PRIMUS GUARANTY LTD
Form 10-Q
August 12, 2005

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2005

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: 001-32307

Primus Guaranty, Ltd.

(Exact name of registrant as specified in its charter)

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

Clarendon House
2 Church Street
Hamilton HM 11, Bermuda
(Address of principal executive offices, including zip code)

441-296-0519
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of August 5, 2005, the number of shares outstanding of the issuer's common stock, $0.08 par value, was 43,121,523.

Primus Guaranty, Ltd.
Form 10-Q
For the quarter ended June 30, 2005

Part I.	**Financial Information**	
Item 1.	Financial Statements	
	Consolidated Statements of Financial Condition	
	June 30, 2005 (Unaudited) and December 31, 2004	3
	Consolidated Statements of Operations (Unaudited)	
	Three and six months ended June 30, 2005 and 2004	4
	Consolidated Statements of Cash Flows (Unaudited)	
	Six months ended June 30, 2005 and 2004	5
	Notes to Consolidated Financial Statements	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	19
	Cautionary Note Regarding Forward-Looking Statements	32
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	34
Item 4.	Controls and Procedures	35
Part II. Other Information		
Item 1.	Legal Proceedings	35
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	35
Item 3.	Defaults upon Senior Securities	36
Item 4.	Submission of Matters to a Vote of Security Holders	36
Item 5.	Other Information	36
Item 6.	Exhibits	36
Signatures		37

Part I. Financial Information

Item 1. Financial Statements

Primus Guaranty, Ltd.
Consolidated Statements of Financial Condition

(dollars in 000s except per share amounts)

	June 30, 2005 (unaudited)	December 31, 2004
Assets		
Cash and cash equivalents	$ 200,852	$ 320,989
Available-for-sale investments	286,657	161,101
Accrued interest receivable	4,934	1,381
Accrued premiums on credit swaps	3,287	3,349
Premiums receivable on credit swaps	169	197
Premiums receivable on financial guarantees	500	800
Asset management fee receivable	39	15
Prepaid expenses	581	868
Unrealized gain on credit swaps, at fair value	17,531	46,517
Fixed assets, less accumulated depreciation of $626 in 2005 and $493 in 2004	1,690	1,800
Internal use software costs, less accumulated amortization of $6,800 in 2005 and $5,893 in 2004	3,722	4,297
Income tax receivable	279	279
Debt issuance costs	1,133	1,125
Total assets	$ 521,374	$ 542,718
Liabilities, preferred securities of subsidiary and shareholders' equity		
Accounts payable and accrued expenses	$ 1,365	$ 904
Compensation accrual	2,617	5,317
Brokerage fees payable	37	14
Taxes payable	184	12
Interest payable	359	364
Long-term debt	75,000	75,000
Unrealized loss on credit swaps, at fair value	4,844	259
Deferred rent payable	446	455
Deferred financial guarantee premiums	607	806
Deferred credit swap premiums	57	69
Total liabilities	85,516	83,200
Preferred securities of subsidiary	98,521	98,521
Shareholders' equity:		
Common stock, $0.08 par value, 62,500,000 shares authorized, 43,120,064 and 42,780,033 shares issued and outstanding at June 30, 2005 and December 31, 2004, respectively	3,675	3,535
Additional paid-in-capital	264,089	264,860
Warrants	612	612
Accumulated other comprehensive income	5	—
Retained earnings	68,956	91,990
Total shareholders' equity	337,337	360,997
Total liabilities, preferred securities of subsidiary and shareholders' equity	$ 521,374	$ 542,718

See accompanying notes.

3

Primus Guaranty, Ltd.
Consolidated Statements of Operations
(amounts in 000s except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
	(unaudited)			
Revenues				
Net credit swap revenue	$ (3,579)	$ 5,865	$ (11,777)	$ 2,835
Premiums earned on financial guarantees	100	97	199	196
Investment portfolio realized gains	23	—	23	—
Interest income on investment portfolio	2,793	716	6,486	1,368
Rental income	—	13	—	40
Asset management fees	49	—	91	—
Foreign currency revaluation	(955)	(33)	(1,519)	(106)
Total net revenues	(1,569)	6,658	(6,497)	4,333
Expenses				
Employee compensation and benefits	3,406	3,861	8,602	7,284
Professional and legal fees	796	363	1,750	778
Fixed asset depreciation and amortization	525	485	1,041	959
Technology and data	398	364	715	671
Rent	186	184	376	357
Bank and investment management fees	278	79	457	163
Rating agency fees	84	75	155	138
Brokerage expense	56	146	89	364
Interest expense	497	—	991	—
Other	249	277	541	443
Total expenses	6,475	5,834	14,717	11,157
Distributions on preferred securities of subsidiary	(1,127)	(605)	(1,775)	(1,147)
Income/ (Loss) before provision for income taxes	(9,171)	219	(22,989)	(7,971)
Provision for income taxes	(9)	(45)	(45)	(117)
Net income/ (loss) available to common shares	$ (9,180)	$ 174	$ (23,034)	$ (8,088)
Earnings/(loss) per common share:				
Basic	$ (0.21)	$ 0.05	$ (0.53)	$ (2.41)
Diluted	$ (0.21)	$ 0.01	$ (0.53)	$ (2.41)
Average common shares outstanding:				
Basic	43,108	3,527	43,160	3,353
Diluted	43,108	34,768	43,160	3,353

See accompanying notes.

4

Primus Guaranty, Ltd.
Consolidated Statements of Cash Flows
(dollars in 000s)

	Six months ended June 30, 2005	2004
	(unaudited)	
Cash flows from operating activities		
Net loss	$ (23,034)	$ (8,088)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Non-cash items included in net income (loss):		
Depreciation of fixed assets	133	110
Amortization of internal use software costs	908	850
Stock compensation	1,534	1,385
Net unrealized loss on credit swap portfolio	33,571	20,068
Unrealized loss on sublease	—	(39)
Deferred rent	(9)	(7)
Amortization of debt issuance costs	22	—
Distributions on preferred securities of subsidiary	1,775	1,147
Increase (decrease) in cash resulting from changes in:		
Premiums receivable on credit swaps	28	(742)
Accrued premiums on credit swaps	62	(78)
Deferred credit swap premiums	(12)	(19)
Deferred financial guarantee premiums	(199)	(196)
Brokerage fees payable	23	84
Accrued interest receivable	(3,553)	78
Premiums receivable on financial guarantees	300	301
Prepaid expenses	287	(197)
Deferred IPO costs	—	(1,934)
Asset management fee receivable	(24)	—
Accounts payable and accrued expenses	461	(254)
Compensation accrual	(2,700)	(2,432)
Interest payable	(5)	—
Taxes payable.	172	72
Net cash provided by operating activities	9,740	10,109
Cash flows from investing activities		
Fixed asset purchases.	(24)	(106)
Net sale (purchase) of investments.	(125,551)	527
Other asset purchases	(332)	(329)
Net cash (used in)/ provided by investing activities	(125,907)	92
Cash flows from financing activities		
Retirement of common shares	(2,397)	—

Proceeds from issuance of common shares		233		—
Debt issuance costs		(31)		—
Exercise of warrants		—		5,502
Net preferred distributions of subsidiary		(1,775)		(1,147)
Net cash (used in)/ provided by financing activities		(3,970)		4,355
Net (decrease)/ increase in cash		(120,137)		14,556
Cash and cash equivalents at beginning of period		320,989		257,967
Cash and cash equivalents at end of period	$	200,852	$	272,523
Supplemental disclosures				
Cash paid for interest	$	482	$	—
Cash paid for taxes	$	4	$	45

See accompanying notes.

Primus Guaranty, Ltd.
Notes to Consolidated Financial Statements
June 30, 2005

1. Organization and Basis of Presentation

Primus Guaranty, Ltd. ("Primus Guaranty" or the "Company"), is a Bermuda holding company and the 100% owner of Primus (Bermuda), Ltd. ("Primus Bermuda"), also a Bermuda holding company. The Company considers its legal domicile to be where it is incorporated, Bermuda. Primus Bermuda is the 100% owner of Primus Group Holdings, LLC ("Primus Group Holdings"), a Delaware limited liability company. Primus Group Holdings has two principal operating subsidiaries: Primus Financial Products, LLC ("Primus Financial"), and Primus Asset Management, Inc. ("Primus Asset Management"). Primus Financial is a Delaware limited liability company that maintains a long-term counterparty credit rating of AAA from Standard & Poor's Rating Services ("S&P") and Aaa from Moody's Investors Service, Inc. ("Moody's" and, together with S&P, the "Rating Agencies"). Primus Financial is primarily a provider of credit risk protection in the form of credit swaps, covering single name, investment grade corporate and sovereign financial obligations. Primus Financial also sells credit protection referencing portfolios containing obligations of multiple reference entities, or tranches. Primus Asset Management is a provider of administrative and technology support to Primus Financial and an asset manager for Primus Financial and third parties.

Primus Financial and Primus Asset Management function as separate entities from Primus Group Holdings. Additionally, the obligations of Primus Financial are not the obligations of Primus Bermuda, Primus Group Holdings, or any other of its affiliates, and vice versa. Primus Asset Management wholly owns Primus Re, Ltd. ("Primus Re"), a Bermuda company that operates as a financial guarantee insurance company and is licensed as a Class 3 Insurer under the Insurance Act of 1978 of Bermuda.

The accompanying unaudited consolidated financial statements of Primus Guaranty, Ltd. have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the periods presented are not necessarily indicative of the results that may be

expected for any other interim period or for the year ended December 31, 2005. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances have been eliminated.

The consolidated financial statements represent a single reportable segment, as defined in Statement of Financial Accounting Standards ("SFAS") No. 131, Disclosures about Segments of an Enterprise and Related Information.

The consolidated financial statements are presented in U.S. dollar equivalents. At June 30, 2005 and December 31, 2004, Primus Financial's credit swap activities were conducted in U.S. dollars and Euros.

Certain 2004 amounts have been reclassified to be consistent with the 2005 presentation.

2. Summary of Significant Accounting Policies

Credit swaps

Credit swaps are over-the-counter ("OTC") derivative financial instruments and are recorded at fair value in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. Obtaining the fair value (as such term is defined in SFAS No. 133) for such instruments requires the use of management judgment. These instruments are valued using pricing models based on the net present value of expected future cash flows and observed prices for other OTC transactions

---

bearing similar risk characteristics. The fair value of these instruments appears on the consolidated statement of financial condition as unrealized gains or losses on credit swaps. The Company does not believe that its credit swaps fall outside the scope of the guidance of SFAS No. 133 paragraph 10d, as amended by SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, because there is no contractual requirement that the protection purchaser be exposed to the underlying risk.

Net credit swap revenue includes realized and unrealized gains and losses on credit swaps and net premiums earned.

Premiums are taken into income as they are earned over a specified time period. Accrued premiums on credit swaps represent premiums earned but not yet payable by Primus Financial's counterparty. Premiums receivable on credit swaps represents premiums that are both earned by and payable to Primus Financial.

Financial Guarantee-Insurance Contracts

The Company has undertaken a limited amount of financial guarantee business through its subsidiary, Primus Re. Financial guarantees are insurance contracts that contingently require the guarantor to make payments to the guaranteed party. The Company designs its guarantee contracts to qualify as non-derivatives in accordance with the scope exception under paragraph 10d of SFAS 133 as amended by SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This scope exception requires that the guaranteed party be exposed to

loss both at inception and over the life of the contract, incurrence of loss must be a precondition for payment under the contract, and these losses are based on payments to be made solely to reimburse the guaranteed party for failure of the debtor to satisfy its required payment obligations under a nonderivative contract, either at pre-specified payment dates or accelerated payment dates as a result of the occurrence of an event of default (as defined in the financial obligation covered by the guarantee contract) or notice of acceleration being made to the debtor by the creditor. Thus, the Company accounts for its financial guarantee contracts in accordance with SFAS No. 60, Accounting and Reporting by Insurance Enterprises. This requires that premiums are deferred and recognized over the life of the contract and that losses are recorded in the period that they occur based on an estimate of the ultimate cost of losses incurred.

The Company does not actively offer financial guarantee insurance. Rather, it is an alternative the Company has available when a counterparty requests an insurance contract instead of a credit swap. Generally, a counterparty's choice of a financial guarantee insurance contract versus a credit swap is determined by economic terms available in the marketplace as well as regulatory and accounting considerations. Also, the purchaser of an insurance contract cannot submit a claim for payment unless it has an insurable loss, whereas the purchaser of a credit swap need not have actual exposure to the underlying risk.

Insurance Premiums Earned and Receivable and Related Expenses

In exchange for providing financial guarantee protection to counterparties, Primus Re receives premiums over the life of the contract. The amount expected over the life of the policy is reflected in the statement of financial condition and will be reduced as payments are received quarterly in advance.

Although Primus Re provides insurance and purchases off-setting credit swaps through "separate accounts" under a private act, those accounts of Primus Re are not deemed to be separate accounts under SOP 03-01, Accounting & Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts for Separate Accounts, since investment performance is not passed through to the contract holder.

Policy acquisition costs include only those expenses that relate primarily to, and vary with, premium production. Such costs generally include compensation of employees involved in underwriting and policy issuance functions, certain rating agency fees, state premium taxes and certain other underwriting expenses. No costs have been deferred by the Company as of June 30, 2005, as any such amounts have been immaterial.

Deferred Financial Guarantee Premiums

Unearned premiums related to the financial guarantee protection provided are used to establish the liability at inception. This liability is reflected in income on a straight-line basis over the period the risk protection is provided.

Unpaid Losses and Loss Expenses on Financial Guarantees

Liabilities for unpaid losses and loss expenses include the accumulation of individual case estimates for claims reported as well as estimates of incurred but not reported claims and estimates of loss settlement expenses on the

obligations it has insured. Estimates will be based upon historical industry loss experience modified for current trends as well as prevailing economic, legal and social conditions. Any changes in estimates are reflected in operating results in the period in which the estimates changed. At June 30, 2005 and at December 31, 2004, the Company had no loss reserves recorded.

Income Taxes

Income tax expense is computed in accordance with the requirements of SFAS No. 109, Accounting for Income Taxes, which prescribes the asset and liability approach to accounting for income taxes. The asset and liability approach requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities.

Employee Compensation Plans

In 2003, the Company adopted the fair value approach on a prospective basis for recording stock-based employee compensation in accordance with the fair value method prescribed by SFAS No. 123, Accounting for Stock-based Compensation, as amended by SFAS No. 148, Accounting for Stock Based Compensation—Transition and Disclosure. Compensation expense is recognized based on the fair value of stock options, performance shares, restricted shares and restricted share units ("RSU") granted over the related vesting period. The fair value of the stock options granted is determined through the use of an option-pricing model.

Recently Issued Accounting Standards

In May 2005, the FASB issued SFAS 154, Accounting Changes and Error Corrections – a replacement of APB Opinion No. 20 and FASB Statement No. 3. This statement requires retrospective application to prior periods' financial statements of changes in accounting principle. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS 154 is not expected to have a significant impact on the Company's financial statements.

In December 2004, the FASB issued SFAS 123R, which replaces SFAS 123 and supersedes APB 25. SFAS 123R eliminates the choice of alternative accounting methods, and requires that all entities follow the fair value based method of SFAS 123. Public entities will be required to apply Statement 123R at the beginning of the first fiscal year beginning after June 15, 2005. The adoption of SFAS 123R is not expected to have a significant impact on the Company's financial statements.

---

3. Cash and Cash Equivalents

The Company and its subsidiaries invest only in obligations of the United States of America or direct debt obligations of U.S. Agencies (including government-sponsored enterprises) rated AAA and Aaa by the respective Rating Agencies, commercial paper rated A-1 and P-1 by the respective Rating Agencies and money market funds.

All outstanding obligations in this category mature within 90 days.

4. Available-for-Sale Investments

Available-for-sale investments included obligations of the United States of America or direct debt obligations of U.S. Agencies (including government-sponsored enterprises) rated AAA and Aaa by the respective Rating Agencies. Available-for-sale investments have original maturities or maturities at time of purchase greater than 91 days. At June 30, 2005, no investment has an original maturity or maturity at time of purchase of greater than 3 years.

Available-for-sale investments are reported in the balance sheet at their fair value. Changes in fair value are reported in other comprehensive income in shareholders' equity.

During the second quarter of 2005, interest income was adjusted to reflect a reduction attributable to the fourth quarter of 2004 (in the amount of $126,000) and the first quarter of 2005 (in the amount of $466,000), as the amortization of purchased premium on certain investment securities was not charged against interest income for such periods. The unrecorded amortization was not material to net income (loss) in either of the previous periods.

5. Credit Swap Revenues and Portfolio

Net credit swap revenue, as presented in the consolidated statement of operations, comprises changes in the fair value of credit swaps, realized gains or losses on the termination of credit swaps and premium income or expense. The realized gains and losses on credit swaps represent realized gains and losses on unwound or assigned credit swaps. The realization of gains or losses on credit swaps will generally result in a reduction in unrealized gains or losses and accrued premium at the point in time realization occurs.

In exchange for providing credit protection to its counterparties, Primus Financial receives premium payments as a series of fixed cash flows. Premiums are taken into income as they are earned over a specified time period. Accrued premiums on credit swaps represent premiums earned but not yet payable by Primus Financial's counterparty. Premiums receivable on credit swaps represents premiums that are both earned by and payable to Primus Financial. When Primus Financial purchases credit protection from its counterparties, Primus Financial pays premiums as a series of fixed cash flows. The premium expense is recognized ratably over the life of the transaction as a component of net credit swap revenue.

Under the terms of Primus Financial's operating guidelines, derivatives transactions can only include credit swaps. Credit swaps are derivative transactions that obligate one party to the transaction (the "Seller") to pay an amount to the other party to the transaction (the "Buyer") should one of a specified group of events ("Credit Events") be incurred by an unrelated third party (the "Reference Entity") specified in the contract. The amount to be paid by the Seller will either be (a) the notional amount of the transaction, in exchange for which the Seller must be delivered a defined obligation of the Reference Entity (called physical settlement), or (b) the difference between the current market value of a defined obligation of the Reference Entity and the notional amount of the transaction (called cash settlement). In exchange for incurring the potential of a Credit Event-generated loss, the Seller will receive a fixed premium for the term of the contract (or until the occurrence of a Credit Event). The fixed premium is generally paid quarterly in arrears over the term of the transaction.

Primus Guaranty, Ltd.
Notes to Consolidated Financial Statements
June 30, 2005

Nearly all transactions entered into between the Buyer and the Seller are subject to an ISDA master agreement executed by both parties. The master agreement allows for the consolidation of the market exposures and termination of all transactions between the Buyer and Seller in the event a Default (as defined by the master agreement) is incurred by either party.

Primus Financial is primarily a Seller of credit swaps, although it may also buy credit swaps. Credit swaps purchased to off-set risks do not qualify as hedges in accordance with SFAS No. 133. In addition, Primus Financial is permitted to purchase credit swaps in order to seek short-term market appreciation as a limited percentage of its overall portfolio (represented as Credit Swaps Purchased as short-term investments in the tables below). The company's operating guidelines and board authorization limit the notional amount of credit swaps purchased for this purpose to seven and a half percent of the notional amount of credit swaps sold.

As a general rule, when the Company sells credit protection, it intends to maintain the transaction until maturity. However, there are two sets of circumstances in which the Company could elect to terminate transactions prior to maturity, and the Company monitors its portfolio on a continuing basis to assess whether those circumstances are present.

First, whenever the Company receives new information suggesting that the credit quality of the underlying risk has deteriorated to a material degree, the Company considers the possibility of terminating the transaction, usually at a loss, to avoid the larger loss that could result if the credit swap were to remain in place until a credit event occurs. The principal factor that governs the Company's decision regarding termination in these circumstances is whether the Company believes that the underlying risk has become substantially greater than the level of risk the Company would choose to assume in entering into a new sale of credit default protection.

Second, the Company may also elect to terminate a transaction for which it has an unrealized gain based on one or more of the following considerations: the likelihood of further gains arising from the position, its view as to whether the capital dedicated to the position would be profitably reallocated, its total exposure to a particular Reference Entity, the total size of its portfolio in relation to its capital and the total size of its swap positions and exposures with a particular counterparty which might be reduced so that the counterparty may enter into additional swaps with the Company.

The Company terminates (or offsets) a credit swap in any one of three ways. The Company may negotiate an agreed termination through the original counterparty (an unwind). The Company may negotiate an assignment and novation of its rights and obligations under the credit swap to a third party (an assignment). As an alternative to terminating a transaction, the Company may enter into an equal and opposite transaction with a third party under which the Company purchases credit default protection on terms that match the terms of the original transaction (an offset). In this last case, both sides of the position may subsequently be unwound or assigned.

In the event of an unwind or assignment, the Company pays or receives a cash settlement negotiated with the counterparty or assignee, based on the fair value of the credit swap contract and the accrued premium on the swap contract at the time of negotiation. The amounts the Company pays or receives are recorded as a realization of fair value and as a realization of accrued premiums in the period in which the termination occurs.

The primary risks inherent in the Company's activities are (a) that Reference Entities specified in its credit swap transactions will incur Credit Events (Credit Events may include any or all of the following: bankruptcy, failure to pay, repudiation or moratorium, and modified or original restructuring) that will require Primus Financial to make payments to the Buyers of the transactions, (b) where Primus Financial is a Buyer of a credit swap and a Credit Event

occurs, the Seller fails to make payment to the Company, and (c) that Buyers of the transactions from Primus Financial will default on their required premium payments at times when the fair value of the underlying transactions are positive to Primus Financial. Since inception, none of these events had occurred.

The Company distinguishes among credit swaps sold – single name, credit swaps sold – tranche, credit swaps purchased as short-term investments and credit swaps purchased to offset the credit risk on credit swaps previously sold. Credit swaps sold – single name refers to credit swap protection relating to a single reference entity. Credit swaps sold – tranche refers to credit swap protection referencing portfolios containing obligations of multiple reference entities, and we began selling protection of this type during the second quarter of 2005. All credit swaps purchased refer to credit swap protection on single name reference entities.

The tables below present the components of credit swap revenues for the three and six months ended June 30, 2005 and 2004, in thousands.

Net credit swap revenues/ (losses) for the three months ended June 30, 2005

	Premium income/ (expense)	Realized gains	Realized (losses)	Change in unrealized gains/(losses)	Total
Credit swaps sold – single name	$ 12,653	$ 470	$ (3,019)	$ (14,765)	$ (4,661)
Credit swaps sold – tranche	96	—	—	467	563
Credit swaps purchased as short-term investments	(329)	635	(23)	219	502
Credit swaps purchased to offset credit risk on certain swaps sold	(23)	—	—	40	17
Total	$ 12,397	$ 1,105	$ (3,042)	$ (14,039)	$ (3,579)

Net credit swap revenues/ (losses) for the six months ended June 30, 2005

	Premium income/ (expense)	Realized gains	Realized (losses)	Change in unrealized gains/(losses)	Total
Credit swaps sold – single name	$ 24,281	$ 589	$ (3,019)	$ (34,728)	$ (12,877)
Credit swaps sold – tranche	96	—	—	467	563
Credit swaps purchased as short-term investments	(732)	656	(30)	626	520
	(46)	—	—	63	17

Credit swaps purchased to offset credit risk on certain swaps sold										
Total	$	23,599	$	1,245	$	(3,049)	$	(33,572)	$	(11,777)

Net credit swap revenues/ (losses) for the three months ended June 30, 2004

		Premium income/ (expense)		Realized gains		Realized (losses)		Change in unrealized gains/(losses)		Total
Credit swaps sold – single name	$	10,398	$	936	$	(1)	$	(5,288)	$	6,045
Credit swaps sold – tranche		(126)		304		(32)		(313)		(167)
Credit swaps purchased to offset credit risk on certain swaps sold		(23)		—		—		10		(13)
Total	$	10,249	$	1,240	$	(33)	$	(5,591)	$	5,865

11

Primus Guaranty, Ltd.
Notes to Consolidated Financial Statements
June 30, 2005

Net credit swap revenues/ (losses) for the six months ended June 30, 2004

		Premium income/ (expense)		Realized gains		Realized (losses)		Change in unrealized gains/(losses)		Total
Credit swaps sold – single name	$	20,408	$	2,109	$	(13)	$	(20,255)	$	2,249
Credit swaps sold – tranche		(248)		740		(47)		137		582
Credit swaps purchased to offset credit risk on certain swaps sold		(46)		—		—		50		4
Total	$	20,114	$	2,849	$	(60)	$	(20,068)	$	2,835

For the six months ended June 30, 2005, two counterparties each generated greater than ten percent of the Company's total premium revenue, and for the six months ended June 30, 2004, three counterparties each generated greater than ten percent of the Company's total premium revenue.

In accordance with accounting principles generally accepted in the United States, the Company carries its credit swaps on its balance sheet at their fair value. Changes in the fair value of the Company's credit swap portfolio are recorded as unrealized gains or losses in the Company's consolidated income statement. If a credit swap has an increase in fair value during a period, the increase will add to the Company's net credit swap revenues for that period. Conversely, if a credit swap has a decline in fair value during the period, the decline will subtract from the Company's net credit swap revenues for that period. Changes in the fair value of the Company's credit swap portfolio are a function of the notional amount and composition of the portfolio and prevailing market credit swap premiums for comparable credit swaps. The Company generally holds the credit swaps it sells to maturity, at which point, assuming no credit event has

occurred, the cumulative unrealized gains and losses on each credit swap would equal zero. In general, the Company aggregates fair values of individual credit swaps by counterparty for presentation on the Company's statement of condition. If the aggregate total of fair values for a counterparty is a net gain, the total is recorded as a component of unrealized gains on credit swaps, at fair value in the statement of financial condition. If the aggregate total of fair values for a counterparty is a net loss, the total is recorded as a component of unrealized losses on credit swaps, at fair value in the statement of financial condition. Aggregation by counterparty is applied where a valid ISDA master agreement is in place with the counterparty. In instances where the Company does not yet have a valid ISDA master agreement with the counterparty, the fair values of individual swap transactions are recorded as components of unrealized gains or losses on credit swaps, at fair value, dependent upon whether the individual contract was at a gain or a loss.

12

Primus Guaranty, Ltd.
Notes to Consolidated Financial Statements
June 30, 2005

The notional amount, fair value and average fair value of open credit swap transactions entered into with third parties at June 30, 2005 and December 31, 2004 are as follows (in thousands):

	June 30, 2005	December 31, 2004
Gross Notional Amounts:		
Credit swaps sold – single name	$ 12,227,060	$ 10,544,728
Credit swaps sold – tranche	50,000	—
Credit swaps purchased	389,512	468,175
Fair value:		
Asset	17,511	46,517
Liability	4,843	259
Average fair value:		
Asset	28,866	33,778
Liability	4,471	392

"Asset" in the above table represents unrealized gains on credit swaps while "Liability" represents unrealized losses on credit swaps. All credit swaps that have been contractually established with each counterparty under an ISDA master agreement are subject to netting arrangements. The notional amounts of the credit swap contracts in the preceding table are presented on a gross basis and the fair values of such contracts are presented net by counterparty, where a master agreement is in place. "Average fair value" in the table above represents the averages over the six months ended June 30, 2005 and the year ended December 31, 2004.

The tables below summarize the notional amounts and net fair value by Reference Entities and Counterparties of credit swap transactions as of June 30, 2005 and December 31, 2004.

Risk off-set transactions are included in the table above and tables below as part of Credit Swaps Purchased. The total notional amounts of risk off-set transactions were $5.0 million at June 30, 2005 and December 31, 2004. Fair value of

the risk offset transactions equaled $(142) thousand and $(206) thousand at June 30, 2005 and December 31, 2004, respectively.

Primus Guaranty, Ltd.
Notes to Consolidated Financial Statements
June 30, 2005

(in thousands and U.S. dollar equivalent)

	June 30, 2005		December 31, 2004	
Moody's Rating Category	Notional Amount	Fair Value	Notional Amount	Fair Value
Reference Entity				
Credit Swaps Sold – Single Name:				
Aaa	$ 625,540	$ 544	$ 651,270	$ 866
Aa	2,284,290	3,197	1,917,131	5,609
A	4,920,193	13,204	4,310,452	22,511
Baa	4,329,983	(57)	3,642,330	19,295
Ba	61,000	(2,186)	23,545	179
Caa	6,054	(905)	—	—
Total	$ 12,227,060	$ 13,797	$ 10,544,728	$ 48,460
Credit Swaps Sold – Tranche:				
Aa	$ 50,000	$ 467	$ —	$ —
Total	$ 50,000	$ 467	$ —	$ —
Credit Swaps Purchased:				
Aaa	$ 44,216	$ (185)	$ 47,090	$ (158)
Aa	12,108	(15)	13,545	(44)
A	200,810	(585)	209,815	(803)
Baa	96,054	(510)	160,635	(969)
NR	36,324	(281)	37,090	(228)
Total	$ 389,512	$ (1,576)	$ 468,175	$ (2,202)
Counterparty Buyer				
Credit Swaps Sold – Single Name:				
Aaa	$ 5,000	$ 21	$ 5,000	$ 49
Aa	10,163,957	8,321	8,304,867	35,922
A	2,058,103	5,455	2,234,861	12,489
Total	$ 12,227,060	$ 13,797	$ 10,544,728	$ 48,460
Credit Swaps Sold – Tranche:				
Aa	$ 50,000	$ 467	$ —	$ —
Total	$ 50,000	$ 467	$ —	$ —
Counterparty Seller				
Credit Swaps Purchased:				

Aa	$ 301,350	$ (1,213)	$ 387,858	$ (1,699)
A	88,162	(363)	80,317	(503)
Total	$ 389,512	$ (1,576)	$ 468,175	$ (2,202)

Primus Guaranty, Ltd.
Notes to Consolidated Financial Statements
June 30, 2005

	June 30, 2005		December 31, 2004	
S&P Rating Category	Notional Amount	Fair Value	Notional Amount	Fair Value
Reference Entity				
Credit Swaps Sold – Single Name:				
AAA	$ 640,540	$ 448	$ 627,725	$ 822
AA	1,962,182	2,388	1,826,628	4,462
A	5,651,273	15,532	4,863,204	25,569
BBB	3,844,011	2,889	3,217,171	17,536
BB	123,000	(6,555)	10,000	71
B	6,054	(905)	—	—
Total	$ 12,227,060	$ 13,797	$ 10,544,728	$ 48,460
Credit Swaps Sold – Tranche:				
AA	$ 50,000	$ 467	$ —	$ —
Total	$ 50,000	$ 467	$ —	$ —
Credit Swaps Purchased:				
AAA	$ 44,216	$ (185)	$ 57,090	$ (198)
AA	24,216	(61)	27,090	(109)
A	213,702	(759)	216,270	(940)
BBB	95,270	(446)	167,725	(955)
N/R	12,108	(125)	—	—
Total	$ 389,512	$ (1,576)	$ 468,175	$ (2,202)
Counterparty Buyer				
Credit Swaps Sold – Single Name:				
AAA	$ 29,216	$ (303)	$ 5,000	$ 49
AA	8,224,179	6,123	6,643,559	27,941
A	3,973,665	7,977	3,896,169	20,470
Total	$ 12,227,060	$ 13,797	$ 10,544,728	$ 48,460
Credit Swaps Sold – Tranche:				
AA	$ 50,000	$ 467	$ —	$ —
Total	$ 50,000	$ 467	$ —	$ —
Counterparty Seller				
Credit Swaps Purchased:				
AA	$ 247,134	$ (1,219)	$ 290,768	$ (1,433)

A	142,378	(357)	177,407	(769)
Total	$ 389,512	$ (1,576)	$ 468,175	$ (2,202)

Primus Financial's operating guidelines impose various limits on the geographical concentration of its business based on the country of domicile of each Reference Entity. Additionally, Primus Financial's counterparties are global financial institutions, and nearly all have entered into Master Agreements with Primus Financial that consolidate the counterparty risk to one office of that counterparty.

Primus Guaranty, Ltd.
Notes to Consolidated Financial Statements
June 30, 2005

The table below shows the geographical distribution of Primus Guaranty's credit swap portfolio by domicile of the Reference Entity and domicile of the counterparty (in thousands and U.S. dollar equivalent):

	June 30, 2005		December 31, 2004	
Country of Domicile	Notional Amount	Fair Value	Notional Amount	Fair Value
Credit Swaps Sold – Single Name				
By Reference Entity:				
North America	$ 7,259,770	$ 2,652	$ 5,798,363	$ 28,926
Europe	4,478,290	10,445	4,367,365	17,733
Pacific	365,000	708	305,000	1,421
Others	124,000	(8)	74,000	380
Total	$ 12,227,060	$ 13,797	$ 10,544,728	$ 48,460
By Counterparty:				
North America	$ 6,687,777	$ 4,899	$ 5,596,849	$ 23,146
Europe	5,482,283	8,808	4,885,879	25,110
Others	57,000	90	62,000	204
Total	$ 12,227,060	$ 13,797	$ 10,544,728	$ 48,460
Credit Swaps Sold – Tranche				
By Counterparty:				
U.S.	$ 50,000	$ 467	$ —	$ —
Total	$ 50,000	$ 467	$ —	$ —
Credit Swaps Purchased				
By Reference Entity:				
North America	$ 220,000	$ (844)	$ 265,000	$ (1,282)
Europe	169,512	(732)	203,175	(920)
Total	$ 389,512	$ (1,576)	$ 468,175	$ (2,202)
By Counterparty:				
North America	$ 171,324	$ (572)	$ 215,635	$ (935)
Europe	198,188	(915)	232,540	(1,110)

Others		20,000		(89)		20,000		(157)
Total	$	389,512	$	(1,576)	$	468,175	$	(2,202)

Notional amount and fair value is not broken out by country for the tranche sold, as it is not applicable.

The table below shows the distribution of Primus Guaranty's credit swap portfolio by year of maturity as of June 30, 2005 and December 31, 2004 (in thousands and U.S. dollar equivalent):

	June 30, 2005				December 31, 2004			
Country of Domicile		Notional Amount		Fair Value of Transaction		Notional Amount		Fair Value of Transaction
Credit Swaps Sold – Single Name								
Year of Maturity								
2005	$	1,745,638	$	908	$	2,841,441	$	3,859
2006		998,562		992		1,014,554		1,340
2007		2,512,296		14,750		2,583,503		20,442
2008		1,123,383		7,673		1,184,157		11,427
2009		2,741,492		(1,385)		2,901,073		11,423
2010		3,105,689		(9,141)		20,000		(31)
Total	$	12,227,060	$	13,797	$	10,544,728	$	48,460
Credit Swaps Sold – Tranche								
Year of Maturity	$	50,000	$	467	$	—	$	—
2010	$	50,000	$	467	$	—	$	—
Credit Swaps Purchased								
Year of Maturity								
2007	$	10,000	$	(47)	$	10,000	$	(43)
2008		15,000		74		15,000		(21)
2009		344,512		(1,605)		443,175		(2,138)
2010		20,000		2		—		—
Total	$	389,512	$	(1,576)	$	468,175	$	(2,202)

6. Long Term Debt of Subsidiary

Primus Financial issued $75.0 million of subordinated deferrable interest notes on July 23, 2004 that mature in July 2034. The notes are subordinated in right of payment to the prior payment in full of all existing and future senior indebtedness of the company, including counterparty claims. The rate on the notes is set through a monthly auction process, although the Company has the option to fix the rate for longer periods of time. The notes are redeemable at the option of Primus Financial, in whole or in part, on any auction date, at a redemption price equal to 100% of the

principal amount of the notes to be redeemed, plus any accrued and unpaid interest thereon to the redemption date. The interest rate on the notes was fixed on the issue date at a rate of 2.57% (LIBOR plus 20 basis points) for a period of one year, expiring in July of 2005, at which point the rate will be set through a monthly auction process. The Company incurred interest expense (excluding amortization of debt issuance costs) of $487 and $969 thousand on these subordinated notes for the three and six months ended June 30, 2005, respectively.

Costs associated with the issuance of this debt were approximately $1.2 million and are shown net of accumulated amortization in the Company's consolidated statement of financial condition as debt issuance costs, and amortized over the life of the debt. Amortization of debt issuance costs is included in interest expense in the Company's consolidated statement of operations.

---

7. Earnings per Share

Basic earnings per share ("EPS") is calculated by dividing earnings available to common stockholders by the weighted average number of common shares outstanding. Diluted EPS is similar to basic EPS, but adjusts for the effect of the potential issuance of common shares. The following table presents the computations of basic and diluted EPS:

		Three months ended June 30,					Six months ended June 30,				
		2005			2004		2005			2004	
Net earnings (loss) available to common stockholders	$	(9,180)		$	174	$	(23,034)		$	(8,088)	
Weighted-average basic shares outstanding		43,108			3,527		43,160			3,353	
Effect of dilutive instruments											
Series A Preferred Stock		—			29,953		—			—	(a)
Employee stock options		—	(a)		91		—	(a)		—	(a)
Restricted share units		—	(a)		426		—	(a)		—	(a)
Warrants		—	(a)		771		—	(a)		—	(a)
Dilutive potential shares		—			31,241		—			—	
Diluted shares		43,108			34,768		43,160			3,353	
Basic EPS	$	(0.21)		$	0.05	$	(0.53)		$	(2.41)	
Diluted EPS	$	(0.21)		$	0.01	$	(0.53)		$	(2.41)	

(a) Securities (including those issuable pursuant to contingent stock agreements) that could potentially dilute basic EPS were not included in the computation of diluted EPS because to do so would have been anti-dilutive for the periods presented. In 2005, employee stock options totaling 157,545 and 195,069 shares, restricted share units equal to 396,883 and 415,601 shares and warrants representing 868,835 and 898,025 shares of common stock were excluded, for the three and six months ended June 30, 2005,

respectively. For the six months ended June 30, 2004, Series A Preferred Stock which converted to 29,953 thousand shares, employee stock options totaling 531,875 shares, restricted share units equaling 728,315 shares and warrants representing 2,476 thousand shares of common stock were excluded.

8. Stock Based Compensation

For the six months ended June 30, 2005, the company retired common shares in an amount equal to approximately $2.4 million, representing the amount withheld to pay employee income taxes due upon the delivery of common shares to its employees. In addition, for the three and six months ended June 30, 2005, approximately 36 thousand and 40 thousand options were exercised, respectively.

18

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion and analysis of our financial condition and results of operations. This discussion should be read in conjunction with our consolidated financial statements and accompanying notes which appear in the Company's Annual Report on Form 10-K. It contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and in the Company's Annual Report on Form 10-K, particularly under the headings "Risk Factors" and "Cautionary Note Regarding Forward-Looking Statements."

Business Overview

We, through our principal operating subsidiary, Primus Financial, are primarily engaged in selling credit protection against investment grade credit obligations of corporate and sovereign entities. In exchange for a fixed quarterly premium, if a bankruptcy, failure to pay or restructuring occurs with respect to a Reference Entity upon which Primus Financial has sold credit protection, Primus Financial agrees to pay the notional amount of the credit swap contract to its Counterparty in exchange for delivery of a credit obligation of that Reference Entity. We seek to minimize the risk inherent in our credit swap portfolio by maintaining a high quality, highly diversified credit swap portfolio across Reference Entities, industries and countries.

Primus Financial has the highest counterparty credit ratings offered by S&P (AAA) and Moody's (Aaa) and is managed by an experienced team of professionals who have expertise in credit analysis, investing, risk management and market analysis.

Primus Asset Management manages the credit swap portfolios of Primus Financial and third parties. For such services, Primus Asset Management receives a management fee.

Primus Re operates as a financial guarantee insurance company, and generates revenue by charging a higher insurance premium for protection sold than the premium it pays for the offsetting protection it purchases.

Critical Accounting Policies

Valuation of Credit Swaps

From the inception of our business, we have applied SFAS, 133, "Accounting for Derivative Instruments and Hedging Activities," which established accounting and reporting standards for derivative instruments. SFAS 133 requires recognition of all credit swaps on the balance sheet at fair value. The market credit swap premium levels used to

determine fair value generally take into account the expectation of such events.

The fair value of the credit swaps depends on a number of factors, primarily the market level of credit swap premiums associated with individual Reference Entities and interest rates. Credit swaps are valued using market-standard pricing models which calculate the net present value of differences between future premiums on currently quoted market credit swaps and the contractual future credit swap premiums on contracts we have undertaken. Our pricing model has been internally developed but is benchmarked against a market-standard model. Generally, our model uses quoted market credit swap premium data on individual Reference Entities that we purchase from an independent pricing service. This service takes pricing information from a number of prominent brokers and dealers in the credit swap market across a range of standard maturities and restructuring terms, and creates average market credit swap premium quotes on specific Reference Entities.

We believe there are a variety of factors that may influence market credit swap premium levels. The principal factor is the market's view of the probability that a Reference Entity will default over the multi-year horizon typical for a credit swap contract. Those views in turn are influenced by the state of the economy, the outlook for corporate financial health in general as well as the outlook for

19

---

particular industries and companies. Additional factors include the magnitude of debt outstanding and debt paying capacity within those same industries and companies. One factor specific to the credit swap market is the capacity of credit swap market participants to sell credit swaps. If, for example, commercial banks are actively buying protection to manage their regulatory capital, this will tend, other factors being equal, to absorb the capacity of protection sellers and cause an increase in market credit swap premiums. Conversely, creation of special purpose vehicles that sell protection create additional protection seller capacity and, absent additional demand, can cause a decrease in market premiums. Absent rapid and steep changes, interest rates have, at most, a limited effect on market credit swap premium levels.

Financial Guarantees

We have undertaken a limited amount of financial guarantee business through our subsidiary, Primus Re. Financial guarantees are insurance contracts that contingently require the guarantor to make payments to the guaranteed party. Primus Re designs its guarantee contracts to qualify as non-derivatives in accordance with the scope exception under paragraph 10d of SFAS 133, as amended by SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". We account for our financial guarantee contracts in accordance with SFAS No. 60, "Accounting and Reporting by Insurance Enterprises". This requires that premiums are deferred and recognized over the life of the contract and that losses are recorded in the period that they occur based on an estimate of the ultimate cost of losses incurred. Policy acquisition costs include only those expenses that relate primarily to, and vary with, premium production. No policy acquisition costs have been deferred by us as of June 30, 2005, as any such amounts have been immaterial. As of June 30, 2005, only three contracts had been written.

We do not actively offer financial guarantee insurance. Rather, it is an alternative we have available when a counterparty requests an insurance contract instead of a credit swap. Generally, a counterparty's choice of a financial guarantee insurance contract versus a credit swap is determined by economic terms available in the marketplace as well as regulatory and accounting considerations. Also, the purchaser of an insurance contract cannot submit a claim for payment unless it has an insurable loss, whereas the purchaser of a credit swap need not have actual exposure to the underlying risk.

Stock-Based Employee Compensation Plans

Prior to 2003, we followed Accounting Principles Board, or APB, No. 25, "Accounting for Stock Issued to Employees". In 2003, we adopted the fair value approach on a prospective basis for recording stock-based employee compensation in accordance with the fair value method prescribed in SFAS 123, "Accounting for Stock-Based Compensation", as amended by SFAS 148, "Accounting for Stock-Based Compensation—Transition and Disclosure". Under these rules, compensation expense is recognized based on the fair value of stock options, performance shares, restricted shares and restricted share units at the time of an award, adjusted and amortized over the related vesting period. The fair value of the stock options granted is determined through the use of a market-standard option-pricing model, which requires judgment as to appropriate volatility and interest rate factors. Prior to our IPO on September 30, 2004, in the absence of a public market for our common shares, management and the board of directors estimated the market value of our common shares for all options, restricted share units and share issuances based on valuation opinions from independent valuation consultants. After the IPO, the fair value used is the market value of our common shares at the grant date.

In December 2004, the FASB issued SFAS 123R, which replaces SFAS 123 and supersedes APB 25. SFAS 123R eliminates the choice of alternative accounting methods, and requires that all entities follow the fair value based method of SFAS 123. Public entities will be required to apply Statement 123R as of the first annual reporting period that begins after June 15, 2005. The adoption of SFAS 123R is not expected to have a significant impact on the Company's financial statements.

20

Results of Operations

Overview

During early 2005, market premium levels on credit swaps were relatively unchanged from levels as of December 31, 2004. However, from March 2005 through the end of the second quarter, we observed significant increases in market premium levels, particularly in certain reference entity industry sectors, such as automobiles and insurance. As a result of the upward movements in market premium levels, the fair value of our credit swaps sold portfolio declined; this decline was partially offset by a slight reduction in unrealized losses on our portfolio of credit swaps purchased. During the second quarter we terminated a number of credit swaps sold in order to mitigate our credit risk, resulting in realized losses of approximately $2.9 million. In addition, we engaged in our first tranche transaction, whereby we sell credit protection referencing portfolios containing obligations of multiple reference entities. We recorded premium income, as well as an unrealized gain on the tranche sold during the second quarter of 2005.

Three months ended June 30, 2005 compared with three months ended June 30, 2004

We had net income (loss) of $(9.2) million and $174 thousand for the three months ended June 30, 2005 and 2004, respectively. The net loss for the quarter ended June 30, 2005 was primarily driven by the increase in unrealized losses caused by the depreciation in the value of the credit swap portfolio during the quarter, coupled with losses realized from the early termination of certain credit swaps and increased expenses as a result of our expanded operations. The results for the quarter ended June 30, 2005 and the quarter ended June 30, 2004, are discussed below.

Net Credit Swap Revenue (Loss)

Net credit swap revenue (loss) was $(3.6) million and $5.9 million for the three months ended June 30, 2005 and 2004, respectively. Net credit swap revenue (loss) includes:

- Net premiums earned;
- Net realized gains (losses) on credit swaps; and
- Net unrealized gains (losses) on credit swaps.

The table below shows the component parts of net credit swap revenue for the three months ended June 30, 2005 and 2004:

($ in thousands)	Three months ended June 30,	
	2005	2004
Net premiums earned	$ 12,396	$ 10,249
Net realized gains (losses) on credit swaps	(1,937)	1,207
Net unrealized losses on credit swaps	(14,038)	(5,591)
Total Net Credit Swap Revenue (Loss)	$ (3,579)	$ 5,865

Net Premiums Earned

Net premiums earned were $12.4 million and $10.2 million for the three months ended June 30, 2005 and 2004, respectively. Net premiums earned include:

- Premium income on credit swaps sold-single name;
- Premium income on credit swaps sold-tranche;
- Premium expense on credit swaps purchased as short-term investments; and
- Premium expense on credit swaps purchased to offset credit risk on certain credit swaps sold.

The increase in net premiums earned was primarily driven by the increase in the size of the credit swaps sold portfolio from the 2004 period, slightly offset by an increase in the premiums paid for credit swaps purchased for short-term investment purposes in the second quarter of 2005. The table below shows the component parts of net premiums earned for the three months ended June 30, 2005 and 2004.

($ in thousands)	Three months ended June 30,	
	2005	2004
Premium income on credit swaps sold-single name	$ 12,653	$ 10,398
Premium income on credit swaps sold-tranche	96	—
Premium expense on credit swaps purchased as short-term investments	(329)	(126)
Premium expense on credit swaps purchased to offset credit risk on certain swaps sold	(23)	(23)

Total Net Premiums Earned	$	12,397	$	10,249

Premium income on credit swaps sold-single name increased primarily as a result of the expansion in our credit swaps sold portfolio. The notional amounts outstanding of credit swaps sold were $12.2 billion and $8.6 billion at June 30, 2005 and 2004, respectively.

We began to sell protection in tranche format during the second quarter of 2005, whereby we sell credit swaps referencing portfolios containing obligations of multiple reference entities. Premium income from the tranche sold was $96 thousand for the second quarter of 2005, and the total notional amount outstanding was $50 million at June 30, 2005.

The premium expense on credit swaps purchased as short-term investments was $329 thousand and $126 thousand for the three months ended June 30, 2005 and 2004, respectively. The notional amounts outstanding on credit swaps purchased as short-term investments were $389.5 million and $217.1 million at June 30, 2005 and 2004, respectively.

The notional amounts of credit swaps that we had purchased to offset credit risk on certain credit swaps sold were $5.0 million and $5.0 million at June 30, 2005 and 2004.

Net Realized Gains (Losses) on Credit Swaps

Our business strategy is generally to hold swaps we sell until maturity. However, there are circumstances in which we may terminate a credit swap prior to maturity, either as a result of credit considerations or in order to realize gains. We cannot identify at the outset of any credit swap transaction whether the credit swap will be terminated or otherwise disposed of prior to its maturity. If the credit swaps we terminate are at attractive market values, we are able to realize gains. Terminating transactions also allows us to accelerate premium receipts and provides for additional growth capacity within our credit swap portfolio.

In certain circumstances we will terminate a credit swap at a realized loss. In general, we terminate credit swaps at a loss where we perceive that the credit quality of the underlying reference entity risk has deteriorated, and we wish to reduce or eliminate our exposure to the reference entity. We may also terminate a credit swap at a loss in order to create opportunity to rebalance our portfolio. We terminated $245.1 million and $70.0 million notional amount of credit swaps sold for the three months ended June 30, 2005 and 2004, respectively. Net realized gains (losses) from the early termination of credit swaps were $(1.9) million and $1.2 million for the three months ended June 30, 2005 and 2004, respectively. The net realized losses incurred during the second quarter of 2005 was primarily the result of our decision to mitigate our exposure to a limited number of reference entities, which had become the subject of leveraged buy-outs which increased the credit risk of those reference entities.

We realized gains of $470 thousand and $936 thousand for the three months ended June 30, 2005 and 2004, respectively. The decrease in realized gains is due to smaller gains on terminations that took

---

place in the 2005 period. We realized losses of $3.0 million and $1 thousand for the three months ended June 30, 2005, and 2004, respectively, of which $2.9 million was caused by the termination of credit swaps to mitigate our credit exposure.

Where we have purchased credit protection as a short-term investment, early termination of the credit swaps is a fundamental part of the business strategy. We terminated $83 million and $115 million notional amount of credit swaps purchased during the three months ended June 30, 2005 and 2004, respectively, realizing a net gain of $612 thousand and $272 thousand, respectively.

Net realized gains (losses) for the three months ended June 30, 2005 and 2004 are summarized below:

($ in thousands)	Three months ended June 30, 2005		Three months ended June 30, 2004	
Realized gains on terminated credit swaps sold – single name	$	470	$	936
Realized losses on terminated credit swaps sold – single name		(3,019)		(1)
Realized gains on terminated credit swaps purchased as short-term investments		635		304
Realized losses on terminated credit swaps purchased as short-term investments		(23)		(32)
Total Net Realized Gains (Losses) on terminated credit swaps	$	(1,937)	$	1,207

Net Unrealized Gains (Losses) on Credit Swaps

Net unrealized losses on credit swaps were $14.0 million for the three months ended June 30, 2005 as compared with $5.6 million for the three months ended June 30, 2004. The increase in unrealized losses on credit swaps reflects the change in the fair value of our credit swap portfolio, and is partially due to the increase in market credit swap premium levels experienced during the quarters ended June 30, 2005 and 2004. In 2005, we also recorded unrealized losses on certain reference entities which were downgraded or were the subject of leveraged buy-outs during the period. The unrealized losses on credit swaps sold-single name, credit swaps sold-tranche and credit swaps purchased as short-term investments and for credit risk offset purposes for the three months ended June 30, 2005 and 2004 are summarized below:

($ in thousands)	Three months ended June 30, 2005		Three months ended June 30, 2004	
Net unrealized losses on credit swaps sold-single name		(14,765)	$	(5,288)
Net unrealized gains on credit swaps sold-tranche		467		—
Net unrealized gains (losses) on credit swaps purchased as short-term investments		219		(313)
Net unrealized gains on credit swaps purchased to offset credit risk on certain credit swaps sold		40		10
Total Net Unrealized Losses on credit swaps	$	(14,039)	$	(5,591)

Asset Management Fees

We commenced our third party asset management activity during the latter part of 2004. For the three months ended June 30, 2005, we recognized $49 thousand of asset management fees. Our asset management contracts also provide for contingent performance fees, none of which have been earned or accrued at June 30, 2005.

Interest Income on Investment Portfolio

We had interest income of approximately $2.8 million and $716 thousand for the three months ended June 30, 2005 and 2004, respectively. The increased interest income is attributable to higher

average invested balances subsequent to the July 2004 issuance of subordinated debt and the raising of additional equity through our IPO, coupled with higher yields in the cash equivalents and investment accounts as compared with the three month period ended June 30, 2004. Interest income for the second quarter has been adjusted to reflect a reduction of interest income attributable to the fourth quarter of 2004 (in the amount of $126,000) and the first quarter of 2005 (in the amount of $466,000), as the amortization of purchased premium on certain investment securities was not charged against interest income for such periods. The unrecorded amortization was not material to net income (loss) in either of the previous periods. Average yields on the cash equivalents and available-for-sale investments were 2.79% for the three month period ended June 30, 2005 (excluding the above adjustment) compared with 1.06% for the three month period ended June 30, 2004. The increase in average yields is primarily due to a general increase in market interest rates, coupled with an extension in the average duration of our investment portfolio in the second quarter of 2005. Our total cash, cash equivalents and available-for-sale securities were approximately $487.5 million and $276.0 million as of June 30, 2005 and 2004, respectively.

Foreign Currency Revaluation

We started selling Euro-denominated credit swaps in February 2003 and at June 30, 2005, Euro-denominated credit swaps comprise 26.9% of the notional amount of our credit swaps sold portfolio. The Euro had depreciated in value against the U.S. dollar by approximately 6.6% and 0.9 % during the second quarter of 2005 and 2004, respectively, and this depreciation resulted in a net loss of $955 thousand and $33 thousand for the three months ended June 30, 2005 and 2004, respectively.

Operating Expenses

Our operating expenses (excluding financing costs) were $5.9 million and $5.8 million for the three months ending June 30, 2005 and 2004, respectively, as summarized below:

($ in thousands)	Three months ended June 30, 2005	Three months ended June 30, 2004
Employee compensation	$ 3,406	$ 3,861
Professional and legal fees	796	363
Fixed asset depreciation and amortization	525	485
Technology and data	398	364
Other	853	761
Total Operating Expenses	$ 5,978	$ 5,834
Number of full-time employees, at end of period	34	31

The decrease in employee compensation over these periods was primarily due to the decrease in the accrual for performance bonuses and performance-related stock compensation. This decrease was offset by a slight increase in salaries expense, due to the increase in number of employees as the business expanded its operations. The increase in

professional fees is related to the increased insurance expenses, and the increased costs associated with the requirements of being a public company. Other operating expenses include rent, bank fees and investment management fees, rating agency fees, brokerage expense, travel and entertainment, exchange fees and other administrative expenses. The increase in other operating expenses is partially due to an increase in bank fees and asset management fees, as our cash, cash equivalents and investment balances were higher during second quarter 2005 as compared with the 2004 period. This was partially offset by a decrease in brokerage fees, as we restricted our use of brokers during 2005. The remainder of the other operating expenses increased over the prior period primarily due to expanded operations and our status as a public Company.

Interest Expense and Preferred Distributions

For the three months ended June 30, 2005, we incurred $487 thousand of interest expense on the $75.0 million 30-year subordinated debt that was issued by Primus Financial in July 2004. The interest

---

rate for the 30-year subordinated debt is fixed at 2.57% for a period of one year from the issuance date. Primus Financial also made net distributions of $1.1 million and $605 thousand during the three months ended June 30, 2005 and 2004, respectively, on the Primus Financial Cumulative Preferred Stock issued in December 2002. The average rates paid on these securities was 3.97% and 1.75% during the three months ended June 30, 2005 and 2004, respectively.

Income Taxes

Provision for income taxes was $9 thousand and $45 thousand for the three months ended June 30, 2005 and 2004, respectively. Primus Guaranty had a net deferred tax asset fully offset by a valuation allowance of $9.3 million and $5.9 million as of June 30, 2005 and 2004, respectively. The change in the deferred tax asset and valuation allowance resulted from Primus Asset Management's estimated net operating loss. As previously discussed, it is expected that only the income of Primus Asset Management and its subsidiary, Primus Re, are likely to be subject to United States federal and local income taxes. However, were Primus Bermuda to be subject to income tax, at a combined United States federal, New York State and New York City income tax rate of 46%, on its United States GAAP income, then its income tax expense (excluding interest and penalties) since inception, would have been approximately $40.6 million through June 30, 2005, and a benefit of approximately $3.6 million for the three months ended June 30, 2005. These figures assume that Primus Financial is not deemed to be making distributions to Primus Bermuda; such distributions would subject Primus Bermuda to an additional United States federal branch profits tax.

Six months ended June 30, 2005 compared with six months ended June 30, 2004

We had a net loss of $23.0 million and $8.1 million for the six months ended June 30, 2005 and 2004, respectively. The net loss in the 2005 period was primarily driven by the increase in unrealized losses caused by the depreciation in the value of our credit swap portfolio, coupled with losses realized from the early termination of credit swaps, and increased expenses as a result of our expanded operations and costs associated with being a public company.

Net Credit Swap Revenue (Loss)

Net credit swap revenue (loss) was $(11.8) million and $2.8 million for the six months ended June 30, 2005 and 2004, respectively. Net credit swap revenue (loss) includes:

- Net premiums earned;
- Net realized gains (losses) on credit swaps; and
- Net unrealized gains (losses) on credit swaps.

The table below shows the component parts of net credit swap revenue (loss) for the six months ended June 30, 2005 and 2004:

($ in thousands)	Six months ended June 30, 2005	Six months ended June 30, 2004
Net premiums earned	$ 23,599	$ 20,114
Net realized gains (losses) on credit swaps	(1,804)	2,789
Net unrealized losses on credit swaps	(33,572)	(20,068)
Total Net Credit Swap Revenue (Loss)	$ (11,777)	$ 2,835

Net Premiums Earned

Net premiums earned were $23.6 million and $20.1 million for the six months ended June 30, 2005 and 2004, respectively. Net premiums earned include:

- Premium income on credit swaps sold – single name;

- Premium income on credit swaps sold – tranche;
- Premium expense on credit swaps purchased as short-term investments; and
- Premium expense on credit swaps purchased to offset credit risk on certain credit swaps sold.

The increase in net premiums earned was primarily driven by the increase in the size of the credit swaps sold portfolio from the 2004 period, slightly offset by an increase in the premiums paid for credit swaps purchased for short-term investment purposes. The table below shows the component parts of net premiums earned for the six months ended June 30, 2005 and 2004.

($ in thousands)	Six months ended June 30, 2005	Six months ended June 30, 2004
Premium income on credit swaps sold-single name	$ 24,281	$ 20,408
Premium income on credit swaps sold-tranche	96	—
Premium expense on credit swaps purchased as short-term investments	(732)	(248)
Premium expense on credit swaps purchased to offset credit risk on certain swaps sold	(46)	(46)
Total Net Premiums Earned	$ 23,599	$ 20,114

Premium income on credit swaps sold-single name increased primarily as a result of the expansion in our credit swap portfolio. The notional amounts outstanding of credit swaps sold were $12.2 billion and $8.6 billion at June 30, 2005 and 2004, respectively.

We began to sell protection in tranche format during the second quarter of 2005, whereby we sell credit swaps referencing portfolios containing obligations of multiple reference entities. Premium income from the tranche sold was $96 thousand for the six months ended June 30, 2005, and the notional amount outstanding was $50 million at June 30, 2005.

The premium expense on credit swaps purchased as short-term investments was $732 thousand and $248 thousand for the six months ended June 30, 2005 and 2004, respectively. The notional amounts outstanding on credit swaps purchased as short-term investments were $389.5 million and $217.1 million at June 30, 2005 and 2004, respectively.

Net Realized Gains (Losses) on Credit Swaps

Our business strategy is generally to hold swaps we sell until maturity. However, there are circumstances in which we may terminate a credit swap prior to maturity, either as a result of credit considerations or in order to realize gains. We cannot identify at the outset of any credit swap transaction whether the credit swap will be terminated or otherwise disposed of prior to its maturity. If the credit swaps we terminate are at attractive market values, we are able to realize gains. Terminating transactions also allows us to accelerate premium receipts and provides for additional growth capacity within our credit swap portfolio.

In certain circumstances we will terminate a credit swap at a realized loss. In general, we terminate credit swaps at a loss where we perceive that the credit quality of the underlying reference entity risk has deteriorated, and we wish to reduce or eliminate our exposure to the reference entity. We may also terminate a credit swap at a loss in order to create opportunity to rebalance our exposure to a reference entity. We terminated $250.1 million and $224.3 million notional amount of credit swaps sold for the six months ended June 30, 2005 and 2004, respectively. Net realized gains/ (losses) on the early termination of credit swaps were $(1.8) million and $2.8 million for the six months ended June 30, 2005 and 2004, respectively. The net realized losses incurred during 2005 were primarily the result of our decision to mitigate our exposure to a limited number of reference entities, which had become the subject of leveraged buy-outs which increased the credit risk of those reference entities.

We realized gains of $589 thousand and $2.1 million for the six months ended June 30, 2005 and 2004, respectively. The decrease in realized gains is due to the smaller gains on terminations that took

---

place in the 2005 period. We realized losses of $3.0 million for the six months ended June 30, 2005, of which $2.9 million was caused by the termination of credit swaps to mitigate our credit exposure, and $13 thousand for the six months ended June 30, 2004.

Where we have purchased credit protection as a short-term investment, early termination of the credit swaps is a fundamental part of the business strategy. We terminated $93.0 million and $189.0 million notional amount of credit swaps purchased during the six months ended June 30, 2005 and 2004, respectively, realizing a net gain of $626 thousand and $693 thousand, respectively.

Net realized gains (losses) for the six months ended June 30, 2005 and 2004 are summarized below:

($ in thousands)

	Six months ended June 30,			
	2005		2004	
Realized gains on terminated credit swaps sold – single name	$	589	$	2,109
Realized losses on terminated credit swaps sold – single name		(3,019)		(13)
Realized gains on terminated credit swaps purchased as short-term investments		656		740
Realized losses on terminated credit swaps purchased as short-term investments		(30)		(47)
Total Net Realized Gains (Losses) on terminated credit swaps	$	(1,804)	$	2,789

Net Unrealized Losses on Credit Swaps

Net unrealized losses on credit swaps were $33.6 million for the six months ended June 30, 2005 as compared with $20.1 million for the six months ended June 30, 2004. The change in unrealized losses on credit swaps reflects the change in the fair value of our credit swap portfolio, and the losses are partially due to the increase in market credit swap premium levels experienced during the six months ended June 30, 2005 and 2004. In 2005, we also recorded unrealized losses on certain reference entities which had become downgraded or were the subject of leveraged buy-outs during the period. The unrealized gains and losses on credit swaps sold-single name, credit swaps sold-tranche and credit swaps purchased as short-term investments and for credit risk offset purposes for the six months ended June 30, 2005 and 2004 are summarized below:

($ in thousands)	Six months ended June 30,			
	2005		2004	
Net unrealized losses on credit swaps sold – single name	$	(34,728)	$	(20,255)
Net unrealized gains on credit swaps sold-tranche		467		—
Net unrealized gains on credit swaps purchased as short-term investments		626		137
Net unrealized gains on credit swaps purchased to offset credit risk on certain credit swaps sold		63		50
Net Unrealized Losses on credit swaps	$	(33,572)	$	(20,068)

Asset Management Fees

We commenced our third party asset management activity during the latter part of 2004. For the six months ended June 30, 2005, we recognized $91 thousand of asset management fees. Our asset management contracts also provide for contingent performance fees, none of which have been earned or accrued at June 30, 2005.

Interest Income on Investment Portfolio

We had interest income of $6.5 million and $1.4 million for the six months ended June 30, 2005 and 2004, respectively. The increased interest income is attributable to higher average invested

balances subsequent to the July 2004 issuance of subordinated debt and the raising of additional equity through our IPO, coupled with higher yields in the cash equivalents and investment accounts, as compared with the six month period ended June 30, 2004. Average yields on the cash equivalents and available-for-sale investments were 2.92% in the six months ended June 30, 2005 compared with 1.02 % in the six months ended June 30, 2004. This increase is primarily due to a general increase in market interest rates, coupled with an extension in the average duration of our investment portfolio during the second quarter of 2005. Our total cash, cash equivalents and available-for-sale investments were approximately $487.5 million and $276.0 million as of June 30, 2005 and 2004, respectively.

Foreign Currency Revaluation

We started selling Euro-denominated credit swaps in February 2003 and by June 30, 2004, Euro-denominated credit swaps comprised 26.9% of the notional amount of our credit swaps sold portfolio. The Euro had depreciated in value against the U.S. dollar by approximately 10.6 % and 3.0% during the first half of 2005 and 2004, respectively, and this depreciation resulted in a net loss of $1.5 million and $106 thousand for the six months ended June 30, 2005 and 2004, respectively.

Operating Expenses

Our operating expenses (excluding financing costs) were approximately $13.7 million and $11.2 million for the six months ending June 30, 2005 and 2004, respectively, as summarized below:

($ in thousands)	Six months ended June 30,	
	2005	2004
Employee compensation	$ 8,602	$ 7,284
Professional and legal fees	1,750	778
Fixed asset depreciation and amortization	1,041	959
Technology and data	715	671
Other	1,618	1,465
Total Operating Expenses	$ 13,726	$ 11,157
Number of full-time employees, at end of period	34	31

The increase in employee compensation over these periods was partially due to the increase in the number of employees as the business expanded its operations. In addition, in the first quarter of 2005 we accrued an additional expense of approximately $800 thousand for the accelerated compensation expenses and accelerated vesting of stock related to the departure of former employees. Professional and legal fees expense includes audit and tax advisor expenses, legal costs and insurance expenses. The increase in professional fees is related to increased costs associated with the requirements of being a public company. Other operating expenses include rent, bank fees and investment management fees, rating agency fees, brokerage expense, travel and entertainment, exchange fees and other administrative expenses. The increase in other operating expenses is partially due to an increase in bank fees and asset management fees, as our cash, cash equivalents and investment balances are higher than the 2004 period. This was partially offset by a decrease in brokerage fees, as we restricted our use of brokers during 2005. The remainder of the other operating expenses increased over the prior period primarily due to expanded operations and our status as a public company.

Interest Expense and Preferred Distributions

For the six months ended June 30, 2005, we incurred $969 thousand of interest expense on the $75.0 million 30-year subordinated debt that was issued by Primus Financial in July 2004. The interest rate for the 30-year subordinated debt

is fixed at 2.57% for a period of one year from the issuance date. Primus Financial also made net distributions of $1.8 million and $1.1 million during the six months ended June 30, 2005 and 2004, respectively, on the Primus Financial Cumulative Preferred Stock issued in December 2002. The average rates paid on these securities was 3.46% and 1.75% during the six months ended June 30, 2005 and 2004, respectively.

Income Taxes

Provision for income taxes was $45 thousand and $117 thousand for the six months ended June 30, 2005 and 2004, respectively. Primus Guaranty had a net deferred tax asset fully offset by a valuation allowance of $9.3 million and $5.9 million as of June 30, 2005 and 2004, respectively. The change in the deferred tax asset and valuation allowance resulted from Primus Asset Management's estimated net operating loss. As previously discussed, it is expected that only the income of Primus Asset Management and its subsidiary, Primus Re, are likely to be subject to United States federal and local income taxes. However, were Primus Bermuda to be subject to income tax, at a combined United States federal, New York State and New York City income tax rate of 46%, on its United States GAAP income, then its income tax expense (excluding interest and penalties) since inception, would have been approximately $40.6 million through June 30, 2005, and a benefit of approximately $9.4 million for the six months ended June 30, 2005. These figures assume that Primus Financial is not deemed to be making distributions to Primus Bermuda; such distributions would subject Primus Bermuda to an additional United States federal branch profits tax.

Contractual Obligations

The following table summarizes our contractual obligations at June 30, 2005 and the effect that those obligations are expected to have on our liquidity and cash flows in future periods:

	Payment due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Property Lease	$ 5,395	$ 753	$ 1,512	$ 1,545	$ 1,585
Subordinated deferrable interest notes	75,000	—(a)	—(a)	—(a)	75,000
Total	$ 80,395	$ 753	$ 1,512	$ 1,545	$ 76,585

(a) Payments on the subordinated deferrable interest notes for the next five years cannot be determined, as it is an auction rate obligation.

Property Lease: Primus Financial has leased its premises at 360 Madison Avenue, New York, New York from Madison 45 LLC at a fixed yearly rental (subject to certain escalations specified in the lease) until August 1, 2012. There are no material restrictions imposed by the lease agreement and the lease is categorized as an operating lease.

Subordinated deferrable interest notes: For information on the terms of our subordinated deferrable interest notes, see Note 6 to our consolidated financial statements.

We have no other material long-term contractual obligations.

Liquidity and Capital Resources

Capital Strategy

Primus Financial, in order to support its AAA/Aaa ratings, is required to maintain capital in an amount determined by the capital models it has agreed upon with S&P and Moody's. The capital required is primarily a function of Primus Financial's credit swap portfolio characteristics, operating expenses and tax position. Retained cash flow and proceeds from financings to increase our capital resources to support our credit swap business.

In connection with the commencement of our operations on March 14, 2002, we were capitalized with $155.0 million from the issuance of our Series A preferred stock to two subsidiaries of XL Capital Ltd, or XL, Transamerica Life Insurance Company, a subsidiary of AEGON USA, Pacific Corporate Group/CalPERS and Radian Group Inc., or Radian. In connection with the issuance of the Series A preferred stock, we issued warrants to Radian enabling them to purchase 1,061,059 common

---

shares at a exercise price of $5.18 per share. On May 15, 2004, Radian exercised these warrants, as a result of which we received $5.5 million. Upon completion of our IPO, all of the Series A preferred stock were converted into common shares of the company.

Primus Financial issued $110.0 million of Primus Financial Cumulative Preferred Stock on December 19, 2002 in two series, Series I and Series II, to a trust, ("the Trust"). In conjunction with the receipt of the securities, the Trust issued $100.0 million of Money Market Preferred Securities Custodial Receipts, or MMP Receipts, in two series, Series A and Series B, to various institutional investors in a private placement. The Trust also issued $10.0 million of Variable Inverse Preferred Securities Custodial Receipts that were retained by Primus Financial. One series of MMP Receipts pays distributions every 28 days based on an auction rate set on the prior business day and the other series makes payments quarterly, based on an auction rate, which is currently set annually, and was last set in January 2005. After December 19, 2012, Primus Financial may redeem the securities, in whole or in part, on any distribution date at the face amount plus accumulated and unpaid dividends. However, Primus Financial is not required to redeem the securities, nor is it required to establish a sinking fund. For the three months ended June 30, 2005 and 2004, Primus Financial made net distributions to the Trust's MMP Receipts of $1.1 million and $605 thousand, respectively. For the six months ended June 30, 2005 and 2004, Primus Financial made net distributions to the Trust's MMP Receipts of $1.8 million and $1.1 million, respectively.

Primus Financial issued $75.0 million of subordinated deferrable interest notes on July 23, 2004. The notes are subordinated in right of payment to the prior payment in full of all existing and future senior indebtedness of the company, including counterparty claims. The notes are redeemable at the option of Primus Financial, in whole or in part, on any auction date, at a redemption price equal to 100% of the principal amount of the notes to be redeemed, plus any accrued and unpaid interest thereon to the redemption date. The interest rate on the notes is fixed at a rate of 2.57% for a period of one year, expiring in July of 2005, at which point the rate will be set through a monthly auction process. The notes mature in July 2034.

Primus Guaranty completed an IPO on October 5, 2004, listing its shares on the NYSE. The company issued 9,143,493 shares at a price of $13.50. Proceeds to the company were $110.7 million, net of the underwriting discount and offering expenses. Primus Guaranty concurrently contributed $60.0 million of the IPO proceeds to Primus Financial to support the growth of its credit swap business. Primus Guaranty has invested the remaining net proceeds

in short-term money market instruments, pending utilization in its credit swap business and/or other businesses related to the credit markets.

Additionally, as required by our operating guidelines, Primus Financial maintains a $37.5 million liquidity facility with Harris Trust and Savings Bank, or Harris Trust. The purpose of the liquidity facility is to provide Primus Financial with cash in the event it is obligated to purchase a Reference Entity's debt obligation as the result of a credit event and could not liquidate its investments in order to settle a purchase on a timely basis. The liquidity facility requires that Primus Financial have United States government securities available to pledge as collateral on any advances made under the facility. The facility is renewable on an annual basis at the option of Primus Financial or Harris Trust. The facility has a maturity date of March 31, 2006. We intend to request an extension of this facility or replace it with a similar facility with another lender at each annual maturity date so long as we are required to do so by the operating guidelines. We have applied to the rating agencies for permission to terminate this facility. As of June 30, 2005, there have been no credit events and there have been no borrowings under the facility.

We receive cash from the receipt of credit swap premiums, the net proceeds from the early termination of credit swaps, interest income earned on our investment portfolio and capital raising activities. Cash has been used to pay our operating expenses, administrative expenses, premiums on credit swaps we have purchased and preferred share distributions. Our cash, cash equivalents and available-for-sale investments were approximately $487.5 million and $482.1 million as of June 30, 2005 and December 31, 2004, respectively.

Cash Flows

Cash flows from operating activities – Net cash provided by operating activities was $9.7 million and $10.1 million for the six months ended June 30, 2005 and 2004, respectively. In 2005 we had higher premium income as compared with the 2004 period, due to the increased size of our credit swaps sold portfolio. However, this increase was offset by net realized losses in the first half of 2005 of $1.8 million, as compared with net realized gains of $2.8 million in the first half of 2004. Additionally, there was an increase in operating expenses in the six months ended June 30, 2005 as compared with the same period of 2004, due to our expanded operations and costs associated with being a public company.

Cash flows from investing activities – Net cash (used in) provided by investing activities was $(125.9) million and $92 thousand for the six months ended June 30, 2005 and 2004, respectively. The main reason for this increase in use of cash was the purchases of available-for-sale securities during the first half of 2005.

Cash flows from financing activities – Net cash (used in) provided by financing activities was $(4.0) million and $4.4 million for the six months ended June 30, 2005 and 2004, respectively. This increase in use of cash is primarily due to the payment of $2.5 million in the first quarter of 2005, representing the amount withheld to pay employee income taxes due upon the delivery of common shares to our employees, coupled with an increase in preferred distributions of a subsidiary in the six months ended June 30, 2005. In addition, during the six months ended June 30, 2004, we received $5.5 million as proceeds from the exercise of warrants.

With our current capital resources and anticipated future credit swap premium receipts and interest income, we believe we have sufficient liquidity to pay our operating expenses and preferred distributions over at least the next twelve months.

Additional Information

U.S. GAAP applicable to derivative contracts requires us to account for the credit swaps that we buy or sell at fair value. The fair value of credit swaps is primarily determined by market credit swap premium levels, as well as the size and tenor of our swaps, and interest rates used to discount future cash flows. Premium levels, in turn, are driven by a number of factors, including the number and size of market participants willing to buy or sell credit protection at any given time and the market's perception of credit risk over the life of a particular credit swap. The latter is in turn a function of macroeconomic factors such as the overall state of the economy, corporate financial health and leverage, and geopolitical concerns. As a general matter, given our strategy of holding credit swaps sold until maturity, we do not seek to manage our overall exposure to market credit swap premium levels by terminating credit swaps prior to their maturity. Accordingly, we expect fluctuations in the fair value of our credit swap portfolio as a result of changes in credit swap premiums over time. These period-to-period changes in value have no significant effect on our business, our economic performance or cash flow. However, reflecting our credit swap portfolio at fair value produces significant changes in our revenue and net income from period to period as the market values of our credit swaps fluctuate.

Despite our strategy of holding credit swaps sold to maturity, we occasionally dispose of credit swaps prior to maturity, but only in circumstances where we believe that the underlying risk related to the credit swap has increased beyond our risk tolerance or where we seek to rebalance our portfolio and create greater capacity for other credit swaps. Under United States GAAP, the full amount of any realized gains and losses on the termination of credit swaps is included in our revenue immediately.

In managing our business and assessing its growth and profitability from a strategic and financial planning perspective, we believe it is appropriate to consider both our United States GAAP financial results as well as the impact on those results of fair value accounting and the termination of credit swaps. Therefore, we evaluate what our economic results would have been if we excluded from revenue the amounts of any unrealized gains and losses on our portfolio of credit swaps sold, and any realized gains from terminations of credit swaps sold prior to maturity, although we amortize those

---

realized gains over the remaining original lives of the terminated contracts. Our board of directors also uses these results in assessing our management's performance and determining compensation.

For the three months ended June 30, 2005 and 2004, we realized $470 thousand and $936 thousand of gains, respectively, from the early termination of credit swaps sold. The amortized gains for those periods were $1.7 million and $1.5 million, respectively. For the six months ended June 30, 2005 and 2004, we realized $589 million and $2.1 million of gains, respectively, from the early termination of credit swaps sold. The amortized gains for those periods were $3.3 million and $3.0 million, respectively. At June 30, 2005, future amortization of gains from all credit swaps terminated prior to that date will be recognized as follows (in thousands):

Year ending December 31, 2005	$	6,701
Year ending December 31, 2006		6,713
Year ending December 31, 2007		4,599
Year ending December 31, 2008		431

Year ending December 31, 2009 15

Recent Accounting Pronouncements

In May 2005, the FASB issued SFAS 154, Accounting Changes and Error Corrections – a replacement of APB Opinion No. 20 and FASB Statement No. 3. This statement requires retrospective application to prior periods' financial statements of changes in accounting principle. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS 154 is not expected to have a significant impact on the Company's financial statements.

In December 2004, the FASB issued SFAS 123R "Share-Based Payment." SFAS 123R replaces FASB Statement No. 123, "Accounting for Stock-Based Compensation", and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employee." SFAS 123R eliminates the choice of alternative accounting methods, and requires that all entities follow the fair value based method of SFAS 123. Public entities will be required to apply Statement 123R as of the first annual reporting period that begins after June 15, 2005. The adoption of SFAS 123R is not expected to have a significant impact on our financial statements.

Cautionary Note Regarding Forward-Looking Statements

This quarterly report of Primus Guaranty includes statements that are not historical or current facts and are "forward-looking statements" made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words "believe," "anticipate," "project," "plan," "expect," "intend," "will likely result," "looking forward" or "will continue," and similar expressions identify forward-looking statements. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. Primus Guaranty cautions readers not to place undue reliance on any such forward-looking statements, which speak only to their respective dates. The following are some of the factors that could affect financial performance or could cause actual results to differ materially from estimates contained in or underlying the Company's forward-looking statements:

- fluctuations in the economic, credit, interest rate or foreign currency environment in the United States (U.S.) and abroad;
- the level of activity within the national and international credit markets;
- competitive conditions and pricing levels;
- legislative and regulatory developments;
- technological developments;
- changes in tax laws;
- changes in international or national political or economic conditions, including any terrorist attacks;

- uncertainties that have not been identified at this time.

The Company undertakes no obligation to publicly correct or update any forward-looking statement if it later becomes aware that such results are not likely to be achieved.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk represents the potential for losses that may result from changes in the value of a financial instrument as a consequence of market conditions. Our primary market risk is increasing or decreasing market credit swap premium levels, which increase or decrease the fair value of our credit swap portfolio. Market credit swap premium levels change as a result of specific events or news related to a Reference Entity, such as a change in a credit rating by any of the rating agencies. Additionally, market credit swap premium levels can vary as a result of changes in market sentiment. As a general matter, given our strategy of holding credit swaps sold until maturity, we do not seek to manage our overall exposure to market credit swap premium levels, and we expect fluctuations in the fair value of our credit swap portfolio as a result of these changes. In cases where we purchase credit swaps as short-term investments, we incur the cost of paying premiums until we terminate the purchased credit protection. We undertake these transactions in the expectation that the market credit swap premium level for the Reference Entity will rise subsequent to our purchase of protection, but any gains realized upon termination may not suffice to offset the premium expense we have incurred while holding the purchased credit protection. Indeed, the market credit swap premium level for the Reference Entity may fall and we may incur termination losses as well as premium expense as a result. The fair value of our credit swaps purchased will be affected by market credit swap premium levels, which will affect our net income. Currently, we purchase a limited amount of credit protection, relative to the size of our portfolio of credit swaps sold, and the cost of purchased credit protection does not materially impact our overall operating margin. The notional amount outstanding on credit swaps we purchased as short-term investments was $389.5 million at June 30, 2005.

We face other market risks, which are likely to have a lesser impact upon our net income than those associated with market credit swap premium level risk. These other risks include interest rate risk associated with market interest rate movements. These movements may affect the value of our credit swap portfolio as our pricing model includes an interest rate component, which is used to discount future expected cash flows. Interest rate movements may also affect the carrying value of our investments.

The Primus Financial Cumulative Preferred Stock pays distributions that are based upon the auction rate preferred market. A difference between the rates we pay in the auction rate preferred market and the interest rates we receive on our investments may result in an additional cost to our company. Assuming that auction results with respect to the Primus Financial Cumulative Preferred Stock reflect prevailing short-term interest rates, each 25 basis point increase or decrease in the level of those rates would increase or decrease Primus Financial's annual distribution cost by approximately $125 thousand for each of the Series A and Series B MMP Receipts, but would not affect distributions on the Series B MMP Receipts as the interest and auction rate for such MMP Receipts were set for a one year period on January 20, 2005.

In addition, interest rate movements may increase or decrease the interest expense we incur on our $75 million of subordinated deferrable interest notes. A 25 basis point increase or decrease in the level of those rates would have increased or decreased Primus Financial's interest expense by $47 thousand and $94 thousand for the three and six months ended June 30, 2005, however, during those periods the interest rate on the subordinated deferrable interest notes was fixed for a one year period expiring in July of 2005, at which point the rate will be set through a monthly auction process. We also have exposure to currency rates as we have sold Euro-denominated credit swaps. As of June 30, 2005, we have kept the premiums received from these transactions in Euro-denominated money market accounts. The value of the cash Euro balances is translated into United States dollars at current spot rates. Changes in the value of the Euro compared with the United States dollar may have an impact on our net income. We do not hedge any interest rate or currency market risks.

Counterparty risk represents the potential for loss should one or more of our counterparties be unable to meet its obligations due to bankruptcy or a similar event, which could adversely affect our results of operations. Our counterparties generally have investment grade credit ratings. At June 30, 2005 and 2004, the notional amount of credit swaps outstanding with respect to our counterparties that had credit ratings of below investment grade were $5.0 million and $6.0 million, respectively. The

fair value of the above-mentioned credit swaps at June 30, 2005 and 2004 were $21 thousand and $27 thousand, respectively. The premiums on these transactions were fully prepaid by the counterparty.

Item 4. Controls and Procedures

The company has carried out an evaluation, under the supervision and with the participation of the company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of disclosure controls and procedures pursuant to rules 13a-15 and 15-15d promulgated under the Securities and Exchange Act of 1934 as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the disclosure controls and procedures are effective to provide reasonable assurance that all material information relating to the company required to be filed in this report have been made known to them in a timely fashion. There have been no changes in internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to affect, internal control over financial reporting.

The company's management, including the Chief Executive Officer and the Chief Financial Officer, does not expect that the company's disclosure controls or its internal controls can prevent all errors and all fraud. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. As a result of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making are faulty, and that breakdowns can occur because of simple error or mistake. As a result of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Accordingly, the company's disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the disclosure controls and procedures are met.

Part II. Other Information

Item 1. Legal Proceedings

In the ordinary course of operating our business, we may encounter a significant risk of litigation from time to time. However, we are not party to nor currently aware of any material pending litigation.

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

Use of Proceeds of Initial Public Offering

The effective date of our registration statement (Registration No. 333-114818) filed on Form S-1 relating to our IPO of common shares was September 29, 2004. In our IPO, we registered and sold 9,143,493 common shares, par value

$.08 per share, at a price of $13.50 per share and an aggregate public offering price of $123,437,156 for the account of the Company. In addition, there were registered and sold, for the account of certain selling shareholders identified in the registration statement, 1,201,335 common shares at a price of $13.50 per share and an aggregate public offering price of $16,218,022. Our IPO was managed and underwritten by Lehman Brothers Inc., Morgan Stanley & Co. Incorporated, Credit Suisse First Boston LLC, UBS Investment Bank, William Blair & Company L.L.C. and Keefe Bruyette & Woods, Inc. The offering commenced on September 29, 2004 and closed on October 5, 2004. Proceeds to us from our IPO, after deduction of the underwriting discounts and commissions payable by the company of approximately $8.64 million and offering costs payable by the company of $4.1 million, totaled approximately $110.7 million. None of the expenses incurred and paid by us in our IPO were direct or indirect payments to our directors, officers, general partners or their associates, to persons owning 10% or more of any class of our equity securities or, except as described below, to our affiliates. Of the $110.7 million raised for the account of the company, approximately $60.0 million has been used to provide additional working capital to our

---

affiliate, Primus Financial, in order to increase its capacity to sell additional credit swaps. Primus Financial has invested this additional capital in accordance with its operating guidelines in United States government agencies and money market instruments. We continue to expect that the remainder of the proceeds from the offering will be used as working capital and for general corporate purposes, including providing additional capital to Primus Financial to enable it to further expand its credit swap business and to pursue opportunities in complementary businesses, such as asset management for third parties and selling credit swaps referencing a broader range of obligations, although specific amounts have not been allocated for these additional purposes. Pending such uses, the balance of $50.7 million has been invested by the company in United States government agencies and money market instruments. The occurrence of unforeseen events, opportunities or changed business conditions, however, could cause us to use the net proceeds of our IPO in a manner other than as described above.

Item 3. Defaults upon Senior Securities

None.

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

Our annual meeting of stockholders was held on May 5, 2005. At that meeting, the following matters were submitted to a vote of our stockholders:

Item No. 1

To approve the election and re-election as directors of the Company to serve three-year terms expiring at the Annual Meeting in 2008 and until their successors are duly elected and qualified.

	For	Withheld
Paul S. Giordano	41,776,250	70,550
Robert R. Lusardi	41,776,250	70,550
John A. Ward III	41,751,177	95,623

Item No. 2

To approve the appointment of Ernst & Young LLP as independent auditors for the Company for the fiscal year ending December 31, 2005.

For	41,824,595
Against	3,425
Abstain	18,780

Item 5. Other Information

None.

Item 6. Exhibits

31.1	Rule 13a–14(a)/15d–14(a) Certification
31.2	Rule 13a–14(a)/15d–14(a) Certification
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Added By Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

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

PRIMUS GUARANTY, LTD.
/s/ Richard Claiden
Richard Claiden
Chief Financial Officer
(Duly Authorized Officer and Principal Financial Officer)

Date: August 12, 2005