

AMERICAN SAFETY INSURANCE HOLDINGS LTD
Form 10-Q
May 10, 2007

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 MARCH 31, 2007

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO _____.

Commission File Number 1-14795

AMERICAN SAFETY INSURANCE HOLDINGS, LTD.

(Exact name of registrant as specified in its charter)

Bermuda Not Applicable (State or other jurisdiction (I.R.S. Employer of incorporation or Identification No.)
organization)

The Boyle Building, 2nd Floor

31 Queen Street

Hamilton HM 11 Bermuda

(Address, zip code of principal executive offices)

(441) 296-8560

(Registrant's telephone number, including area code)

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Indicate by check mark whether 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 such shorter period that registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Yes No

The aggregate number of shares outstanding of registrant's common stock, \$.01 par value, on May 4, 2007 was 10,556,449.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD.

FORM 10-Q

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PART I FINANCIAL INFORMATION**Item 1. Financial Statements**

American Safety Insurance Holdings, Ltd. and Subsidiaries

Consolidated Balance Sheets

| | March 31, <u>2007</u> (Unaudited) | De |
|---|---|---------------|
| Assets | | |
| Investments: | | |
| Fixed maturity securities available for sale, at fair value | \$507,018,878 | \$ 49 |
| Common stock, at fair value | 17,427,952 | 1 |
| Preferred stock, at fair value | 8,221,915 | |
| Short-term investments | <u>36,724,733</u> | <u>4</u> |
| Total investments | 569,393,478 | 55 |
| Cash and cash equivalents | 11,632,740 | 1 |
| Accrued investment income | 4,621,023 | |
| Premiums receivable | 20,765,044 | 2 |
| Ceded unearned premium | 34,202,272 | 3 |
| Reinsurance recoverable | 182,654,578 | 18 |
| Deferred income taxes | 9,886,516 | 1 |
| Deferred policy acquisition costs | 13,818,042 | 1 |
| Property, plant and equipment, net | 8,022,150 | |
| Other assets | <u>9,256,953</u> | |
| Total assets | \$864,252,796 ===== | \$84 ===== |

See accompanying notes to consolidated financial statements (unaudited).

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| | March 31, <u>2007</u> (Unaudited) | Dece |
|--|---|-------|
| Liabilities and Shareholders' Equity | | |
| Liabilities: | | |
| Unpaid losses and loss adjustment expenses | \$ 452,451,337 | \$ 43 |
| Unearned premiums | 113,986,081 | 11 |
| Ceded premiums payable | 23,255,043 | 2 |
| Deferred revenues | 1,269,849 | |
| Accounts payable and accrued expenses | 8,330,896 | 1 |
| Deferred rent | 1,538,987 | |
| Loans payable | 38,269,093 | 3 |
| Funds held | 17,350,310 | 1 |
| Minority interest | <u>3,306,249</u> | |

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| | | |
|---|--------------------|-----------|
| Total liabilities | <u>659,757,845</u> | 65 |
| Shareholders' equity: | | |
| Preferred stock, \$0.01 par value; authorized 5,000,000 shares; no shares issued and outstanding | - | |
| Common stock, \$0.01 par value; authorized 15,000,000 shares; issued and outstanding at March 31, 2007, 10,556,449 and December 31, 2006, 10,554,200 shares | 105,564 | |
| Additional paid-in capital | 104,659,756 | 10 |
| Retained earnings | 98,081,650 | 9 |
| Accumulated other comprehensive income, net | <u>1,647,981</u> | |
| Total shareholders' equity | <u>204,494,951</u> | <u>19</u> |
| Total liabilities and shareholders' equity | \$ 864,252,796 | \$84 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements (unaudited).

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American Safety Insurance Holdings, Ltd. and Subsidiaries
Consolidated Statements of Earnings
(Unaudited)

| | Three Months Ended | |
|-------------------------------------|---------------------|---------------------|
| | <u>March 31,</u> | |
| | <u>2007</u> | <u>2006</u> |
| Revenues: | | |
| Direct premiums earned | \$55,122,309 | \$ 55,834,320 |
| Assumed premiums earned | 1,512,500 | - |
| Ceded premiums earned | <u>(18,276,562)</u> | <u>(21,144,613)</u> |
| Net premiums earned | 38,358,247 | <u>34,689,707</u> |
| Net investment income | 7,223,945 | 4,543,643 |
| Net realized gains | 18,958 | 362,984 |
| Fee income | 515,625 | 492,471 |
| Other income | <u>16,985</u> | <u>16,570</u> |
| Total revenues | 46,133,760 | <u>40,105,375</u> |
| Expenses: | | |
| Losses and loss adjustment expenses | 23,951,284 | 22,155,055 |
| Acquisition expenses | 6,118,237 | 7,054,535 |
| Payroll and related expenses | 4,154,397 | 3,542,467 |
| Real estate expenses | 22,594 | 67,040 |
| Other expenses | 3,405,048 | 2,738,489 |
| Interest expense | 816,407 | 903,046 |
| Minority interest | <u>115,101</u> | <u>(472,456)</u> |
| Total expenses | <u>38,583,068</u> | <u>35,988,176</u> |
| Earnings before income taxes | 7,550,692 | 4,117,199 |
| Income taxes | <u>458,592</u> | <u>16,200</u> |
| Net earnings | \$ 7,092,100 | \$ 4,100,999 |
| | ===== | ===== |
| Net earnings per share: | | |
| Basic | <u>\$ 0.67</u> | <u>\$ 0.61</u> |

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| | | |
|---|----------------|----------------|
| Diluted | <u>\$ 0.65</u> | <u>\$ 0.57</u> |
| Weighted Average number of shares outstanding | | |
| Basic | 10,555,849 | 6,762,687 |
| | ===== | ===== |
| Diluted | 10,930,939 | 7,164,244 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements (unaudited).

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American Safety Insurance Holdings, Ltd. and Subsidiaries

Consolidated Statements of Cash Flow

(Unaudited)

| | Three Month March 31 <u>2007</u> |
|---|--|
| Cash flow from operating activities: | |
| Net earnings | \$7,092,100 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | |
| Realized gains on investments | (18,958) |
| Depreciation expense | 674,327 |
| Stock based compensation expense | 126,096 |
| Amortization of deferred acquisition costs, net | (1,415,278) |
| Amortization of premiums on investments | 125,370 |
| Deferred income taxes | 84,154 |
| Change in operating assets and liabilities | |
| Accrued investment and interest income | (321,345) |
| Premiums receivable | 982,864 |
| Reinsurance recoverable | 2,355,915 |
| Ceded unearned premiums | 1,695,174 |
| Funds held | 1,021,701 |
| Unpaid losses and loss adjustment expenses | 12,777,841 |
| Unearned premiums | (1,211,723) |
| Ceded premiums payable | (2,207,865) |
| Deferred revenues | 77,144 |
| Accounts payable and accrued expenses | (3,480,066) |
| Deferred rent | 129,647 |
| Other, net | <u>429,540</u> |
| Net cash provided by operating activities | <u>18,916,638</u> |
| Cash flow from investing activities: | |
| Purchases of fixed maturities | (37,134,960) |
| Purchases of common stock | (5,138,784) |
| Purchases of preferred stock | - |
| Proceeds from sale of fixed maturities | 21,325,653 |
| Proceeds from sale of common stock | 112,911 |
| Decrease in short-term investments | 3,880,939 |
| Purchase of fixed assets, net | <u>(1,642,508)</u> |

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Net cash used in investing activities

(18,596,749)

Continued on page 5

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| | Three Month <u>March 31</u> <u>2007</u> |
|---|---|
| Cash flow from financing activities: | |
| Proceeds from issuance of common stock | <u>19,555</u> |
| Net cash provided by financing activities | 19,555 |
| Net increase in cash and cash equivalents | 339,444 |
| Cash and cash equivalents at beginning of period | <u>11,293,296</u> |
| Cash and cash equivalents at end of period | \$ 11,632,740 |
| | ===== |
| Supplemental disclosure of cash flow information: | |
| Income taxes paid | \$ - |
| | ===== |
| Interest paid | \$ 783,460 |
| | ===== |
| Non-cash activity (1) | |
| Fixed asset additions | \$ 1,409,340 |
| | ===== |
| Deferred rent | \$ 1,409,340 |
| | ===== |

(1) Represents tenant build out allowance and future reduction in rent over the term of the lease.

See accompanying notes to consolidated financial statements (unaudited).

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American Safety Insurance Holdings, Ltd. and Subsidiaries

Consolidated Statements of Comprehensive Earnings

(Unaudited)

| | Three Months <u>March 31</u> <u>2007</u> | \$ 4,1 |
|---|--|--------|
| Net earnings | \$ 7,092,100 | |
| Other comprehensive earnings before income taxes: | | |
| Unrealized gains (losses) on securities available-for-sale, net of minority interest of | | |

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| | | |
|---|------------------|-------------|
| \$15,947 and \$(239,276) for 2007 and 2006, respectively | 1,390,335 | (3,7 |
| Unrealized gains (losses) on hedging transaction | (73,913) | |
| Reclassification adjustment for realized gains included in net earnings | <u>(18,958)</u> | <u>(3</u> |
| Total other comprehensive earnings (loss) before taxes | 1,297,464 | (4,0 |
| Income tax expense (benefit) related to items of other comprehensive income, net of minority interest of \$(7,483) and \$(81,352) for March 31, 2007 and 2006 respectively. | <u>190,371</u> | <u>(8</u> |
| Other comprehensive earnings (loss) net of income taxes | <u>1,107,093</u> | <u>(3,1</u> |
| Total comprehensive earnings | \$8,199,193 | \$ 9 |
| | ===== | ===== |
| See accompanying notes to consolidated financial statements (unaudited). | | |

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American Safety Insurance Holdings, Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

March 31, 2007

(Unaudited)

Note 1 Basis of Presentation

The accompanying consolidated financial statements of American Safety Insurance Holdings, Ltd. (American Safety Insurance) and its subsidiaries and American Safety Risk Retention Group, Inc. (American Safety RRG), a non-subsidiary risk retention group affiliate (collectively, the Company) are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of financial statements in conformity with GAAP requires management to make estimates, based on the best information available, in recording transactions resulting from business operations. The balance sheet amounts that involve a greater extent of accounting estimates and/or actuarial determinations subject to future changes are the Company s invested assets, deferred income taxes, and the liabilities for unpaid losses and loss adjustment expenses. As additional information becomes available (or actual amounts are determinable), the recorded estimates may be revised and reflected in operating results. While management believes that these estimates are adequate, such estimates may change in the future.

The results of operations for the three months ended March 31, 2007 may not be indicative of the results that may be expected for the fiscal year ending December 31, 2007. These unaudited interim consolidated financial statements and notes should be read in conjunction with the financial statements and notes included in the audited consolidated financial statements on Form 10-K of the Company for the fiscal year ended December 31, 2006.

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The unaudited interim consolidated financial statements include the accounts of American Safety Insurance, each of its subsidiaries and American Safety RRG. All significant intercompany balances have been eliminated.

Note 2 Accounting Pronouncements

During the last two years, the Financial Accounting Standard Board (FASB) has issued a number of accounting pronouncements with various effective dates.

In February 2006, the FASB issued Statement Number 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statement No. 133 and 144. This statement permits fair value measurement for any hybrid financial instruments that contain an embedded derivative that otherwise would require bifurcation. This statement is effective for financial statements issued for fiscal years beginning after September 15, 2006. This statement had no impact on the Company as it does not have any hybrid financial instruments.

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In April 2006, the FASB issued a Staff Position Number FIN 46(R)-6, Determining the Variability to be Considered in Applying FASB Interpretation No. 46(R) (FSP 46R-6). FSP 46R-6 responds to the need for guidance on the relevant risks and rewards that must be identified and evaluated in order to apply FIN 46(R) and is effective for fiscal periods beginning after June 15, 2006. This pronouncement had no impact on the Company as it already consolidates its non-subsidiary affiliate American Safety RRG.

In July 2006, the FASB issued Staff Position Number FIN 48 (FIN 48), Accounting for Uncertainty in Income Taxes. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB statement number 109, Accounting for Income Taxes. This interpretation prescribes a recognition threshold and measurement attributable to the financial statement recognition and measurement of an uncertain tax position taken or expected to be taken in a tax return. The Company has adopted this statement, and based on its analysis it has had no material impact on the Company's financial statements. See Note 6 Income Taxes for additional information.

In September 2006, the FASB issued Statement Number 157, Fair Value Measurements. Prior to this statement, there were different definitions of fair value in GAAP. Moreover, that guidance was dispersed among the many accounting pronouncements that require fair value measurements. This statement creates a single set of guidelines for measuring fair value. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. At the present time, it is expected that this statement will not have a material impact on the Company's financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards Number 159, The Fair Value Option for Financial Assets and Liabilities. This statement allows companies to elect to carry the vast majority of financial assets and liabilities at fair value, with changes in fair value recorded into earnings. This statement is effective for fiscal years beginning after November 15, 2007. The Company has chosen not to adapt this pronouncement.

In April 2007, the FASB issued exposure Draft No. 1530-100 proposing FASB Statement of Financial Accounting Standards (SFAS), Accounting for Financial Guarantee Insurance Contracts an interpretation of FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises. The SFAS as proposed would clarify how SFAS No. 60 applies to financial guarantee insurance contracts and provides guidance on the method of accounting for such contracts. This statement, if adopted as proposed, would be effective for fiscal years beginning after December 31, 2007. The Company does not issue financial guarantee insurance contracts and expects that this statement if adopted as proposed will not have a material impact on the Company's financial statements.

Note 3 Nature of Operations

We are a specialty insurance company that provides customized insurance products and solutions to small

and medium-sized business in industries that we believe are underserved by the standard insurance market. For over twenty years we have developed specialized insurance coverages and alternative risk transfer products not generally available to our customers in the standard insurance market because of the unique characteristics of the risks involved and the associated needs of the insureds. We specialize in underwriting these products for insureds with environmental risks, construction risks and other specialty risks, as well as in developing programs for other specialty classes of risk. See Part II Other Information, Item 1A-Risk Factors for risks facing the Company.

Note 4 Investments

The amortized cost and estimated fair values of the Company's investments at March 31, 2007 and December 31, 2006 are as follows:

| | Amortized <u>Cost</u> | Gross unrealized <u>gains</u> | Gross unrealized <u>losses</u> |
|---|--------------------------|-------------------------------------|--------------------------------------|
| March 31, 2007: | | | |
| Securities available for sale: | | | |
| Fixed maturities: | | | |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | \$135,379,465 | \$ 393,398 | \$ 977,534 |
| States of the U.S. and political subdivisions of the states | 7,575,705 | 47,610 | 189,919 |
| Corporate securities | 138,932,362 | 923,933 | 603,632 |
| Mortgage-backed securities | <u>226,343,451</u> | <u>829,072</u> | <u>1,635,033</u> |
| Total fixed maturities | \$ 508,230,983 ===== | \$ 2,194,013 ===== | \$ 3,406,118 ===== |
| Common Stock | \$ 15,284,511 ===== | \$ 2,565,791 ===== | \$ 422,350 ===== |
| Preferred Stock | \$ 7,906,620 ===== | \$ 317,895 ===== | \$ 2,600 ===== |
| Total | \$ 531,422,114 ===== | \$ 5,077,699 ===== | \$3,831,068 ===== |
| December 31, 2006: | | | |
| Securities available for sale: | | | |
| Fixed maturities: | | | |
| U.S. Treasury securities and obligations of U.S. Government corporations and agencies | \$ 123,390,583 | \$ 368,236 | \$ 1,378,807 |
| States of the U.S. and political subdivisions of the states | 7,584,447 | 42,338 | 238,041 |
| Corporate securities | 131,469,859 | 814,574 | 812,477 |
| Mortgage-backed securities | <u>230,080,072</u> | <u>731,214</u> | <u>2,020,332</u> |
| Total fixed maturities | \$ 492,524,961 ===== | \$ 1,956,362 ===== | \$ 4,449,657 ===== |
| Common stock | \$ 10,258,638 ===== | \$ 2,491,431 ===== | \$ 347,112 ===== |
| Preferred stock | \$ 7,906,620 ===== | \$ 221,830 ===== | \$ 10,390 ===== |
| Total | \$ 510,690,219 ===== | \$ 4,669,623 ===== | \$ 4,807,159 ===== |

Note 5 Segment Information

We segregate our business into real estate operations, insurance operations and other, with the insurance operations segment being further classified into four additional segments: excess and surplus lines (E&S), alternative risk transfer (ART), assumed reinsurance (Assumed Re) and runoff. E&S is further classified into five business lines: environmental, construction, non-construction, excess and surety. ART is further classified into two business lines: specialty programs and fully funded and partially funded. Run-off includes lines of business that we no longer write. Prior year amounts have been reclassified to conform to the current year presentation. Our real estate operations consist solely of our development of the Harbour Village property which is essentially complete.

In E&S, Environmental writes insurance coverages to protect against environmental exposures for the environmental remediation industry and property owners. Construction provides commercial casualty insurance coverages, generally in the area of residential and commercial contractors. Non-construction offers general liability and product liability coverage for smaller manufacturers and distributors, non-habitational real estate and certain owner, landlord and tenant risks. Excess provides excess and umbrella liability over the primary casualty policies of other carriers, with a focus on construction risks. Surety provides payment and performance bonds primarily to the environmental remediation and construction industries.

In our Assumed Re segment, the Company assumes specialty property and casualty business from unaffiliated insurers and reinsurers.

In our ART segment, Specialty Programs facilitates the offering of insurance to homogeneous niche groups of risks. Fully funded provides a mechanism for insureds to post collateral so as to fully, self-insure their risks. In addition we offer a partially funded product to compliment our fully funded product. We are paid a fee for arranging this type of transaction and in the case of partially funded business we may assume some underwriting risks.

Our Run-off segment includes lines of business that we have placed in run-off, such as workers compensation, excess liability insurance for municipalities and commercial lines.

The Other segment consists of amounts associated with realized gains and losses on investments.

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The following table presents key financial data by segment for the three months ended March 31, 2007 and March 31, 2006 (in thousands):

| March 31, 2007 | Real Estate | | Insurance | | | | | | |
|-----------------------------------|-------------|--------|------------|--------|--------|------------|--------------------|-------|-----|
| | | | E&S | | | Assumed Re | | ART | |
| | Env. | Const. | Non-Const. | Excess | Surety | Assumed Re | Specialty Programs | FF | |
| Gross premiums written | 13,138 | 15,993 | 811 | 1,969 | 1,310 | 2,769 | 19,433 | - | |
| Net premiums written | - | 10,747 | 15,702 | 406 | 261 | 1,270 | 2,769 | 7,687 | - |
| Net premiums earned | - | 9,526 | 20,365 | 461 | 227 | 915 | 1,513 | 5,351 | - |
| Fee income earned | - | - | - | - | - | - | - | - | 516 |
| Losses & loss adjustment expenses | - | 5,638 | 12,990 | 299 | 148 | 320 | 1,008 | 3,549 | - |
| Acquisition expenses | - | 2,334 | 3,802 | (330) | (87) | 231 | 300 | (132) | - |
| Underwriting profit (loss) | - | 1,554 | 3,573 | 492 | 166 | 364 | 205 | 1,934 | 516 |

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| | | |
|------------------------------|------|---------|
| Income tax expense (benefit) | (8) | 468 |
| Net earnings (loss) | (14) | 7,087 |
| Assets | 114 | 864,139 |
| Equity | 236 | 204,360 |

| March 31, 2006 | Real Estate | Insurance | | | | | | | |
|-----------------------------------|-------------|-----------|--------|------------|------------|---------|------------|--------------------|-----|
| | | E&S | | | Assumed Re | | ART | | FF |
| | | Env. | Const. | Non-Const. | Excess | Surety | Assumed Re | Specialty Programs | |
| Gross premiums written | - | 12,641 | 22,453 | - | 611 | 870 | - | 16,345 | - |
| Net premiums written | - | 8,071 | 20,185 | - | 168 | 440 | - | 4,526 | - |
| Net premiums earned | - | 8,320 | 20,913 | - | 122 | 353 | - | 4,982 | - |
| Fee income earned | - | - | - | - | - | - | - | - | 492 |
| Losses & loss adjustment expenses | - | 5,695 | 13,485 | - | 73 | 125 | - | 3,077 | - |
| Acquisition expenses | - | 2,641 | 4,174 | - | (32) | 88 | - | 184 | - |
| Underwriting profit (loss) | - | (16) | 3,254 | - | 81 | 140 | - | 1,721 | 492 |
| Income tax expense (benefit) | (25) | | | | | (41) | | | |
| Net earnings (loss) | (42) | | | | | 3,863 | | | |
| Assets | 2,468 | | | | | 703,776 | | | |
| Equity | 715 | | | | | 119,095 | | | |

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The Company conducts business in two geographic segments: United States and Bermuda. Significant differences exist in the regulatory environment in each country, which requires the Company to set forth operations by those geographic segments. The table below describes the Company's operations by geographic segment for the three months ended March 31, 2007 and March 31, 2006 (in thousands):

March 31, 2007

United States

Bermuda

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| | | | |
|----------------|---------------|------------|----|
| Income tax | \$ 459 | \$ - | \$ |
| Net earnings | \$ 864 | \$ 6,228 | \$ |
| Assets | \$519,465 | \$ 344,788 | \$ |
| Equity | \$ 68,923 | \$ 135,572 | \$ |
| March 31, 2006 | United States | Bermuda | |
| Income tax | \$ 16 | \$ - | \$ |
| Net earnings | \$1,046 | \$ 3,055 | \$ |
| Assets | \$533,836 | \$ 172,388 | \$ |
| Equity | \$ 58,348 | \$ 61,359 | \$ |

Note 6 Income Taxes

Total income tax expense (benefit) for the periods ended March 31, 2007 and 2006 was allocated as follows:

| | Three Months Ended <u>March 31,</u> | |
|---|--|---------------------------------|
| | <u>2007</u> | <u>2006</u> |
| Tax expense (benefit) attributable to: | | |
| Income from continuing operations | \$ 458,592 | \$ 16,200 |
| Change in unrealized gains (losses) on hedging transactions | (25,130) | 24,717 |
| Change in unrealized gains (losses) on available for sale securities | <u>222,984</u> 656,446 | <u>(981,869)</u> \$(940,952) |
| Total | ===== | ===== |

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U.S. Federal and state income tax expense (benefit) from continuing operations consist of the following components:

| | Three Months Ended <u>March 31,</u> | |
|-------------------------------|--|--------------------|
| | <u>2007</u> | <u>2006</u> |
| Current | \$ 427,093 | \$ (123,162) |
| Deferred | 84,154 | 139,362 |
| Change in valuation allowance | <u>(52,655)</u> | <u>-</u> |
| Total | \$ 458,592 ===== | \$ 16,200 ===== |

The state income tax expense aggregated \$8,354 and \$15,168 for the three months ended 2006, respectively, and is included in the current provision.

Income tax expense from continuing operations for the periods ended March 31, 2007 from the amount computed by applying the U.S. Federal income tax rate of 34% to earnings before income taxes as a result of the following:

Three Months Ended
March 31,

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| | 2007 | 2006 |
|--|---------------|------------------|
| Expected income tax expense | \$2,567,235 | \$1,399,848 |
| Foreign earned income not subject to direct taxation | (2,117,500) | (1,038,762) |
| Change in valuation allowance | (52,655) | - |
| Tax-exempt interest | - | (202,055) |
| State taxes and other | <u>61,512</u> | <u>(142,831)</u> |
| Total income tax | \$ 458,592 | \$ 16,200 |
| | ===== | ===== |

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Deferred income taxes are based upon temporary differences between the financial statement and tax bases of assets and liabilities. The following deferred taxes are recorded:

| | March 31, <u>2007</u> | December 31, <u>2006</u> |
|---|--------------------------|-----------------------------|
| Deferred tax assets: | | |
| Loss reserve discounting | \$ 8,677,945 | \$ 8,095,876 |
| Unearned premium reserves | 2,554,650 | 2,365,798 |
| Warranty reserve | 18,378 | 152,475 |
| Unrealized loss on securities | 211,160 | 434,144 |
| NOL Carry forward | 778,573 | 817,709 |
| Other | <u>211,545</u> | <u>332,602</u> |
| Gross deferred tax assets | 12,452,251 | 12,198,604 |
| Valuation allowance | <u>(1,089,324)</u> | <u>(1,141,979)</u> |
| Gross deferred tax assets after valuation allowance | 11,362,927 | 11,056,625 |
| Deferred tax liabilities: | | |
| Deferred acquisition costs | 1,370,292 | 809,507 |
| Unrealized gains on hedging transaction | <u>106,119</u> | <u>131,249</u> |
| Gross deferred tax liabilities | <u>1,476,411</u> | <u>940,756</u> |
| Net deferred tax asset | \$9,886,516 | \$10,115,869 |
| | ===== | ===== |

The Company adopted the provisions of FIN 48 on January 1, 2007. In completing its FIN 48 analysis, the Company determined that it did not have any liability for unrecognized tax benefits. The Company does not believe it would be subject to any penalties in any open tax years and, therefore, has not booked any such amounts. The Company would classify interest (if applicable) as interest expense and penalties (if applicable), in operating expenses in the Company's financial statements.

Note 7 Employee Stock Options

The Company's stock option plan grants incentive stock options to employees. The majority of the options outstanding under the plan vest evenly over a three year period and have a term of 10 years. The Company uses the Black-Scholes option pricing model to value stock options. The Company's methodology for valuing options has not changed from December 31, 2006. During the first quarter of 2007, the Company granted 67,500 options compared to 54,000 for the same period of 2006.

The Company started applying the recognition and measurement principles of SFAS No. 123R, Share Based Payment, in the first quarter of 2006. Stock based compensation expense was \$126,096 and \$140,556 for the first quarter of 2007 and 2006, respectively, and is reflected in net earnings under payroll and other related expenses.

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

We are a specialty insurance company that provides customized insurance products and solutions to small and medium-sized businesses in industries that we believe are underserved by the standard insurance market. For over twenty years, we have developed specialized insurance coverages and alternative risk transfer products not generally available to our customers in the standard insurance market because of the unique characteristics of the risks involved and the associated needs of the insureds. We specialize in underwriting these products for insureds with environmental risks and construction risks as well as in developing programs for other specialty classes of risks.

We segregate our business into real estate operations, insurance operations and other, with the insurance operations segment further classified into four additional segments: excess and surplus lines, alternative risk transfer, runoff and a new segment, assumed reinsurance. The excess and surplus lines segment is then further classified into five business lines: environmental, construction, surety, non-construction and excess. The alternative risk transfer segment is further classified into two business lines: specialty programs and fully funded and partially funded. Assumed reinsurance consists of specialty property and casualty business assumed from unaffiliated insurers and reinsurers which began operations in the first quarter of 2007. Our run-off segment includes lines of business that we have placed in run-off, such as workers compensation, excess liability insurance for municipalities and commercial lines. Our other segment consists of amounts associated with realized gains and losses on investments. Our real estate operations consist solely of our development of the Harbour Village property.

The following information is presented on the basis of accounting principles generally accepted in the United States of America (GAAP) and should be read in conjunction with our unaudited consolidated financial statements and the related notes included elsewhere in this report. All amounts and percentages are rounded.

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The table below summarizes the Company's net premiums written and net premiums earned by business line, consolidated revenues and percentage change year over year:

| | Three Months Ended | | 2007 to 2006 |
|----------------------------|--------------------|-----------------|--------------------|
| | March 31, | | |
| | 2007 | 2006 | |
| | (in thousands) | | |
| Net premiums written: | | | |
| Excess and Surplus Lines: | | | |
| Environmental | \$10,747 | \$8,071 | 33.2% |
| Construction | 15,702 | 20,185 | (22.2) |
| Non-construction | 406 | - | 100.0 |
| Excess | 261 | 168 | 55.4 |
| Surety | <u>1,270</u> | <u>440</u> | <u>188.6</u> |
| Total | 28,386 | 28,864 | (1.7) |
| Alternative Risk Transfer: | | | |
| Specialty Programs | 7,687 | 4,526 | 69.9 |
| Assumed Reinsurance | 2,769 | - | 100.0 |
| Run-off | <u>-</u> | <u>-</u> | <u>-</u> |
| Total net premiums written | <u>\$38,842</u> | <u>\$33,390</u> | <u>16.3%</u> |
| Net premiums earned: | | | |
| Excess and Surplus Lines: | | | |
| Environmental | \$9,526 | \$8,320 | 14.5% |
| Construction | 20,365 | 20,913 | (2.6) |
| Non-construction | 461 | - | 100.0 |
| Excess | 227 | 122 | 86.1 |
| Surety | <u>915</u> | <u>353</u> | <u>159.2</u> |
| Total | 31,494 | 29,708 | 6.0 |
| Alternative Risk Transfer: | | | |
| Specialty Programs | 5,351 | 4,982 | 7.4 |
| Assumed Reinsurance | 1,513 | - | 100.0 |
| Run-off | <u>-</u> | <u>-</u> | <u>-</u> |
| Total net premiums earned | <u>38,358</u> | <u>34,690</u> | <u>10.6</u> |

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| | | | |
|-----------------------|-----------------------|-----------------------|--------------------|
| Net investment income | 7,224 | 4,544 | 59.4 |
| Net realized gains | 19 | 363 | (94.8) |
| Fee income | 516 | 492 | 4.9 |
| Other income | <u>17</u> | <u>16</u> | <u>6.3</u> |
| Total Revenues | \$46,134 ===== | \$40,105 ===== | 15.0% ===== |

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The following table sets forth the components of our GAAP combined ratio for the period indicated:

| | Three Months Ended | |
|--------------------------------------|--------------------|-------------|
| | <u>March 31,</u> | |
| | <u>2007</u> | 2006 |
| Loss & loss adjustment expense ratio | 62.4% | 63.9% |
| Expense ratio | <u>33.1</u> | <u>35.6</u> |
| Combined ratio | 95.5% | 99.5% |
| | ===== | ===== |

Net Premiums Earned

Excess and Surplus Lines

Environmental. Net premiums earned increased 14.5% to \$9.5 million for the three months ended March 31, 2007, compared to \$8.3 million for the same period of 2006. The accrual of \$1.8 million of reinstatement premiums resulting from the settlement of a prior year claim negatively impacted net premium earned for 2006. The Company has experienced rate declines averaging in the 10% range in the environmental line for 2007.

Construction. Net premiums earned decreased 2.6% to \$20.4 million for the three months ended March 31, 2007, compared to \$20.9 million for the same period of 2006. During the first quarter of 2007, the Company saw a significant decline in the western states book of business, partially offset by geographic expansion efforts. The principal reason driving the decline was lower renewal retention rates in the western states as the Company continues to exercise underwriting discipline in a more competitive market. The effects of a slowing housing market, which translated into lower average premiums per account and a reduction in audit premiums, also contributed to the decline. Construction premiums were further impacted by rate declines on the Company's book of business averaging in the 10% range.

Non-Construction. The Company's non-construction general liability line, which began production in the second half of 2006, produced \$461,000 of net premiums earned for the three months ended March 31, 2007. This line offers both primary and excess products to smaller manufacturers, distributors, non-habitational real estate and certain owner, landlord and tenant risks. The Company does not intend to write certain high severity classes of products risks such as invasive medical products, pharmaceuticals and neutraceuticals.

Excess. Net premiums earned increased 86.1% to \$227,000 for the three months ended March 31, 2007, compared to \$122,000 for the same period of 2006. The Company's excess product offering is focused primarily in the construction and products liability areas. The addition of the new underwriting team in Middletown New Jersey in 2006 has allowed the Company to expand its excess liability products to write over other carriers' primary policies and to offer umbrella liability coverage.

Surety. Net premiums earned increased 159.2% to \$915,000 for the three months ended March 31, 2007, compared to \$353,000 for the same period of 2006. Effective June 1, 2006 the Company did not renew the quota share reinsurance treaty in its surety line, resulting in an increase in net retentions and, as a result, an increase in net premiums earned. The increase in surety premiums is also due to the Company continuing to focus its growth efforts in the environmental contractor surety market because of the lack of capacity serving this segment of the market. In 2006, the Company expanded its offerings to include non-environmental contractor bonds.

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Alternative Risk Transfer

Specialty Programs. Net premiums earned increased 7.4% to \$5.4 million for the three months ended March 31, 2007, compared to \$4.9 million for the same period of 2006. Net premiums earned increased primarily due to increased retention levels in our specialty programs, thereby allowing the Company the opportunity to increase its earnings potential from underwriting profits. The Company's focus in its specialty programs business line is on insurance programs that allow the Company to participate in underwriting profits while also earning fee income as the policy-issuer.

Fee Income Earned. Fee income earned on fully funded policies increased 4.9% to \$516,000 for the three months ended March 31, 2007, compared to \$492,000 for the same period of 2006. In 2006, the Company added a fully funded product for property catastrophe exposures due to the limited capacity of affordable insurance for the middle market insureds. The Company's products in this line had previously been focused on the construction and health care industries. The Company has seen some adverse impact from the overall market softening on its production efforts in this line as declines in traditional insurance pricing provide a cost effective alternative to self-insurance.

We introduced a partially funded product during the fourth quarter of 2006 to complement our fully funded product. This product is used for entities that want to self insure a portion of their risk and combines a level of underwriting risk with a self-insured component. This is a new product for the Company and there were no fees generated in the first quarter of 2007.

Assumed Reinsurance. The Company through its Bermuda based reinsurance operation, assumes specialty property and casualty business from unaffiliated insurers and reinsurers. In the first quarter of 2007, the Company entered into small participations on four treaties, including treaties covering directors and officers liability, property catastrophe and excess auto liability. This line of business generated \$1.5 million in net premiums earned for the three months ended March 31, 2007.

Net Investment Income

Net investment income increased 59.4% to \$7.2 million for the three months ended March 31, 2007, compared to \$4.5 million for the same period of 2006, due to an increase in the Company's invested assets and higher investment yields. Average invested assets increased to \$560.3 million at March 31, 2007 from \$418.5 million at March 31, 2006, reflecting \$53 million of proceeds from the Company's secondary equity offering in June 2006 and positive cash flows. The average pre-tax and after tax investment yields were 5.2% and 4.4% compared to 4.3% and 3.6% for the three months ended March 31, 2007 and 2006, respectively.

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Net Realized Gains

Net realized gains from the sale of investments decreased 94.8% to \$19,000 for the three months ended March 31, 2007, compared to \$363,000 for the same period of 2006. The Company from time to time may sell securities to fund the cash needs of individual operating subsidiaries or in response to market conditions or interest rate fluctuations in accordance with its investment guidelines.

Losses and Loss Adjustment Expenses

The Company's losses and loss adjustment expense ratio decreased 1.5 percentage points to 62.4% for the three months ended March 31, 2007, from 63.9% for the same period of 2006. The decrease is attributable to an increase in net premiums earned and lower prior year reserve development. For the quarter ended March 31, 2007 the Company had \$436,000 of reserve strengthening resulting from the commutation of a reinsurance agreement with a former program manager compared to \$688,000 of prior year reserve development during the first quarter of 2006. The \$688,000 was related to the settlement of a prior year claim which resulting in \$1.0 million of reserve strengthening, offset in part by favorable development in the Company's environmental business line. Due to the softening in the market, the Company increased its 2007 expected loss ratio.

Acquisition Expenses

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Policy acquisition expenses are amounts that are paid to producers of premiums. These expenses are offset in part by the ceding commissions we receive from our reinsurers. For our program business, fees typically are earned through ceding commissions and have the effect of lowering our acquisition expenses. Policy acquisition expenses decreased to \$6.1 million for the three months ended March 31, 2007, compared to \$7.1 million for the same period of 2006 and as a percentage of net premiums earned, decreased to 16.0% for the three months ended March 31, 2007, compared to 20.3% for the same period of 2006. The decrease in the ratio is due to increased retentions, the change in mix of business in the Company's premium writings and lowered net premiums earned in the first quarter of 2006 as the Company accrued \$1.8 million in reinstatement premiums during that period.

Minority Interest Expense

Minority interest expense is associated with our non-subsidiary affiliate, American Safety RRG. Minority interest expense was \$115,000 for the three months ended March 31, 2007, compared to negative \$472,000 for the same period of 2006. The driver for the change was that, in the first quarter of 2006, American Safety RRG included in expenses \$764,000 related to the settlement of a prior year claim.

Payroll and Other Expenses

Payroll and other expenses increased 20.4% to \$7.6 million for the three months ended March 31, 2007, compared to \$6.3 million for the same period of 2006. The change is due to an increase in head count, which is primarily related to the addition of a claims handling office in California and an underwriting office in New Jersey, and increases in rent expense, depreciation, expenses for allowance for doubtful accounts and costs associated with the relocation of our U.S. subsidiaries.

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Income Taxes

Income tax expense for the first quarter of 2007 was \$459,000 or 6% of pre-tax income, compared to \$16,000, or less than 1% of pre-tax income for the same period of 2006. The primary reason for the lower tax rate in the first quarter of 2006 was the settlement of a prior year claim, resulting in a \$2.8 million pre-tax charge incurred by the Company's U.S. subsidiaries.

Liquidity and Capital Resources

The Company meets its cash requirements and finances its growth principally through cash flows generated from operations. The Company is currently operating in a softening market and as a result, has been experiencing a decline in premium rates due to the entrance of new insurance competitors and overall market conditions. The Company's primary sources of short-term cash flow are premium writings and investment income. Short-term cash requirements relate to claims payments, reinsurance premiums, commissions, salaries, employee benefits and other operating expenses. Due to the uncertainty regarding the timing and amount of settlements of unpaid claims, the Company's future liquidity requirements may vary; therefore, the Company has structured its investment portfolio maturities to help mitigate the variations in those factors. The Company believes its current cash flows are sufficient for the short-term needs of its business and its invested assets are sufficient for the long-term needs of its insurance business.

Net cash provided from operations was \$18.9 million for the three months ended March 31, 2007 as compared to \$10.2 million for the same period of 2006. This increase primarily was attributable to higher net investment income and lower loss payments, which decreased to \$8.8 million for the three months ended March 31, 2007 from \$14.8 million for the same period of 2006.

Our ability to pay future dividends to shareholders will depend, to a significant degree, on the ability of our subsidiaries to generate earnings from which to pay dividends. The jurisdictions in which we and our insurance and reinsurance subsidiaries are domiciled place limitations on the amount of dividends or other distributions payable by insurance companies in order to protect the solvency of insurers. Given our expected growth and the capital requirements associated with that growth, we do not anticipate paying dividends on our common shares in the near future.

Income Taxes

We are incorporated under the laws of Bermuda and, under current Bermuda law, are not obligated to pay taxes in Bermuda based upon income or capital gains. We have received an undertaking from the Minister of Finance in Bermuda pursuant to the provisions of The Exempted Undertakings Tax Protection Act 1966, which exempts us and our shareholders, other than shareholders ordinarily resident in Bermuda, from any Bermuda taxes computed on profits, income or any capital asset, gain or appreciation, or any tax in the nature of estate, duty or inheritance until March 28, 2016. We, exclusive of our United States subsidiaries, do not consider ourselves to be engaged in a trade or business in the United States and accordingly do not expect to be subject to direct United States income taxation. Our U.S. subsidiaries are subject to taxation in the United States.

Combined Ratio

Our underwriting results are best indicated by our GAAP combined ratio, which is the sum of (a) the ratio of incurred losses and settlement expenses to net premiums earned (loss ratio) and (b) the ratio of policy acquisition costs and other operating expenses to net premiums earned (expense ratio). A combined ratio below 100% indicates that a company has an underwriting profit, and a combined ratio above 100% indicates an insurer has an underwriting loss. Our reported expense ratio excludes certain holding company expenses such as interest expense as well as real estate and fee income.

Forward-Looking Statements

Certain statements in this report are forward-looking statements within the meaning of U.S. securities laws. You can generally identify these statements by the use of forward-looking terminology, such as may, will, expect, estimate, anticipate, believe, target, plan, p
continue or the negatives or other variations or similar terminology. Forward-looking statements relate to, among other things:

- o general economic conditions and other factors, including prevailing interest rate levels and stock market performance, which may affect our ability to sell our insurance products and services, the market value of our investments and the lapse rate and profitability of our policies;
- o the availability and terms of future strategic acquisitions;
- o changes in the federal income tax laws and regulations which may affect the relative tax advantages of some of our products;
- o legal or regulatory changes or actions, including those relating to the underwriting of insurance products, regulation of the sale, underwriting and pricing of insurance products and services;
- o our ability to maintain or improve our current rating by A.M. Best Company ("A.M. Best");
- o expectations regarding the adequacy of our reserves for losses and loss adjustment expenses;
- o our ability to leverage our relationships with producers;
- o our areas of projected growth, growth opportunities and growth strategy;
- o our ability to expand our information technology capabilities;
- o the diversification of our insurance risk portfolio; and
- o our future liquidity requirements.

Actual results may differ materially from the results suggested by the forward-looking statements for a number of reasons. We have made these statements based on our plans and analyses of our company, our business and the insurance industry as a whole. Although we believe that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could over time prove to be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this report will themselves prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of this information should not be regarded as a representation by us or any other person that our objectives will be achieved. We expressly disclaim any obligation to update any forward-looking statement unless required by law.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For an in-depth discussion of the Company's market risks, see Management's Discussion and Analysis of Quantitative and Qualitative Disclosures about Market Risk in Item 7A of the Company's Form 10K for the year ended December 31, 2006 and Part II Other Information, Item 1A-Risk Factors herein.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in the Securities Exchange Act Rule 13a-15(e)) as of the end of the period covered by this report, concluded that, as of such date, the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company (including consolidated subsidiaries) would be made known to them.

Changes in Internal Control

There were no changes in the Company's internal control over financial reporting identified in connection with the evaluation described above that occurred during the Company's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

We, through our subsidiaries, are routinely party to pending or threatened litigation or arbitration disputes in the normal course of or related to our business. Based upon information presently available, in view of legal and other defenses available to our subsidiaries, management does not believe that any pending or threatened litigation or arbitration disputes will have any material adverse effect on our financial condition or operating results, except for the matters discussed below.

Warranty Reinsurance Litigation. We were named as a defendant in several cases, liquidation actions and reinsurance claims, collectively identified as the National Warranty issue. American Safety Reinsurance, Ltd. (American Safety Re) was an excess-of-loss reinsurer through a reinsurance treaty with National Warranty Risk Retention Group (National Warranty) that provided insurance coverage to automobile dealerships and other providers that were obligors on automobile warranty contracts they sold to consumers. National Warranty filed for liquidation in the Cayman Islands (the location of its legal creation). This liquidation had a cascading effect, including the subsequent filing of bankruptcy by various obligors of vehicle service contracts insured by National Warranty. As a result, there are potentially over one million vehicle service contracts that are not being honored by the obligors.

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The liquidators of National Warranty made claims of \$25.4 million pursuant to two reinsurance contracts issued by American Safety Re to National Warranty in 2002 and 2003. In addition, consumers of vehicle service contracts sued American Safety Re, and the trial court certified that case as a class action, although we appealed that determination. Lastly, claims have been made by sellers/obligors of the vehicle service contracts who were insured by National Warranty. There were five sellers/obligors cases against us and other professional services providers, including other reinsurers, relating to National Warranty, with claims in excess of \$2.6 million. All of these claims were based on fraud and/or theories of contractual violations. We believe that American Safety Re had valid defenses to the claims including, among others, that it had commuted its obligations under reinsurance treaties, its liability is limited to the amount of coverage provided under the policies, which varies based on premium written by National Warranty and its loss ratios, and that most of the claimants cannot make claims directly under the reinsurance contracts.

On November 17, 2006, we entered into a settlement agreement pursuant to which all claims, other than claims by City Automotive and Oak Services as described below, against ASI parties were settled for \$1.8 million, within the amount previously accrued, in exchange for a complete discharge and release. The settlement was subject to the approval of relevant courts and all necessary approvals have been obtained and the settlement is now final.

City Automotive and Oak Services. The plaintiffs in these two cases are dealers and marketers of the vehicle service contracts. We have entered into an arbitration agreement with the plaintiffs in exchange for a dismissal of all ASI parties from the pending litigation. Pursuant to this arbitration agreement, there is a floor and a ceiling to the award the arbitrators can award. The ceiling is reduced by a percentage amount equal to the percentage that any recovery by City Automotive and Oak Services in their pending litigation against the remaining defendants or in the National Warranty liquidation bears to the plaintiffs' total damages. Arbitration is scheduled for May 18, 2007. The ultimate outcome of these matters cannot now be determined.

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Item 1A. Risk Factors

Our business is subject to a number of risks and uncertainties. These risks and uncertainties are described in detail in our Form 10-K for the year ended December 31, 2006, that is on file with the SEC. Some of these risks are highlighted below.

A downgrade in our A.M. Best rating or increased capital requirements could impair our ability to sell insurance policies.

Some policyholders are required to obtain insurance coverage from insurance companies that have an "A-" (Excellent) rating or higher from A.M. Best. Additionally, many producers are prohibited by their internal guidelines from representing insurance companies that are rated below "A-" (Excellent) by A.M. Best. Because A.M. Best continually monitors companies with regard to their ratings, our ratings could change at any time, and any downgrade of our current rating could impair our ability to sell insurance policies and, ultimately, our financial condition and operating results.

The exclusions and limitations in our policies may not be enforceable.

We draft the terms and conditions of our excess and surplus lines policies to manage our exposure to expanding theories of legal liability in business lines such as asbestos abatement, construction defect, environmental and professional liability. Many of the policies we issue include exclusions or other conditions that define and limit coverage. In addition, many of our policies limit the period during which a policyholder may bring a claim under the policy, which period in many cases is shorter than the statutory period under which these claims can be brought against our policyholders. While these exclusions and limitations help us assess and control our loss exposure, it is possible that a court or regulatory authority could nullify or void an exclusion or limitation, or legislation could be enacted modifying or barring the use of these exclusions and limitations, particularly with respect to evolving business lines such as construction defect. This could result in higher than anticipated losses and loss adjustment expenses by extending coverage beyond our underwriting intent or increasing the number or size of claims, which could have a material adverse effect on our operating results. In some instances, these changes may not become apparent until some time after we have issued the insurance policies that are affected by the changes. As a result, the full extent of liability under our insurance contracts may not be known for many years after a policy is issued.

The risks we underwrite are concentrated in relatively few industries.

We focus much of our underwriting on specialty risks in the construction and environmental remediation industries. For the year ended March 31, 2007, approximately 52.6% of our gross premiums written were in these two industries. We plan to increase our retention of risk in these areas. Accordingly, our operating results could be more exposed than our more diversified competitors to unfavorable changes in business, economic or regulatory conditions, changes in federal, state or local environmental standards and establishment of legal precedents affecting these industries. Similarly, a significant incident impacting one of these industries that has the effect of increasing claims generally (or their settlement value) could negatively impact our financial condition and operating results.

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Policy pricing in our industry is cyclical, and our financial results are impacted by that cyclicity.

The property and casualty insurance industry has historically been a cyclical industry consisting of both soft market periods and hard market periods. During soft market periods, insurers tend to be more aggressive in writing policies and competitive in the pricing of those policies. Hard market periods are characterized by shortages of underwriting capacity and high premium rates. Beginning in 2000, we believe our industry experienced a hardening market, reflected by increasing rates and more restrictive coverage terms. These trends appeared to have started slowing in 2004. We believe the industry is now experiencing a softening market, where pricing generally has become more competitive and policy terms and conditions have become less restrictive. Therefore, we may not be able to achieve our growth and profitability goals. Because this cyclicity is due in large part to the economy, the particular needs of insureds and the actions of our competitors, we cannot predict the timing or duration of changes in the insurance market cycle.

We may respond to market trends by expanding or contracting our underwriting activities, which may cause our financial results to be volatile.

Although we perform substantial due diligence and risk analysis before entering into a new business line or insuring a new type of risk, and carefully assess the impact of exiting a business line, changing business lines inherently has more risk than remaining in the same business lines over a period of time. Because we actively seek to expand or contract our capacity in the markets we serve in response to factors such as loss experience and premium production, our operating results may experience material fluctuations.

Our actual incurred losses may be greater than reserves for our losses and loss adjustment expenses.

Insurance companies are required to maintain reserves to cover their estimated liability for losses and loss adjustment expenses with respect to both reported and incurred but not reported (IBNR) claims. Reserves are estimates at a given time involving actuarial and statistical projections of what we expect to be the cost of the ultimate resolution and administration of claims. These estimates are based on facts and circumstances then known, predictions of future events, estimates of future trends, projected claims frequency and severity, potential judicial expansion of liability precedents, legislative activity and other factors, such as inflation. A full actuarial analysis of our reserves is performed on an annual basis, which may include reserve studies, rate studies and regulatory opinions.

Notwithstanding these efforts, the establishment of appropriate reserves for losses and loss adjustment expenses reserves is an inherently uncertain process, particularly in the environmental remediation industry, construction industry and some of the other industries for which we write policies where extensive historical data may not exist or where the risks insured area long-tail in nature in that claims that have occurred may not be reported to us for long periods of time. For instance, there is little empirical data for residential construction defect claims and hence, traditional actuarial analysis may be inapplicable or less reliable, which may cause our reserve estimates for this business line to be more volatile. Due to these uncertainties, our ultimate losses could materially exceed our reserves for losses and loss adjustment expenses, especially in business lines where we intend to increase our risk retention. For example, during the last two years, we increased our loss reserves as a result of litigation matters specifically related to our construction lines policies and policies written on runoff lines, which lowered our net earnings and shareholders' equity during these periods.

To the extent that reserves for losses or loss adjustment expenses are estimated in the future to be inadequate, we would have to increase our reserves and incur charges to earnings in the periods in which the reserves are increased. In addition, increases in reserves may also cause additional reinsurance premiums to be payable to our reinsurers in the form of reinstatement premiums. These increases in reserves and reinstatement premiums would adversely impact our financial condition and operating results. To the extent any individual case reserves prove to be inadequate, our financial condition and operating results would be adversely affected. For more information on our losses and loss adjustment expenses, see Management's Discussion and Analysis of Financial Condition and Results of Operations.

We are subject to risks related to litigation.

From time to time, we are subject to lawsuits and other claims arising out of our insurance and real estate operations. We have responded to the lawsuits we face and, although the outcome of these lawsuits cannot be predicted, we believe that there are meritorious defenses and intend to vigorously contest these claims. Adverse judgments in one or more of these lawsuits could require us to change aspects of our operations in addition to paying significant damage amounts. In addition, the expenses related to these lawsuits may be significant. Lawsuits can have a material adverse effect on our business and operating results, particularly where we have not established an accrual, or a sufficient accrual, for damages or expenses.

We routinely evaluate opportunities to expand our business through acquisitions of other companies or business lines. There are many risks associated with acquisitions that we may be unable to control.

We evaluate potential acquisition opportunities as a means to grow our business. There are a number of risks attendant to any acquisition. These risks include, among others, the difficulty in integrating the operations and personnel of an acquired company; potential disruption of our ongoing business; inability to successfully integrate acquired systems and insurance programs into our operations; maintenance of uniform standards, controls and procedures; possible impairment of relationships with employees and insureds of an acquired business as a result of changes in management; and that the acquired business may not produce the level of expected profitability. As a result, the impact of any acquisition on our future performance may not be consistent with original expectations, and may impair our business, financial condition and operating results.

Changes in the value of our investment portfolio may have a material impact on our operating results. We rely upon the successful and uninterrupted functioning of our information technology, information processing and telecommunication systems.

We derive a significant portion of our net income from our invested assets. As a result, our operating results depend in part on the performance of our investment portfolio. As of, and for the three months ended, March 31, 2007, the fair value of our investment portfolio was \$569.4 million and our income derived from these assets was \$7.2 million, or 95.7% of our pre-tax earnings. Our investment portfolio is subject to various risks, including:

- o credit risk, which is the risk that our invested assets will decrease in value due to unfavorable changes in the financial prospects or a downgrade in the credit rating of an entity in which we have invested;
- o interest rate risk, which is the risk that our invested assets may decrease due to changes in interest rates;
- o equity price risk, which is the risk that we will incur economic loss due to a decline in equity prices; and
- o duration risk, which is the risk that our invested assets may not adequately match the duration of our insurance liabilities.

Our investment portfolio is comprised mostly of fixed-income securities. We do not hedge our investments against interest rate risk and, accordingly, changes in interest rates may result in fluctuations in the value of these investments.

Our investment portfolio is managed by a professional investment management firm in accordance with detailed investment guidelines established by our Board of Directors that stress diversification of risks, conservation of principal and liquidity. If our investment portfolio is not appropriately matched with our insurance and reinsurance liabilities, we may be forced to liquidate investments prior to their maturity at a significant loss in order to cover these liabilities. This might occur, for instance, in the event of a large or unexpected claim or series of claims. Large investment losses could significantly decrease our asset base, thereby affecting our ability to underwrite new business.

Our Bermuda operations may be subject to U.S. tax.

American Safety Insurance Holdings, Ltd. (American Safety Insurance), its reinsurance subsidiary, American Safety Reinsurance (American Safety Re), and its segregated account captive, American Safety Assurance Ltd. (American Safety Assurance), are organized in Bermuda. American Safety Insurance, American Safety Re and American Safety Assurance are operated in a manner such that none should be subject to U.S. tax (other than U.S. excise tax on insurance and reinsurance premium income attributable to insuring or reinsuring U.S. risks and U.S. withholding tax on some types of U.S. source investment income) because none of these companies should be treated as engaged in a trade or business within the U.S. (and, in the case of American Safety Re and American Safety Assurance, to be doing business through a permanent establishment within the U.S.). However, because there is considerable uncertainty as to the activities that constitute being engaged in a trade or business within the U.S. (and what constitutes a permanent establishment under the income tax treaty between the U.S. and Bermuda (the Bermuda Treaty) as well as the entitlement of American Safety Re and American Safety Assurance to treaty benefits), there can be no assurances that the U.S. Internal Revenue Service (the IRS) will not contend successfully that American Safety Insurance, American Safety Re and/or American Safety Assurance is engaged in a trade or business in the U.S. (or that American Safety Re or American Safety Assurance is carrying on business through a permanent establishment in the U.S.). If any of American Safety Insurance, American Safety Re or American Safety Assurance were considered to be engaged in a trade or business in the U.S., it could be subject to U.S. corporate income taxes and additional branch profits taxes on the portion of its earnings effectively connected to such U.S. business, in which case its operating results could be materially adversely affected.

U.S. persons who hold our common shares may be subject to U.S. federal income taxation at ordinary income rates on their proportionate share of our related party insurance income (RPII).

If the RPII of American Safety Re or American Safety Assurance were to equal or exceed 20% of its gross insurance income in any taxable year and direct or indirect insureds (and persons related to those insureds) own directly or indirectly through entities 20% or more of the voting power or value of American Safety Re or American Safety Assurance, then a U.S. person who owns any of our common shares (directly or indirectly through foreign entities) on the last day of the taxable year would be required to include in its income for U.S. federal income tax purposes that person's pro rata share of that company's RPII for the entire taxable year, determined as if that RPII were distributed proportionately only to U.S. persons at that date regardless of whether that income is distributed. In addition, any RPII that is includible in the income of a U.S. tax-exempt organization may be treated as unrelated business taxable income. Neither American Safety Re nor American Safety Assurance expects gross RPII to equal or exceed 20% of its gross income for 2006 or subsequent years, and neither expects its direct or indirect insureds (including related persons) to directly or indirectly hold 20% or more of its voting power or value, but we cannot be certain that this will be the case because some of the factors which determine the extent of RPII may be beyond our control. If these thresholds are met or exceeded, and if you are an affected U.S. person, your investment could be materially adversely affected. The RPII provisions, however, have never been interpreted by the courts or the U.S. Treasury Department (the Treasury Department) in final regulations, and regulations interpreting the RPII provisions of the Code exist only in proposed form. It is not certain whether these regulations will be adopted in their proposed form or what changes or clarifications might ultimately be made thereto or whether any of those changes, as well as any interpretation or application of RPII by the IRS, the courts or otherwise, might have retroactive effect. The Treasury Department has authority to impose, among other things, additional reporting requirements with respect to RPII. Accordingly, the meaning of the RPII provisions and the application thereof to us is uncertain.

U.S. persons who hold our common shares will be subject to adverse tax consequences if American Safety Insurance is considered to be a Passive Foreign Investment Company (a PFIC) for U.S. federal income tax purposes.>

If American Safety Insurance is considered a PFIC for U.S. federal income tax purposes, a U.S. person who owns our common shares will be subject to adverse tax consequences, including subjecting the investor to a greater tax liability than might otherwise apply and subjecting the investor to tax on amounts in advance of when tax would otherwise be imposed, in which case your investment could be materially adversely affected. In addition, if American Safety Insurance were considered a PFIC, upon the death of any U.S. individual owning our common shares, that individual's heirs or estate would not be entitled to a step-up in the basis of the shares which might otherwise be available under U.S. federal income tax laws. American Safety Insurance does not believe that it is, and does not expect to become, a PFIC for U.S. federal income tax purposes. No assurance can be given, however, that American Safety Insurance will not be deemed a PFIC by the IRS. If American Safety Insurance were considered a PFIC, it could have material adverse tax consequences for an investor that is subject to U.S. federal income taxation. There are currently no regulations regarding the application of the PFIC provisions to an insurance company. New regulations or pronouncements interpreting or clarifying these rules may be forthcoming. We cannot predict what impact, if any, that guidance would have on an investor that is subject to U.S. federal income taxation.

American Safety Insurance, American Safety Re and American Safety Assurance may become subject to Bermuda taxes in the future.

Bermuda currently imposes no income tax on corporations. American Safety Insurance, American Safety Re and American Safety Assurance have received an assurance from the Bermuda Minister of Finance, under The Exempted Undertakings Tax Protection Act 1966 of Bermuda, as amended (the Tax Protection Act), that if any legislation is enacted in Bermuda that would impose tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of that tax will not be applicable to American Safety Insurance, American Safety Re or American Safety Assurance until March 28, 2016. No assurance can be given that American Safety Insurance, American Safety Re or American Safety Assurance will not be subject to any Bermuda tax after that date.

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

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

The following exhibits are filed as part of this report:

| <u>Exhibit No.</u> | <u>Description</u> |
|--------------------|--|
| 11 | Computation of Earnings Per Share |
| 31.1 | Certification Pursuant to § 302 of the Sarbanes-Oxley Act 2002 |
| 31.2 | Certification Pursuant to § 302 of the Sarbanes-Oxley Act 2002 |
| 32.1 | Certification Pursuant to § 906 of the Sarbanes-Oxley Act 2002 |
| 32.2 | Certification Pursuant to § 906 of the Sarbanes-Oxley Act 2002 |

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SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 10th day of May 2007.

American Safety Insurance Holdings, Ltd.

By: /s/ Stephen R. Crim
Stephen R. Crim
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ William C. Tepe
William C. Tepe
Chief Financial Officer
(Principal Financial Officer)