Peace Hills Insurance
2006 Annual Report

growth

vision

To be a well respected, profitable company ranking in the top thirtieth percentile of property and casualty companies in Canada.

contents

bigger

Expanding our company.
Opening up our market.

CHAIRMAN & PRESIDENT'S REPORT

Marvin Yellowbird
Chairman of the Board

Diane Brickner, CIP
President and CEO

"Building and Growing the Company" was the theme of our 2006 strategic planning session. Our vision is "to be a well respected, profitable company ranking in the top thirtieth percentile of property and casualty companies in Canada."

Our business is truly built on relationships and it continues to be a people business, those who excel possess both the skills and local knowledge that makes a difference. This continues to be one of our strengths.

We are dedicated to growing our organization and advancing our position as a premier provider of insurance in Western Canada and we remain convinced that our vision and strategy are right. Our success lies in the completion of this vision.

2006 was the second best year in the company's history. This success is attributed to a combination of growth, diligent underwriting and innovative claims handling. There is not a single department, branch or division of the company that can be complimented for making 2006 such a success; they are all to be praised as it is truly a team effort.

Growth, what a challenge this has been, especially when we are still mandated to reduce automobile premiums. However, in spite of that, we were able to grow our personal auto new business from 4,065 pieces in 2005 to 4,456 in 2006, a 10% increase in policy growth. Every other line of business continued in the same fashion, ending the year with a 15% increase in new business accounts.

During the past two years the insurance industry has not been an easy environment to grow in. Competition has increased as other companies are looking to expand their market share, therefore, we have had to become very innovative in our marketing strategies.

The implementation of our Treasure Chest Contest made a remarkable difference in new business activity. The contest began August 1st and to the end of the year produced a 32% increase in new business, comparing August 2006 to August 2005.

Peace Hills Insurance was the recipient of a Silver Award presentation in Toronto at the National Promotional Products Industry Awards Banquet. We are very proud of the innovation and creative job that our marketing department has done. With a very small budget they generated a great deal of new business.

Mid year Gabe Lee resigned from the Board of Directors of Peace Hills Insurance. We would like to recognize his contribution to the company, especially his expertise with respect to our investment portfolio. Gabe also brought a knowledgeable and positive approach to every aspect of our Board's agenda.

We are very proud of the company's accomplishments this past year. Throughout the last 24 years of continuous change we have preserved our entrepreneurial spirit, which encourages creativity and focuses on broker relationships. As we continue to grow we are committed to maintaining this culture.

Peace Hills Insurance employees will be the driving force for our future growth and the critical ingredient in our ongoing success. Their dedication, hard work, cooperative spirit and expertise will continue to provide Peace Hills with its fundamental strength.

Together as a Board of Directors and employees, we look forward to the future with confidence.

better

Maintaining a positive environment.

Liking where we work.

FINANCE & ADMINISTRATION REPORT

John Morgan, CMA
Vice President,
Finance & Administration

Peace Hills enjoyed a very good year as revenues and investment income exceeded budget, while expenses were less than budget. Net income was $5,907,902 producing a return on equity (ROE) of 15.91%.

Direct written premiums, excluding the company's market share of Facility Association and the Alberta Risk Sharing Pool, totaled $115,021,910, an increase of 7.58% over the prior year. You will see from the detailed analysis in the Underwriting and Marketing report that Peace Hills experienced good growth in all business lines, except for personal lines automobile. Policies in force for personal automobile increased by one from 31,128 to 31,129 while our gross written premium declined by $27,693. At the same time, however, our net incurred losses for personal automobile declined by $2,715,884 resulting in a 3.4% reduction in its net loss ratio.

Impacting premium growth as well was a decline in the company's share of the Facility Association and the Alberta Risk Sharing Pool. Facility revenues of $2,320,996 were 20.84% less than 2005 while the Alberta Risk Sharing Pool revenues of $10,377,282 were 3.99% less than last year. That the Alberta Government automobile plan is depopulating the Facility Association can be seen from the fact our share of Facility has remained constant but our revenues have declined almost 21%.

Overall, premiums from all sources (including Facility Association premiums) totaled $127,720,188, an increase of 5.85% over the prior year.

Loss results were excellent in 2006 with the net loss ratio improving 5.3% over the prior year (57.1% versus 62.4%). There were 8,860 new claims reported in 2006 compared to 8,376 over the prior year. The increase in new claims was offset by the increase in our policy growth so that claims frequency actually declined 0.05%. Combined with the improvement in frequency we experienced only two large weather related losses in 2006 compared to five the year before. The current estimated dollar value of the 2006 catastrophe losses is $1,805,467 compared to 2005 losses of $6,220,457. Last, but not least, there were 54 large losses (other than catastrophic losses) compared to 60 the year before. All of these factors combined helped to reduce our net claims costs from $43,932,441 to $41,084,300.

Investment income increased 7.2% over 2005, a reflection of strong equity markets and increased interest rates. Investment income also benefited from $6,419,000 in funds received from the Facility Association in late 2005. These funds represent each member's share of investments previously held by the association to pay future claims and unearned policy liabilities. The Board of Directors of the Facility Association determined that member companies would likely be able to generate better returns on these funds than could the Association, which has a very conservative investment policy. Peace Hills was able to generate a full year of income on these holdings compared to only four months of income in 2005.

Operations from the Peace Hills Insurance Building in downtown Edmonton resulted in a loss of $146,053 on consolidation, a $75,000 improvement over last year. Increased rental rates played a large part in the improved results as commercial leasing rates in the City of Edmonton are growing rapidly. This figure of $146,053 can be interpreted as the rent and operating costs to Peace Hills General Insurance to occupy 31,600 square feet in a Class A building in downtown Edmonton, which is quite a deal at less than $5.00 per square foot.

Moving forward into next year the company will maintain its focus on growth and cost control. We expect to absorb a greater share of net revenues by reducing the quota share cession from 25% to 15%. There will hopefully be an end to the rate decreases on mandatory coverage from the Alberta Automobile Rate Review Board that have continued since October 2005 and a continuation of the strong investment markets that were experienced throughout 2006.

farther

Continuing to move forward.
Enjoying the journey.

UNDERWRITING & MARKETING REPORT

Jamie Hotte, FCIP
Vice President,
Underwriting & Marketing

Gross Written Premiums

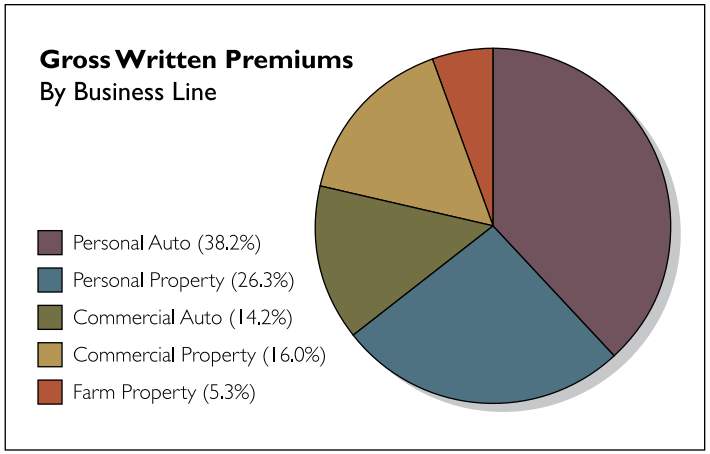
Gross written premiums totaled $115,021,910 (excluding Facility Association and Risk Sharing Pool premiums) which was an increase of 8% over 2005.

In Force Policies

Our policy count increased by just over 6% ending the year with 102,124 policies.

Underwriting Results

Underwriting results improved in 2006 and we produced a net underwriting profit of $4,121,095. Our gross loss ratio decreased by 7% ending the year at 56%.



REVIEW OF EACH BUSINESS LINE

Personal Automobile

Gross written premiums (excluding Facility Association and Risk Sharing Pool premiums) decreased marginally ending the year at $43,927,186. We ceded $10,139,668 to the Alberta Risk Sharing Pool.

Our in force policies increased by one ending the year with 31,129 policies.

Our gross loss ratio remained the same ending the year at 61%.

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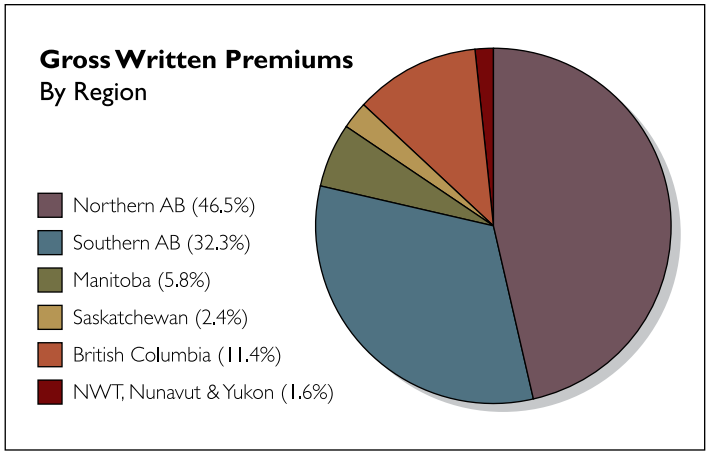
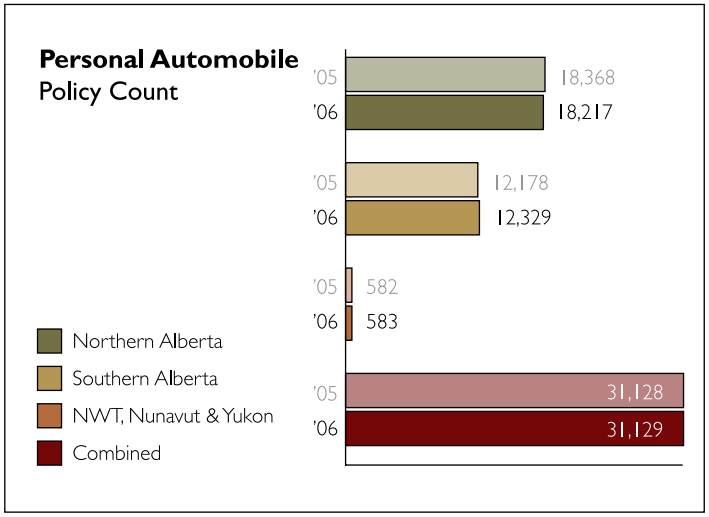


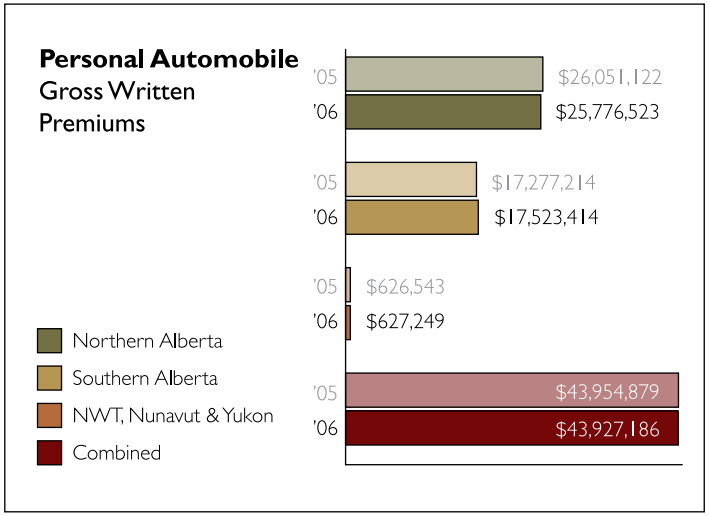
UNDERWRITING & MARKETING REPORT

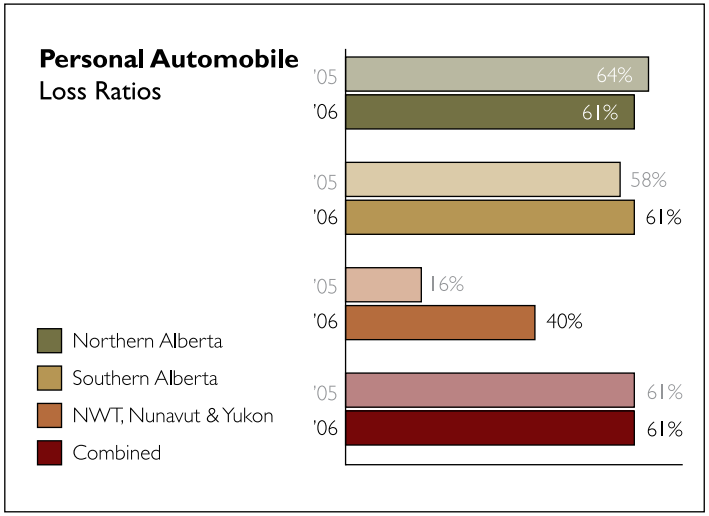
Personal Automobile (cont'd)

Due to the premium freezes legislated by the Provincial Government in October 1, 2003 we were operating with 4 different premium tables. On June 1, 2006 we combined these into a single premium table. In addition, we implemented some changes in our optional coverage premiums. Combined, these changes resulted in an overall reduction of 2.7%.

On November 1, 2006 the Government mandated an additional reduction of 3% on both Liability and Accident Benefits coverage.







UNDERWRITING & MARKETING REPORT

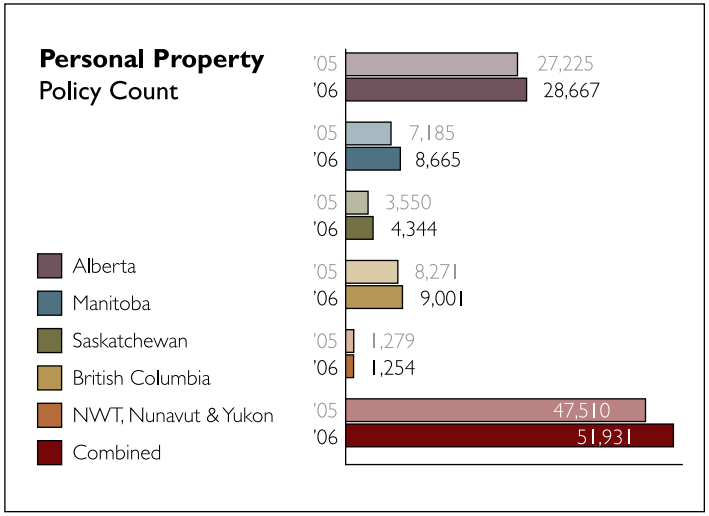
Personal Property

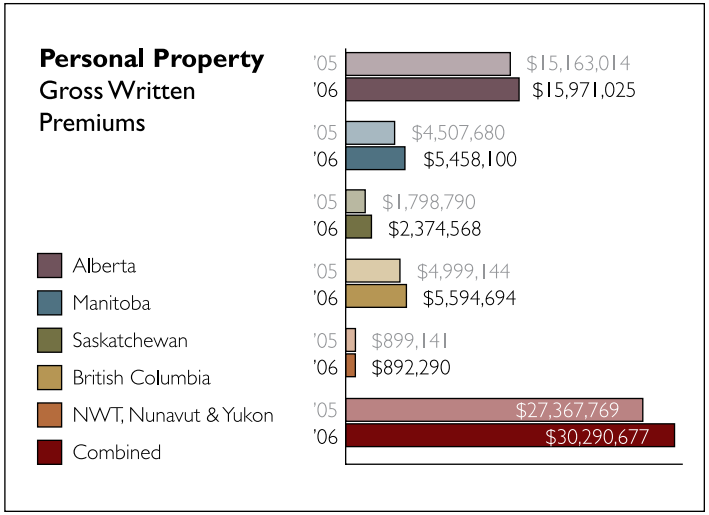
Gross written premiums increased by 11% ending the year at $30,290,677.

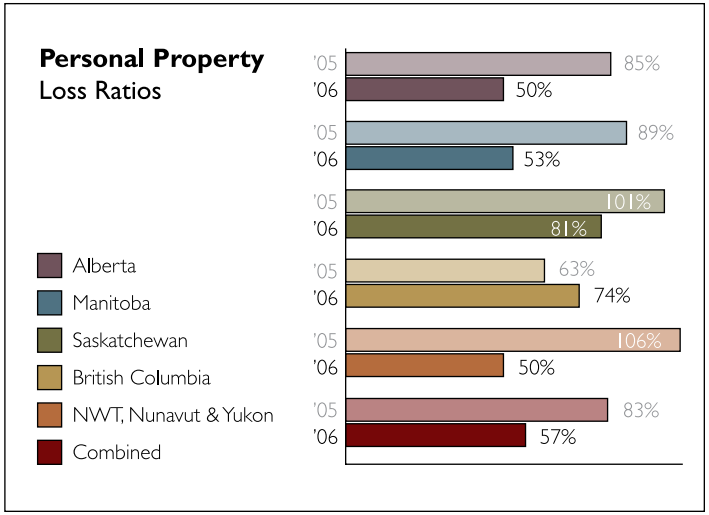
Our in force policies increased by just over 9% ending the year with 51,931 policies.

Our gross loss ratio decreased by 26% ending the year at 57%.

There were no rate changes in 2006.







UNDERWRITING & MARKETING REPORT

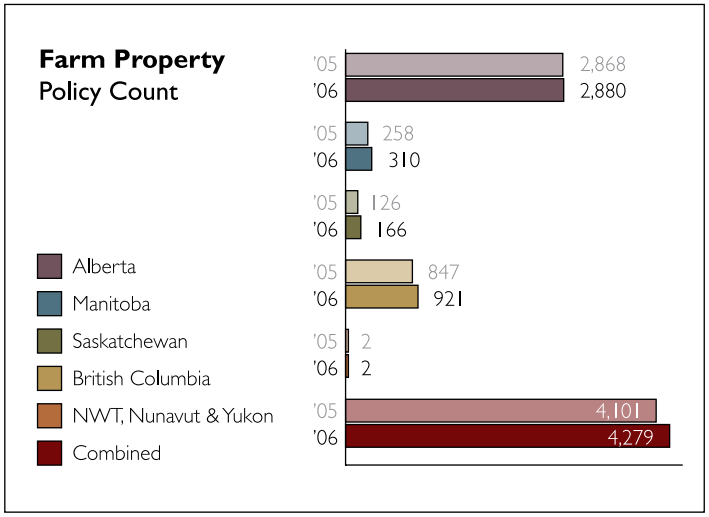
Farm Property

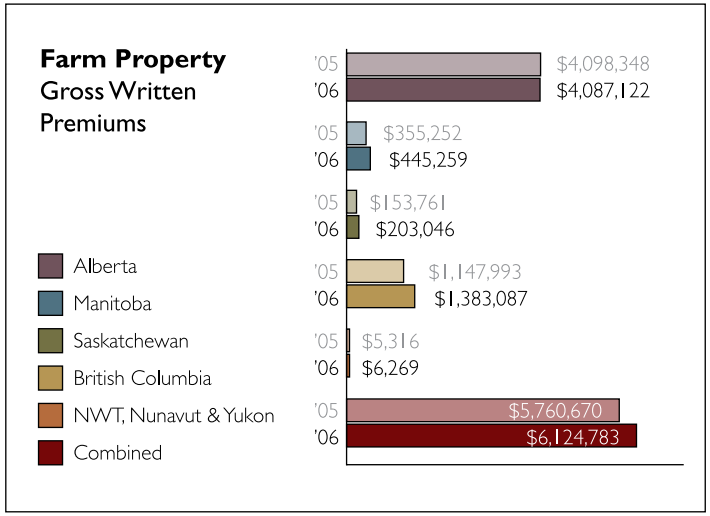
Gross written premiums increased by 6% ending the year at $6,124,783.

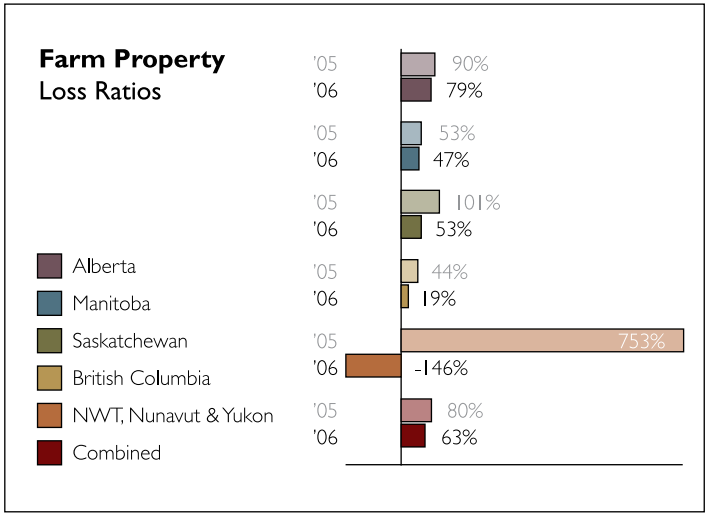
Our in force policies increased by just over 4% ending the year with 4,279 policies.

Our gross loss ratio decreased by 17% ending the year at 63%.

There were no rate changes in 2006.







UNDERWRITING & MARKETING REPORT

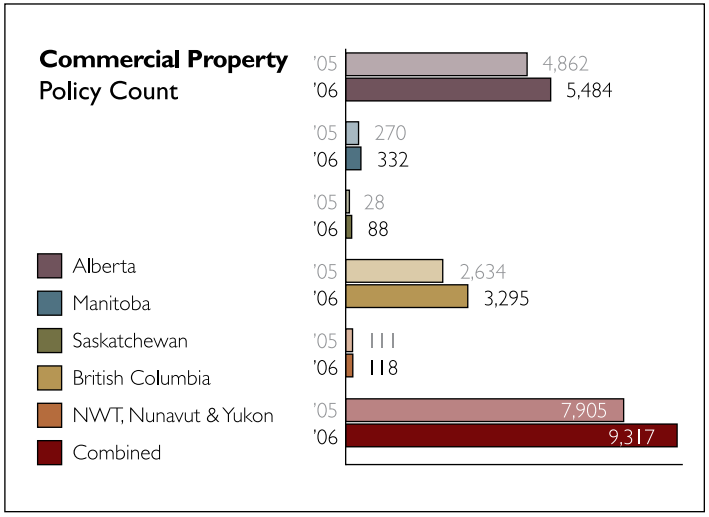
Commercial Property/Casualty

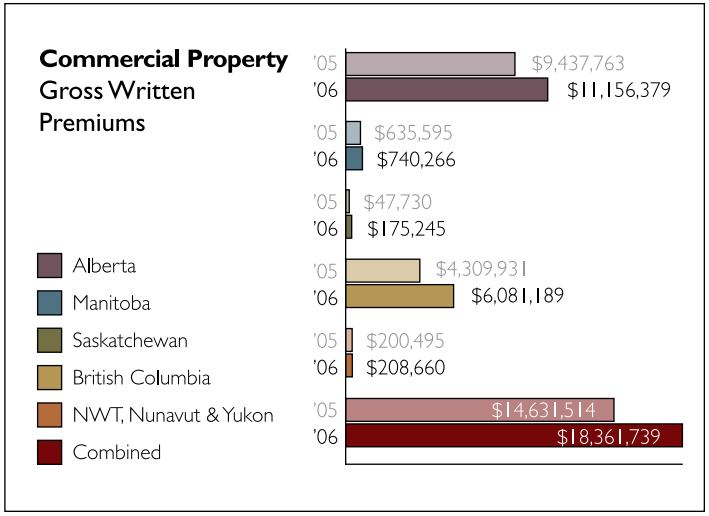
Gross written premiums increased by 26% ending the year at $18,361,739.

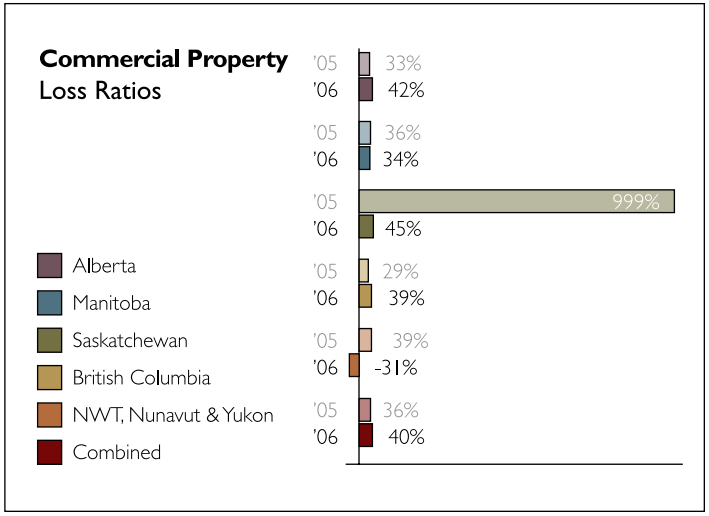
Our in force policies increased by 18% ending the year with 9,317 policies.

Our gross loss ratio increased 4% ending the year at 40%.

We experienced increased competition throughout 2006, however for the most part were able to hold the majority of our premiums at their 2005 levels. On some of the larger accounts we had to reduce premiums slightly in order to retain the business.







UNDERWRITING & MARKETING REPORT

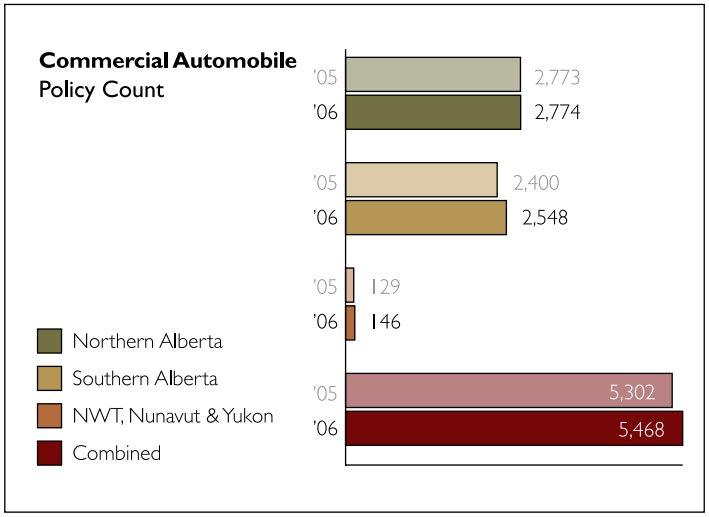
Commercial Automobile

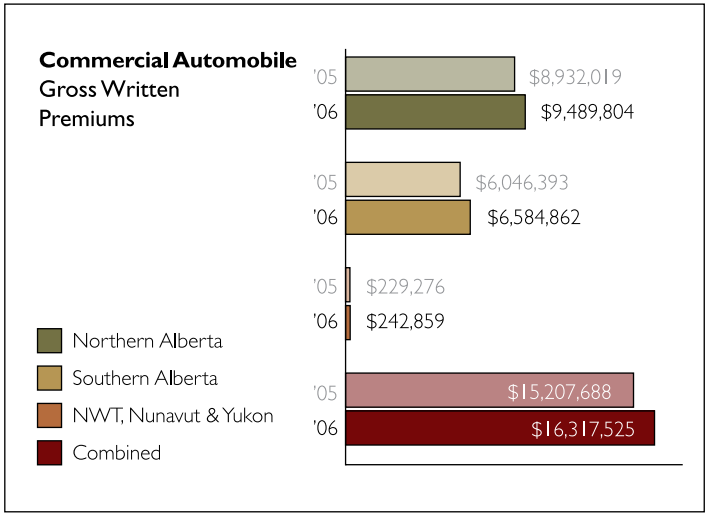
Gross written premiums increased by 7% ending the year at $16,317,525.

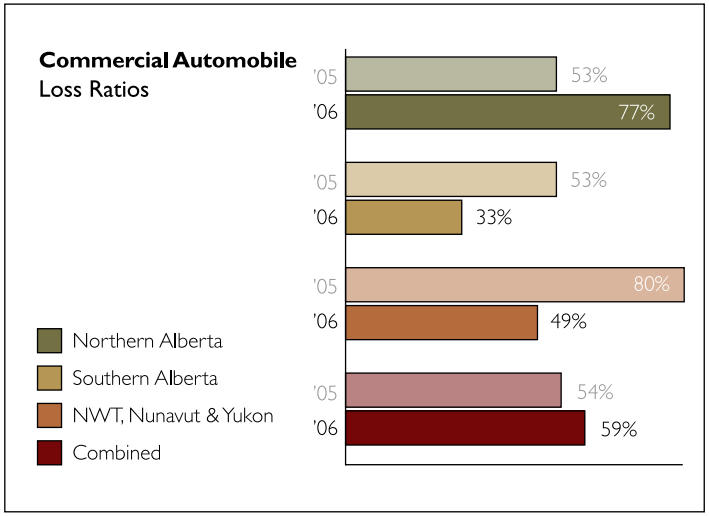
Our in force policies increased 3% ending the year with 5,468 policies.

Our gross loss ratio increased by 5% ending the year at 59%.

There were no rate changes during 2006.







UNDERWRITING & MARKETING REPORT

PROVINCIAL REPORTS

Alberta

Gross written premiums increased by 4% to $90,589,129. Policies in force increased by 3% ending the year with 72,899. Our gross loss ratio decreased by 5% ending the year at 57%.

Manitoba

Gross written premiums increased by 21% to $6,643,625. Policies in force increased by 21% ending the year with 9,307. Our gross loss ratio decreased by 31% ending the year at 50%.

Saskatchewan

Gross written premiums increased by 38% to $2,752,859. Policies in force increased by 24% ending the year with 4,598. Our gross loss ratio decreased by 48% ending the year at 77%.

British Columbia

Gross written premiums increased by 25% to $13,058,970. Policies in force increased by 12.5% ending the year with 13,217. Our gross loss ratio increased by 5% ending the year at 52%.

Northwest Territories

Gross written premiums decreased by 5% to $963,850. Policies in force decreased by 2% ending the year with 1,128. Our gross loss ratio decreased by 49% ending the year at 23%.

Yukon

Gross written premiums increased by 17% to $637,078. Policies in force increased by 13% ending the year with 540. Our gross loss ratio increased by 16% ending the year at 43%.

Nunavut

Gross written premiums decreased by 5% to $376,399. Policies in force decreased by 9% ending the year with 435. Our gross loss ratio decreased by 44% ending the year at 68%.

MARKETING AND OUR BROKERAGE FORCE

Our overall growth was in line with our budgeted growth for the year. We wrote 18,607 new policies during 2006 which was an increase of 16% compared to the prior year.

New Business Incentive Contest

In August 2006 we introduced a new business incentive contest for our brokers. We do attribute a large part of our increase in new business to this contest. In the first 7 months of 2006 our new business was only up by 4.5% however, we ended the year with an overall increase of 15%.

We are extremely proud to report not only has the "Peace Hills Treasure Chest Rewards Contest" assisted in increasing our new business but we were also the recipient of a "Silver Award" presented to us by the National Promotional Products Industry. (See page 17 for a snapshot of this contest.)

UNDERWRITING & MARKETING REPORT

Retention

Even though we have seen signs of the market becoming more competitive, our retention remained at 87%, the same as 2005.

Independent Brokerage Network

We have seen an increase in the number of brokers selling their brokerages and in some cases we have lost our portfolio of business with them. Our commitment to broker distribution remains and we would like to thank all of our brokers for their continued support.

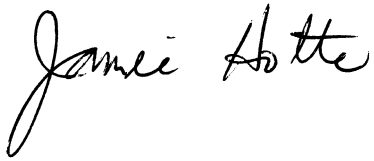
During 2006 we appointed 18 new brokers. Over the year there was some consolidation where larger brokers purchased smaller ones. Overall the number of brokers has decreased, yet the number of locations has increased.

We are represented by 167 brokers with 320 locations throughout western Canada.

PROVINCE	BROKERS	LOCATIONS
British Columbia	22	68
Alberta	116	193
Saskatchewan	7	20
Manitoba	21	36
NWT, Yukon & Nunavut	1	3

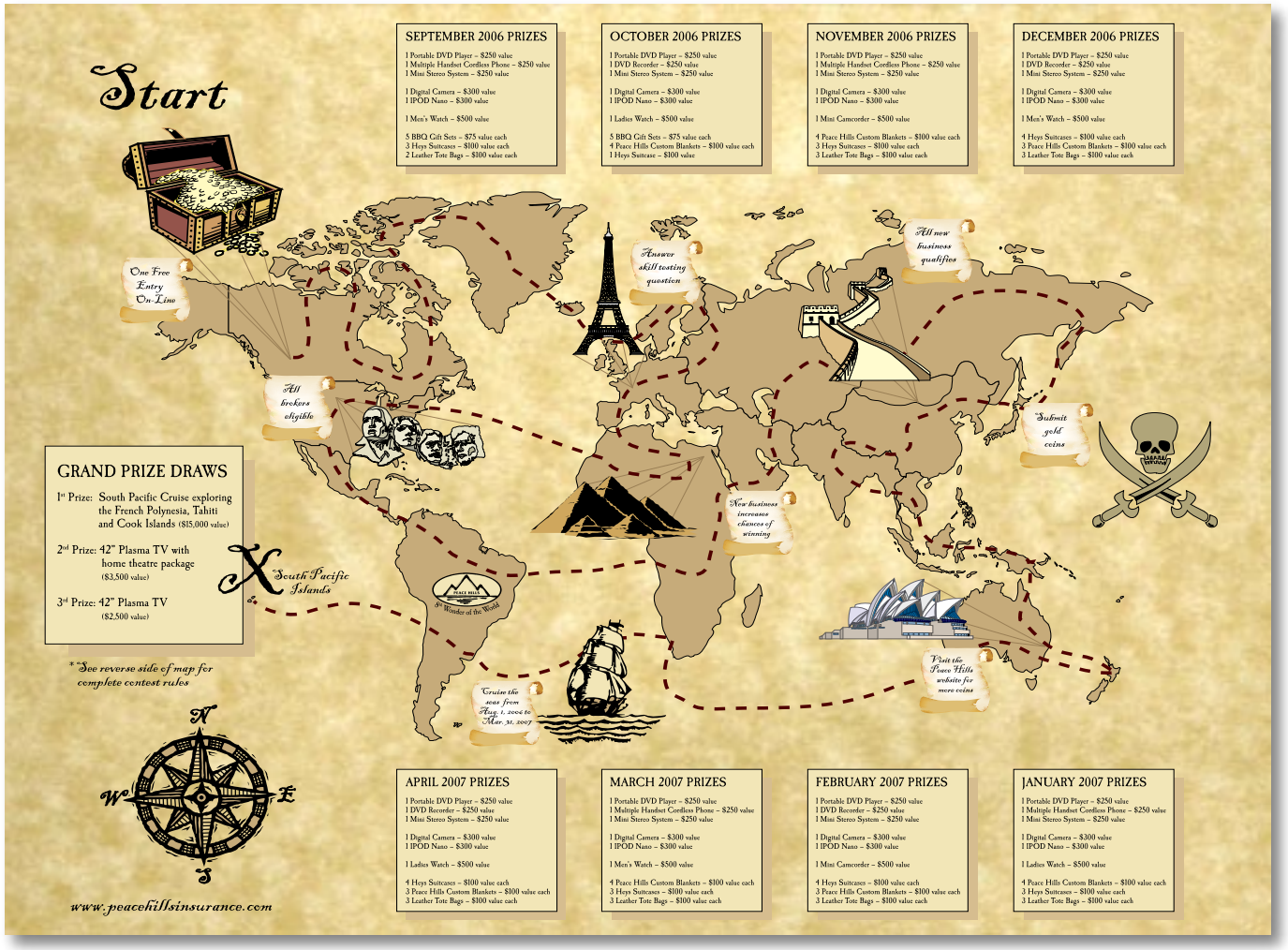
Our Underwriting and Marketing Team

We could not do what we do without our people. I would like to extend my gratitude and thanks to all of our marketing and underwriting team for their commitment to their jobs and for the very successful results they produced.



UNDERWRITING & MARKETING REPORT

Sample of the award winning Treasure Chest Rewards Contest poster.



wiser

Learning from the past.
Looking forward to the future.

CLAIMS REPORT

Robert Doiron, BA, CIP
Vice President, Claims

It is always a good sign when all is quiet on the claims front. Such is the case that 2006 was a rather unremarkable year in the claims world. Our financial results reflect a largely uneventful catastrophe season and fairly static regular claims volume. The votes are in and we have decided to retain the corporate lucky rabbit foot for 2007 as well.

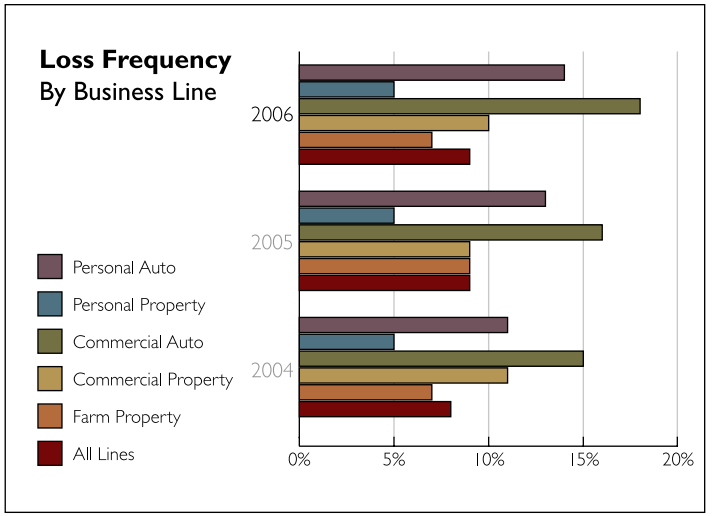
We had only two catastrophes in 2006. A storm blew through Brandon on May 27 – 29, 2006 causing 281 claims for total damage estimated around $755,000. Central Alberta was caught with severe hail August 9 – 11, 2006 causing 125 claims ringing in at around $1,051,000. Catastrophe losses in 2006 compared well with the previous three years in quantity and severity.

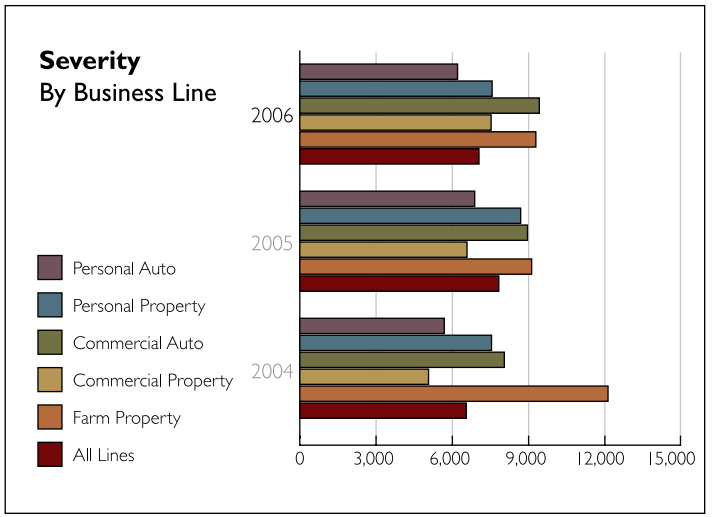
Our loss frequency relative to policy count remained static from 2005 to 2006 at 9%. We had 8,376 new claims in 2005 and 8,860 in 2006. The decrease in severity allowed us to record a 56% loss ratio in 2006 relative to a loss ratio of 63% in 2005.

There was very little in the way of new government initiatives impacting claims in 2006.

One of our greatest challenges is one that has beset all industries in booming Alberta. The chronic shortage of experienced staff available in the industry generally has made it difficult to maintain 100% staffing levels. We continue to struggle to attract new experienced staff and this will likely continue for several years.

Once again our employees have risen to the challenge to provide great customer service while shouldering heavier workloads. We are indeed fortunate to have such a strong core of dedicated people.





stronger

Working hard at what we do.
Doing it very well.

BOARD OF DIRECTORS

Victor Buffalo
Chief

Marvin Yellowbird
Chairman of the Board

Diane Brickner
President and CEO

Pat Buffalo
Executive Vice President

Trevor Swampy
Secretary/Treasurer

Victor Bruno
Elder

John Crier

Leiha Crier

Bill Kordyback

Julian Koziak

Dennis Leonard

Walter Lightning

Lawrence Saddleback

John Szumlas

AUDIT/CONDUCT REVIEW COMMITTEE

Trevor Swampy, *Chair*
Leiha Crier
Julian Koziak
Bill Kordyback
Dennis Leonard
John Szumlas

GOVERNANCE/COMPENSATION COMMITTEE

Pat Buffalo, *Chair*
Marvin Yellowbird
Lawrence Saddleback
John Crier
Dennis Leonard
John Szumlas

INVESTMENT/PHI PROPERTIES LTD. COMMITTEE

John Crier, *Chair*
Lawrence Saddleback
Pat Buffalo
Walter Lightning
Julian Koziak
Bill Kordyback

faster

Becoming more efficient.
Achieving good balance.

MANAGEMENT

Sheldon Bos
Branch Manager, Northern Alberta

John Bud
Information Systems Manager

Kathy Coogan
Controller

Jim Dyson
Personal Lines Manager, Southern Alberta

Donna Lee Genge
Personal Lines Manager, Northern Alberta

Fergus Kavanagh
VP & Branch Manager, Southern Alberta

Daryl Kochan
Regional Manager, British Columbia

Mary Mattern
Human Resources Manager

Keith McCullagh
Commercial Lines Manager, Southern Alberta

Joan McMillan
Executive Assistant

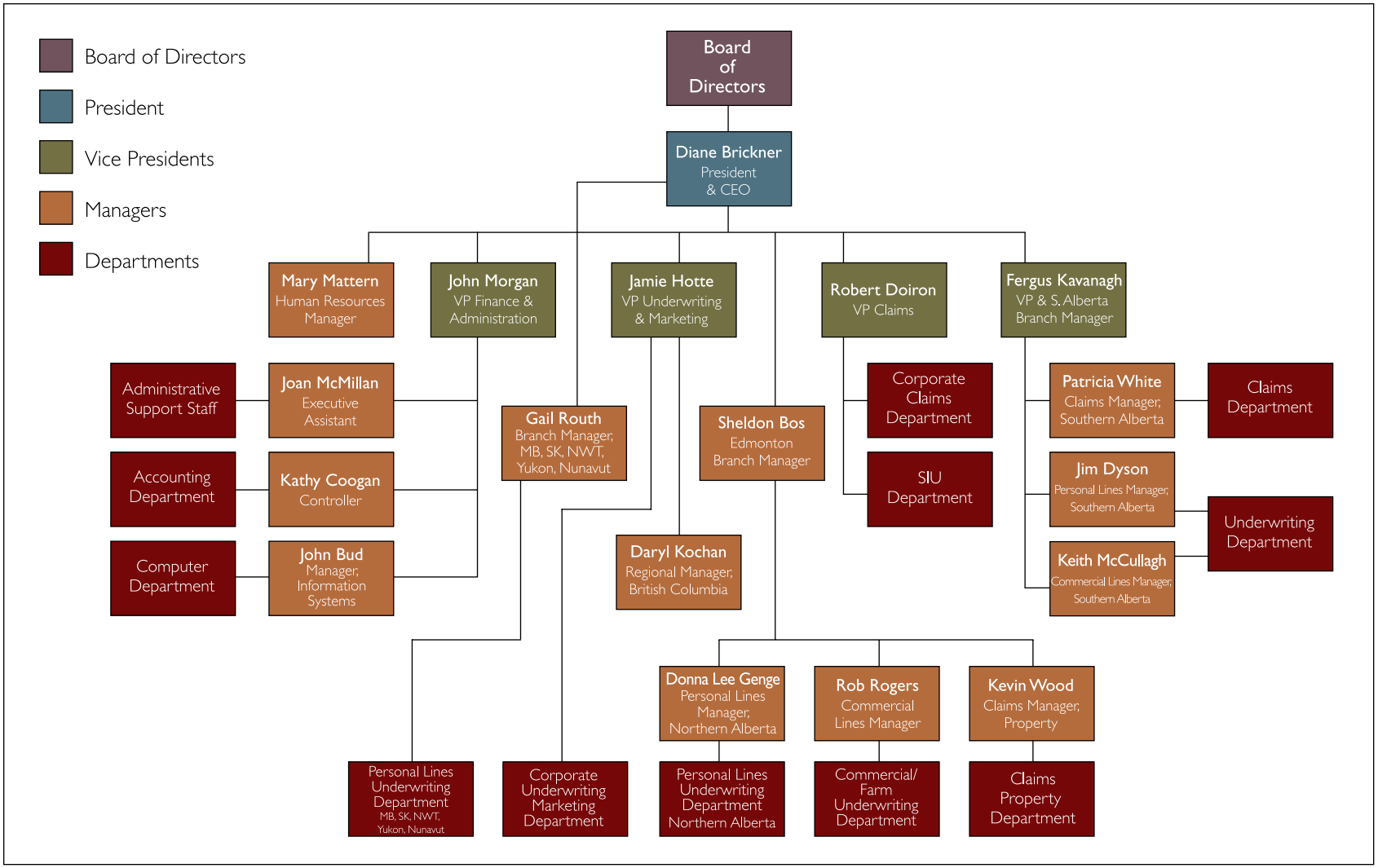
Rob Rogers
Commercial Lines Manager

Gail Routh
Branch Manager, MB, SK, NWT, Yukon, Nunavut

Pat White
Claims Manager, Southern Alberta

Kevin Wood
Claims Manager, Property

CORPORATE STRUCTURE



COMPANY PROFILE

HEAD OFFICE

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Diane Brickner, CIP
President & CEO

John Morgan, CMA
Vice President, Finance & Administration

Jamie Hotte, FCIP
Vice President, Underwriting & Marketing

Robert Doiron, BA, CIP
Vice President, Claims

John Bud, CGA
Manager, Information Systems

Kathy Coogan, CMA
Controller

Mary Mattern, CHRP
Human Resouces Manager

Joan McMillan
Executive Assistant

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Edmonton Branch Manager

Rob Rogers, FCIP, CRM
Commercial Lines Manager

Donna Lee Genge, CIP
Personal Lines Manager, Northern Alberta

Gail Routh, CIP
Branch Manager, MB, SK, NWT, Yukon, Nunavut

Kevin Wood, CIP
Claims Manager, Property

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Vancouver, BC V6E 3X2 Canada
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Daryl Kochan, FCIP
Regional Manager, British Columbia

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Calgary, AB T2P 4G8 Canada
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Fergus Kavanagh
Vice President, Southern Alberta Branch Manager

Jim Dyson, FCIP
Personal Lines Manager

Keith McCullagh, BA, FCIP
Commercial Lines Manager

Patricia White, CIP
Claims Manager

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Edmonton, AB T5J 3N5

ACTUARY

Barbara Addie, FCIA
Baron Insurance Services Inc.
206 Laird Drive
East York, ON M4G 3W4

success

Setting the standard.
And then surpassing it.

financials

MANAGEMENT STATEMENT

Peace Hills General Insurance Company • Year Ended December 31, 2006

The consolidated financial statements are the responsibility of Management and have been prepared in conformity with Canadian generally accepted accounting principles including the accounting requirements of the Superintendent of Insurance for Alberta. In the opinion of Management, the consolidated financial statements fairly reflect the financial position, results of operations and cash flows of Peace Hills General Insurance Company within reasonable bounds of materiality.

Preparation of financial information is an integral part of Management's broader responsibilities for the ongoing operations of the Company. Management maintains an extensive system of internal accounting controls to ensure that transactions are accurately recorded on a timely basis, are properly approved and result in reliable consolidated financial statements. The adequacy of operation of the control systems is monitored on an ongoing basis by Management.

The Board of Directors is responsible for approving the financial statements and has established an Audit Committee, comprised of directors who are not employees of the Company. This committee meets with Management, internal auditors, the actuary and external auditors, all of whom have unrestricted access and the opportunity to have private meetings with the Audit Committee, to review the financial statements. The Audit Committee then submits its report to the Board of Directors recommending approval of the financial statements.

The Superintendent of Insurance for Alberta makes an annual examination and inquiry into the affairs of the Company as deemed necessary to ensure that the Company is in sound financial condition and that the interests of the policyholders are protected under the provisions of the Insurance Act (the "Act").

The actuary has been appointed by the Board of Directors pursuant to the Act. The actuary is required to carry out a valuation of the policy liabilities recorded by the Company in its financial statements and report thereon to the shareholder. Policy liabilities consist of the provisions for and reinsurance recovery of unpaid claims and adjustment expenses on insurance policies in force, including provisions for salvage and subrogation, and future obligations on the unearned portion of insurance policies in force, including deferred policy acquisition costs. The valuation is made in accordance with accepted actuarial practice, as well as any other matter specified in any direction that may be made by regulatory authorities. The actuary, in her verification of the Management information provided by the Company used in the valuation, also makes use of the work of the external auditors. The actuary's report outlines the scope of her work and opinion.

The Company's external auditors have been appointed by the shareholder, pursuant to the Act, to conduct an independent and objective audit of the financial statements of the Company in accordance with Canadian generally accepted auditing standards and report thereon to the shareholder. In carrying out their audit, the auditors also make use of the actuary and her report on the Company's policy liabilities. The auditors' report outlines the scope of their audit and their opinion.

Diane Brickner, CIP
President and CEO

John Morgan, CMA
Vice President,
Finance & Administration

Edmonton, Canada
February 19, 2007

AUDITORS' REPORT

Peace Hills General Insurance Company • Year Ended December 31, 2006

To the Shareholder of Peace Hills General Insurance Company:

We have audited the consolidated balance sheet of Peace Hills General Insurance Company as at December 31, 2006 and the consolidated statements of income and retained earnings and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's Management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Edmonton, Canada
February 19, 2007

Chartered Accountants

ACTUARY'S REPORT

Peace Hills General Insurance Company • Year Ended December 31, 2006

To the Shareholder of Peace Hills General Insurance Company:

I have valued the policy liabilities of Peace Hills General Insurance Company for its balance sheet as at December 31, 2006 and their changes in its statement of income for the year then ended, in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion, the amount of the policy liabilities make appropriate provision for all policyholder obligations and the financial statements fairly present the results of the valuation.

Toronto, Ontario
February 19, 2007

Barbara Addie
Fellow, Canadian Institute of Actuaries

CONSOLIDATED BALANCE SHEET

Peace Hills General Insurance Company • At December 31, 2006

	2006	2005
ASSETS		
Cash and cash equivalents (note 2)	$ 15,289,931	$ 11,134,730
Accrued investment income	566,490	467,918
Investments (note 3)	82,976,912	74,749,206
Due from agents, brokers and policyholders	25,648,514	23,661,716
Due from other insurance companies	13,878,768	14,400,767
Income taxes receivable	-	2,019,783
Other receivables	1,467,886	1,357,415
Amounts recoverable from reinsurers:		
Unpaid claims and adjustment expenses (notes 5 and 6)	34,699,421	33,165,338
Unearned premiums	24,656,093	22,925,910
Salvage and subrogation	(192,753)	(136,628)
	59,162,761	55,954,620
Deferred policy acquisition costs	14,625,448	13,010,284
Future income taxes	3,750,947	3,253,731
Prepaid expenses and other assets	197,386	162,451
Capital assets (note 4)	5,807,739	4,680,376
	$ 223,372,782	$ 204,852,997
LIABILITIES AND SHAREHOLDER'S EQUITY		
Due to agents, brokers and policyholders	$ 2,948,917	$ 3,123,599
Due to other insurance companies	3,579,919	2,666,868
Expenses due and accrued	1,393,717	1,079,779
Income taxes due and accrued	1,140,499	-
Other taxes due and accrued	5,183,931	4,001,721
Funds held for other insurance companies (note 16)	6,419,373	6,419,373
Bank loan payable (note 7)	2,280,500	2,442,500
Unearned premiums	64,135,937	59,005,629
Provision for unpaid claims and adjustment expenses (note 5)	88,873,026	84,906,704
Unearned reinsurance commissions	7,268,418	6,691,711
Other liabilities	185,205	209,675
	183,409,442	170,547,559
Shareholder's equity:		
Share capital (note 8)	2,000,000	2,000,000
Contributed surplus	9,362,250	9,362,250
Retained earnings	28,601,090	22,943,188
	39,963,340	34,305,438
Commitments (note 11)		
Contingent liabilities (note 12)		
	$ 223,372,782	$ 204,852,997

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Chairman, Board of Directors

Chairman, Audit Committee

CONSOLIDATED STATEMENT OF INCOME & RETAINED EARNINGS

Peace Hills General Insurance Company • Year Ended December 31, 2006

	2006	2005
Gross premiums written	$ 127,720,188	$ 120,662,840
Direct premiums written	$ 117,580,520	$ 111,194,826
Net premiums written	$ 73,837,705	$ 69,943,718
Net premiums earned (note 6)	$ 70,487,844	$ 68,974,423
Earned service charge revenue	1,469,281	1,403,550
Underwriting revenue	$ 71,957,125	$ 70,377,973
Expenses incurred (note 6):		
Claims	41,084,300	43,932,441
Commissions	8,506,687	8,577,955
Premium and other taxes	3,693,461	3,508,284
Administrative expenses (note 10)	14,551,582	12,268,620
Total insurance expenses	67,836,030	68,287,300
Underwriting income	4,121,095	2,090,673
Investment income (expenses):		
Interest	2,739,563	2,654,653
Dividends	810,987	667,383
Gain on disposal of investments	2,138,714	1,983,312
General investment expenses	(276,278)	(256,892)
Net investment income	5,412,986	5,048,456
Loss from PHI Properties Limited (note 9)	(146,053)	(220,635)
Income before income taxes	9,388,028	6,918,494
Income taxes:		
Current	3,977,342	2,992,428
Future	(497,216)	(369,704)
	3,480,126	2,622,724
Net income	5,907,902	4,295,770
Retained earnings, beginning of year	22,943,188	18,647,418
Dividends paid	(250,000)	-
Retained earnings, end of year	$ 28,601,090	$ 22,943,188

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

Peace Hills General Insurance Company • Year Ended December 31, 2006

	2006	2005
Cash provided by (used in):		
Operations:		
Net income	$ 5,907,902	$ 4,295,770
Items not affecting cash:		
Future income taxes	(497,216)	(369,704)
Net realized gain on disposal of investments	(2,138,714)	(1,983,312)
Amortization of capital assets	586,553	525,716
Gain on disposal of capital assets	(7,999)	(428)
Change in non-cash operating working capital:		
Deferred policy acquisition costs	(1,615,164)	(1,144,971)
Unpaid claims and adjustment expenses, net of recoverable from reinsurers	2,432,239	5,542,790
Unearned premiums, net of recoverable from reinsurers	3,349,864	969,295
Unearned reinsurance commissions	576,707	928,519
Net change in other non-cash balances	3,594,175	1,088,849
	12,188,347	9,853,524
Financing:		
Payment of dividends	(250,000)	-
Repayment of bank loan payable	(162,000)	(162,000)
	(412,000)	(162,000)
Investments:		
Investments sold or matured:		
Bonds and debentures	5,191,496	20,174,885
Common shares	11,374,531	13,789,096
Other investments	2,183,000	-
Investments acquired:		
Bonds and debentures	(3,466,883)	(24,613,329)
Common shares	(15,410,195)	(17,965,744)
Other investments	(6,074,927)	-
Amortization of bond premiums and (discounts)	113,986	(86,173)
Purchase of capital assets	(1,612,094)	(781,449)
Proceeds on disposal of capital assets	79,940	35,304
	(7,621,146)	(9,447,410)
Net increase in cash and cash equivalents	4,155,201	244,114
Cash and cash equivalents, beginning of year	11,134,730	10,890,616
Cash and cash equivalents, end of year	$ 15,289,931	$ 11,134,730

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Peace Hills General Insurance Company • Year Ended December 31, 2006

Peace Hills General Insurance Company (the "Company") is incorporated under the laws of Alberta. The Company is subject to the Insurance Act of Alberta (the "Act") and is licensed to write all classes of insurance other than life, accident, sickness and hail in British Columbia, Alberta, Saskatchewan, Manitoba and the Northwest, Yukon and Nunavut Territories. The Company has a concentration of business in automobile and property insurance in the Province of Alberta. The Company is subject to regulation by the Superintendent of Insurance in the Province of Alberta.

1. **Significant accounting policies:**

   (a) **Basis of presentation:**

   These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, PHI Properties Limited. All significant inter-company balances and transactions have been eliminated.

   (b) **Rate regulation:**

   The Company writes compulsory automobile business that is subject to rate regulation which comprises approximately 35.3% of net premiums written. The Company's automobile insurance premiums can be impacted by mandatory rate roll backs and mandatory rate assessments as legislated by provincial law and by regulation in certain provinces. This could result in lower future premium rates or reductions to premium rates charged by the Company. In addition, the Company is required, under certain provincial legislation, to participate in risk sharing pools which may impact positively or negatively upon underwriting results. Certain benefit payments are also subject to provincial government regulation including automobile accident benefits.

   (c) **Investments:**

   Investments are accounted for on the following basis:

   (i) General:

   Gains and losses arising on disposal of investments are recognized at the trade date.

   (ii) Bonds and debentures:

   Investments in bonds and debentures are carried at amortized cost. The effective interest rate method is utilized to amortize discounts and premiums on investments in bonds and debentures. Interest income and amortization of discounts and premiums are recorded on an accrual basis over the term of the investment.

   (iii) Common shares:

   Investments in common shares are carried at cost. Dividend income on common shares is accrued on the ex-dividend date.

1. **Significant accounting policies, continued:**

(iv) Other investments:

Investments in mutual funds, private equity and hedge funds are carried at cost.

Where there has been a reduction in the value of an investment below cost that is other than temporary, the investment is written down to recoverable value, and such a provision is recorded in investment income.

(d) Premiums earned and deferred policy acquisition costs:

Insurance premiums are recorded as revenue on a straight-line basis over the terms of the policies. Unearned premiums represent the portion of premiums written that relate to the unexpired term of the policies in force.

Policy acquisition costs are those expenses incurred in the acquisition of business. Acquisition costs comprise commissions, premium taxes, health levies and an allocation of other variable policy issue and underwriting expenses, which relate directly to the acquisition of the business.

Policy acquisition costs related to unearned premiums are only deferred to the extent that they are expected to be recovered from the unearned premiums, and are amortized on a straight line basis over the periods during which the premiums are earned. If the unearned premiums and anticipated investment income are not sufficient to pay expected claims and expenses (including policy maintenance expenses and unamortized policy acquisition costs), a premium deficiency exists. Premium deficiencies are recognized by first writing down the deferred policy acquisition cost asset, with any excess being recognized against underwriting income.

(e) Capital assets:

Capital assets are carried at cost less accumulated amortization. Amortization is provided using the following methods and annual rates:

Asset	Basis	Rate
Building	Straight-line	3%
Building improvements	Straight-line	10%
Automotive equipment	Declining balance	30%
Leasehold improvements	Straight-line	Terms of leases
Office equipment	Declining balance	20%
Computer software	Straight-line	20%
System software	Straight-line	10%

1. **Significant accounting policies, continued:**

(f) **Provision for unpaid claims and adjustment expenses:**

The provision for unpaid claims represents the amount needed to provide for the estimated ultimate expected cost of settling claims related to insured events (both reported and unreported) that have occurred on or before each balance sheet date. The provision for adjustment expenses represents the estimated ultimate expected cost of investigating, resolving and processing these claims. As permitted by the Superintendent of Insurance of Alberta, the provision estimations do not take into consideration the time value of money, or make explicit provision for adverse deviation. These estimates are necessarily subject to uncertainty and are selected from a wide range of possible outcomes.

As a result, all provisions are periodically reviewed and evaluated in the light of emerging claim experience and changing circumstances. Changes in estimates of the ultimate liability are recorded as incurred claims in the current period.

(g) **Salvage and subrogation:**

Salvage and subrogation recoverable are accrued on a specific case by case basis. The gross recoverable is recorded under "other receivables" and the estimated amounts payable to reinsurers is recorded against "amounts recoverable from reinsurers".

(h) **Reinsurance ceded:**

Premiums, claims and expenses are recorded net of amounts ceded to, and recoverable from, reinsurers. Estimates of amounts recoverable from reinsurers on unpaid claims and adjustment expenses and on unearned premiums are recorded on a gross basis as "amounts recoverable from reinsurers".

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy.

(i) **Income taxes:**

Income taxes are accounted for using the asset and liability method. Under this method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment occurs.

1. **Significant accounting policies, continued:**

   (j) **Foreign currency:**

   Monetary items denominated in foreign currency are translated to Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at exchange rates in effect when the assets were acquired or obligations incurred. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in income.

   (k) **Use of estimates:**

   The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. **Cash and cash equivalents:**

The Company considers deposits in banks, certificates of deposit and short-term investments with original maturities of three months or less as cash and cash equivalents. The major components of cash and cash equivalents are as follows:

	2006	2005
Cash	$ 1,338,719	$ 4,754,650
Bank term deposits, maturities in three months or less, at rates of interest varying between 4.7% to 6.5%	13,951,212	6,380,080
	$ 15,289,931	**$ 11,134,730**

3. Investments:

The carrying amounts and fair values of investments are summarized as follows:

					2006
	Carrying amount	Amortized discount/ premium	Gross unrealized gains	Gross unrealized losses	Market value
Bonds and debentures	$ 41,165,155	$ 460,381	$ 1,014,881	$ 548,385	$ 42,092,032
Common shares	37,919,829	–	11,105,902	652,446	48,373,285
Other investments	3,891,928	–	49,467	48,111	3,893,284
	$ 82,976,912	$ 460,381	$ 12,170,250	$ 1,248,942	$ 94,358,601

					2005
	Carrying amount	Amortized discount/ premium	Gross unrealized gains	Gross unrealized losses	Market value
Bonds and debentures	$ 43,170,258	$ 449,841	$ 1,343,761	$ 604,357	$ 44,359,503
Common shares	31,578,948	–	7,960,273	1,076,251	38,462,970
	$ 74,749,206	$ 449,841	$ 9,304,034	$ 1,680,608	$ 82,822,473

Management has reviewed currently available information regarding those investments for which market value is less than carrying amount and ascertained that the carrying amounts are expected to be recovered. As such, the Company determined that no securities in the investment portfolio had suffered an impairment in the market value that is other than temporary.

3. Investments, continued

(a) Bonds and debentures – interest rate risk:

Details of significant terms and conditions and exposures to interest rate risk on investments are as follows:

		2006		2005	
	Interest receivable basis (% range)	Effective rates (% range)	Coupon rates (% range)	Effective rates (% range)	Coupon rates (% range)
Government of Canada	Semi-annual	2.94 to 9.24%	3.00 to 7.25%	2.94 to 9.24%	3.00 to 7.25%
Canadian provincial, municipal and public authorities	Semi-annual	2.58 to 6.87%	3.30 to 7.50%	2.58 to 6.87%	2.91 to 7.50%
Canadian corporate	Quarterly	3.43 to 9.03%	4.20 to 8.30%	3.40 to 9.29%	4.00 to 9.00%

The company holds $1,130,000 (2005 - $3,230,000) in bonds that have a variable rate of return.

(b) Bonds and debentures – principal amount and carrying amount:

The principal amount and carrying amounts are shown by contractual maturity. Actual maturity may differ from contractual maturity because certain issuers have the right to call or prepay certain obligations with or without call or prepayment penalties.

	2006		2005	
Term to maturity	Principal amount	Carrying amount	Principal amount	Carrying amount
Government of Canada:				
Due in one year or less	$ 4,540,000	$ 4,586,222	$ -	$ -
Between one and five years	12,935,000	12,995,919	13,530,000	13,764,222
After five years	6,060,000	5,711,093	8,585,000	8,089,105
Canadian provincial, municipal and public authorities:				
Due in one year or less	630,000	630,225	1,600,000	1,600,274
Between one and five years	1,355,000	1,403,981	1,485,000	1,535,088
After five years	4,550,000	4,817,404	4,550,000	4,832,935
Canadian corporate:				
Due in one year or less	1,170,000	1,178,032	550,000	551,614
Between one and five years	7,460,000	7,582,219	7,250,000	7,371,063
After five years	2,310,000	2,260,060	5,315,000	5,425,957
	$ 41,010,000	**$ 41,165,155**	**$ 42,865,000**	**$ 43,170,258**

3. **Investments, continued**

(c) **Common shares and other investments:**

The Company limits its investment concentration in any one investee or related group of investees to 5% of the Company's total assets, except as allowed by Section 418(1), Insurance Act of Alberta and Regulations.

4. **Capital assets:**

				2006		2005
		Cost		Accumulated amortization		Net book value		Net book value
Land	$	640,000	$	–	$	640,000	$	640,000
Building		2,103,620		368,789		1,734,831		1,689,368
Building improvements		1,386,473		691,729		694,744		833,692
Automotive equipment		765,208		341,128		424,080		250,437
Leasehold improvements		458,733		109,163		349,570		199,460
Office equipment and computer software		2,087,308		1,243,310		843,998		720,410
System software		1,120,516		–		1,120,516		347,009
	$	**8,561,858**	**$**	**2,754,119**	**$**	**5,807,739**	**$**	**4,680,376**

Amortization of capital assets of $517,201 (2005 – $460,832) is included in administrative expenses. Amortization of the building of $69,352 (2005 – $64,884) is included in rental expenses (Note 9). Capital assets include software development costs and leasehold improvements of $1,288,675 (2005 - $347,009) that are not being amortized as they are not in use.

5. **Unpaid claims and adjustment expenses:**

(a) **Nature of unpaid claims and adjustment expenses:**

The provision for unpaid claims and adjustment expenses is determined using expected future claims payments based on assumptions that reflect the expected set of economic conditions and planned courses of action. Uncertainty exists on reported claims in that all information may not be available at the reporting date. In addition, claims may not be reported to the Company immediately, therefore estimates are made as to the value of claims incurred but not yet reported, a value that may take years to finally determine.

5. Unpaid claims and adjustment expenses, continued:

The determination of the provision is dependent on numerous significant assumptions and estimates, which are developed considering the characteristics of the class of business, historical trends, the amount of data available on individual claims and any other pertinent factors. Claims provisions are periodically reviewed and evaluated in light of emerging claims experience and changing circumstances. The resulting changes in the estimates of the ultimate liability are recorded as claims incurred in the period in which the change occurred.

(b) Activity in the provision for unpaid claims and claims adjustment expenses, by line of business, is summarized as follows:

	Property	Automobile	2006 Total	2005 Total
Provision for unpaid claims and adjustment expenses, beginning of year:				
Gross	$ 20,296,002	$ 64,610,702	$ 84,906,704	$ 75,400,774
Reinsurance ceded	10,238,641	22,926,697	33,165,338	29,202,197
Net provisions, beginning of year	10,057,361	41,684,005	51,741,366	46,198,577
Net incurred claims and claim adjustment expenses:				
Provision for insured events of current year	15,247,110	29,673,121	44,920,231	45,306,227
Decrease in provision for insured events of prior years	(383,307)	(3,452,624)	(3,835,931)	(1,373,786)
Total net incurred	14,863,803	26,220,497	41,084,300	43,932,441
Net payments attributable to:				
Current year events	(7,023,651)	(13,834,445)	(20,858,096)	(22,107,505)
Prior year events	(6,155,365)	(11,638,600)	(17,793,965)	(16,282,148)
Total net payments	(13,179,016)	(25,473,045)	(38,652,061)	(38,389,653)
Net provision for unpaid claims and adjustment expenses, end of year	11,742,148	42,431,457	54,173,605	51,741,366
Reinsurance ceded, end of year	10,200,674	24,498,747	34,699,421	33,165,338
Gross provision for unpaid claims and adjustment expenses, end of year	**$ 21,942,822**	**$ 66,930,204**	**$ 88,873,026**	**$ 84,906,704**

6. Underwriting policy and reinsurance ceded:

In the normal course of business, the Company seeks to reduce the loss that may arise from catastrophe or other events that cause unfavorable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers.

Failure of reinsurers to honor their obligations could result in losses to the Company; consequently, allowances are established for amounts deemed uncollectible.

The Company follows the policy of underwriting and reinsuring contracts of insurance that limit the net exposure of the Company to a maximum amount on any one loss of $375,000 (2005 - $375,000) in the event of a claim or a catastrophe, excluding reinstatement fees when applicable.

In addition, the Company has catastrophe reinsurance having an upper limit of $40,000,000 (2005 - $40,000,000).

The Company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvency.

The figures shown in the consolidated statement of income are net of the following amounts relating to reinsurance ceded to other companies:

	2006	2005
Net premiums earned reduced by	$ 42,324,222	$ 40,218,827
Claims incurred reduced by	24,360,390	26,279,038
Commissions and premium taxes reduced by	11,645,446	11,247,892

7. Bank loan payable:

PHI Properties Limited, the Company's wholly-owned subsidiary, owns an office building in Edmonton. The building purchase and the subsequent building improvements were financed by a loan from the Bank of Nova Scotia for a five year term, with twenty year amortization at a floating interest rate of prime plus 0.25% (6.25%). The collateral for the loan is provided by hypothecation of federal and provincial government bonds and treasury bills equal to the amount of the outstanding principal. Annual principal payments of $162,000 are due until the maturity of the loan on May 31, 2011.

8. Share capital:

	2006	2005
Authorized:		
20,000 Common shares with a stated value of $100 per share		
Issued:		
20,000 Common shares	$ 2,000,000	$ 2,000,000

9. PHI Properties Limited:

	2006	2005
Rental income	$ 797,814	$ 632,719
Expenses:		
Operations	649,538	557,322
Amortization	69,352	64,884
Interest	138,904	120,701
Other	86,073	110,447
Total expenses	943,867	853,354
Net loss	**$ (146,053)**	**$ (220,635)**

10. Related party transactions:

The Company donated $1,889,418 (2005 - $171,095) to individual members and organizations of the Samson Cree Nation, which is the ultimate shareholder of the Company. These donations are included in administrative expenses.

11. Commitments:

Operating lease commitments:

The Company has contractual obligations expiring at various dates in 2007 to 2013 in respect of rents payable on leased premises and equipment as follows:

Year ending December 31:		
2007	$	164,790
2008		177,229
2009		146,058
2010		145,244
2011		142,800
2012 and thereafter		214,200

The Company is also responsible for its proportionate share of operating costs under the terms of the premises leases.

12. Contingent liabilities:

In common with the insurance industry in general, the Company is subject to litigation arising in the normal course of conducting its insurance business. The Company is of the opinion that this litigation will not have a significant effect on the financial position, results of operations or cash flows of the Company.

The Company has provided loan guarantees of $1,600,000 (2005 - $1,600,000) with terms ending in the year 2021. These guarantees were made to unrelated parties and there is no carrying amount reflected in the financial statements. In the event of a default the Company will realize recovery on the assets of the entities for which guarantees have been made.

13. Fair value of financial assets and financial liabilities:

Fair values

The fair values of financial instruments approximate the carrying amounts except for investments as disclosed in Note 3.

13. Fair value of financial assets and financial liabilities, continued:

Credit risk

The Company is exposed to credit risk through amounts due from agents, brokers and policyholders and amounts due from other insurance companies. The Company maintains provisions for potential credit losses and any such losses to date have been within Management's expectations. The Company is also exposed to credit risk through contracts with third parties for reinsurance. This risk is mitigated by contracting with reputable organizations, and by utilizing a number of different organizations to mitigate the risk of any one company defaulting on its contractual obligations as disclosed in Note 6.

Interest rate risk

The Company is exposed to interest rate risk through investments in bonds and debentures, which are sensitive to changes in interest rates. The Company is also exposed to interest rate risk through a bank loan bearing interest at bank prime rate plus 0.25%.

Foreign currency risk

The Company is exposed to foreign currency risk, principally to the U.S. dollar, through holding foreign currency denominated common share and other investments in the amount of $14,535,626 (2005 - $13,653,216).

14. Supplemental cash flow information:

	2006	2005
Cash paid for:		
Interest	$ 138,904	$ 120,701
Income taxes	2,953,689	5,022,266
Cash received from:		
Dividends	810,987	593,160
Interest	2,719,425	2,478,640
Income taxes	2,133,292	40,247

15. Alberta Risk Sharing Pool and Facility Association Residual Market:

The Company is a participant in the Alberta Risk Sharing Pool and Facility Association Residual Market ("ARSP" and "FARM"). Both the ARSP and FARM are joint ventures of insurers which provide automobile insurance for owners and operators of motor vehicles who may otherwise have difficulty obtaining such insurance.

The Company proportionately consolidates its interests in the ARSP and FARM, which are restricted to the pool of business relating to Alberta (including Northwest, Yukon and Nunavut Territories).

The Company has included in its accounts the following aggregate amounts in respect of its interests in the ARSP and FARM:

	2006	2005
Assets:		
Due from other insurance companies	$ 8,091,299	$ 8,213,712
Amounts recoverable from reinsurers	4,872,783	4,103,271
Deferred policy acquisition costs	1,693,983	1,781,361
	14,658,065	14,098,344
Liabilities:		
Provision for unpaid claims and adjustment expenses	13,410,635	11,056,361
Unearned premiums	6,080,498	5,356,728
Due to other insurance companies	1,324,661	1,644,780
Other taxes due and accrued	74,132	36,193
	20,899,926	18,094,062
Revenues:		
Premiums earned	8,980,288	9,126,336
Investment income	-	225,142
	8,980,288	9,351,478
Expenses:		
Claims	5,940,577	6,914,396
Commissions	2,384,313	2,106,042
Premium and other taxes	669,911	718,934
Administrative expenses	289,509	402,870
	9,284,310	10,142,242

16. Funds Due to FARM:

FARM reduced its role in investing funds on behalf of participating companies. As a result the Company received its proportionate share of these funds and they are currently held by the Company as part of its investment portfolio. These funds will be returned to FARM over time as needed to facilitate payment of the related policyholder claims.

NOTES

Peace Hills Insurance
2006 Annual Report

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