

2016  
ANNUAL REPORT

DHANDHO

# DHANDHO

## 2016 Annual Report

### Table of Contents

Letter to Partners .....	2
Audited Financial Statements:	
Dhandho Holdings Corp, December 31, 2016 .....	9
Team Dhandho .....	44

Dear Partners:

Dhandho Holdings began operations in 2014 with a starting NAV of \$10/unit. In 2014, organizational, fundraising and legal expenses absorbed a bit of our \$152 million of capital and we ended the year with the NAV at \$9.93/unit. We acquired Stonetrust Insurance on December 31, 2014 and began meaningful operations in 2015. At the end of 2015, the resulting NAV was \$8.36/unit – a loss of 15.8%. The two major causes of the loss were adverse development of \$5 million on Stonetrust reserves and the bankruptcy filing of Horsehead Holdings (a \$17 million hit). At end of 2016, Dhandho's NAV stood at \$8.73/unit – a 4.4% increase over the prior year. More importantly, the intrinsic value of Dhandho is meaningfully higher than the stated \$8.73 book value at 12/31/16.

Dhandho's unaudited estimated NAV was \$9.30/unit and \$9.38/unit on 3/31/17 and 4/30/17, respectively. We're past our low point. Onward and upward. Dhandho stumbled right out of the gate in 2015 and early 2016, but we have mostly recovered and righted the ship. We've closed our office in Puerto Rico. Stonetrust is now a Nebraska domiciled insurer and continues to deliver good underwriting results. More importantly, even with over 40% of Stonetrust's assets invested in fixed income, over the last 28 months (1/1/15 through 4/30/17) the Stonetrust investment portfolio is up over \$16 million. That is a greater than 12% annualized return on tangible book value – nearly double the return of the S&P 500 over the same period. These investment results would be the envy of most US insurance companies.

The Dhandho Holdings public equity investment portfolio is also up meaningfully through April, 2017. Even with these gains it remains deeply undervalued, which bodes well for our future.

### **Putting the Toothpaste back in the Tube**

Two core underlying assumptions that led to the formation of Dhandho have been proved wrong. If I knew in 2013 what I now know in 2017, I would never have embarked on setting up Dhandho. It was a mistake. My focus now is to “try to put the toothpaste back in the tube” as optimally as possible. What were these two mistakes?

1. Insurance is a very tough commoditized business. Buyers of most kinds of insurance think they'll never file a claim and view premiums as an unfair tax. As a result, they seek out the low bid without much regard for the brand name or reputation of the insurer. It is all about price. It is also one of the only industries I know of where one does not know one's cost of goods sold until maybe a decade or two after the goods have been sold. Underpricing is quite easy in this business – and it can feel great in the near term as the cash pours in. However, it can be fatal in the long term.

I believed insurance float was a wonderful thing. What's not to like about being paid to hold other people's money for years and decades on end? That's the headline that suckered me in. The fine print is that, rightfully so, insurance is tightly regulated and there are plenty of

restrictions on how an insurance company can invest its float and surplus. These restrictions force entities like Stonetrust to own dozens of stocks and high-grade bonds. It is very hard to deliver exceptional results when one is required to own lots of high-grade fixed income instruments that pay next to nothing in interest. Also, my 15<sup>th</sup> best stock idea cannot hold a candle to my 3<sup>rd</sup> best idea. However, regulators and rating agencies want to see well diversified stock and bond portfolios and I agree with them.

The good news is that as I write this missive Stonetrust's book value is at an all-time high. The \$16+ million in investment gains has more than offset the \$5 million adverse development hit we took in 2015 (for years pre-dating our ownership of Stonetrust). Stonetrust management is intensely focused on disciplined underwriting. In the last 28 months, Stonetrust has gotten rid of innumerable marginal accounts and passed on lots of businesses where pricing did not make sense. We are trying to do the best with the hand we dealt ourselves – and so far the results aren't bad. So, even though we are doing well with underwriting and investing, it is a very tough business. I am under no illusions that it will be easy to continue to deliver great results.

We started with the premise of using insurance as an anchor for Dhandho Holdings. I spent lots of time looking for other insurance operations to buy. Thankfully, while we came close on a couple, we were unable to close on any additional deals. From now to the time I go to my grave, it is very unlikely I will ever seek to buy another insurance company. Been there. Done that. Got the T-Shirt!

Stonetrust has many stakeholders. These include its owners, regulators, rating agencies, management, team members, agents, policy holders and injured workers. We need to address the concerns of all these groups as we chart its future. I am confident we'll figure out a win-win result for virtually everyone in the foreseeable future.

2. I have found acquiring good private businesses is quite hard. There is a lot of capital sloshing around. These buyers are quite willing to pay full price or even overpay. The few times I came close to buying a private business for Dhandho, it turned into an auction, at which point I moved on. In my 23-year history as a value investor I have had lots of success in finding and buying deeply undervalued businesses in the public markets, but virtually zero experience in acquiring private businesses.

Auction driven equity markets routinely misprice businesses. For example, Dhandho Holdings has small investments in a few publicly traded companies in India. One of these, Kolte-Patil, has a 52-week price range of Rs. 78-204. Kolte-Patil was changing hands at Rs. 78 in December, 2016 and at Rs. 204 in March, 2017. Having studied this real estate developer closely, I am confident that there was no meaningful change in its intrinsic value during these 13 weeks. This is the beautiful thing about public markets. They routinely vacillate between

fear and greed and can serve up some spectacular bargains from time to time. It would be very strange if a seller thought his business was worth \$78 million in December 2016, only to suddenly realize in March, 2017 that the correct selling price should \$204 million! Or that in May, 2017 it is worth \$171 million. Nonetheless, we routinely see wide 52-week high-low ranges for publicly traded stocks all the time. It is a huge advantage for the likes of me.

Private transactions are a completely different animal. Here, it is mostly an intelligent seller facing an intelligent buyer. The intelligent seller usually has the luxury of optimally timing sales when the business is firing on all cylinders. I've thus reached two conclusions:

1. It is quite hard to buy good private businesses in the US presently at bargain prices.
2. It is far easier for me to find meaningfully undervalued businesses in public equity markets. I'd rather fish in the public equities pond.

Hence, I stopped looking for private businesses to buy and increased my focus on investing in public equities in places like India where there is significant mispricing among small and mid-caps at this time.

*Should you find yourself in a chronically leaking boat,  
energy devoted to changing vessels is likely to be more productive  
than energy devoted to patching leaks.*

- Warren Buffett

These two mistakes in combination pretty much eliminate much of the original strategy Dhandho had embarked on. Given this reality, I am focused on returning your capital back to you at the earliest. Our boat isn't leaking, but it just does not have the horsepower to get us to the promised land. Thus I'd like to carefully navigate us back to the dock. That frees you up to seek out a better boat and captain.

I do not want to destroy value by doing this in a rushed manner. I hope to make a meaningful distribution within the next year. And I hope to make a final distribution within three years or less. The goal is to return your entire principal investment (hopefully with some gains) via these two distributions and then leave you with an ownership stake in a private business as a stub after you've gotten all your principal back.

I do not envision more than 5% of the capital we raised being invested in Dhandho Funds. So far, it has absorbed less than 1.5% of our capital. Dhandho Funds has the Junoon Zero Fee Funds and the Junoon ETF. We intend to launch the Dhandho India Zero Fee Funds later this year. One or more of these funds may scale. It is upside with a muted downside. And if we do have success with Dhandho Funds, it will be retained as a private business owned by all of you, paying annual dividends. I will

also work out a mechanism for folks to do a full exit in a few years if they prefer not to deal with being a shareholder of Dhandho Funds.

I am focused on the toothpaste getting back in the tube as prudently and promptly as possible. I appreciate your patience and trust in me. My family invested \$9 million on the same terms as virtually all other Dhandho investors and thus my family's interests are 100% aligned with yours.

Finally, when we do these distributions, I will endeavor to provide investors with a few choices. For example, they can take cash or I'll open up Pabrai Funds for anyone who wants to invest there. We'll also make sure the Junoon Zero Fee Fund and the India Zero Fee Fund are also available as options. I will also transparently advise what my family intends on doing with its distribution.

Now back to a discussion on our core assets:

### **Stonetrust Insurance**

Stonetrust had another decent year. In 2016, on an accident year basis, Stonetrust generated a net combined ratio of 99.8% resulting in a small underwriting gain. We also had favorable reserve development to the tune of \$690,000 for 2015 that improved its combined ratio from 99.0% to 97.8%. The below table summarizes Stonetrust's results in the past five accident years:

<b>Accident Year</b>	<b>Combined Ratio</b>
2016	99.8%
2015	97.8%
2014	96.5%
2013	93.6%
2012	96.9%

It is worth noting that Stonetrust has generated an underwriting profit in each of the last 5 years. Cumulatively, since 2000, Stonetrust has had a net combined ratio of 97.8%. Tim Dietrich and his team continue to do a great job focusing on underwriting profit and not renewing marginal accounts. In 2016, Stonetrust was very selective in accepting new business, fixating on profitable accounts. The numbers reflect this; overall premiums shrunk by 7.5%. Although underwriting profit is the priority, Stonetrust has recently filed and been granted licenses in a number of new states, bringing the total to about 30; and management hopes to start writing policies in Nebraska by the end of 2017.

Stonetrust's re-domestication to Nebraska is complete. Nebraska is an insurance business-friendly state, which has "most favored nation" rules that make it the ideal location to domicile a multi-state underwriter. It has low premium taxes and hence attracts little to no retaliatory taxes from other states.

### **Stonetrust Investment Results**

Stonetrust's investment portfolio generated \$6.5 million in unrealized and realized gains, and \$2.8

million in interest and dividends. By the end of April, 2017, we had an additional \$4+ million in mostly unrealized gains. I expect continued decent investment results in the years ahead.

### **Holding Company Investments**

We own pieces of some exceptional publicly traded businesses run by exceptional managers. I believe these businesses are deeply undervalued. We are concentrated in a handful of names, including a few in India. I love our portfolio and expect us to do quite well in the years to come.

### **Dhandho Funds**

In 2016, Dhandho Holdings formally organized Dhandho Funds, a subsidiary focused on developing unique investment products. The investment management business is a beautiful business and one that I know very well. It requires very little capital – just a few computers, some office space, and a handful of bright brains. If a fund delivers the bacon with excellent performance, it can generate very high returns on equity for its owners. If it has a fair fee structure – like the “0/6/25” fee structure of the Junoon Zero Fee Funds in which incentives are completely aligned – it is a “win-win” for everyone.

In 2016, Dhandho Funds launched the Junoon Funds, which include two investment products: Dhandho Junoon Zero Fee Funds and the Dhandho Junoon ETF, which trades on the NYSE Arca exchange under the ticker JUNE. These are early days for both. Collectively we have about \$10 million in assets in the various Junoon Funds – up from nothing a year ago. You can learn more at [www.dhandhofunds.com](http://www.dhandhofunds.com).

### **An Exceptional Team**

It’s been a true pleasure working with Fahad Missmar since 2014. His role is well beyond that of a CFO. I have repeatedly given Fahad a wide range of challenging assignments and he has always risen to the task. Our quantitative analysts led by Tanvi Arora are a talented bunch. I have nothing but praise for the crew at BDO, Grant Thornton, Edgar Rios at Pietrantonio Mendez & Alvarez (PMA), Liccar, and Mike Froy at Dentons. Our offshore legal advisors, Conyers, Dill & Pearman, are a pleasure to work with. Ajay Desai and his team at UBS are our broker and custodian in the US and they are also very much a part of the team. Kotak Mahindra is our broker and custodian in India and they are simply world-class.

### **2017 Annual Meetings – Save the Date**

There will be two annual meetings held sequentially in Orange County, California & Chicago. These meetings will cover Pabrai Funds, Dhandho Holdings and Dhandho Funds.

Prior to the California meeting on September 9, 2017, we will have the 4th Annual Gran Fondo Dhandho Bike Ride. It’s a scenic ride around the Newport Estuary with views of the Pacific Ocean in Newport Beach, California. Biking can be a dangerous activity; we only want folks

who are decent bikers on the ride. The ride begins at Starbucks in Newport Beach at 8:15 AM, and ends there around 10:30 AM. For folks that just wanna chill, you can come to the Starbucks at 10:30 AM and hang out with us bikers. Here is a link to the Starbucks location:

<http://www.starbucks.com/store/18175/us/jamboree-bristol/3601-jamboree-road-newport-beach-ca-926602961>

Several out-of-towners have rented bikes from ARB Cyclery over the years. Here is a link to their website: <http://www.arbcyclery.com/>. They have a great selection of bikes and will deliver and pick up the bikes from your hotel. Bikers are best off staying at the Newport Beach Marriott Bayview , as it is less than 0.5 miles from our Starbucks rendezvous point. Here is a link to the hotel's website: <http://www.marriott.com/hotels/travel/npbst-newport-beach-marriott-bayview/>.

I hope you'll join me on Saturday morning to experience some of the magic of Southern California.

The **California** meeting is scheduled to be on **Saturday, September 9th, 2017** at 4:00 PM at:

[Soka University](#)

Performing Arts Center

1 University Drive, Aliso Viejo, California 92656

Tel. +1949.480.4000

Soka University has a spectacular campus nestled in the scenic hills of Aliso Viejo. It is a 20 minute drive from Orange County Airport (SNA), and about an hour drive from LAX.

There is a fantastic Marriott Club Sport hotel about 3 miles from Soka University:

[Marriott Renaissance ClubSport](#)

50 Enterprise

Aliso Viejo, CA 92656

Reservations: 800-468-3571

Phone: 949-643-6700

There are many hotels in the area. Here is a link to other hotels near Soka University:

<http://tinyurl.com/8dmevvu>

The **Chicago** meeting is thus scheduled to be on **Saturday, Sept. 16th, 2017** at 4:00 PM at:

[Carlucci's Restaurant](#)

(The Auditorium)

6111 North River Road, Rosemont, Illinois 60018

Tel. +1847.518.0990

Carlucci's is a five minute taxi ride away from O'Hare airport. [The Marriott Suites O'Hare](#) and [The Westin O'Hare](#) are both next to the restaurant. In addition, there are a plethora of hotels in the vicinity. Good deals on O'Hare hotels are usually available on the major travel-related websites.

Agenda:

4:00 – 4:30 PM: Meet and Greet  
4:30 – 6:30 PM: Presentation and Q&A  
6:30 – 7:15 PM: Cocktail Hour  
7:15 PM: Dinner (Chicago only)

In lieu of dinner in California, we'll have an extended cocktail hour with expanded appetizers (multiple food stations), and lots of tables to sit and chat.

The invites will go out electronically via email in July, 2017. Look for it in your inbox! Your significant other and kids of all ages are welcome to attend. As we are now a Registered Investment Advisor, the SEC requires that all guests (excluding family members) must be "accredited investors." The invitation is non-transferable.

I look forward to seeing you in September.

Thanks for your continued interest and support. Feel free to call me at +1949.453.0609 or email me at [mpabrai@dhandho-holdings.com](mailto:mpabrai@dhandho-holdings.com) with any queries or comments.

Warm regards,

A handwritten signature in black ink, appearing to read 'Mohnish Pabrai', with a stylized flourish extending from the end.

Mohnish Pabrai

**DHANDHO HOLDINGS CORP.  
AND SUBSIDIARIES**

***INDEPENDENT AUDITORS' REPORT  
AND  
CONSOLIDATED FINANCIAL STATEMENTS***

December 31, 2016

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**TABLE OF CONTENTS**  
**DECEMBER 31, 2016**

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	<u>Page(s)</u>
<b>INDEPENDENT AUDITORS' REPORT</b>	1-2
<b>FINANCIAL STATEMENTS:</b>	
Consolidated Balance Sheet	3
Consolidated Statement of Net Loss and Comprehensive Income	4
Consolidated Statement of Changes in Stockholders' Equity	5
Consolidated Statement of Cash Flows	6
Notes to the Consolidated Financial Statements	7 - 33



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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of  
Dhandho Holdings Corp. and Subsidiaries:

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Dhandho Holdings Corp. (the "Company"), which comprise the consolidated balance sheet as of December 31, 2016, and the related consolidated statements of net loss and comprehensive income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

### Management's Responsibility for the Consolidated 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 the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibilities

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit 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 from 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 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.



To the Board of Directors and Stockholders of  
Dhandho Holdings Corp. and Subsidiaries  
Page 2

### Opinion

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

*BDO Puerto Rico, P.S.C.*

San Juan, Puerto Rico

May 11, 2017

Certified Public Accountants  
(of Puerto Rico)  
License No.53 Expires December 1, 2018  
Stamp E264770 of P.R. Society of  
Certified Public Accountants has been  
affixed to the file copy of this report

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEET**  
**DECEMBER 31, 2016**

	<u>2016</u>
<b>ASSETS</b>	
Investments in securities available for sale:	
Bonds - (amortized cost of \$33,321,421)	\$ 34,057,266
Common stock - at fair value (cost of \$93,391,133)	100,784,697
Preferred stocks - at fair value (cost of \$14,582,329)	<u>14,535,243</u>
Total investments in securities available for sale	149,377,206
Investment in partnership, at cost	<u>4,000,000</u>
Total investments	153,377,206
Cash and cash equivalents	40,640,433
Premiums receivable, net	19,056,049
Reinsurance receivables and recoverables	2,493,759
Investment income due and accrued	487,352
Deferred tax assets, net	1,495,940
Income taxes receivable	535,031
Deferred policy acquisition costs	1,696,014
Due from related parties	2,858
Property and equipment, net	7,915,218
Intangible assets	4,823,905
Goodwill	2,427,047
Other assets	<u>1,613,026</u>
Total assets	<u>\$ 236,563,838</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	
Losses and loss adjustment expenses	\$ 68,231,420
Unearned premiums	21,552,087
Commissions payable	1,612,767
Advance premiums	711,366
Accounts payable and other liabilities	1,416,179
Taxes, licenses and fees, excluding federal income taxes	4,295,674
Accounts payable to former stockholder of Stonetrust Companies	500,000
Security deposits	1,845,666
Note and mortgage payable	<u>3,893,041</u>
Total liabilities	<u>104,058,200</u>
Stockholders' equity:	
Common stock, no par value, 1,000 shares authorized, issued and outstanding	151,978,990
Treasury stock (4 shares of common stock)	(584,948)
Accumulated deficit	(24,133,210)
Accumulated other comprehensive income	<u>5,244,806</u>
Total stockholders' equity	<u>132,505,638</u>
Total liabilities and stockholders' equity	<u>\$ 236,563,838</u>

The accompanying notes are an integral part of these consolidated financial statements.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF NET LOSS AND COMPREHENSIVE INCOME**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

	<u>2016</u>
Revenues:	
Premiums earned, net of ceded reinsurance premiums incurred of \$2,236,357	\$ 54,909,004
Net investment income	3,136,826
Net realized capital gains	1,857,188
Rental income	350,361
Other income	<u>313,049</u>
Total revenues	<u>60,566,428</u>
Losses and expenses:	
Losses incurred	28,475,007
Loss adjustment expenses incurred	6,549,460
Underwriting and operating expenses	21,851,178
Loss on impairment of investments	2,568,223
Bad debt expense	3,820,869
Exercised holdback securities from former stockholder of Stonetrust Companies	(500,000)
Interest expense	<u>325,980</u>
Total losses and expenses	<u>63,090,717</u>
Loss before income tax	(2,524,289)
Income tax benefit	<u>486,985</u>
Net loss	<u>(2,037,304)</u>
Comprehensive income:	
Unrealized holding gains arising during the period	7,264,582
Reclassification adjustment for loss included in net income	1,449,185
Change in derivative instrument	<u>47,178</u>
Other comprehensive income before taxes	8,760,945
Income tax expense	<u>(1,391,076)</u>
Other comprehensive income, net	<u>7,369,869</u>
Comprehensive income	<u>\$ 5,332,565</u>

The accompanying notes are an integral part of these consolidated financial statements.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

	<u>Common Stock</u>	<u>Treasury Stock</u>	<u>Accumulated Deficit</u>	<u>Accumulated Other Comprehensive (Loss) / Income</u>	<u>Total Stockholders' Equity</u>
Balance, December 31, 2015	\$ 151,978,990	\$ -	\$ (22,095,906)	\$ (2,125,063)	\$ 127,758,021
Repurchase of common stock	-	(584,948)	-	-	(584,948)
Net loss	-	-	(2,037,304)	-	(2,037,304)
Other comprehensive income - net	-	-	-	7,369,869	7,369,869
Balance, December 31, 2016	<u>\$ 151,978,990</u>	<u>\$ (584,948)</u>	<u>\$ (24,133,210)</u>	<u>\$ 5,244,806</u>	<u>\$ 132,505,638</u>

The accompanying notes are an integral part of these consolidated financial statements.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2016**

	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss	\$ (2,037,304)
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization expense	1,070,476
Net amortization on investments	99,001
Deferred income taxes	639,701
Bad debt expense	3,820,869
Loss on impairment on investment securities	2,568,223
Realized gains on investments	(1,857,188)
Loss on disposition of fixed assets	89,593
Changes in operating assets and liabilities:	
Premiums receivable	908,678
Reinsurance receivables and recoverables	25,554
Deferred policy acquisition costs	(39,565)
Income taxes receivable	1,378,480
Accrued investment income	(76,867)
Due from affiliates	(2,692,643)
Other assets	(170,276)
Losses and loss adjustment expenses	2,723,451
Unearned and advance premiums	(1,972,018)
Insurance related taxes and assessments	(122,951)
Commissions and other liabilities	(190,337)
Net cash provided by operating activities	<u>4,164,877</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of investments available-for-sale	(86,480,405)
Proceeds from sales, maturities and prepayments of investments available-for-sale	86,222,284
Purchase in investment in partnership	(2,000,000)
Purchase of property and equipment	(631,577)
Net cash used in investing activities	<u>(2,889,698)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:	
Payments made on mortgage loan	(1,976,560)
Exercise of holdback securities from former stockholder	(500,000)
Repurchase of stock	(584,947)
Net cash used in financing activities	<u>(3,061,507)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(1,786,328)
CASH AND CASH EQUIVALENTS, beginning of year	42,426,761
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 40,640,433</u>
SUPPLEMENTAL CASH FLOW INFORMATION	
Interest paid	<u>\$ 325,496</u>

The accompanying notes are integral part of these consolidated financial statements.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

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**1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Dhandho Holdings Corp. (the “Company” or “DHC”) is a corporation organized under the laws of the Commonwealth of Puerto Rico on October 31, 2014. The Company is owned 73.242% by Dhandho Holdings, L.P. (“DHLP”), and 26.758% by Dhandho Holdings Qualified Purchaser, L.P. (“DHQP”), both limited partnerships organized under the laws of the State of Delaware. The Company’s main business purpose is to make equity investments in privately and publicly held businesses.

On December 31, 2014, the Company acquired 100% of the outstanding common stock of Stonetrust Management Services, LLC (“SMS”) and Stonetrust Holding Company, LLC and its subsidiaries (collectively Stonetrust Companies). Stonetrust Companies are engaged in providing statutory workers’ compensation and employers’ liability insurance coverage in Louisiana, Mississippi, Arkansas, Oklahoma and Texas. The acquisition was completed on December 31, 2014 for a total purchase price of \$35,000,000. See Note 2.

Stonetrust Commercial Insurance Company (“SCIC”), formerly known as Amicus Mutual Insurance Company, was formed in March 2000 as a Louisiana-domiciled mutual insurance company. SCIC received its Certificate of Authority, effective June 30, 2000, to write workers’ compensation insurance in Louisiana. Operations began July 1, 2000 as the successor to Louisiana Associated Commercial Employers Self Insurers Fund (“LACE-SIF”).

Effective January 1, 2006, after a vote of approval by its members, SCIC was converted from a mutual insurance company to a stock insurance company wholly owned by a mutual insurance holding company parent (“Stonetrust Commercial Mutual Insurance Holding Company”). Pursuant to the conversion, Stonetrust Commercial Mutual Insurance Holding Company was owned by the company’s policyholders. In addition, effective January 1, 2006, the name was changed from Amicus Mutual Insurance Company to Stonetrust Commercial Insurance Company.

In 2014, SCIC formed Stonetrust Realty, LLC (“SR”), a wholly-owned subsidiary, for the purpose of acquiring and holding real estate.

Effective December 31, 2014, Stonetrust Commercial Mutual Insurance Holding Company entered into a sponsored demutualization transaction and was renamed Stonetrust Holding Company and converted to a stock company. Immediately following the demutualization, Stonetrust Holding Company and its subsidiaries, SCIC, SR and SMS were acquired by the Company.

Effective December 31, 2015, Stonetrust Holding Company was converted to a Louisiana limited liability company. Upon conversion all the common stock owned by the Company were exchanged for members units of the limited liability company. Stonetrust Holding Company, LLC is authorized to issue a new class of membership units. For U.S federal tax purposes, the LLC will continue to be treated as a Corporation.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

Effective December 31, 2016, Stonetrust Holding Company merged into Stonetrust Commercial Insurance (SCIC). Post merger, SCIC is a direct wholly-owned subsidiary of DHC. In 2016, the Company re-domesticated to Nebraska.

Dhandho India Private Limited (“DIPL”) is a private limited company organized under the laws of India in May 2015. In 2016, DIPL served as a technical support services provider to the Company and its subsidiaries, providing research and development in information technology related to investment management and insurance.

Coverage HQ Agency LLC (“HQ Agency”) was a limited liability company organized under the laws of Puerto Rico in October 2015. The company was engaged in insurance brokerage. HQ Agency was dissolved on June 9, 2016.

Coverage HQ Holdings, LLC (“HQ Holdings”) is a limited liability company organized under the laws of Puerto Rico in November 2015. The company is the sole owner of Coverage HQ Insurance I.I. Corporation (“CoverageHQ”), a Puerto Rico corporation, which is authorized to provide unrestricted property and casualty insurance. CoverageHQ obtained license approval from the Puerto Rico Insurance Commission effective July 1, 2016. However there was no premium underwriting activity during the period ended December 31, 2016.

**Basis of Presentation and Consolidation**

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) using the accrual basis of accounting, and include the accounts of DHC and its wholly-owned subsidiaries, principally the Stonetrust Companies. All significant intercompany accounts and transactions are eliminated in the consolidation.

**Cash and Cash Equivalents**

For purposes of the statement of cash flows, the Company considers cash balances and short-term investments with original maturities of ninety days or less to be cash equivalents.

**Premiums**

Premiums are recognized when earned over the premium paying period of the related workers’ compensation policies. Unearned premiums are established to cover the unexpired portion of premiums written. Premiums are billed and collected according to policy terms predominantly in the form of installments during the policy period. Workers’ compensation premiums are determined based upon the payroll of the insured, the applicable premium rates and, where applicable, an experience-based modification factor, debits, credits, and discounts applied by SCIC underwriters based upon individual risk characteristics. Audit of policyholders’ records are conducted after policy expiration

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

to make a final determination of applicable premiums. As of December 31, 2016, \$2,249,663, were included in premiums receivable for estimated additional amounts of premiums to be billed to SCIC's policyholders.

Premiums collected in advance of the next succeeding policy year are deferred from income recognition and are recorded as advance premiums in the accompanying consolidated balance sheet.

Premium receivables consist of amounts due in the normal course of collection from policyholders located within the states SCIC serves. Receivables for premiums are not secured, other than by security deposits received by SCIC. The portions of premium that are unbilled and will be earned in the future are reported as unearned premiums.

The allowance for doubtful accounts is an amount that management believes will be adequate to absorb probable losses on existing accounts receivable that may become uncollectible based on evaluations of their collectability and prior credit loss experience. Because of uncertainties inherent in the estimation process, management's estimate of credit losses in the receivables outstanding and the related allowance may change as a result of future developments. As of December 31, 2016, the allowance for doubtful accounts had a balance of \$627,758. The potential for additional loss is not believed to be material to the Company's financial position.

**Investments**

The Company classifies its investments as available-for-sale or held-to-maturity based upon its intent and ability to hold the investment, and the nature of the securities purchased. The classification is made at the acquisition date of the security and reassessed each year.

Debt securities for which the Company has the intent and ability to hold to maturity are reported at amortized cost, adjusted for amortization of premiums or discounts and other-than-temporary declines in fair value. Debt and equity securities classified as available-for-sale are reported at estimated fair value, adjusted for other than temporary declines in fair value, with unrealized gains and losses reported as a separate component of stockholder's equity. Realized gains and losses are determined on the specific identification method. Also, see Note 4 for further disclosure regarding fair value.

Investment in partnership is comprised of investments in a pooled investment fund, where the Company's ownership is minor and the Company does not have significant operating or financial influence. It is recorded using the cost method of accounting.

Management evaluates securities for other-than-temporary impairment ("OTTI") periodically and more frequently when economic or market conditions warrant such evaluation. The accounting guidance on OTTI specifies that (a) if an entity does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, then security would not be

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security and it is more likely than not that the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an OTTI of a debt security in earnings and the remaining portion in other comprehensive income. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected based on cash flow projections.

Net investment income consists primarily of interest and dividends. Interest is recognized on the accrual basis and dividends are recorded as earned at the ex-dividend date. Accrual of interest income is suspended for bonds that are in default or when the receipt of interest payment is in doubt. Realized capital gains and losses are determined under the specific identification basis and are recorded in earnings.

**Losses and Loss Adjustment Expenses Incurred and Payable**

Unpaid losses and loss adjustment expenses include an amount determined from individual case estimates and loss reports and an amount, based on past experience, for losses incurred but not reported ("IBNR"). Loss reserves are estimates and are inherently uncertain; they do not and cannot represent an exact measure of ultimate liability. SCIC performs a comprehensive review of its loss reserves at the end of each quarter. Estimating loss reserves is a complex process that involves a combination of actuarial techniques and methods and management judgment to establish the most reasonable estimate of loss reserves. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed, and any adjustments are reflected in the period determined. SCIC does not discount its liabilities for unpaid losses and loss adjustment expenses.

**Property and Equipment**

Property and equipment is stated at cost. Depreciation and amortization are provided under the straight-line method over the estimated useful lives of the related assets. Major additions and betterments are charged to the property accounts, while replacements, maintenance and repairs, which do not improve or extend the lives of the respective assets, are expensed currently. When property is retired or otherwise disposed of, the cost of the asset and the related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in current earnings.

**Impairment of Long-lived Assets**

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Recoverability of assets to be held and used (the fair value) is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment recognized is measured by the amount by which the carrying value of the assets exceeds the fair value of assets. Management has concluded that there are no impairment losses to be recognized as of December 31, 2016.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

**Reinsurance**

The Company seeks to reduce the loss that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with reinsurers. Amounts recoverable from reinsurance are estimated in a manner consistent with the claims liability associated with the reinsurance policy. All reinsurance contracts in place transfer underwriting risks to reinsurers (see Note 11).

The Company limits the maximum net loss that can arise from large risks or risks in concentrated areas of exposure by reinsuring (ceding) certain levels of risks to other insurers under general reinsurance contracts known as “treaties” or by negotiation on an individual risk basis. Amounts recoverable from reinsurance are estimated in a manner consistent with the claim liability associated with the reinsured policy.

**Deferred Policy and Acquisition Costs**

Deferred policy acquisition costs represent the cost of writing business that vary with, and are primarily related to, the successful production of insurance business (principally commissions and premium taxes). Policy acquisition costs are deferred and recognized as expense as related premiums are earned.

**Goodwill and Other Intangibles**

Goodwill represents the excess of the purchase price of an acquired business over the amount assigned to the assets acquired and liabilities assumed. The Company evaluates goodwill on an annual basis, or more frequently if management believes indicators of impairment exist. Such indicators could include, but are not limited to (1) a significant adverse change in legal factors or in business climate, (2) unanticipated competition, or (3) an adverse action or assessment by a regulator. The Company first assesses qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. If management concludes that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, management conducts the two-step quantitative goodwill impairment test. The first step of the impairment test involves comparing the fair value of the applicable reporting unit with its carrying value. The Company estimates the fair values of its reporting units using a combination of the income, or discounted cash flows, approach and the market approach, which utilizes the comparable companies’ data. If the carrying amount of a reporting unit exceeds the reporting unit’s fair value, management performs the second step of the goodwill impairment test. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit’s goodwill with the carrying value of that goodwill. The amount, by which the carrying value of the goodwill exceeds its implied fair value, if any, is recognized as an impairment loss.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

Tradenames are initially measured based on their fair values. Tradenames were categorized as an intangible asset with indefinite life since management expects to continue using the SCIC tradename indefinitely and the tradename renovation process is expected to be easily achievable.

Definite-lived intangible assets, such as product customer relationships, are amortized on a straight-line basis over their estimated or contractual useful lives. The Company continually evaluates the reasonableness of the useful lives of these assets.

Based on current facts, estimates and assumptions used, the Company determined that goodwill and intangible assets were not impaired at December 31, 2016.

**Income Taxes**

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year 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 rate is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts more likely than not to be realized.

The Company follows the accounting standard on accounting for uncertainty in income taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Company may recognize the tax benefit from an uncertain tax position only if it is more-likely-than-not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses de-recognition, classification, interest and penalties on income taxes, and accounting in interim periods.

**Fair Value Measurement**

The fair value of a financial instrument is the amount that would be received in an asset sale or paid to transfer a liability in an orderly transaction between unaffiliated market participants. Assets and liabilities measured at fair value are categorized based on whether the inputs are observable in the market and the degree that the inputs are observable. The categorization of financial instruments within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement. The hierarchy is prioritized into three levels (with Level 3 being the lowest) defined as follows:

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

*Level 1* - Quoted prices in active markets for identical assets or liabilities that the entity has the ability to access.

*Level 2* - Observable inputs other than prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated with observable market data.

*Level 3* - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies, and similar techniques that use significant unobservable inputs.

**Concentration of Credit Risk**

SCIC provides workers' compensation insurance primarily to employers and individuals within the states it serves. The Company extends credit to policyholders using practices common to the insurance industry.

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash deposits, investment securities, reinsurance recoverable and receivables, and balances due from agents and insureds. The Company invests in various types of investment securities. Investment securities are exposed to various risks, such as interest rate, market and credit risk. Management continually evaluates its investment portfolio to manage concentrations in individual securities, issuers of securities, and types of securities, industries, and geographic regions. The Company generally limits its exposure to credit risk from balances on deposit in financial institutions in excess of the federally insured limits. Management believes the credit risk associated with these deposits is minimal.

All demand deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") up to \$250,000. The money market funds are not insured by the FDIC.

**Comprehensive Income**

Comprehensive income is defined as the change in equity of a business enterprise during a period of transactions and other events and circumstances, except those resulting from investment by owners and distributions to owners. Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and derivative instruments, are reported as a separate component of the stockholder's equity section in the balance sheet, such items, along with net income, are components of comprehensive income.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

**Loss Portfolio Transfer**

Under the terms of a Loss Portfolio Transfer (“LPT”) agreement, SCIC acquired the outstanding amounts due under the claim reserves of LACE-SIF for all loss years as valued by LACE-SIF’s independent actuary as of December 31, 2000. In addition, the transfer agreement moved all loss-related liabilities (such as the liability for assessments by the Second Injury Fund and the Office of Workers’ Compensation) and placed SCIC into the place of LACE-SIF to settle all claims and estimated excess policy recoveries. Estimated amounts remaining to be paid under the LPT as of December 31, 2016 totaled \$8,874.

**Use of Estimates**

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The most significant estimates susceptible to change are those used in determining the reserves for losses and loss adjustment expenses, recoverability of deferred assets, the estimate of additional premium to be billed to policyholders and valuation of investment in subsidiaries. Although considerable variability is inherent in these estimates, management believes that the estimates are adequate. The estimates are continually revised and adjusted as necessary. Such adjustments are reflected in current operations.

**Adoption of New Accounting Policies**

In April 2015, the FASB issued Accounting Standards Update No. 2015-03, (ASU No. 2015-03) “Simplifying the Presentation of Debt Issuance Costs”. This update requires debt issuance costs to be shown on the balance sheet as a reduction of the related liability and to classify amortization of debt issuance costs as interest expense. See Note 13 for the effects of the adoption of ASU No. 2015-03.

**Recently Issued Accounting Guidance Not Yet Adopted**

In May 2015, the FASB issued guidance on disclosures for investments in certain entities that calculate NAV per share or its equivalent. Under this amendment, investments for which fair value is measured at NAV using the practical expedient should not be categorized in the fair value hierarchy. The guidance is effective for periods beginning after December 15, 2016. Early adoption is permitted. This guidance is not expected to have a material impact on the Company’s consolidated financial statements.

In May 2015, the FASB issued new guidance which requires insurance entities to provide additional disclosures related to claims liabilities related to short-duration contracts. The additional disclosure requirements include: (1) the claims development information by

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

accident year, net of reinsurance, for the number of years for which claims incurred remain outstanding but not to exceed the most recent 10 years; (2) a reconciliation of claims development information and the aggregate carrying amount of the liability for unpaid claims and claim adjustment expenses; and (3) information about the claims frequency and the amount of the incurred-but-not-reported liabilities for each accident year presented. In addition, a description of the methodologies and assumptions used to determine the amounts disclosed and significant changes in methodologies and assumptions are required. The roll forward of the liability for unpaid claims and claims adjustment expenses, currently required only for annual periods, will also be required for interim periods. The guidance will be effective for annual periods beginning after December 15, 2016 and interim periods thereafter. This guidance is not expected to have a material impact on the Company's consolidated financial statements.

In January 2016, the FASB issued updated guidance to address the recognition, measurement, presentation, and disclosure of certain financial instruments. The updated guidance requires equity investments, except those accounted for under the equity method of accounting, that have readily determinable fair value to be measured at fair value with changes in fair value recognized in net income. Equity investments that do not have readily determinable fair values may be remeasured at fair value either upon the occurrence of an observable price change or upon identification of impairment. A qualitative assessment for impairment is required for equity investments without readily determinable fair values. The updated guidance also eliminates the requirement to disclose the method and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost on the balance sheet. The updated guidance is effective for periods beginning after December 15, 2019 and will require recognition of a cumulative effect adjustment at adoption. This guidance is not expected to have a material impact on the Company's consolidated financial statements.

FASB issued on February 25, 2016. It is expected to be effective for periods beginning after December 15, 2018 for public entities, and for periods beginning after December 15, 2019 for nonpublic entities. Early application is permitted. The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. All leases create an asset and a liability for the lessee in accordance with FASB Concepts Statement No. 6, Elements of Financial Statements, and, therefore, recognition of those lease assets and lease liabilities represents an improvement over previous GAAP, which did not require lease assets and lease liabilities to be recognized for most leases. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term. Lessor accounting remains substantially unchanged with the exception that no leases entered into after the effective date will be classified as leveraged leases. For example, the vast majority of operating leases should remain classified as operating leases, and lessors should continue to recognize lease income for those leases on a generally straight-line basis over the lease term. This guidance is not expected to have a material impact on the Company's consolidated financial statements.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

During the year ended December 31, 2016, the FASB issued other accounting standard updates that were not relevant to the Company's operations.

**2. BUSINESS COMBINATION**

All entities acquired in 2014 were accounted for in accordance with U.S. GAAP relating to business combinations.

On December 31, 2014, the Company completed the acquisition of Stonetrust Commercial Mutual Holding Insurance Company, owner of 100% equity interest in SCIC, which provides statutory workers' compensation and employers' liability insurance coverage to businesses in five (5) states of the United States of America (the "Acquisition"). The Acquisition also included SR and SMS, both Louisiana limited liability companies. SR owns the real estate used by Stonetrust Companies. SMS was the Managing General Agent of SCIC.

Prior to consummating the Acquisition, Stonetrust Commercial Mutual Holding Insurance Company, was converted into a stock holding company pursuant to a Plan of Conversion and Reorganization filed with the Louisiana Department of Insurance.

The total consideration for the Acquisition was \$35 million including an amount due to a former stockholder as explained below, of which \$24 million was allocated to the purchase price of all of the authorized shares of capital stock of Stonetrust Holding Company ("Stonetrust Holding") and its subsidiaries (including SCIC and SR), and \$11 million was allocated to the purchase price of all of the issued and outstanding membership interests of SMS.

In addition to the \$35 million of consideration, the Company also contributed \$30 million to Stonetrust Holding for the benefit of Stonetrust (the "Capital Contribution"). The Capital Contribution was made simultaneously with the closing of the transaction.

The purchase consideration for Stonetrust Companies was allocated to the assets acquired and liabilities assumed based on their estimated fair values on the acquisition date. Goodwill amounting to \$2,427,017 was recognized equal to the excess of the purchase price over the net fair value of identifiable assets acquired and liabilities assumed. Factors contributing to the recognition of goodwill include strategic and synergistic benefits that are expected to be realized as a result of the acquisition. These benefits include insurance market diversification.

As part of the acquisition of Stonetrust, the Company agreed to pay \$2.2 million to a former Stonetrust stockholder. This amount will be paid in 220,000 partnership units of Dhandho Holdings Qualified Purchaser LP ("DHQP"), one of the Company's stockholders. In consideration for the partnership units issued by DHQP, the Company will issue 14.4546 common shares with an estimated value of \$2.2 million to DHQP. The partnership units that will be issued to the Stonetrust former stockholder are subject to certain hold back provisions and are subject to certain future events as defined in the acquisition agreement.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

In accordance with the acquisition agreement the partnership units will be issued to the Stonetrust former stockholder as follows:

<u>Date</u>	<u>Number of Units</u>	<u>Valued NAV of \$10/unit</u>
January 1, 2015	70,000	\$ 700,000
December 31, 2015	50,000	500,000
December 31, 2016	50,000	500,000
December 31, 2017	50,000	500,000
Total	<u>220,000</u>	<u>\$ 2,200,000</u>

On January 1, 2015 DHQP issued 70,000 partnership units to the Stonetrust former stockholder with a value of \$700,000. In consideration for this payment DHQP received 4.60 common shares of DHC with a value of \$700,000.

In 2015, the Company exercised its hold back rights with respect to the partnership units to be issued on December 31, 2015 because certain of the representations made by the former Stonetrust stockholder did not materialize. Since these partnership units will not be issued in the future, the Company re-evaluated the fair value of the Stonetrust net assets acquired resulting in a decrease in goodwill of \$500,000.

As of December 31, 2016, the Company exercised its hold back right with respect to the partnership units to be issued on December 31, 2016 because certain of the representations made by the former Stonetrust stockholder did not materialize. These partnerships units will not be issued in the future.

The partnership units to be issued in calendar year 2017 are subject to the same hold back provisions which will be evaluated at the end of such years. The value of these partnership units amounts to \$500,000 at December 31, 2016 and they are included as an amount payable to former stockholder of Stonetrust Companies in the accompanying consolidated balance sheet.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

**3. INVESTMENTS**

The amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of investment securities available-for-sale by major security type as of December 31, 2016 are as follows:

	2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Loss	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$ 1,571,357	\$ 10,477	\$ -	\$ 1,581,834
State and political subdivisions	10,146,298	115,394	(16,683)	10,245,009
Industrial and miscellaneous	18,108,454	837,268	(83,250)	18,862,472
Mortgage-backed securities	<u>3,495,312</u>	<u>17,255</u>	<u>(144,616)</u>	<u>3,367,951</u>
Total bonds	<u>33,321,421</u>	<u>980,394</u>	<u>(244,549)</u>	<u>34,057,266</u>
Common stocks	93,391,133	9,582,926	(2,189,325)	100,784,734
Preferred stocks	<u>14,582,329</u>	<u>120,659</u>	<u>(167,781)</u>	<u>14,535,207</u>
	<u>107,973,462</u>	<u>9,703,585</u>	<u>(2,357,106)</u>	<u>115,319,941</u>
Total	<u>\$ 141,294,883</u>	<u>\$ 10,683,979</u>	<u>\$ (2,601,655)</u>	<u>\$ 149,377,207</u>

The gross unrealized losses and estimated fair value pertaining to investment securities available-for-sale that have been in a continuous unrealized loss position for less than twelve months and for twelve months or more, are as follows:

	December 31, 2016			
	Less Than 12 Months		Over 12 Months	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$ -	\$ -	\$ -	\$ -
State and political subdivisions	(15,799)	3,115,486	(884)	69,385
Industrial and miscellaneous	(83,250)	4,781,025	-	-
Mortgage-backed securities	<u>(52,015)</u>	<u>2,444,761</u>	<u>(92,601)</u>	<u>542,634</u>
Total bonds	<u>(151,064)</u>	<u>10,341,272</u>	<u>(93,485)</u>	<u>612,019</u>
Common stocks	(549,781)	12,555,531	(1,639,544)	19,698,165
Preferred stocks	<u>(101,187)</u>	<u>4,919,193</u>	<u>(66,594)</u>	<u>1,971,105</u>
	<u>(650,968)</u>	<u>17,474,724</u>	<u>(1,706,138)</u>	<u>21,669,270</u>
Total	<u>\$ (802,032)</u>	<u>\$ 27,815,996</u>	<u>\$ (1,799,623)</u>	<u>\$ 22,281,289</u>

The amortized cost of bonds and notes as of December 31, 2016 has been reduced by net amortization of premiums of \$99,201 to derive the amortized cost of bonds and notes in the accompanying consolidated financial statements.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

The assessment of other-than-temporary impairment is performed periodically. Factors considered in determining whether a loss is temporary include the length of time and the extent to which fair value has been below cost, the severity of the impairment, the cause of the impairment and the financial condition and near-term prospects of the issuer, activity in the market of the issuer which may indicate adverse credit conditions, and the Company's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery.

The Company's review of impairment generally entails identification and evaluation of investments that have indications of possible impairment; analysis of individual investments that have fair values less than amortized cost, including consideration of the length of time the investment has been in an unrealized loss position and the expected recovery period; discussion of evidential matter, including and evaluation of factors or triggers that could cause individual investments to qualify as having other-than-temporary impairment and those that would not support other-than-temporary impairment; and documentation of the results of these analyses.

For equity securities, management considers the various factors described above, including its intent and ability to hold the equity security for a period of time sufficient for recovery to amortized cost. Where management lacks the intent or ability, the security's decline in fair value is deemed to be other-than-temporary and is recorded in earnings. During the year ended December 31, 2016, the Company recorded other-than-temporary impairment adjustments for equity securities of \$481,749.

For debt securities that are not deemed to be credit impaired, management performs additional analysis to assess whether it intends to sell or more-likely-than-not would be required to sell the investment before the expected recovery of the amortized cost basis. In most cases, management has asserted that it has no intent to sell and that it believes it is more-likely-than-not that it will not be required to sell the investment before recovery of its amortized cost basis.

For debt securities, a critical component of the evaluation for other-than-temporary impairments is the identification of credit impaired securities where management does not expect to receive cash flows sufficient to recover the entire amortized cost basis of the security. During the year ended December 31, 2016, the Company recorded an impairment charge of \$2,086,474, related to certain debt securities.

The amortized cost and estimated fair values of investment securities as of December 31, 2016 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage backed securities provide for periodic payments throughout their lives so they are listed in a separate category.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

	<u>2016</u>	
	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Due in 1 year or less	\$ 3,046,409	\$ 3,079,075
Due after 1 year through 5 years	10,340,597	10,496,834
Due after 5 year through 10 years	14,001,056	14,275,305
Due after 10 year through 20 years	661,788	656,646
Due after 20 years	<u>1,776,259</u>	<u>2,181,455</u>
	29,826,109	30,689,315
Mortgage-backed securities	<u>3,495,312</u>	<u>3,367,951</u>
	<u>\$ 33,321,421</u>	<u>\$ 34,057,266</u>

In accordance with regulatory provisions, the Company has pledged bonds with a fair market value of \$3,999,405 to various regulatory agencies as of December 31, 2016. Additionally, at December 31, 2016, the Company has pledged bonds with a fair market value of \$350,595 as collateral required by the Company's counterparty in relation to the interest rate swap transaction described in Note 13.

Components of net investment income were as follows as of December 31:

	<u>2016</u>
Interest on bonds	\$ 1,574,786
Dividends on equity securities	1,727,973
Interest on short-term investments, cash and other	<u>21,732</u>
	3,324,491
Less: investment expenses	<u>(187,665)</u>
	<u>\$ 3,136,826</u>

**4. FAIR VALUE MEASUREMENT**

The following table provides information as of December 31, 2016, about the Company's financial assets measured at fair value at the reporting date:

	<u>2016</u>		
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	\$ -	\$ 1,581,834	\$ -
State and political subdivisions	-	10,245,009	-
Industrial and miscellaneous	-	18,862,472	-
Mortgage-backed securities	-	<u>3,367,951</u>	-
Total bonds	<u>\$ -</u>	<u>\$ 34,057,266</u>	<u>\$ -</u>
Common stocks	<u>\$ 84,670,351</u>	<u>\$ 16,114,370</u>	<u>\$ -</u>
Preferred stocks	<u>\$ 14,485,243</u>	<u>\$ -</u>	<u>\$ 50,000</u>
Derivative instrument - liability	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (87,243)</u>

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

The Company's investments in common stock and preferred stock are exchanged-listed stocks that are actively traded. Unadjusted quoted prices for these securities are provided to the Company principally by independent pricing services that meet Level 1 criteria. In addition, the Company has certain preferred stocks, which are not actively traded and therefore are included in Level 3.

The Company's available for sale debt securities are carried on a recurring basis at estimated fair value which are obtained from independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. These securities are considered Level 2.

The Company's derivative instruments are measured on a recurring basis through a model used by the primary lender. These instruments are considered Level 3 as they are valued using a discounted cash flow model.

The change in carrying values associated with Level 3 financial instruments for the year ended December 31, 2016, are as follows:

Only Level 3 Instruments - December 31, 2015							
	Balance at January 1, 2016	Purchases	Sales/Calls Redemptions	Realized Losses	Unrealized Gain/(Loss)	Transfers in and/or Out of Level 3	Balance at December 31, 2016
Preferred stock	\$ 100,000	\$ -	\$ -	\$ (50,000)	\$ -	\$ -	\$ 50,000
Interest Rate Swap	\$ (134,421)	\$ -	\$ -	\$ -	\$ 47,178	\$ -	\$ (87,243)

**Significant Unobservable Input**

The table below presents qualitative information for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of December 31, 2016.

Fund	2016		
	Fair Value	Valuation Technique	Unobservable Input
Interest Rate Swap	\$ (87,243)	Discounted Cash Flow	Not Applicable
Preferred Stock	\$ 50,000	Acquisition cost	Not Applicable

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

**Fair Value of Financial Instruments**

The following table presents estimated fair values of the Company's financial instruments at December 31, 2016.

	<u>2016</u>	
	<u>Carrying Amount</u>	<u>Fair Value</u>
Cash and cash equivalents	\$ 40,640,433	\$ 40,640,433
Bonds	\$ 34,057,266	\$ 34,057,266
Common stocks	\$ 100,784,698	\$ 100,784,698
Preferred stocks	\$ 14,535,243	\$ 14,535,243
Premiums receivable, net	\$ 19,056,049	\$ 19,056,049
Note payable	\$ 3,893,041	\$ 3,893,041
Derivative instrument - liability	\$ (87,243)	\$ (87,243)

The following methods were used to estimate the fair value of all other financial instruments:

**Cash and cash equivalents** - carrying values of cash and cash equivalents approximates fair values.

**Bonds** - fair values are obtained from independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows.

**Common and preferred stocks** - fair values generally represent quoted market prices for the securities.

**Derivative instruments** - interest rate swap is valued using discounted cash flows models.

**Note payable** - carrying value reported in the consolidated balance sheets for these financial instruments approximates fair value due to the variable interest rate.

**5. CASH AND SHORT TERM INVESTMENTS**

As of December 31, 2016, cash and cash equivalents consists of the following:

	<u>2016</u>
Overnight and demand deposits	\$ 25,334,926
Money market funds	<u>15,305,507</u>
Total cash and cash equivalents	<u>\$ 40,640,433</u>

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

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**6. PROPERTY AND EQUIPMENT**

As of December 31, 2016, property and equipment consisted of the following:

	<u>2016</u>	
	<u>Estimated Useful</u>	
	<u>Life (in years)</u>	<u>Amount</u>
Building and improvements	5-39	\$ 4,645,721
Information systems	5	5,757,990
Office and computer equipments	3-7	468,591
Less: accumulated depreciation and amortization		<u>(3,887,358)</u>
Net depreciable assets		6,984,944
Land		930,274
Total		<u>\$ 7,915,218</u>

Depreciation expense for the period ended December 31, 2016 amounted to \$598,031.

**7. DEFERRED POLICY ACQUISITION COSTS**

Deferred policy acquisition costs represent those costs that are incremental and directly related to the successful acquisition of new or renewal of existing insurance contracts. The Company defers incremental costs that result directly from the acquisition or renewal of an insurance contract. These costs are deferred and expensed over the life of the related policies. Major categories of the Company's deferred policy acquisition costs are as follows:

	<u>2016</u>
Agents' commissions	\$ 739,961
Premium related taxes and assessments	956,053
Total deferred policy acquisition costs	<u>\$ 1,696,014</u>

The following summarizes the activity in the deferred policy acquisition costs:

	<u>2016</u>
Balance, beginning of year	\$ 1,656,449
Policy acquisition costs deferred	6,438,888
Amortization during the year	<u>(6,399,323)</u>
Balance, end of year	<u>\$ 1,696,014</u>

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

**8. OTHER INTANGIBLE ASSETS**

The following table reflects the components of other intangible assets as of December 31, 2016:

	<u>2016</u>		
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net Carrying Amount</u>
Definite-lived intangible asset - Distribution channel	<u>\$ 4,724,446</u>	<u>\$ (944,890)</u>	\$ 3,779,556
Indefinite-lived intangible asset - Tradenames			<u>1,044,349</u>
Total intangible assets			<u>\$ 4,823,905</u>

The following table represents the total estimated amortization of intangible assets with definite lives for each of the next five (5) years:

<u>Year Ending December 31,</u>	<u>Amount</u>
2017	\$ 472,445
2018	472,445
2019	472,445
2020	472,445
2021	472,445
Thereafter	<u>1,417,331</u>
	<u>\$ 3,779,556</u>

As of December 31, 2016, the weighted average remaining life of the intangible assets is approximately 8 years. No significant events or circumstances have occurred that would reduce the fair value of the reporting unit below its carrying amount.

**9. UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES**

Unpaid losses and loss adjustment expenses at December 31, 2016 consists of the following:

	<u>2016</u>
Unpaid losses	\$ 61,401,092
Unpaid loss adjustment expenses	<u>6,830,328</u>
Total	<u>\$ 68,231,420</u>

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

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Activity in the liability for unpaid losses and loss adjustment expenses (LAE) is summarized as follows as of December 31, 2016:

	<u>2016</u>
Reserves for loss and LAE, gross at January 1	\$ 65,507,969
Amounts recoverable from reinsurers on unpaid losses	<u>2,482,603</u>
Reserves for loss and LAE, net - at January 1	<u>63,025,366</u>
Net incurred related to:	
Current year	35,209,834
Prior years	<u>(185,367)</u>
Totalled incurred	35,024,467
Net paid related to:	
Current year	8,367,999
Prior years	<u>23,937,376</u>
Total incurred	<u>32,305,375</u>
Reserves for loss and LAE, net - at December 31	65,744,458
Amounts recoverable from reinsurers on unpaid losses	<u>2,486,962</u>
Reserves for loss an LAE, gross - at December 31	<u>\$ 68,231,420</u>

The estimated cost of loss and LAE attributable to insured events of prior years' decreased by \$185,367 during 2016. Increases or decreases of this nature occur as the result of claim settlements during current year and as additional information is received regarding individual claims, causing changes from the original estimates of the cost of these claims. Recent loss development trends are also taken into account in evaluating the overall adequacy of unpaid losses and LAE.

SCIC has purchased annuities from life insurers under which claimants are payees under structured settlement agreements. These annuities have been used to reduce unpaid losses by approximately \$4,375,000 as of December 31, 2016. SCIC remains liable should the insurers of these annuities fail to perform under the terms of the annuities.

The liability for unpaid losses and loss adjustment expenses as of December 31, 2016 was reviewed by SCIC's internal actuary who concluded that such amounts were reasonable to cover SCIC's obligation for all unpaid losses and loss adjustment expenses.

**10. SECURITY DEPOSITS**

Security deposits are additional funds available to satisfy policyholder obligations to the Company, if necessary, and are non-interest bearing and refundable upon termination from the Company after all expenses are settled for the policyholder. As of December 31, 2016, policyholder security deposits amount to \$1,845,666.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

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**11. REINSURANCE ACTIVITY**

A Summary of SCIC's reinsurance arrangements follows:

Period Covered	Company Retention	Coverage
12/01/00 - 03/31/02	\$ 500,000	Statutory in excces of \$500,000
04/01/02 - 03/31/03	See Below	See Below
04/01/03 - 03/31/04	See Below	See Below
04/01/04 - 03/31/05	\$ 500,000	\$9,500,000 in excess of \$500,000
04/01/05 - 12/31/05	\$ 500,000	\$14,500,000 in excess of \$500,000
01/01/06 - 12/31/06	\$ 500,000	\$14,250,000 in excess of \$750,000
01/01/07 - 12/31/07	\$ 1,000,000	\$14,000,000 in excess of \$1,000,000
01/01/08 - 12/31/08	\$ 1,000,000	\$49,000,000 in excess of \$1,000,000
01/01/09 - 12/31/09	\$ 750,000	\$49,250,000 in excess of \$750,000
01/01/10 - 12/31/10	\$ 1,000,000	\$99,000,000 in excess of \$1,000,000
01/01/11 - 12/31/11	\$ 1,000,000	\$49,000,000 in excess of \$1,000,000
01/01/12 - 12/31/12	\$ 1,000,000	\$29,000,000 in excess of \$1,000,000
01/01/13 - 12/31/13	\$ 750,000	\$29,250,000 in excess of \$750,000
01/01/14 - 12/31/14	\$ 750,000	\$39,250,000 in excess of \$750,000
		\$39,250,000 in excess of \$750,000,
01/01/15 - 12/31/15	\$ 750,000	\$500,000 AAD
01/01/16 - 12/31/16	\$ 2,000,000	\$38,000,000 in excess of \$2,000,000

SCIC entered into a reinsurance treaty providing coverage effective April 1, 2002 through March 31, 2003, for an initial layer of 50% of \$500,000 in excess of \$500,000 per occurrence and an additional layer of \$9,000,000 in excess of the first \$1,000,000 layer.

SCIC entered into reinsurance treaties providing coverage effective April 1, 2003 through March 31, 2004, for a specific layer of \$750,000 in excess of \$250,000 per occurrence limited to the SCIC's retention of the greater of \$1,000,000 or 7.15% of gross net earned premium and an additional layer for the same period of \$9,000,000 in excess of the first \$1,000,000 layer.

The reinsurance contracts do not relieve SCIC from its obligations to policyholders. SCIC evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. As of December 31, 2016, SCIC has approximately \$2,846,962 of reinsurance recoverables based on its actuarially determined ultimate losses and loss adjustment expenses payable, which are unsecured. As of December 31, 2016, amounts due from reinsurers for claims actually paid were \$6,797.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

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The effects of reinsurance on premiums written and earned for 2016 are as follows:

	<u>2016</u>	
	<u>Written</u>	<u>Earned</u>
Direct	\$ 54,433,888	\$ 56,209,003
Assumed - assigned risk pools	932,825	936,358
Ceded	<u>(2,236,357)</u>	<u>(2,236,357)</u>
Net	<u>\$ 53,130,356</u>	<u>\$ 54,909,004</u>

**12. DUE FROM RELATED PARTIES**

The Company regularly enters into transactions with related parties, at terms and conditions agreed upon by management of the Company and related parties. These amounts are payable and received in the normal course of business and related to operating transactions and cash flows needs. As of December 31, 2016, the Company due from related parties totaled \$2,859. The balance is non-interest bearing and has no specific repayment terms.

**13. BAD DEBT EXPENSE**

During 2016, several subsidiaries with outstanding balances owed to the Company were dissolved. The Company assumed these amounts upon liquidation of each of these entities. Additionally as of December 31, 2016, the Company condoned a debt balance from an affiliate company. Below total balance written-off and included in the statement of net loss in bad debt expense:

<u>Entity</u>	<u>Amount</u>
Dhandho Funds, LLC	\$ 2,313,467
Coverage HQ Agency, LLC	625,870
Stonetrust Management Services, LLC	253,642
Stonetrust Holding Company	108,162
Total	<u>\$ 3,301,141</u>

**14. NOTE PAYABLE**

Note payable at December 31, 2016 consist of:

Surplus note	<u>\$ 4,000,000</u>
Less: deferred loans costs	<u>(106,959)</u>
Total	<u>\$ 3,893,041</u>

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

On December 14, 2006, SCIC issued a surplus note in the amount of \$4,000,000 in exchange for cash. The note was underwritten by FTN Financial Capital Markets and is administered by Wilmington Trust Company as registrar/paying agent. Each payment of principal and interest may be made only with the prior approval of the Nebraska Insurance Department and only to the extent SCIC has sufficient surplus to make such payment. In the event of a liquidation proceeding, holders of indebtedness, policy claims and prior claims would have greater priority under both the Liquidation Act and terms of the note and, accordingly, would have the right to be paid in full before any payments of interest and principal are made to note holders.

The terms of the surplus note are as follows:

Date Issued:	December 14, 2006
Interest rate:	Fixed at 8.9% until December 15, 2011 (3 month LIBOR + 4.0% floating rate thereafter
Carrying value of note:	\$ 4,000,000
Date of maturity:	December 15, 2036

On December 15, 2011, SCIC entered into an interest rate swap agreement in connection with the note payable. The swap has a notional amount of \$4,000,000 used to minimize the interest rate exposure on the Floating Rate Surplus Note. The interest swap is used to fix the variable interest rate on the associated debt. The agreement provides for quarterly settlements with maturity date on September 15, 2021. The interest rate to be received on this swap agreement is the 90 days LIBOR plus 4%, and the fixed interest rate to be paid is 6.36%.

As of December 31, 2016, the fair value of this instrument is \$(87,243) and is presented as a liability in the accompanying consolidated balance sheet.

**15. EMPLOYEES' SAVINGS PLAN**

SCIC sponsors a defined contribution 401(K) plan, which covers all employees who are at least 21 years of age and has six (6) months of service with the SCIC. SCIC contributes 3% of eligible employees compensation into the plan and has the option to contribute additional amounts, if so decided. For the year ended December 31, 2016, SCIC contributed \$338,104 to the plan.

**16. RENTAL INCOME**

SR's main activity consists of leasing its real estate facilities to third parties and to SCIC under operating lease agreements. The leases are generally for a period of five (5) years with an option to renew for an additional period. Rental income earned from tenants during the year ended December 31, 2016 amounted to \$524,193, including \$173,832 from SCIC.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

FASB's authoritative guidance on Leases requires rental income to be recorded on a straight-line basis over the non-cancellable terms of the leases. Certain lease agreements contain escalation clauses. Tenant receivable at December 31, 2016 includes \$11,571 for the difference between rental income billed under the contractual terms and the revenue recognized on the straight-line basis.

Future rental commitment under the operating leases as of December 31, 2016 follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2017	\$ 314,085
2018	253,001
2019	145,433
2020	122,378
2021	83,596
Thereafter	<u>153,468</u>
	<u>\$ 1,071,961</u>

**17. INCOME TAXES**

FASB issued authoritative guidance on accounting for uncertainty in income taxes that prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of income tax uncertainties with respect to positions taken or expected to be taken on income tax returns. Under the authoritative accounting guidance, income tax benefits are recognized and measured based upon a two-step model: 1) a tax position must be more likely than not to be sustained based solely on its technical merits in order to be recognized, and 2) the benefit is measured as the largest dollar amount of that position that is more likely than not to be sustained upon settlement. The difference between the benefit recognized in accordance with this model and the tax benefit claimed on a tax return is referred to as an unrecognized tax benefit. No adjustment was required upon adoption of this accounting guidance.

The Company and its subsidiaries are subject to routine audits by the Puerto Rico and U.S. taxing agencies; however, there are currently no audits for any tax periods in progress. The Company and its subsidiaries remain subject to income tax examinations for Puerto Rico and U.S. income taxes generally for calendar years 2013 through 2015.

On November 21, 2014, DHC was granted a partial tax exemption from certain Puerto Rico taxes, including income taxes, and municipal taxes, among others, applicable to its consulting and investment income and eligible property. The exemption period is twenty (20) years. All income generated from the eligible activity is taxed for income tax purposes at a flat rate of 4%. The percentage of exemption for municipal license taxes is 60%.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

On December 15, 2016, the company filed an amendment to delay tax exemption benefits to begin in 2019, in order to reassess its business activities and opportunities in Puerto Rico. As of the issuance of these financials, the amendment request has not been approved by the Department of Economic and Commerce Office of Industrial Tax Exemption. As a result, for income tax purposes the company is treated as a regular tax corporation at the statutory tax rate of 39%. The company is in the process of filing amended tax returns for the periods ending December 31, 2015 and 2014 in order to

reflect this change in tax rate.

DHC has other subsidiaries organized under the laws of the Commonwealth of Puerto Rico. These subsidiaries are limited liability companies ("LLC"), which are exempt from taxes; the earnings that are subject to tax liability pass-through to the sole stockholder, DHC.

The Component of income tax expense for the year ended December 31, 2016, are as follows:

	<u>2016</u>
Federal:	
Current	\$ 214,967
Deferred	(701,952)
Total	<u>\$ (486,985)</u>

As of December 31, 2016, the Company's net deferred tax asset consists of the following components:

	<u>2016</u>
Deferred tax asset:	
Unearned and advance premium	\$ 1,513,915
Discounting of unpaid losses and LAE	912,961
Other than temporary impairment	795,336
Allowance for doubtful accounts	213,377
Capital loss carry-forward	2,788,609
NOL carry-forward	1,520,608
Tax credit carry-forward	236,699
Other	<u>132,697</u>
Gross deferred tax assets	8,114,202
Valuation allowance	<u>(3,658,633)</u>
Gross deferred tax assets after valuation allowance	<u>4,455,569</u>
Deferred tax liability:	
Deferred policy acquisition costs	576,645
Property and equipment	303,768
Unrealized gains on investments	2,018,561
Other	<u>60,655</u>
Gross deferred tax liabilities	<u>2,959,629</u>
Deferred tax asset, net	<u>\$ 1,495,940</u>

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

U.S. GAAP requires the Company to evaluate the recoverability of its deferred tax assets and establish a valuation allowance, if necessary, to reduce the deferred tax asset to an amount that is more likely than not to be realized (a likelihood of more than 50%). In

making this evaluation, the Company is required to consider all available evidence, both positive and negative, including objectively verifiable evidence of taxable income in the immediate ensuing years. At December 31, 2016 management recorded a valuation allowance of \$3,658,633.

DHC and its subsidiaries have carryforward losses available to reduce future taxable income in Puerto Rico and United States of America as follows:

	<u>Amount</u>	<u>Expiration Date</u>
U.S. Federal Tax:		
Ordinary tax loss	\$ 1,092,005	2035
Capital loss	\$ 1,034,013	2020
Puerto Rico:		
Ordinary tax loss	\$ 2,946,989	2026
Capital loss	\$ 16,246,963	2026

The Company recognizes any interest and penalties related to uncertain tax positions in income tax expense; however, there were none during the year ended December 31, 2016.

**18. EQUITY AND STATUTORY RESULTS**

A comparison of U.S. GAAP and statutory net income and total equity of SCIC as of and for the year ended December 31, 2016, is as follows:

	<u>2016</u>	
	<u>U.S. GAAP</u>	<u>Statutory</u>
Net income -		
Year ended December 31, 2016	<u>\$ 2,147,656</u>	<u>\$ 1,426,779</u>
Total equity/capital and surplus -		
December 31, 2016	<u>\$ 56,690,712</u>	<u>\$ 56,217,215</u>

During 2016, SCIC re-domesticated to the State of Nebraska. As a condition of the re-domestication, the Nebraska Department of Insurance (the "Department") and SCIC agreed to certain restrictions and responsibilities being placed on SCIC going forward. In accordance with this agreement, SCIC may not pay any dividends or other distributions to its shareholders without the prior approval of the Department. SCIC is also required to maintain a minimum risk-based capital (RBC) ratio of 350% and was required to enter into an "RBC Maintenance Agreement" with DHC, DHLP and DHQP (together "Dhandho") whereby Dhandho would agree to inject capital into the SCIC if the RBC ratio dropped

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

below the required threshold. Additionally, SCIC is required to have all related party agreements approved by the Department prior to implementation and is required to submit certain information on a monthly and quarterly basis to the Department.

In addition to the RBC requirement discussed above, the Department also imposes minimum risk-based capital requirements that were developed by the NAIC. The formulas for determining the amount of risk-based capital specify various weighting factors that are applied to financial balances or various levels of activity based on the perceived degree of risk. Regulatory compliance is determined by a ratio of the enterprise's regulatory total adjusted capital, also defined by the NAIC. Enterprises below specific trigger points or ratios are classified within certain levels, each of which requires specified corrective action. At December 31, 2016, SCIC's calculation indicated that it exceeded the minimum risk-based capital requirements.

**19. TREASURY STOCK**

The Corporation's Board of Directors authorized the repurchase of shares of the corporation common stock. The company accounts treasury stock using the cost method. On March 22, 2016, the company repurchased 4 shares of common stocks at a price of \$146,237 per share, for a total of \$584,948.

**20. CONTINGENCIES**

Losses and loss adjustment expenses payable consist of case based estimates of the likely loss exposure to SCIC from all known and open claims, including incurred but not reported ("IBNR") attributable to open years. Such estimates are made by SCIC based on an actuarial study prepared SCIC internal actuary, using comparative payment histories after evaluating the nature of the claimants' injuries. The estimate of the total incurred loss is continually revised as additional information becomes available.

Management believes the provision for losses and loss adjustment expenses payable as of December 31, 2016 is adequate to cover the ultimate liabilities. However, it is more than reasonably possible that a change in these estimates will occur in the near term and that the amount ultimately paid may prove to be more or less than the current estimates of liability and that difference may be significant.

SCIC is subject to guaranty fund and other assessments. In the case of premium-based assessments and loss-based assessments, the assessment is accrued either at the time the premiums were written or at the time losses are incurred. SCIC has accrued a liability for guaranty fund and other assessments of \$4,323,894 for December 31, 2016 and \$4,418,625 for 2015. The amounts represent management's best estimates based on current information and may change due to many factors, including SCIC's share of the ultimate cost of insolvencies and changes in the assessment rates.

Lawsuits arise against the Company in the normal course of business. Contingent liabilities arising from litigation and other matters are not considered material in relation to the financial position of the Company.

**DHANDHO HOLDINGS CORP. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2016**

---

**21. SUBSEQUENT EVENTS**

Management has evaluated subsequent events through the date that the consolidated financial statements were available to be issued May 11, 2017, and determined that no events occurred that required further disclosure, other than the matter described below.

As of January 1, 2017, management reassessed and restructured the nature of business of the Company, concluding the main business purpose of the Company will be to serve as a Holding Company. As a result, no investment generating income is expected to be part of the operations in the near future.

# Team Dhandho

**MOHNISH PABRAI**

*Chairman & Chief Executive Officer*

## **Irvine, California**

**FAHAD MISSMAR**, *Chief Financial Officer*

**TANVI ARORA**, *Vice President, Quantitative Analysis*

**FEI LI**, *Quantitative Analyst*

**JAYA BHARATH VELICHERLA**, *Quantitative Analyst*

**YINGZHUO ZHAO**, *Quantitative Analyst*

**VALERIE MAGURSKY**, *Administrative Assistant*

## **Pune, India**

**POOJA KUMARI**, *General Manager & Quantitative Analyst*

**RAHUL MASKE**, *Senior Developer, Technical Team*

**DIVYA BANDYOPADHYAY**, *Business Analyst & Logistical Team Lead*

**ADITI PURWAR**, *Database Administrator*

## **Dhandho Advisory Board**

**TERRY ADAMS**, *Irvine, California*

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Past performance is not indicative of future results. Returns are presented net of all fees and expenses, include the reinvestment of income and are calculated using a simple rate of return. The securities discussed do not represent all securities recommended for the Funds. It is also not a recommendation to buy or sell and one should not presume they will be profitable.

Please be aware that our past Annual Reports may discuss specific securities that have performed well without necessarily addressing those that have underperformed within our Fund(s). Readers should not infer that all investment decisions within the Funds were profitable.

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