

Homeowners Choice, Inc.
Form 10-Q
August 12, 2011
Table of Contents

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

Form 10-Q

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

For the quarterly period ended June 30, 2011

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)

Edgar Filing: Homeowners Choice, Inc. - Form 10-Q

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) 403-3600

Registrant's telephone number, including area code)

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

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

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

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

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

The aggregate number of shares of the Registrant's Common Stock, no par value, outstanding on August 5, 2011 was 6,111,802.

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

| | | |
|---------------|---|--------------|
| ITEM 1 | <u>FINANCIAL STATEMENTS</u> | Page |
| | <u>Condensed Consolidated Balance Sheets, June 30, 2011 (unaudited) and December 31, 2010</u> | 1 |
| | <u>Condensed Consolidated Statements of Earnings Three and Six Months Ended June 30, 2011 and 2010 (unaudited)</u> | 2 |
| | <u>Condensed Consolidated Statements of Cash Flows Six Months Ended June 30, 2011 and 2010 (unaudited)</u> | 3-4 |
| | <u>Condensed Consolidated Statement of Stockholders' Equity Six Months Ended June 30, 2011 (unaudited)</u> | 5 |
| | <u>Notes to Condensed Consolidated Financial Statements (unaudited)</u> | 6-23 |
| ITEM 2 | <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u> | 24-36 |
| ITEM 3 | <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u> | 36 |
| ITEM 4 | <u>CONTROLS AND PROCEDURES</u> | 37 |

PART II OTHER INFORMATION

| | | |
|----------------|---|--------------|
| ITEM 1 | <u>LEGAL PROCEEDINGS</u> | 37 |
| ITEM 1a | <u>RISK FACTORS</u> | 37 |
| ITEM 2 | <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u> | 38 |
| ITEM 6 | <u>EXHIBITS</u> | 39-42 |
| | <u>SIGNATURES</u> | 43 |
| | <u>CERTIFICATIONS</u> | |

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

| | At June 30, 2011 (Unaudited) | At December 31, 2010 |
|---|---------------------------------|----------------------|
| Assets | | |
| Investments: | | |
| Fixed maturity securities, available-for-sale, at fair value (amortized cost \$23,276 and \$28,456) | \$ 23,404 | 28,564 |
| Equity securities, available-for-sale, at fair value | 5,025 | 884 |
| Time deposits | 14,306 | 14,033 |
| | | |
| Total investments | 42,735 | 43,481 |
| Cash and cash equivalents | 80,256 | 54,849 |
| Accrued interest and dividends receivable | 186 | 180 |
| Premiums receivable | 10,263 | 5,822 |
| Assumed reinsurance balances receivable | | 26 |
| Prepaid reinsurance premiums | 8,866 | 17,787 |
| Deferred policy acquisition costs | 10,062 | 9,407 |
| Income taxes receivable | 3,033 | |
| Property and equipment, net | 15,778 | 7,755 |
| Deferred income taxes | | 584 |
| Other assets | 1,665 | 1,057 |
| | | |
| Total assets | \$ 172,844 | 140,948 |
| Liabilities and Stockholders Equity | | |
| Losses and loss adjustment expenses | 24,973 | 22,146 |
| Unearned premiums | 70,530 | 65,034 |
| Advance premiums | 6,900 | 1,114 |
| Deferred income taxes | 1,432 | |
| Payable for securities purchased | 3,002 | |
| Accrued expenses | 2,848 | 2,385 |
| Assumed reinsurance balances payable | 51 | |
| Dividends payable | 218 | |
| Income taxes payable | | 310 |
| Other liabilities | 4,857 | 3,330 |
| | | |
| Total liabilities | 114,811 | 94,319 |
| | | |
| Stockholders equity: | | |
| 7% Series A cumulative convertible preferred stock (liquidation preference \$10.00 per share), no par value, 1,500,000 shares authorized, 1,247,700 shares issued and outstanding in 2011 | | |
| Preferred stock (no par value 18,500,000 shares authorized, no shares issued or outstanding) | | |

Edgar Filing: Homeowners Choice, Inc. - Form 10-Q

| | | |
|--|---------------|---------------|
| Common stock, (no par value, 40,000,000 shares authorized, 6,101,802 and 6,205,396 shares issued and outstanding in 2011 and 2010) | | |
| Additional paid-in capital | 28,532 | 18,606 |
| Retained earnings | 29,559 | 28,065 |
| Accumulated other comprehensive loss | (58) | (42) |
| Total stockholders' equity | 58,033 | 46,629 |
| Total liabilities and stockholders' equity | \$ 172,844 | 140,948 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--|---------------|--------------------------------------|---------------|
| | 2011 | 2010 | 2011 | 2010 |
| Revenue | | | | |
| Gross premiums earned | \$ 31,218 | 29,978 | 62,114 | 60,322 |
| Premiums ceded | (14,174) | (14,333) | (28,396) | (28,436) |
| Net premiums earned | 17,044 | 15,645 | 33,718 | 31,886 |
| Net investment income | 509 | 569 | 1,073 | 1,100 |
| Realized investment gains | 140 | 505 | 293 | 505 |
| Gain on bargain purchase | 936 | | 936 | |
| Other | 1,155 | 692 | 1,813 | 908 |
| Total revenue | 19,784 | 17,411 | 37,833 | 34,399 |
| Expenses | | | | |
| Losses and loss adjustment expenses | 10,523 | 10,863 | 20,926 | 20,676 |
| Policy acquisition and other underwriting expenses | 2,780 | 2,668 | 7,043 | 6,960 |
| Other operating expenses | 2,660 | 1,886 | 4,787 | 3,583 |
| Total expenses | 15,963 | 15,417 | 32,756 | 31,219 |
| Income before income taxes | 3,821 | 1,994 | 5,077 | 3,180 |
| Income taxes | 1,520 | 712 | 1,983 | 1,200 |
| Net income | \$ 2,301 | 1,282 | 3,094 | 1,980 |
| Preferred stock dividends | (361) | | (378) | |
| Income available to common stockholders | \$ 1,940 | 1,282 | 2,716 | 1,980 |
| Basic earnings per common share | \$.32 | .21 | .44 | .32 |
| Diluted earnings per common share | \$.30 | .19 | .43 | .29 |
| Dividends per common share | \$.10 | | .20 | |

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)**

| | Six Months Ended June 30, | |
|--|--------------------------------------|---------------|
| | 2011 | 2010 |
| Cash flows from operating activities: | | |
| Net income | \$ 3,094 | 1,980 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Stock-based compensation | 19 | 68 |
| Net amortization of premiums (discounts) on investments in fixed maturity securities | 61 | (39) |
| Depreciation and amortization | 158 | 57 |
| Deferred income taxes (benefit) | 2,026 | (136) |
| Realized gains on sales of investments | (293) | (505) |
| Gain on bargain purchase | (936) | |
| Changes in operating assets and liabilities: | | |
| Premiums receivable | (4,441) | (5,130) |
| Assumed reinsurance balances receivable | 26 | 19,525 |
| Advance premiums | 5,786 | 5,948 |
| Prepaid reinsurance premiums | 8,921 | (488) |
| Accrued interest and dividends receivable | (6) | 10 |
| Income taxes receivable | (3,033) | |
| Other assets | (476) | (463) |
| Assumed reinsurance balances payable | 51 | 658 |
| Deferred policy acquisition costs | (655) | 542 |
| Losses and loss adjustment expenses | 2,827 | 3,939 |
| Unearned premiums | 5,496 | (2,369) |
| Income taxes payable | (310) | 457 |
| Accrued expenses and other liabilities | 4,568 | 3,664 |
| Net cash provided by operating activities | 22,883 | 27,718 |
| Cash flows from investing activities: | | |
| Cash consideration paid for acquired business | (5,110) | |
| Purchase of property and equipment, net | (1,843) | (7,298) |
| Purchase of fixed maturity securities | (14,165) | (4,546) |
| Purchase of equity securities | (5,330) | |
| Proceeds from sales of fixed maturity securities | 19,614 | 12,242 |
| Proceeds from sales of equity securities | 1,106 | |
| Increase in time deposits, net | (273) | (256) |
| Decrease in short-term investments, net | | 7,443 |
| Net cash (used in) provided by investing activities | (6,001) | 7,585 |
| Cash flows from financing activities: | | |
| Net proceeds from the issuance of preferred stock | 11,307 | |
| Proceeds from the exercise of common stock options | 363 | 100 |
| Cash dividends paid | (1,382) | |
| Repurchases of common stock | (1,887) | (2,595) |

Edgar Filing: Homeowners Choice, Inc. - Form 10-Q

| | | |
|--|-----------|---------|
| Excess tax benefit from common stock options exercised | 124 | 39 |
| Net cash provided by (used in) financing activities | 8,525 | (2,456) |
| Net increase in cash and cash equivalents | 25,407 | 32,847 |
| Cash and cash equivalents at beginning of period | 54,849 | 43,453 |
| Cash and cash equivalents at end of period | \$ 80,256 | 76,300 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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

| | Six Months Ended | |
|--|-------------------------|-------------|
| | June 30, | |
| | 2011 | 2010 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for income taxes | \$ 3,176 | 600 |
| Cash paid for interest | \$ | |
| Non-cash investing activities: | | |
| Unrealized (loss) gain on investments in available for sale securities, net of tax | \$ (16) | 832 |
| Fair value of net assets acquired in connection with business acquisition | \$ 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, 2011****(Dollars in thousands, except share amounts)**

| | Preferred Stock | | Common Stock | | Additional | Accumulated | | |
|---|-----------------|--------|--------------|--------|--------------------|----------------------|--------------------------------|---------|
| | Shares | Amount | Shares | Amount | Paid-In Capital | Retained Earnings | Other Comprehensive Loss | Total |
| Balance at December 31, 2010 | | \$ | 6,205,396 | | 18,606 | 28,065 | (42) | 46,629 |
| Net Income (unaudited) | | | | | | 3,094 | | 3,094 |
| Change in unrealized loss on available-for-sale securities, net of income tax benefit (unaudited) | | | | | | | (16) | (16) |
| Comprehensive income (unaudited) | | | | | | | | 3,078 |
| Proceeds from sale of | | | | | | | | |
| preferred stock (net of offering costs of \$1,170) (unaudited) | 1,247,700 | | | | 11,307 | | | 11,307 |
| Exercise of stock options (unaudited) | | | 145,200 | | 363 | | | 363 |
| Excess tax benefit from stock options exercised (unaudited) | | | | | 124 | | | 124 |
| Common stock dividends (unaudited) | | | | | | (1,222) | | (1,222) |
| Preferred stock dividends (unaudited) | | | | | | (378) | | (378) |
| Repurchases and retirement of common stock (unaudited) | | | (248,794) | | (1,887) | | | (1,887) |
| Stock-based compensation (unaudited) | | | | | 19 | | | 19 |
| Balance at June 30, 2011 (unaudited) | 1,247,700 | \$ | 6,101,802 | | 28,532 | 29,559 | (58) | 58,033 |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(unaudited)

Note 1 Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited, condensed consolidated financial statements for Homeowners Choice, Inc. and its subsidiaries (collectively, the Company), which consist of Homeowners Choice Managers, Inc., Southern Administration, Inc., Claddaugh Casualty Insurance Company, Ltd., HCI Holdings LLC and its subsidiary, TV Investment Holdings, LLC, and Homeowners Choice Property & Casualty Insurance Company, Inc. and its subsidiary, HCPCI Holdings LLC, have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information, and the Securities and Exchange Commission (SEC) rules for interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, in the opinion of management, the accompanying financial statements reflect all normal recurring adjustments necessary to present fairly the Company's financial position as of June 30, 2011 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, 2011. 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, 2010 included in the Company's Form 10-K, which was filed with the SEC on March 29, 2011.

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

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

All significant intercompany balances and transactions have been eliminated.

(continued)

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(unaudited)

Note 1 Summary of Significant Accounting Policies, continued

Basic and diluted earnings per common share. Basic earnings per common share is computed by dividing net income attributable to common shareholders by the weighted-average number of common shares outstanding for the period. 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, 2011 consisted of stock options, common stock warrants, and the 7.0% Series A cumulative convertible preferred stock issued March 25, 2011. Each share of preferred stock is convertible into one share of the Company's common stock (see Note 10).

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

Note 2 Recent Accounting Pronouncements

Accounting Standards Update No. 2011-05. In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05 (ASU 2011-05), *Comprehensive Income (Topic 220), Presentation of Comprehensive Income*. The objective of ASU 2011-05 is to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. To achieve this goal and to facilitate convergence of U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS), the FASB decided to eliminate the option to present components of other comprehensive income as part of the consolidated statement of changes in stockholders' equity. The amendments in ASU 2011-05 require that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The amendments in ASU 2011-05 should be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted, because compliance with the amendments is already permitted. The amendments do not require any transition disclosures. The Company does not expect the adoption of ASU 2011-05 will have a material impact on its consolidated financial statements.

(continued)

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(unaudited)

Note 2 Recent Accounting Pronouncements, continued

Accounting Standards Update No. 2011-04. In May 2011, the FASB issued Accounting Standards Update No. 2011-04 (ASU 2011-04), *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The objective of ASU 2011-04 is to provide clarification of Topic 820 and, also, to ensure that fair value has the same meaning in U.S. generally accepted accounting principles (GAAP) and in international financial reporting standards (IFRSs) and that their respective fair value measurement and disclosure requirements are generally the same. Thus, this update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and IFRSs. The amendment is effective for interim and annual periods beginning after December 15, 2011 and is to be applied prospectively. Early application is not permitted. The Company does not expect the adoption of ASU 2011-04 will have a material impact on its 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 should be applied prospectively upon adoption. Retrospective application to all prior periods presented upon the date of adoption is permitted, but not required. Early adoption is permitted, but only at the beginning of an entity s annual reporting period. Management is currently evaluating the impact of ASU 2010-26 and the effect adoption of this guidance will have on the Company s consolidated financial statements.

(continued)

Table of Contents**HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements****(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, 2011 and December 31, 2010, 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 Cost | Gross Unrealized Gain | Gross Unrealized Loss | Fair Value |
|--|-------------------|-----------------------------|-----------------------------|---------------|
| <u>June 30, 2011</u> | | | | |
| <i>Fixed Maturity Securities:</i> | | | | |
| U.S. Treasury and U.S. government agencies | \$ 587 | 17 | (2) | 602 |
| Corporate bonds | 12,114 | 152 | (110) | 12,156 |
| Commercial mortgage-backed securities | 10,310 | 96 | (26) | 10,380 |
| Other | 265 | 1 | | 266 |
| Total | \$ 23,276 | 266 | (138) | 23,404 |
| <i>Equity securities</i> | \$ 5,248 | 104 | (327) | 5,025 |
| <u>December 31, 2010</u> | | | | |
| <i>Fixed Maturity Securities:</i> | | | | |
| U.S. Treasury and U.S. government agencies | \$ 8,044 | 88 | (37) | 8,095 |
| Corporate bonds | 12,192 | 149 | (75) | 12,266 |
| Commercial mortgage-backed securities | 7,756 | 40 | (53) | 7,743 |
| Other | 464 | 5 | (9) | 460 |
| Total | \$ 28,456 | 282 | (174) | 28,564 |
| <i>Equity securities</i> | \$ 1,061 | 12 | (189) | 884 |

(continued)

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

The scheduled maturities of fixed maturity securities at June 30, 2011 are as follows (in thousands):

| | Amortized Cost | Fair Value |
|--|----------------|------------|
| Available-for-sale | | |
| Due after one year through five years | \$ 8,469 | 8,519 |
| Due after five years through ten years | 4,378 | 4,384 |
| Due after ten years | 119 | 121 |
| Commercial mortgage-backed securities | 10,310 | 10,380 |
| | \$ 23,276 | 23,404 |

Investment Sales 2011 and 2010

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, 2011 and 2010 were as follows (in thousands):

| | Proceeds | Gross Realized Gains | Gross Realized Losses |
|---|-----------|----------------------|-----------------------|
| <u>Three months ended June 30, 2011</u> | | | |
| Fixed maturity securities | \$ 11,916 | 238 | (15) |
| Equity securities* | \$ 574 | 53 | (136) |
| <u>Three months ended June 30, 2010</u> | | | |
| Fixed maturity securities | \$ 12,242 | 505 | |
| <u>Six months ended June 30, 2011</u> | | | |
| Fixed maturity securities | \$ 19,614 | 369 | (38) |
| Equity securities* | \$ 1,106 | 105 | (143) |
| <u>Six months ended June 30, 2010</u> | | | |
| Fixed maturity securities | \$ 12,242 | 505 | |

* 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

Edgar Filing: Homeowners Choice, Inc. - Form 10-Q

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 Earnings. There were no open option contracts at June 30, 2011. There were no equity option contracts during the three and six month periods ended June 30, 2010.

(continued)

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

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

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

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

general market conditions and industry or sector specific factors;

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

the Company's intent and ability to hold the investment for a period of time sufficient to allow for the recovery of costs. Securities with gross unrealized loss positions at June 30, 2011, aggregated by investment category and length of time the individual securities have been in a continuous loss position, are as follows (in thousands):

| | <i>Less Than twelve months</i> | |
|--|--------------------------------------|-----------------------|
| | Gross Unrealized Loss | Fair Value |
| U.S. Treasury and U.S. government agencies | \$ (2) | 77 |
| Corporate bonds | (110) | 7,007 |
| Commercial mortgage-backed securities | (26) | 3,952 |
| Total fixed maturity securities | \$ (138) | 11,036 |
| Equity securities | \$ (327) | 1,144 |

(continued)

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements, Continued

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, 2011.

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 fixed maturity securities measured at fair value as of June 30, 2011 and December 31, 2010, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (in thousands):

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|--|---|---|--|---------------|
| <u>As of June 30, 2011</u> | | | | |
| <i>Fixed maturity securities</i> | | | | |
| U.S. Treasury and U.S. government agencies | \$ 525 | 77 | | 602 |
| Corporate bonds | 12,156 | | | 12,156 |
| Commercial mortgage-backed securities | | 10,380 | | 10,380 |
| Other | | 266 | | 266 |
| Total fixed maturity securities | 12,681 | 10,723 | | 23,404 |
| <i>Equity securities</i> | 5,025 | | | 5,025 |
| Total available-for-sale securities | \$ 17,706 | 10,723 | | 28,429 |

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|--|--|---|--|---------------|
| <u>As of December 31, 2010</u> | | | | |
| <i>Fixed maturity securities</i> | | | | |
| U.S. Treasury and U.S. government agencies | \$ 8,095 | | | 8,095 |
| Corporate bonds | 12,266 | | | 12,266 |
| Commercial mortgage-backed securities | | 7,743 | | 7,743 |
| Other | | 460 | | 460 |
| Total fixed maturity securities | 20,361 | 8,203 | | 28,564 |
| <i>Equity securities</i> | 884 | | | 884 |
| Total available-for-sale securities | \$ 21,245 | 8,203 | | 29,448 |

Edgar Filing: Homeowners Choice, Inc. - Form 10-Q

With respect to the Company's business acquisition completed in April 2011 (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 environmental liability was valued based on third party estimates to complete the site assessment and remediation plan. 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, 2011.

(continued)

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

Effective April 20, 2011, the Company, through its subsidiary, TV Investment Holdings LLC, acquired the assets and operations of Tierra Verde Marina Holdings. The property consists primarily of land and improvements, retail buildings, and a marina facility purchased for \$5.1 million. Operating activities at acquisition include leasing of office and retail space to 11 tenants, wet and dry boat storage for approximately 150 clients, and fuel services with respect to marina clients and other recreational boaters. The Tierra Verde, Florida property and operations were acquired through a foreclosure sale conducted by the Pinellas County Clerk of the Circuit Court. The Company's primary reason for the acquisition was to strengthen its property portfolio through diversification and quality of assets owned.

The fair value of the net assets acquired was approximately \$5.7 million, which exceeds the \$5.1 million purchase price. As a result, the Company recognized a gain on bargain purchase in the amount of \$936,000 (\$575,000 net of tax), which is included in operations for the three and six months ended June 30, 2011. The recorded gain is subject to adjustment as the Company will continue to evaluate the purchase price allocation with respect to certain of the liabilities assumed at acquisition. There were no intangibles acquired with respect to this acquisition. The following table summarizes the Company's preliminary allocation of the net consideration paid to the fair value of the assets acquired and liabilities assumed at April 20, 2011 (in thousands):

| | |
|---|-----------------|
| Property, plant and equipment | \$ 6,338 |
| Other assets | 132 |
| Tenant deposits | (96) |
| Environmental liability (Note 13) | (150) |
| Deferred tax liability | (361) |
| Other liabilities | (178) |
| Fair value of net assets acquired | 5,685 |
| Gain on bargain purchase, net of tax of \$361 | (575) |
| Cash consideration paid | \$ 5,110 |

For the three and six months ended June 30, 2011 and 2010, 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 (dollars in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------------|--|-------------|--------------------------------------|-------------|
| | 2011 | 2010 | 2011 | 2010 |
| Premiums Written | | | | |
| Direct | \$ 54,838 | 49,854 | 69,961 | 64,729 |
| Assumed | (157) | (666) | (2,351) | (6,776) |
| Gross written | 54,681 | 49,188 | 67,610 | 57,953 |
| Ceded | (14,174) | (14,333) | (28,396) | (28,436) |
| Net premiums written | \$ 40,507 | 34,855 | 39,214 | 29,517 |
| Premiums Earned | | | | |
| Direct | \$ 29,160 | 25,024 | 57,147 | 48,342 |
| Assumed | 2,058 | 4,954 | 4,967 | 11,980 |
| Gross earned | 31,218 | 29,978 | 62,114 | 60,322 |
| Ceded | (14,174) | (14,333) | (28,396) | (28,436) |
| Net premiums earned | \$ 17,044 | 15,645 | 33,718 | 31,886 |

During the three and six months ended June 30, 2011 and 2010, there were no recoveries pertaining to reinsurance contracts that were deducted from losses incurred. At June 30, 2011 and December 31, 2010, prepaid reinsurance premiums related to 18 reinsurers 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, 2011 and December 31, 2010.

(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 (dollars in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|------------------------------|--------------------------------|----------------|------------------------------|-----------------|
| | 2011 | 2010 | 2011 | 2010 |
| Balance, beginning of period | \$ 24,050 | 20,805 | 22,146 | 19,178 |
| Incurred related to: | | | | |
| Current period | 6,696 | 11,629 | 15,432 | 21,050 |
| Prior period | 3,827 | (766) | 5,494 | (374) |
| Total incurred | 10,523 | 10,863 | 20,926 | 20,676 |
| Paid related to: | | | | |
| Current period | (6,475) | (6,689) | (8,128) | (9,647) |
| Prior period | (3,125) | (1,862) | (9,971) | (7,090) |
| Total paid | (9,600) | (8,551) | (18,099) | (16,737) |
| Balance, end of period | \$ 24,973 | 23,117 | 24,973 | 23,117 |

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

Note 8 Income Taxes

During the three and 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. During the three and six months ended June 30, 2010, the Company recorded approximately \$0.7 million and \$1.2 million, respectively, of income taxes, which resulted in estimated annual effective tax rates of approximately 36% and 38%, 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. In February 2011, the Company received notice from the Internal Revenue Service with respect to an examination of the Company's 2008 and 2009 federal income tax returns. The examination commenced during the second quarter of 2011 and is still ongoing at June 30, 2011.

(continued)

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

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

| | For the Three Months Ended June 30, 2011 | | | For the Three Months Ended June 30, 2010 | | |
|---------------------------------|---|-------------------------|---------------------|---|-------------------------|---------------------|
| | Income (Numerator) | Shares (Denominator) | Per-Share Amount | Income (Numerator) | Shares (Denominator) | Per-Share Amount |
| Net income | \$ 2,301 | | | \$ 1,282 | | |
| Less: Preferred stock dividends | (361) | | | | | |

Basic Earnings Per Share

| | | | | | | |
|---|-------|-------|---------|-------|-------|---------|
| Income available to common stockholders | 1,940 | 6,071 | \$ 0.32 | 1,282 | 6,153 | \$ 0.21 |
|---|-------|-------|---------|-------|-------|---------|

Effect of Dilutive Securities

| | | | | | | |
|-----------------------------|-----|-------|--|--|-----|--|
| Stock Options | | 411 | | | 499 | |
| Convertible preferred stock | 361 | 1,248 | | | | |

Diluted Earnings Per Share

| | | | | | | |
|---|----------|-------|---------|----------|-------|---------|
| Income available to common stockholders and assumed conversions | \$ 2,301 | 7,730 | \$ 0.30 | \$ 1,282 | 6,652 | \$ 0.19 |
|---|----------|-------|---------|----------|-------|---------|

| | For the Six Months Ended June 30, 2011 | | | For the Six Months Ended June 30, 2010 | | |
|---------------------------------|---|-------------------------|---------------------|---|-------------------------|---------------------|
| | Income (Numerator) | Shares (Denominator) | Per-Share Amount | Income (Numerator) | Shares (Denominator) | Per-Share Amount |
| Net income | \$ 3,094 | | | \$ 1,980 | | |
| Less: Preferred stock dividends | (378) | | | | | |

Basic Earnings Per Share

| | | | | | | |
|---|-------|-------|---------|-------|-------|---------|
| Income available to common stockholders | 2,716 | 6,121 | \$ 0.44 | 1,980 | 6,219 | \$ 0.32 |
|---|-------|-------|---------|-------|-------|---------|

Effect of Dilutive Securities

| | | | | | | |
|-----------------------------|-----|-----|--|--|-----|--|
| Stock Options | | 425 | | | 515 | |
| Convertible preferred stock | 378 | 669 | | | | |

Diluted Earnings Per Share

| | | | | | | |
|--|----------|-------|---------|----------|-------|---------|
| | \$ 3,094 | 7,215 | \$ 0.43 | \$ 1,980 | 6,734 | \$ 0.29 |
|--|----------|-------|---------|----------|-------|---------|

Income available to common stockholders and
assumed conversions

(continued)

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

For each of the three and six months ended June 30, 2011 and 2010, 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. There were no preferred shares outstanding in 2010.

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

Effective March 18, 2009, the Company's Board of Directors authorized a plan to repurchase up to \$3.0 million (inclusive of commissions) of the Company's common shares. The repurchase plan allowed the Company to repurchase shares from time to time through March 19, 2010. This repurchase plan was supplemented in December 2009 upon approval by the Board of Directors to extend the repurchase authority by an additional \$3.0 million and continue until the repurchase plan is terminated by the Company or the maximum number of dollars has been expended. 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, 2011, the Company has reserved 905,001 shares of common stock for issuance upon the exercise of its common stock warrants, all of which were issued coincident with the Company's initial public offering (IPO). A summary of the warrants outstanding at June 30, 2011 is presented below:

| | Number Of Warrants Issued | Number of Common Shares Issuable Upon Conversion of Warrants |
|--|--|---|
| 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 outstanding at June 30, 2011 | 1,738,335 | 905,001 |

(continued)

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements, Continued

(unaudited)

Note 10 Stockholders Equity, continued

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

Preferred Stock

During the three months ended March 31, 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 \$10.00 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 \$10.00 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 \$10.00 per share is subject to proportionate adjustment in the event of stock splits, reverse stock splits, stock dividends, or similar changes with respect to the Company's common stock.

(continued)

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

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 June 8, 2011, the Company's Board of Directors declared a cash dividend on its Series A Preferred shares in the amount of \$0.5833 per share for each of the months of June, July and August 2011. The June 2011 dividend is payable July 27, 2011 to shareholders of record at the close of business on July 1, 2011. The July 2011 dividend is payable August 29, 2011 to shareholders of record at the close of business on August 1, 2011. The August 2011 dividend is payable September 27, 2011 to shareholders of record at the close of business on September 1, 2011.

Note 11 Comprehensive Income

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

| | Three Months Ended | | Six Months Ended | |
|--|---------------------------|-------------|-------------------------|-------------|
| | June 30, | | June 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Net income | \$ 2,301 | 1,282 | 3,094 | 1,980 |
| Other comprehensive income: | | | | |
| Change in unrealized gain on investments: | | | | |
| Unrealized gain arising during the period | 285 | 1,230 | 267 | 1,859 |
| Reclassification adjustment for realized gains | (140) | (505) | (293) | (505) |
| Net change in unrealized gain (loss) | 145 | 725 | (26) | 1,354 |
| Deferred income taxes on above changes | (56) | (280) | 10 | (522) |
| Other comprehensive income (loss) | 89 | 445 | (16) | 832 |
| Comprehensive income | \$ 2,390 | 1,727 | 3,078 | 2,812 |

(continued)

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

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

The Company's 2007 Stock Option and Incentive Plan (the Plan) provides for granting of stock options to employees, directors, consultants, and advisors of the Company. Under the Plan, options may be granted to purchase a total of 6,000,000 shares of the Company's common stock. At June 30, 2011, options to purchase 4,874,800 shares are available for grant under the Plan. The outstanding options vest over periods ranging from immediately vested to five years and are exercisable over the contractual term of ten years.

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

| | Number of Options | Weighted- Average Exercise Price | Weighted- Average Remaining Contractual Term | Aggregate Intrinsic Value |
|----------------------------------|----------------------|---|--|---------------------------------|
| Outstanding at December 31, 2010 | 830,000 | \$ 2.50 | | |
| Forfeited | (24,800) | 2.50 | | |
| Exercised | (145,200) | 2.50 | | |
| Outstanding at June 30, 2011 | 660,000 | 2.50 | 6.0 years | \$ 2,746 |
| Exercisable at June 30, 2011 | 656,800 | \$ 2.50 | 6.0 years | \$ 2,732 |

At June 30, 2011, there was approximately \$3,600 of unrecognized compensation expense related to nonvested stock-based compensation arrangements granted under the Plan, which the Company expects to recognize over a weighted-average period of ten months. 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. The total fair value of shares vesting and recognized as compensation expense was approximately \$24,000 and \$68,000, respectively, for the three and six month periods ended June 30, 2010 and the associated income tax benefit recognized was \$6,000 and \$19,000, respectively. The total intrinsic value of the 40,000 options exercised during the six months ended June 30, 2010 was \$147,000 and the income tax benefit recognized was \$39,000.

No options were granted during the three and six month periods ended June 30, 2011 and 2010.

(continued)

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements, Continued

(unaudited)

Note 13 Commitments and Contingencies

In connection with the Company's April 20, 2011 acquisition of the marina property located in Pinellas County, Florida (see Note 5), 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 contamination occurred during the process of removing fuel tanks from the property. 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, 2011, the \$150,000 accrued at acquisition is included in other liabilities in the accompanying condensed consolidated balance sheet. 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, 2011, 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 14 Related Party Transaction

Effective April 4, 2011, the Company repurchased and retired a total of 80,000 shares of the Company's common stock at a price of \$8.00 per share for a total cost of \$640,000. Such shares were repurchased under a stock purchase agreement with one of the Company's directors at a price below the \$8.20 market value of the Company's common stock on the date of the transaction. Such repurchases were not part of a publicly announced plan or program.

Effective June 27, 2011, the Company repurchased and retired a total of 85,200 shares of the Company's common stock at a price of \$6.50 per share for a total cost of \$553,800. Such shares were repurchased under a stock purchase agreement with the Company's Chief Executive Officer at a price below the \$6.96 market value of the Company's common stock on the date of the transaction. Such repurchases were not part of a publicly announced plan or program.

Effective June 30, 2011, all rights to the software license related to the Company's premium administration application software were assigned to the Company in exchange for a one-time payment of \$50,000. Such payment was made to the Company's director who developed and licensed the software to the Company. The related software license and consulting agreements were terminated coincident with this exchange.

(continued)

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements, Continued

(unaudited)

Note 15 Subsequent Event

On July 26, 2011, the Company's Board of Directors declared a quarterly dividend on its common shares of \$0.10 per share. The dividends will be paid September 16, 2011 to shareholders of record at the close of business August 19, 2011.

Table of Contents

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

You should read the following discussion in conjunction with our condensed consolidated financial statements and related notes and information included under this Item 2 and elsewhere in this quarterly report on Form 10-Q and in our Form 10-K filed with the Securities and Exchange Commission (SEC) on March 29, 2011. 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 gross earned premiums and investment income. We cede a substantial portion of our gross earned premiums to reinsurers to mitigate risks primarily associated with hurricanes and other catastrophic events. Our principal expenses are claims from policyholders, expenses associated with investigating and settling policyholder claims, policy acquisition costs, and other underwriting expenses. As of June 30, 2011, we had total assets of \$172.8 million and stockholders equity of \$58.0 million. Our net income was approximately \$2.3 million and \$3.1 million, respectively, for the three and six months ended June 30, 2011. Income available to common stockholders was approximately \$1.9 million and \$2.7 million, respectively, for the three and six months ended June 30, 2011.

Table of Contents

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 in July and November 2007, February, June, October and December 2008, December 2009, and December 2010. Substantially all of our premium revenue since inception comes from these assumptions. We currently have approximately 59,500 policies in force. Of those policies assumed, approximately 86% are homeowners' insurance policies, and the remaining 14% are a combination of policies written for condominium-owners and tenants. Our current policies in force represent approximately \$130 million in annualized premiums.

Citizens requires us to offer renewals on the policies we acquire for a period of three years subsequent to the initial expiration of the assumed policies. The policyholders have the option to renew with us or they may ask their agent to place their coverage with another insurance company. With respect to the assumptions through December 31, 2009, policyholders could also elect to return to Citizens, i.e. opt out, prior to the policy renewal date. With respect to the December 31, 2010 assumption, the opt-out provision was limited to thirty days from the assumption date. We strive to retain these policies by offering competitive rates to our policyholders.

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

Table of Contents

Recent Developments

Effective June 1, 2011, we entered into excess catastrophe reinsurance treaties, which provide approximately \$345 million of coverage through non-affiliates for aggregate losses and loss adjustment expenses per event during the 2011-2012 hurricane season. We expect to be charged approximately \$55 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, 2011 through May 31, 2012. In comparison, our reinsurance treaties covering the 2010-2011 hurricane season provided \$390 million of coverage through non-affiliates for aggregate losses and loss adjustment expenses per event at a cost to us of approximately \$59 million, which we recognized over the period from June 1, 2010 through May 31, 2011. The slight decrease in reinsurance premiums applicable to the 2011 reinsurance treaty year primarily results from use of current catastrophe models approved by the Florida Office of Insurance Regulation. Our reinsurance costs are expected to be approximately 42% of gross earned premiums during the period from June 1, 2011 through May 31, 2012 compared to 45% during the same period in 2010-2011.

Effective July 1, 2011, we entered into an executive employment agreement with our Chairman, Paresh Patel, to serve as our chief executive officer. Mr. Patel replaces Frank McCahill who had notified us in April 2011 of his intention to resign effective June 30, 2011.

Effective July 12, 2011, our financial stability rating of A Exceptional was reaffirmed by Demotech, Inc.

Table of Contents**RESULTS OF OPERATIONS**

The following table summarizes our results of operations for the three and six months ended June 30, 2011 and 2010 (dollars in thousands, except per share amounts):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|----------|------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 |
| Operating Revenue | | | | |
| Gross premiums earned | \$ 31,218 | 29,978 | 62,114 | 60,322 |
| Premiums ceded | (14,174) | (14,333) | (28,396) | (28,436) |
| Net premiums earned | 17,044 | 15,645 | 33,718 | 31,886 |
| Net investment income | 509 | 569 | 1,073 | 1,100 |
| Realized investment gains | 140 | 505 | 293 | 505 |
| Gain on bargain purchase | 936 | | 936 | |
| Other Income | 1,155 | 692 | 1,813 | 908 |
| Total operating revenue | 19,784 | 17,411 | 37,833 | 34,399 |
| Operating Expenses | | | | |
| Losses and loss adjustment expenses | 10,523 | 10,863 | 20,926 | 20,676 |
| Policy acquisition and other underwriting expenses | 2,780 | 2,668 | 7,043 | 6,960 |
| Other operating expenses | 2,660 | 1,886 | 4,787 | 3,583 |
| Total operating expenses | 15,963 | 15,417 | 32,756 | 31,219 |
| Income before income taxes | 3,821 | 1,994 | 5,077 | 3,180 |
| Income taxes | 1,520 | 712 | 1,983 | 1,200 |
| Net income | \$ 2,301 | 1,282 | 3,094 | 1,980 |
| Preferred stock dividends | (361) | | (378) | |
| Income available to common stockholders | \$ 1,940 | 1,282 | 2,716 | 1,980 |
| Ratios to Net Premiums Earned: | | | | |
| Loss Ratio | 61.74% | 69.43% | 62.06% | 64.84% |
| Expense Ratio | 31.92% | 29.11% | 35.09% | 33.07% |
| Combined Ratio | 93.66% | 98.54% | 97.15% | 97.91% |
| Ratios to Gross Premiums Earned: | | | | |
| Loss Ratio | 33.71% | 36.24% | 33.69% | 34.28% |
| Expense Ratio | 17.43% | 15.19% | 19.05% | 17.48% |
| Combined Ratio | 51.14% | 51.43% | 52.74% | 51.76% |
| Per Share Data: | | | | |
| Basic earnings per common share | \$.32 | .21 | .44 | .32 |

Edgar Filing: Homeowners Choice, Inc. - Form 10-Q

| | | | | | |
|-----------------------------------|----|-----|-----|-----|-----|
| Diluted earnings per common share | \$ | .30 | .19 | .43 | .29 |
|-----------------------------------|----|-----|-----|-----|-----|

Table of Contents

Comparison of the Three Months Ended June 30, 2011 to the Three Months Ended June 30, 2010

Our results of operations for the three months ended June 30, 2011 reflect income available to common stockholders of \$1.9 million, or \$0.30 earnings per diluted common share, compared to income available to common stockholders of \$1.3 million, or \$0.19 earnings per diluted common share, for the three months ended June 30, 2010. Our results for the three months ended June 30, 2011 include a bargain purchase gain of \$936,000 (\$575,000 net of tax), or \$0.07 diluted earnings per common share. The bargain purchase gain relates to our business acquisition completed in April 2011.

Revenue

Gross Premiums Earned for the three months ended June 30, 2011 were \$31.2 million and reflect the revenue from policies assumed from Citizens in connection with the eight assumption transactions through December 2010 and the revenue on the renewal of these policies. Gross premiums earned for the three months ended June 30, 2010 were \$30.0 million and reflect the revenue from policies assumed from Citizens in connection with the seven assumption transactions through December 2009 and the revenue on the renewal of these policies.

Premiums Ceded for the three months ended June 30, 2011 and 2010 were approximately \$14.2 million and \$14.3 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 45.4% and 47.8% of gross premiums earned during the three months ended June 30, 2011 and 2010, respectively.

Net Premiums Earned for the three months ended June 30, 2011 and 2010 were \$17.0 million and \$15.6 million, respectively, and reflect the gross premiums earned less the appropriate reinsurance costs as described above. Net premiums earned increased by \$1.4 million in 2011 as compared to 2010 as a result of the \$1.2 million increase in gross premiums earned and the \$0.2 million decrease in premiums ceded.

Net Premiums Written during the three months ended June 30, 2011 and 2010 totaled \$40.5 million and \$34.9 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, 2011 and 2010 (dollars in thousands):

| | Three Months Ended | |
|-------------------------------|---------------------------|---------------|
| | June 30, | |
| | 2011 | 2010 |
| Net Premiums Written | \$ 40,507 | 34,855 |
| Increase in Unearned Premiums | (23,463) | (19,210) |
| Net Premiums Earned | \$ 17,044 | 15,645 |

Net Investment Income for the three months ended June 30, 2011 and 2010 was \$509,000 and \$569,000, respectively.

Table of Contents

Realized Investment Gains for the three months ended June 30, 2011 and 2010 of \$140,000 and \$505,000 reflects the net gain realized from sales of securities during the period.

Gain on Bargain Purchase was \$936,000 (\$575,000 net of tax), or \$0.07 diluted earnings per common share, for the three months ended June 30, 2011. The bargain purchase gain relates to our business acquisition completed in April 2011. We had no business acquisitions in 2010.

Other Income for the three months ended June 30, 2011 and 2010 was \$1,155,000 and \$692,000, respectively. During the three months ended June 30, 2011, other income includes income from our marina operations, rental income from our Tampa office building, and policy fee income we earn with respect to our issuance of renewal policies. In comparison, our other income for the three months ended June 30, 2010 primarily reflects policy fee income.

Expenses

Our *Losses and Loss Adjustment Expenses* amounted to \$10.5 million and \$10.9 million, respectively, during the three months ended June 30, 2011 and 2010. Our losses and loss adjustment expense reserves are more fully described below under the *Expenses* comparative for the six months ended June 30, 2011 and 2010 and, additionally, under *Critical Accounting Policies and Estimates* below.

Policy Acquisition and Other Underwriting Expenses for the three months ended June 30, 2011 and 2010 of \$2.8 million and \$2.7 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, 2011 and 2010 were \$2.7 million and \$1.9 million, respectively. Such expenses include administrative compensation and related benefits, corporate insurance, professional fees, office lease and related expenses, information system expense, and other general, administrative, and operational costs. The \$0.8 million increase is primarily attributable to increases in compensation and related expenses, professional fees, and expenses related to our real estate and marina operations of \$0.2 million, \$0.1 million, and \$0.4 million, respectively. As of June 30, 2011, we had 88 employees compared to 69 employees as of June 30, 2010.

Income Taxes for the three months ended June 30, 2011 and 2010 were \$1.5 million and \$0.7 million, respectively, for state and federal income taxes resulting in an effective tax rate of 40% for 2011 and 36% for 2010.

Table of Contents

Ratios:

The loss ratio applicable to the three months ended June 30, 2011 (loss and loss adjustment expenses related to net premiums earned) was 61.7% compared to 69.4% for the three months ended June 30, 2010.

The expense ratio applicable to the three months ended June 30, 2011 (policy acquisition and other underwriting expenses related to net premiums earned plus compensation, employee benefits, and other operating expenses) was 31.9% compared to 29.1% for the three months ended June 30, 2010 due to the increase in our expense ratio with respect to our other operating expenses (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 three months ended June 30, 2011 was 93.7% compared to 98.5% for the three months ended June 30, 2010.

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, 2011 was 51.1% compared to 51.4% for the three months ended June 30, 2010.

Comparison of the Six Months Ended June 30, 2011 to the Six Months Ended June 30, 2010

Our results of operations for the six months ended June 30, 2011 reflect income available to common stockholders of \$2.7 million, or \$0.43 earnings per diluted common share, compared to income available to common stockholders of \$2.0 million, or \$0.29 earnings per diluted common share, for the six months ended June 30, 2010. Our results for the six months ended June 30, 2011 include a bargain purchase gain of \$936,000 (\$575,000 net of tax), or \$0.08 diluted earnings per common share. The bargain purchase gain relates to our business acquisition completed in April 2011.

Revenue

Gross Premiums Earned for the six months ending June 30, 2011 were \$62.1 million and reflect the revenue from policies assumed from Citizens in connection with the eight separate assumption transactions through December 2010 and the revenue on the renewal of these policies. Gross premiums earned for the six months ending June 30, 2010 were \$60.3 million and reflect the revenue from policies assumed from Citizens in connection with the seven separate assumption transactions through December 2009 and the revenue on the renewal of these policies.

Premiums Ceded for each of the six months ending June 30, 2011 and 2010 were \$28.4 million. 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 45.7% and 47.1% of gross premiums earned during the six months ending June 30, 2011 and 2010, respectively.

Table of Contents

Net Premiums Earned for the six months ending June 30, 2011 and 2010 were \$33.7 million and \$31.9 million, respectively, and reflect the gross premiums earned less reinsurance costs as described above. Net premiums earned increased by \$1.8 million in 2011 as compared to 2010 as a result of the \$1.8 million increase in gross premiums earned.

Net Premiums Written during the six months ending June 30, 2011 and 2010 totaled \$39.2 million and \$29.5 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, 2011 and 2010 (in thousands):

| | Six Months Ended June 30, | |
|--|--------------------------------------|---------------|
| | 2011 | 2010 |
| Net Premiums Written | \$ 39,214 | 29,517 |
| (Increase) Decrease in Unearned Premiums | (5,496) | 2,369 |
| Net Premiums Earned | \$ 33,718 | 31,886 |

Net Investment Income for the six months ending June 30, 2011 and 2010 was \$1,073,000 and \$1,100,000, respectively.

Realized Investment Gains for the six months ending June 30, 2011 and 2010 of \$293,000 and \$505,000, respectively, reflects the net gain realized from sales of securities during the period.

Gain on Bargain Purchase was \$936,000 (\$575,000 net of tax), or \$0.08 diluted earnings per common share, for the six months ended June 30, 2011. The bargain purchase gain relates to our business acquisition completed in April 2011. We had no business acquisitions in 2010.

Other Income for the six months ending June 30, 2011 and 2010 of \$1,813,000 and \$908,000, respectively. During the six months ended June 30, 2011, other income includes income from our marina operations, rental income from our Tampa office building, and policy fee income we earn with respect to our issuance of renewal policies. In comparison, our other income for the six months ended June 30, 2010 primarily reflects policy fee income.

Expenses

Our *Losses and Loss Adjustment Expenses* amounted to \$20.9 million and \$20.7 million, respectively, during the six months ended June 30, 2011 and 2010.

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 \$22.1 million at December 31, 2010 to \$25.0 million at June 30, 2011. The \$2.9 million increase in our Reserves is comprised of \$13.1 million in new reserves specific to the six months ended June 30, 2011 offset by reductions of \$8.1 million and \$2.1 million in our Reserves for 2010 and 2009 and prior accident years, respectively. The \$13.1 million in Reserves established for 2011 claims is due to the increase in our policy exposure, which resulted in an increase in the amount of reported losses in 2011. The decrease of \$10.2 million specific to our 2010 and 2009 and prior accident-year reserves is due to favorable development arising from lower than expected loss development during 2011 relative to expectations used to establish our Reserve estimates at the end of 2010. 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.

Table of Contents

Policy Acquisition and Other Underwriting Expenses for each of the six months ending June 30, 2011 and 2010 of \$7.0 million 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 six months ending June 30, 2011 and 2010 were \$4.8 million and \$3.6 million, respectively. Such expenses include administrative compensation and related benefits, corporate insurance, professional fees, office lease and related expenses, information system expense, and other general, administrative, and operational costs. The \$1.2 million increase is primarily attributable to increases in compensation and related expenses, professional fees, and expenses related to our real estate and marina operations of \$0.4 million, \$0.2 million, and \$0.6 million, respectively. As of June 30, 2011, we had 88 employees compared to 69 employees as of June 30, 2010.

Income Taxes for the six months ended June 30, 2011 and 2010 were \$2.0 million and \$1.2 million, respectively, for state and federal income taxes resulting in an effective tax rate of 39% for 2011 and 38% for 2010.

Ratios:

The loss ratio applicable to the six months ending June 30, 2011 (loss and loss adjustment expenses related to net premiums earned) was 62.1% compared to 64.8% for the six months ended June 30, 2010.

The expense ratio applicable to the six months ending June 30, 2011 (policy acquisition and other underwriting expenses related to net premiums earned plus compensation, employee benefits, and other operating expenses) was 35.1% compared to 33.1% for the six months ending June 30, 2010 due to the increase in our expense ratio with respect to our other operating expenses (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 ending June 30, 2011 was 97.2% compared to 97.9% for the six months ending June 30, 2010.

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 ending June 30, 2011 was 52.7% compared to 51.8% for the six months ending June 30, 2010.

Table of Contents

Seasonality of Our Business

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

LIQUIDITY AND CAPITAL RESOURCES

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

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.

Table of Contents

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.

Cash Flows

Our cash flows from operating, investing and financing activities for the six months ended June 30, 2011 and 2010 are summarized below.

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.

Cash Flows for the Six Months Ended June 30, 2010

Net cash provided by operating activities for the six months ended June 30, 2010 was approximately \$27.7 million, which resulted primarily from the collection of \$19.5 million from Citizens in connection with our December 2009 assumption transaction and \$6.0 million in advance premiums offset by cash disbursed for operating expenses and losses and loss adjustment expenses. Net cash provided by investing activities of \$7.6 million was primarily due to the receipt of \$12.2 million in proceeds from the sale of securities and \$7.4 million from the redemption of short-term investments offset by \$4.5 million used for new investments in fixed maturity securities and \$7.3 million used to purchased assets, primarily the \$7.1 million used for the purchase of our Tampa office building. Net cash used in financing activities totaled \$2.5 million, which was due to the repurchases during the period of our shares and warrants.

Table of Contents

Investments

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

At June 30, 2011, we have \$28.4 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.

OFF-BALANCE SHEET ARRANGEMENTS

As of December 31, 2010 and June 30, 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.

Table of Contents

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, 2011, \$9.4 million of the total \$25.0 million we have reserved for losses and loss adjustment expenses is specific to our estimate of claims incurred but not reported. The remaining \$15.6 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, 2011, \$9.4 million of the \$15.6 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, 2011 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 Report on Form 10-K, which we filed with the SEC on March 29, 2011. For the six months ended June 30, 2011, 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.

Table of Contents

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, 2011 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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 29, 2011.

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

None.

(b) Use of Proceeds

None.

(c) Repurchases of Securities

During the quarter ended March 31, 2011, the maximum amount designated for repurchases under the Company's formal repurchase plan was expended and the share repurchase program was terminated. The following table provides information with respect to shares repurchased during the quarter ended June 30, 2011 all of which were not part of a publicly announced plan:

| Period | Total Number Of Shares Repurchased | Average Price Paid Per Share |
|------------------|---|---|
| April 1-30, 2011 | 80,000 | 8.00 |
| May 1-31, 2011 | | |
| June 1-30, 2011 | 85,200 | 6.50 |
| Total | 165,200 | \$ 7.23 |

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 stockholders except out of that part of its available and accumulated capital and surplus funds which is derived from realized net operating profits on its business and net realized capital gains. Additionally, Florida statutes preclude our insurance subsidiary from making dividend payments or distributions to stockholders without prior approval of the Florida Office of Insurance Regulation if the dividend or distribution would exceed the larger of (1) the lesser of (a) 10.0% of its capital surplus or (b) net income, not including realized capital gains, plus a two year carry forward, (2) 10.0% of capital surplus with dividends payable constrained to unassigned funds minus 25% of unrealized capital gains or (3) the lesser of (a) 10.0% of capital surplus or (b) net investment income plus a three year carry forward with dividends payable constrained to unassigned funds minus 25% of unrealized capital gains.

Table of Contents

ITEM 6 EXHIBITS

The following documents are filed as part of this report:

| EXHIBIT NUMBER | DESCRIPTION |
|---------------------------|--|
| 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. |

Table of Contents

- 4.6 Form of Unit Certificate. Incorporated by reference to the correspondingly numbered exhibit to our Post-Effective Amendment No. 1 to our Registration Statement on Form S-1 (File No. 333-150513) filed August 6, 2008.
- 4.7 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 10.6 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.
- 10.1 Executive Agreement dated May 1, 2007 between Homeowners Choice, Inc. and Francis X. McCahill, III. Incorporated by reference to the correspondingly numbered exhibit to our Registration Statement on Form S-1 (File No. 333-150513), originally filed April 30, 2008, effective July 24, 2008, as amended.
- 10.2 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 Agreement date July 1, 2011 between Homeowners Choice, Inc. and Paresh Patel

Table of Contents

- 10.5 Consulting Agreement dated June 1, 2007 between Homeowners Choice, Inc. and Scorpio Systems, Inc. Incorporated by reference to the correspondingly numbered exhibit to our Registration Statement on Form S-1 (File No. 333-150513), originally filed April 30, 2008, effective July 24, 2008, as amended. See amendment to Consulting Agreement at Exhibit 10.12.
- 10.6 Homeowners Choice, Inc. 2007 Stock Option and Incentive Plan. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed August 29, 2008.
- 10.7 Form of Incentive Stock Option Agreement. Incorporated by reference to the correspondingly numbered exhibit to our Registration Statement on Form S-1 (File No. 333-150513), originally filed April 30, 2008, effective July 24, 2008, as amended.
- 10.9 Software License Agreement executed April 8, 2008 with an effective date of November 1, 2007 by and between Homeowners Choice, Inc. and Scorpio Systems, Inc. Incorporated by reference to the correspondingly numbered exhibit to our Registration Statement on Form S-1 (File No. 333-150513), originally filed April 30, 2008, effective July 24, 2008, as amended.
- 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.
- 10.12 Amendment dated August 21, 2008 to Consulting Agreement dated June 1, 2007 between Homeowners Choice, Inc. and Scorpio Systems, Inc. Incorporated by reference to Exhibit 10.12 to Form 8-K filed August 21, 2008.
- 10.13 Excess Catastrophe Reinsurance Contract effective June 1, 2011 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.
- 10.14 Reinstatement Premium Protection Agreement effective June 1, 2011 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.

Table of Contents

| | |
|---------|--|
| 10.15 | Aggregate Excess Catastrophe Reinsurance Agreement dated June 1, 2011 by Homeowners Choice Property & Casualty Insurance Company, Inc. and Subscribing Reinsurers (Layer A). Portions of this exhibit have been omitted pursuant to a request for confidential treatment. |
| 10.16 | Aggregate Excess Catastrophe Reinsurance Agreement dated June 1, 2011 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. <u>333-150513</u>), originally filed April 30, 2008, effective July 24, 2008, as amended. |
| 10.19 | Reimbursement Contract effective June 1, 2011 between Homeowners Choice Property & Casualty Insurance Company and the State Board of Administration which administers the Florida Hurricane Catastrophe Fund. |
| 10.20 | Separation Agreement dated June 17, 2011 between Francis X. McCahill, III and Homeowners Choice, Inc. |
| 10.21 | Bill of Sale and Assignment dated July 1, 2011 by Scorpio Systems, Inc. to Homeowners Choice, Inc. |
| 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 |
| 101.INS | XBRL Instance Document. ⁽¹⁾ |
| 101.SCH | XBRL Taxonomy Extension Schema. ⁽¹⁾ |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase. ⁽¹⁾ |
| 101.DEF | XBRL Taxonomy Definition Linkbase. ⁽¹⁾ |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase. ⁽¹⁾ |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase. ⁽¹⁾ |

⁽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.

Table of Contents

SIGNATURES

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

HOMEOWNERS CHOICE, INC.

August 12, 2011

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

August 12, 2011

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.