Energous Corp
Form 10-K
March 15, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the Fiscal Year Ended December 31, 2015

.. 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: 001-36379

ENERGOUS CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

Delaware	46-1318953
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
3590 North First Street, Suite 210, San Jose, CA	95134
(Address of Principal Executive Offices)	(Zip Code)

(408) 963-0200

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Securities registered pursuant to Section 12 (g) of the Act: Common Stock, par value $0.001 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ¨ No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer x

Non-accelerated filer ¨ (Do not check if a smaller reporting company)   Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act): Yes ¨ No x

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter was $84,664,580. Solely for the purposes of this calculation, shares held by directors, executive officers and 10% owners of the registrant have been excluded. Such exclusion should not be deemed a determination or an admission by the registrant that such individuals are, in fact, affiliates of the registrant.

As of March 10, 2016, there were 16,409,739 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The registrant intends to file a definitive proxy statement pursuant to Regulation 14A within 120 days after the end of the fiscal year ended December 31, 2015. Portions of such proxy statement are incorporated by reference into Part III of this Form 10-K.

ENERGOUS CORPORATION

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PART I

As used in this Form 10-K, unless the context otherwise requires the terms “we,” “us,” “our,” and “Energous” refer to Energous Corporation, a Delaware corporation.

FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, that are intended to be covered by the “safe harbor” created by those sections. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, can generally be identified by the use of forward-looking terms such as “believe,” “expect,” “may,” “will,” “should,” “could,” “seek,” “intend,” “plan,” “estimate,” “an other comparable terms. All statements other than statements of historical facts included in this Annual Report on Form 10-K regarding our strategies, prospects, financial condition, operations, costs, plans and objectives are forward-looking statements. Examples of forward-looking statements include, among others, statements we make regarding proposed services, market opportunities and acceptance, expectations for revenues, cash flows and financial performance, intentions for the future and the anticipated results of our development efforts. Forward-looking statements are neither historical facts nor assurances of future performance. Instead, they are based only on our current beliefs, expectations and assumptions regarding the future of our business, future plans and strategies, projections, anticipated events and trends, the economy and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict and many of which are outside of our control. Our actual results and financial condition may differ materially from those indicated in the forward-looking statements. Therefore, you should not rely on any of these forward-looking statements. Important factors that could cause our actual results and financial condition to differ materially from those indicated in the forward-looking statements include, among others, the following: our ability to develop a commercially feasible technology; receipt of necessary regulatory approval; our ability to find and maintain development partners, market acceptance of our technology, the amount and nature of competition in our industry; our ability to protect our intellectual property; and the other risks and uncertainties described in the Risk Factors and in Management's Discussion and Analysis of Financial Condition and Results of Operations sections of this Annual Report on Form 10-K and our subsequently filed Quarterly Reports on Form 10-Q. We undertake no obligation to publicly update any forward-looking statement, whether written or oral, that may be made from time to time, whether as a result of new information, future developments or otherwise.

Item 1. Business

Overview

We are developing a technology called WattUp® that consists of proprietary semiconductor chipsets, software, hardware designs and antennas that can enable RF-based wire-free charging for electronic devices, providing power at a distance and ultimately enabling charging with mobility under full software control. Our anticipated business model is to supply silicon components with reference designs and license our WattUp technology to device and chip manufacturers, wireless service providers and other commercial partners to make wire-free charging an affordable, ubiquitous and convenient option for end users. We believe our proprietary technology can potentially be utilized in a variety of devices, including wearables, Internet of Things (“IoT”) devices, smartphones, tablets, e-book readers, keyboards, mice, remote controls, rechargeable lights, cylindrical batteries and any other device with similar charging requirements that would otherwise need a battery or a connection to a power outlet.

We believe our technology is novel in its approach, in that we are developing a solution that charges electronic devices by surrounding them with a contained three dimensional (“3D”) radio frequency (“RF”) energy pocket (“RF energy pocket”). We are engineering solutions that we expect to enable the wire-free transmission of energy from multiple WattUp transmitters to multiple WattUp receiving devices within a range of up to fifteen (15) feet in radius or in a circular charging envelope of up to thirty (30) feet. We are also developing our transmitter technology to seamlessly mesh, (much like a network of WiFi routers) to form a wire-free charging network that will allow users to charge their devices as they walk from room-to-room or throughout a large space. To date, we have developed multiple transmitter prototypes in various form factors and power capabilities. We have also developed multiple receiver prototypes including smartphone battery cases, toys, fitness trackers, Bluetooth headsets as well as stand-alone receivers.

When the company was first founded, we recognized the need to build and design an enterprise-class network management and control system (“NMS”) that was integral to the architecture and development of our wire-free charging technology. Our NMS system can be scaled up to control an enterprise consisting of thousands of devices or scaled down to work in a home or IoT environment.

The power, distance and mobility capabilities of the WattUp technology were validated independently by Underwriters Laboratories (UL) in October, 2015 and the results published on both the UL and the Energous websites.

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Our technology solution consists principally of transmitter and receiver application specific standard product ("ASSPs") and novel antenna designs driven through innovative algorithms and software applications. We submitted our first ASSP design for wafer fabrication in November 2013 and have since then been developing multiple generations of transmitter and receiver ASSPs, multiple antenna designs, as well as algorithms and software designs that we believe, in the aggregate, will optimize our technology by reducing size and cost, while increasing performance to a level that will enable our technology to be integrated into a broad spectrum of devices. We have developed a "building block" approach which allows us to scale our product implementations by combining multiple transmitter building blocks and/or multiple receiver building blocks to provide the power, distance, size and cost performance necessary to meet application requirements. While the technology is very scalable, in order to provide the necessary strategic focus to grow the company effectively, we have defined our market as devices that require 10 watts or less of power to charge. We will continue to invest in ASSP development as well as in the other components of the WattUp system to improve product performance, efficiency, cost-performance and miniaturization as required to grow the business and expand the ecosystem while also distancing us from any potential competition.

We believe that if our development, regulatory and commercialization efforts are successful, our transmitter and receiver technology will support a broad spectrum of charging solutions ranging from contact-based charging or charging at distances of no more than a few centimeters ("nearfield") to charging at distances of up to 15 feet ("farfield").

In February of 2015 we signed a Development and License Agreement with one of the top consumer electronic companies in the world based on total worldwide revenues. The agreement is milestone-based and, while there are no guarantees that the WattUp® technology will ever be integrated into our strategic partner's consumer devices, we continue to progress the relationship as evidenced by the achievement of our first revenues in late 2015 from Engineering Services resulting from the achievement of certain milestones under the agreement. We anticipate continued progress with the relationship which we expect will result in additional Engineering Services Revenue and ultimately, if fully executed, significant revenues from royalties based on the WattUp® technology being integrated into products being shipped to the consumer.

In February of 2016 we began delivering evaluation kits to potential licensees to allow their respective engineering and product management departments to test and evaluate our technology. We expect that the testing and evaluations currently taking place will lead to an expansion of our licensing partners and will result in products beginning to be shipped to the consumer in late 2016/early 2017.

We have implemented an aggressive intellectual property strategy and are continuing to pursue patent protection for new innovations. As of March 14, 2016, we had in excess of 250 pending patent and provisional patent applications. Additionally, the U.S. Patent and Trademark Office (or the PTO) has issued our first five patents and notified us of the allowance of three additional patents. In addition to the inventions covered by these patents and patent applications, we have identified a significant number of additional specific inventions we believe are novel and patentable. We intend to file for patent protection for the most valuable of these, as well as for other new inventions that we expect to develop. Our strategy is to continually monitor the costs and benefits of each patent application and pursue those that will best protect our business and expand the core value of the Company.

We have recruited and hired a seasoned management team with both private and public company experience and relevant industry experience to develop and execute our operating plan. In addition, we have identified and hired key engineering resources in the areas of ASSP development, antenna development, hardware, software and firmware engineering as well as integration and testing which will allow us to continue to expand our technology and intellectual property as well as meet the support requirements of our licensees.

Our common stock is quoted on the NASDAQ Capital Market under the symbol “WATT”. As of March 8, 2016 we had 52 full-time employees, 42 of which were engineers. We were incorporated in Delaware in October 2012. Our corporate headquarters is located at 3590 North First Street, Suite 210, San Jose, CA 95134. Our website can be accessed at www.energous.com. The information contained on, or that may be obtained from our website, is not, and shall not be deemed to be, part of this Annual Report on Form 10-K.

Our Technology

The wire-free charging solution we are developing employs transmitter technology that creates a targeted 3D RF energy pocket around a receiving device (which may be mobile or fixed).

Figure 1 below shows a basic diagram of our solution. Today this solution is able to send RF energy from the transmitter (also referred to as a Power Router) to individual receiver devices in our laboratory.

Figure 1: Our Wire-free Charging Solution Diagram

First, our proprietary power router, or transmitter, locates the receiver(s) in 3-dimensional space via technology we have developed using standard Bluetooth® communications. Next, the transmitter, through software control, generates a controlled and contained RF-waveform to create an RF energy pocket around the receiver(s). We expect that receiver(s) equipped with our antennas and ASSPs and controlled by our software, will be able to harvest power from this contained RF energy pocket. We believe that these receivers will be incorporated into various devices such as smartphones, wearables, fitness trackers, keyboards and mice, cameras, tablets, toys, IoT devices, sensors, remote controls and other small electronics which contain embedded batteries.

Our transmitter uses proprietary software algorithms to dynamically direct, focus and control our RF waveform in three dimensions as it transmits energy to a moving object (such as a user holding their mobile device as they walk around a room).

Our initial demonstration system was able to transmit energy to multiple devices within a range of fifteen (15) feet in radius or in a circular charging envelope of thirty (30) feet. We believe our current generation ASSPs and those in development will also allow us to significantly reduce the size and cost of both our transmitters and our receivers as well as provide increased delivered power and efficiency and faster synchronization speeds.

In January of 2016 we unveiled a new Miniature WattUp Transmitter as well as a small form factor receiver, both of which were developed as a direct result of our efforts to reduce cost and size. The Miniature WattUp Transmitter can offer either contact-based or non contact-based charging. Non contact-based charging allows for low power charging capabilities within a few millimeters or centimeters distance from the miniature transmitter. Due to its low cost and small size, the miniature transmitter is anticipated to be bundled in-box with WattUp-enabled receivers replacing alternative charging solutions like power adapters and charging cables. The ability to bundle and provide a low cost, portable charging solution for receivers provides portability to the WattUp solution and is anticipated to accelerate the ecosystem build out.

Our Competition

There are numerous existing and commercially available methods to provide charging for battery-powered fixed and mobile devices, including wall plug-in charging, inductive charging, magnetic resonance charging, charging stations and more. To our knowledge, almost all mobile consumer electronic devices equipped with a rechargeable battery come bundled with a method to charge the device (for example, a power cord). Studies indicate that the consumer has grown tired and frustrated with tethered charging solutions and that the market is poised and will be receptive to untethered wire-free power solutions like WattUp developed by Energous Corporation. We believe that the positive market response and interest in the WattUp technology we have seen suggests that consumer electronic companies that develop products incorporating our technology will generate incremental sales and realize highly differentiated competitive advantages.

We believe our WattUp technology has a number of advantages compared to traditional charging technologies in terms of size, cost, mobility and portability. Further, our technology allows us to target a fixed or mobile device, track that device if it moves or is moving, and transmit focused energy to the targeted device to charge the device without having to remove the battery or plug in the device. However, there are a variety of other wireless charging technologies on the market or under development today. These competitive technologies fall into the following categories:

<u>Magnetic Induction.</u> Magnetic induction uses a magnetic coil to create resonance, which can transmit energy over very short distances. Power is delivered as a function of coil size (the larger the coil, the more power), and coils must be directly paired (one receiver coil to one transmitter coil = directly coupled pair) within a typical distance of less than one inch. Products utilizing magnetic induction have been available for 10+ years in products such as rechargeable electronic toothbrushes.

<u>Magnetic Resonance.</u> Magnetic resonance is similar to magnetic induction, as it uses magnetic coils to transmit energy. This technology uses coils that range in size depending on the power levels being transmitted. It has the ability to transmit power at distances up to ~11 inches (30cm) which can be increased with the use of resonance repeaters.

<u>Conductive.</u> Conductive charging uses conductive power transfer to eliminate wires between the charger (often a charging mat) and the charging device. It requires the use of a charging board as the power transmitter to deliver the power, and a charging device, with a built-in receiver, to receive the power. This technology requires direct metal contact between the charging board and the receiver. Once the charging board recognizes the receiver, the charging begins.

RF Harvesting. Harvesting RF energy is at the core of our WattUp technology. RF harvesting typically utilizes directional antennas to target and deliver energy. To our knowledge, there are two other companies attempting to utilize a directional pocket of energy similar to that being developed by Energous.

Laser. Laser charging technology uses very short wavelengths of light to create a collimated beam that maintains its size over distance, using what is described as distributed resonance to deliver power to an optical receiver.

Ultrasound. Ultrasound charging technology converts electric energy into acoustic energy in the form of ultrasound waves. It then reconverts those waves through an “energy-harvesting” receiver.

Our Business Strategy

We intend to be both a supplier of our proprietary ASSPs and a licensor of our antenna designs, software and hardware designs to companies who design, manufacture (or contract for manufacture) and market devices to consumers, military, industrial and other users who would benefit from wire-free charging. We intend to pursue these paths because we believe there are several verticals with total available markets measured in the tens of millions of units per year that would benefit from our technology and, as a result, will purchase our proprietary ASSPs and pay us a royalty for licensing our technology. Our intent is not to compete with our strategic partners by designing and manufacturing competing consumer electronic products, but rather to support the development and proliferation of the WattUp® technology to form a ubiquitous wire-free charging ecosystem along the lines of Wi-Fi.

We believe that our greatest market opportunity lies in creating a ubiquitous ecosystem for wire-free charging at a distance, in much the same way as the Wi-Fi ecosystem has developed. The goal is to ensure interoperability between transmitters and receivers that are based on our technology, regardless of who made them, installed them into finished goods, or marketed them. The implementation of previous ubiquitous solutions such as Wi-Fi and Bluetooth should help to illustrate our goal. For example, Wi-Fi routers, regardless of their designer or manufacturer, work with Wi-Fi receivers installed in various consumer electronic devices, regardless of the manufacturer. As a result, we are following the same roll out strategy as Wi-Fi in that we have:

- Carefully selected initial target markets;
- Built multiple silicon-based chips to advance the technology;
- Partnered with leading product companies;
- Developed reference designs to reduce early adopter risks and foster adoption;
- Provided game-changing benefits to the consumer in terms of utility and convenience;
- Designed initial iterations of the technology to be small but scalable implementations that are compatible on both a local and enterprise scale;
- Invested in ease of use;
- Developed a strategy to build out the ecosystem starting with the consumer and expanding to enterprise, industrial and military;
- Implemented a plan to initially sell ASSPs migrating to a combination of selling ASSPs and integrating our device libraries into third-party silicon such as Bluetooth Low Energy and Power Management Chips; and
- Supported an association like the Air Fuel Alliance (AFA) that is expected to lead to a qualification process to insure compatibility of the WattUp technology across vendors and develop a common user experience at the application level.

In order for our solution to become a ubiquitous solution for charging at a distance, we intend to pursue an ecosystem strategy for our technology, engaging not only potential licensees for our transmitter and receiver technologies, but also their upstream and downstream value chain partners. We also intend to prioritize protecting our intellectual property portfolio, as we believe this strategy will make it less likely that a competing platform will be able to gain a solid foothold in the uncoupled wireless market and compete with our technology in a meaningful way.

We believe strategic relationships with key licensees will enable us to reap the benefits of our technology much faster and with greater penetration than by manufacturing and distributing products ourselves. We believe this business model will also allow us to concentrate our efforts and resources on future projects to accelerate the introduction and adoption of the WattUp solution. As we develop new applications for our technology, we expect to target new strategic relationships in different market sectors.

In order to engage with potential licensees of the WattUp technology we have developed evaluation kits consisting of a transmitter and a receiver along with the enabling software to allow potential strategic partners to test the technology in their labs. The kits form a base "building block" component that is scalable to meet the needs of specific applications. We are developing processes and the support capabilities to assist potential strategic partners as they evaluate the technology and develop specific designs to incorporate it.

In selecting our initial licensees, our goal is to identify partners who are willing to make a significant engineering investment in the integration of the technology and have an internal product cycle that will support rapid deployment with the end goal to release WattUp devices to the consumer as quickly as possible thereby securing a first to market advantage and accelerating the path to revenue and profitability.

Since we are developing a new paradigm as to how consumers will charge their mobile devices and other consumer electronics products, the operational details of our strategy continue to evolve as our technology matures and our engagements with strategic partners solidify. As a result, we expect to make operational course corrections as we steer the company towards our goal of a ubiquitous wirefree charging solution. For example, we may enable third party technology companies to support second and third tier licensing opportunities as a way to expand Energous' scope and accelerate adoption as opposed to trying to expand our internal support capabilities at a cost and pace sufficient to meet the needs of what we anticipate will be strong demand for our technology.

Our Initial Target Markets

We believe that our technology will be compelling to many end markets, each of which may have several potential customers. In an effort to focus our activities and deliver a WattUp-enabled product to the consumer as quickly as possible, we will likely select certain initial target markets and strategic partners because of their time-to-market capabilities and their market potential. As we continue to develop our technology, we intend to add additional markets and partners to expand our market presence.

We identify our initial target markets within these two hardware categories:

<u>Transmitter Target Markets</u>

We believe our transmitters will be developed and released to the consumer in three basic categories:

- Stand-alone transmitters that are either sold independently or bundled as part of a pairing with a WattUp-enabled receiver device;
- Transmitters that are integrated into third party devices like televisions, computer monitor bezels and refrigerator doors; and
- Transmitters that are integrated with Wi-Fi routers to form a single device that provides both connectivity and wire-free power.

Stand-Alone Transmitters:

Our current plans call for stand-alone transmitters to be released in three separate and distinct categories:

Miniature WattUp Transmitters:

Because of their ease of manufacturing and their relative ease of regulatory approval, we expect that products using our miniature transmitter technology will be the first WattUp enabled products to market. Our miniature transmitters are ideally suited to wearables, IoT devices and other small electronics which require a small form factor receiver and a low cost total charging solution. These small, inexpensive transmitters will likely be USB-powered, and will have a range of zero distance from the transmitter (contact-based) to a few millimeters or centimeters from the transmitter. These solutions will initially be one-to-one (one transmitter to one receiver) with follow-on versions being one to many.

Midsize WattUp Transmitters:

We expect that our Midsize WattUp transmitters will be geared to the desktop and will likely have a range of a few centimeters to three feet from the transmitter. We also intend for the midsize transmitters to have tracking ability to support mobile applications and multiple receiving devices. Likely implementations of midsized WattUp transmitters will include small desktop and nightstand transmitters designed to send low power at distances for accessories and wearables. The same technology may also likely be integrated into third party devices like computer monitor bezels, nightstand consumer electronics, accessories such as 12-volt portable chargers and integrated automotive applications.

Full Size WattUp Transmitters:

Full Size WattUp transmitters are full featured transmitters with the power to charge multiple devices at distances of up to fifteen feet or anywhere within a 30-foot diameter circle. We also expect that full size WattUp transmitters will have the ability to “pair” with other full size WattUp transmitters allowing the user to create a large charging envelope encompassing many different rooms or large spaces while seamlessly providing charging to mobile devices that are moving through the coverage space. Full size WattUp transmitters may also play a significant role in the powering of IoT devices that are fixed such as security cameras and sensors.

Transmitters Integrated into Third Party Devices:

The “building block” core architecture developed for the WattUp technology is ideally suited to a broad spectrum of third party devices like televisions and refrigerator doors. The flexibility of the architecture in terms of size, power, distance, and cost affords Energous licensees the opportunity to match our technology with specific requirements and limitations typically found with complex integrations. For example, the WattUp technology could be integrated into the door of a small refrigerator typically found in college dorm rooms providing charging capabilities to mobile devices anywhere in the room. Further, the “pairing” capabilities of the transmitter technology could enable licensees to develop venue-specific consumer electronics products like integrated televisions that are paired with integrated picture frames to provide mobile charging across a large room such as an airport lounge.

Wi-Fi Routers

We see the combination of the wire-free power router and the Wi-Fi router as a natural integration point and a synergistic application of both technologies. The WattUp wire-free power router shares a number of technical characteristics with Wi-Fi routers in that both devices operate in the airwaves in the unlicensed industrial, scientific and medical (“ISM”) bands, both devices owe their success to the utility and convenience they bring to the consumer, both devices rely on antenna structures to send power and data, and both devices “pair” or provide hand off capabilities which allow for large “enabled” sites similar to a mesh network. We also believe that our 3D pocket-forming technology may enhance the data signal of a Wi-Fi router, which we believe will provide an even stronger value proposition to wireless data router manufacturers. Finally, we plan to collaborate with our tier-one consumer electronics company partner to engage with third party Wi-Fi transmitter companies. Our belief is that through this joint approach we will be able to enhance the marketing and manufacturing of transmitters which in turn would help drive the demand for receiving devices and accelerate the build out of the WattUp ecosystem.

The Wi-Fi router market has two segments: commercial and residential. The key differentiator between these segments is that commercial routers tend to have much more robust security features, including virtual private networks and advanced content filtering. We believe that our technology is applicable to both the commercial and residential Wi-Fi router markets based on the building block capabilities mentioned earlier that will enable the WattUp technology to effectively serve and support both markets.

In addition, the Wi-Fi router market has other key players. These include consumer electronics supply chain firms, including original equipment manufacturers (“OEMs”), original design manufacturers (“ODMs”), component manufacturers and branded consumer electronics firms. We believe that each of these categories of players can help to integrate our technology into a commercially available Wi-Fi router.

An ODM designs products either collaboratively with their customers or on their own and manufactures them for sale to companies under the end customer's brand. Additionally, an ODM may engage multiple companies with similar designs that are then marketed under several different end customers' brands. An OEM manufactures products for sale under another firm's brand. We believe that engaging with both types of organizations will be necessary to speed our entry into the market and extend our market reach.

We have ongoing interest from various ODM companies that are exploring the production of the recently announced (January 2016) miniature WattUp transmitter. This miniaturized transmitter design is intended to replace the typical USB cord and power adapter included with many small electronics products today. Incorporation of the WattUp® technology into a mini transmitter would allow the intended product to become waterproof as there is no longer a need for a power input port on the device, while still allowing for an in-box charging solution.

Component suppliers are also a key part of our go-to-market strategy, as most ODMs and OEMs do not design their own components. We expect to be actively engaged with component companies that supply antennas, as well as mixed-signal, power and RF components to the major ODM and OEMs in the Wi-Fi router market.

As part of our go-to-market strategy, we intend to market to major infrastructure developers, both for consumer and commercial applications. Within these consumer markets, we expect that engagements will primarily be with consumer product companies who manufacture and market products to major residential home builders. For commercial installations, we intend to engage with the wireless network operators and private Wi-Fi system operators. We also intend to engage with concentrated consumer destinations (for example, coffee shop and restaurant chains, airport lounges and airports) by educating them on the benefits of our solutions to drive them to seek out and demand our solution from their vendors and suppliers.

Receiver Target Markets

We believe there are a wide variety of potential uses for our receiver technology, including:.

- Smart phones
- Wearable devices
- IOT devices
- Tablets
- Mice
- Gaming consoles and controllers
- Keyboards
- e-book readers
- Remote controls
- Sensors (such as thermostats)
- Toys
- Rechargeable batteries
- Rechargeable lights
- Automotive accessories
- Personal care products (such as toothbrushes or shavers)
- Retail inventory management (such as RFID tags)
- Hand-held industrial devices (such as scanners or keypads)

This list is meant for illustrative purposes only; we cannot guarantee that we will address any of these markets, and we may decide to address a market that is not on the above list. We intend to continuously evaluate our target markets and choose new markets based on factors including (but not limited to) time-to-market, market size and growth, and the strength of our value proposition for a specific application.

Key Strategic Partnership

In January 2015, we signed a Development and License Agreement with a tier-one consumer electronics company to embed WattUp wire-free charging receiver technology in various products including mobile consumer electronics and related accessories.

This Development and License Agreement and subsequent amendments contains both invention and development milestones that we will need to achieve through fiscal 2016 and potentially beyond. If we achieve such milestones, we are entitled to receive milestone-based development payments under the agreement.

During the development phase until one year after the first customer shipment, we will afford this customer a time to market advantage in the licensed product categories.

This agreement was amended in July of 2015 to include transmitter technology which we believe is a key to expanding the WattUp ecosystem given the numbers of transmitters this strategic partner could potentially distribute to the consumer.

We believe that this agreement, and the close collaboration with our partner it entails, will enable us to accelerate commercial development on a number of fronts. If successful, we believe this agreement also paves a very clear path to attaining critical mass in the market for WattUp® wire-free power. We believe that this critical mass could be driven first by the wide adoption of our receiver technology and second by the broad distribution of bundled stand-alone and integrated transmitters into other consumer electronics devices. Finally, having this wide adoption on both the transmitter and the receiver side should create pull and demand for broad adoption of our technology from circles outside of our key strategic partner. With the goal of promoting the establishment of a wire-free charging ecosystem based on the WattUp® technology, we, and this partner, plan to collaborate to introduce WattUp® technology to potential partner companies including router and accessory manufacturers.

Research and Development

Research and development costs account for a substantial portion of our operating expenses. Our research and development expenses were $18.8 million, $12.5 million and $2.1 million for the years ended December 31, 2015, 2014 and 2013, respectively. Research and development expenses are expected to increase in the future as we concentrate our efforts and resources on the commercialization of our technology.

Our Intellectual Property

As a company with a primary focus on licensing, we expect that our most valuable asset will be our intellectual property. This includes U.S. and foreign patents, patent applications and know-how. We are pursuing an aggressive intellectual property strategy and are developing new patents. As of March 14, 2016, we have in excess of 250 pending patent and provisional patent applications. Additionally, the PTO has issued our first five patents and notified us of the allowance of three additional patents. In addition to the inventions covered by these patents and patent applications, we have identified a significant number of additional specific inventions we believe may be novel and patentable. We intend to file for patent protection for the most valuable of these, as well as for other new inventions that we expect to develop.

Government Regulation

Our wire-free charging technology involves the transmission of power using RF energy waves, which is subject to regulation by the Federal Communications Commission ("FCC"), and may be subject to regulation by other federal, state and local agencies. We believe our technology is safe, and we are consulting with the FCC to establish a process by which devices incorporating WattUp® technology can secure required FCC approvals.

As part of the regulatory approval process, we believe devices incorporating the WattUp® technology will need to obtain approvals under both FCC Part 15 and FCC Part 18. We are confident that our technology allows devices to be approved under Part 15. In addition, because our technology involves the transmission of power greater than the power threshold limits of Part 15, we also expect devices incorporating our technology will need to obtain FCC Part 18 approval. The design of the WattUp® technology is such that we believe we will be able to demonstrate that our power transmissions do not violate current FCC regulations pertaining to human exposure to RF emissions and that WattUp® technology complies with the Part 18 technical requirements. However, to our knowledge, the transmission of power in this manner by a consumer product at the ranges we are proposing has not yet been approved by the FCC. There can be no assurance that the FCC will determine that devices incorporating WattUp® technology are eligible for Part 18 approval, that FCC approval will be able to be obtained for specific devices, or that other governmental approvals will not be required.

Employees

As of March 14, 2016, we had 52 full-time employees. None of these employees are covered by a collective bargaining agreement, and we believe our relationship with our employees is good. We also employ consultants, including technical advisors, on an as-needed basis to supplement existing staff. Consultants and technical advisors provide us with expertise in electrical engineering, software development and other specialized areas of engineering and science.

Item 1A. Risk Factors

We are subject to various risks that may materially harm our business, prospects, financial condition and results of operations. This discussion highlights some of the risks that may affect future operating results. These are the risks and uncertainties we believe are most important for you to consider. We cannot be certain that we will successfully address these risks. If we are unable to address these risks, our business may not grow, our stock price may suffer and we may be unable to stay in business. Additional risks and uncertainties not presently known to us, which we currently deem immaterial or which are similar to those faced by other companies in our industry or business in general, may also impair our business, prospects, results of operations and financial condition. The risks discussed below include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements.

Risks Related to Our Business

Other than Engineering Services revenues, we have no history of generating revenue, have a history of operating losses, and we may never achieve or maintain profitability.

We have a limited operating history upon which investors may evaluate our prospects. Other than Engineering Services revenues, we have not generated any revenues to date and we have a history of losses from operations. As of December 31, 2015, we had an accumulated deficit of $78,707,180, that included accumulated expense of $26,265,177 from changes in value of derivative liabilities and, accumulated stock based compensation expense of $8,515,540. Our ability to achieve material revenue-generating operations and, ultimately, achieve profitability will depend on whether we can obtain additional capital when we need it, complete the development of our technology and incorporate that technology into the products sold by our customers. There can be no assurance that we will ever generate revenues or achieve profitability.

Terms of our Development and License Agreement with a tier-one consumer electronics company could inhibit potential licensees from working with us in specific markets.

We have entered into a Development and License Agreement with a tier-one consumer electronics company to embed WattUp® wire-free charging receiver technology in various products including mobile consumer electronics and related accessories. This agreement provides our strategic partner a time-to-market advantage during the development until one year after the first customer shipment for certain consumer products. The time-to-market advantage might inhibit another potential licensee from engaging with us or they may be pressured to seek other solutions which could have a negative impact on our future revenue opportunities.

Our efforts may never demonstrate the feasibility of our technology.

We have developed a working prototype of our technology but significant additional research and development activity will be required before we achieve a commercial product. Our research and development efforts remain subject to all of the risks associated with the development of new products based on emerging technologies, including without limitation unanticipated technical or other problems, the inability to develop a product that may be sold at an acceptable price point and the possible insufficiency of funds needed in order to complete development of these products and enable us to render services. Technical problems may result in delays and cause us to incur additional expenses that would increase our losses. If we cannot complete, or if we experience significant delays in developing our technology, and products and services based on such technology, for use in potential commercial applications, particularly after incurring significant expenditures, our business may fail. In particular, to our knowledge, the technological concepts we are applying to develop commercial applications of wire-free power for fixed and mobile low-power rechargeable devices have not been previously successfully applied by anyone else, if we fail to develop a practical, efficient or economical commercial product based on those technological concepts, our business may fail.

We may not obtain FCC approval for our technology and existing laws or regulations or future legislative or regulatory changes may affect our business.

Our wire-free charging technology involves the transmission of power using RF energy waves, which are subject to regulation by the FCC, and may be subject to regulation by other federal, state and local agencies. We intend to design our technology so that it will operate primarily in the 2.4/5.8 GHz radio frequency range, which is the same range as Wi-Fi routers and several other wireless consumer electronics. Different customer applications may require us to develop our technology to work at different frequencies. For those types of products, the FCC grants what is known as Part 15 approval if, among other things, the human exposure to RF emissions is below certain thresholds. In addition, because our technology involves the transmission of power greater than the power threshold limits of Part 15, we also expect WattUp® devices to need FCC Part 18 approval. To our knowledge, the transmission of power using RF energy waves by a consumer product at the ranges we are proposing has not yet been approved by the FCC, and there can be no assurance that devices incorporating WattUp® technology will be able to obtain FCC approval or that other governmental approvals will not be required. Our efforts to cause the FCC to establish a procedure for the authorization of devices using WattUp® technology by their manufacturers could be costly and time consuming, and if such manufacturers are unable to receive any such required approvals in a timely and cost-efficient manner our business and operating results may be materially adversely affected. The cost of compliance with new laws or regulations governing our technology or future products could adversely affect our financial results. New laws or regulations may impose restrictions or obligations on us that could force us to redesign our technology under development or other future products, and may impose restrictions that are not possible or practicable to comply with, which could cause our business to fail. We cannot predict the impact on our business of any legislation or regulations related to our technology or future products that may be enacted or adopted in the future.

We anticipate future losses and negative cash flow, and it is uncertain if or when we will become profitable.

Other than Engineering Services revenues, we have not generated any revenues to date, and we may never be able to produce material revenues or operate on a profitable basis. As a result, we have incurred losses since our inception and expect to experience operating losses and negative cash flow for the foreseeable future.

We expect to expend significant resources on hiring of personnel and startup costs, including payroll and benefits, product and ASSP testing and development, intellectual property development and prosecution, marketing and promotion, capital expenditures, working capital and general and administrative expenses. We expect to incur costs and expenses related to prototype development, consulting costs, laboratory development costs, obtaining regulatory approvals required for our technology and reference product designs, marketing and other promotional activities, hiring of personnel, and the continued development of relationships with strategic business partners. We may not be able to obtain financing in a sufficient amount or at all. We anticipate our losses will continue to increase from current levels during our development stage.

We may require additional financing to achieve our business plans.

We believe our technology is novel in offering the potential to make wire-free charging an affordable, ubiquitous and convenient service for end users. However, the consumer and commercial electronics industry in general and the power, recharging and alternative recharging segments of that industry in particular are subject to intense and increasing competition and rapidly evolving technologies. Accordingly, for our business plans to succeed we believe it will be important for us to move quickly to develop our technology, obtain required regulatory approvals and engage with strategic partners. As a small company, we may be unable to successfully implement our ambitions of targeting very large markets in an intensely competitive industry segment without significantly increasing our resources. We may not have sufficient funds to fully implement our business plan, the ultimate goal of which is to license our technology to device manufacturers, wireless service providers and other commercial partners to make wire-free charging an affordable, ubiquitous and convenient service for end users. While we believe our current cash on hand, together with anticipated payments received under product development projects entered into with customers, will be sufficient to fund our operations into the second quarter of 2017 depending on how soon we are able to begin to generate meaningful commercial revenue we may need to raise capital through new financings. Such financings could include equity financing, which may be dilutive to stockholders, or debt financing, which would likely restrict our ability to borrow from other sources. In addition, such securities may contain rights, preferences or privileges senior to those of the rights of our current stockholders. There can be no assurance that additional funds will be available on terms attractive to us, or at all. If adequate funds are not available, we may be required to curtail the development of our technology or materially curtail or reduce our operations. We could be forced to sell or dispose of our rights or assets. Any inability to raise adequate funds on commercially reasonable terms could have a material adverse effect on our business, results of operation and financial condition, including the possibility that a lack of funds could cause our business to fail and liquidate with little or no return to investors.

We may have difficulty managing growth in our business.

As we expand our activities, there will be additional demands on our financial, technical, operational and management resources. The failure to continue to upgrade our technical, administrative, operating and financial control systems or the occurrence of unexpected expansion difficulties, including issues relating to our research and development activities and retention of experienced scientists, managers and engineers, could have a material adverse effect on our business, financial condition and results of operations and our ability to timely execute our business plan. If we are unable to implement these actions in a timely manner, our results may be adversely affected.

If products incorporating our technology are commercially launched, and those products does not achieve widespread market acceptance, we will not be able to generate the revenue necessary to support our business.

Achieving acceptance of a wire-free recharging system as a preferred method to recharge low-power fixed and mobile electronic devices will be crucial to our continued success. Consumers and commercial customers will not begin to use or increase the use of products incorporating our technology unless they agree that the convenience of our wire-free charging solution would be worth the additional expense of purchasing such products. We have no history of marketing any product and we and our commercialization partners may fail to generate significant interest in the initial commercial products or any other product incorporating our technology that may be developed. These and other factors, including the following factors, may affect the rate and level of the market acceptance:

- the price products incorporating our technology relative to other products or competing methods of recharging;
- the effectiveness of our sales and marketing efforts or those of our commercialization partners;
- the support and rate of acceptance of our technology and solutions with our joint development partners;
- perception by users, both individual and enterprise users, of our wire-free charging solution's convenience, safety, efficiency, and benefits compared to competing methods of recharging;
- press and blog coverage, social media coverage, and other publicity and public relations factors which are not within our control; and
- regulatory developments related to marketing our solution or their inclusion in others' products.

If we are unable to achieve or maintain market acceptance, our business would be significantly harmed.

If our products or products incorporating our technology are commercially launched, we may experience seasonality or other unevenness in our financial results in consumer markets or a long and variable sales cycle in enterprise markets.

While we do not now have license revenue or a commercial product, our strategy depends on the development of a successful commercial product and effectively licensing our technology into the consumer, enterprise and commercial markets. We will need to understand procurement and buying cycles to be successful in licensing our technology into those markets. We anticipate it is possible that demand for our technology could vary similarly with the market for products with which our technology may be used, for example, the market for new purchases of laptops, tablet, mobile phones, gaming systems, toys, wearables and the like. Such consumer markets are often seasonal, with peaks in and around the December holiday season and the August-September back-to-school season. Enterprises and commercial markets may have annual or other budgeting and buying cycles that could affect us, and, particularly if we are designated as a capital improvement project, we may have a long or unpredictable sales cycle.

We may not be able to achieve all the features we seek to include in our technology.

We have developed a prototype of our product concept that displays limited functionality in a laboratory setting. There are a variety of features we seek to include in our technology that we have not yet achieved. For example, while we believe recharging multiple devices on one transmitter at a commercially acceptable level may be possible theoretically, we have not yet achieved these results, even in the laboratory. We believe our research and development efforts will yield additional functionality over time. However, there can be no assurance that we will be successful in achieving all the features we are targeting and our inability to do so may limit the appeal of our technology to consumers.

Use of our technology under development or other future products may require the user to purchase additional products to use with existing devices. To the extent these additional purchases are inconvenient, the adoption of our technology under development or other future products could be slowed, which would harm our business.

For rechargeable devices that will utilize our receiver technology, the technology may be embedded in a sleeve, case or other enclosure. For example, certain products such as remote controls or toys equipped with replaceable AA size or other sized batteries, would need to be outfitted with enhanced batteries and other hardware that would enable the devices to be rechargeable by our system. In each case, to use a device with our system, an end user will be required to retrofit the device with a receiver and may be required to upgrade the battery technology used with the device (unless, for example, a consumer electronics supply chain firm has built compatible battery technology and a receiver into the device). These additional steps and expenses may offset the convenience for some users and discourage some users from purchasing our technology under development or other future products. Such factors may inhibit adoption of our technology, which would harm our business. We have not developed the enhanced battery to be used in devices, and our ability to enable use of our technology with devices that will require an enhanced battery will depend on our ability to develop a commercial version of such an enhanced battery that could be manufactured at a reasonable cost. If we fail to develop or enable a commercially practicable enhanced battery, we expect our business would be harmed, and we may need to change our strategy and target markets.

Laboratory conditions differ from field conditions, which could affect the effectiveness of our technology under development or other future products. Failures to effectively move from laboratory to the field would harm our business.

Our technology, when used in the field, may not be able to match the observations, developments, test results and performance that our technology may be able to achieve (and we may be able to document) under controlled laboratory circumstances. As one example of the difference between ideal laboratory conditions and field use, consider that in the laboratory, we can arrange for the transmitter to have line-of-sight transmission to a receiver. If we intend to test the performance through obstructions, we can control the configurations of the obstructions and the materials from which such obstructions are made. In the field, however, the receiver may be obscured or obstructed, or placed around a corner. Also, in the field we will have no control over the configuration of the obstructions or the materials that comprise each obstruction. These conditions may significantly decrease or eliminate the power received at the receiver or the effective range, because the RF energy from the transmitter may be absorbed by obscuring or blocking material or may need to be reflected off of a surface to reach the receiver, making the transmission distance longer than straight-line distances. The failure of our technology under development or other future products to be able to meet the demands of users in the field would harm our business.

Safety concerns and legal action by private parties may affect our business.

We believe that our technology is safe. However, it is possible that we could discover safety issues with our technology or that some people may be concerned with wire-free transmission of power in a manner that has occurred with some other wireless technologies as they were put into residential and commercial use, such as the safety concerns that were raised by some regarding the use of cellular telephones and other devices to transmit data wirelessly in close proximity to the human body. While we plan to at least partially address this potential concern by developing our management software and sensor technology to be configurable by users to selectively recharge devices in ways that would be intended to avoid recharging in close proximity to a human body, such as recharging only during predetermined time periods or recharging only when the device is not moving, we do not plan to conduct any tests to determine whether RF waves produce harmful effects on humans or other animals. We may be unable to effectively prevent recharging in close proximity to a user’s body, which could affect the marketability of our technology or could result in requests for law or regulation governing our technology under development or a class of products in which our technology under development would be included. In addition, while we believe our technology is safe, users of our technology under development or other future products who suffer medical ailments may blame the use of products incorporating our technology, as occurred with a small number of users of cellular telephones. A discovery of safety issues relating to our technology would have a material adverse effect on our business and any legal action against us claiming our technology caused harm could be expensive, divert management and adversely affect us or cause our business to fail, whether or not such legal actions were ultimately successful.

Our industry is subject to intense competition and rapid technological change, which may result in products or new solutions that are superior to our technology under development or other future products we may bring to market from time to time. If we are unable to anticipate or keep pace with changes in the marketplace and the direction of technological innovation and customer demands, our technology and products may become less useful or obsolete and our operating results will suffer.

The consumer and commercial electronics industry in general and the power, recharging and alternative recharging segments of that industry in particular are subject to intense and increasing competition and rapidly evolving technologies. Because products incorporating our technology are expected to have long development cycles, we must anticipate changes in the marketplace and the direction of technological innovation and customer demands. To compete successfully, we will need to demonstrate the advantages of our products and technologies over well-established alternative solutions, products and technologies, as well as newer methods of power delivery and convince consumers and enterprises of the advantages of our products and technologies. Traditional wall plug-in recharging remains an inexpensive alternative to our technology under development. Also, directly competing technologies such as inductive charging, magnetic resonance charging, conductive charging, ultrasound and other yet unidentified solutions may have greater consumer acceptance than the technologies we have developed. Furthermore, certain competitors may have greater resources than us and may be better established in the market than we are. We cannot be certain which other companies may have already decided to or may in the future choose to enter our markets. For example, consumer electronics products companies may invest substantial resources in wireless power or other recharging technologies and may decide to enter our target markets. Successful developments of competitors that result in new approaches for recharging could reduce the attractiveness of our products and technologies or render them obsolete.

Our future success will depend in large part on our ability to establish and maintain a competitive position in current and future technologies. Rapid technological development may render our technology under development or future products based on our technology obsolete. Many of our competitors have or may have greater corporate, financial, operational, sales and marketing resources, and more experience in research and development than we have. We cannot assure you that our competitors will not succeed in developing or marketing technologies or products that are more effective or commercially attractive than our products or that would render our technologies and products obsolete. We may not have or be able to raise or develop the financial resources, technical expertise, marketing, distribution or support capabilities to compete successfully in the future. Our success will depend in large part on our ability to maintain a competitive position with our technologies.

Our competitive position also depends on our ability to:

- generate widespread awareness, acceptance and adoption by the consumer and enterprise markets of our technology under development and future products;

- design a product that may be sold at an acceptable price point;
- develop new or enhanced technologies or features that improve the convenience, efficiency, safety or perceived safety, and productivity of our technology under development and future products;
- properly identify customer needs and deliver new products or product enhancements to address those needs;
- limit the time required from proof of feasibility to routine production;
- limit the timing and cost of regulatory approvals;
- attract and retain qualified personnel;
- protect our inventions with patents or otherwise develop proprietary products and processes; and
- secure sufficient capital resources to expand both our continued research and development, and sales and marketing efforts.

If our technology is not competitive based on these or other factors, our business would be harmed.

It is difficult and costly to protect our intellectual property and our proprietary technologies, and we may not be able to ensure their protection.

Our success depends significantly on our ability to obtain, maintain and protect our proprietary rights to the technologies used in our products and products incorporating our technologies. Patents and other proprietary rights provide uncertain protections, and we may be unable to protect our intellectual property. For example, we may be unsuccessful in defending our patents and other proprietary rights against third party challenges.

We have in excess of 250 pending U.S. patents and provisional patent applications on file. The PTO issued our first five patents and notified us of the allowance of three additional patents to protect our technology.

In addition to patents, we expect to rely on a combination of trade secrets, copyright and trademark laws, nondisclosure agreements and other contractual provisions and technical security measures to protect our intellectual property rights. These measures may not be adequate to safeguard our technology. If they do not protect our rights adequately, third parties could use our technology, and our ability to compete in the market would be reduced. Although we are attempting to obtain patent coverage for our technology where available and where we believe appropriate, there are aspects of the technology for which patent coverage may never be sought or received. We may not possess the resources to or may not choose to pursue patent protection outside the United States or any or every country other than the United States where we may eventually decide to sell our future products. Our ability to prevent others from making or selling duplicate or similar technologies will be impaired in those countries in which we have no patent protection. Although we have in excess of 250 pending and provisional patent applications on file in the United States protecting aspects of our technology under development, our patents may not issue as a result of those applications drawing priority or otherwise based on those patent applications, may issue only with limited coverage or may issue and be subsequently successfully challenged by others and held invalid or unenforceable.

Similarly, even if patents do issue based on our applications or future applications, any issued patents may not provide us with any competitive advantages. Competitors may be able to design around our patents or develop products that provide outcomes comparable or superior to ours. Our patents may be held invalid or unenforceable as a result of legal challenges by third parties, and others may challenge the inventorship or ownership of our patents and pending patent applications. In addition, if we choose to and are able to secure protection in countries outside the United States, the laws of some foreign countries may not protect our intellectual property rights to the same extent as do the laws of the United States. In the event a competitor infringes upon our patent or other intellectual property rights, enforcing those rights may be difficult and time consuming. Even if successful, litigation to enforce our intellectual property rights or to defend our patents against challenge could be expensive and time consuming and could divert our management’s attention. We may not have sufficient resources to enforce our intellectual property rights or to defend our patents against a challenge.

We may also in the future as one of our strategies to deploy our technology into the market, license patent and other proprietary rights to aspects of our technology to third parties and customers. Disputes with our licensors may arise regarding the scope and content of these licenses. Further, our ability to expand into additional fields with our technologies may be restricted by our existing licenses or licenses we may grant to third parties in the future.

The policies we use to protect our trade secrets may not be effective in preventing misappropriation of our trade secrets by others. In addition, confidentiality agreements executed by our employees, consultants and advisors may not be enforceable or may not provide meaningful protection for our trade secrets or other proprietary information in the event of unauthorized use or disclosure. Litigating a trade secret claim is expensive and time consuming, and the outcome is unpredictable. In addition, courts outside the United States are sometimes less willing to protect trade secrets. Moreover, our competitors may independently develop equivalent knowledge methods and know-how. If we are unable to protect our intellectual property rights, we may be unable to prevent competitors from using our own inventions and intellectual property to compete against us, and our business may be harmed.

We may be subject to patent infringement or other intellectual property lawsuits which may be costly to defend.

Because our industry is characterized by competing intellectual property, we may be sued for violating the intellectual property rights of others. Determining whether a product infringes a patent involves complex legal and factual issues, and the outcome of patent litigation actions is often uncertain. We have not conducted any significant search of patents issued to third parties, and no assurance can be given that third party patents containing claims covering our products, parts of our products, technology or methods do not exist, have not been filed, or could not be filed or issued. Because of the number of patents issued and patent applications filed in our technical areas or fields (including some pertaining specifically to wireless charging technologies), our competitors or other third parties may assert that our products and technology and the methods we employ in the use of our products and technology are covered by United States or foreign patents held by them. In addition, because patent applications can take many years to issue and because publication schedules for pending applications vary by jurisdiction, there may be applications now pending of which we are unaware, and which may result in issued patents that our technology under development or other future products would infringe. Also, because the claims of published patent applications can change between publication and patent grant, there may be published patent applications that may ultimately issue with claims that we infringe. There could also be existing patents that one or more of our technologies, products or parts may infringe and of which we are unaware. As the number of competitors in the market for wire-free power and alternative recharging solutions increases, and as the number of patents issued in this area grows, the possibility of patent infringement claims against us increases. Some of our competitors may be able to sustain the costs of complex patent litigation more effectively than we can because they have substantially greater resources. In addition, any uncertainties resulting from the initiation and continuation of any litigation could have a material adverse effect on our ability to raise the funds necessary to continue our operations.

In the event that we become subject to a patent infringement or other intellectual property lawsuit and if the relevant patents or other intellectual property were upheld as valid and enforceable and we were found to infringe or violate the terms of a license to which we are a party, we could be prevented from selling any infringing products of ours unless we could obtain a license or were able to redesign the product to avoid infringement. If we were unable to obtain a license or successfully redesign, we might be prevented from selling our technology under development or other future products. If there is an allegation or determination that we have infringed the intellectual property rights of a competitor or other person, we may be required to pay damages, or a settlement or ongoing royalties. In these circumstances, we may be unable to sell our products or license our technology at competitive prices or at all, our business and operating results could be harmed.

We could become subject to product liability claims, product recalls, and warranty claims that could be expensive, divert management's attention and harm our business.

Our business exposes us to potential liability risks that are inherent in the marketing and sale of products used by consumers. We may be held liable if our technology under development now or in the future causes injury or death or are found otherwise unsuitable during usage. Our technology under development incorporates sophisticated components and computer software. Complex software can contain errors, particularly when first introduced. In addition, new products or enhancements may contain undetected errors or performance problems that, despite testing, are discovered only after installation. While we believe our technology is safe, users could allege or possibly prove defects (some of which could be alleged or proved to cause harm to users or others) because we design our technology to perform complex functions involving RF energy, possibly in close proximity to users. A product liability claim, regardless of its merit or eventual outcome, could result in significant legal defense costs. The coverage limits of our insurance policies we may choose to purchase to cover related risks may not be adequate to cover future claims. If sales of products incorporating our technology increase or we suffer future product liability claims, we may be unable to maintain product liability insurance in the future at satisfactory rates or with adequate amounts. A product liability claim, any product recalls or excessive warranty claims, whether arising from defects in design or manufacture or otherwise, could negatively affect our sales or require a change in the design or manufacturing process, any of which could harm our reputation and business, harm our relationship with licensors of our products, result in a decline in revenue and harm our business.

In addition, if a product we or a strategic partner design is defective, whether due to design or manufacturing defects, improper use of the product or other reasons, we or our strategic partners may be required to notify regulatory authorities and/or to recall the product. A required notification to a regulatory authority or recall could result in an investigation by regulatory authorities of products incorporating our technology, which could in turn result in required recalls, restrictions on the sale of such products or other penalties. The adverse publicity resulting from any of these actions could adversely affect the perception of our customers and potential customers. These investigations or recalls, especially if accompanied by unfavorable publicity, could result in our incurring substantial costs, losing revenues and damaging our reputation, each of which would harm our business.

We are subject to risks associated with our utilization of consultants.

To improve productivity and accelerate our development efforts while we build out our own engineering team, we use experienced consultants to assist in selected business functions, including the development of our ASPPs. We take steps to monitor and regulate the performance of these independent third parties. However, arrangements with third party service providers may make our operations vulnerable if these consultants fail to satisfy their obligations to us as a result of their performance, changes in their own operations, financial condition, or other matters outside of our control. Effective management of our consultants is important to our business and strategy. The failure of our consultants to perform as anticipated could result in substantial costs, divert management's attention from other strategic activities, or create other operational or financial problems for us. Terminating or transitioning arrangements with key consultants could result in additional costs and a risk of operational delays, potential errors and possible control issues as a result of the termination or during the transition.

We expect to depend on consumer electronics supply chain firms to manufacture, market and distribute our technology under development. If these strategic partners fail to successfully manufacture, market and distribute our technology under development, our business will be materially harmed.

We currently intend to both supply our semiconductor chips, antennas and related technology directly and license our system architecture, proprietary waveform, antenna designs to consumer electronics supply chain firms. rather than manufacture our technology under development ourselves. We will not be able to control the efforts and resources these consumer electronics supply chain firms would devote to marketing our technology under development or other future products. Those third parties may not be able to successfully market and sell the products they develop based on our technology, may not devote sufficient time and resources to support the marketing and selling efforts and may not market those products at prices that will permit the products to develop, achieve or sustain market acceptance. Finding new licensors could be an expensive and time-consuming process and we may not be able to find suitable consumer electronics supply chain firms and other distribution strategic partners on acceptable terms or at all. If we cannot find suitable third party partners or our third party partners experience difficulties, do not actively market our technology under development or future products or do not otherwise perform under our license agreements, our potential for revenue may be dramatically reduced, and our business could be harmed.

If we become a supplier of our proprietary ASSPs, we will be subject to risks associated with overseas manufacturing.

Part of our business strategy includes selling our proprietary ASSPs directly to consumer electronics companies and the manufacturers of their component parts. If we pursue this strategy, we will be reliant on third-party overseas manufacturers to manufacture our ASSPs. We cannot be certain that our unaffiliated manufacturers will be able to fill our orders in a timely manner. If we experience significant increases in demand, or need to replace an existing manufacturer, there can be no assurance that additional manufacturing capacity will be available when required on terms that are acceptable to us, or at all, or that any manufacturer would allocate sufficient capacity to us in order to meet our requirements. In addition, even if we are able to expand existing or find new manufacturing, we may encounter delays in production and added costs as a result of the time it takes to train manufacturers in our methods, products, quality control standards, and labor, health and safety standards. Any delays, interruption or increased costs in the manufacture of our ASSPs could have an adverse effect on our ability to meet customer demand for our products and harm our business.

Because independent manufacturers would manufacture our ASSPs outside of our principal sales markets, our products would need to be transported by third parties over large geographic distances. Delays in the shipment or delivery of our products due to the availability of transportation, work stoppages, port strikes, infrastructure congestion, or other factors, and costs and delays associated with consolidating or transitioning between manufacturers, could adversely impact our financial performance. In addition, manufacturing delays or unexpected demand for our products may require us to use faster, but more expensive, transportation methods such as aircraft, which could adversely affect our profit margins.

We intend to pursue licensing of our technology as a primary means of commercialization but we may not be able to secure advantageous license agreements. If we are not able to secure advantageous license agreements, our business and results of operations will be adversely affected.

We are pursuing the licensing of our technology as a primary means of commercialization. We believe there are many companies that would be interested in implementing our technology into their devices. Many of these companies are well-known, world-wide companies. We have entered into one product development and license agreement with a tier-one consumer electronics company that has the potential to yield license revenue. In addition, we have also entered into a number of evaluation and joint development agreements with potential strategic partners. However, these agreements do not commit either party to a long-term relationship and any of these parties may disengage with us at any time. Creating a license or other business relationship with these classes of companies will take a substantial effort, as we expect to have to convince them of the efficacy of our technology, meet their design and manufacturing requirements, satisfy their marketing and product needs, and comply with their selection, review and contracting requirements. There can be no assurance that we will be able to gain entry to these companies, or that they will ultimately decide to integrate our technology with their products. We may not be able to secure license agreements with customers on terms that are advantageous to us. Furthermore, the timing and volume of revenue earned from license agreements will be outside of our control. If the license agreements we enter into do not prove to be advantageous to us, our business and results of operations will be adversely affected.

We may not be able to develop a technology that meets our development partner's specifications. Even if we succeed in developing a technology that meets all the specifications in our Development and License Agreement, our development partner could decline to use our technology in its products. Any of these events would have a material adverse effect on our business.

The terms of our only Development and License Agreement with a tier-one consumer products company require us to meet stringent performance specifications and aggressive technical milestones. While we are devoting substantial corporate time and resources to the development of our technology for this company’s products, there can be no assurance that we can meet the performance specifications and technical milestones in the timeframe required by the Development and License Agreement or at all. Further, the decision to embed our technology within its products is completely in our development partner’s discretion and it could decline to use our technology in its products even if we meet all the performance specifications and technical milestones set forth in the agreement. Additionally, the Development and License Agreement prohibits us from the development of our technology for certain product categories until one year following our development partner’s introduction of products with our technology embedded in those categories to consumers. If we are unable to meet the stringent performance specifications and aggressive technical milestones required by the Development and License Agreement or our development partner declines to embed our technology in its products, our business could be significantly harmed in the absence of additional license agreements that equal or exceed the potential of this agreement. The harm to our business resulting from either of these scenarios will exacerbated by the fact that we have agreed to limited exclusivity in certain product categories with our development partner.

We are highly dependent on certain key members of our executive management team. Our inability to retain these individuals could impede our business plan and growth strategies, which could have a negative impact on our business and the value of your investment.

Our ability to implement our business plan depends, to a critical extent, on the continued efforts and services of Stephen Rizzone (President and Chief Executive Officer), Michael Leabman (Chief Technology Officer), Brian Sereda (Chief Financial Officer), and Cesar Johnston (Senior Vice President of Engineering). If we lose the services of any of these persons, we would likely be forced to expend significant time and money in the pursuit of replacements, which may result in a delay in the implementation of our business plan and plan of operations. We can give no assurance that we could find satisfactory replacements for these individuals on terms that would not be unduly expensive or burdensome to us. We do not currently carry a key-man life insurance policy that would assist us in recouping our costs in the event of the death or disability of any of these executives.

Our long-term success and growth strategy depend on our ability to attract, integrate and retain high-level engineering talent.

Because of the highly specialized and complex nature of our business, our success and future growth also depends on management's ability to attract, hire, train, integrate and retain high-level engineering talent. Competition for such personnel is intense as we compete for talent as a pre-revenue company against many large profitable companies and our inability to adequately staff our operations with highly qualified and well-trained engineers could render us less efficient and impede our ability to develop and deliver a commercial product. Such a competitive market could put upward pressure on labor costs for engineering talent. In addition, rising costs associated with certain employee benefits, in particular employee health coverage, could limit our ability to provide certain employee benefits in the future. If we are unable to provide a competitive employee benefits package, including continuing equity incentive grants, recruiting and retaining qualified personnel may become more difficult.

Risks Related to Ownership of Our Common Stock

You may lose all of your investment.

Investing in our common stock involves a high degree of risk. As an investor, you may never recoup all, or even part of, your investment and you may never realize any return on your investment. You must be prepared to lose all of your investment.

Our stock price could be volatile and investors may have difficulty selling their shares.

Our common stock is currently listed on The NASDAQ Capital Market under the symbol "WATT." For the period from March 28, 2014 when trading began on The NASDAQ Capital Market through March 9, 2016, the daily trading volume for shares of our common stock ranged from 6,200 to 5,020,100 shares traded per day, and the average daily trading volume during such period was approximately 220,000 shares.

The market price of the common stock has fluctuated significantly since it was first listed on The NASDAQ Capital Market on March 28, 2014. Since this date, through March 9, 2016, the intra-day trading price has fluctuated from a low of $3.65 to a high of $16.44. The price of our common stock may continue to fluctuate significantly in response to factors, some of which are beyond our control, including the following:

- actual or anticipated variations in operating results;
- the limited number of holders of the common stock;
- changes in the economic performance and/or market valuations of other technology companies;
- our announcements of significant strategic partnerships or other events;
- announcements by other companies in the wire-free charging space;
- articles published or rumors circulated by third parties regarding our business, technology or development partners;
- additions or departures of key personnel; and
- sales or other transactions involving our capital stock, including sales that may occur following the termination of applicable lock-up periods.

We are an "emerging growth company," and are able to take advantage of reduced disclosure requirements applicable to "emerging growth companies," which could make our common stock less attractive to investors.

We are an "emerging growth company," as defined in the Jumpstart Our Business Startups Act of 2012, or JOBS Act, and, for as long as we continue to be an "emerging growth company," we intend to take advantage of certain exemptions from various reporting requirements applicable to other public companies but not to "emerging growth companies," including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. We could be an "emerging growth company" for up to five years, or until the earliest of (i) the last day of the first fiscal year in which our annual gross revenues exceed $1 billion, (ii) the date that we become a "large accelerated filer" as defined in Rule 12b-2 under the Exchange Act, which would occur if the market value of our common stock that is held by non-affiliates exceeds $700.0 million as of the last business day of our most recently completed second fiscal quarter, or (iii) the date on which we have issued more than $1 billion in non-convertible debt during the preceding three year period. We cannot predict if investors will find our common stock less attractive if we choose to rely on these exemptions. If some investors find our common stock less attractive as a result of any choices to reduce future disclosure, there may be a less active trading market for our common stock and our stock price may be more volatile.

We have not paid dividends in the past and have no immediate plans to pay dividends.

We plan to reinvest all of our earnings, to the extent we have earnings, in order to market our products and technology and to cover operating costs and to otherwise become and remain competitive. We do not plan to pay any cash dividends with respect to our securities in the foreseeable future. We cannot assure you that we would, at any time, generate sufficient surplus cash that would be available for distribution to the holders of our common stock as a dividend.

Concentration of ownership among our existing executive officers, directors and significant stockholders may prevent new investors from influencing significant corporate decisions.

All decisions with respect to the management of the Company will be made by our board of directors and our officers, who collectively, beneficially own approximately 6.0% of our common stock, as calculated in accordance with Rule 13d-3 promulgated under the Securities Exchange Act of 1934. In addition, other greater than 5% stockholders such as DvineWave which beneficially owns approximately 10.1% of our common stock as of December 31, 2015 and AWM Investment Company Inc. which beneficially owns approximately 9% of our common stock, as calculated in accordance with Rule 13d-3 promulgated under the Securities Exchange Act of 1934. As a result, these stockholders will be able to exercise a significant level of control over all matters requiring stockholder approval, including the election of directors, amendment of our certificate of incorporation and approval of significant corporate transactions. This control could have the effect of delaying or preventing a change of control of our Company or changes in management and will make the approval of certain transactions difficult or impossible without the support of these stockholders.

We expect to continue to incur significant costs as a result of being a public company that reports to the Securities and Exchange Commission and our management will be required to devote substantial time to meet compliance obligations.

As a public company reporting to the Securities and Exchange Commission ("SEC"), we incur significant legal, accounting and other expenses. We are subject to reporting requirements of the Securities Exchange Act of 1934 and the Sarbanes-Oxley Act of 2002, as well as rules subsequently implemented by the SEC that impose significant requirements on public companies, including requiring establishment and maintenance of effective disclosure and financial controls and changes in corporate governance practices. In addition, on July 21, 2010, the Dodd-Frank Wall Street Reform and Protection Act was enacted. There are significant corporate governance and executive compensation-related provisions in the Dodd-Frank Act that are expected to increase our legal and financial compliance costs, make some activities more difficult, time-consuming or costly and may also place undue strain on our personnel, systems and resources. Our management and other personnel are expected to devote a substantial amount of time to these new compliance initiatives. In addition, we expect these rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified people to serve on our board of directors, our board committees or as executive officers.

We may be subject to securities litigation, which is expensive and could divert management attention.

Our stock price has fluctuated in the past and may be volatile in the future, and in the past, companies that have experienced volatility in the market price of their stock have been subject to an increased incidence of securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business.

An active trading market for our common stock may not be maintained.

Our stock is currently traded on The NASDAQ Capital Market, but we can provide no assurance that we will be able to maintain an active trading market on The NASDAQ Capital Market or any other exchange in the future. If an active market for our common stock is not maintained, it may be difficult for our stockholders to sell shares without depressing the market price for the shares or at all. An inactive market may also impair our ability to raise capital to continue to fund operations by selling shares and may impair our ability to acquire other companies or technologies by using our shares as consideration.

If securities or industry analysts do not publish research or reports about our business, or publish negative reports about our business, our stock price and trading volume could decline.

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. We do not have any control over these analysts. There can be no assurance that analysts will continue to cover us or provide favorable coverage. If one or more of the analysts who cover us downgrade our stock or change their opinion of our stock, our stock price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our stock price or trading volume to decline.

Our charter documents and Delaware law may inhibit a takeover that stockholders consider favorable.

Provisions of our Certificate of Incorporation (or Certificate) and bylaws and applicable provisions of Delaware law may delay or discourage transactions involving an actual or potential change in control or change in our management, including transactions in which stockholders might otherwise receive a premium for their shares, or transactions that our stockholders might otherwise deem to be in their best interests. The provisions in our Certificate and bylaws:

- authorize our board of directors to issue preferred stock without stockholder approval and to designate the rights, preferences and privileges of each class; if issued, such preferred stock would increase the number of outstanding shares of our capital stock and could include terms that may deter an acquisition of us;
- limit who may call stockholder meetings;
- do not permit stockholders to act by written consent;
- do not provide for cumulative voting rights; and
- provide that all vacancies may be filled by the affirmative vote of a majority of directors then in office, even if less than a quorum.

In addition, Section 203 of the Delaware General Corporation Law may limit our ability to engage in any business combination with a person who beneficially owns 15% or more of our outstanding voting stock unless certain conditions are satisfied. This restriction lasts for a period of three years following the share acquisition. These provisions may have the effect of entrenching our management team and may deprive you of the opportunity to sell your shares to potential acquirers at a premium over prevailing prices. This potential inability to obtain a control premium could reduce the price of our common stock.

Item 1B. Unresolved Staff Comment

Not applicable.

Item 2. Properties

On September 10, 2014, we entered into a Lease Agreement (the “Lease”) with Balzer Family Investments, L.P. (the “Landlord”) related to space located at Northpointe Business Center, 3590 North First Street, San Jose, California. The initial term of the lease is 60 months, with initial monthly base rent of $36,720 and the lease is subject to certain annual escalations as defined in the agreement. On October 1, 2014, we relocated our headquarters to this new location. We issued to the Landlord 41,563 shares of the Company’s common stock valued at $500,000, of which $400,000 will be applied to reduce our monthly base rent obligation by $6,732 per month and of which $100,000 was for certain tenant improvements. We recorded $400,000 as prepaid rent on our balance sheet, which is being amortized over the term of the lease and recorded $100,000 as leasehold improvements.

On February 26, 2015, we entered into a sub-lease agreement for additional space in the San Jose area. The agreement has a term which expires on June 30, 2019 and an initial monthly rent of $6,109 per month. On August 25, 2015, we entered into an additional amended sub-lease agreement for additional space in San Jose, CA. The agreement has a term which expires on June 30, 2019 and an initial monthly rent of $4,314 per month. These leases are subject to certain annual escalations as defined in the agreements.

On July 9, 2015, we entered into a sub-lease agreement for additional space in Costa Mesa, CA. The agreement has a term which expires on September 30, 2017 and an initial monthly rent of $6,376 per month. This lease is subject to certain annual escalations as defined in the agreement.

Item 3. Legal Proceedings

We are not currently a party to any pending legal proceedings that we believe will have a material adverse effect on our business or financial conditions. We may, however, be subject to various claims and legal actions arising in the ordinary course of business from time to time.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our shares of common stock are listed on the NASDAQ Capital Market under the symbol "WATT." The table below provides, for the fiscal quarters indicated, the reported high and low closing sales prices for our common stock on the NASDAQ Capital Market since March 28, 2014.

	Price Range	
Fiscal Year Ended December 31, 2014	High	Low
First Quarter (beginning March 28)	$14.75	$10.58
Second Quarter	$15.57	$10.53
Third Quarter	$14.60	$10.01
Fourth Quarter	$11.46	$7.25
Fiscal Year Ended December 31, 2015		
First Quarter	$12.16	$8.63
Second Quarter	$9.58	$6.98
Third Quarter	$8.40	$5.90
Fourth Quarter	$8.84	$6.57

As of December 31, 2015, there were 22 holders of record of our common stock. We believe we have significantly more beneficial holders of our common stock.

We have never paid cash dividends on our securities and we do not anticipate paying any cash dividends on our shares of common stock in the foreseeable future. We intend to retain any future earnings for reinvestment in our business. Any future determination to pay cash dividends will be at the discretion of our board of directors, and will be dependent upon our financial condition, results of operations, capital requirements and such other factors as our board of directors deems relevant.

Item 6. Selected Financial Data

The data set forth below should be read in conjunction with Item 7 – “Management's Discussion and Analysis of Financial Condition and Results of Operations” and the Company’s Financial Statements and notes thereto.

	2015	2014	2013
Selected data from the Statements of Operations:			
Revenue	$2,500,000	$-	$-
Loss from operations	$(27,577,339)	$(20,374,709)	$(4,435,470)
Change in fair value of derivative liabilities	$-	$(26,265,177)	$-
Net loss	$(27,561,702)	$(45,603,110)	$(5,521,081)
Basic and diluted net loss per common share	$(2.07)	$(5.75)	$(2.11)
Selected data from Balance Sheets:			
Total Assets	$32,675,528	$33,828,923	$2,365,867
Convertible promissory notes and derivative liabilities	$-	$-	$7,106,298

The Company has had no long-term liabilities, preferred stock or dividends declared.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are developing a technology called WattUp® that consists of proprietary semiconductor chipsets, software, hardware designs and antennas that can enable RF-based wire-free charging for electronic devices, providing power at a distance and ultimately enabling charging with mobility under full software control. Our anticipated business model is to supply silicon components with reference designs and license our WattUp technology to device and chip manufacturers, wireless service providers and other commercial partners to make wire-free charging an affordable, ubiquitous and convenient option for end users. We believe our proprietary technology can potentially be utilized in a variety of devices, including wearables, Internet of Things (“IoT”) devices, smartphones, tablets, e-book readers, keyboards, mice, remote controls, rechargeable lights, cylindrical batteries and any other device with similar charging requirements that would otherwise need a battery or a connection to a power outlet.

We believe our technology is novel in its approach, in that we are developing a solution that charges electronic devices by surrounding them with a contained three dimensional (“3D”) radio frequency (“RF”) energy pocket (“RF energy pocket”). We are engineering solutions that we expect to enable the wire-free transmission of energy from multiple WattUp transmitters to multiple WattUp receiving devices within a range of up to fifteen (15) feet in radius or in a circular charging envelope of up to thirty (30) feet. We are also developing our transmitter technology to seamlessly mesh, (much like a network of WiFi routers) to form a wire-free charging network that will allow users to charge their devices as they walk from room-to-room or throughout a large space. To date, we have developed multiple transmitter prototypes in various form factors and power capabilities. We have also developed multiple receiver prototypes including smartphone battery cases, toys, fitness trackers, Bluetooth headsets as well as stand-alone receivers.

When the company was first founded, we recognized the need to build and design an enterprise-class network management and control system (“NMS”) that was integral to the architecture and development of our wire-free charging technology. Our NMS system can be scaled up to control an enterprise consisting of thousands of devices or scaled down to work in a home or IoT environment.

The power, distance and mobility capabilities of the WattUp technology were validated independently by Underwriters Laboratories (UL) in October, 2015 and the results published on both the UL and the Energous websites.

Our technology solution consists principally of transmitter and receiver application specific standard product (“ASSPs”) and novel antenna designs driven through innovative algorithms and software applications. We submitted our first ASSP design for wafer fabrication in November 2013 and have since then been developing multiple generations of transmitter and receiver ASSPs, multiple antenna designs, as well as algorithms and software designs that we believe, in the aggregate, will optimize our technology by reducing size and cost, while increasing performance to a level that will enable our technology to be integrated into a broad spectrum of devices. We have developed a “building block” approach which allows us to scale our product implementations by combining multiple transmitter building blocks and/or multiple receiver building blocks to provide the power, distance, size and cost performance necessary to meet application requirements. While the technology is very scalable, in order to provide the necessary strategic focus to grow the company effectively, we have defined our market as devices that require 10 watts or less of power to charge. We will continue to invest in ASSP development as well as in the other components of the WattUp system to improve product performance, efficiency, cost-performance and miniaturization as required to grow the business and expand the ecosystem while also building competitive barriers to any potential competition.

We believe that if our development, regulatory and commercialization efforts are successful, our transmitter and receiver technology will support a broad spectrum of charging solutions ranging from contact-based charging or charging at distances of no more than a few centimeters ("nearfield") to charging at distances of up to 15 feet ("farfield").

In February of 2015 we signed a Development and License Agreement with one of the top consumer electronic companies in the world based on total worldwide revenues. The agreement is milestone-based and, while there are no guarantees that the WattUp® technology will ever be integrated into our strategic partner's consumer devices, we continue to progress the relationship as evidenced by the achievement of our first revenues in late 2015 from Engineering Services resulting from the achievement of certain milestones under the agreement. We anticipate continued progress with the relationship which we expect will result in additional Engineering Services Revenue and ultimately, if fully executed, significant revenues from royalties based on the WattUp® technology being integrated into products being shipped to the consumer.

In February of 2016 we began delivering evaluation kits to potential licensees to allow their respective engineering and product management departments to test and evaluate our technology. We expect that the testing and evaluations currently taking place will lead to an expansion of our licensing partners and will result in products beginning to be shipped to the consumer in late 2016/early 2017.

We have implemented an aggressive intellectual property strategy and are continuing to pursue patent protection for new innovations. As of March 14, 2016, we had in excess of 250 pending patent and provisional patent applications. Additionally, the U.S. Patent and Trademark Office (or the PTO) has issued our first five patents and notified us of the allowance of three additional patents. In addition to the inventions covered by these patents and patent applications, we have identified a significant number of additional specific inventions we believe are novel and patentable. We intend to file for patent protection for the most valuable of these, as well as for other new inventions that we expect to develop. Our strategy is to continually monitor the costs and benefits of each patent application and pursue those that will best protect our business and expand the core value of the Company.

Critical Accounting Estimates and Policies

The following discussion and analysis of financial condition and results of operations is based upon our financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America. Certain accounting policies and estimates are particularly important to the understanding of our financial position and results of operations and require the application of significant judgment by our management or can be materially affected by changes from period to period in economic factors or conditions that are outside of our control. As a result, they are subject to an inherent degree of uncertainty. In applying these policies, our management uses their judgment to determine the appropriate assumptions to be used in the determination of certain estimates. Those estimates are based on our historical operations, our future business plans and projected financial results, the terms of existing contracts, our observance of trends in the industry, information provided by our customers and information available from other outside sources, as appropriate. Please see Note 3 to our financial statements for a more complete description of our significant accounting policies.

Basis of Presentation. The accompanying audited financial statements and footnotes for the years ended December 31, 2015 and 2014 have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") and applicable rules and regulations of the SEC regarding financial information.

Revenue Recognition. We recognize revenue when the following criteria have been met: persuasive evidence of an arrangement exists, services have been rendered, collection of the revenue is reasonably assured, and the fees are fixed or determinable.

We record revenue associated with product development projects that we enter into with certain customers. In general, these projects are associated with complex technology development, and as such we do not have certainty about our ability to achieve the program milestones. Achievement of the milestone is dependent on our performance and the milestone typically needs to be accepted by the customer. The payment associated with achieving the milestone is generally commensurate with our effort or the value of the deliverable and is nonrefundable. We record the expenses related to these projects, generally included in research and development expense, in the periods incurred.

We also receive nonrefundable payments, typically at the beginning of a customer relationship, for which there are no milestones. We recognize this revenue ratably over the initial engineering product development period. We record the expenses related to these projects, generally included in research and development expense, in the periods incurred.

During the year ended December 31, 2015, we recorded revenue of $2,500,000. We recorded no revenue prior to 2015.

Research and Development. Research and development expenses are charged to operations as incurred. For internally developed patents, all patent application costs are expensed as incurred as research and development expense. Patent application costs, generally legal costs, are expensed as research and development costs until such time as the future economic benefits of such patents become more certain. The Company incurred research and development costs of $18,825,041, $12,511,647 and $2,109,890 for the years ended December 31, 2015, 2014 and 2013, respectively.

Income Taxes. The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of items that have been included or excluded in the financial statements or tax returns. Deferred tax assets and liabilities are determined on the basis of the difference between the tax basis of assets and liabilities and their respective financial reporting amounts ("temporary differences") at enacted tax rates in effect for the years in which the temporary differences are expected to reverse.

For the years ended December 31, 2015, 2014 and 2013, the Company had $18,825,041, $11,519,390 and $2,095,367, respectively, of research and development expenses capitalized for federal income tax purposes, with amortization commencing upon the Company receiving an economic benefit from the related research. As of December 31, 2015, the Company had $18,871,801 gross federal and state net operating loss carryovers ("NOLs") and a tax credit carryover of $2,041,385. As of December 31, 2015 and 2014, deferred tax assets consisted principally of net operating loss and tax credit carryovers, the research and development costs and stock-based compensation, and such deferred tax assets were fully reserved. Accordingly, the Company's effective tax rate for the years ended December 31, 2015, 2014 and 2013 was 0%.

Internal Revenue Code Section 382 imposes limitations on the use of net operating loss carryovers when the stock ownership of one or more 5% shareholders (shareholders owning 5% or more of the Company's outstanding capital stock) has increased on a cumulative basis by more than 50 percentage points. Management cannot control the ownership changes occurring as a result of public trading of the Company's Common Stock. Accordingly, there is a risk of an ownership change beyond the control of the Company that could trigger a limitation of the use of the loss carryover. As of December 31, 2015, the Company has not completed an analysis whether an ownership change occurred under Section 382, which, if it did occur, could substantially limit its ability in the future to utilize its NOLs and other tax carryforwards.

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the future generation of taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and taxing strategies in making this assessment. Based on this assessment, management has established a full valuation allowance against all of the net deferred tax assets for each period, since it is more likely than not that all of the deferred tax assets will not be realized.

Tax benefits are recognized only for tax positions that are more likely than not to be sustained upon examination by tax authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely to be realized upon settlement. A liability for "unrecognized tax benefits" is recorded for any tax benefits claimed in the Company's tax returns that do not meet these recognition and measurement standards. As of December 31, 2015, and 2014, no liability for unrecognized tax benefits was required to be reported. The guidance also discusses the classification of related interest and penalties on income taxes. The Company's policy is to record interest and penalties on uncertain tax positions as a component of income tax expense. No interest or penalties were recorded for the years ended December 31, 2015, 2014 and 2013.

Common Stock Purchase Warrants and Other Derivative Financial Instruments. The Company classifies as equity any contracts that (i) require physical settlement or net-share settlement or (ii) provides a choice of net-cash settlement or settlement in the Company's own shares (physical settlement or net-share settlement) providing that such contracts are indexed to the Company's own stock as defined in ASC 815-40 "Contracts in Entity's Own Equity" ("ASC 815-40"). The Company classifies as assets or liabilities any contracts that (i) require net-cash settlement (including a requirement to net cash settle the contract if an event occurs and if that event is outside the Company's control) or (ii) gives the counterparty a choice of net-cash settlement or settlement in shares (physical settlement or net-share settlement). The Company assesses classification of common stock purchase warrants and other free standing derivatives at each reporting date to determine whether a change in classification between assets and liabilities or equity is required.

Results of Operations

For the Years Ended December 31, 2015 and 2014

Revenues. During the year ended December 31, 2015, we recorded revenue of $2,500,000 upon the achievement of milestones under a development and licensing agreement. We recorded no revenue in 2014.

Operating Expenses. During 2015, operating expenses are made up of research and development, general and administrative and marketing expenses. Operating expenses for the years ended December 31, 2015 and 2014 were $30,077,339 and $20,374,709, respectively.

Research and Development Costs. Research and development costs include costs for developing our technology such as ASSP design costs, salaries, software and facility costs. Research and development costs for the years ended December 31, 2015 and 2014 were $18,825,041 and $12,511,647, respectively. The increase in research and development costs of $6,313,394 is primarily due to a $6,324,357 increase in compensation (including an increase in stock-based compensation of $1,892,005) from a larger headcount within the department, a $698,690 increase in spending on components, third party design and engineering supplies principally in support of ASSP development, a $543,928 increase in depreciation allocation, a $477,271 increase in office rent allocation and a $306,694 increase in software expenses primarily from increased expenditures on engineering software, partially offset by a $1,460,768 decrease in consulting expenses as a result of employees now handling duties formerly performed by consultants and a $719,224 decrease in patent filing expenses.

Sales and Marketing Costs. Sales and marketing costs for the years ended December 31, 2015 and 2014 were $3,221,303 and $2,803,359, respectively. The increase in sales and marketing costs of $417,944 is primarily due to increased compensation of $339,355, including increased stock-based compensation of $146,091, from an increased headcount within the department and an increase of $167,074 in trade show expenses primarily as a result of participating in the 2015 Consumer Electronics Show, a $106,520 increase in public relations fees, a $73,061 increase in depreciation allocation, a $41,516 increase in office rent allocation, partially offset by a $359,979 decrease in consulting expenses primarily as a result of employees handling duties formerly performed by consultants.

General and Administrative Expenses. General and administrative expenses include costs for general and corporate functions, including facility fees, travel, telecommunications, insurance, professional fees, consulting fees and other overhead. General and administrative costs for the years ended December 31, 2015 and 2014 were $8,030,995 and $5,059,703, respectively. The increase in general and administrative expense of $2,971,292 is primarily due to a $2,294,644 increase in compensation, including stock-based compensation increase of $1,365,340, from increased headcount within the department and newly executed executive agreements in place during 2015, a $445,967 increase in legal, accounting and insurance costs primarily as a result of operating as a public company during the year ended December 31, 2015 and a $131,560 increase in consulting and outside information technology (IT) services, primarily as a result of increased outside IT services to support a larger staff and fees paid to members of the board of directors.

Loss from Operations. Loss from operations for the years ended December 31, 2015 and 2014 was $27,577,339 and $20,374,709, respectively.

Change in Fair Value of Derivative Liabilities. Change in fair value of derivative liabilities for the year ended December 31, 2015 was $0 as compared to $26,265,177 for the year ended December 31, 2014, as the derivative liabilities were extinguished during the year ended December 31, 2014.

Interest Income (Expense), Net. Interest income for the year ended December 31, 2015 was $15,637 as compared to interest expense, net of $1,024,774 for the year ended December 31, 2014 which included amortization of debt discount of $0 and $964,851, respectively. The change in interest income (expense), net, resulted primarily from the reduction in interest on the convertible notes, including the amortization of debt discount. The related convertible notes were extinguished in April 2014 and accordingly there was no similar amortization during the year ended December 31, 2015.

Gain on Debt Extinguishment. Gain on debt extinguishment for the year ended December 31, 2015 was $0 as compared to $2,084,368 for the year ended December 31, 2014. The gain on debt extinguishment resulted from the April 2014 conversion of the convertible notes and the related extinguishment of the notes, accrued interest payable and the derivative liability.

Net Loss. As a result of the above, net loss for the year ended December 31, 2015 was $27,561,702 as compared to $45,603,110 for the year ended December 31, 2014.

For the Years Ended December 31, 2014 and 2013

Revenues. We recorded no revenue in 2014 or 2013.

Operating Expenses. During 2014, operating expenses were made up of derivative instrument issuance, research, development, general and administrative and marketing expenses. Loss from operations for the years ended December 31, 2014 and 2013 was $20,374,709 and $4,435,470, respectively.

Derivative Issuance Expense. Derivative instrument issuance expense was $0 and $887,062 for the years ended December 31, 2014 and 2013, respectively.

Research and Development Costs. Research and development costs for the years ended December 31, 2014 and 2013 were $12,511,647 and $2,109,890, respectively. The increase is primarily due to a $3,287,398 increase in compensation, including stock-based compensation of $924,702, from a larger headcount within the department, a $3,575,586 increase in spending on components, design and engineering supplies for the demonstration units at the Consumer Electronics Show (“CES”), a $1,051,158 increase in legal costs related to patent application filings and a $2,193,539 increase in hardware and software consulting expenses related to preparation for the demonstration unit presented at CES.

General and Administrative Expenses. General and administrative expenses include costs for general and corporate functions, including facility fees, travel, telecommunications, insurance, professional fees, consulting fees and other overhead. General and administrative costs for the years ended December 31, 2014 and 2013 were $5,059,703 and $1,204,896, respectively. The increase is primarily due to a $1,546,656 increase in compensation, including stock-based compensation of $1,023,890, from adding two new employees within the department and the retention of a full-time Chief Executive Officer for the entire year in 2014, a $749,581 increase in investor relations and consulting costs, a $159,144 increase in insurance costs, primarily as a result of larger D&O premiums, a $188,021 increase in facilities costs, primarily from increased office rent after relocation to the San Jose facility, a $444,762 increase in recruiting costs related to our efforts to recruit and retain certain key employees and an increase of $368,088 in depreciation expense as a result of our acceleration in capital purchases during the second half of 2014.

Marketing Costs. Marketing costs for the years ended December 31,2014 and 2013 were $2,803,359 and $233,622, respectively. The increase is primarily due to increased compensation of $1,346,077, including stock-based compensation of $583,238, from hiring five additional employees to the department during 2014, an increase of $662,448 in public relations and consulting expenses and an increase of $256,368 in travel costs associated with the preparation of CES and meetings with potential customers and strategic partners.

Loss from Operations. Loss from operations for the years ended December 31, 2014 and 2013 was $20,374,709 and $4,435,470, respectively.

Change in Fair Value of Derivative Liabilities. Change in fair value of derivative liabilities for the years ended December 31, 2014 and 2013 was $26,265,177 and $177,000 respectively.

Interest Expense. Interest expense for the years ended December 31, 2014 and 2013 was $1,024,774 and $908,611, respectively, and included amortization of debt discount for the years ended December 31, 2014 and 2013 of $964,851 and $705,289, respectively.

Gain on Debt Extinguishment. Gain on debt extinguishment for the years ended December 31, 2014 was $2,084,368 as compared to $0 for the year ended December 31, 2013. The gain on debt extinguishment resulted from the conversion of the convertible notes and the related extinguishment of the notes, accrued interest payable and the derivative liability.

Net Loss. Net loss for the years ended December 31, 2014 and 2013 was $45,603,110 and $5,521,081, respectively.

Liquidity and Capital Resources

During years ended December 31, 2015 and 2014, we recorded revenue of $2,500,000 and $0, respectively. We incurred a net loss of $27,561,702 and $45,603,110 for the years ended December 31, 2015 and 2014, respectively. Net cash used in operating activities was $20,005,734 and $15,606,423 for the years ended December 31, 2015 and 2014, respectively. Since inception, we have met our liquidity requirements principally through the private placement of convertible notes, the sale of our common stock in a registered initial public offering, the sale of our common stock to a strategic investor, the issuance of our common stock to the Company's landlord to reduce its monthly base rent obligation and pay for certain tenant improvements, the sale of common stock in two secondary offerings and payments received under product development projects entered into with customers.

As of December 31, 2015, we had cash and cash equivalents of $29,872,564.

We believe our current cash on hand, together with anticipated payments received under product development projects entered into with customers, will be sufficient to fund our operations into the second quarter of 2017. However, depending on how soon we are able to achieve meaningful commercial revenues we may require additional financing to fully implement our business plan, the ultimate goal of which is to license our technology to device manufacturers, wireless service providers and other commercial partners to make wire-free charging an affordable, ubiquitous and convenient service for end users. Potential financing sources could include follow-on equity offerings, debt financing, co-development agreements or other alternatives. Depending upon market conditions, we may choose to pursue additional financing to, among other reasons, accelerate our product development efforts, regulatory activities and business development and support functions with a view to capitalizing on the market opportunity we see for our wire-free charging technology. On April 24, 2015, we filed a "shelf" registration statement on Form S-3, which became effective on April 30, 2015. The "shelf" registration statement allows the Company from time to time to sell any combination of debt or equity securities described in the registration statement up to aggregate proceeds of $75,000,000. In November 2015, the Company consummated an offering under the shelf registration of 3,000,005 shares of common stock through which the Company raised net proceeds of $19,048,456.

During the year ended December, 2015, cash flows used in operating activities were $20,005,734, consisting of a net loss of $27,561,702, less non-cash expenses aggregating $6,849,927 (representing principally stock-based compensation of $5,951,414 and depreciation expense of $817,729), a $157,769 increase in prepaid expenses and other current assets, partially offset by an increase of $608,962 in accounts payable and an increase of $283,530 in accrued expenses. During the year ended December 31, 2014, cash flows used in operating activities were $15,606,423, consisting of a net loss of $45,603,110, offset by non-cash expenses of $28,107,841 and net changes in operating assets and liabilities of $1,888,846.

During the years ended December 31, 2015 and 2014, cash flows used in investing activities were $1,032,795 and $1,619,694, respectively. The cash used for year ended December 31, 2015 consisted of the purchase of laboratory and computer equipment and software to accommodate newly hired employees and to support engineering services and testing performed for our customers.

During the year ended December 31, 2015, cash flows provided by financing activities were $19,416,501, which consisted of proceeds from the offering under the shelf registration of $19,048,456, proceeds from contributions to the employee stock purchase program ("ESPP") of $289,787, proceeds from the exercise of stock options of $65,647 and proceeds from the disgorgement of profit from the sale of stock of $12,611. During the year ended December 31, 2014, cash flows provided by financing activities were $46,766,929 and consisted principally of the net proceeds from our IPO of $24,872,170, net proceeds from the secondary offering of $20,993,759 and net proceeds of $900,000 from the sale of our common stock to a strategic investor.

Research and development of new technologies is, by its nature, unpredictable. Although we will undertake development efforts with commercially reasonable diligence, there can be no assurance that our available resources including the net proceeds from our public offerings will be sufficient to enable us to develop our technology to the extent needed to create future revenues to sustain our operations.

We cannot assure that our technology will be adopted, that we will ever earn revenues sufficient to support our operations, or that we will ever be profitable. Furthermore, since we have no committed source of financing, there can be no assurance that we will be able to raise capital as and when we need it to continue our operations.

Contractual Obligations

In the ordinary course of business, we routinely enter into purchase commitments for various aspects of our operations, such as purchases of engineering supplies, lab equipment, chip design engineering, engineering consulting services and software licenses. We do not believe these commitments will have a material effect on our financial condition, results of operations or cash flows.

The following table summarizes our contractual obligations at December 31, 2015 and the effect such obligations are expected to have on our liquidity and cash flows in future periods:

	Total	Less than 1 Year	1 to 3 Years	More than 3 Years
Operating leases	$2,005,214	$529,309	$1,475,905	$ -
Engineering software commitment	1,782,945	792,420	990,525	-
Total	$3,788,159	$1,321,729	$2,466,430	$ -

Off-Balance Sheet Transactions

We do not have any off-balance sheet transactions.

Net earnings

-

-

-

-

11,737,952

-

11,737,952

Other comprehensive income

-

-

-

450,204

-

-

450,204

Grant of stock options

-

-

253,427

-

-

-

253,427

Exercise of stock options

64,834

-

12,374

-

-

-

77,208

Sale of treasury stock

-

-

440,420

-

-

634,268

1,074,688

Stock dividends

274

12,768

30,779

-

(43,821
)

-

-

Conversion Class C to Class A

17,016

(17,016
)

Balance at September 30, 2016

$
26,300,324

$
3,415,032

$
30,969,582

$
(49,154
)

$
72,219,535

$

(1,545,161
)

$
131,310,158

Balance at December 31, 2016

$
27,638,012

$
3,804,458

$
34,813,246

$
264,822

$
67,409,204

$
(1,370,611
)

$
132,559,131

Net earnings

-

-

-

-

5,442,702

-

5,442,702

Other comprehensive income

-

-

-

71,809

-

-

71,809

Grant of stock options

-

-

305,741

-

-

-

305,741

Exercise of stock options

2

206,804

(206,806
)

-

-

-

-

Sale of treasury stock

-

-

575,496

-

-

574,472

1,149,968

Purchase of treasury stock

-

-

-

-

-

(185,470
)

(185,470
)
Stock dividends

930

4

2,350

-

(3,284
)

-

-

Conversion Class C to Class A

1,214

(1,214
)

-

-

-

-

-

Balance at September 30, 2017

$
27,640,158

$
4,010,052

$
35,490,027

$
336,631

$
72,848,622

$
(981,609
)

$
139,343,881

See accompanying notes to condensed consolidated financial statements (unaudited).
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SECURITY NATIONAL FINANCIAL CORPORATION
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30 2017	2016
Cash flows from operating activities:		
Net cash provided by operating activities	$6,030,453	$17,639,672
Cash flows from investing activities:		
Securities held to maturity:		
Purchase-fixed maturity securities	(59,325,291)	(6,519,416)
Calls and maturities - fixed maturity securities	11,933,573	10,032,336
Securities available for sale:		
Purchase - equity securities	(5,126,062)	(3,726,194)
Sales - equity securities	9,153,786	3,349,728
Purchases of short-term investments	(27,483,124)	(13,379,112)
Sales of short-term investments	37,212,174	7,185,582
Net changes in restricted assets	(409,625)	(438,204)
Net changes in perpetual care trusts	(231,415)	(966,367)
Mortgage loans, policy loans, and other investments made	(340,424,956)	(338,457,602)
Payments received for mortgage loans, policy loans and other investments	344,278,996	330,303,396
Purchase of property and equipment	(508,846)	(1,303,979)
Sale of property and equipment	9,977	34,000
Purchase of real estate	(12,474,490)	(19,448,152)
Sale of real estate	8,612,307	5,672,484
Cash paid for purchase of subsidiaries, net of cash acquired	-	(4,328,520)
Net cash used in investing activities	(34,782,996)	(31,990,020)
Cash flows from financing activities:		
Investment contract receipts	9,457,285	8,401,542
Investment contract withdrawals	(11,522,652)	(9,957,964)
Proceeds from stock options exercised	-	77,208
Purchase of treasury stock	(185,470)	-
Repayment of bank loans	(2,142,382)	(1,169,233)
Proceeds from borrowing on bank loans	16,729,056	2,523,670
Net change in warehouse line borrowings	16,022,738	23,893,122
Net change in line of credit borrowings	-	1,439,650
Net cash provided by financing activities	28,358,575	25,207,995
Net change in cash and cash equivalents	(393,968)	10,857,647
Cash and cash equivalents at beginning of period	38,987,430	40,053,242
Cash and cash equivalents at end of period	$38,593,462	$50,910,889
Supplemental Disclosure of Cash Flow Information:		
Cash paid (received) during the year for:		
Interest (net of amount capitalized)	$4,188,579	$3,781,423

Income taxes (net of refunds)	(788,601)	2,538,097
Non Cash Operating, Investing and Financing Activities:		
Transfer of loans held for sale to mortgage loans held for investment	$5,032,147	$7,386,432
Accrued real estate construction costs and retainage	1,932,790	-
Mortgage loans foreclosed into real estate	1,576,196	1,703,476
Benefit plans funded with treasury stock	1,149,968	1,074,688

See accompanying notes to condensed consolidated financial statements (unaudited).
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SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10 Q and Articles 8 and 10 of Regulation S X. Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements of the Company and notes thereto for the year ended December 31, 2016, included in the Company's Annual Report on Form 10-K/A (file number 000-09341). In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. The presentation of certain amounts in the prior year have been reclassified to conform to the 2017 presentation. The Company reclassified certain amounts from other assets to receivables, from receivables to other liabilities, from other assets to other liabilities, from equity securities to other investments, from other liabilities to mortgage loans held for investment, from net investment income to mortgage fee income, and from mortgage fee income to net investment income. These reclassifications had no impact on net earnings or stockholders' equity. Additionally, see the discussion regarding correction of errors in Notes 21 and 22 included in the Company's Form 10-K/A for the year ended December 31, 2016.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant changes in the near term are those used in determining the value of derivative assets and liabilities; those used in determining deferred acquisition costs and the value of business acquired; those used in determining the value of mortgage loans foreclosed to real estate held for investment; those used in determining the liability for future policy benefits and unearned revenue; those used in determining the estimated future costs for pre-need sales; those used in determining the value of mortgage servicing rights; those used in determining allowances for loan losses for mortgage loans held for investment; those used in determining loan loss reserve; and those used in determining deferred tax assets and liabilities. Although some variability is inherent in these estimates, management believes the amounts provided are fairly stated in all material respects.

2) Recent Accounting Pronouncements

ASU No. 2017-01: "Business Combinations (Topic 805): Clarifying the Definition of a Business" – Issued in January 2017, ASU 2017-01 intends to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. Under the current implementation guidance in Topic 805, there are three elements of a business: inputs, processes, and outputs. While an integrated set of assets and activities, collectively referred to as a "set," that is a business usually has outputs, outputs are not required to be present. ASU 2017-01 provides a screen to determine when a set is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. ASU 2017-01 will be effective for the Company on January 1, 2018. While the Company's acquisitions have historically been classified as either business combinations or asset acquisitions, certain acquisitions that were classified as business combinations by the Company likely would have been considered asset acquisitions under the new standard. As a result, transaction costs are more likely to be capitalized since the Company expects some of its future acquisitions to be classified as asset acquisitions under this new standard. In addition, goodwill that was previously allocated to businesses that were sold or held for sale will no longer be allocated and written off upon sale if future sales were deemed to be sales of assets and not businesses.

ASU No. 2016-13: "Financial Instruments – Credit Losses (Topic 326)" – Issued in June 2016, ASU 2016-13 amends guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. For assets held at amortized cost basis, Topic 326 eliminates the probable initial recognition threshold in current generally accepted accounting principles ("GAAP") and, instead, requires an entity to reflect its current estimate of all expected credit losses. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial assets to present the net amount expected to be collected. For available for sale debt securities, credit losses should be measured in a manner similar to current GAAP, however Topic 326 will require that credit losses be presented as an allowance rather than as a write-down. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2019. The Company is in the process of evaluating the potential impact of this standard.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

2) Recent Accounting Pronouncements (Continued)

ASU No. 2016-02: "Leases (Topic 842)" - Issued in February 2016, ASU 2016-02 supersedes the requirements in ASC Topic 840, "Leases", and was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2018. The Company is in the process of evaluating the potential impact of this standard, which is not expected to be material to the Company's results of operations but will have an effect on the balance sheet presentation for leased assets and obligations.

ASU No. 2016-01: "Financial Instruments – Overall (Topic 825-10)" – Issued in January 2016, ASU 2016-01 changes the accounting for non-consolidated equity investments that are not accounted for under the equity method of accounting by requiring changes in fair value to be recognized in income. Under current guidance, changes in fair value for investments of this nature are recognized in accumulated other comprehensive income as a component of stockholders' equity. Additionally, ASU 2016-01 simplifies the impairment assessment of equity investments without readily determinable fair values; requires entities to use the exit price when estimating the fair value of financial instruments; and modifies various presentation disclosure requirements for financial instruments. The Company holds equity securities classified as available for sale securities that are currently measured at fair value with changes in fair value recognized through other comprehensive income. Upon adoption of ASU 2016-01 the Company will be required to recognize changes in the fair value of these equity securities through earnings, thus increasing the volatility of the Company's earnings. However, adoption of this standard will not significantly affect the Company's comprehensive income or stockholders' equity. This new authoritative guidance is effective for interim and annual periods beginning after December 15, 2017, with the cumulative effect of the adoption made to the balance sheet as of the date of adoption. Thus, the adoption will result in a reclassification of the related accumulated net unrealized gains (losses) currently included in accumulated other comprehensive income to retained earnings. See Note 3 for details regarding the Company's equity securities currently classified as available for sale. The Company will adopt this standard beginning January 1, 2018.

ASU No. 2014-09: "Revenue from Contracts with Customers (Topic 606)" - Issued in May 2014, ASU 2014-09 supersedes the revenue recognition requirements in ASC Topic 605, "Revenue Recognition". ASU 2014-09 clarifies the principles for recognizing revenue in order to improve comparability of revenue recognition practices across entities and industries. ASU 2014-09 provides guidance intended to assist in the identification of contracts with customers and separate performance obligations within those contracts, the determination and allocation of the transaction price to those identified performance obligations and the recognition of revenue when a performance obligation has been satisfied. ASU 2014-09 also requires disclosures regarding the nature, amount, timing, and uncertainty of revenues and cash flows from contracts with customers. Insurance contracts are excluded from the scope of this new guidance.

Upon adoption, ASU 2014-09 provides for transition through either a full retrospective approach requiring the restatement of all presented prior periods or a modified retrospective approach, which allows the new recognition standard to be applied to only those contracts that are not completed at the date of transition. If the modified retrospective approach is adopted, a cumulative effect adjustment to retained earnings is performed with additional disclosures required including the amount by which each line item is affected by the transition as compared to the guidance in effect before adoption and an explanation of the reasons for significant changes in these amounts. The Company intends to adopt ASU 2014-09 using the modified retrospective method. The Company does not expect to record a cumulative effect adjustment to its beginning retained earnings as a result of adoption of ASU 2014-09.

The Company's revenues from contracts with customers that are subject to ASU 2014-09 include revenues on mortuary and cemetery contracts. The recognition and measurement of these items is not expected to change as a result of the Company's adoption of ASU 2014-09 and thus the Company does not expect that the adoption of ASU 2014-09 will significantly impact the Company's results of operations or financial position but is still in the process of evaluating the final impact, including the potential impact on disclosures of contracts with customers. The new authoritative guidance is effective for interim and annual periods beginning after December 15, 2017. The Company will adopt this standard beginning January 1, 2018.

The Company has reviewed other recent accounting pronouncements and has determined that they will not significantly impact the Company's results of operations or financial position.

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SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

3) Investments

The Company's investments as of September 30, 2017 are summarized as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
September 30, 2017				
Fixed maturity securities held to maturity carried at amortized cost:				
Bonds:				
U.S. Treasury securities and obligations of U.S. Government agencies	$54,279,156	$237,071	$(226,543)	$54,289,684
Obligations of states and political subdivisions	5,865,790	124,685	(77,272)	5,913,203
Corporate securities including public utilities	160,278,125	14,088,157	(1,285,361)	173,080,921
Mortgage-backed securities	9,764,566	253,573	(171,423)	9,846,716
Redeemable preferred stock	623,635	53,403	-	677,038
Total fixed maturity securities held to maturity	$230,811,272	$14,756,889	$(1,760,599)	$243,807,562
Equity securities available for sale at estimated fair value:				
Common stock:				
Industrial, miscellaneous and all other	$6,310,307	$467,132	$(819,951)	$5,957,488
Total equity securities available for sale at estimated fair value	$6,310,307	$467,132	$(819,951)	$5,957,488
Mortgage loans held for investment at amortized cost:				
Residential	$65,759,761			
Residential construction	41,306,722			
Commercial	42,923,761			
Less: Unamortized deferred loan fees, net	(637,735)			
Less: Allowance for loan losses	(2,051,818)			
Total mortgage loans held for investment	$147,300,691			
Real estate held for investment net of accumulated depreciation:				
Residential	$69,469,220			
Commercial	81,099,778			
Total real estate held for investment	$150,568,998			
Policy loans and other investments at amortized cost:				
Policy loans	$6,677,924			
Insurance assignments	33,340,431			

Federal Home Loan Bank stock	689,400
Other investments	2,923,681
Less: Allowance for doubtful accounts	(1,142,287)
Total policy loans and other investments	$42,489,149
Short-term investments at amortized cost	$17,830,990
Accrued investment income	$3,391,688

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SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

3) Investments (Continued)

The Company's investments as of December 31, 2016 are summarized as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2016:				
Fixed maturity securities held to maturity carried at amortized cost:				
Bonds:				
U.S. Treasury securities and obligations of U.S. Government agencies	$4,475,065	$249,028	$(66,111)	$4,657,982
Obligations of states and political subdivisions	6,017,225	153,514	(133,249)	6,037,490
Corporate securities including public utilities	164,375,636	10,440,989	(3,727,013)	171,089,612
Mortgage-backed securities	9,488,083	221,400	(280,871)	9,428,612
Redeemable preferred stock	623,635	13,418	-	637,053
Total fixed maturity securities held to maturity	$184,979,644	$11,078,349	$(4,207,244)	$191,850,749
Equity securities available for sale at estimated fair value:				
Common stock:				
Industrial, miscellaneous and all other	$10,323,238	$447,110	$(859,092)	$9,911,256
Total securities available for sale carried at estimated fair value	$10,323,238	$447,110	$(859,092)	$9,911,256
Mortgage loans held for investment at amortized cost:				
Residential	$58,593,622			
Residential construction	40,800,117			
Commercial	51,536,622			
Less: Unamortized deferred loan fees, net	(190,846)			
Less: Allowance for loan losses	(1,748,783)			
Total mortgage loans held for investment	$148,990,732			
Real estate held for investment net of accumlated depreciation:				
Residential	$76,191,985			
Commercial	68,973,936			
Total real estate held for investment	$145,165,921			
Policy loans and other investments at amortized cost:				
Policy loans	$6,694,148			

Insurance assignments	33,548,079
Promissory notes	48,797
Federal Home Loan Bank stock	662,100
Other investments	1,765,752
Less: Allowance for doubtful accounts	(1,119,630)
Total policy loans and other investments	$41,599,246
Short-term investments at amortized cost	$27,560,040
Accrued investment income	$2,972,596

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

3) Investments (Continued)

Fixed Maturity Securities

The following tables summarize unrealized losses on fixed maturity securities held to maturity, which are carried at amortized cost, at September 30, 2017 and December 31, 2016. The unrealized losses were primarily related to interest rate fluctuations. The tables set forth unrealized losses by duration with the fair value of the related fixed maturity securities:

	Unrealized Losses for Less than Twelve Months	Fair Value	Unrealized Losses for More than Twelve Months	Fair Value	Total Unrealized Loss	Fair Value
At September 30, 2017						
U.S. Treasury Securities and Obligations of U.S. Government Agencies	$182,493	$51,456,444	$44,050	$851,779	$226,543	$52,308,223
Obligations of states and political subdivisions	18,357	2,486,400	58,915	1,651,253	77,272	4,137,653
Corporate securities	286,166	16,526,010	999,195	10,820,005	1,285,361	27,346,015
Mortgage-backed securities	68,972	2,026,033	102,451	1,156,803	171,423	3,182,836
Total unrealized losses	$555,988	$72,494,887	$1,204,611	$14,479,840	$1,760,599	$86,974,727
At December 31, 2016						
U.S. Treasury Securities and Obligations of U.S. Government Agencies	$66,111	$1,342,088	$-	$-	$66,111	$1,342,088
Obligations of states and political subdivisions	133,249	3,686,856	-	-	133,249	3,686,856
Corporate securities	1,728,312	41,796,016	1,998,701	12,969,135	3,727,013	54,765,151
Mortgage-backed securities	176,715	4,176,089	104,156	940,278	280,871	5,116,367
Total unrealized losses	$2,104,387	$51,001,049	$2,102,857	$13,909,413	$4,207,244	$64,910,462

There were 143 securities with an average fair value of 98.3% of amortized cost at September 30, 2017. There were 250 securities with an average fair value of 93.9% of amortized cost at December 31, 2016. During the three months ended September 30, 2017 and 2016 an other than temporary decline in fair value resulted in the recognition of credit losses on fixed maturity securities of $100,000 and $30,000, respectively, and for the nine months ended September 30, 2017 and 2016 an other than temporary decline in fair value resulted in the recognition of credit losses on fixed maturity securities of $418,366 and $90,000, respectively.

On a quarterly basis, the Company evaluates its fixed maturity securities held to maturity. This evaluation includes a review of current ratings by the National Association of Insurance Commissions ("NAIC"). Securities with a rating of 1 or 2 are considered investment grade and are not reviewed for impairment. Securities with ratings of 3 to 5 are evaluated for impairment. Securities with a rating of 6 are automatically determined to be impaired and are written down. The evaluation involves an analysis of the securities in relation to historical values, interest payment history, projected earnings and revenue growth rates as well as a review of the reason for a downgrade in the NAIC rating.

Based on the analysis of a security that is rated 3 to 5, a determination is made whether the security will likely make interest and principal payments in accordance with the terms of the financial instrument. If it is unlikely that the security will meet contractual obligations, the loss is considered to be other than temporary, the security is written down to the new anticipated market value and an impairment loss is recognized. Impairment losses are treated as credit losses as the Company holds fixed maturity securities to maturity unless the underlying conditions have changed in the financial instrument to require an impairment.

The fair values of fixed maturity securities are based on quoted market prices, when available. For fixed maturity securities not actively traded, fair values are estimated using values obtained from independent pricing services, or in the case of private placements, are estimated by discounting expected future cash flows using a current market value applicable to the coupon rate, credit and maturity of the investments.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

3) Investments (Continued)

The amortized cost and estimated fair value of fixed maturity securities held to maturity, at September 30, 2017, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Held to Maturity:		
Due in 2017	$1,205,533	$1,208,929
Due in 2018 through 2021	77,063,707	78,846,158
Due in 2022 through 2026	54,265,268	56,731,089
Due after 2026	87,888,563	96,497,632
Mortgage-backed securities	9,764,566	9,846,716
Redeemable preferred stock	623,635	677,038
Total held to maturity	$230,811,272	$243,807,562

The Company is a member of the Federal Home Loan Bank of Des Moines ("FHLB"). In June through August of 2017, the Company purchased a total of $50,000,000, par value, of United States Treasury fixed maturity securities that it deposited with the FHLB. These securities will generate interest income for the Company and will be available to use as collateral on any cash borrowings from the FHLB. As of September 30, 2017, the Company did not have any outstanding amounts owed to FHLB.

Equity Securities

The following tables summarize unrealized losses on equity securities available for sale, that were carried at estimated fair value based on quoted trading prices at September 30, 2017 and December 31, 2016. The unrealized losses were primarily the result of decreases in fair value in the retail, industrial and energy sectors. The tables set forth unrealized losses by duration and number of investment positions, together with the fair value of the related equity securities available for sale in a loss position:

	Unrealized Losses for Less than Twelve Months	No. of Investment Positions	Unrealized Losses for More than Twelve Months	No. of Investment Positions	Total Unrealized Losses
At September 30, 2017					
Industrial, miscellaneous and all other	$150,581	108	$669,370	92	$819,951
Total unrealized losses	$150,581	108	$669,370	92	$819,951
Fair Value	$988,159		$1,444,994		$2,433,153
At December 31, 2016					
Industrial, miscellaneous and all other	$215,563	124	$643,529	104	$859,092
Total unrealized losses	$215,563	124	$643,529	104	$859,092
Fair Value	$2,063,144		$1,685,874		$3,749,018

The average fair value of the equity securities available for sale was 74.8% and 81.4% of the original investment as of September 30, 2017 and December 31, 2016, respectively. The intent of the Company is to retain equity securities for a period of time sufficient to allow for the recovery in fair value. However, the Company may sell equity securities during a period in which the fair value has declined below the amount of the original investment. In certain situations, new factors, including changes in the business environment, can change the Company's previous intent to continue holding a security. During the three months ended September 30, 2017 and 2016, an other than temporary decline in the fair value resulted in the recognition of an impairment loss on equity securities of $63,375 and $-0-, respectively, and for the nine months ended September 30, 2017 and 2016, an other than temporary decline in the fair value resulted in the recognition of an impairment loss on equity securities of $63,375 and $43,630, respectively.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
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September 30, 2017 (Unaudited)

3) Investments (Continued)

On a quarterly basis, the Company reviews its investment in equity securities that are in a loss position. The first step is to identify securities by lots which are currently carried on the books at a value greater than the 52-week high. These securities are further evaluated by reviewing current market value in relation to historical value, price earnings ratios, projected earnings, revenue growth rates, negative company related events, market sector comparisons and analyst reports to determine if a security has a reasonable expectation to return to the current cost basis. Based on the analysis, a determination is made whether a security will likely recover from the loss position within a reasonable period of time. If it is unlikely that the security will recover from the loss position, the loss is considered to be other than temporary, the security is written down to a restated value and an impairment loss is recognized.

The fair values for equity securities are based on quoted market prices.

There were no investments, aggregated by issuer, in excess of 10% of shareholders' equity (before net unrealized gains and losses on equity securities available for sale) at September 30, 2017, other than investments issued or guaranteed by the United States Government.
The Company's net realized gains and losses from sales, calls, and maturities, and other than temporary impairments from investments and other assets are summarized as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Fixed maturity securities held to maturity:				
Gross realized gains	$110,529	$65,179	$163,950	$259,635
Gross realized losses	(651,754)	(4,527)	(686,819)	(7,405)
Other than temporary impairments	(100,000)	(30,000)	(418,366)	(90,000)
Equity securities available for sale:				
Gross realized gains	25,898	36,751	132,350	176,331
Gross realized losses	(26)	(4,544)	(58,464)	(37,146)
Other than temporary impairments	(63,375)	-	(63,375)	(43,630)
Other assets:				
Gross realized gains	225,022	191,992	2,006,721	468,675
Gross realized losses	(29,335)	(324,020)	(844,672)	(680,794)
Total	$(483,041)	$(69,169)	$231,325	$45,666

The net realized gains and losses on the sale of securities are recorded on the trade date, and the cost of the securities sold is determined using the specific identification method.

The carrying amount of held to maturity securities sold was $2,240,249 and $1,989,159 for the nine months ended September 30, 2017 and 2016, respectively. The net realized loss related to these sales was $385,484 for the nine months ended September 30, 2017 and the net realized gain related to these sales was $156,154 for the nine months ended September 30, 2016. Although the intent is to buy and hold a fixed maturity security to maturity, the Company will sell a security prior to maturity if conditions have changed within the entity that issued the security to increase the risk of default to an unacceptable level.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

3) Investments (Continued)

Major categories of net investment income are as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Fixed maturity securities	$2,692,586	$2,410,641	$7,475,156	$6,472,847
Equity securities	66,320	78,402	209,517	208,696
Mortgage loans held for investment	2,973,349	2,830,853	8,803,257	8,238,249
Real estate held for investment	2,818,672	2,736,301	8,540,756	8,162,574
Policy loans	195,098	205,537	621,854	558,778
Insurance assignments	3,234,520	2,952,170	9,943,561	8,915,654
Other investments	16,051	-	36,041	13,962
Short-term investments	109,939	20,978	311,989	66,480
Gross investment income	12,106,535	11,234,882	35,942,131	32,637,240
Investment expenses	(3,745,069)	(3,145,025)	(10,383,018)	(9,152,960)
Net investment income	$8,361,466	$8,089,857	$25,559,113	$23,484,280

Net investment income includes income earned by the restricted assets of the cemeteries and mortuaries of $129,235 and $133,289 for the three months ended September 30, 2017 and 2016, respectively, and $369,721 and $295,630 for the nine months ended September 30, 2017 and 2016, respectively.

Net investment income on real estate consists primarily of rental revenue.

Investment expenses consist primarily of depreciation, property taxes, operating expenses of real estate and an estimated portion of administrative expenses relating to investment activities.

Securities on deposit with regulatory authorities as required by law amounted to $9,166,082 at September 30, 2017 and $9,269,121 at December 31, 2016. The pledged securities are included in various assets under investments on the accompanying condensed consolidated balance sheets.

Real Estate Held for Investment

The Company continues to strategically deploy resources into real estate to match the income and yield durations of its primary obligations. The sources for these real estate assets come through its various business units in the form of acquisition, development and foreclosures on mortgage loans.

Commercial Real Estate Held for Investment

The Company owns and manages commercial real estate assets as a means of generating investment income. These assets are acquired in accordance with the Company's goals and objectives for risk-adjusted returns. Due diligence is conducted on each asset using internal and third-party reports. Geographic locations and asset classes of the investment activity is determined by senior management under the direction of the Board of Directors.

The Company employs full-time employees to attend to the day-to-day operations of those assets within the greater Salt Lake area and close surrounding markets. The Company utilizes third party property managers when the geographic boundary does not warrant full-time staff or through strategic lease-up periods. The Company generally looks to acquire assets in regions that are high growth regions for employment and population and in assets that provide operational efficiencies.

The Company currently owns and operates 12 commercial properties in 7 states. These properties include industrial warehouses, office buildings, retail centers, undeveloped land and includes the redevelopment and expansion of its corporate campus in Salt Lake City, Utah. The Company does use debt in strategic cases to leverage established yields or to acquire a higher quality or different class of asset.

The aggregated net ending balance of commercial real estate that serves as collateral for bank borrowings was approximately $65,907,000 and $51,507,000 as of September 30, 2017 and December 31, 2016, respectively. The associated bank loan carrying values totaled approximately $38,161,000 and $21,831,000 as of September 30, 2017 and December 31, 2016, respectively.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

3) Investments (Continued)

The following is a summary of the Company's commercial real estate held for investment for the periods presented:

	Net Ending Balance				Total Square Footage	
	September 30 2017		December 31 2016		September 30 2017	December 31 2016
Arizona	$4,000	(1)	$450,538	(1)	-	16,270
Arkansas	97,219		100,369		3,200	3,200
Kansas	11,993,029		12,450,297		222,679	222,679
Louisiana	499,573		518,700		7,063	7,063
Mississippi	3,748,324		3,818,985		33,821	33,821
New Mexico	7,000	(1)	7,000	(1)	-	-
Texas	3,728,960		3,734,974		23,470	23,470
Utah	61,021,673	(2)	47,893,073	(2)	433,244	433,244
	$81,099,778		$68,973,936		723,477	739,747

(1) Includes undeveloped land

(2) Includes 53rd Center completed in July 2017

Residential Real Estate Held for Investment

The Company owns a portfolio of residential homes primarily as a result of loan foreclosures. The strategy has been to lease these homes to produce cash flow, and allow time for the economic fundamentals to return to the various markets. As an orderly and active market for these homes returns, the Company has the option to dispose or to continue and hold them for cash flow and acceptable returns.

The Company established Security National Real Estate Services ("SNRE") to manage the residential portfolio. SNRE cultivates and maintains the preferred vendor relationships necessary to manage costs and quality of work performed on the portfolio of homes across the country.

As of September 30, 2017, SNRE manages 107 residential properties in 9 states across the United States which includes a newly constructed apartment complex, Dry Creek at East Village, in Sandy, Utah.

The net ending balance of residential real estate that serves as collateral for a bank borrowing was approximately $34,772,000 and $35,798,000, as of September 30, 2017 and December 31, 2016, respectively. The associated bank loan carrying value was approximately $26,893,000 and $27,377,000 as of September 30, 2017 and December 31, 2016, respectively.

The net ending balance of foreclosed residential real estate included in residential real estate held for investment is $34,167,065 and $39,856,434 as of September 30, 2017 and December 31, 2016, respectively.

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SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

3) Investments (Continued)

The following is a summary of the Company's residential real estate held for investment for the periods presented:

	Net Ending Balance September 30 2017	December 31 2016
Arizona	$217,516	$742,259
California	5,663,871	5,848,389
Colorado	-	364,489
Florida	7,311,913	8,327,355
Hawaii	712,286	-
Ohio	46,658	46,658
Oklahoma	17,500	-
Texas	511,486	1,091,188
Utah	54,701,809	59,485,466
Washington	286,181	286,181
	$69,469,220	$76,191,985

Real Estate Owned and Occupied by the Company

The primary business units of the Company occupy a portion of the real estate owned by the Company. Currently, the Company occupies nearly 80,000 square feet, or approximately 10% of the overall commercial real estate holdings.

As of September 30, 2017, real estate owned and occupied by the Company is summarized as follows:

Location	Business Segment	Approximate Square Footage	Square Footage Occupied by the Company
5300 South 360 West, Salt Lake City, UT (1)	Corporate Offices, Life Insurance and Cemetery/Mortuary Operations	36,000	100 %
5201 Green Street, Salt Lake City, UT	Mortgage Operations	36,899	34 %
1044 River Oaks Dr., Flowood, MS	Life Insurance Operations	5,522	27 %

(1) This asset is included in property and equipment on the condensed consolidated balance sheet

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SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

3) Investments (Continued)

Mortgage Loans Held for Investment

Mortgage loans held for investment consist of first and second mortgages. The mortgage loans bear interest at rates ranging from 2.0% to 10.5%, maturity dates range from three months to 30 years and are secured by real estate. Concentrations of credit risk arise when a number of mortgage loan debtors have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. Although the Company has a diversified mortgage loan portfolio consisting of residential mortgages, commercial loans and residential construction loans and requires collateral on all real estate exposures, a substantial portion of its debtors' ability to honor obligations is reliant on the economic stability of the geographic region in which the debtors do business. At September 30, 2017, the Company had 45%, 11%, 11%, 7%, 5%, 5% and 4% of its mortgage loans from borrowers located in the states of Utah, California, Texas, Florida, Arizona, Nevada, and Tennessee, respectively.

Mortgage loans held for investment are carried at their unpaid principal balances adjusted for net deferred fees, charge-offs and the related allowance for loan losses. Interest income is included in net investment income on the condensed consolidated statements of earnings and is recognized when earned. The Company defers related material loan origination fees, net of related direct loan origination costs, and amortizes the net fees over the term of the loans. Origination fees are included in net investment income on the condensed consolidated statements of earnings.

Mortgage loans are secured by the underlying property and require an appraisal at the time of underwriting and funding. Generally, the Company will fund a loan not to exceed 80% of the loan's collateral fair market value. Amounts over 80% will require additional collateral or mortgage insurance by an approved third-party insurer.

The Company provides for losses on its mortgage loans held for investment through an allowance for loan losses (a contra-asset account). The allowance is comprised of two components. The first component is an allowance for collectively evaluated impairment that is based upon the Company's historical experience in collecting similar receivables. The second component is based upon individual evaluation of loans that are determined to be impaired. Upon determining impairment, the Company establishes an individual impairment allowance based upon an assessment of the fair value of the underlying collateral. When a loan becomes delinquent, the Company proceeds to foreclose on the real estate and all expenses for foreclosure are expensed as incurred. Once foreclosed, an adjustment for the lower of cost or fair value is made, if necessary, and the amount is classified as real estate held for investment. The Company will rent the properties until it is deemed desirable to sell them.

The allowance for losses on mortgage loans held for investment could change based on changes in the value of the underlying collateral, the performance status of the loans, or the Company's actual collection experience. The actual losses could change, in the near term, from the established allowance, based upon the occurrence or non-occurrence of these events.

For purposes of determining the allowance for losses, the Company has segmented its mortgage loans held for investment by loan type. The Company's loan types are commercial, residential, and residential construction. The inherent risks within the portfolio vary depending upon the loan type as follows:

Commercial - Underwritten in accordance with the Company's policies to determine the borrower's ability to repay the obligation as agreed. Commercial loans are made primarily based on the underlying collateral supporting the loan. Accordingly, the repayment of a commercial loan depends primarily on the collateral and its ability to generate income and secondary on the borrower's (or guarantors) ability to repay.

Residential – Secured by family dwelling units. These loans are secured by first mortgages on the unit, which are generally the primary residence of the borrower, generally at a loan-to-value ratio ("LTV") of 80% or less.

Residential construction (including land acquisition and development) – Underwritten in accordance with the Company's underwriting policies which include a financial analysis of the builders, borrowers (guarantors), construction cost estimates, and independent appraisal valuations. These loans will rely on the value associated with the project upon completion. These cost and valuation estimates may be inaccurate. Construction loans generally involve the disbursement of substantial funds over a short period of time with repayment substantially dependent upon the success of the completed project and the ability of the borrower to secure long-term financing. Additionally, land is underwritten according to the Company's policies, which include independent appraisal valuations as well as the estimated value associated with the land upon completion of development into finished lots. These cost and valuation estimates may be inaccurate. These loans are considered to be of a higher risk than other mortgage loans due to their ultimate repayment being sensitive to general economic conditions, availability of long-term or construction financing, and interest rate sensitivity.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

3) Investments (Continued)

The following is a summary of the allowance for loan losses as a contra-asset account for the periods presented:

Allowance for Credit Losses and Recorded Investment in Mortgage Loans

	Commercial	Residential	Residential Construction	Total
September 30, 2017				
Allowance for credit losses:				
Beginning balance - January 1, 2017	$187,129	$1,461,540	$100,114	$1,748,783
Charge-offs	-	(49,775)	(64,894)	(114,669)
Provision	-	417,704	-	417,704
Ending balance - September 30, 2017	$187,129	$1,829,469	$35,220	$2,051,818
Ending balance: individually evaluated for impairment	$-	$411,172	$-	$411,172
Ending balance: collectively evaluated for impairment	$187,129	$1,418,297	$35,220	$1,640,646
Mortgage loans:				
Ending balance	$42,923,761	$65,759,761	$41,306,722	$149,990,244
Ending balance: individually evaluated for impairment	$203,806	$5,425,757	$-	$5,629,563
Ending balance: collectively evaluated for impairment	$42,719,955	$60,334,004	$41,306,722	$144,360,681
December 31, 2016				
Allowance for credit losses:				
Beginning balance - January 1, 2016	$187,129	$1,560,877	$100,114	$1,848,120
Charge-offs	-	(420,135)	-	(420,135)
Provision	-	320,798	-	320,798
Ending balance - December 31, 2016	$187,129	$1,461,540	$100,114	$1,748,783
Ending balance: individually evaluated for impairment	$-	$374,501	$-	$374,501
Ending balance: collectively evaluated for impairment	$187,129	$1,087,039	$100,114	$1,374,282
Mortgage loans:				
Ending balance	$51,536,622	$58,593,622	$40,800,117	$150,930,361
Ending balance: individually evaluated for impairment	$202,992	$2,916,538	$64,895	$3,184,425
Ending balance: collectively evaluated for impairment	$51,333,630	$55,677,084	$40,735,222	$147,745,936

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Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

3) Investments (Continued)

The following is a summary of the aging of mortgage loans held for investment for the periods presented:

of Mortgage Loans Held for Investment

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days (1)	In Process of Foreclosure (1)	Total Past Due	Current	Total Mortgage Loans	Allowance for Loan Losses	Unamortized deferred loan fees, net
2017									
	$513,218	$-	$-	$203,806	$717,024	$42,206,737	$42,923,761	$(187,129)	$(229,603)
	22,277	1,236,721	2,200,206	3,225,551	6,684,755	59,075,006	65,759,761	(1,829,469)	(21,578)
nstruction	-	-	-	-	-	41,306,722	41,306,722	(35,220)	(386,554)
	$535,495	$1,236,721	$2,200,206	$3,429,357	$7,401,779	$142,588,465	$149,990,244	$(2,051,818)	$(637,735)
2016									
	$-	$-	$-	$202,992	$202,992	$51,333,630	$51,536,622	$(187,129)	$(155,725)
	964,960	996,779	1,290,355	1,626,183	4,878,277	53,715,345	58,593,622	(1,461,540)	(35,121)
nstruction	-	-	64,895	-	64,895	40,735,222	40,800,117	(100,114)	-
	$964,960	$996,779	$1,355,250	$1,829,175	$5,146,164	$145,784,197	$150,930,361	$(1,748,783)	$(190,846)

ome is not recognized on loans past due greater than 90 days or in foreclosure.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

3) Investments (Continued)

Impaired Mortgage Loans Held for Investment

Impaired mortgage loans held for investment include loans with a related specific valuation allowance or loans whose carrying amount has been reduced to the expected collectible amount because the impairment has been considered other than temporary. The recorded investment in and unpaid principal balance of impaired loans along with the related loan specific allowance for losses, if any, for each reporting period and the average recorded investment and interest income recognized during the time the loans were impaired were as follows:

Impaired Loans

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
September 30, 2017					
With no related allowance recorded:					
Commercial	$203,806	$203,806	$-	$456,524	$ -
Residential	3,872,587	3,872,587	-	3,281,980	-
Residential construction	-	-	-	-	-
With an allowance recorded:					
Commercial	$-	$-	$-	$-	$ -
Residential	1,553,170	1,553,170	411,172	1,287,394	-
Residential construction	-	-	-	-	-
Total:					
Commercial	$203,806	$203,806	$-	$456,524	$ -
Residential	5,425,757	5,425,757	411,172	4,569,374	-
Residential construction	-	-	-	-	-
December 31, 2016					
With no related allowance recorded:					
Commercial	$202,992	$202,992	$-	$202,992	$ -
Residential	-	-	-	-	-
Residential construction	64,895	64,895	-	79,082	-
With an allowance recorded:					
Commercial	$-	$-	$-	$-	$ -
Residential	2,916,538	2,916,538	374,501	3,001,850	-
Residential construction	-	-	-	-	-
Total:					
Commercial	$202,992	$202,992	$-	$202,992	$ -
Residential	2,916,538	2,916,538	374,501	3,001,850	-
Residential construction	64,895	64,895	-	79,082	-

Credit Risk Profile Based on Performance Status

The Company's mortgage loan held for investment portfolio is monitored based on performance of the loans. Monitoring a mortgage loan increases when the loan is delinquent or earlier if there is an indication of impairment. The Company defines non-performing mortgage loans as loans 90 days or greater delinquent or on non-accrual status.
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SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
September 30, 2017 (Unaudited)

3) Investments (Continued)

The Company's performing and non-performing mortgage loans held for investment were as follows:

Mortgage Loans Held for Investment Credit Exposure
Credit Risk Profile Based on Payment Activity

	Commercial		Residential		Residential Construction		Total	
	September 30, 2017	December 31, 2016	September 30, 2017	December 31, 2016	September 30, 2017	December 31, 2016	September 30, 2017	December 31, 2016
Performing	$42,719,955	$51,333,630	$60,334,004	$55,677,084	$41,306,722	$40,735,222	$144,360,681	$147,745,936
Non-performing	203,806	202,992	5,425,757	2,916,538	-	64,895	5,629,563	3,184,425
Total	$42,923,761	$51,536,622	$65,759,761	$58,593,622	$41,306,722	$40,800,117	$149,990,244	$150,930,361

Non-Accrual Mortgage Loans Held for Investment

Once a loan is past due 90 days, it is the policy of the Company to end the accrual of interest income on the loan and write off any interest income that had been accrued. Payments received for loans on a non-accrual status are recognized on a cash basis. Interest income recognized from any payments received for loans on a non-accrual status was immaterial. Accrual of interest resumes if a loan is brought current. Interest not accrued on these loans totals approximately $185,000 and $172,000 as of September 30, 2017 and December 31, 2016, respectively.

The following is a summary of mortgage loans held for investment on a non-accrual status for the periods presented.

	Mortgage Loans on Non-Accrual Status	
	As of September 30 2017	As of December 31 2016
Commercial	$203,806	$202,992
Residential	5,425,757	2,916,538
Residential construction	-	64,895
Total	$5,629,563	$3,184,425

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SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
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4) Loans Held for Sale

Fair Value Option Election

Accounting Standards Codification ("ASC") No. 825, "Financial Instruments", allows for the option to report certain financial assets and liabilities at fair value initially and at subsequent measurement dates with changes in fair value included in earnings. The option may be applied instrument by instrument, but it is irrevocable. The Company elected the fair value option for loans held for sale originated after July 1, 2017. The Company believes the fair value option most closely aligns the timing of the recognition of gains and costs. These loans are intended for sale and the Company believes that the fair value is the best indicator of the resolution of these loans. Electing fair value also reduces certain timing differences and better matches changes in the fair value of these assets with changes in the fair value of the related derivatives used for these assets.

Interest income is recorded based on the contractual terms of the loan and in accordance with the Company's policy on mortgage loans held for investment and is included in mortgage fee income on the condensed consolidated statement of earnings. None of these loans are 90 or more days past due nor on nonaccrual status as of September 30, 2017. See Note 8 to the condensed consolidated financial statements for additional disclosures regarding loans held for sale.

The following is a summary of the aggregate fair value and the aggregate unpaid principal balance ("UPB") of loans held for sale for the periods presented:

	As of September 30 2017
Aggregate fair value	$166,990,187
UPB	161,165,793
Unrealized gain	5,824,394

Mortgage Fee Income

Mortgage fee income consists of origination fees, processing fees, interest income and certain other income related to the origination and sale of mortgage loans held for sale.

Major categories of mortgage fee income for loans held for sale are as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Loan fees	$15,203,107	$11,988,959	$33,291,947	$33,071,486
Interest income	2,097,249	2,204,286	5,679,868	6,022,796
Secondary gains	28,550,295	41,346,576	87,165,736	108,667,085
Change in fair value of loan commitments	(4,833,268)	(1,505,820)	(3,677,554)	1,459,568
Change in fair value of loans held for sale	1,061,917	-	1,061,917	-

Provision for loan loss reserve	(481,727)	(838,238)	(1,435,180)	(2,253,689)
Mortgage fee income	$41,597,573	$53,195,763	$122,086,734	$146,967,246

Loan Loss Reserve

When a repurchase demand corresponding to a mortgage loan previously held for sale and sold to a third-party investor is received from a third-party investor, the relevant data is reviewed and captured so that an estimated future loss can be calculated. The key factors that are used in the estimated loss calculation are as follows: (i) lien position, (ii) payment status, (iii) claim type, (iv) unpaid principal balance, (v) interest rate, and (vi) validity of the demand. Other data is captured and is useful for management purposes; the actual estimated loss is generally based on these key factors. The Company conducts its own review upon the receipt of a repurchase demand. In many instances, the Company is able to resolve the issues relating to the repurchase demand by the third-party investor without having to make any payments to the investor.

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4) Loans Held for Sale (Continued)

The following is a summary of the loan loss reserve that is included in other liabilities and accrued expenses:

	As of September 30 2017	As of December 31 2016
Balance, beginning of period	$627,733	$2,805,900
Provision on current loan originations (1)	1,435,180	2,988,754
Additional provision for loan loss reserve	-	1,700,000
Charge-offs, net of recaptured amounts	108,175	(6,866,921)
Balance, end of period	$2,171,088	$627,733

(1) Included in Mortgage fee income

The Company believes the loan loss reserve represents probable loan losses incurred as of the balance sheet date. Actual loan loss experience could change, in the near-term, from the established reserve based upon claims that could be asserted by third-party investors. The Company believes there is potential to resolve any alleged claims by third-party investors on acceptable terms. If the Company is unable to resolve such claims on acceptable terms, legal action may ensue. In the event of legal action by any third-party investor, the Company believes it has significant defenses to any such action and intends to vigorously defend itself against such action.

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5) Stock Compensation Plans

The Company has four fixed option plans (the "2003 Plan", the "2006 Director Plan", the "2013 Plan" and the "2014 Director Plan"). Compensation expense for options issued of $102,429 and $84,949 has been recognized for these plans for the three months ended September 30, 2017 and 2016, respectively, and $305,741 and $253,427 for the nine months ended September 30, 2017 and 2016, respectively. As of September 30, 2017, the total unrecognized compensation expense related to the options issued was $69,719, which is expected to be recognized over the vesting period of one year.

The Company generally estimates the expected life of the options based upon the contractual term of the options adjusted for actual experience. Future volatility is estimated based upon the weighted historical volatility of the Company's Class A common stock over a period equal to the estimated life of the options. Common stock issued upon exercise of stock options are generally new share issuances rather than from treasury shares.

A summary of the status of the Company's stock compensation plans as of September 30, 2017, and the changes during the nine months ended September 30, 2017, are presented below:

	Number of Class A Shares	Weighted Average Exercise Price	Number of Class C Shares	Weighted Average Exercise Price
Outstanding at December 31, 2016	741,973	$ 4.33	556,298	$ 4.61
Granted	-		-	
Exercised	-		(103,402)	1.31
Cancelled	-		(24,227)	1.31
Outstanding at September 30, 2017	741,973	$ 4.33	428,669	$ 5.59
As of September 30, 2017:				
Options exercisable	706,854	$ 4.21	407,669	$ 5.50
As of September 30, 2017:				
Available options for future grant	525,682		227,750	
Weighted average contractual term of options outstanding at September 30, 2017	6.62 years		2.63 years	
Weighted average contractual term of options exercisable at September 30, 2017	6.50 years		2.55 years	
Aggregated intrinsic value of options outstanding at September 30, 2017 (1)	$941,567		$151,012	
Aggregated intrinsic value of options exercisable at September 30, 2017 (1)	$941,311		$151,012	

(1) The Company used a stock price of $5.10 as of September 30, 2017 to derive intrinsic value.

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5) Stock Compensation Plans (Continued)

A summary of the status of the Company's stock compensation plans as of September 30, 2016, and the changes during the nine months ended September 30, 2016, are presented below:

	Number of Class A Shares	Weighted Average Exercise Price	Number of Class C Shares	Weighted Average Exercise Price
Outstanding at December 31, 2015	618,261	$ 3.89	577,436	$ 3.54
Granted	-		-	
Exercised	(32,417)	2.38	-	
Cancelled	-		-	
Outstanding at September 30, 2016	585,844	$ 3.97	577,436	$ 3.54
As of September 30, 2016:				
Options exercisable	550,792	$ 3.82	551,186	$ 3.38
As of September 30, 2016:				
Available options for future grant	397,342		57,750	
Weighted average contractual term of options outstanding at September 30, 2016	6.99 years		2.00 years	
Weighted average contractual term of options exercisable at September 30, 2016	6.86 years		1.90 years	
Aggregated intrinsic value of options outstanding at September 30, 2016 (1)	$1,179,541		$1,460,167	
Aggregated intrinsic value of options exercisable at September 30, 2016 (1)	$1,179,541		$1,460,167	

(1) The Company used a stock price of $5.86 as of September 30, 2016 to derive intrinsic value.

The total intrinsic value (which is the amount by which the fair value of the underlying stock exceeds the exercise price of an option on the exercise date) of stock options exercised during the nine months ended September 30, 2017 and 2016 was $578,017 and $98,663, respectively.

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6) Earnings Per Share

The basic and diluted earnings per share amounts were calculated as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Numerator:				
Net earnings	$1,096,838	$4,183,005	$5,442,702	$11,737,952
Denominator:				
Basic weighted-average shares outstanding	15,256,857	14,830,078	15,159,569	14,744,779
Effect of dilutive securities:				
Employee stock options	285,803	439,535	315,257	421,266
Diluted weighted-average shares outstanding	15,542,660	15,269,613	15,474,826	15,166,045
Basic net earnings per share	$0.07	$0.28	$0.36	$0.80
Diluted net earnings per share	$0.07	$0.27	$0.35	$0.77

Net earnings per share amounts have been retroactively adjusted for the effect of annual stock dividends. For the nine months ended September 30, 2017 and 2016, there were 486,725 and 250,039 of anti-dilutive employee stock option shares, respectively, that were not included in the computation of diluted net earnings per common share as their effect would be anti-dilutive.

7) Business Segment Information

Description of Products and Services by Segment

The Company has three reportable business segments: life insurance, cemetery and mortuary, and mortgage. The Company's life insurance segment consists of life insurance premiums and operating expenses from the sale of insurance products sold by the Company's independent agency force and net investment income derived from investing policyholder and segment surplus funds. The Company's cemetery and mortuary segment consists of revenues and operating expenses from the sale of at-need cemetery and mortuary merchandise and services at its mortuaries and cemeteries, pre-need sales of cemetery spaces after collection of 10% or more of the purchase price and the net investment income from investing segment surplus funds. The Company's mortgage segment consists of fee income and expenses from the originations of residential mortgage loans and interest earned and interest expenses from warehousing loans held for sale.

Measurement of Segment Profit or Loss and Segment Assets

The accounting policies of the reportable segments are the same as those described in the Significant Accounting Principles of the Form 10-K/A for the year ended December 31, 2016. Intersegment revenues are recorded at cost plus an agreed upon intercompany profit, and are eliminated upon consolidation.

Factors Management Used to Identify the Enterprise's Reportable Segments

The Company's reportable segments are business units that are managed separately due to the different products provided and the need to report separately to the various regulatory jurisdictions. The Company regularly reviews the quantitative thresholds and other criteria to determine when other business segments may need to be reported.

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7) Business Segment Information (Continued)

	Life Insurance	Cemetery/ Mortuary	Mortgage	Intercompany Eliminations	Consolidated
For the Three Months Ended September 30, 2017					
Revenues from external customers	$25,229,759	$2,988,137	$43,753,955	$-	$71,971,851
Intersegment revenues	3,333,593	116,290	86,580	(3,536,463)	-
Segment profit before income taxes	522,574	237,108	378,335	-	1,138,017
For the Three Months Ended September 30, 2016					
Revenues from external customers	$24,972,397	$2,900,917	$55,075,343	$-	$82,948,657
Intersegment revenues	3,318,369	107,745	79,164	(3,505,278)	-
Segment profit before income taxes	2,139,702	54,891	4,378,937	-	6,573,530
For the Nine Months Ended September 30, 2017					
Revenues from external customers	$77,112,117	$9,907,037	$128,953,552	$-	$215,972,706
Intersegment revenues	9,299,671	338,745	268,764	(9,907,180)	-
Segment profit before income taxes	4,824,654	1,331,896	1,873,536	-	8,030,086
Identifiable Assets	853,298,860	94,716,098	190,202,990	(133,079,207)	1,005,138,741
Goodwill	2,765,570	-	-	-	2,765,570
Total Assets	856,064,430	94,716,098	190,202,990	(133,079,207)	1,007,904,311
For the Nine Months Ended September 30, 2016					
Revenues from external customers	$70,616,968	$10,045,384	$151,829,880	$-	$232,492,232
Intersegment revenues	9,780,803	616,532	239,503	(10,636,838)	-
Segment profit before income taxes	5,785,464	1,283,553	11,561,479	-	18,630,496
Identifiable Assets	797,486,493	95,414,964	194,469,525	(138,809,339)	948,561,643
Goodwill	2,765,570	-	-	-	2,765,570
Total Assets	800,252,063	95,414,964	194,469,525	(138,809,339)	951,327,213

8) Fair Value of Financial Instruments

Generally accepted accounting principles (GAAP) defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. GAAP also specifies a fair value hierarchy based upon the observability of inputs used in valuation techniques. Observable inputs (highest level) reflect market data obtained from independent sources, while unobservable inputs (lowest level) reflect internally developed market assumptions. Fair value measurements are classified under the following hierarchy:

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8) Fair Value of Financial Instruments (Continued)

Level 1: Financial assets and financial liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company can access.

Level 2: Financial assets and financial liabilities whose values are based on the following:

a) Quoted prices for similar assets or liabilities in active markets;
b) Quoted prices for identical or similar assets or liabilities in non-active markets; or
c) Valuation models whose inputs are observable, directly or indirectly, for substantially the full term of the asset or liability.

Level 3: Financial assets and financial liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs may reflect the Company's estimates of the assumptions that market participants would use in valuing the financial assets and financial liabilities.

The Company utilizes a combination of third party valuation service providers, brokers, and internal valuation models to determine fair value.

The following methods and assumptions were used by the Company in estimating the fair value disclosures related to significant financial instruments:

The items shown under Level 1 and Level 2 are valued as follows:

Equity Securities Available for Sale: The fair values of investments in equity securities along with methods used to estimate such values are disclosed in Note 3 of the Notes to the condensed consolidated financial statements.

Restricted Assets: A portion of these assets include mutual funds and equity securities that have quoted market prices that are used to determine fair value. Also included are cash and cash equivalents and participations in mortgage loans. The carrying amounts reported in the accompanying condensed consolidated balance sheets for these financial instruments approximate their fair values due to their short-term nature.

Cemetery Endowment Care Trust Investments: A portion of these assets include equity securities that have quoted market prices that are used to determine fair value. Also included are cash and cash equivalents. The carrying amounts reported in the accompanying condensed consolidated balance sheets for these financial instruments approximate their fair values due to their short-term nature.

Call and Put Options: The Company uses quoted market prices to value its call and put options.

Additionally, there were no transfers between Level 1 and Level 2 in the fair value hierarchy.

The items shown under Level 3 are valued as follows:

Loans Held for Sale, at Fair Value: The Company elected the fair value option for all loans held for sale originated after July 1, 2017. The fair value is based on quoted market prices, when available. When a quoted market price is not readily available, the Company uses the market price from its last sale of similar assets.

Loan Commitments and Forward Sale Commitments: The Company's mortgage segment enters into loan commitments with potential borrowers and forward sale commitments to sell loans to third-party investors. The Company also uses a hedging strategy for these transactions. A loan commitment binds the Company to lend funds to a qualified borrower at a specified interest rate and within a specified period of time, generally up to 30 days after issuance of the loan commitment. Loan commitments are defined to be derivatives under GAAP and are recognized at fair value on the consolidated balance sheets with changes in their fair values recorded in current earnings.

The Company estimates the fair value of a loan commitment based on the change in estimated fair value of the underlying mortgage loan, quoted MBS prices, estimates of the fair value of mortgage servicing rights, and an estimate of the probability that the mortgage loan will fund within the terms of the commitment. The change in fair value of the underlying mortgage loan is measured from the date the loan commitment is issued. Following issuance, the value of a mortgage loan commitment can be either positive or negative depending upon the change in value of the underlying mortgage loans. Fallout rates and other factors from the Company's recent historical data are used to estimate the quantity and value of mortgage loans that will fund within the terms of the commitments.

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8) Fair Value of Financial Instruments (Continued)

Interest Rate Swaps: Management considers the interest rate swap instruments to be an effective cash flow hedge against the variable interest rate on bank borrowings since the interest rate swap mirrors the term of the note payable and expires on the maturity date of the bank loan it hedges. The interest rate swaps are derivative financial instruments carried at their fair value. The fair value of the interest rate swap was derived from a model that factors in current market assumptions about future interest rates.

Impaired Mortgage Loans Held for Investment: The Company believes that the fair value of these nonperforming loans will approximate the unpaid principal balance expected to be recovered based on the fair value of the underlying collateral. For residential and commercial properties, the collateral value is estimated by obtaining an independent appraisal. The appraisal typically considers area comparables and property condition as well as potential rental income that could be generated (particularly for commercial properties). For residential construction loans, the collateral is typically incomplete, so fair value is estimated as the replacement cost using data from Marshall and Swift, a provider of building cost information to the real estate construction.

Real Estate Held for Investment: The Company believes that in an orderly market, fair value will approximate the replacement cost of a home and the rental income provides a cash flow stream for investment analysis. The Company believes the highest and best use of the properties are as income producing assets since it is the Company's intent to hold the properties as rental properties, matching the income from the investment in rental properties with the funds required for future estimated policy claims.

It should be noted that for replacement cost, when determining the fair value of mortgage properties, the Company uses Marshall and Swift, a provider of building cost information to the real estate construction industry. For the investment analysis, the Company used market data based upon its real estate operation experience and projected the present value of the net rental income over seven years. The Company also considers area comparables and property condition when determining fair value.

In addition to this analysis performed by the Company, the Company depreciates Real Estate Held for Investment. This depreciation reduces the book value of these properties and lessens the exposure to the Company from further deterioration in real estate values.

Mortgage Servicing Rights: The Company initially recognizes Mortgage Servicing Rights ("MSRs") at their estimated fair values derived from the net cash flows associated with the servicing contracts, where the Company assumes the obligation to service the loan in the sale transaction. The precise fair value of MSRs cannot be readily determined because MSRs are not actively traded in stand-alone markets. Considerable judgment is required to estimate the fair values of these assets and the exercise of such judgment can significantly affect the Company's earnings.

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8) Fair Value of Financial Instruments (Continued)

The following tables summarize Level 1, 2 and 3 financial assets and financial liabilities measured at fair value on a recurring basis by their classification in the condensed consolidated balance sheet at September 30, 2017.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a recurring basis				
Common stock	$5,957,488	$5,957,488	$ -	$-
Total equity securities available for sale	$5,957,488	$5,957,488	$ -	$-
Loans held for sale	$166,990,187	$-	$ -	$166,990,187
Restricted assets (1)	78,421	78,421	-	-
Cemetery perpetual care trust investments (1)	676,881	676,881	-	-
Derivatives - loan commitments (2)	3,140,704	-	-	3,140,704
Total assets accounted for at fair value on a recurring basis	$176,843,681	$6,712,790	$ -	$170,130,891
Liabilities accounted for at fair value on a recurring basis				
Derivatives - bank loan interest rate swaps (3)	$(138)	$-	$ -	$(138)
- call options (4)	(50,452)	(50,452)	-	-
- put options (4)	(63,637)	(63,637)	-	-
- loan commitments (4)	(8,926)	-	-	(8,926)
Total liabilities accounted for at fair value on a recurring basis	$(123,153)	$(114,089)	$ -	$(9,064)

(1) Excluding cash
(2) Included in other assets on the condensed consolidated balance sheet
(3) Included in bank and other loans payable on the condensed consolidated balance sheet
(4) Included in other liabilities and accrued expenses on the condensed consolidated balance sheet

Following is a summary of changes in the condensed consolidated balance sheet line items measured using level 3 inputs:

	Net Loan Commitments	Bank Loan Interest Rate Swaps	Loans Held for Sale
Balance - December 31, 2016	$ 6,809,332	$(3,308)	$-
Purchases			636,022,818

Sales			(473,930,540)
Total gains (losses):			
Included in earnings (1)	(3,677,554)	-	4,897,909
Included in other comprehensive income (2)	-	3,170	-
Balance - September 30, 2017	$ 3,131,778	$ (138)	$ 166,990,187

(1) As a component of Mortgage fee income on the condensed consolidated statement of earnings
(2) As a component of Unrealized gains on derivative instruments on the condensed consolidated statement of comprehensive income

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SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
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8) Fair Value of Financial Instruments (Continued)

The following tables summarize Level 1, 2 and 3 financial assets and financial liabilities measured at fair value on a nonrecurring basis by their classification in the condensed consolidated balance sheet at September 30, 2017.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a nonrecurring basis				
Impaired mortgage loans held for investment	$5,218,392	$ -	$ -	$ 5,218,392
Mortgage servicing rights additions	4,057,974	-	-	4,057,974
Total assets accounted for at fair value on a nonrecurring basis	$9,276,366	$ -	$ -	$ 9,276,366

The following tables summarize Level 1, 2 and 3 financial assets and financial liabilities measured at fair value on a recurring basis by their classification in the condensed consolidated balance sheet at December 31, 2016.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a recurring basis				
Common stock	$9,911,256	$9,911,256	$ -	$ -
Total equity securities available for sale	$9,911,256	$9,911,256	$ -	$ -
Restricted assets (1)	$736,603	$736,603	$ -	$ -
Cemetery perpetual care trust investments (1)	698,202	698,202	-	-
Derivatives - loan commitments (2)	6,911,544	-	-	6,911,544
Total assets accounted for at fair value on a recurring basis	$18,257,605	$11,346,061	$ -	$ 6,911,544
Liabilities accounted for at fair value on a recurring basis				
Derivatives - bank loan interest rate swaps (3)	$(3,308)	-	-	$ (3,308)
- call options (4)	(109,474)	(109,474)	-	-
- put options (4)	(26,494)	(26,494)	-	-
- loan commitments (4)	(102,212)	-	-	(102,212)
Total liabilities accounted for at fair value on a recurring basis	$(241,488)	$(135,968)	$ -	$ (105,520)

(1) Excluding cash

(2) Included in other assets on the condensed consolidated balance sheet
(3) Included in bank and other loans payable on the condensed consolidated balance sheet
(4) Included in other liabilities and accrued expenses on the condensed consolidated balance sheet

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Notes to Condensed Consolidated Financial Statements
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8) Fair Value of Financial Instruments (Continued)

Following is a summary of changes in the condensed consolidated balance sheet line items measured using level 3 inputs:

	Net Loan Commitments	Bank Loan Interest Rate Swaps
Balance - December 31, 2015	$ 7,671,495	$(13,947)
Total gains (losses):		
Included in earnings (1)	(862,163)	-
Included in other comprehensive income (2)	-	10,639
Balance - December 31, 2016	$ 6,809,332	$(3,308)

(1) As a component of Mortgage fee income on the condensed consolidated statement of earnings
(2) As a component of Unrealized gains on derivative instruments on the condensed consolidated statement of comprehensive income

The following tables summarize Level 1, 2 and 3 financial assets and financial liabilities measured at fair value on a nonrecurring basis by their classification in the condensed consolidated balance sheet at December 31, 2016.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a nonrecurring basis				
Impaired mortgage loans held for investment	$2,809,925	$ -	$ -	$2,809,925
Mortgage servicing rights additions	8,603,154	-	-	8,603,154
Real estate held for investment	2,347,820	-	-	2,347,820
Total assets accounted for at fair value on a nonrecurring basis	$13,760,899	$ -	$ -	$13,760,899

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8) Fair Value of Financial Instruments (Continued)

Fair Value of Financial Instruments Carried at Other Than Fair Value

ASC 825, Financial Instruments, requires disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value.

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent limitations in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates presented herein are not necessarily indicative of the amounts the Company could have realized in a sales transaction at September 30, 2017 and December 31, 2016.

The carrying values and estimated fair values for such financial instruments, and their corresponding placement in the fair value hierarchy, are summarized as follows as of September 30, 2017:

	Carrying Value	Level 1	Level 2	Level 3	Total Estimated Fair Value
Assets					
Fixed maturity securities held to maturity	$230,811,272	$ -	$243,807,562	$-	$243,807,562
Mortgage loans held for investment:					
Residential	63,908,714	-	-	68,139,551	68,139,551
Residential construction	40,884,948	-	-	40,884,948	40,884,948
Commercial	42,507,029	-	-	44,223,823	44,223,823
Mortgage loans held for investment, net	$147,300,691	$ -	$-	$153,248,322	$153,248,322
Loans held for sale (at amortized costs)	34,905,719	-	-	35,131,853	35,131,853
Policy loans	6,677,924	-	-	6,677,924	6,677,924
Insurance assignments, net (1)	32,198,144	-	-	32,198,144	32,198,144
Short-term investments	17,830,990	-	17,830,990	-	17,830,990
Mortgage servicing rights, net	20,396,568	-	-	26,785,380	26,785,380
Liabilities					
Bank and other loans payable	$(182,769,531)	$ -	$-	$(182,769,531)	$(182,769,531)
Policyholder account balances (2)	(48,200,442)	-	-	(37,564,692)	(37,564,692)
Future policy benefits - annuities (2)	(99,519,758)	-	-	(100,851,101)	(100,851,101)

(1) Included in policy loans and other investments on the condensed consolidated balance sheet.
(2) Included in future policy benefits and unpaid claims on the condensed consolidated balance sheet.

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8) Fair Value of Financial Instruments (Continued)

The carrying values and estimated fair values for such financial instruments, and their corresponding placement in the fair value hierarchy, are summarized as follows as of December 31, 2016:

	Carrying Value	Level 1	Level 2	Level 3	Total Estimated Fair Value
Assets					
Fixed maturity securities held to maturity	$184,979,644	$ -	$191,850,749	$-	$191,850,749
Mortgage loans held for investment:					
Residential	57,096,961	-	-	61,357,393	61,357,393
Residential construction	40,700,003	-	-	40,700,003	40,700,003
Commercial	51,193,768	-	-	53,299,800	53,299,800
Mortgage loans held for investment, net	$148,990,732	$ -	$-	$155,357,196	$155,357,196
Loans held for sale	189,578,243	-	-	192,289,854	192,289,854
Policy loans	6,694,148	-	-	6,694,148	6,694,148
Insurance assignments, net (1)	32,477,246	-	-	32,477,246	32,477,246
Short-term investments	27,560,040	-	27,560,040	-	27,560,040
Mortgage servicing rights, net	18,872,362	-	-	25,496,832	25,496,832
Liabilities					
Bank and other loans payable	$(152,137,371)	$ -	$-	$(152,137,371)	$(152,137,371)
Policyholder account balances (2)	(49,421,125)	-	-	(38,530,031)	(38,530,031)
Future policy benefits - annuities (2)	(99,388,662)	-	-	(100,253,261)	(100,253,261)

(1) Included in policy loans and other investments on the condensed consolidated balance sheet.
(2) Included in future policy benefits and unpaid claims on the condensed consolidated balance sheet.

The methods, assumptions and significant valuation techniques and inputs used to estimate the fair value of these financial instruments are summarized as follows:

Fixed Maturity Securities Held to Maturity: The fair values of fixed maturity securities are based on quoted market prices, when available. For fixed maturity securities not actively traded, fair values are estimated using values obtained from independent pricing services, or in the case of private placements, are estimated by discounting expected future cash flows using a current market value applicable to the coupon rate, credit and maturity of the investments.

Mortgage Loans Held for Investment: The estimated fair value of the Company's mortgage loans held for investment is determined using various methods. The Company's mortgage loans are grouped into three categories: Residential, Residential Construction and Commercial. When estimating the expected future cash flows, it is assumed that all loans will be held to maturity, and any loans that are non-performing are evaluated individually for impairment.

Residential – The estimated fair value of mortgage loans is determined through a combination of discounted cash flows (estimating expected future cash flows of interest payments and discounting them using current interest rates from single family mortgages) and considering pricing of similar loans that were sold recently.

Residential Construction – These loans are primarily short in maturity accordingly, the estimated fair value is determined to be the carrying value.

Commercial – The estimated fair value is determined by estimating expected future cash flows of interest payments and discounting them using current interest rates for commercial mortgages.

Loans Held for Sale, at Amortized Cost: The fair value is based on quoted market prices, when available. When a quoted market price is not readily available, the Company uses the market price from its last sale of similar assets.

Policy Loans: The carrying amounts reported in the accompanying condensed consolidated balance sheet for these financial instruments approximate their fair values because they are fully collateralized by the cash surrender value of the underlying insurance policies.

8) Fair Value of Financial Instruments (Continued)

Insurance Assignments, Net: These investments are primarily short in maturity, accordingly, the carrying amounts reported in the accompanying condensed consolidated balance sheet for these financial instruments approximate their fair values.

Short-Term Investments: The carrying amounts reported in the accompanying condensed consolidated balance sheet for these financial instruments approximate their fair values due to their short-term nature.

Mortgage Servicing Rights, Net: The methods used to determine fair value of mortgage servicing rights were previously disclosed in this Note 8.

Bank and Other Loans Payable: The carrying amounts reported in the accompanying condensed consolidated balance sheet for these financial instruments approximate their fair values due to their relatively short-term maturities and variable interest rates.

Policyholder Account Balances and Future Policy Benefits-Annuities: Future policy benefit reserves for interest-sensitive insurance products are computed under a retrospective deposit method and represent policy account balances before applicable surrender charges. Policy benefits and claims that are charged to expense include benefit claims incurred in the period in excess of related policy account balances. Interest crediting rates for interest-sensitive insurance products ranged from 1.5% to 6.5%. The fair values for these investment-type insurance contracts are estimated based on the present value of liability cash flows.

The fair values for the Company's insurance contracts other than investment-type contracts are not required to be disclosed. However, the fair values of liabilities under all insurance contracts are taken into consideration in the Company's overall management of interest rate risk, such that the Company's exposure to changing interest rates is minimized through the matching of investment maturities with amounts due under insurance contracts.

9) Allowance for Doubtful Accounts

The Company records an allowance and recognizes an expense for potential losses from other investments and receivables in accordance with generally accepted accounting principles.

Receivables are the result of cemetery and mortuary operations, mortgage loan operations and life insurance operations. The allowance is based upon the Company's historical experience for collectively evaluated impairment. Other allowances are based upon receivables individually evaluated for impairment. Collectability of the cemetery and mortuary receivables is significantly influenced by current economic conditions. The critical issues that impact recovery of mortgage loan operations are interest rate risk, loan underwriting, new regulations and the overall economy.

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10) Derivative Instruments

Mortgage Banking Derivatives

Loan Commitments

The Company is exposed to price risk due to the potential impact of changes in interest rates on the values of loan commitments from the time a loan commitment is made to an applicant to the time the loan that would result from the exercise of that loan commitment is funded. Managing price risk is complicated by the fact that the ultimate percentage of loan commitments that will be exercised (i.e., the number of loans that will be funded) fluctuates. The probability that a loan will not be funded or the loan application is denied or withdrawn within the terms of the commitment is driven by a number of factors, particularly the change, if any, in mortgage rates following the issuance of the loan commitment.

In general, the probability of funding increases if mortgage rates rise and decreases if mortgage rates fall. This is due primarily to the relative attractiveness of current mortgage rates compared to the applicant's committed rate. The probability that a loan will not be funded within the terms of the mortgage loan commitment also is influenced by the source of the applications (retail, broker or correspondent channels), proximity to rate lock expiration, purpose for the loan (purchase or refinance) product type and the application approval status. The Company has developed fallout estimates using historical data that take into account all of the variables, as well as renegotiations of rate and point commitments that tend to occur when mortgage rates fall. These fallout estimates are used to estimate the number of loans that the Company expects to be funded within the terms of the loan commitments and are updated periodically to reflect the most current data.

The Company estimates the fair value of a loan commitment based on the change in estimated fair value of the underlying mortgage loan, quoted MBS prices, estimates of the fair value of mortgage servicing rights, and an estimate of the probability that the mortgage loan will fund within the terms of the commitment. The change in fair value of the underlying mortgage loan is measured from the date the loan commitment is issued and is shown net of expenses. Following issuance, the value of a loan commitment can be either positive or negative depending upon the change in value of the underlying mortgage loans.

Forward Sale Commitments

The Company utilizes forward commitments to economically hedge the price risk associated with its outstanding mortgage loan commitments. A forward commitment protects the Company from losses on sales of the loans arising from exercise of the loan commitments. Management expects these types of commitments will experience changes in fair value opposite to changes in fair value of the loan commitments, thereby reducing earnings volatility related to the recognition in earnings of changes in the values of the commitments.

The net changes in fair value of all loan commitments and forward sale commitments are shown in current earnings as a component of mortgage fee income.

Call and Put Options

The Company uses a strategy of selling "out of the money" call options on its available for sale equity securities as a source of revenue. The options give the purchaser the right to buy from the Company specified equity securities at a set price up to a pre-determined date in the future. The Company uses the strategy of selling put options as a means of generating cash or purchasing equity securities at lower than current market prices. The Company receives an immediate payment of cash for the value of the option and establishes a liability for the fair value of the option. The liability for options is adjusted to fair value at each reporting date. In the event a call option is exercised, the Company recognizes a gain on the sale of the equity security enhanced by the value of the option that was sold. If the option expires unexercised, the Company recognizes a gain from the sale of the option. In the event a put option is exercised, the Company acquires an equity security at the strike price of the option reduced by the value received from the sale of the put option. The equity security is then traded as a normal equity security in the Company's portfolio.

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10) Derivative Instruments (Continued)

The following table shows the notional amount and fair value of derivatives as of September 30, 2017 and December 31, 2016.

Fair Values and Notional Values of Derivative Instruments

		September 30, 2017			December 31, 2016		
Balance Sheet Location		Notional Amount	Asset Fair Value	Liability Fair Value	Notional Amount	Asset Fair Value	Liability Fair Value
Derivatives not designated as hedging instruments:							
Loan commitments	Other assets and Other liabilities	$147,086,043	$3,140,704	$8,926	$191,757,193	$6,911,544	$102,212
Call options	Other liabilities	1,473,050	--	50,452	2,169,850	--	109,474
Put options	Other liabilities	2,593,300	--	63,637	1,336,750	--	26,494
Derivatives designated as fair value hedging instruments:							
Interest rate swaps	Bank and other loans payable	43,940	--	138	175,762	--	3,308
Total		$151,196,333	$3,140,704	$123,153	$195,439,555	$6,911,544	$241,488

The following table shows the gains and losses on derivatives for the periods presented. There were no gains or losses reclassified from accumulated other comprehensive income (OCI) into income or gains or losses recognized in income on derivatives ineffective portion or any amounts excluded from effective testing.

		Net Amount Gain (Loss) Three Months Ended September 30		Net Amount Gain (Loss) Nine Months Ended September 30	
Derivative	Classification	2017	2016	2017	2016
Interest Rate Swaps	Other comprehensive income	$554	$-	$3,170	$5,541
Loan commitments	Mortgage fee income	$(4,833,268)	$(1,505,820)	$(3,677,554)	$1,459,568
Call and put options	Realized gains on investments and other assets	$27,734	$73,250	$216,561	$210,522

11) Reinsurance, Commitments and Contingencies

Reinsurance

The Company follows the procedure of reinsuring risks in excess of a specified limit, which ranges from $25,000 to $100,000. The Company is liable for these amounts in the event such reinsurers are unable to pay their portion of the claims. The Company has also assumed insurance from other companies.

Mortgage Loan Loss Settlements

Future loan losses can be extremely difficult to estimate. However, management believes that the Company's reserve methodology and its current practice of property preservation allow it to estimate its potential losses on loans sold. The estimated liability for indemnification losses is included in other liabilities and accrued expenses and, as of September 30, 2017 and December 31, 2016, the balances were $2,171,000 and $628,000, respectively.

Mortgage Loan Loss Litigation

Lehman Brothers Holdings Litigation – Delaware and New York

In January 2014, Lehman Brothers Holdings, Inc. ("Lehman Holdings") entered into a settlement with the Federal National Mortgage Association (Fannie Mae) concerning the mortgage loan claims that Fannie Mae had asserted against Lehman Holdings, which were based on alleged breaches of certain representations and warranties by Lehman Holdings in the mortgage loans it had sold to Fannie Mae. Lehman Holdings acquired these loans from Aurora Bank, FSB, formerly known as Lehman Brothers Bank, FSB, which in turn purchased the loans from certain residential mortgage loan originators, including SecurityNational Mortgage. A settlement based on similar circumstances was entered into between Lehman Holdings and the Federal Home Loan Mortgage Corporation (Freddie Mac) in February 2014.

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11) Reinsurance, Commitments and Contingencies (Continued)

Lehman Holdings filed a motion in May 2014 with the U.S. Bankruptcy Court of the Southern District of New York to require the mortgage loan originators, including SecurityNational Mortgage, to engage in non-binding mediations of their alleged indemnification claims against the mortgage loan originators relative to the Fannie Mae and Freddie Mac settlements with Lehman Holdings. The mediation was not successful in resolving any issues between SecurityNational Mortgage and Lehman Holdings.

On January 26, 2016, SecurityNational Mortgage filed a declaratory judgment action against Lehman Holdings in the Superior Court for the State of Delaware. In the Delaware action, SecurityNational Mortgage asserted its right to obtain a declaration of rights in that there are allegedly millions of dollars in dispute with Lehman Holdings pertaining to approximately 136 loans. SecurityNational Mortgage sought a declaratory judgment as to its rights as it contends that it has no liability to Lehman Holdings as a result of Lehman Holdings' settlements with Fannie Mae and Freddie Mac. Lehman Holdings filed a motion in the Delaware court seeking to stay or dismiss the declaratory judgment action. On August 24, 2016, the Court ruled that it would exercise its discretion to decline jurisdiction over the action and granted Lehman Holdings' motion to dismiss.

On February 3, 2016, Lehman Holdings filed an adversary proceeding against approximately 150 mortgage loan originators, including SecurityNational Mortgage, in the U.S. Bankruptcy Court of the Southern District of New York seeking a declaration of rights similar in nature to the declaratory judgment that SecurityNational Mortgage sought in its Delaware lawsuit, and for damages relating to the alleged obligations of the defendants under the indemnification provisions of the alleged agreements, in amounts to be determined at trial, including interest, attorneys' fees and costs incurred by Lehman Holdings in enforcing the obligations of the defendants. No response was required to be filed relative to the Complaint or the Amended Complaint dated March 7, 2016. A Case Management Order was entered on November 1, 2016.

On December 27, 2016, pursuant to the Case Management Order, Lehman Holdings filed a Second Amended Complaint against SecurityNational Mortgage, which eliminates the declaratory judgment claim but retains a similar claim for damages as in the Complaint. The case is presently in a motion period. Many of the defendants, including SecurityNational Mortgage, filed a joint motion in the case asserting that the Bankruptcy Court does not have subject matter jurisdiction concerning the matter and that venue is improper. Lehman Holdings' response memorandum was filed on May 31, 2017 and a reply memorandum of the defendants filing the motion was filed on July 14, 2017. A hearing date for the motion has not been set. No Answer to the Second Amended Complaint is required to be filed by SecurityNational Mortgage pending further order of the Court. SecurityNational Mortgage denies that it has any liability to Lehman Holdings and intends to vigorously protect and defend its position.

Other Contingencies and Commitments

The Company has entered into commitments to fund construction and land development loans and has also provided financing for land acquisition and development. As of September 30, 2017, the Company's commitments were approximately $69,601,000 for these loans, of which $41,307,000 had been funded. The Company will advance funds once the work has been completed and an independent inspection is made. The maximum loan commitment ranges between 50% and 80% of appraised value. The Company receives fees and interest for these loans and the interest rate is generally fixed 5.50% to 8.00% per annum. Maturities range between six and eighteen months.

The Company belongs to a captive insurance group for certain casualty insurance, worker compensation and liability programs. Insurance reserves are maintained relative to these programs. The level of exposure from catastrophic events is limited by the purchase of stop-loss and aggregate liability reinsurance coverage. When estimating the insurance liabilities and related reserves, the captive insurance management considers a number of factors, which include historical claims experience, demographic factors, severity factors and valuations provided by independent third-party actuaries. If actual claims or adverse development of loss reserves occurs and exceed these estimates, additional reserves may be required. The estimation process contains uncertainty since captive insurance management must use judgment to estimate the ultimate cost that will be incurred to settle reported claims and unreported claims for incidents incurred but not reported as of the balance sheet date.

The Company is a defendant in various other legal actions arising from the normal conduct of business. Management believes that none of the actions will have a material effect on the Company's financial position or results of operations. Based on management's assessment and legal counsel's representations concerning the likelihood of unfavorable outcomes, no amounts have been accrued for the above claims in the consolidated financial statements.

The Company is not a party to any other material legal proceedings outside the ordinary course of business or to any other legal proceedings, which, if adversely determined, would have a material adverse effect on its financial condition or results of operations.

12) Mortgage Servicing Rights

The Company initially records these Mortgage Servicing Rights ("MSRs") at fair value as discussed in Note 8.

The Company's subsequent accounting for MSRs is based on the class of MSRs. The Company has identified two classes of MSRs: MSRs backed by mortgage loans with initial term of 30 years and MSRs backed by mortgage loans with initial term of 15 years. The Company distinguishes between these classes of MSRs due to their differing sensitivities to change in value as the result of changes in market. After being initially recorded at fair value, MSRs backed by mortgage loans are accounted for using the amortization method. MSR amortization is determined by amortizing the balance straight-line over an estimated seven and nine-year life which estimates the proportion to, and over the period of the estimated future net servicing income of the underlying financial assets.

The Company periodically assesses MSRs for impairment. Impairment occurs when the current fair value of the MSR falls below the asset's carrying value (carrying value is the amortized cost reduced by any related valuation allowance). If MSRs are impaired, the impairment is recognized in current-period earnings and the carrying value of the MSRs is adjusted through a valuation allowance.

Management periodically reviews the various loan strata to determine whether the value of the MSRs in a given stratum is impaired and likely to recover. When management deems recovery of the value to be unlikely in the foreseeable future, a write-down of the cost of the MSRs for that stratum to its estimated recoverable value is charged to the valuation allowance.

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12) Mortgage Servicing Rights (Continued)

The following is a summary of the MSR activity for the periods presented.

	As of September 30 2017	As of December 31 2016
Amortized cost:		
Balance before valuation allowance at beginning of year	$18,872,362	$12,679,755
MSR additions resulting from loan sales	4,057,974	8,603,154
Amortization (1)	(2,533,768)	(2,410,547)
Application of valuation allowance to write down MSRs with other than temporary impairment	-	-
Balance before valuation allowance at end of period	$20,396,568	$18,872,362
Valuation allowance for impairment of MSRs:		
Balance at beginning of year	$-	$-
Additions	-	-
Application of valuation allowance to write down MSRs with other than temporary impairment	-	-
Balance at end of period	$-	$-
Mortgage servicing rights, net	$20,396,568	$18,872,362
Estimated fair value of MSRs at end of period	$26,785,380	$25,496,832

(1) Included in other expenses on the condensed consolidated statements of earnings

The following table summarizes the Company's estimate of future amortization of its existing MSRs carried at amortized cost:

	Estimated MSR Amortization
2017	$ 162,284
2018	3,372,381
2019	3,372,381
2020	3,372,381
2021	3,372,381
Thereafter	6,744,760
Total	$ 20,396,568

The Company collected the following contractual servicing fee income and late fee income as reported in other revenues on the condensed consolidated statement of earnings:

	Three Months Ended September 30		Nine Months Ended September 30	
	2017	2016	2017	2016
Contractual servicing fees	$1,848,831	$1,496,365	$5,359,425	$4,024,720
Late fees	99,077	67,032	266,218	189,237
Total	$1,947,908	$1,563,397	$5,625,643	$4,213,957

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12) Mortgage Servicing Rights (Continued)

The following is a summary of the unpaid principal balances ("UPB") of the servicing portfolio for the periods presented:

	As of September 30 2017	As of December 31 2016
Servicing UPB	$3,003,608,494	$2,720,441,340

The following key assumptions were used in determining MSR value:

	Prepayment Speeds	Average Life (Years)	Discount Rate
September 30, 2017	3.59	6.2	10.01
December 31, 2016	3.77	6.52	10.01

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13) Acquisitions

Acquisition of First Guaranty Insurance Company

On July 11, 2016, the Company, through its wholly owned subsidiary Security National Life, completed the stock purchase transaction with the shareholders of Reppond Holding Corporation, an Arkansas corporation ("Reppond Holding") and sole shareholder of First Guaranty Insurance Company, a Louisiana domestic stock legal reserve life insurance company ("First Guaranty"), to purchase all the outstanding shares of common stock of Reppond Holding. Under the terms of the stock purchase agreement, dated February 17, 2016, between Security National Life and Reppond Holding, which was later amended on March 4 and 17, 2016, Security National Life paid a total of $6,753,000 at the closing in consideration for the purchase of all the outstanding shares of stock of Reppond Holding from its shareholders.

The estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition were as follows:

Fixed maturity securities, held to maturity	$43,878,084
Equity securities, available for sale	646,335
Mortgage loans held for investment	4,528,582
Real estate held for investment	528,947
Policy loans	145,953
Short-term investments	5,358,403
Accrued investment income	585,985
Cash and cash equivalents	2,424,480
Receivables	73,347
Property and equipment	21,083
Deferred tax asset	1,190,862
Receivable from reinsurers	34,948
Other	57,768
Total assets acquired	59,474,777
Future policy benefits and unpaid claims	(52,648,838)
Accounts payable	(6,953)
Other liabilities and accrued expenses	(65,986)
Total liabilities assumed	(52,721,777)
Fair value of net assets acquired/consideration paid	$6,753,000

The estimated fair value of the fixed maturity securities and the equity securities is based on unadjusted quoted prices for identical assets in an active market. These types of financial assets are considered Level 1 under the fair value hierarchy. The estimated fair value of future policy benefits and unpaid claims is based on assumptions of the future value of the business acquired. Based on the unobservable nature of certain of these assumptions, the valuation for these financial liabilities is considered to be Level 3 under the fair value hierarchy. The Company determined that the estimated fair value of the remaining assets and liabilities acquired approximated their book values. The fair value of assets acquired and liabilities assumed were subject to adjustment during the first twelve months after the acquisition date if additional information became available to indicate a more accurate or appropriate value for an asset or liability. No adjustments were made.

SECURITY NATIONAL FINANCIAL CORPORATION AND SUBSIDIARIES
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13) Acquisitions (Continued)

The following unaudited pro forma information has been prepared to present the results of operations of the Company assuming the acquisition of First Guaranty had occurred at the beginning of the three and nine-month periods ended September 30, 2016. This pro forma information is supplemental and does not necessarily present the operations of the Company that would have occurred had the acquisition occurred on those dates and may not reflect the operations that will occur in the future:

	For the Nine Months Ended September 30 (unaudited) 2016
Total revenues	$234,629,101
Net earnings	$11,472,978
Net earnings per Class A equivalent common share	$0.78
Net earnings per Class A equivalent common share assuming dilution	$0.76

The pro forma results for the three and nine-month periods ended September 30, 2017 and for the three-month period ended September 30, 2016 are not included in the table above because the operating results for the First Guaranty acquisition were included in the Company's condensed consolidated statements of earnings for these periods.

14) Income Taxes

The Company's overall effective tax rate for the three months ended September 30, 2017 and 2016 was 3.6% and 36.4%, respectively, which resulted in a provision for income taxes of $41,000 and $2,390,000, respectively. The Company's overall effective tax rate for the nine months ended September 30, 2017 and 2016 was 32.2% and 37.0%, respectively, which resulted in a provision for income taxes of $2,587,000 and $6,892,000, respectively. The Company's effective tax rates differ from the U.S. federal statutory rate of 34% largely due to its provision for state income taxes and a reduction in the valuation allowance related to the prior acquisition of First Guaranty Insurance Company that decreased the effective income tax rates for both periods, when compared to the prior year periods.

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

Overview

The Company's operations over the last several years generally reflect three trends or events which the Company expects to continue: (i) increased attention to "niche" insurance products, such as the Company's funeral plan policies and traditional whole life products; (ii) emphasis on cemetery and mortuary business; and (iii) capitalizing on relatively low interest rates by originating mortgage loans.

Insurance Operations

The Company's life insurance business includes funeral plans and interest-sensitive life insurance, as well as other traditional life, accident and health insurance products. The Company places specific marketing emphasis on funeral plans through pre-need planning.

A funeral plan is a small face value life insurance policy that generally has face coverage of up to $25,000. The Company believes that funeral plans represent a marketing niche that has lower competition because most insurance companies do not offer similar coverage. The purpose of the funeral plan policy is to pay the costs and expenses incurred at the time of a person's death. On a per thousand-dollar cost of insurance basis, these policies can be more expensive to the policyholder than many types of non-burial insurance due to their low face amount, requiring the fixed cost of the policy administration to be distributed over a smaller policy size, and the simplified underwriting practices that result in higher mortality costs.

The following table shows the condensed financial results of the insurance operations for three and nine months ended September 30, 2017 and 2016. See Note 7 to the condensed consolidated financial statements.

	Three months ended September 30 (in thousands of dollars)			Nine months ended September 30 (in thousands of dollars)		
	2017	2016	% Increase (Decrease)	2017	2016	% Increase (Decrease)
Revenues from external customers						
Insurance premiums	$17,490	$17,157	2 %	$52,345	$47,508	10 %
Net investment income	8,110	7,828	4 %	24,831	22,768	9 %
Other	(370)	(13)	2746 %	(64)	341	(119 %)
Total	$25,230	$24,972	1 %	$77,112	$70,617	9 %
Intersegment revenue	$3,334	$3,319	0 %	$9,300	$9,781	(5 %)
Earnings before income taxes	$523	$2,139	(76 %)	$4,825	$5,785	(17 %)

Intersegment revenues are primarily interest income from the warehouse line provided to SecurityNational Mortgage Company ("SecurityNational Mortgage"). Profitability in the three and nine months ended September 30, 2017 has decreased due to increases in benefits and expenses and increases in other than temporary impairments.

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Cemetery and Mortuary Operations

The Company sells mortuary services and products through its eight mortuaries in Utah. The Company also sells cemetery products and services through its five cemeteries in Utah and one cemetery in San Diego County, California. At-need product sales and services are recognized as revenue when the services are performed or when the products are delivered. Pre-need cemetery product sales are deferred until the merchandise is delivered and services performed. Recognition of revenue for cemetery land sales occurs when 10% of the purchase price is received.

The following table shows the condensed financial results of the cemetery and mortuary operations for the three and nine months ended September 30, 2017 and 2016. See Note 7 to the condensed consolidated financial statements.

	Three months ended September 30 (in thousands of dollars)			Nine months ended September 30 (in thousands of dollars)		
	2017	2016	% Increase (Decrease)	2017	2016	% Increase (Decrease)
Revenues from external customers						
Mortuary revenues	$1,161	$1,059	10 %	$3,749	$3,711	1 %
Cemetery revenues	1,697	1,818	(7 %)	6,041	6,186	(2 %)
Other	130	24	442 %	117	148	(21 %)
Total	$2,988	$2,901	3 %	$9,907	$10,045	(1 %)
Earnings before income taxes	$237	$55	331 %	$1,332	$1,284	4 %

Included in other revenue is rental income from residential and commercial properties purchased from Security National Life. Memorial Estates purchased these properties from financing provided by Security National Life. The rental income is offset by property insurance, taxes and maintenance expenses. Memorial Estates has recorded depreciation on these properties of $157,000 and $176,000 for the three months ended September 30, 2017 and 2016, respectively, and $490,000 and $543,000 for the nine months ended September 30, 2017 and 2016, respectively.

Mortgage Operations

The Company's wholly owned subsidiaries, SecurityNational Mortgage and EverLEND Mortgage Company (formerly known as Green Street Mortgage Services, Inc.), are mortgage lenders incorporated under the laws of the State of Utah and approved and regulated by the Federal Housing Administration (FHA), a department of the U.S. Department of Housing and Urban Development (HUD), which originate mortgage loans that qualify for government insurance in the event of default by the borrower, in addition to various conventional mortgage loan products. SecurityNational Mortgage and EverLEND Mortgage originate and refinance mortgage loans on a retail basis. Mortgage loans originated or refinanced by the Company's mortgage subsidiaries are funded through loan purchase agreements with Security National Life and unaffiliated financial institutions.

The Company's mortgage subsidiaries receive fees from borrowers that are involved in mortgage loan originations and refinancings, and secondary fees earned from third party investors that purchase the mortgage loans originated by the mortgage subsidiaries. Mortgage loans originated by the mortgage subsidiaries are generally sold with mortgage servicing rights released to third-party investors or retained by SecurityNational Mortgage. SecurityNational Mortgage currently retains the mortgage servicing rights on approximately 30% of its loan origination volume. These mortgage loans are serviced by either SecurityNational Mortgage or an approved third-party sub-servicer.

For the nine months ended September 30, 2017 and 2016, SecurityNational Mortgage originated 9,773 loans ($1,913,207,000 total volume) and 11,720 loans ($2,252,108,000 total volume), respectively. For the nine months ended September 30, 2017 and 2016, EverLEND Mortgage originated 29 loans ($6,715,000 total volume) and one loan ($256,000 total volume), respectively.

The following table shows the condensed financial results of the mortgage operations for the three and nine months ended September 30, 2017 and 2016. See Note 7 to the condensed consolidated financial statements.

	Three months ended September 30 (in thousands of dollars)			Nine months ended September 30 (in thousands of dollars)		
	2017	2016	% Increase (Decrease)	2017	2016	% Increase (Decrease)
Revenues from external customers						
Income from loan originations	$15,204	$13,728	11 %	$41,788	$43,163	(3 %)
Secondary gains from investors	28,550	41,347	(31 %)	87,166	108,667	(20 %)
Total	$43,754	$55,075	(21 %)	$128,954	$151,830	(15 %)
Earnings before income taxes	$379	$4,379	(91 %)	$1,874	$11,561	(84 %)

The decrease in earnings for the three and nine months ended September 30, 2017 was due to a reduction in mortgage loan originations and refinancings, and subsequent sales into the secondary market.

Mortgage Loan Loss Settlements

Future mortgage loan losses can be extremely difficult to estimate. However, management believes that the Company's reserve methodology and its current practice of property preservation allow it to estimate its potential losses on mortgage loans sold. The estimated liability for indemnification losses was included in other liabilities and accrued expenses and, as of September 30, 2017 and December 31, 2016, the balances were $2,171,000 and $628,000, respectively.

Mortgage Loan Loss Litigation

For a description of the litigation involving SecurityNational Mortgage and Lehman Brothers Holdings, see Part I, Item 1. Notes to Condensed Consolidated Financial Statements (unaudited) in Note 11.

Consolidation

Three Months Ended September 30, 2017 Compared to Three Months Ended September 30, 2016

Total revenues decreased by $10,977,000, or 13.2%, to $71,972,000 for the three months ended September 30, 2017, from $82,949,000 for the comparable period in 2016. Contributing to this decrease in total revenues was a $11,598,000 decrease in mortgage fee income, a $280,000 decrease in realized gains on investments and other assets, a $133,000 increase in other than temporary impairments on investments, and a $59,000 decrease in net mortuary and cemetery sales. This decrease in total revenues was partially offset by a $490,000 increase in other revenues, a $332,000 increase in insurance premiums and other considerations, and a $271,000 increase in net investment income.

Insurance premiums and other considerations increased by $332,000, or 1.9%, to $17,489,000 for the three months ended September 30, 2017, from $17,157,000 for the comparable period in 2016. This increase was primarily due to an increase in renewal premiums and an increase in first year premiums as a result of increased insurance sales.

Net investment income increased by $271,000, or 3.4%, to $8,361,000 for the three months ended September 30, 2017, from $8,090,000 for the comparable period in 2016. This increase was primarily attributable to a $282,000 increase in fixed maturity securities income, a $282,000 increase in insurance assignment income, a $142,000 increase in mortgage loan interest, an $89,000 increase in short-term investment income, an $82,000 increase in rental income from real estate owned, and a $16,000 increase in income from other investments. This increase was partially offset by a $600,000 increase in investment expenses, a $12,000 decrease in equity securities income, and a $10,000 decrease in policy loan income.

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Net mortuary and cemetery sales decreased by $59,000, or 2.1%, to $2,717,000 for the three months ended September 30, 2017, from $2,776,000 for the comparable period in 2016. This decrease was primarily due to a decrease in sales of cemetery plots, markers and vaults.

Realized gains on investments and other assets decreased by $280,000, or 716.1%, to $319,000 in realized losses for the three months ended September 30, 2017, from $39,000 in realized losses for the comparable period in 2016. This decrease in realized gains on investments and other assets was primarily attributable to a $602,000 increase in realized losses on fixed maturity securities, and a $6,000 increase in realized losses on securities available for sale. This increase was partially offset by a $328,000 increase in realized gains on other assets due to the sale of various residential real estate properties.

Mortgage fee income decreased by $11,598,000, or 21.8%, to $41,598,000, for the three months ended September 30, 2017, from $53,196,000 for the comparable period in 2016. This decrease was primarily due to a decline in mortgage loan originations that was indicative of the mortgage loan industry as a whole. The decline in mortgage loan originations was primarily caused by a shortage of available new housing for mortgage loan origination transactions, and the decline in mortgage loan refinancings was primarily caused by recent increases in interest rates on mortgage loans. Additionally, the decline in mortgage originations and refinancings by SecurityNational Mortgage has resulted in a decline in fees earned from third-party investors that purchase mortgage loans from SecurityNational Mortgage.

Other revenues increased by $490,000, or 27.2%, to $2,289,000 for the three months ended September 30, 2017, from $1,799,000 for the comparable period in 2016. This increase was due to an increase in mortgage servicing fees.

Total benefits and expenses were $70,834,000, or 98.4% of total revenues, for the three months ended September 30, 2017, as compared to $76,375,000, or 92.1% of total revenues, for the comparable period in 2016.

Death benefits, surrenders and other policy benefits, and future policy benefits increased by an aggregate of $1,791,000 or 12.6%, to $16,055,000 for the three months ended September 30, 2017, from $14,264,000 for the comparable period in 2016. This increase was primarily the result of a $1,522,000 increase in death benefits and a $352,000 increase in future policy benefits. This increase was partially offset by a $83,000 decrease in surrender and other policy benefits.

Amortization of deferred policy and pre-need acquisition costs and value of business acquired decreased by $62,000, or 2.7%, to $2,239,000 for the three months ended September 30, 2017, from $2,301,000 for the comparable period in 2016. This decrease was primarily due to improved persistency in the traditional life business.

Selling, general and administrative expenses decreased by $7,417,000, or 12.8%, to $50,431,000 for the three months ended September 30, 2017, from $57,848,000 for the comparable period in 2016. This decrease was primarily the result of a $5,396,000 decrease in commissions resulting from a decrease in sales (primarily mortgage fee income), a $1,040,000 decrease in other expenses, a $600,000 decrease in the provision for loan loss reserve, a $555,000 decrease in personnel expenses, a $394,000 decrease in advertising, and a $11,000 decrease in depreciation on property and equipment. This decrease was partially offset by a $444,000 increase in costs related to funding mortgage loans, and a $135,000 increase in rent and rent related expenses.

Interest expense increased by $180,000, or 12.2%, to $1,656,000 for the three months ended September 30, 2017, from $1,476,000 for the comparable period in 2016. This increase was primarily due to an increase in interest expense on mortgage warehouse lines and interest expense on bank loans for real estate held for investment.

Comprehensive income for the three months ended September 30, 2017 and 2016 amounted to gains of $1,191,000 and $4,321,000, respectively. This $3,130,000 decrease in comprehensive income was primarily the result of a $3,086,000 decrease in net income and a $44,000 decrease in unrealized gains in securities available for sale.

Nine Months Ended September 30, 2017 Compared to Nine Months Ended September 30, 2016

Total revenues decreased by $16,519,000, or 7.1%, to $215,973,000 for the nine months ended September 30, 2017, from $232,492,000 for the comparable period in 2016. Contributing to this decrease in total revenues was a $24,881,000 decrease in mortgage fee income, a $348,000 increase in other than temporary impairments on investments, and a $185,000 decrease in net mortuary and cemetery sales. This decrease in total revenues was partially offset by $4,837,000 increase in insurance premiums and other considerations, a $2,075,000 increase in net investment income, a $1,449,000 increase in other revenues, and a $534,000 increase in realized gains on investments and other assets.

Insurance premiums and other considerations increased by $4,837,000, or 10.2%, to $52,345,000 for the nine months ended September 30, 2017, from $47,508,000 for the comparable period in 2016. This increase was primarily due to an increase in renewal premiums and an increase in first year premiums as a result of increased insurance sales.

Net investment income increased by $2,074,000, or 8.8%, to $25,559,000 for the nine months ended September 30, 2017, from $23,484,000 for the comparable period in 2016. This increase was primarily attributable to a $1,028,000 increase in insurance assignment income, a $1,002,000 increase in fixed maturity securities income, a $565,000 increase in mortgage loan interest, a $378,000 increase in rental income from real estate owned, a $246,000 increase in short-term investment income, a $63,000 increase in policy loan income, and a $22,000 increase in income from other investments. This increase was partially offset by a $1,230,000 increase in investment expenses.

Net mortuary and cemetery sales decreased by $185,000, or 1.9%, to $9,357,000 for the nine months ended September 30, 2017, from $9,542,000 for the comparable period in 2016. This decrease was primarily due to a decrease in sales of cemetery plots, markers and vaults.

Realized gains on investments and other assets increased by $534,000, or 297.7%, to $713,000 in realized gains for the nine months ended September 30, 2017, from $179,000 in realized gains for the comparable period in 2016. This increase in realized gains on investments and other assets was primarily attributable to a $1,374,000 increase in realized gains on other assets due to the sale of a commercial real estate property and various residential real estate properties. This increase was partially offset by a $775,000 increase in realized losses on fixed maturity securities, and a $65,000 increase in realized losses on securities available for sale.

Mortgage fee income decreased by $24,881,000, or 16.9%, to $122,086,000, for the nine months ended September 30, 2017, from $146,967,000 for the comparable period in 2016. This decrease was primarily due to a decline in mortgage loan originations that was indicative of the mortgage loan industry as a whole. The decline in mortgage loan originations was primarily caused by a shortage of available new housing for mortgage loan origination transactions, and the decline in mortgage loan refinancings was primarily caused by recent increases in interest rates on mortgage loans. Additionally, the decline in mortgage originations and refinancings by SecurityNational Mortgage has resulted in a decline in fees earned from third-party investors that purchase mortgage loans from SecurityNational Mortgage.

Other revenues increased by $1,449,000, or 29.3%, to $6,394,000 for the nine months ended September 30, 2017, from $4,945,000 for the comparable period in 2016. This increase was due to an increase in mortgage servicing fees.

Total benefits and expenses were $207,943,000, or 96.3% of total revenues, for the nine months ended September 30, 2017, as compared to $213,862,000, or 92.0% of total revenues, for the comparable period in 2016.

Death benefits, surrenders and other policy benefits, and future policy benefits increased by an aggregate of $5,971,000 or 15.0%, to $45,868,000 for the nine months ended September 30, 2017, from $39,897,000 for the comparable period in 2016. This increase was primarily the result of a $3,704,000 increase in death benefits, a $1,892,000 increase in future policy benefits, and a $375,000 increase in surrender and other policy benefits.

Amortization of deferred policy and pre-need acquisition costs and value of business acquired increased by $50,000, or 0.8%, to $6,271,000 for the nine months ended September 30, 2017, from $6,221,000 for the comparable period in 2016. This increase was primarily due to an increase in insurance sales expenses.

Selling, general and administrative expenses decreased by $12,571,000, or 7.7%, to $150,000,000 for the nine months ended September 30, 2017, from $162,571,000 for the comparable period in 2016. This decrease was primarily the result of a $14,338,000 decrease in commissions resulting from a decrease in sales (primarily mortgage fee income), a $646,000 decrease in advertising, and a $600,000 decrease in the provision for loan loss reserve. This increase was partially offset by a $1,220,000 increase in personnel expenses, a $839,000 increase in other expenses, a $458,000 increase in rent and rent related expenses, a $358,000 increase in costs related to funding mortgage loans, and a $138,000 increase in depreciation on property and equipment.

Interest expense increased by $520,000, or 13.8%, to $4,295,000 for the nine months ended September 30, 2017, from $3,775,000 for the comparable period in 2016. This increase was primarily due to an increase in interest expense on mortgage warehouse lines and interest expense on bank loans related to real estate held for investment.

Comprehensive income for the nine months ended September 30, 2017 and 2016 amounted to gains of $5,515,000 and $12,188,000, respectively. This $6,673,000 decrease in comprehensive income was primarily the result of a $6,295,000 decrease in net income and a $378,000 decrease in unrealized gains in securities available for sale.

Liquidity and Capital Resources

The Company's life insurance subsidiaries and cemetery and mortuary subsidiaries realize cash flow from premiums, contract payments and sales on personal services rendered for cemetery and mortuary business, from interest and dividends on invested assets, and from the proceeds from the maturity of held to maturity investments or sale of other investments. The mortgage subsidiaries realize cash flow from fees generated by originating and refinancing mortgage loans, and fees earned from mortgage loans sold to investors. The Company considers these sources of cash flow to be adequate to fund future policyholder and cemetery and mortuary liabilities, which generally are long-term and adequate to pay current policyholder claims, annuity payments, expenses related to the issuance of new policies, the maintenance of existing policies, debt service, and to meet current operating expenses.

During the nine months ended September 30, 2017 and 2016, the Company's operations provided cash of $6,030,000 and $17,639,672, respectively. This decrease was due primarily to a decline in cash collected on loans held for sale during the nine months ended September 30, 2017.

The Company's liability for future policy benefits is expected to be paid out over the long-term due to the Company's market niche of selling funeral plans. Funeral plans are small face value life insurance that will pay the costs and expenses incurred at the time of a person's death. A person generally will keep these policies in force and will not surrender them prior to a person's death. Because of the long-term nature of these liabilities, the Company is able to hold to maturity its bonds, real estate and mortgage loans, thus reducing the risk of liquidating these long-term investments as a result of any sudden changes in fair values.

The Company attempts to match the duration of invested assets with its policyholder and cemetery and mortuary liabilities. The Company may sell investments other than those held to maturity in the portfolio to help in this timing. The Company purchases short-term investments on a temporary basis to meet the expectations of short-term requirements of the Company's products. The Company's investment philosophy is intended to provide a rate of return that will persist during the expected duration of policyholder and cemetery and mortuary liabilities regardless of future interest rate movements.

The Company's investment policy is to invest predominantly in fixed maturity securities, real estate, mortgage loans, and warehousing of mortgage loans on a short-term basis before selling the loans to investors in accordance with the requirements and laws governing the life insurance subsidiaries. Bonds owned by the insurance subsidiaries amounted to $230,188,000 and $184,356,000 as of September 30, 2017 and December 31, 2016, respectively. This represents 38.5% and 33.1% of the total investments as of September 30, 2017 and December 31, 2016, respectively. Generally, all bonds owned by the life insurance subsidiaries are rated by the National Association of Insurance Commissioners.

Under this rating system, there are six categories used for rating bonds. At September 30, 2017, 5.4% (or $12,449,000) and at December 31, 2016, 9.0% (or $16,513,000) of the Company's total bond investments were invested in bonds in rating categories three through six, which were considered non investment grade.

The Company has classified its fixed income securities, including high-yield securities, in its portfolio as held to maturity. Notwithstanding, business conditions may develop in the future which may indicate a need for a higher level of liquidity in the investment portfolio. In that event, the Company believes it could sell short-term investment grade securities before liquidating higher yielding longer-term securities.

The Company is subject to risk based capital guidelines established by statutory regulators requiring minimum capital levels based on the perceived risk of assets, liabilities, disintermediation, and business risk. At September 30, 2017 and December 31, 2016, the life insurance subsidiaries were in compliance with the regulatory criteria.

The Company's total capitalization of stockholders' equity, bank and other loans payable was $322,114,000 as of September 30, 2017, as compared to $284,700,000 as of December 31, 2016. Stockholders' equity as a percent of total capitalization was 43.3% and 46.6% as of September 30, 2017 and December 31, 2016, respectively.

Lapse rates measure the amount of insurance terminated during a particular period. The Company's lapse rate for life insurance in 2016 was 9.6% as compared to a rate of 7.4% for 2015. The 2017 lapse rate to date has been approximately the same as 2016.

At September 30, 2017, the statutory capital and surplus of the Company's life insurance subsidiaries was $42,584,000. The life insurance subsidiaries cannot pay a dividend to its parent company, without approval of state insurance regulatory authorities.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

As a smaller reporting company, the Company is not required to provide information typically disclosed under this item.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

As of September 30, 2017, the Company carried out an evaluation under the supervision and with the participation of its Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed in the Securities and Exchange Commission (SEC) reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time period specified by the SEC's rules and forms and that such information is accumulated and communicated to management, including the Company's CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. The officers have concluded that the Company's disclosure controls and procedures were not effective as of September 30, 2017, and that the unaudited condensed consolidated financial statements included in this Quarterly Report on Form 10-Q fairly present, in all material respects, the Company's financial condition, results of operations and cash flows for the periods presented in conformity with United States Generally Accepted Accounting Principles (GAAP).

Changes in Internal Control over Financial Reporting

Except for the material weaknesses discussed in the Company's Annual Report on Form 10K/A, there have not been any significant changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities and Exchange Act of 1934, as amended) in the third quarter of 2017 that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

Remediation Efforts to Address Material Weakness

During the fourth quarter of 2016, there were changes in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting. Two of the prior errors were determined to be immaterial errors and were noted in connection with the annual audit of the Company's consolidated financial statements for the fiscal year ended December 31, 2016. The other two errors were discovered as a result of a review of current accounting policies and were determined to be material errors. Management has corrected these errors in the Form 10-K/A for the fiscal year ended December 2016. See Notes 21 and 22 to the Company's consolidated financial statements.

The Company is implementing measures to remediate the underlying causes that gave rise to the material weaknesses. The following remediation steps are among the measures currently being implemented at the time of this filing by management: (i) a thorough review of the accounting department to ensure that the staff has the appropriate training and the level of reviews are commensurate with the complexity of the accounting; (ii) a thorough review of the processes and procedures used in the Company's accounting policies and the implementation of those policies; and (iii) engaging an outside specialist to help with the complex accounting matters related to the Company's mortgage banking operations.

The Company believes the measures described above will remediate the control deficiencies that it identified and strengthened its internal control over financial reporting. The Company is committed to continuous improvement of its internal control processes and will continue to diligently review its financial reporting controls and procedures.

Part II - Other Information

Item 1. Legal Proceedings.

For a description of the litigation involving SecurityNational Mortgage and Lehman Brothers Holdings, see Part I, Item 1. Notes to Condensed Consolidated Financial Statements (unaudited) in Note 11.

The Company is not a party to any other material legal proceedings outside the ordinary course of business or to any other legal proceedings, which if adversely determined, would have a material adverse effect on its financial condition or results of operation.

Item 1A. Risk Factors.

As a smaller reporting company, the Company is not required to provide information typically disclosed under this item.

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

Recent Sales of Unregistered Securities and Use of Proceeds from Registered Securities

None.

Issuer Purchases of Equity Securities

On September 11, 2015, the Board approved the Company's Stock Purchase Plan for the mutual benefit of the Company and its stockholders. Under the terms of the Plan, the Company may, in its discretion, purchase shares of Class A common stock from its officers and directors who exercise the stock options granted to them under any of the Company's stock option plans with the proceeds from such purchase to be used to pay the taxes owed by such officers and directors as a result of the exercise of their stock options. Additionally, the officers and directors who exercise their stock options may, in their discretion, request that the Company purchase shares of their Class A common stock with the proceeds from such sale to be used to pay the taxes owed by such officers and directors as a result of the exercise of their stock options.

The Company is authorized under the plan to purchase no more than 60,000 shares of Class A common stock in any calendar year to pay the taxes owed by the officers and directors who exercise their stock options under the Stock Purchase Plan. The Company's purchase price for the Class A common stock under the Stock Purchase Plan shall be equal to the closing sales price of the Company's Class A common stock as reported by The Nasdaq National Market on the day that the applicable stock options are exercised by such officers and directors. The Company may only purchase shares of Class A common stock from the officers and directors exercising their stock options under the Stock Purchase Plan during the "Trading Window" as defined in the Company's Insider Trading Policy and Guidelines.

The following table shows the Company's repurchase activity during the nine months ended September 30, 2017 under the Stock Purchase Plan.

Period	(a) Total Number of Class A Shares Purchased		(b) Average Price Paid per Class A Share	(c) Total Number of Class A Shares Purchased as Part of Publicly Announced Plan or Program	(d) Maximum Number (or Approximate Dollar Value) of Class A Shares that May Yet Be Purchased Under the Plan or Program
1/1/2017-1/31/2017	-		-		
2/1/2017-2/28/2017	-		-		
3/1/2017-3/31/2017	29,393	(1)	$ 6.31		
4/1/2017-4/30/2017	-		-		
5/1/2017-5/31/2017	-		-		
6/1/2017-6/30/2017	-		-		
7/1/2017-7/31/2017	-		-		
8/1/2017-8/31/2017	-		-		
9/1/2017-9/30/2017	-		-		
Total	29,393		$ 6.31	-	-

(1) On March 29, 2017, the Company purchased 29,393 shares of its Class A common stock from Scott M. Quist, Chairman, President and Chief Executive Officer of the Company, pursuant to the Company's Stock Purchase Plan.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits, Financial Statements Schedules and Reports on Form 8-K.

(a)(1) Financial Statements

See "Table of Contents – Part I – Financial Information" under page 2 above

(a)(2) Financial Statement Schedules

None

All other schedules to the consolidated financial statements required by Article 7 of Regulation S X are not required under the related instructions or are inapplicable and therefore have been omitted.

(a)(3) Exhibits

The following Exhibits are filed herewith pursuant to Rule 601 of Regulation S K or are incorporated by reference to previous filings.

3.1 Articles of Amendment to Articles of Incorporation (9)

3.2 Amended Bylaws (11)

4.1 Specimen Class A Stock Certificate (1)

4.2 Specimen Class C Stock Certificate (1)

4.3 Specimen Preferred Stock Certificate and Certificate of Designation of Preferred Stock (1)

7.1 Letter from Eide Bailly, LLP (10)

10.1 Amended Employee Stock Ownership Plan (ESOP) and Trust Agreement (1)

10.2 2003 Stock Option Plan (2)

10.3 2006 Director Stock Option Plan (3)

10.4 2013 Amended Stock Option and Other Equity Incentive Awards Plan (8)

10.5 2014 Director Stock Option Plan (4)

10.6 Employment agreement with Scott M. Quist (6)

10.7 Purchase Agreement among Security National Financial Corporation, SNFC Subsidiary, LLC, American Funeral Financial, LLC, and Hypershop, LLC (5)

10.8 Stock Purchase Agreement among Security National Financial Corporation, and Reppond Holding Company, to purchase First Guaranty Insurance Company (8)

21	Subsidiaries of the Registrant (11)
23.1	Consent of Eide Bailly LLP (7)
23.2	Consent of Mackey Price & Mecham (7)
31.1	Certification pursuant to 18 U.S.C. Section 1350, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification pursuant to 18 U.S.C. Section 1350, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.xml	Instance Document
101.xsd	Taxonomy Extension Schema Document
101.cal	Taxonomy Extension Calculation Linkbase Document
101.def	Taxonomy Extension Definition Linkbase Document
101.lab	Taxonomy Extension Label Linkbase Document
101.pre	Taxonomy Extension Presentation Linkbase Document

(1) Incorporated by reference from Registration Statement on Form S 1, as filed on September 29, 1987
(2) Incorporated by reference from Schedule 14A Definitive Proxy Statement, as filed on June 5, 2003, relating to the Company's Annual Meeting of Stockholders
(3) Incorporated by reference from Schedule 14A Definitive Proxy Statement, as filed on June 1, 2007, relating to the Company's Annual Meeting of Stockholders
(4) Incorporated by reference from Schedule 14A Definitive Proxy Statement, as filed on June 2, 2014, related to Company's Annual Meeting of Stockholders
(5) Incorporated by reference from Report on Form 8-K, as filed on June 13, 2014
(6) Incorporated by reference from Report on Form 10-Q, as filed on August 14, 2015
(7) Incorporated by reference from Registration Statement on Form S-8, as filed on October 20, 2015
(8) Incorporated by reference from Report on Form 10-Q, as filed on August 15, 2016
(9) Incorporated by reference from Report on Form 10-K, as filed on March 31, 2017
(10) Incorporated by reference from Report on Form 8-K, as filed on August 4, 2017
(11) Incorporated by reference from Report on Form 10-Q, as filed on August 25, 2017

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.

REGISTRANT

SECURITY NATIONAL FINANCIAL CORPORATION
Registrant

Dated: November 14, 2017	/s/ Scott M. Quist Scott M. Quist Chairman, President and Chief Executive Officer (Principal Executive Officer)
Dated: November 14, 2017	/s/ Garrett S. Sill Garrett S. Sill Chief Financial Officer and Treasurer (Principal Financial Officer and Principal Accounting Officer)

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