GAINSCO INC. AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2013 and 2012

(With Independent Auditor's Report Thereon)

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700 North Pearl, Suite 2000
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Independent Auditor's Report

The Board of Directors
GAINSCO, INC.
Dallas, Texas

We have audited the accompanying consolidated financial statements of GAINSCO, INC. and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of GAINSCO, INC. and its subsidiaries as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BDO USA, LLP

Dallas, Texas
May 30, 2014

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GAINSCO, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2013 and 2012

(Amounts in thousands, except share data)

Assets		2013	2012
Investments (notes 1, 2 and 3):			
Bonds, available for sale – at fair value (amortized cost: $154,556 – 2013, $153,580 – 2012)	$	153,955	154,425
Preferred stocks, available for sale – at fair value (cost: $2,448 – 2013, $2,447 – 2012)		2,407	2,634
Common stocks, available for sale – at fair value (cost: $428 – 2013, $664 – 2012)		420	536
Common stocks, trading – at fair value		-	27
Certificates of deposit – at cost, which approximates fair value (amortized cost: $100 – 2013 and 2012)		100	100
Other long-term investments –equity method (which approximates) cost		7,515	2,692
Short-term investments – at fair value (amortized cost: $25,252 – 2013, $40,722 – 2012)		25,244	40,720
Total investments		189,641	201,134
Cash		2,302	334
Accrued investment income (note 1)		1,482	1,666
Premiums receivable (net of allowance for doubtful accounts: $771 – 2013, $630 – 2012) (note 1)		40,636	39,595
Finance receivables (net of allowance for doubtful accounts: $8 – 2013) (note 1)		1,734	-
Ceded unpaid claims and claim adjustment expenses (notes 6 and 9)		936	899
Deferred policy acquisition costs (note 1)		6,854	6,811
Property and equipment (net of accumulated depreciation and amortization: $8,884 – 2013, $8,148 – 2012) (notes 1 and 7)		2,212	2,292
Auto vehicle inventory (notes 1 and 8)		6,601	-
Current Federal income taxes (notes 1 and 10)		7	238
Deferred Federal income taxes (net of valuation allowance: $14,843 – 2013, $20,373 – 2012) (notes 1 and 10)		6,413	2,360
Other assets		3,024	3,433
Intangible assets (note 16)		7,500	-
Goodwill – insurance operations (note 1)		609	609
Total assets	$	269,951	259,371

(Continued)

GAINSCO, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2013 and 2012

(Amounts in thousands, except share data)

Liabilities and Shareholders' Equity		2013	2012
Liabilities:			
Unpaid claims and claim adjustment expenses (notes 1 and 9)	$	73,495	79,643
Unearned premiums (note 1)		47,686	47,433
Accounts payable		8,030	6,929
Reinsurance balances payable (note 6)		191	371
Floor plan note payable (note 16)		7,370	-
Note payable (note 4)		9,900	4,900
Subordinated debentures (note 5)		43,000	43,000
Other liabilities		4,202	4,445
Cash overdraft		4,539	9,201
Total liabilities		198,413	195,922
Commitments and contingencies (notes 4, 5, 6, 13, 14, 15, 16 and 17)			
Shareholders' Equity (notes 11 and 12):			
Common stock ($.10 par value, 12,500,000 shares authorized, 5,148,232 shares issued and 4,889,582 shares outstanding at December 31, 2013 and 2012)		515	515
Additional paid-in capital		135,529	135,529
Accumulated deficit		(59,884)	(69,309)
Accumulated other comprehensive (loss) income (notes 2 and 3)		(434)	902
Treasury stock, at cost (258,650 shares at December 31, 2013 and 2012 (notes 1 and 11)		(4,188)	(4,188)
Total shareholders' equity		71,538	63,449
Total liabilities and shareholders' equity	$	269,951	259,371

See accompanying notes to consolidated financial statements.

GAINSCO, INC. AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended December 31, 2013 and 2012

(Amounts in thousands, except per share data)

		2013	2012
Revenues:			
Net premiums earned (notes 1 and 6)	$	191,035	185,706
Net investment income (note 2)		4,348	4,937
Realized investment (losses) gains (note 2 and 3), net:			
Other-than-temporary impairment losses		(251)	(285)
Other realized investment gains, net		632	2,224
Total realized investment gains. net		381	1,939
Agency revenues (note 1)		11,345	11,862
Gross auto sales (notes 1 and 16)		5,521	-
Other revenue, net		42	(21)
Total revenues		212,672	204,423
Expenses:			
Claims and claim adjustment expenses (notes 1, 6 and 9)		140,935	145,876
Policy acquisition costs (note 1)		27,137	27,203
Underwriting and operating expenses		36,912	29,482
Interest expense, net (notes 4 and 5)		2,015	1,931
Total expenses		206,999	204,492
Income (loss) before Federal income taxes		5,673	(69)
Federal income taxes (notes 1 and 10):			
Current expense (benefit)		76	(76)
Deferred (benefit) expense		(3,828)	394
Total income tax (benefit) expense		(3,752)	318
Net income (loss)	$	9,425	(387)
Income (loss) per common share (notes 1, 11 and 12):			
Basic	$	1.93	(.08)
Diluted	$	1.93	(.08)
Weighted average common shares outstanding (notes 11 and 12):			
Basic		4,890	4,807
Diluted		4,890	4,807

See accompanying notes to consolidated financial statements.

GAINSCO, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

Years ended December 31, 2013 and 2012

(Amounts in thousands)

		2013	2012
Net income (loss)	$	9,425	(387)
Other comprehensive (loss) income before tax:			
Unrealized gains (losses) on investments:			
Unrealized holding (losses) gains arising during the period		(1,179)	4,980
Less: Reclassification adjustments for realized gains included in net income (loss)		(381)	(1,939)
Unrealized (losses) gains on investments, net		(1,560)	3,041
Other comprehensive (loss) income, before tax		(1,560)	3,041
Income tax (benefit) expense related to components of other comprehensive (loss) income		(224)	727
Other comprehensive (loss) income, net of tax		(1,336)	2,314
Comprehensive income	$	8,089	1,927

See accompanying notes to consolidated financial statements.

GAINSCO, INC. AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity

Years ended December 31, 2013 and 2012

(Amounts in thousands)

		2013	2012
Common stock:			
Balance at beginning of year	$	515	504
Stock issuance		-	11
Balance at end of year	$	515	515
Additional paid-in capital:			
Balance at beginning of year	$	135,529	139,330
Cash dividend		-	(4,890)
Stock issuance		-	(11)
Stock-based compensation expense		-	1,100
Balance at end of year	$	135,529	135,529
Accumulated deficit:			
Balance at beginning of year	$	(69,309)	(68,922)
Net income (loss)		9,425	(387)
Balance at end of year	$	(59,884)	(69,309)
Accumulated other comprehensive (loss) income:			
Balance at beginning of year	$	902	(1,412)
Other comprehensive (loss) income		(1,336)	2,314
Balance at end of year	$	(434)	902
Treasury stock:			
Balance at beginning and end of year	$	(4,188)	(4,188)
Total shareholders' equity end of year	$	71,538	63,449

See accompanying notes to consolidated financial statements.

GAINSCO, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2013 and 2012

(Amounts in thousands)

		2013	2012
Cash flows from operating activities:			
Net income (loss)	$	9,425	(387)
Adjustments to reconcile net (loss) income to cash provided by operating activities:			
Depreciation and amortization		4,279	3,665
Other-than-temporary impairment of investments		251	285
Non-cash compensation expense		-	1,100
Realized gains (excluding other-than-temporary impairments)		(638)	(2,236)
Unrealized losses on trading securities		6	12
Deferred Federal income tax expense (benefit)		(3,828)	394
Changes in operating assets and liabilities, net of assets acquired:			
Accrued investment income		184	(80)
Premiums receivable		(1,041)	(1,392)
Finance receivables		(1,734)	-
Ceded unpaid claims and claim adjustment expenses		(37)	692
Deferred policy acquisition costs		(43)	36
Auto vehicle inventory, net		717	-
Other assets		382	339
Unpaid claims and claim adjustment expenses		(6,148)	2,462
Unearned premiums		253	2,085
Accounts payable		1,058	350
Reinsurance balances payable		(180)	(132)
Other liabilities		(243)	(571)
Current Federal income taxes		231	(241)
Net cash provided by operating activities	$	2,894	6,381

(Continued)

GAINSCO, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2013 and 2012

(Amounts in thousands)

		2013	2012
Cash flows from investing activities:			
Bonds available for sale:			
Sold	$	31,811	62,126
Matured		25,700	28,505
Purchased		(60,524)	(96,613)
Certificates of deposit:			
Matured		100	185
Purchased		(100)	(100)
Preferred stocks sold		-	1,122
Preferred stocks purchased		-	(1,500)
Common stocks sold		-	195
Common stocks purchased		-	(144)
Common stock trading sold		19	-
Change in securities sold but not settled		-	201
Other long-term investments sold		1,390	-
Other long-term investments purchased		(6,187)	(2,512)
Net change in short-term investments		14,867	2,636
Cash paid for acquisition, net of cash acquired		(7,687)	-
Property and equipment purchased		(653)	(1,935)
Net cash used for investing activities		(1,264)	(7,834)
Cash flows from financing activities:			
Principal payment on note		-	(4,500)
Draw on note payable		5,000	4,900
Dividends paid		-	(4,890)
Net change in cash overdraft		(4,662)	5,504
Net cash provided by financing activities		338	1,014
Net increase (decrease) in cash		1,938	(439)
Cash at beginning of year		334	773
Cash at end of year	$	2,302	334

Supplemental disclosures of cash flow information:
$1,995 and $1,980 in interest was paid during 2013 and 2012, respectively (notes 4 and 5).
$25 and $165 in income tax payments were made during 2013 and 2012, respectively (note 10).

Non-cash supplemental financing activities:
$1,448 and $0 in floor plan note covering inventory acquired during 2013 and 2012, respectively.

See accompanying notes to consolidated financial statements.

(1) Background and Summary of Significant Accounting Policies

(a) Basis of Consolidation

The accompanying consolidated financial statements include the accounts of GAINSCO, INC. ("GANS") and its wholly-owned subsidiaries (collectively, the "Company" or "we"), BSAG, Inc., BSAG Real Estate Holdings, Inc., Bob Stallings Nissan of Baytown, Inc., Stallings Auto Group, Inc. ("SAG"), Bob Stallings Hyundai, Inc. ("BSHI") (collectively the "Auto Group") GAINSCO Service Corp., GAINSCO Auto Insurance Agency, Inc., MGA Insurance Company, Inc. ("MGA") and National Specialty Lines, Inc. ("NSL"). MGA has one wholly owned subsidiary, MGA Agency, Inc. All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements included herein have been prepared by GANS, on the basis of accounting principles generally accepted in the United States ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(b) Nature of Operations

The Company's nonstandard personal auto products are primarily aligned with customers seeking to purchase basic coverage and limits of liability required by statutory requirements, or slightly higher. Our products include coverage for third party liability, for bodily injury and physical damage, as well as collision and comprehensive coverage for theft, physical damage and other perils for an insured's vehicle. Within this context, we offer our product to a wide range of customers who present varying degrees of potential risk to the Company, and we strive to price our product to reflect this range of risk accordingly, in order to earn an underwriting profit. Simultaneously, when actuarially prudent, we attempt to position our product price to be competitive with other companies offering similar products to optimize our likelihood of securing our targeted customers. We offer flexible premium down payment, installment payment, late payment, and policy reinstatement plans that we believe help us secure new customers and retain existing customers, while generating an additional source of income from fees that we charge for those services. We primarily write six-month policies in Arizona, Florida, Nevada, New Mexico and Oklahoma and both one month and six month policies in Texas, with one year policies in California and both six month and one year policies in Georgia and South Carolina. The terms of policies we are permitted to offer varies in the states in which we operate.

GANS expects to use cash during the next twelve months primarily for: (1) interest on the Subordinated debentures and the credit agreement, (2) administrative expenses and (3) investments. The primary sources of cash to meet these obligations are assets held by GANS, dividends from its subsidiaries and the ability to draw from its $15.0 million bank credit agreement that was renewed in December 2012 and now has a maturity date of December 12, 2014. GANS believes the cash available from its short-term investments, dividends from its subsidiaries and advances from its $15.0 million bank credit agreement should be sufficient to meet its expected obligations for the next twelve months.

The Company acquired the net assets of a Hyundai auto dealership in Dallas, Texas on November 13, 2013 by its subsidiary SAG. The aggregate consideration for this acquisition was $7.7 million, subject to certain closing adjustments. The operations that we have acquired as of December 31, 2013 are referred to as the “Auto Group.” The results of operations of the acquired entity since the applicable acquisition date are included in our consolidated financial statements for the year ended December 31, 2013 – see note 16 for further discussion.

(c) Investments

The Company did not hold any held-to-maturity investment securities during 2013 and 2012. Investments classified as trading securities include equity securities bought and held primarily for sale in the near term and are carried at fair value with unrealized holding gains or losses included in current period operations. Investments classified as available-for-sale securities include debt and equity securities that are not classified as held-to-maturity or as trading security investments and are carried at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders’ equity, namely, “Other Comprehensive Income.” Other long-term investments in partnerships or limited liability companies are recorded under the equity method of accounting, which approximates cost. Under the equity method, the investment, originally recorded at cost, is adjusted to recognize our share of the net earnings or losses as they occur.

Investments are stated at fair value and are based on prices quoted in the most active market for each security, the fair value of comparable securities, discounted cash flow models or similar methods. Premiums and discounts on mortgage-backed and asset-backed securities are amortized over a period based on estimated future principal payments, including prepayments. Prepayment assumptions are reviewed periodically and adjusted to reflect actual prepayments and changes in expectations. The most significant determinants of prepayments are the difference between interest rates on the underlying mortgages, or underlying securities, and the current mortgage loan rates and the structure of the security. Other factors affecting prepayments include the size, type and age of underlying mortgages, the geographic location of the mortgaged properties and the credit worthiness of the borrowers. Variations from anticipated prepayments will affect the life and yield of these securities.

Investment securities are exposed to a number of factors, including general economic and business environment, changes in the credit quality of the issuer of the fixed income securities, changes in market conditions or disruptions in particular markets, changes in interest rates, or regulatory changes. Fair values of securities fluctuate based on the magnitude of changing market conditions. Our securities are issued by domestic entities and are backed either by collateral or the credit of the underlying issuer. Factors such as an economic downturn, disruptions in the credit markets, a regulatory change pertaining to the issuer's industry, deterioration in the cash flows or the quality of assets of the issuer, or a change in the issuer's marketplace may adversely affect our ability to collect principal and interest from the issuer. Both equity and fixed income securities have been affected over the past several years, and may be affected in the future, by significant external events. Credit rating downgrades, defaults, and impairments may result in write-downs in the value of the investment securities held by the Company. The Company regularly monitors its portfolio for pricing changes, which might indicate potential impairments, and performs reviews of securities with unrealized losses. In such cases, changes in fair value are evaluated to determine the extent to which such changes are attributable to (i) fundamental factors specific to the issuer, such as financial conditions, business prospects or other factors, or (ii) market-related factors, such as interest rates. When a security in the Company's investment portfolio has an unrealized loss in fair value that is deemed to be other than temporary, the Company reduces the book value of such security to its current fair value, recognizing the credit related decline as a realized loss in the Consolidated Statements of Operations and a revised GAAP cost basis for the security is established.

For fixed maturity securities that are other-than-temporarily impaired, the Company assesses its intent to sell and the likelihood that we will be required to sell the security before recovery of its amortized cost. If a fixed maturity security is considered other-than-temporarily impaired ("OTTI"), but the Company does not intend to and is not more than likely to be required to sell the security prior to its recovery to amortized cost, the amount of the impairment is separated into a credit loss component and the amount due to all other factors. The credit loss component of an impairment charge on a fixed maturity security is determined by the excess of the amortized cost over the present value of the expected cash flows. The present value is determined using the best estimate of cash flows discounted at (1) the effective interest rate implicit at the date of acquisition for non-structured securities or (2) the book yield for structured securities. The techniques and assumptions for determining the best estimate of cash flows varies depending on the type of security. The credit loss component of an impairment charge is recognized in net earnings while the non-credit component is recognized in accumulated other comprehensive income, a component of shareholders' equity.

Accrued investment income is the interest earned on securities which has been recognized in the results of operations, but the cash has not been received from the various security issuers. This accrual is based on the terms of each of the various securities and uses the 'effective interest method' for amortizing the premium and accruing the discount. Realized gains (losses) on securities are computed based upon the "specific identification" method on trade date and include write downs on securities considered to have other than temporary declines in fair value. Dividends on preferred stock are recorded as investment income on the ex-dividend date with a corresponding receivable to be extinguished upon receipt of cash.

(d) Deferred Policy Acquisition Costs and Policy Acquisition Costs

Deferred policy acquisition costs ("DAC") are principally commissions, premium taxes and underwriting expenses which are deferred. With the adoption of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*, in 2012, the Company defers only direct incremental costs associated with successful insurance contract acquisitions. Policy acquisition costs are principally commissions, premium taxes, marketing and underwriting expenses and the change in deferred policy acquisition costs that are charged to operations over the period in which the related premiums are earned. The Company utilizes investment income when assessing recoverability of deferred policy acquisition costs. A premium deficiency and a corresponding charge to income is recognized if the sum of the expected claims and claim adjustment expenses, unamortized acquisition costs and maintenance costs exceeds related unearned premiums and anticipated investment income. At December 31, 2013 and 2012, there was no premium deficiency that was required to be recognized.

Information relating to these net deferred amounts, as of and for the years ended December 31, 2013 and 2012 is summarized as follows:

		2013	2012
		(Amounts in thousands)	
Asset balance, beginning of period	$	6,811	6,847
Deferred commissions		21,189	20,946
Deferred premium taxes and marketing expenses		5,905	6,109
Amortization		(27,051)	(27,091)
Net change		43	(36)
Asset balance, end of period	$	6,854	6,811

(e) Property and Equipment

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is calculated using the straight-line method over the estimated useful lives of the respective assets (leasehold improvements are amortized over the terms of the lease and primarily three years for furniture and equipment). Computer software costs relating to programs for internal use are recorded in property and equipment and are amortized using the straight-line method over three years or the estimated useful life, whichever is longer.

Costs associated with software developed or purchased for internal use are capitalized based on FASBASC 350-40, *Intangibles – Goodwill and Other – Internal-use Software*, and other related guidance. Capitalized costs include external direct costs of materials and services consumed in developing or obtaining internal-use software and payroll for employees directly associated with, and who devote time to, the development of the internal-use software. Costs incurred in development and enhancement of software that do not meet the capitalization criteria, such as costs of activities performed during the preliminary and post-implementation stages, are expensed as incurred. The critical estimate related to this process is the determination of the amount of time devoted by employees to specific stages of internal-use software development projects. The Company reviews any impairment of the capitalized costs on a periodic basis. The Company amortizes such costs over the estimated useful life of the software, which is three years once the software has been placed in service.

(f) Auto Vehicle Inventory

Auto vehicle inventory consists of new, used and demonstrator automobiles sold to consumers. Vehicles acquired since the acquisition of the Hyundai auto dealership are carried at lower of cost-or-market. Cost is computed as amortized cost less manufacturer incentives.

(g) Goodwill and Long-Lived Assets

The excess of the purchase price of NSL over the fair value of net tangible assets acquired was recorded as goodwill, and was attributed to the Southeast Region reporting unit.

The excess of the purchase price of the acquired net tangible assets from the Hyundai auto dealership by the Company's subsidiary, SAG, was preliminarily recorded as goodwill, and was attributed to the Auto Group reporting unit. The Company also preliminarily identified a valued franchise license and assigned a value of $4.8 million as an indefinite lived intangible asset associated with the acquisition, which is also subject to an annual impairment test.

In accordance with ASC 350-20, Intangibles – Goodwill and Other – Goodwill, goodwill is not amortized but rather is subject to a qualitative assessment of events or factors to determine if the annual two-step test of goodwill impairment to be performed. We performed our annual goodwill impairment testing as of December 31 for the reporting units. Under the first step, if the fair value of any reporting unit is less than the carrying value, an indication goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test. In the second step, we compare the goodwill amount reflected in the balance sheet to the implied fair value of the reporting unit's goodwill, determined by allocating the reporting unit's fair value to all of its assets and liabilities in a manner similar to a purchase price allocation.

The implied fair value of the goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a variety of methods, including a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed.

The results of the first step of the impairment test indicated that the fair value exceeded the carrying value of the reporting units. It was therefore not necessary to perform the second step analysis, and no impairment loss was recorded during the fourth quarter of 2013. In addition, no impairment was indicated through our testing during 2012.

(h) Claims and Claim Adjustment Expenses

An insurance company generally makes claim payments as a result of accidents involving the risks insured under the insurance policies it issues. Months and sometimes years may elapse between the occurrence of an accident, reporting of the accident to the insurer and payment of the claim. Insurers record a liability for estimates of claims that will be paid for accidents reported to them, which are referred to as "case reserves." In addition, since accidents are not always reported promptly upon occurrence and because the assessment of existing known claims may change over time with the development of new facts, circumstances and conditions, insurers estimate liabilities for such items, which are referred to as incurred but not reported ("IBNR") reserves.

We maintain reserves for the payment of claims and claim adjustment expenses for both case and IBNR under policies written by the insurance company subsidiary. These claims reserves are estimates, at a given point in time, of amounts that we expect to pay on incurred claims based on facts and circumstances then known. The amount of case claims reserves is primarily based upon a case-by-case evaluation of the type of claim involved, the circumstances surrounding the claim, and the policy provisions relating to the type of claim. The amount of IBNR claims reserves is estimated on the basis of historical information and anticipated future conditions by lines of insurance and actuarial review. Reserves for claim adjustment expenses ("CAE") are intended to cover the ultimate costs of settling claims, including investigation and defense of lawsuits resulting from such claims. Inflation is implicitly reflected in the reserving process through analysis of cost trends and review of historical reserve results.

The process of establishing claims reserves is imprecise and reflects significant judgmental factors. In many liability cases, significant periods of time, ranging up to several years or more, may elapse between the occurrence of an insured claim and the settlement of the claim. The actual emergence of claims and claim adjustment expenses may vary, perhaps materially, from the Company's estimates thereof, because (a) estimates of liabilities are subject to large potential revisions, as the ultimate disposition of claims incurred prior to the financial statement date, whether reported or not, is subject to the outcome of events that have not yet occurred (e.g., jury decisions, court interpretations, legislative changes (even after coverage is written and reserves are initially set) that broaden liability and policy definitions and increase the severity of claims obligations, changes in the medical condition of claimants, public attitudes and social/economic conditions such as inflation), (b) estimates of claims do not make provision for extraordinary future emergence of new classes of claims or types of claims not sufficiently represented in the Company's historical data base or which are not yet quantifiable, and (c) estimates of future costs are subject to the inherent limitation on the ability to predict the aggregate course of future events.

In determining our reserve estimates for nonstandard personal automobile insurance, for each financial reporting date we record our best estimate, which is a point estimate, of our overall unpaid claims and CAE for both current and prior accident years. Because the underlying processes require the use of estimates and professional actuarial judgment, establishing claims reserves is an inherently uncertain process. As our experience develops and we learn new information, our quarterly reserving process may produce revisions to our previously reported claims reserves, which we refer to as "development," and such changes may be material. We recognize favorable development when we decrease our previous estimate of ultimate losses, which results in an increase in net income in the period recognized. We recognize unfavorable development when we increase our previous estimate of ultimate losses, which results in a decrease in net income in the period recognized. Accordingly, while we record our best estimate, our claims reserves are subject to potential variability.

(i) Treasury Stock

The Company records treasury stock in accordance with the "cost method" described in ASC 505-30, *Equity – Treasury Stock* ("ASC 505-30") – see note 11 for further discussion.

(j) Premium Revenues and Premium Receivables

Premiums and policy fees are recognized as earned on a pro rata basis over the period the Company is at risk under the related policy. Agency revenues are primarily fees charged on insureds' premiums due. These fees are earned over the terms of the underlying policies. Unearned premiums represent the portion of premiums written and policy fees which are applicable to the unexpired terms of policies in force. Premiums receivable consist of balances owed for coverages written with the Company. The Company's allowance for doubtful accounts consists of all premiums receivables over thirty days past due.

(k) Gross Auto Sales and Finance Receivables

Gross auto sales consist of sales of new and used vehicles, sales of parts and automotive services by our subsidiary BSHI. We recognize revenue in the period in which products are sold and delivered or services are provided. The automotive services we provide include, but are not limited to, customer-paid repairs and maintenance, as well as repairs and maintenance under manufacturer warranties and extended service contracts. Our finance receivables consists of smaller-balance, homogeneous loans carried at amortized cost, net of allowance for loan losses. We use a combination of forecasting methodologies to determine the allowance for loan losses. Contracts-in-transit primarily represent receivables from financial institutions for the portion of the vehicle sales price financed by our customers – see note 16 for further discussion of the auto dealership acqusition.

(l) Floor Plan Note

Our consumer lending offerings consist of floor plan notes, which are loans to finance the purchase of auto vehicle inventory, also known as wholesale or inventory financing, as well as dealer loans, which are loans to finance improvements to dealership facilities, to provide working capital, and to purchase and/or finance dealership real estate.

(m) Federal Income Taxes

The Company and its subsidiaries file a consolidated Federal income tax return. Deferred income tax items are accounted for under the "asset and liability" method which provides for temporary differences between the reporting of earnings for financial statement purposes and for tax purposes, primarily deferred policy acquisition costs, the discount on unpaid claims and CAE, net operating loss carryforwards and the nondeductible portion of the change in unearned premiums. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment dates.

The Company currently has a valuation allowance for a portion of the tax benefit from its net operating loss ("NOL") carryforwards. ASC 740-10, *Income Taxes – Overall* ("ASC 740-10") requires positive evidence, such as cumulative taxable income over the most recent three-year period and other available objective and subjective evidence, for management to conclude that it is "more likely than not" that a portion or all of the deferred tax assets will be realized. While both objective and subjective evidence are considered, it is the Company's understanding that objective evidence should generally be given more weight in the analysis under ASC 740-10. In making the determination, the Company considered all available evidence, including the fact that the Company generated cumulative taxable income for the three years ended December 31, 2013. The Company does not record a tax valuation allowance relating to the tax effect of net unrealized losses on investments, excluding equity securities, because it is more likely than not that these losses would reverse or be utilized in future periods. The Company has the ability and it is the Company's intent to fully recover the principal, which could require the Company to hold these securities until their maturity; therefore, the Company considers the impairment to be temporary – see note 10.

The Company previously adopted the provisions of ASC 740-10-65, *Income Taxes – Overall – Transition and Open Effective Date Information* ("ASC 740-10-65"). At December 31, 2013, the Company has not identified any material uncertain tax positions in accordance with ASC 740-10-65. The Company is subject to U.S. federal income tax examinations by tax authorities for 2001 and subsequent years.

(n) Fair Value of Financial Instruments

The Company's financial instruments consist primarily of cash, receivables, payables and debt instruments. The carrying values of these financial instruments approximate their respective fair values as they are either short-term in nature or carry interest rates which vary with the market. Fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

(o) Earnings Per Share

Earnings per share ("EPS") for the years ended December 31, 2013 and 2012 is based on a weighted average of the number of common shares outstanding during each year – see note 12. Basic and diluted EPS is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period.

(p) Recently Issued Accounting Standards

Intangibles – Goodwill and Other

In July 2012, the FASB issued ASU 2012-02, *Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment* ("ASU 2012-02"). ASU 2012-02 provides entities with an option to first assess qualitative factors to determine whether events or circumstances indicate that it is more likely than not that the indefinite-lived intangible asset is impaired. If an entity concludes that it is more than 50% likely that an indefinite-lived intangible asset is not impaired, no further analysis is required. However, if an entity concludes otherwise, it would be required to determine the fair value of the indefinite-lived intangible asset to measure the amount of actual impairment, if any, as currently required under US GAAP. Effective January 1, 2013, the Company adopted ASU 2012-02 and the adoption did not have an impact on the consolidated financial statements. There have been no triggering events that would suggest possible impairment or that it is more-likely-than-not that the fair values of indefinite-lived intangible assets are less than their carrying amounts.

Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill (a consensus of the Private Company Council)

In January 2014, the FASB issued ASU 2014-02, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill (a consensus of the Private Company Council)* ("ASU 2014-02"). ASU 2014-02 provides new accounting guidance for private companies that allow for a simpler measurement of goodwill by allowing straight-line amortization over ten years or less than ten years if the entity demonstrates that another useful life is more appropriate. An entity that elects the accounting alternative is further required to make an accounting policy election to test goodwill for impairment at either the entity level or the reporting unit level. Goodwill should be tested for impairment when a triggering event occurs that indicates that the fair value of an entity (or a reporting unit) may be below its carrying amount. When a triggering event occurs, an entity has the option to first assess qualitative factors to determine whether the quantitative impairment test is necessary. If that qualitative assessment indicates that it is more likely than not that goodwill is impaired, the entity must perform the quantitative test to compare the entity's fair value with its carrying amount, including goodwill (or the fair value of the reporting unit with the carrying amount, including goodwill, of the reporting unit). The accounting alternative, if elected, should be applied prospectively to goodwill existing as of the beginning of the period of adoption and new goodwill recognized in annual periods beginning after December 15, 2014. The Company has not elected the early adoption option of the accounting standard as of December 31, 2013.

Presentation of Comprehensive Income

In February 2013, the FASB issued ASU 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* ("ASU 2013-02"), which is intended to improve the reporting of reclassifications out of accumulated other comprehensive income. The ASU requires an entity to report, either on the face of the income statement or in the notes to the financial statements, the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in the income statement if the amount being reclassified is required to be reclassified in its entirety to net income. For other amounts that are not required to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other required disclosures that provide additional detail about those amounts. Effective January 1, 2013, the Company adopted ASU 2013-02. Except for the new disclosure requirements, the adoption of the standard did not have an impact on the consolidated financial statements. The required disclosures are included on the face of the income statement.

Presentation of an Unrecognized Tax Benefit

In July 2013, the FASB issued ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* ("ASU 2013-11"). ASU 2013-11 is effective for the first interim or annual period beginning on or after December 15, 2013 with early adoption permitted. ASU 2013-11 amends ASC Topic 740, *Income Taxes*, to provide guidance and reduce diversity in practice on the financial statement presentation of an unrecognized tax benefit when a NOL carryforward, a similar tax loss, or a tax credit carryforward exists. Except for the changes, if any, in the Company's presentation, the initial application of the standard is not expected to have a material impact on the consolidated financial statements. The Company has not elected for early adoption of the accounting standard as of December 31, 2013.

All other codified accounting standards and interpretations of those standards issued during 2013 did not relate to accounting policies and procedures pertinent to the Company at this time.

(o) Reclassifications

Certain amounts in the prior year's consolidated financial statements have been reclassified to conform to the current period presentation. These reclassifications had no effect on total assets, total liabilities, total shareholders' equity, net income or net cash provided by operating activities as previously reported.

(2) Investments

The following table summarizes the components of net investment income:

		Years ended December 31,	
		2013	2012
		(Amounts in thousands)	
Fixed maturities	$	4,146	4,809
Preferred stocks		145	137
Common stocks		64	98
Other long-term investments		121	(21)
Short-term investments		95	130
		4,571	5,153
Investment expenses		(223)	(216)
Net investment income	$	4,348	4,937

The following tables summarize the amortized cost and estimated fair values of investments:

		December 31, 2013				
		Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Other-than-temporary impairments in AOCI (1)
		(Amounts in thousands)				
Bonds, available for sale:						
U.S. Treasury	$	8,680	324	(13)	8,991	-
U.S. Government agencies		3,589	14	(71)	3,532	-
Corporate bonds		132,944	752	(1,476)	132,220	-
Mortgage backed		9,343	412	(543)	9,212	(133)
Preferred stocks, available for sale		2,448	185	(226)	2,407	-
Common stocks, available for sale		428	-	(8)	420	-
Certificates of deposit		100	-	-	100	-
Other long-term investments		7,515	-	-	7,515	-
Short-term investments		25,252	1	(9)	25,244	-
Total investments	$	190,299	1,688	(2,346)	189,641	(133)

(1) Represents the amount of other-than-temporary impairment losses in "Accumulated other comprehensive income" or "AOCI" which, from January 1, 2009, were not included in earnings under ASC 320-10-65.

		December 31, 2012				
		Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Other-than-temporary impairments in AOCI (1)
		(Amounts in thousands)				
Bonds, available for sale:						
U.S. Treasury	$	6,195	439	-	6,634	-
U.S. Government agencies		4,466	64	-	4,530	-
Corporate bonds		128,827	1,407	(477)	129,757	-
Asset backed		1,338	1	-	1,339	-
Mortgage backed		12,754	192	(781)	12,165	(570)
Preferred stocks, available for sale		2,447	266	(79)	2,634	-
Common stocks, available for sale		664	-	(128)	536	-
Common stocks, trading		27	-	-	27	-
Certificates of deposit		100	-	-	100	-
Other long-term investments		2,692	-	-	2,692	-
Short-term investments		40,722	6	(8)	40,720	-
Total investments	$	200,232	2,375	(1,473)	201,134	(570)

(1) Represents the amount of other-than-temporary impairment losses in "Accumulated other comprehensive income" or "AOCI" which, from January 1, 2009, were not included in earnings under ASC 320-10-65.

GAINSCO, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2013 and 2012

The following tables summarizes the gross unrealized losses showing the length of time that investments have been continuously in an unrealized loss position as of December 31, 2013 and 2012:

	December 31, 2013					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Amounts in thousands)					
U.S. Treasury	$ 6,485	13	-	-	6,485	13
U.S. Government agencies	2,926	71	-	-	2,926	71
Corporate bonds	42,766	900	22,806	576	65,572	1,476
Mortgage backed	1,569	28	5,158	515	6,727	543
Preferred stocks	424	76	698	150	1,122	226
Common stocks	-	-	121	8	121	8
Short-term investments	13.284	9	-	-	13,284	9
Total investments	$ 67,454	1,097	28,783	1,249	96,237	2,346

	December 31, 2012					
	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(Amounts in thousands)					
Corporate bonds	$ 36,592	346	5,135	131	41,727	477
Asset backed	743	-	-	-	743	-
Mortgage backed	1,993	7	5,212	774	7,205	781
Preferred stocks	497	3	272	76	769	79
Common stocks	115	14	421	114	536	128
Short-term investments	11,185	8	-	-	11,185	8
Total investments	$ 51,125	378	11,040	1,095	62,165	1,473

The gross unrealized losses, shown in the above tables, totaling $1,249,000 and $1,095,000 as of December 31, 2013 and 2012, respectively, relate to 36 and 17 individual securities, respectively, that had been in an unrealized loss position for 12 months or more as of such dates. As of December 31, 2013, approximately 90% of the unrealized gross losses were with issuers rated as investment grade by Standard and Poor's (S&P). The decline in the market value is primarily related to the disruption and lack of liquidity in the markets in which these securities trade, along with credit risk aversion by investors. Other important factors include (i) the slowing of prepayments in mortgage and asset backed securities and (ii) the significant decline in the 3 month London Interbank Offered Rate for U.S. dollar deposits ("LIBOR") for securities with floating rate coupons since the purchase of these assets. At this time based upon information currently available, the Company has the ability and it is the Company's intent to fully recover the principal, which could require the Company to hold these securities until their maturity; therefore, the Company considers the impairment to be temporary.

In order to determine whether it is appropriate in an accounting period to recognize OTTI with respect to a portfolio security which has experienced a decline in fair value and as to which the Company has the ability and intent to fully recover principal, the Company considers all available evidence and applies judgment. With corporate debt issues, firm specific performance, industry trends, legislative and regulatory changes, government initiatives, and the macroeconomic environment all play a role in the evaluation process. With respect to asset backed securities (including mortgage backed securities), the Company uses individual cash flow modeling in addition to other available information. In the case of securities as to which the Company has the ability and intent to fully recover principal, if all scheduled principal and interest is expected to be received on a timely basis using the current best estimates of material inputs, such as default frequencies, severities, and prepayment speeds, generally no OTTI would be recognized unless other factors suggest that it would be appropriate to do so. The principal factors that the Company considers in this analysis are the extent to which the fair value of the security has declined, the ratings given to the security by recognized rating agencies, trends in those ratings, and information available to the Company from securities analysts and other commentators, public reports and other credible information.

At December 31, 2013 and 2012, the Company had $2,939,000 and $4,137,000 in par value for nonprime collateralized mortgage obligations (Alt-A securities), respectively. The carrying value and fair value of these investments were $2,519,000 and $2,154,000, respectively, at December 31, 2013 compared to $3,645,000 and $3,018,000, respectively, at December 31, 2012.

	As of December 31,	
Nonprime collateralized mortgage obligations	2013	2012
S&P Ratings:		
AA+	- %	20%
D	100	80
	100%	100%

Included in the Company's fixed income portfolio are hybrid securities with a carrying value of $12,460,000 and fair value of $12,272,000. A hybrid security as used here is one where the issuer of the debt instrument can choose to defer payment of the regularly scheduled interest due for a contractually set maximum period of time, usually five to ten years, without being in technical default on the issue.

One security, with carrying value of $915,000 and $983,000, and a fair value of $841,000 and $847,000, at December 31, 2013 and 2012, respectively, is dependent on the continued claims paying ability of its financial guarantor (MBIA) in order for the Company not to sustain any loss of principal or interest. MBIA is rated B (S&P), and we believe that the probable outcome is that principal and interest will be paid in full and, accordingly, the impairment on that security is considered temporary.

Preferred stocks predominately consist of auction preferred instruments considered to be available for sale and reported at estimated fair value with the net unrealized gains or losses reported after-tax as a component of other comprehensive income. The auction rate securities which the Company owns are each issued by a trust which holds as an asset the preferred stock of a corporation, which are exchange traded. The Company has the option at stated intervals to redeem the auction preferred shares for a pro rata share of the underlying collateral. As of December 31, 2013, we have not chosen this option as the structure of the trust provides a higher coupon on the auction preferred shares than on the underlying collateral shares; and therefore, are of greater economic value. As of December 31, 2013, we do not believe that these underlying shares are other-than-temporarily impaired based on the credit review of the issuers.

Investments in partnerships or limited liability companies are accounted for under the equity method, which approximates cost. These companies are audited on an annual basis. The Company has classified these investments as Other long-term investments.

Estimated fair value of investments on deposit with various regulatory bodies, as required by law, were $5,099,000 and $5,203,000, at December 31, 2013 and 2012, respectively.

The amortized cost and estimated fair value of debt securities (including bonds available for sale, preferred stocks and certificates of deposit) at December 31, 2013 and 2012, by maturity, are shown below.

		2013		2012	
		Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
		(Amounts in thousands)			
Due in one year or less	$	19,278	19,345	28,105	28,237
Due after one year but within five years		91,281	91,336	77,849	78,817
Due after five years but within ten years		5,961	5,756	10,334	10,354
Due after ten years but within twenty years		1,271	1,266	2,502	2,539
Due beyond 20 years		29,970	29,547	23,245	23,708
Asset backed securities		-	-	1,338	1,339
Mortgage backed securities		9,343	9,212	12,754	12,165
	$	157,104	156,462	156,127	157,159

The following table summarizes the S&P ratings on the Company's bonds available for sale as of December 31, 2013:

Bonds available for sale	2013
S&P Ratings:	
AAA	7%
AA+	2
AA-	1
A+	4
A	5
A-	8
BBB+	21
BBB	28
BBB-	13
BB+	2
BB and below	9
	100%

Proceeds from the sale of securities for the years ended December 31, 2013 and 2012 are presented in the following table:

		Years ended December 31,	
		2013	2012
		(Amounts in thousands)	
Proceeds:			
Bonds, available for sale	$	27,840	46,116
Bonds, available for sale principal pay downs	$	3,971	16,010
Preferred stocks, available for sale	$	-	1,122
Common stocks, available for sale	$	-	195
Common stocks, trading	$	19	-
Other invested assets	$	1,390	-

Realized gains and losses on investments for the years ended December 31, 2013 and 2012 are presented in the following table:

		Years ended December 31,	
		2013	2012
		(Amounts in thousands)	
Realized gains:			
Bonds, available for sale	$	626	2,308
Preferred stocks, available for sale		-	122
Common stocks, available for sale		-	51
Other invested assets		47	-
Short-term investments		5	12
Total realized gains		678	2,493
Realized losses:			
Bonds, available for sale		(18)	(257)
Common stocks, trading		(2)	-
Other invested assets		(20)	-
Total realized losses		(40)	(257)
Unrealized losses on trading securities		(6)	(12)
Other-than-temporary impairment losses		(251)	(285)
Total realized investment (losses) gains, net	$	381	1,939

When a security has an unrealized loss in fair value that is deemed to be other than temporary, the Company reduces the book value of the security to its current market value, recognizing the decline as a realized loss in the statement of operations. These determinations primarily reflect the market-related issues associated with the disruption in the mortgage and other credit markets, which created a significant deterioration in both the valuation of the securities as well as our view of future recoverability of the valuation decline.

As discussed in note 1, a portion of certain OTTI losses on debt securities are recognized in "Other comprehensive income" ("OCI"). The net amount recognized in earnings ("credit loss impairments") represents the difference between the amortized cost of the security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment. Any remaining difference between fair value and amortized cost is recognized in OCI.

The following table sets forth the amount of credit loss impairments on debt securities held by the Company as of December 31, 2013, for which a portion of the OTTI loss was recognized in OCI, and the corresponding changes in such amounts.

		(Amounts in thousands)
Balance, January 1, 2013	$	6,903
Credit losses remaining in accumulated deficit related to adoption of ASC 320-10-65		-
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period		-
Credit loss impairments previously recognized on securities impaired to fair value during the period (1)		-
Credit loss impairments recognized in the current period on securities not previously impaired		237
Additional credit loss impairments recognized in the current period on securities previously impaired		14
Increases due to the passage of time on previously recorded credit losses		-
Balance, December 31, 2013	$	7,154

(1) Represents circumstances where the Company determined in the current period that it intends to sell the security or it is more likely than not that it will be required to sell the security before recovery of the security's amortized cost.

During 2013, the Company wrote down $251,000 in securities that were determined to have had an other-than-temporary decline in fair value. During 2012, the Company wrote down $285,000 in securities that were determined to have had an other-than-temporary decline in fair value.

(3) Fair Value Measurements

The Company's estimates of fair value for financial assets and financial liabilities are based on the framework established in ASC 320-10-65. The framework is based on the inputs used in valuation, gives the highest priority to quoted prices in active markets and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates in the ASC 320-10-65 hierarchy is based on whether the significant inputs into the valuation are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company's significant market assumptions. The three levels of the hierarchy are as follows:

- Level 1 – Unadjusted quoted prices for identical assets or liabilities in active markets.
- Level 2 – Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; or valuations based on models where the significant inputs are observable (e.g., interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.
- Level 3 – Valuations based on models where significant inputs are not observable. The unobservable inputs reflect the Company's own estimates as to the assumptions that market participants would use.

Valuation of Investments

The Company receives pricing from independent pricing services, and these are compared to prices available from sources accessed through the Bloomberg Professional System. The number of available quotes varies depending on the security, generally we obtain one quote for Level 1 investments, one to three quotes for Level 2 investments and one to two quotes, if available, for Level 3 investments. If there is a material difference in the prices obtained, further evaluation is made. Market prices and valuations from sources such as the Bloomberg system, TRACE and dealer offerings are used as a check on the prices obtained from the independent pricing services. Should a material difference exist, then an internal valuation is made. For purposes of valuing these securities management produces expected cash flows for the security utilizing the standard mortgage security modeling capabilities available on the Bloomberg Professional System. The key inputs are the default rate, severity of default, and voluntary prepayment rate for the underlying mortgage collateral. These are generally based at the start on the actual historical values of these parameters for the prior three months. These cash flows are then discounted by a required yield derived from market based observations of broker inventory offerings, or in some cases Bloomberg Indices of like securities. Management uses this valuation model primarily with mortgage backed securities where the matrix pricing methodology used by the independent pricing service is too broad in its categorizations. This often involves differences in reasonable prepayment assumptions or significant differences in performance among issuers. In some cases, other external observable inputs such as credit default swap levels are used as input in the fair value analysis.

Fixed Maturities

For U. S. Treasury, U. S. government and corporate bonds, the independent pricing services obtain information on actual transactions from a large network of broker-dealers and determine a representative market price based on trading volume levels. For asset backed and mortgage backed instruments, the independent pricing services obtain information on actual transactions from a large network of broker-dealers and sorts the information into various components, such as asset type, rating, maturity, and spread to a benchmark such as the U.S. Treasury yield curve. These components are used to create a pricing matrix for similar instruments.

All broker-dealer quotations obtained are non-binding. For short-term investments classified as Level 1 and Level 2, the Company uses prices provided by independent pricing services. The preferred stocks classified as Level 3 are all auction rate preferred shares, and the Company utilizes an internal model incorporating observable market inputs.

The Company uses the following hierarchy for each instrument in total invested assets:

1. The Company obtains a price from an independent pricing service.

2. If no price is available from an independent pricing service for the instrument, the Company obtains a market price from a broker-dealer or other reliable source, such as Bloomberg.

3. The Company then validates the price obtained by evaluating its reasonableness. The Company's review process includes quantitative analysis (i.e., credit spreads and interest rate and prepayment fluctuations) and initial and ongoing evaluations of methodologies used by outside parties to calculate fair value and comparing the fair value estimates to its knowledge of the current market. If a price provided by a pricing service is considered to be materially different from the other indications that are obtained, the Company will make a determination of the proper fair value of the instrument based on data inputs available.

In order to determine the proper ASC 320-10-65 classification for each instrument, the Company obtains from its independent pricing service the pricing procedures and inputs used to price the instrument. The Company analyzes this information, taking into account asset type, rating and liquidity, to determine what inputs are observable and unobservable in order to determine the proper ASC 320-10-65 level. For those valued internally, a determination is made as to whether all relevant inputs are observable or unobservable in order to classify correctly.

All of the Company's Level 1 and Level 2 invested assets held at December 31, 2013 and 2012 were priced using either independent pricing services or available market prices to determine fair value. The Company classifies such instruments in active markets as Level 1 and those not in active markets as Level 2. The Preferred stocks in Level 3 were auction preferred instruments and were classified in Level 3 because the market in which they trade remains very inactive. The Corporate bonds in Level 3 are private placements which rarely trade and the issuers have no other debt outstanding to provide a valuation benchmark. The residential mortgage backed securities which are valued in the manner described above are classified as Level 3. Those for which the individual pricing service value is used are classified as Level 2.

The quantitative disclosures about the fair value measurements for each major category of assets at December 31, 2013 and 2012 were as follows:

		December 31, 2013	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
			(Amounts in thousands)		
Assets:					
U.S. Treasury	$	8,991	8,991	-	-
U.S. Government agencies		3,532	-	3,532	-
Corporate bonds		132,220	-	130,950	1,270
Mortgage backed		9,212	-	9,212	-
Total available-for-sale securities		153,955	8,991	143,694	1,270
Preferred stocks		2,407	1,633	-	774
Common stocks		420	420	-	-
Certificates of deposit		100	100	-	-
Short-term investments		25,244	7,882	17,362	-
Total assets classified by ASC 320-10-65(1)	$	182,126	19,026	161,056	2,044
Percentage of total		100%	10%	89%	1%

(1) The investments classified as Other long-term investments are outside the scope of ASC 320-10-65 and, therefore, not disclosed in the table as invested assets classified by ASC 320-10-65.

	December 31, 2012	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(Amounts in thousands)			
Assets:				
U.S. Treasury	$ 6,634	6,634	-	-
U.S. Government agencies	4,530	-	4,530	-
Corporate bonds	129,757	4,487	123,196	2,074
Asset backed	1,339	-	1,339	-
Mortgage backed	12,165	-	11,564	601
Total available-for-sale securities	154,425	11,121	140,629	2,675
Preferred stocks	2,634	1,783	-	851
Common stocks	536	536	-	-
Common stocks, trading	27	27	-	-
Certificates of deposit	100	100	-	-
Short-term investments	40,720	14,754	25,966	-
Total assets classified by ASC 320-10-65(1)	$ 198,442	28,321	166,595	3,526
Percentage of total	100%	14%	84%	2%

(1) The investments classified as Other long-term investments are outside the scope of ASC 320-10-65 and, therefore, not disclosed in the table as invested assets classified by ASC 320-10-65.

Level 1 includes U.S. Treasury securities and exchange-traded securities. Level 2 securities are comprised of securities whose fair value was determined using observable market inputs. Investments classified as Level 3 are primarily comprised of the following: (i) with respect to fixed maturity investments, certain corporation and mortgage backed securities that values provided by an independent pricing service or quoted market prices were not used, many of which are not publicly traded or are not actively traded; and (ii) with respect to equity securities, preferred securities.

The following table provides a summary of changes in fair value associated with the Level 3 assets for the years ended December 31, 2013 and 2012:

		Fair Value Measurements Using Significant Unobservable Inputs (Level 3)	
		December 31,	
		2013	2012
		(Amounts in thousands)	
Beginning balance	$	3,526	8,812
Total gains or losses (realized/unrealized):			
Included in earnings (or changes in net assets)		(14)	-
Included in other comprehensive loss		(1,468)	(1,652)
Purchases, issuances, and settlements, net		-	-
Transfers in and/or out of Level 3		-	(3,634)
Ending balance	$	2,044	3,526

The above table of Level 3 assets begins with the prior period balance and adjusts the balance for the gains or losses (realized and unrealized) that occurred during the current period. Any new purchases that are identified as Level 3 securities are then added and any sales of securities which were previously identified as Level 3 are subtracted. Next, any securities which were previously identified as Level 1 or Level 2 securities and which are currently identified as Level 3 are added. Finally, securities which were previously identified as Level 3 and which are now designated as Level 1 or as Level 2 are subtracted. The ending balance of the Level 3 securities presented above represent our best estimates and may not be substantiated by comparisons to independent markets and, in many cases, could not be realized in immediate settlement of the instruments.

The Company wrote down Alt-A securities (Level 3) for the year ended December 31, 2013 that were determined to have had an other-than-temporary credit related impairment charge.

The Company wrote down Alt-A securities (Level 2) for the year ended December 31, 2012 that were determined to have had an other-than-temporary credit related impairment charge.

Securities transferred out of Level 3 in 2012 represent mortgage-backed securities with the Company previously valued internally. At present, fair values derived from an independent pricing service are utilized. Therefore, these securities were all transferred to Level 2. There were no transfers between Levels 1 and 2 during the periods presented.

(4) Note Payable

In September 2005, the Company entered into a credit agreement with a commercial bank. Interest, payable quarterly, accrued on any outstanding principal balance at a floating rate equal to the 3-month LIBOR. Subsequent amendments changed the interest rate to 3.25% over the three month LIBOR, with a minimum of 4%, and a usage fee of 0.25% on the unused line of credit, converted the credit agreement to a revolving loan with a revolving commitment of up to $15,000,000 and a maturity of December 12, 2014.

At December 31, 2013 and 2012, the monthly interest rate equaled the minimum rate of 4%, with a 0.25% usage fee on the unused note balance. The Company is able to draw on this revolving loan and repay in increments of $100,000 without premium or penalty. Borrowings under the revolving loan are collateralized by the common stock of MGA and NSL, and payment is guaranteed by NSL. The Company had drawn on the revolving loan in the amount of $5,000,000 on November 12, 2013 bringing the note payable balance as of December 31, 2013 to $9,900,000. The Company did not pay down the loan previously drawn down on at the end of 2012. The credit agreement governing the revolving loan contains covenants regarding limits on levels of subsidiary indebtedness, liens, investments, acquisitions, certain mergers, certain asset sales outside the ordinary course of business, and change in control as defined in the agreement. The agreement also contains financial covenants regarding capital of MGA, consolidated net worth of GANS and the combined ratio of the personal auto operation.

(5) Subordinated Debentures

In January 2006, GANS issued $25,000,000 of 30-year subordinated debentures. They require quarterly interest payments at a floating interest rate equal to the 3-month LIBOR plus a margin of 3.85%. They will mature on March 31, 2036 and are redeemable at GANS' option, in whole or in part, at the liquidation amount of $1,000 per debenture.

In December 2006, GANS issued $18,000,000 of 30-year subordinated debentures. They require quarterly interest payments at a floating interest rate equal to the 3-month LIBOR plus a margin of 3.75%. They will mature on March 15, 2037 and are redeemable at GANS' option, in whole or in part, at the liquidation amount of $1,000 per debenture.

The following table summarizes net interest expense recorded and interest payments made in 2013 and 2012:

		2013		2012	
		Net interest expense	Interest payments	Net interest expense	Interest payments
		(Amounts in thousands)			
Note payable	$	252	183	88	84
Subordinated debenture I		1,038	1,064	1,085	1,113
Subordinated debenture II		725	748	758	783
Total	$	2,015	1,995	1,931	1,980

(6) Reinsurance

(a) Assumed

The Company has, in the past, utilized reinsurance arrangements with various non-affiliated admitted insurance companies, whereby the Company underwrote the coverage and assumed the policies 100% from the companies. These arrangements required that the Company maintain escrow accounts to assure payment of the unearned premiums and unpaid claims and CAE relating to risks insured through such arrangements and assumed by the Company.

The following table summarizes the amounts related to the arrangements as of and for the years ended December 31, 2013 and 2012:

		December 31,	
		2013	2012
		(Amounts in thousands)	
Balances held in escrow	$	1,938	2,516
Premiums earned by assumption	$	505	791
Assumed unpaid claims and claim adjustment expenses	$	1,148	1,549

(b) Ceded

Runoff Lines

On February 7, 2002, the Company announced its decision to cease writing commercial, specialty and umbrella lines of insurance due to continued adverse claims development and unprofitable underwriting results, these lines became known as runoff lines. The Company has ceded unpaid claims and CAE of $936,000 as of December 31, 2013.

Nonstandard Personal Auto Lines

In 2012, the Company maintained catastrophe reinsurance on its physical damage coverage for property claims of $14,000,000 in excess of $1,000,000 for a single catastrophe, as well as for aggregate catastrophes. For 2013, the Company maintains catastrophe reinsurance on its physical damage coverage for property claims of $6,500,000 in excess of $1,000,000 for a single catastrophe, as well as $13,000,000 for aggregate catastrophes.

The amounts included in the consolidated statement of operations for reinsurance ceded as of and for the years ended December 31, 2013 and 2012, respectively, are set forth in the following table:

		December 31,	
		2013	2012
		(Amounts in thousands)	
Premiums earned – nonstandard personal auto	$	656	1,031
Claims and claim adjustment expenses – runoff	$	25	3

The Company remains directly liable to their policyholders for all policy obligations and the reinsuring companies are obligated to the Company to the extent of the reinsured portion of the risks.

(7) Property and Equipment

The following schedule summarizes the components of property and equipment:

		As of and for the years ended December 31	
		2013	2012
		(Amounts in thousands)	
Leasehold improvements	$	509	509
Furniture		1,286	1,117
Equipment		2,898	2,707
Software		6,403	6,107
Accumulated depreciation and amortization		(8,884)	(8,148)
Property and equipment, net	$	2,212	2,292
Depreciation expense	$	987	795

(8) Inventory

As of December 31, 2013, the following table summarizes the components of Inventory (amounts in thousands):

		2013
Productive material and supplies	$	15
Finished products, including service parts		6,586
Total inventories	$	6,601

(9) Claims and Claim Adjustment Expenses

The following table sets forth the changes in unpaid claims and claim adjustment expenses, net of reinsurance cessions, as shown in the Company's consolidated financial statements for the periods indicated:

		As of and for the years ended December 31, 2013	2012
		(Amounts in thousands)	
Unpaid claims and claim adjustment expenses, beginning of period	$	79,643	77,181
Less: Ceded unpaid claims and claim adjustment expenses, beginning of period		899	1,591
Net unpaid claims and claim adjustment expenses, beginning of period		78,744	75,590
Net claims and claim adjustment expense incurred related to:			
Current period		130,444	136,342
Prior periods		10,491	9,534
Total net claim and claim adjustment expenses incurred		140,935	145,876
Net claims and claim adjustment expenses paid related to:			
Current period		79,250	85,848
Prior periods		67,870	56,874
Total net claim and claim adjustment expenses paid		147,120	142,722
Net unpaid claims and claim adjustment expenses, end of period		72,559	78,744
Plus: Ceded unpaid claims and claim adjustment expenses, end of period		936	899
Unpaid claims and claim adjustment expenses, end of period	$	73,495	79,643

The unfavorable development in net claims and CAE incurred related to prior periods for 2013 was primarily attributable to the Florida personal injury protection litigation in prior years. The unfavorable development in net claims and CAE incurred related to prior periods for 2012 was primarily attributable to Florida personal injury protection litigation of $13.5 million.

The following table presents the (unfavorable) favorable development in nonstandard personal auto for claims occurring in prior accident years for each region for the years ended December 31, 2013 and 2012:

	December 31,			
	2013		2012	
	(Amounts in thousands)			
Region:				
Southeast (Florida, Georgia, South Carolina and Virginia)	$	(10,197)	$	(12,486)
Southwest (Arizona, California, New Mexico, Nevada and Texas)		(210)		3,038
Net (unfavorable) favorable development	$	(10,407)	$	(9,448)

(10) Federal Income Taxes

In the accompanying consolidated statements of operations, the provisions for Federal income tax as a percent of related pretax income (loss) differ from the Federal statutory income tax rate. A reconciliation of income tax expense using the Federal statutory rates to actual income tax expense follows:

		December 31,	
		2013	2012
		(Amounts in thousands)	
Income tax (benefit) expense at 34%	$	1,929	(23)
Change in net valuation allowance		(5,530)	(208)
Other, net		(151)	549
Income tax (benefit) expense	$	(3,752)	318

The Company recognized a current tax expense for the alternative minimum tax for the years ended December 31, 2013 and 2012:

		2013	2012
		(Amounts in thousands)	
Current tax expense (benefit)	$	76	(76)
Federal Income Tax paid	$	25	165

Under ASC 740-10-65, the primary objective is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled. As a consequence, the portion of the tax expense, which is a result of the change in the deferred tax asset or liability, may not always be consistent with the income reported on the statements of operations. At December 31, 2013, the Company has not identified any uncertain tax positions in accordance with ASC 740-10-65.

As a result of losses in prior years, the Company has NOL carryforwards for tax purposes aggregating the following (amounts in thousands) at December 31, 2013:

		2013
Year set to expire		
2021	$	25,581
2022		13,687
2023		633
2027		12,901
NOL carryforward	$	52,802
Tax benefit of the NOL carryfoward	$	17,953

The tax benefit of the NOL carryforwards is calculated by applying the Federal statutory income tax rate of 34% against the NOL carryforwards. The Company does not record a tax valuation allowance relating to the net unrealized losses on investments, excluding common stocks, because it is more likely than not that these losses would reverse or be utilized in future periods. The Company has the ability and it is the Company’s intent to fully recover the principal, which could require the Company to hold these securities until their maturity; therefore, the Company considers the impairment to be temporary.

The following table represents the tax effect of temporary differences giving rise to the net deferred tax asset established under ASC 740-10-65.

		As of December 31,	
		2013	2012
		(Amounts in thousands)	
Deferred tax assets:			
Net operating loss carryforward	$	17,953	19,355
Discount on unearned premium reserve		3,070	3,055
Unearned fees		863	853
Discount on unpaid claims and claim adjustment expenses		830	1,296
Alternative Minimum Tax carryforward		562	476
Realized capital losses		536	494
Allowance for doubtful accounts		262	214
Net unrealized losses on investments		224	-
Total deferred tax assets		24,300	25,743
Deferred tax liabilities:			
Deferred policy acquisition costs		2,310	2,298
Accrual of discount on bonds		348	268
Depreciation and amortization		223	137
Net unrealized gains on investments		-	307
Other		163	-
Total deferred tax liabilities		3,044	3,010
Net deferred tax asset before valuation allowance		21,256	22,733
Valuation allowance		(14,843)	(20,373)
Net deferred tax asset	$	6,413	2,360

During 2013, the Company reduced the valuation allowance associated with the deferred tax asset by $3,828,000, which is the change in the expectation on the utilization of the NOL carryforwards. Under ASC 740-10, positive evidence, such as taxable income over the most recent three-year period and other available objective and subjective evidence, requires management to conclude that it is “more likely than not” that a portion or all of the deferred tax benefit will be realized. While both objective and subjective evidence are considered, objective evidence should generally be given more weight in the analysis under ASC 740-10. In making the determination, the Company considered all available evidence, including the fact that the Company had estimated cumulative taxable income for the three years ended December 31, 2013 of approximately $13,214,000. Based on a review of available evidence, management concluded that it is more likely than not that the Company will have future taxable income to utilize $6,189,000 of the net deferred tax asset prior to its expiration. The amount of the deferred tax benefit that may ultimately be realized could be affected by changes in tax rates, changes to applicable tax carryforward periods or other statutory or regulatory changes that may limit or impair the value thereof. The deferred tax valuation allowance at December 31, 2013 was $14,843,000 ($3.04 per share).

(11) Shareholders' Equity

The Company has authorized 12,500,000 shares of common stock, par value $.10 per share (the "Common Stock"). Of the authorized shares of common stock, 5,148,232 shares were issued and 4,889,582 shares were outstanding as of December 31, 2013 and 2012. At December 31, 2013 and 2012, the Company held 258,650 shares as treasury stock, respectively.

At December 31, 2013 and 2012, Goff Moore Strategic Partners, LP ("GMSP") owned approximately 34% of the outstanding Common Stock and James R. Reis owned approximately 12%. At December 31, 2013 and 2012, Robert W. Stallings owned approximately 36% and 24% of the outstanding Common Stock, respectively.

On December 7, 2012, the Company announced that its Board of Directors approved a special cash dividend of $1 per share ($4,889,582). The special cash dividend was paid on December 27, 2012 to shareholders of record on December 18, 2012 and was charged to Additional paid-in capital. There were no dividends declared or paid in 2013.

The following table reflects changes in the number of shares of common stock outstanding for the years ended December 31, 2013 and 2012:

	2013	2012
Shares outstanding		
Balance at beginning of period	4,889,582	4,779,852
Shares issued	-	110,000
Balance at end of period	4,889,582	4,889,582

In November 2007, the Board of Directors of the Company authorized the repurchase of up to $5 million worth of the Company's Common Stock. Repurchase may be made from time to time in both the open market and through negotiated transactions. The value of shares that may yet be purchased under the plan was $1,859,354 at December 31, 2013.

The following table presents the statutory policyholders' surplus for MGA as of December 31, 2013 and 2012, and the statutory net income for MGA for the year ended December 31, 2013 and 2012:

		2013	2012
		(Amounts in thousands)	
Statutory policyholders' surplus	$	102,695	91,766
Statutory net income	$	6,440	516

Statutes in Texas restrict the payment of dividends by MGA for any 12 month period to the greater of net income for the preceding year or 10% of surplus as regards policyholders as of the preceding December 31. This amount cannot be greater than unassigned surplus as of the preceding December 31. At December 31, 2013, $10,269,000 is available for dividend payments. Dividends cannot be paid without regulatory notification of no objection from the Texas Department of Insurance.

The Company's statutory capital exceeds the benchmark capital level under the Risk Based Capital ("RBC") formula for its insurance companies. RBC is a method for establishing the minimum amount of capital appropriate for an insurance company to support its overall business operations in consideration of its size and risk profile. As of December 31, 2013, the Company's RBC authorized control level was $13,473,000 and the total adjusted capital was $102,695,000.

(12) Earnings Per Share

The following table sets forth the computation of basic and diluted income (loss) per share (amounts in thousands, except for per share data):

		Years ended December 31,	
		2013	2012
Numerator:			
Net income (loss)	$	9,425	(387)
Numerator for basic earnings per share – income (loss) available to common shareholders		9,425	(387)
Numerator for diluted earnings per share – income (loss) available to common shareholders after assumed conversions	$	9,425	(387)
Denominator:			
Denominator for basic earnings per share – weighted average common shares outstanding		4,890	4,807
Denominator for diluted earnings per share – adjusted weighted average common shares outstanding & assumed conversions		4,890	4,807
Basic earnings (loss) per share	$	1.93	(.08)
Diluted earnings (loss) per share	$	1.93	(.08)

(13) Benefits

The Company has a 401(k) plan for the benefit of its eligible employees. The Company made contributions to the plan that totaled $335,000 and $337,000 for 2013 and 2012, respectively.

The Company entered into executive severance agreements in 2002 with two executive officers, Richard M. Buxton and Daniel J. Coots. The agreements generally provide that the Company shall pay the executive, upon termination of the employment of the executive by the Company without cause or by the executive with good reason during the term of the agreement, a lump sum severance amount equal to the base annual salary of the executive as of the date that the executive's employment with the Company ends. The executive severance agreements do not supersede change in control agreements or any other severance agreements the employees may have with the Company.

As an integral part of the recapitalization consummated in January 2005, the Company entered into new employment agreements with Messrs. Stallings and Reis and an amended employment and related agreements with Mr. Glenn W. Anderson, which were approved by shareholders on January 18, 2005.

The terms of the employment agreements with Messrs. Stallings and Reis are each three years, and each term is automatically extended by an additional year on the same terms and conditions on each anniversary of the effective date (so that, as of each anniversary of the effective date, the term of the employment agreement remains three years), unless either party gives notice of an intention not to extend the term. As of December 31, 2013, the terms and conditions of the employment agreements have been extended.

The term of Mr. Anderson's employment is four years and is automatically extended by an additional year on the same terms and conditions on each anniversary of the effective date (so that, as of each anniversary of the effective date, the term of the employment agreement remains four years), unless either party gives notice of an intention not to extend the term. As of December 31, 2013, the terms and conditions of the employment agreement have been extended.

In 2011, the Company instituted a deferred compensation plan for certain key employees. It has a five-year performance period with annual performance objectives based on the Company achieving minimum gross premiums written targets in 2012 through 2015 and target operating earnings before tax in 2011 through 2015. Compensation is recognized based on achieving individual year performance targets or on achieving cumulative performance results. The compensation is recognized as expense in the current year and deferred for payment under the terms of the plan five years later. For 2013, the deferred compensation payable recorded was $470,000 resulting from achieved performance results from 2011. There was no compensation expense recorded during 2012.

In 2013, this deferred compensation plan was amended for all participants. The amended plan has a five-year performance period from 2014 through 2019 with annual performance objectives based on the Company achieving minimum gross premiums written targets and target operating earnings before tax (attributable to the private passenger automobile insurance business). Compensation expense is recognized based on achieving individual year performance targets or on achieving cumulative performance results. The compensation is recognized as an expense in the current year and deferred for payment five years later under terms of the plan. The amendment removed consideration for deferred compensation for 2013 for these key employees. As a result, there was no compensation expense recorded for 2013.

In the third quarter of 2012, the Board of Directors granted stock awards of 110,000 shares to three of the Company's executive officers. The awards were fully vested upon grant and $1,100,000 was recognized as compensation expense in Underwriting and operating expense based on fair value of $10.00 per share, which was the closing price of our Common Stock on the date of grant. There were no stock awards granted or exercised in 2013.

(14) Commitments and Contingencies

Legal Proceedings

In the normal course of its operations, the Company is named as defendant in various legal actions seeking monetary damages, including cases involving business disputes and those involving allegations that the Company wrongfully denied insurance claims and is liable for damages. Some cases involving insurance claims seek amounts significantly in excess of our policy limits. In the opinion of the Company's management, based on the information currently available, the ultimate liability, if any, resulting from the disposition of such litigation will not have a material adverse effect on the Company's consolidated financial position or results of operations. However, in view of the uncertainties inherent in such litigation, it is possible that the ultimate cost to the Company might exceed the reserves we have established by amounts that could have a material adverse effect on the Company's future results of operations, financial condition and cash flows in a particular reporting period.

In November 2010, a claim for recovery of damages of less than $500 in a Personal Injury Protection ("PIP") in Dade County, Florida (Feijoo v. MGA Insurance Company, Inc.) was amended, with the plaintiff seeking to convert the case to a putative class action representing all persons similarly situated with respect to PIP claims in Florida against MGA. The Amended Complaint seeks damages of an unspecified amount and equitable and other relief. In August 2012, the Court dismissed the class action claims with prejudice, and the individual PIP case was subsequently transferred to County Court. Dismissal of the class action claims is subject to possible appeal by the named Plaintiff at the conclusion of the individual case. While such litigation is inherently unpredictable, the Company believes that the complaint is without merit and intends to defend itself vigorously. As a result, the Company is unable to reasonably estimate a possible range of losses, if any, arising from the litigation.

In April 2011, a putative class action was filed in Dade County, Florida, against MGA (Advanced Chiropractic Center Company, D/B/A Accident & Wellness Centers, as Assignee v. MGA Insurance Company, Inc.). This lawsuit, purportedly brought on behalf of all persons similarly situated with respect to PIP claims in Florida, asserts that the defendant has failed to comply with requirements of the Florida Personal Injury Protection ("PIP") law by improperly calculating the amounts charged against PIP deductibles and seeks damages of an unspecified amount and equitable and other relief. While such litigation is inherently unpredictable, the Company believes that the complaint is without merit and intends to defend itself vigorously. As a result, the Company is unable to reasonably estimate a possible range of losses, if any, arising from the litigation.

In November 2011, a complaint was filed against MGA in the Circuit Court of the Seventeenth Judicial Circuit in and for Broward County, Florida (Pericles v. MGA Insurance Company, Inc.). The complaint arises out of an automobile accident that occurred in 2007. MGA denied coverage under a policy that had expired on the date of the accident. The plaintiff obtained a judgment against the named insured and the driver and is now seeking to enforce the judgment against MGA based on allegations of bad faith. A summary judgment in favor of MGA was granted by the Court in June 2013. The plaintiff has appealed the grant of summary judgment.

In February 2014, a complaint was filed in United States District Court for the Middle District of Florida by 20 automobile body shops, naming as defendants approximately 40 insurance companies, including MGA (A & E Auto Body, Inc. et al. v. 21st Century Centennial Insurance Company d/b/a Farmers Insurance Group, et al.). The complaint alleges various anticompetitive practices used by the defendants to control and depress automobile damage repair costs in Florida. While such litigation is inherently unpredictable, the Company believes that the complaint is without merit and intends to defend the case vigorously. As a result, the Company is unable to reasonably estimate a possible range of losses, if any, arising from the litigation.

Off-balance-sheet-risk

The Company does not have any financial instruments where there is off-balance-sheet-risk of accounting loss due to credit or market risk. There is credit risk in the premiums receivable and reinsurance balances receivable of the Company. At December 31, 2013 and 2012, the Company did not have any claims receivables by individual reinsurers that were material with regard to shareholders' equity.

(15) Leases

The Company entered into a ten-year lease agreement for the home office in May of 2005. After the Company amended the lease in November 2013, a total of 57,204 square feet of office space were leased extending the lease a further ten years. Under the terms of this lease, the Company has the option of terminating the lease agreement at the end of September 2023, subject to payment of a penalty. The Company entered into an eleven-year lease agreement for the Florida office in May of 2010 that includes rentable office space of 22,480 square feet. Under the terms of this lease, the Company has the option of renewing for two additional five year periods through the year 2031. The Company also has the option of terminating the lease agreement during the sixth year of the term subject to payment of a penalty.

The Company assumed the lease of the commercial lease agreement on the auto dealership on the acquisition date. Under the terms of the lease, the Company has the option of extending the lease.

The following table summarizes the Company's lease obligations as of December 31, 2013 (amounts in thousands).

Year		Amount
2014	$	2,213
2015		2,685
2016		1,736
2017		2,036
2018		2,076
Thereafter		13,889
Total	$	24,635

Rental expense is recognized over the term of the lease on a straight line basis for the Florida and the dealership leases only and the home office is expensed as incurred. Rental expense for the Company was $1,859,000 and $1,721,000 for the years ended December 31, 2013 and 2012, respectively.

(16) Acquisition of Auto Dealership

On November 13, 2013, the Company completed the asset purchase of a Hyundai auto dealership in Dallas, Texas by its subsidiary SAG. The cash paid for this acquisition was $7.7 million, subject to certain closing adjustments. The excess of the purchase price over the fair value of the net tangible assets acquired was preliminarily allocated between a valued franchise license (indefinite lived) of $4,800,000 and goodwill of $2,700,000.

The following table summarizes the aggregate consideration and the fair value of net assets acquired at the acquisition date (amounts in thousands):

Auto vehicle inventory	$	5,840
Fixed assets		239
Other assets		43
Accounts payable		(43)
Floor plan note		(5,892)
Net tangible assets acquired		187
Intangible assets		7,500
Cash paid for acquisition	$	7,687

Management determined the purchase price allocations for the acquisition based on estimates of the fair values of the tangible net assets acquired. The fair value of the net assets acquired is preliminary and remain subject to potential adjustments in the valuation of acquired intangibles.

The results of the acquired auto dealership are included in our results beginning November 14, 2013. The following table summarizes the actual amounts included in revenue and earnings in our consolidated financial statements for the year ended December 31, 2013 (amount in thousands), based on the information that was available to management at the time these consolidated financial statements were prepared:

Gross auto sales	$	5,521
Net loss	$	331

In connection with our acquisition of the net assets of the auto dealership in November 2013, the Company entered into a floor plan credit agreement with a commercial bank, which is lending to finance the purchase of auto vehicle inventory, also known as wholesale or inventory financing. In general, the floor plan line is secured by all financed vehicles. The floor plan note is usually structured to yield interest at a floating rate indexed to the prime rate. The rate for a particular dealership is based on, among other things, the dealership's credit worthiness, the amount of the credit line, the risk rating and whether or not the dealership is in default. Interest on floor plan loans is payable monthly on the first day of each month, accrued on any outstanding principal balance at a floating rate to be the lesser of (a) one and six tenths percent above LIBOR in effect on the first day of each LIBOR period or (b) the maximum rate. The credit agreement has a total commitment of up to $7,600,000 and a maturity of December 31, 2014.

At December 31, 2013, the monthly interest rate equaled 1.76875%, with a 1.60% above the LIBOR rate. The amount of the floor plan note as of December 31, 2013 totaled $7,370,000 covering new and used auto vehicle inventory. The Company is able to make advances from time to time not to exceed at any time the aggregate principal amount. All advances shall be evidenced by a promissory note. The credit agreement governing the promissory note contains covenants regarding limits on borrowing/curtailment to new, used, aged used and demo auto vehicles. The agreement also contains financial covenants regarding tangible net worth and maximum loan to value position. For the year ended December 31, 2013, BSHI expensed interest on the floor plan note totaling $3,000. No interest was paid during 2013, as interest is paid on the first day of each month.

(17) Related Parties

In January 2013, the Company entered into a Sponsorship Agreement with Stallings Capital Group Consultants, Ltd. dba Bob Stallings Racing (“Stallings Racing”), continuing the Company’s role as the primary sponsor of a Daytona Prototype Series racing team through December 31, 2013. The Sponsorship Agreement provides that, in consideration of the payment by the Company of a sponsorship fee of $1,000,000, the Company will receive various benefits customary for sponsors of Daytona Prototype Series racing teams, including rights relating to signage on team equipment and access for customers and agents to certain race facilities. The sponsorship fee of $1,000,000 will be paid and expensed commencing February 1, 2013 and throughout the remainder of 2013. The related sponsorship fee will be recorded in the Underwriting and operating expenses line item, consistent with prior sponsorship payments. During 2013, the Company paid and expensed $1.0 million, as the primary sponsor for Stallings Racing.

Stallings Racing is owned and controlled by Robert W. Stallings, the Executive Chairman of the Company. The Company’s Board of Directors authorized the agreement at a meeting in November 2013. In authorizing the agreement, the Board of Directors considered Mr. Stallings’ role and concluded that, under the circumstances, the Sponsorship Agreement is fair to, and in the best interests of, the Company. The Sponsorship Agreement contains provisions protecting the Company’s interests, including a termination provision that permits the Company to unilaterally terminate the agreement at any time and thereby cease making installment payments of the sponsorship fee. In November 2013, the Board of Directors authorized a Sponsorship Agreement for 2014 under similar terms and conditions as the 2013 Sponsorship Agreement, with a sponsorship fee of $1,050,000.

(18) Subsequent Events

In January 2014, a newly-formed subsidiary of the Company, Red Dragon Properties I, Inc., entered into a real estate Purchase Agreement for the acquisition of land to relocate the motor vehicle dealer for the sale and service of new and used motor vehicles. The cash purchase price of the land was $1.1 million.

The Company has evaluated subsequent events from the balance sheet date through May 30, 2014, the date at which the consolidated financial statements were available to be issued, and determined that there are no other items to disclose.