

Conifer Holdings, Inc.
Form 10-Q
November 07, 2018

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

FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the Quarterly Period Ended September 30, 2018
OR
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 001-37536

Conifer Holdings, Inc.
(Exact name of registrant as specified in its charter)
Michigan 27-1298795
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

550 West Merrill Street, Suite 200
Birmingham, Michigan 48009
(Address of principal executive offices) (Zip code)

(248) 559-0840
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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Large accelerated filer Accelerated filer Non-accelerated filer
(Do not check if a smaller reporting company) Emerging growth company
Smaller reporting company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of outstanding shares of the registrant's common stock, no par value, as of November 5, 2018, was 8,602,703.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES

Form 10-Q

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PART 1 - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(dollars in thousands)

| | September 30, 2018 (Unaudited) | December 31, 2017 |
|--|--------------------------------------|----------------------|
| Assets | | |
| Investment securities: | | |
| Debt securities, at fair value (amortized cost of \$125,018 and \$137,004, respectively) | \$ 121,996 | \$ 136,536 |
| Equity securities, at fair value (cost of \$8,890 and \$8,629, respectively) | 9,832 | 9,687 |
| Short-term investments, at fair value | 9,905 | 11,427 |
| Total investments | 141,733 | 157,650 |
| Cash | 16,455 | 11,868 |
| Premiums and agents' balances receivable, net | 22,415 | 22,845 |
| Receivable from affiliate | 1,321 | 1,195 |
| Reinsurance recoverables on unpaid losses | 27,118 | 20,066 |
| Reinsurance recoverables on paid losses | 2,540 | 4,473 |
| Prepaid reinsurance premiums | 1,498 | 1,081 |
| Deferred policy acquisition costs | 11,843 | 12,781 |
| Other assets | 8,074 | 7,073 |
| Total assets | \$ 232,997 | \$ 239,032 |
| Liabilities and Shareholders' Equity | | |
| Liabilities: | | |
| Unpaid losses and loss adjustment expenses | \$ 91,046 | \$ 87,896 |
| Unearned premiums | 51,701 | 57,672 |
| Reinsurance premiums payable | — | 3,299 |
| Debt | 29,750 | 29,027 |
| Accounts payable and other liabilities | 13,961 | 8,312 |
| Total liabilities | 186,458 | 186,206 |
| Commitments and contingencies | — | — |
| Shareholders' equity: | | |
| Common stock, no par value (100,000,000 shares authorized; 8,602,703 and 8,520,328 issued and outstanding, respectively) | 86,915 | 86,199 |
| Accumulated deficit | (36,982 |) (33,010) |
| Accumulated other comprehensive income (loss) | (3,394 |) (363) |
| Total shareholders' equity | 46,539 | 52,826 |
| Total liabilities and shareholders' equity | \$ 232,997 | \$ 239,032 |

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Operations (Unaudited)

(dollars in thousands, except per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|--|-------------|------------------------------------|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| Revenue | | | | |
| Premiums | | | | |
| Gross earned premiums | \$27,318 | \$28,891 | \$82,899 | \$85,493 |
| Ceded earned premiums | (3,868) | (11,232) | (11,711) | (19,198) |
| Net earned premiums | 23,450 | 17,659 | 71,188 | 66,295 |
| Net investment income | 786 | 768 | 2,425 | 2,008 |
| Net realized investment gains (losses) | (21) | 39 | 152 | 31 |
| Change in fair value of equity securities | 151 | — | (116) | — |
| Other gains | — | — | — | 750 |
| Other income | 405 | 477 | 1,212 | 1,203 |
| Total revenue | 24,771 | 18,943 | 74,861 | 70,287 |
| Expenses | | | | |
| Losses and loss adjustment expenses, net | 16,554 | 26,468 | 44,950 | 58,875 |
| Policy acquisition costs | 6,452 | 6,655 | 19,437 | 19,555 |
| Operating expenses | 4,786 | 4,474 | 13,276 | 13,374 |
| Interest expense | 598 | 303 | 1,834 | 745 |
| Total expenses | 28,390 | 37,900 | 79,497 | 92,549 |
| Income (loss) before equity earnings of affiliates and income taxes | (3,619) | (18,957) | (4,636) | (22,262) |
| Equity earnings of affiliates, net of tax | 93 | (76) | 237 | 89 |
| Income tax (benefit) expense | 25 | (135) | 52 | (410) |
| Net income (loss) | \$(3,551) | \$(18,898) | \$(4,451) | \$(21,763) |
| Earnings (loss) per common share, basic and diluted | \$(0.42) | \$(2.46) | \$(0.52) | \$(2.85) |
| Weighted average common shares outstanding, basic and diluted | 8,553,613 | 7,675,952 | 8,531,545 | 7,647,520 |

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

(dollars in thousands)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|------------|------------------------------------|------------|
| | 2018 | 2017 | 2018 | 2017 |
| Net income (loss) | \$(3,551) | \$(18,898) | \$(4,451) | \$(21,763) |
| Other comprehensive income (loss), net of tax: | | | | |
| Unrealized investment gains (losses): | | | | |
| Unrealized investment gains (losses) during the period | (352) |) 377 | (2,574) |) 1,281 |
| Income tax (benefit) expense | — |) 117 | — |) 398 |
| Unrealized investment gains (losses), net of tax | (352) |) 260 | (2,574) |) 883 |
| Less: reclassification adjustments to: | | | | |
| Net realized investment gains (losses) included in net income (loss) | (18) |) 7 | (22) |) 57 |
| Income tax (benefit) expense | — |) — | — |) — |
| Total reclassifications included in net income (loss), net of tax | (18) |) 7 | (22) |) 57 |
| Other comprehensive income (loss) | (334) |) 253 | (2,552) |) 826 |
| Total comprehensive income (loss) | \$(3,885) | \$(18,645) | \$(7,003) | \$(20,937) |

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Shareholders' Equity (Unaudited)

(dollars in thousands)

| | No Par, Common Stock | | Accumulated deficit | Accumulated | Total Shareholders' Equity |
|---|-------------------------|----------|------------------------|--|----------------------------------|
| | Shares | Amount | | Other Comprehensive Income (Loss) | |
| Balances at December 31, 2016 | 7,633,070 | \$80,342 | \$ (11,468) | \$ (1,080) | \$ 67,794 |
| Net loss | — | — | (21,763) | — | (21,763) |
| Issuance of common stock in private placement | 800,000 | 5,000 | | | 5,000 |
| Common stock issuance costs | | (13) | | | (13) |
| Restricted stock unit expense, net | 85,418 | 650 | — | — | 650 |
| Other comprehensive income | — | — | — | 826 | 826 |
| Balances at September 30, 2017 | 8,518,488 | 85,979 | (33,231) | (254) | 52,494 |
| Net loss | — | — | 221 | — | 221 |
| Common stock issuance costs | — | (25) | — | — | (25) |
| Restricted stock unit expense, net | 1,840 | 245 | — | — | 245 |
| Other comprehensive income | — | — | — | (109) | (109) |
| Balances at December 31, 2017 | 8,520,328 | 86,199 | (33,010) | (363) | 52,826 |
| Net loss | — | — | (4,451) | — | (4,451) |
| Restricted stock unit expense, net | 82,375 | 716 | — | — | 716 |
| Other comprehensive loss | — | — | — | (2,552) | (2,552) |
| Cumulative effect of adoption of ASU No. 2016-01, net of taxes | — | — | 556 | (556) | — |
| Cumulative effect of adoption of ASU No. 2018-02, net of taxes | — | — | (77) | 77 | — |
| Balances at September 30, 2018 | 8,602,703 | \$86,915 | \$ (36,982) | \$ (3,394) | \$ 46,539 |

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(In thousands)

| | Nine Months Ended September 30, | |
|--|------------------------------------|-------------|
| | 2018 | 2017 |
| Cash Flows From Operating Activities | | |
| Net income (loss) | \$(4,451) | \$(21,763) |
| Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 254 | 296 |
| Amortization of bond premium and discount, net | 392 | 395 |
| Net realized investment (gains) losses | (152) | (31) |
| Change in fair value of equity securities | 116 | — |
| Restricted stock unit expenses | 716 | 650 |
| Other | (237) | (89) |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in: | | |
| Premiums and agents' balances and other receivables | 304 | 3,467 |
| Reinsurance recoverables | (5,119) | (8,274) |
| Prepaid reinsurance premiums | (417) | 3,038 |
| Deferred policy acquisition costs | 938 | 537 |
| Other assets | (900) | 4,025 |
| Increase (decrease) in: | | |
| Unpaid losses and loss adjustment expenses | 3,150 | 28,105 |
| Unearned premiums | (5,971) | (2,457) |
| Accounts payable and other liabilities | 3,866 | 9,607 |
| Net cash provided by (used in) operating activities | (7,511) | 17,506 |
| Cash Flows From Investing Activities | | |
| Purchase of investments | (63,599) | (159,242) |
| Proceeds from maturities and redemptions of investments | 18,460 | 18,128 |
| Proceeds from sales of investments | 56,632 | 126,345 |
| Purchases of property and equipment | (69) | (6) |
| Net cash provided by (used in) investing activities | 11,424 | (14,775) |
| Cash Flows From Financing Activities | | |
| Proceeds received from issuance of shares of common stock | — | 4,375 |
| Borrowings under debt arrangements | 22,000 | 32,000 |
| Repayment of borrowings under debt arrangements | (20,000) | (19,750) |
| Payment of equity issuance costs | — | (13) |
| Payment of debt issuance costs | (1,326) | (990) |
| Net cash provided by (used in) financing activities | 674 | 15,622 |
| Net increase (decrease) in cash | 4,587 | 18,353 |
| Cash at beginning of period | 11,868 | 12,493 |
| Cash at end of period | \$16,455 | \$30,846 |
| Supplemental Disclosure of Cash Flow Information: | | |
| Interest paid | \$2,386 | \$860 |
| Payable for securities - non cash item | 1,681 | 1,500 |

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include accounts, after elimination of intercompany accounts and transactions, of Conifer Holdings, Inc. (the "Company" or "Conifer"), its wholly owned subsidiaries, Conifer Insurance Company ("CIC"), White Pine Insurance Company ("WPIC"), Red Cedar Insurance Company ("RCIC"), and Sycamore Insurance Agency, Inc. ("SIA"). CIC, WPIC, and RCIC are collectively referred to as the "Insurance Company Subsidiaries." On a stand-alone basis, Conifer Holdings, Inc. is referred to as the "Parent Company."

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The Company has applied the rules and regulations of the United States Securities and Exchange Commission ("SEC") regarding interim financial reporting and therefore the consolidated financial statements do not include all of the information and notes required by GAAP for annual financial statements. In the opinion of management, all adjustments, consisting of items of a normal recurring nature, necessary for a fair presentation of the consolidated interim financial statements, have been included. The results of operations for the nine months ended September 30, 2018, are not necessarily indicative of the results expected for the year ended December 31, 2018.

These consolidated financial statements and the notes thereto should be read in conjunction with the Company's audited consolidated financial statements and related notes included in its Annual Report on Form 10-K/A for the year ended December 31, 2017, as filed with the SEC.

Business

The Company is engaged in the sale of property and casualty insurance products and has organized its business model around two classes of insurance businesses: commercial and personal lines. The Company underwrites a variety of specialty insurance products, including property, general liability, liquor liability, automobile, homeowners and dwelling policies. The Company markets and sells its insurance products through a network of independent agents and managing general agents. Policies are written in all 50 states. The Company's corporate headquarters is located in Birmingham, Michigan with additional office facilities in Florida, Pennsylvania and Tennessee.

The Company also generates other revenues through investment income and other income which mainly consists of installment fees and policy issuance fees generally related to the policies we write. We also generate equity earnings from SIA's 50% owned agency (the "Affiliate"). The Affiliate places small commercial risks mainly for alarm and security guard markets.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. While management believes the amounts included in the consolidated financial statements reflect management's best estimates and assumptions, actual results may differ from these estimates.

Recently Issued Accounting Guidance

Effective January 1, 2018, the Company adopted FASB Accounting Standards Update ("ASU") No. 2016-01, Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities. As a result of adoption of this ASU, equity instruments that do not result in consolidation and are not accounted for under the equity method are measured at fair value and any changes in fair value are recognized in net income. Previously, the Company's equity securities were classified as available-for-sale and changes in fair value were recorded in other comprehensive income. Upon adoption of this ASU, cumulative net unrealized gains on equity securities of \$1.1 million, net of deferred income taxes of \$0.5 million, were reclassified from accumulated other comprehensive income into accumulated deficit. Prior periods have not been recast to conform to the current presentation. See Note 2

~ Investments for details regarding the change in net unrealized gains on equity securities included in net income for the current quarter ended September 30, 2018.

Effective January 1, 2018, the Company early adopted ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The ASU provides an option to reclassify tax effects remaining in accumulated other comprehensive income as a result of the Tax Cuts and Jobs Act (TCJA) to retained earnings. Upon enactment of the TCJA, the U.S. corporate tax rate was reduced from 35% to 21% and the Company's U.S. deferred tax balances were remeasured to the lower enacted U.S. corporate tax rate. GAAP requires the effects of changes in tax rates and laws on deferred tax balances to be recorded as a component of income tax

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

expense in the period of enactment, even if the assets and liabilities relate to items of accumulated other comprehensive income. As a result of adopting the ASU, the Company reclassified \$77,000 of previously recognized deferred taxes from accumulated other comprehensive income into accumulated deficit as of January 1, 2018. In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which addresses the financial reporting of leasing transactions. This update will require the recognition of a right-of-use asset and a corresponding lease liability, discounted to the present value, for all leases that extend beyond 12 months. For operating leases, the asset and liability will be expensed over the lease term on a straight-line basis, with all cash flows included in the operating section of the consolidated statement of cash flows. For finance leases, interest on the lease liability will be recognized separately from the amortization of the right-of-use asset in the consolidated statement of operations and the repayment of the principal portion of the lease liability will be classified as a financing activity while the interest component will be included in the operating section of the consolidated statement of cash flows. This ASU is effective for annual and interim reporting periods beginning after December 15, 2018. Early adoption is permitted. We do not have any financing leases. If the standard were adopted as of September 30, 2018, approximately \$4.4 million of future lease liabilities would be added to our balance sheet with a corresponding right-of-use asset. We have approximately \$860,000 of operating lease expenses for the nine months ended September 30, 2018, and do not expect that there would be a materially different expense upon adoption.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326), which amends the current methodology and timing for recognizing credit losses. This amendment will replace the current GAAP "incurred loss" methodology for credit losses with a methodology based on expected credit losses. The new guidance will also require expanded consideration of a broader range of reasonable and increased supportable information for the credit loss estimates. This ASU is effective for annual and interim reporting periods beginning after December 15, 2019. Early adoption is permitted for years beginning after December 15, 2018. Management is currently evaluating the impact of the guidance.

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 840), which modifies the disclosure requirements for assets and liabilities measured at fair value. The requirements to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, the policy for timing of transfers between levels and the valuation processes for Level 3 fair value measurements have all been removed. However, the changes in unrealized gains and losses included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period must be disclosed along with the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements (or other quantitative information if it is more reasonable). Finally, for investments measured at net asset value, the requirements have been modified so that the timing of liquidation and the date when restrictions from redemption might lapse are only disclosed if the investee has communicated the timing to the entity or announced the timing publicly. This ASU is effective for annual and interim reporting periods beginning after December 15, 2019. Early adoption is permitted upon the issuance of this update. Management is currently evaluating the impact of the guidance.

2. Investments

The cost or amortized cost, gross unrealized gain or loss, and estimated fair value of the investments in securities classified as available for sale at September 30, 2018 and December 31, 2017, were as follows (dollars in thousands):

| September 30, 2018 | | |
|------------------------------|------------------------------|----------------------------|
| Cost or Amortized Cost | Gross Unrealized Gains | Estimated Fair Value |

Debt Securities:

| | | | | |
|--|-----------|-------|-----------|------------|
| U.S. Government | \$15,809 | \$1 | \$(307) |)\$15,503 |
| State and local government | 16,004 | 57 | (305) |)15,756 |
| Corporate debt | 31,742 | 86 | (706) |)31,122 |
| Asset-backed securities | 24,006 | 22 | (187) |)23,841 |
| Mortgage-backed securities | 31,320 | 9 | (1,524) |)29,805 |
| Commercial mortgage-backed securities | 3,890 | — | (100) |)3,790 |
| Collateralized mortgage obligations | 2,247 | 7 | (75) |)2,179 |
| Total debt securities available for sale | \$125,018 | \$182 | \$(3,204) |)\$121,996 |

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CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

| | December 31, 2017 | | | |
|--|-------------------|------------|-----------|-----------|
| | Cost or | Gross | | Estimated |
| | Amortized | Unrealized | | Fair |
| | Cost | Gains | Losses | Value |
| Debt Securities: | | | | |
| U.S. Government | \$17,179 | \$10 | \$(99) | \$17,090 |
| State and local government | 17,302 | 255 | (54) | 17,503 |
| Corporate debt | 38,947 | 170 | (209) | 38,908 |
| Asset-backed securities | 23,539 | 36 | (35) | 23,540 |
| Mortgage-backed securities | 33,942 | 38 | (522) | 33,458 |
| Commercial mortgage-backed securities | 3,532 | 3 | (44) | 3,491 |
| Collateralized mortgage obligations | 2,563 | 19 | (36) | 2,546 |
| Total debt securities available for sale | 137,004 | 531 | (999) | 136,536 |
| Equity Securities (1) | 8,629 | 1,240 | (182) | 9,687 |
| Total securities available for sale | \$145,633 | \$1,771 | \$(1,181) | \$146,223 |

(1) Effective January 1, 2018, the Company adopted ASU No. 2016-01. As a result, equity securities are no longer classified as available-for-sale. Prior periods have not been recast to conform to the current presentation. Refer to Note 1 ~ Summary of Significant Accounting Policies for further details.

The following table summarizes the aggregate fair value and gross unrealized losses, by security type, of the available-for-sale securities in unrealized loss positions. The table segregates the holdings based on the length of time that individual securities have been in a continuous unrealized loss position, as follows (dollars in thousands):

| | September 30, 2018 | | | | | | | | |
|--|---|-------------------------|-----------|---|-------------------------|-----------|---|-------------------------|-----------|
| | Less than 12 months | | | Greater than 12 months | | | Total | | |
| | Fair Value | | | Fair Value of | | | Fair Value | | |
| | No. of Investments of Issues with Unrealized Losses | Gross Unrealized Losses | | No. of Investments of Issues with Unrealized Losses | Gross Unrealized Losses | | No. of Investments of Issues with Unrealized Losses | Gross Unrealized Losses | |
| Debt Securities: | | | | | | | | | |
| U.S. Government | 9 | \$ 9,877 | \$(165) | 10 | \$ 5,300 | \$(142) | 19 | \$ 15,177 | \$(307) |
| State and local government | 40 | 9,239 | (185) | 9 | 2,827 | (120) | 49 | 12,066 | (305) |
| Corporate debt | 47 | 14,716 | (247) | 11 | 7,118 | (459) | 58 | 21,834 | (706) |
| Asset-backed securities | 29 | 18,228 | (173) | 5 | 972 | (14) | 34 | 19,200 | (187) |
| Mortgage-backed securities | 19 | 6,664 | (242) | 28 | 20,999 | (1,282) | 47 | 27,663 | (1,524) |
| Commercial mortgage-backed securities | 4 | 2,310 | (26) | 2 | 1,400 | (74) | 6 | 3,710 | (100) |
| Collateralized mortgage obligations | 9 | 275 | (4) | 3 | 1,553 | (71) | 12 | 1,828 | (75) |
| Total debt securities available for sale | 157 | \$ 61,309 | \$(1,042) | 68 | \$ 40,169 | \$(2,162) | 225 | \$ 101,478 | \$(3,204) |

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

| | December 31, 2017 | | Greater than 12 months | | Total | | | | |
|--|---|-------------------------|---|-------------------------|---|-------------------------|-----|-----------|------------|
| | Less than 12 months | | Greater than 12 months | | Total | | | | |
| | Fair Value | | Fair Value | | Fair Value | | | | |
| | No. of Investments of Issues with Unrealized Losses | Gross Unrealized Losses | No. of Investments of Issues with Unrealized Losses | Gross Unrealized Losses | No. of Investments of Issues with Unrealized Losses | Gross Unrealized Losses | | | |
| Debt Securities: | | | | | | | | | |
| U.S. Government | 12 | \$ 11,555 | \$ (64) | 7 | \$ 2,207 | \$ (35) | 19 | \$ 13,762 | \$ (99) |
| State and local government | 10 | 3,511 | (20) | 7 | 1,424 | (34) | 17 | 4,935 | (54) |
| Corporate debt | 38 | 15,236 | (46) | 106 | 5,555 | (163) | 48 | 21,791 | (209) |
| Asset-backed securities | 20 | 13,948 | (29) | 3 | 915 | (6) | 23 | 14,863 | (35) |
| Mortgage-backed securities | 6 | 4,935 | (19) | 262 | 4,939 | (503) | 32 | 29,874 | (522) |
| Commercial mortgage-backed securities | 3 | 2,026 | (12) | 2 | 722 | (32) | 5 | 2,748 | (44) |
| Collateralized mortgage obligations | 8 | 1,870 | (36) | — | — | — | 8 | 1,870 | (36) |
| Total debt securities available for sale | 97 | 53,081 | (226) | 55 | 36,762 | (773) | 152 | 89,843 | (999) |
| Equity Securities (1) | 13 | 436 | (75) | 4 | 266 | (107) | 17 | 702 | (182) |
| Total securities available for sale | 110 | \$ 53,517 | \$ (301) | 59 | \$ 37,028 | \$ (880) | 169 | \$ 90,545 | \$ (1,181) |

(1) Effective January 1, 2018, the Company adopted ASU No. 2016-01. As a result, equity securities are no longer classified as available-for-sale. Prior periods have not been recast to conform to the current presentation. Refer to Note 1 ~ Summary of Significant Accounting Policies for further details.

The Company analyzed its investment portfolio in accordance with its other-than-temporary impairment ("OTTI") review procedures and determined the Company did not need to record a credit-related OTTI loss in net income, nor recognize a non-credit related OTTI loss in other comprehensive income for the nine months ended September 30, 2018 and 2017.

The Company's sources of net investment income are as follows (dollars in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------------|----------------------------------|-------|---------------------------------|---------|
| | 2018 | 2017 | 2018 | 2017 |
| Debt securities | \$801 | \$733 | \$2,495 | \$2,030 |
| Equity securities | 33 | 44 | 98 | 94 |
| Cash and short-term investments | 19 | 64 | 55 | 91 |
| Total investment income | 853 | 841 | 2,648 | 2,215 |
| Investment expenses | (67) | (73) | (223) | (207) |
| Net investment income | \$786 | \$768 | \$2,425 | \$2,008 |

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

The following table summarizes the gross realized gains and losses from sales or maturities of available-for-sale debt and equity securities (dollars in thousands):

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|--|--|------|---|------|
| Debt securities: | | | | |
| Gross realized gains | \$52 | \$29 | \$54 | \$29 |
| Gross realized losses | (131) | (1) | (146) | (8) |
| Total debt securities | (79) | 28 | (92) | 21 |
| Equity securities: | | | | |
| Gross realized gains | 84 | 11 | 290 | 40 |
| Gross realized losses | (26) | — | (46) | (30) |
| Total equity securities | 58 | 11 | 244 | 10 |
| Total net realized investment gains (losses) | \$(21) | \$39 | \$152 | \$31 |

Proceeds from the sales of debt securities, maturities and other redemptions (primarily the return of capital) were \$23.5 million and \$19.5 million for the nine months ended September 30, 2018 and 2017, respectively.

Effective January 1, 2018, the Company adopted ASU No. 2016-01. As a result, equity securities are no longer classified as available for sale with unrealized gains and losses recognized in other comprehensive income; rather, all changes in fair value of equity securities are now recognized in net income. The change in fair value of equity securities included in net income for the three and nine months ended September 30, 2018, was a \$151,000 gain and a \$116,000 loss, respectively. Prior periods have not been recast for the adoption of this guidance.

The table below summarizes the amortized cost and fair value of available-for-sale debt securities by contractual maturity at September 30, 2018. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or prepay obligations with or without call or prepayment penalties (dollars in thousands):

| | Amortized Cost | Estimated Fair Value |
|--|-------------------|----------------------------|
| Due in one year or less | \$7,009 | \$6,986 |
| Due after one year through five years | 35,377 | 34,818 |
| Due after five years through ten years | 12,972 | 12,578 |
| Due after ten years | 8,197 | 7,999 |
| Securities with contractual maturities | 63,555 | 62,381 |
| Asset-backed securities | 24,006 | 23,841 |
| Mortgage-backed securities | 31,320 | 29,805 |
| Commercial mortgage-backed securities | 3,890 | 3,790 |
| Collateralized mortgage obligations | 2,247 | 2,179 |
| Total debt securities | \$125,018 | \$121,996 |

At September 30, 2018 and December 31, 2017, the Insurance Company Subsidiaries had an aggregate of \$8.2 million on deposit in trust accounts to meet the deposit requirements of various state insurance departments. At September 30, 2018 and December 31, 2017, the Company had \$41.0 million and \$18.4 million, respectively, held in trust accounts to meet collateral requirements with other third-party insurers, relating to various fronting arrangements. There are withdrawal and other restrictions on these deposits, including the type of investments that

may be held, however, the Company may generally invest in high-grade bonds and short-term investments and earn interest on the funds.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
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3. Fair Value Measurements

The Company's financial instruments include assets and liabilities carried at fair value, as well as assets and liabilities carried at cost or amortized cost but disclosed at fair value in these consolidated financial statements. Fair value is defined as the price that would be received for an asset or paid to transfer a liability in the principally most advantageous market for the asset or liability in an orderly transaction between market participants. In determining fair value, the Company applies the market approach, which uses prices and other relevant data based on market transactions involving identical or comparable assets and liabilities. The inputs to valuation techniques used to measure fair value are prioritized into a three-level hierarchy. The hierarchy gives the highest priority to quoted prices from sources independent of the reporting entity ("observable inputs") and the lowest priority to prices determined by the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances ("unobservable inputs"). The fair value hierarchy is as follows:

Level 1—Valuations that are based on quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2—Valuations that are based on observable inputs (other than Level 1 prices) such as quoted prices for similar assets or liabilities at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3—Unobservable inputs that are supported by little or no market activity. The unobservable inputs represent the Company's best assumption of how market participants would price the assets or liabilities.

The following tables present the Company's assets and liabilities measured at fair value on a recurring basis, classified by the valuation hierarchy as of September 30, 2018 and December 31, 2017 (dollars in thousands):

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

| | September 30, 2018 | | | |
|---|-------------------------------|-------------|--------------|----------|
| | Fair Value Measurements Using | | | |
| | Quoted | | | |
| | Prices | | | |
| | in | Significant | Significant | |
| | Active | Other | Unobservable | |
| | Markets | Observable | Inputs | |
| | for | Inputs | (Level 3) | |
| | Identical | (Level 2) | | |
| | Assets | | | |
| | (Level | | | |
| | 1) | | | |
| Total | | | | |
| Assets: | | | | |
| Debt Securities: | | | | |
| U.S. Government | \$15,503 | \$— | \$15,503 | \$ — |
| State and local government | 15,756 | — | 15,756 | — |
| Corporate debt | 31,122 | — | 31,122 | — |
| Asset-backed securities | 23,841 | — | 23,841 | — |
| Mortgage-backed securities | 29,805 | — | 29,805 | — |
| Commercial mortgage-backed securities | 3,790 | — | 3,790 | — |
| Collateralized mortgage obligations | 2,179 | — | 2,179 | — |
| Total debt securities | 121,996 | — | 121,996 | — |
| Equity Securities | 5,645 | 5,381 | 264 | — |
| Short-term investments | 9,905 | 9,905 | — | — |
| Total marketable investments measured at fair value | \$137,546 | \$15,286 | \$122,260 | \$ — |
| Investments measured at NAV: | | | | |
| Investment in limited partnership | \$4,187 | | | |
| Total investments measured at NAV | \$4,187 | | | |
| Total assets measured at fair value | \$141,733 | | | |
| Liabilities: | | | | |
| Senior Unsecured Notes * | \$22,000 | \$22,000 | \$— | \$ — |
| Subordinated Notes * | 9,907 | — | — | 9,907 |
| Total Liabilities measured at fair value | \$31,907 | \$22,000 | \$— | \$ 9,907 |

* Carried at cost or amortized cost on the consolidated balance sheet

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

| | December 31, 2017 | | | |
|---|-------------------------------|------------------|-------------|--------------|
| | Fair Value Measurements Using | | | |
| | | Quoted Prices in | | |
| | | Active | Significant | Significant |
| | | Markets | Other | Unobservable |
| | Total | for | Observable | Inputs |
| | | Identical | Inputs | (Level 3) |
| | | Assets | (Level 2) | (Level 3) |
| | | (Level | | |
| | | 1) | | |
| Assets: | | | | |
| Debt Securities: | | | | |
| U.S. Government | \$17,090 | \$— | \$ 17,090 | \$ — |
| State and local government | 17,503 | — | 17,503 | — |
| Corporate debt | 38,908 | — | 38,908 | — |
| Asset-backed securities | 23,540 | — | 23,540 | — |
| Mortgage-backed securities | 33,458 | | 33,458 | |
| Commercial mortgage-backed securities | 3,491 | | 3,491 | |
| Collateralized mortgage obligations | 2,546 | | 2,546 | |
| Total debt securities | 136,536 | — | 136,536 | — |
| Equity securities | 5,627 | 5,381 | 246 | — |
| Short-term investments | 11,427 | 8,429 | 2,998 | — |
| Total marketable investments measured at fair value | \$153,590 | \$13,810 | \$ 139,780 | \$ — |
| Investments measured at NAV: | | | | |
| Investment in limited partnership | \$4,060 | | | |
| Total investments measured at NAV | \$4,060 | | | |
| Total assets measured at fair value | \$157,650 | | | |
| Liabilities: | | | | |
| Debt * | \$29,888 | \$— | \$ — | \$ 29,888 |
| Total Liabilities measured at fair value | \$29,888 | \$— | \$ — | \$ 29,888 |

* Carried at cost or amortized cost on the consolidated balance sheet

Level 1 investments consist of equity securities traded in an active exchange market. The Company uses unadjusted quoted prices for identical instruments to measure fair value. Level 1 also includes money market funds and other interest-bearing deposits at banks, which are reported as short-term investments. The fair value measurements that were based on Level 1 inputs comprise 10.8% of the fair value of the total investment portfolio as of September 30, 2018.

Level 2 investments include debt securities, which consist of U.S. government agency securities, state and local municipal bonds (including those held as restricted securities), corporate debt securities, mortgage-backed and asset-backed securities. The fair value of securities included in the Level 2 category were based on the market values obtained from a third party pricing service that were evaluated using pricing models that vary by asset class and incorporate available

trade, bid and other observable market information. The third party pricing service monitors market indicators, as well as industry and economic events. The fair value measurements that were based on Level 2 inputs comprise 86.3% of the fair value of the total investment portfolio as of September 30, 2018.

The Company obtains pricing for each security from independent pricing services, investment managers or consultants to assist in determining fair value for its Level 2 investments. To validate that these quoted prices are reasonable estimates of fair value, the Company performs various quantitative and qualitative procedures, such as (i) evaluation of the underlying methodologies, (ii) analysis of recent sales activity, (iii) analytical review of our fair values against current market prices and (iv) comparison of the pricing services' fair value to other pricing services' fair value for the same investment. No markets for

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

the investments were determined to be inactive at period-ends. Based on these procedures, the Company did not adjust the prices or quotes provided from independent pricing services, investment managers or consultants.

As of September 30, 2018, Level 3 is entirely comprised of the Company's subordinated debt. In determining the fair value of the subordinated debt outstanding at September 30, 2018, the security attributes (issue date, maturity, coupon, calls, etc.) and market rates on September 29, 2017 (the date of issuance) were fed into a valuation model. A lognormal trinomial interest rate lattice was created within the model to compute the option adjusted spread ("OAS") which is the amount, in basis points, of interest rate required to be paid under the debt agreement over the risk-free U.S. Treasury rates. The OAS was then fed back into the model along with the September 30, 2018, U.S. Treasury rates. A new lattice was generated and the fair value was computed from the OAS. There were no changes in assumptions of credit risk from the issuance date.

The Company's policy on recognizing transfers between hierarchy levels is applied at the end of each reporting period. There were no transfers between Levels 1, 2 and 3 for the nine months ended September 30, 2018 and 2017, respectively.

4. Deferred Policy Acquisition Costs

The Company defers costs incurred which are incremental and directly related to the successful acquisition of new or renewal insurance business, net of corresponding amounts of ceded reinsurance commissions. Net deferred policy acquisition costs are amortized and charged to expense in proportion to premium earned over the estimated policy term. The Company anticipates that its deferred policy acquisition costs will be fully recoverable and there were no premium deficiencies for the nine months ended September 30, 2018 and 2017. The activity in deferred policy acquisition costs, net of reinsurance transactions, is as follows (dollars in thousands):

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|--|--|----------|---|-----------|
| Balance at beginning of period | \$12,021 | \$12,649 | \$12,781 | \$13,290 |
| Deferred policy acquisition costs | 6,274 | 6,759 | 18,499 | 19,018 |
| Amortization of policy acquisition costs | (6,452) | (6,655) | (19,437) | (19,555) |
| Net change | (178) | 104 | (938) | (537) |
| Balance at end of period | \$11,843 | \$12,753 | \$11,843 | \$12,753 |

5. Unpaid Losses and Loss Adjustment Expenses

The Company establishes reserves for unpaid losses and loss adjustment expenses ("LAE") which represent the estimated ultimate cost of all losses incurred that were both reported and unreported (i.e., incurred but not yet reported losses; or "IBNR") and LAE incurred that remain unpaid at the balance sheet date. The Company's reserving process takes into account known facts and interpretations of circumstances and factors including the Company's experience with similar cases, actual claims paid, historical trends involving claim payment patterns and pending levels of unpaid claims, loss management programs, product mix and contractual terms, changes in law and regulation, judicial decisions, and economic conditions. In the normal course of business, the Company may also supplement its claims processes by utilizing third party adjusters, appraisers, engineers, inspectors, and other professionals and information sources to assess and settle catastrophe and non-catastrophe related claims. The effects of inflation are implicitly considered in the reserving process.

Reserves are estimates of unpaid portions of losses that have occurred, including IBNR losses; therefore the establishment of appropriate reserves is an inherently uncertain and complex process. The ultimate cost of losses may vary materially from recorded amounts, which are based on management's best estimates. The highest degree of uncertainty is associated with reserves for losses incurred in the current reporting period as it contains the greatest proportion of losses that have not been reported or settled. The Company regularly updates its reserve estimates as new information becomes available and as events unfold that may affect the resolution of unsettled claims. Changes in reserve estimates, which may be material, are reported in the results of operations in the period such changes are determined to be needed and recorded.

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Management believes that the reserve for losses and LAE, net of reinsurance recoverables, is appropriately established in the aggregate and adequate to cover the ultimate net cost of reported and unreported claims arising from losses which had occurred by the date of the consolidated financial statements based on available facts and in accordance with applicable laws and regulations.

The table below provides the changes in the reserves for losses and LAE, net of reinsurance recoverables, for the periods indicated as follows (dollars in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|----------|---------------------------------------|----------|
| | 2018 | 2017 | 2018 | 2017 |
| Gross reserves - beginning of period | \$83,662 | \$66,917 | \$87,896 | \$54,651 |
| Less: reinsurance recoverables on unpaid losses | 20,467 | 10,552 | 20,066 | 6,658 |
| Plus: deferred gain on ADC | (2,412) | — | — | — |
| Net reserves - beginning of period | 65,607 | 56,365 | 67,830 | 47,993 |
| Add: incurred losses and LAE, net of reinsurance: | | | | |
| Current period | 13,153 | 24,398 | 40,079 | 49,449 |
| Prior period | 3,401 | 2,070 | 4,871 | 9,426 |
| Total net incurred losses and LAE | 16,554 | 26,468 | 44,950 | 58,875 |
| Deduct: loss and LAE payments, net of reinsurance: | | | | |
| Current period | 5,423 | 7,194 | 11,448 | 14,410 |
| Prior period | 7,877 | 6,411 | 32,471 | 23,230 |
| Total net loss and LAE payments | 13,300 | 13,605 | 43,919 | 37,640 |
| Net reserves - end of period | 68,861 | 69,228 | 68,861 | 69,228 |
| Plus: reinsurance recoverables on unpaid losses | 27,118 | 13,528 | 27,118 | 13,528 |
| Less: deferred gain on ADC | (4,933) | — | (4,933) | — |
| Gross reserves - end of period | \$91,046 | \$82,756 | \$91,046 | \$82,756 |

On September 28, 2017, the Company entered into an adverse development cover reinsurance agreement (the "ADC") to cover loss development of up to \$17.5 million in excess of stated reserves as of June 30, 2017. The agreement provides up to \$17.5 million of reinsurance for adverse net loss reserve development for accident years 2005 through 2016. The agreement attaches when net losses exceed \$1.4 million of the \$36.6 million carried reserves at June 30, 2017, and extends to \$19.5 million in coverage up to \$57.5 million (inclusive of a 10% co-participation).

The Company accounts for the agreement as retroactive reinsurance. For the three and nine months ended September 30, 2018, the Company recorded \$4.1 million and \$7.3 million of net adverse loss development covered under this agreement, which increased the retroactive reinsurance recoverable to \$14.5 million, leaving \$3.0 million of coverage remaining on the ADC. The Company recorded the retroactive reinsurance recoverable in excess of the consideration as a deferred gain that is amortized to earnings using the interest method over the estimated claims settlement period. As of September 30, 2018, the deferred gain of \$4.9 million, net of amortization, is included in Other Liabilities on the consolidated balance sheets.

The Company's incurred losses during the three and nine months ended September 30, 2018, included adverse prior-year reserve development of \$3.4 million and \$4.9 million, respectively. Before the effect of the ADC deferred gain, the commercial lines of business reported \$4.2 million of adverse prior-year development and personal lines

reported \$612,000 of adverse development for the three months ended September 30, 2018. Before the effect of the ADC deferred gain, the commercial lines of business reported \$5.3 million of adverse prior-year development and personal lines reported \$1.9 million of adverse development for the nine months ended September 30, 2018. Included in the unfavorable development was \$83,000 and \$471,000 attributable to additional 2017 losses from Hurricane Harvey for the three and nine months ended September 30, 2018, respectively. The ADC had a favorable impact of \$1.5 million and \$2.4 million on prior year reserve development for the three and nine months ended September 30, 2018, respectively.

The Company's incurred losses during the three and nine months ended September 30, 2017, included prior-year adverse reserve development of \$2.1 million and \$9.4 million, respectively. The \$2.1 million of net adverse development was

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comprised of \$865,000 from the commercial liability line of business, \$697,000 from the Florida homeowners line, \$604,000 from the commercial auto line of business, \$350,000 from the commercial property line, offset by \$446,000 of favorable development from other lines. For the nine months ended September 30, 2017, there was adverse development of \$4.2 million from the commercial liability line of business, \$2.4 million from the Florida homeowners line, \$2.2 million from the commercial property line, \$932,000 from the commercial auto line of business, offset by \$277,000 of favorable development in other lines.

6. Reinsurance

In the normal course of business, the Company seeks to minimize the loss that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with reinsurers. The Company participates in reinsurance agreements in order to limit its loss exposure including protecting against catastrophe losses. The Company primarily ceded all specific property risks in excess of \$300,000 in 2018 and \$500,000 in 2017 and primarily ceded all specific liability risks in excess of \$500,000 in both 2018 and 2017.

Reinsurance does not discharge the direct insurer from liability to its policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers and monitors the concentration of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. To date, the Company has not experienced any significant difficulties in collecting reinsurance recoverables.

The Company assumes written premiums under a few fronting arrangements, most of which are net of other reinsurance arrangements. The fronting arrangements are with unaffiliated insurers who write on behalf of the Company in markets that require a higher A.M. Best rating than the Company's current rating, where the policies are written in a state where the Company is not licensed or for other strategic reasons.

The consideration for the ADC entered into in the third quarter of 2017 was a payment of \$7.2 million, which resulted in a one-time charge to ceded premiums fully earned in the third quarter of 2017. There is a 35% contingent recovery depending on the performance of the reserves over time. No recovery is currently reflected in the financial statements. The following table presents the effects of such reinsurance and assumption transactions on premiums and losses and LAE (dollars in thousands). The 2018 ceded written and earned premium amounts include \$257,000 and \$797,000 of reinsurance reinstatement costs relating to Hurricane Irma for the three and nine months ended September 30, 2018, respectively.

| | Three Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|----------------------|--|-----------|---|-----------|
| Written premiums: | | | | |
| Direct | \$16,814 | \$20,112 | \$53,237 | \$61,731 |
| Assumed | 9,815 | 9,469 | 23,691 | 21,305 |
| Ceded | (3,783) | (11,186) | (11,642) | (19,235) |
| Net written premiums | \$22,846 | \$18,395 | \$65,286 | \$63,801 |
| Earned premiums: | | | | |
| Direct | \$19,955 | \$21,797 | \$61,739 | \$65,817 |

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| | | | | |
|---------------------|----------|-----------|-----------|-----------|
| Assumed | 7,363 | 7,094 | 21,160 | 19,676 |
| Ceded | (3,868) | (11,232) | (11,711) | (19,198) |
| Net earned premiums | \$23,450 | \$17,659 | \$71,188 | \$66,295 |

Losses and LAE:

| | | | | |
|--------------------|----------|----------|-----------|-----------|
| Direct | \$19,324 | \$27,268 | \$46,714 | \$59,496 |
| Assumed | 5,027 | 5,313 | 11,996 | 14,017 |
| Ceded | (7,797) | (6,113) | (13,760) | (14,638) |
| Net Losses and LAE | \$16,554 | \$26,468 | \$44,950 | \$58,875 |

7. Debt

The Company's debt is comprised of three instruments: \$22.0 million of senior unsecured notes which were issued in September 2018, a \$10.0 million line of credit which commenced in June 2018, and \$30.0 million of subordinated notes which commenced in September 2017. A summary of the Company's outstanding debt is as follows (dollars in thousands):

| | September 30, December 31, | |
|------------------------|----------------------------|-----------|
| | 2018 | 2017 |
| Senior unsecured notes | \$ 20,779 | \$ — |
| Subordinated notes | 8,971 | 29,027 |
| Line of credit | — | — |
| Total | \$ 29,750 | \$ 29,027 |

On September 24, 2018, the Company issued \$22.0 million of senior unsecured notes (the "Notes"). The Notes bear interest at the rate of 6.75% per year, and interest on the Notes is payable quarterly in arrears on March 31, June 30, September 30 and December 31 of each year, beginning on December 31, 2018. The Notes will mature on September 30, 2023. The Company may redeem the Notes, in whole or in part at any time or from time to time on or after September 30, 2021, at the redemption price of 100% aggregate principal amount, plus any accrued and unpaid interest. \$20.0 million of the proceeds from the Notes were used to pay off the Company's private placement subordinated notes (the "Subordinated Notes").

On June 21, 2018, the Company entered into a \$10.0 million line of credit. The agreement has a maturity date of June 21, 2019 and bears interest at the London Interbank rate ("LIBOR") plus 2.75% per annum, payable monthly. The agreement includes several covenants, including but not limited to a minimum tangible net worth, a minimum fixed-charge coverage ratio, and minimum statutory risk-based capital levels. As of September 30, 2018, the Company has not drawn down on the line of credit.

On September 29, 2017, the Company executed \$30.0 million of Subordinated Notes. The Subordinated Notes have a maturity date of September 29, 2032, bear interest, payable quarterly at a fixed annual rate of 8.0%, and allow for up to four quarterly interest deferrals. On the fifth and tenth anniversary of the Subordinated Notes, the interest rate resets to 1,250 basis points and 1,500 basis points, respectively, above the 5-year mid-swap rate. The Company paid down \$20.0 million of the Subordinated Notes in September 2018.

The carrying value of the Notes and Subordinated Notes are offset by \$1.2 million and \$1.0 million of debt issuance costs, respectively. The debt issuance costs will be amortized through interest expense over the life of the loans. The Subordinated Notes contain various restrictive covenants that relate to the Company's tangible net worth, fixed-charge coverage ratios, dividend paying capacity, reinsurance retentions, and risk-based capital ratios. At September 30, 2018, the Company was in compliance with all of its financial covenants.

8. Shareholders' Equity

In September 2017, the Company issued \$5.0 million of common equity through a private placement for 800,000 shares priced at \$6.25 per share. The participants in the private placement consisted mainly of members of the Company's management team and insiders, including Chairman and CEO James Petcoff. The Company used the proceeds to strengthen its balance sheet through contributions to the subsidiaries to support their future growth, as well as cover the cost of the ADC and reserve strengthening.

On February 25, 2016, the Company's Board of Directors authorized a stock repurchase program, under which the Company may repurchase up to \$2.1 million of its outstanding common stock. Under this program, management was authorized to repurchase shares at prevailing market prices through open market purchases, privately negotiated transactions, block purchases or otherwise in accordance with applicable federal securities laws, including Rule 10b5-1 and 10b-18 of the Securities Exchange Act of 1934, as amended. The actual timing, number and value of shares repurchased under the program was determined by management in its discretion and depends on a number of factors, including the market price of the Company's stock, general market conditions, and other factors. For the nine months ended September 30, 2018 and 2017, the Company had not repurchased any shares of stock. Repurchased shares remain authorized but not issued or outstanding, and are available to be reissued in the future. As of September 30, 2018 and December 31, 2017, the Company had 8,602,703 and 8,520,328 issued and outstanding shares of common stock, respectively.

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Holders of common stock are entitled to one vote per share and to receive dividends only when and if declared by the board of directors. The holders have no preemptive, conversion or subscription rights.

9. Accumulated Other Comprehensive Income (Loss)

The following table presents changes in accumulated other comprehensive income (loss) for unrealized gains and losses on available-for-sale securities (dollars in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|--|---------|---------------------------------------|-----------|
| | 2018 | 2017 | 2018 | 2017 |
| Balance at beginning of period | \$(3,060) | \$(507) | \$(363) | \$(1,080) |
| Other comprehensive income (loss) before reclassifications | (352) | 260 | (2,574) | 883 |
| Less: amounts reclassified from accumulated other comprehensive income (loss) | (18) | 7 | (22) | 57 |
| Net current period other comprehensive income (loss) | (334) | 253 | (2,552) | 826 |
| Plus: cumulative effect of adoption of ASU No. 2016-01, net of taxes | — | — | (556) | — |
| Plus: cumulative effect of adoption of ASU No. 2018-02, net of taxes | — | — | 77 | — |
| Balance at end of period | \$(3,394) | \$(254) | \$(3,394) | \$(254) |

10. Earnings Per Share

Basic and diluted earnings (loss) per share are computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. The following table presents the calculation of basic and diluted earnings (loss) per common share, as follows (dollars in thousands, except per share amounts):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------|--|------------|------------------------------------|------------|
| | 2018 | 2017 | 2018 | 2017 |
| Net income (loss) | \$(3,551) | \$(18,898) | \$(4,451) | \$(21,763) |

Weighted average common shares, basic and diluted* 8,553,613 7,675,952 8,531,545 7,647,520

Earnings (loss) per common share, basic and diluted \$(0.42) \$(2.46) \$(0.52) \$(2.85)

* The 273,000 and 309,000 nonvested shares of the restricted stock units were anti-dilutive as of September 30, 2018 and September 30, 2017, respectively. Therefore, the basic and diluted weighted average common shares are equal for the three and nine months ended September 30, 2018 and September 30, 2017.

11. Stock-based Compensation

In 2015, the Company issued 390,352 restricted stock units ("RSUs") to executive officers and other employees to be settled in shares of common stock. The total RSUs were valued at \$4.1 million on the dates of grant. In 2016, the Company issued 111,281 RSUs to executive officers and other employees valued at \$909,000 on the date of grant. In 2018, the Company issued 70,000 RSUs to executive officers and other employees valued at \$404,000 on the dates of grant.

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The following summarizes our RSU activity (units in thousands):

| | | Weighted Number Average of Units Grant-Date Fair Value |
|-----------------------------------|-------|---|
| Outstanding at December 31, 2016 | 416 | \$ 9.87 |
| Units vested | (93) | 9.97 |
| Units forfeited | (14) | 9.95 |
| Outstanding at September 30, 2017 | 309 | \$ 9.84 |
| Units vested | (2) | 9.56 |
| Outstanding at December 31, 2017 | 307 | \$ 9.84 |
| Units granted | 70 | 5.76 |
| Units vested | (89) | 10.02 |
| Units forfeited | (15) | 8.81 |
| Outstanding at September 30, 2018 | 273 | \$ 8.79 |

The Company recorded \$716,000 and \$650,000 of compensation expense related to the RSUs for the nine months ended September 30, 2018 and 2017, respectively. The total compensation cost related to the non-vested portion of the restricted stock units which has not been recognized as of September 30, 2018, was \$2.2 million.

12. Commitments and Contingencies

Legal proceedings

The Company and its subsidiaries are subject at times to various claims, lawsuits and proceedings relating principally to alleged errors or omissions in the placement of insurance, claims administration, and other business transactions arising in the ordinary course of business. Where appropriate, the Company vigorously defends such claims, lawsuits and proceedings. Some of these claims, lawsuits and proceedings seek damages, including consequential, exemplary or punitive damages, in amounts that could, if awarded, be significant. Most of the claims, lawsuits and proceedings arising in the ordinary course of business are related to the insurance policy issued. On the basis of current information, the Company does not believe that there is a reasonable possibility that any material loss exceeding amounts already accrued, if any, will result from any of the claims, lawsuits and proceedings to which the Company is subject, either individually, or in the aggregate.

13. Segment Information

The Company is engaged in the sale of property and casualty insurance products and has organized its business model around two classes of insurance businesses: commercial and personal lines. Within these two insurance businesses, the Company offers various insurance products. Such insurance businesses are engaged in underwriting and marketing insurance coverages, and administering claims processing for such policies.

The Company defines its operating segments as components of the business where separate financial information is available and used by the chief operating decision-making group in deciding how to allocate resources to its segments and in assessing its performance. In assessing performance of its operating segments, the Company's chief operating decision-making group, comprised of key senior executives, reviews a number of financial measures including gross written premiums, net earned premiums and losses and LAE, net of reinsurance recoveries. The primary measure used for making decisions about resources to be allocated to an operating segment and assessing its performance is segment underwriting gain or loss which is defined as segment revenues, consisting of net earned premiums and other income,

less segment expenses, consisting of losses and LAE, policy acquisition costs and operating expenses of the operating segments. Operating expenses primarily include compensation and related benefits for underwriting personnel, policy issuance and claims systems, rent and utilities. The Company markets, distributes and sells its insurance products through its own insurance agencies and a network of independent agents. All of the Company's insurance activities are conducted in the United States with a concentration of activity in Florida,

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

Michigan, Texas and Pennsylvania. For the nine months ended September 30, 2018 and 2017, gross written premiums attributable to these four states were 54% and 60%, respectively, of the Company's total gross written premiums.

In addition to the reportable operating segments, the Company maintains a Corporate and Other category to reconcile segment results to the consolidated totals. The Corporate and Other category includes: (i) corporate operating expenses such as salaries and related benefits of the Company's executive management team and finance and information technology personnel, and other corporate headquarters expenses, (ii) interest expense on the Company's debt obligations; (iii) depreciation and amortization on property and equipment, and (iv) all investment income activity. All investment income activity is reported within net investment income and net realized investment gains on the consolidated statements of operations. The Company's assets on the consolidated balance sheet are not allocated to the reportable segments.

The following tables present information by reportable operating segment (dollars in thousands):

| Three Months Ended September 30, 2018 | Commercial Lines | Personal Lines | Corporate & Other | Total |
|---|------------------|----------------|-------------------|-------------|
| Gross written premiums | \$ 24,806 | \$ 1,823 | \$ — | \$ 26,629 |
| Net written premiums | \$ 22,160 | \$ 686 | \$ — | \$ 22,846 |
| Net earned premiums | \$ 21,270 | \$ 2,180 | \$ — | \$ 23,450 |
| Other income | 167 | 199 | 39 | 405 |
| Total revenue | 21,437 | 2,379 | 39 | 23,855 |
| Losses and loss adjustment expenses, net | 14,445 | 2,109 | — | 16,554 |
| Policy acquisition costs | 5,441 | 1,011 | — | 6,452 |
| Operating expenses | 3,969 | 416 | 401 | 4,786 |
| Total expenses | 23,855 | 3,536 | 401 | 27,792 |
| Underwriting gain (loss) | \$ (2,418) | \$ (1,157) | \$ (362) | \$ (3,937) |
| Net investment income | | | 786 | 786 |
| Net realized investment gains | | | (21) | (21) |
| Change in fair value of equity securities | | | 151 | 151 |
| Interest expense | | | (598) | (598) |
| Income (loss) before equity earnings of affiliates and income taxes | | | \$ (44) | \$ (3,619) |

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

| Three Months Ended September 30, 2017 | Commercial Lines | Personal Lines | Corporate & Other | Total |
|---|---------------------|-------------------|----------------------|-------------|
| Gross written premiums | \$ 23,509 | \$ 6,072 | \$ — | \$ 29,581 |
| Net written premiums | \$ 16,221 | \$ 2,174 | \$ — | \$ 18,395 |
| Net earned premiums | \$ 15,658 | \$ 2,001 | \$ — | \$ 17,659 |
| Other income | 162 | 281 | 34 | 477 |
| Total revenue | 15,820 | 2,282 | 34 | 18,136 |
| Losses and loss adjustment expenses, net | 19,589 | 6,879 | — | 26,468 |
| Policy acquisition costs | 5,161 | 1,494 | — | 6,655 |
| Operating expenses | 3,322 | 808 | 344 | 4,474 |
| Total expenses | 28,072 | 9,181 | 344 | 37,597 |
| Underwriting gain (loss) | \$ (12,252) | \$ (6,899) | (310) | (19,461) |
| Net investment income | | | 768 | 768 |
| Net realized investment gains | | | 39 | 39 |
| Interest expense | | | (303) | (303) |
| Income (loss) before equity earnings of affiliates and income taxes | | | \$ 194 | \$ (18,957) |
| Nine Months Ended September 30, 2018 | Commercial Lines | Personal Lines | Corporate & Other | Total |
| Gross written premiums | \$ 71,602 | \$ 5,326 | \$ — | \$ 76,928 |
| Net written premiums | \$ 63,866 | \$ 1,420 | \$ — | \$ 65,286 |
| Net earned premiums | \$ 62,270 | \$ 8,918 | \$ — | \$ 71,188 |
| Other income | 471 | 593 | 148 | 1,212 |
| Total revenue | 62,741 | 9,511 | 148 | 72,400 |
| Losses and loss adjustment expenses, net | 36,979 | 7,971 | — | 44,950 |
| Policy acquisition costs | 16,028 | 3,409 | — | 19,437 |
| Operating expenses | 11,294 | 1,134 | 848 | 13,276 |
| Total expenses | 64,301 | 12,514 | 848 | 77,663 |
| Underwriting gain (loss) | \$ (1,560) | \$ (3,003) | (700) | (5,263) |
| Net investment income | | | 2,425 | 2,425 |
| Net realized investment gains | | | 152 | 152 |
| Change in fair value of equity securities | | | (116) | (116) |
| Interest Expense | | | (1,834) | (1,834) |
| Income (loss) before equity earnings of affiliates and income taxes | | | \$ (73) | \$ (4,636) |

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

| Nine Months Ended September 30, 2017 | Commercial Lines | Personal Lines | Corporate & Other | Total |
|---|---------------------|-------------------|----------------------|-------------|
| Gross written premiums | \$ 66,258 | \$ 16,778 | \$— | \$ 83,036 |
| Net written premiums | \$ 54,616 | \$ 9,185 | \$— | \$ 63,801 |
| Net earned premiums | \$ 55,443 | \$ 10,852 | \$— | \$ 66,295 |
| Other income | 485 | 601 | 117 | 1,203 |
| Total revenue | 55,928 | 11,453 | 117 | 67,498 |
| Losses and loss adjustment expenses, net | 43,819 | 15,056 | — | 58,875 |
| Policy acquisition costs | 15,180 | 4,375 | — | 19,555 |
| Operating expenses | 8,231 | 1,967 | 3,176 | 13,374 |
| Total expenses | 67,230 | 21,398 | 3,176 | 91,804 |
| Underwriting gain (loss) | \$(11,302) | \$(9,945) | (3,059) | (24,306) |
| Net investment income | | | 2,008 | 2,008 |
| Net realized investment gains (losses) | | | 31 | 31 |
| Other gains | | | 750 | 750 |
| Interest expense | | | (745) | (745) |
| Income (loss) before equity earnings of affiliates and income taxes | | | \$(1,015) | \$(22,262) |

14. Subsequent Events

On October 12, 2018 the Company announced that the underwriters for the previously announced public offering of the Company's 6.75% Senior Unsecured Notes due 2023 exercised in full their over-allotment option to purchase an additional \$3.3 million aggregate principal amount of the Notes. The total aggregate principal amount of Notes sold by the Company in the offering increased to \$25.3 million. The principal amount of the Notes is offset by approximately \$1.4 million of debt issuance costs for a net carrying value of \$23.9 million. Refer to Note 7 ~ Debt for further details of the previously announced public offering.

On November 2, 2018, the Company amended the terms of the Subordinated Notes. Under the new terms, the Subordinated Notes carry a principle value of \$10.5 million and mature on September 30, 2038. The Subordinated Notes bear an annual interest rate of 7.5% until September 30, 2023, and 12.5% thereafter. Interest is payable quarterly in arrears on March 31, June 30, September 30 and December 31 of each year, beginning on December 31, 2018. Beginning September 30, 2021, the Company may redeem the Subordinated Notes, in whole or in part, or any quarter thereafter, for a call premium of \$1.1 million on September 30, 2021. The call premium escalates quarterly to \$1.75 million on September 30, 2023, then steps up to \$3.05 million on December 31, 2023, and increases quarterly at a 12.5% per annum rate thereafter. The debt covenants are consistent with the existing Subordinated Note terms. A \$105,000 loan origination fee was paid on the effective date.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

For the Periods Ended September 30, 2018 and 2017

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements (Unaudited), related notes and other financial information appearing elsewhere in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and related notes included in our Annual Report on Form 10-K/A, filed on May 14, 2018 with the U. S. Securities and Exchange Commission.

Forward-Looking Statements

Certain statements contained in this Quarterly Report on Form 10-Q, which are not statements of historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, as Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements give current expectations or forecasts of future events or our future financial or operating performance. Words such as "anticipate," "believe," "estimate," "expect," "intend," "may," "plan," "seek" and similar terms and phrases, or the negative thereof, may be used to identify forward-looking statements.

The forward-looking statements contained in this report are based on management's good-faith belief and reasonable judgment based on current information. The forward-looking statements are qualified by important factors, risks and uncertainties, many of which are beyond our control, that could cause our actual results to differ materially from those in the forward-looking statements, including those described in our Form 10-K/A ("Item 1A Risk Factors") for the fiscal year ended December 31, 2017, our Quarterly Report on Form 10-Q for the quarter ended June 30, 2018 and subsequent reports filed with or furnished to the SEC. Any forward-looking statement made by us in this report speaks only as of the date hereof or as of the date specified herein. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by any applicable laws or regulations.

Business Overview

We are an insurance holding company that markets and services our product offerings through specialty commercial and specialty personal insurance business lines. Our growth has been significant since our founding in 2009. Currently, we are authorized to write insurance as an excess and surplus lines carrier in 45 states, including the District of Columbia. We are also licensed to write insurance as an admitted carrier in 42 states, including the District of Columbia, and we offer our insurance products in all 50 states.

Our revenues are primarily derived from premiums earned from our insurance operations. We also generate other revenues through investment income and other income which mainly consists of installment fees and policy issuance fees generally related to the policies we write.

Our expenses consist primarily of losses and loss adjustment expenses, agents' commissions, and other underwriting and administrative expenses. We organize our operations in two insurance businesses: commercial insurance lines and personal insurance lines.

Through our commercial insurance product lines, we offer coverage for both commercial property and commercial liability. We also offer coverage for commercial automobiles and workers' compensation. Our insurance policies are sold to targeted small and mid-sized businesses on a single or multiple-coverage basis.

Through our personal insurance product lines, we offer homeowners insurance and dwelling fire insurance policies to individuals in several states. Our specialty homeowners insurance product line is primarily comprised of either wind-exposed

homeowners insurance providing hurricane and wind coverage to underserved homeowners in Texas, Hawaii and Florida or

low-value dwelling insurance tailored for owners of lower valued homes, which we offer in Illinois, Indiana and Texas. Due to recent Florida-based industry events, we have been de-emphasizing our Florida homeowners' business and

reducing our exposures in that state, as well as other wind-exposed states like Texas and Hawaii.

Recent Developments

On October 12, 2018, the Company announced that the underwriters exercised in full their overallotment option to purchase an additional \$3.3 million aggregate principal amount of the Company's 6.75% Senior Unsecured Notes due 2023 (the Notes). The sale of these additional Notes increased the total aggregate principal amount of Notes sold by the Company in the offering to \$25.3 million.

On November 2, 2018, the Company amended the terms of the Subordinated Notes. Under the new terms, the Subordinated Notes carry a principle value of \$10.5 million and mature on September 30, 2038. The Subordinated Notes bear an annual interest rate of 7.5% until September 30, 2023, and 12.5% thereafter. Interest is payable quarterly in arrears on March 31, June 30, September 30 and December 31 of each year, beginning on December 31, 2018. Beginning September 30, 2021, the Company may redeem the Subordinated Notes, in whole or in part, or any quarter thereafter, for a call premium of \$1.1 million on September 30, 2021. The call premium escalates quarterly to \$1.75 million on September 30, 2023, then steps up to \$3.05 million on December 31, 2023, and increases quarterly at a 12.5% per annum rate thereafter. The debt covenants are consistent with the existing Subordinated Note terms. A \$105,000 loan origination fee was paid on the effective date.

Critical Accounting Policies and Estimates

In certain circumstances, we are required to make estimates and assumptions that affect amounts reported in our consolidated financial statements and related footnotes. We evaluate these estimates and assumptions periodically on an on-going basis based on a variety of factors. There can be no assurance, however, that actual results will not be materially different than our estimates and assumptions, and that reported results of operation will not be affected by accounting adjustments needed to reflect changes in these estimates and assumptions. During the nine months ended September 30, 2018, there were no material changes to our critical accounting policies and estimates, which are disclosed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in the Company’s Annual Report on Form 10-K/A filed with the SEC on May 14, 2018.

Executive Overview

The Company reported a net loss of \$3.6 million, or \$0.42 per share and \$4.5 million, or \$0.52 per share, for the three and nine months ended September 30, 2018, respectively, compared to a net loss of \$18.9 million, or \$2.46 per share, and \$21.8 million, or \$2.85, for the same periods in 2017.

Adjusted operating loss, a non-GAAP measure, was \$1.2 million, or \$0.14 per share for the three months ended September 30, 2018. Adjusted operating income was \$446,000, or \$0.05 per share, for the nine months ended September 30, 2018. Adjusted operating loss was \$19.1 million, or \$2.48 per share, and \$22.9 million, or \$3.00 per share, for the three and nine months ended September 30, 2017.

Our combined ratio was 116.5% and 107.3% for the three and nine months ended September 30, 2018, compared to 207.3% and 136.0% for the same periods in 2017, respectively.

Results of Operations For The Three Months Ended September 30, 2018 and 2017

The following table summarizes our operating results for the periods indicated (dollars in thousands):

Summary of Operating Results

| | Three Months Ended September 30, | | \$ Change | % Change |
|--|-------------------------------------|------------|------------|-------------|
| | 2018 | 2017 | | |
| Gross written premiums | \$26,629 | \$29,581 | \$(2,952) | (10.0)% |
| Net written premiums | \$22,846 | \$18,395 | \$4,451 | 24.2 % |
| Net earned premiums | \$23,450 | \$17,659 | \$5,791 | 32.8 % |
| Other income | 405 | 477 | (72) | (15.1)% |
| Losses and loss adjustment expenses, net | 16,554 | 26,468 | (9,914) | (37.5)% |
| Policy acquisition costs | 6,452 | 6,655 | (203) | (3.1)% |
| Operating expenses | 4,786 | 4,474 | 312 | 7.0 % |
| Underwriting gain (loss) | (3,937) | (19,461) | 15,524 | * |
| Net investment income | 786 | 768 | 18 | 2.3 % |
| Net realized investment gains (losses) | (21) | 39 | (60) | * |
| Change in fair value of equity securities (1) | 151 | — | 151 | * |
| Interest expense | 598 | 303 | 295 | 97.4 % |
| Income (loss) before equity earnings in affiliate and income taxes | (3,619) | (18,957) | 15,338 | * |
| Equity earnings (losses) of affiliates, net of tax | 93 | (76) | 169 | * |
| Income tax expense (benefit) | 25 | (135) | 160 | * |
| Net income (loss) | \$(3,551) | \$(18,898) | \$15,347 | * |
| Book value per common share outstanding | \$5.41 | \$6.16 | | |

Underwriting Ratios:

| | | | | |
|--------------------|-------|---|-------|---|
| Loss ratio (2) | 69.4 | % | 145.9 | % |
| Expense ratio (3) | 47.1 | % | 61.4 | % |
| Combined ratio (4) | 116.5 | % | 207.3 | % |

Effective January 1, 2018, the Company adopted ASU No. 2016-01. As a result, equity securities are no longer (1) classified as available for sale. Prior periods have not been recast to conform to the current presentation. Refer to Note 1 ~ Summary of Significant Accounting Policies to the financial statements for further details.

(2) The loss ratio is the ratio, expressed as a percentage, of net losses and loss adjustment expenses to net earned premiums and other income.

(3) The expense ratio is the ratio, expressed as a percentage, of policy acquisition costs and operating expenses to net earned premiums and other income.

(4) The combined ratio is the sum of the loss ratio and the expense ratio. A combined ratio under 100% indicates an underwriting profit. A combined ratio over 100% indicates an underwriting loss.

*Percentage change is not meaningful

Premiums

Earned premiums are earned ratably over the term of the policy, whereas written premiums are reflected on the effective date of the policy. Almost all commercial lines and homeowners products have annual policies, under which premiums are earned evenly over one year. The resulting net earned premiums are impacted by the gross and ceded written premiums, earned ratably over time.

Our premiums are presented below for the three months ended September 30, 2018 and 2017 (dollars in thousands):

Summary of Premium Revenue

| | Three Months Ended September 30, | | | |
|------------------------|--|----------|--------------|-------------|
| | 2018 | 2017 | \$ Change | % Change |
| Gross written premiums | | | | |
| Commercial lines | \$24,806 | \$23,509 | \$1,297 | 5.5 % |
| Personal lines | 1,823 | 6,072 | (4,249) | (70.0)% |
| Total | \$26,629 | \$29,581 | \$(2,952) | (10.0)% |
| Net written premiums | | | | |
| Commercial lines | \$22,160 | \$16,221 | \$5,939 | 36.6 % |
| Personal lines | 686 | 2,174 | (1,488) | (68.4)% |
| Total | \$22,846 | \$18,395 | \$4,451 | 24.2 % |
| Net earned premiums | | | | |
| Commercial lines | \$21,270 | \$15,658 | \$5,612 | 35.8 % |
| Personal lines | 2,180 | 2,001 | 179 | 8.9 % |
| Total | \$23,450 | \$17,659 | \$5,791 | 32.8 % |

Gross written premiums decreased \$3.0 million, or 10.0%, to \$26.6 million for the three months ended September 30, 2018, as compared to \$29.6 million for the same period in 2017.

Commercial lines gross written premiums increased \$1.3 million, or 5.5%, to \$24.8 million in the third quarter of 2018, as compared to \$23.5 million for the third quarter of 2017. The increased gross written premiums were equally due to an increase in our hospitality and small business programs.

Personal lines gross written premiums decreased \$4.2 million, or 70.0%, to \$1.8 million in the third quarter of 2018, as compared to \$6.1 million for the same period in 2017. The decrease was the result of management's strategic decision to decrease the Florida homeowners business. The Florida homeowners business decreased by 85.7% for the three months ended September 30, 2018, compared to the same period in 2017. The decrease was also due to management's strategic decision to deemphasize other wind-exposed business in Texas and Hawaii.

Net written premiums increased \$4.5 million, or 24.2%, to \$22.8 million for the three months ended September 30, 2018, as compared to \$18.4 million for the same period in 2017. The increase is partially due to the \$7.2 million ceded written premium (a one-time charge) recorded in the third quarter of 2017 related to the ADC, offset by a decrease in gross written premium for the comparative periods.

Other Income

Other income consists primarily of fees charged to policyholders by the Company for services outside of the premium charge, such as installment billings and policy issuance costs. Commission income is also received by the Company's insurance agencies for writing policies for third party insurance companies. Other income for the three months ended September 30, 2018, decreased \$72,000, or 15.1%, to \$405,000 as compared to \$477,000 for the same period in 2017. The decrease in other income was primarily due to a decrease in gross written premium. As a percentage of gross written premium, other income remained relatively flat at 1.5% for the quarter ended September 30, 2018, compared to 1.6% for the same period in 2017.

Losses and Loss Adjustment Expenses

The tables below detail our losses and loss adjustment expenses ("LAE") and loss ratios for the three months ended September 30, 2018 and 2017 (dollars in thousands).

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| Three Months Ended September 30, 2018 | Commercial Lines | Personal Lines | Total | | |
|---------------------------------------|---------------------|-------------------|-----------|---|--|
| Accident year net losses and LAE | \$ 11,520 | \$ 1,633 | \$ 13,153 | | |
| Net (favorable) adverse development | 2,925 | 476 | 3,401 | | |
| Calendar year net losses and LAE | \$ 14,445 | \$ 2,109 | \$ 16,554 | | |
| | | | | | |
| Accident year loss ratio | 53.7 | % 68.6 | % 55.1 | % | |
| Net (favorable) adverse development | 13.6 | % 20.0 | % 14.3 | % | |
| Calendar year loss ratio | 67.3 | % 88.6 | % 69.4 | % | |
| | | | | | |
| Three Months Ended September 30, 2017 | Commercial Lines | Personal Lines | Total | | |
| Accident year net losses and LAE | \$ 17,678 | \$ 6,720 | \$ 24,398 | | |
| Net (favorable) adverse development | 1,913 | 157 | 2,070 | | |
| Calendar year net losses and LAE | \$ 19,591 | \$ 6,877 | \$ 26,468 | | |
| | | | | | |
| Accident year loss ratio | 111.7 | % 294.5 | % 134.5 | % | |
| Net (favorable) adverse development | 12.1 | % 6.9 | % 11.4 | % | |
| Calendar year loss ratio | 123.8 | % 301.4 | % 145.9 | % | |

Net losses and LAE decreased by \$9.9 million, or 37.5%, for the three months ended September 30, 2018, as compared to the same period in 2017. The calendar year loss ratios were 69.4% and 145.9% for the three months ended September 30, 2018 and 2017, respectively. Third quarter 2017 losses included \$5.0 million of net catastrophe losses related to Hurricanes Harvey and Irma. Before the impact of the ADC deferred gain and hurricane costs, the calendar year and accident year loss ratios were 57.7% and 54.6% for the three months ended September 30, 2018 and 100.0% and 73.0% for the same period in 2017, respectively.

The Company's incurred losses during the three months ended September 30, 2018, included unfavorable prior-year reserve development of \$3.4 million. The Commercial lines experienced \$2.9 million of unfavorable reserve development, while personal lines was unfavorable by \$476,000. The ADC provided \$1.5 million of benefit toward the adverse development, however another \$2.5 million of benefit to be received from the ADC was required to be deferred and recognized in future periods. Included in the unfavorable development was \$83,000 attributable to additional 2017 losses from Hurricane Harvey for the three months ended September 30, 2018.

Total reserve development on prior accident years in the third quarter of 2017 was unfavorable by \$2.1 million, adding 11.4 percentage points to the loss ratio. This was primarily due to adverse development of \$865,000 from the commercial liability line of business, \$697,000 from the Florida homeowners line, \$604,000 from the commercial auto line of business, \$350,000 from the commercial property line, offset by \$446,000 of favorable development from other lines. Incurred losses during the three months ended September 30, 2017 also included \$5.0 million in net catastrophe losses in the current accident year related to Hurricane Harvey and Hurricane Irma.

Expense Ratio

Our expense ratio is calculated by dividing the sum of policy acquisition costs and other underwriting and operating expenses by the sum of net earned premiums and other income. We use the expense ratio to evaluate the operating efficiency of our consolidated operations and each segment. Costs that cannot be readily identifiable as a direct cost of a segment or product line remain in Corporate and Other for segment reporting purposes.

The table below provides the expense ratio by major component.

| | Three Months Ended September 30, 2018 | | | 2017 | | |
|----------------------------|--|-------------------------------------|---------|--|--|----------|
| | Before Reinstatement Costs | Impact of Reinstatement Costs | Total | Before ADC & Reinstatement Costs | Impact of ADC & Reinstatement Costs | Total |
| Commercial Lines | | | | | | |
| Policy acquisition costs | 25.4% | — | % 25.4% | 24.5% | 8.1 | % 32.6 % |
| Operating expenses | 18.5% | — | % 18.5% | 15.7% | 5.3 | % 21.0 % |
| Total | 43.9% | — | % 43.9% | 40.2% | 13.4 | % 53.6 % |
| Personal Lines | | | | | | |
| Policy acquisition costs | 38.4% | 4.1 | % 42.5% | 31.0% | 34.5 | % 65.5 % |
| Operating expenses | 15.8% | 1.7 | % 17.5% | 16.8% | 18.6 | % 35.4 % |
| Total | 54.2% | 5.8 | % 60.0% | 47.8% | 53.1 | % 100.9% |
| Corporate and Other | | | | | | |
| Operating expenses | 1.7 | %— | % 1.7 | 1.3 | %0.6 | % 1.9 % |
| Total | 1.7 | %— | % 1.7 | 1.3 | %0.6 | % 1.9 % |
| Consolidated | | | | | | |
| Policy acquisition costs | 26.8% | 0.2 | % 27.0% | 25.7% | 11.0 | % 36.7 % |
| Operating expenses | 19.8% | 0.3 | % 20.1% | 17.2% | 7.5 | % 24.7 % |
| Total | 46.6% | 0.5 | % 47.1% | 42.9% | 18.5 | % 61.4 % |

Our expense ratio decreased 14.3 percentage points in the three months ended September 30, 2018, as compared to the same period in 2017. The decrease in the ratio was mainly due to increased net earned premium as the expenses were relatively flat in the comparative periods. Net earned premium was \$5.8 million higher in the three months ended September 30, 2018, compared to the same period in 2017, as there was \$7.2 million ceded to the ADC (a one-time charge) and \$600,000 ceded as reinstatement costs of catastrophe reinsurance relating to Hurricane Irma in the third quarter of 2017. Comparatively, there was \$257,000 ceded as reinstatement costs related to Hurricane Irma in the third quarter of 2018 and no ADC costs.

Policy acquisition costs are costs we incur to issue policies, which include commissions, premium taxes, underwriting reports and underwriter compensation costs. The Company offsets direct commissions with ceded commissions from reinsurers. For the three months ended September 30, 2018 and 2017, the percentage of policy acquisition costs to net earned premiums and other income was 27.0% and 36.7%, respectively. Before ADC and reinstatement costs, policy acquisition costs as a percent of net earned premiums increased slightly to 26.8% in the third quarter of 2018 from 25.7% in the third quarter of 2017. The slight increase is due to a change in the mix of business.

Operating expenses consist primarily of employee compensation, information technology and occupancy costs, such as rent and utilities. Operating expenses as a percent of net earned premiums and other income was 20.1% and 24.7% for the three months ended September 30, 2018 and 2017, respectively. Before ADC and reinstatement costs, operating expenses as a percent of net earned premiums and other income were 19.8% for the three months ended September 30, 2018, compared to 17.2% in the same period in 2017. The increase in the operating expense ratio was driven by slightly higher operating expenses, over a slightly lower net earned premium base.

Underwriting Results

We measure the performance of our consolidated results, in part, based on our underwriting gain or loss. The following table provides the underwriting gain or loss for the three months ended September 30, 2018 and 2017 (dollars in thousands):

Underwriting Gain (Loss)

| | Three Months Ended September 30, | | |
|-------------------------|--|------------|-----------|
| | 2018 | 2017 | \$ Change |
| Commercial Lines | \$(2,418) | \$(12,252) | \$9,834 |
| Personal Lines | (1,157) | (6,899) | 5,742 |
| Corporate and Other | (362) | (310) | (52) |
| Total Underwriting Loss | \$(3,937) | \$(19,461) | \$15,524 |

Results of Operations For The Nine Months Ended September 30, 2018 and 2017

The following table summarizes our operating results for the periods indicated (dollars in thousands):

Summary of Operating Results

| | Nine Months Ended September 30, | | \$ Change | % Change |
|--|------------------------------------|-------------|------------|-------------|
| | 2018 | 2017 | | |
| Gross written premiums | \$76,928 | \$83,036 | \$(6,108) | (7.4)% |
| Net written premiums | \$65,286 | \$63,801 | \$1,485 | 2.3 % |
| Net earned premiums | \$71,188 | \$66,295 | \$4,893 | 7.4 % |
| Other income | 1,212 | 1,203 | 9 | 0.7 % |
| Losses and loss adjustment expenses, net | 44,950 | 58,875 | (13,925) | (23.7)% |
| Policy acquisition costs | 19,437 | 19,555 | (118) | (0.6)% |
| Operating expenses | 13,276 | 13,374 | (98) | (0.7)% |
| Underwriting gain (loss) | (5,263) | (24,306) | 19,043 | * |
| Net investment income | 2,425 | 2,008 | 417 | 20.8 % |
| Net realized investment gains (losses) | 152 | 31 | 121 | * |
| Change in fair value of equity securities (1) | (116) | — | (116) | * |
| Other gains | — | 750 | (750) | * |
| Interest expense | 1,834 | 745 | 1,089 | 146.2 % |
| Income (loss) before equity earnings in affiliate and income taxes | (4,636) | (22,262) | 17,626 | * |
| Equity earnings (losses) of affiliates, net of tax | 237 | 89 | 148 | 166.3 % |
| Income tax expense (benefit) | 52 | (410) | 462 | * |
| Net income (loss) | \$(4,451) | \$(21,763) | \$17,312 | * |
| Book value per common share outstanding | \$5.41 | \$6.16 | | |
| Underwriting Ratios: | | | | |
| Loss ratio (2) | 62.1 | % 87.2 | % | |
| Expense ratio (3) | 45.2 | % 48.8 | % | |
| Combined ratio (4) | 107.3 | % 136.0 | % | |

Effective January 1, 2018, the Company adopted ASU No. 2016-01. As a result, equity securities are no longer (1) classified as available-for-sale. Prior periods have not been recast to conform to the current presentation. Refer to Note 1 ~ Summary of Significant Accounting Policies to the financial statements for further details.

(2) The loss ratio is the ratio, expressed as a percentage, of net losses and loss adjustment expenses to net earned premiums and other income.

(3) The expense ratio is the ratio, expressed as a percentage, of policy acquisition costs and operating expenses to net earned premiums and other income.

(4) The combined ratio is the sum of the loss ratio and the expense ratio. A combined ratio under 100% indicates an underwriting profit. A combined ratio over 100% indicates an underwriting loss.

*Percentage change is not meaningful

Premiums

Earned premiums are earned ratably over the term of the policy, whereas written premiums are reflected on the effective date of the policy. All commercial lines and homeowners products have annual policies, under which premiums are earned evenly over one year. The resulting net earned premiums are impacted by the gross and ceded written premiums, earned ratably over time.

Our premiums are presented below for the nine months ended September 30, 2018 and 2017 (dollars in thousands):
Summary of Premium Revenue

| | Nine Months Ended September 30, | | \$ Change | % Change | |
|------------------------|---------------------------------------|----------|--------------|-------------|---|
| | 2018 | 2017 | | | |
| Gross written premiums | | | | | |
| Commercial lines | \$71,602 | \$66,258 | \$5,344 | 8.1 | % |
| Personal lines | 5,326 | 16,778 | (11,452) | (68.3) | % |
| Total | \$76,928 | \$83,036 | \$(6,108) | (7.4) | % |
| Net written premiums | | | | | |
| Commercial lines | \$63,866 | \$54,616 | \$9,250 | 16.9 | % |
| Personal lines | 1,420 | 9,185 | (7,765) | (84.5) | % |
| Total | \$65,286 | \$63,801 | \$1,485 | 2.3 | % |
| Net earned premiums | | | | | |
| Commercial lines | \$62,270 | \$55,443 | \$6,827 | 12.3 | % |
| Personal lines | 8,918 | 10,852 | (1,934) | (17.8) | % |
| Total | \$71,188 | \$66,295 | \$4,893 | 7.4 | % |

Gross written premiums decreased for the nine months ended September 30, 2018, to \$76.9 million, as compared to \$83.0 million for the same period in 2017.

Commercial lines gross written premiums increased \$5.3 million, or 8.1%, to \$71.6 million for the nine months ended September 30, 2018, as compared to \$66.3 million for the same period in 2017. The increased gross written premiums were equally due to an increase in our hospitality and small business programs compared to the same period in the prior year.

Personal lines gross written premiums decreased \$11.5 million, or 68.3%, to \$5.3 million for the nine months ended September 30, 2018, as compared to \$16.8 million for the same period in 2017. The decrease was the result of Management's strategic decision to deemphasize the Company's Florida homeowners business and other wind-exposed business in Texas and Hawaii. The Florida homeowners business decreased by 76% for the nine months ended September 30, 2018, compared to the same period in 2017.

Net written premiums increased \$1.5 million, or 2.3%, to \$65.3 million for the nine months ended September 30, 2018, as compared to \$63.8 million for the same period in 2017.

Other Income

Other income consists primarily of fees charged to policyholders by the Company for services outside of the premium charge, such as installment billings and policy issuance costs. Commission income is also received by the Company's insurance agencies for writing policies for third party insurance companies. Other income for the nine months ended September 30, 2018 and 2017, remained flat at \$1.2 million.

Losses and Loss Adjustment Expenses

The tables below detail our losses and LAE and loss ratios for the nine months ended September 30, 2018 and 2017 (dollars in thousands).

| Nine months ended September 30, 2018 | Commercial Lines | Personal Lines | Total | | |
|--------------------------------------|---------------------|-------------------|-----------|---|------|
| Accident year net losses and LAE | \$ 34,395 | \$ 5,685 | \$ 40,080 | | |
| Net (favorable) adverse development | 2,584 | 2,286 | 4,870 | | |
| Calendar year net loss and LAE | \$ 36,979 | \$ 7,971 | \$ 44,950 | | |
| | | | | | |
| Accident year loss ratio | 54.8 | % | 59.8 | % | 55.4 |
| Net (favorable) adverse development | 4.1 | % | 24.0 | % | 6.7 |
| Calendar year loss ratio | 58.9 | % | 83.8 | % | 62.1 |
| | | | | | |
| | | | | | |
| Nine months ended September 30, 2017 | Commercial Lines | Personal Lines | Total | | |
| Accident year net losses and LAE | \$ 36,620 | \$ 12,829 | \$ 49,449 | | |
| Net (favorable) adverse development | 7,199 | 2,227 | 9,426 | | |
| Calendar year net loss and LAE | \$ 43,819 | \$ 15,056 | \$ 58,875 | | |
| | | | | | |
| Accident year loss ratio | 65.5 | % | 112.0 | % | 73.2 |
| Net (favorable) adverse development | 12.8 | % | 19.4 | % | 14.0 |
| Calendar year loss ratio | 78.3 | % | 131.4 | % | 87.2 |

Net losses and LAE decreased by \$13.9 million, or 23.7%, for the nine months ended September 30, 2018, as compared to the same period in 2017. The calendar year loss ratios were 62.1% and 87.2% for the nine months ended September 30, 2018 and 2017, respectively. Before the impact of the ADC deferred gain and hurricane costs, the calendar year and accident year loss ratios were 54.0% and 54.8% for the nine months ended September 30, 2018, and 78.4% and 59.1% for the same period in 2017, respectively.

Overall reserve development on prior accident years for the nine months ended September 30, 2018 was \$4.9 million of adverse development, adding 6.7 percentage points to the loss ratio. The Commercial lines experienced \$2.6 million of unfavorable reserve development, while personal lines was unfavorable by \$2.3 million. The ADC provided \$2.4 million of benefit toward the adverse development, however another \$4.9 million of benefit to be received from the ADC was required to be deferred and recognized in future periods. Included in the unfavorable development was \$471,000 attributable to additional 2017 losses from Hurricane Harvey.

Total adverse reserve development on prior accident years for the nine months ended September 30, 2017, was \$9.4 million, or 14.0 percentage points. This was due to reserve development in the commercial liability line of \$4.2 million, \$2.2 million in the commercial property line, \$2.4 million in the Florida homeowners line, \$900,000 in the commercial automobile line, offset by \$280,000 of favorable development in other lines. Third quarter incurred losses also included \$5.0 million in net catastrophe losses in the current accident year related to Hurricane Harvey and Hurricane Irma.

Expense Ratio

Our expense ratio is calculated by dividing the sum of policy acquisition costs and other underwriting and operating expenses by the sum of net earned premiums and other income. We use the expense ratio to evaluate the operating efficiency of our consolidated operations and each segment. Costs that cannot be readily identifiable as a direct cost of a segment or product line remain in Corporate and Other for segment reporting purposes.

The table below provides the expense ratio by major component.

| | Nine Months Ended September 30, 2018 | | | 2017 | | |
|----------------------------|---|-------------------------------------|-------|--|--|-------|
| | Before Reinstatement Costs | Impact of Reinstatement Costs | Total | Before ADC & Reinstatement Costs | Impact of ADC & Reinstatement Costs | Total |
| Commercial Lines | | | | | | |
| Policy acquisition costs | 25.4% | 0.1% | 25.5% | 24.8% | 2.3% | 27.1% |
| Operating expenses | 17.9% | 0.1% | 18.0% | 13.5% | 1.2% | 14.7% |
| Total | 43.3% | 0.2% | 43.5% | 38.3% | 3.5% | 41.8% |
| Personal Lines | | | | | | |
| Policy acquisition costs | 34.0% | 1.9% | 35.9% | 31.3% | 6.9% | 38.2% |
| Operating expenses | 11.3% | 0.6% | 11.9% | 14.0% | 3.2% | 17.2% |
| Total | 45.3% | 2.5% | 47.8% | 45.3% | 10.1% | 55.4% |
| Corporate and Other | | | | | | |
| Operating expenses | 1.2% | —% | 1.2% | 4.2% | 0.5% | 4.7% |
| Total | 1.2% | —% | 1.2% | 4.2% | 0.5% | 4.7% |
| Consolidated | | | | | | |
| Policy acquisition costs | 26.6% | 0.3% | 26.9% | 26.0% | 3.0% | 29.0% |
| Operating expenses | 18.1% | 0.2% | 18.3% | 17.7% | 2.1% | 19.8% |
| Total | 44.7% | 0.5% | 45.2% | 43.7% | 5.1% | 48.8% |

Our expense ratio decreased 3.6 percentage points for the nine months ended September 30, 2018, as compared to the same period in 2017. The decrease in the ratio was mainly due to increased net earned premium as the expenses decreased only slightly in the comparative periods. Net earned premium was \$4.9 million higher in the nine months ended September 30, 2018, compared to the same period in 2017, as there was \$7.2 million ceded to the ADC (a one-time charge) and \$600,000 ceded as reinstatement costs of catastrophe reinsurance relating to Hurricane Irma in the third quarter of 2017. Comparatively, there was \$797,000 ceded as reinstatement costs related to Hurricane Irma in the third quarter of 2018 and no ADC costs.

Policy acquisition costs are costs we incur to issue policies, which include commissions, premium taxes, underwriting reports and underwriter compensation costs. The Company offsets direct commissions with ceded commissions from reinsurers. For the nine months ended September 30, 2018 and 2017, the percentage of policy acquisition costs to net earned premiums and other income was 26.9% and 29.0%, respectively. Before ADC and reinstatement costs, policy acquisition costs as a percent of net earned premiums increased slightly to 26.6% in the third quarter of 2018 from 26.0% in the same period in 2017. The slight increase is due to a change in the mix of business.

Operating expenses consist primarily of employee compensation, information technology and occupancy costs, such as rent and utilities. Operating expenses as a percent of net earned premiums and other income was 18.3% and 19.8% for the nine months ended September 30, 2018 and 2017, respectively. Before ADC and reinstatement costs, operating expenses as a percent of net earned premiums and other income were 18.1% for the nine months ended September 30, 2018, compared to 17.7% in the same period in 2017. Overall operating expenses have declined slightly year over year, however, before ADC and reinstatement costs, net earned premium was down slightly causing the ratio to increase.

Underwriting Results

We measure the performance of our consolidated results, in part, based on our underwriting gain or loss. The following table provides the underwriting gain or loss for the nine months ended September 30, 2018 and 2017 (dollars in thousands):

Underwriting Gain (Loss)

| | Nine Months Ended | | \$ Change |
|-------------------------|-------------------|------------|--------------|
| | 2018 | 2017 | |
| Commercial Lines | \$(1,560) | \$(11,302) | \$9,742 |
| Personal Lines | (3,003) | (9,945) | 6,942 |
| Corporate and Other | (700) | (3,059) | 2,359 |
| Total Underwriting Loss | \$(5,263) | \$(24,306) | \$19,043 |

Excluded from the 2018 underwriting loss of \$5.3 million, is \$4.9 million of deferred gain related to the ADC that will be recognized in future periods.

Net Investment Income

Net investment income increased by \$417,000, or 20.8%, to \$2.4 million for the nine months ended September 30, 2018, as compared to \$2.0 million for the same period in 2017. This increase was the result of an increase in the average invested assets and the tax equivalent book yield. Average invested assets through the third quarter of 2018 were \$149.7 million as compared to \$137.2 million in 2017, an increase of \$12.5 million, or 9.1%. As of September 30, 2018, the average invested asset balance was comprised of 86.4% of debt securities, 6.5% of equity securities and 7.1% of short term investments, compared to the September 30, 2017 mix of 85.7% of debt securities, 5.4% of equity securities and 9.0% of short term investments.

The portfolio's average quality was AA at September 30, 2018 and December 31, 2017. The portfolio produced a tax equivalent book yield of 2.65% and 2.35% for the nine months ended September 30, 2018 and 2017, respectively. The average duration of the debt securities portfolio was 3.0 and 3.2 years at September 30, 2018 and December 31, 2017, respectively.

Other Gains

There were no other gains for the nine months ended September 30, 2018, compared to \$750,000 for the same period in 2017. In June of 2017 the Company sold the renewal rights of a portion of the existing low-value dwelling book of business to another carrier. The Company will continue writing this line of business in the future.

Interest Expense

Interest expense was \$1.8 million and \$745,000 for the nine months ended September 30, 2018 and 2017, respectively. The debt balance at September 30, 2018 was \$29.8 million, compared to \$29.0 million at September 30, 2017. The Company's subordinated notes that were entered into at the end of the third quarter of 2017 carry a higher interest rate than the credit facility that existed prior to that. Therefore, there were nine months of interest expense incurred at a higher rate in 2018, than the rate on the previous credit facility in 2017.

Income Tax Expense

The Company had \$52,000 of income tax expense and \$410,000 of income tax benefit for the nine months ended September 30, 2018 and 2017, respectively. The income tax expense for the nine months ended September 30, 2018, was related to state income taxes. The income tax benefit for the nine months ended September 30, 2017 was largely the result of the tax impact of changes in the valuation allowance on its deferred taxes related to changes in unrealized gains.

Liquidity and Capital Resources

Sources and Uses of Funds

At September 30, 2018, we had \$26.4 million in cash and short-term investments. Our principal sources of funds, excluding capital raises, are insurance premiums, investment income, proceeds from maturity and sale of invested assets and installment fees. These funds are primarily used to pay claims, commissions, employee compensation, taxes and other operating expenses, and service debt.

We believe that our existing cash, short-term investments and investment securities balances will be adequate to meet our capital and liquidity needs and the needs of our subsidiaries on a short-term and long-term basis.

We conduct our business operations primarily through our Insurance Company Subsidiaries. Our ability to service debt, and pay administrative expenses is primarily reliant upon our intercompany service fees paid by the Insurance Company Subsidiaries to the Parent Company for management, administrative, and information technology services provided to the Insurance Company Subsidiaries by the Parent Company. Secondly, the Parent Company may receive dividends from the Insurance Company Subsidiaries; however, this is not the primary means in which the Parent Company supports its funding as state insurance laws restrict the ability of our Insurance Company Subsidiaries to declare dividends to the Parent Company. Generally, the limitations are based on the greater of statutory net income for the preceding year or 10% of statutory surplus at the end of the preceding year. There were no dividends paid from our Insurance Company Subsidiaries during the nine months ended September 30, 2018.

Cash Flows

Operating Activities. Cash used in operating activities for the nine months ended September 30, 2018, was \$7.5 million as compared to \$17.5 million provided by operating activities for the same period in 2017. The \$25.0 million reduction in cash from operations was a result of a \$8.0 million decrease in cash collected from gross premiums, mostly due to the reduction in wind-exposed homeowners premiums, a \$6.8 million increase in paid ceded premiums due to the ceded premiums paid on the ADC, and a \$7.9 million increase in net paid losses due, in part, to losses incurred from the 2017 hurricanes.

Investing Activities. Cash provided by investing activities for the nine months ended September 30, 2018, was \$11.4 million as compared to cash used in investing activities of \$14.8 million for the same period in 2017. The fluctuation in the funds used in routine investing activities correlates to the timing of when the portfolio investments matured and securities were repurchased.

Financing Activities. Cash provided by financing activities for the nine months ended September 30, 2018 was \$674,000, compared to \$15.6 million for the same period in 2017. The cash provided by financing activities in 2017 was from net borrowings under debt arrangements. The cash provided from financing activities for the nine months ended September 30, 2018 was small as the Company refinanced from one borrowing arrangement to another.

Outstanding Debt

We are party to \$22.0 million in senior unsecured notes and \$10.0 million in subordinated notes. The \$22.0 million in senior unsecured notes have a maturity of September 30, 2023 and bear interest at the rate of 6.75%, payable quarterly. The subordinated notes have a maturity date of September 29, 2032, bear interest, payable quarterly at a fixed annual rate of 8.0%, and allows for up to four quarterly interest deferrals. As there are no required principle

payments in the short-term, our minimum interest payments on our debt for the remaining three months of 2018 is \$600,000 and \$4.6 million for 2019-2020. Refer to Note 7 ~ Debt of the Notes to the consolidated financial statements, for additional information regarding our outstanding debt.

Non-GAAP Financial Measures

Statutory Capital and Surplus

Statutory capital and surplus is a non-GAAP measure. The Company's insurance subsidiaries' aggregate statutory capital and surplus was \$65.8 million and \$62.5 million at September 30, 2018 and December 31, 2017, respectively.

Adjusted Operating Income and Adjusted Operating Income Per Share

Adjusted operating income and adjusted operating income per share are non-GAAP measures that represent net income allocable to common shareholders excluding net realized investment and other gains, net of tax. Beginning in 2018, the change in fair value of equity securities, net of tax, and the deferred gain on losses ceded to the ADC are also excluded from net income to arrive at adjusted operating income. The most directly comparable financial GAAP measures to adjusted operating income and adjusted operating income per share are net income and net income per share, respectively. Adjusted operating income and adjusted operating income per share are intended as supplemental information and are not meant to replace net income or net income per share. Adjusted operating income and adjusted operating income per share should be read in conjunction with the GAAP financial results. Our definition of adjusted operating income may be different from that used by other companies. The following is a reconciliation of net income (loss) to adjusted operating income (loss) (dollars in thousands), as well as net income (loss) per share to adjusted operating income (loss) per share:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|--|------------|------------------------------------|------------|
| | 2018 | 2017 | 2018 | 2017 |
| Net income (loss) | \$(3,551) | \$(18,898) | \$(4,451) | \$(21,763) |
| Exclude: | | | | |
| Net realized gains (losses) and other gains, net of tax | (21) | 39 | 152 | 781 |
| Tax effect of investment unrealized gains and losses | — | 117 | — | 398 |
| Change in fair value of equity securities, net of tax | 151 | — | (116) | — |
| Net (increase) in deferred gain on losses ceded to ADC, net of tax | (2,521) | — | (4,933) | — |
| Adjusted operating income (loss) | \$(1,160) | \$(19,054) | \$446 | \$(22,942) |
| Weighted average common shares diluted | 8,553,613 | 7,675,952 | 8,531,545 | 7,647,520 |
| Diluted income (loss) per common share: | | | | |
| Net income (loss) | \$(0.42) | \$(2.46) | \$(0.52) | \$(2.85) |
| Exclude: | | | | |
| Net realized gains (losses) and other gains, net of tax | — | 0.01 | 0.02 | 0.10 |
| Tax effect of investment unrealized gains and losses | — | 0.01 | — | 0.05 |
| Change in fair value of equity securities, net of tax | 0.01 | — | (0.01) | — |
| Net (increase) in deferred gain on losses ceded to ADC, net of tax | (0.29) | — | (0.58) | — |
| Adjusted operating income (loss) per share | \$(0.14) | \$(2.48) | \$0.05 | \$(3.00) |

We use adjusted operating income and adjusted operating income per share to assess our performance and to evaluate the results of our overall business. We believe these measures provide investors with valuable information relating to our ongoing performance that may be obscured by the net effect of realized gains and losses as a result of our market risk sensitive instruments, which primarily relate to debt securities that are available for sale and not held for trading purposes. The change in fair value of equity securities and realized gains and losses may vary significantly between periods and are generally driven by external economic developments, such as capital market conditions. Adjusted operating income also excludes the deferral of ceded losses related to the ADC (“deferred gain”) that are directly related to gross losses reported in the current period. Deferring these ceded losses (while required under GAAP) does not reflect the economics of the reinsurance agreement which allows gross losses subject to the ADC to be offset by ceded losses in that period. Accordingly, adjusted operating income excludes the effect of items that tend to be highly variable from period to period and highlights the results from our ongoing business operations and the underlying

loss or profitability of our business. We believe that it is useful for investors to evaluate adjusted operating income and adjusted operating income per share, along with net income and net income per share, when reviewing and evaluating our performance.

Recently Issued Accounting Pronouncements

Refer to Note 1 ~ Summary of Significant Accounting Policies – Recently Issued Accounting Guidance of the Notes to the Consolidated Financial Statements for detailed information regarding recently issued accounting pronouncements.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, as well as, other relevant market rates or price changes. The volatility and liquidity in the markets in which the underlying assets are traded directly influence market risk. The following is a discussion of our primary market risk exposures and how those exposures are currently managed as of September 30, 2018. Our market risk sensitive instruments are primarily related to our debt securities.

Interest Rate Risk

At September 30, 2018, the fair value of our investment portfolio, excluding cash and cash equivalents, was \$141.7 million. Our investment portfolio consists principally of investment-grade, debt securities, all of which are classified as available for sale. Accordingly, the primary market risk exposure to our debt securities is interest rate risk. In general, the fair market value of a portfolio of debt securities increases or decreases inversely with changes in market interest rates, while net investment income realized from future investments in debt securities increases or decreases along with interest rates. We attempt to mitigate interest rate risks by investing in securities with varied maturity dates and by managing the duration of our investment portfolio to a defined range of three to four years. The effective duration of our portfolio as of September 30, 2018 and December 31, 2017 was 3.0 and 3.2 years, respectively. The table below illustrates the sensitivity of the fair value of our debt investments, classified as debt securities and short-term investments, to selected hypothetical changes in interest rates as of September 30, 2018. The selected scenarios are not predictions of future events, but rather illustrate the effect that events may have on the fair value of the debt portfolio and shareholders' equity (dollars in thousands).

| Hypothetical Change in Interest Rates As of September 30, 2018 | Estimated Fair Value | Change in Fair Value | Hypothetical Percentage Increase (Decrease) in Shareholders' | |
|---|----------------------------|----------------------------|--|---------|
| | | | Fair Value | Equity |
| 200 basis point increase | \$123,855 | \$ (8,046) | (6.1)% | (17.3)% |
| 100 basis point increase | 127,812 | (4,089) | (3.1)% | (8.8)% |
| No change | 131,901 | — | — % | — % |
| 100 basis point decrease | 135,726 | 3,825 | 2.9 % | 8.2 % |
| 200 basis point decrease | 139,156 | 7,255 | 5.5 % | 15.6 % |

Credit Risk

An additional exposure to our debt securities portfolio is credit risk. We manage our credit risk by investing only in investment-grade securities. In addition, we comply with applicable statutory requirements which limit the portion of our total investment portfolio that we can invest in any one security.

We are subject to credit risks with respect to our reinsurers. Although a reinsurer is liable for losses to the extent of the coverage which it assumes, our reinsurance contracts do not discharge our insurance companies from primary liability to each policyholder for the full amount of the applicable policy, and consequently our insurance companies remain obligated to pay claims in accordance with the terms of the policies regardless of whether a reinsurer fulfills or defaults on its obligations under the related reinsurance agreement. To mitigate our credit risk to reinsurance companies, we attempt to select financially strong reinsurers with an A.M. Best rating of "A-" or better and continue to evaluate their financial condition throughout the duration of our agreements.

At September 30, 2018, the net amount due to the Company from reinsurers, including ceded unearned premiums, was \$31.2 million. We believe all amounts recorded as due from reinsurers are recoverable.

Effects of Inflation

We do not believe that inflation has a material effect on our results of operations, except for the effect that inflation may have on interest rates and claims costs. We consider the effects of inflation in pricing and estimating reserves for unpaid losses and LAE. The actual effects of inflation on our results are not known until claims are ultimately settled. In addition to general price inflation, we are exposed to a long-term upward trend in the cost of judicial awards for

damages.

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ITEM 4. CONTROLS AND PROCEDURES

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) that are designed to ensure that required information is recorded, processed, summarized and reported within the required timeframe as specified in the SEC's rules and forms of the SEC. Our disclosure controls and procedures are also designed to ensure that information required to be disclosed is accumulated and communicated to the Company's management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Our management, with the participation of the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures at September 30, 2018. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that our disclosure controls and procedures were effective, at the reasonable assurance level, as of September 30, 2018.

Changes in Internal Control over Financial Reporting

For the three months ended September 30, 2018, there were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that have materially affected, or are reasonable likely to materially affect the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information required by this item is included under Note 12 ~ Commitments and Contingencies of the Notes to the Consolidated Financial Statements of the Company's Form 10-Q for the nine months ended September 30, 2018, which is hereby incorporated by reference.

ITEM 1A. RISK FACTORS

There were no material changes to the risk factors disclosed in our Annual Report on Form 10-K/A ("Item 1A Risk Factors") filed with the SEC on May 14, 2018, except the additional risks disclosed in our Quarterly Report on Form 10-Q filed August 8, 2018.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On September 27, 2017, the Company's Board of Directors authorized a private placement stock purchase offering wherein the Company was authorized to sell a maximum of \$7.0 million of the Company's common stock, no par value per share, pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended, and Rule 506(b) of Regulation D as promulgated under the Securities Act and in accordance with applicable federal securities laws, including Rule 10b5-1 and 10b-18 of the Securities Exchange Act of 1934 as amended. The participants in the private placement consisted mainly of members of the Company's management team and Board of Directors, including the Company's Chairman and CEO, James Petcoff.

Under this private placement offering, the Company issued \$5.0 million of common equity consisting of 800,000 shares at the price of \$6.25 per share on September 28, 2017. The Company's common stock closing market price on the Nasdaq Stock Market on September 28, 2017, was \$6.05 per share. The offering was made to accredited investors only. No commissions or other remuneration were paid in connection with the issuance. The actual timing, number and value of shares to be issued under the private placement offering was determined by management in its discretion and depended on a number of factors, including the market price of the Company's stock, general marketing conditions, and other factors. The Company used the proceeds from the issuance to strengthen its balance sheet through contributions to the Insurance Company Subsidiaries to support future growth, as well as to cover the cost of the ADC and reserve strengthening.

On February 25, 2016, the Company's Board of Directors authorized a stock repurchase program, under which the Company may repurchase up to \$2.1 million of its outstanding common stock. Under this program, management was authorized to repurchase shares at prevailing market prices through open market purchases, privately negotiated transactions, block purchases or otherwise in accordance with applicable federal securities laws, including Rule 10b5-1 and 10b-18 of the Securities Exchange Act of 1934, as amended. The actual timing, number and value of shares repurchased under the program was determined by management in its discretion and depended on a number of factors, including the market price of the Company's stock, general market conditions, and other factors. The Company did not repurchase any of its outstanding common stock during 2017 or in the first nine months of 2018.

No underwriters were involved in the foregoing sales of securities. The issuances of the securities described above were deemed to be exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act as transactions by an issuer not involving a public offering.

ITEM 6. EXHIBITS

| Exhibit Number | Exhibit Description | Incorporated by Reference | | |
|-------------------|---|---------------------------|------------------|---------------------------------|
| | | Form | Period Ending | Exhibit / Appendix Number |
| 31.1 | <u>Section 302 Certification — CEO</u> | | | |
| 31.2 | <u>Section 302 Certification — CFO</u> | | | |
| 32.1* | <u>Section 906 Certification — CEO</u> | | | |
| 32.2* | <u>Section 906 Certification — CFO</u> | | | |
| 101.INS | XBRL Instance Document | | | |
| 101.SCH | XBRL Taxonomy Extension Schema Document | | | |
| 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 | | | |

* This certification is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.

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.

CONIFER HOLDINGS, INC.

By: /s/ Harold J. Meloche
Harold J. Meloche
Chief Financial Officer,
Principal Financial Officer,
Principal Accounting Officer

Dated: November 7, 2018