

Homeowners Choice, Inc.  
Form 10-Q  
November 12, 2010  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON D.C. 20549**

**Form 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2010**

**OR**

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission File Number**

**001-34126**

**Homeowners Choice, Inc.**

**(Exact name of Registrant as specified in its charter)**

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**Florida**  
(State of Incorporation)

**20-5961396**  
(IRS Employer

Identification No.)

**2340 Drew Street, Suite 200**

**Clearwater, FL 33765**

(Address, including zip code of principal executive offices)

**(727) 213-3600**

(Registrant's telephone number, including area code)

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No  (The registrant has not yet been phased into the interactive data requirements)

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.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

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

The aggregate number of shares of the registrant's Common Stock, no par value, outstanding on November 5, 2010 was 6,270,439.

**Table of Contents**

**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

**TABLE OF CONTENTS**

|  | Page  |
|--|-------|
| <b>PART I FINANCIAL INFORMATION</b>  |       |
| <b>ITEM 1 <u>FINANCIAL STATEMENTS</u></b>  |       |
| <u>Condensed Consolidated Balance Sheets, September 30, 2010 (unaudited) and December 31, 2009</u>                       | 1     |
| <u>Condensed Consolidated Statements of Earnings Three and Nine Months Ended September 30, 2010 and 2009 (unaudited)</u> | 2     |
| <u>Condensed Consolidated Statements of Cash Flows Nine Months Ended September 30, 2010 and 2009 (unaudited)</u>         | 3     |
| <u>Condensed Consolidated Statement of Stockholders' Equity Nine Months Ended September 30, 2010 (unaudited)</u>         | 4     |
| <u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>  | 5-19  |
| <u>Report by Independent Registered Public Accounting Firm</u>   | 20    |
| <u>Report of Independent Registered Public Accounting Firm</u>   | 21    |
| <b>ITEM 2 <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u></b>               | 22-33 |
| <b>ITEM 3 <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u></b>  | 33    |
| <b>ITEM 4 <u>CONTROLS AND PROCEDURES</u></b>   | 33    |
| <b>PART II OTHER INFORMATION</b>   |       |
| <b>ITEM 1 <u>LEGAL PROCEEDINGS</u></b>   | 34    |
| <b>ITEM 1a <u>RISK FACTORS</u></b>   | 34    |
| <b>ITEM 2 <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u></b>   | 35-36 |
| <b>ITEM 6 <u>EXHIBITS</u></b>  | 37-40 |
| <u>SIGNATURES</u>  | 41    |
| <u>CERTIFICATIONS</u>  |       |

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1 Financial Statements****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Condensed Consolidated Balance Sheets****(Dollars in thousands, except share amounts)**

|  | <b>At September 30,<br/>2010<br/>(Unaudited)</b> | <b>At December 31,<br/>2009</b> |
|--|--|---------------------------------|
| <b>Assets</b>  |  |                                 |
| Investments:   |  |                                 |
| Fixed maturity securities, held-to-maturity, at amortized cost (fair value \$4,250)  | \$   | 4,049                           |
| Fixed maturity securities, available-for-sale, at fair value (amortized cost \$15,027 and \$19,763)                                | 15,619   | 19,266                          |
| Equity securities, available-for-sale, at fair value   | 677  |                                 |
| Time deposits  | 13,900   | 13,507                          |
| Short-term investments   | 1,998  | 11,521                          |
| Total investments  | 32,194   | 48,343                          |
| Cash and cash equivalents  | 78,417   | 43,453                          |
| Accrued interest and dividends receivable  | 110  | 176                             |
| Premiums receivable  | 9,327  | 4,899                           |
| Assumed reinsurance balances receivable  |  | 19,525                          |
| Prepaid reinsurance premiums   | 16,224   | 7,205                           |
| Deferred policy acquisition costs  | 10,301   | 10,496                          |
| Property and equipment, net  | 7,697  | 399                             |
| Deferred income taxes  |  | 2,438                           |
| Income tax receivable  | 1,231  |                                 |
| Other assets   | 1,167  | 958                             |
| Total assets   | \$ 156,668                                       | 137,892                         |
| <b>Liabilities and Stockholders Equity</b>   |  |                                 |
| Losses and loss adjustment expenses  | 22,711   | 19,178                          |
| Unearned premiums  | 72,242   | 68,509                          |
| Advance premiums   | 4,835  | 713                             |
| Assumed reinsurance balances payable   | 243  |                                 |
| Accrued expenses   | 3,175  | 2,906                           |
| Income taxes payable   |  | 167                             |
| Deferred income taxes  | 384  |                                 |
| Other liabilities  | 6,035  | 1,041                           |
| Total liabilities  | 109,625  | 92,514                          |
| Stockholders equity:   |  |                                 |
| Preferred stock (no par value 20,000,000 shares authorized, no shares issued or outstanding)                                       |  |                                 |
| Common stock, (no par value, 40,000,000 shares authorized, 6,080,666 and 6,456,635 shares issued and outstanding in 2010 and 2009) |  |                                 |

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|   |            |         |
|---|------------|---------|
| Additional paid-in capital                    | 18,535     | 21,164  |
| Retained earnings                             | 28,158     | 24,520  |
| Accumulated other comprehensive income (loss) | 350        | (306)   |
| Total stockholders' equity                    | 47,043     | 45,378  |
| Total liabilities and stockholders' equity    | \$ 156,668 | 137,892 |

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Condensed Consolidated Statements of Earnings****(Unaudited)****(Dollars in thousands, except per share amounts)**

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| <b>Revenue</b>                                     |   |             |  |             |
| Gross premiums earned                              | \$ 29,398                                   | 25,204      | 89,720                                     | 84,155      |
| Premiums ceded                                     | (14,314)                                    | (13,193)    | (42,750)                                   | (31,199)    |
| Net premiums earned                                | 15,084                                      | 12,011      | 46,970                                     | 52,956      |
| Net investment income                              | 473   | 517         | 1,572                                      | 1,237       |
| Realized investment gains                          | 1,028                                       |             | 1,534                                      |             |
| Other  | 487   | 253         | 1,395                                      | 1,263       |
| Total revenue                                      | 17,072                                      | 12,781      | 51,471                                     | 55,456      |
| <b>Expenses</b>                                    |   |             |  |             |
| Losses and loss adjustment expenses                | 8,783                                       | 6,650       | 29,459                                     | 29,277      |
| Policy acquisition and other underwriting expenses | 3,730                                       | 3,430       | 10,689                                     | 5,670       |
| Other operating expenses                           | 2,021                                       | 1,365       | 5,604                                      | 4,124       |
| Total expenses                                     | 14,534                                      | 11,445      | 45,752                                     | 39,071      |
| Income before income taxes                         | 2,538                                       | 1,336       | 5,719                                      | 16,385      |
| Income taxes                                       | 881   | 521         | 2,081                                      | 6,282       |
| Net income   | \$ 1,657                                    | 815         | 3,638                                      | 10,103      |
| Basic earnings per share                           | \$ .27                                      | .12         | .59  | 1.48        |
| Diluted earnings per share                         | \$ .25                                      | .11         | .54  | 1.40        |
| Dividends per share                                | \$  |             |  |             |

See accompanying Notes to Condensed Consolidated Financial Statements.



**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Condensed Consolidated Statements of Cash Flows****(Unaudited)****(Dollars in thousands)**

|  | <b>Nine Months Ended<br/>September 30,</b> |                 |
|--|--|-----------------|
|  | <b>2010</b>                                | <b>2009</b>     |
| <b>Cash flows from operating activities:</b>   |  |                 |
| Net income   | \$ 3,638                                   | 10,103          |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |  |                 |
| Stock-based compensation   | 77   | 363             |
| Amortization of discounts on investments in fixed maturity securities                    | (45)                                       | (36)            |
| Loss on disposal of property and equipment   |  | 107             |
| Depreciation and amortization  | 117  | 53              |
| Deferred income taxes  | 2,410                                      | 1,110           |
| Realized gains on sales of investments   | (1,534)                                    |                 |
| <b>Changes in operating assets and liabilities:</b>                                      |  |                 |
| Premiums receivable  | (4,428)                                    | (13,339)        |
| Assumed reinsurance balances receivable  | 19,525                                     |                 |
| Advance premiums   | 4,122                                      |                 |
| Prepaid reinsurance premiums   | (9,019)                                    | 5,255           |
| Reinsurance balances receivable  |  | 157             |
| Accrued interest and dividends receivable  | 66   | (124)           |
| Income taxes receivable  | (1,231)                                    |                 |
| Other assets   | (209)                                      | 77              |
| Assumed reinsurance balances payable   | 243  | (6,136)         |
| Deferred policy acquisition costs  | 195  | (5,047)         |
| Losses and loss adjustment expenses  | 3,533                                      | 6,969           |
| Unearned premiums  | 3,733                                      | 6,142           |
| Income taxes payable   | (167)                                      | (4,788)         |
| Accrued expenses and other liabilities   | 5,263                                      | 3,030           |
| <b>Net cash provided by operating activities</b>   | <b>26,289</b>                              | <b>3,896</b>    |
| <b>Cash flows from investing activities:</b>   |  |                 |
| Purchase of property and equipment, net  | (7,415)                                    | (239)           |
| Repayment of note receivable   |  | 450             |
| Purchase of fixed maturity securities  | (14,731)                                   | (22,439)        |
| Purchase of equity securities  | (2,070)                                    |                 |
| Proceeds from sales of fixed maturity securities   | 25,002                                     | 862             |
| Proceeds from sales of equity securities   | 1,465                                      |                 |
| Increase in time deposits, net   | (393)                                      |                 |
| Decrease (increase) in short-term investments, net                                       | 9,523                                      | (470)           |
| <b>Net cash provided by (used in) investing activities</b>                               | <b>11,381</b>                              | <b>(21,836)</b> |
| <b>Cash flows from financing activities:</b>   |  |                 |
| Proceeds from the exercise of common stock options                                       | 100  | 40              |



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|  |           |          |
|--|-----------|----------|
| Repurchases of common stock                                    | (2,845)   | (2,067)  |
| Excess tax benefit from common stock options exercised         | 39        | 9        |
| Net cash used in financing activities                          | (2,706)   | (2,018)  |
| Net increase (decrease) in cash and cash equivalents           | 34,964    | (19,958) |
| Cash and cash equivalents at beginning of period               | 43,453    | 81,060   |
| Cash and cash equivalents at end of period                     | \$ 78,417 | 61,102   |
| Supplemental disclosure of cash flow information:              |           |          |
| Cash paid for income taxes                                     | \$ 790    | 9,950    |
| Cash paid for interest   | \$        |          |
| Non-cash investing activity -                                  |           |          |
| Unrealized gain on investments, available for sale, net of tax | \$ 656    | 147      |

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Condensed Consolidated Statement of Stockholders' Equity****Nine Months Ended September 30, 2010****(Dollars in thousands, except share amounts)**

|   | Common stock |        | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Change<br>in Other<br>Comprehensive<br>(Loss)/Income | Total   |
|---|--------------|--------|----------------------------------|----------------------|---|---------|
|   | Shares       | Amount |                                  |                      |   |         |
| Balance at December 31, 2009  | 6,456,635    | \$     | 21,164                           | 24,520               | (306)   | 45,378  |
| Net income (unaudited)  |              |        |                                  | 3,638                |   | 3,638   |
| Net change in unrealized gains of available-for-sale securities,<br>net of income taxes (unaudited) |              |        |                                  |                      | 656   | 656     |
| Comprehensive income (unaudited)  |              |        |                                  |                      |   | 4,294   |
| Repurchases and retirement of common stock (unaudited)  | (415,969)    |        | (2,845)                          |                      |   | (2,845) |
| Excess tax benefit from common stock options exercised<br>(unaudited)                               |              |        | 39                               |                      |   | 39      |
| Exercise of common stock options (unaudited)  | 40,000       |        | 100                              |                      |   | 100     |
| Stock-based compensation (unaudited)  |              |        | 77                               |                      |   | 77      |
| Balance at September 30, 2010 (unaudited)   | 6,080,666    | \$     | 18,535                           | 28,158               | 350   | 47,043  |

See accompanying Notes to Condensed Consolidated Financial Statements.

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**Table of Contents**

**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

**Note 1 Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited, condensed consolidated financial statements for Homeowners Choice, Inc. and its subsidiaries (collectively, the Company), which consist of Homeowners Choice Managers, Inc., Southern Administration, Inc., Claddaugh Casualty Insurance Company, Ltd., and Homeowners Choice Property & Casualty Insurance Company, Inc. and its subsidiary, HCPCI Holdings LLC, have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information, and the Securities and Exchange Commission (SEC) rules for interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, in the opinion of management, the accompanying financial statements reflect all normal recurring adjustments necessary to present fairly the Company's financial position as of September 30, 2010 and the results of operations and cash flows for the periods presented. The results of operations for the interim periods presented are not necessarily indicative of the results of operations to be expected for any subsequent interim period or for the fiscal year ending December 31, 2010. The accompanying unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2009 included in the Company's Form 10-K, which was filed with the SEC on March 30, 2010.

In preparing the interim unaudited condensed consolidated financial statements, management was required to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures at the financial reporting date and throughout the periods being reported upon. Certain of the estimates result from judgments that can be subjective and complex and consequently actual results may differ from these estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of loss and loss adjustment expenses, assumed reinsurance balances payable, the recoverability of deferred policy acquisition costs, and the determination of federal income taxes. Although considerable variability is inherent in these estimates, management believes that the amounts provided are reasonable. These estimates are continually reviewed and adjusted as necessary. Such adjustments are reflected in current operations.

All significant intercompany balances and transactions have been eliminated.

***Reclassifications.*** Certain reclassifications of prior period amounts have been made to conform to the current period presentation.

***Advance Premiums.*** Advance premiums represent premiums that have been collected in advance of the policy effective date.

(continued)

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**Table of Contents**

**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements, continued**

**(unaudited)**

**Note 1 Summary of Significant Accounting Policies, continued**

**Investments in Equity Securities.** The Company's investments in equity securities are classified as available-for-sale and carried at fair value as of the balance sheet date. Temporary changes in the fair value of available-for-sale securities are reported in stockholders' equity as a component of accumulated other comprehensive income (loss), net of deferred income taxes. Realized investment gains and losses are determined using the specific identification method.

As part of the Company's investment strategy, put and call options are purchased or sold on various equity securities the Company is willing to buy or sell. The premiums received are recorded as a liability until such time as the options are exercised or expire. Upon exercise, the value of the premium will adjust the basis of the underlying security bought or sold. Options that expire are recorded as income in the period they expire. With respect to these written option contracts, the Company includes the net gain or loss in the amount reported for realized investments gains in the Condensed Consolidated Statement of Earnings. In accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 815, Derivatives and Hedging, in the event the Company has open option contracts at the end of the reporting period, these options are marked to fair value through earnings.

**Note 2 Recent Accounting Pronouncements**

**Accounting Standards Update No. 2010-11.** In March 2010, the FASB issued Accounting Standards Update No. 2010-11 (ASU 2010-11), *Derivatives and Hedging (ASC Topic 815), Scope Exception Related to Embedded Credit Derivatives*. ASU 2010-11 provides clarifications and related additional examples to improve financial reporting by resolving potential ambiguity about the breadth of the embedded credit derivative scope exception in various paragraphs under Topic 815. The amendments in this update will be effective at the beginning of the reporting entity's first fiscal quarter beginning after September 15, 2010 with early adoption permitted. The adoption of this guidance did not have a material effect on the Company's consolidated financial condition or results of operations.

**Accounting Standards Update No. 2010-13.** In April 2010, the FASB issued Accounting Standards Update No. 2010-13 (ASU 2010-13), *Compensation - Stock Compensation (ASC Topic 718), Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades*. This update provides amendments to Topic 718 to clarify that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Such an award should not be classified as a liability if it otherwise qualifies as equity. The amendments were designed to improve GAAP because they improve consistency in financial reporting by eliminating diversity in practice. ASU 2010-13 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. Early adoption is permitted. The adoption of this guidance is not expected to have an effect on the Company's consolidated financial condition or results of operations.

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**Table of Contents**

**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements, continued**

**(unaudited)**

**Note 2 Recent Accounting Pronouncements, continued**

**Accounting Standards Update No. 2010-20.** In July 2010, the FASB issued Accounting Standards Update No. 2010-20 ( ASU 2010-20 ), *Receivables (ASC Topic 310), Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. The objective of the amendments in ASU 2010-20 is to provide financial statement users with greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables. The disclosures should include: the nature of credit risk inherent in the entity's portfolio of financing receivables, how that risk is analyzed and assessed in arriving at the allowance for credit losses, and the changes and reasons for those changes in the allowance for credit losses. For public entities, the amendments in ASU 2010-20 for disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial condition or results of operations.

**Accounting Standards Update No. 2010-25.** In September 2010, the FASB issued Accounting Standards Update No. 2010-25 ( ASU 2010-25 ), *Plan Accounting - Defined Contribution Pension Plans (ASC Topic 962), Reporting Loans to Participants by Defined Contribution Pension Plans*. The objective of the amendments in ASU 2010-25 is to clarify how loans to participants should be classified and measured by defined contribution pension benefit plans. The amendments in this update require that participant loans be classified as notes receivable from participants, which are segregated from plan investments and measured at their unpaid principal balance plus any accrued but unpaid interest. For public entities, the amendments in ASU 2010-25 should be applied retrospectively to all prior periods presented, effective for fiscal years ending after December 15, 2010. Early adoption is permitted. The adoption of this guidance is not expected to have an effect on the Company's consolidated financial condition or results of operations.

**Accounting Standards Update No. 2010-26.** In October 2010, the FASB issued Accounting Standards Update No. 2010-26 ( ASU 2010-26 ), *Financial Services - Insurance (ASC Topic 944), Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*. The objective of the amendments in ASU 2010-26 is to address diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The amendments in this ASU specify which costs should be capitalized. The amendments in ASU 2010-26 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011 and should be applied prospectively upon adoption. Retrospective application to all prior periods presented upon the date of adoption is permitted, but not required. Early adoption is permitted, but only at the beginning of an entity's annual reporting period. Management is currently evaluating the impact of ASU 2010-26 and the effect, if any, adoption of this guidance will have on the Company's consolidated financial statements.

(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, continued****(unaudited)****Note 3 Investments**

The company holds investments in fixed maturity securities as well as equity securities, which are classified as available for sale. At September 30, 2010 and December 31, 2009, the amortized cost, gross unrealized gains and losses, and estimated fair value of the Company's available-for-sale securities by security type were as follows (in thousands):

|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gain | Gross<br>Unrealized<br>Loss | Fair<br>Value |
|--|-------------------|-----------------------------|-----------------------------|---------------|
| <b><u>September 30, 2010</u></b>           |                   |                             |                             |               |
| <i>Fixed Maturity Securities:</i>          |                   |                             |                             |               |
| U.S. Treasury and U.S. government agencies | \$ 2,545          | 24                          |                             | 2,569         |
| Corporate bonds                            | 6,022             | 129                         | (12)                        | 6,139         |
| Commercial mortgage-backed securities      | 6,146             | 458                         | (10)                        | 6,594         |
| Other                                      | 314               | 3                           |                             | 317           |
| <b>Total</b>                               | <b>15,027</b>     | <b>614</b>                  | <b>(22)</b>                 | <b>15,619</b> |
| Equity securities                          | 698               | 9                           | (30)                        | 677           |
| <b><u>December 31, 2009</u></b>            |                   |                             |                             |               |
| <i>Fixed Maturity Securities:</i>          |                   |                             |                             |               |
| U.S. Treasury notes                        | \$ 14,712         |                             | (505)                       | 14,207        |
| Commercial mortgage-backed securities      | 5,051             | 44                          | (36)                        | 5,059         |
| <b>Total</b>                               | <b>\$ 19,763</b>  | <b>44</b>                   | <b>(541)</b>                | <b>19,266</b> |

At December 31, 2009 the Company held investments in fixed maturity securities comprised of corporate bonds, which were classified as held-to-maturity. The amortized cost and estimated fair value of these investments at December 31, 2009 are summarized as follows (in thousands):

|                                 | Amortized<br>Cost | Gross<br>Unrealized<br>Gain | Gross<br>Unrealized<br>Loss | Fair<br>Value |
|---------------------------------|-------------------|-----------------------------|-----------------------------|---------------|
| <b><u>December 31, 2009</u></b> |                   |                             |                             |               |
| Corporate Bonds                 | \$ 4,049          | 237                         | (36)                        | 4,250         |

During the quarter ended June 30, 2010, upon the sale of one security held to maturity, the Company reclassified all remaining held to maturity securities to available for sale. The Company does not anticipate using the held to maturity classification in the future. While the Company continues to have the ability to hold these securities to maturity, the transfers to available for sale were made as a result of a change in

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management's objectives with respect to its investment portfolio, which was newly established in the second quarter of 2009.

(continued)

8

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, continued****(unaudited)****Note 3 Investments, continued**

The scheduled maturities of fixed maturity securities at September 30, 2010 are as follows (in thousands):

|   | Amortized Cost   | Fair Value    |
|---|------------------|---------------|
| <b>Available-for-sale</b>                       |                  |               |
| Due in one year or less                         | \$ 69            | 70            |
| Due after one year through five years           | 4,412            | 4,444         |
| Due after five years through ten years          | 3,999            | 4,105         |
| Due after ten years                             | 261              | 265           |
| Asset and commercial mortgage-backed securities | 6,286            | 6,735         |
|   | <b>\$ 15,027</b> | <b>15,619</b> |

**Investment Sales 2010**

Proceeds received, and the gross realized gains and losses from sales of available for sale securities, for the three and nine month periods ended September 30, 2010 were as follows (in thousands):

|   | Proceeds  | Gross Realized Gains | Gross Realized Losses |
|---|-----------|----------------------|-----------------------|
| <b><u>Three months ended September 30, 2010</u></b> |           |                      |                       |
| Fixed maturity securities                           | \$ 12,760 | 936                  | (1)                   |
| Equity securities*                                  | \$ 1,465  | 114                  | (21)                  |
| <b><u>Nine months ended September 30, 2010</u></b>  |           |                      |                       |
| Fixed maturity securities                           | \$ 25,002 | 1,442                | (1)                   |
| Equity securities*                                  | \$ 1,465  | 114                  | (21)                  |

\* Amounts reported for the three and nine months ended September 30, 2010 include the gross realized gains and losses from equity option contracts. During the quarter ended September 30, 2010, the Company entered into equity contracts for exchange traded call and put options to meet certain investment objectives. With respect to these option contracts, the Company received net proceeds of \$102,000 and realized a gain of \$95,000, which is included in the realized investment gains in the Condensed Consolidated Statements of Earnings. There were no open option contracts at September 30, 2010.



(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, continued****(unaudited)****Note 3 Investments, continued*****Investment Sales 2009***

During the three and nine months ended September 30, 2009, the Company sold one fixed maturity security for gross proceeds of \$862,000, resulting in a realized investment loss of less than \$1,000.

***Other-than-temporary Impairment ( OTTI )***

The Company regularly reviews its individual investment securities for OTTI. The Company considers various factors in determining whether each individual security is other-than-temporarily impaired, including:

the financial condition and near-term prospects of the issuer, including any specific events that may affect its operations or earnings;

the length of time and the extent to which the market value of the security has been below its cost or amortized cost;

general market conditions and industry or sector specific factors;

nonpayment by the issuer of its contractually obligated interest and principal payments; and

the Company's intent and ability to hold the investment for a period of time sufficient to allow for the recovery of costs. Securities with gross unrealized loss positions at September 30, 2010, aggregated by investment category and length of time the individual securities have been in a continuous loss position, are as follows (in thousands):

|                                       | <i>Less Than twelve months</i>       |                       |
|---------------------------------------|--------------------------------------|-----------------------|
|                                       | <b>Gross<br/>Unrealized<br/>Loss</b> | <b>Fair<br/>Value</b> |
| Corporate bonds                       | \$ 12                                | 1,174                 |
| Commercial mortgage-backed securities | \$ 10                                | 960                   |

|                   |       |     |
|-------------------|-------|-----|
| Equity securities | \$ 30 | 362 |
|-------------------|-------|-----|

(continued)

10

**Table of Contents**

**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements, continued**

**(unaudited)**

**Note 3 Investments, continued**

The Company believes there were no fundamental issues such as credit losses or other factors with respect to any of its available-for-sale securities. The unrealized losses on investments in fixed maturity securities were caused by interest rate changes. It is expected that the securities would not be settled at a price less than the par value of the investments. In determining whether equity securities are other than temporarily impaired, the Company considers its intent and ability to hold a security for a period of time sufficient to allow for the recovery of cost. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Company has the ability and intent to hold its available-for-sale investments until a market price recovery or maturity, the Company does not consider any of its investments to be other-than-temporarily impaired at September 30, 2010.

**Note 4 Fair Value Measurements**

Fair values of the Company's available-for-sale securities are determined in accordance with Accounting Standards Codification Topic 820, *Fair Value Measurements and Disclosure*, using valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Fair values are generally measured using quoted prices in active markets for identical securities or other inputs that are observable either directly or indirectly, such as quoted prices for similar securities. In those instances where observable inputs are not available, fair values are measured using unobservable inputs. Unobservable inputs reflect the Company's own assumptions about the assumptions that market participants would use in pricing the security and are developed based on the best information available in the circumstances. Fair value estimates derived from unobservable inputs are significantly affected by the assumptions used, including the discount rates and the estimated amounts and timing of future cash flows. The derived fair value estimates cannot be substantiated by comparison to independent markets and are not necessarily indicative of the amounts that would be realized in a current market exchange.

The fair values for securities that do not trade on a daily basis are determined by management, utilizing prices obtained from an independent pricing service and information provided by brokers. Management reviews the assumptions and methods utilized by the pricing service and then compares the relevant data and pricing to broker-provided data. The Company gains assurance of the overall reasonableness and consistent application of the assumptions and methodologies and compliance with accounting standards for fair value determination through ongoing monitoring of the reported fair values.

(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, continued****(unaudited)****Note 4 Fair Value Measurements, continued**

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels as follows:

Level 1 Unadjusted quoted prices in active markets for identical assets.

Level 2 Other inputs that are observable for the asset, either directly or indirectly.

Level 3 Inputs that are unobservable.

The following table presents information about the Company's available-for-sale securities measured at fair value as of September 30, 2010 and December 31, 2009, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (dollars in thousands):

|  | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total  |
|--|--|---|--|--------|
| <b><u>As of September 30, 2010</u></b> |  |   |  |        |
| Fixed maturity securities              | \$ 8,885   | 6,734   |  | 15,619 |
| Equity securities                      | 677  |   |  | 677    |
| Total available-for-sale securities    | \$ 9,562   | 6,734   |  | 16,296 |
| <b><u>As of December 31, 2009</u></b>  |  |   |  |        |
| Fixed maturity securities              | \$ 14,207  | 5,059   |  | 19,266 |

**Note 5 Property Acquisition**

On June 1, 2010, the Company purchased property in Tampa, Florida for a total purchase price of \$7.1 million. The property consists of 3.5 acres of land, a building with gross area of 122,000 square feet, and a three-story parking garage valued at \$1.2 million, \$5.3 million, and \$0.6 million, respectively. This facility will be used by the Company and its subsidiaries, all of which will be headquartered in the new facility. The Company expects to complete the relocation of its employees and infrastructure by early 2011 upon completion of various building improvements, which are expected to cost the Company between \$1.25 million and \$1.75 million. In addition, the Company expects to lease to non-affiliates up to forty-nine percent of the building's office space, which includes space occupied by existing tenants under lease agreements assumed by the Company at acquisition.

(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, continued****(unaudited)****Note 6 Reinsurance**

The Company cedes a portion of its homeowners insurance exposure to other entities under catastrophe excess of loss reinsurance treaties. The Company remains liable with respect to claims payments in the event that any of the reinsurers are unable to meet their obligations under the reinsurance agreements. The Company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

The impact of the catastrophe excess of loss reinsurance treaties on premiums written and earned is as follows (dollars in thousands):

|                         | <b>Three Months<br/>Ended<br/>September 30,</b> |             | <b>Nine Months<br/>Ended<br/>September 30,</b> |             |
|-------------------------|---|-------------|--|-------------|
|                         | <b>2010</b>                                     | <b>2009</b> | <b>2010</b>                                    | <b>2009</b> |
| <b>Premiums Written</b> |   |             |  |             |
| Direct                  | \$ 36,021                                       | 16,370      | 100,750  | 94,704      |
| Assumed                 | (521)   | (489)       | (7,298)  | (4,407)     |
| Gross written           | 35,500  | 15,881      | 93,452   | 90,297      |
| Ceded                   | (14,314)  | (13,193)    | (42,750)                                       | (31,199)    |
| Net premiums written    | \$ 21,186                                       | 2,688       | 50,702   | 59,098      |
| <b>Premiums Earned</b>  |   |             |  |             |
| Direct                  | \$ 27,616                                       | 20,310      | 75,959   | 44,690      |
| Assumed                 | 1,782   | 4,894       | 13,761   | 39,465      |
| Gross earned            | 29,398  | 25,204      | 89,720   | 84,155      |
| Ceded                   | (14,314)  | (13,193)    | (42,750)                                       | (31,199)    |
| Net premiums earned     | \$ 15,084                                       | 12,011      | 46,970   | 52,956      |

During the three and nine months ended September 30, 2010 and 2009, there were no recoverables pertaining to reinsurance contracts that were deducted from losses incurred. At September 30, 2010 and December 31, 2009, prepaid reinsurance premiums related to 18 and 26 reinsurers, respectively, and there were no amounts receivable with respect to reinsurers. Thus, there were no concentrations of credit risk associated with reinsurance receivables or prepaid reinsurance premiums as of September 30, 2010 and December 31, 2009.

(continued)





**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, continued****(unaudited)****Note 7 Losses and Loss Adjustment Expenses**

The liability for losses and loss adjustment expenses ( LAE ) is determined on an individual case basis for all claims reported. The liability also includes amounts for unallocated loss adjustments expenses, anticipated future claim development and losses incurred, but not reported.

Activity in the liability for unpaid losses and LAE is summarized as follows (dollars in thousands):

|                              | Three Months<br>Ended September 30, |                | Nine Months<br>Ended September 30, |                 |
|------------------------------|-------------------------------------|----------------|------------------------------------|-----------------|
|                              | 2010                                | 2009           | 2010                               | 2009            |
| Balance, beginning of period | \$ 23,117                           | 23,290         | 19,178                             | 14,763          |
| Incurred related to:         |                                     |                |                                    |                 |
| Current period               | 8,912                               | 8,616          | 29,962                             | 32,862          |
| Prior period                 | (129)                               | (1,966)        | (503)                              | (3,585)         |
| <b>Total incurred</b>        | <b>8,783</b>                        | <b>6,650</b>   | <b>29,459</b>                      | <b>29,277</b>   |
| Paid related to:             |                                     |                |                                    |                 |
| Current period               | (7,243)                             | (5,516)        | (16,890)                           | (15,522)        |
| Prior period                 | (1,946)                             | (2,692)        | (9,036)                            | (6,786)         |
| <b>Total paid</b>            | <b>(9,189)</b>                      | <b>(8,208)</b> | <b>(25,926)</b>                    | <b>(22,308)</b> |
| Balance, end of period       | \$ 22,711                           | 21,732         | 22,711                             | 21,732          |

The Company writes insurance in the state of Florida, which could be exposed to hurricanes or other natural catastrophes. Although the occurrence of a major catastrophe could have a significant effect on our monthly or quarterly results, the Company believes that such an event would not be so material as to disrupt the overall normal operations of the Company. However, the Company is unable to predict the frequency or severity of any such events that may occur in the near term or thereafter.

**Note 8 Income Taxes**

During the three and nine months ended September 30, 2010, the Company recorded approximately \$0.9 million and \$2.1 million, respectively, of income taxes, which resulted in estimated annual effective tax rates of approximately 34.7% and 36.4%, respectively. During the three and nine months ended September 30, 2009, the Company recorded approximately \$0.5 million and \$6.3 million, respectively, of income taxes, which resulted in estimated annual effective tax rates of approximately 39.0% and 38.3%, respectively. The Company's estimated annual effective tax rate differs from the statutory federal income tax rate due to state income taxes, stock-based compensation and other nondeductible items.

(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, continued****(unaudited)****Note 9 Earnings Per Share**

A summary of the numerator and denominator of the basic and diluted earnings per share is presented below (dollars and shares in thousands, except per share amounts):

|  | <b>Three Months<br/>Ended<br/>September 30,<br/>2010</b> |       | <b>Nine Months<br/>Ended<br/>September 30,<br/>2009</b> |        |
|--|--|-------|---|--------|
| <b>Numerator:</b>                                |  |       |   |        |
| Net earnings                                     | \$ 1,657   | 815   | 3,638   | 10,103 |
| <b>Denominator:</b>                              |  |       |   |        |
| Weighted average shares - basic                  | 6,100  | 6,698 | 6,179   | 6,811  |
| Effect of dilutive securities -<br>Stock options | 469  | 482   | 497   | 418    |
| Weighted average shares - diluted                | 6,569  | 7,180 | 6,676   | 7,229  |
| <b>Earnings per share basic</b>                  | \$ .27   | .12   | .59   | 1.48   |
| <b>Earnings per share diluted</b>                | \$ .25   | .11   | .54   | 1.40   |

For the three and nine months ended September 30, 2010, 1,738,335 warrants to purchase an aggregate of 905,001 shares of common stock were excluded from the computation of diluted earnings per share because the exercise price of \$9.10 specific to the warrants exceeded the average market price of the Company's common stock. For the three and nine months ended September 30, 2009, 40,000 options and 1,771,668 warrants to purchase an aggregate of 978,334 shares of common stock were excluded from the computation of diluted earnings per share because the exercise price of \$7.00 specific to the options and \$9.10 specific to the warrants exceeded the average market price of the Company's common stock.

(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, continued****(unaudited)****Note 10 Stockholders Equity****Common Stock**

Effective March 18, 2009, the Company's Board of Directors authorized a plan to repurchase up to \$3.0 million (inclusive of commissions) of the Company's common shares. The repurchase plan allowed the Company to repurchase shares from time to time through March 19, 2010. This repurchase plan was supplemented in December 2009 upon approval by the Board of Directors to extend the repurchase authority by an additional \$3.0 million and continue until the repurchase plan is terminated by the Company or the maximum number of dollars has been expended. The shares may be purchased for cash in open market purchases, block transactions and privately negotiated transactions in accordance with applicable federal securities laws. The share repurchase plan may be modified, suspended, terminated or extended by the Company any time without prior notice. During the three months ended September 30, 2010, the Company repurchased and retired a total of 41,568 shares at an average price of \$5.95 per share and a total cost, inclusive of fees and commissions, of \$249,789, or \$6.01 per share, under this authorized repurchase program. During the nine months ended September 30, 2010, the Company repurchased and retired a total of 215,969 shares at an average price of \$6.64 per share and a total cost, inclusive of fees and commissions, of \$1,455,050, or \$6.69 per share. At September 30, 2010, a total of \$1,444,000 is available in connection with this plan.

In addition, in January 2010, the Company repurchased and retired a total of 200,000 shares of the Company's common stock at a price of \$7.00 per share for a total cost of \$1,400,000 (see Note 13 Related Party Transaction). Such repurchase was not part of a publicly announced plan or program.

**Common Stock Warrants**

At September 30, 2010, the Company has reserved 905,001 shares of common stock for issuance upon the exercise of its common stock warrants, all of which were issued coincident with the Company's initial public offering (IPO). A summary of the warrant activity for the nine months ended September 30, 2010 is presented below:

|  | Number<br>Of Warrants<br>Issued | Number of Common Shares<br>Issuable Upon<br>Conversion<br>of Warrants |
|--|---------------------------------|---|
| Warrants issued with IPO units   | 1,666,668                       | 833,334   |
| Warrants issued to the Company's placement agents net of 66,666 warrants forfeited and 33,000 warrants repurchased | 72,000                          | 72,000  |
| Warrants outstanding at December 31, 2009  | 1,738,668                       | 905,334   |
| Placement agent warrants repurchased by the Company at a price of \$1.20 per warrant in January 2010               | (333)                           | (333)   |
| Warrants outstanding at September 30, 2010   | 1,738,335                       | 905,001   |

(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, continued****(unaudited)****Note 10 Stockholders Equity, continued**

The warrants may be exercised at an exercise price equal to \$9.10 per share on or before July 30, 2013. At any time after January 30, 2009 and before the expiration of the warrants, the Company at its option may cancel the warrants in whole or in part, provided that the closing price per share of the Company's common stock has exceeded \$11.38 for at least ten trading days within any period of twenty consecutive trading days, including the last trading day of the period. The placement agents also have the option to effect a cashless exercise in which the warrants would be exchanged for the number of shares which is equal to the intrinsic value of the warrant divided by the current value of the underlying shares.

**Preferred Stock**

At September 30, 2010, the Company is authorized to issue 20,000,000 shares of preferred stock, no par value. The authorized but unissued preferred stock may be issued in one or more series and the shares of each series shall have such rights as determined by the Company's Board of Directors.

**Note 11 Comprehensive Income**

The components of comprehensive income are as follows (dollars in thousands):

|  | Three Months<br>Ended September 30, |      | Nine Months<br>Ended September 30, |        |
|--|-------------------------------------|------|------------------------------------|--------|
|  | 2010                                | 2009 | 2010                               | 2009   |
| <b>Net income</b>                              | \$ 1,657                            | 815  | 3,638                              | 10,103 |
| <b>Other comprehensive income:</b>             |                                     |      |                                    |        |
| Change in unrealized gain on investments:      |                                     |      |                                    |        |
| Unrealized gain arising during the period      | 742                                 | 239  | 2,602                              | 239    |
| Reclassification adjustment for realized gains | (1,028)                             |      | (1,534)                            |        |
| Net change in unrealized gains                 | (286)                               | 239  | 1,068                              | 239    |
| Deferred income taxes on above changes         | 110                                 | (92) | (412)                              | (92)   |
| Other comprehensive income                     | (176)                               | 147  | 656                                | 147    |
| <b>Comprehensive income</b>                    | \$ 1,481                            | 962  | 4,294                              | 10,250 |

(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, continued****(unaudited)****Note 12 Stock-Based Compensation****Stock Option Plan**

The Company accounts for stock-based compensation under the fair value recognition provisions of ASC Topic 718 Compensation Stock Compensation.

The Company's 2007 Stock Option and Incentive Plan (the Plan) provides for granting of stock options to employees, directors, consultants, and advisors of the Company. Under the Plan, options may be granted to purchase a total of 6,000,000 shares of the Company's common stock. At September 30, 2010, options to purchase 4,850,000 shares are available for grant under the Plan. The outstanding options vest over periods ranging from immediately vested to five years and are exercisable over the contractual term of ten years.

A summary of the activity in the Company's stock option plan is as follows (dollars in thousands, except per share amounts):

|                                   | Number of<br>Options | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value |
|-----------------------------------|----------------------|---|--|---------------------------------|
| Outstanding at December 31, 2009  | 1,130,000            | \$ 2.66                                   |  |                                 |
| Forfeited                         | (40,000)             | 7.00                                      |  |                                 |
| Exercised                         | (40,000)             | 2.50                                      |  |                                 |
| Outstanding at September 30, 2010 | 1,050,000            | \$ 2.50                                   | 7.0 years  | \$ 4,200                        |
| Exercisable at September 30, 2010 | 994,000              | \$ 2.50                                   | 7.0 years  | \$ 3,976                        |

At September 30, 2010, there was approximately \$60,000 of unrecognized compensation expense related to nonvested stock-based compensation arrangements granted under the Plan, which the Company expects to recognize over a weighted-average period of 19 months. The total fair value of shares vesting and recognized as compensation expense was approximately \$9,000 and \$77,000, respectively, for the three and nine month periods ended September 30, 2010 and the associated income tax benefit recognized was \$0 and \$19,000, respectively. The total intrinsic value of the 40,000 options exercised during the nine months ended September 30, 2010 was \$147,000 and the income tax benefit recognized was \$39,000. The total fair value of shares vesting and recognized as compensation expense was approximately \$122,000 and \$363,000, respectively, for the three and nine month periods ended September 30, 2009 and the associated income tax benefit recognized was \$35,000 and \$120,000, respectively. The intrinsic value of options exercised during the nine months ended September 30, 2009 was \$42,000 and the income tax benefit recognized was \$9,000.

No options were granted during the three and nine month periods ended September 30, 2010 and 2009.

(continued)





**Table of Contents**

**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements, continued**

**(unaudited)**

**Note 13 Related Party Transaction**

Effective January 20, 2010, the Company repurchased and retired a total of 200,000 shares of the Company's common stock at a price of \$7.00 per share for a total cost of \$1,400,000. Such shares were repurchased under a stock purchase agreement with one of the Company's directors at a price below the \$7.95 market value of the Company's common stock on the date of the transaction. Such repurchases were not part of a publicly announced plan or program.

**Note 14 Subsequent Event**

On October 12, 2010, the Company entered into a purchase agreement with an unrelated third party to acquire approximately 1.5 million shares of common stock of United Insurance Holdings Corp. ( "United"), a Florida-based property and casualty insurance company. This purchase represents approximately 14.6% of United's outstanding common stock as reported by United in its Form 10-Q filed August 9, 2010. The total purchase price for the shares to be acquired is \$4.6 million, or approximately \$2.95 per share, which represents a 28.3% premium to the closing market price of United's common stock on October 12, 2010. In addition, the purchase agreement provides for the transfer to the Company of a warrant for a purchase price of \$100. The warrant, if exercised prior to the October 4, 2011 expiration date, will allow the Company to purchase 220,047 additional shares of United common stock at a price of \$6.00 per share. The closing of this purchase agreement is subject to regulatory approval.

On November 2, 2010, the Company's Board of Directors declared a quarterly dividend of \$0.10 per common share and a special dividend of \$0.20 per common share. The dividends are payable December 20, 2010 to stockholders of record on November 20, 2010.

**Table of Contents**

**Report by Independent Registered Public Accounting Firm**

Hacker, Johnson & Smith, PA, the Company's independent registered public accounting firm, has made a limited review of the financial data as of September 30, 2010, and for the three and nine month periods ended September 30, 2010 and 2009 presented in this document, in accordance with standards established by the Public Company Accounting Oversight Board.

Their report furnished pursuant to Article 8-03 of Regulation S-X is included herein.

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

Homeowners Choice, Inc.

Clearwater, Florida:

We have reviewed the accompanying condensed consolidated balance sheet of Homeowners Choice, Inc. and Subsidiaries (the Company) as of September 30, 2010, and the related condensed consolidated statements of earnings for the three and nine month periods ended September 30, 2010 and 2009, and the related condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2010 and 2009, and the condensed consolidated statement of stockholders' equity for the nine months ended September 30, 2010. These interim condensed financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim condensed consolidated financial statements for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board, the consolidated balance sheet as of December 31, 2009, and the related consolidated statements of earnings, stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated March 26, 2010, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2009, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Hacker, Johnson & Smith PA

HACKER, JOHNSON & SMITH PA  
Tampa, Florida  
November 5, 2010

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**Table of Contents**

**ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion in conjunction with our condensed consolidated financial statements and related notes and information included under this Item 2 and elsewhere in this quarterly report on Form 10-Q and in our Form 10-K filed with the Securities and Exchange Commission ( SEC ) on March 30, 2010. Unless the context requires otherwise, as used in this Form 10-Q, the terms HCI, we, us, our, the Company, our company, and similar references refer to Homeowners Choice, Inc. and its subsidiaries.*

***Forward-Looking Statements***

***In addition to historical information, this quarterly report contains forward-looking statements as defined under federal securities laws. Such statements involve risks and uncertainties, such as statements about our plans, objectives, expectations, assumptions or future events. These statements involve estimates, assumptions, known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from any future results, performances or achievements expressed or implied by the forward-looking statements. Typically, forward-looking statements can be identified by terminology such as anticipate, estimate, plan, project, continuing, ongoing, expect, believe, intend, may, will, should, could, and similar expressions. Among the important factors that could cause actual results to differ materially from those indicated by such forward-looking statements include but are not limited to the effect of governmental regulation; changes in insurance regulations; the frequency and extent of claims; uncertainties inherent in reserve estimates; catastrophic events; a change in the demand for, pricing of, availability or collectability of reinsurance; restrictions on our ability to change premium rates; increased rate pressure on premiums; changing rates of inflation; and other risks and uncertainties detailed herein and from time to time in our SEC reports.***

**OVERVIEW**

**General**

Homeowners Choice, Inc. is a property and casualty insurance holding company incorporated in Florida in 2006. Through our subsidiaries, we provide property and casualty homeowners insurance, condominium-owners insurance, and tenants insurance to individuals owning property in Florida. We offer these insurance products at competitive rates, while pursuing profitability using selective underwriting criteria. Our principal revenues are earned premiums, which are reported net of reinsurance costs, and investment income. We cede a substantial portion of our earned premiums to reinsurers to mitigate risks primarily associated with hurricanes and other catastrophic events. Our principal expenses are claims from policyholders, policy acquisition costs, and other underwriting expenses. As of September 30, 2010, we had total assets of \$156.7 million and stockholders equity of \$47.0 million. Our net income was approximately \$3.6 million for the nine months ended September 30, 2010. Our book value per share increased to \$7.74 as of September 30, 2010 compared to \$7.03 as of December 31, 2009.

We began operations in September of 2007 by participating in a take-out program through which we assumed insurance policies held by Citizens Property Insurance Corporation ( Citizens ), a Florida state-supported insurer. The take-out program is a legislatively mandated program designed to reduce the State's risk exposure by encouraging private companies to assume policies from Citizens.

## **Table of Contents**

We currently have approximately 59,000 property and casualty insurance policies in force. These policies were assumed in seven separate assumption transactions which took place from July 2007 through December 2009, and account for substantially all of our premium revenue since inception. Of those policies assumed, approximately 86% are homeowners insurance policies, and the remaining 14% are a combination of policies written for condominium-owners and tenants. Our existing policies represent approximately \$120 million in annualized premiums.

Subsequent to the initial expiration of the assumed policies, Citizens requires us to offer renewals on the policies we acquire for a period of three years. The policyholders have the option to renew with us or they may ask their agent to place their coverage with another insurance company. With respect to the assumptions through December 31, 2009, policyholders could also elect to return to Citizens, i.e. opt out, prior to the policy renewal date. We strive to retain these policies by offering competitive rates to our policyholders.

We face various challenges to implementing our operating and growth strategies. Since we write policies that cover Florida homeowners, condominium owners, and tenants, we cover losses that may arise from, among other things, catastrophes, which could have a significant effect on our business, results of operations, and financial condition. To mitigate our risk of such losses, we cede a portion of our exposure to other entities under catastrophe excess of loss reinsurance treaties. Even without catastrophic events, we may incur losses and loss adjustment expenses that deviate substantially from our estimates and that may exceed our reserves, in which case our net income and capital would decrease. Our operating and growth strategies may also be impacted by regulation and supervision of our business by the State of Florida, which must approve our policy forms and premium rates as well as monitor our insurance subsidiary's ability to meet all requirements for regulatory compliance. Additionally, we compete with large, well-established insurance companies as well as other specialty insurers that, in most cases, possess greater financial resources, larger agency networks, and greater name recognition.

## **Recent Developments**

Effective October 15, 2010, we received authorization from Citizens to assume up to a maximum of 10,000 additional policies in December 2010.

On October 12, 2010, we entered into a purchase agreement with an unrelated third party to acquire approximately 1.5 million shares of common stock of United Insurance Holdings Corp. (United), a Florida-based property and casualty insurance company. This purchase represents approximately 14.6% of United's outstanding common stock as reported by United in its Form 10-Q filed August 9, 2010. The total purchase price for the shares to be acquired is \$4.6 million, or approximately \$2.95 per share, which represents a 28.3% premium to the closing market price of United's common stock on October 12, 2010. In addition, the purchase agreement provides for the transfer to the Company of a warrant for a purchase price of \$100. The warrant, if exercised prior to the October 4, 2011 expiration date, will allow us to purchase 220,047 additional shares of United common stock at a price of \$6.00 per share. We entered into the agreement, the closing of which is subject to regulatory approval, for investment purposes and as an indication of our serious interest in exploring with United the possibility of combining companies.

**Table of Contents**

On November 2, 2010, the Company's Board of Directors declared a quarterly dividend of \$0.10 per common share and a special dividend of \$0.20 per common share. The dividends are payable December 20, 2010 to stockholders of record on November 20, 2010.

**RESULTS OF OPERATIONS**

The following table summarizes our results of operations for the three and nine months ended September 30, 2010 and 2009 (dollars in thousands, except per share amounts):

|  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| <b>Operating Revenue</b>                           |   |             |  |             |
| Gross premiums earned                              | \$ 29,398                                   | 25,204      | 89,720                                     | 84,155      |
| Premiums ceded                                     | (14,314)                                    | (13,193)    | (42,750)                                   | (31,199)    |
| Net premiums earned                                | 15,084                                      | 12,011      | 46,970                                     | 52,956      |
| Net investment income                              | 473   | 517         | 1,572                                      | 1,237       |
| Realized investment gains                          | 1,028                                       |             | 1,534                                      |             |
| Other Income                                       | 487   | 253         | 1,395                                      | 1,263       |
| Total operating revenue                            | 17,072                                      | 12,781      | 51,471                                     | 55,456      |
| <b>Operating Expenses</b>                          |   |             |  |             |
| Losses and loss adjustment expenses                | 8,783                                       | 6,650       | 29,459                                     | 29,277      |
| Policy acquisition and other underwriting expenses | 3,730                                       | 3,430       | 10,689                                     | 5,670       |
| Other operating expenses                           | 2,021                                       | 1,365       | 5,604                                      | 4,124       |
| Total operating expenses                           | 14,534                                      | 11,445      | 45,752                                     | 39,071      |
| Income before income taxes                         | 2,538                                       | 1,336       | 5,719                                      | 16,385      |
| Income taxes                                       | 881   | 521         | 2,081                                      | 6,282       |
| Net income   | \$ 1,657                                    | 815         | 3,638                                      | 10,103      |
| <b>Ratios to Net Premiums Earned:</b>              |   |             |  |             |
| Loss Ratio   | 58.23%                                      | 55.36%      | 62.72%                                     | 55.29%      |
| Expense Ratio                                      | 38.13%                                      | 39.92%      | 34.69%                                     | 18.50%      |
| Combined Ratio                                     | 96.36%                                      | 95.28%      | 97.41%                                     | 73.79%      |
| <b>Ratios to Gross Premiums Earned:</b>            |   |             |  |             |
| Loss Ratio   | 29.88%                                      | 26.38%      | 32.83%                                     | 34.78%      |
| Expense Ratio                                      | 19.56%                                      | 19.02%      | 18.16%                                     | 11.64%      |
| Combined Ratio                                     | 49.44%                                      | 45.40%      | 50.99%                                     | 46.42%      |

**Per Share Data:**

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|                            |    |     |     |     |      |
|----------------------------|----|-----|-----|-----|------|
| Basic earnings per share   | \$ | .27 | .12 | .59 | 1.48 |
| Diluted earnings per share | \$ | .25 | .11 | .54 | 1.40 |

**Table of Contents**

***Comparison of the Three Months Ended September 30, 2010 to the Three Months Ended September 30, 2009***

Our results of operations for the three months ended September 30, 2010 reflect net income of \$1.7 million, or \$0.25 earnings per diluted share, compared to net income of \$0.8 million, or \$0.11 earnings per diluted share, for the three months ended September 30, 2009.

**Revenue**

*Gross Premiums Earned* for the three months ended September 30, 2010 were \$29.4 million and reflect the revenue from policies assumed from Citizens in connection with the seven assumption transactions through December 2009 and the revenue on the renewal of these policies. Gross premiums earned for the three months ended September 30, 2009 were \$25.2 million and reflect the revenue from policies assumed from Citizens in connection with the assumption transactions through December 2008 and the revenue on the renewal of these policies.

*Premiums Ceded* for the three months ended September 30, 2010 and 2009 were \$14.3 million and \$13.2 million, respectively. Our premiums ceded represent amounts paid to reinsurers to cover losses from catastrophes that exceed the retention defined by our catastrophe excess of loss reinsurance treaties. Our reinsurance rates, which become effective on June 1 of each year, are based primarily on gross insured values reflected in gross premiums earned. The \$1.1 million increase in premiums ceded during 2010 is primarily due to an increase in coverage limits and an increase in our policy exposure base between June 1, 2009 and June 1, 2010. Premiums ceded were 48.7% and 52.3% of gross premiums earned during the three months ended September 30, 2010 and 2009, respectively.

*Net Premiums Earned* for the three months ended September 30, 2010 and 2009 were \$15.1 million and \$12.0 million, respectively, and reflect the gross premiums earned less the appropriate reinsurance costs as described above. Net premiums earned increased by \$3.1 million in 2010 as compared to 2009 as a result of the \$4.2 million increase in gross earned premiums offset by the \$1.1 million increase in our reinsurance premiums.

*Net Premiums Written* during the three months ended September 30, 2010 and 2009 totaled \$21.2 million and \$2.7 million, respectively. Net premiums written represent the premiums charged on policies issued during a fiscal period less any applicable reinsurance costs.

The following is a reconciliation of our total Net Premiums Written to Net Premiums Earned for the three months ended September 30, 2010 and 2009 (dollars in thousands):

|  | <b>Three Months Ended<br/>September 30,</b> |               |
|--|---|---------------|
|  | <b>2010</b>                                 | <b>2009</b>   |
| Net Premiums Written                     | \$ 21,186                                   | 2,688         |
| (Increase)/Decrease in Unearned Premiums | (6,102)                                     | 9,323         |
| <b>Net Premiums Earned</b>               | <b>\$ 15,084</b>                            | <b>12,011</b> |

*Net Investment Income* for each of the three months ended September 30, 2010 and 2009 was \$0.5 million.



**Table of Contents**

*Realized Investment Gains* for the three months ended September 30, 2010 of \$1 million reflects the net gain realized from sales of various available-for-sale securities during the quarter ended September 30, 2010. We had no significant investment gains in the three months ended September 30, 2009.

*Other Income* for the three months ended September 30, 2010 and 2009 of \$487,000 and \$253,000, respectively, primarily reflects the policy fee income we earn with respect to our issuance of renewal policies. Policy fees increased \$187,000 during 2010 as a direct result of the increase in policies written.

**Expenses**

Our *Losses and Loss Adjustment Expenses* amounted to \$8.8 million and \$6.7 million, respectively, during the three months ended September 30, 2010 and 2009. The \$2.1 million increase during 2010 is primarily due to the reported claims and policy exposure in 2010 resulting from the December 2009 assumption. Our losses and loss adjustment expense reserves are more fully described below under the Expenses comparative for the nine months ended September 30, 2010 and 2009 and, additionally, under Critical Accounting Policies and Estimates below.

*Policy Acquisition and Other Underwriting Expenses* for the three months ended September 30, 2010 and 2009 of \$3.7 million and \$3.4 million, respectively, primarily reflect the amortization of deferred acquisition costs, commissions payable to agents for production and renewal of policies, and premium taxes and policy fees. The \$0.3 million increase in 2010 is primarily due to an increase in our commission expense, which is directly attributable to a rise in our renewal premiums in 2010.

*Other Operating Expenses* for the three months ended September 30, 2010 and 2009 were \$2 million and \$1.4 million, respectively. Such expenses include administrative compensation and related benefits, corporate insurance, professional fees, office lease and related expenses, information system expense, and other general and administrative costs. The \$0.6 million increase is primarily attributable to an increase in 2010 for administrative compensation and related benefits. As of September 30, 2010, we had 63 employees compared to 51 employees as of September 30, 2009.

*Income Taxes* for the three months ended September 30, 2010 and 2009 were \$0.9 million and \$0.5 million, respectively, for state and federal income taxes resulting in an effective tax rate of 34.7% for 2010 and 39.0% for 2009.

## **Table of Contents**

### **Ratios:**

The loss ratio applicable to the three months ended September 30, 2010 (loss and loss adjustment expenses related to net premiums earned) was 58.2% compared to 55.4% for the three months ended September 30, 2009. In addition to the increase in our losses and loss adjustment expenses, our loss ratio was negatively impacted by the increase in our reinsurance costs during 2010, which reduced our net premiums earned.

The expense ratio applicable to the three months ended September 30, 2010 (policy acquisition and other underwriting expenses plus other operating expenses related to net premiums earned) was 38.1% compared to 39.9% for the three months ended September 30, 2009. The improvement in our expense ratio is directly attributable to the increase in net premiums earned.

The combined loss and expense ratio (total of all expenses related to net premiums earned) is the key measure of underwriting performance traditionally used in the property and casualty industry. A combined ratio under 100% generally reflects profitable underwriting results. A combined ratio over 100% generally reflects unprofitable underwriting results. Our combined ratio for the three months ended September 30, 2010 was 96.4% compared to 95.3% for the three months ended September 30, 2009.

Due to the impact our reinsurance costs have on net premiums earned from period to period, our management believes the combined loss and expense ratio measured to gross premiums earned is more relevant in assessing overall performance. The combined loss and expense ratio to gross premiums earned for the three months ended September 30, 2010 was 49.4% compared to 45.4% for the three months ended September 30, 2009.

### ***Comparison of the Nine Months Ended September 30, 2010 to the Nine Months Ended September 30, 2009***

Our results of operations for the nine months ended September 30, 2010 reflect net income of \$3.6 million, or \$0.54 earnings per diluted share, compared to net income of \$10.1 million, or \$1.40 earnings per diluted share, for the nine months ended September 30, 2009.

### **Revenue**

*Gross Premiums Earned* for the nine months ended September 30, 2010 were \$89.7 million and reflect the revenue from policies assumed from Citizens in connection with the seven assumption transactions through December 2009 and the revenue on the renewal of these policies. Gross premiums earned for the nine months ended September 30, 2009 were \$84.2 million and reflect the revenue from policies assumed from Citizens in connection with the assumption transactions through December 2008 and the revenue on the renewal of these policies.

*Premiums Ceded* for the nine months ended September 30, 2010 and 2009 were \$42.8 million and \$31.2 million, respectively. Our premiums ceded represent amounts paid to reinsurers to cover losses from catastrophes that exceed the retention levels defined by our catastrophe excess of loss reinsurance treaties. Our reinsurance rates, which become effective on June 1 of each year, are based primarily on gross insured values reflected in gross premiums earned. Thus, the \$11.6

**Table of Contents**

million increase in premiums ceded during 2010 is primarily due to the increase in our policy exposure base between June 1, 2009 and June 1, 2010. Premiums ceded were 47.7% and 37.1% of gross premiums earned during the nine months ended September 30, 2010 and 2009, respectively.

*Net Premiums Earned* for the nine months ended September 30, 2010 and 2009 were \$47 million and \$53 million, respectively, and reflect the gross premiums earned less the appropriate reinsurance costs as described above. Net premiums earned decreased by \$6 million in 2010 as compared to 2009 as a result of the increase in our reinsurance premiums.

*Net Premiums Written* during the nine months ended September 30, 2010 and 2009 totaled \$50.7 million and \$59.1 million, respectively. Net premiums written represent the premiums charged on policies issued during a fiscal period less any applicable reinsurance costs.

The following is a reconciliation of our total Net Premiums Written to Net Premiums Earned for the nine months ended September 30, 2010 and 2009 (dollars in thousands):

|                               | <b>Nine Months Ended<br/>September 30,</b> |               |
|-------------------------------|--|---------------|
|                               | <b>2010</b>                                | <b>2009</b>   |
| Net Premiums Written          | \$ 50,702                                  | 59,098        |
| Increase in Unearned Premiums | (3,732)                                    | (6,142)       |
| <b>Net Premiums Earned</b>    | <b>\$ 46,970</b>                           | <b>52,956</b> |

*Net Investment Income* for the nine months ended September 30, 2010 and 2009 was \$1.6 million and \$1.2 million, respectively. The \$0.4 million increase in total investment income is primarily due to interest income received from our available-for-sale investments, which were added to our investment portfolio beginning in the second quarter of 2009. This increase was offset by a reduction in interest income with respect to various certificates of deposit redeemed since September 30, 2009.

*Realized Investment Gains* for the nine months ended September 30, 2010 of \$1.5 million reflects the net gains realized from sales of one held-to-maturity security and various available-for-sale securities during the nine months ended September 30, 2010. We had no significant investment gains in the nine months ended September 30, 2009.

*Other Income* for the nine months ended September 30, 2010 and 2009 of \$1.4 million and \$1.3 million, respectively, primarily reflects the policy fee income we earn with respect to our issuance of renewal policies.

**Expenses**

Our *Losses and Loss Adjustment Expenses* amounted to \$29.5 million and \$29.3 million, respectively, during the nine months ended September 30, 2010 and 2009.

Our losses and loss adjustment expense reserves ( Reserves ), which are more fully described below under Critical Accounting Policies and Estimates, are specific to homeowners insurance, which is our only line of business. These Reserves include both case reserves on reported claims and our reserves for incurred but not reported ( IBNR ) losses. At each period-end date, the balance of

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**Table of Contents**

our Reserves is based on our best estimate of the ultimate cost of each claim for those known cases and the IBNR loss reserves are estimated based primarily on our historical experience. Our Reserves increased from \$19.2 million at December 31, 2009 to \$22.7 million at September 30, 2010. The \$3.5 million increase in our Reserves during 2010 is comprised of a \$13.1 million increase specific to the 2010 accident year offset by a reduction of \$9 million and \$0.6 million in our Reserves for 2009 and 2008 accident years, respectively. The \$13.1 million in Reserves established for 2010 claims is due to the reported claims and policy exposure resulting from the December 2009 assumption. The decrease of \$9.6 million specific to our 2009 and 2008 accident-year reserves is due to favorable development arising from lower than expected loss development during 2010 relative to expectations used to establish our Reserve estimates at the end of 2009. Factors that are attributable to this favorable development may include a lower severity of claims than the severity of claims considered in establishing our Reserves and actual case development may be more favorable than originally anticipated.

*Policy Acquisition and Other Underwriting Expenses* for the nine months ended September 30, 2010 and 2009 of \$10.7 million and \$5.7 million, respectively, primarily reflect the amortization of deferred acquisition costs, commissions payable to agents for production of policies, and premium taxes and policy fees. The \$5 million increase in 2010 is primarily attributable to an increase in our commissions, premium taxes, and other underwriting expenses directly attributable to policy renewals and an increase in our payroll and other underwriting expenses required to manage our policies in force.

*Other Operating Expenses* for the nine months ended September 30, 2010 and 2009 were \$5.6 million and \$4.1 million, respectively. Such expenses include administrative compensation and related benefits, corporate insurance, professional fees, office lease and related expenses, information system expense, and other general and administrative costs. The \$1.5 million increase is primarily attributable to an increase for administrative compensation and related benefits. As of September 30, 2010, we had 63 employees compared to 51 employees as of September 30, 2009.

*Income Taxes* for the nine months ended September 30, 2010 and 2009 were \$2.1 million and \$6.3 million, respectively, for state and federal income taxes resulting in an effective tax rate of 36.4% for 2010 and 38.3% for 2009.

**Ratios:**

The loss ratio applicable to the nine months ended September 30, 2010 (loss and loss adjustment expenses related to net premiums earned) was 62.7% compared to 55.3% for the nine months ended September 30, 2009. Our loss ratio was negatively impacted by a significant increase in our reinsurance costs during 2010, which reduced our net premiums earned.

The expense ratio applicable to the nine months ended September 30, 2010 (policy acquisition and other underwriting expenses plus other operating expenses related to net premiums earned) was 34.7% compared to 18.5% for the nine months ended September 30, 2009. We have experienced an increase in our expense ratio due to increases in our premium taxes, payroll, and other underwriting expenses required to manage our policies in force as we have renewed more policies in 2010 than in 2009 (see *Policy Acquisition and Other Underwriting Expenses* above). In addition, our expense ratio was negatively impacted by a significant increase in our reinsurance costs during 2010, which reduced our net premiums earned.

## **Table of Contents**

The combined loss and expense ratio (total of all expenses related to net premiums earned) is the key measure of underwriting performance traditionally used in the property and casualty industry. A combined ratio under 100% generally reflects profitable underwriting results. A combined ratio over 100% generally reflects unprofitable underwriting results. Our combined ratio for the nine months ended September 30, 2010 was 97.4% compared to 73.8% for the nine months ended September 30, 2009.

Due to the impact our reinsurance costs have on net premiums earned from period to period, our management believes the combined loss and expense ratio measured to gross premiums earned is more relevant in assessing overall performance. The combined loss and expense ratio to gross premiums earned for the nine months ended September 30, 2010 was 51% compared to 46.4% for the nine months ended September 30, 2009.

### ***Seasonality of Our Business***

We expect to experience increases in our losses and loss adjustment expenses during the period from June 1 through November 30 each year as this is typically the period during which hurricanes and other tropical storms may occur. As a result of such seasonal variations in our reported losses, we anticipate our operating profits during the period from June 1 through November 30 each year may be negatively impacted by an increase in losses and loss adjustment expenses.

## **LIQUIDITY AND CAPITAL RESOURCES**

Since inception, our liquidity requirements have been met through issuance of our common stock and funds from operations. We expect our future liquidity requirements will be met by funds from operations, primarily the cash received by our insurance subsidiary from premiums written and investment income.

Our insurance subsidiary requires liquidity and adequate capital to meet ongoing obligations to policyholders and claimants and to fund operating expenses. In addition, we attempt to maintain adequate levels of liquidity and surplus to manage any differences between the duration of our liabilities and invested assets. In the insurance industry, cash collected for premiums from policies written is invested, interest and dividends are earned thereon, and loss and loss adjustment expenses are paid out over a period of years. This period of time varies by the circumstances surrounding each claim. A substantial portion of our losses and loss adjustment expenses are fully settled and paid within 90 days of the claim receipt date. Additional cash outflow occurs through payments of underwriting costs such as commissions, taxes, payroll, and general overhead expenses.

We believe that we maintain sufficient liquidity to pay our insurance subsidiary's claims and expenses, as well as satisfy commitments in the event of unforeseen events such as reinsurer insolvencies, inadequate premium rates, or reserve deficiencies. We maintain a comprehensive reinsurance program at levels management considers adequate to diversify risk and safeguard our financial position.

In the future, we anticipate our primary use of funds will be to pay claims and operating expenses. In addition, we expect to spend between \$1.25 million to \$1.75 million on enhancements to our new building over the remaining months in 2010.

## **Table of Contents**

### *Cash Flows*

Our cash flows from operating, investing and financing activities for the nine months ended September 30, 2010 and 2009 are summarized below.

#### *Cash Flows for the Nine Months Ended September 30, 2010*

Net cash provided by operating activities for the nine months ended September 30, 2010 was approximately \$26.3 million, which resulted primarily from the collection of \$19.5 million from Citizens in connection with our December 2009 assumption transaction and \$4.1 million in advance premiums offset by cash disbursed for operating expenses and losses and loss adjustment expenses. Net cash provided by investing activities of \$11.4 million was primarily due to the receipt of \$26.5 million in proceeds from the sale of securities and \$9.5 million from the redemption of short-term investments offset by \$16.8 million used for new investments in available-for-sale securities and \$7.4 million used to purchased assets, primarily the \$7.1 million used for the purchase of our new Tampa facility. Net cash used in financing activities totaled \$2.7 million, which was due to the repurchases during the period of our shares and warrants.

#### *Cash Flows for the Nine Months Ended September 30, 2009*

Net cash provided by operating activities for the nine months ended September 30, 2009 was approximately \$3.9 million, which consisted primarily of cash received from net written premiums less cash disbursed for operating expenses and losses and loss adjustment expenses. Net cash used in investing activities of \$21.8 million was primarily due to our purchase of various fixed maturity securities and short-term investments. Additionally, we used \$239,000 to purchase property and equipment. These amounts were offset by our receipt of \$450,000 upon repayment of the note receivable and \$862,000 from the sale of one investment. Net cash used in financing activities totaled \$2 million, which was primarily due to \$2.1 million used for our share repurchase program.

### *Investments*

The main objective of our investment policy is to maximize our after-tax investment income with a minimum of risk given the current financial market. Our excess cash is invested primarily in money market accounts, certificates of deposit (i.e., CDs maturing in less than thirteen months), and time deposits (i.e. CDs maturing in more than twelve months).

At September 30, 2010, we have \$16.3 million of available-for-sale investments, which are carried at fair value. Changes in the general interest rate environment affect the returns available on new fixed maturity investments. While a rising interest rate environment enhances the returns available on new investments, it reduces the market value of existing fixed maturity investments and thus the availability of gains on disposition. A decline in interest rates reduces the returns available on new investments but increases the market value of existing investments, creating the opportunity for realized investment gains on disposition.

With the exception of large national banks, it is our current policy not to maintain cash deposits of more than an aggregate of \$5.5 million in any one bank at any time. In the future, we may alter our investment policy to include or increase investments in federal, state and municipal obligations, preferred and common equity securities and real estate mortgages, as permitted by applicable law, including insurance regulations.

## **Table of Contents**

### **OFF-BALANCE SHEET ARRANGEMENTS**

As of December 31, 2009, we had no off-balance sheet arrangements as defined in Item 303(a)(4) of Regulation S-K.

### **CONTRACTUAL OBLIGATIONS**

As a smaller reporting company as defined by Rule 229.10(f)(1) of the Exchange Act, we are not required to provide the information under this item.

### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

We have prepared our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires us to make estimates and judgments to develop amounts reflected and disclosed in our financial statements. Material estimates that are particularly susceptible to significant change in the near term are related to our losses and loss adjustment expenses ( Reserves ), which include amounts estimated for claims incurred but not yet reported. Reserves are determined by establishing liabilities in amounts estimated to cover incurred losses and loss adjustment expenses. Such Reserves are determined based on our assessment of claims reported and the development of pending claims. These Reserves are based on individual case estimates for the reported losses and loss adjustment expenses and estimates of such amounts that are incurred but not reported ( IBNR ). Changes in the estimated liability are charged or credited to operations as the losses and loss adjustment expenses are adjusted.

The IBNR reserves represent our estimate of the ultimate cost of all claims that have occurred but have not been reported to us and, in some cases, may not yet be known to the insured. Estimating the IBNR component of our Reserves involves considerable judgment on the part of management. At September 30, 2010, \$5.8 million of the total \$22.7 million we have reserved for losses and loss adjustment expenses is specific to our estimate of claims incurred but not reported. The remaining \$16.9 million relates to known cases which have been reported but not yet fully settled in which case we have booked a reserve based on our best estimate of the ultimate cost of each claim. At September 30, 2010, \$7.6 million of the \$16.9 million in reserves for known cases relates to claims incurred during prior years.

Based on all information known to us, we believe our Reserves at September 30, 2010 are adequate to cover our claims for losses that had occurred as of that date including losses yet to be reported. However, these estimates are subject to trends in claim severity and frequency and must continually be reviewed by management. As part of the process, we review historical data and consider various factors, including known and anticipated regulatory and legal developments, changes in social attitudes, inflation and economic conditions. As experience develops and other data becomes available, these estimates are revised, as required, resulting in increases or decreases to the existing unpaid losses and loss adjustment expenses. Adjustments are reflected in the results of operations in the period in which they are made and the liabilities may deviate substantially from prior estimates.

In addition to Reserves, we believe our accounting policies specific to premium revenue recognition, losses and loss adjustment expenses, reinsurance, deferred policy acquisition costs, income taxes, and stock-based compensation expense involve our most significant judgments and

**Table of Contents**

estimates material to our consolidated financial statements. These accounting estimates and related risks that we consider to be our critical accounting estimates are more fully described in our Annual Report on Form 10-K, which we filed with the SEC on March 30, 2010. For the nine months ended September 30, 2010, there have been no material changes with respect to any of our critical accounting policies.

**RECENT ACCOUNTING PRONOUNCEMENTS**

For information with respect to recent accounting pronouncements and the impact of these pronouncements on our consolidated financial statements, see Note 2 to our Notes to Condensed Consolidated Financial Statements.

**ITEM 3 *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***

As a smaller reporting company as defined by Rule 229.10(f)(1) of the Exchange Act, we are not required to provide the information under this item.

**ITEM 4 *CONTROLS AND PROCEDURES***

Under the supervision and with the participation of our Chief Executive Officer (our principal executive officer) and Chief Financial Officer (our principal financial officer), we have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report, and, based on this evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that these disclosure controls and procedures are effective.

There have been no changes in our internal controls over financial reporting during the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.



**Table of Contents**

**PART II OTHER INFORMATION**

**ITEM 1 LEGAL PROCEEDINGS**

The Company is a party to claims and legal actions arising routinely in the ordinary course of our business. Although we cannot predict with certainty the ultimate resolution of the claims and lawsuits asserted against us, we do not believe that any currently pending legal proceedings to which we are a party will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

**ITEM 1a RISK FACTORS**

There have been no material changes from the risk factors previously disclosed in the section entitled Risk Factors in our Form 10-K, which was filed with the Securities and Exchange Commission on March 30, 2010.

**Table of Contents****ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS***(a) Sales of Unregistered Securities*

None.

*(b) Use of Proceeds*

None.

*(c) Repurchases of Securities*

Effective March 18, 2009, our Board of Directors authorized a plan to repurchase up to \$3.0 million (inclusive of commissions) of the Company's common shares. The repurchase plan allowed the Company to repurchase shares from time to time through March 19, 2010. This repurchase plan was supplemented in December 2009 upon approval by the Board of Directors to extend the repurchase authority by an additional \$3.0 million and continue until the repurchase plan is terminated by the Company or the maximum number of dollars has been expended. The shares may be purchased for cash in open market purchases, block transactions and privately negotiated transactions in accordance with applicable federal securities laws. The share repurchase plan may be modified, suspended, terminated or extended by the Company any time without prior notice. During the quarter ended September 30, 2010, the Company repurchased and retired a total of 41,568 shares at an average price of \$5.95 per share and a total cost, inclusive of fees and commissions, of \$249,789, or \$6.01 per share, under this authorized repurchase program. The following table provides information with respect to shares repurchased during the quarter ended September 30, 2010:

| <b>Period</b>        | <b>(a)<br/>Total<br/>Number<br/>Of Shares<br/>Repurchased</b> | <b>(b)<br/>Average<br/>Price Paid<br/>Per<br/>Share</b> | <b>(c)<br/>Total Number<br/>of Shares<br/>Purchased as<br/>Part of<br/>Publicly<br/>Announced Plan<br/>or Program</b> | <b>(d)<br/>Maximum<br/>Number (or<br/>Approximate<br/>Dollar Value)<br/>of Shares that<br/>May Yet be<br/>Purchased</b> |
|----------------------|---|---|---|---|
| July 1-31, 2010      | 16,604  | 5.48  | 16,604  | \$ 1,602,000  |
| August 1-31, 2010    | 12,803  | 6.18  | 12,803  | 1,522,000   |
| September 1-30, 2010 | 12,161  | 6.36  | 12,161  | 1,444,000   |
| Total                | 41,568  | \$ 5.95   | 41,568  |   |

**Table of Contents**

*Working Capital Restrictions and Other Limitations on Payment of Dividends*

We are not subject to working capital restrictions or other limitations on the payment of dividends. Our insurance subsidiary, however, is subject to restrictions on the dividends it may pay to our parent corporation, Homeowners Choice, Inc. Those restrictions could impact our ability to pay dividends.

Under Florida law, a domestic insurer such as our insurance subsidiary, Homeowners Choice Property & Casualty Insurance Company, Inc., may not pay any dividend or distribute cash or other property to its stockholders except out of that part of its available and accumulated capital and surplus funds which is derived from realized net operating profits on its business and net realized capital gains. For a three-year period beginning March 30, 2007, our insurance subsidiary, as a newly licensed Florida insurer, is precluded from paying dividends unless approved in advance by the Florida Office of Insurance Regulation. Additionally, Florida statutes preclude our insurance subsidiary from making dividend payments or distributions to stockholders without prior approval of the Florida Office of Insurance Regulation if the dividend or distribution would exceed the larger of (1) the lesser of (a) 10.0% of its capital surplus or (b) net income, not including realized capital gains, plus a two year carry forward, (2) 10.0% of capital surplus with dividends payable constrained to unassigned funds minus 25% of unrealized capital gains or (3) the lesser of (a) 10.0% of capital surplus or (b) net investment income plus a three year carry forward with dividends payable constrained to unassigned funds minus 25% of unrealized capital gains.

**Table of Contents**

**ITEM 6 EXHIBITS**

The following documents are filed as part of this report:

| <b>EXHIBIT<br/>NUMBER</b> | <b>DESCRIPTION</b>   |
|---------------------------|--|
| 3.1                       | Articles of Incorporation, with amendments. Incorporated by reference to the correspondingly numbered exhibit to our Registration Statement on Form S-1 (File No. <u>333-150513</u> ), originally filed April 30, 2008, effective July 24, 2008, as amended.   |
| 3.2                       | Bylaws as amended April 16, 2009. Incorporated by reference to the correspondingly numbered exhibit to our Current Report on Form 8-K filed April 23, 2009.  |
| 4.1                       | Form of Common Stock Certificate. Incorporated by reference to the correspondingly numbered exhibit to our Post-Effective Amendment No. 1 to our Registration Statement on Form S-1 (File No. <u>333-150513</u> ) filed August 6, 2008.  |
| 4.2                       | Warrant Agreement dated July 30, 2008 between Homeowners Choice, Inc. and American Stock Transfer & Trust Company. Incorporated by reference to the correspondingly numbered exhibit to our Post-Effective Amendment No. 1 to our Registration Statement on Form S-1 (File No. <u>333-150513</u> ) filed August 6, 2008. |
| 4.3                       | Form of Warrant Certificate. Incorporated by reference to the correspondingly numbered exhibit Post-Effective Amendment No. 1 to our Registration Statement on Form S-1 (File No. <u>333-150513</u> ) filed August 6, 2008.  |
| 4.4                       | Warrant Agreement dated July 30, 2008 between Homeowners Choice, Inc. and Anderson & Strudwick, Incorporated. Incorporated by reference to the correspondingly numbered exhibit to our Post-Effective Amendment No. 1 to our Registration Statement on Form S-1 (File No. <u>333-150513</u> ) filed August 6, 2008.      |
| 4.5                       | Form of Warrant Certificate issued to Anderson & Strudwick Incorporated. Incorporated by reference to the correspondingly numbered exhibit to our Post-Effective Amendment No. 1 to our Registration Statement on Form S-1 (File No. <u>333-150513</u> ) filed August 6, 2008.   |

**Table of Contents**

- 4.6 Form of Unit Certificate. Incorporated by reference to the correspondingly numbered exhibit to our Post-Effective Amendment No. 1 to our Registration Statement on Form S-1 (File No. 333-150513) filed August 6, 2008.
- 4.8 Letter Agreement dated August 1, 2008 among Homeowners Choice, Inc., Anderson & Strudwick, Incorporated and GunnAllen Financial, Inc., whereby we waive certain cancellation rights under warrants issued to the other parties. Incorporated by reference to the correspondingly numbered exhibit to our Post-Effective Amendment No. 1 to our Registration Statement on Form S-1 (File No. 333-150513) filed August 6, 2008.
- 4.9 See Exhibits 3.1 and 3.2 of this report for provisions of the Articles of Incorporation, as amended, and our Bylaws, as amended, defining certain rights of security holders. See also Exhibits 10.6 and 10.7 defining certain rights of the recipients of stock options and other equity-based awards.
- 10.1 Executive Agreement dated May 1, 2007 between Homeowners Choice, Inc. and Francis X. McCahill, III. Incorporated by reference to the correspondingly numbered exhibit to our Registration Statement on Form S-1 (File No. 333-150513), originally filed April 30, 2008, effective July 24, 2008, as amended.
- 10.5 Consulting Agreement dated June 1, 2007 between Homeowners Choice, Inc. and Scorpio Systems, Inc. Incorporated by reference to the correspondingly numbered exhibit to our Registration Statement on Form S-1 (File No. 333-150513), originally filed April 30, 2008, effective July 24, 2008, as amended. See amendment to Consulting Agreement at Exhibit 10.12.
- 10.6 Homeowners Choice, Inc. 2007 Stock Option and Incentive Plan. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed August 29, 2008.
- 10.7 Form of Incentive Stock Option Agreement. Incorporated by reference to the correspondingly numbered exhibit to our Registration Statement on Form S-1 (File No. 333-150513), originally filed April 30, 2008, effective July 24, 2008, as amended.
- 10.9 Software License Agreement executed April 8, 2009 with an effective date of November 1, 2007 by and between Homeowners Choice, Inc. and Scorpio Systems, Inc. Incorporated by reference to the correspondingly numbered exhibit to our Registration Statement on Form S-1 (File No. 333-150513), originally filed April 30, 2008, effective July 24, 2008, as amended.

**Table of Contents**

- 10.10 PR-M Non-Bonus Assumption Agreement dated December 1, 2007 by and between Homeowners Choice Property & Casualty Insurance Company, Inc. and Citizens Property Insurance Corporation. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 30, 2010.
- 10.11 Service Contract for Homeowners Claims Handling dated January 29, 2010, but effective January 1, 2010, by and between Homeowners Choice Managers, Inc. and Johns Eastern Company, Inc. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 30, 2010.
- 10.12 Amendment dated August 21, 2008 to Consulting Agreement dated June 1, 2007 between Homeowners Choice, Inc. and Scorpio Systems, Inc. Incorporated by reference to Exhibit 10.12 to Form 8-K filed August 21, 2008.
- 10.13 Excess Catastrophe Reinsurance Contract effective June 1, 2010 by Homeowners Choice Property and Casualty Insurance Company, Inc. and Subscribing Reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed August 13, 2010.
- 10.14 Reinstatement Premium Protection Agreement effective June 1, 2010 by Homeowners Choice Property and Casualty Insurance Company, Inc. and Subscribing Reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed August 13, 2010.
- 10.15 Aggregate Excess Catastrophe Reinsurance Agreement dated June 1, 2010 by Homeowners Choice Property and Casualty Insurance Company, Inc. and Subscribing Reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed August 13, 2010.
- 10.17 Form of indemnification agreement for our officers and directors. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed August 12, 2009.

**Table of Contents**

- 10.18 Lease Agreement dated April 8, 2008 between 2340 Drew St, LLC and Homeowners Choice, Inc. Incorporated by reference to the correspondingly numbered exhibit to our Registration Statement on Form S-1 (File No. 333-150513), originally filed April 30, 2008, effective July 24, 2008, as amended.
- 10.19 Reimbursement Contract effective June 1, 2010 between Homeowners Choice Property and Casualty Insurance Company and the State Board of Administration which administers the Florida Hurricane Catastrophe Fund. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed August 13, 2010.
- 31.1 Certification of the Chief Executive Officer
- 31.2 Certification of the Chief Financial Officer
- 32.1 Written Statement of the Chief Executive Officer Pursuant to 18 U.S.C.ss.1350
- 32.2 Written Statement of the Chief Financial Officer Pursuant to 18 U.S.C.ss.1350

**Table of Contents**

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, who has signed this report on behalf of the Company.

HOMEOWNERS CHOICE, INC.

November 12, 2010

By /s/ Francis X. McCahill III  
Francis X. McCahill III  
President and Chief Executive Officer  
(Principal Executive Officer)

November 12, 2010

By /s/ Richard R. Allen  
Richard R. Allen  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

A signed original of this document has been provided to Homeowners Choice, Inc. and will be retained by Homeowners Choice, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.