

ALPS Corporation and Subsidiaries

Consolidated Financial Statements
(With Independent Auditor's Report Thereon)
December 31, 2017 and 2016

Contents

Independent auditor's report	1
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Financial statements	
Consolidated balance sheets	2-3
Consolidated statements of comprehensive income	4
Consolidated statements of changes in stockholders' equity	5
Consolidated statements of cash flows	6-7
Notes to consolidated financial statements	8-32



Independent Auditor's Report

RSM US LLP

To the Board of Directors
ALPS Corporation and Subsidiaries

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of ALPS Corporation and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2017 and 2016; the related consolidated statements of comprehensive income, changes in stockholders' equity, and cash flows for the years then ended; and the related notes to the consolidated financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ALPS Corporation and Subsidiaries as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

RSM US LLP

Omaha, Nebraska
April 26, 2018

ALPS Corporation and Subsidiaries

Consolidated Balance Sheets
December 31, 2017 and 2016

	2017	2016
Assets		
Investments:		
Investments in securities available for sale, at fair value:		
Fixed maturities	\$ 104,572,887	\$ 94,032,646
Equity securities	10,447,725	7,608,445
Total investments	115,020,612	101,641,091
Cash and cash equivalents	14,412,646	9,731,884
Accrued interest receivable	1,173,715	1,200,769
Accounts receivable	638,225	769,420
Premiums receivable	3,193,932	3,097,462
Income tax receivable	196,096	-
Reinsurance recoverable	68,276,233	45,636,429
Deferred tax assets	1,774,995	3,748,554
Property and equipment, net	7,394,739	7,621,341
Other assets	989,949	713,974
Total assets	\$ 213,071,142	\$ 174,160,924

See notes to consolidated financial statements.

	2017	2016
Liabilities and Stockholders' Equity		
Liabilities:		
Loss and loss adjustment expense reserves	\$ 116,602,281	\$ 90,519,895
Unearned premiums	25,041,775	23,658,973
Reinsurance payable, funds held under reinsurance treaties	15,729,030	5,493,972
Accounts payable and accrued expenses	4,638,503	5,220,741
Surplus notes	10,166,787	10,504,413
Long-term debt	5,656,832	6,224,858
Income tax payable	-	115,591
Total liabilities	177,835,208	141,738,443
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, 5% cumulative convertible	-	5,000,000
Common stock A, voting	3,522	3,522
Common stock C, voting	241	-
Additional paid-in capital	23,111,019	18,111,260
Retained earnings	32,402,553	30,053,102
Treasury stock	(23,159,186)	(22,080,722)
Accumulated other comprehensive income, net of tax	2,877,785	1,335,319
Total stockholders' equity	35,235,934	32,422,481
Total liabilities and stockholders' equity	\$ 213,071,142	\$ 174,160,924

ALPS Corporation and Subsidiaries

**Consolidated Statements of Comprehensive Income
Years Ended December 31, 2017 and 2016**

	2017	2016
Revenues:		
Premiums earned	\$ 46,902,314	\$ 44,876,559
Premiums ceded	(15,517,623)	(14,644,284)
Net premiums earned	31,384,691	30,232,275
Investment income, net	3,848,632	3,842,344
Realized loss on sale of investments	(205,466)	(263,342)
Other revenue	1,914,879	1,882,096
Total revenues	36,942,736	35,693,373
Expenses:		
Losses and loss adjustment expense	48,679,804	34,463,944
Reinsurance recoveries	(29,406,599)	(15,074,273)
Net losses and loss adjustment expenses	19,273,205	19,389,671
Underwriting expenses	1,058,746	1,334,276
Other operating expenses	12,715,969	11,003,032
Total expenses	33,047,920	31,726,979
Income before provision for income taxes	3,894,816	3,966,394
Provision for income taxes:		
Current	293,845	809,356
Deferred provision	1,178,956	536,091
Total provision for income taxes	1,472,801	1,345,447
Net income from continuing operations	2,422,015	2,620,947
Discontinued operations:		
Gain from sale of discontinued operations	187,500	587,500
Loss from operations of discontinued operations	-	(122,233)
Income tax expense	63,750	243,258
Income from discontinued operations	123,750	222,009
Net income	2,545,765	2,842,956
Other comprehensive income (loss) (net of tax):		
Net unrealized gain (loss) on marketable securities, net of tax	1,406,858	(685,980)
Reclassification adjustment for net realized loss (gain) included in net income, net of tax	135,608	173,806
Total other comprehensive income (loss)	1,542,466	(512,174)
Total comprehensive income	\$ 4,088,231	\$ 2,330,782

See notes to consolidated financial statements.

ALPS Corporation and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity Years Ended December 31, 2017 and 2016

	Common Stock A		Common Stock B		Common Stock C		Preferred Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock, at Cost		Total Stockholders' Equity
	Shares	Amount	Shares	Amount	Shares	Amount					Shares	Amount	
Balance, December 31, 2015	3,522	\$ 3,522	6,251	\$ 6,251	-	\$ -	\$ -	\$ 18,111,260	\$ 27,412,474	\$ 1,847,493	1,292	\$ (14,402,697)	\$ 32,978,303
Stock redemption	-	-	(6,251)	(6,251)	-	-	-	-	(77,328)	-	651	(9,470,195)	(9,553,774)
Stock issuance	-	-	-	-	-	-	5,000,000	-	-	-	(124)	1,792,170	6,792,170
Preferred dividends	-	-	-	-	-	-	-	-	(125,000)	-	-	-	(125,000)
Unrealized loss, net of tax	-	-	-	-	-	-	-	-	-	(512,174)	-	-	(512,174)
Net income	-	-	-	-	-	-	-	-	2,842,956	-	-	-	2,842,956
Balance, December 31, 2016	3,522	3,522	-	-	-	-	5,000,000	18,111,260	30,053,102	1,335,319	1,819	(22,080,722)	32,422,481
Stock redemption	-	-	-	-	-	-	-	-	(71,314)	-	80	(1,309,424)	(1,380,738)
Stock issuance	-	-	-	-	241	241	(5,000,000)	4,999,759	-	-	(14)	230,960	230,960
Preferred dividends	-	-	-	-	-	-	-	-	(125,000)	-	-	-	(125,000)
Unrealized loss, net of tax	-	-	-	-	-	-	-	-	-	1,542,466	-	-	1,542,466
Net income	-	-	-	-	-	-	-	-	2,545,765	-	-	-	2,545,765
Balance, December 31, 2017	3,522	\$ 3,522	-	\$ -	241	\$ 241	\$ -	\$ 23,111,019	\$ 32,402,553	\$ 2,877,785	1,885	\$ (23,159,186)	\$ 35,235,934

See notes to consolidated financial statements.

ALPS Corporation and Subsidiaries

Consolidated Statements of Cash Flows
Years Ended December 31, 2017 and 2016

	2017	2016
Cash flows from operating activities:		
Net income	\$ 2,545,765	\$ 2,842,956
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	606,864	658,149
Bond amortization or accretion	350,935	397,430
Deferred tax provision	1,178,956	536,091
Loss on sale of investments	205,466	263,342
Realized loss on disposal PP&E	112,110	-
Realized gain from discontinued operations	(187,500)	(587,500)
Changes in operating assets and liabilities:		
Accrued interest receivable	27,054	(112,597)
Accounts receivable	(56,114)	(341,520)
Premiums receivable	(96,470)	(55,362)
Reinsurance recoverable	(22,639,804)	(921,808)
Current income tax receivable and payable, net	(311,687)	208,204
Other assets	(275,975)	(113,409)
Loss and loss adjustment expense reserve	26,082,386	3,744,725
Unearned premiums	1,382,802	960,425
Reinsurance payable	10,235,058	(1,976,688)
Accounts payable and accrued expenses	272,997	1,018,871
Other	-	(16,429)
Net cash provided by operating activities	19,432,843	6,504,880
Cash flows from investing activities:		
Purchase of property and equipment	(424,673)	(340,304)
Purchase of fixed maturities	(30,121,927)	(30,866,143)
Purchase of equity securities	(19,777,971)	(206,794)
Proceeds from sale of discontinued operations	375,000	400,000
Proceeds from sales, maturities and repayments of bonds	19,535,027	18,138,168
Proceeds from sale of equity securities	17,842,893	608,087
Net cash used in investing activities	(12,571,651)	(12,266,986)

(Continued)

ALPS Corporation and Subsidiaries

Consolidated Statements of Cash Flows (Continued)
Years Ended December 31, 2017 and 2016

	2017	2016
Cash flows from financing activities:		
Payment of long-term debt	\$ (568,026)	\$ (543,055)
Payment of surplus notes	(337,626)	(767,867)
Payment of preferred dividends	(125,000)	(125,000)
Surplus payments	(71,314)	(77,328)
Stock redeemed	(1,309,424)	(9,476,446)
Issuance of stock, preferred and common stock	230,960	6,792,170
Net cash used in financing activities	(2,180,430)	(4,197,526)
Net change in cash and cash equivalents	4,680,762	(9,959,632)
Cash and cash equivalents:		
Beginning of year	9,731,884	19,691,516
End of year	<u>\$ 14,412,646</u>	<u>\$ 9,731,884</u>
Supplemental disclosures of cash flow information:		
Cash paid for interest	<u>\$ 757,853</u>	<u>\$ 732,728</u>
Cash paid for taxes	<u>\$ 633,000</u>	<u>\$ 842,000</u>
Supplemental disclosures of noncash transactions:		
Payables for securities	<u>\$ -</u>	<u>\$ 922,934</u>
Receivables for securities	<u>\$ 1,010</u>	<u>\$ 819</u>

See notes to consolidated financial statements.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 1. Organization

Principles of consolidation: ALPS Corporation is a stock corporation and parent holding company organized under Montana law. ALPS Corporation owns 100 percent of the outstanding shares of each of the following entities: (i) ALPS Property & Casualty Insurance Company (ALPS P&C), a Montana domestic stock insurer that primarily underwrites lawyers' professional liability insurance on a claims-made and reported basis; (ii) ALPS Insurance Agency, Inc. (AIA), a Montana corporation that provides insurance underwriting, claims adjusting, insurance producer and other insurance-related services; and (iii) The Florence Missoula, LLC, a Montana limited liability company that owns and manages the Florence building, located in Missoula, Montana. For purposes of these consolidated financial statements, including the notes attached hereto, the term Company refers to ALPS Corporation and each of the foregoing wholly owned subsidiaries.

During 2016, the Company sold 100 percent of its interest in Peak Investment Management, Ltd. (PEAK), a Montana corporation that operated as a registered investment management company.

During 2016, the Company discontinued the operations of ALPS Risk and Insurance Services, Inc. (ARIS), a Montana corporation that provided startup, management, administrative and support services to captive insurers and other alternative risk transfer entities.

The accompanying consolidated financial statements include the accounts of ALPS Corporation and its wholly owned subsidiaries as of December 31, 2017 and 2016, and the related consolidated statements of comprehensive income, changes in stockholders' equity, and cash flows for the years then ended. All significant intercompany accounts and transactions have been eliminated.

ALPS P&C is a Montana corporation, admitted in and regulated by the State of Montana as a casualty insurance company. ALPS P&C issues policies of professional liability insurance, employment practices liability insurance, and cyber risk and security breach liability insurance to attorneys and law firms.

As of December 31, 2017, ALPS P&C operates exclusively as a fully licensed and admitted insurance company in 45 states, the District of Columbia and the U.S Virgin Islands. The Company relinquished its status and eligibility as a risk retention group (RRG) effective July 8, 2016, and no longer issues policies of insurance as an RRG in any jurisdiction.

Note 2. Summary of Significant Accounting Policies

Basis of presentation: The Company's consolidated financial statements have been presented in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP), as codified by the Financial Accounting Standards Board (FASB).

Cash and cash equivalents: For purposes of the Company's consolidated statements of cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Investments: The Company's investments in fixed-income and equity securities have been designated as available-for-sale and are reported at fair value, with the net unrealized appreciation (depreciation) and other-than-temporary impairments determined to be noncredit-related included in other comprehensive income, net of deferred income taxes, and accumulated other comprehensive income included in stockholders' equity.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 2. Summary of Significant Accounting Policies (Continued)

Fair value is based on an exit price, which is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company employs a hierarchical disclosure framework, which prioritizes and ranks the level of market price observability used in measuring financial instruments at fair value. Market price observability is affected by a number of factors, including the type of instrument and the characteristics specific to the instrument. Financial instruments with readily available active quoted prices or for which fair value can be measured from actively quoted prices generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Investment in a limited partnership is carried at the fair value of the underlying equity investments, measured as the Company's percentage of ownership of the underlying net assets, and is included in the equity securities category in the consolidated balance sheets.

Investment in a limited liability company is carried at fair value of the underlying fund, measured using the net asset value per share (or its equivalent) practical expedient, and is included in the equity securities category in the consolidated balance sheets.

Declines in the fair value of invested assets are reviewed on a quarterly basis to assess whether any other-than-temporary impairment loss should be recorded. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to period-end, forecasted performance of the investee, and the general market condition in the geographic area or industry the investee operates in. For debt securities with unrealized losses due to market conditions or industry-related events and where no specific evidence of deterioration of the issuers' credit exists, if the Company does not intend to sell the debt security and it is more likely than not the Company will not be required to sell the security before a market recovery or maturity, other-than-temporary impairments are not recorded. For equity securities, the Company considers the severity of impairment, duration of impairment, forecasted recovery period, industry outlook, financial condition of the issuer, projected cash flows, issuer credit ratings, and the intent and ability of the Company to hold the investment until the recovery of the cost. For equity securities that are deemed to have an other-than-temporary impairment, the loss is recorded in net income.

If the Company intends to sell a debt security or it is more likely than not that the Company would be required to sell a security before the recovery of its amortized cost, the Company records an other-than-temporary impairment and divides the loss between credit and noncredit. The Company recognizes the credit loss portion in net income and the noncredit loss portion in other comprehensive income and accumulated other comprehensive income. The credit loss portion is determined by comparing the net present value of projected future cash flows with the amortized cost basis of the debt security. The net present value is calculated using the Company's best estimate of the projected future cash flows at the effective interest rate implicit in the debt security at the date of acquisition.

The cost of investments sold is based on the specific-identification method. Investment income is recognized as earned. Bond premiums and discounts are amortized or accreted by the scientific-yield method and are charged or credited to net investment income.

Recognition of insurance premiums, revenues and costs: All insurance-related revenues, benefits and expenses are reported net of reinsurance. Ceded reinsurance amounts with reinsurers relating to reinsurance recoverables for paid and unpaid loss and loss adjustment expenses and ceded unearned premiums are reported on the consolidated balance sheets on a gross basis.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 2. Summary of Significant Accounting Policies (Continued)

Premiums are recognized as revenue ratably over the terms of the respective policies. Unearned premiums are calculated on the daily pro rata method. Premiums receivable from policyholders are recorded at cost with no allowance provided, as policies are monitored and canceled before their unearned premium is greater than any corresponding finance balance. The cost of reinsurance ceded is recognized ratably over the term of the underlying direct policies.

The Company offers an extended reporting period (ERP) endorsement that extends the reporting period during which a claim may be first reported to the Company after expiration or cancellation of the policy period. Where applicable, liabilities associated with ERP endorsements are included in the liability for loss and loss adjustment reserves.

Insurance liabilities: The liability for incurred but unpaid losses and loss adjustment expense represents estimates of the ultimate cost of losses and the cost to process those losses. The estimated ultimate cost of the losses is intended to provide for outstanding case-basis reserves on known claims, future development of those case-basis reserves, and incurred but not reported (IBNR) claims. Such estimates are made without regard to the time value of money. The Company estimates IBNR reserves by applying actuarial standards and loss development factors to historical claims experience. Liabilities for unpaid losses and loss adjustment expenses are necessarily based on assumptions and estimates. While management believes the reported reserve amount is adequate, the ultimate liability may be in excess of or less than the reserve amount reported. The methods for making such estimates and recognizing the liability for unpaid losses and loss adjustment expenses are continually reviewed, and any adjustments are reflected in the period determined.

Reinsurance: In the normal course of business, the Company seeks to reduce its exposure to the risk of loss that may arise from unfavorable underwriting results by transferring a portion of this risk to other insurance enterprises or insurers. The Company records amounts recoverable from its reinsurers on paid losses plus an estimate of amounts recoverable on unpaid losses. The estimate of amounts recoverable on unpaid losses is a function of the Company's liability for unpaid losses associated with the reinsured policies; therefore, the amount changes in conjunction with any changes to the Company's estimate of unpaid losses. Since the estimate of amounts recoverable from reinsurers on unpaid losses may change at any point in the future because of its relation to the Company's reserves for unpaid losses, a reasonable possibility exists that this estimate may change significantly in the near term from the amounts included in the consolidated financial statements.

Deferred policy acquisition costs: Certain costs related to the acquisition of insurance contracts to the extent recoverable have been deferred. Such costs are being amortized as the associated premium revenue is earned. The Company capitalizes only incremental costs directly related to the successful acquisition of new or renewal insurance contracts. Accordingly, acquisition costs consist of commissions and premium taxes of insurance policies that are successfully issued. Deferred acquisition costs are included in other assets.

Discontinued operations: The Company reports the results of operations of a business as discontinued operations if the business is classified as held-for-sale or is being liquidated and disposed. The operations and cash flows of the discontinued business have been or will be eliminated from the ongoing operations of the Company as a result of disposal transactions, and the Company will not have any significant continuing involvement in the operations of the discontinued business after the disposal transaction. The results of discontinued operations are reported in the discontinued operations section of the consolidated statements of comprehensive income for the current and prior periods commencing in the period in which the business is either disposed of or is classified as held-for-sale, including any gain or loss recognized on closing or adjustment of the carrying amount to fair value less cost to sell.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 2. Summary of Significant Accounting Policies (Continued)

Property and equipment: Property and equipment are recorded at cost less accumulated depreciation. Depreciation is provided using straight-line and accelerated methods based upon the assets' useful lives. Costs incurred for normal repairs and maintenance are expensed as incurred.

Impairment of long-lived assets: Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets is measured by a comparison of the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. No impairment charges were recorded during 2017 or 2016.

Income taxes: Deferred income tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using the enacted marginal tax rate. Deferred income tax expenses or credits are based on the changes in the asset or liability from period to period. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The Company has not established any liabilities for uncertain tax positions taken or positions expected to be taken on income tax returns. The Company would establish such liabilities when such positions are judged to not meet the more-likely-than-not threshold based on the technical merits of the positions. Estimated interest and penalties related to uncertain tax positions would be included as a component of income tax expense.

With few exceptions, the Company is no longer subject to examinations by federal tax authorities before 2012, and by Montana, Virginia and Ohio state tax authorities before 2009.

Receivables: The Company grants credit to customers and agents as part of the normal course of business. Management determines the allowance for doubtful customer accounts based on specific customer balances and industry and economic conditions. Premiums that are financed are charged an interest rate up to 8.99 percent annually.

Advertising costs: Advertising costs are expensed when incurred, and for 2017 and 2016 were \$332,544 and \$197,888, respectively.

Risks and uncertainties: Certain risks and uncertainties are inherent to the Company's day-to-day operations and to the process of preparing its consolidated financial statements. The more significant of those risks and uncertainties, as well as the Company's methods for mitigating the risks, are presented below and throughout the notes to the consolidated financial statements.

Estimates: The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. For example, significant estimates and assumptions are utilized in the valuation of investments, valuation of allowances for deferred income tax assets and doubtful accounts, and calculation of loss and loss adjustment expenses. It is reasonably possible that actual experience could differ from the estimates and assumptions utilized, which could have a material impact on the consolidated financial statements.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 2. Summary of Significant Accounting Policies (Continued)

Reinsurance: Reinsurance contracts do not relieve the Company from its obligations to insureds. Failure of reinsurers to honor their obligations could result in losses to the Company; consequently, allowances are established for amounts deemed uncollectible. The Company evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. Management believes that any liability arising from this contingency would not be material to the Company's financial position.

Investment risk: The Company is exposed to risks that issuers of securities owned by the Company will default or that interest rates will change and cause a decrease in the value of its investments. With mortgage-backed securities, the Company is also exposed to prepayment risk, default risks on the underlying mortgages and devaluation of the underlying collateral. If interest rates decline, the velocity at which these securities pay down the principal will increase. Management mitigates these risks by conservatively investing in high-grade securities and by matching maturities of its investments with the anticipated payouts of its liabilities.

Loss reserves: The Company estimates loss and loss adjustment expenses based on the accumulation of case estimates for direct claims and incidents reported, net of applicable policy deductibles and deduction of amounts for reinsurance ceded on reported claims and incidents. The liability for loss adjustment expenses (LAE) is provided by estimating future expenses to be incurred in settlement of the claims provided for in the reserve for losses, net of reinsurance ceded. Actual results could differ from these estimates.

External factors: ALPS P&C is regulated by the state of Montana, as well as states in which it does business. Such regulations, among other things, limit the amount of dividends and impose restrictions on the amount and types of investments. The Company may also be required to seek state approval for rates for policies written in each respective state. Certain states may impose requirements on the coverage provided and restrictions on the amount of rate increases the Company seeks on policies written in that state.

Risk-based capital: The National Association of Insurance Commissioners (NAIC) has developed risk-based capital (RBC) standards for property and casualty insurers that relate an insurer's reported statutory capital and surplus to the risks inherent in its overall operations. The RBC formula uses the statutory annual statement to calculate the minimum indicated capital level to protect the Company from the various risks that it faces. The NAIC model law calls for various levels of regulatory action based on the magnitude of an indicated RBC capital deficiency, if any. The Company continues to monitor internal capital levels at ALPS P&C to ensure that they are in excess of the minimum capital requirements for all RBC action levels. Management believes that the capital levels at ALPS P&C are sufficient to support the level of risk inherent in its operations.

Concentrations of geographic and credit risk: The Company's total gross written premium of \$48,338,079 for the year ended December 31, 2017, included \$9,831,565 for insureds in Virginia; \$4,747,440 for insureds in West Virginia; \$2,948,635 for insureds in Washington; \$2,790,648 for insureds in Montana; \$2,683,884 for insureds in Idaho; \$2,611,361 for insureds in South Carolina; \$2,588,555 for insureds in Nevada; \$2,477,666 for insureds in Alaska; and \$2,292,930 for insureds in Vermont.

The Company maintains its cash and short-term investments with high-quality financial institutions. Interest-bearing and noninterest-bearing accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. From time to time, the Company maintains cash in accounts in excess of FDIC-insured limits. Company has not experienced any losses in such accounts.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 2. Summary of Significant Accounting Policies (Continued)

At December 31, 2017, the Company's investment portfolio was composed of securities of the United States government and agencies, state and municipal governments, corporate securities and mortgage-backed securities, the vast majority of which are investment grade. This portfolio is widely diversified among various issuers and industries and is not dependent on the economic stability of one issuer or industry.

The credit quality of the bond portfolio at December 31, 2017 and 2016, at amortized cost, is presented in the following table:

	2017		2016	
	Amount	Percentage	Amount	Percentage
Highest quality	\$ 96,507,714	95%	\$ 86,292,077	93%
High quality	4,111,040	4%	3,229,657	3%
Medium quality	242,158	0%	1,724,073	2%
Low quality	-	0%	759,877	1%
Lower quality	199,361	0%	-	0%
In or near default	70,500	0%	510,000	1%
All other unclassified	10,202	0%	143,939	0%
	<u>\$ 101,140,975</u>	<u>100%</u>	<u>\$ 92,659,623</u>	<u>100%</u>

Pending accounting pronouncements: In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In August 2015, the FASB issued ASU No. 2015-14, which defers the effective date of ASU No. 2014-09 one year, making it effective for annual reporting periods beginning after December 15, 2018. The Company has not yet selected a transition method and is currently evaluating the effect that the standard will have on the consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which creates a new credit impairment standard for financial assets measured at amortized cost and available-for-sale debt securities. The ASU requires financial assets measured at amortized cost (including loans, trade receivables and held-to-maturity debt securities) to be presented at the net amount expected to be collected, through an allowance for credit losses that are expected to occur over the remaining life of the asset, rather than incurred losses. The ASU requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a direct write-down. The measurement of credit losses for newly recognized financial assets (other than certain purchased assets) and subsequent changes in the allowance for credit losses are recorded in the statement of income as the amounts expected to be collected change. The ASU is effective for fiscal years beginning after December 15, 2020. Early adoption is permitted for fiscal years beginning after December 15, 2018. The Company does not intend to early adopt. The Company is currently evaluating the impact of adopting this new guidance on its consolidated financial statements and does not expect the impact to be significant.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 2. Summary of Significant Accounting Policies (Continued)

In February 2018, the FASB issued ASU No. 2018-02, *Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*, which allows entities to reclassify, from accumulated other comprehensive income to retained earnings, the stranded tax effects resulting from the Tax Cuts and Jobs Act (Tax Reform). The amendments in this update are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The amendments should be applied in the period of adoption or retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the tax reform is recognized. The Company does not intend to early adopt. The effect of the amendments on the Company's consolidated financial statements has not been estimated as December 31, 2017.

Recently adopted accounting pronouncements: In May 2015, the FASB issued ASU No. 2015-09, *Financial Services—Insurance (Topic 944): Disclosure about Short-Duration Contracts*. ASU 2015-09 explicitly requires insurance entities to disclose for annual reporting periods 10 years of accident year development information about the liability for unpaid claims and claim adjustment expenses. ASU 2015-09 is effective for annual periods ending after December 15, 2016, and annual and interim periods thereafter, with early adoption permitted. The guidance affects disclosures only, and therefore, the adoption as of December 31, 2017, had no impact on the Company's results of operations or financial position.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 will be effective for the Company for fiscal years beginning after December 15, 2018. The Company does not believe the adoption of the new financial instruments standard will have a material impact on its consolidated financial statements. During the year ended December 31, 2016, the Company elected to early adopt the amendment that no longer requires disclosure of the fair value of financial instruments that are not measured at fair value, and as such, these disclosures are not included herein. The remainder of this ASU will be adopted in 2019.

Note 3. Property, Plant and Equipment

Property, plant and equipment at cost on December 31, 2017 and 2016, are as follows:

	2017	2016
Building	\$ 5,425,551	\$ 5,425,551
Building renovations	4,573,216	4,471,492
Land	649,000	649,000
Office furniture and equipment	1,175,047	1,424,272
Computer equipment	2,695,575	2,464,325
	<u>14,518,389</u>	<u>14,434,640</u>
Less accumulated depreciation	(7,123,650)	(6,813,299)
Property, plant and equipment, net	<u>\$ 7,394,739</u>	<u>\$ 7,621,341</u>

Depreciation expense was \$606,864 and \$658,149 in 2017 and 2016, respectively.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 4. Investments

The amortized cost, adjusted cost and estimated fair values of available-for-sale securities at December 31, 2017 and 2016, are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2017:				
Bonds:				
U.S. government and agencies	\$ 1,542,579	\$ -	\$ 1,015	1,541,564
State, municipal and other governments	76,977,321	3,378,480	206,279	80,149,522
Corporate securities	5,819,811	25,414	14,437	5,830,788
Commercial mortgage-backed securities	4,009,738	10,733	14,353	4,006,118
Residential mortgage-backed securities	5,954,221	281,356	21,392	6,214,185
Other asset-backed securities	6,837,305	7,505	14,100	6,830,710
Total fixed maturities	101,140,975	3,703,488	271,576	104,572,887
Equity securities	9,519,358	943,849	15,482	10,447,725
Total	<u>\$ 110,660,333</u>	<u>\$ 4,647,337</u>	<u>\$ 287,058</u>	<u>\$ 115,020,612</u>
December 31, 2016:				
Bonds:				
U.S. government and agencies	\$ 110,081	\$ -	\$ 16	\$ 110,065
State, municipal and other governments	72,430,448	2,458,557	1,864,292	73,024,713
Corporate securities	5,306,893	23,704	23,895	5,306,702
Commercial mortgage-backed securities	2,612,967	900	8,093	2,605,774
Residential mortgage-backed securities	5,998,326	429,968	4,130	6,424,164
Other asset-backed securities	6,200,908	369,065	8,745	6,561,228
Total fixed maturities	92,659,623	3,282,194	1,909,171	94,032,646
Equity securities	6,958,257	1,296,208	646,020	7,608,445
Total	<u>\$ 99,617,880</u>	<u>\$ 4,578,402</u>	<u>\$ 2,555,191</u>	<u>\$ 101,641,091</u>

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 4. Investments (Continued)

The following tables present the estimated fair value and gross unrealized losses on the Company's investment securities, aggregated by investment category and length of time that individual investment securities have been in a continuous unrealized loss position, at December 31, 2017 and 2016:

		December 31, 2017					
		Less Than 12 Months		Greater Than or Equal to 12 Months		Total	
		Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Bonds:							
U.S. government agencies	\$	222,660	\$ 1,015	\$ -	\$ -	\$ 222,660	\$ 1,015
State, municipal and other governments		6,441,167	50,499	3,805,748	155,780	10,246,915	206,279
Corporate securities		3,569,124	13,410	163,295	1,027	3,732,419	14,437
Commercial mortgage-backed securities		3,045,288	14,353	-	-	3,045,288	14,353
Residential mortgage-backed securities		2,370,629	20,245	56,175	1,147	2,426,804	21,392
Other asset-backed securities		3,492,476	12,570	249,378	1,530	3,741,854	14,100
		19,141,344	112,092	4,274,596	159,484	23,415,940	271,576
Equity securities		580,398	15,482	-	-	580,398	15,482
Total	\$	19,721,742	\$ 127,574	\$ 4,274,596	\$ 159,484	\$ 23,996,338	\$ 287,058
		December 31, 2016					
		Less Than 12 Months		Greater Than or Equal to 12 Months		Total	
		Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Bonds:							
U.S. government agencies	\$	110,065	\$ 16	\$ -	\$ -	\$ 110,065	\$ 16
State, municipal and other governments		22,899,693	1,265,065	518,934	599,227	23,418,627	1,864,292
Corporate securities		4,051,875	23,895	-	-	4,051,875	23,895
Commercial mortgage-backed securities		1,119,490	5,478	303,557	2,615	1,423,047	8,093
Residential mortgage-backed securities		77,187	1,633	209,333	2,497	286,520	4,130
Other asset-backed securities		1,271,216	8,745	-	-	1,271,216	8,745
		29,529,526	1,304,832	1,031,824	604,339	30,561,350	1,909,171
Equity securities		954,326	200,308	1,051,851	445,712	2,006,177	646,020
Total	\$	30,483,852	\$ 1,505,140	\$ 2,083,675	\$ 1,050,051	\$ 32,567,527	\$ 2,555,191

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 4. Investments (Continued)

At December 31, 2017 and 2016, the unrealized losses on the Company's fixed-income investments were not the result of any credit-related problems; rather, they were caused by interest rate increases and widening in corporate pricing spreads. Substantially all of the issuers have investment-grade ratings; therefore, the Company believes each issuer will be able to meet the contractual terms of the obligation. At December 31, 2017 and 2016, the Company did not have the intent to sell and it was unlikely that the Company would be required to sell the investments before the recovery of its amortized cost basis.

In 2017, certain fixed-income securities became other-than-temporarily impaired and were written down to their fair value, which resulted in realized losses of \$439,500 and are included in the table below. In 2016, certain equity securities became other-than-temporarily impaired and were written down to their fair value, which resulted in realized losses of \$567,119 and are included in the table below.

The Company continues to review its investment portfolios under its impairment review policy. Given the unpredictability of market conditions and the significant judgments involved, there is a continuing risk that declines in fair value may occur and other-than-temporary impairments may be recorded in future periods.

The Company received proceeds from the sale and maturities of investments totaling \$37,377,920 and \$18,746,255 in 2017 and 2016, respectively. Gross realized gains and losses on investments, including other-than-temporary impairments, reflected in the results of operations for the years ended December 31, 2017 and 2016, are as follows:

	Years Ended December 31	
	2017	2016
Realized:		
Gross realized gains on sales:		
Fixed-income securities	\$ 89,216	\$ 158,541
Equity securities	1,308,988	252,133
Total	<u>1,398,204</u>	<u>410,674</u>
Gross realized losses on sales:		
Fixed-income securities	(481,205)	(91,763)
Equity securities	(682,965)	(15,134)
Total	<u>(1,164,170)</u>	<u>(106,897)</u>
Other-than-temporary losses recognized in operations:		
Fixed-income securities	(439,500)	-
Equity securities	-	(567,119)
	<u>(439,500)</u>	<u>(567,119)</u>
Net realized capital losses	<u>\$ (205,466)</u>	<u>\$ (263,342)</u>

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 4. Investments (Continued)

The amortized cost and estimated fair value of fixed-maturity securities at December 31, 2017, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due in one year or less	\$ 2,043,130	\$ 2,046,343
Due after one year through five years	18,268,867	18,713,024
Due after five years through 10 years	17,185,559	18,016,189
Due after 10 years through 20 years	43,810,739	45,587,780
Due after 20 years	19,832,680	20,209,551
Total	<u>\$ 101,140,975</u>	<u>\$ 104,572,887</u>

ALPS P&C has placed in trust with the State of Montana Insurance Commissioner investments with a fair value of \$3,058,913 and \$3,155,810 at December 31, 2017 and 2016, respectively, as required by state law. Fair values of deposits with other states as of December 31, 2017 and 2016, totaled \$2,118,202 and \$1,885,610, respectively.

Net investment income consists of the following:

	Years Ended December 31	
	2017	2016
Fixed maturities	\$ 4,257,630	\$ 4,063,582
Equity securities	264,770	336,484
Short-term investments	45,917	36,671
Other	(412)	1,300
	<u>4,567,905</u>	<u>4,438,037</u>
Investment expenses	(719,273)	(595,693)
Net investment income	<u>\$ 3,848,632</u>	<u>\$ 3,842,344</u>

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 5. Loss and Loss Adjustment Expense Reserves

The following is information about incurred claims development and paid claims development as of December 31, 2017, net of reinsurance, as well as cumulative claim frequency and the total of IBNR liability plus expected development on reported claims included within the net incurred claims amounts.

Professional Liability Insurance

\$ in thousands (except number of reported claims)

Accident Year	Incurred Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance										As of December 31, 2017		
	Unaudited										Total of Incurred-but- Not-Reported Liabilities Plus Expected Development on Reported Claims	Cumulative Number of Reported Claims	
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017			
2008	\$ 20,462	\$ 18,807	\$ 17,601	\$ 16,980	\$ 15,928	\$ 15,866	\$ 15,992	\$ 16,083	\$ 16,073	\$ 15,373	\$	351	495
2009		22,337	20,336	18,222	17,421	17,505	17,504	17,910	17,903	17,564		692	493
2010			21,052	22,777	21,960	20,967	20,917	20,917	20,906	20,306		748	485
2011				31,361	20,935	19,166	18,786	16,979	16,970	16,970		1,087	478
2012					17,467	18,381	18,706	18,692	18,674	18,574		1,344	525
2013						18,511	17,948	18,195	18,153	18,153		2,146	537
2014							19,361	21,276	21,202	21,202		3,585	544
2015								19,774	20,235	20,235		3,649	519
2016									18,924	18,924		5,919	599
2017										19,849		6,542	520
										Total		<u>\$ 187,150</u>	

Professional Liability Insurance

\$ in thousands

Accident Year	Cumulative Paid Claims and Allocated Claim Adjustment Expenses, Net of Reinsurance											
	Unaudited											
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017		
2008	\$ 2,740	\$ 8,401	\$ 10,810	\$ 13,215	\$ 14,307	\$ 15,050	\$ 15,388	\$ 15,112	\$ 15,340	\$ 14,911		
2009		2,384	8,231	12,690	14,635	15,811	16,187	15,895	15,956	16,054		
2010			3,025	8,874	13,579	16,498	18,243	17,947	18,104	18,504		
2011				2,788	9,099	12,191	13,870	14,468	14,629	15,027		
2012					2,990	9,544	12,149	14,507	15,855	16,627		
2013						3,147	7,799	11,545	13,347	14,573		
2014							2,375	8,485	12,312	14,703		
2015								3,530	9,895	13,098		
2016									1,990	6,439		
2017										2,890		
										Total		132,828

All outstanding liabilities before 2008, net of reinsurance 1,045
Liabilities for claims and claim adjustment expenses, net of reinsurance \$ 55,367

The following is supplementary information about average historical claims duration as of December 31, 2017:

Years	Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance									
	Unaudited									
	1	2	3	4	5	6	7	8	9	10
Professional liability insurance	15.0%	31.2%	18.9%	12.1%	6.7%	2.1%	0.9%	0.2%	1.0%	(2.8)%

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 5. Loss and Loss Adjustment Expense Reserves (Continued)

The reconciliation of the net incurred and paid claims development tables to the liability for claims and claim adjustment expenses in the consolidated balance sheet is as follows (in thousands):

	December 31, 2017
Net outstanding liabilities:	
Professional liability insurance	\$ 55,367
Other insurance lines	-
Liabilities for unpaid claims and claim adjustment expenses, net of reinsurance	<u>55,367</u>
Reinsurance recoverable on unpaid claims:	
Professional liability insurance	60,036
Other insurance lines	-
Total reinsurance recoverable on unpaid claims	<u>60,036</u>
Unallocated claims adjustment expenses	1,199
Other	-
	<u>1,199</u>
Total gross liability for unpaid claims and claim adjustment expense	<u>\$ 116,602</u>

The following table provides a reconciliation of the beginning and ending reserve balances for losses and LAE for 2017 and 2016:

	Years Ended December 31	
	2017	2016
Reserve for losses and LAE, beginning of year	<u>\$ 90,519,895</u>	<u>\$ 86,775,170</u>
Add provision for losses and LAE applicable to claims reported in:		
Current year	26,816,520	25,156,018
Prior years	21,863,284	9,307,926
Total incurred losses during the current year	<u>48,679,804</u>	<u>34,463,944</u>
Payments for losses and LAE reported in:		
Current year	3,751,539	2,091,018
Prior years	18,845,879	28,628,201
Net claim payments during the year	<u>22,597,418</u>	<u>30,719,219</u>
Reserve for losses and LAE, end of year	<u>\$ 116,602,281</u>	<u>\$ 90,519,895</u>

Reserves for incurred losses and LAE attributable to claims reported to ALPS P&C in prior years on a gross basis increased by \$21,863,284 during 2017 and by \$9,307,926 during 2016. These changes are generally the result of ongoing analysis of claim files. Original estimates are increased or decreased as additional information becomes known regarding individual claims.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 6. Reinsurance

The Company utilizes reinsurance contracts to reduce its exposure to losses in all aspects of its insurance business. Such reinsurance permits recovery of a portion of losses from reinsurers, although it does not relieve the Company from its primary liability to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial strength of potential reinsurers and continually monitors the financial condition of reinsurers.

Amounts recoverable from reinsurers are estimated based upon assumptions consistent with those used in establishing the liabilities related to the underlying reinsured contracts. Management believes the recoverables are appropriately established. The Company generally strives to diversify its credit risks related to reinsurance ceded. There were no disputes with reinsurers at December 31, 2017 or 2016. The Company has no uncollectible reinsurance recoverables that were written off during the year.

The Company holds letters of credit in the amount of approximately \$7,706,000 and \$7,608,000 at December 31, 2017 and 2016, respectively, to secure recoverable balances from reinsurers not authorized by the Montana Commissioner of Securities and Insurance.

The Company has unsecured aggregate recoverable for losses, paid and unpaid, loss adjustment expenses and unearned premium with the following individual reinsurers, authorized or unauthorized, exceeding 3 percent of stockholders' equity at December 31, 2017 and 2016:

	AM Best Rating	2017	2016
Aspen Insurance	A	\$ 4,980,000	\$ 2,676,000
Axa	NR	2,909,000	-
AXIS Reinsurance Co.	A+	5,685,000	3,695,000
Endurance Reinsurance	A	1,610,000	1,315,000
Everest Reinsurance Co.	A+	2,533,000	2,756,000
Hannover Ruck SE	A+	1,209,000	-
JRG Reinsurance Co.	A	5,650,000	5,848,000
Lawyer's Reinsurance Co.	NR	4,494,000	2,386,000
Lloyd's AFB 791	A	1,159,000	-
Lloyd's AFB 1084	A	1,264,000	-
Lloyd's AFB 2623	A	3,162,000	1,624,000
Lloyd's AFB 4472	A	2,270,000	-
Navigators Ins Co	A	3,879,000	3,177,000
Odyssey	A	1,363,000	-
Protective Insurance Co.	A+	1,794,000	1,699,000
Toa Reinsurance Company of America	A+	1,092,000	-
Transatlantic Reinsurance Co.	A+	9,005,000	8,016,000
		<u>\$ 54,058,000</u>	<u>\$ 33,192,000</u>

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 6. Reinsurance (Continued)

A summary of the impact of ceded reinsurance on written, earned and unearned premiums, and loss and loss adjustment expenses incurred for the years ended December 31, 2017 and 2016, is as follows:

	2017	2016
Premiums written:		
Direct	\$ 48,388,079	\$ 45,756,642
Ceded	(15,847,559)	(15,115,327)
Net premiums written	<u>\$ 32,540,520</u>	<u>\$ 30,641,315</u>
Premiums earned:		
Direct	\$ 46,902,314	\$ 44,876,559
Ceded	(15,517,623)	(14,644,284)
Net premiums earned	<u>\$ 31,384,691</u>	<u>\$ 30,232,275</u>
Unearned premiums:		
Direct	\$ 22,025,630	\$ 20,539,835
Advanced	3,016,145	3,119,138
Ceded	(7,795,487)	(7,413,739)
Net unearned premiums	<u>\$ 17,246,288</u>	<u>\$ 16,245,234</u>
Losses and loss adjustment expenses incurred:		
Direct	\$ 48,679,804	\$ 34,463,944
Ceded	(29,406,599)	(15,074,273)
Net losses and loss adjustment expenses incurred	<u>\$ 19,273,205</u>	<u>\$ 19,389,671</u>

Note 7. Income Taxes

The Company prepares a consolidated federal income tax return that includes all direct and indirect subsidiaries. The Company's affiliates included in the consolidated federal income tax return allocate income tax expenses in accordance with a consolidated tax allocation agreement. Generally, this allocation results in profitable companies recognizing income tax incurred as if the individual company filed a separate return and loss companies recognizing a benefit to the extent their losses contribute to reduce consolidated taxes.

On December 22, 2017, the president of the United States signed into law the Tax Cuts and Jobs Act tax reform legislation. This legislation makes significant changes in U.S. tax law, including a reduction in the corporate tax rates, changes to net operating loss carryforwards and carrybacks, and a repeal of the corporate alternative minimum tax. The legislation reduced the U.S. corporate tax rate from the current rate of 35 percent to 21 percent. As a result of the enacted law, the Company was required to revalue deferred tax assets and liabilities at the enacted rate. This revaluation resulted in a one-time, noncash charge to deferred income tax expense of approximately \$475,000.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 7. Income Taxes (Continued)

The effective tax rate on income before income taxes is different from the prevailing federal income tax rate, as follows:

	Years Ended December 31	
	2017	2016
Amount computed using statutory rate	\$ 1,387,987	\$ 1,506,765
Increase (reduction) in tax resulting from:		
Nonallowable meals, entertainment, dues and other	10,568	8,509
Officer's life insurance premiums	4,586	(44,873)
Tax-exempt interest and dividends	(296,720)	(231,466)
Dividends received deduction	(56,693)	(74,518)
State and foreign income taxes	36,281	2,660
Expense due to enactment of federal tax reform	475,333	-
Change in prior-year estimates	(24,791)	421,628
Total provision	<u>\$ 1,536,551</u>	<u>\$ 1,588,705</u>

Comprehensive income tax expense included in the consolidated financial statements for the years ended December 31, 2017 and 2016, is as follows:

	2017	2016
Current:		
U.S. federal provision	\$ 321,314	\$ 1,049,954
States and foreign	36,281	2,660
	<u>357,595</u>	<u>1,052,614</u>
Deferred:		
U.S. federal provision	1,178,956	536,091
Total tax provision	<u>\$ 1,536,551</u>	<u>\$ 1,588,705</u>

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 7. Income Taxes (Continued)

Deferred income taxes have been established based upon the temporary differences between the financial statement and income tax bases of assets and liabilities. The tax effect of temporary differences that give rise to significant portions of the Company's net deferred income tax asset is as follows:

	December 31	
	2017	2016
Ordinary:		
Unearned/advanced premium adjustment	\$ 724,344	\$ 1,104,676
Unpaid losses and LAE	616,560	1,014,900
Long-term incentive plan payable	374,389	767,434
Deferred acquisition costs	(93,598)	(105,804)
Book to tax depreciation	(35,266)	(109,485)
Accrued dividend	(1,896)	-
	<u>1,584,533</u>	<u>2,671,721</u>
Capital:		
Unrealized gains	(915,659)	(687,891)
Other-than-temporary impairments	92,295	655,460
Capital losses carried forward	6,678	-
	<u>(816,686)</u>	<u>(32,431)</u>
AMT credit	1,007,148	1,109,264
Total deferred tax asset	<u>\$ 1,774,995</u>	<u>\$ 3,748,554</u>

Based upon anticipated future taxable income, the Company's net realized gains, and consideration of all other available evidence, management believes that it is more likely than not that the Company's net deferred income tax asset will be realized.

Note 8. Fair Value Measurements

Fair values of fixed-income and equity securities are based on quoted market prices, where available. The Company obtains one price for each security, primarily from a third-party pricing service (pricing service), which generally uses quoted or other observable inputs for the determination of fair value. The pricing service normally derives the security prices through recently reported trades for identical or similar securities, making adjustments through the reporting date based upon available observable market information. For securities not actively traded, the pricing service may use quoted market prices of comparable instruments or incorporate inputs that are currently observable in the markets for similar securities. Inputs that are often used in the valuation methodologies include, but are not limited to, benchmark curves, benchmarking of like securities, sector groupings and matrix pricing. In addition, the pricing service uses model processes, such as the option-adjusted spread model, to assess interest rate impact and develop prepayment scenarios.

As the Company is responsible for the determination of fair value, it performs monthly analysis on the prices received from third parties for its externally managed portfolios to determine whether the prices are reasonable estimates of fair value. The analysis includes a comparison of prices received from third parties to prices obtained from other sources. There were no adjustments to quoted market prices obtained from third-party pricing services during 2017 and 2016 that were material to the consolidated financial statements.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 8. Fair Value Measurements (Continued)

The Company's financial assets and liabilities carried at fair value have been classified, for disclosure purposes, based on a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The hierarchy gives the highest priority to fair values determined using unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to fair values determined using unobservable inputs (Level 3). An asset's or liability's classification is determined based on the lowest level input that is significant to its measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Levels 1 and 2) and unobservable (Level 3). The levels of the fair value hierarchy are as follows:

Level 1: Valuations are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2: Valuations are derived from inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, such as:

- Quoted prices for similar assets or liabilities in active markets
- Quoted prices for identical or similar assets or liabilities in markets that are not active
- Inputs other than quoted prices that are observable for the asset or liability
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means

Level 3: Valuations are derived from techniques that require significant unobservable inputs. The unobservable inputs reflect the Company's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

For the years ended December 31, 2017 and 2016, there were no transfers of financial assets between the hierarchy levels.

Following is a description of the valuation methodologies used by the Company to value assets measured at fair value.

Major Category	Valued At
State and/or U.S. government obligations and common and/or preferred stock	Closing price reported in the active market in which the individual security is traded; if in an inactive market, based on quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency; securities that trade infrequently and therefore have little or no price transparency are valued using the investment manager's best estimates
Mutual funds	Net asset value (NAV) of shares which are provided by the administrator of the fund
Partnership	Based on the most recent audited financial results

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 8. Fair Value Measurements (Continued)

Major Category	Valued At
Fixed-income securities including corporate, commercial and residential mortgage-backed securities	Closing price reported in the active market in which the bond is traded or based on yields currently available on comparable securities of issuers with similar credit ratings or discounted cash flows approach that maximized observable inputs, such as current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks

The distribution of the Company's investments, which are measured at fair value on a recurring basis, in the valuation hierarchy is as follows:

Assets	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Fixed maturities—available for sale:				
U.S. government and agencies	\$ 1,541,564	\$ -	\$ -	\$ 1,541,564
State, municipal and other governments	-	80,149,522	-	80,149,522
Corporate securities	450,178	5,380,610	-	5,830,788
Commercial mortgage-backed securities	-	4,006,118	-	4,006,118
Residential mortgage-backed securities	-	6,214,185	-	6,214,185
Other asset-backed securities	-	6,830,710	-	6,830,710
	1,991,742	102,581,145	-	104,572,887
Equity securities—available for sale	6,035,870	-	1,266,013	7,301,883
Total	\$ 8,027,612	\$ 102,581,145	\$ 1,266,013	\$ 111,874,770

Assets	December 31, 2016			
	Level 1	Level 2	Level 3	Total
Fixed maturities—available for sale:				
U.S. government and agencies	\$ 110,065	\$ -	\$ -	\$ 110,065
State, municipal and other governments	-	73,024,713	-	73,024,713
Corporate securities	1,380,472	3,926,230	-	5,306,702
Commercial mortgage-backed securities	-	2,605,774	-	2,605,774
Residential mortgage-backed securities	-	6,424,164	-	6,424,164
Other asset-backed securities	-	6,561,228	-	6,561,228
	1,490,537	92,542,109	-	94,032,646
Equity securities—available for sale	6,418,258	-	1,190,187	7,608,445
Total	\$ 7,908,795	\$ 92,542,109	\$ 1,190,187	\$ 101,641,091

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 8. Fair Value Measurements (Continued)

A reconciliation of assets and liabilities measured and carried at fair value on a recurring basis with the use of significant unobservable inputs (Level 3) for the years ended December 31, 2017 and 2016, is as follows:

	Investments in Equity Securities
	<u> </u>
Balance at December 31, 2015	\$ 1,120,576
Gains included in:	
Earnings	-
Other comprehensive income	69,611
Transfers into (out of) Level 3	<u>-</u>
Balance at December 31, 2016	1,190,187
Gains included in:	
Earnings	-
Other comprehensive income	75,826
Transfers into (out of) Level 3	<u>-</u>
Balance at December 31, 2017	<u><u>\$ 1,266,013</u></u>

Note 9. Employee Benefit Plans

The Company sponsors a defined contribution plan known as the ALPS Corporation 401(k) Profit Sharing Plan (the 401(k) Plan). The 401(k) Plan is designed as a type of qualified retirement plan commonly referred to as a 401(k) safe harbor plan. The 401(k) Plan allows participants to make salary deferral contributions to the 401(k) Plan on a pretax basis. The Company also sponsors a Section 125 cafeteria plan (the Cafeteria Plan).

The Company makes a matching contribution to each eligible participant in an amount equal to 100 percent of a participant's salary reduction contribution up to 6 percent of a participant's eligible compensation. The Company makes a fixed dollar contribution in the amount of \$7,800 per employee under the Cafeteria Plan.

For the plan year 2017, the Company contributed \$254,201 to the 401(k) Plan and \$453,240 to the Cafeteria Plan. For plan year 2016, the Company contributed \$274,640 to the 401(k) Plan and \$461,398 to the Cafeteria Plan.

Note 10. Commitments and Contingencies

The Company previously entered into a written employment agreement with the Executive Board Chair (EBC) that expired on December 31, 2015. The position of the Executive Board Chair was eliminated effective December 31, 2015. Pursuant to the terms of the expired employment agreement, the Company and the former EBC entered into a long-term consulting agreement during which the former EBC will render consulting services to the Company for a 7½-year term ending on June 30, 2023.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 10. Commitments and Contingencies (Continued)

As of December 31, 2017 and 2016, each director of the Company has the right to tender to the Company for redemption all Class A Common shares that are held by the director at the time the director retires, resigns or otherwise no longer serves as a director. Upon such tender of Class A Common shares, the Company is obligated to redeem said shares at a redemption price equal to the then-existing book value per share as most recently declared by the Company's Board of Directors. Upon redemption, the Company must pay the total redemption price pursuant to a redemption payment schedule that will provide for full payment of the redemption price no later than December 31 of the fourth calendar year following the calendar year in which the director tenders the shares for redemption. As of December 31, 2017 and 2016, the directors owned, in the aggregate, 373 and 366, respectively, Class A Common shares having a book value of \$6,169,127 and \$5,353,848, respectively. During the year ended December 31, 2017, the Company redeemed no shares owned by Board members.

The Company is not aware of any pending or threatened litigation or any unasserted claims or assessments that management considers to be probable of assertion and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome, the risk of which has not been adequately insured or reinsured against or provision for which has not been adequately reserved.

Note 11. Outstanding Shares

Effective May 31, 2016, the Company's Board of Directors authorized a one-for-six hundred reverse stock split, whereby 2,113,029 outstanding shares of the Company's Class A Common stock were exchanged for 3,522 issued shares of the Company's Class A Common stock. The Company's restated articles of incorporation provide that no shareholder may own a fractional share of Class A Common stock if said shareholder does not own at least one whole share of Class A Common stock. Under the terms of the reverse stock split, shareholders that held a fractional share of less than one whole share as a result of the reverse stock split, were given the option to either: (i) receive a cash payment equal to the then-existing book value per share as most recently declared by the Board of Directors as of May 31, 2016, or (ii) purchase the remaining fractional share necessary to hold one whole share. All shares and related option information presented in these consolidated financial statements and accompanying notes have been retroactively adjusted to reflect the reduced number of issued and outstanding shares resulting from this transaction.

ALPS Corporation is authorized to issue 9,000,000 shares of Class A Common stock having a \$1.00 par value and 1,000,000 shares of Class B nonvoting stock having a \$1.00 par value. ALPS Corporation had approximately 3,522 Class A Common shares issued as of December 31, 2017 and 2016. Of these shares, approximately 1,885 and 1,819 were held in treasury at December 31, 2017 and 2016, respectively. ALPS Corporation had no Class B nonvoting shares issued and outstanding as of December 31, 2017 and 2016.

On May 10, 2016, the Company and a third party entered into a stock purchase agreement whereby the third party received 5,000,000 shares of Class C Preferred stock and 58 shares of Class A Common stock for a total purchase price of \$5,829,994. During the year ended December 31, 2017, the Class C Preferred stock was converted into 241 shares of Class C Common stock in accordance with the terms of the Stock Purchase Agreement. No proceeds were received related to conversion. Following the second anniversary of the closing date, the Class C Common stockholder will have the right to put to the Company for cash up to 50 percent of the aggregate number of common shares held by the Class C stockholder at a per share exercise price equal to the U.S. GAAP adjusted book value per share as of the most recent calendar quarter. The put option is subject to approval by the Board of Directors.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 12. Lease Commitments

The Company has a noncancelable operating lease agreement. The aggregate commitments under the lease agreement at December 31, 2017, are as follows:

Years ending December 31:		
2018	\$	49,063
2019		50,548
2020		51,425
2021		21,427
	\$	<u>172,463</u>

Rent expense for 2017 and 2016 was \$23,365 and \$27,579, respectively.

Rental income from nonaffiliated entities for 2017 and 2016 was \$995,688 and \$922,158, respectively. The majority of these leases are short term in duration, not exceeding 12 months.

Note 13. Long-Term Debt

Long-term debt at December 31, 2017 and 2016, is as follows:

	<u>2017</u>	<u>2016</u>
Promissory notes to Florence Associates Partners in annual installments of various amounts as specified in the individual notes, with 8% interest, with various maturities through March 2021; secured by investments	\$ 810,842	\$ 977,455
Loan payable to First Interstate Bank, due in monthly installments of \$50,000 at 3.9% interest; secured by property, maturing January 2028	4,845,990	5,247,403
Total long-term debt	<u>\$ 5,656,832</u>	<u>\$ 6,224,858</u>

Maturities of long-term debt at December 31, 2017, are as follows:

Years ending December 31:		
2018	\$	598,487
2019		629,500
2020		662,326
2021		697,080
2022		487,117
Thereafter		2,582,322
	\$	<u>5,656,832</u>

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 14. Surplus Notes

The Company has issued the following surplus debentures or similar obligations as of December 31, 2017:

Date Issued	Interest Rate	Par Value	Carrying Value	Principal and/or Interest Paid Current Year	Total Principal and/or Interest Paid	Unapproved Principal and/or Interest	Date of Maturity
10/14/2005	LIBOR + 3.55%	\$ 9,900,000	\$ 9,900,000	\$ 576,892	\$ 6,448,822	\$ 24,109	10/15/2035
12/23/2005	Fed fund rate	266,787	266,787	237,626	10,499,732	15,879	None
			<u>\$ 10,166,787</u>				

The Company has issued the following surplus debentures or similar obligations as of December 31, 2016:

Date Issued	Interest Rate	Par Value	Carrying Value	Principal and/or Interest Paid Current Year	Total Principal and/or Interest Paid	Unapproved Principal and/or Interest	Date of Maturity
10/14/2005	LIBOR + 3.55%	\$ 10,000,000	\$ 10,000,000	\$ 428,226	\$ 5,871,930	\$ 38,866	10/15/2035
12/23/2005	Fed fund rate	504,413	504,413	770,614	10,262,106	48,984	None
			<u>\$ 10,504,413</u>				

ALPS P&C received cash in exchange for a surplus note in the amount of \$10,000,000 issued to Merrill Lynch International on October 14, 2005. This note is administered by U.S. Bank, National Association, as trustee, and has the following repayment conditions and restrictions: payment of interest to be made quarterly in arrears on the 15th of March, June, September and December, and only with the prior approval of the Montana Commissioner of Securities and Insurance.

The Company transferred a liability on its books resulting from the redemption of common stock to ALPS P&C in the amount of \$1,940,892 on December 23, 2005. This liability was then simultaneously converted to a surplus note under the approval of the Montana Commissioner of Securities and Insurance. Payment to shareholders of redeemed shares of ALPS Corporation common stock (transferred liability) is based upon the amount of the total value of the shares on the redemption date and is subject to a repayment schedule between one and seven years. Payments to shareholders are issued on a quarterly basis in January, April, July and October, and are issued only upon prior approval of the Montana Commissioner of Securities and Insurance. Obligation under this note is subordinated in payment to other indebtedness due to creditors and policyholders of ALPS P&C.

Note 15. Long-Term Incentive Plan

In 2013, the Board of Directors created the Long-Term Surrogate Equity Incentive Plan (LTIP), which replaces all of the Company's existing equity-related incentive plans, including stock options and stock appreciation. The LTIP consists of annual grants that provide participants, on a five-year cliff vesting schedule, the right to share in a predefined percentage of incremental growth in the Company's declared book value over the five years following the grant.

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 15. Long-Term Incentive Plan (Continued)

The Board amended the LTIP such that the grants provide participants the right to share in a predefined percentage of the Company's declared book value per share. In 2017 and 2016, the Company recorded \$809,130 and \$853,645, respectively, in expense based on book value per share growth. In 2017 and 2016, the Company paid vested grants of \$1,283,486 and \$-0-, respectively.

Note 16. Dividend Restrictions

Dividends from ALPS P&C are declared by its Board of Directors. Under insurance regulations of the state of Montana, dividends are classified into two types: ordinary and extraordinary. Ordinary dividends require 15-day advance notice to the Montana Commissioner of Securities and Insurance prior to payment. Extraordinary dividends, those which in total exceed 10 percent of the current year-end policyholder's statutory surplus, require approval from the Commissioner 30 days prior to payment. For the years ended December 31, 2017 and 2016, dividends in excess of \$4,070,729 and \$3,830,826, respectively, would be considered extraordinary.

Ordinary dividends in the amount of \$776,647 were declared and paid by ALPS P&C to ALPS Corporation in 2017. ALPS P&C did not pay or declare any dividends to ALPS Corporation in 2016.

Note 17. Statutory Information

The financial statements of ALPS P&C differ from related statutory-basis financial statements principally as follows: (a) the bond portfolio is classified as available-for-sale (carried at fair value) rather than generally being carried at amortized cost; (b) acquisition costs of acquiring new business are deferred and amortized over the life of the policies rather than charged to operations as incurred; (c) certain deferred income tax assets, agents' balances, receivables from affiliates over 90 days old, and certain other assets designated as nonadmitted assets for statutory purposes are reported as assets rather than being charged to surplus; (d) reinsurance reserve credits are reported as assets rather than being offset against the related reserve amounts, and an allowance is established for uncollectible amounts through a charge through earnings rather than through statutory formula-driven methods; and (e) investments in subsidiary companies are consolidated with the accounts and operations of the Company rather than carried at the subsidiary's underlying net assets, with changes credited or charged directly to unassigned surplus.

	Net Income (Loss)		Capital and Surplus	
	2017	2016	2017	2016
Amounts stated in conformity with U.S. GAAP	\$ 2,210,377	\$ 1,762,593	\$ 35,135,109	\$ 31,661,054
Other investment adjustments	-	-	(3,532,325)	(2,625,469)
Deferred policy acquisition costs	(245,349)	143,011	(1,678,097)	(1,432,748)
Nonadmitted assets	-	-	(257,663)	(836,314)
Deferred income taxes	1,426,964	782,393	850,866	998,464
Surplus note fees	(16,257)	21,941	22,609	38,866
Surplus notes	-	-	10,166,787	10,504,413
Amounts stated in conformity with statutory accounting practices	<u>\$ 3,375,735</u>	<u>\$ 2,709,938</u>	<u>\$ 40,707,286</u>	<u>\$ 38,308,266</u>

ALPS Corporation and Subsidiaries

Notes to Consolidated Financial Statements

Note 18. Stock Repurchase Pool

Since 2014, the Company has maintained a Stock Redemption and Purchase Program (the Program), since there is no public market or exchange for the Company's outstanding Class A Common stock. The Program does not involve the Company's issuance of additional or new classes of securities. Instead, the Company maintains the Program to facilitate the sale and purchase of Class A Common stock. The Program provides a corporate redemption option in order to accommodate those shareholders who desire to sell some or all of their Class A Common stock. The Program also facilitates the independent purchasing of Class A Common stock by those interested shareholders who desire to own additional Class A Common stock. For the years ended December 31, 2017 and 2016, the Company redeemed 80 shares and 651 shares of Class A Common stock, respectively, at the aggregate redemption price of \$1,309,424 and \$9,470,195, respectively. For the years ended December 31, 2017 and 2016, existing shareholders purchased 14 shares and 124 shares of Class A Common stock, respectively, at the aggregate purchase price of \$230,960 and \$1,792,170, respectively. The Program allows for the Company's officers, directors and employees (Affiliates) to purchase and sell shares of Class A Common stock. For the years ended December 31, 2017 and 2016, Affiliates purchased 11 shares and 65 shares of Class A Common stock, respectively, at the aggregate purchase price of \$185,619 and \$961,616, respectively. Affiliates did not sell any shares of Class A Common stock in 2017 or 2016.

Note 19. Discontinued Operations

Peak Investment Management, Ltd. was sold on September 1, 2016. The business operations of ALPS Risk and Insurance Services, Inc. were discontinued on October 31, 2016. As a result of the foregoing, the financial results of PEAK and ARIS for the year ended December 31, 2016, have been displayed separately as discontinued operations. Amounts in general are not material to the current presentation, and accordingly, detail disclosure is omitted.

Note 20. Subsequent Event

All of the effects of subsequent events that provide additional evidence about conditions that existed at the consolidated balance sheet date, including the estimates inherent in the process of preparing the consolidated financial statements, are recognized in the consolidated financial statements. The Company does not recognize subsequent events that provide evidence about conditions that did not exist at the consolidated balance sheet date but arose after, but before the consolidated financial statements are available to be issued. In some cases, nonrecognized subsequent events are disclosed to keep the consolidated financial statements from being misleading.

In 2018, the Company entered into a construction contract to remodel the sixth and seventh floors of its Missoula location. The contract has an estimated construction cost of \$3.1 million and is debt financed with a \$3.3 million loan maturing in September 2044. The loan carries an initial interest rate of 3.7 percent through April 2023, at which time the interest rate resets to the Federal Home Loan Bank of Des Moines five-year Regular Fixed-Rate Advance rate plus 1.5 percent. The Company is required to make interest-only payments throughout the construction period, with principal and interest payments commencing once the project is complete.

Subsequent events have been evaluated through April 26, 2018, which is the date the consolidated financial statements were available to be issued.

