



ACMAT CORPORATION

**ACMAT CORPORATION AND SUBSIDIARIES**

Consolidated Financial Statements

September 30, 2012

(Unaudited)

**ACMAT CORPORATION AND SUBSIDIARIES**  
**September 30, 2012**

TABLE OF CONTENTS

	<u>Page</u>
Consolidated Balance Sheets	3
Consolidated Statements of Earnings (Unaudited)	4
Consolidated Statements of Comprehensive Income (Unaudited)	5
Consolidated Statements of Stockholders' Equity (Unaudited)	6
Consolidated Statements of Cash Flows (Unaudited)	7
Notes to Consolidated Financial Statements (Unaudited)	8

**ACMAT CORPORATION AND SUBSIDIARIES**  
**Consolidated Balance Sheets**  
**As of September 30, 2012 and December 31, 2011**

	<b>September 30,</b>	<b>December 31,</b>
<b>Assets</b>	<b>2012</b>	<b>2011</b>
	<u>(Unaudited)</u>	<u></u>
Investments:		
Fixed maturities (Amortized cost of \$52,214,187 in 2012 and \$57,470,706 in 2011)	\$ 53,811,647	58,507,044
Equity securities (Historical cost of \$12,476,177 in 2012 and \$12,439,035 in 2011)	12,082,187	11,255,244
Short-term investments, at cost which approximates fair value	<u>6,582,630</u>	<u>6,654,516</u>
Total investments	<u>72,476,464</u>	<u>76,416,804</u>
Cash and cash equivalents	6,831,216	9,968,438
Accrued interest receivable	485,004	500,296
Premiums receivable, net of allowance for doubtful accounts of \$56,520 in 2012 and \$48,266 in 2011	38,487	424,358
Other receivables	399,138	497,427
Reinsurance recoverable	2,795,121	2,775,428
Prepaid expenses	244,147	71,716
Income taxes receivable	11,807	1,015,135
Deferred income taxes, net	339,495	1,108,753
Property and equipment, net	4,771,754	1,617,923
Deferred policy acquisition costs	141,686	186,858
Ceded unearned premiums	146,871	141,717
Other assets	1,227,655	801,422
Intangibles	<u>1,920,360</u>	<u>1,920,360</u>
Total assets	<u>\$ 91,829,205</u>	<u>97,446,635</u>
<b>Liabilities and Stockholders' Equity</b>		
Reserves for losses and loss adjustment expenses	\$ 16,951,925	17,506,782
Unearned premiums	1,016,346	1,241,007
Collateral held	25,511,861	28,500,822
Reinsurance premiums payable	71,108	57,266
Accounts payable and accrued liabilities	1,836,552	2,297,418
Long-term debt	<u>7,571,429</u>	<u>7,142,857</u>
Total liabilities	<u>52,959,221</u>	<u>56,746,152</u>
Common Stock (No par value; 3,500,000 shares authorized; 468,446 shares issued and outstanding)	468,446	468,546
Class A Stock (No par value; 10,000,000 shares authorized; 805,647 shares issued and outstanding)	805,647	898,655
Retained earnings	36,801,598	39,430,816
Accumulated other comprehensive income (loss)	<u>794,293</u>	<u>(97,534)</u>
Total stockholders' equity	<u>38,869,984</u>	<u>40,700,483</u>
Total liabilities and stockholders' equity	<u>\$ 91,829,205</u>	<u>97,446,635</u>

See Notes to Consolidated Financial Statements (Unaudited)

**ACMAT CORPORATION AND SUBSIDIARIES**  
**Consolidated Statements of Earnings (Unaudited)**  
**For the Three Months and Nine Months Ended September 30, 2012 and 2011**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>Revenues</b>				
Premiums	\$ 676,630	732,707	1,805,615	1,991,162
Net investment income	605,996	703,378	1,964,494	2,095,673
Net realized capital gains	186,976	254,079	904,845	785,335
Fee and other income	28,050	5,436	170,974	101,646
Total revenues	<u>1,497,652</u>	<u>1,695,600</u>	<u>4,845,928</u>	<u>4,973,816</u>
<b>Expenses</b>				
Incurred losses and loss adjustment expenses	67,663	73,271	180,561	223,362
Amortization of deferred acquisition costs	108,887	152,665	303,932	307,768
General and administrative expenses	668,910	868,358	2,720,221	2,918,177
Interest expense	65,169	64,165	190,482	200,656
Total expenses	<u>910,629</u>	<u>1,158,459</u>	<u>3,395,196</u>	<u>3,649,963</u>
Earnings before income taxes	587,023	537,141	1,450,732	1,323,853
Provision for income taxes	195,121	136,337	410,964	332,719
Net earnings	<u>\$ 391,902</u>	<u>400,804</u>	<u>1,039,768</u>	<u>991,134</u>
Basic earnings per-share	\$ 0.30	\$ 0.29	\$ 0.78	\$ 0.72
Diluted earnings per-share	\$ 0.29	\$ 0.27	\$ 0.75	\$ 0.67

See Notes to Consolidated Financial Statements (Unaudited)

**ACMAT CORPORATION AND SUBSIDIARIES**  
**Consolidated Statements of Comprehensive Income (Unaudited)**  
**For the Three Months and Nine Months Ended September 30, 2012 and 2011**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net earnings	\$ 391,902	400,804	1,039,768	991,134
Change in net unrealized gains and losses on investment securities	895,798	(3,229,625)	1,351,253	(3,325,530)
Income tax expense (benefit)	304,571	(1,098,072)	459,426	(1,130,680)
Other comprehensive income (loss), net of taxes	591,227	(2,131,553)	891,827	(2,194,850)
Comprehensive income (loss)	\$ 983,129	(1,730,749)	1,931,595	(1,203,716)

See Notes to Consolidated Financial Statements (Unaudited)

**ACMAT CORPORATION AND SUBSIDIARIES**  
**Consolidated Statements of Stockholders' Equity (Unaudited)**  
**For the Nine Months Ended September 30, 2012 and 2011**

	<u>Common Stock Par value</u>	<u>Class A Stock Par Value</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Stockholders' Equity</u>
Balance as of December 31, 2010	\$ 468,546	898,655	38,193,325	665,733	40,226,259
Comprehensive income (loss)					
Net unrealized losses on investment securities, net of reclassification	-	-	-	(2,194,850)	(2,194,850)
Net earnings	-	-	991,134	-	991,134
Total comprehensive income (loss)	-	-	991,134	(2,194,850)	(1,203,716)
Share-based compensation	-	-	3,816	-	3,816
Balance as of September 30, 2011	<u>\$ 468,546</u>	<u>898,655</u>	<u>39,188,275</u>	<u>(1,529,117)</u>	<u>39,026,359</u>
Balance as of December 31, 2011	\$ 468,546	898,655	39,430,816	(97,534)	40,700,483
Comprehensive income					
Net unrealized gains on investment securities, net of reclassification	-	-	-	891,827	891,827
Net earnings	-	-	1,039,768	-	1,039,768
Total comprehensive income	-	-	1,039,768	891,827	1,931,595
Acquisition and retirement of 181,508 shares of Class A Stock	-	(181,508)	(4,374,686)	-	(4,556,194)
Issuance of 88,500 shares of Class A Stock pursuant to stock options	-	88,500	708,000	-	796,500
Acquisition and retirement of 100 shares of common Stock	(100)	-	(2,300)	-	(2,400)
Balance as of September 30, 2012	<u>\$ 468,446</u>	<u>805,647</u>	<u>36,801,598</u>	<u>794,293</u>	<u>38,869,984</u>

See Notes to Consolidated Financial Statements (Unaudited)

**ACMAT CORPORATION AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows (Unaudited)**  
**For the Nine Months Ended September 30, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities</b>		
Net earnings	\$ 1,039,768	991,134
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	369,458	473,177
Share-based compensation	-	3,816
Net realized capital gains	(904,845)	(948,969)
Deferred income tax expense	379,964	1,607,670
Changes in:		
Accrued interest receivable	15,292	33,024
Receivables	484,160	37,782
Reinsurance recoverable	(19,693)	(8,778)
Income taxes receivable	927,600	(1,247,399)
Deferred policy acquisition costs	45,172	(58,545)
Prepaid expenses and other assets	(598,664)	(67,165)
Reserves for losses and loss adjustment expenses	(554,857)	(1,559,163)
Unearned premiums, net	(229,815)	30,719
Collateral held	(2,988,961)	2,487,812
Reinsurance premiums payable	13,842	41,435
Accounts payable and accrued liabilities	(460,866)	(421,523)
Net cash (used for) provided by operating activities	(2,482,445)	1,395,027
<b>Cash flows from investing activities</b>		
Proceeds from investments sold, matured or redeemed:		
Fixed maturities sold	1,555,676	11,821,341
Maturities and redemptions	15,992,139	3,956,173
Equity securities	25,056,386	18,264,785
Purchases of:		
Fixed maturities	(11,440,279)	(10,158,303)
Equity securities	(25,352,429)	(25,427,183)
Short-term investments, net	71,886	2,224,614
Sale of building, net of commission	-	2,732,570
Capital expenditures	(3,204,634)	(183,611)
Net cash provided by investing activities	2,678,745	3,230,386
<b>Cash flows from financing activities</b>		
Additional borrowing under term loan facility, net	1,479,300	-
Repayments of long-term debt	(1,050,728)	(1,071,429)
Acquisition and retirement of common shares	(2,400)	-
Issuance of Class A shares pursuant to stock options	796,500	-
Acquisition and retirement of Class A shares	(4,556,194)	-
Net cash used for financing activities	(3,333,522)	(1,071,429)
Net change in cash and cash equivalents	(3,137,222)	3,553,984
Cash and cash equivalents, beginning of period	9,968,438	7,058,631
Cash and cash equivalents, end of period	\$ 6,831,216	10,612,615

Supplemental disclosure of cash flows information:

Cash paid for (received from) income taxes	(928,527)	(25,766)
Cash paid for interest	190,482	200,656

See Notes to Consolidated Financial Statements (Unaudited)

**ACMAT CORPORATION AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (Unaudited)**

**(1) Basis of Presentation and Accounting Policies**

**Basis of Presentation**

The consolidated financial statements include the accounts of ACMAT Corporation ("ACMAT" or the "Company") and its subsidiaries. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and are unaudited.

The interim financial information contained in this report has been prepared from the books and records of the Company and its subsidiaries and reflects, in the opinion of the management of the Company, all adjustments (consisting of normal and recurring accruals) necessary to fairly present results of operations for the periods indicated. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior period balances have been reclassified to conform to the current period's presentation.

These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report for the year ended December 31, 2011.

**Adoption of Accounting Standards Updates**

*Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*

In October 2010, the FASB issued updated guidance to address diversity in practice for the accounting for costs associated with acquiring or renewing insurance contracts. This guidance modifies the definition of acquisition costs to specify that a cost must be directly related to the successful acquisition of a new or renewal insurance contract in order to be deferred. If application of this guidance would result in the capitalization of acquisition costs that had not previously been capitalized by a reporting entity, the entity may elect not to capitalize those costs. The updated guidance was effective for the quarter ended March 31, 2012 and was applied retrospectively. The Company's adoption of the updated guidance resulted in a reduction of prior period deferred policy acquisition costs of \$355,472, an increase of prior period net deferred tax asset of \$120,860, and a net reduction of prior period retained earnings of \$234,612.

*Presentation of Comprehensive Income*

In June 2011, the FASB issued updated guidance to increase the prominence of items reported in other comprehensive income by eliminating the option of presenting components of comprehensive income as part of the statement of changes in stockholders' equity. The updated guidance requires that all non-owner changes in stockholders' equity be presented either as a single continuous statement of comprehensive income or in two separate but consecutive statements. The updated guidance is to be applied retrospectively and was effective for the quarter ended March 31, 2012. The updated guidance results in a change in the presentation of the Company's consolidated financial statements but will not have any impact on the Company's results of operations, financial position or liquidity.

*Testing Indefinite-Lived Intangible Assets for Impairment*

In July 2012, the FASB issued updated guidance regarding the impairment test applicable to indefinite-lived intangible assets that is similar to the impairment guidance applicable to goodwill. Under the updated guidance, an entity may assess qualitative factors (such as changes in management, key personnel, strategy, key technology or customers) that may impact the fair value of the indefinite-lived intangible asset and lead to the determination that it is more likely than not that the fair value of the asset is less than its carrying value. If an entity determines that it is more likely than not that the fair value of the intangible asset is less than its carrying value, an impairment test must be performed. The impairment test requires an entity to calculate the estimated fair value of the indefinite-lived intangible asset. If the carrying value of the indefinite-lived intangible asset exceeds its estimated fair value, an impairment loss is recognized in an amount equal to the excess. The updated guidance is effective for the quarter ending March 31, 2013. Early adoption is permitted. The adoption of this guidance is not expected to have a material effect on the Company's results of operations, financial position or liquidity.



**ACMAT CORPORATION AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (Unaudited)**

**Nature of Operations**

ACMAT, through its wholly-owned subsidiary, ACSTAR Insurance Company (“ACSTAR”), provides surety bonds for prime contractors, specialty trade, environmental remediation and asbestos abatement contractors, and miscellaneous surety. ACSTAR is licensed to write business nationwide and is an approved surety by the United States Department of the Treasury.

**(2) Investments**

The amortized cost and fair value of investments in fixed maturities and equity securities classified as available-for-sale as of September 30, 2012 and December 31, 2011 were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized</u>		<u>Fair Value</u>
		<u>Gains</u>	<u>(Losses)</u>	
<u>As of September 30, 2012</u>				
U.S. government and government agencies	\$ 4,776,600	17,403	(2,079)	4,791,924
States, municipalities and political subdivisions	21,951,966	1,077,318	(49,250)	22,980,034
Industrial and miscellaneous	8,774,557	299,018	(81,038)	8,992,537
Mortgage-backed securities	14,507,164	594,103	(304,649)	14,796,618
Redeemable preferred stock	2,203,900	61,380	(14,746)	2,250,534
Total fixed maturities	<u>52,214,187</u>	<u>2,049,222</u>	<u>(451,762)</u>	<u>53,811,647</u>
Perpetual preferred stock	1,892,877	119,401	(50,940)	1,961,338
Common stock	10,583,300	612,765	(1,075,216)	10,120,849
Total equities	<u>12,476,177</u>	<u>732,166</u>	<u>(1,126,156)</u>	<u>12,082,187</u>
Total:	<u>\$ 64,690,364</u>	<u>2,781,388</u>	<u>(1,577,918)</u>	<u>65,893,834</u>
	<u>Amortized Cost</u>	<u>Gross Unrealized</u>		<u>Fair Value</u>
		<u>Gains</u>	<u>(Losses)</u>	
<u>As of December 31, 2011</u>				
U.S. government and government agencies	\$ 4,022,322	8,201	-	4,030,523
States, municipalities and political subdivisions	22,171,109	920,746	(34,789)	23,057,066
Industrial and miscellaneous	8,995,435	147,027	(132,791)	9,009,671
Mortgage-backed securities	20,634,640	535,473	(339,240)	20,830,873
Redeemable preferred stock	1,647,200	28,436	(96,725)	1,578,911
Total fixed maturities	<u>57,470,706</u>	<u>1,639,883</u>	<u>(603,545)</u>	<u>58,507,044</u>
Perpetual preferred stock	2,227,877	77,423	(281,140)	2,024,160
Common stock	10,211,158	551,843	(1,531,917)	9,231,084
Total equities	<u>12,439,035</u>	<u>629,266</u>	<u>(1,813,057)</u>	<u>11,255,244</u>
Total:	<u>\$ 69,909,741</u>	<u>2,269,149</u>	<u>(2,416,602)</u>	<u>69,762,288</u>

**ACMAT CORPORATION AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (Unaudited)**

The following tables summarize, for all investments in an unrealized loss position at September 30, 2012 and December 31, 2011, the aggregate fair value and gross unrealized loss by length of time those securities have been continuously in an unrealized loss position:

	<u>Less than 12 months</u>		<u>Greater than 12 months</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
<u>As of September 30, 2012</u>						
U.S. government and government agencies	\$ -	-	265,403	2,079	265,403	2,079
States, municipalities and political subdivisions	751,604	16,632	883,507	32,618	1,635,111	49,250
Industrial and miscellaneous	694,297	33,137	1,050,689	47,901	1,744,986	81,038
Mortgage-backed securities	488,979	226,926	601,217	77,723	1,090,196	304,649
Redeemable preferred stock	902,260	14,140	236,895	606	1,139,155	14,746
Total fixed maturities	2,837,140	290,835	3,037,711	160,927	5,874,851	451,762
Perpetual preferred stock	299,060	50,940	-	-	299,060	50,940
Common stock	3,367,066	319,009	2,719,550	756,207	6,086,616	1,075,216
Total equities	3,666,126	369,949	2,719,550	756,207	6,385,676	1,126,156
Total:	\$ 6,503,266	660,784	5,757,261	917,134	12,260,527	1,577,918

	<u>Less than 12 months</u>		<u>Greater than 12 months</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
<u>As of December 31, 2011</u>						
States, municipalities and political subdivisions	\$ 60,431	605	1,807,325	34,184	1,867,756	34,789
Industrial and miscellaneous	2,968,268	132,791	-	-	2,968,268	132,791
Mortgage-backed securities	6,059,765	234,085	498,060	105,155	6,557,825	339,240
Redeemable preferred stock	-	-	390,775	96,725	390,775	96,725
Total fixed maturities	9,088,464	367,481	2,696,160	236,064	11,784,624	603,545
Perpetual preferred stock	137,000	63,000	523,260	218,140	660,260	281,140
Common stock	4,877,388	1,359,792	688,400	172,125	5,565,788	1,531,917
Total equities	5,014,388	1,422,792	1,211,660	390,265	6,226,048	1,813,057
Total:	\$ 14,102,852	1,790,273	3,907,820	626,329	18,010,672	2,416,602

**ACMAT CORPORATION AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (Unaudited)**

The following table summarizes, for all fixed maturities and equity securities reported at fair value for which fair value is less than 80% of amortized cost at September 30, 2012, the gross unrealized loss by length of time those securities have continuously been in an unrealized loss position in excess of 20% of amortized cost:

	<b>Period For Which Fair Value is Less than 80% of Amortized Cost</b>				<b>Total</b>
	<b>3 Months or Less</b>	<b>Greater than 3 Months, Less than 6 Months</b>	<b>Greater than 6 Months, Less than 12 Months</b>	<b>Greater than 12 Months</b>	
<u>As of September 30, 2012</u>					
Mortgage-backed securities	\$ 217,625	-	-	62,130	279,755
Perpetual preferred stock	-	50,880	-	-	50,880
Common stock	153,904	308,790	-	145,785	608,479
Total:	\$ 371,529	359,670	-	207,915	939,114

**(3) Fair Value Measurement**

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

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

***Valuation of Investments Reported at Fair Value in the Financial Statements***

The fair value of a financial instrument is the estimated amount at which the instrument could be exchanged in an orderly transaction between knowledgeable, unrelated willing parties, i.e., not in a forced transaction. The estimated fair value of a financial instrument may differ from the amount that could be realized if the security was sold in an immediate sale, e.g., a forced transaction. Additionally, the valuation of fixed maturity investments is more subjective when markets are less liquid due to the lack of market based inputs, which may increase the potential that the estimated fair value (i.e., the carrying amount) of an investment is not reflective of the price at which an actual transaction would occur.

For investments that have quoted market prices in active markets, the Company uses the quoted market prices as fair value and includes these prices in the amounts disclosed in Level 1 of the hierarchy. The Company receives the quoted market prices from a third party nationally recognized pricing service. When quoted market prices are unavailable, the Company utilizes a pricing service to determine an estimate of fair value, which is mainly for its fixed maturity investments. The fair value estimates provided from this pricing service are included in the amount disclosed in Level 2 of the hierarchy. If quoted market prices and an estimate from a pricing service are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or Level 3. The Company bases all of its estimates of fair value for assets on the bid price as it represents what a third party market participant would be willing to pay in an arm's length transaction. The following section describes the valuation methods used by the Company for each type of financial instrument it holds that is carried at fair value.

**ACMAT CORPORATION AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (Unaudited)**

*Fixed Maturities*

The Company utilizes a pricing service to estimate fair value measurements for all of its fixed maturities. The pricing service utilizes market quotations for fixed maturity securities that have quoted prices in active markets. Since fixed maturities other than U.S. Treasury securities generally do not trade on a daily basis, the pricing service prepares estimates of fair value measurements for these securities using its proprietary pricing applications which include available relevant market information, benchmark curves, benchmarking of like securities, sector groupings and matrix pricing.

The fair value estimates of most fixed maturity investments are based on observable market information rather than market quotes. Accordingly, the estimates of fair value for such fixed maturities, other than U.S. Treasury securities, provided by the pricing service are included in the amount disclosed in Level 2 of the hierarchy. The estimated fair value of U.S. Treasury securities are included in the amount disclosed in Level 1 as the estimates are based on unadjusted market prices.

*Equity Securities*

For publicly-traded common stocks, the Company receives prices from a pricing service that are based on observable market transactions and includes these estimates in the amount disclosed in Level 1. Under certain circumstances, current market quotes in active markets are unavailable for certain non-redeemable preferred stocks held by the Company. In these instances, the Company receives an estimate of fair value from the pricing service that provides fair value estimates for the Company's fixed maturities. The service utilizes some of the same methodologies to price the non-redeemable preferred stocks as it does for fixed maturities. The Company includes the estimate in the amount disclosed in Level 2.

*Fair Value Hierarchy*

The following tables present the level within the fair value hierarchy at which the Company's financial assets are measured on a recurring basis at September 30, 2012 and December 31, 2011.

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<u>As of September 30, 2012</u>				
U.S. government and government agencies	\$ 4,791,924	-	-	4,791,924
States, municipalities and political subdivisions	-	22,980,034	-	22,980,034
Industrial and miscellaneous	-	8,992,537	-	8,992,537
Mortgage-backed securities	-	14,796,618	-	14,796,618
Redeemable preferred stock	-	2,250,534	-	2,250,534
	<u>4,791,924</u>	<u>49,019,723</u>	<u>-</u>	<u>53,811,647</u>
Total fixed maturities				
Perpetual preferred stock	-	1,961,338	-	1,961,338
Common stock	<u>10,120,849</u>	<u>-</u>	<u>-</u>	<u>10,120,849</u>
Total equities	<u>10,120,849</u>	<u>1,961,338</u>	<u>-</u>	<u>12,082,187</u>
Total:	<u>\$ 14,912,773</u>	<u>50,981,061</u>	<u>-</u>	<u>65,893,834</u>

**ACMAT CORPORATION AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (Unaudited)**

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<u>As of December 31, 2011</u>				
U.S. government and government agencies	\$ 4,030,523	-	-	4,030,523
States, municipalities and political subdivisions	-	23,057,066	-	23,057,066
Industrial and miscellaneous	-	9,009,671	-	9,009,671
Mortgage-backed securities	-	20,830,873	-	20,830,873
Redeemable preferred stock	-	1,578,911	-	1,578,911
	<u>4,030,523</u>	<u>54,476,521</u>	<u>-</u>	<u>58,507,044</u>
Total fixed maturities				
Perpetual preferred stock	-	2,024,160	-	2,024,160
Common stock	<u>9,231,084</u>	<u>-</u>	<u>-</u>	<u>9,231,084</u>
Total equities	<u>9,231,084</u>	<u>2,024,160</u>	<u>-</u>	<u>11,255,244</u>
Total:	<u>\$ 13,261,607</u>	<u>56,500,681</u>	<u>-</u>	<u>69,762,288</u>

There were no significant transfers between Level 1 and 2 or from level 3 in 2012 or 2011.

**(4) Earnings Per-Share**

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per-share computations for the three months and nine months periods ended September 30, 2012 and 2011:

	<u>2012</u>			<u>2011</u>		
	<u>Net Earnings</u>	<u>Average Shares Outstanding</u>	<u>Net Earnings Per-Share</u>	<u>Net Earnings</u>	<u>Average Shares Outstanding</u>	<u>Net Earnings Per-Share</u>
<u>Three Months Ended September 30,</u>						
Basic earnings per-share	\$ 391,902	1,299,702	0.30	400,804	1,367,201	0.29
Effect of dilutive securities						
Stock options	-	46,932	(0.01)	-	107,923	(0.02)
Diluted earnings per-share	<u>\$ 391,902</u>	<u>1,346,634</u>	<u>0.29</u>	<u>400,804</u>	<u>1,475,124</u>	<u>0.27</u>

	<u>2012</u>			<u>2011</u>		
	<u>Net Earnings</u>	<u>Average Shares Outstanding</u>	<u>Net Earnings Per-Share</u>	<u>Net Earnings</u>	<u>Average Shares Outstanding</u>	<u>Net Earnings Per-Share</u>
<u>Nine Months Ended September 30,</u>						
Basic earnings per-share	\$ 1,039,768	1,335,716	0.78	991,134	1,367,201	0.72
Effect of dilutive securities						
Stock options	-	48,734	(0.03)	-	107,875	(0.05)
Diluted earnings per-share	<u>\$ 1,039,768</u>	<u>1,384,450</u>	<u>0.75</u>	<u>991,134</u>	<u>1,475,076</u>	<u>0.67</u>

**ACMAT CORPORATION AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements (Unaudited)**

**(5) Comprehensive Income**

The following table summarizes reclassification adjustments for other comprehensive income (loss) and the related tax effects for the three months and nine months periods ended September 30, 2012 and 2011:

<u>Three Months Ended September 30,</u>	<u>2012</u>	<u>2011</u>
Unrealized holding (loss) gain arising during period, net of income taxes	\$ 714,631	(1,963,861)
Less: Reclassification adjustment for gains included in earnings, net of income taxes of \$63,572 and \$86,387 in 2012 and 2011, respectively	<u>123,404</u>	<u>167,692</u>
Changes included in comprehensive income:	<u>\$ 591,227</u>	<u>(2,131,553)</u>
<u>Nine Months Ended September 30,</u>	<u>2012</u>	<u>2011</u>
Unrealized holding gain arising during period, net of income taxes	\$ 1,489,025	(1,676,529)
Less: Reclassification adjustment for gains included in earnings, net of income taxes of \$307,647 and \$267,014 in 2012 and 2011, respectively	<u>597,198</u>	<u>518,321</u>
Changes included in comprehensive income:	<u>\$ 891,827</u>	<u>(2,194,850)</u>

**(6) Share-Based Compensation**

The Company periodically grants non-qualified stock options giving certain individuals the right to purchase restricted shares of the Company's Common Stock and Class A Stock. The majority of the options granted generally vest evenly over a five to ten year period and typically feature a term of 10 years. The exercise price is equal to the fair value at the date of grant. The Company uses a variation of the Black-Scholes option pricing model to value stock options.

As of September 30, 2012 there were 156,500 stock options outstanding of which all were vested. There was no share-based compensation expense incurred in 2012 or during the three months period ended September 30, 2011. Share-based compensation expense of \$3,618 is reflected in net earnings for the nine months period ended September 30, 2011. Total unrecognized compensation cost related to share-based incentive compensation awards as of September 30, 2012 and December 31, 2011 was zero.