following the year in which the fees were originally converted into share units, or following termination of service on the board of directors. On August 9, 2006 the Board of Directors voted to amend the Plan s distribution provision so that each distribution in respect of share units will be made in shares of the Company s common stock. For the 2006-2007 annual fee period, based upon the non-employee director s share unit awards elections, a total of 16,719 share units were granted. The directors fee expense for the share units is recognized as earned. As of June 30, 2006, 2,786 share units were deemed earned by the directors, resulting in directors fee expense to Darwin of $45 for the three and six month periods.

(4) Investments

The amortized cost and estimated fair value of fixed maturity securities at June 30, 2006 and December 31, 2005 are as follows:

June 30, 2006	**Cost or Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Type of investment				
U.S. Government bonds	$ 13,222	$	$ (295)	$ 12,927
State and municipal bonds	102,227	1	(1,929)	100,299
Mortgage/asset-backed securities	74,427	11	(1,087)	73,351
Corporate bonds and notes	70,402	14	(1,116)	69,300
Total fixed maturity securities	$ 260,278	$ 26	$ (4,427)	$ 255,877

December 31, 2005	**Cost or Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**

				Fair Value
Type of investment				
U.S. Government bonds	$ 16,163	$	$ (231)	$ 15,932
State and municipal bonds	30,686	342	(28)	31,000
Mortgage/asset-backed securities	39,233	70	(99)	39,204
Corporate bonds and notes	34,750	51	(167)	34,634
Total fixed maturity securities	$ 120,832	$ 463	$ (525)	$ 120,770

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The amortized cost and estimated fair value of fixed maturity securities at June 30, 2006, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due in one year or less	$ 6,484	$ 6,437
Due after one year through five years.	58,658	57,872
Due after five years through ten years	24,245	23,533
Due after ten years	96,464	94,684
Mortgage/asset-backed securities	74,427	73,351
Total	$ 260,278	$ 255,877

An investment in a fixed maturity security which is available-for-sale is impaired if its fair value falls below its book value, and the decline is considered to be other-than-temporary. Darwin s assessment of a decline in fair value includes its current judgment as to the financial position and future prospects of the issuing entity of the security, the length of time and extent to which fair value has been below cost, and Darwin s ability and intent to hold the investment for a period of time sufficient to allow for an anticipated recovery.

The following table summarizes, for all fixed maturity securities in an unrealized loss position at June 30, 2006, the aggregate fair value, and the gross unrealized loss by length of time such securities have continuously been in an unrealized loss position:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
Type of investment						
U.S. Government bonds	$ 3,547	$ (112)	$ 9,380	$ (183)	$ 12,927	$ (295)
State and municipal bonds	96,232	(1,867)	2,462	(62)	98,694	(1,929)
Mortgage/asset-backed securities	46,610	(907)	5,300	(180)	51,910	(1,087)
Corporate bonds and notes	47,864	(939)	6,318	(177)	54,182	(1,116)
Total fixed maturity securities.	$ 194,253	$ (3,825)	$ 23,460	$ (602)	$ 217,713	$ (4,427)

The unrealized losses on fixed maturity securities are primarily interest rate related. Each of the fixed maturity securities with an unrealized loss at June 30, 2006 has a fair value that is greater than 94.1% of its amortized cost. Of the 49 securities that have been in an unrealized loss position for longer than 12 months, 21 are U.S. Treasury securities and each of the remaining securities has a fair value that is greater than 94.1% of its amortized cost. None of the fixed maturity securities with unrealized losses have ever missed, or been delinquent on, a scheduled principal or interest payment, and none are rated below investment grade. As of June 30, 2006 and December 31, 2005, no securities are considered to be other-than-temporarily impaired.

(5) Reinsurance

Reinsurance Effect on Operations

Net premiums written, net premiums earned, and net losses and LAE incurred including reinsurance activity for the three and six months ended June 30, 2006 and 2005 are as follows:

		Three Months Ended June 30,		Six Months Ended June 30,	
		2006	2005	2006	2005
Net Premiums Written:					
Direct premiums written		$ 40,115	$ 4,185	$ 81,195	$ 7,453
Assumed premiums written	Capitol Companies	17,236	32,470	36,040	63,067
Assumed premiums written		713		713	
Ceded premiums written		(21,644)	(15,837)	(44,740)	(29,161)
Net premiums written		$ 36,420	$ 20,818	$ 73,208	$ 41,359
Net Premiums Earned:					
Direct premiums earned		$ 19,308	$ 1,999	$ 31,371	$ 3,154
Assumed premiums earned	Capitol Companies	31,269	28,352	64,437	54,567
Assumed premiums earned		80		80	
Ceded premiums earned		(18,703)	(10,406)	(36,630)	(19,032)
Net premiums earned		$ 31,954	$ 19,945	$ 59,258	$ 38,689

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	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Net Losses and LAE Incurred:				
Direct losses and LAE incurred	$ 11,366	$ 7,870	$ 19,784	$ 8,684
Assumed losses and LAE incurred Capitol Companies	19,961	19,900	42,099	38,337
Assumed losses and LAE incurred	53		53	
Ceded losses and LAE incurred	(9,613)	(14,037)	(20,905)	(20,176)
Net losses and LAE incurred	$ 21,767	$ 13,733	$ 41,031	$ 26,845

The net premiums written table above presents our gross premiums written on the policies of the Capitol Companies (Assumed premiums written Capitol Companies) as well as gross premiums written directly and assumed on the policies of DNA and Darwin Select (Direct and assumed premiums written). Since each of our insurance company subsidiaries obtained its own A.M. Best rating of A- (Excellent) in November 2005, whenever possible, DPUI has written coverage on policies issued by DNA or Darwin Select. However, our insurance company subsidiaries are not currently licensed (in the case of our admitted carrier DNA) or eligible to write business on a surplus lines basis (in the case of Darwin Select) in all U.S. jurisdictions, and DNA does not yet have in place all rate and form filings required to write insurance business in every jurisdiction where it is licensed. In addition, the Capitol Companies have A.M. Best ratings of A (Excellent), and we believe that insureds in certain classes of our business (primarily public D&O) require policies issued by an insurer with an A.M. Best rating of A (Excellent). Consequently, although we expect to write the majority of our future business on policies of our insurance company subsidiaries, we continue to depend upon the Capitol Companies to write policies for a portion of the business produced by DPUI. For the three and six month periods ended June 30, 2006, we wrote $17.2 million and $36.0 million, respectively, of gross premiums through our arrangement with the Capitol Companies, representing 29.7% and 30.6%, respectively, of the total gross premiums produced by DPUI.

(6) Loss and Loss Adjustment Expense (LAE) Reserves

The following table provides a reconciliation of the beginning and ending loss and LAE reserves, net of reinsurance, as shown in the Company s condensed consolidated financial statements for the periods indicated:

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Gross reserves balance at beginning of period	$ 166,486	$ 66,142	$ 138,089	$ 47,207
Less reinsurance recoverables on unpaid losses	(62,522)	(21,710)	(51,260)	(15,572)
Net reserves balance at beginning of period	103,964	44,432	86,829	31,635
Add acquired gross reserves		6,693		6,693
Less reinsured acquired gross reserves		(6,693)		(6,693)
Net reserves balance	103,964	44,432	86,829	31,635
Incurred losses and LAE, net of reinsurance, related to:				
Current period	22,108	13,733	41,372	26,845
Prior periods	(341)		(341)	
Total incurred	21,767	13,733	41,031	26,845

Paid losses and LAE, net of reinsurance, related to:				
Current period	438	283	856	488
Prior periods	1,426	223	3,137	333
Total paid	1,864	506	3,993	821
Net reserves balance at end of period	123,867	57,659	123,867	57,659
Plus reinsurance recoverables on unpaid losses	72,047	35,572	72,047	35,572
Gross reserves balance at end of period	$ 195,914	$ 93,231	$ 195,914	$ 93,231

Darwin continually reviews its loss and LAE reserves and the related reinsurance recoverables. Differences between estimates and ultimate payments are reflected in expense for the period in which the estimates are changed. The actuarial estimates are based on industry claim experience and our own experience and consider current claim trends and premium volume, as well as social and economic conditions. While Darwin has recorded its best estimate of loss and LAE reserves as of June 30, 2006 and 2005, it is possible these estimates may materially change in the future.

Losses and LAE incurred have increased over the prior years due to the expected losses on the increased premiums earned, offset by actual and anticipated reinsurance recoveries (including a provision for recoveries on incurred but not reported losses) on the expected losses. The increase in gross and net loss and LAE reserves primarily reflects increased net premiums earned for all lines of business and limited paid loss activity for the current and prior accident years. These increases are offset for 2006 by a reduction in prior year losses and LAE incurred of $341 due to net favorable development on loss and LAE reserves recorded for accident year 2003. Loss and LAE emergence on the 2003 accident year has been more favorable than anticipated when the original gross and net loss reserves were established. In addition, gross reserves increased during 2005 due to the acquisition of Darwin Select. At the time of acquisition, Darwin Select had outstanding gross loss and LAE reserves of $6,693, that are 100% reinsured by the seller and are fully collateralized. As of June 30, 2006, $1,540 in gross loss and LAE reserves pertaining to the seller of Darwin Select remained outstanding.

(7) Preferred Stock

In 2003, in connection with the formation of the Company, DPUI entered into a subscription agreement with AIHL, whereby AIHL agreed to purchase up to 400,000 shares of Series A Preferred Stock of DPUI for total proceeds of $8,000. At December 31, 2005, 105,300 shares of Series A Preferred Stock had been issued. Effective as of January 1, 2006, the 6,600,000 shares of common stock of DPUI held by AIHL were exchanged for 9,560 additional shares of Series A Preferred Stock of DPUI, increasing the total shares of Series A Preferred Stock issued and outstanding to 114,860 with an aggregate liquidation preference of $2,297. The additional number of shares of Series A Preferred Stock issued was determined on the basis of the December 31, 2005 book value of shares of common stock of DPUI held by AIHL. The shares of Series A Preferred Stock were conditionally redeemable for cash and, in accordance with Emerging Issues Task Force (EITF) Abstract D-98: *Classification and Measurement of Redeemable Securities* (EITF D-98), were classified outside of permanent equity as of December 31, 2005. All outstanding shares of Series A Preferred Stock were redeemed in connection with the initial public offering.

In connection with the Company s reorganization as of January 1, 2006, the shares of common stock of Darwin Group held by AIHL were exchanged for 197,178 shares of Series B Convertible Preferred Stock of DPUI (the parent company after the reorganization). The total number of shares of Series B Convertible Preferred Stock issued was determined on the basis of the December 31, 2005 book value of the shares of common stock of Darwin Group held by AIHL.

On April 1, 2006, the Company declared a dividend of $2,465, calculated at 5.0% of the liquidation preference of the Series B Convertible Preferred Stock, in the form of Series C Preferred Stock to the holders of Series B Preferred Stock.

In connection with the Company s initial public offering on May 19, 2006, the net proceeds of $86,288 were utilized to redeem all of the shares of Series A Preferred Stock at the aggregate liquidation preference of $2,297, and all of the shares of Series C Preferred Stock outstanding at the aggregate liquidation preference of $2,465 and to redeem 5,478,904 shares of of the Series B Convertible Preferred Stock at a redemption price per share, on an as-converted basis, equal to the public offering price less underwriting costs. The remaining outstanding shares of the Series B Convertible Preferred Stock were converted into 9,371,096 shares of common stock. With the redemption or conversion of all the shares of Series A Preferred Stock, Series B Convertible Preferred Stock and Series C Preferred Stock, no additional dividends are required or payable.

(8) Capital Stock

On March 10, 2006, the Company filed a registration statement on Form S-1 with the Securities and Exchange Commission for the purpose of making an initial public offering of common stock. The Company s registration statement was declared effective on May 18, 2006 for the issuance of 5,217,391 shares of common stock at an initial offering price of $16.00 per share. Subsequently, the underwriters of the initial public offering exercised their over-allotment option in which an additional 782,609 shares of common stock were issued at the $16.00 initial public offering price. Gross proceeds from the sale of the 6,000,000 shares of common stock were $96,000. Total costs associated with the initial public offering included $6,720 of underwriting costs and $2,992 of offering expenses. Net proceeds from the offering, including the over-allotment option, after deducting underwriting costs and offering expenses were $86,288.

The net proceeds from the offering were used to redeem all of the shares of Series A Preferred Stock at the aggregate liquidation preference of $2,297 and all of the shares of Series C Convertible Preferred Stock at the aggregate liquidation preference of $2,465. The remaining proceeds of $81,526 were used to redeem a portion of the shares of Series B Convertible Preferred Stock at a redemption price per share, on an as-converted basis, equal to the public offering price less underwriting costs ($14.88 per share) or 5,478,904 shares of common stock on an as-converted basis. The remaining outstanding shares of the Series B Convertible Preferred Stock were converted into 9,371,096 shares of common stock. As a result of the foregoing, the net proceeds of the offering were used to reduce Alleghany s ownership in the Company to approximately 55.0%.

(9) Earnings per Share

Net income available for common stockholders used in the three and six months ended June 30, 2006 calculation of basic earnings per share reflects a reduction for $2,465 in dividends declared and paid in Series C Preferred Stock. The dividend has been added back for the six months ended June 30, 2006 calculation of diluted earnings per share.

The weighted average common shares outstanding for the basic earnings per share reflects no common shares outstanding from January 1, 2006 to May 19, 2006, as all of the shares of common stock outstanding during that period were unvested restricted stock. The weighted average common shares outstanding for basic earnings per share reflects the issuance of 6,000,000 common shares in connection with the Company s initial public offering and the conversion of the Series B Convertible Preferred Stock to 9,371,096 common shares on May 19, 2006 for the three and six months ended June 30, 2006.

The diluted earnings per share calculation for the six months ended June 30, 2006 assumes the conversion of the Series B Convertible Preferred Stock into 14,850,000 shares of common stock for the period from January 1, 2006 to May 19, 2006, the date of the Company s initial public offering, and it reflects the actual shares outstanding, thereafter. The diluted earnings per share calculation for the three and six months ended June 30, 2006 also assumes the dilutive effect of the outstanding restricted stock, options and share units.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Net earnings	$ 3,377	$ 638	$ 6,165	$ 1,062
Less dividend declared and paid on Series B Convertible Preferred Stock	(2,465)		(2,465)	
Net earnings numerator for basic earnings per share	912	638	3,700	1,062
Add dividend declared and paid on Series B Convertible Preferred Stock			2,465	
Net earnings numerator for diluted earnings per share	$ 912	$ 638	$ 6,165	$ 1,062
Weighted average common shares outstanding denominator for basic earnings per share	7,094,352	6,600,000	3,547,176	6,600,000
Effect of dilutive securities:				
Series B Convertible Preferred Stock			11,423,076	
Restricted stock	1,582,183	1,519,224	1,543,904	1,533,049
Options	42,103		20,052	
Share units	1,290		645	
Weighted average common shares outstanding denominator for diluted earnings per share	8,719,928	8,119,224	16,535,583	8,133,049
Basic earnings per share	$ 0.13	$ 0.10	$ 1.04	$ 0.16
Diluted earnings per share	$ 0.10	$ 0.08	$ 0.37	$ 0.13

Diluted earnings per share for the three months ended June 30, 2006 increase from $0.10 to $0.20 when the Series B Convertible Preferred Stock weighted average shares of 7,996,154 and the corresponding $2,465 dividend declared and paid to holders of the Series B Convertible Preferred Stock is included in the computation and therefore have been excluded because of its antidilutive nature for this period. The computation of diluted earnings per share for the six months ended June 30, 2006 of $0.37 reflects the Series B Convertible Preferred Stock as it is not antidilutive with respect to that period. As a result, diluted earnings per share of $0.17 and $0.10 for the three months ended March 31, 2006 and June 30, 2006, respectively, do not sum to the diluted earnings per share amount of $0.37 for the six months ended June 30, 2006.

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(10) Comprehensive Income

The Company s total comprehensive income was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Net earnings	$ 3,377	$ 638	$ 6,165	$ 1,062
Other comprehensive loss:				
Unrealized loss on investments, net of taxes	(1,498)	200	(2,745)	(113)
Reclassification adjustment for losses in net earnings, net of taxes	2		9	39
Unrealized losses on investments	(1,496)	200	(2,736)	(74)
Total comprehensive income	$ 1,881	$ 838	$ 3,429	$ 988

(11) Income Taxes

For the three months ended June 30, 2006, the Company recorded a tax expense of $1,462, or a consolidated tax rate of 30.2%, compared to a tax expense of $326, or a consolidated tax rate of 33.8%, for the three months ended June 30, 2005. For the six months ended June 30, 2006, the Company recorded a tax expense of $2,794, or a consolidated tax rate of 31.2%, compared to a tax expense of $626, or a consolidated tax rate of 37.1%, for the six months ended June 30, 2005. The lower consolidated tax rates for the periods in 2006 compared to 2005 were primarily attributable to a reduction in state income taxes and an increase in investment income received on tax-exempt municipal securities.

(12) Related Party Transactions

In connection with the business produced by DPUI and written on policies of the Capitol Companies, the parties have entered into a management service agreement under which DPUI provides underwriting, management, administration, claims settlement and reinsurance settlement services for the Capitol Companies on this business in exchange for management fees paid by the Capitol Companies to DPUI. The total amount of these fees was $9,726 and $9,845 for the three months ending June 30, 2006 and 2005, respectively, and $20,320 and $17,471 for the six months ending June 30, 2006 and 2005, respectively, which are eliminated in consolidation.

Darwin s condensed consolidated statement of operations reflects fees due to the Capitol Companies for the use of policies of the Capitol Companies for the underwriting of its business. These fees were $86 and $72 for the three months ending June 30, 2006 and 2005, respectively, and $180 and $140 for the six months ending June 30, 2006 and 2005, respectively. Effective January 1, 2006, such fees payable are calculated as 0.5% of premiums written in 2006 by Darwin on policies issued by the Capitol Companies and effective January 1, 2007, this fee will increase to 3.0% of premiums written by Darwin on policies issued by the Capitol Companies.

Certain of Darwin s expenses, primarily its directors and officers liability insurance and its audit fees, have been paid directly by Alleghany and then reimbursed by Darwin to Alleghany. Darwin reimbursed Alleghany for expenses of $46 and $95 in connection with these charges for the three and six months ended June 30, 2006, respectively and $6 for these charges for both the three and six months ended June 30, 2005.

Each of the Darwin and Capitol Companies federal tax liability is determined and settled through a consolidated federal tax return with their ultimate parent, Alleghany. Federal tax payments of $2,707 and $2,267 were made by Darwin to Alleghany during the six months ended June 30, 2006 and 2005, respectively.

(13) Long-Term Incentive Plan

At June 30, 2006 and December 31, 2005, Darwin had recorded liabilities of $2,284 and $2,006, respectively, for the long-term incentive plan. Darwin has not made any payments under the plan.

(14) Segments

Darwin s specialty liability insurance operations comprise one business segment. Management organizes the business around the professional specialty liability insurance market and related products. The Chief Operating Decision Maker reviews results and operating plans and makes decisions on resource allocations on a company-wide basis. The Company s specialty liability insurance business is produced through brokers, agents and program administrators throughout the United States.

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Net premiums earned for the three lines of business is not available as the Company purchases reinsurance that covers parts of more than one line of business, and the Company does not allocate reinsurance costs to each line of business. In addition, as reinsurance costs and structure vary by treaty and the underlying risks and limit profiles of the various products differ, a pro rata allocation of reinsurance across each line of business would not be representative of the actual cost of reinsurance for the line of business. As a result, the net premiums written and earned may not be proportional to the gross premiums written and earned. The following table presents the Company s three specialty liability products gross premiums written and earned for the three and six months ended June 30, 2006 and 2005.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Gross premiums written:				
Directors and officers	$ 12,006	$ 8,509	$ 20,212	$ 14,776
Errors and omissions	24,484	13,816	55,324	26,260
Medical malpractice liability	21,574	14,329	42,412	29,484
Total	$ 58,064	$ 36,654	$ 117,948	$ 70,520
Gross premium earned:				
Directors and officers	$ 9,179	$ 6,845	$ 17,694	$ 13,404
Errors and omissions	20,296	10,945	37,862	20,885
Medical malpractice liability	21,181	12,558	40,332	23,431
Total	$ 50,656	$ 30,348	$ 95,888	$ 57,720

(15) Contingencies

DPUI is subject to routine legal proceedings in the normal course of operating our business. The Company is not involved in any legal proceeding which could reasonably be expected to have a material adverse effect on its business, results of operations or financial condition.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited financial statements and accompanying notes included herein. Some of the information contained in this discussion and analysis or set forth elsewhere in this Form 10-Q constitutes forward-looking statements that involve risks and uncertainties. Please see Note on Forward-Looking Statements for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained herein. Please see Management s Discussion and Analysis of Financial Condition and Results of Operations and our audited December 31, 2005 Consolidated Financial Statements and Notes thereto as presented in our previous filings with the Securities and Exchange Commission, including our Registration Statement on Form S-1 (Reg. No. 333-132355) as amended dated May 18, 2006, for an expanded company history, a detailed discussion of risk factors that may affect our business and other additional information.

Note on Forward Looking Statements

Some statements in this Report are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. All statements other than historical information or statements of current condition contained in this Report, including statements regarding our future financial performance, our business strategy and expected developments in the commercial insurance market, are forward-looking statements. The words expect, intend, plan, believe, project, may, estimate, continue, anticipate, will, and similar expressions of a future or forward-lo nature identify forward-looking statements. We have based these forward-looking statements on management s current expectations. Such statements are subject to a number of risks, uncertainties and other factors that may cause actual events or results to differ materially from those expressed or implied by any of these statements.

Factors that could cause actual events or results to differ materially from our forward-looking statements include, but are not limited to, the following: global economic conditions which could affect the market for specialty liability insurance generally as well as alter the intensity of competition within our markets; changes in the laws, rules and regulations which apply to our insurance companies and which affect how they do business; effects of newly-emerging claim and coverage issues on our insurance businesses, including adverse judicial decisions or regulatory rulings; unexpected loss of key personnel or higher-than-anticipated turnover within our staff; effects of rating agency policies and practices which could impact our insurance companies claims paying and financial strength ratings; market developments affecting the availability and/or the cost of reinsurance, including changes in the recoverability of reinsurance receivables; impact on financial results of actual claims levels exceeding our loss reserves, or changes in what level of loss reserves is estimated to be necessary; impact of industry changes required as a result of insurance industry investigations by state and federal authorities; developments within the securities markets which affect the price or yield on investment securities we purchase and hold in our investment portfolio; our inability for any reason to execute announced and/or future strategic initiatives as planned; and other factors identified in filings with the SEC, including the risk factors set forth in our Registration Statement on Form S-1, as amended, dated May 18, 2006.

These statements should not be regarded as a representation by us or any other person that any anticipated event, future plan or other expectation described or discussed in this Report will be achieved. We undertake no obligation to update publicly or review for any reason any forward-looking statement after the date of this Report or to conform these statements to actual results or changes in our expectations. All subsequent written and oral forward-looking statements attributable to us or individuals acting on our behalf are expressly qualified in their entirety by this paragraph.

Our History

DPUI was originally formed by Stephen Sills, our President and Chief Executive Officer, and Alleghany in March 2003 as an underwriting manager to underwrite professional liability coverages in the D&O, E&O and medical malpractice liability lines for three insurance companies that are wholly-owned subsidiaries of Alleghany: Capitol Indemnity Corporation, Capitol Specialty Insurance Corporation and Platte River Insurance Company (which we refer to, collectively, as the Capitol Companies). DPUI also writes the same professional liability coverages on its two wholly-owned carriers Darwin National Assurance Company (DNA) and Darwin Select Insurance Company (Darwin Select). Since inception, we have had full responsibility for managing the business produced by DPUI and issued on policies of the Capitol Companies, including responsibility for obtaining reinsurance on such business and responsibility for administering claims. Whenever we refer to business generated, written or produced by Darwin, we include business produced by DPUI and written on policies of the Capitol Companies (whether before or after the acquisitions of DNA and Darwin Select), all of which policies are now fully reinsured by DNA.

In February 2004, Alleghany formed Darwin Group, Inc. (Darwin Group), a wholly-owned subsidiary of Alleghany, in order to acquire DNA, an admitted insurance company domiciled in Delaware, from Aegis Holding, Inc., a subsidiary of Associated Electric & Gas Insurance Services Limited. At the time of acquisition, DNA (then named U.S. Aegis Insurance Company) was licensed in 40 states. As of July 31, 2006, DNA was licensed in 48 jurisdictions (including the District of Columbia) and was eligible to write on a surplus lines basis in one additional state (Arkansas).

In May 2005, Darwin Group, through its subsidiary DNA, acquired Darwin Select, a surplus lines insurance company (then named Ulico Indemnity Company) domiciled in Arkansas from Ulico Casualty Company, a subsidiary of ULLICO Inc. As of July 31, 2006, Darwin Select was licensed to write insurance in Arkansas and was eligible to operate on a surplus lines basis in 44 additional states.

Ongoing Arrangements with the Capitol Companies

As described above, DPUI initially was formed as an underwriting manager for the Capitol Companies. Until DNA and Darwin Select obtained independent ratings of A- (Excellent) in November 2005, almost all of the business produced by DPUI was issued on policies of the Capitol Companies. Since DNA and Darwin Select obtained independent ratings from A.M. Best, whenever possible, DPUI has written coverage on policies issued by DNA or Darwin Select. However, our insurance company subsidiaries are not currently licensed (in the case of our admitted carrier DNA) or eligible to write business on a surplus lines basis (in the case of Darwin Select) in all U.S. jurisdictions, and DNA does not yet have in place all rate and form filings required to write insurance business in every jurisdiction where it is licensed. In addition, the Capitol Companies have A.M. Best ratings of A (Excellent), and we believe that insureds in certain classes of our business (primarily public D&O) require policies issued by an insurer with an A.M. Best rating of A (Excellent). Consequently, although we expect to write the majority of our business on policies issued by DNA or Darwin Select, we continue to depend upon the Capitol Companies to write policies for a portion of the business produced by DPUI. These policies are written by the Capitol Companies pursuant to the underwriting management agreements currently in effect and are fully reinsured by DNA.

For the year ended December 31, 2005, we wrote $142.5 million of gross premiums through our arrangement with the Capitol Companies, representing 85.9% of the total gross premiums underwritten by DPUI. Of this amount, $58.5 million, or 35.3% of the total gross premiums produced by DPUI, relates to business written by the Capitol Companies either because the business is in a jurisdiction where our insurance company subsidiaries are not currently licensed or eligible to write business (approximately $26.4 million) or because certain of our insureds require policies issued by an insurer with an A.M. Best rating of A (Excellent) (approximately $32.1 million). By comparison, during the period from January 1, 2006 through June 30, 2006, $81.9 million, or 69.4% of the total gross premiums underwritten by DPUI, was written on policies of our insurance company subsidiaries, and $36.0 million, or 30.6% of such total gross premiums was written on policies of the Capitol Companies. Of this amount, approximately $15.3 million were written in jurisdictions where our insurance company subsidiaries were not licensed or eligible to write business as of the beginning of the most recent quarter and approximately $20.7 million was due to certain of our insureds requiring policies issued by an insurer with an A.M. Best rating of A (Excellent).

We do not expect that our issuance of policies written on the Capitol Companies for the insureds who require an A.M. Best rating of A (Excellent) will continue to decline significantly so long as our rating is A- (Excellent). To date, most of the insureds in this category are public companies purchasing D&O insurance. The following table indicates the amount of public D&O gross premiums written in each of the periods presented as a percentage of total gross premiums written for such period. Management believes that public D&O is the most rating sensitive class of business that we write and, accordingly, that it provides the best available indicator of our level of rating sensitive business.

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Gross Premiums Written	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
	(Dollars in millions)			
Public D&O	$ 10.0	$ 7.3	$ 16.3	$ 12.3
Total Gross Premiums Written	$ 58.1	$ 36.7	$ 117.9	$ 70.5
Percentage of Total Represented by Public D&O	17.2%	19.9%	13.8%	17.4%

While our public D&O writings have declined as a percentage of our total writings, public D&O writings have generally increased in absolute terms as our business has grown. We believe these trends are likely to continue.

We do expect that our issuance of policies written on the Capitol Companies in jurisdictions where our insurance companies are not currently licensed or eligible to write business will decrease as we obtain required licenses or approvals in the various jurisdictions. The following table shows the actual or anticipated filing month of our applications in these jurisdictions by insurance company subsidiary and state as of July 31, 2006:

DNA

State	Actual or Anticipated Application Filing Month
California	August 2006
Wyoming	June 2006

Darwin Select

State	Actual or Anticipated Application Filing Month
Florida	May 2006
Louisiana	August 2006
Minnesota	May 2006
New Hampshire	April 2006
New Mexico	June 2006
New York	April 2006

The timing of the approval of these applications is within the discretion of the various state insurance authorities, and we can provide no assurance as to when, or if, these approvals will be obtained.

Darwin and the Capitol Companies have received regulatory approval from the insurance departments of the relevant states for certain changes to the fee arrangements between Darwin and the Capitol Companies that were agreed to in connection with the Reorganization. The fees charged to Darwin for the issuance of Capitol Companies policies in respect of business produced by DPUI are 0.5% of gross premiums written on policies of the Capitol Companies in 2006, and 3.0% thereafter. In addition, under the new fee arrangements, Darwin is required to reimburse the Capitol Companies for direct expenses that they incur in connection with the issuance of such policies, such as premium taxes and guaranty association assessments. Pursuant to the fee arrangements, Darwin incurred fees to the Capitol Companies of $0.2 million in the first six months of 2006, and reimbursed the Capitol Companies an additional $0.3 million for direct expenses incurred, in connection with the business written on policies of the Capitol Companies. If the fees on the business written on policies of the Capitol Companies had been payable at the maximum rate of 3.0% as provided for under the new fee arrangements, the total fees would have been approximately $1.1 million.

The initial term of the underwriting management agreements between DPUI and the Capitol Companies extends until May 31, 2007 and thereafter renews on an annual basis. However, either party may terminate effective upon an expiration date (whether May 31, 2007 or a subsequent May 31), provided that the terminating party provides 60 days prior notice of termination. In addition, a Capitol Company may terminate at any time, by written notice, when Alleghany does not own at least 51% of the outstanding equity interests in DPUI or upon a sale of all or substantially all of the assets of DPUI to a person other than Alleghany or an affiliate of Alleghany. DPUI may terminate its underwriting management agreement with a Capitol Company at any time, by written notice, when Alleghany does not own at least 51% of the outstanding equity interests in the subject Capitol Company or upon a sale of all or substantially all of the assets of the subject Capitol Company to any person other than Alleghany or an affiliate of Alleghany.

Our Condensed Consolidated Financial Information

The accompanying historical condensed consolidated financial statements are presented on a basis that reflects the actual business written by DPUI, regardless of the originating insurance carrier and include the stand-alone operations of DPUI, Darwin Group and its subsidiaries, DNA and Darwin Select, and certain assets, liabilities and results of operations of the Capitol Companies resulting from the business produced by DPUI and issued on policies of the Capitol Companies. All of the business produced by DPUI and issued on policies of the Capitol Companies was assumed by DNA for all periods presented in these financial statements.

These condensed consolidated financial statements are presented in accordance with U.S. Generally Accepted Accounting Principles (GAAP). The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ significantly from those estimates.

Critical Accounting Estimates

Loss and Loss Adjustment Expense (LAE) Reserves. Darwin establishes reserves on its balance sheets for unpaid losses and LAE related to our insurance contracts. The reserves are our estimated ultimate cost for all reported and unreported loss and LAE incurred and unpaid at the balance sheet date.

The estimate of Darwin s loss and LAE reserves reflects the types of contracts written by Darwin. Darwin s insurance contracts are predominantly written on a claims-made basis. Claims-made insurance contracts are commonly used in Darwin s lines of business and provide coverage for claims related to covered events described in the insurance contract that are made against the insured during the term of the contract and reported to the insurer during a period provided for in the contract.

Darwin has a small number of insurance contracts that are written on an occurrence basis. Occurrence basis insurance contracts provide coverage for losses related to covered events described in the insurance contract that occur during the term of the contract, regardless of the date the loss is reported to the insurer.

For both claims-made and occurrence contracts, a significant amount of time can elapse between the occurrence of an insured event, the reporting of the occurrence to the insurer and the final settlement of the claim (including related settlement costs). Since reporting periods are defined and limited in time under claims-made contracts but are not defined and limited in time under occurrence contracts, the ultimate settlement period for losses incurred under claims-made contracts is generally shorter than under occurrence contracts.

The major components of our loss and LAE reserves are (1) case reserves and (2) IBNR (incurred but not reported) reserves. Both include a provision for LAE. We divide LAE into two types: (1) allocated expenses (ALAE) are those that arise from defending and settling specific claims, such as the cost of outside defense counsel, and (2) unallocated expenses (ULAE) are those that do not arise from and cannot be assigned to specific claims, such as the general expense of maintaining an internal claims department.

Case reserves are liabilities for unpaid losses and ALAE on reported cases. Case reserves are established by claims adjustors as soon as sufficient information has been reported for a reasonable estimate of the expected cost of the claim. The amount of time required for the information to be reported may vary depending on the circumstances of the event that produced the loss. Claim adjustors seek to establish case reserves that are equal to the ultimate payments. The amount of each reserve is based upon an evaluation of the type of claim involved, the circumstances surrounding each claim, the policy provisions relating to the loss, the level of insured deductibles, retentions or co-insurance provisions within the contract and other factors relevant to the specific claim. For claims involving litigation, Darwin utilizes outside attorneys with expertise in the area of litigation as monitoring counsel or defense counsel. In addition to relying on his or her own experience and judgment, a claims adjuster will consider monitoring or defense counsel s estimate of ultimate liability on a claim in the establishment of case reserves. Expenses incurred by the monitoring or defense counsel are included as ALAE reserves. During the loss adjustment period, these estimates are revised as deemed necessary by our claims department based upon developments and periodic reviews of cases. Individual case reserves on all claims are reviewed regularly by claims management. Individual case reserves on severe claims are reviewed for adequacy at least quarterly by senior management.

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IBNR is the estimated liability for (1) changes in the values of claims that have been reported to the company but are not yet settled, as well as (2) claims that have occurred but have not yet been reported. Each claim is settled individually based upon its merits, and it is not unusual for a claim to take years after being reported to settle, especially if legal action is involved. As a result, reserves for unpaid losses and ALAE include significant estimates for IBNR reserves.

Case reserves and IBNR together constitute the reserve for losses and ALAE. An additional ULAE reserve is established on a formula basis as a percentage of premiums earned. In total, these amounts represent management s best estimate, as of each reserve evaluation date, of ultimate settlement costs based on the assessment of facts and circumstances known at that time.

Darwin relies on two actuarial methods that employ significant judgments and assumptions to establish loss and LAE reserves recorded on the balance sheet. Darwin s choice of actuarial methodologies is limited by the fact that, due to Darwin s relatively short history, its loss and LAE emergence since inception lacks sufficient data to be statistically credible for many methodologies.

For each line of business, Darwin uses two methodologies. These methodologies are generally accepted actuarial methods for estimating IBNR and are as follows:

1) *The Bornhuetter-Ferguson (B-F) methodology.* This methodology utilizes:

a) Darwin s initial expected loss ratio. Darwin selects this ratio based on historical insurance industry results. Loss ratio means the ratio of loss and LAE to premiums earned.

b) Expected reporting and development patterns for losses and ALAE. We utilize historical insurance industry results for Darwin s product lines of insurance.

c) Darwin s actual reported losses and ALAE.

The B-F method blends actual reported losses with expected losses based on insurance industry experience.

2) *The Expected Loss Ratio Methodology.* This methodology applies the expected loss ratio to premiums earned (which are the portion of property and casualty premiums written that apply to the expired portion of the policy term). Darwin s selected expected loss ratios under this method are based on historical insurance industry results.

Darwin believes that both of the methodologies used are well-suited to Darwin s relatively short history and few reported losses. In determining loss and LAE reserves, we have generally selected the methodology that indicates the higher reserve. The Expected Loss Ratio methodology has generally produced higher reserve estimates. However, as of June 30, 2006, Darwin s reported losses have reached a level of maturity that has allowed us to introduce an actuarial weighting of the two methodologies. The weighting relies predominantly on the Expected Loss Ratio methodology, but allows the B-F methodology to have a modest impact on our ultimate loss estimates. We expect that weighting of the B-F methodology will increase over time as Darwin s actual loss history becomes more mature and as the volume of business Darwin writes reaches levels where actuarial projections relying on this data are statistically credible.

The two methodologies are complimentary. The Expected Loss Ratio methodology directly reflects the historical, and thus potential, impact of high severity losses. The historical loss ratios that form the basis of the Expected Loss Ratio method are directly impacted by large losses (severity) as they reflect composite industry data. By comparison, the historical insurance industry expected reporting and development patterns utilized in the B-F methodology are most predictive as reported losses mature and/or reach a credible volume. As our losses continue to mature, we expect that the B-F methodology will become a more reliable methodology for us, and that the actuarial weighting that we introduced as of June 30, 2006 will utilize it as a more significant predictor of ultimate loss.

The actuarial weights may be subject to revision as losses are reported and develop toward ultimate values. For example, if all claims reported in an experience year are settled and closed more quickly than expected based upon industry data, the weight applied to the B-F methodology may be adjusted.

The weight applied to the B-F indication for each experience year is 0% at 12 months of maturity and increases to 100% at 72 months of maturity. For example, losses reported to Darwin during 2004:

Are at 12 months of maturity when evaluated on 12/31/04. The B-F indications would receive 0% weighting.

Are at 36 months of maturity when evaluated on 12/31/06. The B-F indications would receive 30% weighting.

Are at 72 months of maturity when evaluated on 12/31/09. The B-F indication would receive 100% weighting.

Complimentary weights are applied to the Expected Loss Ratio methodology for each experience year. This is designed to provide both stability (Expected Loss Ratio method) and moderate responsiveness (B-F method) in determining loss and LAE reserves. The impact of the introduction of the actuarial weighting methodology was a reduction in the net loss and LAE reserves of $341, or 0.2% of the total reserves, reflecting favorable loss and LAE emergence for the 2003 accident year.

Darwin s loss reserve analysis calculates a point estimate rather than a range of reserve estimates. This is done because a significant portion of Darwin s loss and LAE reserves relates to lines of business that are driven by severity rather than frequency of claims. High severity lines of business tend to produce a wide range of reserve estimates which limit the usefulness of the range for selecting reserves. We believe that point estimates based on appropriate actuarial methodologies and reasonable assumptions are more actuarially reasonable. The point estimates are recorded in Darwin s financial statements. Also, we do not discount (recognize the time value of money) in establishing our reserve for losses and LAE.

Darwin could be exposed to losses resulting from a significant liability event, such as an unexpected adverse court decision that impacts multiple insureds, or the occurrence of an unusually high number of liability losses in one reporting period. Such events could have a material adverse impact on Darwin s results during such period. In general, liability claims are susceptible to changes in the legal environment, such as changes in laws impacting claims or changes resulting from judicial decisions interpreting insurance contracts. However, it is often difficult to quantify the impact that such changes in the environment might have on Darwin s reserves. Not all environmental changes are necessarily detrimental to Darwin s loss ratio and reserves. For example, recent medical malpractice tort reform legislation at the state level could result in mitigation of loss which, if not offset by significant reductions in price levels, would result in improvement in Darwin s loss and LAE ratio.

The liabilities that we establish for loss and LAE reserves reflect implicit assumptions regarding economic, legal and insurance variables. These include changes in insurance price levels, the potential effects of future inflation, impacts from law changes and/or judicial decisions, as well as a number of actuarial assumptions that vary across Darwin s lines of business. This data is analyzed by line of business and report/accident year, as appropriate. Along with claim severity, as discussed above and incorporated through the use of industry loss and LAE ratios, two variables that can have significant impact on actuarial analysis of loss and LAE reserves are recent trends in insurance price levels and claim frequency.

Regarding changes in price levels, for its renewals in 2005 and the first six month