

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)

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

For Quarterly Period Ended
June 30, 2017

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: 001-15204

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 No

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 No

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 <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>	Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller Reporting Company <input type="checkbox"/>	Emerging Growth Company <input type="checkbox"/>
---	--	--	---	---

Edgar Filing: KINGSWAY FINANCIAL SERVICES INC - Form 10-Q

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.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No
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	<u>3</u>
ITEM 1. FINANCIAL STATEMENTS	<u>3</u>
Consolidated Balance Sheets as of June 30, 2017 (unaudited) and December 31, 2016	<u>3</u>
Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2017 and 2016 (unaudited)	<u>4</u>
Consolidated Statements of Comprehensive Loss for the Three and Six Months Ended June 30, 2017 and 2016 (unaudited)	<u>5</u>
Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2017 and 2016 (unaudited)	<u>6</u>
Notes to Consolidated Financial Statements (unaudited)	<u>7</u>
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	<u>31</u>
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	<u>43</u>
ITEM 4. CONTROLS AND PROCEDURES	<u>45</u>
PART II - OTHER INFORMATION	<u>45</u>
ITEM 1. LEGAL PROCEEDINGS	<u>45</u>
ITEM 1A. RISK FACTORS	<u>45</u>
ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	<u>45</u>
ITEM 3. DEFAULTS UPON SENIOR SECURITIES	<u>45</u>
ITEM 4. MINE SAFETY DISCLOSURES	<u>45</u>
ITEM 5. OTHER INFORMATION	<u>46</u>
ITEM 6. EXHIBITS	<u>47</u>
SIGNATURES	<u>48</u>

KINGSWAY
FINANCIAL
SERVICES
INC.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Consolidated Balance Sheets

(in thousands, except share data)

	June 30, 2017	December 31, 2016
	(unaudited)	
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

Edgar Filing: KINGSWAY FINANCIAL SERVICES INC - Form 10-Q

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

Edgar Filing: KINGSWAY FINANCIAL SERVICES INC - Form 10-Q

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

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

KINGSWAY
FINANCIAL
SERVICES
INC.

Notes to
Consolidated
Financial
Statements
(Unaudited)
June 30, 2017

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

KINGSWAY
FINANCIAL
SERVICES
INC.

Notes to
Consolidated
Financial
Statements
(Unaudited)
June 30, 2017

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

KINGSWAY
FINANCIAL
SERVICES
INC.

Notes to
Consolidated
Financial
Statements
(Unaudited)
June 30, 2017

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		Six months	
	ended June 30, 2017	2016	ended June 30, 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

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

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

Edgar Filing: KINGSWAY FINANCIAL SERVICES INC - Form 10-Q

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 States, municipalities and political subdivisions	\$23,371	\$ 153	\$—	\$ —	\$23,371	\$ 153
Mortgage-backed	2,330	37	—	—	2,330	37
Asset-backed securities and collateralized mortgage obligations	7,090	79	136	1	7,226	80
Corporate	1,092	3	299	3	1,391	6
Total fixed maturities	6,870	80	—	—	6,870	80
Equity investments:	40,753	352	435	4	41,188	356
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)	Less than 12 Months		Greater than 12 Months		December 31, 2016	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Fixed maturities:						
U.S. government, government agencies and authorities States, municipalities and political subdivisions	\$18,509	\$ 186	\$—	\$ —	\$18,509	\$ 186
Mortgage-backed	2,594	44	—	—	2,594	44
Asset-backed securities and collateralized mortgage obligations	7,709	116	58	—	7,767	116
Corporate	1,830	5	44	—	1,874	5
Total fixed maturities	10,956	154	—	—	10,956	154
Equity investments:						
Common stock	41,598	505	102	—	41,700	505
Warrants	900	293	868	138	1,768	431
Total equity investments	31	20	—	33	31	53
Total	931	313	868	171	1,799	484
	\$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)

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

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:			

Edgar Filing: KINGSWAY FINANCIAL SERVICES INC - Form 10-Q

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

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

Edgar Filing: KINGSWAY FINANCIAL SERVICES INC - Form 10-Q

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.

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

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)

Edgar Filing: KINGSWAY FINANCIAL SERVICES INC - Form 10-Q

(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, 2017	Six months ended June 30, 2016	Three months ended June 30, 2017	Six months ended June 30, 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.

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

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	—

Edgar Filing: KINGSWAY FINANCIAL SERVICES INC - Form 10-Q

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

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

The operating income (loss) by reportable segment in the following table is before income taxes and includes revenues and direct segment costs. Total segment operating income (loss) reconciled to the consolidated net loss for the three and six months ended June 30, 2017 and June 30, 2016 was:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Segment operating income (loss):				
Insurance Underwriting	\$ (417)	\$ 181	\$ (1,159)	\$ (58)
Extended Warranty	685	(780)	1,271	(936)
Leased Real Estate	872	—	1,790	—
Total segment operating income (loss)	1,140	(599)	1,902	(994)
Net investment (loss) income	(2,366)	1,072	(1,663)	1,000
Net realized gains (losses)	734	67	1,132	(104)
Amortization of intangible assets	(289)	(307)	(580)	(602)
Contingent consideration benefit	212	657	212	657
Impairment of intangible assets	—	—	(250)	—
Interest expense not allocated to segments	(1,216)	(1,108)	(2,375)	(2,201)
Other income and expenses not allocated to segments, net	(2,776)	(1,940)	(4,736)	(3,841)
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 investee	(145)	(874)	2,240	(943)
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
Net loss from continuing operations	\$(8,659)	\$(1,999)	\$(10,143)	\$(3,494)

Insurance Underwriting net premiums earned by line of business 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
Insurance Underwriting:				
Private passenger auto liability	\$22,933	\$21,656	\$45,309	\$41,731
Auto physical damage	10,585	10,157	21,131	19,509
Total net premiums earned	\$33,518	\$31,813	\$66,440	\$61,240

NOTE 18 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value amounts represent estimates of the consideration that would currently be agreed upon between knowledgeable, willing parties who are under no compulsion to act. Fair value is best evidenced by quoted bid or ask price, as appropriate, in an active market. Where bid or ask prices are not available, such as in an illiquid or inactive

market, the closing price of the most recent transaction of that instrument subject to appropriate adjustments as required is used. Where quoted market prices are not available, the quoted prices of similar financial instruments or valuation models with observable market-based inputs are used to estimate the fair value. These valuation models may use multiple observable market inputs, including observable interest rates, foreign exchange rates, index levels, credit spreads, equity prices, counterparty credit quality, corresponding market volatility levels and option volatilities. Minimal management judgment is required for fair values calculated using quoted market prices or observable market inputs for models. Greater subjectivity is required when making valuation adjustments for financial instruments in inactive markets or when using models where observable parameters do not exist. Also, the calculation of estimated fair value is based on market conditions at a specific point in time and may not be reflective of future fair values. For the Company's financial instruments carried at cost or amortized cost, the book value is not adjusted to reflect increases or decreases in fair value due to market fluctuations, including those due to interest rate changes, as it is the Company's intention to hold them until there is a recovery of fair value, which may be to maturity.

KINGSWAY
FINANCIAL
SERVICES
INC.

Notes to
Consolidated
Financial
Statements
(Unaudited)
June 30, 2017

The Company classifies its investments in fixed maturities and equity investments as available-for-sale and reports these investments at fair value. The Company's limited liability investment, at fair value, performance shares, subordinated debt and contingent consideration liabilities are measured and reported at fair value.

Fixed maturities and equity investments - Fair values of fixed maturities for which no active market exists are derived from quoted market prices of similar instruments or other third-party evidence. Fair values of equity investments, including warrants, reflect quoted market values based on latest bid prices, where active markets exist, or models based on significant market observable inputs, where no active markets exist.

Limited liability investment, at fair value - The fair value of the limited liability investment, at fair value is calculated based on a model that distributes the net equity of 1347 Investors to all classes of membership interests. The model uses quoted market prices and significant market observable inputs.

Performance shares - The performance shares, for which no active market exists, are required to be valued at fair value as determined in good faith by the Company. Such determination of fair value would require the Company to develop a model based upon relevant observable market inputs as well as significant unobservable inputs, including developing a sufficiently reliable estimate for an appropriate discount to reflect the illiquidity and unique structure of the security. The Company determined its model for the performance shares was not sufficiently reliable. As a result, the Company has assigned a fair value of zero to the performance shares. Refer to Note 6, "Investments," for further details regarding the performance shares.

Subordinated debt - The fair value of the subordinated debt is calculated using a model based on significant market observable inputs and inputs developed by a third party. These inputs include credit spread assumptions developed by a third party and market observable swap rates.

Contingent consideration - The consideration for certain of the Company's acquisitions included future payments to the former owners that are contingent upon the achievement of certain targets over future reporting periods. Liabilities for contingent consideration are measured and reported at fair value and are included in accrued expenses and other liabilities in the consolidated balance sheets. The fair value of contingent consideration liabilities is estimated using internal models without relevant observable market inputs. Estimated payments are discounted using present value techniques to arrive at estimated fair value. Contingent consideration liabilities are revalued each reporting period. Changes in the fair value of contingent consideration liabilities can result from changes to one or multiple inputs, including adjustments to the discount rates or changes in the assumed achievement or timing of any targets. Any changes in fair value are reported in the unaudited consolidated statements of operations as contingent consideration benefit. During the second quarter of 2017, the Company settled its remaining contingent consideration liability; therefore, no contingent consideration liability remains on the consolidated balance sheets as of June 30, 2017.

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

The Company employs a fair value hierarchy to categorize the inputs it uses in valuation techniques to measure the fair value. The extent of use of quoted market prices (Level 1), valuation models using observable market information (Level 2) and internal models without observable market information (Level 3) in the valuation of the Company's financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2017 and December 31, 2016 was as follows:

(in thousands)

	June 30, 2017			
	Fair Value Measurements at the End of the Reporting Period Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Total				

Recurring fair value measurements:

Assets:

Fixed maturities:

U.S. government, government agencies and authorities States, municipalities and political subdivisions	\$26,904	\$—	\$26,904	\$	—
Mortgage-backed Asset-backed securities and collateralized mortgage obligations	3,694	—	3,694	—	—
Corporate	8,353	—	8,353	—	—
Total fixed maturities	2,195	—	2,195	—	—
Equity investments:	15,819	—	15,819	—	—
Common stock	56,965	—	56,965	—	—
Warrants	17,616	17,616	—	—	—
Total equity investments	1,825	638	1,187	—	—
Limited liability investment, at fair value	19,441	18,254	1,187	—	—
Other investments	8,220	—	8,220	—	—
Short-term investments	7,550	—	7,550	—	—
Total assets	151	—	151	—	—
	\$92,327	\$18,254	\$74,073	\$	—

Liabilities:

Subordinated debt	\$48,210	\$—	\$48,210	\$	—
Total liabilities	\$48,210	\$—	\$48,210	\$	—

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

(in thousands)

	December 31, 2016			
	Fair Value Measurements at the			
	End of the Reporting Period			
	Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring fair value measurements:				
Assets:				
Fixed maturities:				
U.S. government, government agencies and authorities	\$28,148	\$—	\$28,148	\$ —
States municipalities and political subdivisions	3,088	—	3,088	—
Mortgage-backed	8,506	—	8,506	—
Asset-backed securities and collateralized mortgage obligations	3,467	—	3,467	—
Corporate	18,555	—	18,555	—
Total fixed maturities	61,764	—	61,764	—
Equity investments:				
Common stock	21,426	21,426	—	—
Warrants	1,804	664	1,140	—
Total equity investments	23,230	22,090	1,140	—
Limited liability investment, at fair value	10,700	—	10,700	—
Other investments	7,975	—	7,975	—
Short-term investments	401	—	401	—
Total assets	\$104,070	\$22,090	\$81,980	\$ —
Liabilities:				
Subordinated debt	\$43,619	\$—	\$43,619	\$ —
Contingent consideration	325	—	—	325

Total liabilities \$43,944 \$— \$43,619 \$ 325

The following table provides a reconciliation of the fair value of recurring Level 3 fair value measurements 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
Contingent consideration:				
Beginning balance	\$325	\$1,982	\$325	\$1,982
Settlement of contingent consideration liabilities	(113)	(1,000)	(113)	(1,000)
Change in fair value of contingent consideration included in net loss	(212)	(657)	(212)	(657)
Ending balance	\$—	\$325	\$—	\$325

KINGSWAY
FINANCIAL
SERVICES
INC.

Notes to
Consolidated
Financial
Statements
(Unaudited)
June 30, 2017

NOTE 19 RELATED PARTY TRANSACTIONS

Related party transactions, including services provided to or received by the Company's subsidiaries, are measured in part by the amount of consideration paid or received as established and agreed by the parties. Management believes consideration paid for such services in each case approximates fair value. Except where disclosed elsewhere in these unaudited consolidated interim financial statements, the following is a summary of related party transactions.

On April 20, 2016, John T. Fitzgerald, the Managing Member of Argo, joined the Company as an Executive Vice President. As part of the agreement to purchase Argo, Mr. Fitzgerald received 160,000 common shares of the Company. On April 21, 2016, the Board of Directors appointed Mr. Fitzgerald as a new director. Pursuant to a Restricted Stock Unit Agreement dated August 24, 2016, the Company granted 500,000 restricted stock units to Mr. Fitzgerald.

On December 14, 2016, the Company sold 100,000 shares of PIH common stock to Ballantyne Strong, Inc. ("Ballantyne") at a price of \$7.57 per share. Kyle Cerminara is the Chief Executive Officer of Ballantyne and Fundamental Global Investors ("FGI"). FGI is a greater than 5% shareholder of the Company.

NOTE 20 COMMITMENTS AND CONTINGENCIES

(a) Legal proceedings:

In connection with its operations in the ordinary course of business, the Company and its subsidiaries are named as defendants in various actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the loss, or range of loss, if any, that may be incurred in connection with any of the various proceedings at this time, it is possible an individual action may result in a loss having a material adverse effect on the Company's financial condition or results of operations.

(b) Guarantee:

The Company provided an indemnity and hold harmless agreement to a third party for certain customs bonds reinsured by Lincoln General Insurance Company ("Lincoln General") during a period of the time Lincoln General was a subsidiary of the Company. This agreement may require the Company to compensate the third party if Lincoln General is unable to fulfill its obligations relating to the customs bonds. The Company's potential exposure under this agreement is not determinable, and no liability has been recorded in the unaudited consolidated interim financial statements at June 30, 2017.

The third party filed a lawsuit on May 11, 2016 seeking damages of \$0.2 million from the Company. The third party's claim has subsequently been amended to seek damages of \$0.9 million from the Company. With respect to this particular lawsuit, the Company does not believe the likelihood of an unfavorable outcome is probable. As a result, no liability has been accrued in the unaudited consolidated interim financial statements at June 30, 2017 with respect to this particular lawsuit. No assurances can be given, however, the Company will not be required to perform under this agreement in a manner that has a material adverse effect on the Company's business, results of operations and financial condition.

(c) Commitment:

The Company has entered into subscription agreements to commit up to \$2.5 million of capital to allow for participation in limited liability investments. At June 30, 2017, the unfunded commitment was \$1.2 million.

KINGSWAY
FINANCIAL
SERVICES
INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
FORWARD-LOOKING STATEMENTS

Management's Discussion and Analysis includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are not historical facts, and involve risks and uncertainties that could cause actual results to differ materially from those expected and projected. Words such as "expects," "believes," "anticipates," "intends," "estimates," "seeks" and variations and similar words and expressions are intended to identify such forward-looking statements. Such forward-looking statements relate to future events or future performance, but reflect Kingsway management's current beliefs, based on information currently available. A number of factors could cause actual events, performance or results to differ materially from the events, performance and results discussed in the forward-looking statements. For information identifying important factors that could cause actual results to differ materially from those anticipated in the forward-looking statements, see Kingsway's securities filings, including its Annual Report on Form 10-K for the year ended December 31, 2016 ("2016 Annual Report"). The Company's securities filings can be accessed on the Canadian Securities Administrators' website at www.sedar.com, on the EDGAR section of the U.S. Securities and Exchange Commission's website at www.sec.gov or through the Company's website at www.kingsway-financial.com. Except as expressly required by applicable securities law, the Company disclaims any intention or obligation to update or revise any forward-looking statements because of new information, future events or otherwise.

OVERVIEW

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

Insurance Underwriting includes the following subsidiaries of the Company: Mendota Insurance Company ("Mendota"), Mendakota Insurance Company ("Mendakota"), Mendakota Casualty Company ("MCC"), Kingsway Amigo Insurance Company ("Amigo") and Kingsway Reinsurance Corporation. Throughout Management's Discussion and Analysis, the term "Insurance Underwriting" is used to refer to this segment.

Insurance Underwriting provides non-standard automobile insurance to individuals 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. For the three months ended June 30, 2017, production in the following states represented 92.4% of the Company's gross premiums written: Florida (27.5%), Texas (15.2%), California (13.8%), Nevada (13.5%), Illinois (12.8%) and Colorado (9.6%). For the six months ended June 30, 2017, production in the following states represented 90.0% of the Company's gross premiums written: Florida (27.2%), Texas (16.8%), Nevada (12.5%), California (12.3%), Illinois (11.5%) and Colorado (9.7%). For the three and six months ended June 30, 2017, non-standard automobile insurance accounted for 100.0% of the Company's gross premiums written. 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 includes the following subsidiaries of the Company: IWS Acquisition Corporation ("IWS") and Trinity Warranty Solutions LLC ("Trinity"). Throughout Management's Discussion and Analysis, the term "Extended Warranty" is used to refer to this segment. 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 ("HVAC"), 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 includes the Company's subsidiary, CMC Industries, Inc. ("CMC"), which was acquired on July 14, 2016. CMC owns, through an indirect wholly owned subsidiary (the "Property Owner"), a parcel of real property consisting of

KINGSWAY
FINANCIAL
SERVICES
INC.

approximately 192 acres located in the State of Texas (the "Real Property"), which is subject to a long-term triple net lease agreement. The Real Property is also subject to a mortgage, which is recorded as note payable in the consolidated balance sheets (the "Mortgage"). Throughout Management's Discussion and Analysis, the term "Leased Real Estate" is used to refer to this segment.

NON-U.S. GAAP FINANCIAL MEASURES

Throughout this quarterly report, we present our operations in the way we believe will be most meaningful, useful and transparent to anyone using this financial information to evaluate our performance. Our 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. In addition to the U.S. GAAP presentation of net loss, we show certain statutory reporting information and other non-U.S. GAAP financial measures we believe are valuable in managing our business and drawing comparisons to our peers. These measures are segment operating income (loss), gross premiums written, net premiums written and underwriting ratios.

Following is a list of non-U.S. GAAP measures found throughout this report with their definitions, relationships to U.S. GAAP measures and explanations of their importance to our operations.

Segment Operating Income (Loss)

Segment operating income (loss) represents one measure of the pretax profitability of our segments and is derived by subtracting direct segment expenses from direct segment revenues. Revenues and expenses are presented in the unaudited consolidated statements of operations, but are not subtotaled by segment; however, this information is available in total and by segment in Note 17, "Segmented Information," to the unaudited consolidated interim financial statements, regarding reportable segment information. The nearest comparable U.S. GAAP measure is loss before income tax expense that, in addition to segment operating income (loss), includes net investment (loss) income, net realized gains (losses), amortization of intangible assets, contingent consideration benefit, impairment of intangible assets, interest expense not allocated to segments, other income not allocated to segments, general and administrative expenses, foreign exchange losses, net, (loss) gain on change in fair value of debt and equity in net (loss) income of investee. A reconciliation of segment operating income (loss) to loss from continuing operations before income tax expense for the three and six months ended June 30, 2017 and 2016 is presented in Table 1 of the "Results of Operations" section of Management's Discussion and Analysis.

Gross Premiums Written

While net premiums earned is the related U.S. GAAP measure used in the unaudited consolidated statements of operations, gross premiums written is the component of net premiums earned that measures insurance business produced before the effect of ceding reinsurance premiums, but without respect to when those premiums will be recognized as actual revenue. We use this measure as an overall gauge of gross business volume in Insurance Underwriting.

Net Premiums Written

While net premiums earned is the related U.S. GAAP measure used in the unaudited consolidated statements of operations, net premiums written is the component of net premiums earned that measures the difference between gross premiums written and the effect of ceding reinsurance premiums, but without respect to when those premiums will be recognized as actual revenue. We use this measure as an indication of retained or net business volume in Insurance Underwriting.

Underwriting Ratios

Kingsway, like many insurance companies, analyzes performance based on underwriting ratios such as loss and loss adjustment expense ratio, expense ratio and combined ratio. The loss and loss adjustment expense ratio is derived by dividing the amount of net loss and loss adjustment expenses incurred by net premiums earned. The expense ratio is derived by dividing the sum of commissions and premium taxes, general and administrative expenses and policy fee income by net premiums earned. The combined ratio is the sum of the loss and loss adjustment expense ratio and the

expense ratio. A combined ratio below 100% demonstrates underwriting profit whereas a combined ratio over 100% demonstrates underwriting loss.

CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

The preparation of unaudited consolidated interim 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

KINGSWAY
FINANCIAL
SERVICES
INC.

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 Company's critical accounting estimates and assumptions are described in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2016 Annual Report. There has been no material change subsequent to December 31, 2016 to the information previously disclosed in the 2016 Annual Report with respect to these critical accounting estimates and assumptions.

RESULTS OF CONTINUING OPERATIONS

A reconciliation of total segment operating income (loss) to net loss for the three and six months ended June 30, 2017 and 2016 is presented in Table 1 below:

Table 1 Segment Operating Income (Loss)

(in thousands of dollars)

	For the three months ended June 30, 2017			For the six months ended June 30, 2016		
	2017	2016	Change	2017	2016	Change
Segment operating income (loss):						
Insurance Underwriting	(417)	)181	(598)	)(1,159	)(58	)(1,101)
Extended Warranty	685	(780)	)1,465	1,271	(936)	)2,207
Leased Real Estate	872	—	872	1,790	—	1,790
Total segment operating income (loss)	1,140	(599)	)1,739	1,902	(994)	)2,896
Net investment (loss) income	(2,366)	1,072	(3,438)	)(1,663	)1,000	(2,663)
Net realized gains (losses)	734	67	667	1,132	(104)	)1,236
Amortization of intangible assets	(289)	)(307	)18	(580)	)(602	)22
Contingent consideration benefit	212	657	(445)	)212	657	(445)
Impairment of intangible assets	—	—	—	(250)	—	(250)
Interest expense not allocated to segments	(1,216)	(1,108)	(108)	)(2,375	)(2,201)	(174)
Other income and expenses not allocated to segments, net	(2,776)	(1,940)	(836)	)(4,736	)(3,841)	(895)
Foreign exchange losses, net	—	(9)	)9	(4)	)(10)	)6
(Loss) gain on change in fair value of debt	(2,702)	1,068	(3,770)	)(4,591	)3,596	(8,187)
Equity in net (loss) income of investee	(145)	)(874	)729	2,240	(943)	)3,183
Loss from continuing operations before income tax expense	(7,408)	(1,973)	(5,435)	)(8,713	)(3,442)	(5,271)
Income tax expense	1,251	26	1,225	1,430	52	1,378
Loss from continuing operations	(8,659)	(1,999)	(6,660)	)(10,143	(3,494)	(6,649)
Gain on disposal of discontinued operations, net of taxes	1,017	1,124	(107)	)1,017	1,124	(107)
Net loss	(7,642)	(875)	(6,767)	)(9,126	)(2,370)	(6,756)

Loss from Continuing Operations and Net Loss

In the second quarter of 2017, we reported loss from continuing operations of \$8.7 million compared to \$2.0 million in the second quarter of 2016. For the six months ended June 30, 2017, we reported loss from continuing operations of \$10.1 million compared to \$3.5 million for the six months ended June 30, 2016. The loss from continuing operations for the three and six months ended June 30, 2017 is primarily due to net investment loss, loss on change in fair value of debt and other income and expenses not allocated to segments. The loss from continuing operations for the three and six months ended June 30, 2016 is primarily attributable to operating loss in Extended Warranty, interest expense not allocated to segments, and other income and expenses not allocated to segments, partially offset by net investment income and gain on change in fair value of debt.

KINGSWAY
FINANCIAL
SERVICES
INC.

For the three months ended June 30, 2017, we reported net loss of \$7.6 million compared to \$0.9 million for the three months ended June 30, 2016. For the six months ended June 30, 2017, we reported net loss of \$9.1 million compared to \$2.4 million for the six months ended June 30, 2016.

Insurance Underwriting

In the second quarter of 2017, Insurance Underwriting gross premiums written were \$30.2 million compared to \$31.4 million in the second quarter of 2016, representing a 3.8% decrease (\$67.0 million year to date compared to \$67.2 million prior year to date, representing a 0.3% decrease). Net premiums written decreased 3.8% to \$30.2 million in the second quarter of 2017 compared with \$31.4 million in the second quarter of 2016 (\$67.0 million year to date compared to \$67.0 million prior year to date, representing a 0.0% decrease). Net premiums earned increased 5.3% to \$33.5 million in the second quarter of 2017 compared with \$31.8 million in the second quarter of 2016 (\$66.4 million year to date compared to \$61.2 million prior year to date, representing an 8.5% increase). The increases in net premiums earned for the three and six months ended June 30, 2017, compared to the same periods in 2016, generally reflect the natural lag between when premiums are written and when they are earned. Of particular note, the Company had approximately 6% fewer policies in force at June 30, 2017 compared to June 30, 2016. The decrease in policies in force while the change in premiums written has been relatively flat is reflective of the significant rate increases the Company has been implementing since last year.

The Insurance Underwriting operating loss was \$0.4 million for the three months ended June 30, 2017 (operating loss of \$1.2 million year to date) compared to operating income of \$0.2 million for the three months ended June 30, 2016 (operating loss of \$0.1 million prior year to date). The increase in operating loss is primarily attributable to unfavorable development for property and casualty loss and loss adjustment expenses from prior accident years as well as an increase in general and administrative expenses because of severance expense recorded for the three and six months ended June 30, 2017 compared to the same periods in 2016.

The Insurance Underwriting loss and loss adjustment expense ratio for the second quarter of 2017 was 78.0% compared to 74.0% for the second quarter of 2016 (77.2% for the six months ended June 30, 2017 compared with 74.6% for the same period in 2016). The increase in the loss and loss adjustment expense ratio is primarily attributable to unfavorable development for property and casualty loss and loss adjustment expenses from prior accident years recorded for the three and six months ended June 30, 2017 compared to the same periods in 2016.

The Insurance Underwriting expense ratio was 23.5% for the second quarter of 2017 compared to 25.8% for the second quarter of 2016 (24.7% for the six months ended June 30, 2017 compared with 25.9% for the same period in 2016). The decrease in the expense ratio for the second quarter of 2017 is primarily attributable to increased net premiums earned and lower general and administrative expenses, including lower bad debt expense, in the second quarter of 2017 compared to the same period in 2016. The decrease in the expense ratio for the six months ended June 30, 2017 is primarily attributable to increased net premiums earned and policy fee income as well as lower bad debt expense for the six months ended June 30, 2017, compared to the same period in 2016.

The Insurance Underwriting combined ratio was 101.5% in the second quarter of 2017 compared with 99.8% in the second quarter of 2016 (101.9% for the six months ended June 30, 2017 compare with 100.5% for the same period in 2016), reflecting the dynamics that affected the loss and loss adjustment expense ratio and expense ratio.

Extended Warranty

The Extended Warranty service fee and commission income increased 27.8% to \$6.9 million for the three months ended June 30, 2017 compared with \$5.4 million for the three months ended June 30, 2016 (\$13.5 million year to date compared to \$10.7 million prior year to date, representing a 26.2% increase). This increase is due to increased service fee and commission income at both IWS and Trinity. IWS experienced increased sales of vehicle service agreements due to higher automobile sales and improved penetration of its credit union distribution channel. Trinity experienced increased sales to existing customers of both its maintenance support and warranty products. The Extended Warranty operating income was \$0.7 million for the three months ended June 30, 2017 compared with operating loss of \$0.8 million for the three months ended June 30, 2016 (\$1.3 million operating income year to date compared with \$0.9

million operating loss prior year to date). The increase in operating income is due to the improved revenues in the three and six months ended June 30, 2017, compared to the same periods in 2016, and also reflects severance expenses and expenses related to an agreement executed with the former owners of IWS recorded in the second quarter of 2016.

KINGSWAY
FINANCIAL
SERVICES
INC.

Leased Real Estate

In the second quarter of 2017, Leased Real Estate rental income was \$3.3 million compared to zero in the second quarter of 2016 (\$6.7 million year to date compared with zero prior year to date). The rental income is derived from CMC's long-term triple net lease. The Company acquired 81% of CMC on July 14, 2016. The Leased Real Estate operating income was \$0.9 million for the three months ended June 30, 2017 compared with zero for the three months ended June 30, 2016 (\$1.8 million year to date compared to zero prior year to date). Leased Real Estate operating income includes interest expense of \$1.6 million and zero for the three months ended June 30, 2017 and 2016, respectively (\$3.1 million and zero, respectively, year to date and prior year to date). See "Investments" section below for further discussion.

Net Investment (Loss) Income

Net investment loss was \$2.4 million in the second quarter of 2017 compared to net investment income of \$1.1 million in the second quarter of 2016 (net investment loss of \$1.7 million year to date compared to net investment income of \$1.0 million prior year to date). The decrease for the three and six months ended June 30, 2017 is primarily due to a decrease in fair value of the Company's investment in 1347 Investors LLC ("1347 Investors") and a \$1.0 million loss recorded during the second quarter of 2017 from one of the Company's limited liability investments. Income or loss from limited liability investments is recognized based upon the Company's share of the earnings of the limited liability entities.

Net Realized Gains (Losses)

Net realized gains were \$0.7 million in the second quarter of 2017 compared to \$0.1 million in the second quarter of 2016 (net realized gains of \$1.1 million year to date compared to net realized losses of \$0.1 million prior year to date). The increase in net realized gains for the three and six months ended June 30, 2017 resulted primarily from the liquidation of equity investments in Insurance Underwriting.

Amortization of Intangible Assets

The Company's intangible assets with definite useful lives are amortized over their estimated useful lives. Amortization of intangible assets was \$0.3 million in the second quarter of 2017 compared to \$0.3 million in the second quarter of 2016 (\$0.6 million year to date compared to \$0.6 million prior year to date).

Contingent Consideration Benefit

Contingent consideration benefit was \$0.2 million for the three and six months ended June 30, 2017 compared to \$0.7 million for the three and six months ended June 30, 2016. The benefit recorded for the three and six months ended June 30, 2017 is attributable to the Company having executed an agreement with the former owner of Trinity. The parties to the Trinity agreement agreed to a fixed payment in exchange for extinguishing the rights to future contingent payments. The benefit recorded for the three and six months ended June 30, 2016 is attributable to the Company having executed an agreement with the former owners of IWS. The parties to the IWS agreement agreed to a fixed payment and other consideration in exchange for extinguishing the rights to future contingent payments. The asset purchase agreements executed by the Company in 2012 and 2013 related to the acquisitions of IWS and Trinity, respectively, provided for additional payments to the former owners of IWS and Trinity contingent upon the achievement of certain targets over future reporting periods. Refer to Note 18, "Fair Value of Financial Instruments," to the unaudited consolidated interim financial statements, for further information.

Impairment of Intangible Assets

During the second quarter of 2017, the Company recorded an impairment charge of zero (\$0.3 million year to date) related to its insurance licenses indefinite lived intangible asset. The impairment recorded was the result of Mendota and Mendakota surrendering their insurance licenses in the state of New Mexico during the first quarter of 2017. No impairment charges were taken on intangible assets during the three and six months ended June 30, 2016.

Interest Expense not Allocated to Segments

Interest expense not allocated to segments for the second quarter of 2017 was \$1.2 million compared to \$1.1 million in the second quarter of 2016 (\$2.4 million year to date compared to \$2.2 million prior year to date). The increase for the

three and six months ended June 30, 2017 is attributable to an increase in the London interbank offered interest rate for three-month U.S. dollar deposits ("LIBOR") for the three and six months ended June 30, 2017 compared to the same periods in 2016. The Company's subordinated debt bears interest at the rate of LIBOR, plus spreads ranging from 3.85% to 4.20%.

KINGSWAY
FINANCIAL
SERVICES
INC.

Other Income and Expenses not Allocated to Segments, Net

Other income and expenses not allocated to segments was a net expense of \$2.8 million in the second quarter of 2017 compared to \$1.9 million in the second quarter of 2016 (\$4.7 million year to date compared to \$3.8 million prior year to date). The increase in net expense is primarily the result of more general and administrative expense for compensation and employee benefits during the three and six months ended June 30, 2017 compared to the same periods in 2016.

Foreign Exchange Losses, Net

During the second quarter of 2017, the Company incurred foreign exchange losses, net of \$0.0 million compared to \$0.0 million in the second quarter of 2016 (\$0.0 million year to date compared to \$0.0 million prior year to date).

(Loss) Gain on Change in Fair Value of Debt

Loss on change in fair value of debt amounted to \$2.7 million in the second quarter of 2017 compared to gain on change in fair value of debt of \$1.1 million in the second quarter of 2016 (loss of \$4.6 million year to date compared to gain of \$3.6 million prior year to date). The loss for the three and six months ended June 30, 2017 is due to an increase in the fair value of the subordinated debt, whereas the gain for the three and six months ended June 30, 2016 is due to a decrease in the fair value of the subordinated debt. See "Debt" section below for further information.

Equity in Net (Loss) Income of Investee

Equity in net loss of investee of \$0.1 million for the second quarter of 2017 and equity in net income of investee of \$2.2 million for the six months ended June 30, 2017 relates to the Company's investment in Itasca Capital Ltd. Equity in net loss of investee of \$0.9 million for the second quarter of 2016 and equity in net loss of investee of \$0.9 million for the six months ended June 30, 2016 relates to the Company's investment in 1347 Capital Corp. See Note 7, "Investment in Investee," to the unaudited consolidated interim financial statements, for further discussion.

Income Tax Expense

Income tax expense for the second quarter of 2017 was \$1.3 million compared to \$0.0 million in the second quarter of 2016 (\$1.4 million year to date compared to \$0.1 million prior year to date). See Note 13, "Income Taxes," to the unaudited consolidated interim financial statements, for additional detail of the income tax expense recorded for the three and six months ended June 30, 2017 and June 30, 2016.

INVESTMENTS

Portfolio Composition

All of our investments in fixed maturities and equity investments are classified as available-for-sale and are reported at fair value. At June 30, 2017, we held cash and cash equivalents and investments with a carrying value of \$151.6 million. Investments held by our insurance subsidiaries must comply with applicable domiciliary state regulations that prescribe the type, quality and concentration of investments. Our U.S. operations typically invest in U.S. dollar-denominated instruments to mitigate their exposure to currency rate fluctuations.

KINGSWAY
FINANCIAL
SERVICES
INC.

Table 2 below summarizes the carrying value of investments, including cash and cash equivalents, at the dates indicated.

TABLE 2 Carrying value of investments, including cash and cash equivalents
(in thousands of dollars, except for percentages)

Type of investment	June 30, 2017	% of Total	December 31, 2016	% of Total	
Fixed maturities:					
U.S. government, government agencies and authorities	26,904	17.7	% 28,148	17.2	%
States, municipalities and political subdivisions	3,694	2.4	% 3,088	1.9	%
Mortgage-backed	8,353	5.5	% 8,506	5.2	%
Asset-backed securities and collateralized mortgage obligations	2,195	1.4	% 3,467	2.1	%
Corporate	15,819	10.4	% 18,555	11.3	%
Total fixed maturities	56,965	37.4	% 61,764	37.7	%
Equity investments:					
Common stock	17,616	11.6	% 21,426	13.1	%
Warrants	1,825	1.2	% 1,804	1.1	%
Total equity investments	19,441	12.8	% 23,230	14.2	%
Limited liability investments	25,533	16.8	% 22,974	14.0	%
Limited liability investment, at fair value	8,220	5.4	% 10,700	6.5	%
Other investments	7,550	5.0	% 7,975	4.9	%
Short-term investments	151	0.1	% 401	0.2	%
Total investments	117,860	77.5	% 127,044	77.5	%
Cash and cash equivalents	33,776	22.5	% 36,475	22.5	%
Total	151,636	100.0	% 163,519	100.0	%

Other-Than-Temporary Impairment

The Company performs a quarterly analysis of its investments portfolio to determine if declines in market value are other-than-temporary. Further information regarding our detailed analysis and factors considered in establishing an other-than-temporary impairment on an investment is discussed within Note 6, "Investments," to the unaudited consolidated interim financial statements.

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 length of time an individual investment may be held in an unrealized loss position may vary based on the opinion of the investment manager and the respective analyses related to valuation and to the various credit risks that may prevent us from recapturing the principal investment. In the case of a fixed maturity investment where the investment manager determines there is little or no risk of default prior to the maturity of a holding, we would elect to hold the investment in an unrealized loss position until the price recovers or the investment matures. In situations where facts emerge that might increase the risk associated with recapture of principal, the Company may elect to sell a fixed maturity investment at a loss.

Due to the inherent volatility of equity markets, we believe an equity investment may trade from time to time below its intrinsic value based on historical valuation measures. In these situations, an equity investment may be maintained in an unrealized loss position for different periods of time based on the underlying economic assumptions driving the investment manager's valuation of the holding.

At June 30, 2017 and December 31, 2016, the gross unrealized losses for fixed maturities and equity investments amounted to \$1.0 million and \$1.0 million, respectively, and there were no unrealized losses attributable to

non-investment grade fixed maturities. At each of June 30, 2017 and December 31, 2016, all unrealized losses on individual investments were considered temporary.

KINGSWAY
FINANCIAL
SERVICES
INC.

Limited Liability Investments

The Company owns investments in various limited liability companies ("LLCs"), limited partnerships ("LPs") and a general partnership ("GP") that primarily invest in income-producing real estate or real estate related investments. The Company's investments in these LLCs, LPs and GP are accounted for under the equity method of accounting and reported as limited liability investments in the consolidated balance sheets. The most recently available financial statements of the LLCs, LPs and GP are used in applying the equity method. The difference between the end of the reporting period of the LLCs, LPs and GP and that of the Company is no more than three months. Most of the real estate investments are held on a triple net lease basis whereby the lessee agrees to pay all real estate taxes, building insurance and maintenance. Table 3 below presents additional information pertaining to the limited liability investments at June 30, 2017 and December 31, 2016.

TABLE 3 Limited liability investments
(in thousands of dollars)

	Carrying Value	
	June 30, 2017	December 31, 2016
Triple net lease limited liability investments	15,010	12,190
Other real estate related limited liability investments	4,266	3,904
Non-real estate limited liability investments	6,257	6,880
Total	25,533	22,974

Triple Net Lease Investments

Table 4 below presents total income from triple net lease investments included in the Company's net loss for the three and six months ended June 30, 2017 and June 30, 2016.

TABLE 4 Income from triple net lease investments included in net loss
(in thousands of dollars)

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Income from triple net lease limited liability investments	434	416	852	550
Income from CMC operations	679	—	1,352	—
Total income included in loss from continuing operations as a result of triple net lease investments and CMC acquisition	1,113	416	2,204	550

The Company has been increasing its exposure to triple net lease investments. These can take the form of limited liability investments as well as the Company's investment in CMC. See Note 5, "Acquisitions, Deconsolidation and Discontinued Operations," to the unaudited consolidated interim financial statements.

Income 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.

Income from CMC operations is consolidated and, for the three months ended June 30, 2017, is comprised of Leased Real Estate segment operating income of \$0.9 million (\$1.8 million year to date), amortization of intangible assets of \$0.0 million (\$0.0 million year to date) and income tax expense of \$0.2 million (\$0.4 million year to date).

With respect to CMC, the Company expects to record income each year based upon the rental income recognized under its existing triple net lease agreement on the Real Property less operating expenses, which are comprised principally of interest on the Mortgage, as well as depreciation and amortization of certain assets acquired. Over the next four years, the Company generally expects to recognize in its consolidated statements of operations income of approximately \$2.7 to \$3.1 million per year related to its ownership of CMC. This estimated range is higher than what

was estimated in the Company's 2016 Annual Report to reflect the approximately \$1.4 million of additional rental income we expect to record each year as a result of a lease amendment executed between CMC and its tenant, effective beginning the first quarter of 2017, 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 "Lease Amendment"). In the Company's 2016 Annual Report, the Company stated it does not expect any positive cash flow to be available from its ownership of CMC because all cash

KINGSWAY
FINANCIAL
SERVICES
INC.

rental income generated by the Real Property is applied to make principal and interest payments on the Mortgage. Because of the Lease Amendment, CMC may be in a position to distribute to the Company some of the cash received from the additional rental income. Any material cash flow to the Company, however, remains likely to occur only upon the occurrence of one of the three events that would trigger payment of service fees. There can be no assurance as to the timing of the occurrence, or the resulting outcome, from one of these events. Refer to the "Liquidity and Capital Resources" section below for further discussion.

Limited Liability Investment, at Fair Value

The Company owns 26.7% of the outstanding units of 1347 Investors. The Company's investment in 1347 Investors is accounted for at fair value and reported as limited liability investment, at fair value in the consolidated balance sheets, with any changes in fair value to be reported in net investment (loss) income in the consolidated statements of operations. 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.

The fair value of this investment is calculated based on a model that distributes the net equity of 1347 Investors to all classes of membership interests. The model uses quoted market prices and significant market observable inputs. The Company recorded net investment loss of \$2.1 million and zero related to this investment for the three months ended June 30, 2017 and June 30, 2016, respectively (\$2.5 million year to date compared to zero prior year to date).

PROPERTY AND CASUALTY UNPAID LOSS AND LOSS ADJUSTMENT EXPENSES

Property and casualty unpaid loss and loss adjustment expenses represent the estimated liabilities for reported loss events, incurred but not reported ("IBNR") loss events and the related estimated loss adjustment expenses.

Tables 5 and 6 present distributions, by line of business, of the provision for property and casualty unpaid loss and loss adjustment expenses gross and net of external reinsurance, respectively.

TABLE 5 Provision for property and casualty unpaid loss and loss adjustment expenses - gross
(in thousands of dollars)

Line of Business	June 30, 2017	December 31, 2016
Non-standard automobile	44,527	52,115
Commercial automobile	616	918
Other	731	762
Total	45,874	53,795

TABLE 6 Provision for property and casualty unpaid loss and loss adjustment expenses - net of reinsurance recoverable (in thousands of dollars)

Line of Business	June 30, 2017	December 31, 2016
Non-standard automobile	44,076	51,497
Commercial automobile	557	855
Other	731	762
Total	45,364	53,114

Non-Standard Automobile

At June 30, 2017 and December 31, 2016, the gross provisions for property and casualty unpaid loss and loss adjustment expenses for our non-standard automobile business were \$44.5 million and \$52.1 million, respectively. The decrease is primarily due to a decrease in unpaid loss and loss adjustment expenses at Mendota.

Commercial Automobile

At June 30, 2017 and December 31, 2016, the gross provisions for property and casualty unpaid loss and loss adjustment expenses for our commercial automobile business were \$0.6 million and \$0.9 million, respectively. The decrease is primarily due to the continuing voluntary run-off of Amigo.

Information with respect to development of our provision for prior years' property and casualty unpaid loss and loss adjustment expenses is presented in Table 7.

KINGSWAY
FINANCIAL
SERVICES
INC.

TABLE 7 Increase (decrease) in prior years' provision for property and casualty unpaid loss and loss adjustment expenses
(in thousands of dollars)

	Three months ended June 30, 2017	Six months ended June 30, 2016
Unfavorable (favorable) change in provision for property and casualty unpaid loss and loss adjustment expenses for prior accident years	784 (24)	996 67

For the three months ended June 30, 2017, the Company reported \$0.8 million of unfavorable development for property and casualty loss and loss adjustment expenses from prior accident years (unfavorable development of \$1.0 million year to date) compared with favorable development of \$0.0 million for the three months ended June 30, 2016 (unfavorable development of \$0.1 million prior year to date). The unfavorable development reported for the three and six months ended June 30, 2017 was primarily related to an increase in property and casualty loss and loss adjustment expenses at Mendota. The favorable development reported for the three months ended June 30, 2016 was primarily related to the decrease in property and casualty loss and loss adjustment expenses at Amigo, partially offset by an increase in property and casualty unpaid 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.

See the "Critical Accounting Estimates and Assumptions" section of Management's Discussion and Analysis of Financial Condition and Results of Operations in the 2016 Annual Report for additional information pertaining to the Company's process of estimating the provision for unpaid loss and loss adjustment expenses.

DEBT

Note Payable

As part of the acquisition of CMC in July 2016, the Company assumed the Mortgage and recorded the Mortgage 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.

Subordinated Debt

Between December 4, 2002 and December 16, 2003, six subsidiary trusts of the Company issued \$90.5 million of 30-year capital securities to third parties in separate private transactions. In each instance, a corresponding floating rate junior subordinated deferrable interest debenture was then issued by Kingsway America Inc. to the trust in exchange for the proceeds from the private sale. The floating rate debentures bear interest at the rate of LIBOR, plus spreads ranging from 3.85% to 4.20%. The Company has the right to call each of these securities at par value any time after five years from their issuance until their maturity.

The Company's subordinated debt is measured and reported at fair value. At June 30, 2017, the carrying value of the subordinated debt is \$48.2 million. The fair value of the subordinated debt is calculated using a model based on significant market observable inputs and inputs developed by a third party. For a description of the market observable inputs and inputs developed by a third party used in determining fair value of debt, see Note 18, "Fair Value of Financial Instruments," to the unaudited consolidated interim financial statements.

During the six months ended June 30, 2017, the market observable swap rates changed, and the Company experienced a decrease in the credit spread assumption developed by the third party. Changes in the market observable swap rates

affect the fair value model in different ways. An increase in the LIBOR swap rates has the effect of increasing the fair value of the Company's subordinated debt while an increase in the risk-free swap rates has the effect of decreasing the fair value. The decrease in the credit spread assumption has the effect of increasing the fair value of the Company's subordinated debt while an increase in the credit spread assumption has the effect of decreasing the fair value. The other primary variable affecting the fair value of debt calculation is the passage of time, which will always have the effect of increasing the fair value of debt. The changes to the credit spread and swap rate variables during the six months ended June 30, 2017, along with the passage of time, contributed to the \$4.6 million increase in fair value of the Company's subordinated debt between December 31, 2016 and June 30, 2017. This increase in fair value is reported as loss on change in fair value of debt in the Company's unaudited consolidated statements of operations.

KINGSWAY
FINANCIAL
SERVICES
INC.

Though the changes in the model assumptions will continue to introduce volatility each quarter to the Company's reported gain or loss on change in fair value of debt, the fair value of the Company's subordinated debt will eventually equal the principal value of the subordinated debt by the time of the stated redemption date of each trust, beginning with the trust maturing on December 4, 2032 and continuing through January 8, 2034, the redemption date of the last of the Company's outstanding trusts. As a result, it should be expected the Company, on average, will continue to report quarterly and annual losses on changes in fair value of debt and from time to time these quarterly and annual losses may be material to the Company's results of operations.

For a description of each of the Company's six subsidiary trusts, see Note 11, "Debt," to the unaudited consolidated interim financial statements.

RECENTLY ISSUED ACCOUNTING STANDARDS

See Note 4, "Recently Issued Accounting Standards," to the unaudited consolidated interim financial statements, for discussion of certain accounting standards that may be applicable to the Company's current and future consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

The purpose of liquidity management is to ensure there is sufficient cash to meet all financial commitments and obligations as they fall due. The liquidity requirements of the Company and its subsidiaries have been met primarily by funds generated from operations, capital raising, disposal of discontinued operations, investment maturities and income and other returns received on investments or from the sale of investments. Cash provided from these sources is used primarily for making investments and for loss and loss adjustment expense payments, debt servicing and other operating expenses. The timing and amount of payments for loss and loss adjustment expenses may differ materially from our provisions for unpaid loss and loss adjustment expenses, which may create increased liquidity requirements.

Cash Flows

During the six months ended June 30, 2017, the Company reported on the unaudited consolidated statements of cash flows \$8.3 million of net cash used in operating activities. The reconciliation between the Company's reported \$9.1 million net loss and the \$8.3 million of net cash used in operating activities can be explained primarily by the \$8.0 million decrease in the provision for unpaid loss and loss adjustment expenses, the \$2.2 million equity in net income of investee and the \$2.1 million increase in other receivables, offset by the \$4.6 million loss on change in fair value of debt, \$2.8 million of depreciation and amortization expense, the \$2.4 million loss on change in fair value of investments, the \$2.1 million increase in deferred service fees and the \$1.4 million decrease in premiums and service fee receivables.

During the six months ended June 30, 2017, the net cash provided by investing activities as reported on the unaudited consolidated statements of cash flows was \$6.9 million. This source of cash was driven primarily by proceeds from sales and maturities of fixed maturities and proceeds from sales of equity investments in excess of purchases of fixed maturities, equity investments and limited liability investments.

During the six months ended June 30, 2017, the net cash used in financing activities as reported on the unaudited consolidated statements of cash flows was \$1.3 million. This use of cash is attributed to principal repayments of \$1.3 million on the Mortgage.

In summary, as reported on the unaudited consolidated statements of cash flows, the Company's net decrease in cash and cash equivalents during the six months ended June 30, 2017 was \$2.7 million.

The Company's Insurance Underwriting subsidiaries fund their obligations primarily through premium and investment income and maturities in the investments portfolios. The Company's Extended Warranty subsidiaries fund their obligations primarily through service fee and commission income. The Company's Leased Real Estate subsidiary funds its obligations through rental income.

The liquidity of the holding company is managed separately from its subsidiaries. Actions available to the holding company to raise liquidity in order to meet its obligations include the sale of passive investments; sale of subsidiaries; issuance of debt or equity securities; and giving notice to its Trust Preferred trustees of its intention to exercise its voluntary right to defer interest payments for up to 20 quarters, which right the Company previously exercised during the period from the first quarter of 2011 through the fourth quarter of 2015.

Receipt of dividends from the Insurance Underwriting subsidiaries is not generally considered a source of liquidity for the holding company. The insurance subsidiaries require regulatory approval for the return of capital and, in certain circumstances, prior to the payment of dividends. At June 30, 2017, the U.S. insurance subsidiaries of the Company were restricted from making any dividend payments to the holding company without regulatory approval pursuant to the domiciliary state insurance regulations.

KINGSWAY
FINANCIAL
SERVICES
INC.

In the Company's 2016 Annual Report, the Company stated it does not expect any positive cash flow to be available from its ownership of CMC because all cash rental income generated by the Real Property is applied to make principal and interest payments on the Mortgage. Because of the Lease Amendment, CMC may be in a position to distribute to the Company some of the cash received from the additional rental income. Any material cash flow to the Company, however, to help the Company meet its holding company obligations remains likely to occur only upon the occurrence of one of the three events described in the next paragraph that would trigger payment of service fees. There can be no assurance as to the timing of the occurrence, or the resulting outcome, from one of these events.

Pursuant to the terms of the management services agreement entered into at the closing of the acquisition of CMC, an affiliate of the seller (the "Service Provider") will provide certain services to CMC and its subsidiaries in exchange for service fees. Such services (collectively, the "Services") will include (i) causing an affiliate of the Service Provider to guaranty certain obligations of the Property Owner (pursuant to an Indemnity and Guaranty Agreement between such affiliate and the holder of the Mortgage (the "Mortgagor")), (ii) providing certain individuals to serve as members of the board of directors and/or certain executive officers of CMC and/or its subsidiaries and (iii) providing asset management services with respect to the Real Property. In exchange for the Services, the Property Owner will pay certain fees to the Service Provider. The payment of such service fees may be triggered by (i) a sale of the Real Property, (ii) a restructuring of the lease to which the Real Property is subject or (iii) a refinancing or restructuring of the Mortgage. The amount of the service fees will range from 40%-80% of the net proceeds generated by the event triggering the payment of the service fees (depending on the nature and timing of the triggering event). The Lease Amendment has not triggered the payment of service fees to the Service Provider.

The holding company's liquidity, defined as the amount of cash in the bank accounts of Kingsway Financial Services Inc. and Kingsway America Inc., was \$9.5 million and \$14.9 million at June 30, 2017 and December 31, 2016, respectively. These amounts are reflected in the cash and cash equivalents of \$33.8 million and \$36.5 million reported at June 30, 2017 and December 31, 2016, respectively, on the Company's consolidated balance sheets. The cash and cash equivalents other than the holding company's liquidity represent restricted and unrestricted cash held by the Company's Insurance Underwriting, Extended Warranty and Leased Real Estate subsidiaries and are not considered to be available to meet holding company obligations, which primarily consist of interest payments on debt; holding company operating expenses; transaction-driven expenses of the Company's merchant banking activities; investments; and any other extraordinary demands on the holding company.

The holding company's liquidity of \$9.5 million at June 30, 2017 represents approximately 11 months of interest payments on subordinated debt and regularly recurring operating expenses before any transaction-driven expenses of the Company's merchant banking activities, any new holding company investments or any other extraordinary demands on the holding company.

While the Company believes it has sources of liquidity available to allow it to continue to meet its holding company obligations, there can be no assurance such sources of liquidity will be available when needed.

Regulatory Capital

In the United States, a risk-based capital ("RBC") formula is used by the National Association of Insurance Commissioners ("NAIC") to identify property and casualty insurance companies that may not be adequately capitalized. In general, insurers reporting surplus as regards policyholders below 200% of the authorized control level, as defined by the NAIC, at December 31 are subject to varying levels of regulatory action, including discontinuation of operations. As of December 31, 2016, surplus as regards policyholders reported by each of our insurance subsidiaries exceeded the 200% threshold.

Our reinsurance subsidiary, which is domiciled in Barbados, is required by the regulator in Barbados to maintain minimum capital levels. As of June 30, 2017, the capital maintained by Kingsway Reinsurance Corporation was in excess of the regulatory capital requirements in Barbados.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has an off-balance sheet arrangement related to a guarantee, which is further described in Note 20, "Commitments and Contingent Liabilities," to the unaudited consolidated interim financial statements.

KINGSWAY
FINANCIAL
SERVICES
INC.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market Risk

Market risk is the risk we will incur losses due to adverse changes in interest or currency exchange rates and equity prices. We have exposure to market risk through our investment activities and our financing activities.

Given our U.S. operations typically invest in U.S. dollar denominated fixed maturity instruments, our primary market risk exposures in the investments portfolio are to changes in interest rates. Periodic changes in interest rate levels generally affect our financial results to the extent the investments are recorded at market value and reinvestment yields are different than the original yields on maturing instruments. During periods of rising interest rates, the market values of the existing fixed maturities will generally decrease. The reverse is true during periods of declining interest rates. We manage our exposure to risks associated with interest rate fluctuations through active review of our investment portfolio by our management and Board, consultation with third-party financial advisors and by managing the maturity profile of our fixed maturity portfolio. Our goal is to maximize the total after-tax return on all of our investments. An important strategy we employ to achieve this goal is to try to hold enough in cash and short-term investments in order to avoid liquidating longer-term investments to pay loss and loss adjustment expenses.

Table 8 below summarizes the fair value by contractual maturities of the fixed maturities portfolio, excluding cash and cash equivalents, at June 30, 2017 and December 31, 2016.

TABLE 8 Fair value of fixed maturities by contractual maturity date
(in thousands of dollars, except for percentages)

	June 30, 2017	% of Total	December 31, 2016	% of Total
Due in less than one year	7,504	13.2	% 6,561	10.6 %
Due in one through five years	40,077	70.4	% 40,750	66.0 %
Due after five through ten years	3,082	5.3	% 4,552	7.4 %
Due after ten years	6,302	11.1	% 9,901	16.0 %
Total	56,965	100.0	% 61,764	100.0 %

At June 30, 2017, 83.6% of fixed maturities, including treasury bills, government bonds and corporate bonds, had contractual maturities of five years or less. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations with or without call or prepayment penalties. The Company holds cash and high-grade short-term assets that, along with fixed maturities, management believes are sufficient in amount for the payment of unpaid loss and loss adjustment expenses and other obligations on a timely basis. In the event additional cash is required to meet obligations to our policyholders and customers, we believe the high-quality investments in the portfolios provide us with sufficient liquidity.

Based upon the results of interest rate sensitivity analysis, Table 9 below shows the interest rate risk of our investments in fixed maturities, measured in terms of fair value (which is equal to the carrying value for all our fixed maturity securities), at June 30, 2017 and December 31, 2016.

KINGSWAY
FINANCIAL
SERVICES
INC.TABLE 9 Sensitivity analysis on fixed maturities
(in thousands of dollars)

	100 Basis Point Decrease in Interest Rates	No Change	100 Basis Point Increase in Interest Rates
June 30, 2017:			
Estimated fair value	\$ 58,276	\$56,965	\$55,654
Estimated increase (decrease) in fair value	\$ 1,311	\$—	\$(1,311)

December 31, 2016:

Estimated fair value	\$ 63,303	\$61,764	\$60,225
Estimated increase (decrease) in fair value	\$ 1,539	\$—	\$(1,539)

We use both fixed and variable rate debt as sources of financing. Because our subordinated debt is LIBOR-based, our primary market risk related to financing activities is to changes in LIBOR. As of June 30, 2017, each one hundred basis point increase in LIBOR would result in an approximately \$0.9 million increase in our annual interest expense.

Equity Risk

Equity risk is the risk we will incur economic losses due to adverse changes in equity prices. Our exposure to changes in equity prices results from our holdings of common stock. We principally manage equity price risk through industry and issuer diversification and asset allocation techniques and by continuously evaluating market conditions.

Credit Risk

Credit risk is defined as the risk of financial loss due to failure of the other party to a financial instrument to discharge an obligation. Credit risk arises from our positions in short-term investments, corporate debt instruments and government bonds.

The Investment Committee of the Board of Directors is responsible for the oversight of key investment policies and limits. These policies and limits are subject to annual review and approval by the Investment Committee. The Investment Committee is also responsible for ensuring these policies are implemented and procedures are in place to manage and control credit risk.

Table 10 below summarizes the composition of the fair values of fixed maturities, excluding cash and cash equivalents, at June 30, 2017 and December 31, 2016, by rating as assigned by Standard and Poor's ("S&P") or Moody's Investors Service ("Moody's"). Fixed maturities consist of predominantly high-quality instruments in corporate and government bonds with approximately 90.2% of those investments rated 'A' or better at June 30, 2017. 'Not Rated' in Table 10 below includes \$3.0 million of 8% preferred stock of 1347 Property Insurance Holdings, Inc., redeemable on February 24, 2020.

TABLE 10 Credit ratings of fixed maturities
(ratings as a percentage of total fixed maturities)

Rating (S&P/Moody's)	June 30, 2017	December 31, 2016	
AAA/Aaa	70.5	% 69.5	%
AA/Aa	7.1	6.4	
A/A	12.6	14.3	
Percentage rated A/A2 or better	90.2	% 90.2	%
BBB/Baa	3.3	3.8	

Edgar Filing: KINGSWAY FINANCIAL SERVICES INC - Form 10-Q

BB/Ba	1.0	1.0	
Not rated	5.5	5.0	
Total	100.0	% 100.0	%

44

KINGSWAY
FINANCIAL
SERVICES
INC.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's management performed an evaluation under the supervision and with the participation of the Company's principal executive officer and the principal financial officer, and completed an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e), as adopted by the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934, as amended ("the Exchange Act") as of June 30, 2017. Disclosure controls and procedures are designed to ensure information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure information required to be disclosed in the reports the Company files or submits under the Exchange Act is accumulated and communicated to management, including the principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosures.

Based on that evaluation, the Company's principal executive officer and principal financial officer concluded the Company's disclosure controls and procedures are ineffective because of the one item discussed below in "Changes in Internal Control over Financial Reporting."

Changes in Internal Control over Financial Reporting

As reported in our 2016 Annual Report, the Company's disclosure controls and procedures as of December 31, 2016 were not effective because of a material weakness in the Company's internal control over financial reporting related to income tax accounting for non-routine transactions.

We are in the process of remediating the identified material weakness in internal control over financial reporting related to income tax accounting for non-routine transactions. Among other actions, we have engaged a nationally recognized accounting firm to assist us, as necessary, with the review of accounting for non-routine transactions. During the second quarter of 2017, we consulted with this firm with respect to income tax accounting for contingent consideration benefits arising from our prior business combinations with IWS and Trinity. Because the Company has not executed a non-routine transaction since December 31, 2016, it has been unable to test completely that it has remediated the identified material weakness. Management believes this approach will eventually prove to effectively remediate the material weakness.

Other than the steps taken to remediate the material weakness described above, during the Company's last fiscal quarter, there were no changes in internal control over financial reporting that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Information concerning pending legal proceedings is incorporated herein by reference to Note 20, "Commitments and Contingencies," to the unaudited consolidated interim financial statements in Part I of this Form 10-Q.

Item 1A. Risk Factors

There are no material changes with respect to those risk factors previously disclosed in our 2016 Annual Report.

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

KINGSWAY
FINANCIAL
SERVICES
INC.

Item 5. Other Information

None

46

KINGSWAY
FINANCIAL
SERVICES
INC.

Item 6. Exhibits

- 31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema

101.CAL XBRL Taxonomy Extension Calculation Linkbase

101.DEF XBRL Taxonomy Extension Definition Linkbase

101.LAB XBRL Taxonomy Extension Label Linkbase

101.PRE XBRL Taxonomy Extension Presentation Linkbase

KINGSWAY
FINANCIAL
SERVICES
INC.

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.

KINGSWAY FINANCIAL SERVICES INC.

Date: August 7, 2017 By: /s/ Larry G. Swets, Jr.

Larry G. Swets, Jr., President and Director
(principal executive officer)

Date: August 7, 2017 By: /s/ William A. Hickey, Jr.

William A. Hickey, Jr., Chief Financial Officer and Executive Vice President
(principal financial officer)