

ASSURANCEAMERICA CORP

Form 10-K/A

April 15, 2008

**SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

**Form 10-K/A
Amendment No. 1**

**ANNUAL REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2007**
 **TRANSITION REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES ACT OF 1934**

Commission File Number: 0-6334

ASSURANCEAMERICA CORPORATION

NEVADA
*(State or Other Jurisdiction of
Incorporation or Organization)*

87-0281240
(I.R.S. Employer Identification No.)

**5500 Interstate North Pkwy., Suite 600, Atlanta,
Georgia**
(Address of Principal Executive Offices)

30328
(Zip Code)

Issuer's telephone number (770) 952-0200

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act: Common Stock, par value \$0.01 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act: Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act: Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes No

The aggregate market value of the voting and non-voting common equity held by persons other than affiliates of the registrant as of June 30, 2007 was \$16,300,301 based on a sale price of \$1.00 per share.

There were 64,923,881 shares of the registrant's common stock outstanding as of March 15, 2008.

Documents Incorporated By Reference

Parts of the Registrant's definitive proxy statement for the 2008 Annual Meeting of Shareholders to be held on April 24, 2008 are incorporated by reference into Part III of this report.

EXPLANATORY NOTE

AssuranceAmerica Corporation (the Company) is filing this Amendment No. 1 on Form 10-K/A in order to correct a clerical omission in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007 (the Form 10-K) filed on March 28, 2008. The conformed signature of Porter Keadle Moore, LLP was inadvertently omitted from the Report of Independent Registered Public Accounting Firm contained at page F-2 of Form 10-K. Porter Keadle Moore, LLP manually signed the original copy of its report, but a conformed signature representing its signature was inadvertently omitted from Form 10-K. The Company is amending Item 8 of the Form 10-K solely for the purpose of including the conformed signature.

No other changes are being made to the Financial Statements or other information in Item 8. In addition, no changes are being made pursuant to this amendment to any other item of the Form 10-K other than updating of the Exhibits to include updated Certifications of the Chief Executive and Acting Chief Financial Officer. In accordance with the Securities and Exchange Commission's rules applicable to the filing of amendments to Annual Reports on Form 10-K, we are including in this amendment the complete text of Item 8.

PART II

Item 8. *FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA*

All information required to be disclosed in Item 8 is incorporated by reference from the section entitled *Index to Financial Statements* in Item 15 of this Annual Report.

PART IV

Item 15. *EXHIBITS AND FINANCIAL STATEMENT SCHEDULES*

(a) Documents filed as part of this report:

(1) Financial Statements

The following financial statements of the Company, together with the Report of the Company's Independent Registered Public Accounting Firm dated March 25, 2008, are filed herewith:

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| Consolidated Balance Sheets as of December 31, 2007 and 2006 | F-3 |
| Consolidated Statements of Operations for the years ended December 31, 2007 and 2006 | F-5 |
| Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2007 and 2006 | F-6 |
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(2) Financial Statement Schedules

All financial statement schedules are omitted, as the required information is inapplicable or the information is presented in the respective financial statements or related notes.

(3) Exhibits

- 2.1 Agreement and Plan of Merger and Reorganization dated April 1, 2003, by and among the Company, AA Holdings Acquisition Sub, Inc., AA Holdings, LLC and AssuranceAmerica Corporation (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on April 16, 2003).
- 2.2 Asset Purchase Agreement by and between Trustway Insurance Agencies, LLC, AssuranceAmerica Corporation, Thomas-Cook Holding Company and James C. Cook (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K dated August 3, 2004).
- 3.1 Amended And Restated Articles of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-QSB for the quarter ended September 30, 2003).
- 3.2 Amendment to Amended and Restated Articles of Incorporation of the Company (incorporated by reference to Appendix A to the Company's Definitive Proxy Statement filed on September 9, 2003).

- 3.3 By-Laws of the Company (incorporated by reference to the Company's Form 10 filed on May 30, 1972).
- 3.4 Amendment to the Company's By-Laws adopted February 14, 2001 (incorporated by reference to Exhibit 3ii to the Company's Quarterly Report on Form 10-QSB for the quarter ended December 31, 2000).
- 3.5 Amendment to the Company's By-Laws adopted June 26, 2003 (incorporated by reference to Exhibit 3.4 to the Company's Annual Report on Form 10-KSB/A for the year ended March 31, 2003).
- 3.6 Amendment to the Company's By-Laws adopted June 15, 2004 (incorporated by reference to Exhibit 3.6 to the Company's Annual Report on Form 10-KSB/A for the year ended December 31, 2004).

- 4.1 Certificate of Designations Establishing the Powers, Preferences, Limitations, Restrictions and Relative Rights of Series A Convertible Preferred Stock of AssuranceAmerica Corporation (incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-QSB for the quarter ended June 30, 2004).
- 4.2 Amendment to Certificate of Designations Establishing the Powers, Preferences, Limitations, Restrictions and Relative Rights of Series A Convertible Preferred Stock of AssuranceAmerica Corporation (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on April 15, 2005).
- 4.3 Amended and Restated Trust Agreement dated December 22, 2005 (incorporated by reference to Exhibit 4.1 to the Company's Form 8-K filed on December 27, 2005).
- 4.4 Junior Subordinated Indenture dated December 22, 2005 (incorporated by reference to Exhibit 4.2 to the Company's Form 8-K filed on December 27, 2005).
- 10.1 Brainworks Ventures, Inc. Stock Option Plan (incorporated by reference to Exhibit A to the Company's Definitive Proxy Statement filed on October 20, 2000).
- 10.2 Amendment to the Brainworks Ventures, Inc. Stock Option Plan (incorporated by reference to Appendix 3 to the Company's Definitive Proxy Statement filed on April 11, 2006).
- 10.3 Promissory Note assumed by the Company to Guy W. Millner dated February 10, 2003 (incorporated by reference to Exhibit 10.2 to the Company's Form 10-KSB/A for the year ending December 31, 2004).
- 10.4 Promissory Note assumed by the Company to Lawrence Stumbaugh dated January 3, 2003 (incorporated by reference to Exhibit 10.3 to the Company's Form 10-KSB/A for the year ending December 31, 2004).
- 10.5 Promissory Note assumed by the Company to Guy W. Millner dated August 31, 2002 (incorporated by reference to Exhibit 10.4 to the Company's Form 10-KSB/A for the year ending December 31, 2004).
- 10.6 Employment Agreement between Agencies and James C. Cook dated July 31, 2004 (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated August 3, 2003).
- 10.7 Executive Employment Agreement between AssuranceAmerica General Agency, LLC and Joseph J. Skruck (incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K dated March 8, 2006).
- 10.8 Stock Purchase Agreement (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on April 15, 2005).
- 10.9 Amendment to Stock Purchase Agreement (incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on May 10, 2005).
- 10.10 Registration Rights Agreement (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed on April 15, 2005).
- 10.11 Description of Executive Bonus Plan (incorporated by reference to Exhibit 10.1 of the Company's Form 10-QSB for the quarter ended June 30, 2005).
- 10.12 Guarantee Agreement dated December 22, 2005 (incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed on December 27, 2005).
- 10.13 Executive Employment Agreement between Sercap Holdings, LLC and Lawrence Stumbaugh effective July 10, 2002 and assumed by the Company effective April 1, 2003 (incorporated by reference to Exhibit 10.12 to the Company's Form 10KSB for the year ending December 31, 2005).
- 14.1 Code of Conduct (incorporated by reference to Exhibit 14.1 to the Company's Transition Report on Form 10-KSB for the transition period from April 1, 2003 to December 31, 2003).
- 16.1 Letter on change in certifying accountant as required by Item 304(a)(3) (incorporated by reference to Exhibit 16.2 to the Company's Form 8-K/A filed on December 20, 2006)
- 21.1 List of Subsidiaries
- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Controller Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1

Certification of Chief Executive Officer and Controller Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

REGISTRANT:

ASSURANCEAMERICA CORPORATION

Date: April 15, 2008

By: /s/ Lawrence Stumbaugh

Lawrence Stumbaugh, Chief Executive Officer

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
AssuranceAmerica Corporation

We have audited the consolidated balance sheets of AssuranceAmerica Corporation and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in stockholders' equity, comprehensive income, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of AssuranceAmerica Corporation and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We were not engaged to examine management's assertion about the effectiveness of AssuranceAmerica Corporation's internal control over financial reporting as of December 31, 2007 included in the accompanying Form 10-K and, accordingly, we do not express an opinion thereon.

/s/ Porter Keadle Moore, LLP
Atlanta, Georgia
March 25, 2008

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (AUDITED)

| | December 31, 2007 | December 31, 2006 |
|---|-----------------------|----------------------|
| Assets | | |
| Cash and cash equivalents | \$ 5,511,842 | \$ 8,185,539 |
| Short-term investments | 642,924 | 619,843 |
| Long-term investments | 14,838,738 | 10,446,830 |
| Marketable equity securities | 2,563,040 | 2,055,983 |
| Other securities | 155,000 | 155,000 |
| Investment income due and accrued | 158,981 | 117,363 |
| Receivable from insureds | 28,802,125 | 18,707,773 |
| Reinsurance recoverable (including \$6,077,396 and \$5,130,845 on paid losses) | 29,327,012 | 22,563,990 |
| Prepaid reinsurance premiums | 21,145,161 | 14,012,481 |
| Deferred acquisition costs | 2,130,323 | 800,125 |
| Property and equipment (net of accumulated depreciation of \$2,737,288 and \$2,136,512) | 2,360,747 | 2,481,660 |
| Other receivables | 2,966,287 | 585,999 |
| Prepaid expenses | 861,588 | 273,733 |
| Intangibles (net of accumulated amortization of \$2,240,233 and \$1,824,334) | 11,368,383 | 11,114,882 |
| Security deposits | 86,438 | 74,140 |
| Prepaid income tax | 148,677 | 668,677 |
| Deferred tax assets | 1,824,453 | 2,506,503 |
| Other assets | 361,419 | 374,365 |
| Total assets | \$ 125,253,138 | \$ 95,744,886 |

| | December 31, 2007 | December 31, 2006 |
|--|------------------------------|------------------------------|
| Liabilities and stockholders equity | | |
| Accounts payable and accrued expenses | \$ 7,184,132 | \$ 5,039,900 |
| Unearned premium | 30,991,565 | 20,614,781 |
| Unpaid losses and loss adjustment expenses | 33,660,814 | 24,904,492 |
| Reinsurance payable | 25,174,138 | 16,744,406 |
| Provisional commission reserve | 2,963,308 | 2,319,540 |
| Notes payable and related party debt | 4,482,862 | 5,797,122 |
| Junior subordinated debentures payable | 4,968,519 | 4,961,852 |
| Capital lease obligations | | 265,670 |
| Total liabilities | 109,425,338 | 80,647,763 |
| Commitments and contingencies | | |
| Stockholders equity | | |
| Common stock, \$.01 par value (authorized 120,000,000 and 80,000,000, outstanding 64,803,881 and 56,072,971) | 648,039 | 560,730 |
| Preferred stock, \$.01 par value (authorized 5,000,000, outstanding 0 and 840,000; liquidation preference \$0 and \$4,200,000) | | 8,400 |
| Surplus-paid in | 16,782,588 | 16,426,292 |
| Accumulated deficit | (1,673,332) | (1,948,711) |
| Accumulated other comprehensive income: | | |
| Net unrealized gains on investment securities, net of taxes | 70,505 | 50,412 |
| Total stockholders equity | 15,827,800 | 15,097,123 |
| Total liabilities and stockholders equity | \$ 125,253,138 | \$ 95,744,886 |

See accompanying notes to consolidated financial statements.

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS (AUDITED)

For the years ended December 31,

| | 2007 | 2006 |
|---|-------------------|---------------------|
| Revenue: | | |
| Gross premiums written | \$ 88,395,199 | \$ 69,108,965 |
| Ceded premiums written | (59,763,971) | (47,016,892) |
| Net premiums written | 28,631,228 | 22,092,073 |
| Increase in unearned premiums, net of prepaid reinsurance premiums | (3,244,105) | (1,239,097) |
| Net premiums earned | 25,387,123 | 20,852,976 |
| Commission income | 20,870,068 | 22,232,993 |
| Managing general agent fees | 10,912,946 | 9,249,488 |
| Net investment income | 801,950 | 727,969 |
| Net investment gains on securities | 34,469 | 24,445 |
| Other fee income | 372,146 | 634,971 |
| Total revenue | 58,378,702 | 53,722,842 |
| Expenses: | | |
| Losses and loss adjustment expenses | 18,864,642 | 15,318,922 |
| Selling, general, and administrative | 36,189,148 | 33,091,167 |
| Stock option expense | 333,694 | 429,351 |
| Depreciation and amortization expense | 1,185,271 | 1,030,165 |
| Interest expense | 1,013,364 | 1,141,368 |
| Total operating expenses | 57,586,119 | 51,010,973 |
| Income before provision for income tax expense | 792,583 | 2,711,869 |
| Income tax provision (benefit) | 517,204 | (2,019,730) |
| Net income before dividends on preferred stock | 275,379 | 4,731,599 |
| Dividends on preferred stock | | 421,200 |
| Net income attributable to common stockholders | \$ 275,379 | \$ 4,310,399 |
| Earnings per common share | | |
| Basic | \$ 0.004 | 0.080 |
| Diluted | \$ 0.004 | 0.075 |
| Weighted average shares outstanding-basic | 61,913,645 | 53,609,956 |
| Weighted average shares outstanding-diluted | 62,656,305 | 63,480,814 |

See accompanying notes to consolidated financial statements.

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (AUDITED)

For the years ended December 31, 2007 and 2006

| | Common Stock | Preferred Stock | Paid in Capital | Accumulated Deficit | Accumulated Change in Other Comprehensive Income, Net of Taxes | Total |
|--|-----------------|--------------------|--------------------|------------------------|--|-------------------|
| Balance, December 31, 2005 | \$ 511,673 | \$ 12,660 | \$ 15,678,015 | \$ (6,259,110) | \$ | \$ 9,943,238 |
| Stock issued | 6,457 | | 398,516 | | | 404,973 |
| Stock issuance expenses | | | (41,250) | | | (41,250) |
| Conversion of preferred to common stock | 42,600 | (4,260) | (38,340) | | | |
| Stock option expense | | | 429,351 | | | 429,351 |
| Change in value of available-for-sale securities, net of taxes | | | | | 50,412 | 50,412 |
| Preferred dividends paid | | | | (421,200) | | (421,200) |
| Net income | | | | 4,731,599 | | 4,731,599 |
| Balance, December 31, 2006 | 560,730 | 8,400 | 16,426,292 | (1,948,711) | 50,412 | 15,097,123 |
| Stock issued | 3,309 | | 113,292 | | | 116,601 |
| Stock issuance expenses | | | (15,090) | | | (15,090) |
| Conversion of preferred to common stock | 84,000 | (8,400) | (75,600) | | | |
| Stock option expense | | | 333,694 | | | 333,694 |
| Change in value of | | | | | 20,093 | 20,093 |

available-for-sale
securities, net of
taxes

Net income 275,379 275,379

**Balance,
December 31,
2007**

\$ 648,039 \$ 16,782,588 \$ (1,673,332) \$ 70,505 \$ 15,827,800

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Share Activity
(in thousands)

| | 2007 | 2006 |
|--------------------------------|-------------|-------------|
| Common stock | | |
| Issued | | |
| At beginning of year | 56,073 | 51,167 |
| Issued | 331 | 646 |
| Converted from preferred stock | 8,400 | 4,260 |
| At end of year | 64,804 | 56,073 |
| Preferred stock | | |
| Issued | | |
| At beginning of year | 840 | 1,266 |
| Converted to preferred stock | (840) | (426) |
| At end of year | | 840 |

See accompanying notes to consolidated financial statements.

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (AUDITED)

For the years ended December 31,

| | 2007 | 2006 |
|---|-------------------|---------------------|
| Net income | \$ 275,379 | \$ 4,731,599 |
| Other comprehensive income: | | |
| Change in unrealized gains of investments: | | |
| Unrealized gains arising during the year | 66,618 | 105,104 |
| Reclassification adjustment for realized gains recognized during the year | (34,469) | (24,445) |
| Net change in unrealized gains | 32,149 | 80,659 |
| Deferred income tax effect on above changes | (12,056) | (30,247) |
| Other comprehensive income | 20,093 | 50,412 |
| Comprehensive income | \$ 295,472 | \$ 4,782,011 |

See accompanying notes to consolidated financial statements.

**ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (AUDITED)**

For the Years Ended December 31, 2007 and 2006

| | 2007 | 2006 |
|--|--------------------|--------------------|
| Cash flows from operating activities: | | |
| Net income | \$ 275,379 | \$ 4,731,599 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Net investment gains | (34,469) | (24,445) |
| Depreciation and amortization | 1,205,226 | 1,036,832 |
| Stock-based compensation | 333,694 | 429,351 |
| Loss on disposal of property and equipment | 137,928 | 18,602 |
| Deferred tax provision (benefit) | 669,994 | (2,183,791) |
| Changes in assets and liabilities: | | |
| Investment income due and accrued | (41,618) | (36,213) |
| Receivables | (12,474,640) | (3,367,517) |
| Prepaid expenses and other assets | (587,207) | (77,439) |
| Unearned premiums | 10,376,784 | 4,040,308 |
| Unpaid loss and loss adjustment expenses | 8,756,322 | 9,794,618 |
| Reinsurance payable | 8,429,732 | 6,506,325 |
| Reinsurance recoverable | (6,763,022) | (7,773,891) |
| Prepaid reinsurance premiums | (7,132,680) | (2,801,211) |
| Accounts payable and accrued expenses | 2,146,202 | (2,424,942) |
| Prepaid income taxes | 520,000 | (668,677) |
| Deferred acquisition costs | (1,330,197) | (1,586) |
| Provisional commission reserve | 643,768 | 615,161 |
| Net cash provided by operating activities | 5,131,196 | 7,813,084 |
| Cash flows from investing activities, net of effect of agency acquisitions: | | |
| Purchases of property and equipment, net | (786,387) | (1,490,247) |
| Proceeds from sales, maturities and calls of investments | 2,842,020 | 4,226,387 |
| Purchases of investments | (7,745,206) | (8,704,104) |
| Cash paid for acquisition of agencies, net of cash acquired | (400,000) | (361,700) |
| Net cash used by investing activities, net of effect of agency acquisitions | (6,089,573) | (6,329,664) |
| Cash flows from financing activities: | | |
| Repayments of notes payable | (1,551,160) | (1,954,746) |
| Preferred dividends paid | | (421,200) |
| Proceeds from capital lease obligations | | 108,739 |
| Repayments of capital lease obligations | (265,671) | (63,224) |
| Stock issued net of expenses | 101,511 | 363,723 |
| Net cash used by financing activities | (1,715,320) | (1,966,708) |

| | | |
|---|--------------|--------------|
| Net decrease in cash and cash equivalents | (2,673,697) | (483,288) |
| Cash and cash equivalents, beginning of period | 8,185,539 | 8,668,827 |
| Cash and cash equivalents, end of period | \$ 5,511,842 | \$ 8,185,539 |

See note 14 for supplemental cash flow information.

See accompanying notes to consolidated financial statements.

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2007 and 2006

(1) Description of Business

AssuranceAmerica Corporation, a Nevada corporation (the Company) is an insurance holding company whose business is comprised of AssuranceAmerica Insurance Company (AAIC), AssuranceAmerica Managing General Agency, LLC (MGA) and TrustWay Insurance Agencies, LLC (TrustWay), each wholly-owned. Trustway in turn, has an 80% interest in Trustway Partners Agencies of Alabama (TWPAA). The Company solicits and underwrites nonstandard private passenger automobile insurance. The Company is headquartered in Atlanta, Georgia.

(2) Summary of Significant Accounting Policies

Basis of Consolidation and Presentation

The accompanying consolidated financial statements include the accounts and operations of the Company. All material intercompany accounts and transactions have been eliminated. The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (GAAP).

Estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported financial statement balances as well as the disclosure of contingent assets and liabilities. Actual results could differ materially from those estimates used.

The Company's liability for unpaid losses and loss adjustment expenses (an estimate of the ultimate cost to settle claims both reported and unreported), although supported by actuarial projections and other data, is ultimately based on management's reasoned expectations of future events. Although considerable variability is inherent in these estimates, management believes that this liability is adequate. Estimates are reviewed regularly and adjusted as necessary. Such adjustments are reflected in current operations.

Goodwill represents the amount by which the cost of acquired net assets exceeds their related fair value. Other intangible assets include the costs of specifically identifiable intangible assets, primarily customer renewal lists. In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, the carrying value of goodwill and other intangible assets is reviewed annually or whenever events or changes in circumstances indicate that the carrying amount might not be recoverable. The Company uses an independent valuation firm to assist in its assessment of possible impairment of intangible assets. If the fair value of the operations to which goodwill relates is less than the carrying amount of those operations, including unamortized goodwill, the carrying amount of goodwill is reduced accordingly with a charge to expense. No impairment losses have been recognized in the 2007 or 2006 statement of operations.

Recognition of Revenues

Insurance premiums are recognized pro rata over the terms of the policies. The unearned portion of premiums is included in the Consolidated Balance Sheet as a liability for unearned premium. Commission income is recognized in the period the insurance policy is written and is reduced by an estimate of future cancellations. Installment and other fees are recognized in the periods the services are rendered.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, approximate fair value because of their short maturities. The carrying amounts of equity securities and long-term bonds purchased are adjusted to reflect the current market

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

value. The carrying value of the junior subordinated debentures approximates the fair value because the interest rate adjusts quarterly.

Deferred Acquisition Costs

Deferred acquisition costs (DAC) include premium taxes and commissions incurred in connection with the production of new and renewal business, less ceding commissions allowed by reinsurers. These costs are deferred and amortized over the period in which the related premiums are earned. The Company does not consider anticipated investment income in determining the recoverability of these costs. Based on current indications, management believes that these costs will be fully recoverable and, accordingly, no reduction in DAC has been recognized.

Contingencies

In the normal course of business, the Company is named as a defendant in lawsuits related to claims and other insurance policy issues. Some of the actions seek extra-contractual and/or punitive damages. These actions are vigorously defended unless a reasonable settlement appears appropriate. In the opinion of management, the ultimate outcome of known litigation is not expected to be material to the Company's financial condition, results of operations, or cash flows.

Start-Up Costs

Start-up costs are expensed when incurred.

Cash and Cash Equivalents

Cash and cash equivalents include cash demand deposits, money market accounts and bank certificates of deposit with a maturity of less than three months.

Property and Equipment

Property and equipment is recorded at cost and depreciated on a straight-line basis. The estimated useful lives used for depreciation purposes are: Furniture and fixtures 5 to 7 years; equipment 3 to 5 years; software currently in service to 5 years; leasehold improvements over the remaining life of the lease, including options. Improvements, additions and major renewals which extend the life of an asset are capitalized. Repairs are expensed in the year incurred. Depreciation expense was \$769,373 and \$604,076 for the twelve months ended December 31, 2007 and 2006, respectively.

A summary of property and equipment is as follows:

| | December 31, 2007 | December 31, 2006 |
|-------------------------|------------------------------|------------------------------|
| Furniture and equipment | \$ 1,406,473 | \$ 1,337,210 |
| Computer equipment | 1,642,114 | 1,457,834 |

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| | | | |
|--------------------------------|--------------|----|-------------|
| Computer software | 1,016,864 | | 769,488 |
| Leasehold improvements | 1,032,584 | | 1,053,640 |
| Less: accumulated depreciation | (2,737,288) | | (2,136,512) |
| | \$ 2,360,747 | \$ | 2,481,660 |

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

Amortization of Intangible Assets

Intangible assets consist of non-competition agreements, renewal lists, restrictive covenants and goodwill. Intangible assets are stated at cost. Effective January 1, 2002, the Company adopted the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 requires that goodwill and certain intangibles with indefinite lives no longer be amortized, but instead be tested for impairment at least annually. The non-competition agreements and restrictive covenants are amortized on a straight-line basis varying from 2 1/2 years to 5 years and the renewal lists are being amortized on a straight-line basis over periods ranging from 7 to 10 years. Amortization expense was \$415,899 and \$426,088 for the twelve months ended December 31, 2007 and 2006, respectively.

Intangible assets include the following:

| | December 31, 2007 | December 31, 2006 |
|-------------------------------|--------------------------|--------------------------|
| Goodwill | \$ 9,188,991 | \$ 8,763,566 |
| Non-compete clause | 781,500 | 760,000 |
| Renewal list | 3,418,125 | 3,195,650 |
| Restrictive covenants | 220,000 | 220,000 |
| | 13,608,616 | 12,939,216 |
| Less accumulated amortization | (2,240,233) | (1,824,334) |
| | \$ 11,368,383 | \$ 11,114,882 |

The estimated aggregate amortization expense for each of the succeeding five fiscal years is:

| | |
|------|------------|
| 2008 | \$ 425,002 |
| 2009 | \$ 382,515 |
| 2010 | \$ 348,777 |
| 2011 | \$ 347,277 |
| 2012 | \$ 344,082 |

Based upon its most recent analysis, the Company believes that no impairment of goodwill exists at December 31, 2007 or December 31, 2006.

Advertising

Advertising costs are expensed as incurred. Advertising expense for the years ended December 31, 2007 and 2006 was \$1,180,562 and \$1,189,397 respectively.

Stock Options

Effective January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share-based Payment (SFAS 123R). The provisions of SFAS 123R require companies to expense in their financial statements the estimated fair value of awarded stock options after the effective date. The Company adopted this statement using the modified prospective application. For options granted and vested prior to the effective date, the Company continues to follow the intrinsic value method set forth in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25), and disclose the pro forma effects on net income had the fair value of these options been expensed. The disclosure provisions required by SFAS 123R are provided in Note 8.

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are established for temporary differences between the financial reporting bases and the tax bases of assets and liabilities, at the enacted tax rates expected to be in effect when the temporary differences are expected to be recovered or settled. The principal assets and liabilities that generate these temporary differences are unearned premiums, loss and loss adjustment expense reserves, deferred policy acquisition costs, operating loss and tax-credit carry forwards and non-deductible provisions for unearned revenue. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in net income in the period that includes the enactment date.

The Company has entered into a tax sharing agreement with AAIC and TWPAA. The operating results for AAIC are included in the consolidated income tax return filed by the Company. The income tax provision is computed separately for AAIC and the Company. TrustWay and MGA are not tax paying entities for federal income tax purposes and their results are consolidated with the Company's tax return. AAIC only pays federal income tax.

(3) Investments

All of the Company's equity and long-term investment securities have been classified as available-for-sale because all of the Company's long-term securities are available to be sold in response to the Company's liquidity needs, changes in market interest rates and asset-liability management strategies, and other economic factors. Investments available-for-sale are stated at fair value on the balance sheet. Unrealized gains and losses are excluded from earnings and are reported as a component of other comprehensive income within shareholders' equity, net of related deferred income taxes.

A decline in the fair value of an available-for-sale security below cost that is deemed other than temporary results in a charge to income, resulting in the establishment of a new cost basis for the security. Net unrealized gains for the twelve months ended December 31, 2007 and 2006 were \$112,808 and \$80,659, respectively.

Premiums and discounts are amortized or accreted, respectively, over the life of the related fixed maturity security as an adjustment to yield using a method that approximates the effective interest method. Dividends and interest income are recognized when earned. Realized gains and losses are included in earnings and are derived using the specific-identification method for determining the cost of securities sold.

At December 31, 2007, long-term investments carried at market value of \$3,637,557 and short-term investments of approximately \$124,042 were pledged by one of the Company's subsidiaries under requirements of regulatory authorities.

A summary of investments follows as of:

| | December 31, 2007 | December 31, 2006 |
|---|--------------------------|--------------------------|
| Short-term investments and bank certificates of deposit | \$ 642,924 | \$ 619,843 |
| U.S. Treasury securities and | | |

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| | | |
|--|---------------|---------------|
| obligations of U.S. government corporations and agencies | 7,058,831 | 4,773,194 |
| Obligations of states and political subdivisions | 6,245,337 | 4,110,076 |
| Corporate debt securities | 1,534,570 | 1,563,560 |
| Marketable equity securities | 2,563,040 | 2,055,983 |
| Total | \$ 18,044,702 | \$ 13,122,656 |

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

The amortized cost, fair value and gross unrealized gains or losses of debt securities available-for-sale at December 31, 2007, by contractual maturity, is shown below:

| Years to Maturity | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--------------------------|-----------------------|-------------------------------|--------------------------------|----------------------|
| Within one year | \$ 777,246 | \$ | \$ 984 | \$ 776,262 |
| One to five years | 2,061,648 | 8,696 | 66 | 2,070,278 |
| Five to ten years | 2,109,702 | 41,453 | 41,587 | 2,109,568 |
| Over ten years | 9,890,759 | 62,862 | 70,991 | 9,882,630 |
| Total | \$ 14,839,355 | \$ 113,011 | \$ 113,628 | \$ 14,838,738 |

The amortized cost, fair value and gross unrealized gains or losses of securities available-for-sale at December 31, 2007 and 2006, by security type, is shown below:

| Security type | December 31, 2007 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|--------------------------|-----------------------|-------------------------------|--------------------------------|----------------------|
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | | \$ 7,011,785 | \$ 48,096 | \$ 1,050 | \$ 7,058,831 |
| Obligations of states and political subdivisions | | 6,253,419 | 62,909 | 70,991 | 6,245,337 |
| Corporate debt securities | | 1,574,151 | 2,006 | 41,587 | 1,534,570 |
| Marketable equity securities | | 2,449,615 | 276,851 | 163,426 | 2,563,040 |
| Total | | \$ 17,288,970 | \$ 389,862 | \$ 277,054 | \$ 17,401,778 |

| Security type | December 31, 2006 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|--------------------------|-----------------------|-------------------------------|--------------------------------|-------------------|
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | | \$ 5,295,497 | \$ | \$ 22,460 | \$ 5,273,037 |
| Obligations of states and political subdivisions | | 4,045,076 | 70,010 | 5,010 | 4,110,076 |

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| | | | | |
|------------------------------|---------------|------------|-----------|---------------|
| Corporate debt securities | 1,582,363 | | 18,803 | 1,563,560 |
| Marketable equity securities | 1,999,061 | 70,611 | 13,689 | 2,055,983 |
| Total | \$ 12,921,997 | \$ 140,621 | \$ 59,962 | \$ 13,002,656 |

As of December 31, 2007, the Company has determined that all of the unrealized losses in the table above were temporary. There were no fundamental issues with any of these securities and the Company has the ability and intent to hold the securities until there is a recovery in fair value. There were no securities with unrealized losses of greater than 10% of book value.

The carrying amounts of individual assets are reviewed at each balance sheet date to assess whether the fair values have declined below the carrying amounts. The company considers internal and external information, such as credit ratings in concluding that the impairments are not other than temporary.

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

The following table shows the gross unrealized losses and fair value of securities, aggregated by category and length of time that securities have been in a continuous unrealized loss position at December 31, 2007 and 2006.

| | Less Than Twelve Months | | Over Twelve Months | |
|---|--|--|--|--|
| | Gross Unrealized Losses | Estimated Market Fair Value | Gross Unrealized Losses | Estimated Market Fair Value |
| December 31, 2007: | | | | |
| U.S. Treasury and government agencies | \$ 98 | \$ 177,246 | \$ 952 | \$ 1,098,391 |
| Obligations of state and political entities | 1,912 | 513,580 | 69,079 | 2,674,489 |
| Corporate debt securities | | | 41,587 | 497,750 |
| Equity Securities | 148,909 | 903,485 | 14,517 | 113,069 |
| | \$ 150,919 | \$ 1,594,311 | \$ 126,135 | \$ 4,383,699 |
| December 31, 2006: | | | | |
| U.S. Treasury and government agencies | \$ 1,399 | \$ 851,788 | \$ 21,061 | \$ 3,817,510 |
| Obligations of state and political entities | 5,010 | 528,172 | | |
| Corporate debt securities | 14,229 | 1,041,484 | 4,574 | 526,650 |
| Equity Securities | 13,689 | 479,886 | | |
| | \$ 34,327 | \$ 2,901,330 | \$ 25,635 | \$ 4,344,160 |

The total proceeds received on investments amounted to \$2,842,020 and \$4,226,387 for the year 2007 and 2006, respectively. The company had realized gains and losses of \$102,776 and \$68,307 during 2007 and \$33,770 and \$9,325 for the same period last year.

(4) Losses and Loss Adjustment Expenses

The estimated liabilities for losses and loss adjustment expenses (LAE) include the accumulation of estimates for losses for claims reported prior to the balance sheet dates (case reserves), estimates (based upon actuarial analysis of historical data) of losses for claims incurred but not reported (IBNR) and for the development of case reserves to ultimate values, and estimates of expenses for investigating, adjusting and settling all incurred claims. Amounts reported are estimates of the ultimate costs of settlement, net of estimated salvage and subrogation. These estimated liabilities are subject to the outcome of future events, such as changes in medical and repair costs as well as economic and social conditions that impact the settlement of claims. Management believes that, given the inherent variability in any such estimates, the aggregate reserves are within a reasonable and acceptable range of adequacy. The methods of making such estimates and for establishing the resulting reserves are reviewed and updated quarterly and any resulting adjustments are reflected in current operations.

A summary of unpaid losses and loss adjustment expenses, net of reinsurance ceded, is as follows:

| | December 31, 2007 | December 31, 2006 |
|------------|--------------------------|--------------------------|
| Case basis | \$ 4,200,577 | \$ 3,510,978 |
| IBNR | 6,210,621 | 3,960,369 |
| Total | \$ 10,411,198 | \$ 7,471,347 |

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

Activity in the liability for unpaid claims and claim adjustment expenses is summarized as follows:

| | 2007 | 2006 |
|---|---------------|---------------|
| Balance at January 1 | \$ 24,904,492 | \$ 15,109,874 |
| Less reinsurance recoverables on unpaid losses | 17,433,145 | 10,576,912 |
| Net balance at January 1 | 7,471,347 | 4,532,962 |
| Add Losses and LAE incurred, net, related to: | | |
| Current year | 19,087,643 | 15,159,788 |
| Prior years | (223,000) | 159,134 |
| Net Losses and LAE incurred in the current year | 18,864,642 | 15,318,922 |
| Deduct Losses and LAE paid, net, related to: | | |
| Current year | 11,348,794 | 9,437,032 |
| Prior years | 4,576,000 | 2,943,505 |
| Net claim payments in the current year | 15,924,794 | 12,380,537 |
| Net balance at December 31 | 10,411,198 | 7,471,347 |
| Plus reinsurance recoverables on unpaid losses | 23,249,616 | 17,433,145 |
| Balance at December 31 | \$ 33,660,814 | \$ 24,904,492 |

The majority of the Company's net claim payments related to accidents occurring in the current year. As a result of changes in estimates of insured events in prior years, the net claims and claim adjustment expenses incurred decreased by \$223,000 in 2007 reflecting lower than anticipated losses and increased by \$159,134 for 2006 due to minor additional development.

(5) Reinsurance

In the normal course of business, the Company seeks to reduce its overall risk levels by obtaining reinsurance from other insurance enterprises or reinsurers. Reinsurance premiums and reserves on reinsured business are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Reinsurance contracts do not relieve the Company from its obligations to policyholders. The Company periodically reviews the financial condition of its reinsurers to minimize its exposure to losses from reinsurer insolvencies.

Reinsurance assets include balances due from other insurance companies under the terms of reinsurance agreements. Amounts applicable to ceded unearned premiums, ceded loss payments and ceded claims liabilities are reported as assets in the accompanying balance sheets. Under the reinsurance agreements the Company has two reinsurers that are required to collateralize the reinsurance recoverables. As of December 31, 2007 both reinsurers have provided a letter

of credit and a secured trust account to provide security sufficient to satisfy AAIC's obligations under the reinsurance agreement. The Company believes the fair value of its reinsurance recoverables approximates their carrying amounts.

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

The impact of reinsurance on the statements of operations for the period ended December 31 is as follows:

| | 2007 | 2006 |
|--|----------------------|----------------------|
| Premiums written: | | |
| Direct | \$ 86,829,481 | \$ 68,825,601 |
| Assumed | 1,565,717 | 283,364 |
| Ceded | 59,763,970 | 47,016,892 |
| Net | \$ 28,631,228 | \$ 22,092,073 |
| Premiums earned: | | |
| Direct | \$ 76,834,157 | \$ 64,768,234 |
| Assumed | 1,184,255 | 300,423 |
| Ceded | 52,631,289 | 44,215,681 |
| Net | \$ 25,387,123 | \$ 20,852,976 |
| Losses and loss adjustment expenses incurred: | | |
| Direct | \$ 59,626,954 | \$ 51,008,247 |
| Assumed | 856,571 | 413 |
| Ceded | 41,618,883 | 35,689,738 |
| Net | \$ 18,864,642 | \$ 15,318,922 |
| The impact of reinsurance on the balance sheets as of December 31 is as follows: | | |
| Unpaid losses and loss adjustment expense: | | |
| Direct | \$ 33,391,172 | \$ 24,904,492 |
| Assumed | 269,642 | |
| Ceded | 23,249,616 | 17,433,145 |
| Net | \$ 10,411,198 | \$ 7,471,347 |
| Unearned premiums: | | |
| Direct | \$ 30,495,191 | \$ 20,499,867 |
| Assumed | 496,374 | 114,914 |
| Ceded | 21,145,161 | 14,012,481 |
| Net | \$ 9,846,404 | \$ 6,602,300 |

The Company received \$13,866,387 in commissions on premiums ceded during 2007. Had all of the Company's reinsurance agreements been cancelled at December 31, 2007, the Company would have returned \$4,893,584 in reinsurance commissions to its reinsurers and its reinsurers would have returned \$21,145,161 in unearned premiums to the Company. The company paid commissions of \$417,942 on premiums assumed during 2007. Had all of the assumed agreements been cancelled at December 31, 2007, the Company would have received \$118,380 in reinsurance commissions from its reinsurers and the Company would have returned \$496,374 in unearned premiums to its reinsurers.

Contingent Reinsurance Commission and Provisional Commission Reserve

The Company's primary reinsurance contract provides ceding commissions for premiums written which are subject to adjustment. The amount of ceding commissions, net of adjustments, is determined by the loss experience

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

for the reinsurance agreement term. The reinsurers provide commissions on a sliding scale with maximum and minimum achievable levels. The reinsurers pay the Company with the provisional commissions, before adjustment. The Company adjusts the commissions based on the current loss experience for the policy year premiums. This results in establishing a liability for the excess of provisional commissions retained compared to amounts recognized, which is subject to variation until the ultimate loss experience is determinable.

The total liability for excess provisional commissions received as of December 31, 2007 by policy year is:

| Policy Year | Amount |
|--------------------|---------------|
| 2005 | \$ 3,162 |
| 2006 | 1,339,499 |
| 2007 | 1,620,647 |
| Total | \$ 2,963,308 |

(6) Long-Term Debt

Notes Payable, Related Party

The Company has various notes payable to related parties totaling to \$2,537,295 at December 31, 2007. This Notes Payable debt consists primarily of unsecured promissory notes payable to its Chairman and its Chief Executive Officer. The promissory notes provide for the repayment of principal beginning in December 2004 in an amount equal to the greater of \$1.1 million or an amount equal to 25% of the Company's net income after tax, plus non-cash items, less working capital. However, the promissory notes also permit the Company to postpone any and all payments under the promissory notes without obtaining the consent of the holders, and without giving notice or paying additional consideration. As a result of the acquisition of a Georgia insurance agency in 2004, the Company also has an unsecured promissory note payable to a former Division President of the Company. The promissory note carries an interest rate of 8% and provides for the repayment of principal in three equal annual installments beginning August 2005. The final principal payment was made August 1, 2007. On January 2007, the Company issued an unsecured promissory note in the amount \$114,400 to a Division President who oversees the Company's Alabama agencies. The promissory note carries an interest rate of 8% interest payable in two annual installments beginning in January 1, 2009.

Other Notes Payable

As a result of the acquisitions of two Alabama insurance agencies in 2007, the Company also has unsecured promissory notes payable to the former owners. The first promissory note, executed in connection with the acquisition of The Covenant Insurance Group, Inc. effective September 7, 2007, carries an interest rate of 8%. This note provides for the payment of interest in four quarterly installments beginning September 6, 2007 through December 6, 2008. Amounts due under this note, as of December 31, 2007, total \$90,000. The second promissory note, executed in connection with the acquisition of the assets of Bush Insurance, Inc. effective October 31, 2007, carries an interest rate of 8%, in the amount of \$32,500 and is payable in full January 1, 2008. The company has a final principal payment

related to the acquisition of The Insurance Center in the amount of \$1,567,000 due on July 1, 2008. Further, the company will make a final payment of \$141,667 for the purchase of Tampa No-Fault Insurance Agency, Inc. on March 1, 2008.

Junior Subordinated Debentures

On December 22, 2005, the Company, through a newly-formed Delaware statutory trust, AssuranceAmerica Capital Trust I (the Trust), consummated the private placement of 5,000 of the Trust s floating rate Capital Securities, with a liquidation amount of \$1,000 per capital security (the Capital Securities). In connection with the Trust s issuance and sale of the Capital Securities, the Company purchased from the Trust 155 of the Trust s floating

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

rate Common Securities, with a liquidation amount of \$1,000 per common security (the Common Securities). The Trust used the proceeds from the issuance and sale of the Capital Securities and the Common Securities to purchase \$5,155,000 in aggregate principal amount of the floating rate junior subordinated debentures of the Company (the Debentures). The Debentures bear interest at a floating rate of three-month LIBOR plus 5.75% per annum, reset quarterly. The Debentures and Capital Securities mature on December 31, 2035, but may be redeemed at par beginning December 31, 2010 if and to the extent the Company exercises its right to redeem the Debentures. The Capital Securities require quarterly distributions by the Trust to the holders of the Capital Securities, at a floating rate of three-month LIBOR plus 5.75% per annum, reset quarterly. Distributions are cumulative and will accrue from the date of original issuance but may be deferred for a period of up to 20 consecutive quarterly interest payment periods if the Company exercises its right under the Indenture to defer the payment of interest on the Debentures. The Company has guaranteed the obligations of the Trust.

Scheduled Maturities

The aggregate annual maturities of payments due on debt outstanding as of December 31 are as follows:

| | Amount |
|---------------------|---------------|
| 2008 | \$ 2,907,811 |
| 2009 | 1,057,200 |
| 2010 | 519,518 |
| 2011 | |
| 2012 | |
| 2013 and thereafter | 5,013,908 |
| Total | \$ 9,451,381 |

(7) Income Taxes

The provision for federal and state income taxes for the years ended are as follows:

| | December 31, | |
|--|---------------------|----------------|
| | 2007 | 2006 |
| Current | \$ (152,790) | \$ 164,061 |
| Reversal of prior year valuation allowance | | (2,266,000) |
| Deferred | 669,994 | 82,209 |
| Total provision for income taxes | \$ 517,204 | \$ (2,019,730) |

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

The provision for income taxes in the accompanying consolidated statements of operations differed from the statutory rate of 34% as follows:

| | 2007 | 2006 |
|--|-------------|----------------|
| Income before income taxes | \$ 792,583 | \$ 2,711,869 |
| Income tax expense at statutory rate | \$ 269,478 | \$ 922,035 |
| Tax effect of: | | |
| Tax exempt interest income | (67,485) | (31,395) |
| Incentive stock option expense | 113,456 | |
| Utilization of net operating loss carry-forwards | | (482,460) |
| Reversal of prior year valuation allowance | | (2,266,000) |
| State taxes, net of federal tax benefit | 55,268 | 22,328 |
| Other, net | 146,487 | (184,238) |
| Total income tax expense | \$ 517,204 | \$ (2,019,730) |

The balance sheets reflect net deferred income tax asset amounts that resulted from temporary differences as of December 31 as follows:

| | 2007 | 2006 |
|---|--------------|--------------|
| Deferred income tax assets: | | |
| Discounting of loss reserves | \$ 217,000 | \$ 188,000 |
| Federal operating loss carry-forward | 813,000 | 1,051,000 |
| Amortization of intangibles | 703,000 | 781,000 |
| Unearned premium reserves | 738,000 | 495,000 |
| Unearned commission reserves | 225,000 | 220,000 |
| Other | 1,000 | 161,000 |
| Gross deferred tax assets | \$ 2,697,000 | \$ 2,896,000 |
| Deferred income tax liabilities: | | |
| Deferred acquisition costs | 800,000 | 300,000 |
| Depreciation | 29,547 | 59,497 |
| Unrealized gains on securities available for sale | 43,000 | 30,000 |
| Gross deferred tax liabilities | 872,547 | 389,497 |
| Net deferred tax assets | \$ 1,824,453 | \$ 2,506,503 |

SFAS No. 109, Accounting for Income Taxes, requires that a valuation allowance be established when it is more-likely-than-not that all or a portion of a deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences are deductible. In making this determination, management considers all available positive and negative evidence affecting specific deferred tax assets, including the Company's past and anticipated future performance, the reversal of deferred tax liabilities and the implementation of tax planning strategies. Objective positive evidence is necessary to support a conclusion that a valuation allowance is not needed for all or a portion of the deferred tax assets when significant negative evidence exists.

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

The Company has net operating loss carry-forwards that may be offset against future taxable income and tax credits that may be used against future income taxes. If not used, the carry-forwards will expire in varying amounts between the year 2015 and December 31, 2025. The loss carry-forwards at December 31, 2007 were \$2,168,532. Utilization of part of the net operating losses carried forward will be limited under Section 382 of the Internal Revenue Code as the Company experienced an ownership change greater than 50% effective April 1, 2003, and on January 1, 2006 for carry-forwards related to the acquisition of The Insurance Center, Inc. Accordingly, certain net operating losses may not be realizable in future years due to this limitation.

The Company has unused net operating loss carry forwards available to offset future taxable income as follows:

| | |
|--------------|--------------|
| Expires 2018 | \$ 124,903 |
| Expires 2019 | 572,863 |
| Expires 2020 | 920,162 |
| Expires 2021 | 124,456 |
| Expires 2022 | 166,999 |
| Expires 2024 | 241,662 |
| Expires 2025 | 17,487 |
| | \$ 2,168,532 |

On July 13, 2006, the FASB issued Interpretation No. 48 (FIN 48), the *Accounting for Uncertainty in Income Taxes an interpretation of FASB 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The evaluation of a tax position in accordance with FIN 48 is a two-step process. The Company must determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, the Company should presume that the position will be examined by the appropriate taxing authority. A tax position that meets the more-likely-than-not threshold is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. The Company adopted the provisions of FIN 48 with respect to all of our tax positions as of December 31, 2007. The cumulative effect of applying FIN 48, which was zero, would have been reported as an adjustment in the opening balance of retained earnings at January 1, 2007.

Based on the judgment of management and its tax advisors, all items included in the inventory of tax positions have been determined to meet the more-likely-than-not standard and have been included at full value in the financial statements of the Company.

The Company classifies interest on income tax related balances as interest expense and classifies tax related penalties as operating expense. To date, the Company has not incurred any tax related interest or penalties.

(8) Capital Stock

Preferred Stock

During 2005, the Company issued 840,000 shares of its series A convertible preferred stock for an aggregate consideration of \$4,200,000. The series A convertible stock pays a cumulative semi-annual dividend of \$0.20 per share. Each outstanding share of preferred stock is convertible into ten shares of common stock automatically two years from the date of issuance, or at any time prior to such automatic conversion at the Holder's request, and has the voting rights of 10 common shares. The outstanding preferred stock will automatically convert, if not converted

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

sooner, at various times during 2007 with the last automatic conversion scheduled for May 24, 2007. During 2007 the remaining 840,000 shares of preferred stock converted to 8,400,000 shares of common stock.

Common Stock

During the first quarter of 2006, the Company issued 600,000 shares of common stock, \$0.01 par value, through a private placement. During 2006, 426,000 shares of preferred stock converted to 4,260,000 shares of common stock, and during 2007, 840,000 shares were converted to 8,400,000 shares of common stock.

Stock-Based Compensation

The Company's 2000 Stock Option Plan provides for the granting of stock options to officers, key employees, directors, consultants, independent contractors and other agents at the discretion of the Board of Directors. The Company believes that such awards better align the interests of its associates with those of its shareholders. Options become exercisable at various dates, generally vesting over a five-year continuous period of service and have similar contractual terms. Certain employment agreements may provide for accelerated vesting if there is a change in control of the Company (as defined in the Plan). Generally, options are issued with exercise prices no less than the fair market value of the common stock at the time of the grant (or in the case of a ten-percent-or-greater stockholder, 110 percent of fair market value).

The aggregate number of common shares authorized under the plan is currently 7,500,000. Prior to the merger with AssuranceAmerica Corporation, a Georgia corporation, the Company had issued options to purchase 948,918 shares of common stock and, after the merger the Company had issued options to purchase 1,300,000 shares of common stock. In connection with such merger, the outstanding options to purchase shares of AssuranceAmerica common stock were exchanged on a one-for-one basis for options to purchase shares of the Company's common stock under the Company's 2000 Stock Option Plan. On April 27, 2006 the shareholders voted in favor of an amendment to the Company's 2000 Stock Option Plan to increase the number of shares available for issuance from 5,000,000 to 7,500,000.

Effective January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), *Share-based Payment* (SFAS 123R). The provisions of SFAS 123R require companies to expense in their financial statements the estimated fair value of awarded stock options after the effective date. The Company adopted this statement using the modified prospective application. For options granted and vested prior to the effective date, the Company continues to follow the intrinsic value method set forth in Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees* (APB No. 25), and disclose the pro forma effects on net income had the fair value of these options been expensed.

The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton option-pricing model using the assumptions noted in the following table. Expected volatilities are based on historical volatilities of the Company's stock. The Company uses historical data to estimate expected term and option forfeitures within the valuation model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The Company does not provide for any expected dividends or discount for post-vesting restrictions in the model.

| | 2007 | 2006 |
|-----------------------------|-------------|-------------|
| Expected volatility | 106%-120% | 111%-119% |
| Weighted average volatility | 113% | 112% |
| Risk-free interest rate | 2.00%-2.80% | 1.90%-2.40% |
| Expected term (in years) | 5.0 | 5.0 |

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

A summary of all stock option activity during 2007 and 2006 follows:

| Options Outstanding | 2007 | | 2006 | |
|----------------------------|-----------------------------|--|-----------------------------|--|
| | Number of Shares | Weighted Average Exercise Price | Number of Shares | Weighted Average Exercise Price |
| Beginning of year | 5,347,225 | \$ 0.85 | 4,215,628 | \$ 0.97 |
| Add (deduct): | | | | |
| Granted | 2,451,000 | \$ 0.87 | 2,431,315 | \$ 1.10 |
| Exercised | (314,000) | \$ 0.44 | (45,650) | \$ 0.33 |
| Forfeited | (2,437,560) | \$ 0.88 | (1,014,150) | \$ 0.86 |
| Expired | (100,000) | \$ 4.35 | (239,918) | \$ 5.56 |
| End of year | 4,946,665 | \$ 0.80 | 5,347,225 | \$ 0.85 |
| Exercisable, end of year | 1,524,883 | \$ 0.57 | 1,394,782 | \$ 0.76 |

The weighted-average grant date fair value of options granted during the twelve-months ended December 31, 2007 and December 31, 2006, using the Black-Scholes-Merton option-pricing model, was \$0.6973 and \$0.6817, respectively. The total intrinsic value of options exercised during the twelve months ended December 31, 2007 and December 31, 2006 was \$162,000 and \$60,091, respectively.

Total compensation cost for share-based payment arrangements recognized for the twelve month period ended December 31, 2007 and December 31, 2006 was \$333,694 and \$429,351, respectively.

As of December 31, 2007, the total compensation cost related to non-vested awards not yet recognized in the financial statements is \$1,519,358. The Company expects to recognize the compensation cost over the weighted-average contractual term of 4.4 years.

For options granted and vested prior to the effective date, the Company continues to follow the intrinsic value method set forth in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25), but disclose the pro forma effects on net income had the fair value of these options been expensed. The pro forma effect of the application of APB Opinion No. 25 for options granted and vested prior to January 1, 2006 was:

| | For the Twelve Months Ended December 31, 2007 2006 | |
|--|--|--------------|
| Net income attributable to common stockholders, as reported | \$ 275,379 | \$ 4,310,399 |
| Compensation effect, net of tax effect | (131,588) | (214,692) |

| | | |
|---|------------|--------------|
| Pro forma net income (loss) | \$ 143,791 | \$ 4,095,707 |
| Basic and diluted net income attributable to common stockholders | | |
| As reported Basic | \$ 0.004 | \$ 0.080 |
| Pro forma Basic | \$ 0.002 | \$ 0.076 |
| As reported Diluted | \$ 0.004 | \$ 0.075 |
| Pro forma Diluted | \$ 0.002 | \$ 0.065 |

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

The following fully vested stock options and stock options expected to vest were outstanding or exercisable as of December 31, 2007:

| | Options Outstanding | Options Exercisable |
|---|--------------------------------|--------------------------------|
| Number of shares | 4,946,665 | 1,524,883 |
| Weighted average exercise price | \$ 0.80 | \$ 0.57 |
| Aggregate intrinsic value | \$ 326,600 | \$ 278,040 |
| Weighted average remaining contractual term | 4.43 years | 1.92 years |

The following stock options were outstanding or exercisable as of December 31, 2007:

| Range of Exercise Prices | Options Outstanding | | | Options Exercisable | |
|---------------------------------|-----------------------------|--|--|-----------------------------|--|
| | Number of Shares | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number of Shares | Weighted Average Exercise Price |
| < \$1.00 | 3,806,665 | 4.59 years | \$ 0.64 | 1,435,383 | \$ 0.50 |
| \$1.00 < \$3.00 | 1,140,000 | 3.87 years | \$ 1.31 | 89,500 | \$ 1.63 |
| | 4,946,665 | 4.43 years | \$ 0.80 | 1,524,883 | \$ 0.57 |

(9) Risk

The following is a description of the most significant risks facing the Company and how it mitigates those risks:

(I) **LEGAL/REGULATORY RISKS** the risk that changes in the regulatory environment in which an insurer operates will create additional expenses not anticipated by the insurer in pricing its products. That is, regulatory initiatives designed to reduce insurer profits, restrict underwriting practices and risk classifications, mandate rate reductions and refunds, and new legal theories or insurance company insolvencies through guaranty fund assessments may create costs for the insurer beyond those recorded in the financial statements. The Company attempts to mitigate this risk by monitoring proposed regulatory legislation and by assessing the impact of new laws. As the Company writes business only in five states, it is more exposed to this risk than some of its more geographically balanced competitors.

(II) **CREDIT RISK** the risk that issuers of securities owned by the Company will default or that other parties, including reinsurers to whom business is ceded, which owe the Company money, will not pay. The Company attempts to minimize this risk by adhering to a conservative investment strategy, maintaining reinsurance agreements with financially sound reinsurers with an A.M. Best rating of B++ or better, and by requiring a letter of credit or trust fund to secure reinsurance recoverables as well as provide for any amounts deemed uncollectible. As of December 31,

2007, there were no amounts deemed uncollectible.

(III) INTEREST RATE RISK the risk that interest rates will change and cause a decrease in the value of an insurer's investments. To the extent that liabilities come due more quickly than assets mature, an insurer might have to sell assets prior to maturity and potentially recognize a gain or a loss. The Company, in accordance with its investment policy, manages its investment portfolio duration according to expected liability duration needs. Since the Company's liabilities are predominantly short-term, the investment portfolio is also short-term duration. The investment policy requires that the duration of the investment portfolio will not diverge from the Company's liability duration by more than + 15%.

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

Concentration of Risk

The Company operates in Alabama, Florida, Georgia, Louisiana, Mississippi, South Carolina and Texas and is dependent upon the economies in those states. Automobiles insured through AAIC are principally in Alabama, Florida, Georgia, Louisiana, Mississippi, South Carolina and Texas. Premium rate increases generally must be approved by state insurance commissioners.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash. The Company maintains cash and cash equivalents with various financial institutions. The Company's policy is to maintain balances with high credit quality financial institutions. The Company has not sustained material credit losses from instruments held at financial institutions.

The Company maintains a relationship with five reinsurers. The Company performs periodic evaluations of the relative credit standing of each of these companies.

Regulatory Requirements and Restrictions

To retain its certificate of authority, the South Carolina Insurance Code requires that AAIC maintain capital and surplus at a minimum of \$3.0 million. At December 31, 2007, AAIC's statutory capital and surplus was approximately \$12.0 million. AAIC is required to adhere to a prescribed net premium-to-surplus ratio. At December 31, 2007, AAIC was in compliance with this requirement.

Under the South Carolina Insurance Code, AAIC must receive prior regulatory approval to pay a dividend in an amount exceeding ten percent 10% of policyholder surplus or net income, minus realized capital gains, whichever is greater.

The Company is required to comply with the NAIC risk-based capital (RBC) requirements. RBC is a method of measuring the amount of capital appropriate for an insurance company to support its overall business operations and to ensure that it has an acceptably low expectation of becoming financially impaired in light of its size and risk profile. NAIC's RBC standards are used by regulators to determine appropriate regulatory actions relating to insurers which show signs of weak or deteriorating condition and are evaluated on at least an annual basis at the end of each year. The model law provides for increasing levels of regulatory intervention as the ratio of an insurer's total adjusted capital and surplus decreases relative to its risk based capital, culminating with mandatory control of the operations of the insurer by the domiciliary insurance department at the so-called mandatory control level. As of December 31, 2007, based upon calculations using the appropriate NAIC formula, AAIC's total adjusted capital is in excess of ratios which would require any form of corrective actions on our part or action on the part of the regulators.

The NAIC Insurance Regulatory Information System (IRIS) is part of a collection of analytical tools designed to provide state insurance regulators with an integrated approach to screening and analyzing the financial condition of insurance companies operating in their respective states. IRIS is intended to assist state insurance regulators in targeting resources to those insurers in greatest need of regulatory attention. IRIS consists of two phases: statistical and analytical. In the statistical phase, the NAIC database generates key financial ratio results based on financial information obtained from insurers' annual statutory statements. The analytical phase is a review of the annual

statements, financial ratios and other automated solvency tools. The primary goal of the analytical phase is to identify companies that appear to require immediate regulatory attention. A ratio result falling outside the usual range of IRIS ratios is not considered a failing result; rather, unusual values are viewed as part of the regulatory early monitoring system. Furthermore, in some years, it may not be unusual for financially sound companies to have several ratios with results outside the usual ranges. An insurance company may fall out of the usual range for one or more ratios because of specific transactions that are in themselves immaterial. As of

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

December 31, 2007, AAIC had one IRIS ratio outside the usual range. The ratio outside the range is attributable to the Company's high leverage of reinsurance. We do not expect any regulatory action as a result of these results outside of the usual range.

(10) Commitments and Contingencies

Operating Leases

The Company has entered into operating leases primarily for office space and certain equipment. These leases are classified as operating leases. The future minimum rental payments required under long-term non-cancelable leases are summarized as follows:

| Year Ending December 31, | Amount |
|---------------------------------|---------------------|
| 2008 | \$ 1,736,580 |
| 2009 | 1,501,926 |
| 2010 | 1,399,646 |
| 2011 | 1,280,099 |
| 2012 | 1,093,259 |
| Thereafter | 1,826,624 |
| | \$ 8,838,134 |

Rent expense totaled \$1,483,603 and \$1,423,911 for 2007 and 2006, respectively.

In 2007, the Company paid to a third party a license fee of \$8,820 per month for the use of their software. The agreement is subject to a 5% annual increase and is renewable at the option of the Company.

Capital Leases

The Company did not have any capital leases as of December 31, 2007.

Defined Contribution Plan

The Company's employees participate in the AssuranceAmerica 401(k) defined contribution retirement plan. Under the plan, the Company can elect to make discretionary contributions. The Company contributed \$49,541 and \$0 to this plan during 2007 and 2006, respectively. The plan currently matches 25% on the first 4% of employee earnings. Under the plan, the Company can elect to make discretionary contributions. The plan currently matches a portion of employee contributions. The eligibility requirements are 21 years of age, 6 months of service and full time employment.

Legal Proceedings

The Company is involved in litigation in the ordinary course of business, both as a defendant and as a plaintiff. The Company may from time to time be subject to a variety of legal and regulatory actions relating to the Company's current and past business operations. The company vigorously defends these actions unless a reasonable settlement appears appropriate.

(11) Business Combination

On January 16, 2006 TrustWay, purchased all of the assets of Tampa No-Fault Insurance Agency, Inc. (TNF) pursuant to the terms of an Asset Purchase Agreement (the APA) by and between the Company, TrustWay, Tampa No-Fault Insurance Agency, Inc., Mario A. Suarez, Mary Suarez, and Mario C. Suarez. TNF is an insurance agency selling primarily nonstandard automobile insurance in Tampa, Florida. The purchase price was \$425,000 payable

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

one-third in cash at the closing and the delivery of a promissory note for the remainder payable in two equal annual payments of principal with quarterly interest payments at 8%. Each principal also agreed to a three-year restrictive covenants prohibiting them from competing with the TNF, soliciting its customers, or hiring its employees. As part of the total purchase price, the Company assigned \$155,650 to the purchased book of business amortized over a ten-year period. The Company assigned \$269,350 to goodwill which is being valued in accordance with FAS 142.

On January 27, 2006, the Company acquired The Insurance Center, Inc. (TIC), doing business as Apple Insurance Mall, a 16-office insurance agency selling primarily nonstandard automobile insurance in southern Florida. The acquisition was effected by the merger of a subsidiary of the Company and TIC with TIC being the survivor pursuant to the terms of an Agreement and Plan of Merger by and among the Company, AAC Merger Corporation I, The Insurance Center, Inc., and Shareholders Representative dated January 27, 2006 (Merger Agreement). The total consideration paid for all shares of TIC was \$3,900,000 subject to adjustment upward or downward on a dollar for dollar basis for every dollar that the tangible net worth of TIC as defined in the Merger Agreement is greater or less than one dollar as of December 31, 2005. Based upon an estimated tangible net worth as of December 31, 2005, the estimated merger price was \$3,161,931. The consideration was paid by the delivery of \$1,115,744 cash to an escrow agent, the payment of certain liabilities of TIC, and the delivery of the Company's promissory note for \$1,900,000 with principal due on July 1, 2008 and quarterly interest payments at 8%; the principal of the note is subject to offset in accordance with the terms of the Merger Agreement. The final calculation of the merger consideration, based on an evaluation of the final tangible net worth, was \$2,828,536. Immediately following the merger described above, TIC was merged into a subsidiary of TrustWay with the subsidiary of TrustWay being the survivor. As part of the total purchase price, the Company assigned \$1,650,000 to the purchased book of business amortized over a ten-year period. The Company assigned \$2,106,122 to goodwill which is being valued in accordance with FAS 142.

On January 1, 2007, TrustWay acquired 80% of the assets and assumed certain liabilities of Frontline Insurance Group, LLC. (FIG), a 4-office insurance agency located in Alabama, selling primarily non-standard automobile insurance and other specialty products. Thereafter, TrustWay formed a new subsidiary, TWPAA, which would operate FIG under this newly formed company. Frontline's owner was hired as President of TWPAA. The terms of the agreement include payments at closing of \$300,000 in cash and a promissory note in the amount of \$114,400 was also issued at the closing for a total purchase price of \$414,400. The promissory note carries an 8% rate of interest payable in two annual installments beginning January 1, 2008 and the final payment on January 1, 2009. As part of the purchase price, the company assigned \$142,500 to the purchased book of business to be amortized over a ten-year period and \$271,900 assigned to goodwill, which is being valued in accordance with FAS 142. The principal also agreed to a five year restrictive covenant prohibiting him from soliciting customers, or hiring its employees.

On September 6, 2007, TWPAA acquired the assets of Covenant Insurance Group of America, LLC located in Abbeville, Alabama, selling primarily non-standard automobile insurance. The terms of the agreement include payments at closing of \$100,000 in cash and a promissory note in the amount of \$90,000 was also issued at the closing for a total purchase price of \$190,000. The promissory note carries an 8% rate of interest payable in four equal quarterly payments at 8%, beginning September 6, 2007 through December 31, 2008. As part of the purchase price, the Company assigned \$38,700 to the purchased book of business to be amortized over a ten-year period and a \$15,000 non-competitive covenant to be amortized over five years, and \$136,300 assigned to goodwill, which is being valued in accordance with FAS 142.

On October 31, 2007, TWPAA acquired the assets of Bush Insurance, Inc. (Bush) located in Montgomery, Alabama, selling primarily non-standard automobile insurance. The terms of the agreement include payments at closing of

\$32,500 in cash and a promissory note in the amount of \$32,500 was also issued at the closing for a total purchase price of \$65,000. The promissory rate carries an 8% rate of interest payable in one payment on January 1, 2008. As part of the purchase price, the Company assigned \$41,275 to the purchased book of business to be

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

amortized over a ten-year period, a \$6,500 non-competitive covenant to be amortized over five years, and \$17,225 assigned to goodwill, which is being valued in accordance with FAS 142.

All of the aforementioned acquisitions reflect a 20% minority interest held by the President of TWPAA.

(12) Net Income Per Share

Basic and diluted income per common share is computed using the weighted average number of common shares outstanding during the period. Potential common shares not included in the calculations of net income per share for the years ended December 31, 2007 and 2006, because their inclusion would be anti-dilutive, are as follows:

| | 2007 | 2006 |
|---------------|-----------|-----------|
| Warrants | | 80,000 |
| Stock options | 2,931,665 | 2,799,725 |
| | 2,931,665 | 2,879,725 |

The reconciliation of the amounts used in the computation of both basic earnings per share and diluted earnings per share for the years ended December 31, 2007 and 2006 are as follows:

| | Net Income | Average Shares Outstanding | Per Share Amount |
|---|--------------|----------------------------|------------------|
| For the year ended December 31, 2007: | | | |
| Net income basic | \$ 275,379 | 61,913,645 | 0.004 |
| Effect of dilutive stock warrants and options | | 742,660 | |
| Net income diluted | \$ 275,379 | 62,656,305 | 0.004 |
| For the year ended December 31, 2006: | | | |
| Net income basic | \$ 4,310,399 | 53,609,956 | 0.080 |
| Effect of common shares issued upon conversion of preferred | 421,200 | 8,400,000 | |
| Effect of dilutive stock warrants and options | | 1,470,858 | |
| Net income diluted | \$ 4,731,599 | 63,480,814 | 0.075 |

(13) Related Party Transactions

In the past, the Company's Chairman and Chief Executive Officer, have loaned us approximately \$6.2 million and \$0.3 million, respectively. Additional payments of \$241,130 and \$759,791 for accrued and unpaid interest were made to the Company's Chairman in 2007 and 2006, respectively. We also made principal payments to its Chairman in the amount of \$1,000,000 and \$397,059 in 2007 and 2006, respectively. The Company made payments of accrued and unpaid interest on the Promissory Note to its Chief Executive Officer, of \$5,889 and \$13,894 in 2007 and 2006, respectively. The Company made principal payments to its Chief Executive Officer in the amount of \$100,000 and \$100,728 in 2007 and 2006, respectively. Outstanding amounts under these promissory notes held by the Company accrue interest at an annual rate of 8%. The Note to its Chief Executive Officer requires annual principal payments of \$100,000 beginning December, 2004, with a final payment in 2008. The Notes to its Chairman require annual principal payments of the greater of \$500,000 or 25% of free cash flow (net income after tax plus non cash items minus working capital) on each of two notes beginning in December, 2004 and ending in 2010. The promissory notes are unsecured.

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
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In July 2004, the Company purchased substantially all of the assets of Thomas-Cook Holding Company (TCHC), which was controlled by a former Division President of the Company. Pursuant to the Agreement, as consideration for the purchased assets, the Company paid TCHC \$462,000 in cash, issued TCHC a promissory note in the amount of \$1,078,000, and issued TCHC 1,320,000 shares of our common stock. The principal amount of the promissory note is payable in three equal installments on each of August 1, 2005, August 1, 2006 and August 1, 2007. Outstanding amounts under the promissory note accrue interest at an annual rate of 8%. The Company is required to make payments of accrued and unpaid interest on outstanding amounts under the promissory note on a quarterly basis. The Company incurred \$21,435 and \$48,085 of interest expense on this promissory note in 2007 and 2006, respectively. We made principal payments in the amount of \$359,333 and \$359,333 in 2007 and 2006, respectively.

AAIC and MGA are party to a Management Agreement. Under the agreement, AAIC will appoint MGA as its managing general agent in the states where it is licensed to do business. Under the terms of the agreement, MGA provides all of the marketing, underwriting, accounting, product management, legal, policyholder administration and claims functions for AAIC. As compensation for its services, MGA receives the amount of ceding commission AAIC receives from its reinsurers. MGA also pays AAIC a fronting fee. Additionally, MGA receives various fees related to insurance transactions associated with these policies that vary according to state insurance laws and regulations.

TrustWay is comprised of 50 retail insurance agencies with 41 locations in Florida, 5 in Alabama and 4 locations in Georgia. TrustWay has been appointed by AAIC to sell non-standard personal automobile insurance. TrustWay receives commissions from MGA and unaffiliated insurers and various fees from insureds associated with the sale of these policies.

The Company provides executive management services, including finance, audit and legal, to MGA and TrustWay. The Company charges a management fee to these subsidiaries in exchange for these services.

The Company has entered into a tax sharing agreement with AAIC and TWPAA. The operating results for AAIC and TWPAA are included in the consolidated income tax return filed by the Company. The income tax provision is computed separately for AAIC, TWPAA and the Company. TrustWay and MGA are not tax paying entities for federal income tax purposes and their results are consolidated with the Company's tax return. AAIC only pays federal income tax.

(14) Supplemental Cash Flow Information

| | 2007 | 2006 |
|---------------------------------------|--------------|--------------|
| Cash paid (received) during the year: | | |
| Interest | \$ 1,013,364 | \$ 1,121,691 |
| Income tax payment (refund) | (672,793) | 832,738 |

The Company recorded net unrealized gains on investment securities during 2007 and 2006 in the amount of \$20,093 and \$50,412, respectively, net of taxes.

On January 16, 2006 Trustway purchased the assets of Tampa No-Fault Insurance Agency, Inc. As part of the purchase agreement, Trustway issued a note payable in the amount of \$283,333.

On January 27, 2006, Trustway acquired The Insurance Center, Inc. As part of the purchase agreement, Trustway issued a note payable in the amount of \$1,900,000, subject to adjustment as noted in the Business Combination footnote.

On January 1, 2007, TWAAA purchased the assets of Frontline Insurance Group, LLC. As part of the purchase agreement, TWAAA issued a note payable in the amount of \$114,400.

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ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Continued)
December 31, 2007 and 2006

On September 6, 2007, TWCAA purchased the assets of Covenant Insurance Group of America, LLC. As part of the purchase agreement, TWCAA issued a note payable in the amount of \$90,000.

On October 31, 2007, TWCAA purchased the assets of Bush Insurance, Inc. As part of the purchase agreement, TWCAA issued a note payable in the amount of \$32,500.

The following table illustrates the composition of acquisitions for the twelve months ended December 31, 2007 and 2006:

| | 2007 | 2006 |
|-------------------------------|-------------|--------------|
| Fair value of assets acquired | \$ 669,400 | \$ 3,253,536 |
| Cash paid to Sellers | (400,000) | (1,257,411) |
| Liabilities assumed | \$ 269,400 | \$ 1,996,125 |

(15) Recent Accounting Pronouncements

The Company periodically reviews recent accounting pronouncements issued by the Financial Accounting Standards Board, American Institute of Certified Public Accountants, Emerging Issues Task Force and Staff Accounting Bulletins issued by the United States Securities and Exchange Commission to determine the potential impact on the Company's financial statements. Based on its most recent review, the Company has determined that the recently issued but not yet effective accounting pronouncements will not have a material impact on its financial statements.

In September 2006 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements. This Statement does not require any new fair value measurements, but rather, it provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. However, the application of this Statement may change how fair value is determined. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years.

In September 2006 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. The standard permits an entity to elect the fair value option on an instrument-by-instrument basis. The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years.

(16) Reclassification

Certain reclassifications have been made to the 2006 financial statements to conform to the 2007 presentations.

(17) Segment Reporting

The Company's subsidiaries are each unique operating entities performing a separate business function. AAIC, a property and casualty insurance company focuses on writing nonstandard automobile business in the states of Georgia, Alabama, Florida, Louisiana, Mississippi, South Carolina and Texas. MGA markets AAIC's policies through more than 1,600 independent agencies in these states. MGA provides all of the underwriting, accounting, product management, legal, policyholder administration and claims functions for AAIC and for two unaffiliated insurers related to the non-standard automobile insurance policies produced by the MGA in Florida and Texas. MGA receives various fees related to insurance transactions that vary according to state insurance laws and regulations. TrustWay is comprised of 50 retail insurance agencies that focus on selling nonstandard automobile policies and related coverages in Georgia, Florida and Alabama. TrustWay receives commissions and various fees associated with the sale of the products and services from its appointing insurance carriers.

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
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December 31, 2007 and 2006

The Company evaluates profitability based on pretax income. Pretax income for each segment is defined as the revenues less the segment's operating expenses including depreciation, amortization and interest. Following are the operating results for the Company's various segments and an overview of segment assets:

| | MGA | TrustWay | AAIC | Company | Eliminations | Consolidated |
|------------------------------|-----------------------|-----------------|-------------|----------------|---------------------|---------------------|
| | (In thousands) | | | | | |
| 2007 | | | | | | |
| Revenues | | | | | | |
| External customer | \$ 6,561 | \$ 5,554 | \$ 26,263 | \$ | \$ | \$ 58,378 |
| Intersegment | 6,713 | 3,938 | 3,010 | 2,970 | (16,631) | |
| Income | | | | | | |
| Segment pretax income(loss) | 1,302 | (3,792) | 3,911 | (629) | | 792 |
| Assets | | | | | | |
| Segment assets | 8,416 | 8,504 | 108,353 | 23,943 | (23,963) | 125,253 |
| | | | | | | |
| | MGA | TrustWay | AAIC | Company | Eliminations | Consolidated |
| | (In thousands) | | | | | |
| 2006 | | | | | | |
| Revenues | | | | | | |
| External customer | \$ 22,477 | \$ 9,641 | \$ 21,600 | \$ 5 | \$ | \$ 53,723 |
| Intersegment | 5,391 | 2,502 | 2,409 | 2,186 | (12,488) | |
| Income | | | | | | |
| Segment pretax income (loss) | 2,394 | (1,433) | 2,979 | (1,228) | | 2,712 |
| Assets | | | | | | |
| Segment assets | 5,262 | 11,153 | 75,294 | 24,670 | (20,634) | 95,745 |