KINGSWAY FINANCIAL SERVICES INC
Form 10-Q
November 03, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

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

For Quarterly Period Ended September 30, 2016

or

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

For the Transition Period from _____ to _____

Commission File Number: 001-15204

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

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

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

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x
The number of shares outstanding of the registrant's common stock as of November 3, 2016 was 19,842,806.

KINGSWAY
FINANCIAL
SERVICES
INC.

Table Of Contents

KINGSWAY
FINANCIAL
SERVICES
INC.

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

	September 30, 2016 (unaudited)	December 31, 2015
Assets		
Investments:		
Fixed maturities, at fair value (amortized cost of $60,934 and $55,606, respectively)	$ 61,326	$ 55,559
Equity investments, at fair value (cost of $21,145 and $26,428, respectively)	21,518	27,559
Limited liability investments	29,091	20,141
Other investments, at cost which approximates fair value	7,251	4,077
Short-term investments, at cost which approximates fair value	670	400
Total investments	119,856	107,736
Cash and cash equivalents	30,705	51,701
Investments in investees	3,129	1,772
Accrued investment income	535	594
Premiums receivable, net of allowance for doubtful accounts of $135 and $165, respectively	33,570	27,090
Service fee receivable, net of allowance for doubtful accounts of $295 and $276, respectively	1,278	911
Other receivables, net of allowance for doubtful accounts of $806 and $806, respectively	4,979	3,789
Reinsurance recoverable	830	1,422
Prepaid reinsurance premiums	49	7
Deferred acquisition costs, net	14,553	12,143
Income taxes recoverable	—	61
Property and equipment, net of accumulated depreciation of $9,613 and $12,537, respectively	91,239	5,577
Goodwill	10,078	10,078
Intangible assets, net of accumulated amortization of $7,320 and $6,009, respectively	123,178	14,736
Other assets	4,823	3,405
Total Assets	$ 438,802	$ 241,022
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid loss and loss adjustment expenses:		
Property and casualty	$ 48,991	$ 55,471
Vehicle service agreements	3,055	2,975
Total unpaid loss and loss adjustment expenses	52,046	58,446
Unearned premiums	42,650	35,234
Reinsurance payable	241	145
Note payable	190,931	—
Subordinated debt, at fair value	38,774	39,898
Deferred income tax liability	6,086	2,924

Deferred service fees	36,641	34,319
Income taxes payable	2,031	—
Accrued expenses and other liabilities	20,411	19,959
Total Liabilities	389,811	190,925
Class A preferred stock, no par value; unlimited number authorized; 262,876 and 262,876 issued and outstanding at September 30, 2016 and December 31, 2015, respectively; redemption amount of $6,572	6,419	6,394
Shareholders' Equity:		
Common stock, no par value; unlimited number authorized; 19,842,806 and 19,709,706 issued and outstanding at September 30, 2016 and December 31, 2015, respectively	—	—
Additional paid-in capital	343,106	341,646
Accumulated deficit	(310,493)	(308,995)
Accumulated other comprehensive income	9,195	9,300
Shareholders' equity attributable to common shareholders	41,808	41,951
Noncontrolling interests in consolidated subsidiaries	764	1,752
Total Shareholders' Equity	42,572	43,703
Total Liabilities and Shareholders' Equity	$ 438,802	$ 241,022

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

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

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Revenues:				
Net premiums earned	$32,949	$29,197	$94,189	$88,427
Service fee and commission income	6,330	6,184	17,046	17,430
Rental income	2,426	—	2,426	—
Net investment income	1,036	791	2,036	2,632
Net realized gains (losses)	46	83	(58)	136
Other-than-temporary impairment loss	—	—	—	(10)
Other income	3,038	2,303	8,203	13,174
Total revenues	45,825	38,558	123,842	121,789
Operating expenses:				
Loss and loss adjustment expenses	26,804	22,914	75,139	69,054
Commissions and premium taxes	5,928	5,653	17,629	17,199
Cost of services sold	1,381	1,408	2,924	3,129
General and administrative expenses	9,949	9,997	30,326	31,748
Amortization of intangible assets	779	307	1,381	937
Contingent consideration (benefit) expense	—	110	(657)	364
Total operating expenses	44,841	40,389	126,742	122,431
Operating income (loss)	984	(1,831)	(2,900)	(642)
Other (revenues) expenses, net:				
Interest expense	2,448	1,248	4,649	4,053
Foreign exchange losses, net	4	58	14	1,210
Loss (gain) on change in fair value of debt	2,472	(2,458)	(1,124)	(1,491)
(Gain) loss on deconsolidation of subsidiary	(5,643)	—	(5,643)	4,420
Equity in net loss of investees	61	192	1,004	399
Total other (revenues) expenses, net	(658)	(960)	(1,100)	8,591
Income (loss) from continuing operations before income tax expense	1,642	(871)	(1,800)	(9,233)
Income tax expense	55	23	107	79
Income (loss) from continuing operations	1,587	(894)	(1,907)	(9,312)
Income from discontinued operations, net of taxes	—	—	—	1,426
Gain on disposal of discontinued operations, net of taxes	—	—	1,124	11,259
Net income (loss)	1,587	(894)	(783)	3,373
Less: net income (loss) attributable to noncontrolling interests in consolidated subsidiaries	48	(86)	(352)	74
Less: dividends on preferred stock	110	83	274	246
Net income (loss) attributable to common shareholders	$1,429	$(891)	$(705)	$3,053
Earnings (loss) per share - continuing operations:				
Basic:	$0.07	$(0.05)	$(0.09)	$(0.49)
Diluted:	$0.06	$(0.05)	$(0.09)	$(0.49)
Earnings per share - discontinued operations:				

Basic:	$—	$—	$0.06	$0.64
Diluted:	$—	$—	$0.06	$0.64
Earnings (loss) per share – net income (loss) attributable to common shareholders:				
Basic:	$0.07	$(0.05)	$(0.04)	$0.15
Diluted:	$0.06	$(0.05)	$(0.04)	$0.15
Weighted average shares outstanding (in ‘000s):				
Basic:	19,843	19,710	19,791	19,710
Diluted:	22,958	19,710	19,791	19,710

See accompanying notes to unaudited consolidated financial statements.

4

KINGSWAY FINANCIAL SERVICES INC.

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

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net income (loss)	$1,587	$(894)	$(783)	$3,373
Other comprehensive loss, net of taxes[1]:				
Unrealized (losses) gains on fixed maturities and equity investments:				
Unrealized (losses) gains arising during the period	(328)	(2,271)	377	(3,704)
Reclassification adjustment for amounts included in net income (loss)	21	90	(484)	1,554
Foreign currency translation adjustments	—	—	—	858
Recognition of currency translation loss on deconsolidation of subsidiary	—	—	—	1,243
Other comprehensive loss	(307)	(2,181)	(107)	(49)
Comprehensive income (loss)	1,280	(3,075)	(890)	3,324
Less: comprehensive income (loss) attributable to noncontrolling interests in consolidated subsidiaries	45	(85)	(354)	(395)
Comprehensive income (loss) attributable to common shareholders	$1,235	$(2,990)	$(536)	$3,719

(1) Net of income tax expense of $0 and $0 for the three and nine months ended September 30, 2016 and September 30, 2015, respectively.
See accompanying notes to unaudited consolidated financial statements

KINGSWAY FINANCIAL SERVICES INC.

Consolidated Statements of Cash Flows
(in thousands)
(Unaudited)

	Nine months ended September 30,	
	2016	2015
Cash provided by (used in):		
Operating activities:		
Net (loss) income	$(783)	$3,373
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Gain on disposal of discontinued operations, net of taxes	(1,124)	(11,259)
Equity in net loss of investees	1,004	399
Equity in net income of limited liability investments	(800)	(1,590)
Depreciation and amortization expense	1,962	1,400
Contingent consideration (benefit) expense	(657)	364
Stock-based compensation expense, net of forfeitures	716	598
Net realized losses (gains)	58	(136)
Gain on change in fair value of debt	(1,124)	(1,491)
Deferred income taxes	76	66
Other-than-temporary impairment loss	—	10
Amortization of fixed maturities premiums and discounts	176	245
Amortization of note payable premium	(203)	—
(Gain) loss on deconsolidation of subsidiary	(5,643)	4,420
Changes in operating assets and liabilities:		
Premiums and service fee receivable, net	(6,847)	(1,591)
Other receivables, net, adjusted for CMC assets acquired	773	(670)
Reinsurance recoverable	592	1,965
Prepaid reinsurance premiums	(42)	(41)
Deferred acquisition costs, net	(2,410)	(344)
Income taxes recoverable	61	18
Unpaid loss and loss adjustment expenses	(6,400)	(8,457)
Unearned premiums	7,416	1,320
Reinsurance payable	96	(73)
Deferred service fees	2,322	(363)
Other, net, adjusted for CMC assets acquired and liabilities assumed	(345)	1,299
Net cash used in operating activities	(11,126)	(10,538)
Investing activities:		
Proceeds from sales and maturities of fixed maturities	19,805	23,302
Proceeds from sales of equity investments	3,721	617
Purchases of fixed maturities	(24,816)	(25,788)
Purchases of equity investments	(1,541)	(7,666)
Net acquisitions of limited liability investments	(2,870)	(6,604)
Net purchases of other investments	(3,173)	(600)
Net (purchases of) proceeds from short-term investments	(533)	4
Net proceeds from sale of discontinued operations	1,404	44,919

Acquisition of business, net of cash acquired	(494)	—
Net purchases of property and equipment, adjusted for CMC assets acquired	(641)	(175)
Net cash (used in) provided by investing activities	(9,138)	28,009
Financing activities:		
Repurchase of common stock for cancellation	(125)	—
Principal payments on note payable assumed in CMC acquisition	(607)	—
Redemption of LROC preferred units	—	(12,920)
Net cash used in financing activities	(732)	(12,920)
Net (decrease) increase in cash and cash equivalents	(20,996)	4,551
Cash and cash equivalents at beginning of period	51,701	71,234
Cash and cash equivalents at end of period	$30,705	$75,785

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited)
September 30, 2016

NOTE 1 BUSINESS

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

NOTE 2 BASIS OF PRESENTATION

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

The accompanying unaudited consolidated interim financial statements and footnotes should be read in conjunction with the audited consolidated financial statements and footnotes included within our Annual Report on Form 10-K ("2015 Annual Report") for the year ended December 31, 2015.

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

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

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

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

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

There have been no material changes to our significant accounting policies as reported in our 2015 Annual Report. The Company has added the following significant accounting policies during 2016.

Revenue recognition:

Contingent revenue

The terms of the sale of one of the Company's subsidiaries includes potential receipt by the Company of future earnout payments. The gain related to the earnout payments is recorded when the consideration is determined to be realizable and is reported in the consolidated statements of operations as gain on disposal of discontinued operations, net of taxes.

Rental income

Rental income from operating leases is recognized on a straight-line basis, based on contractual lease terms with fixed and determinable increases over the non-cancellable term of the related lease when collectability is reasonably assured. Rental income recognized in excess of amounts contractually due and collected pursuant to the underlying lease is recorded in other receivables in the consolidated balance sheets.

NOTE 4 RECENTLY ISSUED ACCOUNTING STANDARDS

(a) Adoption of New Accounting Standards:

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

In February 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis ("ASU 2015-02"). The amendments in ASU 2015-02 affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities ("VIEs") or voting interest entities while also eliminating the presumption that a general partner should consolidate a limited partnership. Effective January 1, 2016, the Company adopted ASU 2015-02. The adoption of the standard did not have an impact on the consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments ("ASU 2015-16"). ASU 2015-16 simplifies the accounting for measurement-period adjustments in a business combination by requiring the acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The effect on earnings as a result of the change to the provisional amounts, calculated as if the accounting had been completed as of the acquisition date, must be recorded in the reporting period in which the adjustment amounts are determined rather than retrospectively. The effects, by line item, if any, must be disclosed. Effective January 1, 2016, the Company adopted ASU 2015-16. The adoption of the standard did not have an impact on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-07, Investments-Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting ("ASU 2016-07"). ASU 2016-07 simplifies the transition to equity method accounting by requiring an equity method investor to add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting. ASU 2016-07 is effective for annual reporting periods beginning after December 15, 2016 and should be applied prospectively upon the effective date. Early adoption is permitted. Effective January 1, 2016, the Company adopted ASU 2016-07. The adoption of the standard did not have a material impact on the consolidated financial statements.

(b) Accounting Standards Not Yet Adopted:

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle of ASU 2014-09 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date ("ASU 2015-14"). This amendment defers the effective date of the previously issued ASU 2014-09 until the interim and annual reporting periods beginning after December 15, 2017. Earlier application is permitted for interim and annual reporting periods beginning after December 15, 2016. In addition, the FASB has issued four related ASU's on principal versus agent guidance (ASU 2016-08), identifying performance obligations and the licensing implementation guidance (ASU 2016-10), a revision of certain SEC Staff Observer comments (ASU 2016-11) and implementation guidance (ASU 2016-12). Insurance contracts are not within the scope of ASU 2014-09; therefore, this standard would not apply to the Company's Insurance Underwriting segment. The Company is currently evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements.

In May 2015, the FASB issued ASU 2015-09, Financial Services-Insurance (Topic 944): Disclosures about Short-Duration Contracts ("ASU 2015-09"). ASU 2015-09 was issued to enhance disclosures about an entity’s insurance liabilities, including the nature, amount, timing and uncertainty of cash flows related to those liabilities. ASU 2015-09 is effective for annual reporting periods beginning after December 15, 2015 and for interim periods beginning after December 15, 2016. Early adoption is permitted. Except for the increased disclosure requirements, the Company does not believe the adoption will have a material effect on its consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited)
September 30, 2016

In January 2016, the FASB issued ASU 2016-01, Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). The amendments in ASU 2016-01 address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most significantly, ASU 2016-01 requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of an investee) to be measured at fair value with changes in fair value recognized in net income (loss). For public business entities, the amendments in ASU 2016-01 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and will be applied using a cumulative-effect adjustment to accumulated deficit as of the beginning of the fiscal year of adoption. The Company currently records its equity investments at fair value with net unrealized gains or losses reported in accumulated other comprehensive income. Adoption of ASU 2016-01 will require the changes in fair value on equity investments with readily determinable fair values to be recorded in net (loss) income. Adoption of ASU 2016-01 is not expected to have a material impact on the Company's financial position, cash flows or total comprehensive income (loss), but could have a significant impact on the Company's results of operations and earnings (loss) per share as changes in fair value will be presented in net income (loss) rather than other comprehensive loss.

In February 2016, the FASB issued ASU 2016-02, Leases ("ASU 2016-02"). ASU 2016-02 was issued to improve the financial reporting of leasing transactions. Under current guidance for lessees, leases are only included on the balance sheet if certain criteria, classifying the agreement as a capital lease, are met. This update will require the recognition of a right-of-use asset and a corresponding lease liability, discounted to the present value, for all leases that extend beyond 12 months. For operating leases, the asset and liability will be expensed over the lease term on a straight-line basis, with all cash flows included in the operating section of the statement of cash flows. For finance leases, interest on the lease liability will be recognized separately from the amortization of the right-of-use asset in the statement of comprehensive income and the repayment of the principal portion of the lease liability will be classified as a financing activity while the interest component will be included in the operating section of the statement of cash flows. ASU 2016-02 is effective for annual and interim reporting periods beginning after December 15, 2018. Early adoption is permitted. Upon adoption, leases will be recognized and measured at the beginning of the earliest period presented using a modified retrospective approach. The Company is currently evaluating the impact of the adoption of ASU 2016-02 on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). ASU 2016-09 was issued to simplify the accounting for share-based payment awards. The guidance requires that, prospectively, all tax effects related to share-based payments be made through the statement of operations at the time of settlement as opposed to excess tax benefits being recognized in additional paid-in-capital under the current guidance. ASU 2016-09 also removes the requirement to delay recognition of a tax benefit until it reduces current taxes payable. This change is required to be applied on a modified retrospective basis, with a cumulative-effect adjustment to opening accumulated deficit. Additionally, all tax related cash flows resulting from share-based payments are to be reported as operating activities on the statement of cash flows, a change from the current requirement to present tax benefits as an inflow from financing activities and an outflow from operating activities. ASU 2016-09 is effective for annual and interim reporting periods beginning after December 15, 2016. Early adoption is permitted with any adjustments reflected as of the beginning of the fiscal year of adoption. The Company does not believe the adoption of ASU 2016-09 will have a material impact on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments ("ASU 2016-15"). The objective of ASU 2016-15 is to reduce diversity in the classification of cash receipts and payments for specific cash flow issues, including debt prepayment or debt extinguishment costs, contingent consideration payments made after a business combination and proceeds from the settlement of insurance claims. ASU 2016-15 is effective for fiscal years beginning after December 31, 2017, and interim periods within those fiscal years. Early adoption of ASU 2016-15 is permitted. The Company does not believe the adoption of ASU 2016-15 will have a material impact on its consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited)
September 30, 2016

NOTE 5 ACQUISITIONS, DECONSOLIDATIONS AND DISCONTINUED OPERATIONS
(a) Acquisitions
CMC Industries, Inc.:

On July 14, 2016, the Company completed the acquisition of 81% of CMC Industries, Inc. ("CMC") for cash consideration of $1.5 million. The consolidated statements of operations include the earnings of CMC from the date of acquisition. As further discussed in Note 18, "Segmented Information," CMC is included in the Leased Real Estate segment. CMC owns, through an indirect wholly owned subsidiary (the "Property Owner"), a parcel of real property consisting of approximately 192 acres located in the State of Texas (the "Real Property"). The Real Property is leased to a third party pursuant to a long-term triple net lease. The Real Property is also subject to a mortgage in the principal amount of $180.0 million (the "Mortgage") at the date of acquisition. The Mortgage is nonrecourse indebtedness with respect to CMC and its subsidiaries (including the Property Owner), and the Mortgage is not, nor will it be, guaranteed by Kingsway or its affiliates. All cash rental income generated by the Real Property is applied to make principal and interest payments on the Mortgage. The Mortgage is recorded as note payable on the consolidated balance sheets.
The Company intends to finalize by December 31, 2016 its fair value analysis of the assets acquired and liabilities assumed. The assets acquired and liabilities assumed are recorded in the unaudited consolidated interim financial statements at their estimated fair market values. These estimates, allocations and calculations are subject to change as we obtain further information; therefore, the final fair market values of the assets acquired and liabilities assumed may not agree with the estimates included in the unaudited consolidated interim financial statements. The following is an estimated allocation of the assets acquired and liabilities assumed at the date of acquisition:

(in thousands)

	July 14, 2016
Cash and cash equivalents	$1,006
Other receivables	1,963
Property and equipment	86,333
Intangible asset - subject to amortization	109,092
Other assets	1,385
Total assets	$199,779
Note payable	$191,741
Deferred income tax liability	3,086
Income taxes payable	2,056
Accrued expenses and other liabilities	1,097

Noncontrolling interest in CMC	299
Total liabilities and noncontrolling interest	$198,279
Purchase price	$1,500

The consolidated statements of operations include the earnings of CMC from the date of acquisition. From the date of acquisition through September 30, 2016, CMC earned revenue of $2.4 million and net income of $0.2 million. The following unaudited pro forma summary presents the Company's consolidated financial statements for the nine months ended September 30, 2016 and September 30, 2015 as if CMC had been acquired on January 1, 2015. The pro forma summary is presented for illustrative purposes only and does not purport to represent the results of our operations that would have actually occurred had the acquisition occurred on January 1, 2015 or project our results of operations as of any future date or for any future period, as applicable.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited)
September 30, 2016

(in thousands, except per share data)	Nine months ended September 30, 2016	2015
Revenues	$130,464	$130,799
Loss from continuing operations attributable to common shareholders	$(466)	$(8,768)
Basic loss per share - continuing operations	$(0.02)	$(0.44)
Diluted loss per share - continuing operations	$(0.02)	$(0.44)

Argo Management Group LLC:

Effective April 21, 2016, the Company issued 160,000 shares of its common stock to acquire Argo Management Group LLC ("Argo"). The Argo purchase price of $0.7 million was determined using the closing price of Kingsway common stock on the date the 160,000 shares were issued. The consolidated statements of operations include the earnings of Argo from the date of acquisition. No supplemental pro forma revenue and earnings information related to the acquisition has been presented for the nine months ended September 30, 2016 and September 30, 2015, as the impact is immaterial. Argo's primary business is to act as the Managing Member of Argo Holdings Fund I, LLC, an investment fund organized for purposes of making control-oriented equity investments in established lower middle market companies based in North America, with a focus on search fund investments.

This acquisition was accounted for as a business combination using the acquisition method of accounting. The purchase price was allocated to the assets acquired and liabilities assumed based upon their estimated fair values at the date of acquisition. During the second quarter of 2016, the Company completed its fair value analysis on the assets acquired and liabilities assumed. Separately identifiable intangible assets of $0.7 million were recognized resulting from the valuations of contract-based management fee and promote fee revenues. Refer to Note 9, "Intangible Assets," for further disclosure of the intangible assets related to this acquisition.
The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition:
(in thousands)

	April 21, 2016
Cash and cash equivalents	$5
Other receivables	17
Intangible assets - subject to amortization	731
Other assets	5
Total assets	$758

Accrued expenses and other liabilities	$ 14
Total liabilities	$ 14
Purchase price	$ 744

(b) Deconsolidations

1347 Investors LLC:

At June 30, 2016, the Company owned 61.0% of the outstanding units of 1347 Investors LLC ("1347 Investors"). Because the Company owned more than 50% of the outstanding units, 1347 Investors was included in the unaudited consolidated interim financial statements of the Company. 1347 Investors had an investment in the common stock and private units of 1347 Capital Corp. which was reflected in investments in investees in the consolidated balance sheets. 1347 Capital Corp., which completed an initial public offering on July 21, 2014 and which had 24 months from the date of the initial public offering to complete a successful business combination, was formed for the purpose of entering into a merger, share exchange, asset acquisition or other similar business combination with one or more businesses or entities.

On March 23, 2016, 1347 Capital Corp. announced the signing of a definitive agreement with Limbach Holdings LLC ("Limbach"), in which 1347 Capital Corp. would merge with Limbach. On July 21, 2016, Limbach announced the closing of the previously announced merger, and 1347 Capital Corp. was renamed Limbach Holdings, Inc. As a result of this transaction, the Company's ownership percentage in 1347 Investors was reduced to 26.7% at the transaction date, leading the Company to record a non-cash gain of $5.6 million during the third quarter of 2016 related to the deconsolidation of 1347 Investors. This gain results from removing the carrying value of the noncontrolling interest in 1347 Investors and the carrying value of the consolidated net assets of 1347 Investors, which the Company reported prior to the closing of the transaction, and recording the fair value of the Company's 26.7% retained noncontrolling investment in 1347 Investors as of the transaction date. Subsequent to the transaction date, the Company will account for its remaining noncontrolling investment in 1347 Investors under the equity method of accounting.

Kingsway Linked Return of Capital Trust:

On July 14, 2005, Kingsway Linked Return of Capital Trust ("KLROC Trust") completed its public offering of C$78.0 million through the issuance of 3,120,000 LROC 5% preferred units due June 30, 2015 ("LROC preferred units"), of which the Company was a promoter. KLROC Trust’s net proceeds of the public offering was C$74.1 million.

Beginning in 2009, the Company began purchasing LROC preferred units. During 2009, the Company acquired 833,715 LROC preferred units. During the second quarter of 2010, the Company commenced the take-over bid (the "KLROC Offer") to acquire up to 1,500,000 units at a price per unit of C$20.00 in cash. The KLROC Offer expired on July 23, 2010, and 1,525,150 units were tendered, of which 1,500,000 were purchased on a pro-rata basis. The tender was paid for using available cash.

As a result of these acquisitions, the Company beneficially owned and controlled 2,333,715 units, representing 74.8% of the issued and outstanding LROC preferred units and began consolidating the financial statements of KLROC Trust effective July 23, 2010. In the consolidated financial statements, the par value of the units owned was netted against the liability related to the LROC preferred units due June 30, 2015. At December 31, 2014, the Company's outstanding net obligation was C$15.8 million.

During the second quarter of 2015, the Company's controlling interest in KLROC Trust was reduced to zero upon the Company's repayment of its C$15.8 million outstanding on its LROC preferred units due June 30, 2015. As a result, the Company recorded a non-cash loss on deconsolidation of KLROC Trust of $4.4 million during the second quarter of 2015. This reported loss results from removing the net assets and accumulated other comprehensive loss of KLROC Trust from the Company’s consolidated balance sheets.

(c) Discontinued Operations

On April 1, 2015, the Company closed on the sale of its subsidiary, Assigned Risk Solutions Ltd. ("ARS") for $47.0 million in cash. During the second quarter of 2015, the Company received additional post-closing cash consideration of $2.0 million. The terms of the sale also provide for potential receipt by the Company of future earnout payments equal to 1.25% of ARS' written premium and fee income during the earnout periods. The earnout payments are payable in three annual installments beginning in April 2016 through April 2018. During the second quarter of 2016, the Company received cash consideration of $1.4 million, representing the first annual installment earnout payment. Net of expenses, the Company recorded an additional gain on disposal of ARS of $1.1 million for the nine months ended September 30, 2016. As a result of the sale, ARS, previously disclosed as part of the Insurance Services segment, has been classified as a discontinued operation. The earnings of ARS are disclosed as discontinued operations in the unaudited consolidated statements of operations for all periods presented. Summary financial information included in income from discontinued operations, net of taxes for the three and nine months ended September 30, 2016 and September 30, 2015 is presented below:

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited)
September 30, 2016

(in thousands)	Three months ended September 30, 2016	2015	Nine months ended September 30, 2016	2015
Revenues:				
Service fee and commission income	$ —	$ —	$ —	$ 8,342
Other expense	—	—	—	(20)
Total revenues	—	—	—	8,322
Expenses:				
General and administrative expenses	—	—	&	