KINGSWAY FINANCIAL SERVICES INC
Form 10-Q
August 07, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark
One)

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

For Quarterly Period Ended
June 30, 2017
or

o	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: 001-15204

Kingsway Financial Services Inc.
(Exact name of registrant as specified in its charter)

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

45 St. Clair Avenue West, Suite 400 Toronto, Ontario M4V 1K9
(Address of principal executive offices and zip code)
1-416-848-1171
(Registrant's telephone number, including area code)

Indicate by checkmark 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 the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o	Emerging Growth Company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x
The number of shares, including restricted common shares, outstanding of the registrant's common stock as of August 7, 2017 was 23,410,855.

KINGSWAY
FINANCIAL
SERVICES
INC.

Table Of Contents

PART I - FINANCIAL INFORMATION	3
ITEM 1. FINANCIAL STATEMENTS	3
Consolidated Balance Sheets as of June 30, 2017 (unaudited) and December 31, 2016	3
Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2017 and 2016 (unaudited)	4
Consolidated Statements of Comprehensive Loss for the Three and Six Months Ended June 30, 2017 and 2016 (unaudited)	5
Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2017 and 2016 (unaudited)	6
Notes to Consolidated Financial Statements (unaudited)	7
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	31
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	43
ITEM 4. CONTROLS AND PROCEDURES	45
PART II - OTHER INFORMATION	45
ITEM 1. LEGAL PROCEEDINGS	45
ITEM 1A. RISK FACTORS	45
ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	45
ITEM 3. DEFAULTS UPON SENIOR SECURITIES	45
ITEM 4. MINE SAFETY DISCLOSURES	45
ITEM 5. OTHER INFORMATION	46
ITEM 6. EXHIBITS	47
SIGNATURES	48

KINGSWAY FINANCIAL SERVICES INC.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets

(in thousands, except share data)

	June 30, 2017 (unaudited)	December 31, 2016
Assets		
Investments:		
Fixed maturities, at fair value (amortized cost of $57,172 and $62,136, respectively)	$ 56,965	$ 61,764
Equity investments, at fair value (cost of $16,699 and $19,099, respectively)	19,441	23,230
Limited liability investments	25,533	22,974
Limited liability investment, at fair value	8,220	10,700
Other investments, at cost which approximates fair value	7,550	7,975
Short-term investments, at cost which approximates fair value	151	401
Total investments	117,860	127,044
Cash and cash equivalents	33,776	36,475
Investment in investee	5,355	3,116
Accrued investment income	893	790
Premiums receivable, net of allowance for doubtful accounts of $115 and $115, respectively	30,113	31,564
Service fee receivable, net of allowance for doubtful accounts of $276 and $274, respectively	1,408	1,320
Other receivables, net of allowance for doubtful accounts of $806 and $806, respectively	6,765	4,692
Reinsurance recoverable	569	784
Deferred acquisition costs, net	13,709	13,609
Property and equipment, net of accumulated depreciation of $12,894 and $10,603, respectively	114,809	116,961
Goodwill	71,061	71,061
Intangible assets, net of accumulated amortization of $7,761 and $7,181, respectively	88,187	89,017
Other assets	4,539	4,588
Total Assets	$ 489,044	$ 501,021
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid loss and loss adjustment expenses:		
Property and casualty	$ 45,874	$ 53,795
Vehicle service agreements	2,794	2,915
Total unpaid loss and loss adjustment expenses	48,668	56,710
Unearned premiums	40,770	40,176
Reinsurance payable	87	100
Note payable	188,328	190,074
Subordinated debt, at fair value	48,210	43,619
Deferred income tax liability	49,726	48,720
Deferred service fees	37,883	35,822

Income taxes payable	2,352	2,051
Accrued expenses and other liabilities	19,912	20,487
Total Liabilities	435,936	437,759
Class A preferred stock, no par value; unlimited number authorized; 262,876 and 262,876 issued and outstanding at June 30, 2017 and December 31, 2016, respectively; redemption amount of $6,572	6,444	6,427
Shareholders' Equity:		
Common stock, no par value; unlimited number authorized; 21,458,190 and 21,458,190 issued and outstanding at June 30, 2017 and December 31, 2016, respectively	—	—
Additional paid-in capital	354,422	353,882
Accumulated deficit	(307,328)	(297,668)
Accumulated other comprehensive loss	(1,467)	(208)
Shareholders' equity attributable to common shareholders	45,627	56,006
Noncontrolling interests in consolidated subsidiaries	1,037	829
Total Shareholders' Equity	46,664	56,835
Total Liabilities, Class A preferred stock and Shareholders' Equity	$ 489,044	$ 501,021

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Statements of Operations
(in thousands, except per share data)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Revenues:				
Net premiums earned	$33,518	$31,813	$66,440	$61,240
Service fee and commission income	6,873	5,394	13,435	10,716
Rental income	3,341	—	6,682	—
Net investment (loss) income	(2,366)	1,072	(1,663)	1,000
Net realized gains (losses)	734	67	1,132	(104)
Other income	2,815	2,791	5,630	5,165
Total revenues	44,915	41,137	91,656	78,017
Operating expenses:				
Loss and loss adjustment expenses	27,468	24,838	53,878	48,335
Commissions and premium taxes	6,475	6,103	12,753	11,701
Cost of services sold	1,291	770	2,595	1,543
General and administrative expenses	11,380	10,826	22,652	20,377
Leased real estate segment interest expense	1,569	—	3,143	—
Amortization of intangible assets	289	307	580	602
Contingent consideration benefit	(212)	(657)	(212)	(657)
Impairment of intangible assets	—	—	250	—
Total operating expenses	48,260	42,187	95,639	81,901
Operating loss	(3,345)	(1,050)	(3,983)	(3,884)
Other expenses (revenues), net:				
Interest expense not allocated to segments	1,216	1,108	2,375	2,201
Foreign exchange losses, net	—	9	4	10
Loss (gain) on change in fair value of debt	2,702	(1,068)	4,591	(3,596)
Equity in net loss (income) of investees	145	874	(2,240)	943
Total other expenses (revenues), net	4,063	923	4,730	(442)
Loss from continuing operations before income tax expense	(7,408)	(1,973)	(8,713)	(3,442)
Income tax expense	1,251	26	1,430	52
Loss from continuing operations	(8,659)	(1,999)	(10,143)	(3,494)
Gain on disposal of discontinued operations, net of taxes	1,017	1,124	1,017	1,124
Net loss	(7,642)	(875)	(9,126)	(2,370)
Less: net income (loss) attributable to noncontrolling interests in consolidated subsidiaries	100	(361)	205	(400)
Less: dividends on preferred stock	123	82	244	164
Net loss attributable to common shareholders	$(7,865)	$(596)	$(9,575)	$(2,134)
Loss per share - continuing operations:				
Basic:	$(0.41)	$(0.09)	$(0.49)	$(0.16)
Diluted:	$(0.41)	$(0.09)	$(0.49)	$(0.16)
Earnings per share - discontinued operations:				
Basic:	$0.05	$0.06	$0.05	$0.06
Diluted:	$0.05	$0.06	$0.05	$0.06

Loss per share – net loss attributable to common shareholders:				
Basic:	$(0.37)	$(0.03)	$(0.45)	$(0.11)
Diluted:	$(0.37)	$(0.03)	$(0.45)	$(0.11)
Weighted-average shares outstanding (in ‘000s):				
Basic:	21,458	19,818	21,458	19,764
Diluted:	21,458	19,818	21,458	19,764

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Statements of Comprehensive Loss
(in thousands)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Net loss	$(7,642)	$(875)	$(9,126)	$(2,370)
Other comprehensive (loss) income, net of taxes[1]:				
Unrealized (losses) gains on fixed maturities and equity investments:				
Unrealized (losses) gains arising during the period	(1,064)	430	(1,227)	705
Reclassification adjustment for amounts included in net loss	478	(73)	(29)	(505)
Other comprehensive (loss) income	(586)	357	(1,256)	200
Comprehensive loss	(8,228)	(518)	(10,382)	(2,170)
Less: comprehensive income (loss) attributable to noncontrolling interests in consolidated subsidiaries	102	(360)	208	(399)
Comprehensive loss attributable to common shareholders	$(8,330)	$(158)	$(10,590)	$(1,771)

(1) Net of income tax expense of $0 and $0 for the three and six months ended June 30, 2017, respectively, and $0 and $0 for the three and six months ended June 30, 2016, respectively.

See accompanying notes to unaudited consolidated financial statements

5

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Statements of Cash Flows
(in thousands)
(Unaudited)

	Six months ended June 30, 2017	2016
Cash provided by (used in):		
Operating activities:		
Net loss	$(9,126)	$(2,370)
Adjustments to reconcile net loss to net cash used in operating activities:		
Gain on disposal of discontinued operations, net of taxes	(1,017)	(1,124)
Equity in net (income) loss of investee	(2,240)	943
Equity in net loss (income) of limited liability investments	281	(310)
Loss on change in fair value of investments	2,433	246
Depreciation and amortization expense	2,793	697
Contingent consideration benefit	(212)	(657)
Stock-based compensation expense, net of forfeitures	588	474
Net realized (gains) losses	(1,132)	104
Loss (gain) on change in fair value of debt	4,591	(3,596)
Deferred income taxes	1,005	44
Intangible asset impairment	250	—
Amortization of fixed maturities premiums and discounts	112	133
Amortization of note payable premium	(483)	—
Changes in operating assets and liabilities:		
Premiums and service fee receivable, net	1,363	(4,864)
Other receivables, net	(2,073)	682
Reinsurance recoverable	215	463
Deferred acquisition costs, net	(100)	(1,681)
Income taxes recoverable	—	(5)
Unpaid loss and loss adjustment expenses	(8,042)	(3,276)
Unearned premiums	594	5,888
Reinsurance payable	(13)	139
Deferred service fees	2,061	1,680
Other, net	(161)	1,358
Net cash used in operating activities	(8,313)	(5,032)
Investing activities:		
Proceeds from sales and maturities of fixed maturities	9,863	13,349
Proceeds from sales of equity investments	5,879	3,721
Purchases of fixed maturities	(4,981)	(19,781)
Purchases of equity investments	(2,644)	(1,541)
Net acquisitions of limited liability investments	(2,870)	(1,017)
Net proceeds from (purchases of) other investments	425	(1,357)
Net proceeds from (purchases of) short-term investments	250	(533)
Net proceeds from sale of discontinued operations	1,017	1,124
Net purchases of property and equipment	(61)	(622)
Net cash provided by (used in) investing activities	6,878	(6,657)

Financing activities:		
Repurchase of common stock for cancellation	—	(125)
Principal payments on note payable	(1,264)	—
Net cash used in financing activities	(1,264)	(125)
Net decrease in cash and cash equivalents	(2,699)	(11,814)
Cash and cash equivalents at beginning of period	36,475	51,701
Cash and cash equivalents at end of period	$33,776	$39,887

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited)
June 30, 2017

NOTE 1 BUSINESS

Kingsway Financial Services Inc. (the "Company" or "Kingsway") was incorporated under the Business Corporations Act (Ontario) on September 19, 1989. Kingsway is a Canadian holding company with operating subsidiaries located in the United States. The Company operates as a merchant bank with a focus on long-term value-creation. The Company owns or controls subsidiaries primarily in the insurance, extended warranty, asset management and real estate industries and pursues non-control investments and other opportunities acting as an advisor, an investor and a financier.

NOTE 2 BASIS OF PRESENTATION

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") 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 notes required by U.S. GAAP for complete financial statements of the Company. In the opinion of management, all adjustments necessary for a fair presentation have been included and are of a normal recurring nature. Interim results are not necessarily indicative of the results that may be expected for the year.

The accompanying unaudited consolidated interim financial statements and footnotes should be read in conjunction with the audited consolidated financial statements and footnotes included within our Annual Report on Form 10-K ("2016 Annual Report") for the year ended December 31, 2016.

The unaudited consolidated interim financial statements include the accounts of the Company and its subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation.

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts and classifications of assets and liabilities, revenues and expenses, and the related disclosures of contingent assets and liabilities in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates. Estimates and their underlying assumptions are reviewed on an ongoing basis. Changes in estimates are recorded in the accounting period in which they are determined. The critical accounting estimates and assumptions in the accompanying unaudited consolidated interim financial statements include the provision for unpaid loss and loss adjustment expenses; valuation of fixed maturities and equity investments; impairment assessment of investments; valuation of limited liability investment, at fair value; valuation of deferred income taxes; valuation and impairment assessment of intangible assets; goodwill recoverability; deferred acquisition costs; fair value assumptions for performance shares; fair value assumptions for subordinated debt obligations; and contingent consideration.

The fair values of the Company's investments in fixed maturities and equity investments, limited liability investment, at fair value, performance shares, subordinated debt and contingent consideration are estimated using a fair value hierarchy to categorize the inputs it uses in valuation techniques. The fair value of the Company's investment in investee is based on quoted market prices. Fair values for other investments approximate their unpaid principal balance. The carrying amounts reported in the consolidated balance sheets approximate fair values for cash, short-term

investments and certain other assets and other liabilities because of their short-term nature.
The Company's financial results contained herein are reported in U.S. dollars unless otherwise indicated.
NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
There have been no material changes to our significant accounting policies as reported in our 2016 Annual Report.
NOTE 4 RECENTLY ISSUED ACCOUNTING STANDARDS
(a) Adoption of New Accounting Standards:
In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). ASU 2016-09 was issued to simplify the accounting for share-based payment awards. The guidance requires, prospectively, all tax effects related to share-based payments be made through the statement of operations at the time of settlement as opposed to excess tax benefits being recognized in additional paid-in-capital under the current guidance. ASU 2016-09 also removes the requirement to delay recognition of a tax benefit until it reduces current taxes payable. This change is required to be applied on a modified retrospective basis, with a cumulative-effect adjustment to opening accumulated deficit. Additionally, all tax related cash flows resulting from share-based payments are to be reported as operating activities on the statement of cash flows, a change from the current requirement to present tax benefits as an inflow from financing

activities and an outflow from operating activities. ASU 2016-09 is effective for annual and interim reporting periods beginning after December 15, 2016. Early adoption is permitted with any adjustments reflected as of the beginning of the fiscal year of adoption. Effective January 1, 2017, the Company adopted ASU 2016-09. The adoption of the standard did not affect the Company's consolidated financial statements.

(b) Accounting Standards Not Yet Adopted:

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle of ASU 2014-09 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date ("ASU 2015-14"). This amendment defers the effective date of the previously issued ASU 2014-09 until the interim and annual reporting periods beginning after December 15, 2017. Earlier application is permitted for interim and annual reporting periods beginning after December 15, 2016. In addition, the FASB has issued four related ASU's on principal versus agent guidance (ASU 2016-08), identifying performance obligations and the licensing implementation guidance (ASU 2016-10), a revision of certain SEC Staff Observer comments (ASU 2016-11) and implementation guidance (ASU 2016-12). Insurance contracts are not within the scope of ASU 2014-09; therefore, this standard would not apply to the Company's Insurance Underwriting segment. The Company is currently evaluating the potential effect of the adoption of ASU 2014-09 on its consolidated financial statements, but, at this time, the Company does not believe the adoption of ASU 2014-09 will have a material effect on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). The amendments in ASU 2016-01 address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most significantly, ASU 2016-01 requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of an investee) to be measured at fair value with changes in fair value recognized in net income (loss). For public business entities, the amendments in ASU 2016-01 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and will be applied using a cumulative-effect adjustment to accumulated deficit as of the beginning of the fiscal year of adoption. The Company currently records its equity investments at fair value with net unrealized gains or losses reported in accumulated other comprehensive loss. Adoption of ASU 2016-01 will require the changes in fair value on equity investments with readily determinable fair values to be recorded in net income (loss). Subsequent to adoption, ASU 2016-01 could have a significant effect on the Company's results of operations and earnings (loss) per share as changes in fair value will be presented in net income (loss) rather than other comprehensive income (loss).

In February 2016, the FASB issued ASU 2016-02, Leases ("ASU 2016-02"). ASU 2016-02 was issued to improve the financial reporting of leasing transactions. Under current guidance for lessees, leases are only included on the balance sheet if certain criteria, classifying the agreement as a capital lease, are met. This update will require the recognition of a right-of-use asset and a corresponding lease liability, discounted to the present value, for all leases that extend

beyond 12 months. For operating leases, the asset and liability will be expensed over the lease term on a straight-line basis, with all cash flows included in the operating section of the statement of cash flows. For finance leases, interest on the lease liability will be recognized separately from the amortization of the right-of-use asset in the statement of comprehensive income and the repayment of the principal portion of the lease liability will be classified as a financing activity while the interest component will be included in the operating section of the statement of cash flows. ASU 2016-02 is effective for annual and interim reporting periods beginning after December 15, 2018. Early adoption is permitted. Upon adoption, leases will be recognized and measured at the beginning of the earliest period presented using a modified retrospective approach. The Company does not believe the adoption of ASU 2016-02 will have a material effect on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). The objective of ASU 2016-15 is to reduce diversity in the classification of cash receipts and payments for specific cash flow issues, including debt prepayment or debt extinguishment costs, contingent consideration payments made after a business combination and proceeds from the settlement of insurance claims. ASU 2016-15 is effective for fiscal years beginning after December 31, 2017, and interim periods within those fiscal years. Early adoption of ASU 2016-15 is permitted. The Company does not believe the adoption of ASU 2016-15 will have a material effect on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment ("ASU 2017-04"). ASU 2017-04 was issued to simplify the subsequent measurement of goodwill. This update changes the impairment test by requiring an entity to compare the fair value of a reporting unit with its carrying amount as opposed to

comparing the carrying amount of goodwill with its implied fair value. ASU 2017-04 is effective for annual and interim reporting periods beginning after December 15, 2019. Early adoption is permitted. The Company does not believe the adoption of ASU 2017-04 will have a material effect on its consolidated financial statements.

NOTE 5 ACQUISITIONS, DECONSOLIDATION AND DISCONTINUED OPERATIONS

(a) Acquisitions

CMC Industries, Inc.:

On July 14, 2016, the Company completed the acquisition of 81.0% of CMC Industries, Inc. ("CMC") for cash consideration of $1.5 million. As further discussed in Note 17, "Segmented Information," CMC is included in the Leased Real Estate segment. CMC owns, through an indirect wholly owned subsidiary (the "Property Owner"), a parcel of real property consisting of approximately 192 acres located in the State of Texas (the "Real Property"). The Real Property is leased to a third party pursuant to a long-term triple net lease. Effective beginning the first quarter of 2017, the Company executed a lease amendment between CMC and its tenant under which the tenant will pay an aggregate $25.0 million of additional rental income through May 2034, the remaining term of the lease. The Real Property is also subject to a mortgage, which is recorded as note payable in the consolidated balance sheets (the "Mortgage"). The Mortgage is nonrecourse indebtedness with respect to CMC and its subsidiaries (including the Property Owner), and the Mortgage is not, nor will it be, guaranteed by Kingsway or its affiliates.
This acquisition was accounted for as a business combination using the acquisition method of accounting. The purchase price was allocated to the assets acquired and liabilities assumed based upon their estimated fair values at the date of acquisition. During the fourth quarter of 2016, the Company completed its fair value analysis on the assets acquired and liabilities assumed. Goodwill of $61.0 million was recognized. The goodwill is not deductible for tax purposes. Separately identifiable intangible assets of $74.8 million were recognized resulting from the valuations of in-place lease and a tenant relationship. Refer to Note 9, "Intangible Assets," for further disclosure of the intangible assets related to this acquisition. The Mortgage was recorded at its estimated fair value of $191.7 million, which included the unpaid principal amount of $180.0 million as of the date of acquisition plus a premium of $11.7 million. Refer to Note 11, "Debt," for further discussion of the Mortgage. The Company also recognized a below market lease liability of $0.9 million, which is included in accrued expenses and other liabilities. The below market lease liability resulted from the terms of the acquired operating lease contract being unfavorable relative to market terms of comparable leases on the date of acquisition. The below market lease liability is amortized on a straight-line basis over the remaining term of the lease, as determined at the acquisition date. Amortization of below market lease liabilities is included in rental income in the consolidated statements of operations.
Argo Management Group LLC:

Effective April 21, 2016, the Company issued 160,000 shares of its common stock to acquire Argo Management Group LLC ("Argo"). The Argo purchase price of $0.7 million was determined using the closing price of Kingsway common stock on the date the 160,000 shares were issued. Argo's primary business is to act as the Managing Member

of Argo Holdings Fund I, LLC, an investment fund organized for purposes of making control-oriented equity investments in established lower middle market companies based in North America, with a focus on search fund investments.

This acquisition was accounted for as a business combination using the acquisition method of accounting. The purchase price was allocated to the assets acquired and liabilities assumed based upon their estimated fair values at the date of acquisition. During the second quarter of 2016, the Company completed its fair value analysis on the assets acquired and liabilities assumed. Separately identifiable intangible assets of $0.7 million were recognized resulting from the valuations of contract-based management fee and promote fee revenues. Refer to Note 9, "Intangible Assets," for further disclosure of the intangible assets related to this acquisition.

(b) Deconsolidation

1347 Investors LLC:

At June 30, 2016, the Company owned 61.0% of the outstanding units of 1347 Investors LLC ("1347 Investors"). Because the Company owned more than 50% of the outstanding units, 1347 Investors was included in the unaudited consolidated interim financial statements of the Company. 1347 Investors had an investment in the common stock and private units of 1347 Capital Corp., which was reflected in investment in investee in the consolidated balance sheets. 1347 Capital Corp., which completed an initial public offering on July 21, 2014 and had 24 months from the date of the initial public offering to complete a successful

business combination, was formed for the purpose of entering into a merger, share exchange, asset acquisition or other similar business combination with one or more businesses or entities.

On March 23, 2016, 1347 Capital Corp. announced the signing of a definitive agreement with Limbach Holdings LLC ("Limbach"), in which 1347 Capital Corp. would merge with Limbach. On July 21, 2016, Limbach announced the closing of the previously announced merger, and 1347 Capital Corp. was renamed Limbach Holdings, Inc. As a result of this transaction, the Company's ownership percentage in 1347 Investors was reduced to 26.7% at the transaction date. Subsequent to the transaction date, the Company is accounting for its remaining noncontrolling investment in 1347 Investors at fair value.

(c) Discontinued Operations

On April 1, 2015, the Company closed on the sale of its subsidiary, Assigned Risk Solutions Ltd. ("ARS") for $47.0 million in cash. During the second quarter of 2015, the Company received additional post-closing cash consideration of $2.0 million. The terms of the sale also provide for potential receipt by the Company of future earnout payments equal to 1.25% of ARS' written premium and fee income during the earnout periods. The earnout payments are payable in three annual installments beginning in April 2016 through April 2018. During the second quarters of 2017 and 2016, the Company received cash consideration, before expenses, of $1.3 million and $1.4 million, respectively, representing the first two annual installment earnout payments. Net of expenses, the Company recorded an additional gain on disposal of ARS of $1.0 million and $1.1 million for the three and six months ended June 30, 2017 and 2016, respectively. As a result of the sale, ARS, previously disclosed as part of the Extended Warranty (formerly Insurance Services) segment, has been classified as a discontinued operation. The earnings of ARS are disclosed as discontinued operations in the unaudited consolidated statements of operations for all periods presented. Summary financial information included in income from discontinued operations, net of taxes for the three and six months ended June 30, 2017 and June 30, 2016 is presented below:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Gain on disposal of discontinued operations before income tax benefit	$1,017	$1,124	$1,017	$1,124
Income tax benefit	—	—	—	—
Gain on disposal of discontinued operations, net of taxes	$1,017	$1,124	$1,017	$1,124

NOTE 6 INVESTMENTS

The amortized cost, gross unrealized gains and losses, and estimated fair value of the Company's investments in fixed maturities and equity investments at June 30, 2017 and December 31, 2016 are summarized in the tables shown below:

(in thousands)	June 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. government, government agencies and authorities	$27,033	$ 24	$ 153	$ 26,904
States, municipalities and political subdivisions	3,722	9	37	3,694
Mortgage-backed	8,419	14	80	8,353
Asset-backed securities and collateralized mortgage obligations	2,197	4	6	2,195
Corporate	15,801	98	80	15,819
Total fixed maturities	57,172	149	356	56,965
Equity investments:				
Common stock	15,222	2,996	602	17,616
Warrants - publicly traded	517	199	78	638
Warrants - not publicly traded	960	227	—	1,187
Total equity investments	16,699	3,422	680	19,441
Total fixed maturities and equity investments	$73,871	$ 3,571	$ 1,036	$ 76,406

(in thousands)	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. government, government agencies and authorities	$28,312	$ 22	$ 186	$ 28,148
States, municipalities and political subdivisions	3,131	1	44	3,088
Mortgage-backed	8,610	12	116	8,506
Asset-backed securities and collateralized mortgage obligations	3,468	4	5	3,467
Corporate	18,615	94	154	18,555
Total fixed maturities	62,136	133	505	61,764
Equity investments:				
Common stock	17,701	4,156	431	21,426
Warrants - publicly traded	438	279	53	664

Warrants - not publicly traded	960	180	—	1,140
Total equity investments	19,099	4,615	484	23,230
Total fixed maturities and equity investments	$ 81,235	$ 4,748	$ 989	$ 84,994

Net unrealized gains and losses in the tables above are reported as other comprehensive (loss) income with the exception of net unrealized gains of $0.2 million, at June 30, 2017, and $0.2 million, at December 31, 2016, related to warrants - not publicly traded, which are reported in the consolidated statements of operations.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited)
June 30, 2017

The table below summarizes the Company's fixed maturities at June 30, 2017 by contractual maturity periods. Actual results may differ as issuers may have the right to call or prepay obligations, with or without penalties, prior to the contractual maturity of these obligations.

(in thousands)	June 30, 2017	
	Amortized Cost	Estimated Fair Value
Due in one year or less	$7,518	$ 7,504
Due after one year through five years	40,198	40,077
Due after five years through ten years	3,107	3,082
Due after ten years	6,349	6,302
Total	$57,172	$ 56,965

The following tables highlight the aggregate unrealized loss position, by security type, of fixed maturities and equity investments in unrealized loss positions as of June 30, 2017 and December 31, 2016. The tables segregate the holdings based on the period of time the investments have been continuously held in unrealized loss positions.

(in thousands)					June 30, 2017	
	Less than 12 Months		Greater than 12 Months		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Fixed maturities:						
U.S. government, government agencies and authorities	$23,371	$ 153	$—	$ —	$23,371	$ 153
States, municipalities and political subdivisions	2,330	37	—	—	2,330	37
Mortgage-backed	7,090	79	136	1	7,226	80
Asset-backed securities and collateralized mortgage obligations	1,092	3	299	3	1,391	6
Corporate	6,870	80	—	—	6,870	80
Total fixed maturities	40,753	352	435	4	41,188	356
Equity investments:						
Common stock	1,317	146	666	456	1,983	602
Warrants	258	31	1	47	259	78
Total equity investments	1,575	177	667	503	2,242	680
Total	$42,328	$ 529	$1,102	$ 507	$43,430	$ 1,036

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited)
June 30, 2017

(in thousands)	December 31, 2016					
	Less than 12 Months		Greater than 12 Months		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Fixed maturities:						
U.S. government, government agencies and authorities	$18,509	$ 186	$—	$ —	$18,509	$ 186
States, municipalities and political subdivisions	2,594	44	—	—	2,594	44
Mortgage-backed	7,709	116	58	—	7,767	116
Asset-backed securities and collateralized mortgage obligations	1,830	5	44	—	1,874	5
Corporate	10,956	154	—	—	10,956	154
Total fixed maturities	41,598	505	102	—	41,700	505
Equity investments:						
Common stock	900	293	868	138	1,768	431
Warrants	31	20	—	33	31	53
Total equity investments	931	313	868	171	1,799	484
Total	$42,529	$ 818	$970	$ 171	$43,499	$ 989

Fixed maturities and equity investments contain approximately 168 and 173 individual investments that were in unrealized loss positions as of June 30, 2017 and December 31, 2016, respectively.

The establishment of an other-than-temporary impairment on an investment requires a number of judgments and estimates. The Company performs a quarterly analysis of the individual investments to determine if declines in market value are other-than-temporary. The analysis includes some or all of the following procedures as deemed appropriate by the Company:

- identifying all unrealized loss positions that have existed for at least six months;
- identifying other circumstances management believes may affect the recoverability of the unrealized loss positions;
- obtaining a valuation analysis from third-party investment managers regarding the intrinsic value of these investments based on their knowledge and experience together with market-based valuation techniques;
- reviewing the trading range of certain investments over the preceding calendar period;
- assessing if declines in market value are other-than-temporary for debt instruments based on the investment grade credit ratings from third-party rating agencies;
- assessing if declines in market value are other-than-temporary for any debt instrument with a non-investment grade credit rating based on the continuity of its debt service record;
- determining the necessary provision for declines in market value that are considered other-than-temporary based on the analyses performed; and

- assessing the Company's ability and intent to hold these investments at least until the investment impairment is recovered.

The risks and uncertainties inherent in the assessment methodology used to determine declines in market value that are other-than-temporary include, but may not be limited to, the following:

- the opinions of professional investment managers could be incorrect;
- the past trading patterns of individual investments may not reflect future valuation trends;
- the credit ratings assigned by independent credit rating agencies may be incorrect due to unforeseen or unknown facts related to a company's financial situation; and
- the debt service pattern of non-investment grade instruments may not reflect future debt service capabilities and may not reflect a company's unknown underlying financial problems.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited)
June 30, 2017

As a result of the analysis performed by the Company to determine declines in market value that are other-than-temporary, there were no write-downs for other-than-temporary impairments related to investments recorded for the three and six months ended June 30, 2017 and June 30, 2016.

The Company has reviewed currently available information regarding investments with estimated fair values less than their carrying amounts and believes these unrealized losses are not other-than-temporary and are primarily due to temporary market and sector-related factors rather than to issuer-specific factors. The Company does not intend to sell those investments, and it is not likely it will be required to sell those investments before recovery of its amortized cost.

The Company does not have any exposure to subprime mortgage-backed investments.

Limited liability investments include investments in limited liability companies, limited partnerships and a general partnership that primarily invest in income-producing real estate or real estate related investments. The Company's interests in these investments are not deemed minor and, therefore, are accounted for under the equity method of accounting. The most recently available financial statements are used in applying the equity method. The difference between the end of the reporting period of the limited liability entities and that of the Company is no more than three months. As of June 30, 2017 and December 31, 2016, the carrying value of limited liability investments totaled $25.5 million and $23.0 million, respectively. At June 30, 2017, the Company has unfunded commitments totaling $1.2 million to fund limited liability investments. Income or loss from limited liability investments is recognized based on the Company's share of the earnings of the limited liability entities and is included in net investment (loss) income.

Limited liability investment, at fair value represents the Company's investment in 1347 Investors. In connection with the deconsolidation of 1347 Investors during the third quarter of 2016, the Company retained a minority investment in 1347 Investors. The Company made an irrevocable election to account for this investment at fair value. As of June 30, 2017 and December 31, 2016, the carrying value of the Company's limited liability investment, at fair value was $8.2 million and $10.7 million, respectively. At June 30, 2017, there was no unfunded commitment related to the limited liability investment, at fair value.

Other investments include mortgage and collateral loans and are reported at their unpaid principal balance. As of June 30, 2017 and December 31, 2016, the carrying value of other investments totaled $7.6 million and $8.0 million, respectively.

The Company had previously entered into two separate performance share grant agreements with 1347 Property Insurance Holdings, Inc. ("PIH"), whereby the Company will be entitled to receive up to an aggregate of 475,000 shares of PIH common stock upon achievement of certain milestones for PIH’s stock price. Pursuant to the performance share grant agreements, if at any time the last sales price of PIH’s common stock equals or exceeds: (i) $10.00 per share (as adjusted for stock splits, stock dividends, reorganizations, recapitalizations and the like) for any 20 trading days within any 30-trading day period, the Company will receive 100,000 shares of PIH common stock; (ii) $12.00 per share (as adjusted for stock splits, stock dividends, reorganizations, recapitalizations and the like) for any 20 trading days within any 30-trading day period, the Company will receive 125,000 shares of PIH common stock (in addition to the 100,000 shares of common stock earned pursuant to clause (i) herein); (iii) $15.00 per share (as adjusted for stock splits, stock dividends, reorganizations, recapitalizations and the like) for any 20 trading days within any 30-trading day period, the Company will receive 125,000 shares of PIH common stock (in addition to the 225,000

shares of common stock earned pursuant to clauses (i) and (ii) herein); and (iv) $18.00 per share (as adjusted for stock splits, stock dividends, reorganizations, recapitalizations and the like) for any 20 trading days within any 30-trading day period, the Company will receive 125,000 shares of PIH common stock (in addition to the 350,000 shares of common stock earned pursuant to clauses (i), (ii) and (iii) herein). To the extent shares of PIH common stock are granted to the Company under either of the performance share grant agreements, they will be recorded at the time the shares are granted and will have a valuation equal to the last sales price of PIH common stock on the day prior to such grant. No shares were received by the Company under either of the performance share grant agreements as of June 30, 2017. Refer to Note 18, "Fair Value of Financial Instruments," for further details regarding the performance shares.
Gross realized gains and losses on fixed maturities and equity investments for the three and six months ended June 30, 2017 and June 30, 2016 are comprised as follows:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Gross realized gains	$735	$214	$1,159	$248
Gross realized losses	(1)	(147)	(27)	(352)
Net realized gains (losses)	$734	$67	$1,132	$(104)

14

Net investment (loss) income for the three and six months ended June 30, 2017 and June 30, 2016 is comprised as follows:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Investment (loss) income:				
Interest from fixed maturities	$228	$242	$434	$460
Dividends	127	126	269	392
(Loss) income from limited liability investments	(581)	511	(281)	310
Loss on change in fair value of limited liability investment, at fair value	(2,113)	—	(2,480)	—
(Loss) gain on change in fair value of warrants - not publicly traded	(198)	141	47	(246)
Other	205	100	415	139
Gross investment (loss) income	(2,332)	1,120	(1,596)	1,055
Investment expenses	(34)	(48)	(67)	(55)
Net investment (loss) income	$(2,366)	$1,072	$(1,663)	$1,000

Fixed maturities and short-term investments with an estimated fair value of $12.8 million and $13.1 million were on deposit with state and provincial regulatory authorities at June 30, 2017 and December 31, 2016, respectively. From time to time, the Company pledges investments to third parties as deposits or to collateralize liabilities incurred under its policies of insurance. The amount of such pledged investments was $16.9 million and $16.4 million at June 30, 2017 and December 31, 2016, respectively.

NOTE 7 INVESTMENT IN INVESTEE

Investment in investee includes the Company's investment in the common stock of Itasca Capital Ltd. ("ICL") and is accounted for under the equity method. Prior to the second quarter of 2016, the Company's investment in ICL was included in equity investments in the consolidated balance sheets. During the second quarter of 2016, the Company's ownership percentage in ICL was increased to 31.2%. As a result of this change in ownership, the Company determined its investment in the common stock of ICL qualified for the equity method of accounting and, thus, is included in investment in investee in the consolidated balance sheets at June 30, 2017 and December 31, 2016. The Company's investment in ICL is recorded on a three-month lag basis. The carrying value, estimated fair value and approximate equity percentage for the Company's investment in ICL at June 30, 2017 and December 31, 2016 were as follows:

(in thousands, except for percentages)	June 30, 2017			December 31, 2016		
	Equity Percentage	Estimated Fair Value	Carrying Value	Equity Percentage	Estimated Fair Value	Carrying Value

ICL	31.2 %	$ 4,192	$ 5,355	31.2 %	$ 4,251	$ 3,116

The estimated fair value of the Company's investment in ICL at June 30, 2017 in the table above is calculated based on the published closing price of ICL at March 31, 2017 to be consistent with the three-month lag in reporting its carrying value under the equity method. The estimated fair value of the Company's investment in ICL based on the published closing price of ICL at June 30, 2017 is $3.7 million.

Equity in net loss of investee of $0.1 million and equity in net income of investee of $2.2 million for the three and six months ended June 30, 2017, respectively, relates to the Company's investment in ICL.

The Company previously had an investment in the common stock and private units of 1347 Capital Corp., which was included in investment in investee in the consolidated balance sheet at June 30, 2016. Equity in net loss of investees of $0.9 million and $0.9 million for the three and six months ended June 30, 2016, respectively, relates to the Company's investment in 1347 Capital Corp.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements
(Unaudited)
June 30, 2017

NOTE 8 DEFERRED ACQUISITION COSTS

Policy acquisition costs consist primarily of commissions, premium taxes, and underwriting and agency expenses, net of ceding commission income, incurred related to successful efforts to acquire new or renewal insurance contracts and vehicle service agreements. Acquisition costs deferred on both property and casualty insurance products and vehicle service agreements are amortized over the period in which the related revenues are earned.

The components of deferred acquisition costs and the related amortization expense for the three and six months ended June 30, 2017 and June 30, 2016 are comprised as follows:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Beginning balance, net	$14,113	$13,440	$13,609	$12,143
Additions	7,011	7,180	14,698	14,769
Amortization	(7,415)	(6,796)	(14,598)	(13,088)
Balance at June 30, net	$13,709	$13,824	$13,709	$13,824

NOTE 9 INTANGIBLE ASSETS

Intangible assets at June 30, 2017 and December 31, 2016 are comprised as follows:

(in thousands)	June 30, 2017		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Intangible assets subject to amortization:			
Database	$4,918	$ 2,275	$2,643
Vehicle service agreements in-force	3,680	3,597	83
Customer relationships	3,611	1,748	1,863
In-place lease	1,125	60	1,065
Contract-based revenues	731	81	650
Intangible assets not subject to amortization:			
Tenant relationship	73,667	—	73,667
Insurance licenses	7,553	—	7,553
Trade name	663	—	663
Total	$95,948	$ 7,761	$88,187

(in thousands)	December 31, 2016		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Intangible assets subject to amortization:			

Database	$ 4,918	$ 2,029	$ 2,889
Vehicle service agreements in-force	3,680	3,554	126
Customer relationships	3,611	1,521	2,090
In-place lease	1,125	29	1,096
Contract-based revenues	731	48	683
Intangible assets not subject to amortization:			
Tenant relationship	73,667	—	73,667
Insurance licenses	7,803	—	7,803
Trade name	663	—	663
Total	$ 96,198	$ 7,181	$ 89,017

16

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited)
June 30, 2017

As further discussed in Note 5, "Acquisitions, Deconsolidation and Discontinued Operations," during 2016, the Company recorded $74.8 million of separately identifiable intangible assets related to in-place lease and tenant relationship, as part of the acquisition of CMC. The in-place lease intangible asset of $1.1 million is being amortized on a straight-line basis over its estimated useful life of approximately 18 years, which is based on the term of the existing operating lease. The tenant relationship intangible asset of $73.7 million relates to a single long-term tenant relationship. The Company has determined there are no legal, regulatory, contractual, competitive, economic or other factors limiting the useful life of the tenant relationship; therefore, the tenant relationship intangible asset is deemed to have an indefinite useful life and is not amortized.

As further discussed in Note 5, "Acquisitions, Deconsolidation and Discontinued Operations," during the second quarter of 2016, the Company recorded $0.7 million of separately identifiable intangible assets for contract-based management fee and promote fee revenues as part of the acquisition of Argo. The contract-based management fee revenue intangible asset is being amortized over nine years. The contract-based promote fee revenue intangible asset is being amortized over a three-year period beginning in 2022. The amortization periods for the contract-based revenues intangible assets are based on the patterns in which the economic benefits of the intangible assets are expected to be consumed.

The Company's other intangible assets with definite useful lives are amortized either based on the patterns in which the economic benefits of the intangible assets are expected to be consumed or using the straight-line method over their estimated useful lives, which range from seven to fifteen years. Amortization of intangible assets was $0.3 million and $0.3 million for the three months ended June 30, 2017 and June 30, 2016, respectively ($0.6 million and $0.6 million for the six months ended June 30, 2017 and June 30, 2016, respectively).

The tenant relationship, insurance licenses and trade name intangible assets have indefinite useful lives and are not amortized. During the six months ended June 30, 2017, the Company recorded an impairment charge of $0.3 million related to its insurance licenses indefinite lived intangible asset. The impairment recorded was the result of Mendota Insurance Company ("Mendota") and Mendakota Insurance Company ("Mendakota") surrendering their insurance licenses in the state of New Mexico during the first quarter of 2017.

NOTE 10 UNPAID LOSS AND LOSS ADJUSTMENT EXPENSES

The establishment of the provision for unpaid loss and loss adjustment expenses is based on known facts and interpretation of circumstances and is, therefore, a complex and dynamic process influenced by a large variety of factors. These factors include the Company's experience with similar cases and historical trends involving loss payment patterns, pending levels of unpaid loss and loss adjustment expenses, product mix or concentration, loss severity and loss frequency patterns.

Other factors include the continually evolving and changing regulatory and legal environment; actuarial studies; professional experience and expertise of the Company's claims departments' personnel and independent adjusters retained to handle individual claims; the quality of the data used for projection purposes; existing claims management practices including claims-handling and settlement practices; the effect of inflationary trends on future loss settlement costs; court decisions; economic conditions; and public attitudes.

Consequently, the process of determining the provision for unpaid loss and loss adjustment expenses necessarily involves risks that the actual loss and loss adjustment expenses incurred by the Company will deviate, perhaps materially, from the estimates recorded.

The Company's evaluation of the adequacy of unpaid loss and loss adjustment expenses includes a re-estimation of the liability for unpaid loss and loss adjustment expenses relating to each preceding financial year compared to the liability that was previously established.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements
(Unaudited)
June 30, 2017

(a) Property and Casualty

The results of this comparison and the changes in the provision for property and casualty unpaid loss and loss adjustment expenses, net of amounts recoverable from reinsurers, as of June 30, 2017 and June 30, 2016 were as follows:

(in thousands)	June 30, 2017	June 30, 2016
Balance at beginning of period, gross	$53,795	$55,471
Less reinsurance recoverable related to property and casualty unpaid loss and loss adjustment expenses	681	1,207
Balance at beginning of period, net	53,114	54,264
Incurred related to:		
Current year	50,324	45,614
Prior years	996	67
Paid related to:		
Current year	(23,094)	(22,060)
Prior years	(35,975)	(26,535)
Balance at end of period, net	45,365	51,350
Plus reinsurance recoverable related to property and casualty unpaid loss and loss adjustment expenses	509	845
Balance at end of period, gross	$45,874	$52,195

The Company reported unfavorable development on property and casualty unpaid loss and loss adjustment expenses of $1.0 million and $0.1 million for the six months ended June 30, 2017 and June 30, 2016, respectively. The unfavorable development for the six months ended June 30, 2017 was primarily related to an increase in property and casualty loss and loss adjustment expenses at Mendota. The unfavorable development reported for the six months ended June 30, 2016 was primarily related to property and casualty loss and loss adjustment expenses at Mendota, partially offset by a decrease in property and casualty unpaid loss and loss adjustment expenses at Amigo.

(b) Vehicle Service Agreements

The results of the comparison and the changes in the provision for vehicle service agreement unpaid loss and loss adjustment expenses as of June 30, 2017 and June 30, 2016 were as follows:

(in thousands)	June 30, 2017	June 30, 2016
Balance at beginning of period	$2,915	$2,975
Incurred related to:		
Current year	2,558	2,654
Prior years	—	—
Paid related to:		
Current year	(2,616)	(2,502)

Prior years	(63)	(152)
Balance at end of period	$2,794	$2,975

18

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements
(Unaudited)
June 30, 2017

NOTE 11 DEBT

Debt consists of the following instruments at June 30, 2017 and December 31, 2016:

(in thousands)	June 30, 2017			December 31, 2016		
	Principal	Carrying Value	Fair Value	Principal	Carrying Value	Fair Value
Note payable	$177,518	$188,328	$186,341	$178,781	$190,074	$190,074
Subordinated debt	90,500	48,210	48,210	90,500	43,619	43,619
Total	$268,018	$236,538	$234,551	$269,281	$233,693	$233,693

As further discussed in Note 5, "Acquisitions, Deconsolidation and Discontinued Operations," as part of the acquisition of CMC, the Mortgage, which is recorded as note payable in the consolidated balance sheets, was recorded at its estimated fair value of $191.7 million, which included the unpaid principal amount of $180.0 million as of the date of acquisition plus a premium of $11.7 million. The Mortgage matures on May 15, 2034 and has a fixed interest rate of 4.07%. The Mortgage is carried in the consolidated balance sheets at its amortized cost, which reflects the monthly pay-down of principal as well as the amortization of the premium using the effective interest rate method. The fair value of the Mortgage disclosed in the table above is derived from quoted market prices of A-rated industrial bonds with similar maturities.

The subordinated debt is carried in the consolidated balance sheets at fair value. See Note 18, "Fair Value of Financial Instruments," for further discussion of the subordinated debt. Subordinated debt consists of the following trust preferred debt instruments:

Issuer	Principal (in thousands)	Issue date	Interest	Redemption date
Kingsway CT Statutory Trust I	$ 15,000	12/4/2002	annual interest rate equal to LIBOR, plus 4.00% payable quarterly	12/4/2032
Kingsway CT Statutory Trust II	$ 17,500	5/15/2003	annual interest rate equal to LIBOR, plus 4.10% payable quarterly	5/15/2033
Kingsway CT Statutory Trust III	$ 20,000	10/29/2003	annual interest rate equal to LIBOR, plus 3.95% payable quarterly	10/29/2033
Kingsway DE Statutory Trust III	$ 15,000	5/22/2003	annual interest rate equal to LIBOR, plus 4.20% payable quarterly	5/22/2033
Kingsway DE Statutory Trust IV	$ 10,000	9/30/2003	annual interest rate equal to LIBOR, plus 3.85% payable quarterly	9/30/2033
Kingsway DE Statutory Trust VI	$ 13,000	1/8/2004	annual interest rate equal to LIBOR, plus 4.00% payable quarterly	1/8/2034

NOTE 12 FINANCE LEASE OBLIGATION LIABILITY

On October 2, 2014, the Company completed a sale and leaseback transaction involving building and land located in Miami, Florida, which was previously recorded as asset held for sale. The transaction did not qualify for sales recognition and was accounted for as a financing due to the Company's continuing involvement with the property as a result of nonrecourse financing provided to the buyer in the form of prepaid rent. A finance lease obligation liability equal to the selling price of the property was established at the date of the transaction. During the lease term, the Company will record interest expense on the finance lease obligation at its incremental borrowing rate and will increase the finance lease obligation liability by the same amount.

During the second quarter of 2017, the Company was informed of the landlord's intent to terminate the lease agreement effective October 10, 2017. The Company has the option to vacate the property and effectively terminate the lease earlier than October 10, 2017. Upon termination of the lease, the Company will no longer have continuing involvement with the property and will, then, recognize the sale of the property as well as a related gain of approximately $0.7 million. The gain will result primarily from removing the carrying values of the land, building and finance lease obligation liability from the consolidated balance sheets and from the return of part of the original prepaid rent. At June 30, 2017 and December 31, 2016, finance lease obligation liability of $5.1 million and $5.1 million, respectively, is included in accrued expenses and other liabilities in the consolidated balance sheets. At June 30, 2017 and December 31, 2016, the carrying value of the land and building of $4.7 million and $4.8 million, respectively, is included in property and equipment in the consolidated balance sheets.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements
(Unaudited)
June 30, 2017

NOTE 13 INCOME TAXES

Income tax expense for the three and six months ended June 30, 2017 and June 30, 2016 varies from the amount that would result by applying the applicable United States corporate income tax rate of 34% to loss before income tax expense. The following table summarizes the differences:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Income tax benefit at United States statutory income tax rate	$(2,519)	$(671)	$(2,962)	$(1,170)
Valuation allowance	2,401	251	2,945	640
Indefinite life intangibles	1,058	22	1,005	44
Change in unrecognized tax benefits[1]	160	—	372	—
Non-deductible compensation	101	381	200	449
Foreign operations subject to different tax rates	45	38	(94)	74
Other	5	5	(36)	15
Income tax expense	$1,251	$26	$1,430	$52

(1) Includes interest and penalty expense related to unrecognized tax benefits.

The Company maintains a valuation allowance for its gross deferred tax assets at June 30, 2017 and December 31, 2016. The Company's operations have generated substantial operating losses in prior years. These losses can be available to reduce income taxes that might otherwise be incurred on future taxable income; however, it is uncertain whether the Company will generate the taxable income necessary to utilize these losses or other reversing temporary differences. This uncertainty has caused management to place a full valuation allowance on its June 30, 2017 and December 31, 2016 net deferred tax asset, excluding the deferred income tax liability amounts set forth in the paragraph below.

The Company carries a deferred income tax liability of $49.7 million and $48.7 million at June 30, 2017 and December 31, 2016, respectively. At June 30, 2017, $13.4 million relates to deferred income tax liabilities scheduled to reverse in periods after the expiration of the Company's consolidated U.S. net operating loss carryforwards and $36.3 million relates to land and indefinite lived intangible assets. At December 31, 2016, $13.4 million relates to deferred income tax liabilities scheduled to reverse in periods after the expiration of the Company's consolidated U.S. net operating loss carryforwards and $35.3 million relates to land and indefinite lived intangible assets. The Company considered a tax planning strategy in arriving at its June 30, 2017 and December 31, 2016 deferred income tax liability.

As of June 30, 2017 and December 31, 2016, the Company carried a liability for unrecognized tax benefits of $1.3 million and $1.3 million, respectively, included in income taxes payable in the consolidated balance sheets. The Company classifies interest and penalty accruals, if any, related to unrecognized tax benefits as income tax expense. The Company recorded income tax expense of $0.2 million and zero related to interest and penalty accruals for the three months ended June 30, 2017 and June 30, 2016, respectively ($0.4 million and zero for the six months ended June 30, 2017 and June 30, 2016, respectively). At June 30, 2017 and December 31, 2016, the Company carried an

accrual for the payment of interest and penalties of $0.8 million and $0.4 million, respectively, included in income taxes payable in the consolidated balance sheets.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements
(Unaudited)
June 30, 2017

NOTE 14 LOSS FROM CONTINUING OPERATIONS PER SHARE

The following table sets forth the reconciliation of numerators and denominators for the basic and diluted loss from continuing operations per share computation for the three and six months ended June 30, 2017 and June 30, 2016:

(in thousands, except per share data)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Numerator:				
Loss from continuing operations	$(8,659)	$(1,999)	$(10,143)	$(3,494)
(Less) plus: net (income) loss attributable to noncontrolling interests	(100)	361	(205)	400
Less: dividends on preferred stock	(123)	(82)	(244)	(164)
Loss from continuing operations attributable to common shareholders	$(8,882)	$(1,720)	$(10,592)	$(3,258)
Denominator:				
Weighted-average common shares outstanding	21,458	19,818	21,458	19,764
Effect of potentially dilutive securities	—	—	—	—
Weighted-average diluted shares	21,458	19,818	21,458	19,764
Basic loss from continuing operations per share	$(0.41)	$(0.09)	$(0.49)	$(0.16)
Diluted loss from continuing operations per share	$(0.41)	$(0.09)	$(0.49)	$(0.16)

Basic loss from continuing operations per share is calculated using weighted-average common shares outstanding. Diluted loss from continuing operations per share is calculated using weighted-average diluted shares. Weighted-average diluted shares is calculated by adding the effect of potentially dilutive securities to weighted-average common shares outstanding. Potentially dilutive securities consist of stock options, unvested restricted stock awards, unvested restricted stock units, warrants and convertible preferred stock. Because the Company is reporting a loss from continuing operations for the three and six months ended June 30, 2017 and June 30, 2016, all potentially dilutive securities outstanding were excluded from the calculation of diluted loss from continuing operations per share since their inclusion would have been anti-dilutive.

NOTE 15 STOCK-BASED COMPENSATION

(a) Stock Options

The following table summarizes the stock option activity during the six months ended June 30, 2017:

	Number of Options Outstanding	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value (in Thousands)
Outstanding at December 31, 2016	651,875	$ 4.51	1.4	$ 1,134
Granted	—	—		
Expired	—	—		
Outstanding at June 30, 2017	651,875	$ 4.51	0.9	$ 1,004

Exercisable at June 30, 2017	651,875	$ 4.51	0.9	$ 1,004

The aggregate intrinsic value of stock options outstanding and exercisable is the difference between the June 30, 2017 market price for the Company's common shares and the exercise price of the options, multiplied by the number of options where the fair value exceeds the exercise price.

The Company uses the Black-Scholes option pricing model to estimate the fair value of each option on the date of grant. No options were granted during the six months ended June 30, 2017.

(b) Restricted Stock Awards

Under the 2013 Equity Incentive Plan, the Company made grants of restricted common stock awards ("Restricted Stock Awards") to certain officers of the Company on March 28, 2014. The Restricted Stock Awards shall become fully vested and the restriction period shall lapse as of March 28, 2024 subject to the officers' continued employment through the vesting date. The Restricted Stock Awards are amortized on a straight-line basis over the ten-year requisite service period. Total unamortized compensation expense related to unvested Restricted Stock Awards at June 30, 2017 was $5.5 million. The grant-date fair value of the Restricted Stock Awards was determined using the closing price of Kingsway common stock on the date of grant. The following table summarizes the activity related to unvested Restricted Stock Awards for the six months ended June 30, 2017:

	Number of Restricted Stock Awards	Weighted-Average Grant Date Fair Value (per Share)
Unvested at December 31, 2016	1,952,665	$ 4.14
Granted	—	—
Forfeited	—	—
Unvested at June 30, 2017	1,952,665	$ 4.14

(c) Restricted Stock Units

The Company granted restricted common stock units ("Restricted Stock Units") to an officer of the Company pursuant to a Restricted Stock Unit Agreement dated August 24, 2016. Each Restricted Stock Unit represents a right to receive one common share on the vesting date. The Restricted Stock Units shall become fully vested and the restriction period shall lapse as of March 28, 2024 subject to the officer's continued employment through the vesting date. The Restricted Stock Units are amortized on a straight-line basis over the requisite service period. Total unamortized compensation expense related to unvested Restricted Stock Units at June 30, 2017 was $2.5 million. The grant-date fair value of the Restricted Stock Units was determined using the closing price of Kingsway common stock on the date of grant. The following table summarizes the activity related to unvested Restricted Stock Units for the six months ended June 30, 2017:

	Number of Restricted Stock Units	Weighted-Average Grant Date Fair Value (per Share)
Unvested at December 31, 2016	500,000	$ 5.73

Granted	—	—
Vested	—	—
Forfeited	—	—
Unvested at June 30, 2017	500,000	$ 5.73

Total stock-based compensation expense, net of forfeitures, was $0.3 million and $0.3 million for the three months ended June 30, 2017 and June 30, 2016, respectively ($0.6 million and $0.5 million for the six months ended June 30, 2017 and June 30, 2016, respectively).

NOTE 16 ACCUMULATED OTHER COMPREHENSIVE LOSS

The tables below detail the changes in the balances of each component of accumulated other comprehensive loss, net of tax, for the three and six months ended June 30, 2017 and June 30, 2016 as relates to shareholders' equity attributable to common shareholders on the consolidated balance sheets. On the other hand, the unaudited consolidated statements of comprehensive loss

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited)
June 30, 2017

present the components of other comprehensive (loss) income, net of tax, only for the three and six months ended June 30, 2017 and June 30, 2016 and inclusive of the components attributable to noncontrolling interests in consolidated subsidiaries.

(in thousands)	Three months ended June 30, 2017		
	Unrealized Gains (Losses) on Fixed Maturities and Equity Investments	Foreign Currency Translation Adjustments	Total Accumulated Other Comprehensive Loss
Balance at April 1, 2017	$ 2,901	$(3,780)	$ (879)
Other comprehensive loss arising during the period	(1,066)	—	(1,066)
Amounts reclassified from accumulated other comprehensive loss	478	—	478
Net current-period other comprehensive loss	(588)	—	(588)
Balance at June 30, 2017	$ 2,313	$(3,780)	$ (1,467)

(in thousands)	Three months ended June 30, 2016		
	Unrealized Gains (Losses) on Fixed Maturities and Equity Investments	Foreign Currency Translation Adjustments	Total Accumulated Other Comprehensive Loss
Balance at April 1, 2016	$ 1,137	$(3,780)	$ (2,643)
Other comprehensive income arising during the period	430	—	430
Amounts reclassified from accumulated other comprehensive loss	(73)	—	(73)
Net current-period other comprehensive income	357	—	357
Balance at June 30, 2016	$ 1,494	$(3,780)	$ (2,286)

(in thousands)	Six months ended June 30, 2017		
	Unrealized Gains (Losses) on Fixed Maturities and Equity Investments	Foreign Currency Translation Adjustments	Total Accumulated Other Comprehensive Loss
Balance at January 1, 2017	$ 3,572	$(3,780)	$ (208)
Other comprehensive loss arising during the period	(1,230)	—	(1,230)
Amounts reclassified from accumulated other comprehensive loss	(29)	—	(29)
Net current-period other comprehensive loss	(1,259)	—	(1,259)
Balance at June 30, 2017	$ 2,313	$(3,780)	$ (1,467)

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited)
June 30, 2017

(in thousands)	Six months ended June 30, 2016		
	Unrealized Gains (Losses) on Fixed Maturities and Equity Investments	Foreign Currency Translation Adjustments	Total Accumulated Other Comprehensive Loss
Balance at January 1, 2016	$ 1,294	$ (3,780)	$ (2,486)
Other comprehensive income arising during the period	705	—	705
Amounts reclassified from accumulated other comprehensive loss	(505)	—	(505)
Net current-period other comprehensive loss	200	—	200
Balance at June 30, 2016	$ 1,494	$ (3,780)	$ (2,286)

Components of accumulated other comprehensive loss were reclassified to the following lines of the unaudited consolidated statements of operations for the three and six months ended June 30, 2017 and June 30, 2016:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Reclassification of accumulated other comprehensive loss from unrealized gains (losses) on fixed maturities and equity investments to:				
Net realized (losses) gains	$ (478)	$ 73	$ 29	$ 505
Other-than-temporary impairment loss	—	—	—	—
Loss before income tax expense	(478)	73	29	505
Income tax expense	—	—	—	—
Net (loss) gain	$ (478)	$ 73	29	505

NOTE 17 SEGMENTED INFORMATION

The Company conducts its business through the following three reportable segments: Insurance Underwriting, Extended Warranty (formerly Insurance Services) and Leased Real Estate.

Insurance Underwriting Segment

Insurance Underwriting includes the following subsidiaries of the Company: Mendota, Mendakota, Mendakota Casualty Company ("MCC"), Kingsway Amigo Insurance Company ("Amigo") and Kingsway Reinsurance

Corporation (collectively, "Insurance Underwriting"). Insurance Underwriting principally offers personal automobile insurance to drivers who do not meet the criteria for coverage by standard automobile insurers. Insurance Underwriting has policyholders in 12 states; however, new business is accepted in only eight states.

The Company previously placed Amigo and MCC into voluntary run-off in 2012 and 2011, respectively. Each of Amigo and MCC entered into a comprehensive run-off plan that was approved by its respective state of domicile. Kingsway continues to manage Amigo and MCC in a manner consistent with the run-off plans. During the first quarter of 2015, MCC sent a letter of intent to the Illinois Department of Insurance to resume writing private passenger automobile policies in the state of Illinois. MCC began writing these policies on April 1, 2015.

Extended Warranty Segment

Extended Warranty includes the following subsidiaries of the Company: IWS Acquisition Corporation ("IWS") and Trinity Warranty Solutions LLC ("Trinity") (collectively, "Extended Warranty"). Prior to the second quarter of 2017, Extended Warranty was referred to as Insurance Services.

IWS is a licensed motor vehicle service agreement company and is a provider of after-market vehicle protection services distributed by credit unions in 24 states to their members.

Trinity is a provider of warranty products and maintenance support to consumers and businesses in the heating, ventilation, air conditioning, standby generator, commercial LED lighting and refrigeration industries. Trinity distributes its warranty products through original equipment manufacturers, HVAC distributors and commercial and residential contractors. Trinity distributes its maintenance support directly through corporate owners of retail spaces throughout the United States.

Leased Real Estate Segment

Leased Real Estate includes the Company's subsidiary, CMC, which was acquired on July 14, 2016. CMC owns the Real Property, which is leased to a third party pursuant to a long-term triple net lease. The Real Property is also subject to the Mortgage. When assessing and measuring the operational and financial performance of the Leased Real Estate segment, interest expense related to the Mortgage is included in Leased Real Estate's segment operating income.

Revenues and Operating Income (Loss) by Reportable Segment

Results for the Company's reportable segments are based on the Company's internal financial reporting systems and are consistent with those followed in the preparation of the unaudited consolidated interim financial statements. The following tables provide financial data used by management. Segment assets are not allocated for management use and, therefore, are not included in the segment disclosures below.

Revenues by reportable segment reconciled to consolidated revenues for the three and six months ended June 30, 2017 and June 30, 2016 were:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Revenues:				
Insurance Underwriting:				
Net premiums earned	$33,518	$31,813	$66,440	$61,240
Other income	2,560	2,665	5,033	4,938
Total Insurance Underwriting	36,078	34,478	71,473	66,178
Extended Warranty:				
Service fee and commission income	6,873	5,394	13,435	10,716
Other income	51	62	136	116
Total Extended Warranty	6,924	5,456	13,571	10,832
Leased Real Estate:				
Rental income	3,341	—	6,682	—
Other income	160	—	372	—
Total Leased Real Estate	3,501	—	7,054	—

Total segment revenues	46,503	39,934	92,098	77,010
Net premiums earned not allocated to segments	—	—	—	—
Net investment (loss) income	(2,366)	1,072	(1,663)	1,000
Net realized gains (losses)	734	67	1,132	(104)
Other income not allocated to segments	44	64	89	111
Total revenues	$44,915	$41,137	$91,656	$78,017