

KINGSWAY FINANCIAL SERVICES INC  
Form 10-Q  
November 05, 2014

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

FORM 10-Q  
(Mark One)

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

For Quarterly Period Ended September 30, 2014

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-15204

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

Ontario, Canada  
(State or other jurisdiction of  
incorporation or organization)

Not Applicable (I.R.S. Employer  
Identification No.)

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

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

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

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

Large accelerated filer  Accelerated filer  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

The number of shares outstanding of the registrant's common stock as of November 5, 2014 was 19,709,706.

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KINGSWAY FINANCIAL SERVICES INC.

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## KINGSWAY FINANCIAL SERVICES INC.

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## Consolidated Balance Sheets

(in thousands, except per share data)

	September 30, 2014 (unaudited)	December 31, 2013
Assets		
Investments:		
Fixed maturities, at fair value (amortized cost of \$48,355 and \$53,455, respectively)	\$48,648	\$54,151
Equity investments, at fair value (cost of \$12,344 and \$3,554, respectively)	14,932	7,137
Limited liability investments	6,997	4,406
Other investments, at cost which approximates fair value	2,000	3,000
Short-term investments, at cost which approximates fair value	401	501
Total investments	72,978	69,195
Cash and cash equivalents	87,273	98,589
Investment in investee	2,222	—
Accrued investment income	884	614
Premiums receivable, net of allowance for doubtful accounts of \$2,173 and \$2,123, respectively	30,600	32,035
Service fee receivable, net of allowance for doubtful accounts of \$247 and \$0, respectively	22,243	19,012
Other receivables, net of allowance for doubtful accounts of \$1,061 and \$1,062, respectively	5,273	4,097
Reinsurance recoverable	4,003	10,335
Prepaid reinsurance premiums	55	6,816
Deferred acquisition costs, net	12,463	12,392
Property and equipment, net of accumulated depreciation of \$16,399 and \$15,848, respectively	1,261	1,662
Goodwill	10,588	10,588
Intangible assets, net of accumulated amortization of \$19,803 and \$18,583, respectively	47,698	48,918
Other assets	3,672	4,039
Asset held for sale	5,167	6,347
Total Assets	\$306,380	\$324,639
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid loss and loss adjustment expenses:		
Property and casualty	\$68,156	\$84,534
Vehicle service agreements	2,975	3,128
Total unpaid loss and loss adjustment expenses	71,131	87,662
Unearned premiums	38,396	48,577
Reinsurance payable	49	1,033
LROC preferred units, at fair value	14,106	14,854
Senior unsecured debentures, at fair value	—	14,356

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Subordinated debt, at fair value	39,418	28,471
Deferred income tax liability	5,076	4,173
Deferred service fees	50,477	48,788
Income taxes payable	80	2,984
Accrued expenses and other liabilities	41,329	36,821
Total Liabilities	\$260,062	\$287,719
Shareholders' Equity:		
Class A preferred stock, no par value; unlimited number authorized; 262,876 and zero issued and outstanding at September 30, 2014 and December 31, 2013, respectively	\$6,330	\$—
Common stock, no par value; unlimited number authorized; 19,709,706 and 16,429,761 issued and outstanding at September 30, 2014 and December 31, 2013, respectively	—	—
Additional paid-in capital	340,595	324,803
Accumulated deficit	(312,596	) (298,930
Accumulated other comprehensive income	8,300	9,601
Shareholders' equity attributable to common shareholders	42,629	35,474
Noncontrolling interests in consolidated subsidiaries	3,689	1,446
Total Shareholders' Equity	46,318	36,920
Total Liabilities and Shareholders' Equity	\$306,380	\$324,639
See accompanying notes to unaudited consolidated financial statements.		

## KINGSWAY FINANCIAL SERVICES INC.

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

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
<b>Revenues:</b>				
Net premiums earned	\$28,418	\$26,041	\$89,093	\$82,406
Service fee and commission income	14,102	12,156	42,752	37,332
Net investment income	542	409	1,296	1,805
Net realized gains (losses)	329	321	5,459	(1,056 )
Other-than-temporary impairment loss	—	—	—	(1,800 )
Other income	2,142	2,723	6,680	7,115
Total revenues	45,533	41,650	145,280	125,802
<b>Expenses:</b>				
Loss and loss adjustment expenses	22,361	21,343	65,216	67,789
Commissions and premium taxes	5,738	6,683	17,823	18,566
Cost of services sold	1,544	951	3,337	1,097
General and administrative expenses	16,510	19,030	52,659	58,622
Restructuring expense	5	223	(29 )	1,150
Interest expense	1,417	1,808	4,214	5,568
Amortization of intangible assets	397	508	1,220	1,574
Contingent consideration expense	267	155	801	465
Impairment of asset held for sale	—	—	1,180	1,446
Total expenses	48,239	50,701	146,421	156,277
Loss from continuing operations before (loss) gain on change in fair value of debt, loss on disposal of subsidiary, loss on buy-back of debt, equity in net (loss) income of investee and income tax expense (benefit)	(2,706 )	(9,051 )	(1,141 )	(30,475 )
(Loss) gain on change in fair value of debt	(2,963 )	3,801	(10,199 )	(2,812 )
Loss on disposal of subsidiary	—	—	(1,242 )	—
Loss on buy-back of debt	—	—	—	(24 )
Equity in net (loss) income of investee	(83 )	—	(83 )	255
Loss from continuing operations before income tax expense (benefit)	(5,752 )	(5,250 )	(12,665 )	(33,056 )
Income tax expense (benefit)	343	403	(90 )	(398 )
Loss from continuing operations	(6,095 )	(5,653 )	(12,575 )	(32,658 )
Gain on liquidation of subsidiaries, net of taxes	—	7,227	—	7,227
Net (loss) income	(6,095 )	1,574	(12,575 )	(25,431 )
Less: net income (loss) attributable to noncontrolling interests in consolidated subsidiaries	778	(305 )	873	407
Less: dividends on preferred stock	83	—	218	—
Net (loss) income attributable to common shareholders	\$(6,956 )	\$1,879	\$(13,666 )	\$(25,838 )

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Loss per share - continuing operations:

Basic:	\$ (0.41 )	\$ (0.39 )	\$ (0.82 )	\$ (2.48 )
Diluted:	\$ (0.41 )	\$ (0.39 )	\$ (0.82 )	\$ (2.48 )

(Loss) earnings per share – net (loss)  
income attributable to common  
shareholders:

Basic:	\$ (0.41 )	\$ 0.14	\$ (0.82 )	\$ (1.94 )
Diluted:	\$ (0.41 )	\$ 0.14	\$ (0.82 )	\$ (1.94 )

Weighted average shares outstanding (in  
'000s):

Basic:	16,993	13,684	16,620	13,329
Diluted:	16,993	13,684	16,620	13,329

See accompanying notes to unaudited consolidated financial statements.

## KINGSWAY FINANCIAL SERVICES INC.

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

	Three months ended September 30, 2014		2013		Nine months ended September 30, 2014		2013	
Net (loss) income	\$ (6,095	)	\$ 1,574		\$ (12,575	)	\$ (25,431	)
Other comprehensive loss, net of taxes <sup>(1)</sup> :								
Unrealized (losses) gains on fixed maturities and equity investments:								
Unrealized (losses) gains arising during the period	(2,244	)	(281	)	(2,924	)	855	
Reclassification adjustment for amounts included in net (loss) income	187		1,860		1,526		2,142	
Foreign currency translation adjustments	(22	)	1		(37	)	—	
Recognition of currency translation gain on liquidation of subsidiaries	—		(7,227	)	—		(7,227	)
Equity in other comprehensive income of investee	—		—		—		642	
Other comprehensive loss	(2,079	)	(5,647	)	(1,435	)	(3,588	)
Comprehensive loss	(8,174	)	(4,073	)	(14,010	)	(29,019	)
Less: comprehensive income (loss) attributable to noncontrolling interests in consolidated subsidiaries	795		(312	)	768		359	
Comprehensive loss attributable to common shareholders	\$ (8,969	)	\$ (3,761	)	\$ (14,778	)	\$ (29,378	)

(1) Net of income tax expense (benefit) of \$0 and \$0 for the three and nine months ended September 30, 2014 and September 30, 2013, respectively.

See accompanying notes to unaudited consolidated financial statements

## KINGSWAY FINANCIAL SERVICES INC.

## Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Nine months ended September 30,	
	2014	2013
Cash provided by (used in):		
Operating activities:		
Net loss	\$(12,575	) \$(25,431
Adjustments to reconcile net loss to net cash used in operating activities:		
Gain on liquidation of subsidiaries, net of taxes	—	(7,227
Equity in net loss (income) of investee	83	(255
Equity in net income of limited liability investments	(201	) (133
Depreciation and amortization	2,006	2,786
Contingent consideration expense	801	465
Stock based compensation expense, net of forfeitures	1,033	198
Net realized (gains) losses	(5,459	) 1,056
Loss on change in fair value of debt	10,199	2,812
Deferred income taxes	1,079	144
Other than temporary impairment loss	—	1,800
Amortization of fixed maturities premiums and discounts	515	2,302
Loss on disposal of subsidiary	1,242	—
Impairment of asset held for sale	1,180	1,446
Realized loss on buy-back of debt	—	24
Changes in operating assets and liabilities:		
Premiums and service fee receivable	(1,796	) 8
Other receivables	(1,176	) (7,918
Reinsurance recoverable	6,332	(6,751
Prepaid reinsurance premiums	6,761	(944
Deferred acquisition costs	(71	) 3,411
Unpaid loss and loss adjustment expenses	(16,531	) (13,696
Unearned premiums	(10,181	) 2,799
Reinsurance payable	(984	) (721
Deferred service fees	1,689	255
Other, net	1,640	4,895
Net cash used in operating activities	(14,414	) (38,675
Investing activities:		
Proceeds from sales and maturities of fixed maturities	21,722	18,725
Proceeds from sales of equity investments	6,761	8,799
Proceeds from sales of other investments	1,000	—
Proceeds from sales of investment in investee	—	13,638
Purchase of fixed maturities	(21,293	) (4,725
Purchase of equity investments	(10,180	) (286
Net acquisition of limited liability investments	(1,159	) (919
Purchase of other investments	—	(1,031
Net purchases of short-term investments	(103	) (325
Acquisition of business, net of cash acquired	—	(1,052
Net purchases of property and equipment and intangible assets	(384	) (455
Net cash (used in) provided by investing activities	(3,636	) 32,369
Financing activities:		

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Proceeds from issuance of preferred stock, net	6,330	—	
Proceeds from issuance of common stock, net	—	12,113	
Proceeds from issuance of warrants	14,760	—	
Redemption of senior unsecured debentures	(14,356	) (583	)
Net cash provided by financing activities	6,734	11,530	
Net (decrease) increase in cash and cash equivalents	(11,316	) 5,224	
Cash and cash equivalents at beginning of period	98,589	80,813	
Cash and cash equivalents at end of period	\$87,273	\$86,037	
See accompanying notes to unaudited consolidated financial statements.			

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

NOTE 1 BUSINESS

Kingsway Financial Services Inc. (the "Company" or "Kingsway") was incorporated under the Business Corporations Act (Ontario) on September 19, 1989. Kingsway is a Canadian holding company with operating subsidiaries located in the United States. The Company operates as a merchant bank primarily engaged, through its subsidiaries, in the property and casualty insurance business.

NOTE 2 BASIS OF PRESENTATION

The accompanying unaudited consolidated interim financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements of the Company. In the opinion of management, all adjustments necessary for a fair presentation have been included and are of a normal recurring nature. Interim results are not necessarily indicative of the results that may be expected for the year.

The accompanying unaudited consolidated interim financial statements and footnotes should be read in conjunction with the audited consolidated financial statements and footnotes included within our Annual Report on Form 10-K ("2013 Annual Report") for the year ended December 31, 2013.

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

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

The fair values of the Company's investments in fixed maturities and equity investments, LROC preferred units, senior unsecured debentures, subordinated debt and contingent consideration are estimated using a fair value hierarchy to categorize the inputs it uses in valuation techniques. Fair values for other investments approximate their unpaid principal balance. The carrying amounts reported in the consolidated balance sheets approximate fair values for cash, short-term investments and certain other assets and other liabilities because of their short-term nature.

The Company's financial results contained herein are reported in U.S. dollars unless otherwise indicated.

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

There have been no material changes to our significant accounting policies as reported in our 2013 Annual Report.

NOTE 4 RECENTLY ISSUED ACCOUNTING STANDARDS

In July 2013, the FASB issued ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ("ASU 2013-11"). ASU 2013-11 amends ASC Topic 740, Income Taxes, to provide guidance and reduce diversity in practice on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. Effective January 1, 2014, the Company adopted ASU 2013-11. Except for the new disclosure requirements, the adoption of the standard did not have an impact on the consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle of ASC 2014-09 is that an entity recognizes revenue to depict the transfer of promised

goods or services to customers in an amount that reflects the consideration to which the entity expected to be entitled in exchange for those goods or services. ASC 2014-09 is effective for reporting periods beginning after December 15, 2016 and early adoption is not permitted. Insurance contracts are not within the scope of ASU 2014-09, therefore this standard would not apply to the Company's Insurance Underwriting segment. The Company is evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

NOTE 5 ACQUISITION, DISPOSITIONS AND LIQUIDATIONS

(a) Acquisition

Trinity Warranty Solutions LLC:

Effective May 22, 2013, the Company's subsidiary, Trinity Warranty Solutions LLC ("Trinity"), acquired certain intangible assets and liabilities of Trinity Warranty Corp. for total consideration consisting of approximately \$1.1 million in cash and future contingent payments. As further discussed in Note 18, "Segmented Information," Trinity is included in the Insurance Services segment. Trinity is based in Illinois and is a provider of warranty products and maintenance support to consumers and businesses in the heating, ventilation, air conditioning ("HVAC") and refrigeration industry.

This acquisition was accounted for as a business combination using the purchase method of accounting. The purchase price was allocated to the assets purchased and liabilities assumed based upon their estimated fair values at the date of acquisition. During the fourth quarter of 2013, the Company completed its fair value analysis on the assets acquired and liabilities assumed. Goodwill of \$1.1 million was recognized in addition to \$0.5 million of a separately identifiable intangible asset for customer-related relationships. The fair value analysis performed resulted in the establishment of a \$0.6 million liability effective May 22, 2013 related to present value of future contingent payments. The maximum the Company can pay in future contingent payments is \$2.4 million, on an undiscounted basis. The contingent payments are payable annually beginning in 2014 through 2023, are subject to the achievement of certain targets and may be adjusted in future periods based on actual performance achieved. As of September 30, 2014, the recorded value of the contingent payment liability is \$1.0 million, which is included in accrued expenses and other liabilities on the consolidated balance sheets.

(b) Dispositions

1347 Property Insurance Holdings, Inc.:

Effective March 31, 2014, the Company's wholly owned subsidiary, 1347 Property Insurance Holdings, Inc. ("PIH"), formerly known as Maison Insurance Holdings, Inc., completed an initial public offering of its common stock. Total consideration to the Company as a result of this transaction was \$7.7 million, consisting of a 28.7% interest in the common shares of PIH. As a result of the disposal, the Company recognized a loss of \$1.2 million during the first quarter of 2014. The earnings of PIH are included in the consolidated statements of operations through the March 31, 2014 transaction date. At March 31, 2014, the Company's investment in the common stock of PIH was reported as investment in investee in the consolidated balance sheets.

During the second quarter of 2014, PIH announced the closing and settlement of an underwritten public offering of 2,875,000 shares of its common stock at a price to the public of \$8.00 per share. As a result of the issuance of additional shares of common stock, the Company's approximate voting percentage in PIH was reduced to 15.7% at June 30, 2014. As a result of this change in ownership and other qualitative factors, the Company determined that its investment in the common stock of PIH no longer qualified for the equity method of accounting. Accordingly, the Company's investment in PIH common stock is included in equity investments and reported at its fair value of \$7.8 million in the consolidated balance sheets at September 30, 2014.

Investment in Atlas Financial Holdings, Inc.:

The Company formerly held an investment in the preferred and restricted voting common stock of Atlas Financial Holdings, Inc. ("Atlas") that was recorded as investment in investee in the consolidated balance sheets. On February 12, 2013, the Company executed an underwriting agreement to sell 2,625,000 shares of Atlas common stock. The shares were being offered as part of Atlas' United States initial public offering at a price per share of \$5.85. During the first quarter of 2013, the Company received net proceeds of \$13.6 million and recognized a loss of \$1.7 million, which is included in net realized gains (losses) on the consolidated statements of operations, resulting from commissions and other expenses incurred as part of the sale. As a result of this sale, the Company's approximate voting percentage in Atlas was reduced to 16.5%. As a result of this change in ownership and other qualitative factors, the Company determined that its investment in the common stock of Atlas no longer qualified for the equity method of accounting. Prior to discontinuing the use of the equity method of accounting for Atlas, the Company used a reporting lag of three months to report its proportionate share of Atlas' results.

Equity in net income of investee related to Atlas was zero and \$0.3 million for the nine months ended September 30, 2014 and September 30, 2013, respectively. The Company also recognized an increase to shareholders' equity attributable to common shareholders of zero and \$0.6 million for the three and nine months ended September 30, 2013, respectively, for the Company's pro rata share of Atlas' accumulated other comprehensive income.

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

During the fourth quarter of 2013, the Company further reduced its investment in the common stock of Atlas. The Company's investment in Atlas common stock at September 30, 2014 is included in equity investments and reported at fair value of \$1.8 million in the consolidated balance sheets.

## (c) Liquidations

During 2013, the Company's subsidiaries, Kingsway Reinsurance (Bermuda) Ltd. ("KRL") and Kingsway 2007 General Partnership ("2007 GP"), were liquidated. As a result of the liquidations of these subsidiaries, the Company realized a net after-tax gain of \$7.2 million for the three months ended September 30, 2013. This gain represents the foreign exchange gain previously recorded in accumulated other comprehensive income and now recognized in the statement of operations as a result of the liquidations of KRL and 2007 GP. Summarized financial information for liquidation of subsidiaries is shown below:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Liquidations:				
Gain on liquidations before income taxes	—	7,227	—	7,227
Income tax benefit	—	—	—	—
Gain on liquidation of subsidiaries, net of taxes	—	7,227	—	7,227

## NOTE 6 INVESTMENTS

The amortized cost, gross unrealized gains and losses, and estimated fair value of the Company's investments in fixed maturities and equity investments at September 30, 2014 and December 31, 2013 are summarized in the tables shown below:

(in thousands)	September 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. government, government agencies and authorities	\$10,199	\$403	\$14	\$10,588
Canadian government	4,681	—	248	4,433
States municipalities and political subdivisions	6,102	91	—	6,193
Mortgage-backed	4,391	21	14	4,398
Asset-backed securities and collateralized mortgage obligations	7,756	3	8	7,751
Corporate	15,226	103	44	15,285
Total fixed maturities	48,355	621	328	48,648
Equity investments:				
Common stock	12,215	2,698	121	14,792
Warrants	129	11	—	140
Total equity investments	12,344	2,709	121	14,932
Total fixed maturities and equity investments	\$60,699	\$3,330	\$449	\$63,580

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

(in thousands)	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. government, government agencies and authorities	\$17,777	\$591	\$30	\$18,338
Canadian government	4,235	—	153	4,082
States municipalities and political subdivisions	6,126	105	—	6,231
Mortgage-backed	1,993	15	2	2,006
Asset-backed securities and collateralized mortgage obligations	3,996	1	3	3,994
Corporate	19,328	183	11	19,500
Total fixed maturities	53,455	895	199	54,151
Equity investments:				
Common stock	3,554	3,623	40	7,137
Total fixed maturities and equity investments	\$57,009	\$4,518	\$239	\$61,288

The table below summarizes the Company's fixed maturities at September 30, 2014 by contractual maturity periods. Actual results may differ as issuers may have the right to call or prepay obligations, with or without penalties, prior to the contractual maturity of these obligations.

(in thousands)	September 30, 2014	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$11,957	\$11,760
Due after one year through five years	31,214	31,302
Due after five years through ten years	1,215	1,607
Due after ten years	3,969	3,979
Total	\$48,355	\$48,648

The following tables highlight the aggregate unrealized loss position, by security type, of fixed maturities and equity investments in unrealized loss positions as of September 30, 2014 and December 31, 2013. The tables segregate the holdings based on the period of time the investments have been continuously held in unrealized loss positions.

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

(in thousands)					September 30, 2014	
	Less than 12 Months		Greater than 12 Months		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Fixed maturities:						
U.S. government, government agencies and authorities	\$2,518	\$14	\$224	\$—	\$2,742	\$14
Canadian government	—	—	4,433	248	4,433	248
Mortgage-backed	2,729	14	—	—	2,729	14
Asset-backed securities and collateralized mortgage obligations	2,950	8	—	—	2,950	8
Corporate	9,557	34	—	10	9,557	44
Total fixed maturities	17,754	70	4,657	258	22,411	328
Equity investments:						
Common stock	1,824	121	—	—	1,824	121
Total	\$19,578	\$191	\$4,657	\$258	\$24,235	\$449

(in thousands)					December 31, 2013	
	Less than 12 Months		Greater than 12 Months		Total	
	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Fixed maturities:						
U.S. government, government agencies and authorities	\$4,008	\$30	\$—	\$—	\$4,008	\$30
Canadian government	—	—	4,082	153	4,082	153
Mortgage-backed	919	2	—	—	919	2
Asset-backed securities and collateralized mortgage obligations	3,474	3	—	—	3,474	3
Corporate	408	1	—	10	408	11
Total fixed maturities	8,809	36	4,082	163	12,891	199
Equity investments:						
Common stock	969	35	1	5	970	40
Total	\$9,778	\$71	\$4,083	\$168	\$13,861	\$239

Fixed maturities and equity investments contain approximately 59 and 27 individual investments that were in unrealized loss positions as of September 30, 2014 and December 31, 2013, respectively.

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

- identifying all unrealized loss positions that have existed for at least six months;
- identifying other circumstances which management believes may impact the recoverability of the unrealized loss positions;
- obtaining a valuation analysis from third-party investment managers regarding the intrinsic value of these investments based on their knowledge and experience together with market-based valuation techniques;
- reviewing the trading range of certain investments over the preceding calendar period;



KINGSWAY FINANCIAL SERVICES INC.

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assessing if declines in market value are other-than-temporary for debt instruments based on the investment grade credit ratings from third-party rating agencies;  
 assessing if declines in market value are other-than-temporary for any debt instrument with a non-investment grade credit rating based on the continuity of its debt service record;  
 determining the necessary provision for declines in market value that are considered other-than-temporary based on the analyses performed; and  
 assessing the Company's ability and intent to hold these investments at least until the investment impairment is recovered.

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

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

As a result of the analysis performed by the Company to determine declines in market value that are other-than-temporary, there were no write-downs for other-than-temporary impairments related to investments for the three and nine months ended September 30, 2014.

On July 8, 2013, the Company announced that it had entered into a non-binding letter of intent with its former investee, Atlas, to sell its holdings of Atlas preferred stock for 90.0% of liquidation value, or \$16.2 million. On August 1, 2013, the Company announced that the transaction had closed. As a result, the Company recorded a write-down for other-than-temporary impairment related to its investment in Atlas preferred stock of zero and \$1.8 million for the three and nine months ended September 30, 2013. There were no write-downs related to fixed maturities or other investments for the three and nine months ended September 30, 2013.

There were no other-than-temporary losses recognized in other comprehensive loss for the three and nine months ended September 30, 2014 and September 30, 2013.

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

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

Limited liability investments include investments in limited liability companies and a limited partnership that primarily invest in income-producing real estate or real estate related investments. The Company's interests in these investments are not deemed minor and, therefore, are accounted for under the equity method of accounting. As of September 30, 2014 and December 31, 2013, the carrying value of limited liability investments totaled \$7.0 million and \$4.4 million, respectively. At September 30, 2014, the Company has unfunded commitments totaling \$0.5 million to fund limited liability investments. Income from limited liability investments is recognized based on the Company's share of the earnings of the limited liability entities and is included in net investment income.

Other investments include collateral loans and are reported at their unpaid principal balance. As of September 30, 2014 and December 31, 2013, the carrying value of other investments totaled \$2.0 million and \$3.0 million, respectively.

Gross realized gains and losses on fixed maturities, equity investments and limited liability investments for the three and nine months ended September 30, 2014 and September 30, 2013 were as follows:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Gross realized gains	\$ 330	\$ 321	\$ 5,469	\$ 694

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Gross realized losses	(1	)	—	(10	)	(32	)
Total	\$329		\$321	\$5,459		\$662	

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## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

Gross realized losses for the nine months ended September 30, 2013 reported in the preceding table excludes the realized loss of \$1.7 million on the sale of Atlas common stock recorded during the first quarter of 2013. At the time this loss was incurred, the Atlas common stock was classified as investment in investee. Refer to Note 5, "Acquisition, Dispositions and Liquidations," for further discussion.

Net investment income for the three and nine months ended September 30, 2014 and September 30, 2013, respectively, is comprised as follows:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Investment income				
Interest from fixed maturities	\$284	\$314	\$827	\$964
Dividends	67	101	153	591
Income from limited liability investments	176	(22)	201	133
Other	29	51	257	310
Gross investment income	556	444	1,438	1,998
Investment expenses	(14)	(35)	(142)	(193)
Net investment income	\$542	\$409	\$1,296	\$1,805

At September 30, 2014, fixed maturities and short-term investments with an estimated fair value of \$11.9 million were on deposit with state and provincial regulatory authorities. Also, from time to time, the Company pledges investments to third-parties to collateralize liabilities incurred under its policies of insurance. At September 30, 2014, the amount of such pledged securities was \$17.4 million.

**NOTE 7 INVESTMENT IN INVESTEE**

Investment in investee includes the Company's investment in the common stock and private units of 1347 Capital Corp. and is accounted for under the equity method. 1347 Capital Corp. was formed for the purpose of entering into a merger, share exchange, asset acquisition or other similar business combination with one or more businesses or entities. The carrying value, estimated fair value and approximate equity percentage for the Company's investment in 1347 Capital Corp. at September 30, 2014 were as follows:

(in thousands, except for percentages)	September 30, 2014		
	Equity percentage	Estimated Fair Value	Carrying value
1347 Capital Corp.	22.7	% \$13,008	\$2,222

Equity in net loss of investee related to 1347 Capital Corp. was \$0.1 million and zero for the three months ended September 30, 2014 and September 30, 2013, respectively (\$0.1 million and zero, respectively, year to date).

The Company formerly held an investment in Atlas that was recorded as investment in investee in the consolidated balance sheets. Refer to Note 5, "Acquisition, Dispositions and Liquidations," to the unaudited consolidated interim financial statements, for discussion of the Company's disposition of its investment in Atlas.

**NOTE 8 DEFERRED ACQUISITION COSTS**

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

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

The components of deferred acquisition costs and the related amortization expense for the three and nine months ended September 30, 2014 and 2013, respectively, are comprised as follows:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Beginning balance, net	\$12,625	\$11,797	\$12,392	\$14,102
Additions	6,632	4,952	20,733	20,719
Amortization	(6,794 )	(6,058 )	(19,619 )	(24,130 )
Acquisition costs disposed of during the year related to PIH	—	—	(1,043 )	—
Balance at September 30, net	\$12,463	\$10,691	\$12,463	\$10,691

## NOTE 9 INTANGIBLE ASSETS

Intangible assets are comprised as follows:

(in thousands)	September 30, 2014		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Intangible assets subject to amortization			
Database	\$4,918	\$922	\$3,996
Vehicle service agreements in-force	3,680	2,786	894
Customer-related relationships	3,611	612	2,999
Non-compete agreement	70	45	25
Intangible assets not subject to amortization			
Renewal rights	46,756	15,438	31,318
Insurance licenses	7,803	—	7,803
Trade name	663	—	663
Total	\$67,501	\$19,803	\$47,698

(in thousands)	December 31, 2013		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Intangible assets subject to amortization			
Database	\$4,918	\$554	\$4,364
Vehicle service agreements in-force	3,680	2,220	1,460
Customer-related relationships	3,611	344	3,267
Non-compete agreement	70	27	43
Intangible assets not subject to amortization			
Renewal rights	46,756	15,438	31,318
Insurance licenses	7,803	—	7,803
Trade name	663	—	663
Total	\$67,501	\$18,583	\$48,918

The Company's intangible assets with definite useful lives are amortized over their estimated useful lives.

Amortization of intangible assets was \$0.4 million and \$0.5 million for the three months ended September 30, 2014 and September 30, 2013, respectively (\$1.2 million and \$1.6 million for the nine months ended September 30, 2014 and September 30, 2013, respectively).

The insurance licenses, renewal rights and trade name intangible assets have indefinite useful lives and are not amortized. The renewal rights intangible assets, recognized related to the acquisitions of Northeast Alliance Insurance Agency, LLC ("NEA") and Assigned Risk Solutions Ltd. ("ARS"), were originally being amortized on a straight-line basis over 10 to 15 years. As a result



KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

of the acquisition of ARS during 2010, the Company determined that it was necessary to re-examine the useful lives assigned to the renewal rights intangible assets due to the fact that NEA and ARS service the assigned risk business in the states of New York and New Jersey and operate in the New York voluntary markets where there is limited competition for the renewal rights. As a result of the review performed, the Company determined that there were no legal, regulatory, contractual, competitive, economic, or other factors limiting the useful life of the renewal rights intangible assets; therefore, effective January 1, 2011, the renewal rights intangible assets were deemed to have indefinite useful lives and are no longer being amortized. The renewal rights had accumulated amortization of \$15.4 million at December 31, 2010.

**NOTE 10 ASSET HELD FOR SALE**

As of September 30, 2014, property consisting of building and land located in Miami, Florida with a carrying value of \$5.2 million was classified as held for sale. During the nine months ended September 30, 2014 and September 30, 2013, the Company recorded write-downs of \$1.2 million and \$1.4 million, respectively, related to the asset held for sale. At September 30, 2014, the carrying value of the property is equal to its fair value net of estimated selling costs. On October 2, 2014, the Company closed on the sale of the property. The Company will record the disposal during the fourth quarter of 2014.

**NOTE 11 UNPAID LOSS AND LOSS ADJUSTMENT EXPENSES**

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

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

Consequently, the process of determining the provision necessarily involves risks that the actual results will deviate, perhaps materially, from the best estimates made.

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

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

## (a) Property and Casualty

The results of this comparison and the changes in the provision for property and casualty unpaid loss and loss adjustment expenses, net of amounts recoverable from reinsurers, as of September 30, 2014 and September 30, 2013 were as follows:

(in thousands)	September 30, 2014	September 30, 2013
Balance at beginning of period, gross	\$84,534	\$103,116
Less reinsurance recoverable related to property and casualty unpaid loss and loss adjustment expenses	7,942	5,478
Balance at beginning of period, net	76,592	97,638
Incurred related to:		
Current year	61,177	63,347
Prior years	(1,151)	(427)
Paid related to:		
Current year	(35,172)	(35,653)
Prior years	(36,219)	(43,092)
Disposal of unpaid loss and loss adjustment expenses related to PIH	(405)	—
Balance at end of period, net	64,822	81,813
Plus reinsurance recoverable related to property and casualty unpaid loss and loss adjustment expenses	3,334	8,173
Balance at end of period, gross	\$68,156	\$89,986

## (b) Vehicle Service Agreements

The results of the comparison and the changes in the provision for vehicle service agreement unpaid loss and loss adjustment expenses as of September 30, 2014 and September 30, 2013 were as follows:

(in thousands)	September 30, 2014	September 30, 2013
Balance at beginning of period	\$3,128	\$3,448
Incurred related to:		
Current year	5,190	4,869
Prior years	—	—
Paid related to:		
Current year	(5,282)	(5,354)
Prior years	(61)	(81)
Balance at end of period	\$2,975	\$2,882

## NOTE 12 DEBT

Debt consists of the following instruments:

(in thousands)	September 30, 2014		December 31, 2013	
	Principal	Fair Value	Principal	Fair Value
7.5% senior notes due 2014	\$—	\$—	\$14,356	\$14,356
LROC preferred units due 2015	14,106	14,106	14,854	14,854
Subordinated debt	90,500	39,418	90,500	28,471
Total	\$104,606	\$53,524	\$119,710	\$57,681

## KINGSWAY FINANCIAL SERVICES INC.

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Subordinated indebtedness mentioned above consists of the following trust preferred debt instruments:

Issuer	Principal	Issue date	Interest	Redemption date
Kingsway CT Statutory Trust I	15,000	12/4/2002	annual interest rate equal to LIBOR, plus 4.00% payable quarterly	12/4/2032
Kingsway CT Statutory Trust II	17,500	5/15/2003	annual interest rate equal to LIBOR, plus 4.10% payable quarterly	5/15/2033
Kingsway CT Statutory Trust III	20,000	10/29/2003	annual interest rate equal to LIBOR, plus 3.95% payable quarterly	10/29/2033
Kingsway DE Statutory Trust III	15,000	5/23/2003	annual interest rate equal to LIBOR, plus 4.20% payable quarterly	5/23/2033
Kingsway DE Statutory Trust IV	10,000	9/30/2003	annual interest rate equal to LIBOR, plus 3.85% payable quarterly	9/30/2033
Kingsway DE Statutory Trust VI	13,000	1/8/2004	annual interest rate equal to LIBOR, plus 4.00% payable quarterly	1/8/2034

During the first quarter of 2011, the Company gave notice to its Trust Preferred trustees of its intention to exercise its voluntary right to defer interest payments for up to 20 quarters, pursuant to the contractual terms of its outstanding Trust Preferred indentures, which permit interest deferral. This action does not constitute a default under the Company's Trust Preferred indentures or any of its other debt indentures. At September 30, 2014, deferred interest payable of \$16.2 million is included in accrued expenses and other liabilities in the consolidated balance sheets.

During the first quarter of 2014, the Company repaid the \$14.4 million remaining amount outstanding on its senior unsecured debentures due February 1, 2014. No debt repurchases were made during the three and nine months ended September 30, 2014. During the first quarter of 2013, the Company purchased for \$0.6 million, including accrued interest, \$0.6 million of par value of its senior unsecured debentures due February 1, 2014 with a carrying value of \$0.6 million, including accrued interest, recording a loss of \$0.0 million. No debt repurchases were made during the three months ended September 30, 2013.

## NOTE 13 INCOME TAXES

Income tax expense (benefit) for the three and nine months ended September 30, 2014 and September 30, 2013, respectively, varies from the amount that would result by applying the applicable United States corporate income tax rate of 34% to loss from continuing operations before income tax expense (benefit). The following table summarizes the differences:

(in thousands)	Three months ended September		Nine months ended September	
	30, 2014	2013	30, 2014	2013
Income tax benefit at United States statutory income tax rate	(1,956	) (1,785	) (4,306	) (11,239
Valuation allowance	2,119	2,120	4,579	11,385
Change in unrecognized tax benefits	—	117	(1,024	) 117
Non-taxable dividend income	(414	) (414	) (1,244	) (1,261
Indefinite life intangibles	283	280	849	828
Prior year tax	—	—	(341	) (710
Other	311	85	1,397	482
Income tax expense (benefit)	343	403	(90	) (398

The Company maintains a valuation allowance for its gross deferred tax assets at September 30, 2014 and December 31, 2013. The Company's operations have generated substantial operating losses during the last several years. These losses can be available to reduce income taxes that might otherwise be incurred on future taxable income. The Company's operations, however, remain challenged and, as a result, it is uncertain whether the Company will generate the taxable income necessary to utilize these losses or other reversing temporary differences. This uncertainty

has caused management to place a full valuation allowance on its September 30, 2014 and December 31, 2013 net deferred tax asset. The Company carries a deferred income tax liability of \$5.1 million and \$4.2 million at September 30, 2014 and December 31, 2013, respectively, of which \$5.0 million and \$4.2 million, respectively, relates to indefinite life intangible assets.

## KINGSWAY FINANCIAL SERVICES INC.

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As of September 30, 2014 and December 31, 2013, the Company carried a liability for unrecognized tax benefits of \$0.2 million and \$3.2 million, respectively, that is included in income taxes payable in the consolidated balance sheets. The Company generally recognizes interest and penalties related to unrecognized tax benefits in income tax benefit.

## NOTE 14 LOSS FROM CONTINUING OPERATIONS PER SHARE

The following table sets forth the reconciliation of numerators and denominators for the basic and diluted loss from continuing operations per share computation for the three and nine months ended September 30, 2014 and September 30, 2013:

(in thousands, except per share data)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Numerator:				
Loss from continuing operations	(6,095	) (5,653	) (12,575	) (32,658
(Less) plus: net (income) loss attributable to noncontrolling interests	(778	) 305	(873	) (407
Less: dividends on preferred stock	(83	) —	(218	) —
Loss from continuing operations attributable to common shareholders	(6,956	) (5,348	) (13,666	) (33,065
Denominator:				
Weighted average basic shares				
Weighted average common shares outstanding	16,993	13,684	16,620	13,329
Weighted average diluted shares				
Weighted average common shares outstanding	16,993	13,684	16,620	13,329
Effect of potentially dilutive securities	—	—	—	—
Total weighted average diluted shares	16,993	13,684	16,620	13,329
Basic loss from continuing operations per common share	\$(0.41	) \$(0.39	) \$(0.82	) \$(2.48
Diluted loss from continuing operations per common share	\$(0.41	) \$(0.39	) \$(0.82	) \$(2.48

Loss from continuing operations per share is based on the weighted-average number of shares outstanding. Diluted weighted-average shares is calculated by adjusting basic weighted-average shares outstanding by all potentially dilutive securities. Potentially dilutive securities consist of stock options, unvested restricted stock awards, warrants and convertible preferred stock. Since the Company is reporting a loss from continuing operations for the three and nine months ended September 30, 2014 and September 30, 2013, all potentially dilutive securities outstanding were excluded from the calculation of both basic and diluted loss from continuing operations per share since their inclusion would have been anti-dilutive.

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

## NOTE 15 STOCK-BASED COMPENSATION

## (a) Stock Options

The following table summarizes the stock option activity during the nine months ended September 30, 2014: (in thousands, except for share data)

	Number of Options Outstanding	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2013	355,625	C\$ 18.35		—
Granted	611,875	\$ 4.50		
Exchanged and Cancelled	(351,875 )	C\$ 18.12		
Expired	(1,875 )	C\$ 40.12		
Forfeited	(1,875 )	C\$ 40.12		
Outstanding at September 30, 2014	611,875	\$ 4.50	3.5	1,089
Exercisable at September 30, 2014	611,875	\$ 4.50	3.5	1,089

The aggregate intrinsic value of stock options outstanding and exercisable is the difference between the September 30, 2014 market price for the Company's common shares and the exercise price of the options, multiplied by the number of options where the fair value exceeds the exercise price.

The Company uses the Black-Scholes option pricing model to estimate the fair value of each option on the date of grant. The assumptions used in the Black-Scholes pricing model for options granted or exchanged during the nine months ended September 30, 2014 were as follows:

	September 30, 2014	
Risk-free interest rate	0.06% - 1.4%	
Dividend yield	—	
Expected volatility	0.4	%
Expected term (in years)	0.78 - 4	

## (b) Restricted Stock Awards

Under the 2013 Equity Incentive Plan, the Company made grants of restricted stock to certain officers of the Company. The restricted stock vests after a ten-year period and is subject to the officer's continued employment through the vesting date. The restricted stock is amortized on a straight-line basis over the ten-year requisite service period. Total unamortized compensation expense related to unvested awards at September 30, 2014 was \$7.7 million. The grant-date fair value of restricted stock awards is determined using the closing price of Kingsway common stock on the date of grant. The following table summarizes the activity related to unvested restricted stock for the nine months ended September 30, 2014:

(in thousands, except for share data)

	Restricted stock awards	Weighted-average grant date fair value (per share)
Unvested at December 31, 2013	—	—
Granted	1,972,345	\$4.14
Unvested at September 30, 2014	1,972,345	\$4.14

Total stock-based compensation expense, net of forfeitures was \$0.2 million and \$0.1 million for the three months ended September 30, 2014 and September 30, 2013, respectively (\$1.0 million and \$0.2 million, respectively, year to date).

KINGSWAY FINANCIAL SERVICES INC.

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NOTE 16 SHAREHOLDERS' EQUITY

(a) Preferred Shares

On May 13, 2013, the Company's shareholders approved an amendment to the Company's Articles of Incorporation to create an unlimited number of zero par value class A preferred shares. The Company's Board of Directors will have the ability to fix the designation, rights, privileges, restrictions and conditions attaching to the shares of each series of preferred shares. The preferred shares will have priority over the common shares.

On February 3, 2014, the Company closed on its previously announced private placement totaling \$6.6 million. At closing, the Company received gross proceeds of \$6.6 million, resulting from the sale and issuance of 262,876 units for a purchase price of \$25.00 per unit. Net proceeds to the Company were \$6.3 million after deducting expenses. Each unit consists of one class A convertible preferred share, series 1 (the "Preferred Shares"), and 6.25 common share class C purchase warrants. Each Preferred Share is convertible into 6.25 common shares at a conversion price of \$4.00 per common share any time at the option of the holder prior to April 1, 2021. The maximum number of common shares issuable upon conversion of the Preferred Shares is 1,642,975 common shares. Each warrant will entitle the subscriber to purchase one common share of Kingsway at a price of \$5.00 per common share at any time after September 16, 2016 and prior to expiry on September 15, 2023.

The Preferred Shares are not entitled to vote. The holders of the Preferred Shares are entitled to receive fixed, cumulative, preferential cash dividends at a rate of \$1.25 per Preferred Share per year. The cash dividend rate shall be revised to \$1.875 per Preferred Share per year if the dividend accumulates for a period greater than 30 consecutive months from the date of the most recent dividend payment. On and after February 3, 2016, the Company may redeem all or any part of the then outstanding Preferred Shares for the price of \$28.75 per Preferred Share, plus accrued but unpaid dividends thereon, whether or not declared, up to and including the date specified for redemption. The Company will redeem any Preferred Shares not previously converted into common shares, and which remain outstanding on April 1, 2021, for the price of \$25.00 per Preferred Share, plus accrued but unpaid dividends, whether or not declared, up to and including the date specified for redemption.

On July 8, 2014, the holders of the Company's series B warrants approved certain amendments to the terms of the Series B Warrant Agreement dated September 16, 2013. The Series B Warrant Agreement Amendments permit the Company to issue up to 1,642,975 additional Series B Warrants and complete the Series C Warrant Exchange. Under the Series C Warrant Exchange, each class C purchase warrant is automatically exchanged for a Series B Warrant.

(b) Common Shares

On May 30, 2013, the Company announced that it had filed a registration statement for a proposed rights offering relating to transferable subscription rights to purchase up to approximately \$13.1 million of its shares of common stock (the "Common Shares") and warrants to purchase Common Shares. The rights offering was made in the United States pursuant to a registration statement on Form S-1 that was previously filed with the Securities and Exchange Commission and became effective on July 24, 2013. On September 16, 2013, the transaction closed. Subscription rights to purchase 3,280,790 units were exercised, resulting in gross proceeds to the Company of \$13.1 million. Net proceeds to the Company were \$12.1 million after deducting commissions and other offering expenses.

Under the rights offering, each shareholder of record as of August 9, 2013 (the "Record Date") received, at no charge, one subscription right for each Common Share owned on the Record Date (the "Subscription Right"). Four Subscription Rights entitled the holder to purchase one unit (a "Unit") consisting of one Common Share, one Series A Warrant (a "Series A Warrant") and one Series B Warrant (a "Series B Warrant", and together with the Series A Warrants, the "Warrants"). Each Warrant entitled the holder to purchase one Common Share. The subscription price was \$4.00 per Unit. The exercise prices per Common Share for each Series A Warrant is \$4.50 and for each Series B Warrant is \$5.00. Each Series A Warrant is redeemable by the Company and has a term of seven years from its date of issuance. Each Series B Warrant is non-redeemable and has a term of ten years from its date of issuance. The Company may redeem the Series A Warrants at a price of \$0.25 per Warrant if, and only if, the closing price of the Common Shares equals or exceeds \$6.00 per Common Share for twenty consecutive trading days on the New York

Stock Exchange or such other market or exchange as the Common Shares of the Company trade on or are quoted at the time of redemption; but in any event, no earlier than the first anniversary date of issuance. Subject to applicable securities laws, the Warrants may be exercised at any time starting on the first day of the thirty-seventh month after the date of issuance until any time on or before the seventh anniversary after the date of issuance for the Series A Warrants and the tenth anniversary after the date of issuance for the Series B Warrants. Holders who fully exercise their Subscription Rights will be entitled to subscribe for an additional amount of

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

Units, if any, that are not purchased by other shareholders or their transferees through the exercise of their basic subscription privileges, in an amount equal to up to five Units for each Unit for which such holder was otherwise entitled to subscribe.

On August 18, 2014, the Company announced its intention to redeem its outstanding Series A Warrants, which were issued pursuant to the rights offering. Holders of Series A Warrants could exercise their outstanding Series A Warrants at \$4.50 per common share. Any Series A Warrants that remained unexercised after September 19, 2014 were automatically redeemed by the Company at the redemption price of \$0.25 per Series A Warrant. During the three months ended September 30, 2014, Series A Warrants to purchase 3,279,945 shares of common stock were exercised, resulting in cash proceeds of \$14.8 million. The 845 Series A Warrants that remained unexercised were redeemed by the Company at the redemption price of \$0.25.

## NOTE 17 ACCUMULATED OTHER COMPREHENSIVE INCOME

The table below details the change in the balance of each component of accumulated other comprehensive income, net of tax, for the three and nine months ended September 30, 2014 and September 30, 2013 as relates to shareholders' equity attributable to common shareholders on the unaudited consolidated balance sheets. On the other hand, the unaudited consolidated statements of comprehensive loss present the components of other comprehensive loss, net of tax, only for the three and nine months ended September 30, 2014 and September 30, 2013 and inclusive of the components attributable to noncontrolling interests in consolidated subsidiaries.

(in thousands)	Three months ended September 30, 2014			
	Unrealized Gains (Losses) on Fixed Maturities and Equity Investments	Foreign Currency Translation Adjustments	Equity in Other Comprehensive Income of Investee	Total Accumulated Other Comprehensive Income
Beginning balance	\$ 16,301	\$(5,935)	) \$—	\$ 10,366
Other comprehensive loss before reclassifications	(2,231)	) (22)	) —	(2,253)
Amounts reclassified from accumulated other comprehensive income	187	—	—	187
Net current-period other comprehensive loss	(2,044)	) (22)	) —	(2,066)
Balance at September 30, 2014 (in thousands)	\$ 14,257	\$(5,957)	) \$—	\$ 8,300
(in thousands)	Three months ended September 30, 2013			
	Unrealized Gains (Losses) on Fixed Maturities and Equity Investments	Foreign Currency Translation Adjustments	Equity in Other Comprehensive Income of Investee	Total Accumulated Other Comprehensive Income
Beginning balance	\$ 15,628	\$ 1,234	\$—	\$ 16,862
Other comprehensive (loss) income before reclassifications	(274)	) 1	—	(273)
	1,860	(7,227)	) —	(5,367)

Amounts reclassified from accumulated  
other comprehensive income

Net current-period other comprehensive income (loss)	1,586	(7,226	) —	(5,640	)
Balance at September 30, 2013	\$17,214	\$(5,992	) \$—	\$11,222	

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

(in thousands)	Nine months ended September 30, 2014			
	Unrealized Gains (Losses) on Fixed Maturities and Equity Investments	Foreign Currency Translation Adjustments	Equity in Other Comprehensive Income of Investee	Total Accumulated Other Comprehensive Income
Beginning balance	\$15,583	\$(5,982	) \$—	\$9,601
Other comprehensive (loss) income before reclassifications	(2,852	) 25	—	(2,827
Amounts reclassified from accumulated other comprehensive income	1,526	—	—	1,526
Net current-period other comprehensive (loss) income	(1,326	) 25	—	(1,301
Balance at September 30, 2014 (in thousands)	\$14,257	\$(5,957	) \$—	\$8,300
(in thousands)	Nine months ended September 30, 2013			
	Unrealized Gains on Fixed Maturities and Equity Investments	Foreign Currency Translation Adjustments	Equity in Other Comprehensive (Loss) Income of Investee	Total Accumulated Other Comprehensive Income
Beginning balance	\$14,194	\$1,210	\$(642	) \$14,762
Other comprehensive income before reclassifications	878	25	642	1,545
Amounts reclassified from accumulated other comprehensive income	2,142	(7,227	) —	(5,085
Net current-period other comprehensive income (loss)	3,020	(7,202	) 642	(3,540
Balance at September 30, 2013	\$17,214	\$(5,992	) \$—	\$11,222

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

Components of accumulated other comprehensive income were reclassified to the following lines of the unaudited consolidated statements of operations for the three and nine months ended September 30, 2014 and September 30, 2013:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Reclassification of accumulated other comprehensive income from unrealized (losses) gains on fixed maturities and equity investments to:				
Net realized gains (losses)	\$(187 )	\$(1,860 )	\$(1,526 )	\$(2,142 )
Other-than-temporary impairment loss	—	—	—	—
Loss from continuing operations before income tax expense (benefit)	(187 )	(1,860 )	(1,526 )	(2,142 )
Income tax expense (benefit)	—	—	—	—
Net (loss) income	(187 )	(1,860 )	(1,526 )	(2,142 )
Reclassification of accumulated other comprehensive income from foreign currency translation adjustments to:				
Gain on liquidation of subsidiaries, net of tax	—	7,227	—	7,227
Net (loss) income	—	7,227	—	7,227
Total reclassification from accumulated other comprehensive income to net (loss) income	\$(187 )	\$5,367	\$(1,526 )	\$5,085

## NOTE 18 SEGMENTED INFORMATION

The Company operates as a merchant bank primarily engaged, through its subsidiaries, in the property and casualty insurance business. The Company conducts its business through the following two reportable segments: Insurance Underwriting and Insurance Services.

## Insurance Underwriting Segment

Effective March 31, 2014, the Company's wholly owned subsidiary, PIH, completed an initial public offering of its common stock. Upon completion of the transaction, the Company maintained a minority ownership interest in the common shares of PIH. The earnings of PIH are included in the consolidated statements of operations through the March 31, 2014 transaction date. Prior to the transaction, PIH was included in the Insurance Underwriting segment. As a result of the disposal of the Company's majority interest in PIH on March 31, 2014, all segmented information has been restated to exclude PIH from the Insurance Underwriting segment.

Insurance Underwriting includes the following subsidiaries of the Company: Mendota Insurance Company, Mendakota Insurance Company, Universal Casualty Company ("UCC"), Kingsway Amigo Insurance Company ("Amigo") and Kingsway Reinsurance Corporation (collectively, "Insurance Underwriting"). In September 2013, Kingsway Reinsurance (Bermuda) Ltd., formerly included in Insurance Underwriting, was liquidated. Insurance Underwriting principally offers personal automobile insurance to drivers who do not meet the criteria for coverage by standard automobile insurers and actively conducts business in 15 states.

The Company previously placed Amigo and UCC into voluntary run-off in 2012 and 2011, respectively. Each of Amigo and UCC has entered into a comprehensive run-off plan which has been approved by its respective state of domicile. Kingsway continues to manage Amigo and UCC in a manner consistent with the run-off plans.

Insurance Services Segment

Insurance Services includes the following subsidiaries of the Company: ARS, IWS Acquisition Corporation ("IWS") and Trinity (collectively, "Insurance Services").

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

ARS is a licensed property and casualty agent, full service managing general agent and third-party administrator focused primarily on the assigned risk market. ARS is licensed to administer business in 22 states but generates its revenues primarily by operating in the states of New York and New Jersey.

IWS is a licensed motor vehicle service agreement company and is a provider of after-market vehicle protection services distributed by credit unions in 26 states to their members.

Trinity is a provider of warranty products and maintenance support to consumers and businesses in the HVAC and refrigeration industry. Trinity distributes its warranty products through original equipment manufacturers, HVAC distributors and commercial and residential contractors. Trinity distributes its maintenance support directly through corporate owners of retail spaces throughout the United States.

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

Revenues by reportable segment reconciled to consolidated revenues for the three and nine months ended September 30, 2014 and 2013 were:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenues:				
Insurance Underwriting:				
Net premiums earned	\$28,418	\$25,212	\$84,979	\$79,968
Other income	2,131	2,327	6,378	7,034
Total Insurance Underwriting	30,549	27,539	91,357	87,002
Insurance Services:				
Service fee and commission income	14,102	12,156	42,752	37,332
Other income	118	79	307	254
Total Insurance Services	14,220	12,235	43,059	37,586
Total segment revenues	44,769	39,774	134,416	124,588
Net premiums earned not allocated to segments	—	829	4,114	2,438
Net investment income	542	409	1,296	1,805
Net realized gains (losses)	329	321	5,459	(1,056 )
Other-than-temporary impairment loss	—	—	—	(1,800 )
Other income (loss) not allocated to segments	(107 )	317	(5 )	(173 )
Total revenues	\$45,533	\$41,650	\$145,280	\$125,802

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

The operating income (loss) of each segment in the following table is before income taxes and includes revenues and direct segment costs.

Segment operating income (loss) reconciled to the consolidated loss from continuing operations for the three and nine months ended September 30, 2014 and 2013 were:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Segment operating income (loss)				
Insurance Underwriting	\$(481 )	\$(4,738 )	\$75	\$(12,295 )
Insurance Services	1,242	(311 )	4,337	2,116
Total segment operating income (loss)	761	(5,049 )	4,412	(10,179 )
Net investment income	542	409	1,296	1,805
Net realized gains (losses)	329	321	5,459	(1,056 )
Other-than-temporary impairment loss	—	—	—	(1,800 )
Other income and expenses not allocated to segments, net	(2,257 )	(2,261 )	(4,893 )	(10,192 )
Interest expense	(1,417 )	(1,808 )	(4,214 )	(5,568 )
Amortization of intangible assets	(397 )	(508 )	(1,220 )	(1,574 )
Contingent consideration expense	(267 )	(155 )	(801 )	(465 )
Impairment of asset held for sale	—	—	(1,180 )	(1,446 )
(Loss) gain on change in fair value of debt	(2,963 )	3,801	(10,199 )	(2,812 )
Loss on disposal of subsidiary	—	—	(1,242 )	—
Loss on buy-back of debt	—	—	—	(24 )
Equity in net (loss) income of investee	(83 )	—	(83 )	255
Loss from continuing operations before income tax expense (benefit)	\$(5,752 )	\$(5,250 )	\$(12,665 )	\$(33,056 )
Income tax expense (benefit)	343	403	(90 )	(398 )
Loss from continuing operations	\$(6,095 )	\$(5,653 )	\$(12,575 )	\$(32,658 )

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

Net premiums earned by line of business for the three and nine months ended September 30, 2014 and 2013 were:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
<b>Insurance Underwriting:</b>				
Private passenger auto liability	\$19,066	\$16,926	\$56,842	\$54,763
Auto physical damage	9,352	8,269	28,137	24,442
Total non-standard automobile	28,418	25,195	\$84,979	\$79,205
Commercial auto liability	—	17	—	763
Total Insurance Underwriting	28,418	25,212	84,979	79,968
<b>Net premiums earned not allocated to segments:</b>				
Allied lines	—	846	1,944	1,472
Homeowners	—	(18	) 2,159	965
Other	—	1	11	1
Total net premiums earned not allocated to segments	—	829	4,114	2,438
Total net premiums earned	\$28,418	\$26,041	\$89,093	\$82,406

## NOTE 19 RESTRUCTURING

On September 17, 2012, the Company announced that it was restructuring its Insurance Underwriting and Insurance Services segments. As part of the restructuring, the Company intends to streamline its non-standard property and casualty insurance business operations. Specific to Insurance Underwriting, during the fourth quarter of 2012, the Company began taking steps to place all of Amigo into voluntary run-off. Amigo has entered into a comprehensive run-off plan which has been approved by the Florida Office of Insurance Regulation. Kingsway continues to manage Amigo in a manner consistent with its filed run-off plan.

As part of the restructuring, the Company will reduce staffing levels to be consistent with placing Amigo into run-off. The Company estimated that Insurance Underwriting would incur approximately \$2.0 million in cash severance expenses due to reductions-in-force as part of the restructuring during the period beginning with the announcement through the end of 2013. From the time the restructuring was announced on September 17, 2012 through September 30, 2014, the Company has incurred severance expense of \$2.0 million, \$2.0 million of which has been paid through September 30, 2014.

Changes in the restructuring liability, which is included in accrued expenses and other liabilities in the consolidated balance sheets, and the related restructuring expense for the three and nine months ended September 30, 2014 and September 30, 2013 is as follows:

(in thousands)	Restructuring liability, beginning of period	For the three months ended September 30, 2014		
		Restructuring expense	Cash payments	Restructuring liability, end of period
<b>Insurance Underwriting:</b>				
Severance	35	—	(35	) —
Lease abandonment	503	16	(91	) 428
Total Insurance Underwriting	538	16	(126	) 428
<b>Insurance Services:</b>				
Lease abandonment	72	(11	) (9	) 52
Total Insurance Services	72	(11	) (9	) 52
Total	610	5	(135	) 480



## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

(in thousands)	Restructuring liability, beginning of period	For the three months ended September 30, 2013		
		Restructuring expense	Cash payments	Restructuring liability, end of period
Insurance Underwriting:				
Severance	44	203	(131)	) 116
Lease abandonment	1,071	20	(89)	) 1,002
Total	1,115	223	(220)	) 1,118

(in thousands)	Restructuring liability, beginning of period	For the nine months ended September 30, 2014		
		Restructuring expense	Cash payments	Restructuring liability, end of period
Insurance Underwriting:				
Severance	236	(74)	(162)	) —
Lease abandonment	654	48	(274)	) 428
Total Insurance Underwriting	890	(26)	(436)	) 428
Insurance Services:				
Lease abandonment	94	(3)	(39)	) 52
Total Insurance Services	94	(3)	(39)	) 52
Severance expense not allocated to segments	146	—	(146)	) —
Total	1,130	(29)	(621)	) 480

(in thousands)	Restructuring liability, beginning of period	For the nine months ended September 30, 2013		
		Restructuring expense	Cash payments	Restructuring liability, end of period
Insurance Underwriting:				
Severance	214	1,089	(1,187)	) 116
Lease abandonment	1,207	61	(266)	) 1,002
Total	1,421	1,150	(1,453)	) 1,118

## NOTE 20 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value amounts represent estimates of the consideration that would currently be agreed upon between knowledgeable, willing parties who are under no compulsion to act. Fair value is best evidenced by quoted bid or ask price, as appropriate, in an active market. Where bid or ask prices are not available, such as in an illiquid or inactive market, the closing price of the most recent transaction of that instrument subject to appropriate adjustments as required is used. Where quoted market prices are not available, the quoted prices of similar financial instruments or valuation models with observable market-based inputs are used to estimate the fair value. These valuation models may use multiple observable market inputs, including observable interest rates, foreign exchange rates, index levels, credit spreads, equity prices, counterparty credit quality, corresponding market volatility levels and option volatilities. Minimal management judgment is required for fair values calculated using quoted market prices or observable market inputs for models. Greater subjectivity is required when making valuation adjustments for financial instruments in

inactive markets or when using models where observable parameters do not exist. Also, the calculation of estimated fair value is based on market conditions at a specific point in time and may not be reflective of future fair values. For the Company's financial instruments carried at cost or amortized cost, the book value is not adjusted to reflect increases or decreases in fair value due to market fluctuations, including those due to interest rate changes, as it is the Company's intention to hold them until there is a recovery of fair value, which may be to maturity.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

The Company classifies its investments in fixed maturities and equity investments as available-for-sale and reports these investments at fair value. The Company's LROC preferred units, senior unsecured debentures, subordinated debt and contingent consideration liabilities are measured and reported at fair value.

Fixed maturities and equity investments - Fair values of fixed maturities for which no active market exists are derived from quoted market prices of similar instruments or other third-party evidence. Fair values of equity investments are considered to approximate quoted market values based on the latest bid prices in active markets.

Debt - The fair value of the LROC preferred units is based on quoted market prices, and the fair value of the subordinated debt is estimated using an internal model based on significant market observable inputs. The fair value of senior unsecured debentures, for which no active market exists, was derived from quoted market prices of similar instruments or other third-party evidence.

Contingent consideration - The consideration for certain of the Company's acquisitions includes future payments to the former owners that are contingent upon the achievement of certain targets over future reporting periods. Liabilities for contingent consideration are measured and reported at fair value and are included in accrued expenses and other liabilities in the consolidated balance sheets. The fair value of contingent consideration liabilities is estimated using internal models without relevant observable market inputs. Estimated payments are discounted using present value techniques to arrive at estimated fair value. Changes in the fair value of contingent consideration liabilities can result from changes to one or multiple inputs, including adjustments to the discount rates or changes in the assumed achievement or timing of any targets. Changes in assumptions could have an impact on the payout of contingent consideration liabilities. Changes in fair value are reported in the consolidated statements of operations as contingent consideration expense. The maximum the Company can pay in future contingent payments is \$13.5 million, on an undiscounted basis.

The Company employs a fair value hierarchy to categorize the inputs it uses in valuation techniques to measure the fair value. The extent of use of quoted market prices (Level 1), valuation models using observable market information (Level 2) and internal models without observable market information (Level 3) in the valuation of the Company's financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2014 and December 31, 2013 was as follows:

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

(in thousands)

		September 30, 2014		
		Fair Value Measurements at the End of the Reporting Period Using		
	Total	Quoted Prices in Active Markets for Identical Assets(Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring fair value measurements				
Assets:				
Fixed maturities:				
U.S. government, government agencies and authorities	\$10,588	\$—	\$10,588	\$—
Canadian government	4,433	—	4,433	—
States municipalities and political subdivisions	6,193	—	6,193	—
Mortgage-backed	4,398	—	4,398	—
Asset-backed securities and collateralized mortgage obligations	7,751	—	7,751	—
Corporate	15,285	—	15,285	—
Total fixed maturities	48,648	—	48,648	—
Equity investments:				
Common stock	14,792	14,792	—	—
Warrants	140	140	—	—
Total equity investments	14,932	14,932	—	—
Other investments	2,000	—	2,000	—
Short-term investments	401	—	401	—
Total assets	\$65,981	\$14,932	\$51,049	\$—
Liabilities:				
LROC preferred units	14,106	14,106	—	—
Subordinated debt	39,418	—	39,418	—
Contingent consideration	6,145	—	—	6,145
Total liabilities	\$59,669	\$14,106	\$39,418	\$6,145

## KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

(in thousands)	Total	December 31, 2013 Fair Value Measurements at the End of the Reporting Period Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Recurring fair value measurements				
Assets:				
Fixed maturities:				
U.S. government, government agencies and authorities	\$18,338	\$—	\$18,338	\$—
Canadian government	4,082	—	4,082	—
States municipalities and political subdivisions	6,231	—	6,231	—
Mortgage-backed	2,006	—	2,006	—
Asset-backed securities and collateralized mortgage obligations	3,994	—	3,994	—
Corporate	19,500	—	19,500	—
Total fixed maturities	54,151	—	54,151	—
Equity investments	7,137	7,137	—	—
Other investments	3,000	—	3,000	—
Short-term investments	501	—	501	—
Total assets	\$64,789	\$7,137	\$57,652	\$—
Liabilities:				
LROC preferred units	14,854	14,854	—	—
Senior unsecured debentures	14,356	—	14,356	—
Subordinated debt	28,471	—	28,471	—
Contingent consideration	5,344	—	—	5,344
Total liabilities	\$63,025	\$14,854	\$42,827	\$5,344

The following table provides a reconciliation of the fair value of recurring Level 3 fair value measurements for the three and nine months ended September 30, 2014 and September 30, 2013:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Contingent consideration:				
Beginning balance	\$5,878	\$4,297	\$5,344	\$3,987
Change in fair value of contingent consideration included in net loss	267	155	801	465
Ending balance	\$6,145	\$4,452	\$6,145	\$4,452



KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) September 30, 2014

NOTE 21 RELATED PARTY TRANSACTIONS

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

On February 11, 2014, the Company's subsidiary, 1347 Advisors LLC ("1347 Advisors") entered into a Management Services Agreement ("MSA") with PIH which provides for certain services, including forecasting, analysis of capital structure and reinsurance programs, consultation in future restructuring or capital raising transactions, and consultation in corporate development initiatives, that 1347 Advisors will provide to PIH unless and until 1347 Advisors and PIH agree to terminate the services.

On March 7, 2014, the Company's subsidiary, 1347 Capital LLC ("1347 Capital") appointed Gordon G. Pratt, CEO of Fund Management Group ("FMG"), as Chairman of 1347 Capital. At September 30, 2014, the Company has a note receivable of \$1.5 million outstanding from FMG.

On March 26, 2014, the Company entered into a Performance Share Grant Agreement with PIH, whereby the Company will be entitled to receive up to an aggregate of 375,000 shares of PIH common stock upon achievement of certain milestones for PIH's stock price. Pursuant to the terms of the Performance Share Grant Agreement, if at any time the last sales price of PIH's common stock equals or exceeds: (i) \$12.00 per share (as adjusted for stock splits, stock dividends, reorganizations, recapitalizations and the like) for any 20 trading days within any 30-trading day period, the Company will receive 125,000 shares of PIH common stock; (ii) \$15.00 per share (as adjusted for stock splits, stock dividends, reorganizations, recapitalizations and the like) for any 20 trading days within any 30-trading day period, the Company will receive 125,000 shares of PIH common stock (in addition to the 125,000 shares of common stock earned pursuant to clause (i) herein); and (iii) \$18.00 per share (as adjusted for stock splits, stock dividends, reorganizations, recapitalizations and the like) for any 20 trading days within any 30-trading day period, the Company will receive 125,000 shares of PIH common stock (in addition to the 250,000 shares of common stock earned pursuant to clauses (i) and (ii) herein). The shares of common stock granted to the Company will have a valuation equal to the last sales price of PIH common stock on the day prior to such grant.

On August 28, 2014, the Company entered into a \$0.5 million line of credit with Itasca Golf Investors, LLC ("Itasca Golf"). During the second quarter, the Company made an investment in Itasca Golf which is included in limited liability investments on the unaudited consolidated balance sheets. On August 29, 2014, the Company advanced \$0.5 million to Itasca Golf under the line of credit which is included in other receivables on the unaudited consolidated balance sheets. The line of credit matures on August 28, 2016.

NOTE 22 COMMITMENTS AND CONTINGENCIES

(a) Legal proceedings:

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

(b) Commitment:

The Company has entered into subscription agreements to commit up to \$6.0 million of capital to allow for participation in limited liability investments which invest principally in income-producing real estate. At September 30, 2014, the unfunded commitment was \$0.5 million.



KINGSWAY FINANCIAL SERVICES INC.

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

Management's Discussion and Analysis includes "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are not historical facts, and involve risks and uncertainties that could cause actual results to differ materially from those expected and projected. Words such as "expects", "believes", "anticipates", "intends", "estimates", "seeks" and variations and similar words and expressions are intended to identify such forward looking statements. Such forward looking statements relate to future events or future performance, but reflect Kingsway management's current beliefs, based on information currently available. A number of factors could cause actual events, performance or results to differ materially from the events, performance and results discussed in the forward looking statements. For information identifying important factors that could cause actual results to differ materially from those anticipated in the forward looking statements, see Kingsway's securities filings, including its Annual Report on Form 10-K for the year ended December 31, 2013 ("2013 Annual Report"). The Company's securities filings can be accessed on the Canadian Securities Administrators' website at [www.sedar.com](http://www.sedar.com), and on the EDGAR section of the U.S. Securities and Exchange Commission's website at [www.sec.gov](http://www.sec.gov) or through the Company's website at [www.kingsway-financial.com](http://www.kingsway-financial.com). Except as expressly required by applicable securities law, the Company disclaims any intention or obligation to update or revise any forward looking statements whether as a result of new information, future events or otherwise.

OVERVIEW

Kingsway is a Canadian holding company with operating subsidiaries located in the United States. The Company operates as a merchant bank primarily engaged, through its subsidiaries, in the property and casualty insurance business. Kingsway conducts its business through the following two reportable segments: Insurance Underwriting and Insurance Services.

Effective March 31, 2014, the Company's wholly owned subsidiary, 1347 Property Insurance Holdings, Inc. ("PIH"), formerly known as Maison Insurance Holdings, Inc., completed an initial public offering of its common stock. Upon completion of the transaction, the Company maintained a minority ownership interest in the common shares of PIH. The earnings of PIH are included in the consolidated statements of operations through the March 31, 2014 transaction date. Prior to the transaction, PIH was included in the Insurance Underwriting segment. As a result of the disposal of the Company's majority interest in PIH on March 31, 2014, all segmented information has been restated to exclude PIH from the Insurance Underwriting segment.

Insurance Underwriting includes the following subsidiaries of the Company: Mendota Insurance Company ("Mendota"), Mendakota Insurance Company ("Mendakota"), Universal Casualty Company ("UCC"), Kingsway Amigo Insurance Company ("Amigo") and Kingsway Reinsurance Corporation. In September 2013, Kingsway Reinsurance (Bermuda) Ltd., formerly included in Insurance Underwriting, was liquidated. Throughout Management's Discussion and Analysis, the term "Insurance Underwriting" is used to refer to this segment.

Insurance Underwriting actively conducts business in 15 states. For the three months ended September 30, 2014, production in the following states represented 82.1% of the Company's gross premiums written: Florida (19.9%), Texas (17.8%), Illinois (15.0%), Nevada (10.5%), California (9.8%) and Colorado (9.1%). For the nine months ended September 30, 2014, production in the following states represented 80.9% of the Company's gross premiums written: Florida (18.5%), Texas (17.4%), Illinois (15.6%), Nevada (10.0%), Colorado (9.8%) and California (9.6%).

Insurance Underwriting principally offers personal automobile insurance to drivers who do not meet the criteria for coverage by standard automobile insurers. For the three months ended September 30, 2014, non-standard automobile insurance accounted for 100.0% (93.9% year to date) of the Company's gross premiums written.

The Company previously placed Amigo and UCC into voluntary run-off in 2012 and 2011, respectively. Each of Amigo and UCC has entered into a comprehensive run-off plan which has been approved by its respective state of domicile. Kingsway continues to manage Amigo and UCC in a manner consistent with the run-off plans.

Insurance Services includes the following subsidiaries of the Company: Assigned Risk Solutions Ltd. ("ARS"), IWS Acquisition Corporation ("IWS") and Trinity Warranty Solutions LLC ("Trinity"). Throughout Management's

Discussion and Analysis, the term "Insurance Services" is used to refer to this segment.

ARS is a licensed property and casualty agent, full service managing general agent and third-party administrator focused primarily on the assigned risk market. ARS is licensed to administer business in 22 states but generates its revenues primarily by operating in the states of New York and New Jersey.