Annual Letter to Shareholders of Kingsway Financial Services Inc.

April 26, 2016

Dear Fellow Shareholder,

2015 was a year that provided us with a few wins and a few continued struggles. More importantly, it was also a year during which we planted seeds of opportunity for future harvesting. On balance we are pleased that, for the first time since we began our restructuring, we reported a positive net income for the year. Although we have previously highlighted the challenges and limitations of gauging our improved financial position by only looking at net income, it is, nonetheless, an accomplishment to report $0.8 million of net income[1] for 2015 versus the net loss[2] of $13.1 million reported for 2014. Another measure we look to for measuring our business is adjusted operating income.[3] We reported $7.2 million of adjusted operating income for 2015 versus $8.0 million for 2014 despite reporting approximately $2.5 million less in investment income and net realized gains. We expect the investment portfolio results will be "lumpy" as we do not manage to quarterly or annual returns but instead invest for a longer view with a willingness to accept interim volatility. As we did in last year's shareholder letter, we remind our shareholders of our philosophy:

> *Kingsway focuses on building **long-term value** by compounding capital with investments/acquisitions/financings that offer **asymmetric risk/reward** potential with a **margin of safety** supported by **private market values** using a merchant banking approach.*[4]

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[1] More specifically, Net Income Attributable to Common Shareholders.

[2] More specifically, Net Loss Attributable to Common Shareholders.

[3] Adjusted operating income is a non-GAAP measure comprised of segment operating income (loss) as well as net investment income, net realized gains, other-than-temporary impairment loss, equity in net loss of investee and net revenues of 1347 Advisors LLC. Segment operating income (loss) is a non-GAAP measure derived by subtracting direct segment expenses from direct segment revenues. Please refer to the section entitled "Non-U.S. GAAP Financial Measures" in the Management's Discussion and Analysis section of the Company's Annual Report on Form 10-K for the year ended December 31, 2015 for a detailed description of segment operating income (loss).

[4] For more detail and background on our investment philosophy, we urge newer shareholders to read the 2013 Annual Letter to Shareholders of Kingsway Financial Services Inc., which can be found in the Investor Relations section of our website and at http://bit.ly/kfs2013.

Some highlights (and struggles) of 2015 (and some post year-end mentionables):

- KLROC debt due June 30, 2015 was extinguished -- the company's only remaining senior and short-term debt. (As a side note, I don't know who is happier about this, our accounting group given the complexity of that structure or our board for creating a less leveraged balance sheet!)
- Deferred interest on our trust preferred debt was brought current giving us the opportunity to repurchase our common stock, an intention that we announced in November 2015 and began implementing a few weeks ago.
- We sold Assigned Risk Solutions for a gain in excess of $11 million and conversion of significant goodwill and intangible assets into cash.
- We realized significant value on our strategic investment in 1347 Property Insurance Holdings through the buyback of the Management Services Agreement.
- We generated $2.8 million of investment income and realized gains from our passive investments in Oak Street Real Estate Capital Fund II, LP and DG TN Portfolio, LLC and set up a strategic opportunity in net lease real estate.
- Our non-standard auto ("NSA") business remained steady but not yet profitable.
- Our warranty businesses struggled to produce the growth and profit we expect from them.

Businesses Owned (and Sold)

Assigned Risk Solutions ("ARS")

We sold ARS in 2015. As discussed in last year's letter, it was an asset that we believe had appreciated to the point where we could no longer increase the value of its core competency beyond what the buyer was willing to pay. It was a bittersweet sale as ARS generated a significant portion of our recurring profits, and we knew it would be challenging to replace those profits in 2016 given we used much of the proceeds to pay down debt. It was a good example of how our strategy works as our 2010 acquisition of JBA & Associates provided the catalyst to transform an underperforming part of our balance sheet into the company now known as ARS. We expect to collect more cash in 2016, 2017 and 2018, resulting from earnout provisions in the ARS sale agreement, as ARS continues to perform for the buyer. Still a win/win and a part of our track record we endeavor to repeat with our other businesses.

Warranty – IWS Acquisition Corporation ("IWS") and Trinity Warranty Solutions ("Trinity")

IWS has generated cumulative EBITDA of $4.7 million,[5] against a $4.9 million purchase price, since we acquired it in November of 2012. Although that exceeds our expected returns on a project, the asset has a significant untapped potential. Our frustrations with IWS are based on knowing it has the product, service and infrastructure to begin to address the significant market opportunity it focuses on. 2015 revenues for IWS were down approximately 10%. GAAP revenue is a tough measure in the vehicle service agreement sector because of the long-tail

[5] EBITDA of $4.7 million represents GAAP earnings before interest, taxes, depreciation and amortization expenses, including contingent consideration expense, for the period from November 2012 through December 2015.

nature of revenue recognition. As we focus more on warranty, we will provide more details of the metrics we use to manage the business and monitor the health of its intrinsic economic value.

Trinity has been a struggle since our original purchase. We invested meaningfully into the company as it was growing rapidly. At the end of 2015, we made a decision to curtail our investment in growth and focus on profitability. 2015 resulted in flat revenue growth with significantly higher losses (stemming from the previous growth investments). Gross margins remained steady, but were not large enough to produce a profit based on the flat growth. In 2016, the challenge will be to put the historical investment to work in growing the top line while managing expenses. Trinity has the potential to be a great business for us, but we need a sharper focus on profitability before we can move back into growth mode.

We just announced an addition to the team, JT Fitzgerald, who will head a new unit we are calling 1347 Warranty Holdings to help us advance our strategic direction in warranty. Despite our challenges in the portfolio companies we currently own, we are committed to the effort necessary to obtain the required return on the capital we have working here. Much like the efforts at ARS in the early years, we do not always see real-time results as the revenue recognition and sales cycle in warranty is multi-year. JT has his work cut out for him, and he has my confidence. Come to the Annual General Meeting and see why I am excited about JT joining the team. Think of him as a Co-Chief Capital Allocator.

Traditional Insurance

NSA represents $57.9 million of enterprise value at year-end 2015 (compared to $52.4 million at year-end 2014).[6] The increase in enterprise value during 2015 was driven by investment gains in the NSA portfolio of invested assets and income from our continued successful run-offs of Mendakota Casualty Company and Kingsway Amigo Insurance Company which more than offset underwriting losses in our continuing operations.

We would look for a traditional insurance company to earn 10-15% return on its tangible value (depending on the risk of loss from its underwriting exposure). NSA had a combined ratio[7] of 101.5% for 2015 – as a reminder anything below 100% means underwriting profit for an insurance company. We need to find a way to achieve a combined ratio of 96-98% which would provide us approximately $2.4-4.8 million of underwriting profit before investment returns based upon our current net premiums earned. Although we talk about investments in the Passive Investments section, many of those investments are funded through the float from

[6] NSA enterprise value equals the GAAP equity in Mendota Insurance Company, Mendakota Insurance Company, Mendakota Casualty Company and Kingsway Amigo Insurance Company plus $9.1 million of intercompany surplus notes and $7.8 million of GAAP intangible assets on the holding company balance sheet stemming from the 2007 acquisition of Mendota Insurance Company and Mendakota Insurance Company.

[7] The GAAP combined ratio is the sum of the loss and loss adjustment expense ratio and the expense ratio. The loss and loss adjustment expense ratio is derived by dividing the amount of net loss and loss adjustment expenses incurred by net premiums earned. The expense ratio is derived by dividing the sum of commissions, premium taxes, general and administrative expenses and policy fee income by net premiums earned.

the insurance operations. NSA provided $108.8 million (compared to $109.3 million at December 31, 2014) of GAAP cash and cash equivalents and investments for us to manage. We need to perform better on the underwriting results so that our capital is working for us twice. A strategic review is under way to determine how best we can accomplish this objective. Stay tuned.

Passive Investments

Net Lease Real Estate

Last year's letter highlighted our investment in Oak Street's credit tenant net lease fund. In 2015, we purchased several properties from that fund by exchanging our units of the fund. We are looking for ways to make net lease real estate more strategic to Kingsway. Since inception, we have invested a total of $9.5 million in net lease real estate investments and have recognized cumulative investment income and gains of $3.6 million. Today, we have $10.9 million of capital deployed[8] in net leases -- all still managed by Oak Street. Although there are limits to our ability to utilize our balance sheet to continue to invest in this asset class, we would like to expand our involvement there and will look to asset management or permanent capital vehicle opportunities to expand our upside participation in this asset class.

Net lease also represents an attractive opportunity to deploy one of our key off balance sheet assets. Our deferred tax asset provides us unique opportunities to be owners of highly leveraged properties with strong credit tenants and associated credit tenant loans that result in situations with no cash flow but current taxable income. Our deferred tax position allows us to absorb that current "phantom" income without having to deploy further capital while accumulating real long-term economic value to be harvested in the future when these properties are refinanced or sold. I hope to be able to develop a strategy for efficiently converting some of our deferred tax asset into a portfolio of leased real estate generating material long-term economic value for us. Look for us to do something in this area in the near future.

1347 Property Insurance Holdings ("PIH")

We terminated our Management Services Agreement with PIH in February of 2015. We received significant value in the form of $2.0 million of cash, a $3.0 million preferred stock security and 1,500,000 warrants[9] for eliminating our longer term participation in the growth of the business. We also received a performance share grant which entitles us to receive 100,000 shares of PIH common stock when the PIH common stock price reaches $10. This performance share grant is in addition to the performance share grants we received in 2014 which entitle us to receive 125,000 shares of PIH common stock for each of PIH common stock price milestones of $12, $15 and $18. We are aligned with our fellow shareholders in the ultimate success of PIH. As of the date of this letter, we have recognized $11.6 million of value in the form of cash,

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[8] In this case, using GAAP carrying value.
[9] The warrants have a strike price of $15 and expire on February 24, 2022.

common stock, common stock warrants and preferred stock received, with no value yet having been recognized for any of the performance shares, against our original $8.8 million of capital deployed while PIH was wholly owned by KFS. This is the good news.

The challenging news has been the stock price performance. Although the team at PIH has reported an average return on deployed statutory capital of 19.5% for 2014 and 2015,[10] the daily voting machine has decided that PIH is worth less than its book value. I think the market has it wrong, and we are pleased with PIH management's performance on the capital deployed while not risking the capital entrusted to them by growing in highly competitive markets where returns are diminishing. That being said, we are keen to keep an eye on how further capital gets deployed and will encourage them to distribute excess capital if the long-term outlook to deploy the excess capital changes. The share buyback program recently implemented by PIH alludes to their willingness to engage in shareholder-friendly activity.

<u>Other</u>

1347 Capital Corp., our Special Purpose Acquisition Company ("SPAC"), spent the year looking for a merger partner. You may have noticed it signed a definitive merger agreement with Limbach Holdings LLC ("Limbach"), a commercial mechanical engineering and construction contractor. We are working on closing this mid-2016. We invest in other SPACs with the insurance float for the risk/reward opportunity. As a proprietor, we look for interesting companies with a thesis attractive to public shareholders. We believe Limbach fits that mold, but we have our work cut out for us to get it closed. Should we be successful, we will convert our SPAC investment into a large shareholding of the company with additional warrant upside.

Another area of interest to us is venture capital investing. We have made a handful of small investments in venture companies in order to gain exposure to opportunities which will allow us to use the tools in our merchant banking tool belt to create value beyond the limited balance sheet capital we can deploy. One tool we have used in the past (with our Atlas Financial Holdings spinout) is the Capital Pool Company ("CPC") structure in Canada. CPCs are more efficient "go-public vehicles" than SPACs. We are looking into a variation of the CPC for use in the U.S. to utilize the skills we have honed in those vehicles as a way to provide creative solutions to the opportunities facing our portfolio companies. Although this currently doesn't reach the level of a strategic initiative, we are always looking for areas ripe for using our skills to create attractive risk/rewards.

Another interesting opportunity is Kobex Capital Corp. ("Kobex"). We made an investment in Kobex in the second half of 2015, based on its significant discount to cash value, with the goal of investing in opportunities with other like-minded shareholders. Kobex could become either an interesting permanent capital vehicle to manage or a merger vehicle as it transforms to Itasca Capital Ltd. should its shareholders agree. We invested below its cash value and expect Kobex to convert its deferred tax asset into tangible value. Time will tell.

[10] 19.5% represents the average of the return on average equity for 2014 and 2015 for Maison Insurance Company, the wholly owned insurance company subsidiary of PIH, as reported by SNL Financial.

Random Thoughts

As many of you know, I do not pay attention to our share price on a daily basis. Nor do I go shopping for apparel often, but when Nordstrom runs a sale of 25-33% off, I pay attention and get out the list of things I need. Similarly, sometimes the stock market gives you the chance to pick up things on sale. The KFS share buyback is like my trip to Nordstrom, not on my usual to-do list, but the shares are on sale and the board and I (who represent nearly 38%[11] of the company) believe we are getting a bargain.

In past years I have strayed into random areas of interest such as accounting and activism. There is no shortage of things we find interesting (like the upcoming presidential election, the assault on inversions and the lack of accuracy with which the so-called "experts" prognosticate the price of oil), but, in looking for something relevant to assist our shareholders to better understand what makes us tick, I came up empty (although the oil commentary came close…maybe next year). So, rather than stretching for something, I figured I would try something different. We are looking for more opportunities in net lease. Sale leasebacks or existing leveraged leased properties (especially with zero cash flow or phantom income) are of the most interest. If you know of something that fits that description, email us at netlease@1347capital.com. We can get creative, and we do better solving "problems" than being buyers at auction.

We continue to work hard as stewards of your capital with the goal of compounding it over the long-term. It hasn't always been the case where the majority of our attention could be focused on compounding rather than restructuring, but the events of 2015 have given us that opportunity and I suspect 2016 will be a productive year for planting seeds for future harvest. If you have specific opportunities you think could be of interest or you want to introduce yourself as a shareholder, text me at 630-290-2432. My only requirement for a return call is you identify yourself by name and include your exact shareholdings. I tried this during our campaign with Kobex with surprising (and very productive) results and wanted to extend the offer to our supportive partners at Kingsway. Speak to you soon.

Sincerely,

Larry G. Swets, Jr.
Shareholder & CEO

[11] This includes 6% of total outstanding shares held by your CEO that are restricted.

This Annual Letter to Shareholders of Kingsway Financial Services Inc. should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

Forward-Looking Statements

This shareholder letter includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are not historical facts, and involve risks and uncertainties that could cause actual results to differ materially from those expected and projected. Words such as "expects", "believes", "anticipates", "intends", "estimates", "seeks" and variations and similar words and expressions are intended to identify such forward-looking statements. Such forward-looking statements relate to future events or future performance, but reflect Kingsway management's current beliefs, based on information currently available. A number of factors could cause actual events, performance or results to differ materially from the events, performance and results discussed in the forward-looking statements. For information identifying important factors that could cause actual results to differ materially from those anticipated in the forward looking statements, please refer to the section entitled "Risk Factors" in the Company's 2015 Annual Report on Form 10-K. Except as expressly required by applicable securities law, the Company disclaims any intention or obligation to update or revise any forward looking statements whether as a result of new information, future events or otherwise.