KINGSWAY FINANCIAL SERVICES INC
Form 10-Q
November 09, 2015

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

---

FORM 10-Q
(Mark One)

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

For Quarterly Period Ended September 30, 2015
or

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

For the Transition Period from _____ to _____

Commission File Number: 001-15204

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

---

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

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

---

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

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

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

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

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

The number of shares outstanding of the registrant's common stock as of November 9, 2015 was 19,709,706.

KINGSWAY FINANCIAL SERVICES INC.

Table Of Contents

KINGSWAY FINANCIAL SERVICES INC.

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

| | September 30, 2015 (unaudited) | December 31, 2014 |
|---|---|---|
| Assets | | |
| Investments: | | |
| Fixed maturities, at fair value (amortized cost of $59,366 and $56,000, respectively) | $59,764 | $56,195 |
| Equity investments, at fair value (cost of $24,666 and $16,579, respectively) | 25,296 | 19,618 |
| Limited liability investments | 15,377 | 7,294 |
| Other investments, at cost which approximates fair value | 4,102 | 3,576 |
| Short-term investments, at cost which approximates fair value | 400 | 400 |
| Total investments | 104,939 | 87,083 |
| Cash and cash equivalents | 75,785 | 71,234 |
| Investment in investee | 1,712 | 2,115 |
| Accrued investment income | 856 | 141 |
| Premiums receivable, net of allowance for doubtful accounts of $258 and $1,889, respectively | 30,052 | 28,885 |
| Service fee receivable, net of allowance for doubtful accounts of $269 and $247, respectively | 1,388 | 964 |
| Other receivables, net of allowance for doubtful accounts of $806 and $806, respectively | 5,815 | 5,145 |
| Reinsurance recoverable | 1,687 | 3,652 |
| Prepaid reinsurance premiums | 49 | 8 |
| Deferred acquisition costs, net | 12,541 | 12,197 |
| Income taxes recoverable | 56 | 74 |
| Property and equipment, net of accumulated depreciation of $12,399 and $15,751, respectively | 5,687 | 5,975 |
| Goodwill | 10,078 | 10,078 |
| Intangible assets, net of accumulated amortization of $5,702 and $4,765, respectively | 15,043 | 15,980 |
| Other assets | 3,180 | 3,638 |
| Assets held for sale | — | 54,553 |
| Total Assets | $268,868 | $301,722 |
| Liabilities and Shareholders' Equity | | |
| Liabilities: | | |
| Unpaid loss and loss adjustment expenses: | | |
| Property and casualty | $55,438 | $63,895 |
| Vehicle service agreements | 2,975 | 2,975 |
| Total unpaid loss and loss adjustment expenses | 58,413 | 66,870 |
| Unearned premiums | 37,752 | 36,432 |
| Reinsurance payable | 452 | 525 |
| LROC preferred units, at fair value | — | 13,618 |

| | | |
|---|---|---|
| Subordinated debt, at fair value | 39,865 | 40,659 |
| Deferred income tax liability | 2,902 | 2,837 |
| Deferred service fees | 34,733 | 35,096 |
| Accrued expenses and other liabilities | 42,823 | 35,836 |
| Liabilities held for sale | — | 21,653 |
| Total Liabilities | 216,940 | 253,526 |
| | | |
| Class A preferred stock, no par value; unlimited number authorized; 262,876 and 262,876 issued and outstanding at September 30, 2015 and December 31, 2014, respectively; redemption amount of $6,572 | 6,386 | 6,330 |
| | | |
| Shareholders' Equity: | | |
| Common stock, no par value; unlimited number authorized; 19,709,706 and 19,709,706 issued and outstanding at September 30, 2015 and December 31, 2014, respectively | — | — |
| Additional paid-in capital | 341,443 | 340,844 |
| Accumulated deficit | (306,655) | (312,050) |
| Accumulated other comprehensive income | 9,090 | 8,670 |
| Shareholders' equity attributable to common shareholders | 43,878 | 37,464 |
| Noncontrolling interests in consolidated subsidiaries | 1,664 | 4,402 |
| Total Shareholders' Equity | 45,542 | 41,866 |
| Total Liabilities and Shareholders' Equity | $268,868 | $301,722 |

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

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

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Revenues: | | | | |
| Net premiums earned | $29,197 | $28,418 | $88,427 | $89,093 |
| Service fee and commission income | 6,184 | 6,949 | 17,430 | 19,040 |
| Net investment income | 791 | 542 | 2,632 | 1,296 |
| Net realized gains | 83 | 329 | 136 | 5,459 |
| Other-than-temporary impairment loss | — | — | (10) | — |
| Other income | 2,303 | 2,369 | 13,174 | 6,929 |
| Total revenues | 38,558 | 38,607 | 121,789 | 121,817 |
| Operating expenses: | | | | |
| Loss and loss adjustment expenses | 22,914 | 22,361 | 69,054 | 65,216 |
| Commissions and premium taxes | 5,653 | 5,738 | 17,199 | 17,823 |
| Cost of services sold | 1,408 | 1,544 | 3,129 | 3,337 |
| General and administrative expenses | 9,997 | 10,206 | 31,748 | 33,196 |
| Amortization of intangible assets | 307 | 397 | 937 | 1,220 |
| Contingent consideration expense | 110 | 267 | 364 | 801 |
| Impairment of asset held for sale | — | — | — | 1,180 |
| Total operating expenses | 40,389 | 40,513 | 122,431 | 122,773 |
| Operating loss | (1,831) | (1,906) | (642) | (956) |
| Other (revenues) expenses, net: | | | | |
| Interest expense | 1,248 | 1,417 | 4,053 | 4,214 |
| Foreign exchange losses, net | 58 | 230 | 1,210 | 271 |
| (Gain) loss on change in fair value of debt | (2,458) | 2,963 | (1,491) | 10,199 |
| Loss on disposal of subsidiary | — | — | — | 1,242 |
| Loss on deconsolidation of subsidiary | — | — | 4,420 | — |
| Equity in net loss of investee | 192 | 83 | 399 | 83 |
| Total other (revenues) expenses, net | (960) | 4,693 | 8,591 | 16,009 |
| Loss from continuing operations before income tax expense (benefit) | (871) | (6,599) | (9,233) | (16,965) |
| Income tax expense (benefit) | 23 | 28 | 79 | (971) |
| Loss from continuing operations | (894) | (6,627) | (9,312) | (15,994) |
| Income from discontinued operations, net of taxes | — | 532 | 1,426 | 3,419 |
| Gain on disposal of discontinued operations, net of taxes | — | — | 11,259 | — |
| Net (loss) income | (894) | (6,095) | 3,373 | (12,575) |
| Less: net (loss) income attributable to noncontrolling interests in consolidated subsidiaries | (86) | 778 | 74 | 873 |
| Less: dividends on preferred stock | 83 | 83 | 246 | 218 |
| Net (loss) income attributable to common shareholders | $(891) | $(6,956) | $3,053 | $(13,666) |
| Loss per share - continuing operations: | | | | |
| Basic: | $(0.05) | $(0.44) | $(0.49) | $(1.03) |

| | | | | |
|---|---|---|---|---|
| Diluted: | $(0.05) | $(0.44) | $(0.49) | $(1.03) |
| Earnings per share - discontinued operations: | | | | |
| Basic: | $— | $0.03 | $0.64 | $0.21 |
| Diluted: | $— | $0.03 | $0.64 | $0.21 |
| (Loss) earnings per share – net (loss) income attributable to common shareholders: | | | | |
| Basic: | $(0.05) | $(0.41) | $0.15 | $(0.82) |
| Diluted: | $(0.05) | $(0.41) | $0.15 | $(0.82) |
| Weighted average shares outstanding (in ‘000s): | | | | |
| Basic: | 19,710 | 16,993 | 19,710 | 16,620 |
| Diluted: | 19,710 | 16,993 | 19,710 | 16,620 |

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.

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

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Net (loss) income | $(894) | $(6,095) | $3,373 | $(12,575) |
| Other comprehensive loss, net of taxes(1): | | | | |
| Unrealized (losses) gains on fixed maturities and equity investments: | | | | |
| Unrealized losses arising during the period | (2,271) | (2,244) | (3,704) | (2,924) |
| Reclassification adjustment for amounts included in net (loss) income | 90 | 187 | 1,554 | 1,526 |
| Foreign currency translation adjustments | — | (22) | 858 | (37) |
| Recognition of currency translation loss on deconsolidation of subsidiary | — | — | 1,243 | — |
| Other comprehensive loss | (2,181) | (2,079) | (49) | (1,435) |
| Comprehensive (loss) income | (3,075) | (8,174) | $3,324 | $(14,010) |
| Less: comprehensive (loss) income attributable to noncontrolling interests in consolidated subsidiaries | (85) | 795 | (395) | 768 |
| Comprehensive (loss) income attributable to common shareholders | $(2,990) | $(8,969) | $3,719 | $(14,778) |

(1) Net of income tax expense (benefit) of $0 and $0 for the three and nine months ended September 30, 2015 and September 30, 2014, respectively.

See accompanying notes to unaudited consolidated financial statements

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

| | Nine months ended September 30, | |
|---|---|---|
| | 2015 | 2014 |
| Cash provided by (used in): | | |
| Operating activities: | | |
| Net income (loss) | $3,373 | $(12,575) |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: | | |
| Gain on disposal of discontinued operations | (11,259) | — |
| Equity in net loss of investee | 399 | 83 |
| Equity in net income of limited liability investments | (1,590) | (201) |
| Depreciation and amortization expense | 1,400 | 1,888 |
| Contingent consideration expense | 364 | 801 |
| Stock based compensation expense, net of forfeitures | 598 | 1,033 |
| Net realized gains | (136) | (5,459) |
| (Gain) loss on change in fair value of debt | (1,491) | 10,199 |
| Deferred income taxes | 66 | 241 |
| Other-than-temporary impairment loss | 10 | — |
| Amortization of fixed maturities premiums and discounts | 245 | 515 |

| | | |
|---|---|---|
| Loss on disposal of subsidiary | — | 1,242 |
| Impairment of asset held for sale | — | 1,180 |
| Changes in operating assets and liabilities: | | |
| Premiums and service fee receivable | (1,591) | 590 |
| Other receivables | (670) | (1,186) |
| Reinsurance recoverable | 1,965 | 6,332 |
| Prepaid reinsurance premiums | (41) | 6,761 |
| Deferred acquisition costs, net | (344) | (71) |
| Income taxes recoverable | 18 | — |
| Unpaid loss and loss adjustment expenses | (8,457) | (16,531) |
| Unearned premiums | 1,320 | (10,181) |
| Reinsurance payable | (73) | (984) |
| Deferred service fees | (363) | 1,181 |
| Other, net | 5,719 | 1,428 |
| Net cash used in operating activities | (10,538) | (13,714) |
| Investing activities: | | |
| Proceeds from sales and maturities of fixed maturities | 23,302 | 21,722 |
| Proceeds from sales of equity investments | 617 | 6,761 |
| Purchases of fixed maturities | (25,788) | (21,293) |
| Purchases of equity investments | (7,666) | (10,180) |
| Net acquisition of limited liability investments | (6,604) | (1,159) |
| Net (purchases of) proceeds from other investments | (600) | 1,000 |
| Net proceeds from (purchases of) short-term investments | 4 | (103) |
| Net proceeds from sale of discontinued operations | 44,919 | — |
| Net purchases of property and equipment | (175) | (1,565) |
| Net cash provided by (used in) investing activities | 28,009 | (4,817) |
| Financing activities: | | |
| Proceeds from issuance of preferred stock, net | — | 6,330 |
| Proceeds from issuance of warrants | — | 14,760 |
| Redemption of LROC preferred units | (12,920) | — |
| Redemption of senior unsecured debentures | — | (14,356) |
| Net cash (used in) provided by financing activities | (12,920) | 6,734 |
| Net increase (decrease) in cash and cash equivalents | 4,551 | (11,797) |
| Cash and cash equivalents at beginning of period | 71,234 | 97,505 |
| Cash and cash equivalents at end of period | $75,785 | $85,708 |

See accompanying notes to unaudited consolidated financial statements.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 1 BUSINESS

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

NOTE 2 BASIS OF PRESENTATION

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

The accompanying unaudited consolidated interim financial statements and footnotes should be read in conjunction with the audited consolidated financial statements and footnotes included within our Annual Report on Form 10-K ("2014 Annual Report") for the year ended December 31, 2014.

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

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

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

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

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Derivative financial instruments

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

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

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 4 RECENTLY ISSUED ACCOUNTING STANDARDS

(a) Adoption of New Accounting Standards:

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

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

(b) Accounting Standards Not Yet Adopted:

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle of ASU 2014-09 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for reporting periods beginning after December 15, 2017 and early adoption permitted. Insurance contracts are not within the scope of ASU 2014-09, therefore this standard would not apply to the Company's Insurance Underwriting segment. The Company is currently evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements.

In January 2015, the FASB issued ASU 2015-02, 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. ASU 2015-02 is effective for fiscal years beginning after December 15, 2015 and interim periods within those years with early adoption being permissible. The Company is currently evaluating the impact of the adoption of ASU 2015-02 on its consolidated financial statements.

In May 2015, the FASB issued ASU 2015-09, Financial Services - Insurance ("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, 2015

NOTE 5 DISPOSITION, DECONSOLIDATION AND DISCONTINUED OPERATIONS

(a) Disposition

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

During the second quarter of 2014, PIH announced the closing and settlement of an underwritten public offering of 2,875,000 shares of its common stock at a price to the public of $8.00 per share. As a result of the issuance of additional shares of common stock, the Company's approximate voting percentage in PIH was reduced to 15.7% at June 30, 2014. As a result of this change in ownership and other qualitative factors, the Company determined that its investment in the common stock of PIH no longer qualified for the equity method of accounting. During the fourth quarter of 2014, the Company purchased additional shares of PIH which increased the Company's approximate voting percentage in PIH to 16.9% at December 31, 2014. The Company's investment in PIH common stock is included in equity investments and reported at its estimated fair value of $7.8 million in the consolidated balance sheet at September 30, 2015.

(b) Deconsolidation

On July 14, 2005, Kingsway Linked Return of Capital Trust ("KLROC Trust") completed its public offering of C$78.0 million 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 for the nine months ended September 30, 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. The deconsolidation reduced consolidated shareholders’ equity by $2.8 million at June 30, 2015.

(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 future earnout payments to the Company 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. 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 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, 2015 and 2014 is presented below:

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Revenues: | | | | |
| Service fee and commission income | $— | $7,153 | $8,342 | $23,712 |
| Other income (expense) | — | 3 | (20) | 24 |
| Total revenues | — | 7,156 | 8,322 | 23,736 |
| Expenses: | | | | |
| General and administrative expenses | — | 6,309 | 6,462 | 19,435 |
| Income from discontinued operations before income tax expense | — | 847 | 1,860 | 4,301 |
| Income tax expense | — | 315 | 434 | 882 |
| Income from discontinued operations, net of taxes | — | 532 | 1,426 | 3,419 |
| Gain on disposal of discontinued operations before income tax benefit | — | — | 11,010 | — |
| Income tax benefit | — | — | (249) | — |
| Gain on disposal of discontinued operations, net of taxes | — | — | 11,259 | — |
| Total gain from discontinued operations, net of taxes | $— | $532 | $12,685 | $3,419 |

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

| (in thousands) | December 31, 2014 |
|---|---|
| Assets | |
| Cash and cash equivalents | $2,792 |
| Service fee receivable | 19,006 |
| Other receivables | 257 |
| Income taxes recoverable | 150 |
| Property and equipment, net of accumulated depreciation | 193 |
| Goodwill | 510 |
| Intangible assets, net of accumulated amortization | 31,318 |
| Other assets | 327 |
| Assets held for sale | $54,553 |
| Liabilities | |
| Deferred income tax liability | $2,550 |
| Deferred service fees | 14,358 |
| Accrued expenses and other liabilities | 4,745 |
| Liabilities held for sale | $21,653 |

For the nine months ended September 30, 2015 and September 30, 2014, ARS' net cash provided by operating activities was $0.0 million and $0.5 million, respectively. ARS had no cash flows from investing activities for the nine months ended September 30, 2015 and September 30, 2014.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 6 INVESTMENTS

The amortized cost, gross unrealized gains and losses, and estimated fair value of the Company's investments in fixed maturities and equity investments at September 30, 2015 and December 31, 2014 are summarized in the tables shown below:

| (in thousands) | September 30, 2015 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Fixed maturities: | | | | |
| U.S. government, government agencies and authorities | $20,490 | $203 | $— | $20,693 |
| States, municipalities and political subdivisions | 2,917 | 37 | — | 2,954 |
| Mortgage-backed | 8,583 | 85 | 11 | 8,657 |
| Asset-backed securities and collateralized mortgage obligations | 7,599 | 20 | 2 | 7,617 |
| Corporate | 19,777 | 78 | 12 | 19,843 |
| Total fixed maturities | 59,366 | 423 | 25 | 59,764 |
| Equity investments: | | | | |
| Common stock | 23,460 | 3,042 | 2,330 | 24,172 |
| Warrants | 1,206 | 99 | 181 | 1,124 |
| Total equity investments | 24,666 | 3,141 | 2,511 | 25,296 |
| Total fixed maturities and equity investments | $84,032 | $3,564 | $2,536 | $85,060 |

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

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

The table below summarizes the Company's fixed maturities at September 30, 2015 by contractual maturity periods. Actual results may differ as issuers may have the right to call or prepay obligations, with or without penalties, prior to the contractual maturity of these obligations.

| (in thousands) | September 30, 2015 | |
|---|---|---|
| | Amortized Cost | Estimated Fair Value |
| Due in one year or less | $10,642 | $10,803 |
| Due after one year through five years | 37,897 | 38,047 |
| Due after five years through ten years | 2,151 | 2,165 |
| Due after ten years | 8,676 | 8,749 |
| Total | $59,366 | $59,764 |

The following tables highlight the aggregate unrealized loss position, by security type, of fixed maturities and equity investments in unrealized loss positions as of September 30, 2015 and December 31, 2014. The tables segregate the holdings based on the period of time the investments have been continuously held in unrealized loss positions.

| (in thousands) | | | | | September 30, 2015 | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | Greater than 12 Months | | Total | |
| | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss |
| Fixed maturities: | | | | | | |
| U.S. government, government agencies and authorities | $500 | $— | $— | $— | $500 | $— |
| Mortgage-backed | 2,597 | 11 | — | — | 2,597 | 11 |
| Asset-backed securities and collateralized mortgage obligations | 2,571 | 2 | — | — | 2,571 | 2 |
| Corporate | 4,512 | 12 | — | — | 4,512 | 12 |
| Total fixed maturities | 10,180 | 25 | — | — | 10,180 | 25 |
| Equity investments: | | | | | | |
| Common stock | 15,898 | 2,330 | — | — | 15,898 | 2,330 |
| Warrants | 904 | 181 | — | — | 904 | 181 |
| Total equity investments | 16,802 | 2,511 | — | — | 16,802 | 2,511 |
| Total | $26,982 | $2,536 | $— | $— | $26,982 | $2,536 |

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

| (in thousands) | | | | | December 31, 2014 | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | Greater than 12 Months | | Total | |
| | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss | Estimated Fair Value | Unrealized Loss |
| Fixed maturities: | | | | | | |
| U.S. government, government agencies and authorities | $12,784 | $10 | $473 | $— | $13,257 | $10 |
| Canadian government | — | — | 4,242 | 277 | 4,242 | 277 |
| States, municipalities and political subdivisions | 250 | — | — | — | 250 | — |
| Mortgage-backed | 2,816 | 15 | — | — | 2,816 | 15 |
| Asset-backed securities and collateralized mortgage obligations | 5,097 | 10 | — | — | 5,097 | 10 |
| Corporate | 6,226 | 20 | — | 10 | 6,226 | 30 |
| Total fixed maturities | 27,173 | 55 | 4,715 | 287 | 31,888 | 342 |
| Equity investments: | | | | | | |
| Common stock | 4,164 | 284 | — | — | 4,164 | 284 |
| Warrants | 92 | 37 | — | — | 92 | 37 |
| Total equity investments | 4,256 | 321 | — | — | 4,256 | 321 |
| Total | $31,429 | $376 | $4,715 | $287 | $36,144 | $663 |

Fixed maturities and equity investments contain approximately 58 and 71 individual investments that were in unrealized loss positions as of September 30, 2015 and December 31, 2014, respectively.

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

- identifying all unrealized loss positions that have existed for at least six months;
- identifying other circumstances which management believes may impact the recoverability of the unrealized loss positions;
- obtaining a valuation analysis from third-party investment managers regarding the intrinsic value of these investments based on their knowledge and experience together with market-based valuation techniques;
- reviewing the trading range of certain investments over the preceding calendar period;
- assessing if declines in market value are other-than-temporary for debt instruments based on the investment grade credit ratings from third-party rating agencies;
- assessing if declines in market value are other-than-temporary for any debt instrument with a non-investment grade credit rating based on the continuity of its debt service record;
- determining the necessary provision for declines in market value that are considered other-than-temporary based on the analyses performed; and
- assessing the Company's ability and intent to hold these investments at least until the investment impairment is recovered.

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

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

the debt service pattern of non-investment grade instruments may not reflect future debt service capabilities and may not reflect a company's unknown underlying financial problems.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

As a result of the analysis performed by the Company to determine declines in market value that are other-than-temporary, there were no write-downs for other-than-temporary impairments recorded for the three months ended September 30, 2015 and September 30, 2014, respectively, and for the nine months ended September 30, 2014. For the nine months ended September 30, 2015, the Company recorded a write-down of $0.0 million for other-than-temporary impairment related to fixed maturities.

There were $0.0 million of other-than-temporary losses recognized in other comprehensive loss for the nine months ended September 30, 2015. There were no other-than-temporary losses recognized in other comprehensive loss for the three months ended September 30, 2015 and September 30, 2014, respectively, or for the nine months ended September 30, 2014.

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

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

Limited liability investments include investments in limited liability companies and limited partnerships that primarily invest in income-producing real estate or real estate related investments. The Company's interests in these investments are not deemed minor and, therefore, are accounted for under the equity method of accounting. As of September 30, 2015 and December 31, 2014, the carrying value of limited liability investments totaled $15.4 million and $7.3 million, respectively. At September 30, 2015, the Company has unfunded commitments totaling $2.4 million to fund limited liability investments. Income from limited liability investments is recognized based on the Company's share of the earnings of the limited liability entities and is included in net investment income.

Other investments include mortgage and collateral loans and are reported at their unpaid principal balance. As of September 30, 2015 and December 31, 2014, the carrying value of other investments totaled $4.1 million and $3.6 million, respectively.

Gross realized gains and losses on fixed maturities, equity investments and limited liability investments for the three and nine months ended September 30, 2015 and September 30, 2014 were as follows:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Gross realized gains | $84 | $330 | $137 | $5,469 |
| Gross realized losses | (1) | (1) | (1) | (10) |
| Net realized gains | $83 | $329 | $136 | $5,459 |

Net investment income for the three and nine months ended September 30, 2015 and September 30, 2014, respectively, is comprised as follows:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Investment income | | | | |
| Interest from fixed maturities | $255 | $284 | $648 | $827 |
| Dividends | 169 | 67 | 517 | 153 |
| Income from limited liability investments | 595 | 176 | 1,590 | 201 |
| Loss on change in fair value of warrants | (222) | — | (57) | — |
| Other | 40 | 29 | 106 | 257 |
| Gross investment income | 837 | 556 | 2,804 | 1,438 |
| Investment expenses | (46) | (14) | (172) | (142) |
| Net investment income | $791 | $542 | $2,632 | $1,296 |

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

At September 30, 2015, fixed maturities and short-term investments with an estimated fair value of $13.0 million were on deposit with state and provincial regulatory authorities. Also, from time to time, the Company pledges investments to third-parties to collateralize liabilities incurred under its policies of insurance. At September 30, 2015, the amount of such pledged securities was $17.0 million.

NOTE 7 INVESTMENT IN INVESTEE

Investment in investee includes the Company's investment in the common stock and private units of 1347 Capital Corp. and is accounted for under the equity method. 1347 Capital Corp. was formed for the purpose of entering into a merger, share exchange, asset acquisition or other similar business combination with one or more businesses or entities. The carrying value, estimated fair value and approximate equity percentage for the Company's investment in 1347 Capital Corp. at September 30, 2015 and December 31, 2014 were as follows:

(in thousands, except for percentages)

| | September 30, 2015 | | | December 31, 2014 | | |
|---|---|---|---|---|---|---|
| | Equity Percentage | Estimated Fair Value | Carrying Value | Equity Percentage | Estimated Fair Value | Carrying value |
| 1347 Capital Corp. | 21.0 % | $12,353 | $1,712 | 22.7 % | $13,038 | $2,115 |

Equity in net loss of investee was $0.2 million and $0.1 million for the three months ended September 30, 2015 and September 30, 2014, respectively ($0.4 million and $0.1 million for the nine months ended September 30, 2015 and September 30, 2014, respectively).

NOTE 8 DEFERRED ACQUISITION COSTS

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

The components of deferred acquisition costs and the related amortization expense for the three and nine months ended September 30, 2015 and 2014, respectively, are comprised as follows:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Beginning balance, net | $12,617 | $12,625 | $12,197 | $12,392 |
| Additions | 5,843 | 6,632 | 19,561 | 20,733 |
| Amortization | (5,919) | (6,794) | (19,217) | (19,619) |
| Acquisition costs disposed of during the year related to PIH | — | — | — | (1,043) |
| Balance at September 30, net | $12,541 | $12,463 | $12,541 | $12,463 |

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 9 INTANGIBLE ASSETS

Intangible assets are comprised as follows:

| (in thousands) | September 30, 2015 | | |
|---|---|---|---|
| | Gross Carrying Value | Accumulated Amortization | Net Carrying Value |
| Intangible assets subject to amortization | | | |
| Database | $4,918 | $1,414 | $3,504 |
| Vehicle service agreements in-force | 3,680 | 3,265 | 415 |
| Customer-related relationships | 3,611 | 958 | 2,653 |
| Non-compete agreement | 70 | 65 | 5 |
| Intangible assets not subject to amortization | | | |
| Insurance licenses | 7,803 | — | 7,803 |
| Trade name | 663 | — | 663 |
| Total | $20,745 | $5,702 | $15,043 |

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

The Company's intangible assets with definite useful lives are amortized either based on the pattern in which the economic benefits of the intangible asset are expected to be consumed or using the straight-line method over their estimated useful lives, which range from three to fifteen years. Amortization of intangible assets was $0.3 million and $0.4 million for the three months ended September 30, 2015 and September 30, 2014, respectively ($0.9 million and $1.2 million for the nine months ended September 30, 2015 and September 30, 2014, respectively). The insurance licenses and trade name intangible assets have indefinite useful lives and are not amortized.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 10 UNPAID LOSS AND LOSS ADJUSTMENT EXPENSES

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

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

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

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

(a) Property and Casualty

The results of this comparison and the changes in the provision for property and casualty unpaid loss and loss adjustment expenses, net of amounts recoverable from reinsurers, as of September 30, 2015 and September 30, 2014 were as follows:

| (in thousands) | September 30, 2015 | September 30, 2014 |
|---|---|---|
| Balance at beginning of period, gross | $63,895 | $84,534 |
| Less reinsurance recoverable related to property and casualty unpaid loss and loss adjustment expenses | 3,203 | 7,942 |
| Balance at beginning of period, net | 60,692 | 76,592 |
| Incurred related to: | | |
| Current year | 64,893 | 61,177 |
| Prior years | (299) | (1,151) |
| Paid related to: | | |
| Current year | (37,378) | (35,172) |
| Prior years | (33,993) | (36,219) |
| Disposal of unpaid loss and loss adjustment expenses related to PIH | — | (405) |
| Balance at end of period, net | 53,915 | 64,822 |
| Plus reinsurance recoverable related to property and casualty unpaid loss and loss adjustment expenses | 1,523 | 3,334 |
| Balance at end of period, gross | $55,438 | $68,156 |

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

(b) Vehicle Service Agreements
The results of the comparison and the changes in the provision for vehicle service agreement unpaid loss and loss adjustment expenses as of September 30, 2015 and September 30, 2014 were as follows:

| (in thousands) | September 30, 2015 | September 30, 2014 |
|---|---|---|
| Balance at beginning of period | $2,975 | $3,128 |
| Incurred related to: | | |
| Current year | 4,460 | 5,190 |
| Prior years | — | — |
| Paid related to: | | |
| Current year | (4,350) | (5,282) |
| Prior years | (110) | (61) |
| Balance at end of period | $2,975 | $2,975 |

NOTE 11 DEBT
Debt consists of the following instruments:

| (in thousands) | September 30, 2015 | | December 31, 2014 | |
|---|---|---|---|---|
| | Principal | Fair Value | Principal | Fair Value |
| LROC preferred units due 2015 | $— | $— | $13,618 | $13,618 |
| Subordinated debt | 90,500 | 39,865 | 90,500 | 40,659 |
| Total | $90,500 | $39,865 | $104,118 | $54,277 |

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

| Issuer | Principal | Issue date | Interest | Redemption date |
|---|---|---|---|---|
| Kingsway CT Statutory Trust I | $15,000 | 12/4/2002 | annual interest rate equal to LIBOR, plus 4.00% payable quarterly | 12/4/2032 |
| Kingsway CT Statutory Trust II | $17,500 | 5/15/2003 | annual interest rate equal to LIBOR, plus 4.10% payable quarterly | 5/15/2033 |
| Kingsway CT Statutory Trust III | $20,000 | 10/29/2003 | annual interest rate equal to LIBOR, plus 3.95% payable quarterly | 10/29/2033 |
| Kingsway DE Statutory Trust III | $15,000 | 5/22/2003 | annual interest rate equal to LIBOR, plus 4.20% payable quarterly | 5/22/2033 |
| Kingsway DE Statutory Trust IV | $10,000 | 9/30/2003 | annual interest rate equal to LIBOR, plus 3.85% payable quarterly | 9/30/2033 |
| Kingsway DE Statutory Trust VI | $13,000 | 1/8/2004 | annual interest rate equal to LIBOR, plus 4.00% payable quarterly | 1/8/2034 |

During the first quarter of 2011, the Company gave notice to its Trust Preferred trustees of its intention to exercise its voluntary right to defer interest payments for up to 20 quarters, pursuant to the contractual terms of its outstanding Trust Preferred indentures, which permit interest deferral. This action does not constitute a default under the Company's Trust Preferred indentures or any of its other debt indentures. At September 30, 2015 and December 31, 2014, deferred interest payable of $21.1 million and $17.4 million, respectively, is included in accrued expenses and other liabilities in the consolidated balance sheets. On November 6, 2015, the Company paid $22.1 million to its Trust Preferred trustees to be used by the trustees to pay the interest which the Company has been deferring since the first quarter of 2011.
During the second quarter of 2015, the Company repaid its C$15.8 million outstanding on its LROC preferred units due June 30, 2015.

During the first quarter of 2014, the Company repaid the $14.4 million remaining amount outstanding on its senior unsecured debentures due February 1, 2014. No debt repurchases were made during the three and nine months ended September 30, 2015 and September 30, 2014.

NOTE 12 FINANCE LEASE OBLIGATION LIABILITY
On October 2, 2014, the Company completed a sale and leaseback transaction involving building and land located in Miami, Florida, which was previously recorded as asset held for sale. The transaction did not qualify for sales recognition and was accounted for as a financing due to the Company's continuing involvement with the property as a result of nonrecourse financing provided to the buyer in the form of prepaid rent. A finance lease obligation liability equal to the selling price of the property was established at the date of the transaction. During the five-year lease term, the Company will record interest expense on the finance lease obligation at its incremental borrowing rate and will increase the finance lease obligation liability by the same amount. At the end of the lease term, the Company will no longer have continuing involvement with the property and will then recognize the sale of the property as well as the gain that will result from removing the net book value of the land and building and finance lease obligation liability from the consolidated balance sheets. At September 30, 2015 and December 31, 2014, finance lease obligation liability of $4.9 million and $4.7 million, respectively, is included in accrued expenses and other liabilities in the consolidated balance sheets.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 13 INCOME TAXES

Income tax expense (benefit) for the three and nine months ended September 30, 2015 and September 30, 2014, respectively, varies from the amount that would result by applying the applicable United States corporate income tax rate of 34% to loss from continuing operations before income tax expense (benefit). The following table summarizes the differences:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Income tax benefit at United States statutory income tax rate | $(296) | $(2,244) | $(3,139) | $(5,768) |
| Valuation allowance | 128 | 2,387 | 661 | 6,005 |
| Deconsolidation of subsidiary | (7) | — | 2,384 | — |
| Change in unrecognized tax benefits | — | — | — | (1,024) |
| Non-taxable dividend income | — | (414) | (415) | (1,244) |
| Foreign operations subject to different tax rates | 31 | 127 | 186 | 399 |
| State income tax (net of federal tax benefit) | — | 4 | 8 | 215 |
| Disposition of subsidiary | — | — | — | 422 |
| Prior year tax | — | — | — | (341) |
| Other | 167 | 168 | 394 | 365 |
| Income tax expense (benefit) | $23 | $28 | $79 | $(971) |

The Company maintains a valuation allowance for its gross deferred tax assets at September 30, 2015 and December 31, 2014. The Company's operations have generated substantial operating losses during the last several years. These losses can be available to reduce income taxes that might otherwise be incurred on future taxable income. The Company's operations, however, remain challenged and, as a result, it is uncertain whether the Company will generate the taxable income necessary to utilize these losses or other reversing temporary differences. This uncertainty has caused management to place a full valuation allowance on its September 30, 2015 and December 31, 2014 net deferred tax asset. The Company carries a deferred income tax liability of $2.9 million and $2.8 million at September 30, 2015 and December 31, 2014, respectively, all of which relates to indefinite life intangible assets.

As of September 30, 2015, the Company had no unrecognized tax benefits. The Company analyzed its tax positions in accordance with the provisions of ASC Topic 740, Income Taxes, and has determined that there are currently no uncertain tax positions. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 14 LOSS FROM CONTINUING OPERATIONS PER SHARE

The following table sets forth the reconciliation of numerators and denominators for the basic and diluted loss from continuing operations per share computation for the three and nine months ended September 30, 2015 and September 30, 2014:

| (in thousands, except per share data) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Numerator: | | | | |
| Loss from continuing operations | $(894) | $(6,627) | $(9,312) | $(15,994) |
| Plus (less): net loss (income) attributable to noncontrolling interests | 86 | (778) | (74) | (873) |
| Less: dividends on preferred stock | (83) | (83) | (246) | (218) |
| Loss from continuing operations attributable to common shareholders | $(891) | $(7,488) | $(9,632) | $(17,085) |
| Denominator: | | | | |
| Weighted average basic shares | | | | |
| Weighted average common shares outstanding | 19,710 | 16,993 | 19,710 | 16,620 |
| Weighted average diluted shares | | | | |
| Weighted average common shares outstanding | 19,710 | 16,993 | 19,710 | 16,620 |
| Effect of potentially dilutive securities | — | — | — | — |
| Total weighted average diluted shares | 19,710 | 16,993 | 19,710 | 16,620 |
| Basic loss from continuing operations per common share | $(0.05) | $(0.44) | $(0.49) | $(1.03) |
| Diluted loss from continuing operations per common share | $(0.05) | $(0.44) | $(0.49) | $(1.03) |

Loss from continuing operations per share is based on the weighted-average number of shares outstanding. Diluted weighted-average shares is calculated by adjusting basic weighted-average shares outstanding by all potentially dilutive securities. Potentially dilutive securities consist of stock options, unvested restricted stock awards, warrants and convertible preferred stock. Since the Company is reporting a loss from continuing operations for the three and nine months ended September 30, 2015 and September 30, 2014, all potentially dilutive securities outstanding were excluded from the calculation of diluted loss from continuing operations per share since their inclusion would have been anti-dilutive.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 15 STOCK-BASED COMPENSATION
(a) Stock Options
The following table summarizes the stock option activity during the nine months ended September 30, 2015:
(in thousands, except for share data)

| | Number of Options Outstanding | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (in Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at December 31, 2014 | 611,875 | $ 4.50 | 3.2 | $642 |
| Granted | — | $ — | | |
| Expired | — | $ — | | |
| Outstanding at September 30, 2015 | 611,875 | $ 4.50 | 2.5 | $73 |
| Exercisable at September 30, 2015 | 611,875 | $ 4.50 | 2.5 | $73 |

The aggregate intrinsic value of stock options outstanding and exercisable is the difference between the September 30, 2015 market price for the Company's common shares and the exercise price of the options, multiplied by the number of options where the fair value exceeds the exercise price.
The Company uses the Black-Scholes option pricing model to estimate the fair value of each option on the date of grant. No options were granted during the nine months ended September 30, 2015.
(b) Restricted Stock Awards
Under the 2013 Equity Incentive Plan, the Company made grants of restricted common stock ("Restricted Stock") to certain officers of the Company. The Restricted Stock vests after a ten-year period and is subject to the officer's continued employment through the vesting date. The Restricted Stock is amortized on a straight-line basis over the ten-year requisite service period. Total unamortized compensation expense related to unvested awards at September 30, 2015 was $6.9 million. The grant-date fair value of the Restricted Stock was determined using the closing price of Kingsway common stock on the date of grant. The following table summarizes the activity related to unvested Restricted Stock for the nine months ended September 30, 2015:
(in thousands, except for share data)

| | Restricted Stock Awards | Weighted-Average Grant Date Fair Value (per Share) |
|---|---|---|
| Unvested at December 31, 2014 | 1,972,345 | $4.14 |
| Granted | — | — |
| Forfeited | (19,680) | 4.14 |
| Unvested at September 30, 2015 | 1,952,665 | $4.14 |

Total stock-based compensation expense, net of forfeitures was $0.2 million and $0.2 million for the three months ended September 30, 2015 and September 30, 2014, respectively ($0.6 million and $1.0 million for the nine months ended September 30, 2015 and September 30, 2014, respectively).

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 16 SHAREHOLDERS' EQUITY

On February 3, 2014, the Company closed on its private placement totaling $6.6 million. At closing, the Company received gross proceeds of $6.6 million, resulting from the sale and issuance of 262,876 units for a purchase price of $25.00 per unit. Net proceeds to the Company were $6.3 million after deducting expenses.

Each unit consists of one class A convertible preferred share, series 1 (the "Preferred Shares"), and 6.25 common share class C purchase warrants. Each Preferred Share is convertible into 6.25 common shares at a conversion price of $4.00 per common share any time at the option of the holder prior to April 1, 2021. The maximum number of common shares issuable upon conversion of the Preferred Shares is 1,642,975 common shares. Each warrant will entitle the subscriber to purchase one common share of Kingsway at a price of $5.00 per common share at any time after September 16, 2016 and prior to expiry on September 15, 2023.

The Preferred Shares are not entitled to vote. The holders of the Preferred Shares are entitled to receive fixed, cumulative, preferential cash dividends at a rate of $1.25 per Preferred Share per year. The cash dividend rate shall be revised to $1.875 per Preferred Share per year if the dividend accumulates for a period greater than 30 consecutive months from the date of the most recent dividend payment. On and after February 3, 2016, the Company may redeem all or any part of the then outstanding Preferred Shares for the price of $28.75 per Preferred Share, plus accrued but unpaid dividends thereon, whether or not declared, up to and including the date specified for redemption. The Company will redeem any Preferred Shares not previously converted into common shares, and which remain outstanding on April 1, 2021, for the price of $25.00 per Preferred Share, plus accrued but unpaid dividends, whether or not declared, up to and including the date specified for redemption. At September 30, 2015 and December 31, 2014, accrued dividends of $0.5 million and $0.3 million were included in accrued expenses and other liabilities in the consolidated balance sheets.

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

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

On August 18, 2014, the Company announced its intention to redeem its outstanding series A warrants, which were issued pursuant to the Company's 2013 rights offering. Holders of series A warrants could exercise their outstanding series A warrants at $4.50 per common share. Any series A warrants that remained unexercised after September 19, 2014 were automatically redeemed by the Company at the redemption price of $0.25 per series A warrant. During the nine months ended September 30, 2014, series A warrants to purchase 3,279,945 shares of common stock were exercised, resulting in cash proceeds of $14.8 million. The 845 series A warrants that remained unexercised were redeemed by the Company at the redemption price of $0.25.

NOTE 17 ACCUMULATED OTHER COMPREHENSIVE INCOME

The table below details the change in the balance of each component of accumulated other comprehensive income, net of tax, for the three and nine months ended September 30, 2015 and September 30, 2014 as relates to shareholders' equity attributable to common shareholders on the consolidated balance sheets. On the other hand, the unaudited consolidated statements of comprehensive (loss) income present the components of other comprehensive loss, net of tax, only for the three and nine months ended September 30, 2015 and September 30, 2014 and inclusive of the components attributable to noncontrolling interests in consolidated subsidiaries.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

| (in thousands) | Three months ended September 30, 2015 | | |
|---|---|---|---|
| | Unrealized Gains (Losses) on Fixed Maturities and Equity Investments | Foreign Currency Translation Adjustments | Total Accumulated Other Comprehensive Income |
| Balance at July 1, 2015 | $14,686 | $(3,415) | $11,271 |
| Other comprehensive loss before reclassifications | (2,271) | — | (2,271) |
| Amounts reclassified from accumulated other comprehensive income | 90 | — | 90 |
| Net current-period other comprehensive loss | (2,181) | — | (2,181) |
| Balance at September 30, 2015 | $12,505 | $(3,415) | $9,090 |

| (in thousands) | Three months ended September 30, 2014 | | |
|---|---|---|---|
| | Unrealized Gains (Losses) on Fixed Maturities and Equity Investments | Foreign Currency Translation Adjustments | Total Accumulated Other Comprehensive Income |
| Balance at July 1, 2014 | $16,301 | $(5,935) | $10,366 |
| Other comprehensive loss before reclassifications | (2,231) | (22) | (2,253) |
| Amounts reclassified from accumulated other comprehensive income | 187 | — | 187 |
| Net current-period other comprehensive loss | (2,044) | (22) | (2,066) |
| Balance at September 30, 2014 | $14,257 | $(5,957) | $8,300 |

| (in thousands) | Nine months ended September 30, 2015 | | |
|---|---|---|---|
| | Unrealized Gains (Losses) on Fixed Maturities and Equity Investments | Foreign Currency Translation Adjustments | Total Accumulated Other Comprehensive Income |
| Balance at January 1, 2015 | $14,622 | $(5,952) | $8,670 |
| Other comprehensive (loss) income before reclassifications | (3,447) | 1,294 | (2,153) |
| Amounts reclassified from accumulated other comprehensive income | 1,330 | 1,243 | 2,573 |
| Net current-period other comprehensive (loss) income | (2,117) | 2,537 | 420 |
| Balance at September 30, 2015 | $12,505 | $(3,415) | $9,090 |

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

| (in thousands) | Nine months ended September 30, 2014 | | |
|---|---|---|---|
| | Unrealized Gains (Losses) on Fixed Maturities and Equity Investments | Foreign Currency Translation Adjustments | Total Accumulated Other Comprehensive Income |
| Balance at January 1, 2014 | $15,583 | $(5,982) | $9,601 |
| Other comprehensive (loss) income before reclassifications | (2,852) | 25 | (2,827) |
| Amounts reclassified from accumulated other comprehensive income | 1,526 | — | 1,526 |
| Net current-period other comprehensive (loss) income | (1,326) | 25 | (1,301) |
| Balance at September 30, 2014 | $14,257 | $(5,957) | $8,300 |

Components of accumulated other comprehensive income were reclassified to the following lines of the unaudited consolidated statements of operations for the three and nine months ended September 30, 2015 and September 30, 2014:

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Reclassification of accumulated other comprehensive income from unrealized gains (losses) on fixed maturities and equity investments to: | | | | |
| Net realized gains | $(90) | $(187) | $(1,320) | $(1,526) |
| Other-than-temporary impairment loss | — | — | (10) | — |
| Loss from continuing operations before income tax expense (benefit) | (90) | (187) | (1,330) | (1,526) |
| Income tax expense (benefit) | — | — | — | — |
| Net (loss) income | (90) | (187) | (1,330) | (1,526) |
| Reclassification of accumulated other comprehensive income from foreign currency translation adjustments to: | | | | |
| Loss on deconsolidation of subsidiary | — | — | (1,243) | — |
| Loss from continuing operations before income tax expense (benefit) | — | — | (1,243) | — |
| Income tax expense (benefit) | — | — | — | — |
| Net (loss) income | — | — | (1,243) | — |
| Total reclassification from accumulated other comprehensive income to net (loss) income | $(90) | $(187) | $(2,573) | $(1,526) |

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 18 SEGMENTED INFORMATION

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

Insurance Underwriting Segment

Insurance Underwriting includes the following subsidiaries of the Company: Mendota Insurance Company, Mendakota Insurance Company, Mendakota Casualty Company (formerly Universal Casualty Company) ("MCC"), Kingsway Amigo Insurance Company ("Amigo") and Kingsway Reinsurance Corporation (collectively, "Insurance Underwriting"). Insurance Underwriting principally offers personal automobile insurance to drivers who do not meet the criteria for coverage by standard automobile insurers. Insurance Underwriting has policyholders in 13 states; however, new business is accepted in only nine states.

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

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

Insurance Services Segment

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

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

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

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

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

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

Revenues by reportable segment reconciled to consolidated revenues for the three and nine months ended September 30, 2015 and 2014 were:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Revenues: | | | | |
| Insurance Underwriting: | | | | |
| Net premiums earned | $29,197 | $28,418 | $88,427 | $84,979 |
| Other income | 2,162 | 2,131 | 6,763 | 6,378 |
| Total Insurance Underwriting | 31,359 | 30,549 | 95,190 | 91,357 |
| Insurance Services: | | | | |
| Service fee and commission income | 6,184 | 6,949 | 17,430 | 19,040 |
| Other income | 95 | 115 | 299 | 285 |
| Total Insurance Services | 6,279 | 7,064 | 17,729 | 19,325 |
| Total segment revenues | 37,638 | 37,613 | 112,919 | 110,682 |
| Net premiums earned not allocated to segments | — | — | — | 4,114 |
| Net investment income | 791 | 542 | 2,632 | 1,296 |
| Net realized gains | 83 | 329 | 136 | 5,459 |
| Other-than-temporary impairment loss | — | — | (10) | — |
| Other income not allocated to segments | 46 | 123 | 6,112 | 266 |
| Total revenues | $38,558 | $38,607 | $121,789 | $121,817 |

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

The operating (loss) income of each segment in the following table is before income taxes and includes revenues and direct segment costs.
Segment operating (loss) income reconciled to the consolidated loss from continuing operations for the three and nine months ended September 30, 2015 and 2014 were:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Segment operating (loss) income | | | | |
| Insurance Underwriting | $(216) | $(481) | $(374) | $75 |
| Insurance Services | (185) | 395 | (473) | 36 |
| Total segment operating (loss) income | (401) | (86) | (847) | 111 |
| Net investment income | 791 | 542 | 2,632 | 1,296 |
| Net realized gains | 83 | 329 | 136 | 5,459 |
| Other-than-temporary impairment loss | — | — | (10) | — |
| Other income and expenses not allocated to segments, net | (1,887) | (2,027) | (1,252) | (4,621) |
| Amortization of intangible assets | (307) | (397) | (937) | (1,220) |
| Contingent consideration expense | (110) | (267) | (364) | (801) |
| Impairment of asset held for sale | — | — | — | (1,180) |
| Interest expense | (1,248) | (1,417) | (4,053) | (4,214) |
| Foreign exchange (losses) gains, net | (58) | (230) | (1,210) | (271) |
| Gain (loss) on change in fair value of debt | 2,458 | (2,963) | 1,491 | (10,199) |
| Loss on disposal of subsidiary | — | — | — | (1,242) |
| Loss on deconsolidation of subsidiary | — | — | (4,420) | — |
| Equity in net loss of investee | (192) | (83) | (399) | (83) |
| Loss from continuing operations before income tax expense (benefit) | (871) | (6,599) | (9,233) | (16,965) |
| Income tax expense (benefit) | 23 | 28 | 79 | (971) |
| Loss from continuing operations | $(894) | $(6,627) | $(9,312) | $(15,994) |

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

Net premiums earned by line of business for the three and nine months ended September 30, 2015 and 2014 were:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Insurance Underwriting: | | | | |
| Private passenger auto liability | $19,745 | $19,066 | $59,376 | $56,842 |
| Auto physical damage | 9,452 | 9,352 | 29,051 | 28,137 |
| Total non-standard automobile | 29,197 | 28,418 | 88,427 | 84,979 |
| Commercial auto liability | — | — | — | — |
| Total Insurance Underwriting | 29,197 | 28,418 | 88,427 | 84,979 |
| Net premiums earned not allocated to segments: | | | | |
| Allied lines | — | — | — | 1,944 |
| Homeowners | — | — | — | 2,159 |
| Other | — | — | — | 11 |
| Total net premiums earned not allocated to segments | — | — | — | 4,114 |
| Total net premiums earned | $29,197 | $28,418 | $88,427 | $89,093 |

NOTE 19 RESTRUCTURING

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

As part of the restructuring, the Company reduced staffing levels to be consistent with placing Amigo into run-off. The Company estimated that Insurance Underwriting would incur approximately $2.0 million in cash severance expenses due to reductions-in-force as part of the restructuring during the period beginning with the announcement through the end of 2013. As of December 31, 2014, the Company paid $2.0 million related to severance incurred as part of the restructuring. At December 31, 2014, the remaining severance liability related to the restructuring is zero.

Changes in the restructuring liability, which is included in accrued expenses and other liabilities in the consolidated balance sheets, and the related restructuring expense, which is included in general and administrative expenses in the consolidated statements of operations, for the three and nine months ended September 30, 2015 and September 30, 2014 are as follows:

| (in thousands) | For the three months ended September 30, 2015 | | | |
|---|---|---|---|---|
| | Restructuring Liability, Beginning of Period | Restructuring Expense | Cash Payments | Restructuring Liability, End of Period |
| Insurance Underwriting: | | | | |
| Lease abandonment | $294 | $15 | $(44) | $265 |
| Total Insurance Underwriting | 294 | 15 | (44) | 265 |
| Insurance Services: | | | | |
| Lease abandonment | 21 | — | (10) | 11 |
| Total Insurance Services | 21 | — | (10) | 11 |
| Total | $315 | $15 | $(54) | $276 |

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

| (in thousands) | For the three months ended September 30, 2014 | | | |
|---|---|---|---|---|
| | Restructuring Liability, Beginning of Period | Restructuring Expense | Cash Payments | Restructuring Liability, End of Period |
| Insurance Underwriting: | | | | |
| Severance | $35 | $— | $(35) | $— |
| Lease abandonment | 503 | 16 | (91) | 428 |
| Total Insurance Underwriting | 538 | 16 | (126) | 428 |
| Insurance Services: | | | | |
| Lease abandonment | 72 | (11) | (9) | 52 |
| Total Insurance Services | 72 | (11) | (9) | 52 |
| Total | $610 | $5 | $(135) | $480 |

| | For the nine months ended September 30, 2015 | | | |
|---|---|---|---|---|
| | Restructuring Liability, Beginning of Period | Restructuring Expense | Cash Payments | Restructuring Liability, End of Period |
| Insurance Underwriting: | | | | |
| Lease abandonment | $352 | $45 | $(132) | $265 |
| Total Insurance Underwriting | 352 | 45 | (132) | 265 |
| Insurance Services: | | | | |
| Lease abandonment | 41 | — | (30) | 11 |
| Total Insurance Services | 41 | — | (30) | 11 |
| Total | $393 | $45 | $(162) | $276 |

| | For the nine months ended September 30, 2014 | | | |
|---|---|---|---|---|
| | Restructuring Liability, Beginning of Period | Restructuring Expense | Cash Payments | Restructuring Liability, End of Period |
| Insurance Underwriting: | | | | |
| Severance | $236 | $(74) | $(162) | $— |
| Lease abandonment | 654 | 48 | (274) | 428 |
| Total Insurance Underwriting | 890 | (26) | (436) | 428 |
| Insurance Services: | | | | |
| Lease abandonment | 94 | (3) | (39) | 52 |
| Total Insurance Services | 94 | (3) | (39) | 52 |
| Severance expense not allocated to segments | 146 | — | (146) | — |
| Total | $1,130 | $(29) | $(621) | $480 |

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 20 RELATED PARTY TRANSACTIONS

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

On February 11, 2014, the Company's subsidiary, 1347 Advisors LLC ("1347 Advisors") entered into a Management Services Agreement ("MSA") with PIH which provides for certain services, including forecasting, analysis of capital structure and reinsurance programs, consultation in future restructuring or capital raising transactions, and consultation in corporate development initiatives, that 1347 Advisors will provide to PIH unless and until 1347 Advisors and PIH agree to terminate the services. On February 24, 2015, the Company announced that it had entered into a definitive agreement with PIH to terminate the MSA. Pursuant to the transaction, 1347 Advisors received the following consideration: $2.0 million in cash; $3.0 million of 8% preferred stock of PIH, redeemable in five years; a Performance Shares Grant Agreement with PIH, whereby 1347 Advisors will be entitled to receive 100,000 shares of PIH common stock if at any time the last sales price of PIH's common stock equals or exceeds $10.00 per share for any 20 trading days within any 30-trading day period; and warrants to purchase 1,500,000 shares of common stock of PIH with a strike price of $15.00, expiring in seven years. The Company recorded a gain of $6.0 million during the first quarter of 2015 related to the termination of the MSA, which is included in other income in the unaudited consolidated statements of operations. To the extent shares of PIH common stock are granted to the Company under the Performance Shares Grant Agreement, they will be recorded at the time the shares are granted and will have a valuation equal to the last sales price of PIH common stock on the day prior to such grant. No shares were received by the Company under the Performance Shares Grant Agreement as of September 30, 2015. Refer to Note 21, "Fair Value of Financial Instruments," for further details regarding the performance shares.

On March 26, 2014, the Company entered into a Performance Share Grant Agreement with PIH, whereby the Company will be entitled to receive up to an aggregate of 375,000 shares of PIH common stock upon achievement of certain milestones for PIH’s stock price. Pursuant to the terms of the Performance Share Grant Agreement, if at any time the last sales price of PIH’s common stock equals or exceeds: (i) $12.00 per share (as adjusted for stock splits, stock dividends, reorganizations, recapitalizations and the like) for any 20 trading days within any 30-trading day period, the Company will receive 125,000 shares of PIH common stock; (ii) $15.00 per share (as adjusted for stock splits, stock dividends, reorganizations, recapitalizations and the like) for any 20 trading days within any 30-trading day period, the Company will receive 125,000 shares of PIH common stock (in addition to the 125,000 shares of common stock earned pursuant to clause (i) herein); and (iii) $18.00 per share (as adjusted for stock splits, stock dividends, reorganizations, recapitalizations and the like) for any 20 trading days within any 30-trading day period, the Company will receive 125,000 shares of PIH common stock (in addition to the 250,000 shares of common stock earned pursuant to clauses (i) and (ii) herein). ). To the extent shares of PIH common stock are granted to the Company under the Performance Share Grant Agreement, they will be recorded at the time the shares are granted and will have a valuation equal to the last sales price of PIH common stock on the day prior to such grant. No shares were received by the Company under the Performance Share Grant Agreement as of September 30, 2015. Refer to Note 21, "Fair Value of Financial Instruments," for further details regarding the performance shares.

On March 7, 2014, the Company's subsidiary, 1347 Capital LLC ("1347 Capital") appointed Gordon G. Pratt, CEO of Fund Management Group ("FMG"), as Chairman of 1347 Capital. At September 30, 2015, the Company has a note receivable of $1.5 million outstanding from FMG which is included in other receivables in the consolidated balance sheets.

During the second quarter of 2014, the Company made an investment in Itasca Golf Investors, LLC ("Itasca Golf") which is included in limited liability investments on the consolidated balance sheets. On August 28, 2014, the Company entered into a $0.5 million line of credit with Itasca Golf. On August 29, 2014, the Company advanced $0.5 million to Itasca Golf under the line of credit which is included in other receivables on the consolidated balance sheets. On June 11, 2015, the line of credit was increased by $0.2 million. On June 11, 2015, the Company advanced $0.1 million to Itasca Golf under the line of credit which is included in other receivables on the consolidated balance sheets. The line of credit matures on August 28, 2016.

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 21 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value amounts represent estimates of the consideration that would currently be agreed upon between knowledgeable, willing parties who are under no compulsion to act. Fair value is best evidenced by quoted bid or ask price, as appropriate, in an active market. Where bid or ask prices are not available, such as in an illiquid or inactive market, the closing price of the most recent transaction of that instrument subject to appropriate adjustments as required is used. Where quoted market prices are not available, the quoted prices of similar financial instruments or valuation models with observable market-based inputs are used to estimate the fair value. These valuation models may use multiple observable market inputs, including observable interest rates, foreign exchange rates, index levels, credit spreads, equity prices, counterparty credit quality, corresponding market volatility levels and option volatilities. Minimal management judgment is required for fair values calculated using quoted market prices or observable market inputs for models. Greater subjectivity is required when making valuation adjustments for financial instruments in inactive markets or when using models where observable parameters do not exist. Also, the calculation of estimated fair value is based on market conditions at a specific point in time and may not be reflective of future fair values. For the Company's financial instruments carried at cost or amortized cost, the book value is not adjusted to reflect increases or decreases in fair value due to market fluctuations, including those due to interest rate changes, as it is the Company's intention to hold them until there is a recovery of fair value, which may be to maturity.

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

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

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

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

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

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

The Company employs a fair value hierarchy to categorize the inputs it uses in valuation techniques to measure the fair value. The extent of use of quoted market prices (Level 1), valuation models using observable market information (Level 2) and internal models without observable market information (Level 3) in the valuation of the Company's financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2015 and December 31, 2014 was as follows:

| (in thousands) | September 30, 2015 | | | |
|---|---|---|---|---|
| | | Fair Value Measurements at the End of the Reporting Period Using | | |
| | Total | Quoted Prices in Active Markets for Identical Assets(Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Recurring fair value measurements | | | | |
| Assets: | | | | |
| Fixed maturities: | | | | |
| U.S. government, government agencies and authorities | $20,693 | $— | $20,693 | $— |
| States, municipalities and political subdivisions | 2,954 | — | 2,954 | — |
| Mortgage-backed | 8,657 | — | 8,657 | — |
| Asset-backed securities and collateralized mortgage obligations | 7,617 | — | 7,617 | — |
| Corporate | 19,843 | — | 19,843 | — |
| Total fixed maturities | 59,764 | — | 59,764 | — |
| Equity investments: | | | | |
| Common stock | 24,172 | 24,172 | — | — |
| Warrants | 1,124 | 221 | 903 | — |
| Total equity investments | 25,296 | 24,393 | 903 | — |
| Other investments | 4,102 | — | 4,102 | — |
| Short-term investments | 400 | — | 400 | — |
| Total assets | $89,562 | $24,393 | $65,169 | $— |
| Liabilities: | | | | |
| Subordinated debt | $39,865 | $— | $39,865 | $— |
| Contingent consideration | 3,485 | — | — | 3,485 |
| Total liabilities | $43,350 | $— | $39,865 | $3,485 |

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

| (in thousands) | December 31, 2014 | | | |
|---|---|---|---|---|
| | Fair Value Measurements at the End of the Reporting Period Using | | | |
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Recurring fair value measurements | | | | |
| Assets: | | | | |
| Fixed maturities: | | | | |
| U.S. government, government agencies and authorities | $20,759 | $— | $20,759 | $— |
| Canadian government | 4,242 | — | 4,242 | — |
| States municipalities and political subdivisions | 3,419 | — | 3,419 | — |
| Mortgage-backed | 5,352 | — | 5,352 | — |
| Asset-backed securities and collateralized mortgage obligations | 7,214 | — | 7,214 | — |
| Corporate | 15,209 | — | 15,209 | — |
| Total fixed maturities | 56,195 | — | 56,195 | — |
| Equity investments: | | | | |
| Common stock | 19,526 | 19,526 | — | — |
| Warrants | 92 | 92 | | |
| Total equity investments | 19,618 | 19,618 | — | — |
| Other investments | 3,576 | — | 3,576 | — |
| Short-term investments | 400 | — | 400 | — |
| Total assets | $79,789 | $19,618 | $60,171 | $— |
| Liabilities: | | | | |
| LROC preferred units | $13,618 | $13,618 | $— | $— |
| Subordinated debt | 40,659 | — | 40,659 | — |
| Contingent consideration | 3,121 | — | — | 3,121 |
| Total liabilities | $57,398 | $13,618 | $40,659 | $3,121 |

The following table provides a reconciliation of the fair value of recurring Level 3 fair value measurements for the three and nine months ended September 30, 2015 and September 30, 2014:

| (in thousands) | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Contingent consideration: | | | | |
| Beginning balance | $3,375 | $5,878 | $3,121 | $5,344 |
| Change in fair value of contingent consideration included in net (loss) income | 110 | 267 | 364 | 801 |
| Ending balance | $3,485 | $6,145 | $3,485 | $6,145 |

KINGSWAY FINANCIAL SERVICES INC.
Notes to Consolidated Financial Statements (Unaudited) September 30, 2015

NOTE 22 COMMITMENTS AND CONTINGENCIES

(a) Legal proceedings:

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

(b) Guarantee:

The Company provided an indemnity and hold harmless agreement to a third-party for customs bonds reinsured by Lincoln General Insurance Company ("Lincoln General") during the time Lincoln General was a subsidiary of the Company. This agreement may require the Company to compensate the third-party if Lincoln General is unable to fulfill its obligations relating to the customs bonds. The Company's potential exposure under this agreement is not determinable, and no liability has been recorded in the unaudited consolidated interim financial statements at September 30, 2015.

(c) Commitment:

The Company has entered into subscription agreements to commit up to $8.5 million of capital to allow for participation in limited liability investments which invest principally in income-producing real estate. At September 30, 2015, the unfunded commitment was $2.4 million.

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

FORWARD LOOKING STATEMENTS

Management's Discussion and Analysis includes “forward looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are not historical facts, and involve risks and uncertainties that could cause actual results to differ materially from those expected and projected. Words such as “expects”, “believes”, “anticipates”, “intends”, “estimates”, “seeks” and variations and similar words and expressions are intended to identify such forward looking statements. Such forward looking statements relate to future events or future performance, but reflect Kingsway management’s current beliefs, based on information currently available. A number of factors could cause actual events, performance or results to differ materially from the events, performance and results discussed in the forward looking statements. For information identifying important factors that could cause actual results to differ materially from those anticipated in the forward looking statements, see Kingsway’s securities filings, including its Annual Report on Form 10-K for the year ended December 31, 2014 ("2014 Annual Report"). The Company's securities filings can be accessed on the Canadian Securities Administrators’ website at www.sedar.com, and on the EDGAR section of the U.S. Securities and Exchange Commission’s website at www.sec.gov or through the Company’s website at www.kingsway-financial.com. Except as expressly required by applicable securities law, the Company disclaims any intention or obligation to update or revise any forward looking statements whether as a result of new information, future events or otherwise.

OVERVIEW

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

Insurance Underwriting includes the following subsidiaries of the Company: Mendota Insurance Company ("Mendota"), Mendakota Insurance Company ("Mendakota"), Mendakota Casualty Company (formerly Universal Casualty Company) ("MCC"), Kingsway Amigo Insurance Company ("Amigo") and Kingsway Reinsurance Corporation. Throughout Management's Discussion and Analysis, the term "Insurance Underwriting" is used to refer to this segment.

Insurance Underwriting provides non-standard automobile insurance to individuals who do not meet the criteria for coverage by standard automobile insurers. Insurance Underwriting has policyholders in 13 states; however, new business is accepted in only nine states. For the three months ended September 30, 2015, production in the following states represented 86.4% of the Company's gross premiums written: Florida (26.5%), Illinois (16.2%), Texas (15.8%), Nevada (10.0%), California (10.0%), and Colorado (7.9%). For the nine months ended September 30, 2015, production in the following states represented 84.3% of the Company's gross premiums written: Florida (23.3%), Texas (16.4%), Illinois (15.1%), California (10.8%), Nevada (10.0%) and Colorado (8.7%). For the three and nine months ended September 30, 2015, non-standard automobile insurance accounted for 100.0% of the Company's gross premiums written.

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

Insurance Services includes the following subsidiaries of the Company: IWS Acquisition Corporation ("IWS") and Trinity Warranty Solutions LLC ("Trinity"). Throughout Management's Discussion and Analysis, the term "Insurance Services" is used to refer to this segment.

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

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

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

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

## NON-U.S. GAAP FINANCIAL MEASURES

Throughout this quarterly report, we present our operations in the way we believe will be most meaningful, useful and transparent to anyone using this financial information to evaluate our performance. In addition to the U.S. GAAP presentation of net (loss) income, we show certain statutory reporting information and other non-U.S. GAAP financial measures which we believe are valuable in managing our business and drawing comparisons to our peers. These measures are segment operating (loss) income, gross premiums written, net premiums written and underwriting ratios. Following is a list of non-U.S. GAAP measures found throughout this report with their definitions, relationships to U.S. GAAP measures and explanations of their importance to our operations.

### Segment Operating (Loss) Income

Segment operating (loss) income represents one measure of the pretax profitability of our segments and is derived by subtracting direct segment expenses from direct segment revenues. Revenues and expenses are presented in the unaudited consolidated statements of operations, but are not subtotaled by segment; however, this information is available in total and by segment in Note 18, "Segmented Information," to the unaudited consolidated interim financial statements, regarding reportable segment information. The nearest comparable U.S. GAAP measure is loss from continuing operations before income tax expense (benefit) which, in addition to operating (loss) income, includes net investment income, net realized gains, other-than-temporary impairment loss, other income not allocated to segments, general and administrative expenses, amortization of intangible assets, contingent consideration expense, impairment of asset held for sale, interest expense, foreign exchange losses (gains), net, (gain) loss on change in fair value of debt, loss on disposal of subsidiary, loss on deconsolidation of subsidiary and equity in net loss of investee. A reconciliation of segment operating (loss) income to loss from continuing operations before income tax expense (benefit) for the three and nine months ended September 30, 2015 and 2014 is presented in Table 1 of the "Results of Continuing Operations" section of Management's Discussion and Analysis.

Gross Premiums Written

While net premiums earned is the related U.S. GAAP measure used in the unaudited consolidated statements of operations, gross premiums written is the component of net premiums earned that measures insurance business produced before the impact of ceding reinsurance premiums, but without respect to when those premiums will be recognized as actual revenue. We use this measure as an overall gauge of gross business volume in Insurance Underwriting.

Net Premiums Written

While net premiums earned is the related U.S. GAAP measure used in the unaudited consolidated statements of operations, net premiums written is the component of net premiums earned that measures the difference between gross premiums written and the impact of ceding reinsurance premiums, but without respect to when those premiums will be recognized as actual revenue. We use this measure as an indication of retained or net business volume in Insurance Underwriting.

Underwriting Ratios

Kingsway, like many insurance companies, analyzes performance based on underwriting ratios such as loss and loss adjustment expense ratio, expense ratio and combined ratio. The loss and loss adjustment expense ratio is derived by dividing the amount of net loss and loss adjustment expenses incurred by net premiums earned. The expense ratio is derived by dividing the sum of commissions and premium taxes, general and administrative expenses and policy fee income by net premiums earned. The combined ratio is the sum of the loss and loss adjustment expense ratio and the expense ratio. A combined ratio below 100% demonstrates underwriting profit whereas a combined ratio over 100% demonstrates underwriting loss.

CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

The preparation of unaudited consolidated interim 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 for the reporting period. Actual results could differ from these estimates. Estimates and their underlying assumptions are reviewed on an ongoing basis. Changes in estimates are recorded in the accounting period in which they are determined. The critical accounting estimates and assumptions in the accompanying unaudited consolidated interim financial statements include the provision for unpaid loss and loss adjustment expenses; valuation of fixed maturities and equity investments; valuation of deferred income taxes; valuation of intangible assets; goodwill recoverability; deferred acquisition costs; fair value assumptions for performance shares; fair value assumptions for debt obligations; and contingent consideration.

The Company’s critical accounting estimates and assumptions are described in Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2014 Annual Report. There has been no material change subsequent to December 31, 2014 to the information previously disclosed in the 2014 Annual Report with respect to these critical accounting estimates and assumptions, except as disclosed below.

Derivative Financial Instruments

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

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

KINGSWAY FINANCIAL SERVICES INC.

RESULTS OF CONTINUING OPERATIONS

A reconciliation of total segment operating (loss) income to net (loss) income for the three and nine months ended September 30, 2015 and 2014 is presented in Table 1 below:

Table 1 Segment Operating (Loss) Income

For the three and nine months ended September 30 (in thousands of dollars)

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|---|---|---|---|---|---|---|
| | 2015 | 2014 | Change | 2015 | 2014 | Change |
| Segment operating (loss) income | | | | | | |
| Insurance Underwriting | (216) | (481) | 265 | (374) | 75 | (449) |
| Insurance Services | (185) | 395 | (580) | (473) | 36 | (509) |
| Total segment operating (loss) income | (401) | (86) | (315) | (847) | 111 | (958) |
| Net investment income | 791 | 542 | 249 | 2,632 | 1,296 | 1,336 |
| Net realized gains | 83 | 329 | (246) | 136 | 5,459 | (5,323) |
| Other-than-temporary impairment loss | — | — | — | (10) | — | (10) |
| Other income and expenses not allocated to segments, net | (1,887) | (2,027) | 140 | (1,252) | (4,621) | 3,369 |
| Amortization of intangible assets | (307) | (397) | 90 | (937) | (1,220) | 283 |
| Contingent consideration expense | (110) | (267) | 157 | (364) | (801) | 437 |
| Impairment of asset held for sale | — | — | — | — | (1,180) | 1,180 |
| Interest expense | (1,248) | (1,417) | 169 | (4,053) | (4,214) | 161 |
| Foreign exchange losses, net | (58) | (230) | 172 | (1,210) | (271) | (939) |
| Gain (loss) on change in fair value of debt | 2,458 | (2,963) | 5,421 | 1,491 | (10,199) | 11,690 |
| Loss on disposal of subsidiary | — | — | — | — | (1,242) | 1,242 |
| Loss on deconsolidation of subsidiary | — | — | — | (4,420) | — | (4,420) |
| Equity in net loss of investee | (192) | (83) | (109) | (399) | (83) | (316) |
| Loss from continuing operations before income tax expense (benefit) | (871) | (6,599) | 5,728 | (9,233) | (16,965) | 7,732 |
| Income tax expense (benefit) | 23 | 28 | (5) | 79 | (971) | 1,050 |
| Loss from continuing operations | (894) | (6,627) | 5,733 | (9,312) | (15,994) | 6,682 |
| Income from discontinued operations, net of taxes | — | 532 | (532) | 1,426 | 3,419 | (1,993) |
| Gain on disposal of discontinued operations, net of taxes | — | — | — | 11,259 | — | 11,259 |
| Net (loss) income | (894) | (6,095) | 5,201 | 3,373 | (12,575) | 15,948 |

Loss from Continuing Operations and Net (Loss) Income

In the third quarter of 2015, we reported loss from continuing operations of $0.9 million compared to $6.6 million in the third quarter of 2014. For the nine months ended September 30, 2015, we reported loss from continuing operations of $9.3 million compared to $16.0 million for the nine months ended September 30, 2014. The loss from continuing operations for the three months ended September 30, 2015 is primarily attributable to interest expense and to income and expenses not allocated to segments, partially offset by a gain on change in fair value of debt. The loss from continuing operations for the nine months ended September 30, 2015 is primarily attributable to income and expenses not allocated to segments, interest expense, foreign exchange losses and loss on deconsolidation of subsidiary, partially offset by gain on change in fair value of debt and net investment income.

The loss from continuing operations for the three months ended September 30, 2014 is primarily due to income and expenses not allocated to segments, interest expense and loss on change in fair value of debt. The loss from continuing operations for the nine months ended September 30, 2014 is primarily due to income and expenses not allocated to segments, impairment of asset held for sale, interest expense, loss on change in fair value of debt and loss on disposal of subsidiary, partially offset by net realized gains.

For the three months ended September 30, 2015, we reported net loss of $0.9 million compared to $6.1 million for the three months ended September 30, 2014. For the nine months ended September 30, 2015, we reported net income of $3.4 million compared to net loss of $12.6 million for the nine months ended September 30, 2014.

Insurance Underwriting

In the third quarter of 2015, Insurance Underwriting gross premiums written were $29.1 million compared to $28.7 million in the third quarter of 2014, representing a 1.4% increase ($89.9 million year to date compared to $87.4 million prior year to date, representing a 2.9% increase). Net premiums written increased 1.4% to $29.1 million in the third quarter of 2015 compared with $28.7 million in the third quarter of 2014 ($89.7 million year to date compared to $91.5 million prior year to date, representing a 2.0% decrease). Net premiums earned increased 2.8% to $29.2 million in the third quarter of 2015 compared with $28.4 million in the third quarter of 2014 ($88.4 million year to date compared to $85.0 million prior year to date, representing a 4.0% increase). The increase in net premiums written and earned for the three months ended September 30, 2015 results primarily from increased premium volumes at Mendota, Mendakota and MCC.

The Insurance Underwriting operating loss was $0.2 million for the three months ended September 30, 2015 ($0.4 million year to date) compared to $0.5 million for the three months ended September 30, 2014 (income of $0.1 million prior year to date). The decrease in operating loss for the three months ended September 30, 2015 is primarily attributable to an overall reduction in general expenses at Mendota. The decrease in operating income for the nine months ended September 30, 2015 is primarily attributable to an increase in loss and loss adjustment expenses at Mendota to reflect higher losses in its property lines of business during 2015, partially offset by an overall reduction in general expenses.

The Insurance Underwriting loss and loss adjustment expense ratio for the third quarter of 2015 was 73.5% compared to 72.5% for the third quarter of 2014 (73.1% for the nine months ended September 30, 2015 compared with 70.2% for the same period in 2014). The increase in the loss and loss adjustment expense ratio for the three and nine months ended September 30, 2015 is primarily attributable to an increase in loss and loss adjustment expenses at Mendota to reflect higher losses in its property lines of business during 2015.

The Insurance Underwriting expense ratio was 27.6% for the third quarter of 2015 compared to 29.6% for the third quarter of 2014 (28.0% for the nine months ended September 30, 2015 compared with 30.1% for the same period in 2014). The decrease in the expense ratio is primarily due to an overall reduction in general expenses. The Insurance Underwriting expense ratio includes policy fee income of $2.1 million and $2.0 million for the three months ended September 30, 2015 and 2014, respectively ($6.3 million and $6.1 million, respectively, year to date and prior year to date).

The Insurance Underwriting combined ratio was 101.1% in the third quarter of 2015 compared with 102.1% in the third quarter of 2014 (101.1% for the nine months ended September 30, 2015 compared with 100.3% for the same period in 2014), reflecting the dynamics which affected the loss and loss adjustment expense ratio and expense ratio.

Insurance Services

The Insurance Services service fee and commission income decreased 10.1% to $6.2 million for the three months ended September 30, 2015 compared with $6.9 million for the three months ended September 30, 2014 ($17.4 million year to date compared to $19.0 million prior year to date, representing a 8.4% decrease). The decrease for the three and nine months ended September 30, 2015 is due to decreased service fee and commission income at IWS and Trinity. The Insurance Services operating loss was $0.2 million for the three months ended September 30, 2015 ($0.5 million year to date) compared with income of $0.4 million for the three months ended September 30, 2014 (income of $0.0 million prior year to date).

Net Investment Income

Net investment income was $0.8 million in the third quarter of 2015 ($2.6 million year to date) compared to $0.5 million in the third quarter of 2014 ($1.3 million prior year to date). The increase for the three months ended September 30, 2015 is primarily due to an increase in income from limited liability investments, offset by a decrease in fair value of derivative instrument warrants. The increase for the nine months ended September 30, 2015 is due to an increase in income from limited liability investments. Income from limited liability investments is recognized based on the Company's share of the earnings of the limited liability entities.

Net Realized Gains

Net realized gains were $0.1 million in the third quarter of 2015 ($0.1 million year to date) compared to $0.3 million in the third quarter of 2014 ($5.5 million prior year to date). The net realized gains for the nine months ended September 30, 2014 resulted primarily from the liquidation of equity investments in Insurance Underwriting.

Other Income and Expenses not Allocated to Segments, Net

Other income and expenses not allocated to segments was a net expense of $1.9 million in the third quarter of 2015 compared to $2.0 million in the third quarter of 2014 ($1.3 million year to date compared to $4.6 million prior year to date). The decrease in net expense for the three months ended September 30, 2015 is primarily due to a decrease in corporate general expenses during the third quarter of 2015 compared to the third quarter of 2014. The decrease in net expense for the nine months ended September 30, 2015 is primarily the result of a $6.0 million gain recorded during the first quarter of 2015 related to the termination of the Company's Management Services Agreement with PIH, as further discussed in Note 20, "Related Party Transactions," to the unaudited consolidated interim financial statements, partially offset by $2.3 million of income reported during the first quarter of 2014 related to PIH. As further discussed in Note 5, "Disposition, Deconsolidation and Discontinued Operations," to the unaudited consolidated interim financial statements, effective March 31, 2014, PIH completed an initial public offering of its common stock. The earnings of PIH are included in the unaudited consolidated statements of operations through the March 31, 2014 transaction date. Prior to the transaction, PIH was included in the Insurance Underwriting segment. As a result of the disposal of the Company's majority interest in PIH on March 31, 2014, all segmented information has been restated to exclude PIH from the Insurance Underwriting segment and to include its earnings in other income and expenses not allocated to segments, net.

Amortization of Intangible Assets

The Company's intangible assets with definite useful lives are amortized over their estimated useful lives. Amortization of intangible assets was $0.3 million for the third quarter of 2015 compared to $0.4 million in the third quarter of 2014 ($0.9 million year to date compared to $1.2 million prior year to date). The decrease is primarily attributed to less amortization expense related to the IWS vehicle service agreement ("VSA") in-force intangible asset for the three and nine months ended September 30, 2015 compared to the same periods in 2014. The VSA in-force asset is amortized over a seven-year term as the corresponding deferred service fees acquired are earned as revenue.

Contingent Consideration Expense

Contingent consideration expense was $0.1 million for the third quarter of 2015 compared to $0.3 million in the third quarter of 2014 ($0.4 million year to date compared to $0.8 million prior year to date). During the fourth quarter of 2014, the Company reevaluated its contingent consideration liabilities and recorded an adjustment to reduce the balance of its contingent consideration liabilities at December 31, 2014. As a result of the reevaluation, the Company concluded that the accretion pattern for its contingent consideration liabilities should be revised, leading the Company to record less contingent consideration expense in 2015 compared to 2014.

Impairment of Asset Held for Sale

As of September 30, 2014, property consisting of building and land located in Miami, Florida with a carrying value of $5.2 million was classified as held for sale. During the nine months ended September 30, 2014, the Company recorded an impairment write-down of $1.2 million related to the asset held for sale.

Interest Expense

Interest expense for the third quarter of 2015 was $1.2 million compared to $1.4 million in the third quarter of 2014 ($4.1 million year to date compared to $4.2 million prior year to date). The decrease for the three and nine months ended September 30, 2015 is attributable to the repayment during June 2015 of the outstanding principal balance on the LROC preferred units due June 30, 2015.

Foreign Exchange Losses, Net

During the third quarter of 2015, the Company incurred foreign exchange losses of $0.1 million compared to gains of $0.2 million in the third quarter of 2014 (losses of $1.2 million year to date compared to $0.3 million prior year to date). Foreign exchange losses, net for the nine months ended September 30, 2015 and 2014 were incurred primarily related to conversion of the net Canadian dollar assets of Kingsway Linked Return of Capital Trust ("KLROC Trust").

39

Gain (Loss) on Change in Fair Value of Debt
The gain on change in fair value of debt amounted to $2.5 million in the third quarter of 2015 compared to a loss of $3.0 million in the third quarter of 2014 (gain of $1.5 million year to date compared to a loss of $10.2 million prior year to date). The gain for the third quarter of 2015 is due to a decrease in the fair value of the subordinated debt, whereas the loss for the third quarter of 2014 is primarily due to an increase in the fair value of the subordinated debt. The 2015 year to date gain is primarily due to a decrease in the fair values of the subordinated debt and LROC preferred units, whereas the 2014 year to date loss is due to an increase in the fair value of the Company's subordinated debt, partially offset by a decrease in the fair value of the LROC preferred units. For information regarding the Company's approach to determining fair value of debt, see Note 21, "Fair Value of Financial Instruments," to the unaudited consolidated interim financial statements.
Loss on Disposal of Subsidiary
Effective March 31, 2014, the Company's wholly owned subsidiary, PIH, completed an initial public offering of its common stock. Upon completion of the transaction, the Company maintained a minority ownership interest in the common shares of PIH. As a result of the disposal, the Company recognized a loss of $1.2 million for the nine months ended September 30, 2014. See Note 5, "Disposition, Deconsolidation and Discontinued Operations," to the unaudited consolidated interim financial statements, for further details.
Loss on Deconsolidation of Subsidiary
Prior to the second quarter of 2015, the Company beneficially owned and controlled 74.8% of KLROC Trust. As a result, the Company had been consolidating the financial statements of KLROC Trust. 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 subsidiary of $4.4 million for the nine months ended September 30, 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. The deconsolidation reduced consolidated shareholders’ equity by $2.8 million at June 30, 2015. Refer to Note 5, "Disposition, Deconsolidation and Discontinued Operations," to the unaudited consolidated interim financial statements, for further discussion.
Equity in Net Loss of Investee
Equity in net loss of investee for the three and nine months ended September 30, 2015 represents the Company's investment in 1347 Capital Corp. See Note 7, "Investment in Investee," to the unaudited consolidated interim financial statements, for further discussion.
Income Tax Expense (Benefit)
Income tax expense for the third quarter of 2015 was $0.0 million compared to $0.0 million in the third quarter of 2014 (expense of $0.1 million year to date compared to a benefit of $1.0 million prior year to date). See Note 13, "Income Taxes," to the unaudited consolidated interim financial statements, for additional detail of the income tax expense (benefit) recorded for the three and nine months ended September 30, 2015 and September 30, 2014, respectively.

INVESTMENTS
Portfolio Composition
All of our investments in fixed maturities and equity investments are classified as available-for-sale and are reported at fair value. At September 30, 2015, we held cash and cash equivalents and investments with a carrying value of $180.7 million. As of September 30, 2015, we held an investments portfolio comprised primarily of fixed maturities issued by the U.S. Government, government agencies and high quality corporate issuers. Investments held by our insurance subsidiaries must comply with applicable domiciliary state regulations that prescribe the type, quality and concentration of investments. Our U.S. operations typically invest in U.S. dollar-denominated instruments to mitigate their exposure to currency rate fluctuations.

Table 2 below summarizes the carrying value of investments, including cash and cash equivalents, at the dates indicated.
TABLE 2 Carrying value of investments, including cash and cash equivalents
(in thousands of dollars, except for percentages)

| Type of investment | September 30, 2015 | % of Total | | December 31, 2014 | % of Total | |
|---|---|---|---|---|---|---|
| Fixed maturities: | | | | | | |
| U.S. government, government agencies and authorities | 20,693 | 11.5 | % | 20,759 | 13.0 | % |
| Canadian government | — | — | % | 4,242 | 2.6 | % |
| States, municipalities and political subdivisions | 2,954 | 1.6 | % | 3,419 | 2.2 | % |
| Mortgage-backed | 8,657 | 4.8 | % | 5,352 | 3.4 | % |
| Asset-backed securities and collateralized mortgage obligations | 7,617 | 4.2 | % | 7,214 | 4.6 | % |
| Corporate | 19,843 | 11.0 | % | 15,209 | 9.6 | % |
| Total fixed maturities | 59,764 | 33.1 | % | 56,195 | 35.4 | % |
| Equity investments: | | | | | | |
| Common stock | 24,172 | 13.4 | % | 19,526 | 12.3 | % |
| Warrants | 1,124 | 0.6 | % | 92 | 0.1 | % |
| Total equity investments | 25,296 | 14.0 | % | 19,618 | 12.4 | % |
| Limited liability investments | 15,377 | 8.5 | % | 7,294 | 4.6 | % |
| Other investments | 4,102 | 2.3 | % | 3,576 | 2.3 | % |
| Short-term investments | 400 | 0.2 | % | 400 | 0.3 | % |
| Total investments | 104,939 | 58.1 | % | 87,083 | 55.0 | % |
| Cash and cash equivalents | 75,785 | 41.9 | % | 71,234 | 45.0 | % |
| Total | 180,724 | 100.0 | % | 158,317 | 100.0 | % |

Liquidity and Cash Flow Risk
Table 3 below summarizes the fair value by contractual maturities of the fixed maturities portfolio, excluding cash and cash equivalents, at September 30, 2015 and December 31, 2014.
TABLE 3 Fair value of fixed maturities by contractual maturity date
(in thousands of dollars)

| | September 30, 2015 | % of Total | | December 31, 2014 | % of Total | |
|---|---|---|---|---|---|---|
| Due in less than one year | 10,803 | 18.1 | % | 19,256 | 34.3 | % |
| Due in one through five years | 38,047 | 63.7 | % | 30,166 | 53.7 | % |
| Due after five through ten years | 2,165 | 3.6 | % | 1,540 | 2.7 | % |
| Due after ten years | 8,749 | 14.6 | % | 5,233 | 9.3 | % |
| Total | 59,764 | 100.0 | % | 56,195 | 100.0 | % |

At September 30, 2015, 81.8% of fixed maturities, including treasury bills, government bonds and corporate bonds, had contractual maturities of five years or less. Actual maturities may differ from contractual maturities because certain issuers have the right to call or prepay obligations with or without call or prepayment penalties. The Company holds cash and high-grade short-term assets which, along with fixed maturities, management believes are sufficient in amount for the payment of unpaid loss and loss adjustment expenses and other operating subsidiary obligations on a timely basis. In the event that additional cash is required to meet obligations to our policyholders and customers, we believe that the high-quality, liquid investments in the portfolios provide us with sufficient liquidity.

41

KINGSWAY FINANCIAL SERVICES INC.

Market Risk
Market risk is the risk that we will incur losses due to adverse changes in interest or currency exchange rates and equity prices. Given our U.S. operations typically invest in U.S. dollar denominated fixed maturity instruments, our primary market risk exposures in the investments portfolio are to changes in interest rates.
Because the investments portfolio is comprised of primarily fixed maturity instruments that are usually held to maturity, periodic changes in interest rate levels generally impact our financial results to the extent that the investments are recorded at market value and reinvestment yields are different than the original yields on maturing instruments. During periods of rising interest rates, the market values of the existing fixed maturities will generally decrease. The reverse is true during periods of declining interest rates.
Credit Risk
Credit risk is defined as the risk of financial loss due to failure of the other party to a financial instrument to discharge an obligation. Credit risk arises from our positions in short-term investments, corporate debt instruments and government bonds.
The Investment and Capital Committee of the Board of Directors is responsible for the oversight of key investment policies and limits. These policies and limits are subject to annual review and approval by the Investment and Capital Committee. The Investment and Capital Committee is also responsible for ensuring that these policies are implemented and that procedures are in place to manage and control credit risk.
Table 4 below summarizes the composition of the fair values of fixed maturities, excluding cash and cash equivalents, at September 30, 2015 and December 31, 2014, by rating as assigned by Standard and Poor's ("S&P") or Moody's Investors Service ("Moody's"). Fixed maturities consist of predominantly high-quality instruments in corporate and government bonds with approximately 91.5% of those investments rated 'A' or better at September 30, 2015. During the first quarter of 2015, the Company received $3.0 million of 8% preferred stock of PIH, redeemable in five years, related to the termination of the Company's Management Services Agreement with PIH, as further discussed in Note 20, "Related Party Transactions," to the unaudited consolidated interim financial statements. The preferred stock is not rated.
TABLE 4 Credit ratings of fixed maturities

| Rating (S&P/Moody's) | September 30, 2015 | | December 31, 2014 | |
|---|---|---|---|---|
| AAA/Aaa | 61.2 | % | 65.3 | % |
| AA/Aa | 11.6 | | 8.4 | |
| A/A | 18.7 | | 21.9 | |
| Percentage rated A/A2 or better | 91.5 | % | 95.6 | % |
| BBB/Baa | 3.5 | | 4.4 | |
| Not rated | 5.0 | | — | |
| Total | 100.0 | % | 100.0 | % |

Other-Than-Temporary Impairment
The Company performs a quarterly analysis of its investments portfolio to determine if declines in market value are other-than-temporary. Further information regarding our detailed analysis and factors considered in establishing an other-than-temporary impairment on an investment is discussed within Note 6, "Investments," to the unaudited consolidated interim financial statements.
As a result of the analysis performed by the Company to determine declines in market value that are other-than-temporary, there were no write-downs for other-than-temporary impairments recorded for the three months ended September 30, 2015 and September 30, 2014, respectively, and for the nine months ended September 30, 2014. For the nine months ended September 30, 2015, the Company recorded a write-down of $0.0 million for other-than-temporary impairment related to fixed maturities.
The length of time an individual investment may be held in an unrealized loss position may vary based on the opinion of the investment manager and the respective analyses related to valuation and to the various credit risks that may prevent us from recapturing the principal investment. In the case of an individual investment with a maturity date where the investment manager determines that there is little or no risk of default prior to the maturity of a holding, we would elect to hold the investment in an unrealized loss position until the price recovers or the investment matures. In

situations where facts emerge that might increase the risk associated with recapture of principal, the Company may elect to sell investments at a loss.

At September 30, 2015 and December 31, 2014, the gross unrealized losses for fixed maturities and equity investments amounted to $2.5 million and $0.7 million, respectively, and there were no unrealized losses attributable to non-investment grade fixed maturities. At each of September 30, 2015 and December 31, 2014, all unrealized losses on individual investments were considered temporary.

Limited Liability Investments

The Company owns investments in various limited liability companies ("LLCs") and limited partnerships ("LPs") that primarily invest in income-producing real estate or real estate related investments. The Company's investments in the LLCs and LPs are accounted for under the equity method of accounting and reported as limited liability investments in the consolidated balance sheets. The real estate investments are held on a triple net lease basis whereby the lessee agrees to pay all real estate taxes, building insurance and maintenance. The real estate investments yield between 7.5% - 8% minimum preferred return on invested capital. In October 2015, the Company sold certain of these investments. The Company estimates that it will record a gain of approximately $1.2 million during the fourth quarter of 2015 related to these sales. Table 5 below presents additional information pertaining to the limited liability investments at September 30, 2015 and December 31, 2014.

TABLE 5 Limited liability investments
(in thousands of dollars)

| | Unfunded Commitment | Carrying Value | |
|---|---|---|---|
| Limited liability investments: | September 30, 2015 | September 30, 2015 | December 31, 2014 |
| Real estate held through LP | 369 | 4,524 | 4,524 |
| Investments held through LLC | 1,650 | 10,147 | 2,636 |
| Other | 350 | 706 | 134 |
| Total | 2,369 | 15,377 | 7,294 |

Investment in Investee

At September 30, 2015, the Company owns 61.0% of the outstanding units of 1347 Investors LLC ("1347 Investors"). Because the Company owns more than 50% of the outstanding units, 1347 Investors is included in the unaudited consolidated interim financial statements of the Company. 1347 Investors has an investment in the common stock and private units of 1347 Capital Corp. which is reflected as investment in investee in the consolidated balance sheets. 1347 Capital Corp. was formed for the purpose of entering into a merger, share exchange, asset acquisition or other similar business combination with one or more businesses or entities.

On July 21, 2014, 1347 Capital Corp. completed an initial public offering of 4.0 million units at a price to the public of $10.00 per unit for total gross proceeds of $40.0 million. Each unit issued in the initial public offering consists of one share of common stock, one right to receive one-tenth of a share of common stock automatically on the consummation of an initial business combination, and one warrant to acquire one-half of one share of common stock at a price of $11.50 per full share of common stock. On July 23, 2014, the option to purchase an additional 600,000 units that 1347 Capital Corp. had granted to the underwriters for additional gross proceeds of $6.0 million was completed. As a result, 1347 Capital Corp. issued a total of 4.6 million units in its initial public offering, generating total gross proceeds of $46.0 million.

1347 Capital Corp. has 24 months from July 21, 2014, the date of the initial public offering, to complete a successful business combination. Had a successful business combination been consummated during the third quarter of 2015, and assuming the September 30, 2015 closing stock price for 1347 Capital Corp. common shares, the Company estimates the increase in its shareholders’ equity would have been approximately $5.8 million at September 30, 2015. There can be no assurance that 1347 Capital Corp. will complete a successful business combination. In the event 1347 Capital Corp. does not complete a successful business combination, the Company estimates its shareholders’ equity would decrease by approximately $1.7 million.

PROPERTY AND CASUALTY UNPAID LOSS AND LOSS ADJUSTMENT EXPENSES

Property and casualty unpaid loss and loss adjustment expenses represent the estimated liabilities for reported loss events, incurred but not reported ("IBNR") loss events and the related estimated loss adjustment expenses.

Tables 6 and 7 present distributions, by line of business, of the provision for property and casualty unpaid loss and loss adjustment expenses gross and net of external reinsurance, respectively.

43

TABLE 6 Provision for property and casualty unpaid loss and loss adjustment expenses - gross
(in thousands of dollars)

| Line of Business | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Non-standard automobile | 52,371 | 58,493 |
| Commercial automobile | 2,070 | 4,248 |
| Other | 997 | 1,154 |
| Total | 55,438 | 63,895 |

TABLE 7 Provision for property and casualty unpaid loss and loss adjustment expenses - net of reinsurance recoverable
(in thousands of dollars)

| Line of Business | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Non-standard automobile | 50,929 | 55,476 |
| Commercial automobile | 1,989 | 4,062 |
| Other | 997 | 1,154 |
| Total | 53,915 | 60,692 |

Non-Standard Automobile

At September 30, 2015 and December 31, 2014, the gross provisions for property and casualty unpaid loss and loss adjustment expenses for our non-standard automobile business were $52.4 million and $58.5 million, respectively. The decrease is due to a decline at Mendota and Amigo.

Commercial Automobile

At September 30, 2015 and December 31, 2014, the gross provisions for property and casualty unpaid loss and loss adjustment expenses for our commercial automobile business were $2.1 million and $4.2 million, respectively. The decrease is due to the continuing voluntary run-offs of Amigo and MCC.

Information with respect to development of our provision for prior years' property and casualty unpaid loss and loss adjustment expenses is presented in Table 8.

TABLE 8 Increase (decrease) in prior years' provision for property and casualty unpaid loss and loss adjustment expenses
(in thousands of dollars)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Unfavorable (favorable) change in provision for property and casualty unpaid loss and loss adjustment expenses for prior accident years: | 185 | (285) | (299) | (1,151) |

For the three months ended September 30, 2015, the Company reported $0.2 million of unfavorable development for property and casualty unpaid loss and loss adjustment expenses from prior accident years (favorable development of $0.3 million year to date) compared with favorable development of $0.3 million for the three months ended September 30, 2014 ($1.2 million prior year to date). The unfavorable development reported for the three months ended September 30, 2015 was primarily related to the increase in property and casualty unpaid loss and loss adjustment expenses at Mendota, offset by a decrease in property and casualty unpaid loss and loss adjustment expenses at Amigo. The favorable development reported for the nine months ended September 30, 2015 was primarily related to the decrease in property and casualty unpaid loss and loss adjustment expenses at Amigo, offset by an increase in property and casualty unpaid loss and loss adjustment expenses at Mendota. The favorable development reported for the three and nine months ended September 30, 2014 was primarily related to the decrease in property and casualty unpaid loss and loss adjustment expenses at Amigo.

The Company cannot predict whether property and casualty unpaid loss and loss adjustment expenses will develop favorably or unfavorably from the amounts reported in the Company's unaudited consolidated interim financial statements. The Company believes that any such development will not have a material effect on the Company's consolidated equity but could have a material effect on the Company's consolidated financial results for a given period. See the "Critical Accounting Estimates and Assumptions" section of Management's Discussion and Analysis of Financial Condition and Results of Operations in the 2014 Annual Report for additional information pertaining to the Company's process of estimating the provision for unpaid loss and loss adjustment expenses.

RECENTLY ISSUED ACCOUNTING STANDARDS

See Note 4, "Recently Issued Accounting Standards," to the unaudited consolidated interim financial statements, for discussion of certain accounting standards that may be applicable to the Company's current and future consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

The purpose of liquidity management is to ensure that there is sufficient cash to meet all financial commitments and obligations as they fall due. The liquidity requirements of the Company and its subsidiaries have been met primarily by funds generated from operations, disposal of discontinued operations, investment maturities and income and other returns received on investments. Cash provided from these sources is used primarily for loss and loss adjustment expense payments, debt servicing and other operating expenses. The timing and amount of payments for loss and loss adjustment expenses may differ materially from our provisions for unpaid loss and loss adjustment expenses, which may create increased liquidity requirements.

Cash Flows

During the nine months ended September 30, 2015, the net cash used in operating activities as reported on the unaudited consolidated statements of cash flows was $10.5 million. This use of cash can be explained primarily by the loss from continuing operations of $9.3 million and the decrease in the provision for unpaid loss and loss adjustment expenses of $8.5 million, offset by the decrease in reinsurance recoverable of $2.0 million and the change in other, net of $5.7 million, primarily due to the increase in accrued expenses and other liabilities.

During the nine months ended September 30, 2015, the net cash provided by investing activities as reported on the unaudited consolidated statements of cash flows was $28.0 million. This source of cash was driven primarily by the net proceeds from the sale of ARS of $44.9 million, as further discussed in Note 5, "Disposition, Deconsolidation and Discontinued Operations," to the unaudited consolidated interim financial statements, partially offset by purchases of fixed maturities, equity investments and limited liability investments in excess of proceeds from sales and maturities of fixed maturities and equity investments.

During the nine months ended September 30, 2015, the net cash used in financing activities as reported on the unaudited consolidated statements of cash flows was $12.9 million. This use of cash is due to the redemption of C$15.8 million outstanding of LROC preferred units due June 30, 2015, as further discussed in Note 5, "Disposition, Deconsolidation and Discontinued Operations," to the unaudited consolidated interim financial statements.

In summary, as reported on the unaudited consolidated statements of cash flows, the Company's net increase in cash and cash equivalents during the nine months ended September 30, 2015 was $4.6 million.

The Company's Insurance Underwriting subsidiaries fund their obligations primarily through premium and investment income and maturities in the investments portfolios. The Company's Insurance Services subsidiaries fund their obligations primarily through service fee and commission income. As a holding company, Kingsway funds its obligations, which primarily consist of interest payments on debt as well as holding company operating expenses, primarily through the sale of subsidiaries and other assets; issuance of debt and equity securities; and receipt of dividends from its non-insurance subsidiaries. On the other hand, the insurance subsidiaries require regulatory approval for the return of capital and, in certain circumstances, prior to the payment of dividends. At September 30, 2015, the U.S. insurance subsidiaries of the Company were restricted from making any dividend payments without regulatory approval pursuant to the domiciliary state insurance regulations.

On February 3, 2014, the Company closed on its private placement totaling $6.6 million, as further discussed in Note 16, "Shareholders' Equity," to the unaudited consolidated interim financial statements. At closing, the Company received gross proceeds of $6.6 million, resulting from the sale and issuance of 262,876 units for a purchase price of

$25.00 per unit. Net proceeds to the Company were $6.3 million after deducting expenses.

Regulatory Capital

In the United States, a risk-based capital ("RBC") formula is used by the National Association of Insurance Commissioners ("NAIC") to identify property and casualty insurance companies that may not be adequately capitalized. In general, insurers reporting surplus as regards policyholders below 200% of the authorized control level, as defined by the NAIC, at December 31 are subject to varying levels of regulatory action, including discontinuation of operations. As of December 31, 2014, surplus as regards policyholders reported by each of our insurance subsidiaries exceeded the 200% threshold.

Our reinsurance subsidiary, which is domiciled in Barbados, is required by the regulator in Barbados to maintain minimum capital levels. As of September 30, 2015, the capital maintained by Kingsway Reinsurance Corporation was in excess of the regulatory capital requirements in Barbados.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are a smaller reporting company as defined in Rule 12b-2 of the Exchange Act; therefore, pursuant to Regulation S-K, we are not required to make disclosures under this Item.

Item 4. Controls and Procedures

The Company's management performed an evaluation under the supervision and with the participation of the Company's principal executive officer and the principal financial officer, and completed an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e), as adopted by the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934, as amended ("the Exchange Act") as of September 30, 2015. Disclosure controls and procedures are the controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to management, including the principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosures.

Based on that evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective.

During the Company's last fiscal quarter, there were no changes in internal control over financial reporting that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Information concerning pending legal proceedings is incorporated herein by reference to Note 22, "Commitments and Contingencies," to the unaudited consolidated interim financial statements in Part I of this Form 10-Q.

Item 1A. Risk Factors

There are no material changes with respect to those risk factors previously disclosed in our 2014 Annual Report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None

Item 6. Exhibits

| | |
|---|---|
| 31.1 | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase |

KINGSWAY FINANCIAL SERVICES INC.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

KINGSWAY FINANCIAL SERVICES INC.

| | | | |
|---|---|---|---|
| Date: | November 9, 2015 | By: | /s/ Larry G. Swets, Jr.<br>Larry G. Swets, Jr., President, Chief Executive Officer and Director<br>(principal executive officer) |
| Date: | November 9, 2015 | By: | /s/ William A. Hickey, Jr.<br>William A. Hickey, Jr., Chief Financial Officer and Executive Vice President<br>(principal financial officer) |