Homeowners Choice, Inc.
Form 10-Q
November 12, 2008
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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 September 30, 2008

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)

Florida	**20-5961396**
(State of Incorporation)	*(IRS Employer Identification No.)*

2340 Drew Street, Suite 200

Clearwater, FL 33765

(Address, including zip code of principal executive offices)

(727) 213-3600

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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. (Check one):

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

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

The aggregate number of shares of the Registrant s Common Stock, no par value, outstanding on November 5, 2008 was 6,888,668.

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HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

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PART I FINANCIAL INFORMATION

ITEM 1 *FINANCIAL STATEMENTS*

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Dollars in thousands)

	At September 30, 2008 (Unaudited)	At December 31, 2007
Assets		
Cash and cash equivalents	$ 26,169	15,729
Short-term investments	26,382	17,055
Accrued interest and dividends receivable	55	60
Premiums receivable	12,888	3,256
Ceded reinsurance balances receivable	2,830	
Assumed reinsurance balances receivable	497	
Deferred policy acquisition costs	5,424	3,163
Office equipment, net	237	36
Deferred income taxes, net	1,161	653
Income taxes receivable	152	
Other assets	223	41
Total assets	$ 76,018	39,993
Liabilities and Stockholders Equity		
Losses and loss adjustment expenses	7,323	1,688
Unearned premiums	34,233	19,814
Ceded reinsurance balances payable		1,060
Assumed reinsurance balances payable		833
Accrued expenses	1,711	832
Income taxes payable		1,266
Other liabilities	733	162
Total liabilities	44,000	25,655
Stockholders equity:		
Preferred stock (no par value 20,000,000 shares authorized, no shares issued or outstanding)		
Common stock, (no par value, 40,000,000 shares authorized, 6,848,668 and 5,182,000 shares issued and outstanding in 2008 and 2007)		
Additional paid-in capital	23,525	13,383
Retained earnings	8,493	955
Total stockholders equity	32,018	14,338
Total liabilities and stockholders equity	$ 76,018	39,993

See accompanying Notes to Condensed Consolidated Financial Statements.

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HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

(Unaudited)

(Dollars in thousands, except per share amounts)

		Three Months Ended September 30,		Nine Months Ended September 30,	
		2008	2007	2008	2007
Revenue					
Net premiums earned	$	8,051	1,692	28,309	1,692
Net investment income		425	203	1,152	314
Other		189		591	
Total revenue		8,665	1,895	30,052	2,006
Expenses					
Losses and loss adjustment expenses		4,565	984	11,011	984
Policy acquisition and other underwriting expenses		2,774	1,182	6,893	1,188
Pre-opening expenses			75		419
Total expenses		7,339	2,241	17,904	2,591
Income (loss) before income taxes		1,326	(346)	12,148	(585)
Income tax expense (benefit)		524	(232)	4,610	(192)
Net income (loss)	$	802	(114)	7,538	(393)
Basic earnings (loss) per share	$	.13	(.02)	1.36	(.12)
Diluted earnings (loss) per share	$	.12	(.02)	1.33	(.12)
Dividends per share	$				

See accompanying Notes to Condensed Consolidated Financial Statements.

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HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

	Nine Months Ended September 30, 2008	2007
Cash flows from operating activities:		
Net income (loss)	$ 7,538	(393)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Stock-based compensation	344	320
Depreciation and amortization	17	1
Deferred income tax benefit	(508)	(344)
Loss on sale of office equipment	1	
Changes in operating assets and liabilities:		
Premiums receivable	(9,632)	(2)
Reinsurance balances receivable	(2,830)	
Assumed reinsurance balances receivable	(497)	
Accrued interest and dividends receivable	5	(102)
Other assets	(182)	(70)
Reinsurance balances payable	(1,893)	1,091
Deferred policy acquisition costs	(2,261)	(817)
Losses and loss adjustment expenses	5,635	734
Unearned premiums	14,419	5,144
Income taxes payable	(1,418)	152
Accrued expenses and other liabilities	1,450	9
Net cash provided by operating activities	10,188	5,723
Cash flows from investing activities:		
Purchase of office equipment, net	(221)	(17)
Proceeds from sale of office equipment	2	
Purchase of short-term investments, net	(9,327)	(2,004)
Net cash used in investing activities	(9,546)	(2,021)
Cash flows from financing activity-		
Net proceeds from sale of common stock and warrants	9,798	12,955
Net increase in cash and cash equivalents	10,440	16,657
Cash and cash equivalents at beginning of period	15,729	1
Cash and cash equivalents at end of period	$ 26,169	16,658
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$ 6,537	

Cash paid for interest	$

See accompanying Notes to Condensed Consolidated Financial Statements.

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HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Condensed Consolidated Statement of Stockholders Equity

Nine Months Ended September 30, 2008

(Dollars in thousands)

	Common stock		Additional Paid-In	Retained	Total Stockholders
	Shares	Amount	Capital	Earnings	Equity
Balance at December 31, 2007	5,182,000	$	13,383	955	14,338
Proceeds from the sale of common stock (unaudited)	1,666,668		7,526		7,526
Common stock warrants (unaudited)			2,272		2,272
Net income (unaudited)				7,538	7,538
Stock-based compensation (unaudited)			344		344
Balance at September 30, 2008 (unaudited)	6,848,668	$	23,525	8,493	32,018

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 Basis of Presentation

The accompanying unaudited, condensed consolidated financial statements for Homeowners Choice, Inc. and its subsidiaries (collectively, the Company), which consist of Homeowners Choice Property & Casualty Insurance Company, Inc., Homeowners Choice Managers, Inc., Southern Administration, Inc., and Claddaugh Casualty Insurance Company, Ltd., 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 and do not include all information and footnotes required by GAAP for complete financial statements. In the opinion of management, the accompanying unaudited interim condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the Company s financial position as of September 30, 2008 and the results of operations and cash flows for the periods presented. The results of operations for interim periods are not necessarily indicative of the results of operations to be expected for the fiscal year ending December 31, 2008 or any other interim period. 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, 2007 included in the Company s Registration Statement on Form S-1 (as amended), which was declared effective by the SEC on July 24, 2008.

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, which would be reflected in future periods.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of loss and loss adjustment expense reserves, the recoverability of deferred policy acquisition costs, the determination of federal income taxes, and the net realizable value of reinsurance recoverables. 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.

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HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements, Continued

(unaudited)

Note 2 Recent Accounting Pronouncements

Effective January 1, 2008, the Company adopted the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157) for financial assets and liabilities, which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. Fair value is defined under SFAS 157 as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the assets or liabilities in an orderly transaction between market participants on the measurement date. Subsequent changes in fair value of these financial assets and liabilities are recognized in earnings or other comprehensive income when they occur. The effective date of the provisions of SFAS 157 for non-financial assets and liabilities, except for items recognized at fair value on a recurring basis, was deferred by FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157 (FSP FAS 157-2), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of FSP FAS 157-2. In addition, on October 10, 2008, the FASB issued FASB Staff Position No. 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active (FAS 157-3). FAS 157-3 clarifies the application of SFAS 157 in a market that is not active and provides factors to take into consideration when determining the fair value of an asset in an inactive market. FAS 157-3 was effective upon issuance, including prior periods for which financial statements have not been issued and did not have an impact on our financial statements. The Company is currently assessing the potential impact that the deferred portions of SFAS 157 will have on its financial statements.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (SFAS 141(R)). SFAS 141(R) is effective for fiscal years beginning after December 15, 2008 and early implementation is not permitted. SFAS 141(R) requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. Acquisition related costs including finder s fees, advisory, legal, accounting valuation and other professional and consulting fees are required to be expensed as incurred. Management is in the process of evaluating the impact of SFAS 141(R) and does not anticipate it will have a material impact on the Company s consolidated financial condition or results of operations.

In December 2007, the FASB issued SFAS No.160, Noncontrolling Interests in Consolidated Financial Statements (SFAS 160). SFAS 160 requires the Company to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. Management is in the process of evaluating the impact of SFAS 160 and does not anticipate it will have a material effect on the Company s consolidated financial condition or results of operations.

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HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements, Continued

(unaudited)

Note 2 Recent Accounting Pronouncements, continued

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (SFAS 161). SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about a) how and why an entity uses derivative instruments, b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. Companies are required to adopt SFAS 161 for fiscal years beginning after November 15, 2008. The Company does not believe the adoption will have a material impact on its consolidated financial statements. Presently, the Company is not involved in any transactions subject to reporting under SFAS 161.

In May 2008, the FASB issued FASB Statement No. 163 (SFAS 163), Accounting for Financial Guarantee Insurance Contracts, an interpretation of SFAS Statement No. 60. SFAS 163 requires that an insurance enterprise recognizes a claim liability prior to an event of default (insured event) when there is evidence that credit deterioration has occurred in an insured financial obligation. SFAS 163 also clarifies how Statement 60 applies to financial guarantee insurance contracts, including the recognition and measurement to be used to account for premium revenue and claim liabilities. Those clarifications will increase comparability in financial reporting of financial guarantee insurance contracts by insurance enterprises. SFAS 163 also requires expanded disclosures about financial guarantee insurance contracts. SFAS 163 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. The Company is currently evaluating the impact, if any, that SFAS 163 will have on its consolidated financial statements. Presently, the Company is not involved in any transactions subject to reporting under SFAS 161.

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HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements, Continued

(unaudited)

Note 3 Fair Value Measurement

Effective January 1, 2008, the Company adopted SFAS No. 157 for financial assets and liabilities. SFAS 157 establishes a framework for measuring fair value, clarifies the definition of fair value and expands disclosures regarding fair value measurements. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the reporting date. SFAS 157 builds on current practice and requirements under existing accounting pronouncements and, accordingly, does not prescribe any new fair value measurements.

SFAS 157 establishes a three-tier hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value as follows:

Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.

Level 3: Unobservable inputs in which there is little or no market data available, which require the reporting entity to develop its own assumptions.

The following table presents information about the Company s assets measured at fair value on a recurring basis as of September 30, 2008, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (dollars in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2008
Short-term investments	$	26,382		26,382

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HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements, Continued

(unaudited)

Note 4 Reinsurance

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,
	2008	2007	