FIRST ACCEPTANCE CORPORATION

3813 Green Hills Village Drive
Nashville, TN 37215

Telephone: (615) 844-2800

QUARTERLY REPORT

FOR THE QUARTER ENDED MARCH 31, 2018

ISSUER'S EQUITY SECURITIES

Common Stock
Par Value $.01 per share
75,000,000 Shares Authorized
41,309,080 Shares Outstanding at March 31, 2018

First Acceptance Corporation is responsible for the content of this Quarterly Report. The securities described in this document are not registered with, and the information contained in this report has not been filed with, or approved by, the U.S. Securities and Exchange Commission.

FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
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This is the first quarterly report by First Acceptance Corporation (the "Company") since it commenced trading on the OTC Market on April 9, 2018. The Company previously traded on the New York Stock Exchange. The information in this report updates the Annual Report on Form 10-K for the year ended December 31, 2017 previously filed by the Company with the Securities and Exchange Commission. Accordingly, this report should therefore be reviewed in conjunction with that year-end report and any other interim reports or updates since provided. The Company has deregistered and no longer files reports with the Securities and Exchange Commission.

Forward-Looking Statements

This report contains forward-looking statements. All statements made in this report, other than statements of historical fact, are forward-looking statements. You can identify these statements from our use of the words "may," "should," "could," "potential," "continue," "plan," "forecast," "estimate," "project," "believe," "intent," "anticipate," "expect," "target," "is likely," "will," or the negative of these terms and similar expressions. These forward-looking statements may include, among other things, statements and assumptions relating to:

- the accuracy and adequacy of our loss reserving methodologies;
- income, income per share and other financial performance measures;
- the anticipated effects on our results of operations or financial condition from recent and expected developments or events;
- the financial condition of, and other issues relating to the strength of and liquidity available to, issuers of securities held in our investment portfolio;
- and our business and growth strategies.

We believe that our expectations are based on reasonable assumptions. However, these forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance or achievements, or industry results to differ materially from our expectations of future results, performance or achievements expressed or implied by these forward-looking statements. In addition, our past results of operations do not necessarily indicate our future results. We discuss these and other uncertainties in "Item 1A. Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2017 filed by the Company with the Securities and Exchange Commission.

You should not place undue reliance on any forward-looking statements. These statements speak only as of the date of this report. Except as otherwise required by applicable laws, we undertake no obligation to publicly update or revise any forward-looking statements or the risk factors described in this report, whether as a result of new information, future events, changed circumstances or any other reason after the date of this report.

Item 1. Exact Name of the Issuer and Address and Telephone Number of Issuer's Principal Office

Name of the Company or Issuer:
First Acceptance Corporation

Address of Principal Office:
3813 Green Hills Village Drive
Nashville, TN 37215
Telephone: 615-844-2800
Web: www.acceptance.com

Item 2. Shares Outstanding

Common shares	3/31/2018	12/31/2017
Authorized:	75,000,000 shares	75,000,000 shares
Outstanding:	41,309,080 shares	41,234,730 shares
Freely Tradable (public float):	approx. 9,100,000 shares	approx. 9,250,000 shares
Number of beneficial holders owning at least 100 shares:	approx. 700 holders	approx. 700 holders
Number of registered holders:	269 holders	273 holders
Preferred shares		
Authorized:	10,000,000 shares	10,000,000 shares
Outstanding:	0 shares	0 shares
Freely Tradable (public float):	0 shares	0 shares
Number of record holders:	0 holders	0 holders

Item 3. Interim Consolidated Financial Statements

The interim consolidated financial statements of First Acceptance Corporation as of March 31, 2018 are attached hereto as Exhibit 3.1 and are hereby incorporated by reference into this Quarterly Report, including:

(1) Consolidated Balance Sheets;
(2) Consolidated Statement of Comprehensive Income;
(3) Consolidated Statement of Cash Flows; and
(4) Notes to Consolidated Financial Statements

Item 4. Management's Discussion and Analysis of Financial Condition and Consolidated Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements which involve risks and uncertainties. Our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a difference include those discussed in Item 1A. "Risk Factors" in our Annual Report on Form 10-K for year ended December 31, 2017 filed by the Company with the Securities and Exchange Commission. The following discussion should be read in conjunction with our consolidated financial statements included with this report and our consolidated financial statements and related Management's Discussion and Analysis of Financial Condition and Results of Operations for year ended December 31, 2017 included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed by the Company with the Securities and Exchange Commission.

General

We are principally a retailer, servicer and underwriter of non-standard personal automobile insurance. Non-standard personal automobile insurance is made available to individuals because of their inability or unwillingness to obtain standard insurance coverage due to various factors, including payment history, payment preference, and failure in the past to maintain continuous insurance coverage, driving record and/or vehicle type. At March 31, 2018, we also owned a tract of land in San Antonio, Texas that is held for sale.

At March 31, 2018, we leased and operated 349 retail locations (or “stores”) and a call center staffed by employee-agents who primarily sell non-standard personal automobile insurance products underwritten by us as well as certain commissionable ancillary products. In most states, our employee-agents also sell a complementary insurance product providing personal property and liability coverage for renters underwritten by us. In addition, retail locations in some markets offer non-standard personal automobile insurance serviced and underwritten by other third-party insurance carriers for which we receive a commission.

Our insurance operations actively generate revenue from selling non-standard personal automobile insurance products and related products in 16 states. We currently conduct our servicing and underwriting operations in 13 states and are licensed as an insurer in 13 additional states.

The majority of our 349 stores primarily sell non-standard personal automobile insurance products underwritten by us. The other retail locations primarily offer non-standard personal automobile insurance serviced and underwritten by other third-party insurance carriers for which we receive a commission.

See the discussion in Item 1. “Business—General” in our Annual Report on Form 10-K for the year ended December 31, 2017 filed by the Company with the Securities and Exchange Commission for additional information with respect to our business.

In response to consumer demand to purchase personal automobile insurance through a non-retail sales channel, we offer customers the choice to purchase a policy through an employee-agent in our call center or via our www.acceptance.com website and mobile platform. As of March 31, 2018, approximately 10% and 7% of our policies in force were sold through our website and call center, respectively.

We have commenced carefully deploying a long-term strategic plan with the goal of fully capitalizing on the strengths of our agency model going forward. While the objectives of the past year entailed returning to profitability and building team member morale, in the near and longer term we are looking to capitalize on our key internal capabilities and manage external risks. In this regard, we are gradually implementing a program to leverage the strengths of our agency model (i.e. retail locations, employee-agents, carrier relationships, technology and support staff) across our footprint so that we can deploy our insurance company capital and surplus in the markets where it will generate the highest return. This plan involves the likely use of third-party insurers for non-standard automobile insurance in most of our legacy markets as well as an increased emphasis on “other-than-auto” insurance products (commercial, term life, renters, motorcycle and homeowners) in all markets.

In late 2017, this agency model of using additional third-party insurers for non-standard automobile insurance in our legacy markets was deployed across Illinois and in selected retail stores in Texas and Georgia. During the first quarter of 2018, we converted six stores in Ohio. We will execute a plan to convert remaining markets throughout the remainder of this year. This practice enables us to earn commission income from non-standard automobile insurance customers whose underwriting profile finds them better suited for an insurer carrier other than one of our own. “Other-than-auto” efforts are underway in all markets.

Consolidated Results of Operations

Overview

Our insurance operations actively generate revenues from selling non-standard personal automobile insurance products and related products in 16 states. We currently conduct our servicing and underwriting operations in 13 states through three insurance company subsidiaries: First Acceptance Insurance Company, Inc., First Acceptance Insurance Company of Georgia, Inc. and First Acceptance Insurance Company of Tennessee, Inc. Our insurance revenues were primarily generated from:

- premiums earned, including policy and renewal fees, from sales of policies written and assumed by our insurance company subsidiaries;
- commission and fee income, including installment fees on policies written, agency fees and commissions and fees for other ancillary products and policies sold on behalf of third-party insurance carriers; and
- investment income earned on the invested assets of the insurance company subsidiaries.

Our insurance operations present a combined ratio as a measure of its overall underwriting profitability. The components of the combined ratio are as follows:

Loss Ratio - Loss ratio is the ratio (expressed as a percentage) of losses and loss adjustment expenses incurred to premiums earned and is a basic element of underwriting profitability. We calculate this ratio based on all direct and assumed premiums earned, net of ceded reinsurance.

Expense Ratio - Expense ratio is the ratio (expressed as a percentage) of insurance operating expenses (including depreciation and amortization) to net premiums earned. Insurance operating expenses are reduced by commission and fee income. This is a measurement that illustrates relative management efficiency in administering our operations.

Combined Ratio - Combined ratio is the sum of the loss ratio and the expense ratio. If the combined ratio is at or above 100%, an insurance company cannot be profitable without sufficient investment income.

The following table presents the loss, expense, and combined ratios for our insurance operations:

	Three Months Ended March 31,	
	2018	**2017**
Loss	68.7%	80.6%
Expense	19.1%	16.6%
Combined	87.8%	97.2%

The above loss ratios include the calendar year results of the current and prior accident periods. Excluding the development related to prior periods, the loss ratio for the three months ended March 31, 2018 was 74.8% as compared with 81.4% for the three months ended March 31, 2017.

Three Months Ended March 31, 2018 Compared with the Three Months Ended March 31, 2017

Consolidated Results

Revenues for the three months ended March 31, 2018 decreased 6% to $82.7 million from $88.1 million in the same period in the prior year. Income before income taxes, for the three months ended March 31, 2018 was $7.2 million, compared with income before income taxes of $1.6 million for the three months ended March 31, 2017. Net income for the three months ended March 31, 2018 was $5.4 million, compared with net income of $0.7 million for the three months ended March 31, 2017. Basic and diluted net income per share were $0.13 for the three months ended March 31, 2018, compared with a basic and diluted net income per share of $0.02 for the same period in the prior year. Net income for the three months ended March 18, 2018 reflects the lowering of the federal corporate tax rate to 21% from 35% in the prior year as a result of the recent tax legislation.

For the three months ended March 31, 2018 and 2017, we recognized favorable prior period loss and loss adjustment expenses (“LAE”) development of $4.1 million and $0.5 million, respectively. Net income for the three months ended March 31, 2018 included $386 thousand in unrealized losses on equity securities (See Note 5 to our Consolidated Financial Statements for additional information regarding recently adopted accounting pronouncements).

Premiums Earned

Premiums earned decreased by $3.6 million, or 5%, to $66.2 million for the three months ended March 31, 2018, from $69.8 million for the three months ended March 31, 2017. This decrease was the result of a targeted decline in new policies written to eliminate unprofitable business through store closures, rate increases and the tightening of underwriting standards. These actions resulted in a 11% decrease in our year-over-year policies in force which was partially offset by a 5% year-over-year increase in our average in-force premium that was driven by rate actions.

Commission and Fee Income

Commission and fee income decreased by $1.4 million, or 8%, to $15.8 million for the three months ended March 31, 2018, from $17.2 million for the three months ended March 31, 2017. This decrease was primarily the result of a decrease in third-party non-standard automobile commissions and in monthly billing fees as a result of the previously-mentioned decline in the number of policies in force.

Investment Income

Investment income increased by $0.1 million to $1.1 million for the three months ended March 31, 2018, from $1.0 million for the three months ended March 31, 2017. At March 31, 2018 and 2017, the tax-equivalent book yields for our managed fixed maturities and cash equivalents portfolio were 2.2% and 1.9%, respectively, with effective durations of 2.96 and 2.46 years, respectively.

Net Losses on Investments, Available-for-sale

Net losses on investments, available-for-sale, during the three months ended March 31, 2018 and 2017 included $386 thousand of net unrealized losses on equity securities and $5 thousand of net realized losses from redemptions, respectively. Prior to the January 1, 2018 adoption of a new accounting pronouncement, net unrealized gain (loss) on equity securities was included in other comprehensive income (loss).

Loss and Loss Adjustment Expenses

The loss ratio was 68.7% for the three months ended March 31, 2018, compared with 80.6% for the three months ended March 31, 2017. We experienced favorable development related to prior periods of $4.1 million for the three months ended March 31, 2018, compared with favorable development of $0.5 million for the three months ended March 31, 2017. The favorable development for the three months ended March 31, 2018 was attributable to improved severity across all coverages for the 2017 accident year. The favorable development for the three months ended March 31, 2017 was primarily the result of favorable LAE development related to bodily injury claims over multiple prior accident periods, partially offset by some unfavorable development related to bodily injury severity.

Excluding the development related to prior periods, the loss ratio for the three months ended March 31, 2018 was 74.8% as compared with 80.5% for the preceding three months ended December 31, 2017. We believe that this improvement in the loss ratio was the result of our aggressive rate and underwriting actions in addition to a moderate reduction in claims frequency.

Insurance Operating Expenses

Insurance operating expenses decreased 1% to $27.9 million for the three months ended March 31, 2018, from $28.1 million for the three months ended March 31, 2017. The expense ratio was 19.1% for the three months ended March 31, 2018, compared with 16.6% for the three months ended March 31, 2017. The year-over-year increase in the expense ratio was primarily due to the decrease in premiums earned and the previously-mentioned decline in commission and fee income. Overall, the combined ratio decreased to 87.8% for the three months ended March 31, 2018 from 97.2% for the three months ended March 31, 2017.

Provision for Income Taxes

The provision for income taxes was $1.8 million for the three months ended March 31, 2018, compared with $0.8 million for the three months ended March 31, 2017. The provision for the three months ended March 18, 2018 reflects the lowering of the federal corporate tax rate to 21% from 35% in the prior year as a result of the recent tax legislation.

In assessing our ability to realize our deferred tax assets ("DTA"), both positive and negative evidence are used to evaluate the allowance. Our evaluation placed greater weight on our outlook for future taxable income over the allowable time period for realization of the DTA and concluded that it is more likely than not that the remaining DTA will be realized. Regarding the length of time available to realize the DTA, at March 31, 2018, $11.5 million of the DTA related to net operating loss carryforwards do not expire until 2032 through 2036 and $2.0 million in AMT ("Alternative Minimum Tax") carryforwards are fully refundable by 2021 under the recent tax law legislation if not utilized. The DTA valuation allowance may be adjusted in future periods if management determines that it is more likely than not that some portion or all of the DTA will not be realized. In the event the DTA valuation allowance is adjusted, we would record an income tax expense for the adjustment.

Interest Expense

We incurred $1.2 million and $1.1 million of interest expense for the three months ended March 31, 2018 and 2017, respectively. Interest expense is from our debentures payable and the term loan from our principal stockholder to finance the July 1, 2015 Titan Agencies acquisition. For additional information, see "Liquidity and Capital Resources" in this report.

Liquidity and Capital Resources

Our primary sources of funds are premiums, fees and investment income from our insurance company subsidiaries and commissions and fee income from our non-insurance company subsidiaries. Our primary uses of funds are the payment of claims and operating expenses. Net cash provided by operating activities for the three months ended March 31, 2018 was $5.2 million, compared with $1.6 million for the same period in the prior year. This increase was primarily the result of the Company's improved loss and LAE ratio. Net cash used in investing activities for the three months ended March 31, 2018 was $4.3 million, compared to net cash provided by investing activities of $0.2 million for the same period in the prior year. This change was primarily the result of an increase in purchases of investments in the current period.

Our holding company requires cash for general corporate overhead expenses and for debt service related to our debentures and term loan payable. The holding company's primary source of unrestricted cash to meet its obligations is the sale of ancillary products and insurance policies on behalf of third-party carriers by our agency operations. At March 31, 2018, our holding company had $3.5 million available remaining in unrestricted cash and investments. These funds and the additional unrestricted cash from our agency operations will be used to pay our future cash requirements outside of the insurance company subsidiaries in the short-term and foreseeable future.

The holding company has debt service requirements related to the debentures payable and the term loan to a principal stockholder. The debentures are interest-only and mature in full in July 2037. The debentures accrue interest at a variable rate equal to Three-Month LIBOR plus 375 basis points, which resets quarterly. The interest rate related to the debentures for the three months ended March 31, 2018 ranged from 5.128% to 5.517%. In April 2018, the interest rate reset to 6.109% through July 2018. The term loan is interest-only and matures in full in June 2025. The interest rate on the term loan is 8%.

State insurance laws limit the amount of dividends that may be paid from our insurance company subsidiaries. At March 31, 2018, our insurance company subsidiaries could not pay any dividends due to a negative unassigned surplus position.

We have three insurance company subsidiaries that are organized and domiciled under the insurance statutes of Texas, Georgia, and Tennessee. Our insurance company subsidiaries also operate under licenses issued by various state insurance authorities. Such licenses may be of perpetual duration or periodically renewable, provided we continue to meet applicable regulatory requirements.

The National Association of Insurance Commissioners ("NAIC") Model Act for risk-based capital provides formulas to determine each December 31 on an annual basis the amount of statutory capital and surplus that an insurance company needs to ensure that it has an acceptable expectation of not becoming financially impaired. Failure to meet applicable risk-based capital requirements could subject our insurance company subsidiaries to further examination or corrective action imposed by state regulators, including limitations on their writing of additional business, state supervision or even liquidation. Although statutory risk-based capital calculations are only made as of each December 31, we have estimated that the insurance company subsidiaries remain above the company action levels as of March 31, 2018. There are also statutory guidelines that suggest that on an annual calendar year basis an insurance company should not exceed a ratio of net premiums written to statutory capital and surplus of 3-to-1. On a combined basis, the ratio for our insurance company subsidiaries of net premiums written for the last twelve months to statutory capital and surplus was 3.8-to-1 at March 31, 2018, which is in excess of the suggested guidelines.

Since August 2016, management has operated under a business plan to reduce premium writings and increase statutory capital and surplus to address the net premiums written to statutory capital and surplus guidelines. For the three months ended March 31, 2018, the insurance company subsidiaries experienced an increase in capital and surplus of $5.8 million or 9%, and a reduction in net premiums written of $8.8 million or 3% for the trailing twelve-month period.

We believe that existing cash and investment balances, when combined with anticipated cash flows as noted above, will be adequate to meet our expected liquidity needs, for both the holding company and our insurance company subsidiaries, in both the short-term and the foreseeable future.

Item 5. Legal Proceedings

The Company is named as a defendant in various lawsuits, arising in the ordinary course of business, generally relating to its insurance operations. All legal actions relating to claims made under insurance policies are considered by the Company in establishing its loss and loss adjustment expense reserves. The Company also faces lawsuits from time to time that seek damages beyond policy limits, commonly known as bad faith claims, as well as class action and individual lawsuits that involve issues arising in the course of the Company's business. The Company continually evaluates potential liabilities and reserves for litigation of these types using the criteria established by FASB ASC 450, *Contingencies* ("FASB ASC 450"). Pursuant to FASB ASC 450, reserves for a loss may only be recognized if the likelihood of occurrence is probable and the amount can be reasonably estimated. If a loss, while not probable, is judged to be reasonably possible, management will disclose, if it can be estimated, a possible range of loss or state that an estimate cannot be made. Management evaluates each legal action and records reserves for losses, as warranted, by establishing a reserve in its consolidated balance sheets in loss and loss adjustment expense reserves for bad faith claims and in other liabilities for other lawsuits. Amounts incurred are recorded in the Company's consolidated statements of comprehensive income (loss) in losses and loss adjustment expenses for bad faith claims and in insurance operating expenses for other lawsuits unless otherwise disclosed.

Item 6. Defaults Upon Senior Securities

None.

Item 7. Other Information

None.

Item 8. Exhibits

3.1 Interim Consolidated Financial Statements

Item 9. Certifications

I, Kenneth D. Russell, Chief Executive Officer, certify that:

1. I have reviewed this quarterly disclosure statement of First Acceptance Corporation;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information includes or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

May 8, 2018

/s/ Kenneth D. Russell
Kenneth D. Russell
Chief Executive Officer

I, Brent J. Gay, Chief Financial Officer, certify that:

1. I have reviewed this quarterly disclosure statement of First Acceptance Corporation;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information includes or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

May 8, 2018

/s/ Brent J. Gay
Brent J. Gay
Chief Financial Officer

Exhibit 3.1 Interim Consolidated Financial Statements

FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

	March 31, 2018 (Unaudited)	December 31, 2017
ASSETS		
Investments, available-for-sale at fair value (amortized cost of $158,248 and $129,742, respectively)	$ 155,886	$ 129,945
Cash, cash equivalents, and restricted cash	116,387	115,477
Premiums, fees, and commissions receivable, net of allowance of $207 and $275, respectively	89,731	69,624
Deferred tax assets, net	19,119	20,549
Other investments	9,673	9,750
Other assets	6,475	6,438
Property and equipment, net	3,129	2,888
Deferred acquisition costs	5,793	4,947
Goodwill	29,384	29,384
Identifiable intangible assets, net	6,701	6,857
TOTAL ASSETS	$ 442,278	$ 395,859
LIABILITIES AND STOCKHOLDERS' EQUITY		
Loss and loss adjustment expense reserves	$ 153,482	$ 159,130
Unearned premiums and fees	105,475	82,620
Debentures payable	40,359	40,348
Term loan from principal stockholder	29,812	29,805
Payable for securities	24,994	—
Accrued expenses	5,082	5,975
Other liabilities	14,851	13,224
Total liabilities	374,055	331,102
Stockholders' equity:		
Preferred stock, $.01 par value, 10,000 shares authorized	—	—
Common stock, $.01 par value, 75,000 shares authorized; 41,309 and 41,235 issued and outstanding, respectively	413	413
Additional paid-in capital	458,225	458,124
Accumulated other comprehensive (loss) income, net of tax of $(1,503) and $(990), respectively	(1,691)	1,900
Accumulated deficit	(388,724)	(395,680)
Total stockholders' equity	68,223	64,757
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 442,278	$ 395,859

See notes to consolidated financial statements.

FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(in thousands, except per share data)

	Three Months Ended March 31, 2018	Three Months Ended March 31, 2017
Revenues:		
Premiums earned	$ 66,196	$ 69,813
Commission and fee income	15,819	17,228
Investment income	1,078	1,033
Net losses on investments, available-for-sale	(386)	(5)
	82,707	88,069
Costs and expenses:		
Losses and loss adjustment expenses	45,479	56,280
Insurance operating expenses	27,883	28,056
Other operating expenses	222	271
Stock-based compensation	124	39
Depreciation	433	546
Amortization of identifiable intangibles assets	156	203
Interest expense	1,165	1,098
	75,462	86,493
Income before income taxes	7,245	1,576
Provision for income taxes	1,805	846
Net income	$ 5,440	$ 730
Net income per share:		
Basic	$ 0.13	$ 0.02
Diluted	$ 0.13	$ 0.02
Number of shares used to calculate net income per share:		
Basic	41,249	41,160
Diluted	41,363	41,181
Reconciliation of net income to other comprehensive income:		
Net income	$ 5,440	$ 730
Net unrealized change in investments, net of tax of $(110) and $236, respectively	(2,074)	438
Comprehensive income	$ 3,366	$ 1,168
Detail of net losses on investments, available-for-sale:		
Net realized losses on sales and redemptions	$ —	$ (5)
Net unrealized losses on equity securities, available-for-sale	(386)	—
Net realized gains (losses) on investments, available-for-sale	$ (386)	$ (5)

See notes to consolidated financial statements.

FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(in thousands)

	Three Months Ended March 31,	
	2018	2017
Cash flows from operating activities:		
Net income	$ 5,440	$ 730
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	433	546
Amortization of identifiable intangibles assets	156	203
Stock-based compensation	124	39
Deferred income taxes	1,538	644
Net realized losses on redemptions of investments	—	5
Investment (income) loss from other investments	41	(149)
Other	44	139
Change in:		
Premiums, fees, and commission receivable	(20,039)	(23,888)
Deferred acquisition costs	(846)	(1,017)
Loss and loss adjustment expense reserves	(5,648)	(4,669)
Unearned premiums and fees	22,855	28,016
Other liabilities	1,627	2,375
Other	(503)	(1,370)
Net cash provided by operating activities	5,222	1,604
Cash flows from investing activities:		
Purchases of investments, available-for-sale	(29,988)	(505)
Maturities and redemptions of investments, available-for-sale	1,370	670
Net increase in payable for securities	24,994	—
Purchases of other investments	—	(78)
Distributions from other investments	36	256
Capital expenditures	(703)	(122)
Proceeds from sale of fixed assets	2	—
Acquisition of identifiable intangible assets	—	(10)
Net cash (used in) provided by investing activities	(4,289)	211
Cash flows from financing activities:		
Taxes remitted in relation to employee restricted stock units exercised	(23)	—
Net cash used in financing activities	(23)	—
Net change in cash, cash equivalents, and restricted cash	910	1,815
Cash, cash equivalents, and restricted cash, beginning of period	115,477	118,681
Cash, cash equivalents, and restricted cash, end of period	$ 116,387	$ 120,496

See notes to consolidated financial statements.

1. General

The consolidated financial statements of First Acceptance Corporation (the “Company”) included herein have been prepared without audit. Accordingly, certain information and disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been omitted. In the opinion of management, the consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair statement of the interim periods.

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year. These consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2017 filed by the Company with the Securities and Exchange Commission.

2. Investments

Investments, Available-for-Sale

The following tables summarize the Company’s investment securities (in thousands).

March 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agencies	$44,634	$56	$(482)	$44,208
Political subdivisions	4,080	—	(44)	4,036
Revenue and assessment	5,142	161	(46)	5,257
Corporate bonds	44,028	2	(2,337)	41,693
Collateralized mortgage obligations:				
Agency backed	43,460	44	(1,492)	42,012
Non-agency backed – residential	2,012	609	(4)	2,617
Non-agency backed – commercial	54	351	—	405
Total fixed maturities, available-for-sale	143,410	1,223	(4,405)	140,228
Preferred stocks, available-for-sale	3,025	176	(128)	3,073
Mutual funds, available-for-sale	11,813	772	—	12,585
	$158,248	$2,171	$(4,533)	$155,886

The following tables set forth the amount of gross unrealized losses by current severity (as compared to amortized cost) and length of time that individual securities have been in a continuous unrealized loss position (in thousands).

Length of Gross Unrealized Losses at March 31, 2018:	Fair Value of Securities with Gross Unrealized Losses	Gross Unrealized Losses	Severity of Gross Unrealized Losses		
			Less than 5%	5% to 10%	Greater than 10%
Less than or equal to:					
Three months	$ —	$ (388)	$ (388)	$ —	$ —
Six months	7,560	(89)	(89)	—	—
Nine months	21,596	(581)	(450)	(131)	—
Twelve months	—	—	—	—	—
Greater than twelve months	54,606	(3,475)	(586)	(2,552)	(337)
Total	$ 83,762	$ (4,533)	$ (1,513)	$ (2,683)	$ (337)

For the three months ended March 31, 2018, the Company did not recognize any OTTI charges on its fixed maturities, available for sale in net income. Unrealized gains and losses on equity securities (preferred stocks and mutual funds) are recognized as a component of net income. The Company believes that the securities having unrealized losses at March 31, 2018 were not other-than-temporarily impaired. The Company also does not intend to sell any of these securities and it is more likely than not that the Company will not be required to sell any of these securities before the recovery of their amortized cost basis.

3. Losses and Loss Adjustment Expenses Incurred and Paid

Information regarding the reserve for unpaid losses and loss adjustment expenses ("LAE") is as follows (in thousands).

	March 31, 2018	March 31, 2017
Liability for unpaid losses and LAE at beginning of period, gross	$ 159,130	$ 161,079
Reinsurance balances receivable	(840)	(769)
Liability for unpaid losses and LAE at beginning of period, net	158,290	160,310
Add: Provision for losses and LAE:		
Current period	49,530	56,812
Prior periods	(4,051)	(532)
Net losses and LAE incurred	45,479	56,280
Less: Losses and LAE paid:		
Current period	12,073	16,137
Prior periods	39,089	44,806
Net losses and LAE paid	51,162	60,943
Liability for unpaid losses and LAE at end of period, net	152,607	155,647
Reinsurance balances receivable	875	763
Liability for unpaid losses and LAE at end of period, gross	$ 153,482	$ 156,410

The favorable development for the three months ended March 31, 2018 was attributable to improved severity across all coverages for the 2017 accident year.

The favorable development for the three months ended March 31, 2017 was primarily the result of favorable LAE development related to bodily injury claims over multiple prior accident periods, partially offset by some unfavorable development on losses related to bodily injury severity.

4. Income Taxes

The provision for income taxes consisted of the following (in thousands).

	Three Months Ended March 31, 2018	Three Months Ended March 31, 2017
Federal:		
Current	$ —	$ 122
Deferred	1,565	627
	1,565	749
State:		
Current	267	80
Deferred	(27)	17
	240	97
	$ 1,805	$ 846

The provision for income taxes differs from the amounts computed by applying the statutory federal corporate tax rates of 21% and 35% for the three months ended March 31, 2018 and 2017, respectively, to income before income taxes as a result of the following (in thousands).

	Three Months Ended March 31, 2018	Three Months Ended March 31, 2017
Provision for income taxes at statutory rate	$ 1,521	$ 552
Tax effect of:		
Tax-exempt investment income	(11)	(14)
Stock-based compensation benefits not realized	69	229
State income taxes, net of federal income tax benefit and state valuation allowance	184	69
Other	42	10
	$ 1,805	$ 846

The Company had a deferred tax asset ("DTA") valuation allowance of $1.6 million at March 31, 2018 and $1.3 million at December 31, 2017, attributable to certain amounts related to state taxes, unrealized losses on investments, available for sale and OTTI that are not more likely than not to be realized. In assessing the Company's ability to realize the DTA, both positive and negative evidence are used to evaluate the allowance. The Company placed greater weight on its outlook for future taxable income over the allowable time period for realization of the DTA and concluded that it is more likely than not that the remaining DTA will be realized. Regarding the length of time available to realize the DTA, at March 31, 2018, $11.5 million of the DTA related to net operating loss carryforwards do not expire until 2032 through 2036 and $2.0 million in AMT ("Alternative Minimum Tax") carryforwards are fully refundable by 2021 under the new tax legislation if not utilized. The DTA valuation allowance may be adjusted in future periods if management determines that it is more likely than not that some portion or all of the DTA will not be realized. In the event the DTA valuation allowance is adjusted, the Company would record an income tax expense for the adjustment.

5. Recent Accounting Pronouncements Adopted

As of January 1, 2018, the Company adopted the following new accounting pronouncements:

Accounting Standard Update ("ASU") No. 2014-09, "*Revenue from Contracts with Customers,*" superseded virtually all revenue recognition guidance under GAAP. However, the new standard did not change accounting guidance for insurance contracts. The Company does have revenue from non-insurance arrangements and various types of fee income related to its insurance contracts which did fall under this guidance. Based on our evaluation, including contract reviews, the Company did not determine any impact to our consolidated financial statements upon adopting this new guidance as of January 1, 2018.

ASU No. 2016-01, "Financial Instruments – Overall (Subtopic 825-20): Recognition and *Measure of Financial Assets and Financial Liabilities*" required entities to measure many equity investments at fair value and recognize changes in fair value in net income (loss), as opposed to the previous practice of other comprehensive income (loss). This change has been applied to the Company's investments in mutual funds and preferred stock in the accompanying consolidated financial statements. As a result of this change, the net unrealized gain in equity securities of $1.5 million as of January 1, 2018 was reclassified from other accumulated comprehensive loss to accumulated deficit within stockholders' equity and the net unrealized loss on equity securities for the three months ended March 31, 2018 was recorded as a component of net income. The guidance also provided a new measurement alternative for equity investments that do not have readily determinable fair values and do not qualify for the net asset value practical expedient. Under this alternative, these investments can be measured at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. This guidance is now applied to the Company's other investment in the common stock of a real estate investment trust.