

ASSURANCEAMERICA CORP

Form 10-Q

November 14, 2007

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-Q**

(Mark one)

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

**For the quarterly period ended September 30, 2007**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 0-06334  
AssuranceAmerica Corporation**

(Exact name of small business issuer as specified in its charter)

**Nevada**  
(State of Incorporation)

**87-0281240**  
(IRS Employer ID Number)

**5500 Interstate North Parkway, Suite 600**  
(Address of principal executive offices)

**30328**  
(Zip Code)

**(770) 952-0200**

(Issuer's telephone number, including area code)

Check whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the preceding 12 months (or 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):  
 Large accelerated filer       Accelerated filer       Non-accelerated filer

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

There were 64,803,881 shares of the Registrant's \$.01 par value Common Stock outstanding as of November 1, 2007, and no shares of the Registrant's \$.01 par value Series A Convertible Preferred Stock ( Preferred Stock ) outstanding as of November 1, 2007.

**ASSURANCEAMERICA CORPORATION**  
**Index to Form 10-Q**

	<b>Page</b>
<b><u>PART I FINANCIAL INFORMATION</u></b>	
<b><u>Item 1 Financial Statements</u></b>	
<u>Consolidated Balance Sheets as of September 30, 2007 and December 31, 2006</u>	3
<u>Consolidated Statements of Operations for the Three Months and Nine Months Ended September 30, 2007 and September 30, 2006</u>	4
<u>Consolidated Statements of Comprehensive Income for the Three Months and Nine Months Ended September 30, 2007 and September 30, 2006</u>	5
<u>Consolidated Statements of Cash Flows for Nine Months ended September 30, 2007 and September 30, 2006</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
<b><u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	14
<b><u>Item 3 Quantitative and Qualitative Disclosures about Market Risk</u></b>	18
<b><u>Item 4 Controls and Procedures</u></b>	19
<b><u>PART II OTHER INFORMATION</u></b>	
<b><u>Item 1 Legal Proceedings</u></b>	20
<b><u>Item 1A Risk Factors</u></b>	20
<b><u>Item 6 Exhibits</u></b>	24
<b><u>Signatures</u></b>	25
<u>EX-31.1 SECTION 302 CERTIFICATION OF THE CEO</u>	
<u>EX-31.1 SECTION 302 CERTIFICATION OF THE ACTING CFO</u>	
<u>EX-32.1 SECTION 906 CERTIFICATION OF THE CEO AND ACTING CFO</u>	
Page 2 of 28	

---

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

**ASSURANCEAMERICA CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
**September 30, 2007 and December 31, 2006**

	<b>September 30, 2007 (Unaudited)</b>	<b>December 31, 2006 Audited</b>
<b>Assets</b>		
Cash and cash equivalents	\$ 5,646,982	\$ 8,185,539
Short-term investments	124,140	619,843
Long-term investments, available for sale at fair value	15,235,390	10,446,830
Marketable equity securities	2,241,023	2,055,983
Other securities	155,000	155,000
Investment income due and accrued	199,857	117,363
Receivable from insureds	30,224,879	18,707,773
Reinsurance recoverable (including \$10,653,056 and \$5,130,845 on paid losses)	32,010,952	22,563,990
Prepaid reinsurance premiums	22,325,518	14,012,481
Deferred acquisition costs	1,917,226	800,125
Property and equipment (net of accumulated depreciation of \$2,688,624 and \$2,136,512)	2,435,936	2,481,660
Other receivables	2,924,529	585,999
Prepaid expenses	372,107	273,733
Intangibles (net of accumulated amortization of \$2,134,433 and \$1,824,334)	11,410,419	11,114,882
Security deposits	82,719	74,140
Prepaid income tax	365,490	668,677
Deferred tax assets	2,065,463	2,506,503
Other assets	364,655	374,365
<b>Total assets</b>	<b>\$ 130,102,285</b>	<b>\$ 95,744,886</b>
<b>Liabilities and stockholders equity</b>		
Accounts payable and accrued expenses	\$ 8,000,710	\$ 5,039,900
Unearned premium	32,913,494	20,614,781
Unpaid losses and loss adjustment expenses	30,752,102	24,904,492
Reinsurance payable	29,552,588	16,744,406
Provisional commission reserve	2,634,075	2,319,540
Notes payable	4,822,718	5,797,122
Junior subordinated debentures payable	4,966,852	4,961,852
Capital lease obligations	200,913	265,670
<b>Total liabilities</b>	<b>113,843,452</b>	<b>80,647,763</b>
<b>Minority interest</b>	<b>2,655</b>	

**Commitments and contingencies****Stockholders equity**

Common stock, .01 par value (authorized 120,000,000, outstanding 64,803,881 and 56,072,971)	648,038	560,730
Preferred stock, .01 par value (authorized 5,000,000, outstanding 0 and 840,000; liquidation preference \$0 and \$4,200,000)		8,400
Surplus-paid in	16,792,982	16,426,292
Accumulated deficit	(1,232,716)	(1,948,711)
Accumulated other comprehensive income:		
Net unrealized gains on investment securities, net of taxes	47,874	50,412
<b>Total stockholders equity</b>	16,256,178	15,097,123
<b>Total liabilities and stockholders equity</b>	\$ 130,102,285	\$ 95,744,886

See accompanying notes to consolidated financial statements.

Page 3 of 28

Table of Contents

**ASSURANCEAMERICA CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the Three and Nine Months Ended September 30, 2007 and 2006**  
**(Unaudited)**

	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Revenue:</b>				
Gross premiums written	\$ 21,535,015	\$ 18,334,710	\$ 69,964,867	\$ 53,839,302
Gross premiums ceded	(14,553,205)	(12,530,148)	(47,230,864)	(36,609,876)
<b>Net premiums written</b>	<b>6,981,810</b>	<b>5,804,562</b>	<b>22,734,003</b>	<b>17,229,426</b>
Increase in unearned premiums, net of prepaid reinsurance premiums	(185,972)	(600,836)	(3,985,676)	(1,597,628)
<b>Net premiums earned</b>	<b>6,795,838</b>	<b>5,203,726</b>	<b>18,748,327</b>	<b>15,631,798</b>
Commission income	4,498,414	5,251,593	16,302,203	17,676,337
Managing general agent fees	2,871,324	2,308,140	8,109,556	7,163,620
Net investment income	209,132	215,447	602,935	520,659
Net investment gains (losses) on securities	(9,573)		16,666	
Other fee income	49,578	148,298	297,794	498,663
<b>Total revenue</b>	<b>14,414,713</b>	<b>13,127,204</b>	<b>44,077,481</b>	<b>41,491,077</b>
<b>Expenses:</b>				
Losses and loss adjustment expenses	4,726,493	3,359,596	13,593,464	11,371,346
Selling, general and administrative expenses	9,021,080	8,284,789	27,003,762	25,747,254
Stock option expense	110,888	71,841	329,000	233,572
Depreciation and amortization expense	256,016	269,420	904,665	710,171
Interest expense	255,785	289,823	775,161	866,372
<b>Total operating expenses</b>	<b>14,370,262</b>	<b>12,275,469</b>	<b>42,606,052</b>	<b>38,928,715</b>
<b>Income before provision for income tax expense</b>	<b>44,451</b>	<b>851,735</b>	<b>1,471,429</b>	<b>2,562,362</b>
Income tax provision	89,942	68,428	752,777	618,715
<b>Net income (loss) before minority interest</b>	<b>(45,491)</b>	<b>783,307</b>	<b>718,652</b>	<b>1,943,647</b>
Minority interest	(1,971)		2,655	
<b>Net income (loss)</b>	<b>(43,520)</b>	<b>783,307</b>	<b>715,997</b>	<b>1,943,647</b>
<b>Dividends on preferred stock</b>		<b>84,000</b>		<b>337,200</b>
<b>Net income (loss) attributable to common stockholders</b>	<b>\$ (43,520)</b>	<b>\$ 699,307</b>	<b>\$ 715,997</b>	<b>\$ 1,606,447</b>

**Earnings (loss) per common share**

Edgar Filing: ASSURANCEAMERICA CORP - Form 10-Q

Basic	\$ (0.001)	\$ 0.013	\$ 0.012	\$ 0.030
Diluted	\$ (0.001)	\$ 0.012	\$ 0.012	\$ 0.030
Weighted average shares outstanding-basic	64,731,908	54,857,778	60,939,646	52,779,929
Weighted average shares outstanding-diluted	65,475,724	65,170,050	61,732,488	63,230,240

See accompanying notes to consolidated financial statements.

Page 4 of 28

---

Table of Contents

**ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**For the Three and Nine Months September 30, 2007 and 2006**  
**(Unaudited)**

	<b>Three Months</b>		<b>Nine Months</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
<b>Net income (loss)</b>	\$ (43,520)	\$ 699,307	\$ 715,997	\$ 1,606,447
<b>Other comprehensive income (loss):</b>				
Change in unrealized gains (losses) of investments arising during the period	224,763	238,640	(4,061)	49,152
Deferred income tax loss (benefit) on above changes	(84,286)	89,490)	1,523	(18,432)
<b>Other comprehensive income (loss)</b>	140,477	149,150	(2,538)	30,720
<b>Comprehensive income</b>	\$ 96,957	\$ 848,457	\$ 713,459	\$ 1,637,167

See accompanying notes to consolidated financial statements.

Page 5 of 28

---



**Table of Contents**

**ASSURANCEAMERICA CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Nine Months ended September 30, 2007 and 2006**  
**(Unaudited)**

	<b>2007</b>	<b>2006</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 715,997	\$ 1,943,647
<b>Adjustments to reconcile net income to net cash provided by operating activities, net of effect of agency acquisitions:</b>		
Net investment gains on securities	(16,666)	
Minority interests	2,655	
Depreciation and amortization	909,663	715,172
Stock-based compensation	329,000	233,572
Deferred tax benefit	442,563	180,603
<b>Changes in assets and liabilities:</b>		
Investment income due and accrued	(82,494)	(97,819)
Receivables	(13,855,635)	(5,993,879)
Prepaid expenses and other assets	(97,242)	(251,117)
Unearned premiums	12,298,713	5,117,163
Unpaid loss and loss adjustment expenses	5,847,610	8,215,432
Ceded reinsurance payable	12,808,182	6,687,274
Reinsurance recoverable	(9,446,962)	(6,269,585)
Prepaid reinsurance premiums	(8,313,037)	(3,519,535)
Accounts payable and accrued expenses	2,959,570	(1,468,101)
Prepaid income taxes	303,187	(172,030)
Deferred acquisition costs	(1,117,101)	(91,417)
Provisional commission reserve	314,534	328,968
<b>Net cash provided by operating activities, net of effect of agency acquisitions</b>	<b>4,002,537</b>	<b>5,558,348</b>
<b>Cash flows from investing activities, net of effect of agency acquisitions:</b>		
Purchases of property and equipment, net	(548,839)	(906,500)
Proceeds from sales, call and maturities of investments	1,433,650	253,054
Purchases of investments	(5,898,942)	(6,092,799)
Cash paid for acquisition of agencies, net of cash acquired	(400,000)	(548,305)
<b>Net cash used by investing activities, net of effect of agency acquisitions</b>	<b>(5,414,131)</b>	<b>(7,294,550)</b>
<b>Cash flows from financing activities, net of effect of agency acquisitions:</b>		
Repayments of notes payable	(1,178,804)	(1,638,404)
Preferred dividends paid		(253,200)
Proceeds (repayments) on capital lease obligations, net	(64,759)	66,002
Proceeds from stock issued	116,600	363,723
<b>Net cash used by financing activities, net of effect of agency acquisitions:</b>	<b>(1,126,963)</b>	<b>(1,461,879)</b>

<b>Net decrease in cash and cash equivalents</b>	(2,538,557)	(3,198,081)
<b>Cash and cash equivalents, beginning of period</b>	8,185,539	8,668,827
<b>Cash and cash equivalents, end of period</b>	\$ 5,646,982	\$ 5,470,746

See accompanying notes to consolidated financial statements.

Page 6 of 28

---

**Table of Contents**

**ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements**  
**September 30, 2007 and 2006**

**(1) Description of Business**

AssuranceAmerica Corporation, a Nevada corporation (the Company) is an insurance holding company whose business is comprised of AssuranceAmerica Insurance Company (AAIC), AssuranceAmerica Managing General Agency, LLC (MGA) and TrustWay Insurance Agencies, LLC (TrustWay), each wholly-owned. The Company solicits and underwrites nonstandard private passenger automobile insurance. The Company is headquartered in Atlanta, Georgia.

**(2) Summary of Significant Accounting Policies**

**Basis of Consolidation and Presentation**

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Such financial statements do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In our opinion, all adjustments (consisting solely of normal recurring accruals) necessary for a fair presentation have been included in the accompanying financial statements. Certain items in prior period financial statements have been reclassified to conform to the current presentation. For further information, please refer to our audited consolidated financial statements appearing in the Form 10-KSB for the year ended December 31, 2006.

**Estimates**

A discussion of our significant accounting policies and the use of estimates is included in the notes to the consolidated financial statements included in the Company's Financial Statements for the year ended December 31, 2006 as filed with the Securities and Exchange Commission in the 2006 Form 10-KSB.

**Current-Year Adoption of Accounting Pronouncements**

On January 1, 2007, we adopted Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*. This Interpretation required us to develop a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Additional information regarding the adoption of FIN No. 48 is included in Note 5 to these Consolidated Financial Statements.

**(3) Losses and Loss Adjustment Expenses**

The estimated liabilities for losses and loss adjustment expenses (LAE) include the accumulation of estimates for losses for claims reported prior to the balance sheet dates (case reserves), estimates (based upon actuarial analysis of historical data) of losses for claims incurred but not reported (IBNR) and for the development of case reserves to ultimate values, and estimates of expenses for investigating, adjusting and settling all incurred claims. Amounts reported are estimates of the ultimate costs of settlement, net of estimated salvage and subrogation. These estimated liabilities are subject to the outcome of future events, such as changes in medical and repair costs as well as economic and social conditions that impact the settlement of claims. Management believes that, given the inherent variability in any such estimates, the aggregate reserves are within a reasonable and acceptable range of

adequacy. The methods of making such estimates and for establishing the resulting reserves are reviewed and updated quarterly and any resulting adjustments are reflected in current operations.

A summary of unpaid losses and loss adjustment expenses, net of reinsurance ceded, is as follows:

	<b>September 30, 2007</b>	<b>December 31, 2006</b>
Case basis	\$ 3,990,337	\$ 3,510,978
IBNR	5,403,869	3,960,369
Total	\$ 9,394,206	\$ 7,471,347

Page 7 of 28

---

**Table of Contents****(4) Reinsurance**

In the normal course of business, the Company seeks to reduce its overall risk levels by obtaining reinsurance from other insurance enterprises or reinsurers. Reinsurance premiums and reserves on reinsured business are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Reinsurance contracts do not relieve the Company from its obligations to policyholders. The Company periodically reviews the financial condition of its reinsurers to minimize its exposure to losses from reinsurer insolvencies.

Reinsurance assets include balances due from other insurance companies under the terms of reinsurance agreements. Amounts applicable to ceded unearned premiums, ceded loss payments and ceded claims liabilities are reported as assets in the accompanying balance sheets. The Company believes the fair value of its reinsurance recoverables approximates their carrying amounts.

The impact of reinsurance on the statements of operations for the three and nine-month periods ended September 30, 2007 and 2006 is as follows:

	Three Months		Nine Months	
	2007	2006	2007	2006
<b>Premiums written:</b>				
Direct	\$ 21,145,204	\$ 18,327,803	\$ 68,784,027	\$ 53,617,384
Assumed	389,811	6,907	1,180,840	221,918
Ceded	14,553,205	12,530,148	47,230,864	36,609,876
Net	<b>\$ 6,981,810</b>	<b>\$ 5,804,562</b>	<b>\$ 22,734,003</b>	<b>\$ 17,229,426</b>
<b>Premiums earned:</b>				
Direct	\$ 20,348,021	\$ 16,153,098	\$ 56,885,146	\$ 48,483,459
Assumed	369,866	76,400	781,009	238,681
Ceded	13,922,049	11,025,772	38,917,828	33,090,342
Net	<b>\$ 6,795,838</b>	<b>\$ 5,203,726</b>	<b>\$ 18,748,327</b>	<b>\$ 15,631,798</b>
<b>Losses and loss adjustment expenses incurred:</b>				
Direct	\$ 14,686,373	\$ 11,205,653	\$ 43,410,668	\$ 37,898,652
Assumed	312,760		543,172	
Ceded	10,272,640	7,846,057	30,360,376	26,527,306
Net	<b>\$ 4,726,493</b>	<b>\$ 3,359,596</b>	<b>\$ 13,593,464</b>	<b>\$ 11,371,346</b>

The impact of reinsurance on the balance sheets as of September 30, 2007 and December 31, 2006 is as follows:

	September 30, 2007	December 31, 2006
<b>Unpaid losses and loss adjustment expense:</b>		
Direct	\$ 30,549,895	\$ 24,904,492
Assumed	202,207	
Ceded	21,357,896	17,433,145

Net	\$	<b>9,394,206</b>	\$	<b>7,471,347</b>
<b>Unearned premiums:</b>				
Direct	\$	32,398,750	\$	20,499,867
Assumed		514,744		114,914
Ceded		22,325,518		14,012,481
Net	\$	<b>10,587,976</b>	\$	<b>6,602,300</b>

The Company received \$3,783,834 and \$12,280,025 in commissions on premiums ceded during the three and nine-month periods ended September 30, 2007, respectively. Had all of the Company's reinsurance agreements been cancelled at September 30, 2007, the Company would have returned \$5,804,635 in reinsurance commissions to its reinsurers and its reinsurers would have returned \$22,325,518 in unearned premiums to the Company.

Page 8 of 28

---

**Table of Contents****(5) Income Taxes**

The provision for federal and state income taxes for the three and nine-month periods ended September 30, 2007 and 2006 is as follows:

	Three Months		Nine Months	
	2007	2006	2007	2006
Current	\$ (79,368)	\$ (33,895)	\$ 310,214	\$ 583,712
Deferred	169,310	102,323	442,563	35,003
Total provision for income taxes	\$ 89,942	\$ 68,428	\$ 752,777	\$ 618,715

On July 13, 2006, the FASB issued Interpretation No. 48 (FIN 48), the *Accounting for Uncertainty in Income Taxes an interpretation of FASB 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The evaluation of a tax position in accordance with FIN 48 is a two-step process. The Company must determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, the Company should presume that the position will be examined by the appropriate taxing authority. A tax position that meets the more-likely-than-not threshold is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. The Company adopted the provisions of FIN 48 with respect to all of our tax positions as of January 1, 2007. The cumulative effect of applying FIN 48 would have been reported as an adjustment in the opening balance of retained earnings at January 1, 2007. We have determined the impact of adopting FIN 48 to be immaterial.

The Company classifies interest on income tax related balances as interest expense and classifies tax related penalties as operating expense. To date, the Company has not incurred any tax related interest or penalties.

**(6) Capital Stock****Preferred Stock**

The series A convertible stock pays a cumulative semi-annual dividend of \$0.20 per share. Each outstanding share of preferred stock is convertible into ten shares of common stock automatically two years from the date of issuance, or at any time prior to such automatic conversion at the Holder's request, and has the voting rights of 10 common shares. The outstanding preferred stock automatically converted, if not converted sooner, at various times during 2007 with the last automatic conversion on May 24, 2007. During the first nine months of 2007, 840,000 shares of preferred stock converted to 8,400,000 shares of common stock. During the second quarter of 2006, 240,000 shares of preferred stock converted to 2,400,000 shares of common stock.

**Common Stock**

During the first nine months of 2006, the Company issued 840,000 shares of common stock, \$0.01 par value, through a private placement. During the first nine months of 2007, 840,000 shares of preferred stock converted to 8,400,000 shares of common stock.

**Stock-Based Compensation**

Edgar Filing: ASSURANCEAMERICA CORP - Form 10-Q

The weighted-average grant date fair value of options granted during the nine-months ended September 30, 2007 and September 30, 2006, using the Black-Scholes-Merton option-pricing model, was \$0.7844 and \$0.7807, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2007 and September 30, 2006 was \$162,000 and \$60,091, respectively.

Total compensation cost for share-based payment arrangements recognized for the three and nine-month periods ended September 30, 2007 was \$110,888 and \$329,000, respectively. Total compensation cost for share-based payment arrangements recognized for the three and nine month periods ended September 30, 2006 was \$71,841 and \$233,572, respectively. The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton option-pricing model using the assumptions noted in the following table.

	<b>September 30, 2007</b>	<b>September 30, 2006</b>
Expected volatility	106% - 120%	142% - 156%
Weighted average volatility	113%	151%
Risk-free interest rate	2.00% - 2.70%	1.90% - 2.40%
Expected term (in years)	5.0	5.0

---



**Table of Contents**

A summary of all stock option activity during the nine months ending September 30, 2007 and 2006 is as follows:

	2007		2006	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
<b>Options Outstanding</b>				
January 1	5,347,225	\$ 0.85	4,215,628	\$ 0.97
Add (deduct):				
Granted	330,000	\$ 1.06	1,132,315	\$ 0.86
Exercised	(50,000)	\$ 0.25		
Forfeited	(416,750)	\$ 0.78	(239,500)	\$ 0.85
Expired			(8,000)	\$ 5.50
March 31	5,210,475	\$ 0.87	5,100,443	\$ 0.95
Add (deduct):				
Granted	1,091,000	\$ 0.96	448,500	\$ 1.69
Exercised	(120,000)	\$ 0.60	(40,000)	\$ 0.25
Forfeited	(1,099,510)	\$ 0.83	(315,400)	\$ 0.86
Expired	(20,000)	\$ 0.75	(90,000)	\$ 5.67
June 30	5,061,965	\$ 0.91	5,103,543	\$ 0.94
Add (deduct):				
Granted	235,000	\$ 0.91	560,500	\$ 1.12
Exercised	(144,000)	\$ 0.46	(5,650)	\$ 0.88
Forfeited	(170,000)	\$ 0.92	(129,100)	\$ 0.85
Expired	(80,000)	\$ 5.25		
September 30	4,902,965	\$ 0.86	5,529,293	\$ 0.96
Exercisable, September 30	1,166,183	\$ 0.57	1,418,430	\$ 1.13

**(7) Commitments and Contingencies*****Contractual Commitments***

The Company leases office space for its corporate headquarters in Atlanta, Georgia under a 12-year lease that commenced on May 1, 2003. The Company leases retail office space at various locations in Georgia, Florida and Alabama under short to medium term commercial leases. The Company also leases office equipment for use in its various locations. Rent expense for long-term leases with predetermined minimum rental escalations is recognized on a straight-line basis, and the difference between the recognized rental expense and amounts payable under the leases, or deferred rent, is included in other liabilities. The Company has a software license agreement with terms greater than one year.

The Company also has contractual commitments in association with long-term debt owed to current and former owners of the Company and in connection with a Junior Subordinated Debentures issued in December 2005. Please refer to Note 6 of the *Notes to Consolidated Financial Statements*, as December 31, 2006 for additional information about the long-term debt arrangements.

Minimum amounts due under the Company's noncancelable commitments at September 30, 2007 are as follows:

<b>Payments due by period</b>	<b>Long-Term Debt Obligations</b>	<b>Operating Lease Obligations</b>	<b>Capital Lease Obligations</b>	<b>Total</b>
<b>Less than 1 year</b>	\$ 1,285,811	\$ 1,526,158	\$ 104,632	\$ 2,916,601
<b>1-3 years</b>	3,634,976	2,209,423	136,628	5,981,027
<b>4-5 years</b>		1,612,972		1,612,972
<b>More than 5 years</b>	4,966,852	1,820,559		6,787,411
<b>Total</b>	\$ 9,887,639	\$ 7,169,112	241,260	\$ 17,298,011
<b>Less amount representing interest</b>			(40,347)	
<b>Present value of minimum lease payments</b>			\$ 200,913	

Page 10 of 28

**Table of Contents****Defined Contribution Plan**

The Company's employees participate in the AssuranceAmerica 401(k) defined contribution retirement plan. Under the plan, the Company can elect to make discretionary contributions. Effective January 1, 2007, the Company elected to match 25% of employee contributions up to 4% of gross earnings. Matching contributions during the first nine months of 2007 totaled \$37,054. The Company did not make contributions in 2006. The eligibility requirements are 21 years of age, 6 months of service and full time employment.

**Legal Proceedings**

The Company is involved in litigation in the ordinary course of business, both as a defendant and as a plaintiff. The Company may from time to time be subject to a variety of legal and regulatory actions relating to the Company's current and past business operations. The company vigorously defends these actions unless a reasonable settlement appears appropriate.

See Subsequent Event Note (11) for additional information.

**(8) Net Income Per Share**

Basic and diluted income per common share is computed using the weighted average number of common shares outstanding during the period. Potential common shares not included in the calculations of net income per share for the three and nine-month periods ended September 30, 2007 and 2006, because their inclusion would be anti-dilutive, are as follows:

	Three Months		Nine Months	
	2007	2006	2007	2006
Warrants		141,918		141,918
Stock options	3,576,965	528,500	3,576,965	528,500
	3,576,965	670,418	3,576,965	670,418

The reconciliation of the amounts used in the computation of both basic earnings per share and diluted earnings per share for the three and nine-month periods ended September 30, 2007 and 2006 are as follows:

	Net Income	Average Shares Outstanding	Per Share Amount
<b>For the three months ended September 30, 2007:</b>			
Net income (loss) basic	\$ (43,520)	64,731,908	\$ (0.001)
Effect of common shares issued upon conversion of preferred			
Effect of dilutive stock warrants and options		743,816	
Net income diluted	\$ (43,520)	65,475,724	(0.001)
<b>For the three months ended September 30, 2006:</b>			
Net income (loss) basic	\$ 699,307	54,857,778	0.013

Edgar Filing: ASSURANCEAMERICA CORP - Form 10-Q

Effect of common shares issued upon conversion of preferred	84,000	8,400,000	
Effect of dilutive stock warrants and options		1,912,272	
Net income diluted	\$ 783,307	65,170,050	0.012
<b>For the nine months ended September 30, 2007:</b>			
Net income basic	\$ 715,997	60,939,646	0.012
Effect of common shares issued upon conversion of preferred			
Effect of dilutive stock warrants and options		792,842	
Net income diluted	\$ 715,997	61,732,488	0.012
<b>For the nine months ended September 30, 2006:</b>			
Net income basic	\$ 1,606,447	52,779,929	0.030
Effect of common shares issued upon conversion of preferred	337,200	8,400,000	
Effect of dilutive stock warrants and options		2,050,311	
Net income diluted	\$ 1,943,647	63,230,240	0.030

Page 11 of 28

---

**Table of Contents****(9) Supplemental Cash Flow Information**

	2007	2006
Cash paid during the nine months ended September 30:		
Interest	\$ 775,158	\$ 576,549
Income taxes	\$ 7,025	\$ 825,000

The Company recorded net unrealized losses on investment securities during the nine-months ended September 30, 2007 in the amount of \$2,538, net of taxes, and unrealized gains on investment securities in the amount of \$30,720, net of taxes, for the nine-month period ended September 30, 2006.

On January 16, 2006 the Company purchased the assets of Tampa No-Fault Insurance Agency, Inc. As part of the purchase agreement, the Company issued a note payable in the amount of \$283,333.

On January 27, 2006, the Company acquired The Insurance Center, Inc. As part of the purchase agreement, the Company issued a note payable in the amount of \$1,900,000.

On January 3, 2007, the Company purchased the assets of Frontline Insurance Group, LLC. As part of the purchase agreement, the Company issued a note payable in the amount of \$114,400.

On September 6, 2007, the Company purchased the assets of Covenant Insurance Group of America, LLC. As part of the purchase agreement, the Company issued a note payable in the amount of \$90,000.

The following table illustrates the composition of acquisitions for the nine months ended September 30, 2007 and 2006:

	2007	2006
Fair value of assets acquired	\$ 604,400	\$ 3,253,536
Cash paid to Sellers	(400,000)	(1,257,411)
Liabilities assumed	\$ 204,400	\$ 1,996,125

**(10) Recent Accounting Pronouncements**

The Company periodically reviews recent accounting pronouncements issued by the Financial Accounting Standards Board, American Institute of Certified Public Accountants, Emerging Issues Task Force and Staff Accounting Bulletins issued by the United States Securities and Exchange Commission to determine the potential impact on the Company's financial statements. Based on its most recent review, the Company has determined that the majority of these recently issued accounting standards either do not apply to the Company or will not have a material impact on its financial statements.

In February 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 159 (SFAS No. 159), *The Fair Value for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115*. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement is expected to expand the use of fair value measurement, which is consistent with the FASB's long-term measurement objective for accounting for financial instruments. This statement is effective as of the beginning of an entity's first fiscal year

that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply SFAS No. 157, *Fair Value Measurements*. The Company expects to adopt this standard beginning January 1, 2008. The financial statement impact is being evaluated, however, it is not expected to be material to the Company's financial position, results of operations or disclosures.

**Table of Contents****(11) Subsequent Event**

On October 3, 2007 a final award of Arbitrators (the Award ) was entered in the matter of James C. Cook, Thomas Cook Holding Company ( TCHA ), AssuranceAmerica Corporation (the Company ) and Trustway Insurance Agencies, LLC (the Claimants ) versus Worldwide Insurance Network, Inc. ( WIN ). The underlying lawsuit, which was brought in August of 2004 on behalf of WIN sought statutory damages, alleging that James C. Cook and TCHA failed to provide it a right of first refusal in not presenting a legitimate offer with proper notice, transferring the management agreement that it had with WIN to a party that would not accept or assume the restrictive covenants, revealing confidential information, and defrauding it by Claimants operation of the program without WIN s approval. The Company sought damages as a result of lost profits arising from the WIN s wrongful termination, as well as commissions and bonuses earned by Claimants but withheld by WIN. The Arbitrators findings concluded that the Company was required to pay WIN the \$415,685 actually paid in commissions while Claimants were operating the program without WIN s knowledge or permission. Further, the Company is required to pay \$65,247 in additional arbitration expenses. Since this award was known prior to the issuance of the September 30, 2007, financial statements, the Company included the \$415,685 judgment in the calculation of commission income and included the \$65,247 of expenses in general and administrative expenses.

**(12) Segment Reporting**

The Company s subsidiaries are each unique operating entities performing a separate business function. AAIC, a property and casualty insurance company focuses on writing nonstandard automobile business in the states of Georgia, Alabama, Florida, Louisiana, Mississippi, South Carolina and Texas. MGA markets AAIC s policies through more than 1,500 independent agencies in these states. MGA provides all of the underwriting, accounting, product management, legal, policyholder administration and claims functions for AAIC and for two unaffiliated insurers that write non-standard automobile insurance policies produced by the MGA in Florida and Texas. MGA receives various fees related to insurance transactions that vary according to state insurance laws and regulations. TrustWay is comprised of 48 retail insurance agencies that focus on selling nonstandard automobile policies and related coverage s in Georgia, Florida and Alabama. TrustWay receives commissions and various fees associated with the sale of the products and services from its appointing insurance carriers.

The Company evaluates profitability based on pretax income. Pretax income for each segment is defined as the revenues less the segment s operating expenses including depreciation, amortization and interest.

Following are the operating results for the Company s various segments and an overview of segment assets:

(\$ in thousands)	MGA	TrustWay	AAIC	Company	Eliminations	Consolidated
<b>THIRD QUARTER 2007</b>						
<b>Revenues</b>						
External customer	\$6,539	877	6,998			<b>14,414</b>
Intersegment	\$1,620	813	743	743	(3,919)	
<b>Income</b>						
Segment pretax income(loss)	\$ 354	(1,475)	1,358	(192)		<b>45</b>
<b>Assets</b>						
Segment assets	\$8,168	11,155	110,531	23,047	(22,799)	<b>130,102</b>

(\$ in thousands)	MGA	TrustWay	AAIC	Company	Eliminations	Consolidated
-------------------	-----	----------	------	---------	--------------	--------------

**THIRD QUARTER****2006****Revenues**

Edgar Filing: ASSURANCEAMERICA CORP - Form 10-Q

External customer	\$ 5,369	2,339	5,419			<b>13,127</b>
Intersegment	\$ 1,371	555	641	547	(3,114)	
<b>Income</b>						
Segment pretax						
income(loss)	\$ 252	(478)	1,453	(375)		<b>852</b>
<b>Assets</b>						
Segment assets	\$ 5,390	12,349	74,467	21,503	(20,451)	<b>93,258</b>
<b>FIRST NINE</b>						
<b>MONTHS 2007</b>						
<b>Revenues</b>						
External customer	\$20,632	4,074	19,371			<b>44,077</b>
Intersegment	\$ 5,335	3,372	2,412	2,228	(13,347)	
<b>Income</b>						
Segment pretax						
income(loss)	\$ 966	(1,954)	3,190	(730)		<b>1,472</b>
<b>Assets</b>						
Segment assets	\$ 8,168	11,155	110,531	23,047	(22,799)	<b>130,102</b>

Page 13 of 28



**Table of Contents**

(\$ in thousands)	MGA	TrustWay	AAIC	Company	Eliminations	Consolidated
<b>FIRST NINE MONTHS</b>						
<b>2006</b>						
<b>Revenues</b>						
External customer	\$ 17,732	7,608	16,146	5		<b>41,491</b>
Intersegment	\$ 4,253	2,086	1,877	1,640	(9,856)	
<b>Income</b>						
Segment pretax income(loss)	\$ 1,589	(477)	2,265	(815)		<b>2,562</b>
<b>Assets</b>						
Segment assets	\$ 5,390	12,349	74,467	21,503	(20,451)	<b>93,258</b>

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

Investments and cash as of September 30, 2007 increased \$1.9 million from investments and cash of \$21.5 million as of December 31, 2006. The increase was due in part to \$2.5 million in cash and income generated through operating activities. The increase was offset by \$0.3 million used to purchase the assets of Frontline Insurance Group, LLC on January 3, 2007 and \$.1 million used to purchase the assets of Covenant Insurance Group of America, LLC on September 6, 2007. The Company issued new promissory notes in connection with the acquisitions in the amount of \$0.2 million. The Company's long-term investments of \$18.0 million are primarily in direct obligations of the U.S. Treasury as well as those securities unconditionally guaranteed as to the payment of principal and interest by the United States government or any agency thereof and in high-quality corporate and municipal bonds of Georgia-based issuers. The Company's investment activities are made in accordance with the Company's Investment Policy. The objectives of the investment policy are to obtain favorable after-tax returns on investments through a diversified portfolio of fixed income, equity and real estate holdings. The Company's investment criteria and practices reflect the short-term duration of its contractual obligations with policyholders and regulators. Tax considerations include federal and state income tax as well as premium tax abatement and credit opportunities offered to insurance companies in the states where AAIC writes policies.

Premiums receivable as of September 30, 2007 increased \$11.5 million to \$30.2 million compared to December 31, 2006. The balance represents amounts due from AAIC's insureds and the increase is directly attributable to the increase in AAIC's premium writings during the first nine months of 2007. The Company's policy is to write off receivable balances immediately upon cancellation or expiration, and the Company does not consider an allowance for doubtful accounts to be necessary.

Reinsurance recoverable as of September 30, 2007 increased \$9.4 million, to \$32.0 million compared to December 31, 2006. The increase is directly related to AAIC's continued growth. AAIC maintains a quota-share reinsurance treaty with its reinsurers in which it cedes 70% of both premiums and losses. The \$32.0 million represents the reinsurers' portion of losses and loss adjustment expense, both paid and unpaid. All amounts are considered current.

Prepaid reinsurance premiums as of September 30, 2007 increased \$8.3 million to \$22.3 million compared to December 31, 2006. The increase results from AAIC's continued growth and represents premiums ceded to its reinsurers which have not been fully earned.

Deferred acquisition costs as of September 30, 2007 increased \$1.1 million to \$1.9 million compared to December 31, 2006. The increase resulted from AAIC's continued growth. The amount represents agents' commissions and other variable expenses associated with acquiring the insurance policies that are being deferred to coincide with the earnings of the related policy premiums.

Other receivables as of September 30, 2007 increased \$2.3 million to \$2.9 million compared to December 31, 2006. The balances represent TrustWay receivables from insurance carriers for direct bill commissions and balances

due to the MGA from insurance carriers for amounts owed in accordance with the terms of its managing general agency agreements. The change in the TrustWay receivables is directly attributable to direct bill commissions from carriers and related premium produced during the first nine months months of 2007. The increase in the MGA receivables is directly attributable to increases in business placed by the MGA in the states of Florida and Texas on behalf of two non-affiliated insurers.

Intangible assets as of September 30, 2007 increased \$0.3 million to \$11.4 million from the balance of \$11.1 million as of

Page 14 of 28

---

**Table of Contents**

December 31, 2006. This increase is directly related to the goodwill and other intangibles recorded in connection with the Company's acquisition of the assets of two Alabama insurance agencies less amortization of identifiable intangible assets for the first nine-months of 2007.

Accounts payable and accrued expenses as of September 30, 2007 increased \$3.0 million from December 31, 2006 to \$8.0 million. \$1.0 million of the balance represents the Company's liability due to carriers related to an increase in direct bill agency business, \$0.7 million increase in unclaimed property, \$0.7 million increase in accrued expenses for payroll and general expense and \$.4 million accrual for return commission related to a subsequent legal event that occurred on October 3, 2007.

Unearned premium as of September 30, 2007 increased \$12.3 million to \$32.9 million from December 31, 2006, and represents premiums written but not earned. This is directly attributable to the increase in AAIC's premium writings during the first nine months of 2007.

Unpaid losses and loss adjustment expenses increased \$5.8 million to \$30.7 million as of September 30, 2007 from \$24.9 million at December 31, 2006. This amount represents management's estimates of future amounts needed to pay claims and related expenses and the increase correlates with the increase in AAIC's writings and anticipated future losses.

Reinsurance payable as of September 30, 2007 increased \$12.8 million to \$29.6 million, compared to the balance at December 31, 2006. The amount represents premiums owed to the Company's reinsurers. AAIC maintains a quota-share reinsurance treaty with its reinsurers in which it cedes 70% of both premiums and losses. The increase is directly attributable to the increase in AAIC's premium writings during the first nine months of 2007.

**Liquidity and Capital Resources**

Net cash provided by operating activities for the nine-month period ended September 30, 2007 was \$4.0 million compared to \$5.6 million for the same period of 2006.

Investing activities for the nine-month period ended September 30, 2007 consisted of the purchase of leasehold improvements and property and equipment in the amount of \$0.5 million in our headquarters and in TrustWay; the purchase of two Alabama agencies during the year and \$5.8 million in purchases, less \$1.4 million in sales, of investments in compliance with various Departments of Insurance requirements for issuance of Certificates of Authority and general investment policies of the Company.

Financing activities for the nine-month period ended September 30, 2007 included the issuance of common stock resulting in additional capital of \$0.1 million. Debt repayments for the periods ended September 30, 2007 and 2006 were \$1.2 million and \$1.6 million, respectively, and the Company issued two promissory notes in connection with the acquisition of agencies in the amount of \$0.2 million.

The Company's liquidity and capital needs have been met in the past through premium, commission and fee income, loans from its Chairman, its Chief Executive Officer, a former Division President of the Company and a current Division President of the Company and issuance of its Series A Convertible Preferred Stock, Common Stock and Debt Securities. The Company's related party debt consists of unsecured promissory notes payable to its Chairman, its Chief Executive Officer, a former Division President of the Company and a current Division President of the Company. The promissory notes carry an interest rate of 8% per annum and provide for the repayment of principal on an annual basis. During the first quarter of 2006, the Company issued 600,000 shares of its Common Stock for an aggregate consideration of \$390,000. On December 22, 2005, the Company, through a newly-formed Delaware statutory trust, AssuranceAmerica Capital Trust I (the "Trust"), consummated the private placement of 5,000 of the Trust's floating rate capital securities, with a liquidation amount of \$1,000 per capital security (the "Capital Securities"). In connection with the Trust's issuance and sale of the Capital Securities, the Company purchased from the Trust 155 of the Trust's floating rate common securities, with a liquidation amount of \$1,000 per common security (the "Common Securities"). The Trust used the proceeds from the issuance and sale of the Capital Securities and the Common Securities to purchase \$5,155,000 in aggregate principal amount of the floating rate junior subordinated debentures of the Company (the "Debentures"). The Capital Securities mature on December 31, 2035, but may be redeemed at par beginning December 31, 2010 if and to the extent the Company exercises its right to redeem the Debentures. The Capital Securities require quarterly distributions by the Trust to the holders of the Capital Securities, at a floating rate of three-month LIBOR plus 5.75% per annum, reset quarterly. Distributions are cumulative and will

accrue from the date of original issuance but may be deferred for a period of up to 20 consecutive quarterly interest payment periods if the Company exercises its right under the Indenture to defer the payment of interest on the Debentures.

The growth of the Company has and will continue to strain its liquidity and capital resources. As of September 30, 2007, AAIC's Capital and Surplus was \$11.8 million due to continued positive underwriting results.

Page 15 of 28

---

**Table of Contents****Results of Operations**

The Company reported net loss of \$44,000 and net income of \$0.7 million for the three and nine-month periods ended September 30, 2007 compared to net income of \$0.7 million and \$1.6 million for the three and nine-month periods ended September 30, 2006. The Company reported basic earnings (loss) per common share of (\$0.001) and \$0.012 for the three and nine month periods ended September 30, 2007 compared to \$0.013 and \$0.003 for the three and nine-month periods ended September 30, 2006. Fully diluted earnings (loss) per common share for the three and nine-month periods ended September 30, 2007 was (\$0.001) and \$0.012 compared to \$0.012 and \$0.003 for the three and nine month periods ended September 30, 2006. The third quarter loss was mainly attributable to the aforementioned subsequent event and a decline in operating results from the retail operating segment.

**Revenues***Premiums*

Gross premiums written for the three and nine month periods ended September 30, 2007 were \$21.5 million and \$70.0 million, respectively. In the comparable period for 2006, AAIC recorded \$18.3 million and \$53.8 million, respectively, in gross premiums written. 2007 gross premiums written includes insurance premiums written directly by AAIC, direct premiums written, of \$21.1 million and \$68.8 million in the respective three and nine month periods, plus \$0.4 and \$1.2 million, in the respective three and nine month periods, of premiums associated with the insurance risk transferred to AAIC by two unaffiliated insurance companies pursuant to a reinsurance contract, assumed premiums written. 2006 gross premiums written includes direct premiums written of \$18.3 million and \$53.6 million in the respective three and nine month periods, plus \$7,000 and \$0.2 million, in the respective three and nine month periods, of assumed premiums written. The majority of our growth occurred in Florida, where AAIC began writing policies in 2006. Entry into Florida accounted for \$19.6 million of the \$15.2 million increase, or 129%, during 2007 over the comparable 2006 period. As of September 30, 2007 Florida accounts for 38% of year-to-date direct written premium, surpassing Georgia for the first time in the history of the Company. This is due also, in part to the decline in Georgia premium during the first nine months of 2007 from the comparable 2006 period. Rate increases during the latter part of 2006 continued to suppress Georgia growth. Georgia premium for the nine month period ended September 30, 2007 declined \$5.9 million or 18% from the 2006 comparable period. South Carolina premium declined \$1.6 million in response to rate increases and competition during the first nine months of 2007, when compared with the first nine months of 2006. Growth in Louisiana premium of \$2.5 million during the first nine months reflects entry into this new state during the fourth quarter of 2006. Generally, policies in force increased 30% from December 31, 2006 to September 30, 2007. The Company cedes approximately 70% of its direct premiums written to its reinsurers and the amount ceded for the three and nine month periods ended September 30, 2007, was \$14.6 million and \$47.2 million, respectively.

Premiums written refers to the total amount of premiums billed to the policyholder less the amount of premiums returned, generally as a result of cancellations, during a given period. Premiums written become premiums earned as the policy ages. Barring premium rate changes, if an insurance company writes the same mix of business each year, premiums written and premiums earned will be equal and the unearned premium reserve will remain constant. During periods of growth, the unearned premium reserve will increase, causing premiums earned to be less than premiums written. Conversely, during periods of decline, the unearned premium reserve will decrease, causing premiums earned to be greater than premiums written. The Company's net earned premium, after deducting reinsurance, was \$6.8 million and \$18.7 million for the three and nine month periods ended September 30, 2007 and compares to \$5.2 million and \$15.6 million, respectively, for the three and nine month periods ended September 30, 2006.

*Commission and Fee Income*

MGA and TrustWay produce and service non-standard personal automobile insurance business for our own carrier and other insurers. We receive service fees for agency, underwriting, policy administration, and claims adjusting services performed on behalf of these insurers. We also receive commission and service fee income in TrustWay on other insurance products produced for unaffiliated insurance companies on which we do not bear underwriting risk, including travel protection, vehicle protection and hospital indemnity insurance policies. Commission rates vary between carriers and are applied to written premium to determine commission income.

Commission income, as a result of business produced in both TrustWay and MGA, for the three and nine month periods ended September 30, 2007 was \$4.5 million and \$16.3 million, respectively, compared to \$5.3 million and \$17.7 million for the same periods ended September 30, 2006. During the fourth quarter of 2006, TrustWay closed five locations for strategic reasons, which resulted in a decline in revenue for our Florida agencies. Increases in Florida business as noted above stemmed from both increased production with unaffiliated Florida agencies. Total commission income earned by TrustWay from the production of AAIC for the three and nine month periods ended September 30, 2007 totaled \$.9 million and \$3.4 million, respectively and this amount is eliminated from total commission income (revenue) and commission expense. AAIC pays MGA commission on the 30% of premium which AAIC retains. This amount is subsequently eliminated upon consolidation. The amount eliminated was \$1.6 million and \$5.3 million, respectively, for the three and nine month periods ended September 30, 2007.

Managing general agent fees for the three and nine month periods ended September 30, 2007 were \$2.9 million and \$8.1 million, respectively, an increase of \$0.6 million and \$0.9 million, when compared to the same periods of 2006.

Page 16 of 28

---

**Table of Contents**

Other fee income was flat and decreased \$0.2 million for the three and nine month periods ended September 30, 2007 from the comparable periods of 2006. TrustWay collects fees for various services performed and for additional products sold to insureds. As TrustWay writes more direct bill policies, increasing policy renewals and related commissions, fee income is reduced.

*Net Investment Income*

Our investment portfolio is generally highly liquid and consists substantially of readily marketable, investment-grade debt and equity securities. Net investment income is primarily comprised of interest and dividends earned on these securities, net of related investment expenses. Net investment income was \$.2 million and \$.6 million for the three and nine month periods ended September 30, 2007 from \$0.2 million and \$0.5 million in the comparable 2006 periods. This is primarily a result of an increase in average invested assets. The improved cash flows from our insurance operations resulted in increases in average invested assets.

**Expenses***Insurance Loss and Loss Adjustment Expenses*

Insurance losses and loss adjustment expenses include payments made to settle claims, estimates for future claim payments and changes in those estimates for current and prior periods, as well as loss adjustment expenses incurred in connection with settling claims. Insurance losses and loss adjustment expenses are influenced by many factors, such as claims frequency and severity trends, the impact of changes in estimates for prior accident years, and increases in the cost of medical treatment and automobile repairs. The anticipated impact of inflation is considered when we establish our premium rates and set loss reserves. We perform a rolling quarterly actuarial analysis each month and establish or adjust (for prior accident quarters) reserves, based upon our estimate of the ultimate incurred losses and loss adjustment expenses to reflect loss development information and trends that have been updated for the most recent quarter's activity. Each month our estimate of ultimate loss and loss adjustment expenses is evaluated by accident quarter, by state and by major coverage grouping (e.g., bodily injury, physical damage) and changes in estimates are reflected in the period the additional information becomes known.

We have historically used reinsurance to manage our exposure to loss by ceding a portion of our gross losses and loss adjustment expenses to reinsurers. We remain obligated for amounts covered by reinsurance, however, in the event that the reinsurers do not meet their obligations under the agreements (due to, for example, disputes with the reinsurer or the reinsurer's insolvency). The Company cedes approximately 70% of its direct loss and loss adjustment expenses incurred to its reinsurers and the amount ceded for the three and nine month periods ended September 30, 2007 was \$10.2 million and \$30.4 million, respectively.

After making deductions for the effect of reinsurance, losses and loss adjustment expenses were \$4.7 million and \$13.6 million for the three and nine month periods ended September 30, 2007. As a percentage of earned premiums, this amount increased for the three month period ended September 30, 2007 from 64.6% to 69.5%, when compared with the same period in 2006. As a percentage of earned premiums, this amount decreased for the nine month period ended September 30, 2007 from 72.7% to 72.5%, when compared with the same period in 2006. The amount represents actual payments made and changes in estimated future payments to be made to or on behalf of its policyholders, including the expenses associated with settling claims. The decrease in the year-over-year loss ratio is in part due to planned price increases in certain states in response to previously reported loss increases.

*Other Expenses*

Other operating expenses, including selling and general and administrative increased \$0.7 million and \$1.3 million for the three and nine-month periods ended September 30, 2007 when compared to the same periods of 2006. As a percentage of revenue, selling and general and administrative expenses for the three month period ended September 30, 2007 decreased from 63.1% to 62.6% when compared to the 2006 period. As a percentage of revenue, selling and general and administrative expenses for the nine month period ended September 30, 2007 decreased from 62.1% to 61.3% when compared to the 2006 period. Depreciation and amortization expense decreased \$0.1 million and increased \$0.1 million for the three and nine month periods ended September 30, 2007 when compared to the same periods of 2006. These increases are associated with the increase in fixed and intangible assets, including the added depreciable and amortizable assets from the four agency acquisitions in January 2006 and January 2007.

*Income Tax Expense*

The provision for income taxes for the three and nine month periods ended September 30, 2007 consists of federal and state income taxes at the Company's effective tax rate. The Company's tax expense was \$0.1 million and \$0.8 million for the three and nine month periods ended September 30, 2007, representing an effective tax rate of 51% for the first nine months of 2007. This tax expense compares with \$0.1 million and \$0.6 million for the comparable 2006 periods, which was an effective tax rate of 24% for the year. The tax rate for the three and nine month periods ended September 30, 2006 included a partial reversal of prior year valuation allowances on net operating loss carry-forwards.

*Off-Balance Sheet Arrangements*

Page 17 of 28

---



**Table of Contents**

The Company did not have any off-balance sheet arrangements during the nine months ended September 30, 2007.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are primarily exposed to the impact of interest rate changes, changes in market values of investments and to credit risk.

In the normal course of business, we employ established policies and procedures to manage our exposure to changes in interest rates, fluctuations in the fair market value of debt and equity securities and credit risk. We seek to mitigate these risks by various actions described below.

Our cash flows from operations and short-term cash position generally have been more than sufficient to meet our projected obligations for claim payments, which by the nature of the personal automobile insurance business, tend to have an average duration of less than one year. As a result, it has been unnecessary for the Company to employ elaborate market risk management techniques involving complicated asset and liability duration matching or hedging strategies.

***Interest Rate Risk***

*Investments.* Our investment portfolio consists primarily of fixed-maturity debt securities, all of which are classified as available for sale. For these securities, we seek to provide for liquidity and diversification while maximizing income without sacrificing investment quality. The value of the fixed maturity securities portfolio is subject to interest rate risk where the value of the fixed maturity securities portfolio decreases as market interest rates increase, and conversely, when market interest rates decrease, the value of the fixed maturity securities portfolio increases. Duration is a common measure of the sensitivity of a fixed maturity security's value to changes in interest rates. More specifically, it is the approximate percentage change in the value of a bond or bond portfolio due to a 100 basis point change in interest rates. The higher the duration, the more sensitive a fixed maturity security is to market interest rate fluctuations. Effective duration also measures this sensitivity, but it takes into account call terms, as well as changes in remaining term, coupon rate, cash flow, and other items. We strive to limit interest rate risk by selecting investments with characteristics such as duration, yield and liquidity tailored to the anticipated cash outflow characteristics of our liabilities. Interest rate risk includes the risk from movements in the underlying market rate and in the credit spread of the respective sectors of the debt securities in our portfolio. We do not hedge our exposure to interest rate risk because we have the capacity to, and typically do, hold fixed-maturity investments to maturity. The effective duration of the portfolio as of September 30, 2007 was 4.61 years. Should market interest rates increase 1.0%, our fixed income portfolio would be expected to decline in market value by \$0.9 million, or 5.9%. Conversely, a 1.0% decline in interest rates would result in approximately \$0.5 million, or 3.1%, appreciation in the market value of our fixed income portfolio.

*Credit Facility.* We also have exposure to market risk for changes in interest rates because we have variable rate debt. The interest rate we pay increases or decreases with the changes in LIBOR. Based on our borrowings under the floating rate credit agreement at September 30, 2007, a 10% increase in market interest rates would increase our annual net interest expense by approximately \$20,000. Conversely, a 10% decrease in market interest rates would decrease our annual net interest expense by approximately \$20,000.

The graphical depiction of the relationship between the yield on bonds of the same credit quality with different maturities is usually referred to as a yield curve. Because the yield on U.S. Treasury securities is the base rate (or risk free rate) from which non-government bond yields are normally benchmarked, the most commonly constructed yield curve is derived from the observation of prices and yields in the Treasury market. An upward sloping curve, where yield rises steadily as maturity increases, is referred to as a normal yield curve.

The following table shows the carrying values of our fixed maturity securities, which are reported at fair value, and our debt, which is reported at amortized cost. The table also presents estimated fair values at adjusted market rates assuming a parallel 100 basis point increase in market interest rates, given the effective duration noted above. The following sensitivity analysis summarizes only the exposure to market interest rate risk:

<b>Estimated Carrying Value at</b>	<b>Change in</b>
--	------------------

<b>(Dollar amounts in thousands)</b>	<b>Carrying</b>	<b>Adjusted Market Rates/Prices Indicated Above</b>	<b>Value as a Percentage of Carrying Value</b>
<b>September 30, 2007</b>	<b>Value</b>		
Fixed maturity securities available-for-sale, at fair value	\$15,425.4	\$ 14,331.1	(7.1)%

The discussion above provides only a limited, point-in-time view of the market risk sensitivity of our fixed rate financial instruments. The actual impact of interest rate changes on our fixed maturity securities in particular may differ significantly from those shown, as the analysis assumes a parallel shift in market interest rates. The analysis also does not consider any actions we could take in response to actual and/or anticipated changes in interest rates.

Page 18 of 28

---

**Table of Contents**

The difference between long-term Treasury yields and short-term Treasury yields are usually referred as the slope of the yield curve. If the spread between the long end of the curve, where maturities are high, and the short end of the curve, where maturities are low, narrows, the yield curve is said to be flattening. Conversely, if the spread between the long end of the curve and the short end of the curve widens, the yield curve is said to be steepening. If the yields on the long end of the curve fall below those of the short end of the curve, the yield curve is said to be inverted.

The analysis above assumes a parallel shift in interest rates. However, the curve may also steepen, flatten or become inverted. This type of behavior may affect certain sections of the curve in disproportionate amounts. For example, if short-term Treasury yields rise and the yield curve flattens, fixed maturity instruments with short duration may be impacted to a greater degree than fixed maturity instruments with longer duration. Conversely, if long-term Treasury yields rise and the yield curve steepens, fixed maturity instruments with long duration may be impacted to a greater degree than fixed maturity instruments with shorter duration.

The following summarizes the effective duration distribution of our fixed maturity securities portfolio.

	<b>Duration Ranges</b>					
	Below 1	1 to 3	3 to 5	5 to 7	7 to 10	10 to 20
<b>September 30, 2007</b>						
Fair value percentage of fixed maturity security portfolio	7.2%	16.3%	29.9%	37.0%	9.6%	0.0%

**Equity Price Risk**

*Investments.* The marketable equity securities portfolio of our insurance subsidiary, which is carried on our consolidated balance sheets at estimated fair value, has exposure to price risk, which is the risk of potential loss in estimated fair value resulting from adverse changes in prices. The objective of our insurance subsidiary is to earn competitive relative returns by investing in diverse portfolios of high-quality, liquid securities.

**Credit Risk**

*Investments.* The fixed maturity securities portfolio of our insurance subsidiary is subject to credit risk. This risk is the potential loss in market value resulting from adverse changes in the borrower's ability to repay the debt. We attempt to manage our credit risk through issuer and industry diversification. We regularly monitor our overall investment results and review compliance with our investment objectives and guidelines. Our investment guidelines include limitations on the minimum rating of debt securities in our investment portfolio, as well as restrictions on investments in debt securities of a single issuer. All of the debt securities in our portfolio were rated investment grade by the National Association of Insurance Commissioners, or the NAIC, and Standard & Poor's as of September 30, 2007.

*Reinsurance.* The Carrier places reinsurance with five major unaffiliated reinsurers. Two of the reinsurers are authorized and three are unauthorized. To the extent that a reinsurer may be unable to pay losses for which it is liable to Carrier under the terms of its reinsurance agreement, Carrier remains liable for such losses. The Company attempts to minimize this risk by maintaining reinsurance agreements with financially sound reinsurers. The Company maintains security trust agreements with the two unauthorized reinsurers, whereby all reinsurance receivables are pre-funded and secured. As of September 30, 2007 there were no amounts deemed uncollectible.

**ITEM 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this report on Form 10-Q, the Company's Chief Executive Officer and acting Chief Financial Officer carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures in accordance with Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934 (the Exchange Act). Based on this evaluation, the Company's Chief Executive Officer and acting Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure and are effective to ensure that such information is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There were no significant changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) identified in connection with the foregoing evaluation that occurred during the nine month period ended September 30, 2007, that have materially affected, or are reasonably likely to materially affect subsequent to the date of the evaluation, the Company's internal control over financial reporting.

Page 19 of 28

---

**Table of Contents****PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

See Note 11 to the Consolidated Financial Statements Subsequent Event

**ITEM 1A. RISK FACTORS**

*An investment in Company common stock involves a number of risks. Investors should carefully consider the following information, together with the other information contained in the Company's Annual Report on Form 10-KSB, before investing in Company common stock. Further, such factors could cause actual results to differ materially from those contained in any forward-looking statement contained in this report, statements by us in periodic press releases and oral statements by Company officials to securities analysts and stockholders during presentations about us.*

**We face intense competition from other automobile insurance providers.**

The non-standard automobile insurance business is highly competitive and, except for regulatory considerations, there are relatively few barriers to entry. We compete with both large national insurance providers and smaller regional companies. The largest automobile insurance companies include The Progressive Corporation, The Allstate Corporation, State Farm Mutual Automobile Insurance Company, GEICO, Farmers Insurance Group, Safeco Corp., and American International Group (AIG). Our chief competitors include some of these companies as well as Mercury General Corporation, Infinity Property & Casualty Corporation, Affirmative Insurance Holdings, Inc., and Direct General Corporation. Some of our competitors have more capital, higher ratings and greater resources than we have, and may offer a broader range of products and lower prices and down payments than we offer. Some of our competitors that sell insurance policies directly to customers, rather than through agencies or brokerages as we do, may have certain competitive advantages, including increased name recognition among customers, direct relationships with policyholders and potentially lower cost structures. In addition, it is possible that new competitors will enter the non-standard automobile insurance market. Our loss of business to competitors could have a material impact on our growth and profitability. Further, competition could result in lower premium rates and less favorable policy terms and conditions, which could reduce our underwriting margins.

**Our concentration on non-standard automobile insurance could make us more susceptible to unfavorable market conditions.**

We underwrite exclusively non-standard automobile insurance. Given this focus, negative developments in the economic, competitive or regulatory conditions affecting the non-standard automobile insurance industry could have a material adverse effect on our results of operations, financial condition and cash flows. In addition, these developments could have a greater effect on us, compared to more diversified insurers that also sell other types of automobile insurance products. Our profitability can be affected by cyclicalities in the non-standard automobile insurance industry caused by price competition and fluctuations in underwriting capacity in the market, as well as changes in the regulatory environment.

**Our success depends on our ability to price the risks we underwrite accurately.**

Our results of operations and financial condition depend on our ability to underwrite and set rates accurately for a full spectrum of risks. Rate adequacy is necessary to generate sufficient premiums to pay losses, loss adjustment expenses and underwriting expenses and to earn a profit. If we fail to assess accurately the risks that we assume, we may fail to establish adequate premium rates, which could reduce our income and have a material adverse effect on our results of operations, financial condition or cash flows.

In order to price our products accurately, we must collect and properly analyze a substantial volume of data; develop, test and apply appropriate rating formulas; closely monitor and timely recognize changes in trends; and project both severity and frequency of losses with reasonable accuracy. Our ability to undertake these efforts successfully, and as a result price our products accurately, is subject to a number of risks and uncertainties, including, without limitation:

availability of sufficient reliable data;

incorrect or incomplete analysis of available data;

uncertainties inherent in estimates and assumptions, generally;

selection and application of appropriate rating formulas or other pricing methodologies;

unanticipated or inconsistent court decisions, legislation or regulatory action;

ongoing changes in our claim settlement practices, which can influence the amounts paid on claims;

changing driving patterns, which could adversely affect both frequency and severity of claims;

unexpected inflation in the medical sector of the economy, resulting in increased bodily injury and personal injury protection claim severity; and

unanticipated inflation in automobile repair costs, automobile parts prices and used automobile prices, adversely affecting automobile physical damage claim severity.

Page 20 of 28

---

**Table of Contents**

Such risks may result in our pricing being based on inadequate or inaccurate data or inappropriate analyses, assumptions or methodologies, and may cause us to estimate incorrectly future increases in the frequency or severity of claims. As a result, we could underprice our products, which would negatively affect our profit margins, or we could overprice our products, which could reduce our volume and competitiveness. In either event, our results of operations, financial condition and cash flows could be materially and adversely affected.

**Our losses and loss adjustment expenses may exceed our loss and loss adjustment expense reserves, which could adversely impact our results of operation, financial condition and cash flows.**

Our financial statements include loss and loss adjustment expense reserves, which represent our best estimate of the amounts that we will ultimately pay on claims and the related costs of adjusting those claims as of the date of the financial statements. We rely heavily on our historical loss and loss adjustment expense experience in determining these loss and loss adjustment expense reserves. The historic development of reserves for losses and loss adjustment expenses may not necessarily reflect future trends in the development of these amounts. In addition, factors such as inflation, claims settlement patterns and legislative activities, regulatory activities, and litigation trends may also affect loss and loss adjustment expense reserves. As a result of these and other risks and uncertainties, ultimate losses and loss adjustment expenses may deviate, perhaps substantially, from our estimates of losses and loss adjustment expenses included in the loss and loss adjustment expense reserves in our financial statements. If actual losses and loss adjustment expenses exceed our expectations, our net income and our capital would decrease. Actual paid losses and loss adjustment expenses may be in excess of the loss and loss adjustment expense reserve estimates reflected in our financial statements.

**We are subject to comprehensive regulation, and our ability to earn profits may be adversely affected by these regulations.**

We are subject to comprehensive regulation by government agencies in the states where our insurance subsidiaries are domiciled and where these subsidiaries issue policies and handle claims. Certain states impose restrictions or require prior regulatory approval of certain corporate actions, which may adversely affect our ability to operate, innovate, obtain necessary rate adjustments in a timely manner or grow our business profitably. In addition, certain federal laws impose additional requirements on insurers. Our ability to comply with these laws and regulations, and to obtain necessary regulatory action in a timely manner, is and will continue to be critical to our success.

*Required Licensing.* We operate under licenses issued by various state insurance authorities. If a regulatory authority denies or delays granting a new license, our ability to enter that market quickly can be substantially impaired.

*Transactions Between Insurance Companies and Their Affiliates.* Transactions between our subsidiaries and their affiliates (including us) generally must be disclosed to the state regulators, and prior approval of the applicable regulator generally is required before any material or extraordinary transaction may be consummated. State regulators may refuse to approve or delay approval of such a transaction, which may impact our ability to innovate or operate efficiently.

*Regulation of Insurance Rates and Approval of Policy Forms.* The insurance laws of the states in which our insurance subsidiaries operate require insurance companies to file insurance rate schedules and insurance policy forms for review and/or approval. If, as permitted in some states, we begin using new rates before they are approved, we may be required to issue refunds or credits to our policyholders if the new rates are ultimately deemed excessive or unfair and disapproved by the applicable state regulator. Accordingly, our ability to respond to market developments or increased costs in that state can be adversely affected.

*Restrictions on Cancellation, Non-Renewal or Withdrawal.* Many states have laws and regulations that limit an insurer's ability to exit a market. For example, certain states limit an automobile insurer's ability to cancel or not renew policies. Some states prohibit an insurer from withdrawing from one or more lines of business in the state, except pursuant to a plan approved by the state insurance department. In some states, this restriction applies to significant reductions in the amount of insurance written, not just to a complete withdrawal. These laws and regulations could limit our ability to exit or reduce our writings in unprofitable markets or discontinue unprofitable products in the future.

*Other Regulations.* We must also comply with regulations involving, among other things:  
the use of non-public consumer information and related privacy issues;

investment restrictions;

the use of credit history in underwriting and rating;

the payment of dividends;

the acquisition or disposition of an insurance company or of any company controlling an insurance company;

the involuntary assignments of high-risk policies, participation in reinsurance facilities and underwriting associations, assessments and other governmental charges; and

reporting with respect to financial condition.

Compliance with laws and regulations addressing these and other issues often will result in increased administrative costs. In addition, these laws and regulations may limit our ability to underwrite and price risks accurately, prevent us from obtaining timely rate increases necessary to cover increased costs and may restrict our ability to discontinue unprofitable relationships or exit unprofitable markets. These results, in turn, may adversely affect our results of operation or our ability or desire to grow our business in certain jurisdictions. The failure to comply with these laws and regulations may also result in actions by regulators, fines and penalties, and in extreme cases, revocation of our ability to do business in that jurisdiction. In addition, we may face individual and class action lawsuits by our insureds and other parties for alleged violations of certain of these laws or regulations.

Page 21 of 28

---



**Table of Contents**

***Our insurance subsidiaries are subject to minimum capital and surplus requirements. Our failure to meet these requirements could subject us to regulatory action.***

The laws of the states of domicile of our insurance subsidiaries impose risk-based capital standards and other minimum capital and surplus requirements. Failure to meet applicable risk-based capital requirements or minimum statutory capital requirements could subject us to further examination or corrective action imposed by state regulators, including limitations on our writing of additional business, state supervision or liquidation. Any changes in existing risk-based capital requirements or minimum statutory capital requirements may require us to increase our statutory capital levels, which we may be unable to do.

***Regulation may become more extensive in the future, which may adversely affect our business.***

States may make existing insurance laws and regulations more restrictive in the future or enact new restrictive laws. In such events, we may seek to reduce our premium writings in, or to withdraw entirely from, these states. In addition, from time to time, the United States Congress and certain federal agencies investigate the current condition of the insurance industry to determine whether federal regulation is necessary. We are unable to predict whether and to what extent new laws and regulations that would affect our business will be adopted in the future, the timing of any such adoption and what effects, if any, they may have on our financial condition, results of operations, and cash flows.

***Our failure to pay claims accurately could adversely affect our business, financial condition, results of operations and cash flows.***

We must accurately evaluate and pay claims that are made under our policies. Many factors affect our ability to pay claims accurately, including the training and experience of our claims representatives, our claims organization's culture and the effectiveness of our management, our ability to develop or select and implement appropriate procedures and systems to support our claims functions and other factors. Our failure to pay claims accurately could lead to material litigation, undermine our reputation in the marketplace, impair our image and materially adversely affect our financial condition, results of operations and cash flows.

In addition, if we do not train new claims employees effectively or lose a significant number of experienced claims employees our claims department's ability to handle an increasing workload could be adversely affected. In addition to potentially requiring that growth be slowed in the affected markets, we could suffer in decreased quality of claims work, which in turn could lower our operating margins.

***The policy service fee revenues could be adversely affected by insurance regulation.***

Policy service fee revenues have provided additional revenues equivalent to approximately 10.7% of gross premium produced by MGA. These fees include policy origination fees and installment fees to compensate us for the costs of providing installment payment plans, as well as late payment, policy cancellation, policy rewrite and reinstatement fees. Our revenues could be reduced by changes in insurance regulation that restrict our ability to charge these fees. Those arrangements are subject to insurance holding company act regulation in the states where our insurance subsidiaries are domiciled. Continued payment of these fees could be affected if insurance regulators in these states determined that these arrangements are not permissible under the insurance holding company acts.

***New pricing, claim and coverage issues and class action litigation are continually emerging in the automobile insurance industry, and these new issues could adversely impact our results of operations and financial condition.***

As automobile insurance industry practices and regulatory, judicial and consumer conditions change, unexpected and unintended issues related to claims, coverage and business practices may emerge. These issues can have an adverse effect on our business by changing the way we price our products, including limiting the factors we may consider when we underwrite risks, by extending coverage beyond our underwriting intent, by increasing the size or frequency of claims or by requiring us to change our claims handling practices and procedures or our practices for charging fees. The effects of these unforeseen emerging issues could negatively affect our results of operations, financial condition and cash flows.

***We may be unable to attract and retain independent agents and brokers.***

We distribute our products exclusively through independent agents and brokers. We compete with other insurance carriers to attract producers and maintain commercial relationships with them. Some of our competitors offer a larger variety of products, lower prices for insurance coverage or higher commissions. We may not be able to continue to attract and retain independent agents and brokers to sell our products. Our inability to continue to recruit and retain

productive independent agents and brokers would have an adverse effect on our financial condition and results of operations and could impact our cash flows.

**We rely on information technology and telecommunication systems, and the failure of these systems could materially and adversely affect our business.**

Our business is highly dependent upon the successful and uninterrupted functioning of our information technology and telecommunications systems. We rely on these systems to process new and renewal business, provide customer service, make claims payments and facilitate collections and cancellations. These systems also enable us to perform actuarial and other modeling functions necessary for underwriting and rate development. The failure of these systems could interrupt our operations or materially impact our ability to evaluate and write new business. Because our information technology and telecommunication systems interface with and depend on third-party systems, we could experience service denials if demand for such service exceeds capacity or such third-party systems fail or experience interruptions. If sustained or repeated, a system failure or service denial could result in a deterioration of our ability to write and process new and renewal business and provide customer service or compromise our ability to pay claims in a timely manner. This outcome could result in a material adverse effect on our business and our results of operations, financial condition and cash flows.

Page 22 of 28

---

**Table of Contents****Our ability to operate our company effectively could be impaired if we lose key personnel.**

We manage our business with a number of key personnel, including our executive officers, the loss of whom could have a material adverse effect on our business and our results of operations, financial condition and cash flows. Only our Chief Executive Officer, Lawrence Stumbaugh and our Executive Vice President and MGA President, Joseph Skruck, have employment agreements with us. In addition, as our business develops and expands, we believe that our future success will depend greatly on our continued ability to attract and retain highly skilled and qualified personnel. We may not be able to continue to employ key personnel and may not be able to attract and retain qualified personnel in the future. Failure to retain or attract key personnel could have a material adverse effect on our business and our results of operations, financial condition and cash flows. We do not have key person life insurance to cover our executive officers.

**Our debt service obligations could impede our operations, flexibility and financial performance.**

Our level of debt could affect our financial performance. As of September 30, 2007, we had consolidated indebtedness (other than trade payables and certain other short term debt) of approximately \$9.8 million. In addition, borrowings under our trust preferred arrangement bear interest at rates that may fluctuate. Therefore, increases in interest rates on the obligations under our credit agreement would adversely affect our income and cash flow that would be available for the payment of interest and principal on the loans outstanding.

If we do not have enough money to pay our debt service obligations, we may be required to refinance all or part of our existing debt, sell assets, borrow more money or raise equity. In that event, we may not be able to refinance our debt, sell assets, borrow more money or raise equity on terms acceptable to us or at all.

**Adverse securities market conditions can have significant and negative effects on our investment portfolio.**

Our results of operations depend in part on the performance of our invested assets. As of September 30, 2007, 87% of our investment portfolio was invested in fixed maturity securities with the remainder equity investments. Certain risks are inherent in connection with fixed maturity securities, including loss upon default and price volatility in reaction to changes in interest rates, credit spreads, deterioration in the financial condition of the issuers and general market conditions. An increase in interest rates lowers prices on fixed maturity securities, and any sales we make during a period of increasing interest rates may result in losses. Also, investment income earned from future investments in fixed maturity securities will decrease if interest rates decrease.

In addition, our investment portfolio is subject to risks inherent in the capital markets. The functioning of those markets, the values of our investments and our ability to liquidate investments on short notice may be adversely affected if those markets are disrupted by national or international events including, without limitation, wars, terrorist attacks, recessions or depressions, high inflation or a deflationary environment, the collapse of governments or financial markets, and other factors or events.

If our investment portfolio were impaired by market or issuer-specific conditions to a substantial degree, our financial condition, results of operations and cash flows could be materially adversely affected. Further, our income from these investments could be materially reduced, and write-downs of the value of certain securities could further reduce our profitability. In addition, a decrease in value of our investment portfolio could put us at risk of failing to satisfy regulatory capital requirements. If we were not able to supplement our subsidiaries' capital by issuing debt or equity securities on acceptable terms, our ability to continue growing could be adversely affected.

**Our operations could be adversely affected if conditions in the states where our business is concentrated were to deteriorate.**

For the nine month period ended September 30, 2007, we generated approximately 78% of our gross written premium in our top two states, Florida and Georgia. Our revenues and profitability are therefore subject to prevailing regulatory, legal, economic, demographic, competitive and other conditions in those states. Changes in any of those conditions could have an adverse effect on our results of operations, financial condition and cash flows. Adverse regulatory developments in any of those states, which could include, among others, reductions in the rates permitted to be charged, inadequate rate increases, restrictions on our ability to reject applications for coverage or on how we handle claims, or more fundamental changes in the design or implementation of the automobile insurance regulatory framework, could have a material adverse effect on our results of operations, financial condition and cash flows.

**Severe weather conditions and other catastrophes may result in an increase in the number and amount of claims filed against us.**

Our business is also exposed to the risk of severe weather conditions and other catastrophes in the states in which we operate. Catastrophes include severe hurricanes, tornadoes, hail storms, floods, windstorms, earthquakes, fires and other events such as terrorist attacks and riots, each of which tends to be unpredictable. Such conditions may result in higher incidence of automobile accidents and increase the number of claims. Because many of our insureds live near the coastlines, we have potential exposure to hurricanes and major coastal storms. In addition, our business could be impaired if a significant portion of our business or systems were shut down by, or if we were unable to gain access to certain of our facilities as a result of such an event. If such events were to occur with enough severity, our results of operations, financial condition and cash flows could be materially adversely affected.

**Our financial condition may be adversely affected if one or more parties with which we enter into significant contracts becomes insolvent or experiences other financial hardship.**

Our business is dependent on the performance by third parties of their responsibilities under various contractual relationships, including without limitation, contracts for the acquisitions of goods and services (such as telecommunications and information technology software, equipment and support and other services that are integral to our operations) and arrangements for transferring certain of our risks (including our corporate insurance policies). If one or more of these parties were to default on

Page 23 of 28

---

**Table of Contents**

the performance of their obligations under their respective contracts or determine to abandon or terminate support for a system, product or service that is significant to our business, we could suffer significant financial losses and operational problems, which could in turn adversely affect our financial condition, results of operations and cash flows.

**ITEM 6. EXHIBITS**

(a) Exhibits.

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Acting Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer and Acting Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Page 24 of 28

---

**Table of Contents**

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ASSURANCEAMERICA CORPORATION

Date: November 14,  
2007

/s/ Lawrence Stumbaugh

Lawrence Stumbaugh  
Chief Executive Officer

Date: November 14,  
2007

/s/ Gregory D. Woods

Gregory D. Woods  
Acting Chief Financial Officer

Page 25 of 28