KINGSWAY FINANCIAL SERVICES INC
Form 10-Q
May 07, 2015

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

FORM 10-Q
(Mark One)

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

For Quarterly Period Ended March 31, 2015
or

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

For the Transition Period from _____ to _____

Commission File Number: 001-15204

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

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

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

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

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

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

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

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

The number of shares outstanding of the registrant's common stock as of May 7, 2015 was 19,709,706.

KINGSWAY FINANCIAL SERVICES INC.

Table Of Contents

KINGSWAY FINANCIAL SERVICES INC.

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
Consolidated Balance Sheets
(in thousands, except per share data)

	March 31, 2015	December 31, 2014
	(unaudited)	
Assets		
Investments:		
Fixed maturities, at fair value (amortized cost of $58,432 and $56,000, respectively)	$58,812	$56,195
Equity investments, at fair value (cost of $21,968 and $16,579, respectively)	24,635	19,618
Limited liability investments	11,098	7,294
Other investments, at cost which approximates fair value	3,551	3,576
Short-term investments, at cost which approximates fair value	400	400
Total investments	98,496	87,083
Cash and cash equivalents	63,566	71,234
Investment in investee	1,975	2,115
Accrued investment income	805	141
Premiums receivable, net of allowance for doubtful accounts of $260 and $1,889, respectively	33,971	28,885
Service fee receivable, net of allowance for doubtful accounts of $247 and $247, respectively	734	964
Other receivables, net of allowance for doubtful accounts of $806 and $806, respectively	5,214	5,145
Reinsurance recoverable	3,247	3,652
Prepaid reinsurance premiums	134	8
Deferred acquisition costs, net	13,203	12,197
Income taxes recoverable	54	74
Property and equipment, net of accumulated depreciation of $12,099 and $15,751, respectively	5,851	5,975
Goodwill	10,078	10,078
Intangible assets, net of accumulated amortization of $5,082 and $4,765, respectively	15,663	15,980
Other assets	3,341	3,638
Assets held for sale	54,200	54,553
Total Assets	$310,532	$301,722
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid loss and loss adjustment expenses:		
Property and casualty	$59,522	$63,895
Vehicle service agreements	2,975	2,975
Total unpaid loss and loss adjustment expenses	62,497	66,870
Unearned premiums	42,565	36,432
Reinsurance payable	785	525
LROC preferred units, at fair value	12,473	13,618

Subordinated debt, at fair value	41,543	40,659
Deferred income tax liability	2,859	2,837
Deferred service fees	34,452	35,096
Accrued expenses and other liabilities	41,255	35,836
Liabilities held for sale	20,537	21,653
Total Liabilities	258,966	253,526
Class A preferred stock, no par value; unlimited number authorized; 262,876 and 262,876 issued and outstanding at March 31, 2015 and December 31, 2014, respectively	6,360	6,330
Shareholders' Equity:		
Common stock, no par value; unlimited number authorized; 19,709,706 and 19,709,706 issued and outstanding at March 31, 2015 and December 31, 2014, respectively	—	—
Additional paid-in capital	341,045	340,844
Accumulated deficit	(309,923)	(312,050)
Accumulated other comprehensive income	8,755	8,670
Shareholders' equity attributable to common shareholders	39,877	37,464
Noncontrolling interests in consolidated subsidiaries	5,329	4,402
Total Shareholders' Equity	45,206	41,866
Total Liabilities and Shareholders' Equity	$310,532	$301,722

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,	
	2015	2014
Revenues:		
Net premiums earned	$29,030	$31,920
Service fee and commission income	5,398	6,065
Net investment income	1,313	413
Net realized gains	—	39
Other-than-temporary impairment loss	(10)	—
Other income	7,965	2,058
Total revenues	43,696	40,495
Expenses:		
Loss and loss adjustment expenses	21,953	21,061
Commissions and premium taxes	5,747	6,553
Cost of services sold	663	856
General and administrative expenses	11,561	11,904
Restructuring expense	15	20
Interest expense	1,391	1,433
Amortization of intangible assets	317	414
Contingent consideration expense	144	267
Total expenses	41,791	42,508
Income (loss) from continuing operations before gain on change in fair value of debt, loss on disposal of subsidiary, equity in net loss of investee and income tax expense	1,905	(2,013)
Gain on change in fair value of debt	261	563
Loss on disposal of subsidiary	—	(1,242)
Equity in net loss of investee	(136)	—
Income (loss) from continuing operations before income tax expense	2,030	(2,692)
Income tax expense	22	60
Income (loss) from continuing operations	2,008	(2,752)
Income from discontinued operations, net of taxes	1,426	1,746
Net income (loss)	3,434	(1,006)
Less: net income attributable to noncontrolling interests in consolidated subsidiaries	1,224	653
Less: dividends on preferred stock	81	53
Net income (loss) attributable to common shareholders	$2,129	$(1,712)
Earnings (loss) per share - continuing operations:		
Basic:	$0.04	$(0.21)
Diluted:	$0.03	$(0.21)
Earnings per share - discontinued operations:		
Basic:	$0.07	$0.11
Diluted:	$0.07	$0.11
Earnings (loss) per share – net income (loss) attributable to common shareholders:		
Basic:	$0.11	$(0.10)
Diluted:	$0.10	$(0.10)
Weighted average shares outstanding (in ‘000s):		

Basic:	19,710	16,430
Diluted:	21,149	16,430

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

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

	Three months ended March 31, 2015	2014
Net income (loss)	$3,434	$(1,006)
Other comprehensive (loss) income, net of taxes[1]:		
Unrealized (losses) gains on fixed maturities and equity investments:		
Unrealized (losses) gains arising during the period	(200)	1,226
Reclassification adjustment for amounts included in net income (loss)	13	52
Foreign currency translation adjustments	(26)	(18)
Other comprehensive (loss) income	(213)	1,260
Comprehensive income	$3,221	$254
Less: comprehensive income attributable to noncontrolling interests in consolidated subsidiaries	927	541
Comprehensive income (loss) attributable to common shareholders	$2,294	$(287)

(1) Net of income tax expense of $0 and $0 for the three months ended March 31, 2015 and March 31, 2014, 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, 2015	2014
Cash provided by (used in):		
Operating activities:		
Net income (loss)	$3,434	$(1,006)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Income from discontinued operations, net of taxes	(1,426)	(1,746)
Equity in net loss of investee	136	—
Equity in net income of limited liability investments	(929)	(22)
Depreciation and amortization expense	480	653
Contingent consideration expense	144	267
Stock based compensation expense, net of forfeitures	201	624
Net realized gains	—	(39)
Gain on change in fair value of debt	(261)	(563)
Deferred income taxes	22	198
Other-than-temporary impairment loss	10	—
Amortization of fixed maturities premiums and discounts	79	206
Loss on disposal of subsidiary	—	1,242
Changes in operating assets and liabilities:		
Premiums and service fee receivable	(4,856)	(608)
Other receivables	(69)	(1,077)
Reinsurance recoverable	405	2,766
Prepaid reinsurance premiums	(126)	6,668
Deferred acquisition costs, net	(1,006)	(167)
Income taxes recoverable	20	—
Unpaid loss and loss adjustment expenses	(4,373)	(7,249)
Unearned premiums	6,133	(7,598)
Reinsurance payable	260	(888)
Deferred service fees	(644)	231
Other, net	2,553	264
Net cash provided by (used in) operating activities	187	(7,844)
Investing activities:		
Proceeds from sales and maturities of fixed maturities	1,195	5,100
Proceeds from sales of equity investments	308	71
Purchases of fixed maturities	(4,722)	(5,878)
Purchases of equity investments	(1,738)	(1,593)
Net acquisition of limited liability investments	(2,859)	(263)
Proceeds from other investments	—	1,000
Net purchases of short-term investments	—	(103)
Acquisition of investee	—	(7,661)
Net purchases of property and equipment	(39)	(290)
Net cash used in investing activities	(7,855)	(9,617)
Financing activities:		
Proceeds from issuance of preferred stock, net	—	6,402
Redemption of senior unsecured debentures	—	(14,356)

Net cash used in financing activities	—	(7,954)
Net decrease in cash and cash equivalents	(7,668)	(25,415)
Cash and cash equivalents at beginning of period	71,234	97,505
Cash and cash equivalents at end of period	$63,566	$72,090

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

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 ("2014 Annual Report") for the year ended December 31, 2014.

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 performance shares; fair value assumptions for debt obligations; and contingent consideration.

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

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

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

There have been no material changes to our significant accounting policies as reported in our 2014 Annual Report, except as disclosed below.

Derivative financial instruments

Derivative financial instruments include investments in warrants and performance shares issued to the Company under various performance share grant agreements. Refer to Note 20, "Related Party Transactions," for further details regarding the performance shares. Warrants are classified as equity investments in the consolidated balance sheets.

The Company measures derivative financial instruments at fair value. The fair value of derivative financial instruments is required to be revalued each reporting period, with corresponding changes in fair value recorded in the consolidated statements of operations, or, in the case of warrants that are actively traded, in other comprehensive (loss) income. Realized gains or losses are recognized upon settlement of the contracts.

NOTE 4 RECENTLY ISSUED ACCOUNTING STANDARDS

(a) Adoption of New Accounting Standards:

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("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 Accounting Standards Codification 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 April 2014, the FASB issued ASU 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity ("ASU 2014-08"). ASU 2014-08 amends the requirements for reporting and disclosing discontinued operations. Under ASU 2014-08, a disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has or will have a major effect on the entity’s operations and financial results. Effective January 1, 2015, the Company adopted ASU 2014-08. The adoption of the standard did not have an impact on the consolidated financial statements.

(b) Accounting Standards Not Yet Adopted:

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle of ASU 2014-09 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 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 currently evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements.

NOTE 5 DISPOSITION AND DISCONTINUED OPERATIONS

(a) 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 during the first quarter of 2014. The earnings of PIH are included in the unaudited 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. During the fourth quarter of 2014, the Company purchased additional shares of PIH which increased the Company's approximate voting percentage in PIH to 16.9% at December 31, 2014. The Company's investment in PIH common stock is included in equity investments and reported at its fair value of $8.2 million in the consolidated balance sheets at March 31, 2015.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

(b) Discontinued Operations

On April 1, 2015, the Company closed on the sale of its subsidiary, Assigned Risk Solutions Ltd. ("ARS"). As a result, ARS, previously disclosed as part of the Insurance Services segment, has been classified as a discontinued operation. The earnings of ARS are disclosed as discontinued operations in the consolidated statements of operations for all periods presented. Summary financial information included in income from discontinued operations, net of taxes for the three months ended March 31, 2015 and 2014 is presented below:

(in thousands)	Three months ended March 31,	
	2015	2014
Revenues:		
Service fee and commission income	$8,342	$8,659
Other (expense) income	(20)	14
Total revenues	8,322	8,673
Expenses:		
General and administrative expenses	6,462	6,621
Income from discontinued operations before income tax expense	1,860	2,052
Income tax expense	434	306
Income from discontinued operations, net of taxes	$1,426	$1,746

The assets and liabilities of ARS are presented as held for sale in the consolidated balance sheets. The carrying amounts of the major classes of assets and liabilities of ARS at March 31, 2015 and December 31, 2014 were as follows:

(in thousands)	March 31, 2015	December 31, 2014
Assets		
Cash and cash equivalents	$2,108	$2,792
Service fee receivable	19,462	19,006
Other receivables	325	257
Income taxes recoverable	144	150
Property and equipment, net of accumulated depreciation	139	193
Goodwill	510	510
Intangible assets, net of accumulated amortization	31,318	31,318
Other assets	194	327
Assets held for sale	$54,200	$54,553
Liabilities		
Deferred income tax liability	$2,977	$2,550
Deferred service fees	14,323	14,358
Accrued expenses and other liabilities	3,237	4,745
Liabilities held for sale	$20,537	$21,653

For the three months ended March 31, 2015 and March 31, 2014, ARS' net cash used in operating activities was $0.0 million and $1.1 million, respectively. ARS had no cash flows from investing activities for the three months ended March 31, 2015 and March 31, 2014.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

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, 2015 and December 31, 2014 are summarized in the tables shown below:

(in thousands)	March 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. government, government agencies and authorities	$21,247	$323	$—	$21,570
Canadian government	4,438	—	285	4,153
States, municipalities and political subdivisions	3,358	56	—	3,414
Mortgage-backed	4,948	73	9	5,012
Asset-backed securities and collateralized mortgage obligations	6,952	11	2	6,961
Corporate	17,489	216	3	17,702
Total fixed maturities	58,432	679	299	58,812
Equity investments:				
Preferred stock	3,000	—	—	3,000
Common stock	17,804	3,350	595	20,559
Warrants	1,164	16	104	1,076
Total equity investments	21,968	3,366	699	24,635
Total fixed maturities and equity investments	$80,400	$4,045	$998	$83,447

(in thousands)	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities:				
U.S. government, government agencies and authorities	$20,436	$333	$10	$20,759
Canadian government	4,519	—	277	4,242
States, municipalities and political subdivisions	3,358	61	—	3,419
Mortgage-backed	5,330	37	15	5,352
Asset-backed securities and collateralized mortgage obligations	7,221	3	10	7,214
Corporate	15,136	103	30	15,209
Total fixed maturities	56,000	537	342	56,195
Equity investments:				
Common stock	16,450	3,360	284	19,526
Warrants	129	—	37	92
Total equity investments	16,579	3,360	321	19,618
Total fixed maturities and equity investments	$72,579	$3,897	$663	$75,813

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

The table below summarizes the Company's fixed maturities at March 31, 2015 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)	March 31, 2015	
	Amortized Cost	Estimated Fair Value
Due in one year or less	$19,635	$19,368
Due after one year through five years	32,241	32,812
Due after five years through ten years	1,720	1,733
Due after ten years	4,836	4,899
Total	$58,432	$58,812

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, 2015 and December 31, 2014. 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, 2015	
	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	$220	$—	$—	$—	$220	$—
Canadian government	—	—	4,152	285	4,152	285
Mortgage-backed	1,594	9	—	—	1,594	9
Asset-backed securities and collateralized mortgage obligations	2,597	2	—	—	2,597	2
Corporate	2,176	3	—	—	2,176	3
Total fixed maturities	6,587	14	4,152	285	10,739	299
Equity investments:						
Common stock	11,188	595	—	—	11,188	595
Warrants	984	104	—	—	984	104
Total equity investments	12,172	699	—	—	12,172	699
Total	$18,759	$713	$4,152	$285	$22,911	$998

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

(in thousands)					December 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	$12,784	$10	$473	$—	$13,257	$10
Canadian government	—	—	4,242	277	4,242	277
States, municipalities and political subdivisions	250	—	—	—	250	—
Mortgage-backed	2,816	15	—	—	2,816	15
Asset-backed securities and collateralized mortgage obligations	5,097	10	—	—	5,097	10
Corporate	6,226	20	—	10	6,226	30
Total fixed maturities	27,173	55	4,715	287	31,888	342
Equity investments:						
Common stock	4,164	284	—	—	4,164	284
Warrants	92	37	—	—	92	37
Total equity investments	4,256	321	—	—	4,256	321
Total	$31,429	$376	$4,715	$287	$36,144	$663

Fixed maturities and equity investments contain approximately 39 and 71 individual investments that were in unrealized loss positions as of March 31, 2015 and December 31, 2014, 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.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

As a result of the analysis performed by the Company to determine declines in market value that are other-than-temporary, the Company recorded a write-down for other-than-temporary impairment related to fixed maturities of $0.0 million for the three months ended March 31, 2015. There were no write-downs for other-than-temporary impairments related to equity investments or other investments for the three months ended March 31, 2015. There were no write-downs for other-than-temporary impairments related to investments for the three months ended March 31, 2014.

There were $0.0 million and zero of other-than-temporary losses recognized in other comprehensive (loss) income for the three months ended March 31, 2015 and March 31, 2014, respectively.

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 limited partnerships 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 March 31, 2015 and December 31, 2014, the carrying value of limited liability investments totaled $11.1 million and $7.3 million, respectively. At March 31, 2015, the Company has unfunded commitments totaling $2.4 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 mortgage loans and are reported at their unpaid principal balance. As of March 31, 2015 and December 31, 2014, the carrying value of other investments totaled $3.6 million and $3.6 million, respectively.

Gross realized gains and losses on fixed maturities, equity investments and limited liability investments for the three months ended March 31, 2015 and March 31, 2014 were as follows:

(in thousands)	Three months ended March 31,	
	2015	2014
Gross realized gains	$—	$48
Gross realized losses	—	(9)
Total	$—	$39

Net investment income for the three months ended March 31, 2015 and March 31, 2014, respectively, is comprised as follows:

(in thousands)	Three months ended March 31,	
	2015	2014
Investment income		
Interest from fixed maturities	$269	$272
Dividends	147	32
Income from limited liability investments	929	22
Other	34	142
Gross investment income	1,379	468
Investment expenses	(66)	(55)
Net investment income	$1,313	$413

At March 31, 2015, fixed maturities and short-term investments with an estimated fair value of $13.1 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, 2015, the amount of such pledged securities was $17.2 million.

13

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

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 March 31, 2015 and December 31, 2014 were as follows:

(in thousands, except for percentages)

	March 31, 2015			December 31, 2014		
	Equity Percentage	Estimated Fair Value	Carrying Value	Equity Percentage	Estimated Fair Value	Carrying value
1347 Capital Corp.	21.0 %	$12,082	$1,975	22.7 %	$13,038	$2,115

Equity in net loss of investee was $0.1 million and zero for the three months ended March 31, 2015 and March 31, 2014, respectively.

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, 2015 and 2014, respectively, are comprised as follows:

(in thousands)	Three months ended March 31,	
	2015	2014
Beginning balance, net	$12,197	$12,392
Additions	7,554	7,274
Amortization	(6,548)	(6,064)
Acquisition costs disposed of during the year related to PIH	—	(1,043)
Balance at March 31, net	$13,203	$12,559

NOTE 9 INTANGIBLE ASSETS

Intangible assets are comprised as follows:

(in thousands)	March 31, 2015		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Intangible assets subject to amortization			
Database	$4,918	$1,168	$3,750
Vehicle service agreements in-force	3,680	3,072	608
Customer-related relationships	3,611	787	2,824
Non-compete agreement	70	55	15
Intangible assets not subject to amortization			
Insurance licenses	7,803	—	7,803
Trade name	663	—	663
Total	$20,745	$5,082	$15,663

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

(in thousands)	December 31, 2014		
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Intangible assets subject to amortization			
Database	$4,918	$1,045	$3,873
Vehicle service agreements in-force	3,680	2,975	705
Customer-related relationships	3,611	695	2,916
Non-compete agreement	70	50	20
Intangible assets not subject to amortization			
Insurance licenses	7,803	—	7,803
Trade name	663	—	663
Total	$20,745	$4,765	$15,980

The Company's intangible assets with definite useful lives are amortized either based on the pattern in which the economic benefits of the intangible asset are expected to be consumed or using the straight-line method over their estimated useful lives, which range from three to fifteen years. Amortization of intangible assets was $0.3 million and $0.4 million for the three months ended March 31, 2015 and March 31, 2014, respectively. The insurance licenses and trade name intangible assets have indefinite useful lives and are not amortized.

NOTE 10 UNPAID LOSS AND LOSS ADJUSTMENT EXPENSES

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

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

Consequently, the process of determining the provision 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) March 31, 2015

(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, 2015 and March 31, 2014 were as follows:

(in thousands)	March 31, 2015	March 31, 2014
Balance at beginning of period, gross	$63,895	$84,534
Less reinsurance recoverable related to property and casualty unpaid loss and loss adjustment expenses	3,203	7,942
Balance at beginning of period, net	60,692	76,592
Incurred related to:		
Current year	20,472	19,887
Prior years	(76)	(586)
Paid related to:		
Current year	(7,532)	(6,268)
Prior years	(16,740)	(17,727)
Disposal of unpaid loss and loss adjustment expenses related to PIH	—	(405)
Balance at end of period, net	56,816	71,493
Plus reinsurance recoverable related to property and casualty unpaid loss and loss adjustment expenses	2,706	5,792
Balance at end of period, gross	$59,522	$77,285

(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 March 31, 2015 and March 31, 2014 were as follows:

(in thousands)	March 31, 2015	March 31, 2014
Balance at beginning of period	$2,975	$3,128
Incurred related to:		
Current year	1,557	1,760
Prior years	—	—
Paid related to:		
Current year	(1,446)	(1,699)
Prior years	(111)	(61)
Balance at end of period	$2,975	$3,128

NOTE 11 DEBT
Debt consists of the following instruments:

(in thousands)	March 31, 2015		December 31, 2014	
	Principal	Fair Value	Principal	Fair Value
LROC preferred units due 2015	$12,473	$12,473	$13,618	$13,618
Subordinated debt	90,500	41,543	90,500	40,659
Total	$102,973	$54,016	$104,118	$54,277

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

Subordinated debt 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 March 31, 2015 and December 31, 2014, deferred interest payable of $18.6 million and $17.4 million, respectively, 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 months ended March 31, 2015 and March 31, 2014.

NOTE 12 FINANCE LEASE OBLIGATION LIABILITY

On October 2, 2014, the Company completed a sale and leaseback transaction involving building and land located in Miami, Florida, which was previously recorded as asset held for sale. The transaction did not qualify for sales recognition and was accounted for as a financing due to the Company's continuing involvement with the property as a result of nonrecourse financing provided to the buyer in the form of prepaid rent. A finance lease obligation liability equal to the selling price of the property was established at the date of the transaction. During the five-year lease term, the Company will record interest expense on the finance lease obligation at its incremental borrowing rate and will increase the finance lease obligation liability by the same amount. At the end of the lease term, the Company will no longer have continuing involvement with the property and will then recognize the sale of the property as well as the gain that will result from removing the net book value of the land and building and finance lease obligation liability from the consolidated balance sheets. At March 31, 2015 and December 31, 2014, finance lease obligation liability of $4.8 million and $4.7 million, respectively, is included in accrued expenses and other liabilities in the consolidated balance sheets.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

NOTE 13 INCOME TAXES

Income tax expense for the three months ended March 31, 2015 and March 31, 2014, respectively, varies from the amount that would result by applying the applicable United States corporate income tax rate of 34% to income (loss) from continuing operations before income tax expense. The following table summarizes the differences:

(in thousands)	Three months ended March 31,	
	2015	2014
Income tax expense (benefit) at United States statutory income tax rate	690	(915)
Valuation allowance	(638)	666
Non-taxable dividend income	(424)	(415)
Foreign operations subject to different tax rates	122	130
State income tax (net of federal tax benefit)	—	212
Disposition of subsidiary	—	422
Prior year tax	—	(341)
Other	272	301
Income tax expense	22	60

The Company maintains a valuation allowance for its gross deferred tax assets at March 31, 2015 and December 31, 2014. 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 March 31, 2015 and December 31, 2014 net deferred tax asset. The Company carries a deferred income tax liability of $2.9 million and $2.8 million at March 31, 2015 and December 31, 2014, respectively, all of which relates to indefinite life intangible assets.

As of March 31, 2015, the Company had no unrecognized tax benefits. The Company analyzed its tax positions in accordance with the provisions of ASC Topic 740, Income Taxes, and has determined that there are currently no uncertain tax positions. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

NOTE 14 EARNINGS (LOSS) FROM CONTINUING OPERATIONS PER SHARE

The following table sets forth the reconciliation of numerators and denominators for the basic and diluted earnings (loss) from continuing operations per share computation for the three months ended March 31, 2015 and March 31, 2014:

(in thousands, except per share data)	Three months ended March 31, 2015	Three months ended March 31, 2014
Numerator:		
Income (loss) from continuing operations	$2,008	$(2,752)
Less: net income attributable to noncontrolling interests	(1,224)	(653)
Less: dividends on preferred stock	(81)	(53)
Income (loss) from continuing operations attributable to common shareholders	$703	$(3,458)
Denominator:		
Weighted average basic shares		
Weighted average common shares outstanding	19,710	16,430
Weighted average diluted shares		
Weighted average common shares outstanding	19,710	16,430
Effect of potentially dilutive securities:		
Stock options	130	—
Unvested restricted stock awards	689	—
Warrants	620	—
Convertible preferred stock	—	—
Total weighted average diluted shares	21,149	16,430
Basic earnings (loss) from continuing operations per common share	$0.04	$(0.21)
Diluted earnings (loss) from continuing operations per common share	$0.03	$(0.21)

Earnings (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.

The dilutive effect of the stock options, unvested restricted stock awards and warrants are reflected in diluted earnings from continuing operations per share by application of the treasury stock method. The dilutive effect of the convertible preferred stock is reflected in diluted earnings from continuing operations per share by application of the if-converted method. The effects of these potentially dilutive securities are excluded from the computation of diluted earnings per share in periods in which the effect would be anti-dilutive. Convertible preferred stock is anti-dilutive when the amount of dividend declared or accumulated in the current period per common share obtainable upon conversion exceeds basic earnings from continuing operations per share. For the three months ended March 31, 2015, the convertible preferred stock was deemed to be anti-dilutive and was excluded from the calculation of diluted earnings from continuing operations per share.

Since the Company is reporting a loss from continuing operations for the three months ended March 31, 2014, all potentially dilutive securities outstanding were excluded from the calculation of diluted loss from continuing operations per share since their inclusion would have been anti-dilutive.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

NOTE 15 STOCK-BASED COMPENSATION
(a) Stock Options
The following table summarizes the stock option activity during the three months ended March 31, 2015:
(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, 2014	611,875	$ 4.50	3.2	$642
Granted	—	$ —		
Expired	—	$ —		
Outstanding at March 31, 2015	611,875	$ 4.50	3.0	$765
Exercisable at March 31, 2015	611,875	$ 4.50	3.0	$765

The aggregate intrinsic value of stock options outstanding and exercisable is the difference between the March 31, 2015 market price for the Company's common shares and the exercise price of the options, multiplied by the number of options where the fair value exceeds the exercise price.
The Company uses the Black-Scholes option pricing model to estimate the fair value of each option on the date of grant. No options were granted during the three months ended March 31, 2015.
(b) Restricted Stock Awards
Under the 2013 Equity Incentive Plan, the Company made grants of restricted common stock ("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 March 31, 2015 was $7.3 million. The grant-date fair value of the Restricted Stock was determined using the closing price of Kingsway common stock on the date of grant. The following table summarizes the activity related to unvested Restricted Stock for the three months ended March 31, 2015:
(in thousands, except for share data)

	Restricted stock awards	Weighted-average grant date fair value (per share)
Unvested at December 31, 2014	1,972,345	$4.14
Granted	—	—
Unvested at March 31, 2015	1,972,345	$4.14

Total stock-based compensation expense, net of forfeitures was $0.2 million and $0.6 million for the three months ended March 31, 2015 and March 31, 2014, respectively.

NOTE 16 SHAREHOLDERS' EQUITY
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.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

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. At March 31, 2015 and December 31, 2014, accrued dividends of $0.4 million and $0.3 million were included in accrued expenses and other liabilities in the consolidated balance sheets.

In accordance with FASB ASC Topic 480-10-S99-3A, SEC Staff Announcement: Classification and Measurement of Redeemable Securities, redemption features which are not solely within the control of the issuer are required to be presented outside of permanent equity on the consolidated balance sheets. As described above, the holder has the option to convert the Preferred Shares at any time; however, if not converted, they are required to be redeemed on April 1, 2021. As such, the Preferred Shares are presented in temporary or mezzanine equity on the consolidated balance sheets and will be accreted up to the stated redemption value of $6.6 million through the April 1, 2021 redemption date.

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 was automatically exchanged for a Series B Warrant.

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 months ended March 31, 2015 and March 31, 2014 as relates to shareholders' equity attributable to common shareholders on the consolidated balance sheets. On the other hand, the unaudited consolidated statements of comprehensive income present the components of other comprehensive (loss) income, net of tax, only for the three months ended March 31, 2015 and March 31, 2014 and inclusive of the components attributable to noncontrolling interests in consolidated subsidiaries.

(in thousands)	Three months ended March 31, 2015		
	Unrealized Gains (Losses) on Fixed Maturities and Equity Investments	Foreign Currency Translation Adjustments	Total Accumulated Other Comprehensive Income
Balance at January 1, 2015	$14,622	$(5,952)	$8,670
Other comprehensive (loss) income before reclassifications	(108)	180	72
Amounts reclassified from accumulated other comprehensive income	13	—	13
Net current-period other comprehensive (loss) income	(95)	180	85
Balance at March 31, 2015	$14,527	$(5,772)	$8,755

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

(in thousands)	Three months ended March 31, 2014		
	Unrealized Gains on Fixed Maturities and Equity Investments	Foreign Currency Translation Adjustments	Total Accumulated Other Comprehensive Income
Balance at January 1, 2014	$15,583	$(5,982)	$9,601
Other comprehensive income before reclassifications	1,276	44	1,320
Amounts reclassified from accumulated other comprehensive income	52	—	52
Net current-period other comprehensive income	1,328	44	1,372
Balance at March 31, 2014	$16,911	$(5,938)	$10,973

Components of accumulated other comprehensive income were reclassified to the following lines of the unaudited consolidated statements of operations for the three months ended March 31, 2015 and March 31, 2014:

	Three months ended March 31,	
	2015	2014
Reclassification of accumulated other comprehensive income from unrealized gains (losses) on fixed maturities and equity investments to:		
Net realized gains	$(3)	$(52)
Other-than-temporary impairment loss	(10)	—
Income (loss) from continuing operations before income tax expense	(13)	(52)
Income tax expense	—	—
Net income (loss)	(13)	(52)

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

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

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

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 unaudited 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 Services Segment

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

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

Effective April 1, 2015, the Company closed on the sale of its wholly owned subsidiary, ARS. As a result, ARS has been classified as discontinued operations and the results of their operations are reported separately for all periods presented. Prior to the transaction, ARS was included in the Insurance Services segment. As a result of classifying ARS as a discontinued operation, all segmented information has been restated to exclude ARS from the Insurance Services segment.

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

Revenues by reportable segment reconciled to consolidated revenues for the three months ended March 31, 2015 and 2014 were:

(in thousands)	Three months ended March 31,	
	2015	2014
Revenues:		
Insurance Underwriting:		
Net premiums earned	$29,030	$27,806
Other income	2,237	2,134
Total Insurance Underwriting	31,267	29,940
Insurance Services:		
Service fee and commission income	5,398	6,065
Other income	97	86
Total Insurance Services	5,495	6,151
Total segment revenues	36,762	36,091
Net premiums earned not allocated to segments	—	4,114
Net investment income	1,313	413
Net realized gains	—	39
Other-than-temporary impairment loss	(10)	—
Other income (loss) not allocated to segments	5,631	(162)
Total revenues	$43,696	$40,495

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

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 income (loss) from continuing operations for the three months ended March 31, 2015 and 2014 were:

(in thousands)	Three months ended March 31, 2015	2014
Segment operating income (loss)		
Insurance Underwriting	$322	$257
Insurance Services	(186)	(138)
Total segment operating income	136	119
Net investment income	1,313	413
Net realized gains	—	39
Other-than-temporary impairment loss	(10)	—
Other income and expenses not allocated to segments, net	2,318	(470)
Interest expense	(1,391)	(1,433)
Amortization of intangible assets	(317)	(414)
Contingent consideration expense	(144)	(267)
Gain on change in fair value of debt	261	563
Loss on disposal of subsidiary	—	(1,242)
Equity in net loss of investee	(136)	—
Income (loss) from continuing operations before income tax expense	$2,030	$(2,692)
Income tax expense	22	60
Income (loss) from continuing operations	$2,008	$(2,752)

24

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

Net premiums earned by line of business for the three months ended March 31, 2015 and 2014 were:

(in thousands)	Three months ended March 31, 2015	2014
Insurance Underwriting:		
Private passenger auto liability	$19,339	$18,556
Auto physical damage	9,691	9,250
Total non-standard automobile	29,030	27,806
Commercial auto liability	—	—
Total Insurance Underwriting	29,030	27,806
Net premiums earned not allocated to segments:		
Allied lines	—	1,944
Homeowners	—	2,159
Other	—	11
Total net premiums earned not allocated to segments	—	4,114
Total net premiums earned	$29,030	$31,920

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 reduced 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. As of December 31, 2014, the Company paid $2.0 million related to severance incurred as part of the restructuring. At December 31, 2014, the remaining severance liability related to the restructuring is zero.

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 months ended March 31, 2015 and March 31, 2014 is as follows:

(in thousands)	For the three months ended March 31, 2015			
	Restructuring liability, beginning of period	Restructuring expense	Cash payments	Restructuring liability, end of period
Insurance Underwriting:				
Lease abandonment	$352	$15	$(44)	$323
Total Insurance Underwriting	352	15	(44)	323
Insurance Services:				
Lease abandonment	41	—	(10)	31
Total Insurance Services	41	—	(10)	31
Total	$393	$15	$(54)	$354

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

(in thousands)	For the three months ended March 31, 2014			
	Restructuring liability, beginning of period	Restructuring expense	Cash payments	Restructuring liability, end of period
Insurance Underwriting:				
Severance	$236	$—	$(127)	$109
Lease abandonment	654	16	(92)	578
Total Insurance Underwriting	890	16	(219)	687
Insurance Services:				
Lease abandonment	94	4	(15)	83
Total Insurance Services	94	4	(15)	83
Severance expense not allocated to segments	146	—	(146)	—
Total	$1,130	$20	$(380)	$770

NOTE 20 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 February 24, 2015, the Company announced that it had entered into a definitive agreement with PIH to terminate the MSA. Pursuant to the transaction, 1347 Advisors received the following consideration: $2.0 million in cash; $3.0 million of 8% preferred stock of PIH, redeemable in five years; a Performance Shares Grant Agreement with PIH, whereby 1347 Advisors will be entitled to receive 100,000 shares of PIH common stock if at any time the last sales price of PIH's common stock equals or exceeds $10.00 per share for any 20 trading days within any 30-trading day period; and warrants to purchase 1,500,000 shares of common stock of PIH with a strike price of $15.00, expiring in seven years. The Company recorded a gain of $6.0 million during the first quarter of 2015 related to the termination of the MSA, which is included in other income in the unaudited consolidated statements of operations. To the extent shares of PIH common stock are granted to the Company under the Performance Shares Grant Agreement, they will be recorded at the time the shares are granted and will have a valuation equal to the last sales price of PIH common stock on the day prior to such grant. No shares were received by the Company under the Performance Shares Grant Agreement as of March 31, 2015. Refer to Note 21, "Fair Value of Financial Instruments," for further details regarding the performance shares.

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).). To the extent shares of PIH common stock are granted to the Company under the Performance Share Grant Agreement, they will be recorded at the time the shares are granted and will have a valuation equal to the last sales price of PIH common stock on the day prior to such grant. No shares were received by the Company under the Performance Share Grant Agreement as of March 31, 2015. Refer to Note 21, "Fair Value of Financial Instruments," for further details regarding the performance shares.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

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 March 31, 2015, the Company has a note receivable of $1.5 million outstanding from FMG which is included in other receivables in the consolidated balance sheets.

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

NOTE 21 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.

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 performance shares, LROC preferred units, subordinated debt and contingent consideration liabilities are measured and reported at fair value.

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

Performance shares - The performance shares, for which no active market exists, are required to be valued at fair value as determined in good faith by the Company. Such determination of fair value would require the Company to develop a model based upon relevant observable market inputs as well as significant unobservable inputs, including developing a sufficiently reliable estimate for an appropriate discount to reflect the illiquidity and unique structure of the security. The Company determined that its model for the performance shares was not sufficiently reliable. As a result, the Company has assigned a fair value of zero to the performance shares. Refer to Note 20, "Related Party Transactions," for further details regarding the performance shares.

Debt - The fair value of the LROC preferred units is based on quoted market prices, and the fair value of the subordinated debt is calculated by a third-party using a model based on significant market observable inputs.

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. Contingent consideration liabilities are revalued each reporting period. Changes in the fair value of contingent consideration liabilities can result from changes to one or multiple inputs, including adjustments to the discount rates or changes in the assumed achievement or timing of any targets. Changes in assumptions could have an impact on the payout of contingent consideration liabilities. Changes in fair value are reported in the unaudited 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

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

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 March 31, 2015 and December 31, 2014 was as follows:

(in thousands)		March 31, 2015		
		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	$21,570	$—	$21,570	$—
Canadian government	4,153	—	4,153	—
States, municipalities and political subdivisions	3,414	—	3,414	—
Mortgage-backed	5,012	—	5,012	—
Asset-backed securities and collateralized mortgage obligations	6,961	—	6,961	—
Corporate	17,702	—	17,702	—
Total fixed maturities	58,812	—	58,812	—
Equity investments:				
Preferred stock	3,000	—	3,000	—
Common stock	20,559	20,559	—	—
Warrants	1,076	176	900	—
Total equity investments	24,635	20,735	3,900	—
Other investments	3,551	—	3,551	—
Short-term investments	400	—	400	—
Total assets	$87,398	$20,735	$66,663	$—
Liabilities:				
LROC preferred units	12,473	12,473	—	—
Subordinated debt	41,543	—	41,543	—
Contingent consideration	3,265	—	—	3,265
Total liabilities	$57,281	$12,473	$41,543	$3,265

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) March 31, 2015

(in thousands)	December 31, 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	$20,759	$—	$20,759	$—
Canadian government	4,242	—	4,242	—
States municipalities and political subdivisions	3,419	—	3,419	—
Mortgage-backed	5,352	—	5,352	—
Asset-backed securities and collateralized mortgage obligations	7,214	—		