

Homeowners Choice, Inc.  
Form 10-Q  
August 14, 2012  
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**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 June 30, 2012**

**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.)

**5300 West Cypress Street, Suite 100**

**Tampa, FL 33607**

(Address, including zip code of principal executive offices)

**(813) 405-3600**

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

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 August 7, 2012 was 9,425,551.

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**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

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**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)**

|  | At June 30, 2012<br>(Unaudited) | At December 31, 2011 |
|--|---------------------------------|----------------------|
| <b>Assets</b>  |                                 |                      |
| Investments:   |                                 |                      |
| Fixed-maturity securities, available-for-sale, at fair value (amortized cost \$38,363 and \$34,147)  | \$ 40,141                       | 34,642               |
| Equity securities, available-for-sale, at fair value   | 8,669                           | 5,207                |
| Time deposits  | 7,184                           | 12,427               |
| Other investments  | 15,636                          | 6,483                |
| <b>Total investments</b>   | <b>71,630</b>                   | <b>58,759</b>        |
| Cash and cash equivalents  | 131,088                         | 100,355              |
| Accrued interest and dividends receivable  | 546                             | 408                  |
| Premiums receivable  | 20,738                          | 12,222               |
| Assumed reinsurance balances receivable  |                                 | 1,687                |
| Prepaid reinsurance premiums   | 26,484                          | 14,169               |
| Deferred policy acquisition costs  | 12,476                          | 12,321               |
| Property and equipment, net  | 10,586                          | 10,499               |
| Goodwill   | 161                             | 161                  |
| Income taxes receivable  | 4,900                           |                      |
| Deferred income taxes  |                                 | 2,368                |
| Other assets   | 2,220                           | 1,869                |
| <b>Total assets</b>  | <b>\$ 280,829</b>               | <b>214,818</b>       |
| <b>Liabilities and Stockholders' Equity</b>  |                                 |                      |
| Losses and loss adjustment expenses  | 37,313                          | 27,424               |
| Unearned premiums  | 120,429                         | 108,677              |
| Advance premiums   | 9,004                           | 2,132                |
| Assumed reinsurance balances payable   | 1,389                           |                      |
| Accrued expenses   | 4,439                           | 3,478                |
| Deferred income taxes  | 1,877                           |                      |
| Dividends payable  | 104                             | 218                  |
| Income taxes payable   |                                 | 4,956                |
| Other liabilities  | 8,273                           | 4,103                |
| <b>Total liabilities</b>   | <b>182,828</b>                  | <b>150,988</b>       |
| <b>Stockholders' equity:</b>   |                                 |                      |
| 7% Series A cumulative convertible preferred stock (liquidation preference \$10.00 per share), no par value, 1,500,000 shares authorized, 592,324 and 1,247,700 shares issued and outstanding in 2012 and 2011, respectively |                                 |                      |
| Preferred stock (no par value, 18,500,000 shares authorized, no shares issued or outstanding)  |                                 |                      |

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Common stock, (no par value, 40,000,000 shares authorized, 9,205,097 and 6,202,485 shares issued and outstanding in 2012 and 2011, respectively)

|  |            |         |
|--|------------|---------|
| Additional paid-in capital                 | 51,742     | 29,636  |
| Retained earnings                          | 45,179     | 33,986  |
| Accumulated other comprehensive income     | 1,080      | 208     |
| Total stockholders' equity                 | 98,001     | 63,830  |
| Total liabilities and stockholders' equity | \$ 280,829 | 214,818 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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

|  | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2012</b>                            | <b>2011</b> | <b>2012</b>                          | <b>2011</b> |
| <b>Revenue</b>                                     |  |             |                                      |             |
| Gross premiums earned                              | \$ 53,772                              | 31,218      | 108,470                              | 62,114      |
| Premiums ceded                                     | (17,497)                               | (14,174)    | (31,826)                             | (28,396)    |
| Net premiums earned                                | 36,275                                 | 17,044      | 76,644                               | 33,718      |
| Net investment income                              | 302                                    | 507         | 824                                  | 1,071       |
| Policy fee income                                  | 1,028                                  | 667         | 1,543                                | 854         |
| Realized investment gains                          | 9                                      | 140         | 30                                   | 293         |
| Gain on bargain purchase                           | 179                                    | 936         | 179                                  | 936         |
| Other  | 1,062                                  | 187         | 1,287                                | 658         |
| Total revenue                                      | 38,855                                 | 19,481      | 80,507                               | 37,530      |
| <b>Expenses</b>                                    |  |             |                                      |             |
| Losses and loss adjustment expenses                | 16,197                                 | 10,523      | 35,365                               | 20,926      |
| Policy acquisition and other underwriting expenses | 5,915                                  | 2,780       | 12,500                               | 7,043       |
| Other operating expenses                           | 4,734                                  | 2,357       | 9,252                                | 4,484       |
| Total expenses                                     | 26,846                                 | 15,660      | 57,117                               | 32,453      |
| Income before income taxes                         | 12,009                                 | 3,821       | 23,390                               | 5,077       |
| Income taxes                                       | 4,747                                  | 1,520       | 9,160                                | 1,983       |
| Net income   | \$ 7,262                               | 2,301       | 14,230                               | 3,094       |
| Preferred stock dividends                          | (63)                                   | (361)       | (244)                                | (378)       |
| Income available to common stockholders            | \$ 7,199                               | 1,940       | 13,986                               | 2,716       |
| Basic earnings per common share                    | \$ .85                                 | .32         | 1.89                                 | .44         |
| Diluted earnings per common share                  | \$ .74                                 | .30         | 1.60                                 | .43         |
| Dividends per common share                         | \$ .20                                 | .10         | .35                                  | .20         |

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See accompanying Notes to Condensed Consolidated Financial Statements.

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

|  | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2012</b>                            | <b>2011</b> | <b>2012</b>                          | <b>2011</b> |
| Net income                                       | \$ 7,262                               | 2,301       | 14,230                               | 3,094       |
| Other comprehensive income:                      |  |             |                                      |             |
| Change in unrealized gain (loss) on investments: |  |             |                                      |             |
| Unrealized gain arising during the period        | 175                                    | 285         | 1,449                                | 267         |
| Reclassification adjustment for realized gains   | (9)                                    | (140)       | (30)                                 | (293)       |
| Net change in unrealized gain (loss)             | 166                                    | 145         | 1,419                                | (26)        |
| Deferred income taxes on above change            | (64)                                   | (56)        | (547)                                | 10          |
| Total other comprehensive income (loss)          | 102                                    | 89          | 872                                  | (16)        |
| Comprehensive income                             | \$ 7,364                               | 2,390       | 15,102                               | 3,078       |

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>Six Months Ended<br/>June 30,</b> |                |
|--|--------------------------------------|----------------|
|  | <b>2012</b>                          | <b>2011</b>    |
| <b>Cash flows from operating activities:</b>   |                                      |                |
| Net income   | \$ 14,230                            | 3,094          |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |                                      |                |
| Stock-based compensation   | 212                                  | 19             |
| Net amortization of premiums on investments in fixed-maturity securities                 | 111                                  | 61             |
| Depreciation and amortization  | 637                                  | 158            |
| Deferred income taxes  | 3,698                                | 2,026          |
| Realized gains on sales of investments   | (30)                                 | (293)          |
| Gain on bargain purchase   | (179)                                | (936)          |
| <b>Changes in operating assets and liabilities:</b>                                      |                                      |                |
| Premiums receivable  | (8,516)                              | (4,441)        |
| Assumed reinsurance balances receivable  | 1,687                                | 26             |
| Advance premiums   | 6,872                                | 5,786          |
| Prepaid reinsurance premiums   | (12,315)                             | 8,921          |
| Accrued interest and dividends receivable  | (138)                                | (6)            |
| Income taxes receivable  | (4,900)                              | (3,033)        |
| Other assets   | (445)                                | (476)          |
| Assumed reinsurance balances payable   | 1,389                                | 51             |
| Deferred policy acquisition costs  | (155)                                | (655)          |
| Losses and loss adjustment expenses  | 9,889                                | 2,827          |
| Unearned premiums  | 11,752                               | 5,496          |
| Income taxes payable   | (4,956)                              | (310)          |
| Accrued expenses and other liabilities   | 5,131                                | 4,568          |
| <b>Net cash provided by operating activities</b>   | <b>23,974</b>                        | <b>22,883</b>  |
| <b>Cash flows from investing activities:</b>   |                                      |                |
| Cash consideration paid for acquired business, net of cash acquired                      | (8,157)                              | (5,110)        |
| Purchase of property and equipment, net  | (480)                                | (1,843)        |
| Purchase of other investments  | (967)                                |                |
| Purchase of fixed-maturity securities  | (6,710)                              | (14,165)       |
| Purchase of equity securities  | (4,844)                              | (5,330)        |
| Proceeds from sales, calls and repayments of fixed-maturity securities                   | 2,419                                | 19,614         |
| Proceeds from sales of equity securities   | 1,512                                | 1,106          |
| Decrease (increase) in time deposits, net  | 5,243                                | (273)          |
| <b>Net cash used in investing activities</b>   | <b>(11,984)</b>                      | <b>(6,001)</b> |
| <b>Cash flows from financing activities:</b>   |                                      |                |
| Net proceeds from the issuance of common stock   | 20,082                               |                |
| Net proceeds from the issuance of preferred stock  |                                      | 11,307         |
| Proceeds from the exercise of common stock options                                       |                                      | 363            |
| Proceeds from the exercise of common stock warrants                                      | 1,375                                |                |

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|  |            |         |
|--|------------|---------|
| Cash dividends paid                                    | (3,151)    | (1,382) |
| Repurchases of common stock                            |            | (1,887) |
| Excess tax benefit from common stock options exercised | 437        | 124     |
| Net cash provided by financing activities              | 18,743     | 8,525   |
| Net increase in cash and cash equivalents              | 30,733     | 25,407  |
| Cash and cash equivalents at beginning of period       | 100,355    | 54,849  |
| Cash and cash equivalents at end of period             | \$ 131,088 | 80,256  |

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**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

**Condensed Consolidated Statements of Cash Flows, continued**

**(Unaudited)**

**(Dollars in thousands)**

|  | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--------------------------------------|-------------|
|  | <b>2012</b>                          | <b>2011</b> |
| <b>Supplemental disclosure of cash flow information:</b>                           |                                      |             |
| Cash paid for income taxes   | \$ 14,880                            | 3,176       |
| Cash paid for interest   | \$                                   |             |
| <b>Non-cash investing activities:</b>  |                                      |             |
| Unrealized gain (loss) on investments in available for sale securities, net of tax | \$ 872                               | (16)        |
| Fair value of net assets acquired in connection with business acquisition          | \$ 8,267                             | 5,685       |

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Condensed Consolidated Statement of Stockholders' Equity****Six Months Ended June 30, 2012****(Dollars in thousands, except share amounts)**

|   | Preferred Stock |        | Common Stock |        | Additional | Retained | Accumulated   |         |
|---|-----------------|--------|--------------|--------|------------|----------|---------------|---------|
|   | Shares          | Amount | Shares       | Amount | Paid-In    | Earnings | Other         | Total   |
|   |                 |        |              |        | Capital    |          | Comprehensive |         |
|   |                 |        |              |        |            |          | Income        |         |
| Balance at December 31, 2011  | 1,247,700       | \$     | 6,202,485    | \$     | 29,636     | 33,986   | 208           | 63,830  |
| Net Income (unaudited)  |                 |        |              |        |            | 14,230   |               | 14,230  |
| Change in unrealized gain on available-for-sale securities, net of income taxes (unaudited) |                 |        |              |        |            |          | 872           | 872     |
| Exercise of common stock options (unaudited)  |                 |        | 145,594      |        |            |          |               |         |
| Exercise of common stock warrants (unaudited)   |                 |        | 161,642      |        | 1,375      |          |               | 1,375   |
| Excess tax benefit from stock options exercised (unaudited)                                 |                 |        |              |        | 437        |          |               | 437     |
| Conversion of preferred stock to common stock (unaudited)                                   | (655,376)       |        | 655,376      |        |            |          |               |         |
| Issuance of Restricted Stock (unaudited)  |                 |        | 200,000      |        | 153        |          |               | 153     |
| Issuance of Common Stock (unaudited)  |                 |        | 1,840,000    |        | 20,082     |          |               | 20,082  |
| Common stock dividends (unaudited)  |                 |        |              |        |            | (2,793)  |               | (2,793) |
| Preferred stock dividends (unaudited)   |                 |        |              |        |            | (244)    |               | (244)   |
| Stock-based compensation (unaudited)  |                 |        |              |        | 59         |          |               | 59      |
| Balance at June 30, 2012 (unaudited)  | 592,324         | \$     | 9,205,097    | \$     | 51,742     | 45,179   | 1,080         | 98,001  |

See accompanying Notes to Condensed Consolidated Financial Statements.

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**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) 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 June 30, 2012 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, 2012. 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, 2011 included in the Company's Form 10-K, which was filed with the SEC on March 30, 2012.

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, the recoverability of deferred policy acquisition costs, and the determination of deferred 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.

***Acquisition Accounting.*** The Company accounts for business combinations using the acquisition method, which requires an allocation of the purchase price of an acquired entity to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. Goodwill represents the excess of the purchase price over the net tangible and intangible assets acquired. In the event the net assets acquired exceed the purchase price, the Company will recognize a gain on bargain purchase.

(continued)

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**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

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

**(unaudited)**

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

**Goodwill.** Goodwill is not amortized. Rather, the Company is required to test goodwill for impairment at least annually or sooner in the event there are changes in circumstances indicating the asset may be impaired. The Company's goodwill relates to a business acquisition completed in the fourth quarter of 2011. The Company plans to perform its goodwill impairment test in the fourth quarter of each year beginning with the fourth quarter in 2012. Thus, the Company did not recognize any impairment charges in the three and six months ended June 30, 2012.

**Foreign Currency.** The functional currency of the Company's Indian subsidiary is the U.S. dollar. As such, the monetary assets and liabilities of this subsidiary are remeasured into U.S. dollars at the exchange rate in effect on the balance sheet date. Non-monetary assets and liabilities are remeasured using historical rates. Expenses recorded in the local currency are remeasured at the prevailing exchange rate. Exchange gains and losses resulting from these remeasurements are included in the results of operations.

**Stock-based Compensation.** The Company accounts for stock-based compensation under the fair value recognition provisions of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 718 Compensation Stock Compensation, which requires the measurement and recognition of compensation for all stock-based awards made to employees and directors including stock options and restricted stock issuances based on estimated fair values. In accordance with ASC Topic 718, the fair value of stock-based awards is amortized over the requisite service period, which is defined as the period during which an employee is required to provide service in exchange for an award. The Company uses a straight-line attribution method for all grants that include only a service condition. The Company's restricted stock awards include both service and market conditions. As a result, certain restricted stock grants are expensed over the derived service period for each separately vesting tranche.

**Basic and diluted earnings per common share.** Basic earnings per common share is computed by dividing net income attributable to common stockholders by the weighted-average number of common shares outstanding for the period. ASC Topic 260 requires the inclusion of restricted stock as participating securities since holders of the Company's restricted stock have the right to share in dividends, if declared, equally with common stockholders. During periods of net income, participating securities are allocated a proportional share of net income determined by dividing total weighted-average participating securities by the sum of total weighted-average common shares and participating securities (the two-class method). Diluted earnings per common share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted. Potentially dilutive securities at June 30, 2012 consisted of stock options, common stock warrants, restricted stock, and the 7.0% Series A cumulative convertible preferred stock issued March 25, 2011 (see Note 10 Stockholders Equity).

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

(continued)

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**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

**Note 2 Recent Accounting Pronouncements**

**Accounting Standards Update No. 2011-11.** In December 2011, the FASB issued Accounting Standards Update No. 2011-11 ( ASU 2011-11 ), *Balance Sheet (Topic 210), Disclosures about Offsetting Assets and Liabilities*. The objective of ASU 2011-11 is to enhance disclosures required by GAAP by requiring improved information about financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with Section 210-20-45 or Section 815-10-45. This information will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position. The amendments in ASU 2011-11 are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by ASU 2011-11 retrospectively for all comparative periods presented. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

**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 ASU 2010-26 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 can be applied prospectively upon adoption. Retrospective or prospective application is permitted. Early adoption is permitted, but only at the beginning of an entity's annual reporting period. The Company adopted ASU 2010-26 effective January 1, 2012 on a prospective basis. As such, the Company recognized additional amortization expense of \$1.2 million with a corresponding decrease in deferred acquisition costs as of the date of adoption. This one-time adjustment reduced our net income for the six months ended June 30, 2012 by approximately \$741,000, or \$0.09 earnings per diluted common share. In addition, certain direct marketing, compensation, and other administrative costs will no longer be deferred. Rather, such costs will be expensed as incurred beginning January 1, 2012.

(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(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 June 30, 2012 and December 31, 2011, 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>June 30, 2012</u></b>                       |                   |                             |                             |               |
| <i>Fixed-maturity Securities:</i>                 |                   |                             |                             |               |
| U.S. Treasury and U.S. government agencies        | \$ 516            | 56                          |                             | 572           |
| Corporate bonds                                   | 12,274            | 316                         | (104)                       | 12,486        |
| Commercial mortgage-backed securities             | 10,797            | 627                         | (1)                         | 11,423        |
| State, municipalities, and political subdivisions | 10,279            | 698                         |                             | 10,977        |
| Other   | 4,497             | 186                         |                             | 4,683         |
| Total   | \$ 38,363         | 1,883                       | (105)                       | 40,141        |
| <i>Equity securities</i>                          | \$ 8,690          | 274                         | (295)                       | 8,669         |
| <b><u>December 31, 2011</u></b>                   |                   |                             |                             |               |
| <i>Fixed-maturity Securities:</i>                 |                   |                             |                             |               |
| U.S. Treasury and U.S. government agencies        | \$ 509            | 47                          |                             | 556           |
| Corporate bonds                                   | 10,199            | 58                          | (417)                       | 9,840         |
| Commercial mortgage-backed securities             | 10,574            | 314                         | (14)                        | 10,874        |
| State, municipalities, and political subdivisions | 9,982             | 393                         | (3)                         | 10,372        |
| Other   | 2,883             | 117                         |                             | 3,000         |
| Total   | \$ 34,147         | 929                         | (434)                       | 34,642        |
| <i>Equity securities</i>                          | \$ 5,364          | 133                         | (290)                       | 5,207         |

(continued)



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

The scheduled maturities of fixed-maturity securities at June 30, 2012 are as follows (in thousands):

|  | Amortized Cost | Fair Value |
|--|----------------|------------|
| <b>Available-for-sale</b>              |                |            |
| Due in one year or less                | \$ 2,397       | 2,420      |
| Due after one year through five years  | 9,408          | 9,517      |
| Due after five years through ten years | 10,895         | 11,392     |
| Due after ten years                    | 4,866          | 5,389      |
| Commercial mortgage-backed securities  | 10,797         | 11,423     |
|  | \$ 38,363      | 40,141     |

**Investment Sales**

Proceeds received, and the gross realized gains and losses from sales of available for sale securities, for the three and six months ended June 30, 2012 and 2011 were as follows (in thousands):

|   | Proceeds  | Gross Realized Gains | Gross Realized Losses |
|---|-----------|----------------------|-----------------------|
| <u>Three months ended June 30, 2012</u> |           |                      |                       |
| Fixed-maturity securities               | \$ 1,197  | 11                   |                       |
| Equity securities                       | \$ 1,412  | 8                    | (10)                  |
| <u>Three months ended June 30, 2011</u> |           |                      |                       |
| Fixed-maturity securities               | \$ 11,916 | 238                  | (15)                  |
| Equity securities                       | \$ 574    | 53                   | (136)                 |
| <u>Six months ended June 30, 2012</u>   |           |                      |                       |
| Fixed-maturity securities               | \$ 2,419  | 40                   | (3)                   |
| Equity securities                       | \$ 1,512  | 8                    | (15)                  |
| <u>Six months ended June 30, 2011</u>   |           |                      |                       |
| Fixed-maturity securities               | \$ 19,614 | 369                  | (38)                  |

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|                   |          |     |       |
|-------------------|----------|-----|-------|
| Equity securities | \$ 1,106 | 105 | (143) |
|-------------------|----------|-----|-------|

Amounts reported for the three and six months ended June 30, 2011 include the gross realized gains and losses from equity option contracts. During the three and six months ended June 30, 2011, 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 \$22,000 and \$73,000 and realized gains of \$22,000 and \$73,000 for the three and six months ended June 30, 2011, respectively, which is included in the realized investment gains in the Condensed Consolidated Statements of Income. There were no open option contracts at June 30, 2011. The Company held no option contracts during the three and six months ended June 30, 2012.

(continued)

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

The Company regularly reviews its individual investment securities for other-than-temporary impairment ( OTTI ). The Company considers various factors in determining whether each individual security is OTTI, 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 June 30, 2012, aggregated by investment category and length of time the individual securities have been in a continuous loss position, are as follows (in thousands):

|  | Less than Twelve Months     |               | Twelve Months<br>or<br>Greater |               | Total                       |               |
|--|-----------------------------|---------------|--------------------------------|---------------|-----------------------------|---------------|
|  | Gross<br>Unrealized<br>Loss | Fair<br>Value | Gross<br>Unrealized<br>Loss    | Fair<br>Value | Gross<br>Unrealized<br>Loss | Fair<br>Value |
| <b><u>As of June 30, 2012</u></b>          |                             |               |                                |               |                             |               |
| <i>Fixed-maturity securities</i>           |                             |               |                                |               |                             |               |
| Corporate Bonds                            | \$ (5)                      | 839           | (99)                           | 1,938         | (104)                       | 2,777         |
| Commercial mortgage-backed securities      | (1)                         | 224           |                                |               | (1)                         | 224           |
| <b>Total fixed-maturity securities</b>     | <b>(6)</b>                  | <b>1,063</b>  | <b>(99)</b>                    | <b>1,938</b>  | <b>(105)</b>                | <b>3,001</b>  |
| <i>Equity securities</i>                   | (123)                       | 2,559         | (172)                          | 109           | (295)                       | 2,668         |
| <b>Total available-for-sale securities</b> | <b>\$ (129)</b>             | <b>3,622</b>  | <b>(271)</b>                   | <b>2,047</b>  | <b>(400)</b>                | <b>5,669</b>  |

(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(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 or market conditions 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 June 30, 2012.

***Other Investments***

Other investments consist primarily of real estate and the related assets and operations of the marina acquired in 2011 and the real estate and related assets of the marina and restaurant facilities acquired in 2012. Operating activities related to the Company's real estate investments include leasing of office and retail space to tenants, wet and dry boat storage, a restaurant, and fuel services with respect to marina clients and other recreational boaters.

Other investments consist of the following as of June 30, 2012 and December 31, 2011 (in thousands):

|  | At June 30, 2012 | At December 31, 2011 |
|--|------------------|----------------------|
| Building                                       | \$ 2,788         | 1,418                |
| Land   | 10,619           | 4,438                |
| Land improvements                              | 1,307            | 283                  |
| Other  | 1,076            | 404                  |
| Total, at cost                                 | 15,790           | 6,543                |
| Less accumulated depreciation and amortization | (154)            | (60)                 |
| Other investments                              | \$ 15,636        | 6,483                |

(continued)

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**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(unaudited)**

**Note 4 Fair Value Measurements**

Fair values of the Company's available-for-sale fixed-maturity securities are determined in accordance with ASC 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 fixed-maturity 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.

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.

(continued)

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

The following table presents information about the Company's available-for-sale securities measured at fair value as of June 30, 2012 and December 31, 2011, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (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 June 30, 2012</u></b>                 |  |   |  |        |
| <i>Fixed-maturity securities</i>                  |  |   |  |        |
| U.S. Treasury and U.S. government agencies        | \$ 572   |   |  | 572    |
| Corporate bonds                                   | 12,486   |   |  | 12,486 |
| Commercial mortgage-backed securities             |  | 11,423  |  | 11,423 |
| State, municipalities, and political subdivisions | 10,977   |   |  | 10,977 |
| Other   | 4,221  | 462   |  | 4,683  |
| Total fixed-maturity securities                   | 28,256   | 11,885  |  | 40,141 |
| <i>Equity securities</i>                          | 8,669  |   |  | 8,669  |
| Total available-for-sale securities               | \$ 36,925  | 11,885  |  | 48,810 |
| <b><u>As of December 31, 2011</u></b>             |  |   |  |        |
| <i>Fixed-maturity securities</i>                  |  |   |  |        |
| U.S. Treasury and U.S. government agencies        | \$ 556   |   |  | 556    |
| Corporate bonds                                   | 9,840  |   |  | 9,840  |
| Commercial mortgage-backed securities             |  | 10,874  |  | 10,874 |
| State, municipalities, and political subdivisions | 10,372   |   |  | 10,372 |
| Other   | 2,735  | 265   |  | 3,000  |
| Total fixed-maturity securities                   | 23,503   | 11,139  |  | 34,642 |
| <i>Equity securities</i>                          | 5,207  |   |  | 5,207  |
| Total available-for-sale securities               | \$ 28,710  | 11,139  |  | 39,849 |

With respect to the Company's business acquisition completed in April 2012 (see Note 5), all assets acquired and liabilities assumed were valued based on Level 3 measurements. Property, plant and equipment was valued based on an external appraisal using the sales comparison approach and other unobservable inputs. The carrying amounts of all other assets and liabilities approximated their fair values at the acquisition date.

There were no transfers between Level 1, 2 or 3 during the six months ended June 30, 2012 or the year ended December 31, 2011.

(continued)



**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, Continued****(unaudited)****Note 5 Business Acquisition**

Effective April 2, 2012, the Company, through its subsidiary, HCI Holdings LLC, acquired the assets and operations of John's Pass Marina, Inc. and Rice Family Holdings LLLP. The property consists primarily of ten acres of waterfront property and land improvements, which include a waterfront restaurant and a marina facility purchased for approximately \$8.2 million. Operating activities at acquisition include the restaurant as well as wet boat storage for approximately 13 clients, and fuel services with respect to marina clients and other recreational boaters. The Treasure Island, Florida property and operations were acquired to further strengthen and diversify the Company's property portfolio and business operations.

The fair value of the net assets acquired was approximately \$8.3 million, which exceeded the \$8.2 million purchase price. As a result, the Company recognized a gain on bargain purchase in the amount of \$179,000 (\$119,000 net of tax), which is included in operations for the three and six months ended June 30, 2012. The recorded gain is subject to adjustment as the Company will continue to evaluate the purchase price allocation during the measurement period. The following table summarizes the Company's preliminary allocation of the net consideration paid to the fair value of the assets acquired, identifiable intangible assets acquired and liabilities assumed at April 2, 2012 (in thousands):

|  |          |
|--|----------|
| Property, plant and equipment                | \$ 8,280 |
| Other assets                                 | 56       |
| Cash   | 9        |
| Deferred tax liability                       | (60)     |
| <br>   |          |
| Fair value of net assets acquired            | 8,285    |
| Gain on bargain purchase, net of tax of \$60 | (119)    |
| <br>   |          |
| Cash consideration paid                      | \$ 8,166 |

For the three and six months ended June 30, 2012, the effects of this acquisition were not material to the Company's condensed consolidated financial statements and basic and diluted earnings per share and, as such, pro forma information has not been presented.

(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(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 (in thousands):

|                         | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|-------------------------|--|-------------|--------------------------------------|-------------|
|                         | <b>2012</b>                            | <b>2011</b> | <b>2012</b>                          | <b>2011</b> |
| <b>Premiums Written</b> |  |             |                                      |             |
| Direct                  | \$ 83,669                              | 54,838      | 121,842                              | 69,961      |
| Assumed                 | (342)                                  | (157)       | (1,620)                              | (2,351)     |
| Gross written           | 83,327                                 | 54,681      | 120,222                              | 67,610      |
| Ceded                   | (17,497)                               | (14,174)    | (31,826)                             | (28,396)    |
| Net premiums written    | \$ 65,830                              | 40,507      | 88,396                               | 39,214      |
| <b>Premiums Earned</b>  |  |             |                                      |             |
| Direct                  | \$ 39,873                              | 29,160      | 73,171                               | 57,147      |
| Assumed                 | 13,899                                 | 2,058       | 35,299                               | 4,967       |
| Gross earned            | 53,772                                 | 31,218      | 108,470                              | 62,114      |
| Ceded                   | (17,497)                               | (14,174)    | (31,826)                             | (28,396)    |
| Net premiums earned     | \$ 36,275                              | 17,044      | 76,644                               | 33,718      |

During the three and six months ended June 30, 2012 and 2011, there were no recoveries pertaining to reinsurance contracts that were deducted from losses incurred. At June 30, 2012 and December 31, 2011, prepaid reinsurance premiums related to 31 and 18 reinsurers, respectively, and there were no amounts receivable with respect to reinsurers. Thus, there were no concentrations of credit risk associated with reinsurance receivables and prepaid reinsurance premiums as of June 30, 2012 and December 31, 2011.

(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 expenses, anticipated future claim development and losses incurred, but not reported.

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

|                              | <b>Three Months Ended<br/>June 30,</b> |                | <b>Six Months Ended<br/>June 30,</b> |                 |
|------------------------------|--|----------------|--------------------------------------|-----------------|
|                              | <b>2012</b>                            | <b>2011</b>    | <b>2012</b>                          | <b>2011</b>     |
| Balance, beginning of period | \$ 33,476                              | 24,050         | 27,424                               | 22,146          |
| Incurred related to:         |  |                |                                      |                 |
| Current period               | 15,995                                 | 6,696          | 34,401                               | 15,432          |
| Prior period                 | 202                                    | 3,827          | 964                                  | 5,494           |
| <b>Total incurred</b>        | <b>16,197</b>                          | <b>10,523</b>  | <b>35,365</b>                        | <b>20,926</b>   |
| Paid related to:             |  |                |                                      |                 |
| Current period               | (8,691)                                | (6,475)        | (13,082)                             | (8,128)         |
| Prior period                 | (3,669)                                | (3,125)        | (12,394)                             | (9,971)         |
| <b>Total paid</b>            | <b>(12,360)</b>                        | <b>(9,600)</b> | <b>(25,476)</b>                      | <b>(18,099)</b> |
| Balance, end of period       | \$ 37,313                              | 24,973         | 37,313                               | 24,973          |

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.

(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, Continued****(unaudited)****Note 8 Income Taxes**

During the three and six months ended June 30, 2012, the Company recorded approximately \$4.7 million and \$9.2 million, respectively, of income taxes, which resulted in estimated annual effective tax rates of approximately 40% and 39%, respectively. During the three and six months ended June 30, 2011, the Company recorded approximately \$1.5 million and \$2.0 million, respectively, of income taxes, which resulted in estimated annual effective tax rates of approximately 40% and 39%, 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.

**Note 9 Earnings Per Share**

Topic 260 of the FASB Accounting Standards Codification requires the Company to use the two-class method in computing basic earnings per share since holders of the Company's restricted stock have the right to share in dividends, if declared, equally with common stockholders. These participating securities have the effect of diluting both basic and diluted earnings per share during periods of net income.

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

|   | For the Three Months Ended<br>June 30, 2012 |                         |                     | For the Three Months Ended<br>June 30, 2011 |                         |                     |
|---|---|-------------------------|---------------------|---|-------------------------|---------------------|
|   | Income<br>(Numerator)                       | Shares<br>(Denominator) | Per-Share<br>Amount | Income<br>(Numerator)                       | Shares<br>(Denominator) | Per-Share<br>Amount |
| Net income  | \$ 7,262                                    |                         |                     | \$ 2,301                                    |                         |                     |
| Less: Preferred stock dividends                       | (63)  |                         |                     | (361)                                       |                         |                     |
| Less: Income attributable to participating securities | (87)  |                         |                     |   |                         |                     |

**Basic Earnings Per Share**

|  |       |       |         |       |       |         |
|--|-------|-------|---------|-------|-------|---------|
| Income allocated to common stockholders - basic earnings per share | 7,112 | 8,325 | \$ 0.85 | 1,940 | 6,071 | \$ 0.32 |
|--|-------|-------|---------|-------|-------|---------|

**Effect of Dilutive Securities**

|                             |    |     |  |     |       |  |
|-----------------------------|----|-----|--|-----|-------|--|
| Stock options               |    | 215 |  |     | 411   |  |
| Convertible preferred stock | 63 | 705 |  | 361 | 1,248 |  |
| Warrants                    |    | 406 |  |     |       |  |

**Diluted Earnings Per Share**

|   |          |       |         |          |       |         |
|---|----------|-------|---------|----------|-------|---------|
| Income available to common stockholders and assumed conversions | \$ 7,175 | 9,651 | \$ 0.74 | \$ 2,301 | 7,730 | \$ 0.30 |
|---|----------|-------|---------|----------|-------|---------|

(continued)

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

|   | For the Six Months Ended<br>June 30, 2012 |                         |                     | For the Six Months Ended<br>June 30, 2011 |                         |                     |
|---|---|-------------------------|---------------------|---|-------------------------|---------------------|
|   | Income<br>(Numerator)                     | Shares<br>(Denominator) | Per-Share<br>Amount | Income<br>(Numerator)                     | Shares<br>(Denominator) | Per-Share<br>Amount |
| Net income  | \$ 14,230                                 |                         |                     | \$ 3,094                                  |                         |                     |
| Less: Preferred stock dividends                       | (244)                                     |                         |                     | (378)                                     |                         |                     |
| Less: Income attributable to participating securities | (105)                                     |                         |                     |   |                         |                     |

**Basic Earnings Per Share**

|  |        |       |         |       |       |         |
|--|--------|-------|---------|-------|-------|---------|
| Income allocated to common stockholders basic earnings per share | 13,881 | 7,326 | \$ 1.89 | 2,716 | 6,121 | \$ 0.44 |
|--|--------|-------|---------|-------|-------|---------|

**Effect of Dilutive Securities**

|                             |     |     |  |     |     |  |
|-----------------------------|-----|-----|--|-----|-----|--|
| Stock options               |     | 229 |  |     | 425 |  |
| Convertible preferred stock | 244 | 956 |  | 378 | 669 |  |
| Warrants                    |     | 303 |  |     |     |  |

**Diluted Earnings Per Share**

|   |           |       |         |          |       |         |
|---|-----------|-------|---------|----------|-------|---------|
| Income available to common stockholders and assumed conversions | \$ 14,125 | 8,814 | \$ 1.60 | \$ 3,094 | 7,215 | \$ 0.43 |
|---|-----------|-------|---------|----------|-------|---------|

For the three and six months ended June 30, 2011, 1,738,335 warrants to purchase 905,001 shares of common stock were excluded from the computation of diluted earnings per share because the exercise price of \$9.10 exceeded the average market price of the Company's common stock.

**Note 10 Stockholders Equity****Common Stock**

On April 19, 2012, the Company entered into an underwriting agreement (the "Underwriting Agreement") pursuant to which the Company agreed to sell 1,600,000 shares of the Company's common stock, no par value per share (the "Common Stock"), for \$11.75 per share, less a 6.0% underwriting commission. Under the terms of the Underwriting Agreement, the Company granted the underwriter an option to purchase up to an additional 240,000 shares of Common Stock at the public offering price, less a 6.0% underwriting commission, within 45 days from the date of the Underwriting Agreement to cover over-allotments, if any. The offering was made pursuant to the Company's effective registration statement on Form S-3, as amended (Registration Statement No. 333-180322), and the Prospectus Supplement dated April 19, 2012. On April 23, 2012, the underwriter elected to fully exercise its over-allotment option. The closing of the sale of an aggregate of 1,840,000 shares of Common Stock occurred on April 25, 2012. The offering resulted in aggregate gross proceeds to the Company of approximately \$21.6 million and net proceeds

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of approximately \$20.1 million after underwriting commissions and offering expenses.

(continued)

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

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. During the three months ended March 31, 2011, the Company repurchased and retired a total of 83,594 shares at an average price of \$8.23 per share and a total cost, inclusive of fees and commissions, of \$693,000, or \$8.29 per share.

As of March 28, 2011, the maximum amount designated for repurchases under this plan was expended and the share repurchase program was terminated.

**Common Stock Warrants**

At June 30, 2012, the Company has reserved 1,187,237 shares of common stock for issuance upon the exercise of its common stock warrants. A summary of the warrants outstanding at June 30, 2012 is presented below:

|  | <b>Number Of<br/>Warrants<br/>Outstanding</b> | <b>Number of<br/>Common<br/>Shares<br/>Issuable<br/>Upon<br/>Conversion<br/>of Warrants<br/>Outstanding</b> |
|--|---|---|
| Warrants issued with IPO units   | 1,666,668                                     | 833,334   |
| Warrants issued to the Company's placement agents net of forfeitures and repurchases | 71,667  | 71,667  |
| Warrants issued in 2011*   | 1,000,000                                     | 500,000   |
| Warrants outstanding at December 31, 2011  | 2,738,335                                     | 1,405,001   |
| Exercise of warrants issued with IPO units   | (302,194)                                     | (151,097)   |
| Exercise of placement agent warrants   | (66,667)                                      | (66,667)  |
| Warrants outstanding at June 30, 2012  | 2,369,474                                     | 1,187,237   |

\* In connection with the HomeWise assumption transaction in November 2011, the Company issued 1,000,000 warrants, which may be exercised to purchase 500,000 shares of the Company's common stock at a per share exercise price of \$9.10.

The warrants issued prior to 2011 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



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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. During the six months ended June 30, 2012, 10,546 shares of common stock were issued upon the cashless exercise of 66,667 warrants in February.

(continued)

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

The fair value of warrants issued in 2011 was estimated on the date of issuance using the following assumptions and the Black-Scholes option pricing model:

|  |          |
|--|----------|
| Expected volatility                                | 52%      |
| Risk-free interest rate                            | .23%     |
| Expected dividend yield                            | 5.00%    |
| Expected life (in years)                           | 1.75     |
| Per share grant date fair value of warrants issued | \$ 0.754 |

The Company is amortizing the \$754,000 aggregate value of the warrants over the expected policy term of the policies assumed in the transaction. The warrants, the issuance of which is not registered or required to be registered under the Securities Act of 1933, are exercisable for a term beginning on November 1, 2011 through July 31, 2013 unless cancelled earlier at the Company's option under the terms specified by the warrant agreement.

***Preferred Stock***

In March 2011 the Company designated 1,500,000 shares of the Company's preferred stock as Series A cumulative convertible preferred stock (Series A Preferred).

On March 25, 2011, the Company closed its preferred stock offering under which a total of 1,247,700 shares of its Series A Preferred were sold for gross proceeds of approximately \$12.5 million and net proceeds after offering costs of approximately \$11.3 million. Dividends on the Series A Preferred will be cumulative from the date of original issue and will accrue on the last day of each month, at an annual rate of 7.0% of the \$10 liquidation preference per share, equivalent to a fixed annual amount of \$0.70 per share. Accrued but unpaid dividends will accumulate and earn additional dividends at 7.0%, compounded monthly.

Shareholders of Series A Preferred may convert all or any portion of their shares, at their option, at any time, into shares of the Company's common stock at an initial conversion rate of one share of common stock for each share of Series A Preferred, which is equivalent to an initial conversion price of \$10 per share; provided, however, that the Company may terminate this conversion right on or after March 31, 2014, if for at least twenty trading days within any period of thirty consecutive trading days, the market price of the Company's common stock exceeds the conversion price of the Series A Preferred by more than 20% and our common stock is then traded on the New York Stock Exchange, the NASDAQ Global Select Market, the NASDAQ Global Market, the NASDAQ Capital Market, or the NYSE Amex. Under certain circumstances, the Company will be required to adjust the conversion rate. The initial conversion price of \$10 per share is subject to proportionate adjustment in the event of stock splits, reverse stock splits, stock dividends, or similar changes with respect to the Company's common stock.

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**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

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

**(unaudited)**

**Note 10 Stockholders Equity, continued**

During the three and six months ended June 30, 2012, holders of 454,235 and 655,376 shares of Series A Preferred converted their Series A Preferred shares to 454,235 and 655,376 shares of common stock, respectively. There were no preferred stock conversions during the three and six months ended June 30, 2011. As of June 30, 2012, 592,324 shares of Series A Preferred remain outstanding.

Shareholders of record of the Company's Series A Preferred at the close of business on a date for determining shareholders entitled to dividends will be entitled to receive the dividends payable on their Series A Preferred shares on the corresponding dividend payment date notwithstanding the conversion of such Series A Preferred shares before the dividend payment date. The Series A Preferred terms include a provision requiring such shareholders to pay an amount equal to the amount of the dividend payable. That requirement has been permanently waived by the Company.

Holders of the Series A Preferred shares generally have no voting rights, except under limited circumstances, and holders are entitled to receive cumulative preferential dividends when and as declared by the Company's Board of Directors.

In addition, the Company is authorized to issue up to an additional 18,500,000 shares of preferred stock, no par value. The authorized but unissued and undesignated 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 subject to the rights of the holders of the Series A Preferred.

On May 31, 2012, the Company's Board of Directors declared a cash dividend on its Series A Preferred shares in the amount of \$0.05833 per share for each of the months of July, August, and September 2012. The July 2012 dividend is payable July 27, 2012 to shareholders of record at the close of business on July 2, 2012. The August 2012 dividend is payable August 27, 2012 to shareholders of record at the close of business on August 1, 2012. The September 2012 dividend is payable September 27, 2012 to shareholders of record at the close of business on September 4, 2012.

(continued)

**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, Continued****(unaudited)****Note 11 Stock-Based Compensation****2007 Stock Option and Incentive 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 ( 2007 Plan ) provided for granting of stock-based compensation to employees, directors, consultants, and advisors of the Company. Under the 2007 Plan, an aggregate of 6,000,000 shares of the Company's common stock could be granted to include stock options and restricted stock. On April 20, 2012, the Company's Board of Directors adopted, subject to shareholder approval, the 2012 Omnibus Incentive Plan (the 2012 Plan ). The 2012 Plan was approved by Shareholders effective May 24, 2012 at which time the 2007 Plan was terminated and the remaining 4,604,800 shares reserved for future issuance were cancelled. The aggregate number of shares of the Company's common stock reserved and available for issuance pursuant to awards granted under the 2012 Plan is 5,000,000 of which only 4,000,000 shares of our common stock may be issued upon the exercise of incentive stock options. At June 30, 2012, no shares have been granted and 5,000,000 shares are available for grant under the 2012 Plan.

**Stock Options**

Outstanding stock options granted under the 2007 Plan 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 2007 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, 2011 | 620,000              | \$ 2.97                                   |  |                                 |
| Exercised                        | (217,003)            | 3.33                                      |  |                                 |
| Outstanding at June 30, 2012     | 402,997              | 2.78                                      | 5.3 years  | \$ 5,971                        |
| Exercisable at June 30, 2012     | 382,997              | \$ 2.60                                   | 5.1 years  | \$ 5,745                        |

At June 30, 2012, there was approximately \$35,000 of unrecognized compensation expense related to nonvested stock-based compensation related to stock options granted under the 2007 Plan, which the Company expects to recognize over a weighted-average period of 22 months. The total fair value of shares vesting and recognized as compensation expense was approximately \$6,000 and \$59,000, respectively, for the three and six month periods ended June 30, 2012. There was no associated income tax benefit recognized in 2012 with respect to the compensation expense related to



**Table of Contents****HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements, Continued****(unaudited)****Note 11 Stock-Based Compensation, continued**

stock options. During the six months ended June 30, 2012, a total of 217,003 options were exercised and net settled by surrender of 71,409 shares. The total intrinsic value of the options exercised during the six months ended June 30, 2012 was \$1,470,101 and the associated income tax benefit recognized was approximately \$437,000. The total fair value of shares vesting and recognized as compensation expense was approximately \$9,400 and \$18,600, respectively, for the three and six month periods ended June 30, 2011. There was no associated income tax benefit recognized with respect to the share compensation expense in 2011. The total intrinsic value of the 145,200 options exercised during the six months ended June 30, 2011 was \$684,220 and the income tax benefit recognized was \$168,000.

No stock options were granted during the three and six month periods ended June 30, 2012 and 2011.

***Restricted Stock Awards***

During the three months ended June 30, 2012, the Company granted restricted stock awards to certain executive officers in connection with their service to the Company. The terms of the Company's restricted stock grants include both service and market-based conditions. The fair value of the awards with market-based conditions is determined using a Monte Carlo simulation method which calculates many potential outcomes for an award and then establishes fair value based on the most likely outcome. The determination of fair value with respect to the awards with only service-based conditions is based on the value of the Company's stock on the grant date.

Information with respect to unvested restricted stock awards, which were granted in April and May 2012 under the Company's 2007 Plan, is as follows:

|                                  | <b>Number of<br/>Restricted<br/>Stock<br/>Awards</b> | <b>Weighted-<br/>Average<br/>Grant<br/>Date Fair<br/>Value</b> |
|----------------------------------|--|--|
| Outstanding at December 31, 2011 |  |  |
| Issued                           | 200,000  | \$ 12.91   |
| Outstanding at June 30, 2012     | 200,000  | \$ 12.91   |

At June 30, 2012, there was approximately \$2.4 million of total unrecognized compensation expense related to nonvested restricted stock arrangements granted under the Company's 2007 Plan. The Company expects to recognize the remaining compensation expense over a weighted-average period of 42 months.

No restricted stock was granted during the three and six months ended June 30, 2011.

(continued)



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**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

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

**(unaudited)**

**Note 12 Commitments and Contingencies**

In connection with the Company's April 20, 2011 acquisition of the marina property located in Pinellas County, Florida, the Company assumed the liability to complete a site assessment and remediation of environmental contamination that resulted from a petroleum release at the marina site in late 2009. The Company and its environmental consultants have assumed the remedial action work plan developed by prior management and its environmental consultant, which consists of completing the site assessment, performing soil excavation, and installing wells for collection of groundwater and soil samples throughout the monitoring phase of the project. At acquisition, the Company recorded a liability of \$150,000 with respect to the planned remedial action. Such liability was determined based on reasonably estimable costs of completing the actions defined in the existing ongoing work plan. As of June 30, 2012, a total of \$32,000 has been expended with respect to the site assessment and the remaining \$118,000 accrued at acquisition is included in other liabilities in the accompanying condensed consolidated balance sheets. Although the Company has accrued all reasonably estimable costs of completing the actions defined in the current ongoing work plan, it is possible that additional testing and additional environmental monitoring and remediation will be required in the near future as part of the Company's ongoing discussions with the Florida Department of Health, the agency contracted by the Florida Department of Environmental Protection to administer cases of petroleum contamination in Pinellas County, in which case additional expenses could significantly exceed the current estimated liability. However, based on information known at June 30, 2012, the Company does not expect that such additional expenses would have a material adverse effect on the liquidity or financial condition of the Company.

**Note 13 Related Party Transaction**

On June 1, 2012, Claddaugh Casualty Insurance Company, Ltd. ( Claddaugh ), the Company's Bermuda-based captive reinsurer, entered into a reinsurance treaty with Moksha Re SPC Ltd. and multiple capital partners ( Moksha ) whereby a portion of the business assumed from the Company's insurance subsidiary, Homeowners Choice Property & Casualty Insurance Company, Inc. ( HCPC ), is ceded by Claddaugh to Moksha. With respect to the 2012-2013 treaty year, which covers the period from June 1, 2012 through May 31, 2013, Moksha assumed \$13.8 million of the total covered exposure for approximately \$4.0 million in premiums, a rate which management believes to be competitive with market rates available to Claddaugh. The \$4.0 million premium was fully paid by Claddaugh in June 2012. Moksha capital partners deposited an aggregate of \$9.8 million into a trust account along with the \$4.0 million premium paid by Claddaugh to fully collateralize Moksha's exposure. Trust assets may be withdrawn by HCPC, the trust beneficiary, in the event amounts are due under the 2012-2013 Moksha reinsurance agreement. Among the Moksha capital partner participants, the Company's chief executive officer and the Company's vice president of investor relations contributed \$700,000 and \$200,000, respectively. In addition, members of the chief executive officer's immediate family contributed \$942,500. The remaining capital partner participants, who are multiple parties unrelated to the Company, contributed the balance of \$7,960,000.

(continued)



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**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES**

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

**(unaudited)**

**Note 14 Subsequent Event**

On July 25, 2012, the Company's Board of Directors declared a quarterly dividend on its common shares of \$0.20 per share. The dividend will be paid September 21, 2012 to shareholders of record at the close of business August 17, 2012.

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**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, 2012. 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 June 30, 2012, we had total assets of \$280.8 million and stockholders equity of \$98.0 million. Our net income was approximately \$7.3 million and \$14.2 million, respectively, for the three and six months ended June 30, 2012. Income available to common stockholders was approximately \$7.2 million and \$14.0 million, respectively, for the three and six months ended June 30, 2012.

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We began operations in June 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. Policies were assumed in eight separate assumption transactions which took place from July 2007 through December 2010. In November 2011, we completed an assumption transaction with HomeWise Insurance Company ( HomeWise ) through which we acquired the Florida policies of HomeWise. Substantially all of our premium revenue since inception has come from the policies acquired in these assumption transactions. Our current policies in force represent approximately \$220 million in annualized premiums. Through the Citizens assumptions and HomeWise acquisition, we have been able to increase our geographic diversification within the state of Florida.

We strive to retain these policies by offering competitive rates to our policyholders at premiums we consider commensurate with the risk.

We face various challenges to implementing our operating and growth strategies. Since our policies cover Florida homeowners, condominium owners, and tenants, we cover losses that may arise from, among other things, catastrophes such as hurricanes, tropical storms and tornadoes, which could have a significant effect on our business, results of operations, and financial condition. To mitigate our risk of such catastrophic losses, we cede a portion of our exposure to reinsurers 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. We believe recent trends in the competitive environment in Florida however, such as a de-emphasis of Florida property risk by large national insurers and efforts by the state of Florida to reduce exposure at Citizens, bode well for our competitive position in the market.

## **Recent Developments**

Effective June 1, 2012, we entered into excess catastrophe reinsurance treaties, which provide approximately \$531 million of coverage through non-affiliates for aggregate losses and loss adjustment expenses per event during the 2012-2013 hurricane season. We expect to be charged approximately \$96.0 million in annual premiums with respect to these new reinsurance treaties, with such costs to be recognized over the reinsurance treaty period covering June 1, 2012 through May 31, 2013. In comparison, our reinsurance treaties covering the 2011-2012 hurricane season provided \$345 million of coverage through non-affiliates for aggregate losses and loss adjustment expenses per event at a cost to us of approximately \$55 million, which we recognized over the period from June 1, 2011 through May 31, 2012. The increase in reinsurance premiums applicable to the 2012-13 reinsurance treaty year primarily results from the increase in exposure as a result of our acquisition of the Florida HomeWise policies in November 2011. Our reinsurance costs are expected to be approximately 43% to 45% of gross earned premiums during the period from June 1, 2012 through May 31, 2013.

**Table of Contents****RESULTS OF OPERATIONS**

The following table summarizes our results of operations for the three and six months ended June 30, 2012 and 2011 (dollars in thousands, except per share amounts):

|  | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|--|--------------------------------|----------|------------------------------|----------|
|  | 2012                           | 2011     | 2012                         | 2011     |
| <b>Operating Revenue</b>                           |                                |          |                              |          |
| Gross premiums earned                              | \$ 53,772                      | 31,218   | 108,470                      | 62,114   |
| Premiums ceded                                     | (17,497)                       | (14,174) | (31,826)                     | (28,396) |
| Net premiums earned                                | 36,275                         | 17,044   | 76,644                       | 33,718   |
| Net investment income                              | 302                            | 507      | 824                          | 1,071    |
| Policy fee income                                  | 1,028                          | 667      | 1,543                        | 854      |
| Realized investment gains                          | 9                              | 140      | 30                           | 293      |
| Gain on bargain purchase                           | 179                            | 936      | 179                          | 936      |
| Other Income                                       | 1,062                          | 187      | 1,287                        | 658      |
| Total operating revenue                            | 38,855                         | 19,481   | 80,507                       | 37,530   |
| <b>Operating Expenses</b>                          |                                |          |                              |          |
| Losses and loss adjustment expenses                | 16,197                         | 10,523   | 35,365                       | 20,926   |
| Policy acquisition and other underwriting expenses | 5,915                          | 2,780    | 12,500                       | 7,043    |
| Other operating expenses                           | 4,734                          | 2,357    | 9,252                        | 4,484    |
| Total operating expenses                           | 26,846                         | 15,660   | 57,117                       | 32,453   |
| Income before income taxes                         | 12,009                         | 3,821    | 23,390                       | 5,077    |
| Income taxes                                       | 4,747                          | 1,520    | 9,160                        | 1,983    |
| Net income   | \$ 7,262                       | 2,301    | 14,230                       | 3,094    |
| Preferred stock dividends                          | (63)                           | (361)    | (244)                        | (378)    |
| Income available to common stockholders            | \$ 7,199                       | 1,940    | 13,986                       | 2,716    |
| <b>Ratios to Net Premiums Earned:</b>              |                                |          |                              |          |
| Loss Ratio   | 44.65%                         | 61.74%   | 46.14%                       | 62.06%   |
| Expense Ratio                                      | 29.36%                         | 30.14%   | 28.38%                       | 34.19%   |
| Combined Ratio                                     | 74.01%                         | 91.88%   | 74.52%                       | 96.25%   |
| <b>Ratios to Gross Premiums Earned:</b>            |                                |          |                              |          |
| Loss Ratio   | 30.12%                         | 33.71%   | 32.60%                       | 33.69%   |
| Expense Ratio                                      | 19.80%                         | 16.46%   | 20.05%                       | 18.56%   |
| Combined Ratio                                     | 49.92%                         | 50.17%   | 52.65%                       | 52.25%   |
| <b>Per Share Data:</b>                             |                                |          |                              |          |
| Basic earnings per common share                    | \$ .85                         | .32      | 1.89                         | .44      |

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|                                   |    |     |     |      |     |
|-----------------------------------|----|-----|-----|------|-----|
| Diluted earnings per common share | \$ | .74 | .30 | 1.60 | .43 |
|-----------------------------------|----|-----|-----|------|-----|

**Table of Contents*****Comparison of the Three Months ended June 30, 2012 to the Three Months ended June 30, 2011***

Our results of operations for the three months ended June 30, 2012 reflect income available to common stockholders of \$7.2 million, or \$0.74 earnings per diluted common share, compared to income available to common stockholders of \$1.9 million, or \$0.30 earnings per diluted common share, for the three months ended June 30, 2011.

**Revenue**

*Gross Premiums Earned* for the three months ended June 30, 2012 were \$53.8 million and principally reflect the revenue from policies acquired from HomeWise and policies originally acquired from Citizens. The policies acquired from HomeWise in November 2011 contributed approximately \$13.9 million to our gross premiums earned for the three months ended June 30, 2012. Gross premiums earned for the three months ended June 30, 2011 were \$31.2 million and principally reflect the revenue from policies assumed from Citizens.

*Premiums Ceded* for the three months ended June 30, 2012 and 2011 were approximately \$17.5 million and \$14.2 million, respectively. Our premiums ceded represent amounts paid to reinsurers to cover losses from catastrophes that exceed the thresholds defined by our catastrophe excess of loss reinsurance treaties. Our reinsurance rates are based primarily on policy exposures reflected in gross premiums earned. Premiums ceded were 32.5% and 45.4% of gross premiums earned during the three months ended June 30, 2012 and 2011, respectively. The decrease in 2012 is primarily due to lower costs during the first two months of the quarter related to policies assumed from HomeWise in November 2011, which were subject to minimal reinsurance premiums. We anticipate our reinsurance cost will range from 43% to 45% of gross premiums earned for the reinsurance treaty year beginning in June 2012.

*Net Premiums Earned* for the three months ended June 30, 2012 and 2011 were \$36.3 million and \$17.0 million, respectively, and reflect the gross premiums earned less the appropriate reinsurance costs as described above. Net premiums earned increased by \$19.3 million in 2012 as compared to 2011 as a result of the \$22.6 million increase in gross premiums earned and the \$3.3 million increase in premiums ceded.

*Net Premiums Written* during the three months ended June 30, 2012 and 2011 totaled \$65.8 million and \$40.5 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 June 30, 2012 and 2011 (dollars in thousands):

|                               | <b>Three Months Ended<br/>June 30,</b> |               |
|-------------------------------|--|---------------|
|                               | <b>2012</b>                            | <b>2011</b>   |
| Net Premiums Written          | \$ 65,830                              | 40,507        |
| Increase in Unearned Premiums | (29,555)                               | (23,463)      |
| <b>Net Premiums Earned</b>    | <b>\$ 36,275</b>                       | <b>17,044</b> |

*Net Investment Income* for the three months ended June 30, 2012 and 2011 was \$0.3 million and \$0.5 million, respectively. There were no other-than-temporary impairments recorded during the three months ended June 30, 2012 and 2011.

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*Realized Investment Gains* for the three months ended June 30, 2012 and 2011 of \$9,000 and \$140,000, respectively, reflect the net gain realized from sales of securities during the period.

*Policy Fee Income* for the three months ended June 30, 2012 and 2011 was \$1.0 million and \$0.7 million, respectively, and reflects the policy fee income we earn with respect to our issuance of renewal policies.

*Gain on Bargain Purchase* was \$179,000 (\$119,000 net of tax), or \$0.02 diluted earnings per common share, for the three months ended June 30, 2012. The bargain purchase gain relates to our business acquisition completed in April 2012. In the prior year, we had a gain on bargain purchase of \$936,000 (\$575,000 net of tax), or \$0.07 diluted earnings per common share, related to our business acquisition completed in April 2011.

*Other Income* for the three months ended June 30, 2012 and 2011 was \$1.1 million and \$0.2 million, respectively. During the three months ended June 30, 2012, other income is primarily related to approximately \$0.2 million of rental income from our Tampa office building and approximately \$0.9 million from nonrecurring items. During the three months ended June 30, 2011, other income is primarily related to rental income from our Tampa office building.

**Expenses**

*Our Losses and Loss Adjustment Expenses* amounted to \$16.2 million and \$10.5 million, respectively, during the three months ended June 30, 2012 and 2011. Our losses for the three months ended June 30, 2012 include approximately \$2.0 million related to 274 claims from Tropical Storm Debby, which occurred in June 2012. Our losses and loss adjustment expense reserves are more fully described below under the *Expenses* comparative for the six months ended June 30, 2012 and 2011 and, additionally, under *Critical Accounting Policies and Estimates* below.

*Policy Acquisition and Other Underwriting Expenses* for the three months ended June 30, 2012 and 2011 of \$5.9 million and \$2.8 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.

*Other Operating Expenses* for the three months ended June 30, 2012 and 2011 were \$4.7 million and \$2.4 million, respectively. The \$2.3 million increase is primarily attributable to a \$1.3 million increase in compensation and related expenses and a \$1.0 million increase in our other administrative costs, which include a variety of professional service fees, license fees, corporate insurances, lease expense, information system expense, and other general expenses. As of June 30, 2012, we had 121 employees located at our headquarters in Tampa, Florida compared to 88 employees as of June 30, 2011. We also have 63 employees located in Noida, India at June 30, 2012 versus none at June 30, 2011.

*Income Taxes* for the three months ended June 30, 2012 and 2011 were \$4.7 million and \$1.5 million, respectively, for state and federal income taxes resulting in an effective tax rate of 39.5% for 2012 and 39.8% for 2011.

**Ratios:**

The loss ratio applicable to the three months ended June 30, 2012 (loss and loss adjustment expenses related to net premiums earned) was 44.7% compared to 61.7% for the three months ended June 30, 2011.

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The expense ratio applicable to the three months ended June 30, 2012 (policy acquisition and other underwriting expenses related to net premiums earned plus compensation, employee benefits, and other operating expenses) was 29.4% compared to 30.1% for the three months ended June 30, 2011.

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 June 30, 2012 was 74.0% compared to 91.9% for the three months ended June 30, 2011.

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 June 30, 2012 was 49.9% compared to 50.2% for the three months ended June 30, 2011.

### ***Comparison of the Six Months ended June 30, 2012 to the Six Months ended June 30, 2011***

Our results of operations for the six months ended June 30, 2012 reflect income available to common stockholders of \$14.0 million, or \$1.60 earnings per diluted common share, compared to income available to common stockholders of \$2.7 million, or \$0.43 earnings per diluted common share, for the six months ended June 30, 2011. Our results for the six months ended June 30, 2012 and 2011 include bargain purchase gains on acquisitions of \$179,000 (\$119,000 net of tax) and \$936,000 (\$575,000 net of tax), respectively, or \$0.02 and \$0.08 diluted earnings per common share, respectively.

## **Revenue**

*Gross Premiums Earned* for the six months ended June 30, 2012 were \$108.5 million and reflect the revenue from policies acquired from HomeWise and policies originally assumed from Citizens. The policies acquired from HomeWise in November 2011 contributed approximately \$35.3 million to our gross premiums earned for the six months ended June 30, 2012. Gross premiums earned for the six months ended June 30, 2011 were \$62.1 million and principally reflect the revenue from policies assumed from Citizens.

*Premiums Ceded* for the six months ended June 30, 2012 and 2011 were \$31.8 million and \$28.4 million, respectively. Our premiums ceded represent amounts paid to reinsurers to cover losses from catastrophes that exceed the thresholds defined by our catastrophe excess of loss reinsurance treaties. Our reinsurance rates are based primarily on policy exposures reflected in gross premiums earned. Premiums ceded were 29.3% and 45.7% of gross premiums earned during the six months ended June 30, 2012 and 2011, respectively. The decrease in 2012 is primarily due to lower costs during the first five months of 2012 related to policies assumed from HomeWise, which were subject to minimal reinsurance premiums. We anticipate our reinsurance cost will range from 43% to 45% of gross premiums earned for the reinsurance treaty year beginning in June 2012.

*Net Premiums Earned* for the six months ended June 30, 2012 and 2011 were \$76.6 million and \$33.7 million, respectively, and reflect the gross premiums earned less reinsurance costs as described above. Net premiums earned increased by \$42.9 million in 2012 as compared to 2011 as a result of the \$46.3 million increase in gross premiums earned and \$3.4 million increase in premiums ceded.



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*Net Premiums Written* during the six months ended June 30, 2012 and 2011 totaled \$88.4 million and \$39.2 million, respectively. Net premiums written represent the premiums charged on policies issued during a fiscal period less reinsurance costs.

The following is a reconciliation of our total Net Premiums Written to Net Premiums Earned for the six months ended June 30, 2012 and 2011 (in thousands):

|                               | <b>Six Months Ended June 30,</b> |               |
|-------------------------------|----------------------------------|---------------|
|                               | <b>2012</b>                      | <b>2011</b>   |
| Net Premiums Written          | \$ 88,396                        | 39,214        |
| Increase in Unearned Premiums | (11,752)                         | (5,496)       |
| <b>Net Premiums Earned</b>    | <b>\$ 76,644</b>                 | <b>33,718</b> |

*Net Investment Income* for the six months ended June 30, 2012 and 2011 was \$0.8 million and \$1.1 million, respectively.

*Policy Fee Income* for the six months ended June 30, 2012 and 2011 was \$1.5 million and \$0.9 million, respectively, and reflects the policy fee income we earn with respect to our issuance of renewal policies.

*Realized Investment Gains* for the six months ended June 30, 2012 and 2011 of \$30,000 and \$293,000, respectively, reflects the net gain realized from sales of securities during the period.

*Gain on Bargain Purchase* was \$179,000 (\$119,000 net of tax), or \$0.02 diluted earnings per common share, and \$936,000 (\$575,000 net of tax), or \$0.08 diluted earnings per common share, for the six months ended June 30, 2012 and 2011, respectively. The bargain purchase gains relates to our business acquisitions completed in April 2012 and in April 2011.

*Other Income* for the six months ended June 30, 2012 and 2011 was \$1.3 million and \$0.7 million, respectively. During the six months ended June 30, 2012, other income is primarily related to approximately \$0.4 million of rental income from our Tampa office building and approximately \$0.9 million from nonrecurring items. During the six months ended June 30, 2011, other income is primarily related to rental income from our Tampa office building.

**Expenses**

Our *Losses and Loss Adjustment Expenses* amounted to \$35.4 million and \$20.9 million, respectively, during the six months ended June 30, 2012 and 2011. Our losses for the six months ended June 30, 2012 include approximately \$2.0 million related to 274 claims from Tropical Storm Debby, which occurred in June 2012.

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 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 \$27.4 million at December 31, 2011 to \$37.3 million at June 30, 2012. The \$9.9 million increase in our Reserves is comprised of \$21.3 million in new reserves specific to the six months ended June 30, 2012 offset by reductions of \$8.8 million and \$2.6 million in our Reserves for

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2011 and 2010 and prior accident years, respectively. The \$21.3 million in Reserves established for 2012 claims is due to the increase in our policy exposure, which resulted in an increase in the amount of reported losses in 2012. The decrease of \$11.4 million specific to our 2011 and 2010 and prior accident-year reserves is due to favorable development arising from lower than expected loss development during 2012 relative to expectations used to establish our Reserve estimates at the end of 2011. 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 six months ended June 30, 2012 and 2011 were \$12.5 million and \$7.0 million, respectively, and 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 \$5.5 million increase in 2012 is primarily attributable to an increase in our commissions and premium taxes for policy renewals combined with the one-time, \$1.2 million adjustment specific to our adoption in January 2012 of Financial Accounting Standards Board Accounting Standards Update No. 2010-26 (see Note 2 Recent Accounting Pronouncements to the unaudited condensed consolidated financial statements).

*Other Operating Expenses* for the six months ended June 30, 2012 and 2011 were \$9.3 million and \$4.5 million, respectively. The \$4.8 million increase is primarily attributable to a \$2.4 million increase in compensation and related expenses and a \$2.4 million increase in our administrative costs, which include a variety of professional service fees, license fees, corporate insurances, lease expense, information system expense, and other general expenses. As of June 30, 2012, we had 121 employees located at our headquarters in Tampa, Florida compared to 88 employees as of June 30, 2011. We also have 63 employees located in Noida, India at June 30, 2012 versus none at June 30, 2011.

*Income Taxes* for the six months ended June 30, 2012 and 2011 were \$9.2 million and \$2.0 million, respectively, for state and federal income taxes resulting in an effective tax rate of 39.2% for 2012 and 39.1% for 2011.

**Ratios:**

The loss ratio applicable to the six months ended June 30, 2012 (loss and loss adjustment expenses related to net premiums earned) was 46.1% compared to 62.1% for the six months ended June 30, 2011.

The expense ratio applicable to the six months ended June 30, 2012 (policy acquisition and other underwriting expenses related to net premiums earned plus compensation, employee benefits, and other operating expenses) was 28.4% compared to 34.2% for the six months ended June 30, 2011 (see *Other Operating Expenses* above).

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 six months ended June 30, 2012 was 74.5% compared to 96.3% for the six months ended June 30, 2011.

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 six months ended June 30, 2012 was 52.7% compared to 52.3% for the six months ended June 30, 2011.

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

Our insurance business is seasonal as hurricanes and tropical storms typically occur during the period from June 1 through November 30 each year. With our reinsurance treaty year effective June 1 each year, any variation in the cost of our reinsurance, whether due to changes in reinsurance rates or changes in the total insured value of our policy base, will occur and be reflected in our financial results beginning June 1 each year.

### **LIQUIDITY AND CAPITAL RESOURCES**

Since inception, our liquidity requirements have been met through issuance of our common and preferred 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 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.

### ***Common Stock***

On April 19, 2012, we entered into an underwriting agreement (the "Underwriting Agreement") pursuant to which we agreed to sell 1,600,000 shares of the Company's common stock, no par value per share (the "Common Stock"), for \$11.75 per share, less a 6.0% underwriting commission. Under the terms of the Underwriting Agreement, we granted the underwriter an option to purchase up to an additional 240,000 shares of Common Stock at the public offering price, less a 6.0% underwriting commission, within 45 days from the date of the Underwriting Agreement to cover over-allotments, if any. The offering was made pursuant to our effective registration statement on Form S-3, as amended (Registration Statement No. 333-180322), and the Prospectus Supplement dated April 19, 2012. On April 23, 2012, the underwriter elected to fully exercise its overallotment option. The closing of the sale of an aggregate of 1,840,000 shares of Common Stock occurred on April 25, 2012. The offering resulted in aggregate gross proceeds to the Company of approximately \$21.6 million and net proceeds of approximately \$20.1 million after underwriting commissions and offering expenses.

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### *Preferred Stock*

On March 25, 2011, we closed our preferred stock offering under which a total of 1,247,700 shares of our Series A cumulative convertible preferred stock ( Series A Preferred ) were sold for gross proceeds of approximately \$12.5 million and net proceeds after offering costs of approximately \$11.3 million. Dividends on the Series A Preferred are cumulative from the date of original issue and accrue on the last day of each month, at an annual rate of 7.0% of the \$10.00 liquidation preference per share, equivalent to a fixed annual amount of \$0.70 per share. Accrued but unpaid dividends accumulate and earn additional dividends at 7.0%, compounded monthly.

Shareholders of Series A Preferred may convert all or any portion of their shares, at their option, at any time, into shares of the Company's common stock at an initial conversion rate of one share of common stock for each share of Series A Preferred, which is equivalent to an initial conversion price of \$10.00 per share; provided, however, that we may terminate this conversion right on or after March 31, 2014, if for at least twenty trading days within any period of thirty consecutive trading days, the market price of our common stock exceeds the conversion price of the Series A Preferred by more than 20% and our common stock is then traded on the New York Stock Exchange, the NASDAQ Global Select Market, the NASDAQ Global Market, the NASDAQ Capital Market, or the NYSE Amex. Under certain circumstances, we will be required to adjust the conversion rate. The initial conversion price of \$10.00 per share is subject to proportionate adjustment in the event of stock splits, reverse stock splits, stock dividends, or similar changes with respect to our common stock. During the six months ended June 30, 2012, holders of 655,376 shares of Series A Preferred converted their Series A Preferred shares to 655,376 shares of common stock. As of June 30, 2012, 592,324 shares of Series A Preferred remain outstanding. Shareholders of record of our Series A Preferred at the close of business on a date for determining shareholders entitled to dividends will be entitled to receive the dividends payable on their Series A Preferred shares on the corresponding dividend payment date notwithstanding the conversion of such Series A Preferred shares before the dividend payment date. The Series A Preferred terms include a provision requiring such shareholders to pay an amount equal to the amount of the dividend payable. That requirement has been permanently waived by the Company.

The Series A Preferred is not redeemable prior to March 31, 2014. If the Company issues a conversion cancellation notice, the Series A Preferred will be redeemable on or after March 31, 2014 for cash, at our option, in whole or in part, at \$10.00 per share, plus accrued and unpaid dividends to the redemption date. Otherwise, the Series A Preferred will be redeemable for cash, at our option, in whole or in part, at a redemption price equal to \$10.40 per share for redemptions on or after March 31, 2014; \$10.20 per share for redemptions on or after March 31, 2015; and \$10.00 per share for redemptions on or after March 31, 2016 plus accrued and unpaid dividends to the redemption date.

The Series A Preferred shares have no stated maturity and are not subject to any sinking fund or mandatory redemption requirements.

Holders of the Series A Preferred shares generally have no voting rights, except under limited circumstances, and holders are entitled to receive cumulative preferential dividends when and as declared by our Board of Directors.

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*Cash Flows*

Our cash flows from operating, investing and financing activities for the six months ended June 30, 2012 and 2011 are summarized below.

*Cash Flows for the Six months ended June 30, 2012*

Net cash provided by operating activities for the six months ended June 30, 2012 was approximately \$24.0 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 \$12.0 million was primarily due to our business acquisition completed in April 2012 of \$8.2 million, the purchases of available-for-sale securities of \$11.5 million, purchases of other investments of approximately \$1.0 million, and the purchase of \$0.5 million in property and equipment offset by redemptions of time deposits of \$5.2 million, the proceeds from sales of available-for-sale securities of \$3.9 million. Net cash provided by financing activities totaled \$18.7 million, which was primarily due to \$20.1 million from the issuance of common stock and \$1.4 million from the exercise of common stock warrants offset by \$3.2 million in cash dividends paid.

*Cash Flows for the Six months ended June 30, 2011*

Net cash provided by operating activities for the six months ended June 30, 2011 was approximately \$22.9 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 \$6.0 million was primarily due to our business acquisition completed in April 2011. Net cash provided by financing activities totaled \$8.5 million, which was primarily due to \$11.3 million from the issuance of preferred stock offset by \$1.4 million in cash dividends paid and \$1.9 million used to repurchase our common shares.

*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, time deposits (i.e. CDs maturing in more than twelve months), and available-for-sale investments.

At June 30, 2012, we have \$40.1 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 fixed-maturity investments but increases the market value of existing fixed-maturity 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. From time to time, we may have in excess of \$5.5 million of cash designated for investment and on deposit at a single national brokerage firm. 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.

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

As of June 30, 2012 and December 31, 2011, 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 condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The preparation of these condensed 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 June 30, 2012, \$17.3 million of the total \$37.3 million we have reserved for losses and loss adjustment expenses is specific to our estimate of claims incurred but not reported. The remaining \$20.0 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 June 30, 2012, \$8.7 million of the \$20.0 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 June 30, 2012 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 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

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Report on Form 10-K, which we filed with the SEC on March 30, 2012. For the six months ended June 30, 2012, 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 June 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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**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, 2012.

**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*

None.

*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 if our Board of Directors determines to do so.

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 stockholder 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. Additionally, Florida statutes preclude our insurance subsidiary from making dividend payments or distributions to its stockholder, Homeowners Choice, Inc., 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.



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**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 Form 10-K filed March 29, 2011.   |
| 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.  |
| 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. <u>333-150513</u> ) filed August 6, 2008.  |

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- 4.7 Warrant Agreement dated July 30, 2008, between Homeowners Choice, Inc. and GunnAllen Financial, Inc. 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 10.5, 10.6 and 10.7 defining certain rights of the recipients of stock options and other equity-based awards.
- 4.10 Specimen 7% Series A Cumulative Preferred Stock Certificate Incorporated by reference to Exhibit 4.2 to Form 8-A filed March 25, 2011.
- 4.11 Warrant Agreement dated November 2, 2011 between Homeowners Choice, Inc. and Glencoe Acquisition , Inc. as to the issuance of 1,000,000 warrants.
- 10.1 Excess of Loss Retrocession Contract issued to Claddaugh Casualty Insurance Company, Ltd. Incorporated by reference to Exhibit 10.1 to Form 8-K Filed August 13, 2012.
- 10.2 Executive Agreement dated May 1, 2007 between Homeowners Choice, Inc. and Richard R. Allen. 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.
- 10.3 Placement Agreement dated March 25, 2011 between Homeowners Choice, Inc. and Anderson & Strudwick, Incorporated. Incorporated by reference to exhibit 1.1 to our Form 8-K filed March 31, 2011.
- 10.4 Executive Employment Agreement dated July 1, 2011 between Homeowners Choice, Inc. and Paresh Patel. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed August 12, 2011.
- 10.5 Homeowners Choice, Inc. 2012 Omnibus Incentive Plan. Incorporated by reference to Appendix A to our Definitive Proxy Statement on Schedule 14A filed April 27, 2012

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- 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.
- 10.10 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 Reinstatement Premium Protection Agreement effective June 1, 2012 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.
- 10.12 Excess Catastrophe Reinsurance Contract effective June 1, 2012 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.
- 10.13 Excess Catastrophe Reinsurance Contract effective June 1, 2012 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.
- 10.14 Reinstatement Premium Protection Agreement effective June 1, 2012 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.
- 10.15 Aggregate Excess Catastrophe Reinsurance Agreement dated June 1, 2012 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.

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- 10.16 Aggregate Excess Catastrophe Reinsurance Agreement dated June 1, 2012 by Homeowners Choice Property & Casualty Insurance Company, Inc. and Subscribing Reinsurers (Layer B). Portions of this exhibit have been omitted pursuant to a request for confidential treatment.
- 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.
- 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, 2012 between Homeowners Choice Property and Casualty Insurance Company and the State Board of Administration which administers the Florida Hurricane Catastrophe Fund.
- 10.20 Per Occurrence Excess Of Loss Reinsurance contract dated June 1, 2012 by Homeowners Choice Property & Casualty Insurance Company, Inc. and subscribing reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment.
- 10.22 All other perils reinsurance agreement effective January 1, 2012 through May 31, 2012 by and between Homeowners Choice Property & Casualty Insurance Company, Inc. and various reinsurers. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 30, 2012.
- 10.23 Retention bonus agreement dated February 16, 2012 between Homeowners Choice, Inc. and Paresh Patel. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 30, 2012.
- 10.24 Executive Employment Agreement dated March 8, 2012 between Homeowners Choice, Inc. and Scott R. Wallace. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 30, 2012.
- 10.25 Assumption Agreement dated November 2, 2011 by and between Homeowners Choice Property & Casualty Insurance Company, Inc. and HomeWise Insurance Company. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 30, 2012.
- 10.26 Commercial Real Estate Contract dated March 9, 2012 among HCI Holdings LLC and Rice Family Holdings, LLLP, John s Pass Marina, Inc. and Gators on the Pass, Inc. Incorporated by reference to Exhibit 10.26 of our Form 10-Q filed May 14, 2012.
- 10.27 Restricted Stock Agreement dated April 20, 2012 whereby the Company issued 100,000 shares of restricted common stock to Scott R. Wallace. Incorporated by reference to Exhibit 10.27 of our Form 10-Q filed May 14, 2012.
- 10.28 Restricted Stock Agreement dated May 8, 2012 whereby the Company issued 30,000 shares of restricted common stock to Richard R. Allen. Incorporated by reference to Exhibit 10.28 of our Form 8-K filed May 10, 2012.
- 10.29 Restricted Stock Agreement dated May 8, 2012 whereby the Company issued 30,000 shares of restricted common stock to Sanjay Madhu. Incorporated by reference to Exhibit 10.29 of our Form 8-K filed May 10, 2012.
- 10.30 Restricted Stock Agreement dated May 8, 2012 whereby the Company issued 20,000 shares of restricted common stock to Andrew L. Graham. Incorporated by reference to Exhibit 10.30 of our Form 8-K filed May 10, 2012.
- 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

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|---------|---|
| 101.INS | XBRL Instance Document. <sup>(1)</sup>                        |
| 101.SCH | XBRL Taxonomy Extension Schema. <sup>(1)</sup>                |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase. <sup>(1)</sup>  |
| 101.DEF | XBRL Definition Linkbase. <sup>(1)</sup>                      |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase. <sup>(1)</sup>        |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase. <sup>(1)</sup> |

- (1) Pursuant to Rule 406T of U.S. Securities and Exchange Commission Regulation S-T, the interactive data files on Exhibit 101 of this report are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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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.

August 14, 2012

By /s/ Paresh Patel  
Paresh Patel  
Chief Executive Officer  
(Principal Executive Officer)

August 14, 2012

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.