KINGSWAY FINANCIAL SERVICES INC
Form 40-F
March 30, 2007

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549

FORM 40-F

[Check one]
o **Registration Statement Pursuant to Section 12 of the Securities Exchange Act of 1934**
or
x **Annual Report Pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934**

For the fiscal year ended: **December 31, 2006** Commission File Number: 1-15212

KINGSWAY FINANCIAL SERVICES INC.

(Exact name of Registrant as specified in its charter)

Ontario	**6331**	**Not Applicable**
(Province or Other Jurisdiction of Incorporation or Organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification Number, if applicable)*

7120 Hurontario Street, Suite 800, Mississauga, Ontario, Canada L5W 0A9
(905) 677-8889

(Address and telephone number of Registrant's principal executive offices)

Kelly Marketti
Kingsway America Inc.
150 Northwest Point Blvd. 6th Floor Elk Grove Village, Illinois 60007
(847) 871-6400

(Name, address (including zip code) and telephone number (including area code) of agent for service in the United States)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	**Name of each exchange on which registered**
Common Shares, no par value	New York Stock Exchange, Inc.

Securities registered or to be registered pursuant to Section 12(g) of the Act. **N/A**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act. **N/A**

For annual reports, indicate by check mark the information filed with this Form:

x Annual information form x Audited annual financial statements

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

55,884,525 Common Shares outstanding as of December 31, 2006

Indicate by check mark whether the Registrant by filing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934 (the "Exchange Act"). If "Yes" is marked, indicate the filing number assigned to the Registrant in connection with such Rule.

Yes ______ 82-______ No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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

KINGSWAY FINANCIAL SERVICES INC.

DOCUMENTS FILED UNDER COVER OF THIS FORM

Item	Description	Sequential Page Number
1.	Annual Information Form dated March 30, 2007 for the year ended December 31, 2006.	1
2.	Audited Consolidated Financial Statements of the Registrant for the fiscal years ended December 31, 2006 and 2005, including a reconciliation of U.S. and Canadian generally accepted accounting principles.	19
3.	Management's Discussion and Analysis of Financial Condition and Results of Operations.	81

Document No. 1

KINGSWAY FINANCIAL SERVICES INC.

2006 ANNUAL INFORMATION FORM

March 30, 2007

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1. INCORPORATION

Kingsway Financial Services Inc. ("KFSI") was incorporated under the Business Corporations Act (Ontario) on September 19, 1989. On November 10, 1995, KFSI filed articles of amendment deleting its private company share restrictions, subdividing KFSI's outstanding common shares on a three for one basis, and deleting the Class A Special Shares and the Class B Special Shares that were previously authorized. On October 11, 1996, KFSI filed articles of amendment to sub-divide the common shares on a two for one basis. On April 27, 1998, KFSI filed articles of amendment to subdivide the common shares on a two for one basis. The principal and registered office of KFSI is located at 7120 Hurontario Street, Suite 800, Mississauga, Ontario, L5W 0A9.

2. INTER-CORPORATE RELATIONSHIPS

KFSI's material subsidiaries and their intercorporate relationship with KFSI as of the most recent financial year end are listed and described in Note 1(a) to the Consolidated Financial Statements of KFSI contained in KFSI's 2006 Annual Report (the "Annual Report") which is incorporated herein by reference. All subsidiaries are 100% owned, directly or indirectly, (except for qualifying shares of York Fire & Casualty Insurance Company and Kingsway General Insurance Company held by directors in order to satisfy applicable statutory requirements).

3. GENERAL DEVELOPMENT OF THE BUSINESS

KFSI is a holding company which operates through its wholly owned subsidiaries in the property and casualty insurance business. Since its inception in 1986, Kingsway General Insurance Company ("KGIC") has provided property and casualty insurance in specialized lines in Canada, primarily in the automobile insurance market. In 1989, KGIC became a wholly owned subsidiary of KFSI. Since KFSI's initial public offering in 1995, KFSI has made selective acquisitions in Canada and the United States, including its insurance subsidiaries, American Service Insurance Company, Inc., U.S. Security Insurance Company, Jevco Insurance Company ("Jevco"), Southern United Fire Insurance Company, Universal Casualty Company, Lincoln General Insurance Company, York Fire & Casualty Insurance Company, American Country Insurance Company, and Zephyr Insurance Company Inc. ("Zephyr"). In addition, insurance subsidiaries have developed specific books of business by entering into contracts with program managers. All of the dollar amounts are expressed in U.S. dollars, except where otherwise indicated. References to C$ are to Canadian dollars.

Significant events that have influenced the general development of the business over the last three years include:

(a) the completion in January 2004 of a private placement of $100 million in 10 year 7.5% senior notes and the completion in March 2004 of the sale of an additional $25 million of the 10-year 7.5% senior notes;

(b) the C$150 million syndicated unsecured revolving credit facility in March 2004, the renewal of that credit facility in December 2004 and the replacement of that facility with a C$150 million syndicated unsecured revolving credit facility in February, 2006;

(c) the completion of two quota share reinsurance agreements effective April 2004 permitting Lincoln General Insurance Company and Kingsway General Insurance Company to cede a variable amount of premiums to reinsurers rated A+ or better by AM Best which expired and were not renewed in 2005;

(d) the completion in July 2005 of the public offering of C$78 million of 5.00% Kingsway Linked Return of Capital Preferred Units ("LROC Preferred Units") due June 30, 2015, the net proceeds of which were used for a series of investments that included the purchase of an approximately C$74.1 million 7.12% senior note due June 30, 2015 issued by an affiliate of KFSI;

(e) the closing in October 2005 of the acquisition of HI Holdings, Inc. (“HI”) for $24.6 million, which includes HI's wholly owned subsidiary Zephyr;

(f) the completion, in November, 2005 of a program management agreement between Lincoln General Insurance Company with The Robert Plan Corporation (“RPC”) which provided that the KFSI affiliate would assume risk relating to assigned risk obligations acquired from other insurers and in 2006 and early 2007, the subsequent purchase of the renewal rights of the RPC’s assigned risk business for approximately $35.5 million relating to this acquisition;

(g) the entering into a new $175 million unsecured credit facility in June, 2006 which matures in June 2009 to replace the C$150 million 364 day revolving credit facility; and

(h) the acquisition expected to close in April, 2007, pending regulatory approval, of Mendota Insurance Company. Mendota is a dedicated non-standard insurance provider licensed in 43 states and currently writes business in 20 states through a network of approximately 6,000 independent agency locations.

4. NARRATIVE DESCRIPTION OF THE BUSINESS

Commercial trucking insurance has become the largest business line for Kingsway. KFSI is considered to be one of the largest trucking insurers in North America. This line of business comprised 33% of KFSI's gross premiums written ("GPW") (the total premiums on insurance underwritten before deduction of reinsurance premiums ceded) in 2006.

In 2006, non-standard automobile business accounted for 26% of KFSI's $1,932.7 million of GPW. Non-standard automobile insurance is the insuring of automobile risks for drivers with worse than average driving records primarily as a result of accidents or traffic violations.

KFSI's premium distribution by line and geographic areas is set out in Note 12 to the Consolidated Financial Statements contained in the Annual Report which is incorporated herein by reference.

In addition to revenue derived from premiums earned, KFSI also derives revenue from premium financing and investment income. This revenue amounted to $149.9 million in 2006 as compared to $131.3 million in 2005.

KFSI strives to remain a disciplined underwriter. KFSI has earned a profit from its underwriting activities in 2006 and has done so for 14 of the last 17 fiscal years including 7 of the last 10 years. The selected Supplemental Financial Information set out on page 81 of the Annual Report, which is incorporated herein by reference, provides details of the gross premiums written, underwriting profits, and key ratios from KFSI's insurance operations compared to industry results for the eight year period ending December 31, 2006 and are incorporated herein by reference.

Employees

As at December 31, 2006, KFSI employed an aggregate of approximately 2,440 personnel, none of whom are unionized. We believe our relationship with our employees is good.

Liquidity

Capital required for KFSI's business has been obtained from KFSI's public offerings of common shares and debt securities, its syndicated term and operating lending facilities, the issuance of trust preferred securities and has been internally generated from net income. KFSI’s operations create liquidity by collecting and investing premiums, as more fully discussed on page 41 of the Annual Report, which are incorporated by reference herein.

Investment Portfolio

The fair value of the investment portfolio increased 5% to $3,085.3 million as at December 31, 2006 from $2,933.0 million as at December 31, 2005. Returns on a pre-tax basis were 5.0% for the year compared with 4.7% for 2005. The investment portfolio as at December 31, 2006 and December 31, 2005 is comprised of assets from a number of different classes as reflected in Note 3 to the 2006 Consolidated Financial Statements set out on pages 67 to 69 of the Annual Report, which are incorporated herein by reference.

Competitive Position

The insurance industry is price competitive in all markets in which KFSI’s insurance subsidiaries operate. KFSI's subsidiaries strive to employ disciplined underwriting practices with the objective of rejecting underpriced risks. The combined ratio of claims plus underwriting expenses compared to net premiums earned is the traditional measure of underwriting results of property and casualty companies. In any year when the ratio exceeds 100%, it generally indicates that unprofitable business has been underwritten. Through deliberate underwriting, pricing, risk selection, claims management, and non-renewal of unprofitable policies, KFSI has produced an underwriting profit in 14 of the last 17 years.

During 2006, KFSI increased its GPW 2% to $1.93 billion compared to $1.89 billion in 2005. The increases came primarily from the owner-operator trucking insurance line of business in Canada and the new assigned risk program written with The Robert Plan Corporation that commenced January 1, 2006. In certain segments of the insurance market, KFSI noticed a continued softening of the market and wrote reduced premium volumes. KFSI believes that it is better to write less business with higher profits than to compete with other insurers at lower premiums to increase volume at the expense of higher combined ratios. In 2006, Kingsway's combined ratio from Canadian and U.S. Operations was 94.5% and 100.8%, respectively, compared with the industry averages of 92.2% and 93.3%, respectively.

5. RISK FACTORS

The risks faced by KFSI are described on pages 47 to 55 of the Annual Report and those pages are incorporated herein by reference.

6. DIVIDEND POLICY

The ability of KFSI to pay dividends is largely dependent upon its ability to receive dividends from its subsidiaries. The insurance subsidiaries are regulated and are required to maintain statutory capital in order to write insurance policies. Regulatory authorities may impose, from time to time, additional restrictions which may affect the actual amounts available to KFSI for the payment of dividends.

During the fiscal year ended December 31, 2004, KFSI did not pay any dividends. KFSI paid and declared cash dividends in the aggregate amount of C$0.26 per share and C$0.20 per share for the fiscal year ended December 31, 2006 and 2005, respectively. KFSI has declared a quarterly dividend of C$0.075 per share payable on March 30, 2007. Any decision to pay dividends on KFSI's common shares in the future will be dependent upon the financial requirements of KFSI to finance future growth, the financial condition of KFSI and other factors which the Board of Directors of KFSI may consider appropriate in the circumstances.

7. DESCRIPTION OF CAPITAL STRUCTURE

(a) Common Shares

General Description of Capital Structure

The authorized capital of KFSI consists of an unlimited number of common shares, of which, as of March 16, 2007, 55,711,525 common shares were outstanding. All common shares have the same attributes, including the right to one vote per share.

On November 3, 2005, KFSI announced its intention to commence a normal course issuer bid (“NCIB”) to repurchase up to 2,823,000 common shares of the Company, being approximately five percent of the total number of common shares then outstanding. Under this NCIB, purchases were eligible to commence on November 8, 2005 and end no later than November 7, 2006. During this period, 562,800 common shares were repurchased at an average price of C$22.13. On November 7, 2006, KFSI announced its intention to commence another NCIB to repurchase up to 2,800,000 common shares, ending no later than November 8, 2007 and being no more than five percent of the total number of common shares outstanding. As of December 31, 2006, 242,200 common shares had been repurchased at an average price of C$24.39 under this NCIB.

Change of Control

Many state insurance laws intended primarily for the protection of policyholders require advance approval by state insurance commissioners of any change in control of an insurance company that is domiciled (or, in some cases, having such substantial business that it is deemed to be commercially domiciled) in that state. “Control” is generally presumed to exist through the ownership of 10% or more of the voting securities of a domestic insurance company or of any company that controls a domestic insurance company. In addition, insurance laws in many states contain provisions that require prenotification to the insurance commissioners of a change in control of a non-domestic insurance company licensed in those states.

Any future transactions that would constitute a change in Control of our U.S. insurance company subsidiaries, including a change of Control of KFSI, would generally require the party acquiring Control to obtain the prior approval by the insurance departments of the insurance subsidiaries’ states of domicile or commercial domicile, if any, and may require pre-acquisition notification in applicable states that have adopted pre-acquisition notification provisions. Obtaining these approvals could result in material delay of, or deter, any such transaction.

In addition, Jevco is a federal property and casualty insurance company continued under the *Insurance Companies Act* (Canada) ("ICA"), and licensed to carry on property and casualty insurance business in all of the provinces and territories of Canada. The ICA is administered, and activities of Jevco are supervised, by the Office of the Superintendent of Financial Institutions ("OSFI"). Under the ICA, advance approval by OSFI is required prior to the acquisition of a significant interest in an insurance company licensed thereunder. A “significant interest” is generally a direct or indirect ownership interest representing 10% of the voting rights or 25% of the shareholders’ equity of an insurance company.

(b) Debt Securities

KFSI has issued C$78 million of 8.25% unsecured senior debentures with a maturity date of December 31, 2007. The debentures are redeemable prior to the maturity date, at KFSI's option, providing at least 30 days notice to debenture holders. Interest on the debentures is payable semi-annually in arrears.

Kingsway America Inc., a subsidiary of KFSI, has issued $125 million 7.50% senior notes due in 2014. The notes are fully and unconditionally guaranteed by KFSI. The notes will be redeemable at Kingsway America Inc.'s option on or after February 1, 2009.

Between December 4, 2002 and December 16, 2003, six subsidiary trusts of KFSI issued $90.5 million of 30 year capital securities to third parties in separate private transactions. In each instance, a corresponding floating rate junior subordinated deferrable interest debenture was then issued by Kingsway America Inc. to the trust in exchange for the proceeds from the private sale. The floating rate debentures bear interest at the London interbank offered interest rate for three-month U.S. dollar deposits, plus spreads ranging from 3.85% to 4.20%, but until dates ranging from December 4, 2007 to January 8, 2009, the interest rates will not exceed 12.45% to 12.75%. KFSI has the right to call each of these securities at par anytime after five years from their issuance until their maturity.

In July, 2005, in connection with the offering of LROC Preferred Units, an affiliate of KFSI issued an unsecured senior note in the principal amount of C$74.1 million. This note bears interest at the rate of 7.12% per annum and matures June 30, 2015.

(c) Ratings

The ratings received from rating organizations for securities of KFSI are described on page 43 and 44 of the Annual Report and those pages are incorporated herein by reference.

8. MARKET FOR SECURITIES

(a) Trading Price and Volume

The common shares of KFSI are listed on the Toronto Stock Exchange (the "TSX") and the New York Stock Exchange (Symbol KFS).

The following chart sets forth the high and low sales price and volume for the common shares of KFSI on the TSX for the periods indicated in Canadian dollars:

Month	High	Low	Volume
January 2006	24.55	22.90	2,532,700
February 2006	25.05	23.06	2,973,800
March 2006	24.50	23.01	3,001,800
April 2006	24.50	23.12	1,556,400
May 2006	24.22	21.45	3,248,500
June 2006	22.28	19.22	3,114,600
July 2006	21.17	19.25	2,397,300
August 2006	23.40	20.02	2,094,900
September 2006	25.90	22.76	2,806,900
October 2006	26.96	24.67	2,782,200
November 2006	25.95	24.06	2,075,700
December 2006	26.09	23.11	2,676,100

(b) Prior Sales

No common shares of KFSI were issued during the fiscal year ending December 31, 2006 except for 209,072 common shares issued on the exercise of options granted pursuant to KFSI's Amended and Restated Stock Option Plan.

9. DIRECTORS AND OFFICERS

(a) Name, Occupation and Security Holding

The following table and the notes thereto state the names of all executive officers of the Corporation, all other positions or offices with the Corporation and its subsidiaries now held by them, their principal occupations or employment and the number of Common Shares and Options of the Corporation beneficially owned, directly or indirectly, by each of them, or over which they exert control or direction as of March 16, 2007. The same information relating to the directors of the Corporation is contained in the Election of Directors section of the Management

Information Circular of KFSI dated March 16, 2007, which is incorporated herein by reference.

Name and Municipality of Residence	Position with the Corporation	Common Shares of the Corporation beneficially owned, directly or indirectly, or controlled or directed	Number of Options Held
William G. Star Mississauga, ON	Chairman, President and Chief Executive Officer, KFSI	406,629	700,000
W. Shaun Jackson Oakville, ON	Executive Vice President and Chief Financial Officer, KFSI	78,670	365,000
Frank Amodeo Toronto, ON	Vice President, KFSI	6,631	37,500
Denis Cloutier Newmarket, ON	Vice President and Chief Actuary - Canadian Operations, KFSI	1,311	25,000
Dennis Fielding Pickering, ON	Vice President, KFSI	5,435	40,500
Laura Foster Toronto, ON	Vice President, Internal Audit, KFSI	1,478	14,000
Shelly Gobin Mississauga, ON	Vice President and Treasurer, KFSI	59,247	37,500
Tom Mallozzi Brampton, ON	Vice President, Underwriting	794	12,000
Claude Smith Cambridge, ON	Vice President and Chief Information Officer, KFSI	3,387	38,500
Andrew Wright Toronto, ON	Vice President, Reinsurance and Risk Management, KFSI	890	13,000

Denis Cloutier joined KFSI in January, 2001 as Chief Actuary and was promoted to Vice President and Chief Actuary, Canadian Operations in September, 2006.

Laura Foster joined KFSI in December, 2003. Prior thereto, Ms. Foster was Assistant Vice President, Corporate Compliance at Canada Life Assurance Company from July, 1998 to August, 2003.

Tom Mallozzi joined KFSI in December, 2005. Prior thereto, Mr. Mallozzi was with Kingsway General as Vice President, Personal Lines from January, 2003 until December, 2005. From November, 1998 to December, 2002 Mr. Mallozzi was Manager, Personal Lines with Allianz Insurance Company.

Andrew Wright joined KFSI in July, 2004. Prior thereto, Mr. Wright was Senior Reinsurance Underwriter at Aviva Canada Inc. from April, 2002 to July, 2004. From October, 2000 to April, 2002, Mr. Wright was a consultant and teaching advisor for the Insurance Institute of Canada.

Except as noted above, for the past five years each executive officer has been engaged in his current occupation or in other capacities within the same or a related entity.

As a group, the directors and officers of KFSI own, directly or indirectly or exercise control or direction over 645,079 (1.1% of the total outstanding) common shares of KFSI. The information as to shares owned indirectly or over which control or direction is exercised by the directors and officers, but which are not registered in their names, not being within the knowledge of KFSI, has been furnished by such officers of KFSI.

The Corporation does not have an Executive Committee. Mr. Walsh serves as KFSI's Lead Director. The Board of Directors has established an Audit Committee comprised solely of outside Directors, namely Messrs. Atkins, Di Giacomo, Farnam and Walsh. In addition, the Corporation has an Investment Committee comprised of Messrs. Di Giacomo, Star, Sullivan and Walsh, a Nominating Committee comprised of Messrs. Atkins, Walsh, Reeve and Sullivan, and a Compensation and Management Resources Committee comprised of Messrs. Farnam, Di Giacomo, Beamish and Gillespie.

(b) Cease Trade Order

Mr. Gillespie, a member of the Board of Directors since 2006, was a director of Atlas Cold Storage Income Trust during a time in which all of the directors were subject to a cease trade order as a result of failing to file quarterly financial reports within the time requirements mandated by Canadian securities laws. The cease trade order was lifted on May 11, 2004.

(c) Conflicts of Interest

To the knowledge of KFSI, no director or officer of KFSI has an existing or potential material conflict of interest with KFSI or any of its subsidiaries.

10. LEGAL PROCEEDINGS

In connection with its operations, KFSI and its subsidiaries are, from time to time, named as defendants in actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the outcome of the various proceedings at this time, such actions have generally been resolved with minimal damages or expense in excess of amounts provided and KFSI does not believe that it will incur any significant additional loss or expense in connection with such actions.

11. INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

The Audit Committee reviewed all related party transactions between KFSI and its subsidiaries and the officers and directors of KFSI. The Audit Committee determined that there were no related party transactions that required disclosure under any securities laws other than commissions of approximately $56,000 paid by a cruise ship operator to a corporation owned by the spouse of the President and Chief Executive Officer of KFSI for an incentive cruise sponsored by KFSI for certain of its brokers.

12. AUDIT COMMITTEE INFORMATION

(a) Composition of the Audit Committee

The Audit Committee of KFSI is composed of the following four members: David H. Atkins, Thomas A. Di Giacomo, Walter E. Farnam and F. Michael Walsh. Mr. Farnam was appointed a member in February, 2006. The responsibilities and duties of the Audit Committee are set out in the Audit Committee's charter, the text of which is set forth in Appendix I to this Annual Information Form.

The Board of Directors believes that the composition of the Audit Committee reflects a high level of financial literacy and expertise. Each member of the Audit Committee has been determined by the Board of Directors to be "independent" and "financially literate" as such terms are defined under Canadian and United States securities laws and the NYSE rules. In addition, the Board has determined that Mr. Atkins is an "Audit Committee Financial Expert" as such term is defined under United States securities laws. The Board has made these determinations based on the education and breadth and depth of experience of each member of the Committee. The following is a description of the education and experience of each member of the Committee that is relevant to the performance of his or her responsibilities as a member of the Audit Committee:

David H. Atkins is an independent consultant. He previously was a Senior Advisor to Lang Michener LLP, a law firm, from 1999 to 2007. He is a fellow of the Institute of Chartered Accountants of Ontario. Mr. Atkins consults to the insurance and other industries regarding business strategy, mergers, acquisitions, governance and financial reporting. He also advises with regard to regulatory compliance. Mr. Atkins has lectured extensively with respect to governance and audit committee issues. Mr. Atkins is Chairman for the Swiss Reinsurance group in Canada and also sits on the board of several Swiss Reinsurance subsidiaries in the United States and Canada, as well as serving on the boards of several other companies including Pareto Corporation, Pethealth Inc., Nightingale Informatix Inc. and Integrated Asset Management Inc.

Thomas A. Di Giacomo has been the President of Tadico Limited, a business consulting and investment firm since 1994. Prior thereto he held a number of positions at Manulife Financial, the most recent being Chairman of the Board, President and CEO from 1990-1993. Mr. Di Giacomo is the Chairman of RDM Corporation and is a member of the St. Michael's College Foundation of the University of Toronto and past chairman of Kids Help Phone - a Canadian charity that provides national, bilingual confidential phone and web counselling, referral and information services for children and youth. Mr. Di Giacomo sits on the Board of several companies including Cinram International Income Fund, Xceed Mortgage Corporation, Menu Foods Income Fund and Afriore Limited.

Walter E. Farnam received a B.A. from Brown University. During his career, Mr. Farnam has held various senior positions in the insurance industry and from 1998 until his retirement in June, 2001 served as Chairman of the Board of the CGU Insurance Group in the United States. Prior to June, 1998 Mr. Farnam was Chairman and Chief Executive Officer of General Accident Insurance in Philadelphia. He also held the position of President and Chief Operating Officer of General Accident Insurance in the United States from July, 1985 through August 1991. He is a Fellow of the Casualty Actuarial Society and is Past Chairman of the Council of Insurance Company Executives. Mr. Farnam also served on the Executive Committee and Board of Trustees of the American Institute for Chartered Property Casualty Underwriters/Insurance Institute of America. Mr. Farnam is currently a member of the board of directors of Crozer-Keystone Health System and Executive Service Corps of Delaware Valley, both of which are not for profit organizations.

F. Michael Walsh is a retired investment industry executive, who prior to January 2000 was Senior Vice-President, Secretary and a Director of First Marathon Securities Limited (now National Bank Financial) and Vice-President and Secretary of First Marathon Inc. He is a Retired Industry Member of the Ontario District Council of the Investment Dealers Association of Canada and has served as an advisor to the staff of the Ontario Securities Commission and was formerly a member of the Council on Investment Issues of the Conference Board of Canada. He is a Past-chair of the Board of Governors of the University of Guelph and received the Queen's Golden Jubilee Medal in 2003 for excellence in leadership and governance of a post-secondary institution as a volunteer. Mr. Walsh sits on the Board of Neo Material Technologies Inc., a corporation whose shares are listed on the Toronto Stock Exchange.

(b) Shareholders' Auditors' Service Fees

Aggregate fees paid to the Shareholders' Auditors during the fiscal years ended December 31, 2006 and 2005 were as follows:

(in Canadian dollars)	2006 Fee Amount	2005 Fee Amount
Audit Fees	$ 4,237,000	$ 2,121,000
Audit-related Fees	$ 190,000	$ 169,000
Tax Fees	$ 162,000	$ 245,000
All Other Fees	$ 2,000	$ 2,000
Total:	$ 4,591,000	$ 2,437,000

13. TRANSFER AGENT AND REGISTRAR

KFSI's transfer agent and registrar is Computershare Investor Services Inc. at its principal office in Toronto, Ontario.

14. INTERESTS OF EXPERTS

(a) Names of Experts

KPMG LLP prepared auditors' reports in regard to the consolidated financial statements of KFSI for the fiscal year ending December 31, 2006 and in regard to the Company's internal control over financial reporting at December 31, 2006. The Canadian Institute of Chartered Accountants gives authority to the reports.

Pierre Laurin, of Tillinghast, a business of Towers Perrin Inc., prepared an actuary report in regard to the consolidated financial statements of KFSI for the fiscal year ending December 31, 2006. The Canadian Institute of Actuaries gives authority to the report.

(b) Interests of Experts

KPMG is independent with respect to the Company within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario and the rules of the US Securities Exchange Commission.

Pierre Laurin, of Tillinghast, a business of Towers Perrin Inc. has advised that he is independent with respect to the Company within the meaning of the Rules of Professional Conduct of the Canadian Institute of Actuaries.

15. ADDITIONAL INFORMATION

Financial information about the Corporation is contained in its comparative financial statements and Management's Discussion and Analysis for fiscal year ended December 31, 2006, and additional information relating to the Corporation is on SEDAR at www.sedar.com.

Additional information, including directors' and officers' remuneration and indebtedness, the principal holders of KFSI securities and securities authorized for issuance under equity compensation plans, where applicable, is contained in KFSI's Proxy Circular dated as of March 16, 2007 in connection with its Annual Meeting of Shareholders to be held on May 3, 2007, which involves the election of directors.

Copies of the Annual Information Form, as well as copies of the 2006 Annual Report of KFSI for the year ended December 31, 2006 and Proxy Circular dated March 16, 2007 may be obtained from:

Kingsway Financial Services Inc., Secretary
c/o Fogler, Rubinoff LLP
95 Wellington Street West
Suite 1200,
Toronto-Dominion Centre
Toronto, Ontario M5J 2Z9

Telephone: 416-841-8857
Fax: 416-841-8852

APPENDIX I

KINGSWAY FINANCIAL SERVICES INC.
AUDIT COMMITTEE CHARTER

I. Purpose

The Audit Committee is appointed by the Board of Directors to assist the Board in fulfilling its oversight responsibilities with respect to (a) the integrity of the Company's financial statements, (b) the Company's compliance with legal and regulatory requirements, (c) the external auditor's qualifications and independence, and (d) the performance of the Company's internal audit function and the performance of the external auditors. The Audit Committee's primary duties and responsibilities are to:

i. Identify and monitor the management of the principal risks that could impact the financial reporting of the Company.

ii. Monitor the integrity of the Company's financial reporting process and system of internal controls regarding financial reporting and accounting appropriateness and compliance.

iii. Recommend the appointment of and monitor the independence and performance of the company's external auditors and the external appointed actuary.

iv. Provide an avenue of communication among the external auditors, the external appointed actuary, management and the Board of Directors.

v. Review the annual audited financial statements with management and the external auditor.

II. Organization

Audit Committee members shall meet the requirements of the Business Corporations Act (Ontario), all applicable securities laws, and the Toronto Stock Exchange and the New York Stock Exchange. The Audit Committee shall be comprised of three or more directors as determined by the Board, each of whom shall be outside directors who are unrelated, free from any relationship that would interfere with the exercise of his or her independent judgment. All members of the Committee shall be financially literate, being defined as able to read and understand basic financial statements, and the Chair of the Committee shall have accounting or related financial management expertise. The Audit Committee shall assist the Board in determining whether or not one or more members of the Audit Committee is an "audit committee financial expert" as defined in SEC Release 33-8177.

Audit Committee members shall be appointed by the Board annually at the meeting of the Board of Directors next following the annual meeting. The Audit Committee Chair shall be designated by the full board or if it does not do so, the members of the Committee may designate a Chair by majority vote of the Committee membership.

III. Structure and Meetings

The Committee shall meet at least quarterly, or more frequently as circumstances dictate. The Audit Committee Chair shall prepare and/or approve an agenda in advance of each meeting. The Committee should meet privately in executive session with each of management, the external auditors, the external appointed actuary, the internal auditor and as a committee to discuss any matters that the Committee or each of these groups believe should be discussed.

The Audit Committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the external auditors as well any other employees or consultants to Kingsway and its subsidiaries. The Audit Committee has the ability to retain, at the Company's expense, special legal, accounting, or other consultants or experts it deems necessary in the performance of its duties.

IV. Responsibilities and Duties

The Audit Committee shall have the power and authority of the Board of Directors to perform the following duties and fulfil the following responsibilities.

Review Procedures

1. Review and reassess the adequacy of this Mandate at least annually and submit the mandate to the Board of Directors for approval.

2. Review the Company's annual audited financial statements and discuss the Company's quarterly financial statements and related documents prior to filing or distribution. Review should include discussion with management and external auditors of significant issues regarding accounting principles, practice, and significant management estimates and judgments as well as the contents of "Management's Discussion and Analysis".

3. In consultation with management, external auditors, and external appointed actuary, consider the integrity of the Company's financial reporting processes and internal controls. Discuss significant financial risk exposures and the steps management has taken to monitor, control, and report such exposures. Review significant findings prepared by the external auditors together with management's responses.

4. Review the effectiveness of the overall process for identifying the principal risks affecting financial reporting and provide the Committee's view to the Board of Directors.

5. Review the Company's quarterly financial results and related documents prior to the release of earnings and/or the company's quarterly financial statements prior to filing or distribution shall be reviewed by the full Board of Directors.

6. Review financial statements and other related documents to be included in any prospectus or other offering document of the Company.

7. Discuss the Company's earnings press releases as well as financial information and earnings guidance provided to analysts and rating agencies.

External Auditors and Actuaries

8. The external auditors are accountable to the Audit Committee and the Board of Directors, as representatives of the shareholders. The Audit Committee shall review the independence and performance of the auditors and annually recommend to the Board of Directors the appointment of the external auditors or approve any discharge of auditors when circumstances warrant.

9. Recommend the appointment and approve the appointment, compensation and work carried out by the external auditors, including the provision of both audit related and non-audit related services.

10. On not less than an annual basis, the Committee should review and discuss with the external auditors all significant relationships they have with the Company that could impair the auditors' independence.

11. Review the external auditors' audit plan and in particular, discuss and approve audit scope, staffing, locations, reliance upon management and general audit approach.

12. On not less than an annual basis review with the external auditors:

   i. all critical accounting policies and practices to be used in connection with the auditor's report.

   ii. all alternative treatments within GAAP for policies and practices related to material items that have been discussed with management, including ramifications of the use of such alternative disclosures and treatments; and the treatment preferred by the auditor; and

   iii. other material written communications between the auditor and the management of the Company, such as any management representation letter, schedule of unadjusted differences, reports on observations and recommendations on internal control, engagement letter and independence letter.

13. Prior to releasing the year-end earnings, discuss the results of the audit with the external auditors. Discuss certain matters required to be communicated to audit committees in accordance with the standards established by the Canadian Institute of Chartered Accountants.

14. Consider the external auditors' judgments about the quality and appropriateness of the Company's accounting principles as applied in the Company's financial reporting.

15. Set clear hiring policies for employees or former employees of the external auditors.

16. Consider the external appointed actuary's judgment about the appropriateness of management's selection of assumptions of methods to determine the unpaid claims liabilities included in the company's year-end financial statements.

Internal Audit Department and Legal Compliance

17. Discuss policies with respect to risk assessment and risk management.

18. On not less than an annual basis, obtain and review a report by the external auditor describing the Company's internal quality-control procedures and any material issues raised by the most recent internal quality-control review, or peer review of the Company.

19. Review significant internal audit reports together with management's response and follow-up to these reports.

20. Meet separately, periodically, with management, with internal auditors and with external auditors.

21. Review formal whistleblower procedures that address the receipt, retention and treatment of complaints regarding accounting, internal controls and auditing matters and the confidential anonymous submission by employees of any concerns regarding questionable accounting or auditing matters.

22. On at least an annual basis, review with the Company's counsel any legal matters that could have a significant impact on the organization's financial statements, the Company's compliance with applicable laws and regulations, and inquiries received from regulators or governmental agencies.

23. Develop and recommend to the full Board a set of corporate governance principles, review such principles annually and recommend any modifications thereto.

24. Consider corporate governance issues that may arise from time to time and make recommendations to the Board with respect thereto.

25. Confer, as appropriate, with the General Counsel on matters of corporate governance.

Other Audit Committee Responsibilities

26. Annually assess the effectiveness of the committee against this Mandate and report the results of the assessment to the Board

27. Perform any other activities consistent with this Mandate, the Company's by-laws and governing law, as the Committee or the Board deems necessary or appropriate.

28. Maintain minutes of meetings and periodically report to the Board of Directors on significant results of the foregoing activities.

29. Establish, review, and update periodically a Code of Conduct for the CEO and other Senior Financial Officers and Code of Ethical Conduct for others and ensure that management has established a system to enforce these Codes.

30. The Audit Committee will annually review a summary of director and officers' related party transactions and potential conflicts of interest.

December 2006

Document No. 2

Consolidated Financial Statements of

KINGSWAY FINANCIAL SERVICES INC.

As at December 31, 2006 and 2005

MANAGEMENT STATEMENT ON RESPONSIBILITY FOR FINANCIAL INFORMATION

Management is responsible for presentation and preparation of the annual consolidated financial statements, Management's Discussion and Analysis ("MDA") and all other information in the Company's Annual Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and the requirements of the Securities and Exchange Commission ("SEC") including a reconciliation to generally accepted accounting principles in the United States. Financial information appearing elsewhere in the Company's Annual Report is consistent with the consolidated financial statements.

The MDA has been prepared in accordance with the requirements of securities regulators, including National Instrument 51-102 of the Canadian securities regulators as well as item 303 of Regulation S-K of the Securities Exchange Act of the United States, and their related published requirements.

The consolidated financial statements and information in the MDA necessarily include amounts based on informed judgements and estimates of the expected effects of current events and transactions with appropriate consideration to materiality. In addition, in preparing the financial information management must make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. The MDA also includes information regarding the estimated impact of current transactions and events, sources of liquidity and capital resources, operating trends, risks and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because future events and circumstances may not occur as expected.

In meeting its responsibility for the reliability of the consolidated financial statements and for the accounting systems from which they are derived, management maintains the necessary system of internal controls. These controls are designed to provide management with reasonable assurance that the financial records are reliable for preparing financial statements and other financial information, that assets are safeguarded against unauthorized use or disposition and that liabilities are recognized.

The Board of Directors oversees management's responsibilities for financial reporting through an Audit Committee, which is composed entirely of directors who are neither officers nor employees of the Company. The Audit Committee reviews the consolidated financial statements and recommends them to the board for approval. The Audit Committee also reviews and monitors the Company's system of internal controls as reported by management or the external auditors.

Role of the Actuary

With respect to the preparation of these financial statements, management prepares a valuation, including the selection of appropriate assumptions, of the Company's obligations at the balance sheet date under insurance policies issued by its subsidiaries. With respect to the preparation of these financial statements, the independent actuary, Pierre Laurin of Tillinghast, a business of Towers Perrin Inc., carries out a review of management's valuation of the estimated unpaid claim liabilities and provides an opinion to the Board of Directors regarding the appropriateness of the estimated unpaid claim liabilities recorded by management to meet all policyholder claim obligations of the Company at the balance sheet date. The work to form that opinion includes an examination of the sufficiency and reliability of data, and review of the valuation process used by management. The independent actuary is responsible for assessing whether the assumptions and methods used for the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation, and associated regulations and directives. In performing the review of these estimated liabilities determined by management, which are by their very nature inherently variable, the actuary makes assumptions as to future loss ratios, trends, reinsurance recoveries, expenses and other contingencies, taking into consideration the circumstances of the Company and the nature of the insurance policies. In carrying out their work, the independent actuary makes use of the work of the external auditors with regards to data upon which their calculations are based.

The valuation is based on projections of future claims and claim adjustment expenses on claims incurred at the balance sheet date. It is certain that actual future claims and claim adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. Further, the projections make no provision for new classes or claim categories not sufficiently recognized in the claims database.

Management is responsible for the accuracy and completeness of the underlying data used in the valuation. The actuary's report outlines the scope of the review and the opinion.

Role of the Auditor

The independent registered public accounting firm, KPMG LLP, have been appointed by the Audit Committee and ratified by the shareholders. Their responsibility is to conduct an independent and objective audit of the financial statements in accordance with Canadian generally accepted auditing standards and in 2006 the standards of the Public Company Accounting Oversight Board (United States) and to report thereon to the shareholders. In carrying out their audit procedures relating to the claims liabilities of the Company, the auditors make use of the work and report of the independent actuary. The shareholders' auditors have full and unrestricted access to the Board of Directors and the Audit Committee to discuss audit, financial reporting and related findings. The auditors' report outlines the scope of their audit and their opinion.

/s/ William G. Star	/s/ W. Shaun Jackson
William G. Star President & Chief Executive Officer	W. Shaun Jackson Executive Vice President & Chief Financial Officer

March 30, 2007

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting, and have designed such internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles (GAAP), including a reconciliation to U.S. GAAP.

Management has used the *Internal Control - Integrated Framework* to assess the effectiveness of the Company's internal control over the financial reporting as of December 31, 2006, which is a recognized and suitable framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, and has concluded that such internal control over financial reporting is effective as of December 31, 2006.

The independent registered public accounting firm, KPMG LLP, appointed by the Audit Committee and ratified by the shareholders, who have audited the consolidated financial statements of the Company, has issued an attestation report on management's assessment of the Company's internal control over financial reporting.

/s/ William G. Star

William G. Star
President & Chief Executive Officer

/s/ W. Shaun Jackson

W. Shaun Jackson
Executive Vice President & Chief Financial Officer

March 30, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of Kingsway Financial Services Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Kingsway Financial Services Inc. (the "Company") maintained effective internal control over financial reporting as of December 31, 2006, based on the criteria established in the *Internal Control - Integrated Framework*, issued by the committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles, including a reconciliation to United States generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's asset that could have a material effect on its financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluations of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the criteria established in *Internal Control - Integrated Framework*, issued by COSO. Also in our opinion the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the criteria established in the *Internal Control - Integrated Framework*, issued by COSO.

We have also conducted our audits on the consolidated financial statements in accordance with Canadian generally accepted auditing standards. With respect to the consolidated financial statements for the year ended December 31, 2006, we have also conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our report dated March 30, 2007, expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Chartered Accountants
Toronto, Canada
March 30, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors of Kingsway Financial Services Inc.:

We have audited the accompanying consolidated balance sheets of Kingsway Financial Services Inc. as of December 31, 2006 and December 31, 2005 and the related consolidated statements of operations, retained earnings, currency translation adjustment and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. With respect to the consolidated financial statements for the year ended December 31, 2006, we have also conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and December 31, 2005 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2006 in conformity with Canadian generally accepted accounting principles.
Canadian generally accepted accounting principles vary in certain significant respects from US generally accepted accounting principles. Information relating to the nature and effect of such differences is presented in Note 19 to the consolidated financial statements.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company’s internal control over financial reporting as of December 31, 2006, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 30, 2007 expressed an unqualified opinion on management’s assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP
Chartered Accountants

Toronto, Canada
March 30, 2007

ACTUARY'S REPORT

I have reviewed the unpaid claims liabilities of Kingsway Financial Services Inc. determined by management and recorded in its consolidated balance sheet at December 31, 2006 and their changes in the consolidated statement of operations for the year then ended in accordance with Canadian accepted actuarial practice.

Under Canadian accepted actuarial practice, the valuation of unpaid claims liabilities reflects the time value of money. Management has chosen not to reflect the time value of money in determining the valuation of the unpaid claims liabilities in the consolidated financial statements.

In my opinion, except as described in the preceding paragraph, management's valuation of the unpaid claims liabilities is appropriate and the consolidated financial statements fairly present the results of the valuation.

The unpaid claims liabilities as at December 31, 2005 and the changes in unpaid claims for the two year yearly periods then ended were reviewed by another actuary at Towers Perrin Inc. The other actuaries' report dated February 7, 2006 expressed an opinion without reservation except that it contained a similar exception for management choosing not to reflect the time value of money in determining the valuation of the unpaid claims liabilities as referred to the above.

/s/ Pierre Laurin

Pierre Laurin, Towers Perrin Inc.
Fellow Canadian Institute of Actuaries

March 30, 2007

KINGSWAY FINANCIAL SERVICES INC.
Consolidated Balance Sheets

As at December 31
(In thousands of U.S. dollars)

		2006		2005
Assets				
Cash and cash equivalents	$	129,706	$	111,034
Investments (note 3)		2,929,090		2,803,790
Accrued investment income		28,365		25,126
Accounts receivable and other assets		318,332		282,764
Due from reinsurers and other insurers (note 8)		208,090		222,974
Deferred policy acquisition costs		158,527		148,829
Income taxes recoverable		2,017		-
Future income taxes (note 9)		75,212		57,939
Capital assets (note 4)		108,149		71,608
Goodwill and intangible assets (notes 1(f), 11(b) & 11(c))		90,850		71,130
	$	4,048,338	$	3,795,194
Liabilities and Shareholders' Equity				
Liabilities:				
Bank indebtedness (note 13(a))	$	52,149	$	11,767
Loans payable (note 13(d))		66,222		66,222
Accounts payable and accrued liabilities		124,760		129,666
Income taxes payable		-		6,817
Unearned premiums		682,452		649,228
Unpaid claims (note 10)		1,939,363		1,844,211
Senior unsecured debentures (note 13(b))		191,930		192,068
Subordinated indebtedness (note 13(c))		90,500		90,500
		3,147,376		2,990,479
Shareholders' equity:				
Share capital (note 5)		328,473		331,470
Contributed surplus		5,352		3,237
Currency translation adjustment		7,011		9,958
Retained earnings		560,126		460,050
		900,962		804,715
Contingent liabilities (note 15)				
	$	4,048,338	$	3,795,194

See accompanying notes to consolidated financial statements.

On behalf of the Board:

/s/ F. Michael Walsh Director

/s/ David H. Atkins	Director

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KINGSWAY FINANCIAL SERVICES INC.
Consolidated Statements of Operations

Years ended December 31
(In thousands of U.S. dollars, except per share amounts)

		2006		2005		2004
Gross premiums written	$	1,932,750	$	1,894,660	$	2,001,806
Net premiums written	$	1,803,382	$	1,824,393	$	1,739,264
Revenue:						
Net premiums earned (note 8)	$	1,766,497	$	1,791,943	$	1,778,374
Net investment income (note 3)		120,871		93,035		74,266
Net realized gains (note 3)		28,987		38,239		20,392
		1,916,355		1,923,217		1,873,032
Expenses:						
Claims incurred (notes 8 and 10)		1,234,525		1,224,506		1,260,093
Commissions and premium taxes (note 8)		328,443		361,875		330,769
General and administrative expenses		182,256		155,773		148,096
Interest expense		30,247		25,921		21,171
Amortization of intangible assets		1,030		795		530
		1,776,501		1,768,870		1,760,659
Income before income taxes		139,854		154,347		112,373
Income taxes (recovery) (note 9):						
Current		33,160		28,208		4,004
Future		(16,615)		(8,869)		7,355
		16,545		19,339		11,359
Net income	$	123,309	$	135,008	$	101,014
Earnings per share (note 5):						
Basic	$	2.19	$	2.39	$	1.80
Diluted	$	2.17	$	2.37	$	1.79
Dividends declared per common share	C$	0.26	C$	0.20	C$	-

See accompanying notes to consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.
Consolidated Statements of Retained Earnings

Years ended December 31
(In thousands of U.S. dollars)

	2006	2005	2004
Retained earnings, beginning of year	$ 460,050	$ 334,468	$ 233,454
Net income	123,309	135,008	101,014
Common share dividends	(12,988)	(9,426)	-
Repurchase of common shares for cancellation	(10,245)	-	-
Retained earnings, end of year	$ 560,126	$ 460,050	$ 334,468

See accompanying notes to consolidated financial statements.

Consolidated Statements of Currency Translation Adjustment

Years ended December 31
(In thousands of U.S. dollars)

	2006	2005	2004
Currency translation adjustment, beginning of year	$ 9,958	$ 1,720	$ (6,747)
Net unrealized foreign exchange translation gains (losses)	(2,947)	8,238	8,467
Currency translation adjustment,end of year	$ 7,011	$ 9,958	$ 1,720

See accompanying notes to consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.
Consolidated Statements of Cash Flows

Years ended December 31
(In thousands of U.S. dollars)

	2006	2005	2004
Cash provided by (used in):			
Operating activities:			
Net income	$ 123,309	$ 135,008	$ 101,014
Items not affecting cash:			
Amortization of intangibles	1,030	795	530
Amortization of capital assets and deferred charges	6,598	6,884	7,422
Future income taxes	(17,362)	(6,924)	7,115
Net realized gains	(28,987)	(38,239)	(20,392)
Amortization of bond premiums and discounts	(2,667)	10,825	19,777
	81,921	108,349	115,466
Change in non-cash balances:			
Deferred policy acquisition costs	(9,801)	(2,868)	(12,339)
Due from reinsurers and other insurers	29,266	34,713	(212,948)
Increase (decrease) in funds withheld payable to reinsurer	-	(78,691)	78,691
Unearned premiums	34,037	(10,386)	27,744
Unpaid claims	95,036	149,891	381,642
Increase in contributed surplus	2,115	1,468	1,242
Net change in other non-cash balances	(65,346)	71,271	12,162
	167,228	273,747	391,660
Financing activities:			
Increase in share capital	3,005	2,926	2,434
Repurchase of common shares for cancellation	(16,246)	-	-
Common share dividend	(12,988)	(9,426)	-
Increase (decrease) in bank indebtedness and loans payable	40,845	17,378	(63,044)
Increase in senior unsecured debentures	-	-	125,000
	14,616	10,878	64,390
Investing activities:			
Purchase of investments	(3,279,985)	(2,590,018)	(2,408,406)
Proceeds from sale of investments	3,164,215	2,356,581	1,959,283
Financed premiums receivable, net	18,369	3,973	(17,617)
Acquisitions (note 11)	(22,415)	(11,892)	-
Additions to capital assets	(43,356)	(19,338)	(12,790)
	(163,172)	(260,694)	(479,530)
Increase (decrease) in cash during the year	18,672	23,931	(23,480)
Cash and cash equivalents, beginning of year	111,034	87,103	110,583
Cash and cash equivalents, end of year	$ 129,706	$ 111,034	$ 87,103

See accompanying notes to consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.
Consolidated Statements of Cash Flows

Years ended December 31
(In thousands of U.S. dollars)

		2006		2005		2004
Supplementary disclosure of cash information:						
Represented by:						
Cash on hand and balances with banks		126,887		100,290		85,879
Investments with maturities less than 30 days		2,819		10,744		1,224
Cash and cash equivalents, end of year	$	129,706	$	111,034	$	87,103
Cash paid for:						
Interest	$	30,170	$	25,474	$	18,753
Income taxes		45,659		13,141		14,995

See accompanying notes to consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

Kingsway Financial Services Inc. (the “Company”) was incorporated under the Business Corporations Act (Ontario) on September 19, 1989. The Company is a financial services holding company which, through its subsidiaries in Canada, United States, Barbados and Bermuda, is engaged in property and casualty insurance.

1. Summary of significant accounting policies:

(a) Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Acquisitions are accounted for by the purchase method, whereby the results of acquired companies are included only from the date of acquisition, and divestitures are included up to the date of disposal. Assets and liabilities of the acquired companies are included in the financial statements at their fair values at the date of acquisition. The Company holds interests in variable interest entities that are not included in the consolidated financial statements which are more fully described in note 14.

The following is a list of our material subsidiaries, all of which are 100% owned, directly or indirectly, (except for qualifying shares of York Fire & Casualty Insurance Company and Kingsway General Insurance Company held by directors in order to satisfy applicable statutory requirements), with the jurisdiction of incorporation indicated in brackets:

American Country Holdings Inc. (Illinois); American Country Insurance Company (Illinois); American Country Financial Services Corp. (Illinois); American Country Underwriting Agency Inc. (Illinois); American Country Professional Services Corp. (Illinois); American Service Investment Corporation (Illinois); American Service Insurance Company, Inc. (Illinois); ARK Insurance Agency Inc. (Illinois); Avalon Risk Management, Inc. (Illinois); Appco Finance Corporation (Florida); Appco SPV L.L.C. (Florida); Auto Body Tech Inc. (Florida); Funding Plus of America (Alabama); Hamilton Risk Management Company (Florida); HI Holdings, Inc. (Hawaii); Insurance Management Services Inc. (Florida); U.S. Security Insurance Company (Florida); Jevco Insurance Company (Canada); Kingsway America Inc. (Delaware); Kingsway Nova Scotia Finance, ULC (Nova Scotia); Kingsway General Insurance Company (Ontario); Kingsway Reinsurance (Bermuda) Ltd. (Bermuda); Kingsway Reinsurance Corporation (Barbados); Kingsway U.S. Finance Partnership (Delaware); Kingsway U.S. Tier II Finance Partnership (Delaware); Southern United Holding, Inc. (Alabama); Southern United Fire Insurance Company (Alabama); Southern United General Agency of Texas, Inc. (Texas); UCC Corporation (Nevada); Universal Casualty Company (Illinois); Walshire Assurance Company (Pennsylvania); Lincoln General Insurance Company (Pennsylvania); York Fire & Casualty Insurance Company (Ontario); Zephyr Insurance Company (Hawaii); and RPC Insurance Agency L.L.C. (Delaware).

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

1. Summary of significant accounting policies (continued):

(b) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from these estimates and changes in estimates are recorded in the accounting period in which they are determined.

(c) Investments:

Fixed term investments are carried at amortized cost providing for the amortization of the discount or premium on a constant yield basis to maturity. Investments in common and preferred shares are carried at cost. Where a decline in value of an investment is considered to be other than temporary a write-down of the investment is recorded.

(d) Investment income:

Investment income is recorded as it accrues. Dividend income on common and preferred shares is recorded on the ex-dividend date. Gains and losses on disposal of investments are determined and recorded as at the trade date, and are calculated on the basis of average cost.

(e) Cash and cash equivalents:

Cash and cash equivalents includes cash and securities with maturities of less than thirty days.

(f) Goodwill and other intangible assets:

When the Company acquires a subsidiary or other business where it exerts significant influence, the fair value of the net tangible and intangible assets acquired is determined and compared to the amount paid for the subsidiary or business acquired. Any excess of the amount paid over the fair value of those net assets is considered to be goodwill.

Goodwill is tested at least annually for impairment to ensure that its fair value is greater than or equal to the carrying value. Any excess of carrying value over fair value is charged to income in the period in which the impairment is determined. At December 31, 2006 and 2005, the carrying value of goodwill was $69,030,000 and $68,880,000, respectively (note 11(b) & 11 (c)).

1. Summary of significant accounting policies (continued):

(f) Goodwill and other intangible assets (continued):

When the Company acquires a subsidiary or other business where it exerts significant influence or acquires certain assets, intangible assets may be acquired, which are recorded at their fair value at the time of the acquisition. Intangible assets with a definite useful life are amortized to income on a straight line basis over its defined useful life. The Company writes down the value of an intangible asset with a definite useful life when the undiscounted cash flows are not expected to allow for full recovery of the carrying value. At December 31, 2006 and 2005 intangible assets with a definite useful life, net of accumulated amortization, were $19,570,000 and $nil, respectively.

Intangible assets with an indefinite useful life are not subject to amortization and are tested at least annually for impairment to ensure that its fair value is greater than or equal to its carrying value. Any excess of carrying value over fair value is charged to income in the period in which the impairment is determined. At December 31, 2006 and 2005 the Company had intangible assets with an indefinite life, net of accumulated depreciation of $2,250,000 and $2,250,000, respectively.

Amortization of intangible assets reported in the Consolidated Statements of Operations for the years ended December 31, 2006, 2005 and 2004 was $1,030,000, $795,000 and $530,000, respectively. There were no write-downs of goodwill or intangible assets due to impairment during the years ended December 31, 2006, 2005, and 2004.

(g) Deferred policy acquisition costs:

The Company defers brokers’ commissions, premium taxes and other underwriting and marketing costs relating to the acquisition of premiums written to the extent they are considered recoverable. These costs are then expensed as the related premiums are earned. The method followed in determining the deferred policy acquisition costs limits the deferral to its realizable value by giving consideration to estimated future claims and expenses to be incurred as premiums are earned. Changes in estimates, if any, are recorded in the accounting period in which they are determined. Anticipated investment income is included in determining the realizable value of the deferred policy acquisition costs.

1. Summary of significant accounting policies (continued):

(h) Premium revenue and unearned premiums:

The Company earns premium revenue over the period covered by each individual insurance contract in proportion to the insurance protection provided. For motorcycle premiums, a higher percentage of the premiums are earned during the summer months, which is the motorcycle riding season in Canada. For all other lines of business, the premiums are earned evenly over the contract period. Unearned premiums represent the portion of premiums written related to the unexpired risk portion of the policy at the year end.

The reinsurers' share of unearned premiums is recognized as amounts recoverable using principles consistent with the Company's method for determining the unearned premium liability.

A significant portion of the Company's revenue is subject to regulatory approvals. In Canada, automobile insurance premium rates other than for fleet automobiles are regulated by the provincial government authorities. In the United States, property and casualty insurance premium rates are subject to regulation by state government authorities. Regulation of premium rates is based on claims and other costs of providing insurance coverage. Regulatory approvals can limit or reduce premium rates that can be charged, or delay the implementation of changes in rates.

(i) Unpaid claims:

The provision for unpaid claims includes adjustment expenses and represents an estimate for the full amount of all expected costs, including investigation, and the projected final settlements of claims incurred on or before the balance sheet date. The provision does not take into consideration the time value of money or make an explicit provision for adverse deviation.

These estimates of future loss activity are necessarily subject to uncertainty and are selected from a wide range of possible outcomes. All provisions are periodically reviewed and evaluated in the light of emerging claim experience and changing circumstances. The resulting changes in estimates of the ultimate liability are recorded as incurred claims in the accounting period in which they are determined.

1. Summary of significant accounting policies (continued):

(j) Reinsurance:

Net premiums earned and claims incurred are recorded net of amounts ceded to, and recoverable from, reinsurers. Estimates of amounts recoverable from reinsurers on unpaid claims are recorded separately from estimated amounts payable to policyholders. Unearned premiums are also reported before reduction for business ceded to reinsurers and the reinsurers' portion is classified with amounts due from reinsurers.

Amounts recoverable from reinsurers are estimated and recognized in a manner consistent with the Company's method for determining the related policy liability associated with the reinsured policy.

(j) Translation of foreign currencies:

The consolidated financial statements have been presented in U.S. dollars as the Company's principal investments and cash flows are influenced primarily by the U.S. dollar. The operations of its subsidiaries in Canada, Bermuda and its head office operations are self sustaining. Assets and liabilities of non U.S. dollar denominated subsidiaries are translated at year end rates of exchange. Revenue and expenses are translated at the average rate of exchange for the year. The net unrealized gains or losses which result from translation are deferred and included in shareholders' equity under the caption "currency translation adjustment". The currency translation adjustment will change with fluctuations in the Canadian to U.S. dollar exchange rate.

All amounts expressed in the financial statements are in U.S. dollars unless otherwise noted.

(k) Income taxes:

The Company follows the asset and liability method of accounting for income taxes, whereby future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment.

1. Summary of significant accounting policies (continued):

(m) Stock-based compensation plan:

The Company has a stock-based compensation plan which is described in note 6. The Company uses the fair-value method of accounting for stock-based compensation awards granted to employees and non-employee directors for options granted on or after January 1, 2003. The Company determines the fair value of the stock options on their grant date using the Black-Scholes option pricing model and records the fair value as a compensation expense over the period that the stock options vest, with a corresponding increase to contributed surplus. When these stock options are exercised, the amount of proceeds, together with the amount recorded in contributed surplus, is recorded in share capital.

No compensation expense is recognized for stock options granted prior to January 1, 2003. The consideration paid by employees and non-employee directors on exercise of these stock options is credited to share capital.

During 2006 the Company adopted the recommendation by EIC 162 for stock-based compensation for employees eligible to retire before the vesting date. The additional stock compensation expense relating to eligible employees in 2006 was $648,000.

(n) Capital assets:

Capital assets are reported in the financial statements at amortized cost. Amortization of capital assets has been provided by the straight-line method over the estimated useful lives of such assets. The useful lives range from 10 to 40 years for buildings, 3 to 39 years for leasehold improvements, 3 to 10 years for furniture and equipment, 3 to 5 years for computers and software development, and 3 to 5 years for automobiles.

2. Future change in accounting policy:

In April 2005, the CICA issued three new standards to be applied prospectively, Section 3855 Financial Instruments - Recognition and Measurement, Section 3865 Hedges and Section 1530 Comprehensive Income, effective for years starting on or after October 1, 2006. The Company will adopt these standards on January 1, 2007.

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

2. Future change in accounting policy (continued):

The new rules will require the Company to classify all financial instruments as held for trading, held to maturity, available for sale or as loans and receivables.

The majority of the Company's financial instruments will be classified as available for sale and be reported on the financial statements at fair value, with the changes in the unrealized gains or losses reported in a new component of shareholders' equity called other comprehensive income. The remainder will be classified as either loans or receivables which will continue to be carried at amortized cost or as held for trading and will be carried at fair market value with the changes in unrealized gains or losses reported in net income.

The effect of the adoption of the new standards on the balance sheet at January 1, 2007 will be to increase shareholder's equity by $26.5 million.

3. Investments:

The carrying amounts and fair values of investments are summarized below:

					December 31, 2006
		Carrying amount	Gross Unrealized Gains	Gross Unrealized Losses	Fair value
Term deposits		$ 379,574	$ 45	$ 491	$ 379,128
Bonds:					
Canadian	- Government	221,457	2,585	292	223,750
	- Corporate	339,575	5,603	699	344,479
U.S.	- Government	70,275	334	1,077	69,532
	- Corporate	1,265,673	3,429	18,863	1,250,239
Other	- Government	40,326	348	725	39,949
	- Corporate	177,980	1,534	2,752	176,762
Sub-total		$ 2,494,860	$ 13,878	$ 24,899	$ 2,483,839
Common shares	- Canadian	182,326	28,927	11,888	199,365
	- U.S.	184,376	23,942	3,490	204,828
Financed premiums		67,528	-	-	67,528
		$ 2,929,090	$ 66,747	$ 40,277	$ 2,955,560

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3. Investments (continued):

The maturity profile of the bonds and term deposits investments at their carrying amounts and fair values as at December 31, 2006 is as follows:

	Carrying Amount	Fair Value
Due in one year or less	$ 602,114	$ 600,024
Due after one year through five years	1,168,583	1,157,516
Due after five years through ten years	587,862	590,922
Due after ten years	136,301	135,377
	$ 2,494,860	$ 2,483,839

The carrying amounts and fair values of investments are summarized below:

					December 31, 2005
		Carrying amount	Gross Unrealized Gains	Gross Unrealized Losses	Fair value
Term deposits		$ 383,071	$ 10	$ 1,347	$ 381,734
Bonds:					
Canadian	- Government	199,500	3,432	276	202,656
	- Corporate	279,953	6,558	756	285,755
U.S.	- Government	144,835	374	2,092	143,117
	- Corporate	1,122,624	1,831	24,425	1,100,030
Other	- Government	83,981	43	1,996	82,028
	- Corporate	179,002	89	3,433	175,658
Sub-total		$ 2,392,966	$ 12,337	$ 34,325	$ 2,370,978
Preferred shares	- Canadian	1,290	62	-	1,352
Common shares	- Canadian	152,347	32,522	6,127	178,742
	- U.S.	171,483	19,087	5,357	185,213
Financed premiums		85,704	-	-	85,704
		$ 2,803,790	$ 64,008	$ 45,809	$ 2,821,989

The maturity profile of the bonds and term deposits investments at their carrying amounts and fair values as at December 31, 2005 is as follows:

	Carrying Amount	Fair Value
Due in one year or less	$ 717,729	$ 712,709

Due after one year through five years		1,075,914		1,057,350
Due after five years through ten years		465,112		467,484
Due after ten years		134,211		133,435
	$	2,392,966	$	2,370,978

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(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

3. Investments (continued):

The amounts are shown by contractual maturity. Actual maturity may differ from contractual maturity because certain borrowers have the right to call or repay certain obligations with or without call or prepayment penalties.

The following tables highlight the aggregate unrealized loss position, by security type, of holdings in an unrealized loss position as at December 31, 2006 and 2005. The tables segregate the holdings based on the period of time the securities have been continuously held in an unrealized loss position.

	0-6 months	6-12 months	over 12 months	December 31, 2006 Total
Common Shares				
Number of Positions	123	5	7	135
Fair Value	$ 96,854	$ 24,109	$ 2,623	$ 123,586
Carrying Value	108,696	27,134	3,134	138,964
Unrealized Loss	(11,842)	(3,025)	(511)	(15,378)
Term Deposits and Bonds				
Number of Positions	257	37	275	569
Fair Value	$ 576,098	$ 250,695	$ 786,893	$ 1,613,686
Carrying Value	581,826	251,591	805,168	1,638,585
Unrealized Loss	(5,728)	(896)	(18,275)	(24,899)
Total				
Number of Positions	380	42	282	704
Fair Value	$ 672,952	$ 274,804	$ 789,516	$ 1,737,272
Carrying Value	690,522	278,725	808,302	1,777,549
Unrealized Loss	(17,570)	(3,921)	(18,786)	(40,277)

	0-6 months	6-12 months	over 12 months	December 31, 2005 Total
Common Shares				
Number of Positions	99	5	1	105
Fair Value	$ 78,026	$ 11,617	$ 347	$ 89,990
Carrying Value	86,674	14,332	468	101,474
Unrealized Loss	(8,648)	(2,715)	(121)	(11,484)
Term Deposits and Bonds				
Number of Positions	526	49	18	593
Fair Value	$ 998,187	$ 111,911	$ 631,370	$ 1,741,468
Carrying Value	1,014,577	114,085	647,131	1,775,793
Unrealized Loss	(16,390)	(2,174)	(15,761)	(34,325)
Total				
Number of Positions	625	54	19	698
Fair Value	$ 1,076,213	$ 123,528	$ 631,717	$ 1,831,458
Carrying Value	1,101,251	128,417	647,599	1,877,267

Unrealized Loss	(25,038)	(4,889)	(15,882)	(45,809)

3. Investments (continued):

Fair values of term deposits, bonds and common and preferred shares are measured using approximate quoted market values based on the latest bid prices. Financed premiums represent the portion of the insured's monthly premium payments that are not yet due. Certain insureds have the option to pay a portion of the premium when the policy is placed in force and the balance in monthly instalments. The insured pays an additional premium for this option, reflecting handling costs and the investment income that would have been earned on such premium, had the total amount been collected at the beginning of the policy period. The additional premium is essentially an interest payment on the balance of the unpaid premium and is recognized as investment income over the period of the policy. The fair value of financed premiums, which are realized over the term of the related policies of up to one year, approximates their carrying amount.

Management has reviewed currently available information regarding those investments whose estimated fair value is less than their carrying amount and ascertained that the carrying amounts are expected to be recovered. Debt securities whose carrying amount exceeds fair value can be held until maturity when management expects to receive the principal amount. Principally, unrealized losses on debt securities have arisen due to increases in market interest rates rather than deteriorating creditworthiness of the issuers.

Management performs a quarterly analysis of the Company's investment holdings 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 management:

- identifying all security holdings in an unrealized loss position that has existed for at least six months or other circumstances which management believes may impact the recoverability of the security;
- obtaining a valuation analysis from third party investment managers regarding the intrinsic value of these holdings based on their knowledge, experience and other market based valuation techniques;
- reviewing the trading range of certain securities over the preceding calendar period;
- assessing if declines in market value are other than temporary for debt security holdings based on the investment grade credit rating from third party security rating agencies;
- assessing if declines in market value are other than temporary for any debt security holding with non-investment grade credit rating based on the continuity of their debt service record; and

3. Investments (continued):

- determining the necessary provision for declines in market value that are considered other than temporary based on the analyses performed.

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

- the opinion of professional investment managers could be incorrect;

- the past trading patterns of individual securities 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 securities may not reflect future debt service capabilities and may not reflect the company's unknown underlying financial problems.

The length of time securities may be held in an unrealized loss position may vary based on the opinion of the appointed investment managers and their respective analyses related to valuation and the various credit risks that may prevent the Company from recapturing the principal investment. If the appointed investment manager determines there is little or no risk of default prior to the maturity of a holding, the Company would elect to hold the security in an unrealized loss position until the price recovers or the security matures.

In situations where facts emerge that might increase the risk associated with recapture of principal, securities would be traded and losses realized. Due to the current volatility of the equity markets, the Company believes there are a number of securities currently trading at values below their respective intrinsic values based on historical valuation measures. In these situations, holdings may be maintained in an unrealized loss position for different periods of time based on the underlying economic assumptions influencing the investment manager's valuation of the holding. In cases where the economic realities divert from the underlying assumptions driving the investment manager's valuation, securities would be traded and losses realized. In cases where the economic assumptions coincide with valuation assumptions, the holding would be maintained until the market value of the security recovers in the public markets.

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

3. Investments (continued):

All of the Company's fixed term investments have fixed interest rates. The coupon rates for the Company's fixed term investments range from 2.25% to 11.00% at December 31, 2006 and 1.50% to 12.00% at December 31, 2005.

The Company limits its investment concentration in any one investee or related group of investees other than government issues, to less than 5% of the Company's investments.

Net investment income for the years ended December 31 is comprised as follows:

		2006		2005		2004
Investment income:						
Interest on short-term investments	$	17,547	$	9,881	$	6,335
Interest on bonds		90,826		73,615		56,114
Dividends		12,026		8,939		5,707
Premium finance		5,836		7,059		8,614
Other		2,258		1,447		2,309
Gross investment income		128,493		100,941		79,079
Investment expenses		7,622		7,906		4,813
Net investment income	$	120,871	$	93,035	$	74,266

Net realized gains for the years ended December 31, 2006, 2005, and 2004 were $28,987,000, $38,239,000 and $20,392,000, respectively. Included in net realized gains were adjustments to the carrying value of investments for declines in market value considered other than temporary of $4,582,000, $4,806,000 and $1,291,0000 for the years ended December 31, 2006, 2005 and 2004, respectively.

As at December 31, 2006, bonds and term deposits with an estimated fair value of $40,260,000 (2005 - $34,392,000) were on deposit with regulatory authorities.

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4. Capital assets:

	Cost	Accumulated Amortization	2006 Carrying Value
Land	$ 10,439	$ -	$ 10,439
Buildings	77,746	5,319	72,427
Leasehold Improvements	13,627	3,276	10,351
Furniture and equipment	11,929	6,756	5,173
Computers and software development	31,863	22,890	8,973
Automobiles	2,008	1,222	786
Total	$ 147,612	$ 39,463	$ 108,149

	Cost	Accumulated Amortization	2005 Carrying Value
Land	$ 7,830	$ -	$ 7,830
Buildings	43,786	4,771	39,015
Leasehold Improvements	13,686	2,264	11,422
Furniture and equipment	10,407	6,389	4,018
Computers and software development	28,240	19,642	8,598
Automobiles	1,674	949	725
Total	$ 105,623	$ 34,015	$ 71,608

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(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

5. Share capital:

Authorized:
Unlimited number of common shares

Share transactions consist of the following:

	Shares Issued	Stock Options		Weighted-Average Exercise Price*		Amount
Balance as at December 31, 2003	55,829,794	1,686,135	$	12.19	$	326,111
Stock options:						
Granted in year		481,000		15.19		
Exercised in year	380,456	(380,456)		8.46		2,433
Forfeited in year		(55,167)		15.69		
Expired in year		(2)		11.50		
Balance as at December 31, 2004	56,210,250	1,731,510	$	13.73	$	328,544
Stock options:						
Granted in year		552,576		19.70		
Exercised in year	270,203	(270,203)		11.48		2,511
Forfeited in year		(46,368)		17.91		
Stock-based compensation expense						415
Balance as at December 31, 2005	56,480,453	1,967,515	$	15.66	$	331,470
Stock options:						
Granted in year		611,350		24.55		
Exercised in year	209,072	(209,072)		14.12		2,604
Forfeited in year		(24,917)		19.50		
Stock-based compensation expense						400
Normal course issuer bid (note 5(e) & 5(f))	(805,000)	-		-		(6,001)
Balance as at December 31, 2006	55,884,525	2,344,876	$	18.07	$	328,473

*Weighted average price is stated in Canadian dollars as per the terms of the option.

5. Share capital (continued):

(a) During the year ended December 31, 2006, options to acquire 209,072 shares (2005 - 270,203; 2004 - 380,456 shares) were exercised at prices from C$4.30 to C$19.70 per share (2005 - C$4.30 to C$19.66 per share; 2004 - C$4.30 to C$15.19 per share).

(b) The weighted average number of shares outstanding for the years ended December 31, 2006, 2005 and 2004 were 56,233,964, 56,423,207 and 56,123,976, respectively. On a diluted basis, the weighted average number of shares outstanding for the years ended December 31, 2006, 2005 and 2004 were 56,868,785, 56,962,868 and 56,549,496, respectively.

(c) During 2006, the Company declared dividends payable in Canadian dollars of C$0.0625 per share payable for the first three quarters and C$0.075 per share for the last quarter. Total dividends declared in 2006 were C$0.2625 per common share. Dividends paid to common shareholders during 2006 were C$14,749,872 and C$11,291,300 in 2005.

(d) Options exercised during the year resulted in an increase in share capital from contributed surplus of $400,000 for the year ended December 31, 2006 and $415,000 for the year ended December 31, 2005.

(e) On November 8, 2005 the Company obtained approval from the Toronto Stock Exchange to make a normal course issuer bid for its common shares. For the twelve month period ending November 7, 2006 the Company repurchased 562,800 of its common shares at an average price of $19.66.

(f) On November 9, 2006 the Company obtained approval from the Toronto Stock Exchange to make a normal course issuer bid for its common shares. For the twelve month period ending November 8, 2007 the Company may repurchase up to 2,800,000 shares in total representing approximately 5% of the outstanding common shares. For the period of November 9, 2006 to December 31, 2006, the Company had repurchased 242,200 of its common shares at an average price of $21.16. For the year ended December 31, 2006 the Company had repurchased a total of 805,000 of its common shares at an average price of $20.11.

6. Stock-based compensation:

(a) The Company has established a stock option incentive plan for directors, officers and key employees of the Company and its subsidiaries. At December 31, 2006, the maximum number of common shares that may be issued under the plan is 4,800,000 (2005 - 4,800,000) common shares. The maximum number of common shares available for issuance to any one person under the stock option plan is 5% of the common shares outstanding at the time of the grant.

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

6. Stock-based compensation (continued):

The exercise price is based on the market value of the shares at the time the option is granted. In general, the options vest evenly over a three year period and are exercisable for periods not exceeding 10 years.

The intrinsic value of a stock option grant is the difference between the current market price for the Company's common shares and the exercise price of the option. The aggregate intrinsic value for the stock options outstanding at December 31, 2006, 2005 and 2004 was C$14.6 million, C$15.4 million and C$9.1 million, respectively. The aggregate intrinsic value for stock options exercisable at December 31, 2006, 2005 and 2004 was C$11.9 million, C$9.5 million and C$5.8 million, respectively.

The following tables summarize information about stock options outstanding as at December 31, 2006, December 31, 2005 and December 31, 2004:

Exercise prices are stated in Canadian dollars as per the terms of the option.

December 31, 2006

Exercise Price	Date of Grant	Expiry Date	Remaining Contractual Life (Years)	Number Outstanding	Number Exercisable
C$24.55	13-Feb-06	13-Feb-11	4.1	603,850	-
C$19.70	14-Feb-05	14-Feb-10	3.1	512,951	162,784
C$15.19	12-Feb-04	12-Feb-09	2.1	365,737	224,237
C$13.53	10-Feb-03	10-Feb-13	6.1	329,335	329,335
C$19.66	21-Feb-02	21-Feb-12	5.2	306,000	306,000
C$ 7.80	22-Feb-01	22-Feb-11	4.2	127,002	127,002
C$ 4.30	24-Feb-00	14-Feb-10	3.2	100,001	100,001
	Total		4.0	2,344,876	1,249,359

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6. Stock-based compensation (continued):

December 31, 2005

Exercise Price	Date of Grant	Expiry Date	Remaining Contractual Life (Years)	Number Outstanding	Number Exercisable
C$19.70	14-Feb-05	14-Feb-10	4.1	542,500	-
C$15.19	12-Feb-04	12-Feb-09	3.1	424,004	130,337
C$13.53	10-Feb-03	10-Feb-13	7.1	394,505	248,672
C$19.66	21-Feb-02	21-Feb-12	6.2	340,000	340,000
C$ 7.80	22-Feb-01	22-Feb-11	5.2	146,170	146,170
C$ 4.30	24-Feb-00	24-Feb-10	4.2	120,336	120,336
	Total		4.9	1,967,515	985,515

December 31, 2004

Exercise Price	Date of Grant	Expiry Date	Remaining Contractual Life (Years)	Number Outstanding	Number Exercisable
C$15.19	12-Feb-04	12-Feb-09	4.1	453,833	-
C$13.53	10-Feb-03	10-Feb-13	8.1	485,169	182,836
C$19.66	21-Feb-02	21-Feb-12	7.2	403,500	269,000
C$ 7.80	22-Feb-01	22-Feb-11	6.2	202,339	202,339
C$ 4.30	24-Feb-00	24-Feb-10	5.2	186,669	186,669
	Total		6.3	1,731,510	840,844

At December 31, 2006, 2005 and 2004 the number of options exercisable is 1,249,359, 985,515 and 840,844, respectively, with weighted average prices of C$14.81, C$13.89 and C$12.06, respectively.

The Company determines the fair value of options granted using the Black-Scholes option pricing model. The per share fair value of options granted during 2006, 2005 and 2004 was C$6.11, C$3.58 and C$3.79.

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(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

6. Stock-based compensation (continued):

The Company does not record any compensation expense for stock options granted prior to 2003. When these stock options are exercised, the Company will include the amount of proceeds in share capital. The impact on net income and earnings per share if the Company had measured the compensation element of stock options granted based on the fair value on the date of grant on all outstanding stock options on their grant date is disclosed as follows:

	2006	2005	2004
Stock option expense included in employee compensation expense	$ 2,515	$ 1,883	$ 1,242
Net income, as reported	$ 123,309	$ 135,008	$ 101,014
Additional expense that would have been recorded if all outstanding stock options granted before January 1, 2003 had been expensed	-	68	1,452
Pro forma net income	$ 123,309	$ 134,940	$ 99,562
Basic earnings per share			
As reported	$ 2.19	$ 2.39	$ 1.80
Pro forma	2.19	2.39	1.77
Diluted earnings per share			
As reported	$ 2.17	$ 2.37	$ 1.79
Pro forma	2.17	2.37	1.76

Stock option expense above is charged to earnings and is included as a separate component of Shareholders’ Equity under the caption Contributed Surplus.

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

6. Stock-based compensation (continued):

The fair value of the options granted was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2006	2005	2004
Risk-free interest rate	4.02%	3.53%	3.49%
Dividend yield	1.02%	0.9%	0.0%
Volatility of the expected market price of the Company's common shares	31.4%	22.5%	30.3%
Expected option life (in years)	3.5	3.9	4.7

The Black-Scholes option valuation model was developed for use in estimating fair value of traded options that have no vesting restrictions and are fully transferable. As the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the above pro forma adjustments are not necessarily a reliable single measure of the fair value of the Company's employee stock options.

(b) The Company has an employee share purchase plan where qualifying employees can choose each year to have up to 5% of their annual base earnings withheld to purchase the Company's common shares. The Company matches one half of the employee contribution amount, and its contributions vest immediately. All contributions are used by the plan administrator to purchase common shares in the open market. The Company's contribution is expensed as paid and for the years ended December 31, 2006, 2005 and 2004 totalled $727,000, $553,000 and $390,000, respectively.

7. Pension benefits:

The Company maintains a separate defined contribution pension plan in Canada and in the U.S. for all of its qualified employees including the employees of all subsidiaries. In Canada, qualifying employees can choose each year to have up to 5% of their annual base earnings subject the maximum Registered Retirement Savings Plan ("rrsp") deduction limit, withheld to contribute to the applicable plan. The rrsp deduction limit is the lesser of 18% of earned income for the preceding year or C$18,000, C$16,500 and C$15,500 for 2006, 2005 and 2004 respectively, The Company matches one half of the employee contribution amount, and its contributions vest immediately. In the U.S., qualifying employees can choose to voluntarily contribute up to 60% of their annual earnings to an overall limitation of $15,000 in 2006, $14,000 in 2005 and $13,000 in 2004. The Company matches 50% of the employee contribution amount each payroll period up to 5%.

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

7. Pension benefits (continued):

The contributions for the U.S. plan vest based on years of service with 100% vesting after five years of service. The Company's contribution is expensed as paid and for the years ended December 31, 2006, 2005 and 2004 totalled $1,581,000, $1,247,000 and $1,058,000, respectively. All Company obligations to the plans were fully funded as of December 31, 2006.

Prior to December 31, 1997, substantially all salaried employees of the Company's subsidiary American Country were covered by a defined benefit pension plan sponsored by American Country. Effective December 31, 1997, upon resolution of its board of directors, the plan was frozen. The reported pension expense for American Country was $104,000, $113,000 and $60,000 in 2006, 2005, and 2004 respectively.

8. Underwriting policy and reinsurance ceded:

In the normal course of business, the Company seeks to reduce the loss that may arise from catastrophe or other events that cause unfavourable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers. The Company is not relieved of its primary obligation to the policyholder as a result of the reinsurance transaction.

Failure of reinsurers to honour their obligations could result in losses to the Company, consequently, the Company continually evaluates the financial condition of its reinsurers and monitors concentrations of credit risk to minimize its exposure to significant losses from reinsurer insolvency.

The Company follows the policy of underwriting and reinsuring contracts of insurance, which limits the company's net exposure to the following maximum amounts:

	Years ended December 31					
		2006		2005		2004
Property claims						
- Canadian operations	C$	1,000	C$	500	C$	500
- U.S. operations	$	500	$	500	$	500
Casualty claims						
- Canadian operations	C$	2,500	C$	2,500	C$	2,500
- U.S. operations	$	1,000	$	1,000	$	1,000

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(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

8. Underwriting policy and reinsurance ceded (continued):

In addition, the Company has obtained catastrophe reinsurance protection which provides coverage in the event of a series of events. This reinsurance limits its net retained exposure and provides coverage up to certain maximum per occurrence amounts in excess of the retained loss other than catastrophe risks in Hawaii as follows:

	Years ended December 31					
		2006		2005		2004
Canada						
- Retained loss	C$	5,000	C$	5,000	C$	5,000
- Maximum coverage	C$	145,000	C$	145,000	C$	45,000
United States						
- Retained loss	$	5,000	$	2,000	$	5,000
- Maximum coverage	$	20,000	$	18,000	$	45,000

On October 31, 2005, the Company acquired Zephyr Insurance Inc. ("Zephyr") in Hawaii. Zephyr is protected by a separate catastrophe reinsurance program under a 95% quota-share treaty and excess of loss treaty. Under this program Zephyr retains up to $7,540,000 in net losses subject to a maximum cover of $1,000,000,000.

During 2004, the Company entered into two quota-share contracts. The Company did not renew the quota share reinsurance treaties upon their expiry on April 1, 2005.

The unearned premium balance is affected by the reinsurance ceded as a portion of the unearned premium will be owed to the reinsurer as the premiums are earned in the subsequent periods. The amounts deducted for reinsurance ceded from net premiums earned, claims incurred and commissions and premium taxes for the years December 31, 2006, 2005 and 2004 were as follows:

		2006		2005		2004
Net premiums earned	$	127,274	$	123,715	$	213,135
Claims incurred		39,256		90,506		152,187
Commissions and premium taxes		29,018		34,498		54,435

The amount of assumed premiums written was $86,211,000, $141,799,000 and $232,431,000 for the years ended December 31, 2006, 2005 and 2004, respectively. The amount of assumed premiums earned was $93,091,000, $142,831,000 and $235,054,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

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(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

9. Income taxes:

(a) The Company's provision for income taxes, compared to statutory rates is summarized as follows:

	2006	2005	2004
Provision for taxes at Canadian statutory marginal income tax rate	$ 50,515	$ 55,750	$ 40,589
Non-taxable investment income	(398)	(1,812)	(1,117)
Foreign operations subject to different tax rates	(33,892)	(34,218)	(28,493)
Change in tax rates and other	320	(381)	380
Provision for income taxes	$ 16,545	$ 19,339	$ 11,359

(b) The components of future income tax balances are as follows:

	2006	2005
Future income tax assets:		
Losses carried forward	$ 33,398	$ 10,924
Unpaid claims and unearned premiums	32,090	30,037
Investments	8,526	10,276
Share issue expenses	430	1,298
Contingent commission accruals	5,510	12,358
Other	39,631	5,565
Valuation allowance	(498)	(500)
Future income tax assets	119,087	69,958
Future income tax liabilities:		
Deferred policy acquisition costs	(39,313)	(7,943)
Investments	(525)	(791)
Guaranteed payments	(2,572)	(2,238)
Other	(1,465)	(1,047)
Future income tax liabilities	(43,875)	(12,019)
Net future income tax assets	$ 75,212	$ 57,939

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

9. Income taxes (continued):

(c) Amounts and expiration dates of the operating loss carryforwards are as follows:

Year of net operating loss	Expiration date		Net operating loss
U.S. operations:			
1995	2010	$	546
1997	2012		1,284
2000	2020		710
2001	2021		14,936
2002	2022		4,405
2003	2023		891
2004	2024		207
2005	2025		282
2006	2026		74,971

(d) The Company established valuation allowances of $498,000 and $500,000 for its gross future tax assets at December 31, 2006 and 2005, respectively. Based on the Company’s expectations of adjusted taxable income, its ability to change its investment strategy, as well as reversing gross future tax liabilities, management believes it is more likely than not that the Company will fully realize the gross future tax assets, with the exception of its net operating losses. The valuation allowances are a result of the potential inability to utilize net operating losses before expiration.

10. Unpaid claims:

(a) Nature of unpaid claims:

The establishment of the estimated provision for unpaid claims 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 claim payment patterns, loss payments, pending levels of unpaid claims, product mix or concentration, claims severity and claim frequency patterns.

10. Unpaid claims (continued):

Other factors include the continually evolving and changing regulatory and legal environment, actuarial studies, professional experience and expertise of the Company's claim 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 claims settlement costs, court decisions, economic conditions and public attitudes. In addition, time can be a critical part of the provision determination, since the longer the span between the incidence of a loss and the payment or settlement of the claims, the more variable the ultimate settlement amount can be. Accordingly, short tail claims such as property claims, tend to be more reasonably predictable than long tail claims, such as general liability and automobile accident benefit claims that are less predictable.

Consequently, the process of establishing the estimated provision for unpaid claims is complex and imprecise as it relies on the judgement and opinions of a large number of individuals, on historical precedent and trends, on prevailing legal, economic, social and regulatory trends and on expectations as to future developments. The process of determining the provision necessarily involves risks that the actual results will deviate, perhaps substantially, from the best estimates made.

(b) Provision for unpaid claims:

The Company’s annual evaluation of the adequacy of unpaid claims includes a re-estimation of the liability for unpaid claims relating to each preceding financial year compared to the liability that was originally established. The results of this comparison and the changes in the provision for unpaid claims, net of amounts recoverable from reinsurers, for the years ended December 31, 2006, 2005 and 2004 were as follows:

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

10. Unpaid claims (continued):

	2006	2005	2004
Unpaid claims - beginning of year - net	$ 1,662,551	$ 1,463,280	$ 1,188,610
Provision for claims occurring:			
In the current year	1,193,288	1,217,952	1,220,604
In prior years	64,329	24,233	53,196
Claims paid during the year relating to:			
The current year	(409,236)	(424,997)	(446,230)
The prior years	(745,286)	(674,373)	(582,869))
Claims transferred on expiry of quota share agreement	-	33,788	-
Currency translation adjustment	(2,714)	22,668	29,969
Unpaid claims - end of year - net	1,762,932	1,662,551	1,463,280
Reinsurers' and other insurers'share of unpaid claims	176,431	181,660	225,945
Unpaid claims - end of year	$ 1,939,363	$ 1,844,211	$ 1,689,225

The results for the years ended December 31, 2006, 2005 and 2004 were adversely affected by the evaluation of unpaid claims related to prior years. In 2004, unfavourable development on unpaid claims came primarily from Alberta non-standard automobile claims and long-haul trucking claims in the U.S. from terminated programs, in 2005, primarily from a terminated trucking program and Alberta non-standard automobile claims and in 2006, primarily from long-haul trucking claims in the U.S. and from allocated loss adjustment expenses on contractor property claims in the U.S.

Canadian Operations

The Canadian operations reported favourable reserve development of $11.1 millioin in the 2006 compared to unfavourable reserve development of $2.1 million in 2005. Alberta and Ontario Trucking business contributed $2.1 million of prior years' claims development compared to $4.7 million in 2005 and $6.9 million in 2004. Alberta non-standard automobile contributed $5.2 million of favourable development in 2006 compared to $12.6 million and $15.7 million of unfavourable development in 2005 and 2004, respectively.

10. Unpaid claims (continued):

U.S. Operations

The U.S. operations reported unfavourable reserve development of $75.4 million in 2006 compared to $22.2 million in 2005. We previously outsourced the claims settlement and case reserving process for the U.S. program business. Over the last few years we have made a concerted effort to bring most of these arrangements in-house and have significantly increased our internal resources as part of this focused initiative. As part of these initiatives we have, over this period of time, completed a comprehensive review of all claim reserves previously handled by third parties. This review process identified several areas where the previous claims reserves were inadequate resulting in unfavourable development of the prior years' claims reserves. Trucking business contributed $59.3 million of the prior years' claims development in 2006, compared to $29.5 million in 2005 and $23.8 million in 2004. Property & liability business contributed $13.5 million of the prior years' claims development in 2006, compared to $17.4 million in 2005 and favourable development of $7.1 million in 2004. Allocated loss adjustment expenses on contractor's claims in the property & liability segment contributed $19.6 million in prior years' claims development. In 2006 which was offset by favourable development on other property business.

(c) Ranges of unpaid claims:

The Company's policy is, to the extent that management's estimates of gross reserve levels at our individual insurance subsidiaries are less than the point estimates recommended by their independent appointed actuary, those gross reserve levels will be increased to levels that are no less than the point estimate recommended by the independent appointed actuary. The ranges of provision for gross unpaid claims for our U.S. and Canadian operations estimated by our independent actuary and the actual carried provision for unpaid claims were as follows:

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

10. Unpaid claims (continued):

As of December 31, 2006		**Low**		**High**		**Carried**
U.S. Operations	$	990,991	$	1,274,850	$	1,138,407
Canadian Operations		684,189		915,267		800,956
Total	$	1,675,180	$	2,190,117	$	1,939,363

As of December 31, 2005		**Low**		**High**		**Carried**
U.S. Operations	$	992,920	$	1,211,515	$	1,084,843
Canadian Operations						759,368
Total					$	1,844,211

For 2005 in Canada, the independent appointed actuary developed a point estimate only in accordance with actuarial standards.

(d) The fair value of unpaid claims and adjustment expenses, gross and recoverable from reinsurers, has been omitted because it is not practicable to determine fair value with sufficient reliability.

11. Acquisitions:

(a) Hamilton:

In 1999 the Company acquired all of the outstanding shares of Hamilton Investments, Inc. (“Hamilton”). All consideration was payable in cash, part of which was paid at closing, with the remaining payments based on the earnings of Hamilton for the fiscal years 1999 to 2003. The present value of the guaranteed future payments was accrued at the date of acquisition. The additional consideration paid during the year ended December 31, 2004 was $2,013,750. No contingent consideration based on earnings was paid.

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

11. Acquisitions (continued):

(b) Zephyr:

On October 31, 2005, the Company acquired 100% of the voting shares of HI Holdings Inc. for an estimated $25,000,000, and preliminary goodwill of $4,326,000. During 2006 the final purchase price was agreed with the sellers at $24,629,000, and goodwill of $4,494,000 was determined for this acquisition.

The transaction includes HI's wholly owned subsidiary, Zephyr Insurance Company Inc. whose primary business is residential hurricane insurance. The earnings of HI Holdings have been included in the statement of operations from November 1, 2005.

HI Holdings, at the time of acquisition had total assets of approximately $71,113,000 (excluding goodwill) consisting primarily of marketable securities and total liabilities of approximately $51,541,000

(c) Robert Plan Corporation ("RPC"):

In 2006, the Company entered into an agreement with The Robert Plan Corporation (RPC) whereby the Company acquired the renewal rights of RPC's assigned risk business. As part of these arrangements, RPC has been given the authority to market the assigned risk programs on behalf of the Company and the Company has assumed certain operating functions related to this business. RPC has also been granted an option for a limited period of time to repurchase these rights and acquire these operations functions from the Company. The Company recognized an intangible asset of $20,600,000 relating to this acquisition and amortization of $1,030,000 was recorded in 2006. The Company determined that the intangible asset has a definite life and will amortize it to income on a straight line basis over its defined useful life currently estimated at 10 years.

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

12. Segmented information:

The Company provides property and casualty insurance and other insurance related services in three reportable segments: Canada, the United States and corporate and other insurance related services. The Company's Canadian and United States segments include transactions with the Company's reinsurance subsidiaries. At the present time, other insurance related services are not significant. Results for the Company's operating segments are based on the Company's internal financial reporting systems and are consistent with those followed in the preparation of the consolidated financial statements.

The segmented information for December 31, 2006 is summarized as follows:

	Canada	United States	Corporate and Other	Total
Gross premiums written	$ 590,766	$ 1,341,984	$ -	$ 1,932,750
Net premiums earned	562,444	1,204,053	-	1,766,497
Investment income (loss)	53,026	68,448	(603)	120,871
Net realized gains	16,244	12,743	-	28,987
Interest expense	-	23,086	7,161	30,247
Amortization of capital assets	1,289	3,332	1,625	6,246
Amortization of intangible assets	-	1,030	-	1,030
Net income tax expense (recovery)	22,595	(15,410)	9,360	16,545
Net income (loss)	69,026	62,721	(8,438)	123,309
Capital assets	$ 49,055	$ 55,915	$ 3,179	$ 108,149
Goodwill and intangible assets	7,887	82,963	-	90,850
Total assets	1,508,561	2,507,123	32,654	4,048,338

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

12. Segmented information (continued)

The segmented information for December 31, 2005 is summarized as follows:

	Canada	United States	Corporate and Other	Total
Gross premiums written	$ 609,934	$ 1,284,726	$ -	$ 1,894,660
Net premiums earned	582,491	1,209,452	-	1,791,943
Investment income (loss)	40,595	54,129	(1,689)	93,035
Net realized gains (losses)	23,864	14,406	(31)	38,239
Interest expense	-	19,329	6,592	25,921
Amortization of capital assets	1,007	4,113	1,058	6,178
Amortization of intangible assets	-	795	-	795
Net income tax expense (recovery)	22,389	(5,805)	2,755	19,339
Net income (loss)	65,579	81,553	(12,124)	135,008
Capital assets	$ 21,967	$ 45,158	$ 4,483	$ 71,608
Goodwill and intangible assets	7,903	63,227	-	71,130
Total assets	1,392,469	2,374,081	28,644	3,795,194

The segmented information for December 31, 2004 is summarized below:

	Canada	United States	Corporate and Other	Total
Gross premiums written	$ 583,515	$ 1,418,291	$ -	$ 2,001,806
Net premiums earned	501,914	1,276,460	-	1,778,374
Investment income (loss)	31,694	42,984	(412)	74,266
Net realized gains	6,629	13,750	13	20,392
Interest expense	-	15,166	6,005	21,171
Amortization of capital assets	783	5,140	924	6,847
Amortization of intangible assets	-	530	-	530
Net income tax expense (recovery)	11,335	(2,920)	2,944	11,359
Net income (loss)	32,770	73,769	(5,525)	101,014
Capital assets	$ 12,521	$ 43,332	$ 2,663	$ 58,516
Goodwill and intangible assets	7,647	59,673	-	67,320
Total assets	1,240,329	2,250,479	28,584	3,519,392

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12. Segmented information (continued):

The Company's gross premiums written are derived from the following business lines and geographical areas:

	2006	2005	2004
Business Line			
Personal Lines:			
Non-Standard Auto	26%	29%	35%
Standard Auto	6%	7%	6%
Motorcycle	3%	3%	2%
Property (including Liability)	6%	3%	2%
Other Specialty Lines	2%	2%	2%
Total Personal Lines	43%	44%	47%
Commercial Lines:			
Trucking	33%	31%	29%
Commercial Auto	14%	12%	12%
Property (including Liability)	7%	10%	10%
Other Specialty Lines	3%	3%	2%
Total Commercial Lines	57%	56%	53%
Total Gross Premiums Written	100%	100%	100%

	2006	2005	2004
Geographical Area			
United States:			
California	14%	14%	14%
Illinois	10%	11%	10%
Florida	9%	10%	10%
Texas	6%	6%	8%
New Jersey	3%	3%	3%
New York	4%	1%	2%
Hawaii	3%	1%	2%
Other	20%	22%	22%
Total United States	69%	68%	71%
Canada:			
Ontario	19%	20%	17%
Alberta	4%	5%	5%
Quebec	6%	5%	5%
Other	2%	2%	2%
Total Canada	31%	32%	29%

Total Gross Premiums Written	100%	100%	100%

13. Indebtedness:

(a) Bank indebtedness:

On March 5, 2004, the Company entered into a C$150 million revolving credit facility with a syndicate of three banks. In December 2004 the facility was extended for a further 364 days and matured on March 3, 2006. The facility bore interest at a floating rate based on the type of loan and the Company's senior unsecured debt rating. The amount outstanding under this facility as at December 31, 2005 was $11,178,000, with an effective interest rate of approximately 5%.

On February 15, 2006, the Company entered into a C$150 million 364 day revolving credit facility with a syndicate of two banks that replaced the above facility. Depending on the type of loan, the facility bore interest at a floating rate based on the Company's senior unsecured debt rating. This facility was replaced on June 23, 2006.

On June 23, 2006, the Company entered into a new $175 million 3 year revolving facility with a syndicate of three banks. This new facility replaced the above C$150 million 364 day revolving credit facility and contains similar terms, conditions and financial covenants. The amounts outstanding under this facility as at December 31, 2006 were $51,607,000 with an effective interest rate of 5.7%.

(b) Senior unsecured debentures:

On December 6, 2002, the Company issued C$78 million of 8.25% unsecured senior debentures with a maturity date of December 31, 2007. The debentures are redeemable prior to the maturity date, at the Company's option, upon at least 30 days notice to debenture holders. Interest on the debentures is payable semi-annually in arrears. The net proceeds to the Company were C$77,087,420. Interest payments were C$6,435,000 for each of the last three years.

On January 29, 2004, a subsidiary of the Company, Kingsway America Inc., completed the sale of $100 million 7.50% senior notes due 2014. The notes are fully and unconditionally guaranteed by the Company. The notes are redeemable at Kingsway America's option on or after February 1, 2009.In March 2004 an additional $25 million of these senior notes were issued. Interest paid during the year was $9,375,000, $9,375,000 for 2005 and $4,818,000 for 2004.

13. Indebtedness (continued):

(c) Subordinated indebtedness:

Between December 4, 2002 and December 16, 2003, six subsidiary trusts of the Company issued $90.5 million of 30 year capital securities to third parties in separate private transactions. In each instance, a corresponding floating rate junior subordinated deferrable interest debenture was then issued by Kingsway America Inc. to the trust in exchange for the proceeds from the private sale. The floating rate debentures bear interest at the rate of the London interbank offered interest rate for three month U.S. dollar deposits, plus spreads ranging from 3.85% to 4.20%, but until dates ranging from December 4, 2007 to January 8, 2009, the interest rates will not exceed 12.45% to 12.75%. The Company has the right to call each of these securities at par anytime after five years from their issuance until their maturity. The net proceeds to the Company were $70,877,000 after deducting expenses of $4,625,000. Interest paid during the year was $8,479,000, $6,702,000 for 2005 and $4,947,000 for 2004.

(d) Loan payable:

On July 14, 2005 Kingsway Linked Return of Capital Trust (“KLROC Trust”) completed its public offering of C$78 million of 5.00% Kingsway Linked Return of Capital Preferred Units due June 30, 2015 of which the Company was a promoter. The net proceeds of the offering were used by KLROC Trust for a series of investments that included the purchase of a C$74.1 million 7.12% senior note due June 30, 2015 issued by an affiliate.

Kingsway America Inc., a U.S. subsidiary has a promissory note payable balance of approximately $66.2 million with Kingsway ROC LLC, an affiliated company. The note was issued on July 15, 2005 and bears interest at 7.37% annually. The note principal is payable on June 30, 2015. Interest paid during the year was $4,881,000 and $2,061,000 for 2005.

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13. Indebtedness (continued):

(e) Contractual obligations:

The table below provides a breakdown of contractual obligations as described above in items (a) - (d) and note 15(f) as follows:

Payments Due by Period				
		2006		2005
Bank indebtedness	$	52,149	$	11,767
Construction contracts (note 15(f))		9,595		-
Senior unsecured debentures		191,930		192,068
Subordinated indebtedness		90,550		90,500
Loan payable		66,222		66,222
Total	$	410,446	$	360,557

14. Variable interest entities:

Variable interest entities include entities where the equity invested in the entity is considered insufficient to finance the entity's activities. The Company has two controlled entities which are variable interest entities and therefore not consolidated based on accounting standards as the Company is not considered to be the primary beneficiary. The Company accounts for its investment in these entities using the equity method and includes the investment in other assets of the Consolidated Balance Sheet. The Company's share of earnings in these entities is included in net investment income in the Consolidated Statement of Operations. As the funds invested in this non-consolidated affiliated entity formed part of the C$74.1 million note referred to in note 13(d), the effect of this transaction is to show additional debt on the Company's financial statements and an off-setting equity investment of C$8.3 million in the non-consolidated affiliated entity.

15. Commitments and contingent liabilities:

(a) Legal Proceedings:

In connection with its operations, the Company and its subsidiaries are, from time to time, named as defendants in actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the outcome of the various proceedings at this time, such actions have generally been resolved with minimal damages or expense in excess of amounts provided and the Company does not believe that it will incur any significant additional loss or expense in connection with such actions.

(b) Statutory Requirements:

Statutory policyholders' capital and surplus of the Company's insurance subsidiaries was $1,070.7 million and $977.5 million at December 31, 2006 and 2005, respectively.

The Company's subsidiaries are subject to certain requirements and restrictions under applicable state and provincial insurance legislation including minimum asset requirements and dividend restrictions. At December 31, 2006, under the various insurance regulatory restrictions, the Company's insurance and reinsurance subsidiaries have an aggregate dividend capacity of $515.9 million (2005 - $403.5 million).

(c) Letters of Credit:

On October 4, 2002 the Company entered into an annually renewable syndicated $350 million letter of credit facility. The letter of credit facility is principally used to collateralize inter-company reinsurance balances for statutory capital management purposes. The Company pledges securities to collateralize the utilized portion of the letter of credit facility. At December 31, 2006 and 2005 the letter of credit facility utilization was $272.3 million and $227.3 million, respectively.

Also, from time to time, the Company pledges securities to third parties to collateralize liabilities incurred under its policies of insurance. At December 31, 2006 and 2005, the amount of pledged securities was $25.8 million and $39.4 million, respectively.

(d) Charitable donations:

In 2004 the Company agreed to make a gift contribution of C$3 million to the Trillium Health Centre Foundation to be payable in equal instalments over the period of six years beginning in 2005. This contribution is being used to operate the Kingsway Financial Spine Centre in Mississauga, Ontario and is expensed as paid.

15. Commitments and contingent liabilities (continued):

(e) Guarantee:

The Company provided a guarantee for the payment of principal and interest for a non-controlled affiliated entity which entered into a cross-currency swap transaction July 14, 2005 in conjunction with the Kingsway Linked Return of Capital Trust transaction described in note 13 (d) whereby the affiliate swapped fixed Canadian dollar payments for fixed U.S. dollar payments. The guarantee extends until the swap agreement terminates on June 30, 2015.

(f) Property:

In 2005, the Company acquired a real estate property to construct a new corporate head office. The cost of this project is estimated to be approximately C$40 million. The outstanding commitments related to this project were $9,595,000 at December 31, 2006.

16. Securitization transaction:

During the year one of the Company's U.S. subsidiaries entered into a five year revolving securitization agreement to transfer its premium finance receivables to a third party Trust. The premium finance receivables are generally for a six month term corresponding to the underlying insurance policy issued by the U.S. subsidiary. The Company sold finance premium receivables of $16.0 million to the Trust, recorded an associated retained interest in the discounted cash flows from the cash reserve deposit maintained with the Trust and established a liability for future servicing costs. The effect of this off-balance sheet arrangement is to remove the related premium finance receivable asset from the balance sheet.

17. Fair value disclosure:

The fair value of financial assets and liabilities, other than investments (note 3) and unpaid claims (note 10) approximate their carrying amounts.

18. Subsequent events:

(a) Sale of property:

On December 21, 2006, the Company signed an agreement for the sale of the existing head office building located at 5310 Explorer Drive, Mississauga, Ontario, in the amount of $10,150,000 with a closing date of February 28, 2007.

(b) Business acquisition:

On January 24, 2007, the Company reached a definitive agreement to acquire Mendota Insurance Company, a wholly owned subsidiary of The St. Paul Travelers Companies. The transaction also includes Mendakota Insurance and Mendota Insurance Agency, Inc. wholly owned subsidiaries of Mendota Insurance Company. The acquisition is subject to regulatory approvals.

Mendota is non-standard automobile insurer headquartered in St. Paul, Minnesota, and licensed to write business in 43 states, through a network of approximately 6,000 independent agency locations.

19. Reconciliation of Canadian and United States Generally Accepted Accounting Principles:

The consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles ("GAAP") in Canada. The significant differences between Canadian GAAP and U.S. GAAP, which affect the Company's consolidated financial statements, are described below:

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements

(Tabular amounts in thousands of U.S. dollars, except for per share amounts)

19. Reconciliation of Canadian and United States Generally Accepted Accounting Principles (continued):

The following table reconciles the consolidated net income as reported under Canadian GAAP with net income and other comprehensive income in accordance with U.S. GAAP:

	2006	2005	2004
Net income based on Canadian GAAP	$ 123,309	$ 135,008	$ 101,014
Impact on net income of U.S. GAAP adjustments, net of tax:			