

FIRST ACCEPTANCE CORPORATION



3813 Green Hills Village Drive
Nashville, TN 37215

Telephone: (615) 844-2800

QUARTERLY REPORT

FOR THE QUARTER ENDED MARCH 31, 2024

ISSUER'S EQUITY SECURITIES

Common Stock
Par Value \$.01 per share
75,000,000 Shares Authorized
38,086,238 Shares Outstanding at March 31, 2024

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 report reviews the financial condition and results of operations of First Acceptance Corporation. The information in this report updates the Annual Information and Disclosure Statement and Annual Report for the year ended December 31, 2023, previously filed by the Company with the OTCQX. Accordingly, this report should therefore be reviewed in conjunction with these year-end reports and any other interim reports or updates since provided.

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 “Risk Factors” of our Annual Report for the year ended December 31, 2023, filed by the Company with the OTCQX.

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.firstacceptance.com

Item 2. Shares Outstanding

	<u>Common shares</u>	<u>3/31/2024</u>	<u>12/31/2023</u>
Authorized:		75,000,000 shares	75,000,000 shares
Outstanding:		38,086,238 shares	38,264,718 shares
Freely Tradable (public float):		10,469,526 shares	10,711,656 shares
Number of beneficial holders owning at least 100 shares:		approx. 1,100 holders	approx. 1,100 holders
Number of registered holders:		236 holders	237 holders
	<u>Preferred shares</u>		
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, 2024, are attached hereto as Exhibit 3.1 and are hereby incorporated by reference into this Quarterly Report, including:

- (1) Consolidated Balance Sheets;
- (2) Consolidated Statements of Income;
- (3) Consolidated Statements of Stockholders’ Equity;
- (4) Consolidated Statements of Cash Flows; and
- (5) 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 that 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 “Risk Factors” in our Annual Report for the year ended December 31, 2023, filed by the Company with OTCQX. 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 the year ended December 31, 2023 included in our Annual Report for the year ended December 31, 2023 filed by the Company with the OTCQX.

General

Through December 1, 2023, we owned and operated “Acceptance Insurance,” an insurance agency headquartered in Nashville, Tennessee. We operated under an “Agency Model” and sold insurance and related products underwritten and serviced by our own insurance companies, known as the First Acceptance Insurance Group, (“Acceptance business”) and through third-party carriers for which we received a commission (“3PC business”).

Acceptance Insurance primarily sold non-standard personal automobile insurance through our own insurance companies and third-party carriers. Non-standard personal automobile insurance is sought after by individuals because of their inability or unwillingness to obtain standard insurance coverage due to various factors including their payment preference, failure to have maintained continuous insurance coverage, or their driving record. We also offered a variety of other commissionable third-party products such as roadside assistance and in most states, we also sold (and continue to sell) an insurance product for renters that we underwrite.

Through December 1, 2023, Acceptance Insurance leased and operated 288 retail locations staffed with employee agents. In addition to these retail locations, we previously completed sales over the phone through employee agents in our call center or over the internet through our consumer-based website and mobile platform.

Effective with the sale of Acceptance Insurance, the Company has changed the primary distribution of its premiums written from the fixed cost of Company-operated retail locations staffed by employee agents to the variable cost of a new independent agency relationship with the buyer. Through a production agreement with the buyer, the source of the premiums written through the former retail channel continues through this new independent agent relationship, in addition to production through other existing retail locations of the buyer. The buyer is eligible to receive contingent bonus commission payments of \$3.3 million on each of February 1, 2025, 2026, and 2027, based on annual production targets. The Company, however, will no longer receive commission and fee income from the sale of insurance policies from third-party carriers through its former retail locations.

Subsequent to December 1, 2023, we now solely offer our own underwritten insurance policies through independent agents in 15 states, and we are also licensed to write insurance in 11 other states that are not currently utilized.

For the three months ended March 31, 2024, two single independent agents produced 47% and 33% of premiums earned, respectively, and as of March 31, 2024, comprised 53% and 23% of policies in-force, respectively. At March 31, 2024, we also had approximately 200 other active independent agents who represent the balance of the Company’s business.

Sale of Insurance Agency Subsidiary

On December 1, 2023, the Company entered into a securities purchase agreement with the buyer to sell 100% of its issued and outstanding shares of capital stock of its wholly owned subsidiary, Acceptance Insurance Agency of Tennessee, Inc. (“the Insurance Agency”), for net cash consideration of up to \$120 million which included \$55 million paid at closing and \$20 million held in escrow which is being released monthly from March 2024 through December 2024. The Company is eligible to receive additional contingent consideration of \$15 million (held in escrow), \$10 million, and \$20 million on December 1, 2024, 2025, and 2026, respectively, based upon achievement of certain annual premium production targets.

On March 31, 2024, future consideration receivable from this sale of \$57.5 million is recorded at fair value, utilizing a discounted cash flow approach.

The purchase agreement provides that the Company would receive its additional contingent consideration in its entirety should the buyer fail to submit applications within the applicable underwriting guidelines of the First Acceptance Insurance Group provided that the Company has not breached any of its agreements with the buyer. The agreement also provides that the Company maintain \$100 million of capital and surplus in the Insurance Companies through December 31, 2026. As of March 31, 2024 and May 7, 2024, the Company is not in breach of contract.

Consolidated Results of Operations

Overview

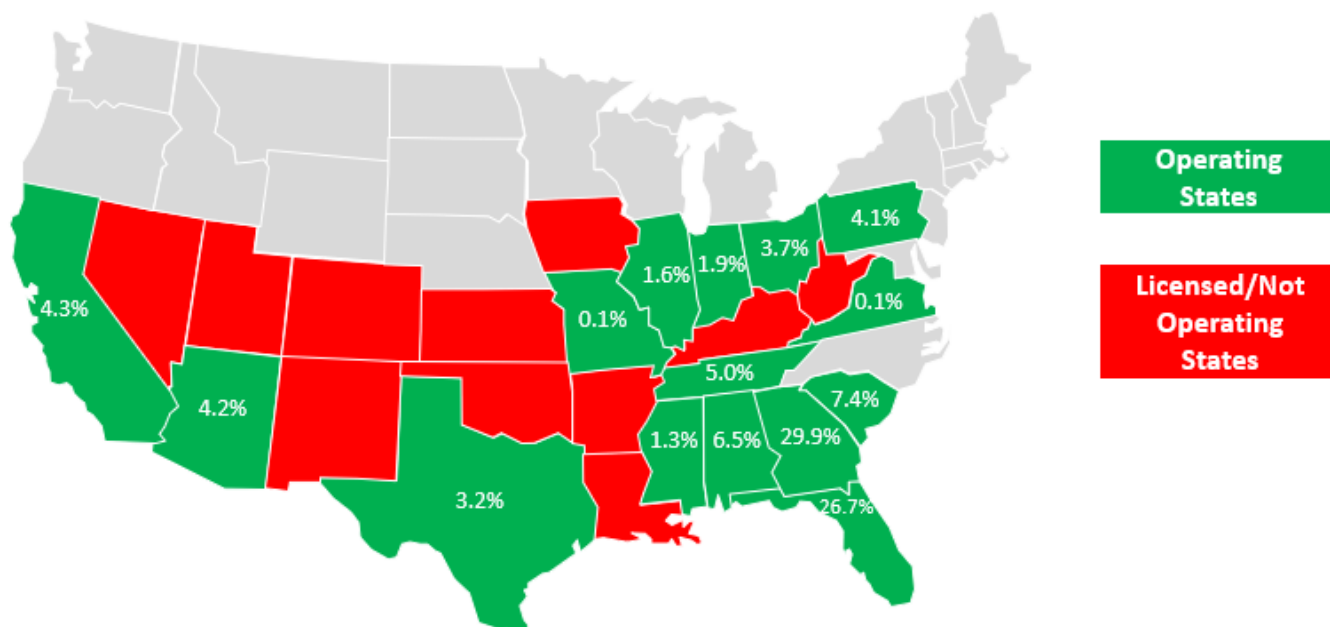
Our insurance operations generated revenues from selling non-standard personal automobile insurance products and related products. We currently conduct our servicing and underwriting operations in 15 states through three insurance company subsidiaries: First Acceptance Insurance Company, Inc., First Acceptance Insurance Company of Georgia, Inc., and First Acceptance Insurance Company of Tennessee, Inc., and through December 1, 2023 as an insurance agency through Acceptance Insurance Agency of Tennessee, Inc. Our 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 agency fees and commissions and fees for other ancillary products and policies sold on behalf of third-party insurance carriers (through December 1, 2023);
- billing fees and service charges on policies written and assumed by our insurance company subsidiaries; and
- investment income earned on the invested assets of the insurance company subsidiaries.

The following tables present premiums earned by state (in thousands). Premiums earned are presented in the state in which the underlying insured risk of the related Acceptance business is located.

	Three Months Ended March 31,	
	2024	2023
Georgia	\$ 39,040	\$ 20,185
Florida	34,915	16,130
South Carolina	9,617	3,598
Alabama	8,544	8,596
Tennessee	6,582	5,525
California	5,602	5,664
Arizona	5,449	3,027
Pennsylvania	5,364	2,645
Ohio	4,862	2,979
Texas	4,187	2,167
Indiana	2,505	1,724
Illinois	2,030	1,465
Mississippi	1,699	1,322
Virginia	128	82
Missouri	26	25
	<u>\$ 130,550</u>	<u>\$ 75,134</u>

The following map presents the percentage of premiums earned by state for the three months ended March 31, 2024:



Our insurance companies present a combined ratio as a measure of their 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 (“LAE”) 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 billing fees and service charges from insureds. This is a measurement that illustrates relative management efficiency in administering our insurance companies.

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 companies:

	Three Months Ended March 31,	
	2024	2023
Loss	70.0%	75.2%
Expense	26.2%	27.2%
Combined	96.2%	102.4%

Three Months Ended March 31, 2024 Compared with the Three Months Ended March 31, 2023

Consolidated Results

Revenues for the three months ended March 31, 2024, increased 48% to \$145.3 million from \$97.9 million in the same period in the prior year. Income before taxes for the three months ended March 31, 2024 was \$8.9 million compared with \$1.4 million for the three months ended March 31, 2023. Net income for the three months ended March 31, 2024 was \$6.9 million, compared with \$1.2 million for the three months ended March 31, 2023. Diluted net income per share was \$0.18 for the three months ended March 31, 2024 compared with \$0.03 for the same period in the prior year.

For the three months ended March 31, 2024, we recognized unfavorable prior period loss and LAE development of \$3.9 million compared with \$1.0 million, for the same period in the prior year.

Revenues and net income for the three months ended March 31, 2024 and 2023 both included \$0.5 million in net gains on investments.

Premiums Earned

Premiums earned increased by \$55.5 million, or 74%, to \$130.6 million for the three months ended March 31, 2024 from \$75.1 million for the three months ended March 31, 2023. This increase in premiums earned was driven significantly by the impact of recent premium rate increases and by an increase in policies in-force compared to the prior year, primarily as a result of the growth in the independent agent channel. The growth in this channel was driven by the growth and state expansion of an independent agent which utilizes a technology-driven method of distribution.

The average in-force premium for policies-in-force as of March 31, 2024 has increased 9.3% from the same period in the prior year as a result of the continuing impact of premium rate actions taken by the Company in response to the increase in loss severity that began in the latter half of 2022 and continued into 2023.

Commission and Fee Income

As a result of the December 1, 2023 sale of the Insurance Agency, the Company no longer receives commission and fee income from third-party insurance companies and the sale of ancillary products. The Company does, however, continue to receive managing general agency fees on premiums written in certain states.

Billing Fees and Service Charges

Billing fees and service charges increased by \$2.5 million, or 47%, to \$7.8 million for the three months ended March 31, 2024, from \$5.3 million for the three months ended March 31, 2023. This increase is primarily the result of the increase in policies in-force compared to the prior year.

Investment Income

Investment income increased by \$2.6 million, or 153%, to \$4.3 million for the three months ended March 31, 2024 from \$1.7 million for the three months ended March 31, 2023. This increase was primarily the result of higher yields on short-term cash equivalents and fixed maturities as well as improved returns on other investments, in addition to an increase in total invested assets as a result of cash provided from operations during the prior year and from the December 1, 2023 sale of the Insurance Agency. Investment income for the three months ended March 31, 2024 also included \$0.9 million in accretion of the discounted present value of the consideration receivable from the sale of the Insurance Agency.

At March 31, 2024 and 2023, the tax-equivalent book yields for our managed fixed maturities and cash equivalents portfolio were 4.0% and 3.0%, respectively, with effective durations of 2.52 and 2.33 years, respectively. Yield has increased as the Company has taken advantage of the increase in interest rates by investing previously uninvested cash and reinvesting portfolio maturities at higher interest rates.

Net Gains on Investments

Net gains on investments for both the three months ended March 31, 2024 and 2023 of \$0.5 million represented unrealized gains on equity securities.

Loss and Loss Adjustment Expenses

The loss ratio was 70.0% for the three months ended March 31, 2024 compared with 75.2% for the three months ended March 31, 2023.

We experienced unfavorable development related to prior periods of \$3.9 million for the three months ended March 31, 2024 compared to \$1.0 million for the three months ended March 31, 2023. The unfavorable development for the three months ended March 31, 2024 was primarily attributable to higher than expected loss severity on bodily injury losses in the third and fourth quarters of the 2023 accident year. The unfavorable development for the three months ended March 31, 2023 was primarily attributable to higher than expected loss severity on physical damage losses in the 2022 accident year and the fourth quarter of 2021.

Excluding the development related to prior periods, the loss ratio for the three months ended March 31, 2024 was 67.1% as compared with 73.9% for the three months ended March 31, 2023. This improvement in the accident year loss ratio is primarily the result of the impact of rate increases and a reduction in loss frequency.

Insurance Operating Expenses

Insurance operating expenses increased 13% to \$43.0 million for the three months ended March 31, 2024 from \$38.2 for the three months ended March 31, 2023. This increase was primarily the result of higher commissions to independent agents as a result of the increase in business written through this channel during the current year. Following the December 1, 2023 sale of the Insurance Agency, independent agent commissions, a variable cost, are now the largest component of insurance operating expenses and were \$26.4 million for the three months ended March 31, 2024.

The insurance companies' expense ratio was 26.2% for the three months ended March 31, 2024, compared with 27.2% for the three months ended March 31, 2023.

Provision for Income Taxes

Income tax expense was \$2.0 million for the three months ended March 31, 2024 compared with \$0.3 million for the three months ended March 31, 2023. The effective tax rate increased to 22.5% for the three months ended March 31, 2023 from 18.3% for the three months ended March 31, 2023.

In assessing our ability to realize our deferred tax asset ("DTA"), both positive and negative evidence are used to evaluate the allowance. We placed the greatest weight on the Company's 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. 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

Interest expense increased to \$1.0 million for the three months ended March 31, 2024 from \$0.9 million for the three months ended March 31, 2023. Interest expense increased primarily as a result of the increase in the applicable variable interest rate and may increase in the future should interest rates continue to rise. For additional information, see "Liquidity and Capital Resources" in this report.

Liquidity and Capital Resources

Our primary sources of funds are premiums, billing fees and service charges, and investment income from our insurance company subsidiaries. Through December 1, 2023, we also received 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, 2024 was \$29.2 million, compared with \$8.2 million for the same period in the prior year. This change was primarily due to the result of an increase in net income from operations for the current period and increases in premium collections and the reserve for loss and loss adjustment expenses.

Net cash used in investing activities for the three months ended March 31, 2024 was \$44.3 million compared to \$7.0 million for the same period in the prior year. This change was primarily the result of an increase in the purchase of securities in the current period as the Company continues to take advantage of the favorable interest rate environment by investing previously uninvested cash.

Our holding company requires cash for general corporate overhead expenses and debt service related to our debentures payable. Following the sale of the Insurance Agency, the holding company's primary source of unrestricted cash to meet its obligations are managing general agency fees, dividends from the insurance companies, and the remaining proceeds to be received through 2026 from the sale of the Insurance Agency as noted in the following paragraph. As of March 31, 2024, our holding company had adequate unrestricted cash to meet current obligations. We also believe that these funds and the additional anticipated unrestricted cash from the sources noted above will be sufficient to pay our future cash requirements outside of the insurance company subsidiaries.

As a result of the sale of the Insurance Agency, the Company will receive additional unrestricted cash of \$20 million currently held in escrow that is being released monthly from March 2024 through December 2024. The Company is also eligible to receive additional maximum contingent consideration of \$15 million, \$10 million, and \$20 million, on December 1, 2024, 2025 and 2026, respectively, based upon achievement of certain annual production targets. The cash from the contingent consideration payments to the Company would be unrestricted unless required by the Insurance Companies to maintain \$100 million of capital and surplus as per the purchase agreement.

The holding company has debt service requirements related to the debentures payable. The debentures are interest-only and mature in full in July 2037. Effective July 1, 2023, with the sunset of LIBOR, the debentures now accrue interest at a variable rate equal to an adjusted Three-Month CME term SOFR rate plus 375 basis points, which resets quarterly. The interest rate related to the debentures for the three months ended March 31, 2024, ranged from 9.329% to 9.402%. In April 2024, the interest rate reset to 9.341% through July 2024.

State insurance laws limit the amount of distributions that may be paid from our insurance company subsidiaries. As of March 31, 2024, the dividend limitation was \$12.1 million.

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. As of March 31, 2024, the insurance company subsidiaries remain above the company action levels. 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. For the three months ended March 31, 2024, each insurance company subsidiary was within this guideline.

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 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 7, 2024

/s/ Kenneth D. Russell

Kenneth D. Russell

Interim Chief Executive Officer

I, Brian Dickman, 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 7, 2024

/s/ Brian Dickman

Brian Dickman

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, 2024	December 31, 2023
	(Unaudited)	
ASSETS		
Investments in fixed maturities, available-for-sale at fair value (amortized cost of \$244,013 and \$200,544, respectively)	\$ 235,192	\$ 192,885
Investments in equity securities at fair value (cost of \$9,969 and \$9,125, respectively)	12,019	10,660
Cash, cash equivalents, and restricted cash	93,858	109,780
Premiums, fees, and commissions receivable, net of allowance of \$288 and \$491, respectively	183,612	149,764
Receivable for securities	2,795	—
Consideration receivable from the sale of insurance agency, at fair value	57,478	59,825
Other investments	5,869	5,639
Other assets	7,992	9,977
Operating lease right-of-use assets	4,845	5,020
Property and equipment, net	2,642	2,892
Deferred acquisition costs	10,190	9,452
Identifiable intangible assets, net	1,515	1,530
TOTAL ASSETS	\$ 618,007	\$ 557,424
LIABILITIES AND STOCKHOLDERS' EQUITY		
Loss and loss adjustment expense reserves	\$ 186,706	\$ 165,346
Unearned premiums and fees	202,101	164,479
Debentures payable	40,632	40,621
Operating lease liabilities	5,219	5,401
Deferred tax liability, net	1,511	4,558
Payable for securities	977	1,510
Accrued expenses	9,438	10,023
Income taxes payable	9,783	5,733
Other liabilities	14,250	17,905
Total liabilities	470,617	415,576
Stockholders' equity:		
Preferred stock, \$.01 par value, 10,000 shares authorized	—	—
Common stock, \$.01 par value, 75,000 shares authorized; 38,086 and 38,265 issued and outstanding, respectively	380	382
Additional paid-in capital	455,844	456,309
Accumulated other comprehensive loss, net of tax of \$(3,034) and \$(2,790), respectively	(5,788)	(4,869)
Accumulated deficit	(303,046)	(309,974)
Total stockholders' equity	147,390	141,848
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 618,007	\$ 557,424

See notes to consolidated financial statements.

FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)
(in thousands, except per share data)

	Three Months Ended March 31,	
	2024	2023
Revenues:		
Premiums earned	\$ 130,550	\$ 75,134
Commission and fee income	2,087	15,237
Billing fees and service charges	7,770	5,336
Investment income	4,319	1,716
Net gains on investments	537	486
	<u>145,263</u>	<u>97,909</u>
Costs and expenses:		
Losses and loss adjustment expenses	91,499	56,578
Insurance operating expenses	42,974	38,157
Other operating expenses	310	177
Stock-based compensation	222	68
Depreciation	319	523
Amortization of identifiable intangibles assets	15	99
Interest expense	986	889
	<u>136,325</u>	<u>96,491</u>
Income before income taxes	8,938	1,418
Provision for income taxes	2,010	260
Net income	<u>\$ 6,928</u>	<u>\$ 1,158</u>
Net income per share:		
Basic	<u>\$ 0.18</u>	<u>\$ 0.03</u>
Diluted	<u>\$ 0.18</u>	<u>\$ 0.03</u>
Number of shares used to calculate net income per share:		
Basic	<u>38,103</u>	<u>37,933</u>
Diluted	<u>38,681</u>	<u>37,978</u>
Reconciliation of net income to other comprehensive income:		
Net income	\$ 6,928	\$ 1,158
Net unrealized change in investments, net of tax (benefit) expense of \$(244) and \$265, respectively	(919)	997
Comprehensive income	<u>\$ 6,009</u>	<u>\$ 2,155</u>
Detail of net gains on investments:		
Net realized gains (losses) on sales and redemptions	\$ 23	\$ (8)
Net unrealized gains on equity securities	514	494
Net gains on investments	<u>\$ 537</u>	<u>\$ 486</u>

See notes to consolidated financial statements.

FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited)

	Common Stock		Additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulated deficit	Total stockholders' equity
	Shares	Amount				
Balances at December 31, 2022	37,868	\$ 379	\$ 455,891	\$ (6,862)	\$ (383,886)	\$ 65,522
Net income	—	—	—	—	1,158	1,158
Net unrealized change on investments (net of tax expense of \$265)	—	—	—	997	—	997
Stock-based compensation	—	—	59	—	—	59
Vested restricted stock units, net of repurchases	203	1	(34)	—	—	(33)
Balances at March 31, 2023	<u>38,071</u>	<u>\$ 380</u>	<u>\$ 455,916</u>	<u>\$ (5,865)</u>	<u>\$ (382,728)</u>	<u>\$ 67,703</u>
	Common Stock		Additional paid-in capital	Accumulated other comprehensive income (loss)	Accumulated deficit	Total stockholders' equity
	Shares	Amount				
Balances at December 31, 2023	38,265	\$ 382	\$ 456,309	\$ (4,869)	\$ (309,974)	\$ 141,848
Net income	—	—	—	—	6,928	6,928
Net unrealized change on investments (net of tax benefit of \$244)	—	—	—	(919)	—	(919)
Stock-based compensation	—	—	222	—	—	222
Vested restricted stock units	106	1	—	—	—	(1)
Retirement of treasury stock	(285)	(3)	(687)	—	—	(690)
Balances at March 31, 2024	<u>38,086</u>	<u>\$ 380</u>	<u>\$ 455,844</u>	<u>\$ (5,788)</u>	<u>\$ (303,046)</u>	<u>\$ 147,390</u>

See notes to consolidated financial statements.

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

(in thousands)

	Three Months Ended	
	March 31,	
	2024	2023
Cash flows from operating activities:		
Net income	\$ 6,928	\$ 1,158
Adjustments to reconcile net income to cash provided by operating activities:		
Unrealized gains on equity securities	(514)	(494)
Depreciation	319	523
Amortization of identifiable intangibles assets	15	99
Accretion of present value discount of sales consideration receivable	(903)	—
Stock-based compensation	222	68
Deferred income taxes	(2,803)	349
Investment income from other investments	(115)	(269)
Realized (gains) losses on sales and redemptions of investments	(23)	8
Other	(83)	(61)
Change in:		
Premiums, fees, and commission receivable	(33,848)	(28,954)
Deferred acquisition costs	(738)	(1,372)
Loss and loss adjustment expense reserves	21,360	5,507
Unearned premiums and fees	37,622	27,916
Other assets	1,985	1,374
Accrued expenses	(585)	215
Income taxes payable	4,050	—
Other liabilities	(3,655)	2,069
Other	3	63
Net cash provided by operating activities	<u>29,237</u>	<u>8,198</u>
Cash flows from investing activities:		
Purchases of investments	(54,566)	(10,962)
Redemptions of fixed maturities	9,865	4,082
Sales and redemptions of investments	232	316
Distributions from other investments	144	450
Capital expenditures	(69)	(836)
Receivable/payable for securities	(3,328)	—
Collections on consideration receivable from sale of insurance agency	<u>3,250</u>	<u>—</u>
Net cash used in investing activities	<u>(44,472)</u>	<u>(6,950)</u>
Cash flows from financing activities:		
Purchase of treasury stock, at cost	(687)	—
Taxes remitted in relation to employee restricted stock units exercised	<u>—</u>	<u>(34)</u>
Net cash used in financing activities	<u>(687)</u>	<u>(34)</u>
Net change in cash, cash equivalents, and restricted cash	(15,922)	1,214
Cash, cash equivalents, and restricted cash, beginning of period	<u>109,780</u>	<u>49,072</u>
Cash, cash equivalents, and restricted cash, end of period	<u>\$ 93,858</u>	<u>\$ 50,286</u>
Supplemental disclosure of cash paid for:		
Taxes	\$ 796	\$ 6
Interest	\$ 991	\$ 860

See notes to consolidated financial statements.

FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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 for the year ended December 31, 2023 filed by the Company with OTCQX.

For the three months ended March 31, 2024, two single independent agents produced 47% and 33% of premiums earned, respectively.

2. Investments

Investments, Available-for-Sale

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

<u>March 31, 2024</u>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Fixed maturities, available-for-sale:				
U.S. government and agencies	\$ 28,994	\$ 21	\$ (155)	\$ 28,860
Political subdivisions	3,025	—	(125)	2,990
Revenue and assessment	18,875	10	(259)	18,626
Corporate bonds	101,117	290	(1,451)	99,956
Asset backed securities	47,515	78	(346)	47,247
Collateralized mortgage obligations:				
Agency backed	42,694	5	(7,308)	35,391
Non-agency backed – residential	804	485	(57)	1,232
Non-agency backed – commercial	989	—	(9)	980
Total fixed maturities, available-for-sale	\$ 244,013	\$ 889	\$ (9,710)	\$ 235,192

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

Length of Gross Unrealized Losses <u>At March 31, 2024:</u>	Fair Value of Securities with		Severity of Gross Unrealized Losses		
	Gross Unrealized Losses	Gross Unrealized Losses	Less than 5%	5% to 10%	Greater than 10%
Less than or equal to:					
Three months	\$ 75,993	\$ (418)	\$ (418)	\$ —	\$ —
Six months	5,692	(105)	(92)	—	(13)
Nine months	2,012	(27)	(27)	—	—
Twelve months	15,608	(186)	(182)	—	(4)
Greater than twelve months	78,723	(8,974)	(1,082)	(1,223)	(6,669)
Total	\$ 178,028	\$ (9,710)	\$ (1,801)	\$ (1,223)	\$ (6,686)

FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The fair value and gross unrealized losses of investments in fixed maturities at March 31, 2024, by the length of time that individual securities have been in a continuous unrealized loss position follows (in thousands).

	Less than 12 months		12 months or longer		Total Gross Losses
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	
March 31, 2024					
Fixed maturities, available-for-sale:					
U.S. government and agencies	\$ 23,917	\$ (150)	\$ 1,944	\$ (5)	\$ (155)
Political subdivisions	508	(2)	2,392	(123)	(125)
Revenue and assessment	9,047	(117)	5,132	(142)	(259)
Corporate bonds	34,361	(234)	29,702	(1,217)	(1,451)
Asset backed securities	30,357	(210)	4,096	(136)	(346)
Collateralized mortgage obligations:					
Agency backed	—	—	35,207	(7,308)	(7,308)
Non-agency backed – residential	135	(14)	250	(43)	(57)
Non-agency backed – commercial	980	(9)	—	—	(9)
Total fixed maturities, available-for-sale	<u>\$ 99,305</u>	<u>\$ (736)</u>	<u>\$ 78,723</u>	<u>\$ (8,974)</u>	<u>\$ (9,710)</u>

At March 31, 2024, the Company had 116 fixed maturities with gross unrealized losses that have been in a gross unrealized loss position for less than or equal to twelve months and 59 fixed maturities with gross unrealized losses that have been in a gross unrealized loss position for greater than twelve months.

For the three months ended March 31, 2024, and 2023, the Company did not recognize any other-than-temporary-impairment (“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, 2024, were not other-than-temporarily impaired and are attributable to the increase in interest rates they were originally purchased. 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,	
	2024	2023
Liability for unpaid losses and LAE at beginning of period, gross	\$ 165,346	\$ 107,100
Reinsurance balances receivable	(2)	(97)
Liability for unpaid losses and LAE at beginning of period, net	165,344	107,003
Add: Provision for losses and LAE:		
Current period	87,626	55,546
Prior periods	3,873	1,032
Net losses and LAE incurred	91,499	56,578
Less: Losses and LAE paid:		
Current period	15,805	20,298
Prior periods	54,332	30,590
Net losses and LAE paid	70,137	50,888
Liability for unpaid losses and LAE at end of period, net	186,706	112,693
Reinsurance balances receivable	—	(86)
Liability for unpaid losses and LAE at end of period, gross	<u>\$ 186,706</u>	<u>\$ 112,607</u>

FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The unfavorable development for the three months ended March 31, 2024 was primarily attributable to higher than expected loss severity on bodily injury losses in the third and fourth quarters of the 2023 accident year.

The unfavorable development for the three months ended March 31, 2023 was primarily attributable to higher than expected loss severity on physical damage losses in the 2022 accident year and the 2021 accident year.

4. Income Taxes

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

	Three Months Ended March 31,	
	2024	2023
Federal:		
Current	\$ 4,310	\$ —
Deferred	(2,485)	239
	1,825	239
State:		
Current	503	(89)
Deferred	(318)	110
	185	21
	<u>\$ 2,010</u>	<u>\$ 260</u>

The provision for income taxes differs from the amounts computed by applying the statutory federal corporate tax rate of 21% to income before income taxes as a result of the following (in thousands).

	Three Months Ended March 31,	
	2024	2023
Provision for income taxes at statutory rate	\$ 1,877	\$ 298
Tax effect of:		
Tax-exempt investment income	(10)	(5)
Stock-based compensation benefits realized	(1)	(9)
State income taxes, net of federal income tax benefit and state valuation allowance	79	21
Other	65	(45)
	<u>\$ 2,010</u>	<u>\$ 260</u>

ASC Topic 740, *Income Taxes*, establishes procedures to measure deferred tax assets and liabilities and assess whether a valuation allowance relative to existing deferred tax assets is necessary. Management assesses the likelihood of realization of the Company's deferred tax assets and the need for a valuation allowance concerning those assets based on the weight of available positive and negative evidence. As of March 31, 2024, and December 31, 2023, management determined that a valuation allowance of \$2.4 million and \$2.1 million, respectively, was necessary relative to certain state taxes net operating loss carryforwards and OTTI which are not expected to be realized. Management also determined at March 31, 2024, and December 31, 2023, that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the remaining deferred tax assets not covered by this valuation allowance.

The deferred tax asset ("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, or previously recognized valuation allowance should be released. In the event the DTA valuation allowance is adjusted, the Company would record an income tax expense for the adjustment.

FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

5. Leases

The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use (“ROU”) assets and lease liabilities on our consolidated balance sheets. The Company does not have any finance leases.

ROU assets represent the Company’s right to use an underlying asset for the lease term and lease liabilities represent the Company’s obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. As the Company’s leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at the commencement date in determining the present value of lease payments. Lease terms may include options to extend the lease when it is reasonably certain that the option will be exercised. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

The Company has operating leases, which in 2023 included retail stores (sold effective December 1, 2023), corporate offices, and certain equipment. The leases have remaining lease terms of four years to eight years. Both operating lease costs and cash flows for the three months ended March 31, 2024, were \$0.3 million. Operating lease cost and cash flows for the three months ended March 31, 2023, were \$2.2 million and \$2.3 million, respectively.

Supplemental balance sheet information related to leases was as follows:

	March 31,	
	2024	2023
Operating lease right-of-use assets	\$ 4,845	\$ 14,581
Operating lease liabilities	5,219	14,821
Weighted average remaining lease term	5.57 years	5.07 years
Weighted average discount rate	6.50%	6.51%

Maturities of operating lease liabilities were as follows:

For the Year Ended December 31,	Amount
2024 (excluding the three months ended March 31, 2024)	\$ 725
2025	975
2026	985
2027	996
2028	780
Thereafter	2,025
Total lease payments	\$ 6,486
Less imputed interest	(1,267)
Total	\$ 5,219

6. Sale of Insurance Agency Subsidiary

On December 1, 2023, the Company entered into a securities purchase agreement with the buyer to sell 100% of its issued and outstanding shares of capital stock of its wholly owned subsidiary, the Insurance Agency, for net cash consideration of up to \$120 million which included \$55 million paid at closing and \$20 million held in escrow which is being released monthly from March 2024 through December 2024. The Company is eligible to receive additional contingent consideration of \$15 million (held in escrow), \$10 million, and \$20 million on December 1, 2024, 2025, and 2026, respectively, based upon achievement of certain annual premium production targets.

At March 31, 2024, future consideration receivable from this sale of \$57.5 million is recorded at fair value, utilizing a discounted cash flow approach.

The purchase agreement provides that the Company would receive its additional contingent consideration in its entirety should the buyer fail to submit applications within the applicable underwriting guidelines of the Insurance Companies, provided that the Company has not breached any of its agreements with the buyer. The agreement also provides that the Company maintain \$100

FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

million of capital and surplus in the Insurance Companies through December 31, 2026. As of March 31, 2024, and May 7, 2024, the Company is not in breach of contract.

The Insurance Agency was the retail sales agency operation of the Company, and principally sold non-standard automobile insurance and related products through employee agents operating from 288 leased retail locations in 13 states. The insurance sold by the Insurance Agency was underwritten and serviced by the Insurance Companies and through third-party carriers for which we received a commission. The purchase agreement provides that, effective December 1, 2023, the buyer operates as an independent agent for the Insurance Companies' non-standard automobile insurance products written through the Insurance Agency. Following this transaction, the Insurance Companies currently sell non-standard personal automobile insurance written solely through independent agents, including the buyer.