

UNICO AMERICAN CORP  
Form 10-Q  
August 12, 2016

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 **June 30, 2016** 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**

**95-2583928**

*(State or Other Jurisdiction of*

*(I.R.S. Employee*

*Incorporation or Organization)*

*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 X 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 X 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 X

(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 X

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 August 11, 2016</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****CONSOLIDATED BALANCE SHEETS**

|                                                                                                                        | June 30<br>2016<br>(Unaudited) | December 31<br>2015 |
|------------------------------------------------------------------------------------------------------------------------|--------------------------------|---------------------|
| <b>ASSETS</b>                                                                                                          |                                |                     |
| Investments                                                                                                            |                                |                     |
| Available-for-sale:                                                                                                    |                                |                     |
| Fixed maturities, at fair value (amortized cost: \$86,359,294 at June 30, 2016, and \$82,202,727 at December 31, 2015) | \$ 86,421,658                  | \$ 82,161,291       |
| Short-term investments, at fair value                                                                                  | 6,958,841                      | 15,640,803          |
| Total Investments                                                                                                      | 93,380,499                     | 97,802,094          |
| Cash                                                                                                                   | 389,690                        | 334,495             |
| Accrued investment income                                                                                              | 143,525                        | 85,915              |
| Receivables, net                                                                                                       | 6,273,342                      | 5,505,361           |
| Reinsurance recoverable:                                                                                               |                                |                     |
| Paid losses and loss adjustment expenses                                                                               | 286,270                        | 751,323             |
| Unpaid losses and loss adjustment expenses                                                                             | 9,641,767                      | 9,636,961           |
| Deferred policy acquisition costs                                                                                      | 4,495,106                      | 4,233,396           |
| Property and equipment, net                                                                                            | 10,503,271                     | 10,220,720          |
| Deferred income taxes                                                                                                  | 1,288,816                      | 1,334,087           |
| Other assets                                                                                                           | 15,141,137                     | 10,266,083          |
| Total Assets                                                                                                           | \$ 141,543,423                 | \$ 140,170,435      |

**LIABILITIES AND STOCKHOLDERS' EQUITY**

|                                            |               |               |
|--------------------------------------------|---------------|---------------|
| <b>LIABILITIES</b>                         |               |               |
| Unpaid losses and loss adjustment expenses | \$ 48,987,443 | \$ 49,093,571 |
| Unearned premiums                          | 19,265,015    | 18,079,253    |
| Advance premium and premium deposits       | 441,579       | 212,255       |
| Accrued expenses and other liabilities     | 2,564,792     | 2,443,284     |

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|                                                                                                                                                   |               |               |
|---------------------------------------------------------------------------------------------------------------------------------------------------|---------------|---------------|
| Total Liabilities                                                                                                                                 | \$71,258,829  | \$69,828,363  |
| Commitments and contingencies                                                                                                                     |               |               |
| STOCKHOLDERS' EQUITY                                                                                                                              |               |               |
| Common stock, no par – authorized 10,000,000 shares; issued and outstanding shares 5,307,133 at June 30, 2016, and 5,315,945 at December 31, 2015 | \$3,749,768   | \$3,742,547   |
| Accumulated other comprehensive income (loss)                                                                                                     | 41,160        | (27,348 )     |
| Retained earnings                                                                                                                                 | 66,493,666    | 66,626,873    |
| Total Stockholders' Equity                                                                                                                        | \$70,284,594  | \$70,342,072  |
| Total Liabilities and Stockholders' Equity                                                                                                        | \$141,543,423 | \$140,170,435 |

See condensed notes to unaudited consolidated financial statements.

## UNICO AMERICAN CORPORATION

## AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

|                                     | Three Months Ended<br>June 30 |             | Six Months Ended<br><u>June 30</u> |              |
|-------------------------------------|-------------------------------|-------------|------------------------------------|--------------|
|                                     | 2016                          | 2015        | <u>2016</u>                        | <u>2015</u>  |
| <b>REVENUES</b>                     |                               |             |                                    |              |
| Insurance company operation:        |                               |             |                                    |              |
| Net earned premium                  | \$7,717,951                   | \$7,327,855 | \$15,290,366                       | \$14,292,999 |
| Investment income                   | 212,344                       | 97,853      | 424,344                            | 185,176      |
| Net realized investments losses     | —                             | —           | (1,278 )                           | —            |
| Other income                        | 67,684                        | 168,881     | 135,278                            | 241,095      |
| Total Insurance Company Operation   | 7,997,979                     | 7,594,589   | 15,848,710                         | 14,719,270   |
| Other insurance operations:         |                               |             |                                    |              |
| Gross commissions and fees          | 708,939                       | 701,995     | 1,366,184                          | 1,393,214    |
| Investment income                   | 106                           | 82          | 197                                | 167          |
| Finance fees earned                 | 15,608                        | 15,208      | 32,217                             | 30,981       |
| Other income                        | —                             | 1,817       | 5,002                              | 2,258        |
| Total Revenues                      | 8,722,632                     | 8,313,691   | 17,252,310                         | 16,145,890   |
| <b>EXPENSES</b>                     |                               |             |                                    |              |
| Losses and loss adjustment expenses | 4,858,757                     | 4,633,516   | 9,944,251                          | 9,527,423    |
| Policy acquisition costs            | 1,701,091                     | 1,599,883   | 3,400,751                          | 3,092,713    |
| Salaries and employee benefits      | 1,279,849                     | 1,166,206   | 2,661,433                          | 2,414,113    |
| Commissions to agents/brokers       | 40,636                        | 44,756      | 81,055                             | 89,344       |
| Other operating expenses            | 633,705                       | 686,657     | 1,226,252                          | 1,430,661    |
| Total Expenses                      | 8,514,038                     | 8,131,018   | 17,313,742                         | 16,554,254   |
| Income (loss) before taxes          | 208,594                       | 182,673     | (61,432 )                          | (408,364 )   |
| Income tax expense (benefit)        | 57,564                        | 70,292      | (13,475 )                          | (123,960 )   |
| Net Income (Loss)                   | \$151,030                     | \$112,381   | \$(47,957 )                        | \$(284,404 ) |

## PER SHARE DATA:

## Basic

|                           |        |        |           |           |
|---------------------------|--------|--------|-----------|-----------|
| Earnings (loss) per share | \$0.03 | \$0.02 | \$(0.01 ) | \$(0.05 ) |
|---------------------------|--------|--------|-----------|-----------|

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|                           |           |           |           |           |
|---------------------------|-----------|-----------|-----------|-----------|
| Weighted average shares   | 5,307,133 | 5,339,392 | 5,308,255 | 5,340,270 |
| Diluted                   |           |           |           |           |
| Earnings (loss) per share | \$0.03    | \$0.02    | \$(0.01)  | \$(0.05)  |
| Weighted average shares   | 5,308,501 | 5,342,944 | 5,308,255 | 5,340,270 |

See condensed notes to unaudited consolidated financial statements.

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UNICO AMERICAN CORPORATION

AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

|                                                                                                                                              | Three Months Ended<br>June 30 |           | Six Months Ended<br>June 30 |              |
|----------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------|-----------|-----------------------------|--------------|
|                                                                                                                                              | 2016                          | 2015      | 2016                        | 2015         |
| Net income (loss)                                                                                                                            | \$151,030                     | \$112,381 | \$(47,957 )                 | \$(284,404 ) |
| Other changes in comprehensive income (loss):                                                                                                |                               |           |                             |              |
| Changes in unrealized gains (losses) on securities classified as available-for-sale arising during the period                                | 10,963                        | (14,195 ) | 103,800                     | 69,837       |
| Income tax benefit (expense) related to changes in unrealized gains on securities classified as available-for-sale arising during the period | (3,728 )                      | 4,826     | (35,292 )                   | (23,745 )    |
| Comprehensive Income (Loss)                                                                                                                  | \$158,265                     | \$103,012 | \$20,551                    | \$(238,312)  |

See condensed notes to unaudited consolidated financial statements.



## UNICO AMERICAN CORPORATION

## AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

|                                                                | For the Six Months Ended<br>June 30 |              |
|----------------------------------------------------------------|-------------------------------------|--------------|
|                                                                | 2016                                | 2015         |
| Cash flows from operating activities:                          |                                     |              |
| Net loss                                                       | \$(47,957 )                         | \$(284,404 ) |
| Adjustments to reconcile net loss to net cash from operations: |                                     |              |
| Depreciation and amortization                                  | 239,914                             | 234,345      |
| Bond amortization, net                                         | (8,567 )                            | (9,054 )     |
| Non-cash stock based compensation                              | 11,552                              | 11,552       |
| Changes in assets and liabilities:                             |                                     |              |
| Net receivables and accrued investment income                  | (825,591 )                          | (952,580 )   |
| Reinsurance recoverable                                        | 460,247                             | (462,692 )   |
| Deferred policy acquisition costs                              | (261,710 )                          | (387,191 )   |
| Other assets                                                   | (4,847,221)                         | (111,974 )   |
| Unpaid losses and loss adjustment expenses                     | (106,128 )                          | (164,846 )   |
| Unearned premium                                               | 1,185,762                           | 1,716,663    |
| Advance premium and premium deposits                           | 229,324                             | 133,077      |
| Accrued expenses and other liabilities                         | 121,508                             | (446,737 )   |
| Income taxes current/deferred                                  | (17,853 )                           | (128,377 )   |
| Net Cash Used by Operating Activities                          | (3,866,720)                         | (852,218 )   |
| Cash flows from investing activities:                          |                                     |              |
| Purchase of fixed maturity investments                         | (5,194,000)                         | (21,323,858) |
| Proceeds from maturity of fixed maturity investments           | 1,046,000                           | 1,949,000    |
| Net decrease in short-term investments                         | 8,681,962                           | 20,647,434   |
| Additions to property and equipment                            | (522,465 )                          | (339,919 )   |
| Net Cash Provided by Investing Activities                      | 4,011,497                           | 932,657      |
| Cash flows from financing activities:                          |                                     |              |
| Repurchase of common stock                                     | (89,582 )                           | (23,490 )    |
| Net Cash Used by Financing Activities                          | (89,582 )                           | (23,490 )    |
| Net increase in cash                                           | 55,195                              | 56,949       |
| Cash at beginning of period                                    | 334,495                             | 309,162      |
| Cash at End of Period                                          | \$389,690                           | \$366,111    |

Supplemental cash flow information

Cash paid during the period for:

Interest

—

—

Income taxes

\$8,774

\$8,900

See condensed notes to unaudited consolidated financial statements.

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UNICO AMERICAN CORPORATION

AND SUBSIDIARIES

CONDENSED NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2016

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Unico American Corporation (the “Company” or “Unico”) 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. References to Unico or the Company 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 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 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 and six months ended June 30, 2016, are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. Quarterly financial statements should be read in conjunction with the consolidated financial statements and related notes in the Company’s 2015 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 the current quarter’s 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 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 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 Consolidated Balance Sheets for these instruments approximate their fair values.

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

- Receivables, net – The carrying amounts reported in the 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 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 June 30, 2016, and December 31, 2015, the Company had remaining authority under the 2008 program to repurchase up to an aggregate of 188,655 and 197,467 shares of its common stock, respectively. 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 June 30, 2016. The Company repurchased 8,812 shares of stock during the six months ended June 30, 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 repurchased 2,204 shares of stock during the three and six months ended June 30, 2015, in unsolicited transactions at a cost of \$23,490 of which \$1,083 was allocated to capital and \$22,407 was allocated to retained earnings. The Company has or will retire all repurchased stock.

**NOTE 3 – EARNINGS (LOSS) PER SHARE**

The following table represents the reconciliation of the Company's basic earnings (loss) per share and diluted earnings (loss) per share computations reported on the Consolidated Statements of Operations for the three and six months ended June 30, 2016 and 2015:

|                                                 | Three Months Ended<br>June 30 |             | Six Months Ended<br>June 30 |              |
|-------------------------------------------------|-------------------------------|-------------|-----------------------------|--------------|
|                                                 | <u>2016</u>                   | <u>2015</u> | <u>2016</u>                 | <u>2015</u>  |
| <b><u>Basic Earnings (Loss) Per Share</u></b>   |                               |             |                             |              |
| Net income (loss)                               | \$ 151,030                    | \$ 112,381  | \$(47,957 )                 | \$(284,404 ) |
| Weighted average shares outstanding             | 5,307,133                     | 5,339,392   | 5,308,255                   | 5,340,270    |
| Basic earnings (loss) per share                 | \$0.03                        | \$0.02      | \$(0.01 )                   | \$(0.05 )    |
| <b><u>Diluted Earnings (Loss) Per Share</u></b> |                               |             |                             |              |
| Net income (loss)                               | \$ 151,030                    | \$ 112,381  | \$(47,957 )                 | \$(284,404 ) |
| Weighted average shares outstanding             | 5,307,133                     | 5,339,392   | 5,308,255                   | 5,340,270    |
| Effect of dilutive securities                   | 1,368                         | 3,552       | —                           | —            |
| Diluted shares outstanding                      | 5,308,501                     | 5,342,944   | 5,308,255                   | 5,340,270    |
| Diluted earnings (loss) per share               | \$0.03                        | \$0.02      | \$(0.01 )                   | \$(0.05 )    |

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. As of June 30, 2016 and 2015, the Company had 684 and 5,523 common share equivalents, respectively, that were excluded in the six months diluted (loss) per share calculation.

NOTE 4 – RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard 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 the use of the expected credit loss model for its premium receivables and reinsurance recoverables and 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.

In May 2015, 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 is not expected to have any impact on the Company’s consolidated financial statements. The disclosure mandated by ASU 2015-09 will become effective for annual and quarterly reporting periods ended on and after December 31, 2016.

#### NOTE 5 – ACCOUNTING FOR INCOME TAXES

The Company and its wholly owned subsidiaries file consolidated federal and state income tax returns. Pursuant to the tax allocation agreement, Crusader Insurance Company (“Crusader”) and American Acceptance Corporation (“AAC”), wholly owned subsidiaries of the Company, 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 2012 and California state income tax authorities for tax returns filed starting at taxable year 2011. There are no ongoing examinations of income tax returns by federal or state tax authorities.

As of June 30, 2016, and December 31, 2015, the Company had no unrecognized tax benefits or liabilities. In addition, the Company 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 insurance company, Crusader is obligated to pay a premium tax on gross premiums written in all states in which 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.

#### NOTE 6 – PROPERTY AND EQUIPMENT, NET

Property and equipment consist of the following:

|                                           | June 30<br>2016 | December 31<br>2015 |
|-------------------------------------------|-----------------|---------------------|
| Building located in Calabasas, California | \$8,321,180     | \$8,217,477         |
| Furniture, fixtures and equipment         | 2,665,603       | 2,251,623           |
| Accumulated depreciation and amortization | (2,443,941 )    | (2,204,027 )        |
| Land located in Calabasas, California     | 1,787,485       | 1,787,485           |
| Computer software under development       | 172,944         | 168,162             |

|                             |               |               |
|-----------------------------|---------------|---------------|
| Property and equipment, net | \$ 10,503,271 | \$ 10,220,720 |
|-----------------------------|---------------|---------------|

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 and six months ended June 30, 2016, was \$124,631 and \$239,914, respectively, and for the three and six months ended June 30, 2015, was \$116,894 and \$234,345, respectively.

The Calabasas building has generated rental revenue from non-affiliated tenants in the amount of \$56,628 and \$116,034 for the three and six months ended June 30, 2016, respectively, and \$39,109 and \$88,966 for the three and six months ended June 30, 2015, respectively. This rental revenue is included in "Other income" from insurance company operation in the Company's Consolidated Statements of Operations.

The Calabasas building has incurred operating expenses (including depreciation) in the amount of \$164,360 and \$336,237 for the three and six months ended June 30, 2016, respectively, and \$165,125 and \$344,204 for the three and six months ended June 30, 2015, respectively. These operating expenses are included in "Other operating expenses" in the Company's Consolidated Statements of Operations.



The total square footage of the Calabasas building is 46,884, including common areas. As of June 30, 2016, 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.

#### 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 total revenues for the three and six months ended June 30, 2016, compared to 91% of total revenues for the three and six months ended June 30, 2015. The Company’s remaining operations constitute a variety of specialty insurance services, each with unique characteristics and individually insignificant to total revenues.

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

|                                         | Three Months Ended<br><u>June 30</u> |             | Six Months Ended<br>June 30 |              |
|-----------------------------------------|--------------------------------------|-------------|-----------------------------|--------------|
|                                         | 2016                                 | 2015        | 2016                        | 2015         |
| Revenues                                |                                      |             |                             |              |
| Insurance company operation             | \$7,997,979                          | \$7,594,589 | \$15,848,710                | \$14,719,270 |
| Other insurance operations              | 3,543,106                            | 3,382,306   | 6,741,252                   | 6,523,946    |
| Intersegment eliminations (1)           | (2,818,453)                          | (2,663,204) | (5,337,652)                 | (5,097,326)  |
| Total other insurance operations        | 724,653                              | 719,102     | 1,403,600                   | 1,426,620    |
| Total revenues                          | \$8,722,632                          | \$8,313,691 | \$17,252,310                | \$16,145,890 |
| Income (Loss) Before Income Taxes       |                                      |             |                             |              |
| Insurance company operation             | \$304,736                            | \$254,512   | \$558,489                   | \$(2,068)    |
| Other insurance operations              | (96,142)                             | (71,839)    | (619,921)                   | (406,296)    |
| Total income (loss) before income taxes | \$208,594                            | \$182,673   | \$(61,432)                  | \$(408,364)  |

|         |             |
|---------|-------------|
| June 30 | December 31 |
| 2016    | 2015        |

## Assets

|                                   |                |                |
|-----------------------------------|----------------|----------------|
| Insurance company operation       | \$ 127,015,998 | \$ 126,406,439 |
| Intersegment eliminations (2)     | (1,491,520 )   | (1,409,797 )   |
| Total insurance company operation | 125,524,478    | 124,996,642    |
| Other insurance operations        | 16,018,945     | 15,173,793     |
| Total assets                      | \$ 141,543,423 | \$ 140,170,435 |

Intersegment revenue eliminations reflect rents paid by Unico to Crusader for space 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 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 fair value hierarchy level 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 June 30, 2016, and December 31, 2015:

|                                           | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|-------------------------------------------|----------------|----------------|----------------|--------------|
| June 30, 2016                             |                |                |                |              |
| Financial instruments:                    |                |                |                |              |
| Fixed maturity securities:                |                |                |                |              |
| U.S. treasury securities                  | \$24,146,658   | \$—            | \$—            | \$24,146,658 |
| Certificates of deposit                   | —              | 62,275,000     | —              | 62,275,000   |
| Total fixed maturity securities           | 24,146,658     | 62,275,000     | —              | 86,421,658   |
| Cash and short-term investments           | 7,348,531      | —              | —              | 7,348,531    |
| Total financial instruments at fair value | \$31,495,189   | \$62,275,000   | \$—            | \$93,770,189 |
| December 31, 2015                         |                |                |                |              |
| Financial instruments:                    |                |                |                |              |
| Fixed maturity securities:                |                |                |                |              |
| U.S. treasury securities                  | \$24,034,291   | \$—            | \$—            | \$24,034,291 |

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|                                           |              |              |     |              |
|-------------------------------------------|--------------|--------------|-----|--------------|
| Certificates of deposit                   | —            | 58,127,000   | —   | 58,127,000   |
| Total fixed maturity securities           | 24,034,291   | 58,127,000   | —   | 82,161,291   |
| Cash and short-term investments           | 15,975,298   | —            | —   | 15,975,298   |
| Total financial instruments at fair value | \$40,009,589 | \$58,127,000 | \$— | \$98,136,589 |

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 and six months ended June 30, 2016 and 2015.

NOTE 9 – INVESTMENTS

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

|                                                 | Three Months Ended |             | Six Months Ended |             |
|-------------------------------------------------|--------------------|-------------|------------------|-------------|
|                                                 | <u>June 30</u>     |             | <u>June 30</u>   |             |
|                                                 | <u>2016</u>        | <u>2015</u> | <u>2016</u>      | <u>2015</u> |
| Fixed maturities                                | \$180,828          | \$85,229    | \$358,665        | \$157,165   |
| Short-term investments                          | 31,622             | 12,706      | 65,876           | 28,178      |
| Total investment income                         | 212,450            | 97,935      | 424,541          | 185,343     |
| Net realized losses                             | —                  | —           | (1,278 )         | —           |
| Total investment income and net realized losses | \$212,450          | \$97,935    | \$423,263        | \$185,343   |

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 |
|--------------------------|--------------|------------------------------|-------------------------------|----------------------------|
| June 30, 2016            |              |                              |                               |                            |
| Available for sale:      |              |                              |                               |                            |
| <u>Fixed maturities</u>  |              |                              |                               |                            |
| Certificates of deposit  | \$62,275,000 | \$—                          | \$—                           | \$62,275,000               |
| U.S. treasury securities | 24,084,294   | 62,364                       | —                             | 24,146,658                 |
| Total fixed maturities   | \$86,359,294 | \$62,364                     | \$—                           | \$86,421,658               |

December 31, 2015

Available for sale:

Fixed maturities

|                          |              |         |            |              |
|--------------------------|--------------|---------|------------|--------------|
| Certificates of deposit  | \$58,127,000 | \$—     | \$—        | \$58,127,000 |
| U.S. treasury securities | 24,075,727   | 3,188   | (44,624)   | 24,034,291   |
| Total fixed maturities   | \$82,202,727 | \$3,188 | \$(44,624) | \$82,161,291 |

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

|                                                             | June 30<br>2016 | December<br>31<br>2015 |
|-------------------------------------------------------------|-----------------|------------------------|
| Gross unrealized gains of fixed maturities                  | \$62,364        | \$3,188                |
| Gross unrealized (losses) of fixed maturities               | —               | (44,624)               |
| Net unrealized gains (losses) on investments                | 62,364          | (41,436)               |
| Deferred federal tax (expense) benefit                      | (21,204)        | 14,088                 |
| Net unrealized gains (losses), net of deferred income taxes | \$41,160        | \$(27,348)             |

At December 31, 2015, the Company had three fixed maturity investments with gross unrealized losses of \$38,509 for a continuous period of less than 12 months and two fixed maturity investments with gross unrealized losses of \$6,115 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 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 December 31, 2015, 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. The Company sold three certificates of deposit during the six months ended June 30, 2016. These securities had an amortized cost of \$746,000. The Company realized an investment loss of \$1,278 on the sale. The Company did not sell any fixed maturity investments and there were no realized investment gains or losses during the three months ended June 30, 2016, nor during the three and six months ended June 30, 2015. 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 \$61,675,000 and \$57,527,000 of brokered certificates of deposit as of June 30, 2016, and December 31, 2015, 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 certificates of deposit 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 MUFG 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 by UnionBank Global Custody Services for the benefit of the Company, and are FDIC insured within permissible limits. As of June 30, 2016, and December 31, 2015, the Company's remaining certificates of deposit totaling \$600,000 are from four different banks and represent statutory deposits that are assigned to and are 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 in the state of Nevada. All the Company's brokered and non-brokered certificates of deposit are within the FDIC insured permissible limits.

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

|                                 | June 30<br>2016 | December 31<br>2015 |
|---------------------------------|-----------------|---------------------|
| U.S. treasury bills             | \$—             | \$9,987,804         |
| U.S. treasury money market fund | 5,063,582       | 3,357,841           |
| Certificates of deposit         | 948,000         | 1,346,000           |
| Bank money market accounts      | 945,496         | 947,395             |
| Bank savings accounts           | 1,763           | 1,763               |
| Total short-term investments    | \$6,958,841     | \$15,640,803        |

#### NOTE 10 – 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. The cash deposits in lieu of an appeal bond of \$13,373,793 and \$7,924,178 were included in "Other assets" in the Consolidated Balance Sheets as of June 30, 2016, and December 31,

2015, respectively. Management believes the ultimate outcome of this litigation will be covered by Crusader's reinsurance, subject to retention and participation. 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 IBNR as of June 30, 2016, and December 31, 2015.

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 other individual paid the Company to settle the claim against him. The Company collected \$0 during the three and six months ended June 30, 2016 and 2015. As of June 30, 2016, and December 31, 2015, the agent's balance due to Unifax was \$1,181,272. As of June 30, 2016, and December 31, 2015, 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 June 30, 2016, the Company continues to pursue collection of the judgments from the three principals.



On October 9, 2015, the Company filed a lawsuit in the Superior Court for the State of California, County of Los Angeles, Central District against a software vendor, Insurance Systems, Inc. ("ISI"). The lawsuit sought an unspecified amount in monetary damages plus punitive damages against ISI. Causes of action stated in the lawsuit included fraudulent inducement and intentional misrepresentation, negligent misrepresentation, negligence, violation of business and professional code, breach of implied warranty of merchantability, breach of implied warranty of fitness, breach of contract and breach of implied covenant of good faith and fair dealings. Subsequently, the lawsuit was removed to the United States District Court for the Central District of California and all causes of action have been disallowed by the court except for breach of contract. On May 16, 2016, ISI filed a countersuit against the Company for \$1,792,398 for unpaid invoices plus damages for alleged breach of the contract related to implementation of the ISI computer software by the Company. The Company is vigorously defending the countersuit and believes it to be without merit. The Company has asserted various affirmative defenses in opposition to the ISI countersuit including defenses of fraud in inducement, fraudulent concealment, and negligent misrepresentation.

## **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 June 30, 2016, were \$8,722,632 compared to \$8,313,691 for the three months ended June 30, 2015, an increase of \$408,941 (5%). Total revenues for the six months ended June 30, 2016, were \$17,252,310 compared to \$16,145,890 for the six months ended June 30, 2015, an increase of \$1,106,420 (7%). The Company had net income of \$151,030 for the three months ended June 30, 2016, compared to net income of \$112,381 for the three months ended June 30, 2015, an increase of \$38,649 (34%). The Company had a net loss of \$47,957 for the six months ended June 30, 2016, compared to a net loss of \$284,404 for the six months ended June 30, 2015, a decrease of \$236,447 (83%).

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 2015 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 operation, commission and fee income generated from the insurance agency operation, fee income from the premium finance operation, and investment income from cash generated primarily from the insurance company operation. The insurance company operation generated approximately 92% of total revenues for the three and six months ended June 30, 2016, compared to 91% of total revenues for the three and six months ended June 30, 2015. The Company's remaining operations constitute a variety of specialty insurance services, each with unique characteristics and individually not material to total revenues.

#### Insurance Company Operation

As of June 30, 2016, Crusader Insurance Company ("Crusader"), a wholly owned subsidiary of the Company, was licensed as an admitted insurance carrier in the states of Arizona, California, Nevada, Oregon, and Washington. From 2004 until June 2014, all of Crusader's business was written in the state of California. In June 2014, Crusader began writing business in the state of Arizona. During the three and six months ended June 30, 2016, 99.3% and 99.4% of Crusader's total direct written premium (before premium ceded to reinsurers) was produced in California, respectively, compared to 99.6% and 99.5% for the three and six months ended June 30, 2015, respectively. 98% and 99% of Crusader's business was commercial multi-peril policies for the three and six months ended June 30, 2016, respectively, compared to 98% and 99% for the three and six months ended June 30, 2015, respectively. In October 2015, 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 statutory accounting principles 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 not defined under U.S. generally accepted accounting principles (“GAAP”). Earned premium, the most directly comparable GAAP measure, 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 June 30 |             | Six Months Ended June 30 |              |
|-----------------------------------|----------------------------|-------------|--------------------------|--------------|
|                                   | 2016                       | 2015        | 2016                     | 2015         |
| Net written premium               | \$8,754,768                | \$8,359,569 | \$16,460,358             | \$15,982,098 |
| Change in direct unearned premium | (1,051,264)                | (1,057,951) | (1,185,753)              | (1,716,662)  |
| Change in ceded unearned premium  | 14,447                     | 26,237      | 15,761                   | 27,563       |
| Net earned premium                | \$7,717,951                | \$7,327,855 | \$15,290,366             | \$14,292,999 |

For the three months ended June 30, 2016, direct written premium, as reported on Crusader’s statutory financial statements, was \$10,270,811 compared to \$9,706,609 for the three months ended June 30, 2015, an increase of \$564,202 (6%). For the six months ended June 30, 2016, direct written premium, as reported on Crusader’s statutory financial statements, was \$19,453,366 compared to \$18,579,571 for the six months ended June 30, 2015, an increase of \$873,795 (5%).

The insurance company operation 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 before income taxes is as follows:

| Three Months Ended June 30 | Six Months Ended June 30 | Increase |
|----------------------------|--------------------------|----------|
|----------------------------|--------------------------|----------|

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|                                           | <u>2016</u> | <u>2015</u> | Increase<br>(Decrease) | <u>2016</u>  | <u>2015</u>  |           |
|-------------------------------------------|-------------|-------------|------------------------|--------------|--------------|-----------|
| Net written premium                       | \$8,754,768 | \$8,359,569 | \$395,199              | \$16,460,358 | \$15,982,098 | \$478,260 |
| Change in net unearned premium            | (1,036,817) | (1,031,714) | (5,103 )               | (1,169,992 ) | (1,689,099 ) | 519,107   |
| Net earned premium                        | 7,717,951   | 7,327,855   | 390,096                | 15,290,366   | 14,292,999   | 997,367   |
| Less:                                     |             |             |                        |              |              |           |
| Losses and loss adjustment expenses       | 4,858,757   | 4,633,516   | 225,241                | 9,944,251    | 9,527,423    | 416,828   |
| Policy acquisition costs                  | 1,701,091   | 1,599,883   | 101,208                | 3,400,751    | 3,092,713    | 308,038   |
| Total underwriting expenses               | 6,559,848   | 6,233,399   | 326,449                | 13,345,002   | 12,620,136   | 724,866   |
| Underwriting profit (before income taxes) | \$1,158,103 | \$1,094,456 | \$63,647               | \$1,945,364  | \$1,672,863  | \$272,501 |

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

|                                              | Three Months Ended June 30 |             |                   | Six Months Ended June 30 |              |                   |
|----------------------------------------------|----------------------------|-------------|-------------------|--------------------------|--------------|-------------------|
|                                              |                            |             | Increase          |                          |              | Increase          |
|                                              | <u>2016</u>                | <u>2015</u> | <u>(Decrease)</u> | <u>2016</u>              | <u>2015</u>  | <u>(Decrease)</u> |
| Losses and loss adjustment expenses          |                            |             |                   |                          |              |                   |
| Provision for insured events of current year | \$5,603,427                | \$5,280,840 | \$322,587         | \$10,327,095             | \$11,286,539 | \$(959,444 )      |
| Development of insured events of prior years | (744,670 )                 | (647,324 )  | (97,346 )         | (382,844 )               | (1,759,116 ) | 1,376,272         |
| Total losses and loss adjustment expenses    | \$4,858,757                | \$4,633,516 | \$225,241         | \$9,944,251              | \$9,527,423  | \$416,828         |

Losses and loss adjustment expenses were 63% and 65% of net earned premium for the three and six months ended June 30, 2016, respectively, compared to 63% and 67% of net earned premium for the three and six months ended June 30, 2015, respectively.

#### 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 8% of total revenues in the three and six months ended June 30, 2016, compared to approximately 9% of total revenues in the three and six months ended June 30, 2015.

#### Investments and Liquidity

The Company generated revenues from its total invested assets of \$93,318,135 (at amortized cost) and \$106,148,997 (at amortized cost) as of June 30, 2016 and 2015, respectively, and from two cash deposits by Crusader, in lieu of appeal bonds, placed with the Los Angeles Superior Court. These deposits, totaling \$13,373,793, were made in December 2015 and March 2016 and were included in "Other assets" in the Consolidated Balance Sheet as of June 30, 2016. Investment income included in insurance company operation and other insurance operations revenue increased \$114,515 (117%) and \$239,198 (129%) to \$212,450 and \$424,541 for the three and six months ended June 30, 2016, respectively, compared to \$97,935 and \$185,343 for the three and six months ended June 30, 2015, respectively. The increase in investment income was primarily a result of an increase in the Company's annualized yield on average invested assets to 0.9% for the three and six months ended June 30, 2016, from 0.4% and 0.3% for the three and six months ended June 30, 2015, respectively. The increase in the annualized yield on average invested assets is primarily a result of a decrease in lower yielding short-term investments and an increase in higher yielding fixed maturity investments. 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 June 30, 2016, 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 June 30, 2016, the weighted average maturity of the Company's investments is approximately 1.1 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 and investments (at amortized cost) of the Company at June 30, 2016, were \$93,707,825 compared to \$98,178,025 at December 31, 2015. Crusader's cash and investments were 99% of the total cash and investments (at amortized cost) held by the Company as of June 30, 2016, and December 31, 2015.

As of June 30, 2016, the Company had invested \$86,359,294 (at amortized cost) or 93% of its total invested assets in fixed maturity obligations, which included \$24,084,294 (28% of fixed maturity investments) in U.S. treasury notes and \$62,275,000 (72% of fixed maturity investments) in long-term certificates of deposit. As of December 31, 2015, the Company had invested \$82,202,727 (at amortized cost) or 84% of its total invested assets in fixed maturity obligations, which included \$24,075,727 (29% of fixed maturity investments) in U.S. treasury notes and \$58,127,000 (71% 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.

The Company's investment guidelines on equity securities limit investments in equity securities to an aggregate maximum of \$2,000,000. The Company's investment guidelines on fixed maturities limit those investments to high-grade obligations with a maximum term of 8 years. The maximum investment authorized in any one issuer is \$2,000,000. This dollar limitation excludes bond premiums paid in excess of par value and U.S. government or U.S. government guaranteed issues. When the Company invests in fixed maturity municipal securities, preference is given to issues that are pre-refunded and secured by U.S. treasury securities. The short-term investments are 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 are rated, readily marketable, and could be liquidated without any materially adverse financial impact.

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 June 30, 2016, and December 31, 2015, the Company had remaining authority under the 2008 program to repurchase up to an aggregate of 188,655 and 197,467 shares of its common stock, respectively. 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 June 30, 2016. The Company repurchased 8,812 shares of stock during the six months ended June 30, 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 repurchased 2,204 shares of stock during the three and six months ended June 30, 2015, in unsolicited transactions at a cost of \$23,490 of which \$1,083 was allocated to capital and \$22,407 was allocated to retained earnings. The Company has or will retire all repurchased stock.

The Company reported \$3,866,720 net cash used by operating activities for the six months ended June 30, 2016, compared to \$852,218 net cash used by operating activities for the six months ended June 30, 2015. The largest contributor to the use of cash for the six months ended June 30, 2016, was a \$5,449,615 cash deposit by Crusader in lieu of an appeal bond placed with the Los Angeles Superior Court on March 21, 2016. This cash deposit was in addition to the \$7,924,178 cash deposit by Crusader in lieu of an appeal bond placed with the Los Angeles Superior Court on December 28, 2015, to appeal two judgments on a Crusader policy liability claim.

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 due primarily to its small claims population which may result in greater fluctuations in claim frequency and/or severity. Although the 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 June 30, 2016, 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 June 30, 2016.

### **Results of Operations**

All comparisons made in this discussion are comparing the three and six months ended June 30, 2016, to the three and six months ended June 30, 2015, unless otherwise indicated.

For the three and six months ended June 30, 2016, total revenues were \$8,722,632 and \$17,252,310, respectively, an increase of \$408,941 (5%) and \$1,106,420 (7%), compared to total revenues of \$8,313,691 and \$16,145,890 for the three and six months ended June 30, 2015, respectively. For the three and six months ended June 30, 2016, the Company had income before taxes of \$208,594 and a loss before taxes of \$61,432, respectively, an increase of \$25,921 (14%) and a decrease of \$346,932 (85%), compared to income before taxes of \$182,673 and a loss before taxes of \$408,364 for the three and six months ended June 30, 2015, respectively. For the three and six months ended June 30, 2016, the Company had net income of \$151,030 and a net loss of \$47,957, respectively, an increase of \$38,649 (34%) and a decrease of \$236,447 (83%), compared to net income of \$112,381 and a net loss of \$284,404 for the three and six months ended June 30, 2015, respectively.



The increase in revenues of \$408,941 (5%) for the three months ended June 30, 2016, compared to June 30, 2015, was due primarily to an increase in net earned premium of \$390,096 (5%). The increase in revenues of \$1,106,420 (7%) for the six months ended June 30, 2016, compared to June 30, 2015, was due primarily to an increase in net earned premium of \$997,367 (7%).

The increase in income before tax of \$25,921 (14%) for the three months ended June 30, 2016, compared to the three months ended June 30, 2015, was due primarily to the increase in net earned premium of \$390,096 (5%) partially offset by increases in losses and loss adjustment expenses of \$225,241 (5%) and in policy acquisition costs of \$101,208 (6%). The decrease in loss before tax of \$346,932 (85%) for the six months ended June 30, 2016, compared to the six months ended June 30, 2015, was due primarily to the increase in net earned premium of \$997,367 (7%) partially offset by increases in losses and loss adjustment expenses of \$416,828 (4%) and in policy acquisition costs of \$308,038 (10%).

**Written premium** is a required statutory measure. Direct written premium reported on Crusader's statutory financial statements increased \$564,202 (6%) and \$873,795 (5%) to \$10,270,811 and \$19,453,366 for the three and six months ended June 30, 2016, respectively, compared to \$9,706,609 and \$18,579,571 for the three and six months ended June 30, 2015, respectively.

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. Nonetheless, Crusader believes that it can grow its sales and profitability by continuing to focus upon four areas of its operations: (1) product development, (2) improved service to retail brokers, (3) appointment of captive and independent retail agents, and (4) geographical expansion. 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. Crusader does not intend to substantially increase its number of appointed retail agents until the Company replaces its policy administration system.

**Earned premium** (before reinsurance) increased \$570,889 (7%) to \$9,219,547 and \$1,404,695 (8%) to \$18,267,604 for the three and six months ended June 30, 2016, respectively, compared to \$8,648,658 and \$16,862,909 for the three and six months ended June 30, 2015, respectively. The Company writes annual policies and, therefore, earns written premium ratably over the one-year policy term.

Ceded earned premium increased \$180,793 (14%) to \$1,501,596 and \$407,328 (16%) to \$2,977,238 for the three and six months ended June 30, 2016, respectively, compared to \$1,320,803 and \$2,569,910 for the three and six months ended June 30, 2015, respectively. Ceded earned premium as a percentage of direct earned premium was 16% for the three and six months ended June 30, 2016, and 15% for the three and six months ended June 30, 2015.

In calendar years 2016 and 2015, Crusader retained a participation in its excess of loss reinsurance treaties of 10% 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 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). In calendar year 2015, 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 (\$31,000,000 in excess of \$10,000,000).

Crusader's excess of loss reinsurance treaties provided for a contingent commission for accident years 2006, 2004 and 2003. Crusader's 2006 1<sup>st</sup> layer primary excess of loss reinsurance treaty provided for a contingent commission equal to 20% of the net profit, if any, accruing to the reinsurer. Crusader's 2004 and 2003 1<sup>st</sup> layer primary excess of loss reinsurance treaties provided for a contingent commission to the Company equal to 45% of the net profit, if any, accruing to the reinsurer. Any contingent commission received is subject to return based on future development of ceded losses and loss adjustment expenses. As of June 30, 2016, and December 31, 2015, the unearned contingent commission balance included in "Accrued expenses and other liabilities" in the Consolidated Balance Sheets was \$0. The contingent commission (loss) recognized was \$0 and \$(31,806) for the three months ended June 30, 2016 and 2015, respectively, and \$0 and \$(31,806) for the six months ended June 30, 2016 and 2015, respectively.

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 GAAP. As of June 30, 2016, 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 June 30 |             |           | Six Months Ended June 30 |              |             |
|--------------------------------------------------------|----------------------------|-------------|-----------|--------------------------|--------------|-------------|
|                                                        | 2016                       | 2015        | Increase  | 2016                     | 2015         | Increase    |
| Direct earned premium                                  | \$9,219,547                | \$8,648,658 | \$570,889 | \$18,267,604             | \$16,862,909 | \$1,404,695 |
| Ceded earned premium                                   | 1,501,596                  | 1,320,803   | 180,793   | 2,977,238                | 2,569,910    | 407,328     |
| Net earned premium                                     | \$7,717,951                | \$7,327,855 | \$390,096 | \$15,290,366             | \$14,292,999 | \$997,367   |
| Ratio of ceded earned premium to direct earned premium | 16                         | % 15        | %         | 16                       | % 15         | %           |

**Investment income**, included in insurance company operation and other insurance operations revenues, increased \$114,515 (117%) to \$212,450 and \$239,198 (129%) to \$424,541 for the three and six months ended June 30, 2016, respectively, compared to \$97,935 and \$185,343 for the three and six months ended June 30, 2015, respectively.

The increase in investment income was primarily a result of an increase in the Company's annualized yield on average invested assets to 0.9% for the three and six months ended June 30, 2016, respectively, from 0.4% and 0.3% for the three and six months ended June 30, 2015. The increase in the annualized yield on average invested assets is primarily a result of a decrease in lower yielding short-term investments and an increase in higher yielding fixed maturity investments.

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

|                                               | Three Months Ended            |               | Six Months Ended              |               |
|-----------------------------------------------|-------------------------------|---------------|-------------------------------|---------------|
|                                               | <u>June 30</u><br><u>2016</u> | <u>2015</u>   | <u>June 30</u><br><u>2016</u> | <u>2015</u>   |
| Average invested assets* - at amortized cost: | \$92,984,269                  | \$106,406,920 | \$95,580,833                  | \$106,780,758 |
| Interest income                               |                               |               |                               |               |
| Insurance company operation                   | \$212,344                     | \$97,853      | \$424,344                     | \$185,176     |
| Other insurance operations                    | 106                           | 82            | 197                           | 167           |
| Total investment income                       | \$212,450                     | \$97,935      | \$424,541                     | \$185,343     |

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Annualized yield on average invested assets      0.9                      %      0.4                      %      0.9                      %      0.3                      %

\*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 June 30, 2016, by contractual maturity, are as follows:

| Maturities by        | Par          |                       |                   | Weighted             |   |
|----------------------|--------------|-----------------------|-------------------|----------------------|---|
| <u>Calendar Year</u> | <u>Value</u> | <u>Amortized Cost</u> | <u>Fair Value</u> | <u>Average Yield</u> |   |
| December 31, 2016    | \$17,473,000 | \$17,471,888          | \$17,475,346      | 0.7                  | % |
| December 31, 2017    | 51,782,000   | 51,767,269            | 51,826,062        | 0.8                  | % |
| December 31, 2018    | 15,526,000   | 15,526,137            | 15,526,250        | 1.2                  | % |
| December 31, 2019    | 1,494,000    | 1,494,000             | 1,494,000         | 1.3                  | % |
| December 31, 2020    | 100,000      | 100,000               | 100,000           | 0.3                  | % |
| Total                | \$86,375,000 | \$86,359,294          | \$86,421,658      | 0.9                  | % |

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 1.1 years as of June 30, 2016, and 1.5 years as of June 30, 2015. Due to the current interest rate environment, management believes it is prudent to purchase fixed maturity investments with maturities of five years or less and with minimal credit risk.

At June 30, 2016, the Company had six fixed maturity securities with gross unrealized gains of \$62,364. At December 31, 2015, the Company had three fixed maturity investments with gross unrealized losses of \$38,509 for a continuous period of less than 12 months and two fixed maturity investments with gross unrealized losses of \$6,115 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 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. As of December 31, 2015, all unrealized losses were on the U.S. treasury securities, and these unrealized losses 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. The Company sold three certificates of deposit during the six months ended June 30, 2016. These securities had an amortized cost of \$746,000. The Company realized an investment loss of \$1,278 on the sale. The Company did not sell any fixed maturity investments and there were no realized investment gains or losses during the three months ended June 30, 2016, nor during the three and six months ended June 30, 2015. 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 operation and other insurance operations revenues, decreased \$103,014 (60%) to \$67,684 and \$103,073 (42%) to \$140,280 for the three and six months ended June 30, 2016, respectively, compared to \$170,698 and \$243,353 for the three and six months ended June 30, 2015, respectively. The decreases are due primarily to \$0 contingent commission recognized on Crusader's excess of loss reinsurance treaties for accident years 2006, 2004 and 2003 for the three and six months ended June 30, 2016, respectively, compared to \$123,494 and \$91,686 for the three and six months ended June 30, 2015, respectively.

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**Gross commissions and fees** increased \$6,944 (1%) to \$708,939 and decreased \$27,030 (2%) to \$1,366,184 for the three and six months ended June 30, 2016, respectively, compared to \$701,995 and \$1,393,214 for the three and six months ended June 30, 2015, respectively.

The changes in gross commission and fee income for the three and six months ended June 30, 2016, compared to the three and six months ended June 30, 2015, are as follows:

|                                                     | Three Months Ended June 30 |           |                        | <u>Six Months Ended June 30</u> |             |                        |
|-----------------------------------------------------|----------------------------|-----------|------------------------|---------------------------------|-------------|------------------------|
|                                                     | 2016                       | 2015      | Increase<br>(Decrease) | 2016                            | 2015        | Increase<br>(Decrease) |
| Policy fee income                                   | \$432,518                  | \$430,431 | \$2,087                | \$842,507                       | \$836,338   | \$6,169                |
| Health insurance program                            | 256,899                    | 247,536   | 9,363                  | 474,711                         | 493,044     | (18,333 )              |
| Membership and fee income                           | 19,522                     | 22,402    | (2,880 )               | 40,147                          | 45,570      | (5,423 )               |
| Daily automobile rental insurance program:          |                            |           |                        |                                 |             |                        |
| Commission income (excluding contingent commission) | —                          | 1,626     | (1,626 )               | —                               | 1,675       | (1,675 )               |
| Contingent commission                               | —                          | —         | —                      | 8,819                           | 16,587      | (7,768 )               |
| Total                                               | \$708,939                  | \$701,995 | \$6,944                | \$1,366,184                     | \$1,393,214 | \$(27,030 )            |

Unifax Insurance Systems, Inc. (“Unifax”), a wholly owned subsidiary of the Company, 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 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 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 consolidated financial statements. Policy fee income increased \$2,087 (0.5%) and \$6,169 (0.7%) in the three and six months ended June 30, 2016, respectively, compared to the three and six months ended June 30, 2015.

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 \$9,363 (4%) and decreased \$18,333 (4%) in the three and six months ended June 30, 2016, respectively, compared to the three and six months ended June 30, 2015.

Insurance Club, Inc., dba AAQHC An Administrator (“AAQHC”), a wholly owned subsidiary of the Company, 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 \$2,880 (13%) and \$5,423 (12%) in the three and six months ended June 30, 2016, respectively, compared to the three and six months ended June 30, 2015. These decreases were primarily a result of a decrease in the number of association members enrolled in AAQHC during the three and six months ended June 30, 2016, compared to the number of association members enrolled during the three and six months ended June 30, 2015.

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 American Acceptance Corporation (“AAC”), a wholly owned subsidiary of the Company, increased \$400 (3%) to \$15,608 and \$1,236 (4%) to \$32,217 for the three and six months ended June 30, 2016, respectively, compared to \$15,208 and \$30,981 for the three and six months ended June 31, 2015, respectively. The increases in fees earned during the three and six months ended June 30, 2016, compared to the three and six months ended June 30, 2015, are primarily a result of more late fees earned during the period compared to the prior year period. During the three and six months ended June 30, 2016, AAC issued 817 and 1,622 loans, respectively, and had 2,422 loans outstanding as of June 30, 2016. During the three and six months ended June 30, 2015, AAC issued 906 and 1,783 loans, respectively,

and had 2,570 loans outstanding as of June 30, 2015. 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 and six months ended June 30, 2016 and 2015. 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 63% and 65% of net earned premium for the three and six months ended June 30, 2016, respectively, compared to 63% and 67% of net earned premium for the three and six months ended June 30, 2015, respectively.

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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 June 30 |              | Increase<br>(Decrease) |
|----------------------------------------------|----------------------------|--------------|------------------------|
|                                              | 2016                       | 2015         |                        |
| Net earned premium                           | \$7,717,951                | \$7,327,855  | \$390,096              |
| Losses and loss adjustment expenses:         |                            |              |                        |
| Provision for insured events of current year | 5,603,427                  | 5,280,840    | 322,587                |
| Development of insured events of prior years | (744,670 )                 | (647,324 )   | (97,346 )              |
| Total losses and loss adjustment expenses    | \$4,858,757                | \$4,633,516  | \$225,241              |
| Calendar year loss ratio                     | 63                         | % 63         | %                      |
|                                              | Six Months Ended June 30   |              | Increase<br>(Decrease) |
|                                              | 2016                       | 2015         |                        |
| Net earned premium                           | \$15,290,366               | \$14,292,999 | \$997,367              |
| Losses and loss adjustment expenses:         |                            |              |                        |
| Provision for insured events of current year | 10,327,095                 | 11,286,539   | (959,444 )             |
| Development of insured events of prior years | (382,844 )                 | (1,759,116 ) | 1,376,272              |
| Total losses and loss adjustment expenses    | \$9,944,251                | \$9,527,423  | \$416,828              |
| Calendar year loss ratio                     | 65                         | % 67         | %                      |

The current accident year losses and loss adjustment expenses in the three and six months ended June 30, 2016, were 73% and 68% of net earned premium, respectively, compared to the current accident year losses and loss adjustment expenses of 72% and 79% of net earned premium in the three and six months ended June 30, 2015, respectively.

The Company reported a \$97,346 increase in the favorable development of insured events of prior years during the three months ended June 30, 2016, compared with the three months ended June 30, 2015. The Company reported a \$1,376,272 decrease in the favorable development of insured events of prior years during the six months ended June 30, 2016, compared with the six months ended June 30, 2015. The \$744,670 and \$382,844 favorable developments of insured events of prior years during the three and six months ended June 30, 2016, respectively, are due primarily to favorable development in the 2012, 2010 and 2009 accident years.

The variability of the Crusader's losses and loss adjustment expenses for the periods presented is due primarily to the small and diverse Crusader's policyholders and claims population, 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 policy acquisition costs include Crusader expenses and 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. Ceding commission is received on excess of loss ceded premium, and 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 policy acquisition costs to determine that costs related to successful policy acquisition are capitalized and deferred. These policy acquisition costs were approximately 22% of net earned premium for the three and six months ended June 30, 2016 and 2015. The policy acquisition costs increased in the three and six months ended June 30, 2016, compared to the three and six months ended June 30, 2015, due primarily to the increase in the commission expenses associated with the increase in the net earned premium in the three and six months ended June 30, 2016.

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

Three Months Ended June 30

Six Months Ended June 30

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|                                             | 2016        | 2015        | <u>Increase</u> | 2016        | 2015        | Increase  |
|---------------------------------------------|-------------|-------------|-----------------|-------------|-------------|-----------|
| Policy acquisition costs                    | \$1,701,091 | \$1,599,883 | \$101,208       | \$3,400,751 | \$3,092,713 | \$308,038 |
| Ratio to net earned premium<br>(GAAP ratio) | 22          | % 22        | %               | 22          | % 22        | %         |

**Salaries and employee benefits** increased \$113,643 (10%) to \$1,279,849 and \$247,320 (10%) to \$2,661,433 for the three and six months ended June 30, 2016, respectively, compared to \$1,166,206 and \$2,414,113 for the three and six months ended June 30, 2015, respectively.

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

|                                                      | Three Months Ended June 30 |             |                   |
|------------------------------------------------------|----------------------------|-------------|-------------------|
|                                                      | Increase                   |             |                   |
|                                                      | <u>2016</u>                | <u>2015</u> | <u>(Decrease)</u> |
| Total salaries and employee benefits incurred        | \$1,994,064                | \$1,792,209 | \$201,855         |
| Less: charged to losses and loss adjustment expenses | (281,468 )                 | (255,608 )  | (25,860 )         |
| Less: capitalized to policy acquisition costs        | (432,747 )                 | (370,395 )  | (62,352 )         |
| Net amount charged to operating expenses             | \$1,279,849                | \$1,166,206 | \$113,643         |

|                                                      | Six Months Ended June 30 |             |                   |
|------------------------------------------------------|--------------------------|-------------|-------------------|
|                                                      |                          |             | Increase          |
|                                                      | <u>2016</u>              | <u>2015</u> | <u>(Decrease)</u> |
| Total salaries and employee benefits incurred        | \$4,024,984              | \$3,641,145 | \$383,839         |
| Less: charged to losses and loss adjustment expenses | (569,582 )               | (504,274 )  | (65,308 )         |
| Less: capitalized to policy acquisition costs        | (793,969 )               | (722,758 )  | (71,211 )         |
| Net amount charged to operating expenses             | \$2,661,433              | \$2,414,113 | \$247,320         |

**Commissions to agents/brokers** decreased \$4,120 (9%) to \$40,636 and \$8,289 (9%) to \$81,055 for the three and six months ended June 30, 2016, respectively, compared to \$44,756 and \$89,344 for the three and six months ended June 30, 2015.

**Other operating expenses** decreased \$52,952 (8%) to \$633,705 and \$204,409 (14%) to \$1,226,252 for the three and six months ended June 30, 2016, respectively, compared to \$686,657 and \$1,430,661 for the three and six months ended June 30, 2015, respectively. The decreases in other operating expenses for the three and six months ended June 30, 2016, compared to the three and six months ended June 30, 2015, are primarily related to lower rent partially offset by higher outside director fees.

**Income tax provision** decreased \$12,728 (18%) to an income tax expense of \$57,564 (28% of pre-tax income) and increased \$110,485 (89%) to a benefit of \$13,475 (22% of pre-tax loss) for the three and six months ended June 30, 2016, respectively, compared to an income tax expense of \$70,292 (38% of pre-tax income) and a benefit of \$123,960 (30% of pre-tax loss) for the three and six months ended June 30, 2015, respectively. The income tax provision is primarily related to income before taxes. The calculated tax rate for the six months ended June 30, 2016, consisted of a federal tax benefit rate of 30% and a state income tax expense rate of approximately 8%. The calculated tax rate for the six months ended June 30, 2015, consisted of a federal tax benefit rate of 32% and a state income tax expense rate of approximately 2%.

### 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:

|                                                 | June 30      | December 31  | Increase          |
|-------------------------------------------------|--------------|--------------|-------------------|
|                                                 | <u>2016</u>  | <u>2015</u>  | <u>(Decrease)</u> |
| Fixed maturity bonds (at amortized value)       | \$24,084,294 | \$24,075,727 | \$8,567           |
| Short-term cash investments (at cost)           | 6,958,841    | 15,640,803   | (8,681,962 )      |
| Certificates of deposit - over 1 year (at cost) | 62,275,000   | 58,127,000   | 4,148,000         |
| Total invested assets                           | \$93,318,135 | \$97,843,530 | \$(4,525,395 )    |

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 June 30, 2016, 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 1 – LEGAL PROCEEDINGS**

On October 9, 2015, the Company filed a lawsuit in the Superior Court for the State of California, County of Los Angeles, Central District against a software vendor, Insurance Systems, Inc. (“ISI”). The lawsuit sought an unspecified amount in monetary damages plus punitive damages against ISI. Causes of action stated in the lawsuit included fraudulent inducement and intentional misrepresentation, negligent misrepresentation, negligence, violation of business and professional code, breach of implied warranty of merchantability, breach of implied warranty of fitness, breach of contract and breach of implied covenant of good faith and fair dealings. Subsequently, the lawsuit was removed to the United States District Court for the Central District of California and all causes of action have been disallowed by the court except for breach of contract. On May 16, 2016, ISI filed a countersuit against the Company for \$1,792,398 for unpaid invoices plus damages for alleged breach of the contract related to implementation of the ISI computer software by the Company. The Company is vigorously defending the countersuit and believes it to be without merit. The Company has asserted various affirmative defenses in opposition to the ISI countersuit including defenses of fraud in inducement, fraudulent concealment, and negligent misrepresentation.

##### **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, 2015, 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.

The following information from the Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2016, formatted in XBRL (Extensible Business Reporting Language) and furnished electronically herewith: (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations; (iii) the Consolidated Statements of Comprehensive (Loss) Income; (iv) the Consolidated Statements of Cash Flows; and (v) the Condensed Notes to Unaudited 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.



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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: August 11, 2016 By: /s/ CARY L. CHELDIN

Cary L. Cheldin

Chairman of the Board, President and Chief

Executive Officer, (Principal Executive Officer)

Date: August 11, 2016 By: /s/ MICHAEL BUDNITSKY

Michael Budnitsky

Treasurer, Chief Financial Officer, (Principal

Accounting and Principal Financial Officer)

