Annual Letter to Shareholders of Kingsway Financial Services Inc.

April 25, 2017

Dear Fellow Shareholder,

In past letters, we highlighted what we described as "turning the corner." Although our 2016 financial performance shows a mixed result -- mostly from booking prior year loss reserves in our non-standard auto business (more on that later) -- we made a large leap forward towards our long-term objective of meaningfully growing shareholder value. We reported net income for the second consecutive year, with 2016 net income attributable to shareholders of $0.4 million. Reported adjusted operating loss was $0.5 million[1] for 2016, but it should be noted that amount includes a net $7.6 million charge as a result of loss reserve adjustments in the non-standard auto business related to 2015 and prior years. As we move forward with our goals of improving operating performance at our non-standard auto business; building the warranty platform; and utilizing credit tenant lease assets to monetize the tax asset, our focus will be on compounding our shareholders' capital. The best way we know how to measure that (albeit an imperfect one) is by reporting growth in book value per share. Year-end GAAP book value per share was $2.65, a 19.4% increase over prior year-end and at the upper bound of the 15-20% range we highlighted in the Investor Day presentation held in November. This growth in book value per share was in spite of a non-cash $3.7 million loss on change in fair value of debt and a non-cash expense of $1.2 million related to the amortization of intangible assets created by purchase accounting adjustments. We view the fair valuing of debt as a real cost over time, but it is very volatile in the short-run. Regarding intangible amortization, GAAP requires us to record this expense even though it is our view that this expense does not represent a real "cost." In fact, in a year in which earnings improved dramatically at our purchased warranty businesses, an argument could be made that the value of these assets actually increased!

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[1] Adjusted operating loss is a non-GAAP measure comprised of segment operating income (loss) as well as net investment income (loss), net realized gains (loss), other-than-temporary impairment loss, equity in net income (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 Kingsway Financial Services Inc. ("Kingsway") Annual Report on Form 10-K for the year ended December 31, 2016 for a detailed description of segment operating income (loss). Please refer to Kingsway's press release dated March 13, 2017 announcing its fourth quarter and year-end 2016 results for a reconciliation of segment operating loss and adjusted operating loss to GAAP net income.

This is probably a good time to remind our partners of our philosophy:

> *Kingsway focuses on building* ***long-term value*** *by compounding capital with investments/acquisition/financings that offer* ***asymmetric risk/reward*** *potential with a* ***margin of safety*** *supported by* ***private market values*** *using a merchant banking approach*[2]*.*

I want to take some time to introduce to you the newest member of our executive team, but probably better described as my "partner" at Kingsway. JT (or John T. Fitzgerald according to the proxy) joined us in April of 2016 after almost a year of us working together on projects of mutual interest. In fact, JT was providing us some insights into the operational challenges at the warranty businesses in hopes that we might explore acquisitions together. As we contemplated how to work together, it became more evident that JT shares the same passion for value-based buying of businesses and investing. After JT's commitment to make a meaningful investment in Kingsway concurrent with our acquisition of the general partner of his investment fund, JT joined the team. Subsequently, earlier this year, we named him President of Kingsway to reflect our partnership approach to the business. Think of JT as Co-Chief Capital Allocator (with a primary focus on our Businesses Owned) as we look to deploy capital on your behalf. I have known JT for years as a fellow forum-mate in YPO[3] and can't be more excited about the future with a partner aboard this journey. Feel free to reach out to JT (by the way, he has agreed to accept any/all complaints from shareholders so I can stay focused on writing letters…I just couldn't get his permission to publish his mobile number!).

Some highlights (and struggles) of 2016:

- Leadership changes with addition of JT, hiring of Steve Harrison at our non-standard auto business and promotion of Eric Wikander at IWS, one of our warranty businesses.
- Acquisition of CMC, Inc. and the resulting exposure to a credit tenant lease with a Berkshire Hathaway subsidiary, BNSF, that resulted in income of $10.4 million reported for 2016. The income is primarily a result of unlocking some of the federal income tax benefit reflected in the valuation allowance carried against our deferred tax asset, which in turn was generated by our historical net operating losses.
- Merger between the special purpose acquisition company ("SPAC") we sponsored (1347 Capital Corp.) and Limbach Holdings LLC, leading to the formation of Limbach Holdings, Inc. (NASDAQ: LMB). This resulted in an $8.8 million increase in our shareholders' equity from the close of the merger in July through the end of 2016.
- Successful campaign and further deployment of capital into Itasca Capital Ltd. (TSXV: ICL) that resulted in the ICL share price increasing, during our tenure operating the company

[2] 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.
[3] Young Presidents Organization.

under a management services agreement, from C$0.65 on June 9, 2016, the date of the ICL special shareholders' meeting, to C$0.81 as of April 19, 2017. ICL's reported book value per share increased 75% from June 30, 2016 to December 31, 2016, the date of their most recently published financial statement.

- Raised equity capital of $10.5 million at a premium to our trading price, aligning ourselves with long-term patient shareholders who share our vision/approach.
- Significant performance improvement in our warranty-related businesses year over year.
- Adverse loss reserve development of $9.1 million related to the continuing operations of our non-standard auto business, offset by reserve releases of $1.5 million at our runoff businesses, for a net $7.6 million charge as a result of loss reserve adjustments in the non-standard auto business related to 2015 and prior years.

Businesses Owned

IWS Acquisition Corporation ("IWS")

IWS stands for Intercontinental Warranty Services. It has been in business since 1991, serving the credit union sector by providing vehicle service agreements ("VSA") with a focus on quality of service. 2016 was a transformational year at IWS. In May, we promoted Eric Wikander to the position of President, marking a transition away from the family-run company that we acquired in 2012. Eric has been with IWS for almost 19 years as of this writing and had been operating as the de facto General Manager for many years under the previous family owners. Eric's promotion was roundly celebrated by the employees at IWS and is certainly well deserved. Eric and his team immediately set to work to improve the culture and re-energize the business under new leadership. Of note, Eric and his team aligned organizational incentives around reinvigorating penetration of the credit union channel and growth in VSAs in-force. We are happy to report that after years of declines, the number of VSAs funded during 2016 grew by 11.5% over the number funded during 2015. IWS also successfully launched several new ancillary vehicle protection products that will help them win new clients. Re-bounding growth along with good stewardship of resources and expenses delivered strong operating performance. EBITDA[4] increased 2.8% from 2015 to 2016, and, after adjusting 2016 EBITDA for $0.9 million of extraordinary expenses related to settlements made with the previous owners, "normalized" EBITDA increased 104.9%.

There is continued room to grow this business, as credit unions currently hold well over $1.3 trillion dollars of assets[5] and have become an increasingly popular alternative to traditional banks following the credit crisis. Nationally, credit union memberships have grown by 18% from year-end 2010 through year-end 2016[6]. New and used automobile loans comprise approximately one-third of credit union loan volume,[7] and those car owners recognize the value of IWS' protection

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[4] EBITDA represents GAAP earnings before interest, taxes, depreciation and amortization expenses, including contingent consideration expense (benefit).

[5] Source: Year End 2016 U.S. Credit Union Profile compiled by CUNA Economics & Statistics.

[6] Source: Year End 2016 U.S. Credit Union Profile compiled by CUNA Economics & Statistics.

[7] Source: Year End 2016 U.S. Credit Union Profile compiled by CUNA Economics & Statistics.

products. Under Eric's leadership, our focus in 2017 will be on adding new distribution partners with continued penetration of the credit union channel. We are mindful of the risk of a retreat from the recent high levels of automobile sales nationally and the potential impact this could have on our growth plans going forward. That said, IWS has plenty of room to grow market share in its channel. We anticipate growing our sales of VSAs (our preferred measure of economic value added) by over 5% this year in spite of emerging vehicle sales headwinds. We expect great things from Eric and his team in the years to come!

If you are interested in any of our vehicle protection products, please visit our newly re-vamped website at www.iwsgroup.com.

Trinity Warranty Solutions ("Trinity")

As you recall, Trinity provides warranty and dispatch services on heating, ventilation, air-conditioning (HVAC), refrigeration, generators and commercial equipment that competitors ignore (like large commercial chillers). In years past, Trinity focused on growing the business to scale and was willing to incur operating losses with a view that those losses represented investments in the future. That focus shifted in 2016 towards one of profitable growth.

Peter Dikeos and his team at Trinity made significant progress in 2016 towards our new profitable growth goals. We are happy to report that revenue increased by 10.5% in 2016 from 2015 and gross margins[8] increased from 28.0% to 31.9% during the same period. Remarkably, in spite of that growth, Peter was able to deliver operating expense reductions of $0.7 million during 2016 versus the prior year. Growing revenue, improving gross margins and lowering overhead expenses are always a winning combination! EBITDA improved to a narrow loss for 2016. Of note, the acceleration in the business delivered positive EBITDA in the second half of the year. Trinity has carried strong revenue, margin and profitability momentum into 2017.

Trinity has two businesses, National Accounts and Warranty, which we expect to provide strong double-digit margins in the long run. We expect Trinity to exceed $8 million of revenue in 2017 and to be cash flow positive for the year.

Non-standard Auto ("NSA")

As previously mentioned, at year-end we recorded loss reserve strengthening of $9.1 million related to the continuing operations of our non-standard auto business related to adverse development for accident years 2015 and prior. It has been said that loss reserving and the actuarial methods used to arrive at these estimates is akin to driving at high speed while looking

[8] Gross margin is defined as (i) GAAP service fee and commission income net of GAAP bad debt expense, GAAP commission expense and GAAP cost of services sold; divided by (ii) GAAP service fee and commission income. 2015 gross margin is calculated on service fee and commission income of $5,911,020; bad debt expense of $51,063; commission expense of $158,773; and cost of services sold of $4,043,696. 2016 gross margin is calculated on service fee and commission income of $6,529,374; bad debt expense of $38,064; commission expense of $217,256; and cost of services sold of $4,193,407.

through the rear window (something we hope none of our insureds is doing!). We plan to arrive at our destination correctly, but sometimes we err and are forced to adjust our path. We believe the loss reserve strengthening we took will get us firmly back on course but cannot overlook the persistent industry-wide trends of higher miles driven (distractedly) and resurgent inflation in the costs of fixing cars and the people who drive (and crash) them. Throughout 2016, we increased our rates to combat these trends and will continue to monitor our loss experience and react as necessary. We believe a hardening market will provide the opportunity for additional rate taking in 2017.

Bill Hickey, our able CFO, has maintained a steady hand on the tiller as we steer our runoff businesses into port. Loss reserve releases of $1.5 million from these runoff businesses helped to partially offset the $9.1 million loss reserve strengthening at NSA's continuing operations.

It was not all bad in 2016 at NSA. As previously mentioned, we recruited and hired industry veteran Steve Harrison to the position of President. Steve brings a lifetime of industry experience in non-standard auto insurance and has immediately set to work to implement an underwriting profit improvement plan. It includes raising prices, tightening underwriting standards, focusing on claims process excellence and reducing expenses. In particular, Steve and his team intend to:

- Implement a new software operating system for both claims and policies to improve organizational efficiencies.
- Increase fee income and minimize exposure to bad debt expense to be more in line with industry benchmarks.
- Reorganize the claims management organization, including opening a Nashville, TN claims office.

Our goal is to put NSA in a position to deliver an underwriting profit consistently. We have our work cut out for us, but we have a great team in place; we have confidence in them; and we know they are up to the task.

CMC Industries, Inc. ("CMC")

CMC is the operating business that holds the credit tenant lease with BNSF. We own 81% of the company and consolidate for accounting and tax. The lease expires in 2034, by which time $112.0 million of the non-recourse debt assumed at the time of the acquisition will have been paid down. Our investment in CMC was under $2 million but has generated an increase in GAAP shareholders' equity of $10.7 million[9] during 2016. Earlier this year, our partners Leo and Larry at Terracap negotiated a significant enhancement to the lease with BNSF. In exchange for an additional $25 million in lease payments (spread over the remaining 17 years of the lease), we provided a purchase option at $150 million. With a balloon of $68 million on the debt at lease expiration in 2034, we look forward to additional value being recognized on this operation.

[9] This amount is comprised of (i) $10.4 million included in GAAP net income from the time of the CMC acquisition in July through year-end 2016 plus (ii) $0.3 million included in GAAP shareholders' equity to reflect the noncontrolling interest of the 19% minority owner of CMC.

Argo Management Group LLC ("Argo")

We acquired Argo in April 2016. Argo is the manager of a fund dedicated to investing in search funds and their target company acquisitions. For the uninitiated, a search fund is essentially a smaller, private version of its larger cousin, the SPAC, something with which we were already familiar. Unlike a SPAC, however, the search fund entrepreneurs transition into operating roles at the companies they acquire. In order to avoid sounding promotional about Argo's fund, we will instead point you to the Stanford Graduate School of Business study, "2016 SEARCH FUND STUDY: SELECTED OBSERVATIONS."[10] We suspect you will find the asset class and its historical returns very interesting. We are grateful for, and humbled by, the steady stream of exceedingly bright, driven and entrepreneurial young MBAs we get to meet and invest in on behalf of Argo and its fund.

Passive Investments

One of the attractive parts of our warranty and insurance businesses is the float that is generated by those businesses. This float (think of it as a non-callable liability) provides us with investment leverage on our shareholders' equity. At year-end 2016, we had an investment portfolio, including cash and cash equivalents, across the enterprise of approximately $163.5 million, or $7.62 per share. Those investments consist of a high-quality fixed maturities portfolio (to provide us a measure of safety versus the needed payouts of loss reserves) and more attractive capital appreciation alternatives with a focus on our asymmetric risk/reward philosophy. We have highlighted some of those below to provide insight into our approach.

Net Lease Investments

We continue to prefer taking credit risk in triple net real estate credit tenant opportunities to stretching for yield in the traditional fixed income market. We find the risk/reward to be more attractive. In the past, we have highlighted our involvement with Marc Zahr and his team at Oak Street. We were their first institutional investor, and now they manage hundreds of millions of dollars of institutional money. We applaud their success! Our transition from the Oak Street fund investment into Net Lease Investment Grade Portfolio, LLC and other similar vehicles (still managed by Oak Street) continues to provide us attractive returns. We deployed $8.5 million between 2012 and 2014 into triple net lease portfolios managed by Oak Street. As a result of subsequent equity pickups, these investments now have a GAAP carrying value of $12.2 million at year-end 2016. In 2016 alone, we reported $1.4 million of equity pickup as part of our GAAP net investment income, representing a 16.3% return for 2016 against the original $8.5 million investment.

In 2017, we are focused on taking our experiences with CMC and the Net Lease Investment Grade Portfolio and creating a strategic approach that, coupled with our deferred tax asset, has the potential to provide significant shareholder value on capital deployed.

[10] This study can be found at https://www.gsb.stanford.edu/sites/gsb/files/files-fpp/26891/ces-search-fund-study-2016.pdf.

1347 Property Insurance Holdings ("PIH")

Our investment in PIH (NASDAQ: PIH) continues to be a work in progress. During the past year, PIH has attracted a new large shareholder in Ballantyne Strong (NYSE MKT: BTN) and other related portfolios led by Kyle Cerminara. PIH welcomed Kyle to the board at the end of 2016. Kyle has been a friend of our firm on this and other Kingsway opportunities. He supports the existing PIH team and the direction set out when we first founded the company as a subsidiary of Kingsway. In 2017, I was named Chairman of PIH after our longtime investing partner, Gordon Pratt, retired from the PIH board to focus his efforts at LMB after LMB's successful SPAC merger (discussed in more detail below). We are thankful for Gordon's time at the helm in helping take PIH public and successfully obtaining a license to write business in Florida.

It will not surprise you that we often take a contrarian view on opportunities as one of the approaches to achieving asymmetric risk/reward. PIH represents one of those opportunities in our opinion. Florida has had significant challenges in the property market. It would be wise to consider moving slow, but the challenges facing the competitors already writing meaningful business provide PIH an advantage since it does not have a legacy exposure. We are excited about PIH's prospects with this additional opportunity to write in Florida.

1347 Investors LLC ("1347 Investors")

As discussed in last year's letter, our focus at 1347 Capital Corp. was to complete the merger with Limbach Holdings LLC. In July, the merger was consummated, resulting in LMB. After a grueling process led by our invaluable team member Hassan Baqar (along with Sajjad, Tera and numerous others), LMB started trading on July 21. 1347 Investors was the sponsor entity that held our promote shares. In order to ensure the success of the merger, 1347 Investors raised significant capital that resulted in our obtaining a meaningful stake in this business, which is led by the capable hands of Charlie Bacon and his team. Mike Powell again proved to be a friend of the firm when he brought Limbach to our attention. Thank him when you get a chance.

Our investment in Itasca Capital Ltd. (TSXV: ICL and formerly known as Kobex) was instrumental in achieving the success of the LMB merger. Led by Kyle Cerminara, the board of ICL invested $10 million in the Class A shares of 1347 Investors, providing ICL with a unique risk/reward exposure to LMB. We thank Kyle for his leadership and confidence in this project that has produced a substantial appreciation of value for ICL and Kingsway.

1347 Investors and the use of the SPAC structure is a good example of how we utilize the merchant banking approach to create opportunities for Kingsway alongside like-minded investors. We want to find other permanent capital vehicles to leverage our expertise to deploy capital beyond our own balance sheet.

Kingsway's "oil adventure"

During 2016, we formed a vehicle to capitalize on the dislocation created by the then-prevailing low oil price environment. Sir John Templeton said it best when he wrote, "To buy when others are despondently selling and to sell when others are euphorically buying takes the greatest courage, but provides the greatest profit." This vehicle acquired mineral leases and oilfield assets of a producing oilfield at what we deem to be a deep discount to intrinsic value.

We have long said that the best opportunities are usually found among things most others won't (or can't) do. This view is borne not from contrarianism for contrarianism's sake, but rather out of the conviction that the best investments arise at the extremes of market cycles. Many people and firms can't make investments in mineral rights of producing oil fields. In April of last year, at a time when oil prices were plumbing new depths daily, those who could buy not only weren't buying, many were "despondently selling."

We still have much work to do to turn this opportunity into a success. We purchased a good asset at a great price, but we still have to get the "bubblin' crude" out of the ground. We are quite obviously not oilfield operators; therefore, we have entered into a management agreement with Promise Energy Operations ("Promise") to manage the assets. Promise has significant experience operating oil and gas assets and will aid in identifying opportunities to grow the reserve base via acquisition if compelling opportunities present themselves. More to come.

Random Thoughts

We consider ourselves students of the discipline of value investing. Our bookshelves are lined with dog-eared stacks of books by Graham, Fisher, Greenblatt, Marks, Klarman, Munger and others. As students of the art, we readily acknowledge that avoiding investments in highly leveraged firms is axiomatic in the value investing community. Given that, we have some difficulty in reconciling the success we have experienced in search fund investing – private acquisitions of small companies using significant leverage to boost equity returns.

We suspect that the attractive returns generated by our search fund investments is largely attributable to (i) buying companies at attractive valuations; (ii) using borrowed money to do so and (iii) using the cash flow generated by the businesses to aggressively pay down debt. Naturally, the skeptical reader will say that a leveraged balance sheet eliminates the margin of safety required for value investing.

In thinking about this topic further, we recently met Dan Rasmussen, a bright, upstart hedge fund manager who founded Verdad Fund Advisers. Dan has an interesting strategy that fuses a low-fee, diversified investment approach with the classic value LBO model by investing in leveraged small cap value stocks. Dan's firm identifies cheap, small, levered firms that also have a strong history of prudent capital allocation (read: paying down debt). Given our experience, we think he may be on to something. We believe our construction of the leveraged public offering of LMB also fits this model. Although we are currently struggling with asset prices generally, we may look at this strategy for other opportunities in the future.

A quick thought on capital structure. Over the long run, we would hope to be able to buy stock back at a discount to our intrinsic value if the scenario presents itself, thereby giving each remaining shareholder a larger piece of the pie. On occasion, however, we may be presented with opportunities to issue equity that aligns us with like-minded, long-term shareholders. In these instances, even though we would suffer a bit of ownership dilution, we believe the enterprise would be stronger so long as we believed we had opportunities to deploy that new capital at attractive risk/rewards. In 2016, we found two shareholders who match the description of "Owners Wanted," and they supplied us with $10.5 million of additional capital that we anticipate using to create accretive returns on capital.

In last year's letter, we suggested we would plant some seeds in 2016 for future harvest. Our acquisition of CMC, successful deployment at ICL and subsequent investments in LMB through 1347 Investors LLC certainly qualify from our perspective. We look for 2017 to be a year when we compound those successes with additional opportunities. We could always use a few more credit tenant NNN assets (if you have any of interest, ping us at netlease@1347capital.com) and would also like to focus on deploying capital to cash flowing businesses demonstrating attractive risk/reward profiles (send us ideas at bizbuyer@1347capital.com). As always, feel free to reach out to Larry via text at 630-290-2432 (with the obligatory information of name and exact shareholdings) if you have other ideas or want to introduce yourself as a shareholder. Have a blessed 2017, and we look forward to meeting at our Annual General Meeting.

Sincerely,

Larry G. Swets, Jr.
Shareholder & CEO

John T. Fitzgerald
Shareholder & President

This Annual Letter to Shareholders of Kingsway Financial Services Inc. ("Kingsway") should be read in conjunction with Kingsway's Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

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 Kingsway's 2016 Annual Report on Form 10-K. Except as expressly required by applicable securities law, Kingsway disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events or otherwise.