

KINGSWAY FINANCIAL SERVICES INC
Form 10-Q
May 08, 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

March 31, 2014

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

For the quarterly period ended March 31, 2014

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 May 8, 2014 was 16,429,761.

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)

	March 31, 2014 (unaudited)	December 31, 2013
Assets		
Investments:		
Fixed maturities, at fair value (amortized cost of \$50,778 and \$53,455, respectively)	\$51,456	\$54,151
Equity investments, at fair value (cost of \$5,103 and \$3,554, respectively)	9,982	7,137
Limited liability investments	4,701	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	68,540	-69,195
Cash and cash equivalents	72,080	98,589
Investment in investee	7,661	—
Accrued investment income	1,096	614
Premiums receivable, net of allowance for doubtful accounts of \$1,839 and \$2,123, respectively	32,609	32,035
Service fee receivable, net of allowance for doubtful accounts of \$245 and \$0, respectively	22,622	19,012
Other receivables, net of allowance for doubtful accounts of \$1,061 and \$1,062, respectively	5,106	4,097
Reinsurance recoverable	7,569	10,335
Prepaid reinsurance premiums	148	6,816
Deferred acquisition costs, net	12,559	12,392
Property and equipment, net of accumulated depreciation of \$15,894 and \$15,848, respectively	1,671	1,662
Goodwill	10,588	10,588
Intangible assets, net of accumulated amortization of \$18,997 and \$18,583, respectively	48,504	48,918
Other assets	3,525	4,039
Asset held for sale	6,347	6,347
Total Assets	\$300,625	\$324,639
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid loss and loss adjustment expenses:		
Property and casualty	\$77,285	\$84,534
Vehicle service agreements	3,128	3,128
Total unpaid loss and loss adjustment expenses	80,413	87,662
Unearned premiums	40,979	48,577
Reinsurance payable	145	1,033
LROC preferred units, at fair value	14,291	14,854
Senior unsecured debentures, at fair value	—	14,356

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Subordinated debt, at fair value	28,471	28,471
Deferred income tax liability	4,456	4,173
Deferred service fees	49,262	48,788
Income taxes payable	921	2,984
Accrued expenses and other liabilities	37,538	36,821
Total Liabilities	\$256,476	\$287,719
Shareholders' Equity:		
Class A preferred stock, no par value; unlimited number authorized; 262,876 and zero issued and outstanding at March 31, 2014 and December 31, 2013, respectively	\$6,402	\$—
Common stock, no par value; unlimited number authorized; 16,429,761 and 16,429,761 issued and outstanding at March 31, 2014 and December 31, 2013, respectively	—	—
Additional paid-in capital	325,427	324,803
Accumulated deficit	(300,640	) (298,930
Accumulated other comprehensive income	10,973	9,601
Shareholders' equity attributable to common shareholders	42,162	35,474
Noncontrolling interests in consolidated subsidiaries	1,987	1,446
Total Shareholders' Equity	44,149	36,920
Total Liabilities and Shareholders' Equity	\$300,625	\$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 March 31,	
	2014	2013
Revenues:		
Net premiums earned	\$31,920	\$28,068
Service fee and commission income	14,724	13,124
Net investment income	413	580
Net realized gains (losses)	39	(1,409)
Other income	2,071	2,218
Total revenues	49,167	42,581
Expenses:		
Loss and loss adjustment expenses	21,061	21,831
Commissions and premium taxes	6,553	6,712
Cost of services sold	856	—
General and administrative expenses	18,524	19,604
Restructuring expense	20	780
Interest expense	1,433	1,833
Amortization of intangible assets	414	558
Contingent consideration expense	267	155
Total expenses	49,128	51,473
Income (loss) before gain (loss) on change in fair value of debt, loss on disposal of subsidiary, loss on buy-back of debt, equity in net income of investee and income tax expense (benefit)	39	(8,892)
Gain (loss) on change in fair value of debt	563	(8,951)
Loss on disposal of subsidiary	(1,242)	—
Loss on buy-back of debt	—	(24)
Equity in net income of investee	—	255
Loss before income tax expense (benefit)	(640)	(17,612)
Income tax expense (benefit)	366	(276)
Net loss	(1,006)	(17,336)
Less: net income attributable to noncontrolling interests in consolidated subsidiaries	653	95
Less: dividends on preferred stock	53	—
Net loss attributable to common shareholders	\$(1,712)	\$(17,431)
Loss per share – net loss attributable to common shareholders:		
Basic:	\$ (0.10)	\$ (1.33)
Diluted:	(0.10)	(1.33)
Weighted average shares outstanding (in '000s):		
Basic:	16,430	13,149
Diluted:	16,430	13,149

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

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

	Three months ended March 31,	
	2014	2013
Net loss	\$(1,006)	\$(17,336)
Other comprehensive income (loss), net of taxes ⁽¹⁾ :		
Unrealized gains (losses) on fixed maturities and equity investments:		
Unrealized gains (losses) arising during the period	1,226	(503)
Reclassification adjustment for amounts included in net loss	52	248
Foreign currency translation adjustments	(18)	1
Equity in other comprehensive loss of investee	—	(105)
Other comprehensive income (loss)	1,260	(359)
Comprehensive income (loss)	254	(17,695)
Less: comprehensive income attributable to noncontrolling interests in consolidated subsidiaries	541	66
Comprehensive loss attributable to common shareholders	\$(287)	\$(17,761)

(1) Net of income tax expense (benefit) of \$0 and \$0 for the three months ended March 31, 2014 and March 31, 2013, respectively.

See accompanying notes to unaudited consolidated financial statements

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three months ended March 31,	
	2014	2013
Cash provided by (used in):		
Operating activities:		
Net loss	\$(1,006	) \$(17,336
Adjustments to reconcile net loss to net cash used in operating activities:		
Equity in net income of investee	—	(255
Equity in net income of limited liability investments	(22	) (50
Depreciation and amortization	693	1,002
Contingent consideration expense	267	155
Stock based compensation expense, net of forfeitures	624	—
Net realized (gains) losses	(39	) 1,409
(Gain) loss on change in fair value of debt	(563	) 8,951
Deferred income taxes	459	(416
Amortization of fixed maturities premiums and discounts	206	1,270
Loss on disposal of subsidiary	1,242	—
Realized loss on buy-back of debt	—	24
Changes in operating assets and liabilities:		
Premiums and service fee receivable	(4,184	) (6,086
Reinsurance recoverable	2,766	(6,108
Prepaid reinsurance premiums	6,668	(2,922
Deferred acquisition costs	(167	) 1,417
Unpaid loss and loss adjustment expenses	(7,249	) (5,360
Unearned premiums	(7,598	) 7,069
Reinsurance payable	(888	) 5,681
Deferred service fees	474	(174
Other, net	(623	) 470
Net cash used in operating activities	(8,940	) (11,259
Investing activities:		
Proceeds from sales and maturities of fixed maturities	5,100	9,348
Proceeds from sales of equity investments	71	175
Proceeds from sales of investment in investee	—	13,638
Purchase of fixed maturities	(5,878	) (879
Purchase of equity investments	(1,593	) (23
Net acquisition of limited liability investments	(263	) 99
Proceeds from other investments	1,000	—
Net purchases of short-term investments	(103	) (325
Acquisition of investee	(7,661) —
Net purchases of property and equipment	(288	) (183
Net cash (used in) provided by investing activities	(9,615	) 21,850
Financing activities:		
Proceeds from issuance of preferred stock, net	6,402	—
Redemption of senior unsecured debentures	(14,356	) (583
Net cash used in financing activities	(7,954	) (583
Net (decrease) increase in cash and cash equivalents	(26,509) 10,008
Cash and cash equivalents at beginning of period	98,589	80,813

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Cash and cash equivalents at end of period	\$72,080	\$90,821
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See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) March 31, 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 2012, the FASB issued ASU 2012-02, Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment ("ASU 2012-02"). ASU 2012-02 provides entities with an option to first assess qualitative factors to determine whether events or circumstances indicate that it is more likely than not that the indefinite-lived intangible asset is impaired. If an entity concludes that it is more than 50% likely that an indefinite-lived intangible asset is not impaired, no further analysis is required. However, if an entity concludes otherwise, it would be required to determine the fair value of the indefinite-lived intangible asset to measure the amount of actual impairment, if any, as currently required under US GAAP. Effective January 1, 2013, the Company adopted ASU 2012-02 and the adoption did not have an impact on the consolidated financial statements. There have been no triggering events that would suggest possible impairment or that it is more-likely-than-not that the fair values of indefinite-lived intangible assets are less than their carrying amounts.

In February 2013, the FASB issued ASU 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income ("ASU 2013-02"), which is intended to improve the reporting of reclassifications out of accumulated other comprehensive income. The ASU requires an entity to report, either on the face of the income statement or in the notes to the financial statements, the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in the income

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) March 31, 2014

statement if the amount being reclassified is required to be reclassified in its entirety to net income. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other required disclosures that provide additional detail about those amounts. Effective January 1, 2013, the Company adopted ASU 2013-02. Except for the new disclosure requirements, the adoption of the standard did not have an impact on the consolidated financial statements. The required disclosures are included in Note 17, "Accumulated Other Comprehensive Income."

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.

NOTE 5 ACQUISITION AND DISPOSITION

(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. Refer to Note 9, "Intangible Assets," for further disclosure on intangible assets related to this acquisition. 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 March 31, 2014, the recorded value of the contingent payment liability is \$0.8 million, which is included in accrued expenses and other liabilities on the consolidated balance sheets.

(b) Disposition

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 for the three months ended March 31, 2014. The earnings of PIH are included in the consolidated statements of operations through the March 31, 2014 transaction date. Refer to Note 7, "Investment in Investee," for further disclosure on the Company's investment in PIH at March 31, 2014.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) March 31, 2014

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 March 31, 2014 and December 31, 2013 are summarized in the tables shown below:

(in thousands)	March 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. government, government agencies and authorities	\$ 15,255	\$ 531	\$ 21	\$ 15,765
Canadian government	4,417	—	161	4,256
States municipalities and political subdivisions	6,118	138	—	6,256
Mortgage-backed	1,952	16	1	1,967
Asset-backed securities and collateralized mortgage obligations	4,489	4	2	4,491
Corporate	18,547	184	10	18,721
Total fixed maturities	50,778	873	195	51,456
Equity investments:				
Common stock	5,103	4,972	93	9,982
Total fixed maturities and equity investments	\$ 55,881	\$ 5,845	\$ 288	\$ 61,438
(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 March 31, 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.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) March 31, 2014

(in thousands)	March 31, 2014	
	Amortized Cost	Estimated Fair Value
Due in one year or less	\$17,500	\$17,596
Due after one year through five years	30,733	31,296
Due after five years through ten years	614	619
Due after ten years	1,931	1,945
Total	\$50,778	\$51,456

The following tables highlight the aggregate unrealized loss position, by security type, of fixed maturities and equity investments in unrealized loss positions as of March 31, 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.

(in thousands)	March 31, 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	\$2,514	\$19	\$861	\$2	\$3,375	\$21
Canadian government	—	—	4,256	161	4,256	161
Mortgage-backed	603	1	—	—	603	1
Asset-backed securities and collateralized mortgage obligations	1,273	2	—	—	1,273	2
Corporate	816	10	—	—	816	10
Total fixed maturities	5,206	32	5,117	163	10,323	195
Equity investments:						
Common stock	1,618	93	—	—	1,618	93
Total	\$6,824	\$125	\$5,117	\$163	\$11,941	\$288

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) March 31, 2014

(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 18 and 27 individual investments that were in unrealized loss positions as of March 31, 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;
- 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 months ended March 31, 2014 and March 31, 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

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) March 31, 2014

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. The Company's interests in these investments are not deemed minor and, therefore, are accounted for under the equity method of accounting. As of March 31, 2014 and December 31, 2013, the carrying value of limited liability investments totaled \$4.7 million and \$4.4 million, respectively. At March 31, 2014, the Company has unfunded commitments totaling \$1.5 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 March 31, 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 months ended March 31, 2014 and March 31, 2013 were as follows:

(in thousands)	Three months ended March 31,	
	2014	2013
Gross realized gains	\$48	\$309
Gross realized losses	(9) —
Total	\$39	\$309

Gross realized losses for the three months ended March 31, 2013 reported in the preceding table excludes the realized loss on sale of Atlas Financial Holdings Inc. ("Atlas") common stock recorded during the first quarter of 2013. Refer to Note 7, "Investment in Investee," for further discussion.

Net investment income for the three months ended March 31, 2014 and March 31, 2013, respectively, is comprised as follows:

(in thousands)	Three months ended March 31,	
	2014	2013
Investment income		
Interest from fixed maturities	\$272	\$282
Dividends	32	253
Income from limited liability investments	22	50
Other	142	92
Gross investment income	468	677
Investment expenses	(55	) (97
Net investment income	\$413	\$580

At March 31, 2014, fixed maturities and short-term investments with an estimated fair value of \$13.4 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 March 31, 2014, the amount of such pledged securities was \$17.4 million.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) March 31, 2014

NOTE 7 INVESTMENT IN INVESTEE

Investment in investee includes the Company's investment in the common stock of PIH. The carrying value, estimated fair value and approximate voting and equity percentages for the Company's investment in the common stock of PIH, which is accounted for under the equity method of accounting and reported as investment in investee in the Company's consolidated balance sheets at March 31, 2014, were as follows:

(in thousands, except for percentages)

	March 31, 2014			
	Voting percentage	Equity percentage	Estimated Fair Value	Carrying value
PIH	28.7	% 28.7	% \$8,000	\$7,661

The fair value of the Company's investment in PIH at March 31, 2014 in the table above is calculated based on the initial public offering price of \$8.00 per share.

Investment in investee formerly included the Company's investment in the preferred and restricted voting common stock of Atlas. 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 was zero and \$0.3 million for the three months ended March 31, 2014 and March 31, 2013, respectively. The Company also recognized a decrease to shareholders' equity attributable to common shareholders of \$0.1 million for the three months ended March 31, 2013, for the Company's pro rata share of its investee's accumulated other comprehensive income.

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 March 31, 2014 is included in equity investments and reported at fair value of \$1.8 million in the consolidated balance sheets.

NOTE 8 DEFERRED ACQUISITION COSTS

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

The components of deferred acquisition costs and the related amortization expense for the three months ended March 31, 2014 and 2013, respectively, are comprised as follows:

(in thousands)	Three months ended March 31,	
	2014	2013
Balance at January 1, net	\$12,392	\$14,102
Additions	7,274	9,172
Amortization	(6,064)	(10,589)
Acquisition costs disposed of during the year related to PIH	(1,043)	—
Balance at March 31, net	\$12,559	\$12,685

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) March 31, 2014

NOTE 9 INTANGIBLE ASSETS

Intangible assets are comprised as follows:

(in thousands)

	March 31, 2014		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Intangible assets subject to amortization			
Database	\$4,918	\$676	\$4,242
Vehicle service agreement in-force	3,680	2,409	1,271
Customer-related relationships	3,611	441	3,170
Non-compete agreement	70	33	37
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	\$18,997	\$48,504

(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 agreement 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 \$0.6 million for the three months ended March 31, 2014 and March 31, 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 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 March 31, 2014, property consisting of building and land located in Miami, Florida with a carrying value of \$6.3 million was classified as held for sale. At March 31, 2014, the carrying value of the property is equal to its fair value net of estimated selling costs.

KINGSWAY FINANCIAL SERVICES INC.

Notes to Consolidated Financial Statements (Unaudited) March 31, 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.

(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 March 31, 2014 and