

UNICO AMERICAN CORP  
Form 10-Q  
May 15, 2017

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

Quarterly Report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended **March 31, 2017** or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File No. **0-3978**

**UNICO AMERICAN CORPORATION**

*(Exact Name of Registrant as Specified in Its Charter)*

**Nevada**

*(State or Other Jurisdiction of  
Incorporation or Organization)*

**95-2583928**

*(I.R.S. Employee  
Identification No.)*

**26050 Mureau Road, Calabasas, California 91302**

*(Address of Principal Executive Offices) (Zip Code)*

**(818) 591-9800**

*(Registrant's Telephone Number, Including Area Code)*

**No Change**

*(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)*

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company  Emerging growth company

(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| <u>Class</u>                          | <u>Outstanding at May 15, 2017</u> |
|---------------------------------------|------------------------------------|
| Common Stock, \$0 par value per share | 5,307,133                          |

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**PART 1 - FINANCIAL INFORMATION****ITEM 1 - FINANCIAL STATEMENTS**

## UNICO AMERICAN CORPORATION

## AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

|   | March 31<br>2017<br>(Unaudited) | December 31<br><u>2016</u> |
|---|---------------------------------|----------------------------|
| <b>ASSETS</b>   |                                 |                            |
| Investments   |                                 |                            |
| Available-for-sale:   |                                 |                            |
| Fixed maturities, at fair value (amortized cost: \$68,236,670 at March 31, 2017, and \$80,371,842 at December 31, 2016) | \$ 68,240,425                   | \$ 80,383,925              |
| Short-term investments, at fair value   | 21,802,697                      | 10,204,603                 |
| Total Investments   | 90,043,122                      | 90,588,528                 |
| Cash and restricted cash  | 13,602,118                      | 13,496,379                 |
| Accrued investment income   | 211,770                         | 185,916                    |
| Receivables, net  | 6,260,931                       | 6,008,083                  |
| Reinsurance recoverable:  |                                 |                            |
| Paid losses and loss adjustment expenses  | 157,791                         | 260,744                    |
| Unpaid losses and loss adjustment expenses  | 9,885,632                       | 9,520,970                  |
| Deferred policy acquisition costs   | 4,420,746                       | 4,432,299                  |
| Property and equipment, net   | 10,186,014                      | 10,282,532                 |
| Deferred income taxes   | 1,173,686                       | 1,177,346                  |
| Other assets  | 3,018,315                       | 2,269,408                  |
| Total Assets  | \$ 138,960,125                  | \$ 138,222,205             |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                 |                            |
| <b>LIABILITIES</b>  |                                 |                            |
| Unpaid losses and loss adjustment expenses  | \$ 49,890,049                   | \$ 47,055,787              |
| Unearned premiums   | 19,397,282                      | 19,374,740                 |
| Advance premium and premium deposits  | 393,380                         | 224,055                    |
| Accrued expenses and other liabilities  | 2,519,749                       | 2,660,983                  |

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|  |               |               |
|--|---------------|---------------|
| Total Liabilities  | \$72,200,460  | \$69,315,565  |
| Commitments and contingencies  |               |               |
| STOCKHOLDERS' EQUITY   |               |               |
| Common stock, no par – authorized 10,000,000 shares; issued and outstanding shares<br>5,307,133 at March 31, 2017, and December 31, 2016 | \$3,767,096   | \$3,761,320   |
| Accumulated other comprehensive income   | 2,478         | 7,975         |
| Retained earnings  | 62,990,091    | 65,137,345    |
| Total Stockholders' Equity   | \$66,759,665  | \$68,906,640  |
| Total Liabilities and Stockholders' Equity   | \$138,960,125 | \$138,222,205 |

See notes to condensed consolidated financial statements (unaudited).

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## UNICO AMERICAN CORPORATION

## AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

|                                     | Three Months Ended |              |
|-------------------------------------|--------------------|--------------|
|                                     | <u>March 31</u>    |              |
|                                     | <u>2017</u>        | <u>2016</u>  |
| REVENUES                            |                    |              |
| Insurance company operation:        |                    |              |
| Net earned premium                  | \$7,920,699        | \$7,572,415  |
| Investment income                   | 212,186            | 212,000      |
| Net realized investments losses     | —                  | (1,278 )     |
| Other income                        | 68,212             | 67,594       |
| Total Insurance Company Operation   | 8,201,097          | 7,850,731    |
| Other insurance operations:         |                    |              |
| Gross commissions and fees          | 741,175            | 657,245      |
| Investment income                   | 49                 | 91           |
| Finance fees earned                 | 18,161             | 16,609       |
| Other income                        | 15                 | 5,002        |
| Total Revenues                      | 8,960,497          | 8,529,678    |
| EXPENSES                            |                    |              |
| Losses and loss adjustment expenses | 8,525,181          | 5,085,494    |
| Policy acquisition costs            | 1,497,634          | 1,699,660    |
| Salaries and employee benefits      | 1,348,643          | 1,381,584    |
| Commissions to agents/brokers       | 41,889             | 40,419       |
| Other operating expenses            | <u>814,499</u>     | 592,547      |
| Total Expenses                      | 12,227,846         | 8,799,704    |
| Loss before taxes                   | (3,267,349 )       | (270,026 )   |
| Income tax benefit                  | 1,120,097          | 71,039       |
| Net Loss                            | \$(2,147,252 )     | \$(198,987 ) |

## PER SHARE DATA:

|                |           |           |
|----------------|-----------|-----------|
| Basic          |           |           |
| Loss Per Share | \$(0.40 ) | \$(0.04 ) |

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|                         |           |           |
|-------------------------|-----------|-----------|
| Weighted Average Shares | 5,307,133 | 5,309,377 |
| Diluted                 |           |           |
| Loss Per Share          | \$(0.40 ) | \$(0.04 ) |
| Weighted Average Shares | 5,307,133 | 5,309,377 |

See notes to condensed consolidated financial statements (unaudited).

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UNICO AMERICAN CORPORATION

AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(UNAUDITED)

|   | Three Months Ended<br>March 31 |             |
|---|--------------------------------|-------------|
|   | 2017                           | 2016        |
| Net loss  | \$(2,147,252)                  | \$(198,987) |
| Other changes in comprehensive loss:  |                                |             |
| Changes in unrealized (losses) and gains on securities classified as available-for-sale arising during the period   | (8,328 )                       | 92,837      |
| Income tax benefit and (expense) related to changes in unrealized (losses) and gains on securities classified as available-for-sale arising during the period | 2,832                          | (31,564 )   |
| Comprehensive Losses  | \$(2,152,748)                  | \$(137,714) |

See notes to condensed consolidated financial statements (unaudited).



## UNICO AMERICAN CORPORATION

## AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

|  | Three Months Ended |              |
|--|--------------------|--------------|
|  | March 31           |              |
|  | 2017               | 2016         |
| Cash flows from operating activities:                          |                    |              |
| Net loss   | \$(2,147,252 )     | \$(198,987 ) |
| Adjustments to reconcile net loss to net cash from operations: |                    |              |
| Depreciation and amortization                                  | 132,269            | 115,283      |
| Bond amortization, net   | (2,828 )           | (4,284 )     |
| Bad debt expense   | 13,352             | 39           |
| Non-cash stock based compensation                              | 5,776              | 5,776        |
| Changes in assets and liabilities:                             |                    |              |
| Net receivables and accrued investment income                  | (292,054 )         | (276,402 )   |
| Reinsurance recoverable  | (261,709 )         | (871,392 )   |
| Deferred policy acquisition costs                              | 11,553             | (87,944 )    |
| Other assets   | 375,717            | 538,725      |
| Unpaid losses and loss adjustment expenses                     | 2,834,262          | 917,713      |
| Unearned premiums  | 22,542             | 134,489      |
| Advance premium and premium deposits                           | 169,325            | 281,492      |
| Accrued expenses and other liabilities                         | (141,236 )         | 206,124      |
| Income taxes current/deferred                                  | (1,118,132 )       | (68,840 )    |
| Net Cash Provided (Used) by Operating Activities               | (398,415 )         | 691,792      |
| Cash flows from investing activities:                          |                    |              |
| Purchase of fixed maturity investments                         | (100,000 )         | (200,000 )   |
| Proceeds from maturity of fixed maturity investments           | 12,238,000         | 1,046,000    |
| Net decrease (increase) in short-term investments              | (11,598,094)       | 4,351,412    |
| Additions to property and equipment                            | (35,752 )          | (351,777 )   |
| Net Cash Provided by Investing Activities                      | 504,154            | 4,845,635    |
| Cash flows from financing activities:                          |                    |              |
| Repurchase of common stock                                     | —                  | (89,582 )    |
| Net Cash Used by Financing Activities                          | —                  | (89,582 )    |
| Net increase in cash and restricted cash                       | 105,739            | 5,447,845    |
| Cash and restricted cash at beginning of period                | 13,496,379         | 8,258,673    |

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|   |               |               |
|---|---------------|---------------|
| Cash and Restricted Cash at End of Period | \$ 13,602,118 | \$ 13,706,518 |
| Supplemental cash flow information        |               |               |
| Cash paid during the period for:          |               |               |
| Interest                                  | —             | —             |
| Income taxes                              | —             | —             |

See notes to condensed consolidated financial statements (unaudited).

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UNICO AMERICAN CORPORATION

AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

MARCH 31, 2017

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Unico American Corporation is an insurance holding company that underwrites property and casualty insurance through its insurance company subsidiary; provides property, casualty, and health insurance through its agency subsidiaries; and provides insurance premium financing and membership association services through its other subsidiaries. Unico American Corporation is referred to herein as the "Company" or "Unico" and such references include both the corporation and its subsidiaries, all of which are wholly owned. Unico was incorporated under the laws of Nevada in 1969.

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of Unico American Corporation and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and the instructions to Form 10-Q and Rule 8-03 of Regulation S-X for smaller reporting companies. Accordingly, the financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2017, are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. Quarterly financial statements should be read in conjunction with the consolidated financial statements and related notes in the Company's 2016 Annual Report on Form 10-K as filed with the Securities and Exchange Commission. Certain reclassifications have been made to prior period amounts to conform to current quarter presentation.

Use of Estimates in the Preparation of the Financial Statements

The preparation of financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect its reported amounts of assets and liabilities and its disclosure of any contingent assets and liabilities at the date of its financial statements, as well as its reported amounts of revenues and expenses during the reporting period. The most significant assumptions in the preparation of these condensed consolidated financial statements relate to losses and loss adjustment expenses. While every effort is made to ensure the integrity of such estimates, actual results may differ.

Fair Value of Financial Instruments

The Company employs a fair value hierarchy that prioritizes the inputs for valuation techniques used to measure fair value. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Financial assets and financial liabilities recorded on the Condensed Consolidated Balance Sheets at fair value are categorized based on the reliability of inputs for the valuation techniques. (See Note 8.)

The Company has used the following methods and assumptions in estimating its fair value disclosures:

- Fixed maturities:

1. Investment securities, excluding long-term certificates of deposit – Fair values are obtained from a national quotation service.

2. Long-term certificates of deposit – The carrying amounts reported in the Condensed Consolidated Balance Sheets for these instruments approximate their fair values.

- Cash and short-term investments – The carrying amounts reported in the Condensed Consolidated Balance Sheets approximate their fair values given the short-term nature of these instruments.

- Receivables, net – The carrying amounts reported in the Condensed Consolidated Balance Sheets approximate their fair values given the short-term nature of these instruments.

- Accrued expenses and other liabilities – The carrying amounts reported in the Condensed Consolidated Balance Sheets approximate the fair values given the short-term nature of these instruments.

#### NOTE 2 – REPURCHASE OF COMMON STOCK – EFFECTS ON STOCKHOLDERS’ EQUITY

On December 19, 2008, the Board of Directors authorized a stock repurchase program to acquire from time to time up to an aggregate of 500,000 shares of the Company’s common stock. This program has no expiration date and may be terminated by the Board of Directors at any time. As of March 31, 2017, and December 31, 2016, the Company had remaining authority under the 2008 program to repurchase up to an aggregate of 188,655 shares of its common stock. The 2008 program is the only program under which there is authority to repurchase shares of the Company’s common stock. The Company did not repurchase any stock during the three months ended March 31, 2017. The Company repurchased 8,812 shares of stock during the three months ended March 31, 2016, in unsolicited transactions at a cost of \$89,582 of which \$4,331 was allocated to capital and \$85,251 was allocated to retained earnings. The Company has or will retire all stock repurchased.

#### NOTE 3 – LOSS PER SHARE

The following table represents the reconciliation of the Company's basic loss per share and diluted loss per share computations reported on the Condensed Consolidated Statements of Operations for the three months ended March 31, 2017 and 2016:

|                                     | Three Months Ended |              |
|-------------------------------------|--------------------|--------------|
|                                     | <u>March 31</u>    |              |
|                                     | 2017               | 2016         |
| Basic Loss Per Share                |                    |              |
| Net loss                            | \$(2,147,252)      | \$(198,987 ) |
| Weighted average shares outstanding | 5,307,133          | 5,309,377    |
| Basic loss per share                | \$(0.40 )          | \$(0.04 )    |
| Diluted Loss per Share              |                    |              |
| Net loss                            | \$(2,147,252)      | \$(198,987 ) |
| Weighted average shares outstanding | 5,307,133          | 5,309,377    |
| Diluted shares outstanding          | 5,307,133          | 5,309,377    |
| Diluted loss per share              | \$(0.40 )          | \$(0.04 )    |

Basic earnings per share exclude the impact of common share equivalents and are based upon the weighted average common shares outstanding. Diluted earnings per share utilize the average market price per share when applying the treasury stock method in determining common share dilution. When outstanding stock options are dilutive, they are

treated as common share equivalents for purposes of computing diluted earnings per share and represent the difference between basic and diluted weighted average shares outstanding. In loss periods, stock options are excluded from the calculation of diluted loss per share, as the inclusion of stock options would have an anti-dilutive effect.

#### NOTE 4 – RECENTLY ISSUED ACCOUNTING STANDARDS

During the three months ended March 31, 2017, the Financial Accounting Standards Board (“FASB”) has not issued any accounting standards that are expected to have a material impact on the Company’s condensed consolidated financial statements.

In June 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-13 “Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 replaces the current incurred loss methodology for recognizing credit losses with a current expected credit loss model, which requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. ASU 2016-13 also requires enhanced disclosures for better understanding of significant estimates and judgments used in estimating credit losses. The Company is currently evaluating the effect ASU 2016-13 will have on the Company’s consolidated financial statements, but expects the primary changes to be (i) the use of the expected credit loss model for its premium receivables and reinsurance recoverables and (ii) the presentation of credit losses within the available-for-sale fixed maturities portfolio through an allowance method rather than as a direct write-down. ASU 2016-13 will become effective for fiscal years beginning after December 31, 2019, but provides for an early adoption for fiscal years beginning after December 31, 2018. The Company has not determined when it will adopt ASU 2016-13.

In February 2016, the FASB issued ASU 2016-02 “Leases.” This ASU requires lessees to recognize on the balance sheet the assets and liabilities for the rights and obligations created by all leases, including those historically accounted for as operating leases. The Company is currently evaluating the effect ASU 2016-02 will have on the Company's consolidated financial statements. The guidance is effective for interim and annual periods beginning after December 31, 2018, and will be applied under a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18 “Statement of Cash Flows: Restricted Cash.” The ASU requires that a statement of cash flows explain the change during the period of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statements of cash flows. The Company early adopted this ASU as of December 31, 2016, and the ASU was applied using a retrospective approach for each period presented. Upon adoption of this ASU, the Company's consolidated statements of cash flows included restricted cash in the beginning-of-period and end-of-period total amounts for cash and restricted cash. The ASU did not have a material impact on the Company's consolidated financial statements, but the ASU required additional disclosures in “Note 10 – Cash and Restricted Cash” to these condensed consolidated financial statements.

In May 2015, the FASB issued ASU 2015-09 “Disclosures About Short-Duration Contracts.” The objective of this ASU is to increase transparency about significant estimates in unpaid losses and loss adjustment expenses and provide additional information about amount, timing and uncertainty of cash flows related to unpaid losses and loss adjustment expenses. ASU 2015-09 also requires entities to disclose information about significant changes in methodologies and assumptions used to calculate the liability for loss and loss expense reserves, including reasons for the change and the effects on the financial statements. ASU 2015-09 also requires entities to disclose a roll forward of the liability of loss and loss expense reserves for annual and interim reporting periods. The effective date of ASU 2015-09 is for annual reporting periods beginning after December 15, 2015, and interim reporting periods beginning after December 15, 2016. The Company adopted this ASU as of December 31, 2016. The ASU did not have a material impact on the Company's consolidated financial statements, but the ASU required additional disclosures in “Note 11 – Unpaid Losses and Loss Adjustment Expenses” to these condensed consolidated financial statements.

#### NOTE 5 – ACCOUNTING FOR INCOME TAXES

The Company and its wholly owned subsidiaries file consolidated federal and state income tax returns. Pursuant to a tax allocation agreement, the Company's subsidiaries, Crusader Insurance Company (“Crusader”) and American Acceptance Corporation (“AAC”), are allocated taxes or tax credits in the case of losses, at current corporate rates based on their own taxable income or loss. The Company files income tax returns under U.S. federal and various state jurisdictions. The Company is subject to examination by U.S. federal income tax authorities for tax returns filed starting at taxable year 2013 and California state income tax authorities for tax returns filed starting at taxable year 2012. There are no ongoing examinations of income tax returns by federal or state tax authorities.

As of March 31, 2017, and December 31, 2016, the Company had no unrecognized tax benefits or liabilities and, therefore, had not accrued interest and penalties related to unrecognized tax benefits or liabilities. However, if interest and penalties would need to be accrued related to unrecognized tax benefits or liabilities, such amounts would be recognized as a component of federal income tax expense.

As a California based insurance company, Crusader is obligated to pay a premium tax on gross premiums written in all states that Crusader is admitted. Premium taxes are deferred and amortized as the related premiums are earned. The premium tax is in lieu of state franchise taxes and is not included in the provision for state taxes.

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NOTE 6 – PROPERTY AND EQUIPMENT, NET

Property and equipment consist of the following:

|  | March 31<br>2017 | December 31<br>2016 |
|--|------------------|---------------------|
| Building and leasehold improvements located in Calabasas, California | \$8,345,740      | \$8,339,807         |
| Furniture, fixtures, and equipment                                   | 2,683,288        | 2,673,670           |
| Computer software  | 189,377          | 169,177             |
| Accumulated depreciation and amortization                            | (2,819,876 )     | (2,687,607 )        |
| Land located in Calabasas, California                                | 1,787,485        | 1,787,485           |
| Property and equipment, net  | \$10,186,014     | \$10,282,532        |

Depreciation on the Calabasas building, owned by Crusader, is computed using the straight line method over 39 years. Depreciation on furniture, fixtures, and equipment in the Calabasas building is computed using the straight line method over 3 to 15 years. Amortization of leasehold improvements in the Calabasas building is being computed using the shorter of the useful life of the leasehold improvements or the remaining years of the lease. Depreciation and amortization expense on all property and equipment for the three months ended March 31, 2017 and 2016, was \$132,269 and \$115,283, respectively.

For the three months ended March 31, 2017 and 2016, the Calabasas building has generated rental revenue from non-affiliated tenants in the amount of \$57,745 and \$59,406 which is included in “Other income” from insurance company operation in the Company’s Condensed Consolidated Statements of Operations.

For the three months ended March 31, 2017 and 2016, the Calabasas building incurred operating expenses (including depreciation) in the amount of \$166,974 and \$171,877 which are included in “Other operating expenses” in the Company’s Condensed Consolidated Statements of Operations.

The total square footage of the Calabasas building is 46,884, including common areas. As of March 31, 2017, 10,292 square feet of the Calabasas building was leased to non-affiliated entities and 4,189 square feet was vacant and available to be leased to non-affiliated entities.

The Company capitalizes certain computer software costs purchased from outside vendors for internal use. These costs also include configuration and customization activities, coding, testing and installation. Training costs and maintenance are expensed as incurred, while upgrade and enhancements are capitalized if it is probable that such

expenditure will result in additional functionality. The capitalized costs are not depreciated until the software is placed into production. The Company's software related to the Company's new general ledger system was placed into production in the current period, and, thus the Company began depreciating the software.

NOTE 7 – SEGMENT REPORTING

ASC Topic 280, "Segment Reporting," establishes standards for the way information about operating segments is reported in financial statements. The Company has identified its insurance company operation as its primary reporting segment. Revenues from this segment comprised 92% of consolidated revenues for the three months ended March 31, 2017 and 2016. The Company's remaining operations constitute a variety of specialty insurance services, each with unique characteristics and individually insignificant to consolidated revenues.

Revenues, income (loss) before income taxes, and assets by segment are as follows:

|                                   | Three Months Ended |              |
|-----------------------------------|--------------------|--------------|
|                                   | March 31           |              |
|                                   | <u>2017</u>        | <u>2016</u>  |
| Revenues                          |                    |              |
| Insurance company operation       | \$8,201,097        | \$7,850,731  |
| Other insurance operations        | 3,389,455          | 3,198,146    |
| Intersegment eliminations (1)     | (2,630,055)        | (2,519,199)  |
| Total other insurance operations  | 759,400            | 678,947      |
| Total revenues                    | \$8,960,497        | \$8,529,678  |
| Income (Loss) before Income Taxes |                    |              |
| Insurance company operation       | \$(3,063,919)      | \$253,754    |
| Other insurance operations        | (203,430 )         | (523,780 )   |
| Total loss before income taxes    | \$(3,267,349)      | \$(270,026 ) |

|                                   | As of         |               |
|-----------------------------------|---------------|---------------|
|                                   | March 31      | December 31   |
|                                   | 2017          | 2015          |
| Assets                            |               |               |
| Insurance company operation       | \$126,857,152 | \$124,325,620 |
| Intersegment eliminations (2)     | (2,456,298 )  | (1,579,820 )  |
| Total insurance company operation | 124,400,854   | 122,745,800   |
| Other insurance operations        | 14,559,271    | 15,476,405    |
| Total assets                      | \$138,960,125 | \$138,222,205 |

Intersegment revenue eliminations reflect rents paid by Unico to Crusader for spaced leased in the Calabasas (1) building and commissions paid by Crusader to Unifax Insurance Systems, Inc. (“Unifax”), a wholly owned subsidiary of Unico.

(2) Intersegment asset eliminations reflect the elimination of Crusader receivables from Unifax and Unifax payables to Crusader.

#### NOTE 8 – FAIR VALUE OF FINANCIAL INSTRUMENTS

In determining the fair value of its financial instruments, the Company employs a fair value hierarchy that prioritizes the inputs for the valuation techniques used to measure fair value. The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Financial assets and financial liabilities recorded on the Condensed Consolidated Balance Sheets at fair value are categorized based on the reliability of inputs for the valuation techniques as follows:

Level 1 – Financial assets and financial liabilities whose values are based on unadjusted quoted prices in active markets for identical assets or liabilities as of the reporting date.

Level 2 – Financial assets and financial liabilities whose values are based on quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in non-active markets; or valuation models whose inputs are observable, directly or indirectly, for substantially the full term of the asset or liability as of the reporting date.

Level 3 – Financial assets and financial liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect the Company's estimates of the assumptions that market participants would use in valuing the financial assets and financial liabilities as of the reporting date.

The hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. Thus, a Level 3 fair value measurement may include inputs that are observable (Level 1 or Level 2) or unobservable (Level 3). The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

The following table presents information about the Company's consolidated financial instruments and their estimated fair values, which are measured on a recurring basis, and are allocated among the three levels within the fair value hierarchy as of March 31, 2017, and December 31, 2016:

|   | Level 1       | Level 2       | Level<br>3 | Total          |
|---|---------------|---------------|------------|----------------|
| March 31, 2017                            |               |               |            |                |
| Financial instruments:                    |               |               |            |                |
| Fixed maturity securities:                |               |               |            |                |
| U.S. treasury securities                  | \$ 14,098,425 | \$—           | \$ —       | \$ 14,098,425  |
| Certificates of deposit                   | —             | 54,142,000    | —          | 54,142,000     |
| Total fixed maturity securities           | 14,098,425    | 54,142,000    | —          | 68,240,425     |
| Cash and restricted cash                  | 13,602,118    | —             | —          | 13,602,118     |
| Short-term investments                    | 21,802,697    | —             | —          | 21,802,697     |
| Total financial instruments at fair value | \$ 49,503,240 | \$ 54,142,000 | \$ —       | \$ 103,645,240 |
| December 31, 2016                         |               |               |            |                |
| Financial instruments:                    |               |               |            |                |
| Fixed maturity securities:                |               |               |            |                |
| U.S. treasury securities                  | \$ 19,103,925 | \$—           | \$ —       | \$ 19,103,925  |
| Certificates of deposit                   | —             | 61,280,000    | —          | 61,280,000     |
| Total fixed maturity securities           | 19,103,925    | 61,280,000    | —          | 80,383,925     |
| Cash and restricted cash                  | 13,496,379    | —             | —          | 13,496,379     |
| Short-term investments                    | 10,204,603    | —             | —          | 10,204,603     |
| Total financial instruments at fair value | \$ 42,804,907 | \$ 61,280,000 | \$ —       | \$ 104,084,907 |

Fair value measurements are not adjusted for transaction costs. The Company recognizes transfers between levels at either the actual date of the event or a change in circumstances that caused the transfer. The Company did not have any transfers between Levels 1, 2, and 3 of the fair value hierarchy during the three months ended March 31, 2017 and 2016.

#### NOTE 9 – INVESTMENTS

A summary of total investment income and net realized losses is as follows:

|                        | Three Months Ended |             |
|------------------------|--------------------|-------------|
|                        | <u>March 31</u>    |             |
|                        | <u>2017</u>        | <u>2016</u> |
| Fixed maturities       | \$ 178,433         | \$ 177,837  |
| Short-term investments | 33,802             | 34,254      |

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|   |           |           |
|---|-----------|-----------|
| Total investment income                   | 212,235   | 212,091   |
| Net realized losses                       | —         | (1,278 )  |
| Investment income and net realized losses | \$212,235 | \$210,813 |

The amortized cost and estimated fair values of investments in fixed maturities by category are as follows:

|                          | Amortized    | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair<br>Value |
|--------------------------|--------------|------------------------------|-------------------------------|----------------------------|
|                          | <u>Cost</u>  | <u>Gains</u>                 | <u>Losses</u>                 | <u>Value</u>               |
| March 31, 2017           |              |                              |                               |                            |
| Available-for-sale:      |              |                              |                               |                            |
| Fixed maturities         |              |                              |                               |                            |
| Certificates of deposit  | \$54,142,000 | \$ —                         | \$ —                          | \$54,142,000               |
| U.S. treasury securities | 14,094,670   | 5,279                        | (1,524 )                      | 14,098,425                 |
| Total fixed maturities   | \$68,236,670 | \$ 5,279                     | \$ (1,524 )                   | \$68,240,425               |

|                          |              | Gross        | Gross         | Estimated    |
|--------------------------|--------------|--------------|---------------|--------------|
|                          | Amortized    | Unrealized   | Unrealized    | Fair         |
|                          | <u>Cost</u>  | <u>Gains</u> | <u>Losses</u> | <u>Value</u> |
| December 31, 2016        |              |              |               |              |
| Available-for-sale:      |              |              |               |              |
| Fixed maturities         |              |              |               |              |
| Certificates of deposit  | \$61,280,000 | \$—          | \$—           | \$61,280,000 |
| U.S. treasury securities | 19,091,842   | 14,205       | (2,122 )      | 19,103,925   |
| Total fixed maturities   | \$80,371,842 | \$ 14,205    | \$ (2,122 )   | \$80,383,925 |

A summary of the unrealized gains (losses) on investments in fixed maturities carried at fair value and the applicable deferred federal income taxes are shown below:

|  | March   | December  |
|--|---------|-----------|
|  | 31      | 31        |
|  | 2017    | 2016      |
| Gross unrealized gains on fixed maturities         | \$5,279 | \$ 14,205 |
| Gross unrealized losses on fixed maturities        | (1,524) | (2,122 )  |
| Net unrealized gains on fixed maturities           | 3,755   | 12,083    |
| Deferred federal tax expense                       | (1,277) | (4,108 )  |
| Net unrealized gains, net of deferred income taxes | \$2,478 | \$ 7,975  |

At March 31, 2017, the Company had one fixed maturity investment with an unrealized loss of \$1,118 for a continuous period of less than 12 months and one fixed maturity investment with an unrealized loss of \$406 for a continuous period of more than 12 months. At December 31, 2016, the Company had no fixed maturity investments with gross unrealized losses for a continuous period of less than 12 months and three U.S. treasury securities with gross unrealized losses for a continuous period of more than 12 months.

The Company closely monitors its investments. If an unrealized loss is determined to be other-than-temporary, it is written off as a realized loss through the Condensed Consolidated Statements of Operations. The Company's methodology of assessing other-than-temporary impairments is based on security-specific analysis as of the balance sheet date and considers various factors including the length of time to maturity and the extent to which the fair value has been less than the cost, the financial condition and the near-term prospects of the issuer, and whether the debtor is current on its contractually obligated interest and principal payments. The unrealized losses on the U.S. treasury securities as of March 31, 2017, and December 31, 2016, were determined to be temporary.

Although the Company does not intend to sell its fixed maturity investments prior to maturity, the Company may sell investment securities from time to time in response to cash flow requirements, economic and/or market conditions.

During the three months ended March 31, 2017, the Company did not sell any fixed maturity investments. There were no realized investment gains or losses during the three months ended March 31, 2017. During the three months ended March 31, 2016, the Company sold three certificates of deposit. These securities had amortized cost of \$746,000. The Company realized an investment loss of \$1,278 on the sale. The unrealized gains or losses from fixed maturities are reported as "Accumulated other comprehensive income," which is a separate component of stockholders' equity, net of any deferred tax effect.

The Company's investment in certificates of deposit included \$53,642,000 and \$60,780,000 of brokered certificates of deposit as of March 31, 2017, and December 31, 2016, respectively. Brokered certificates of deposit provide the safety and security of a certificate of deposit combined with the convenience gained by one-stop shopping for rates at various institutions. This allows the Company to spread its investments across multiple institutions so that all of its certificate of deposit investments are insured by the Federal Deposit Insurance Corporation ("FDIC"). Brokered certificates of deposit are purchased through UnionBanc Investment Services, LLC, a registered broker-dealer, investment advisor, member of FINRA/SIPC, and a subsidiary of Union Bank, N.A. Brokered certificates of deposit are a direct obligation of the issuing depository institution, are bank products of the issuing depository institution, are held in the name of Union Bank as Custodian for the benefit of the Company, and are FDIC insured within permissible limits. All the Company's brokered certificates of deposit are within the FDIC insured permissible limits.



The following securities from four different banks represent statutory deposits that are assigned to and held by the California State Treasurer and the Insurance Commissioner of the State of Nevada. These deposits are required for writing certain lines of business in California and for admission to transact insurance business in the state of Nevada.

|                           | March 31<br>2017 | December<br>31<br>2016 |
|---------------------------|------------------|------------------------|
| Certificates of deposit   | \$ 500,000       | \$ 500,000             |
| Short-term investments    | 100,000          | 100,000                |
| Total state held deposits | \$ 600,000       | \$ 600,000             |

All the Company's brokered and non-brokered certificates of deposit are within the FDIC insured permissible limits. Due to nature of the Company's business, certain bank accounts may exceed FDIC insured permissible limits.

Short-term investments have an initial maturity of one year or less and consist of the following:

|                                 | March 31<br>2017 | December 31<br>2016 |
|---------------------------------|------------------|---------------------|
| U.S. treasury money market fund | \$ 20,747,374    | \$ 8,542,292        |
| Certificates of deposit         | 350,000          | 1,098,000           |
| Bank money market accounts      | 703,560          | 562,548             |
| Bank savings accounts           | 1,763            | 1,763               |
| Total short-term investments    | \$ 21,802,697    | \$ 10,204,603       |

#### NOTE 10 – CASH AND RESTRICTED CASH

The following table provides a reconciliation of cash and restricted cash reported within the condensed consolidated balance sheets to the amounts shown in the condensed consolidated statements of cash flows:

|                          | March 31<br>2017 | December 31<br>2016 |
|--------------------------|------------------|---------------------|
| Cash                     | \$ 228,325       | \$ 122,586          |
| Restricted cash          | 13,373,793       | 13,373,793          |
| Cash and restricted cash | \$ 13,602,118    | \$ 13,496,379       |

The restricted cash is represented by two cash deposits placed by Crusader with the Los Angeles Superior Court in lieu of appeal bonds. In December 2015, a judgment was finalized on a Crusader policy liability claim. Crusader is appealing the judgment. As a part of the appeal, Crusader deposited \$7,924,178 in cash with the Los Angeles Superior Court on December 28, 2015, in lieu of an appeal bond. This cash deposit was required to appeal the judgment. In March 2016, an additional judgment for plaintiff's attorney fees and costs on this Crusader policy liability claim was finalized. The Company is also appealing this additional judgment. That additional appeal required an additional \$5,449,615 cash deposit which was made on March 21, 2016, in lieu of an appeal bond.

**NOTE 11 – UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES**

The following table provides an analysis of Crusader's loss and loss adjustment expense reserves, including a reconciliation of the beginning and ending balance sheet liability for the periods indicated:

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|  | Three Months Ended<br>March 31 |              |
|--|--------------------------------|--------------|
|  | 2017                           | 2016         |
| Reserve for unpaid losses and loss adjustment expenses at January 1 – gross of reinsurance | \$47,055,787                   | \$49,093,571 |
| Less reinsurance recoverable on unpaid losses and loss adjustment expenses                 | 9,520,970                      | 9,636,961    |
| Reserve for unpaid losses and loss adjustment expenses at January 1 – net of reinsurance   | 37,534,817                     | 39,456,610   |
| Incurred losses and loss adjustment expenses:  |                                |              |
| Provision for insured events of current year   | 6,497,566                      | 4,723,668    |
| Development of insured events of prior years   | 2,027,615                      | 361,826      |
| Total incurred losses and loss adjustment expenses   | 8,525,181                      | 5,085,494    |
| Loss and loss adjustment expense payments:   |                                |              |
| Attributable to insured events of the current year   | 1,035,179                      | 465,024      |
| Attributable to insured events of prior years  | 5,020,402                      | 4,705,011    |
| Total payments   | 6,055,581                      | 5,170,035    |
| Reserve for unpaid losses and loss adjustment expenses at March 31 – net of reinsurance    | 40,004,417                     | 39,372,069   |
| Reinsurance recoverable on unpaid losses and loss adjustment expenses                      | 9,885,632                      | 10,639,215   |
| Reserve for unpaid losses and loss adjustment expenses at March 31 – gross of reinsurance  | \$49,890,049                   | \$50,011,284 |

Some lines of insurance are commonly referred to as "long-tail" lines because of the extended time required before claims are ultimately settled. Lines of insurance in which claims are settled relatively quickly are called "short-tail" lines. It is generally more difficult to estimate loss reserves for long-tail lines because of the long period of time that elapses between the occurrence of a claim and its final disposition and the difficulty of estimating the settlement value of the claim. Crusader's short-tail lines consist of its property coverages, and its long-tail lines consist of its liability coverages. However, Crusader's long-tail liability claims tend to be settled relatively quicker than other long-tail lines not underwritten by Crusader, such as workers' compensation, professional liability, umbrella liability, and medical malpractice. Since trends develop over longer periods of time on long-tail lines of business, the Company generally gives credibility to those trends more slowly than for short-tail or less volatile lines of business.

The \$1,773,898 increase in the provision for insured events of current year for the three months ended March 31, 2017, compared to the provision for insured events of current year for the three months ended March 31, 2016, was due primarily to an aberrational increase in the frequency and severity of accident year 2017 short-tail property claims.

The \$1,665,789 increase in the development of insured events of prior years for the three months ended March 31, 2017, compared to the three months ended March 31, 2016, was primarily due to higher than expected long-tail liability claims in accident years 2013, 2014, and 2016.

NOTE 12 – CONTINGENCIES

The Company, by virtue of the nature of the business conducted by it, becomes involved in numerous legal proceedings as either plaintiff or defendant. From time to time, the Company is required to resort to legal proceedings against vendors providing services to the Company or against customers or their agents to enforce collection of premiums, commissions, or fees. These routine items of litigation do not materially affect the Company and are handled on a routine basis by the Company through its counsel.

The Company establishes reserves for lawsuits, regulatory actions, and other contingencies for which the Company is able to estimate its potential exposure and believes a loss is probable. For loss contingencies believed to be reasonably possible, the Company discloses the nature of the loss contingency, an estimate of the possible loss, a range of loss, or a statement that such an estimate cannot be made.

Likewise, the Company is sometimes named as a cross-defendant in litigation, which is principally directed against an insured who was issued a policy of insurance directly or indirectly through the Company. Incidental actions related to disputes concerning the issuance or non-issuance of individual policies are sometimes brought by customers or others. These items are also handled on a routine basis by counsel, and they do not generally affect the operations of the Company. Management is confident that the ultimate outcome of pending litigation should not have an adverse effect on the Company's consolidated results of operations or financial position. The Company vigorously defends itself unless a reasonable settlement appears appropriate.

In December 2015, a judgment was finalized on a Crusader policy liability claim. Crusader is appealing the judgment. As a part of the appeal, Crusader deposited \$7,924,178 in cash in lieu of an appeal bond with the Los Angeles Superior Court on December 28, 2015. This cash deposit was required to appeal the judgment. In March 2016, an additional judgment for plaintiff's attorney fees and costs on this Crusader policy liability claim was finalized. The Company is also appealing this additional judgment. That additional appeal required an additional cash deposit in lieu of an appeal bond of \$5,449,615. The additional cash deposit was made on March 21, 2016. These cash deposits for the appeals represent 150% of the judgments. Management believes the ultimate outcome of this litigation will be covered by Crusader's reinsurance. Since this litigation was related to a Crusader claim in its normal course of business, management's best estimate for ultimate liability related to this litigation was included in Crusader's loss and loss adjustment expense reserves as of March 31, 2017 and December 31, 2016.

One of the Company's agents, which was appointed in 2008 to assist the Company in implementing its Trucking Program, failed to pay the net premium and policy fees due Unifax, the exclusive general agent for Crusader. The agent was initially late in paying its February 2009 production that was due to Unifax on April 15, 2009. In May 2009, as a result of the agent's failure to timely pay its balance due to Unifax, the Company terminated its agency agreement and assumed ownership and control of that agent's policy expirations written with the Company. The Company subsequently commenced legal proceedings against the agent corporation, its three principals (who personally guaranteed the agent's obligations) and another individual for the recovery of the balance due and any related recovery costs incurred. All related recovery costs have been expensed as incurred. The agent corporation and two of its principals filed bankruptcy. The corporation was adjudicated bankrupt. The Company obtained judgments, non-dischargeable in bankruptcy, for the full amount due from the two principals who filed bankruptcy. The other principal stipulated to a judgment of \$1,200,000. The claim against the fourth individual was resolved. The Company collected \$0 during the three months ended March 31, 2017 and 2016. As of March 31, 2017, and December 31, 2016, the agent's balance due to Unifax was \$1,181,272. As of March 31, 2017, and December 31, 2016, the Company's bad debt reserve associated with this matter was \$1,181,272, which represents 100% of the balance due to Unifax. Although the receivable is fully reserved for financial reporting purposes at March 31, 2017, the Company continues to pursue collection of the judgments from the three principals.

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

### General

Unico American Corporation, referred to herein as the "Company" or "Unico," is an insurance holding company that underwrites property and casualty insurance through its insurance company subsidiary; provides property, casualty, health and life insurance through its agency subsidiaries; provides insurance premium financing; and provides membership association services.

Total revenues for the three months ended March 31, 2017, was \$8,960,497 compared to \$8,529,678 for the three months ended March 31, 2016, an increase of \$430,819 (5%). The Company had net loss of \$2,147,252 for the three months ended March 31, 2017, compared to net loss of \$198,987 for the three months ended March 31, 2016, an increase in net loss of \$1,948,265.

This overview discusses some of the relevant factors that management considers in evaluating the Company's performance, prospects, and risks. It is not all inclusive and is meant to be read in conjunction with the entirety of the management discussion and analysis, the Company's consolidated financial statements and notes thereto, and all other items contained within the Company's 2016 Annual Report on Form 10-K as filed with the Securities and Exchange Commission.

#### Revenue and Income Generation

The Company receives its revenues primarily from earned premium derived from the insurance company operations, commission and fee income generated from the insurance agency operations, finance charges and fee income from the premium finance operations, and investment income from cash generated primarily from the insurance company operation. The insurance company operation generated approximately 92% of consolidated revenues for the three months ended March 31, 2017 and 2016. The Company's remaining operations constitute a variety of specialty insurance services, each with unique characteristics and individually not material to consolidated revenues.

Insurance Company Operation

As of March 31, 2017, Crusader Insurance Company (“Crusader”) was licensed as an admitted insurance carrier in the states of Arizona, California, Nevada, Oregon, and Washington. Since 2004, all of Crusader’s business was written in the state of California until June 2014 when Crusader also began writing business in the state of Arizona. During the three months ended March 31, 2017 and 2016, 98% and 99% of Crusader’s business was commercial multi-peril policies. On October 28, 2016, A.M. Best Company reaffirmed Crusader’s financial strength rating of A- (Excellent) and a rating outlook of “stable.” In addition, A.M. Best Company assigned Crusader an Issuer Credit Rating of a- (Excellent).

The property and casualty insurance business is cyclical in nature, and the previous years have been characterized as a “soft market.” The conditions of a soft market include premium rates that are stable or falling and insurance is readily available. Contrarily, “hard market” conditions occur during periods in which premium rates rise and coverage may be more difficult to find. The Company believes that the California property and casualty insurance market is intensely competitive but relatively stable.

Written premium is a financial measure that is defined, under the statutory accounting practices prescribed or permitted the California Department of Insurance, as the contractually determined amount charged by the insurance company to the policyholder for the effective period of the contract based on the expectation of risk, policy benefits, and expenses associated with the coverage provided by the terms of the policies. Written premium is a required statutory measure. Written premium is defined under GAAP in Accounting Standards Codification Topic 405, “Liabilities,” as “premiums on all policies an entity has issued in a period.” Earned premium represents the portion of written premium that is recognized as income in the financial statements for the period presented and earned on a pro-rata basis over the terms of the policies.

The following is a reconciliation of net written premium to net earned premium (after premium ceded to reinsurers):

|                                   | Three Months Ended |             |
|-----------------------------------|--------------------|-------------|
|                                   | March 31           |             |
|                                   | 2017               | 2016        |
| Net written premium               | \$7,942,843        | \$7,705,590 |
| Change in direct unearned premium | (22,541 )          | (134,489 )  |
| Change in ceded unearned premium  | 397                | 1,314       |
| Net earned premium                | \$7,920,699        | \$7,572,415 |

For the three months ended March 31, 2017, direct written premium (before premium ceded to reinsurers) as reported on Crusader’s statutory financial statements was \$9,570,025 compared to \$9,182,555 for the three months ended March 31, 2016, an increase of \$387,470 (4%).

The Company's insurance operations underwriting profitability is defined by pre-tax underwriting profit, which is calculated as net earned premium less losses and loss adjustment expenses and policy acquisition costs.

Crusader's underwriting profit (loss) before income taxes is as follows:

|  | Three Months Ended |             |                        |
|--|--------------------|-------------|------------------------|
|  | March 31           |             | Increase<br>(Decrease) |
|  | 2017               | 2016        |                        |
| Net written premium                            | \$7,942,843        | \$7,705,590 | \$237,253              |
| Change in net unearned premium                 | (22,144 )          | (133,175 )  | 118,031                |
| Net earned premium                             | 7,920,699          | 7,572,415   | 348,284                |
| Less underwriting expenses:                    |                    |             |                        |
| Losses and loss adjustment expenses            | 8,525,181          | 5,085,494   | 3,439,687              |
| Policy acquisition costs                       | 1,497,634          | 1,699,660   | 202,026                |
| Total underwriting expenses                    | 10,022,815         | 6,785,154   | 3,237,661              |
| Underwriting profit (loss) before income taxes | \$(2,102,116 )     | \$787,261   | \$(2,889,377)          |



The following table provides an analysis of the losses and loss adjustment expenses:

|  | Three Months Ended |            |             |            |                 |
|--|--------------------|------------|-------------|------------|-----------------|
|  | March 31           |            | 2016        |            | <u>Increase</u> |
|  | 2017               | Loss Ratio | 2016        | Loss Ratio |                 |
| Net earned premium                           | \$7,920,699        |            | \$7,572,415 |            | \$348,284       |
| Losses and loss adjustment expenses:         |                    |            |             |            |                 |
| Provision for insured events of current year | 6,497,566          | 82 %       | 4,723,668   | 62 %       | 1,773,898       |
| Development of insured events of prior years | 2,027,615          | 26 %       | 361,826     | 5 %        | 1,665,789       |
| Total losses and loss adjustment expenses    | \$8,525,181        | 108 %      | \$5,085,494 | 67 %       | \$3,439,687     |

#### Revenues from Other Insurance Operations

The Company's revenues from other insurance operations consist of commissions, fees, investment and other income. Excluding investment and other income, these operations accounted for approximately 9% and 8% of total revenues in the three months ended March 31, 2017 and 2016, respectively.

#### Investments and Liquidity

The Company generated revenues from its total invested assets of \$90,039,367 (at amortized cost) and \$92,650,402 (at amortized cost) as of March 31, 2017 and 2016, respectively, and from two cash deposits placed with the Los Angeles Superior Court by Crusader in lieu of appeal bonds. These two deposits, totaling \$13,373,793, were made on December 28, 2015, for \$7,924,178, and on March 21, 2016, for \$5,449,615, and their respective balances were included in "Cash and restricted cash" on the Condensed Consolidated Balance Sheets and were not a part of the total invested assets as of March 31, 2017, and December 31, 2016.

Investment income increased \$144 (0.1%) to \$212,235 for the three months ended March 31, 2017, compared to \$212,091 for the three months ended March 31, 2016. The Company's annualized yield on average invested assets was 0.9% for the three months ended March 31, 2017 and 2016. Due to the current interest rate and financial market environment, management believes it is prudent to purchase fixed maturity investments with maturities of 5 years or less and with minimal credit risk. As of March 31, 2017, all of the Company's investments are in U.S. treasury securities, FDIC insured certificates of deposit, money market funds, and a savings account. The Company's investments in U.S treasury securities and money market funds are readily marketable. As of March 31, 2017, the weighted average maturity of the Company's investments is approximately 1.2 years.

## **Liquidity and Capital Resources**

Crusader generates a significant amount of cash as a result of its holdings of unearned premium reserves, its reserves for loss and loss adjustment expense payments, and its capital and surplus. Crusader's loss and loss adjustment expense payments are the most significant cash flow requirement of the Company. These payments are continually monitored and projected to ensure that the Company has the liquidity to cover these payments without the need to liquidate its investments. Cash, restricted cash, and investments (at amortized cost) of the Company at March 31, 2017, were \$103,641,485, compared to \$104,072,824 at December 31, 2016. Crusader's cash, restricted cash, and investments were 99% of the total cash and investments (at amortized cost) held by the Company as of March 31, 2017, and December 31, 2016.

As of March 31, 2017, the Company had invested \$68,236,670 (at amortized cost) or 76% of its total invested assets in fixed maturity obligations, which included \$14,094,670 (21% of fixed maturity investments) in U.S. treasury notes and \$54,142,000 (79% of fixed maturity investments) in long-term certificates of deposit. As of December 31, 2016, the Company had invested \$80,371,842 (at amortized cost) or 89% of its total invested assets in fixed maturity obligations, which included \$19,091,842 (24% of fixed maturity investments) in U.S. treasury notes and \$61,280,000 (76% of fixed maturity investments) in long-term certificates of deposit. The remaining balance of the Company's investments are in short-term investments that include U.S. treasury bills, a U.S. treasury money market fund, certificates of deposit, bank money market accounts, and a bank savings account that are all highly rated and redeemable within one year.

The Company is required to classify its investment securities into one of three categories: held-to-maturity, available-for-sale, or trading securities. Although all of the Company's investment in fixed maturity securities are classified as available-for-sale and, while the Company may sell investment securities from time to time in response to economic and market conditions, its investment guidelines place primary emphasis on buying and holding high-quality investments to maturity.

For a period beginning prior to fiscal 2015 and ending on March 24, 2017, the Company's investment guidelines on equity securities limited investments in equity securities to an aggregate maximum of \$2,000,000. The Company's investment guidelines on fixed maturities limited those investments to high-grade obligations with a maximum term of 8 years. The maximum investment authorized in any one issuer was \$2,000,000. This dollar limitation excluded bond premiums paid in excess of par value and U.S. government or U.S. government guaranteed issues. When the Company invested in fixed maturity municipal securities, preference was given to issues that are pre-refunded and secured by U.S. treasury securities. The short-term investments were either U.S. government obligations, FDIC insured, or are in an institution with a Moody's rating of at least P2 and/or a Standard & Poor's rating of A1. All of the Company's fixed maturity investment securities were rated, readily marketable, and could be liquidated without any materially adverse financial impact.

On March 24, 2017, the Company's Board of Directors approved new investment guidelines. Those guidelines are similar to what the Company believes are general investment guidelines used by Crusader's peers.

Under the new investment guidelines, investments may only include U.S. treasury notes, U.S. government agency notes, mortgage-backed securities (including pass through securities and collateralized mortgage obligations) that are backed by agency and non-agency collateral, commercial mortgage-backed securities, U.S. corporate obligations, asset backed securities, (including but not limited to credit card, automobile and home equity backed securities), tax-exempt bonds, preferred stocks, common stocks, commercial paper, repurchase agreements (treasuries only), mutual funds, exchange traded funds, bank certificates of deposits and time deposits. The new investment guidelines provide for certain investment limitations in each investment category.

Unless agreed to in advance in writing by Crusader, investments in the following types of securities are prohibited:

- Mortgage loans, except for mortgage backed securities issued by an agency of the U.S. government.
- Derivative mortgage-backed securities including interest only, principal only and inverse floating rate securities. All fixed maturity real estate securities, except mortgage-backed securities (including pass through securities and collateralized mortgage obligations) that are backed by agency and non-agency collateral and commercial mortgage-backed securities.
- Options and futures contracts.
- All non-U.S. dollar denominated securities.
- Any security that would not be in compliance with the regulations of Crusader's state of domicile.

Historically, the Company managed Crusader's investments in-house. Effective April 1, 2017, an outside investment advisor began managing Crusader's investments. The advisor's role currently is limited to maintaining Crusader's portfolio within the new investment guidelines and providing investment accounting services to the Company. The investments will continue to be held by Crusader's current custodian, Union Bank Global Custody Services.

On December 19, 2008, the Board of Directors authorized a stock repurchase program to acquire from time to time up to an aggregate of 500,000 shares of the Company's common stock. This program has no expiration date and may be terminated by the Board of Directors at any time. As of March 31, 2017, and December 31, 2016, the Company had remaining authority under the 2008 program to repurchase up to an aggregate of 188,655 shares of its common stock. The 2008 program is the only program under which there is authority to repurchase shares of the Company's common stock. The Company did not repurchase any stock during the three months ended March 31, 2017. The Company repurchased 8,812 shares of stock during the three months ended March 31, 2016, in unsolicited transactions at a cost of \$89,582 of which \$4,331 was allocated to capital and \$85,251 was allocated to retained earnings. The Company has or will retire all stock repurchased.

The Company reported \$398,415 net cash used by operating activities for the three months ended March 31, 2017, compared to \$691,792 net cash provided by operating activities for the three months ended March 31, 2016. Other fluctuations in cash flows from operating activities relate to the timing of the collection and the payment of insurance-related receivables and payables. The variability of the Company's losses and loss adjustment expenses is primarily due to its small population of claims which may result in greater fluctuations in claim frequency and/or severity. Although the Condensed Consolidated Statements of Cash Flows reflect net cash used by operating activities, the Company does not anticipate future liquidity problems, and it continues to be well capitalized and adequately reserved.

Although material capital expenditures may also be funded through borrowings, the Company believes that its cash and short-term investments at March 31, 2017, net of statutory deposits of \$700,000, and California insurance company statutory dividend restrictions applicable to Crusader, plus the cash to be generated from operations, should be sufficient to meet its operating requirements during the next 12 months without the necessity of borrowing funds. Since trust receivables were in excess of trust payables, there were no trust restrictions on cash and short-term investments at March 31, 2017.

### **Results of Operations**

All comparisons made in this discussion are comparing the three months ended March 31, 2017, to the three months ended March 31, 2016, unless otherwise indicated.

For the three months ended March 31, 2017, total revenues were \$8,960,497, an increase of \$430,819 (5%) compared to total revenues of \$8,529,678 for the three months ended March 31, 2016. For the three months ended March 31, 2017, the Company had loss before taxes of \$3,267,349, an increase of \$2,997,323 (1110%) compared to loss before taxes of \$270,026 for the three months ended March 31, 2016. For the three months ended March 31, 2017, the Company had net loss of \$2,147,252, an increase of \$1,948,265 (979%) compared to net loss of \$198,987 for the three months ended March 31, 2016.

The increase in revenues of \$430,819 (5%) for the three months ended March 31, 2017, when compared to March 31, 2016, was primarily due to an increase in net earned premium of \$348,284 (5%).

The increase in loss before tax of \$2,997,323 for the three months ended March 31, 2017, compared to the three months ended March 31, 2016, was due primarily to the increase in losses and loss adjustment expenses of \$3,439,687 (68%) offset partially by an increase in revenues of \$430,819 (5%).

**Written premium** is a required statutory measure. Direct written premium reported on Crusader's statutory financial statements increased \$387,470 (4%) to \$9,570,025 for the three months ended March 31, 2017, compared to \$9,182,555 for the three months ended March 31, 2016.

The property casualty insurance marketplace continues to be intensely competitive. While Crusader attempts to meet such competition with competitive prices, its emphasis is on service, promotion, and distribution. Crusader believes that rate adequacy is more important than premium growth and that underwriting profit (net earned premium less losses and loss adjustment expenses and policy acquisition costs) is its primary goal. As a result, in November 2016, Crusader filed for rate increases on several programs with California Department of Insurance; those increases were

approved on May 15, 2017.

Nonetheless, Crusader believes that it can grow its sales and profitability by continuing to focus upon five areas of its operations: (1) product development, (2) improved service to retail brokers, (3) appointment of captive and independent retail agents, (4) geographical expansion, and (5) use of alternative marketing channels. While the Company's policy administration system continues to support the Company's existing operations, the Company believes it would realize more competitive parity with respect to product and service by switching or upgrading to a more contemporary platform. The Company is currently evaluating its alternatives.

**Earned premium** (before reinsurance) increased \$499,409 (6%) to \$9,547,484 for the three months ended March 31, 2017, compared to \$9,048,075 for the three months ended March 31, 2016. The Company writes annual policies and, therefore, earns written premium ratably over the one-year policy term.

Ceded earned premium increased \$151,125 (10%) to \$1,626,785 for the three months ended March 31, 2017, compared to \$1,475,660 for the three months ended March 31, 2016. Ceded earned premium as a percentage of direct earned premium was 17% and 16% for the three months ended March 31, 2017 and 2016, respectively.

In calendar years 2017 and 2016, Crusader retained a participation in its excess of loss reinsurance treaties of 5% and 10%, respectively in its 1<sup>st</sup> layer (\$500,000 in excess of \$500,000), 0% in its 2<sup>nd</sup> layer (\$2,000,000 in excess of \$1,000,000) and 0% in its property and casualty clash treaty. In calendar year 2017 and 2016, Crusader retained a participation in its Catastrophe excess of loss reinsurance treaties of 5% in its 1<sup>st</sup> layer (\$9,000,000 in excess of \$1,000,000) and 0% in its 2<sup>nd</sup> layer (\$36,000,000 in excess of \$10,000,000).

The Company evaluates each of its ceded reinsurance contracts at its inception to determine if there is a sufficient risk transfer to allow the contract to be accounted for as reinsurance under current accounting literature. As of March 31, 2017, all such ceded contracts are accounted for as risk transfer reinsurance.

Crusader's direct, ceded and net earned premium are as follows:

|  | Three Months Ended |             |           |
|--|--------------------|-------------|-----------|
|  | March 31<br>2017   | 2016        | Increase  |
| Direct earned premium                                  | \$9,547,484        | \$9,048,075 | \$499,409 |
| Ceded earned premium                                   | 1,626,785          | 1,475,660   | 151,125   |
| Net earned premium                                     | \$7,920,699        | \$7,572,415 | \$348,284 |
| Ratio of ceded earned premium to direct earned premium | 17                 | % 16        | %         |

**Investment income** increased \$144 (0.1%) to \$212,235 for the three months ended March 31, 2017, compared to \$212,091 for the three months ended March 31, 2016. The Company had no realized gains or losses for the three months ended March 31, 2017 and had realized losses of \$1,278 for the three months ended March 31, 2016. The Company's annualized yield on average invested assets was 0.9% for the three months ended March 31, 2017 and 2016.

Investment income, excluding net realized losses, and average annualized yields on the Company's average invested assets are as follows:

|  | Three Months Ended             |              |
|--|--------------------------------|--------------|
|  | <u>March 31</u><br><u>2017</u> | <u>2016</u>  |
| Average invested assets* - at amortized cost | \$90,310,610                   | \$95,246,966 |
| Interest income:                             |                                |              |
| Insurance company operation                  | \$212,186                      | \$212,000    |
| Other insurance operations                   | 49                             | 91           |
| Total investment income                      | \$212,235                      | \$212,091    |
| Annualized yield on average invested assets  | 0.9                            | % 0.9 %      |

\*The average is based on the beginning and ending balance of the amortized cost of the invested assets for each respective period.

The par value, amortized cost, estimated market value and weighted average yield of fixed maturity investments at March 31, 2017, by contractual maturity are as follows:

| Maturities by | Par Value | Weighted |
|---------------|-----------|----------|
|---------------|-----------|----------|

| <u>Calendar Year</u> |              | <u>Amortized<br/>Cost</u> | <u>Fair Value</u> | <u>Average<br/>Yield</u> |   |
|----------------------|--------------|---------------------------|-------------------|--------------------------|---|
| December 31, 2017    | \$40,494,000 | \$40,488,592              | \$40,492,752      | 0.9                      | % |
| December 31, 2018    | 21,520,000   | 21,520,078                | 21,519,673        | 1.1                      | % |
| December 31, 2019    | 5,980,000    | 5,980,000                 | 5,980,000         | 1.1                      | % |
| December 31, 2021    | 598,000      | 598,000                   | 598,000           | 1.7                      | % |
| Total                | \$68,592,000 | \$68,586,670              | \$68,590,425      | 1.0                      | % |

Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

The weighted average maturity of the Company's fixed maturity investments was 1.2 years as of March 31, 2017, and 1.3 years as of March 31, 2016. Due to the current interest rate environment, management believes it is prudent to purchase fixed maturity investments with maturities of 5 years or less and with minimal credit risk.

At March 31, 2017, the Company had one fixed maturity investment with an unrealized loss of \$1,118 for a continuous period of less than 12 months and one fixed maturity investment with an unrealized loss of \$406 for a continuous period of more than 12 months. At December 31, 2016, the Company had no fixed maturity investments with gross unrealized losses for a continuous period of less than 12 months and three U.S. treasury securities with gross unrealized losses for a continuous period of more than 12 months.

The Company closely monitors its investments. If an unrealized loss is determined to be other-than-temporary, it is written off as a realized loss through the Condensed Consolidated Statements of Operations. The Company's methodology of assessing other-than-temporary impairments is based on security-specific analysis as of the balance sheet date and considers various factors including the length of time to maturity and the extent to which the fair value has been less than the cost, the financial condition and the near-term prospects of the issuer, and whether the debtor is current on its contractually obligated interest and principal payments. The unrealized losses on the U.S. treasury securities in unrealized loss positions as of March 31, 2017, and December 31, 2016, were determined to be temporary.



Although the Company does not have an intent to sell its fixed maturity investments, the Company may sell investment securities from time to time in response to economic and market conditions. During the three months ended March 31, 2017, the Company did not sell any fixed maturity investments. There were no realized investment gains or losses during the three months ended March 31, 2017. During the three months ended March 31, 2016, the Company sold three certificates of deposit. These securities had amortized cost of \$746,000. The Company realized an investment loss of \$1,278 on the sale. The unrealized gains or losses from fixed maturities are reported as “Accumulated other comprehensive income,” which is a separate component of stockholders’ equity, net of any deferred tax effect.

**Other income** included in Insurance Company Revenues and Other Insurance Operations decreased \$4,369 (6%) to \$68,227 for the three months ended March 31, 2017, compared to \$72,596 for the three months ended March 31, 2016.

**Gross commissions and fees** increased \$83,930 (13%) to \$741,175 for the three months ended March 31, 2017, compared to gross commissions and fees of \$657,245 for the three months ended March 31, 2016.

The changes in gross commission and fee income for the three months ended March 31, 2017, as compared to the three months ended March 31, 2016, are as follows:

|  | Three Months Ended |           |                        |
|--|--------------------|-----------|------------------------|
|  | March 31           |           | Increase<br>(Decrease) |
|  | 2017               | 2016      |                        |
| Policy fee income                          | \$407,336          | \$409,989 | \$(2,653 )             |
| Health insurance program                   | 311,211            | 217,812   | 93,399                 |
| Membership and fee income                  | 18,252             | 20,625    | (2,373 )               |
| Daily automobile rental insurance program: |                    |           |                        |
| Contingent commission                      | 4,376              | 8,819     | (4,443 )               |
| Total                                      | \$741,175          | \$657,245 | \$(83,930 )            |

Unifax Insurance Systems, Inc. (“Unifax”) sells and services insurance policies for Crusader. The commissions paid by Crusader to Unifax are eliminated as intercompany transactions and are not reflected as income in the condensed consolidated financial statements. Unifax also receives non-refundable policy fee income that is directly related to the Crusader policies it sells. For financial statement reporting purposes, policy fees are earned ratably over the life of the related insurance policy. The unearned portion of the policy fee is recorded as a liability on the Condensed Consolidated Balance Sheets under “Accrued expenses and other liabilities.” The earned portion of the policy fee charged to the policyholder by Unifax is recognized as income in the condensed consolidated financial statements. Policy fee income decreased \$2,653 (less than 1%) in the three months ended March 31, 2017, compared to the three

months ended March 31, 2016.

American Insurance Brokers, Inc. (“AIB”), a wholly owned subsidiary of the Company, markets health insurance in California through non-affiliated insurance companies for individuals and groups. For these services, AIB receives commission based on the premiums that it writes. Commission income increased \$93,399 (43%) in the three months ended March 31, 2017, compared to the three months ended March 31, 2016. The increase in commission income reported in the three months ended March 31, 2017, when compared to the prior year period, is primarily a result of a cumulative commission correction of \$68,971 by the non-affiliated insurance carriers.

The Company's wholly owned subsidiary Insurance Club, Inc., dba AAQHC An Administrator (“AAQHC”), is a third party administrator for contracted insurance companies and is a membership association that provides various consumer benefits to its members, including participation in group health care insurance policies that AAQHC negotiates for the association. For these services, AAQHC receives membership and fee income from its members. Membership and fee income decreased \$2,373 (12%) for the three months ended March 31, 2017, compared to the three months ended March 31, 2016. This decrease is primarily a result of a decrease in the number of individual members offset by an increase in the number of group members.

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The daily automobile rental insurance program was produced by Bedford Insurance Services, Inc. (“Bedford”), a wholly owned subsidiary of the Company. Bedford received commission income from non-affiliated insurance companies based on written premium and continues to receive contingent commission on previous business written. The Company no longer actively markets this program.

**Finance fees earned** consist of late fees, returned check fees and payment processing fees. These fees earned by the Company’s wholly owned premium finance subsidiary, American Acceptance Corporation (“AAC”), increased \$1,552 (9%) to \$18,161 for the three months ended March 31, 2017, compared to \$16,609 in fees earned during the three months ended March 31, 2016. The increase in fees earned during the three months ended March 31, 2017, compared to three months ended March 31, 2016, is primarily a result of more late fees earned during the period compared to the prior year period. AAC issued 743 loans and had 2,196 loans outstanding during the three months ended March 31, 2017, compared to 805 loans issued and 2,416 loans outstanding during the three months ended March 31, 2016. AAC provides premium financing only for Crusader policies produced by Unifax in California. AAC reduced the interest rate charged on premiums financed to 0% beginning July 20, 2010, and, therefore, did not earn any finance charges during the three months ended March 31, 2017 and 2016. This reduction in the interest rate charged was initiated in an effort to increase the sales of existing renewal and new business written by Unifax for Crusader. Due to the low interest rate environment, the cost of money to provide this incentive is not material. The Company monitors the cost of providing this incentive and depending on the cost/benefit determination, can continue to offer it or withdraw it at any time.

**Losses and loss adjustment expenses** were 108% of net earned premium for the three months ended March 31, 2017, compared to 67% of net earned premium for the three months ended March 31, 2016.

Loss ratio is calculated by dividing losses and loss adjustment expenses by net earned premium. Losses and loss adjustment expenses and loss ratios are as follows:

|  | Three Months Ended<br>March 31 |                       |             |                       |                 |
|--|--------------------------------|-----------------------|-------------|-----------------------|-----------------|
|  | <u>2017</u>                    | 2017<br>Loss<br>Ratio | <u>2016</u> | 2016<br>Loss<br>Ratio | <u>Increase</u> |
| Net earned premium                           | \$7,920,699                    |                       | \$7,572,415 |                       | \$348,284       |
| Losses and loss adjustment expenses:         |                                |                       |             |                       |                 |
| Provision for insured events of current year | 6,497,566                      | 82 %                  | 4,723,668   | 62 %                  | 1,773,898       |
| Development of insured events of prior years | 2,027,615                      | 26 %                  | 361,826     | 5 %                   | 1,665,789       |
| Total losses and loss adjustment expenses    | \$8,525,181                    | 108 %                 | \$5,085,494 | 67 %                  | \$3,439,687     |

Some lines of insurance are commonly referred to as "long-tail" lines because of the extended time required before claims are ultimately settled. Lines of insurance in which claims are settled relatively quickly are called "short-tail" lines. It is generally more difficult to estimate loss reserves for long-tail lines because of the long period of time that elapses between the occurrence of a claim and its final disposition and the difficulty of estimating the settlement value of the claim. Crusader's short-tail lines consist of its property coverages, and its long-tail lines consist of its liability coverages. However, Crusader's long-tail liability claims tend to be settled relatively quicker than other long-tail lines not underwritten by Crusader, such as workers' compensation, professional liability, umbrella liability, and medical malpractice. Since trends develop over longer periods of time on long-tail lines of business, the Company generally gives credibility to those trends more slowly than for short-tail or less volatile lines of business.

The \$1,773,898 increase in the provision for insured events of current year for the three months ended March 31, 2017, compared to the provision for insured events of current year for the three months ended March 31, 2016, was due primarily to an aberrational increase in the frequency and severity of accident year 2017 short-tail property claims.

The \$1,665,789 increase in the development of insured events of prior years for the three months ended March 31, 2017, compared to the three months ended March 31, 2016, was primarily due to higher than expected long-tail liability claims in accident years 2013, 2014, and 2016.

While it is difficult to estimate adequacy of loss and loss adjustment expense reserves, historically, the Company was able to establish sufficient loss and loss adjustment expense reserves to mitigate adverse prior accident year developments.

The following table breaks out adverse (favorable) development from total losses and loss adjustment expenses quarterly since March 31, 2014:

|                        | <u>Provision for Insured<br/>Events of Current Year</u> | <u>Adverse (Favorable) Development of<br/>Insured Events of Prior Years</u> | <u>Total Losses and Loss<br/>Adjustment Expenses</u> |
|------------------------|---|---|--|
| Three Months<br>Ended: |   |   |  |
| March 31,<br>2017      | \$6,497,566   | \$2,027,615   | \$8,525,181  |
| December 31,<br>2016   | 5,731,198   | (886,671  | ) 4,844,527  |
| September 30,<br>2016  | 6,792,115   | 1,245,985   | 8,038,100  |
| June 30, 2016          | 5,603,427   | (744,670  | ) 4,858,757  |
| March 31,<br>2016      | 4,723,668   | 361,826   | 5,085,494  |
| December 31,<br>2015   | 5,125,146   | 164,230   | 5,289,376  |
| September 30,<br>2015  | 5,195,943   | (849,426  | ) 4,346,517  |
| June 30, 2015          | 5,280,840   | (647,324  | ) 4,633,516  |
| March 31,<br>2015      | 6,005,699   | (1,111,792  | ) 4,893,907  |
| December 31,<br>2014   | 4,473,359   | (552,836  | ) 3,920,523  |
| September 30,<br>2014  | 4,686,287   | (529,807  | ) 4,156,480  |
| June 30, 2014          | 4,455,943   | (808,178  | ) 3,647,765  |
| March 31,<br>2014      | 4,310,293   | (1,417,943  | ) 2,892,350  |

The variability of the Crusader's losses and loss adjustment expenses for the periods presented is primarily due to the small and diverse population of the Crusader's policyholders and claims, which may result in greater fluctuations in claim frequency and/or severity. In addition, Crusader's reinsurance retention, which is relatively high in relationship to its net earned premium, can result in increased loss ratio volatility when large losses are incurred in a relatively short period of time. Nevertheless, management believes that its reinsurance retention is reasonable given the amount of Crusader's surplus and its goal to minimize ceded premium.

The preparation of the Company's consolidated financial statements requires estimation of certain liabilities, most significantly the liability for unpaid losses and loss adjustment expenses. Management makes its best estimate of the liability for these unpaid claims costs as of the end of each fiscal quarter. Due to the inherent uncertainties in estimating the Company's unpaid claims costs, actual loss and loss adjustment expense payments are expected to vary, perhaps significantly, from any estimate made prior to the settling of all claims. Variability is inherent in establishing loss and loss adjustment expense reserves, especially for a small insurer like Crusader. For any given line of insurance, accident year, or other group of claims, there is a continuum of possible loss and loss adjustment expense reserve estimates, each having its own unique degree of propriety or reasonableness. Due to the complexity and nature of the insurance claims process, there are potentially an infinite number of reasonably likely scenarios. Management draws on its collective experience to judgmentally determine its best estimate. In addition to applying a variety of standard actuarial methods to the data, an extensive series of diagnostic tests are applied to the resultant loss and loss adjustment expense reserve estimates to determine management's best estimate of the unpaid claims liability. Among the statistics reviewed for each accident year are: loss and loss adjustment expense development patterns; frequencies; severities; and ratios of loss to premium, loss adjustment expense to premium, and loss adjustment expense to loss.

When there is clear evidence that the actual claims costs emerged are different than expected for any prior accident year, the claims cost estimates for that year are revised accordingly. If the claims costs that emerge are less favorable than initially anticipated, generally, the Company increases its loss and loss adjustment expense reserves immediately. However, if the claims costs that emerge are more favorable than initially anticipated, generally, the Company reduces its loss and loss adjustment expense reserves over time while it continues to assess the validity of the observed trends based on the subsequent emerged claim costs.

The establishment of loss and loss adjustment expense reserves is a detailed process as there are many factors that can ultimately affect the final settlement of a claim. Estimates are based on a variety of industry data and on the Company's current and historical accident year claims data, including but not limited to reported claim counts, open claim counts, closed claim counts, closed claim counts with payments, paid losses, paid loss adjustment expenses, case loss reserves, case loss adjustment expense reserves, earned premiums and policy exposures, salvage and subrogation, and unallocated loss adjustment expenses paid. Many other factors, including changes in reinsurance, changes in pricing, changes in policy forms and coverage, changes in underwriting and risk selection, legislative changes, results of litigation and inflation are also taken into account.

At the end of each fiscal quarter, the Company's loss and loss adjustment expense reserves for each accident year (i.e., for all claims incurred within each year) are re-evaluated independently by the Company's president, the Company's chief financial officer, and by an independent consulting actuary. Generally accepted actuarial methods, including the widely used Bornhuetter-Ferguson and loss development methods, are employed to estimate ultimate claims costs. An actuarial central estimate of the ultimate claims costs and IBNR reserves is ultimately determined by management and tested for reasonableness by the independent consulting actuary.

**Policy acquisition costs** consist of commissions, premium taxes, inspection fees, and certain other underwriting costs that are directly related to and vary with the successful production of Crusader insurance policies. These costs include both Crusader expenses and the allocated expenses of other Unico subsidiaries. Crusader's reinsurers pay Crusader a ceding commission, which is primarily a reimbursement of the acquisition cost related to the ceded premium. No ceding commission is received on facultative or catastrophe ceded premium. Policy acquisition costs, net of ceding commission, are deferred and amortized as the related premiums are earned. The Company annually reevaluates its acquisition costs to determine that costs related to successful policy acquisition are capitalized and deferred. These costs were approximately 19% and 22% of net earned premium for the three months ended March 31, 2017 and 2016, respectively. Policy acquisition costs decreased in the three months ended March 31, 2017, as compared to the prior year period, due primarily to a decrease in bonus commission payments to brokers and agents in 2017 related to the 2016 results.

Policy acquisition costs and the ratio to net earned premium are as follows:

|  | Three Months Ended |              |            |
|--|--------------------|--------------|------------|
|  | March 31<br>2017   | 2016         | Decrease   |
| Policy acquisition costs                 | \$ 1,497,634       | \$ 1,699,660 | \$ 202,026 |
| Ratio to net earned premium (GAAP ratio) | 19                 | % 22         | %          |

**Salaries and employee benefits** decreased \$32,941 (2%) to \$1,348,643 for the three months ended March 31, 2017, compared to \$1,381,584 for the three months ended March 31, 2016.

Salaries and employee benefits incurred and charged to operating expenses are as follows:

|  | Three Months Ended      |             |                            |
|--|-------------------------|-------------|----------------------------|
|  | March 31<br><u>2017</u> | <u>2016</u> | Increase<br><br>(Decrease) |

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|  |             |             |             |
|--|-------------|-------------|-------------|
| Total salaries and employee benefits incurred        | \$1,997,271 | \$2,030,921 | \$(33,650 ) |
| Less: charged to losses and loss adjustment expenses | (323,018 )  | (288,114 )  | (34,904 )   |
| Less: capitalized to policy acquisition costs        | (325,610 )  | (361,223 )  | 35,613      |
| Net amount charged to operating expenses             | \$1,348,643 | \$1,381,584 | \$(32,941 ) |

**Commissions to agents/brokers** increased \$1,470 (4%) to \$41,889 for the three months ended March 31, 2017, compared to \$40,419 for the three months ended March 31, 2016.

**Other operating expenses** increased \$221,952 (37%) to \$814,499 for the three months ended March 31, 2017, compared to \$592,547 for the three months ended March 31, 2016. The increase in other operating expenses for the three months ended March 31, 2017, compared to the three months ended March 31, 2016, is related primarily to fees associated with the on-going California Department of Insurance financial examination of Crusader.

**Income tax benefit** increased \$1,049,058 (1,477%) to \$1,120,097 (34% of pre-tax loss) for the three months ended March 31, 2017, from an income tax benefit of \$71,039 (26% of pre-tax loss) for the three months ended March 31, 2016. The increase in income tax benefit during the three months ended March 31, 2017, when compared to three months ended March 31, 2016, was primarily due to an increase of \$2,997,323 in pre-tax loss of \$3,267,349 for the three months ended March 31, 2017, compared to pre-tax loss of \$270,026 for the three months ended March 31, 2016. The calculated tax rate for the three months ended March 31, 2017, consisted of federal tax benefit rate of 34% and a state income tax benefit rate of 0.5%. The calculated tax rate for the three months ended March 31, 2016, was comprised of a calculated federal tax benefit rate of approximately 32% while the calculated state tax expense rate was approximately 6%.



## Forward Looking Statements

Certain statements contained herein, including the sections entitled “Business,” “Legal Proceedings” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” that are not historical facts are forward looking. These statements, which may be identified by forward looking words or phrases such as “anticipate,” “appear,” “believe,” “estimate,” “expect,” “intend,” “may,” “plan,” “should,” and “would” involve risks and uncertainties, many of which are beyond the control of the Company. Such risks and uncertainties could cause actual results to differ materially from these forward looking statements. Factors which could cause actual results to differ materially include: underwriting or marketing actions not being effective; rate increases for coverages not being sufficient; premium rate adequacy relating to competition or regulation; actual versus estimated claim experience; the outcome of rate change filings with regulatory authorities; acceptance by insureds of rate changes; adequacy of rate changes; changes in Crusader’s A.M. Best rating; regulatory changes or developments; the outcome of regulatory proceedings; unforeseen calamities; general market conditions; and the Company’s ability to introduce new profitable products.

## ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company’s Consolidated Balance Sheets include a substantial amount of invested assets whose fair values are subject to various market risk exposures including interest rate risk and equity price risk.

The Company’s invested assets consist of the following:

|  | March 31      | December 31   | Increase          |
|--|---------------|---------------|-------------------|
|  | <u>2017</u>   | <u>2016</u>   | <u>(Decrease)</u> |
| Fixed maturity bonds (at amortized value)                            | \$ 14,094,670 | \$ 19,091,842 | \$(4,987,172 )    |
| Short-term cash investments (at cost)                                | 21,802,697    | 10,204,603    | 11,598,094        |
| Certificates of deposit with original maturity over 1 year (at cost) | 54,142,000    | 61,280,000    | (7,138,000 )      |
| Total invested assets  | \$ 90,039,367 | \$ 90,576,445 | \$(537,078 )      |

There have been no material changes in the composition of the Company’s invested assets or market risk exposures since the end of the preceding fiscal year end.

## ITEM 4 – CONTROLS AND PROCEDURES

An evaluation was carried out by the Company’s management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures as of March 31, 2017, as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

During the period covered by this report, there has been no change in the Company's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or 15d-15 under the Securities Exchange Act of 1934 that has materially affected or is reasonably likely to materially affect the Company's internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **ITEM 1A – RISK FACTORS**

There were no material changes from risk factors as previously disclosed in the Company's Form 10-K for the year ended December 31, 2016, in response to Item 1A to Part I of Form 10-K.

### **ITEM 6 – EXHIBITS**

31.1 Certificate of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certificate of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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The following information from the Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2017, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the 101 Condensed Consolidated Balance Sheets; (ii) the Condensed Consolidated Statements of Operations; (iii) the Condensed Consolidated Statements of Comprehensive Loss; (iv) the Condensed Consolidated Statements of Cash Flows; and (v) the Condensed Notes to Unaudited Condensed Consolidated Financial Statements.\*

\*XBRL information is furnished and deemed not filed as part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act and otherwise is not subject to liability under these sections.

SIGNATURES

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

UNICO AMERICAN CORPORATION

Date: May 15, 2017 By: /s/ CARY L. CHELDIN

Cary L. Cheldin

Chairman of the Board, President and Chief

Executive Officer (Principal Executive Officer)

Date: May 15, 2017 By: /s/ MICHAEL BUDNITSKY

Michael Budnitsky

Treasurer, Chief Financial Officer (Principal

Accounting and Principal Financial Officer)

