

UNIVERSAL INSURANCE HOLDINGS, INC.  
Form 10-Q  
November 06, 2009

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-20848

UNIVERSAL INSURANCE HOLDINGS, INC.  
(Exact name of registrant as specified in its charter)

Delaware 65-0231984  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

1110 W. Commercial Blvd., Suite 100, Fort Lauderdale, Florida 33309

(Address of principal executive offices)

(954) 958-1200

(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 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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 38,505,036 shares of common stock, par value \$0.01 per share, outstanding on November 6, 2009.

**UNIVERSAL INSURANCE HOLDINGS, INC.**  
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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To The Board of Directors and Stockholders of  
Universal Insurance Holdings, Inc. and Subsidiaries

Fort Lauderdale, Florida

We have reviewed the accompanying Condensed Consolidated Balance Sheet of **Universal Insurance Holdings, Inc. and Subsidiaries** as of September 30, 2009 and the related Condensed Consolidated Statements of Operations for the nine-month and three-month periods ended September 30, 2009 and 2008 and Cash Flows for each of the nine-month periods ended September 30, 2009 and 2008. These interim financial statements are the responsibility of the Company's management.

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

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

/s/ Blackman Kallick LLP

Chicago, Illinois

November 6, 2009



**PART I -- FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****UNIVERSAL INSURANCE HOLDINGS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

| <b>ASSETS</b>  | <b>(Unaudited)</b>            |                              |
|--|-------------------------------|------------------------------|
|  | <b>September 30,<br/>2009</b> | <b>December 31,<br/>2008</b> |
| Cash and cash equivalents                            | \$ 275,042,884                | \$ 256,964,637               |
| <b>Investments</b>                                   |                               |                              |
| Fixed maturities held to maturity, at amortized cost | -                             | 4,334,405                    |
| Fixed maturities available for sale, at fair value   | 18,575,023                    | -                            |
| Equity securities available for sale, at fair value  | 70,785,948                    | 1,314,370                    |
| Real estate, net                                     | 3,322,298                     | 3,399,609                    |
| Prepaid reinsurance premiums                         | 207,851,243                   | 173,046,776                  |
| Reinsurance recoverables                             | 48,631,361                    | 44,009,847                   |
| Premiums receivable, net                             | 44,307,299                    | 40,358,720                   |
| Receivable from securities                           | 5,386,709                     | -                            |
| Accrued investment income                            | 96,092                        | 102,187                      |
| Other receivables                                    | 5,232,569                     | 2,545,292                    |
| Income taxes recoverable                             | 907,597                       | 2,482,923                    |
| Property and equipment, net                          | 1,114,877                     | 864,125                      |
| Deferred policy acquisition costs, net               | 9,116,132                     | 407,946                      |
| Deferred income taxes                                | 7,783,514                     | 14,113,463                   |
| Other assets   | 823,134                       | 692,612                      |
| <b>Total assets</b>                                  | <b>\$ 698,976,680</b>         | <b>\$ 544,636,912</b>        |

**LIABILITIES AND STOCKHOLDERS' EQUITY****LIABILITIES:**

|  |                    |                    |
|--|--------------------|--------------------|
| Unpaid losses and loss adjustment expenses | \$ 98,263,500      | \$ 87,947,774      |
| Unearned premiums                          | 293,494,305        | 258,489,460        |
| Accounts payable                           | 3,205,674          | 3,147,260          |
| Bank overdraft                             | 20,258,937         | 15,699,930         |
| Payable for securities                     | 8,182,205          | 1,273,941          |
| Reinsurance payable, net                   | 79,948,331         | 23,984,248         |
| Income taxes payable                       | 235,571            | -                  |
| Dividends payable                          | 4,516,460          | -                  |
| Other accrued expenses                     | 22,960,397         | 14,680,443         |
| Advance premium                            | 16,016,282         | 12,860,201         |
| Long-term debt                             | 25,000,000         | 25,000,000         |
| <b>Total liabilities</b>                   | <b>572,081,662</b> | <b>443,083,257</b> |

**STOCKHOLDERS' EQUITY:**

|   |       |       |
|---|-------|-------|
| Cumulative convertible preferred stock, \$.01 par value | 1,087 | 1,387 |
| Authorized shares - 1,000,000                           |       |       |
| Issued shares - 108,640 and 138,640                     |       |       |
| Outstanding shares - 108,640 and 138,640                |       |       |



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|  |                |                |
|--|----------------|----------------|
| Minimum liquidation preference - \$288,190 and \$1,419,700       |                |                |
| Common stock, \$.01 par value                                    | 402,528        | 401,578        |
| Authorized shares - 55,000,000                                   |                |                |
| Issued shares - 40,253,019 and 40,158,019                        |                |                |
| Outstanding shares - 37,644,036 and 37,542,172                   |                |                |
| Treasury shares, at cost - 1,747,983 and 1,709,847 shares        | (7,571,305)    | (7,381,768)    |
| Common stock held in trust, at cost - 861,000 and 906,000 shares | (697,410)      | (733,860)      |
| Additional paid-in capital                                       | 35,706,602     | 33,587,414     |
| Accumulated other comprehensive income, net of taxes             | 4,615,739      | 24,834         |
| Retained earnings  | 94,437,777     | 75,654,070     |
| Total stockholders' equity                                       | 126,895,018    | 101,553,655    |
| Total liabilities and stockholders' equity                       | \$ 698,976,680 | \$ 544,636,912 |

The accompanying notes to Condensed Consolidated financial statements are an integral part of these statements.



**UNIVERSAL INSURANCE HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

|   | For the Nine<br>Months Ended September 30, |                      | For the Three<br>Months Ended September 30, |                     |
|---|--|----------------------|---|---------------------|
|   | 2009                                       | 2008                 | 2009  | 2008                |
| <b>PREMIUMS EARNED AND OTHER REVENUES</b>               |  |                      |   |                     |
|   |  |                      | \$  | \$                  |
| Direct premiums written                                 | \$ 436,610,689                             | \$ 394,304,531       | 134,626,400                                 | 124,718,631         |
| Ceded premiums written                                  | (328,518,186)                              | (275,284,862)        | (104,152,022)                               | (91,295,102)        |
| Net premiums written                                    | 108,092,503                                | 119,019,669          | 30,474,378                                  | 33,423,529          |
| (Increase) decrease in net unearned premium             | (200,377)                                  | (9,679,531)          | 2,283,358                                   | 4,659,359           |
| Premiums earned, net                                    | 107,892,126                                | 109,340,138          | 32,757,736                                  | 38,082,888          |
| Net investment income                                   | 1,385,007                                  | 3,628,472            | 586,525                                     | 1,109,770           |
| Realized gains on investments                           | 13,588,681                                 | -                    | 12,136,072                                  | -                   |
| Foreign currency gains on investments                   | 6,156,945                                  | -                    | 6,084,629                                   | -                   |
| Commission revenue                                      | 23,413,086                                 | 20,526,922           | 8,105,468                                   | 6,677,703           |
| Other revenue   | 4,214,347                                  | 3,658,373            | 1,312,617                                   | 1,304,663           |
| <b>Total premiums earned and other revenues</b>         | <b>156,650,192</b>                         | <b>137,153,905</b>   | <b>60,983,047</b>                           | <b>47,175,024</b>   |
| <b>OPERATING COSTS AND EXPENSES</b>                     |  |                      |   |                     |
| Losses and loss adjustment expenses                     | 68,695,552                                 | 53,861,445           | 23,768,729                                  | 23,619,417          |
| General and administrative expenses                     | 36,789,168                                 | 29,316,796           | 18,674,744                                  | 11,832,474          |
| <b>Total operating costs and expenses</b>               | <b>105,484,720</b>                         | <b>83,178,241</b>    | <b>42,443,473</b>                           | <b>35,451,891</b>   |
| <b>INCOME BEFORE INCOME TAXES</b>                       | <b>51,165,472</b>                          | <b>53,975,664</b>    | <b>18,539,574</b>                           | <b>11,723,133</b>   |
| Income taxes, current                                   | 16,127,712                                 | 22,006,536           | 7,178,058                                   | 3,968,670           |
| Income taxes, deferred                                  | 3,446,852                                  | (909,992)            | (153,004)                                   | 381,809             |
| Income taxes, net                                       | 19,574,564                                 | 21,096,544           | 7,025,054                                   | 4,350,479           |
| <b>NET INCOME</b>                                       | <b>\$ 31,590,908</b>                       | <b>\$ 32,879,120</b> | <b>\$ 11,514,520</b>                        | <b>\$ 7,372,654</b> |
| Basic net income per common share                       | \$ 0.84                                    | \$ 0.88              | \$ 0.31                                     | \$ 0.20             |
| Weighted average of common shares outstanding - Basic   | 37,601,409                                 | 37,448,000           | 37,625,013                                  | 37,500,000          |
| Fully diluted net income per share                      | \$ 0.78                                    | \$ 0.81              | \$ 0.28                                     | \$ 0.19             |
| Weighted average of common shares outstanding - Diluted | 40,374,409                                 | 40,530,000           | 40,671,509                                  | 39,926,000          |
| Cash dividend declared per common share                 | \$ 0.34                                    | \$ 0.20              | \$ -  | \$ 0.10             |
|   |  |                      |   |                     |
|   |  | For the Nine         |   | For the Three       |

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|   | Months Ended September 30, |                      | Months Ended September 30, |                     |
|---|----------------------------|----------------------|----------------------------|---------------------|
|   | 2009                       | 2008                 | 2009                       | 2008                |
| <b>Comprehensive Income:</b>                              |                            |                      |                            |                     |
| Net income  | \$ 31,590,908              | \$ 32,879,120        | \$ 11,514,520              | \$ 7,372,654        |
| Change in net unrealized gains on investments, net of tax | 4,590,905                  | -                    | (3,638,071)                | -                   |
| <b>Comprehensive Income</b>                               | <b>\$ 36,181,813</b>       | <b>\$ 32,879,120</b> | <b>\$ 7,876,449</b>        | <b>\$ 7,372,654</b> |

The accompanying notes to Condensed Consolidated financial statements are an integral part of these statements.

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**UNIVERSAL INSURANCE HOLDINGS, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 AND 2008  
(Unaudited)**

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|  | Common<br>Shares | Preferred<br>Stock<br>Shares | Common<br>Stock<br>Amount | Preferred<br>Stock<br>Amount | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Stock Held<br>in Trust | Treasury<br>Stock |
|--|------------------|------------------------------|---------------------------|------------------------------|----------------------------------|----------------------|---|------------------------|-------------------|
| <b>For the Nine Months Ended September 30, 2009</b>                            |                  |                              |                           |                              |                                  |                      |   |                        |                   |
| Balance,<br>December 31,<br>2008   | \$40,158,019     | \$138,640                    | 401,578                   | \$ 1,387                     | \$33,587,414                     | \$75,654,070         | \$ 24,834                                       | \$ (733,860)           | \$(7,381,760)     |
| Issuance of<br>common<br>shares  | 20,000           |                              | 200                       |                              | 21,800                           |                      |   |                        |                   |
| Preferred stock<br>conversion  | 75,000           | (30,000)                     | 750                       | (300)                        | (450)                            |                      |   |                        |                   |
| Release of<br>shares<br>from SGT   |                  |                              |                           |                              | 136,550                          |                      |   | 36,450                 | (189,530)         |
| Stock<br>compensation<br>plans   |                  |                              |                           |                              | 1,421,332                        |                      |   |                        |                   |
| Net income   |                  |                              |                           |                              |                                  | 31,590,908           |   |                        |                   |
| Tax benefit on exercise<br>of stock<br>options                                 |                  |                              |                           |                              | 49,549                           |                      |   |                        |                   |
| Amortization of deferred<br>compensation                                       |                  |                              |                           |                              | 490,407                          |                      |   |                        |                   |
| Declaration of dividends   |                  |                              |                           |                              |                                  | (12,807,201)         |   |                        |                   |
| Net unrealized gains on<br>investments,<br>net of<br>tax effect of \$2,883,096 |                  |                              |                           |                              |                                  |                      | 4,590,905                                       |                        |                   |
| Balance,<br>September<br>30, 2009  | \$40,253,019     | \$108,640                    | 402,528                   | \$ 1,087                     | \$35,706,602                     | \$94,437,777         | \$ 4,615,739                                    | \$ (697,410)           | \$(7,571,300)     |
| <b>For the Nine Months Ended September 30, 2008</b>                            |                  |                              |                           |                              |                                  |                      |   |                        |                   |
| Balance,<br>December 31,<br>2007   | \$39,307,103     | \$138,640                    | 393,072                   | \$ 1,387                     | \$24,779,798                     | \$50,724,674         |   | \$(2,349,000)          | \$(974,740)       |
| Issuance of<br>common  |                  |                              |                           |                              |                                  |                      |   |                        |                   |

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|  |              |           |             |  |
|--|--------------|-----------|-------------|--|
| shares                                   | 1,516,000    | 15,157    | 2,505,370   | (3,407,23  |
| Release of shares                        |              |           |             |  |
| from SGT                                 |              |           | 25,330      | 1,615,140 (4,041,70  |
| Repurchase of common vshares             |              |           |             | (2,999,78  |
| Retirement of treasury shares            | (965,084)    | (9,651)   | (4,032,054) | 4,041,70   |
| Stock compensation plans                 |              |           | 3,372,832   |  |
| Net income                               |              |           | 32,879,120  |  |
| Tax benefit on exercise of stock options |              |           | 5,706,780   |  |
| Amortization of deferred compensation    |              |           | 231,245     |  |
| Declaration of dividends                 |              |           | (7,647,004) |  |
| Balance, September 30, 2008              | \$39,858,019 | \$138,640 | 398,578     | \$ 1,387\$32,589,301 \$75,956,790 \$ (733,860)\$ (7,381,76 |

The accompanying notes to Condensed Consolidated financial statements are an integral part of these statements.

**UNIVERSAL INSURANCE HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

|   | Nine Months Ended<br>September 30, 2009 | Nine Months<br>Ended<br>September 30,<br>2008 |
|---|---|---|
| Cash flows from operating activities  |   |   |
| Net Income  | \$ 31,590,908                           | \$ 32,879,120                                 |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |   |
| Allowance for doubtful accounts   | 1,056,636                               | 1,184,144                                     |
| Depreciation  | 336,075                                 | 352,877                                       |
| Amortization of cost of stock options   | 1,421,332                               | 3,372,831                                     |
| Amortization of restricted stock grant  | 490,407                                 | 231,246                                       |
| Realized gains on investments   | (13,588,681)                            | -   |
| Foreign currency gains on investments   | (6,108,112)                             | -   |
| Net amortization of premium / accretion of discount                               | 203,653                                 | 20,911  |
| Deferred taxes  | 3,446,852                               | (909,991)                                     |
| Tax benefit on exercise of stock options  | (13,531)                                | (4,677,743)                                   |
| Other   | 130,121                                 | -   |
| Net change in assets and liabilities relating to operating activities:            |   |   |
| Prepaid reinsurance premiums  | (34,804,467)                            | (6,344,061)                                   |
| Reinsurance recoverables  | (4,621,514)                             | (3,346,013)                                   |
| Premiums receivable   | (5,005,214)                             | (8,509,666)                                   |
| Accrued investment income   | 7,113                                   | (196,404)                                     |
| Other receivables   | (2,817,396)                             | (1,811,946)                                   |
| Income taxes recoverable  | 1,624,875                               | 841,597                                       |
| Deferred acquisition costs, net   | (8,708,186)                             | -   |
| Deferred ceding commission, net   | -                                       | 253,280                                       |
| Other assets  | (171,583)                               | (253,224)                                     |
| Unpaid losses and loss adjustment expenses  | 10,315,726                              | 6,375,956                                     |
| Unearned premiums   | 35,004,845                              | 16,023,592                                    |
| Accounts payable  | 58,414                                  | (830,894)                                     |
| Reinsurance payable   | 55,964,083                              | 31,616,636                                    |
| Taxes payable   | 235,571                                 | -   |
| Other accrued expenses  | 8,279,954                               | 2,822,272                                     |
| Advance premium   | 3,156,081                               | 3,925,117                                     |
| Net cash provided by operating activities   | 77,483,962                              | 73,019,637                                    |
| Cash flows from investing activities  |   |   |
| Purchases of fixed maturities   | (206,473,797)                           | (4,369,500)                                   |
| Proceeds from sales of fixed maturities   | 203,451,919                             | -   |
| Purchases of equity securities, available for sale                                | (131,231,211)                           | -   |
| Proceeds from sales of equity securities, available for sale                      | 79,069,631                              | -   |
| Capital expenditures and building improvements                                    | (509,517)                               | (443,314)                                     |
| Net cash used in investing activities   | (55,692,975)                            | (4,812,814)                                   |



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|   |                |                |
|---|----------------|----------------|
| Cash flows from financing activities                |                |                |
| Bank overdraft                                      | 4,559,007      | 16,972,799     |
| Preferred stock dividend                            | (22,462)       | (37,462)       |
| Common stock dividend                               | (8,268,279)    | (7,126,470)    |
| Issuance of common stock                            | 22,000         | 130,530        |
| Acquisition of treasury stock                       | (16,537)       | (6,418,257)    |
| Tax benefit on exercise of stock options            | 13,531         | 4,677,743      |
| Repayments of loans payable                         | -              | (2,820)        |
| Net cash (used in) provided by financing activities | (3,712,740)    | 8,196,063      |
|   |                |                |
| Net increase in cash and cash equivalents           | 18,078,247     | 76,402,886     |
| Cash and cash equivalents at beginning of period    | 256,964,637    | 216,685,954    |
| Cash and cash equivalents at end of period          | \$ 275,042,884 | \$ 293,088,840 |
| Non cash items:                                     |                |                |
| Dividends accrued                                   | \$ 4,516,460   | \$ 3,724,218   |

The accompanying notes to Condensed Consolidated financial statements are an integral part of these statements.

**UNIVERSAL INSURANCE HOLDINGS, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 30, 2009**

**(Unaudited)**

**1. Nature of Operations and Basis of Presentation**

**Nature of Operations**

Universal Insurance Holdings, Inc. (the “Company”) was originally incorporated as Universal Heights, Inc. in Delaware in November 1990. The Company changed its name to Universal Insurance Holdings, Inc. on January 12, 2001. The Company, through its wholly owned subsidiary, Universal Insurance Holding Company of Florida, formed Universal Property & Casualty Insurance Company (“UPCIC”) in 1997.

**Basis of Presentation**

Our unaudited Condensed Consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) and include the accounts of Universal Insurance Holdings, Inc. and its subsidiaries. We have made all adjustments that, in our opinion, are necessary for a fair statement of results of the interim periods, and all such adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to prior period amounts to conform to the current period presentation. Such reclassifications were of an immaterial amount and had no effect on net income or stockholders’ equity. The Condensed Consolidated financial statements should be read in conjunction with our annual audited consolidated financial statements and related notes. Certain financial information that is included in annual financial statements prepared in accordance with GAAP is not required for interim reporting and has been condensed or omitted.

Management must make estimates and assumptions that affect amounts reported in our Condensed Consolidated financial statements and in disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

**2. Significant Accounting Policies**

We reported Significant Accounting Policies in our Annual Report on Form 10-K for the year ended December 31, 2008. The following are new or revised policies.

*Securities Held to Maturity.* Investments for which the Company has the ability and intent to hold to maturity are reported at amortized cost, adjusted for amortization of premiums or discounts and other-than-temporary declines in fair value. Realized gains and losses are determined using the first in, first out (“FIFO”) method.

*Securities Available for Sale.* Investments available for sale are stated at fair value on the balance sheet. Unrealized gains and losses are excluded from earnings and are reported as a component of other comprehensive income within stockholders’ equity, net of related deferred income taxes. Realized gains and losses are determined using the FIFO method.

*Impairment of Securities.* For investments classified as available for sale, the difference between fair value and amortized cost for fixed income securities and cost for equity securities, net of deferred income taxes (as disclosed in Note 5), is reported as a component of accumulated other comprehensive income on the Condensed Consolidated Balance Sheet and is not reflected in the operating results of any period until reclassified to net income upon the consummation of a transaction with an unrelated third party or when the decline in fair value is deemed other-than-temporary. The assessment of whether the impairment of a security's fair value is other-than-temporary is performed using a portfolio review as well as a case-by-case review considering a wide range of factors.

There are a number of assumptions and estimates inherent in evaluating impairments and determining if they are other-than-temporary, including: 1) the Company's ability and intent to hold the investment for a period of time sufficient to allow for an anticipated recovery in value; 2) the expected recoverability of principal and interest; 3) the length of time and extent to which the fair value has been less than amortized cost for fixed income securities or cost for equity securities; 4) the financial condition, near-term and long-term prospects of the issue or issuer, including relevant industry conditions and trends, and implications of rating agency actions and offering prices; and 5) the specific reasons that a security is in a significant unrealized loss position, including market conditions which could affect liquidity. Additionally, once assumptions and estimates are made, any number of changes in facts and circumstances could cause us to subsequently determine that an impairment is other-than-temporary, including: 1) general economic conditions that are worse than previously forecasted or that have a greater adverse effect on a particular issuer or industry sector than originally estimated; 2) changes in the facts and circumstances related to a particular issue or issuer's ability to meet all of its contractual obligations; and 3) changes in facts and circumstances obtained that cause a change in our ability or intent to hold a security to maturity or until it recovers in value.

The Company performed an evaluation of its investments classified as available for sale and has determined that as of September 30, 2009, it held equity securities with unrealized losses in the aggregate amount of \$577,379 and fixed maturities with unrealized losses in the aggregate amount of \$15,800. The Company held no securities for which impairment is other-than-temporary.

*Fair Market Value of Financial Instruments.* The Company uses the following methods and assumptions in estimating the fair value of financial instruments.

Cash equivalents: the carrying amount approximates fair value because of the short maturity of those instruments.

Fixed maturities: the carrying amount for fixed maturities classified as held to maturity securities reported in the Condensed Consolidated Balance Sheet represents amortized cost. The carrying amount for fixed maturities classified as available for sale represents fair value, which is determined using unadjusted quoted market prices, with unrealized gains and losses excluded from earnings and reported in a separate component of stockholders' equity, namely, Accumulated Other Comprehensive Income.

Equity securities: the Company's equity securities are classified as "available for sale" and are, therefore, carried on the Condensed Consolidated Balance Sheet at fair value using unadjusted quoted market prices.

Long-term debt: The Company's long-term debt was held at a carrying value of \$25,000,000 as of September 30, 2009 and December 31, 2008. The fair value of long-term debt as of September 30, 2009 was estimated based on discounted cash flows



utilizing interest rates currently offered for similar products and determined to be \$17,728,045.

*Concentrations of Credit Risk.* Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and cash equivalents, premiums receivable and reinsurance recoverables.

Concentrations of credit risk with respect to cash on deposit are limited by the Company's policy of investing excess cash in money market accounts and repurchase agreements backed by the US Government and US Government Agency Securities with major national banks. These accounts are held by the Institutional Trust & Custody division of U.S. Bank, the Trust Department of SunTrust Bank and Evergreen Investment Management Company, LLC.

The Company maintains depository relationships with SunTrust Bank and Wachovia Bank, N.A. It is the Company's policy not to have a balance of more than \$250,000 for any of its affiliates at either institution on any given day to minimize exposure to a bank failure. Both banks participate in FDIC's Temporary Liquidity Guarantee Program, which provides unlimited deposit insurance coverage through December 31, 2009 for non-interest bearing transaction accounts. Cash balances in excess of FDIC-insured limits are transferred daily into custodial accounts with SunTrust Bank where cash is immediately invested into shares of Ridgeworth Institutional US Treasury Securities Money Market.

Concentrations of credit risk with respect to premiums receivable are limited due to the large number of individuals comprising the Company's customer base. However, the majority of the Company's revenues are currently derived from products and services offered to customers in Florida, which could be adversely affected by economic downturns, an increase in competition or other environmental changes.

In order to reduce credit risk for amounts due from reinsurers, UPCIC and American Platinum Property & Casualty Insurance Company ("APPCIC") seek to do business with financially sound reinsurance companies and regularly evaluate the financial strength of all reinsurers used. UPCIC's largest reinsurer, Everest Reinsurance Company, has the following ratings from each of the rating agencies: A+ from A.M. Best Company, A+ from Standard and Poor's Rating Services and Aa3 from Moody's Investors Service, Inc. As of September 30, 2009 and December 31, 2008, UPCIC's reinsurance portfolio contained the following authorized reinsurers that had unsecured recoverables for paid and unpaid losses, including incurred but not reported ("IBNR") reserves, loss adjustment expenses and unearned premiums whose aggregate balance exceeded 3% of UPCIC's statutory surplus:

|                                    | As of September<br>30,<br>2009 | As of December 31,<br>2008 |
|------------------------------------|--------------------------------|----------------------------|
| <u>Reinsurer</u>                   |                                |                            |
| Everest Reinsurance Company        | \$ 193,874,970                 | \$ 168,444,284             |
| Florida Hurricane Catastrophe Fund | -                              | 31,445,808                 |
| Total                              | \$ 193,874,970                 | \$ 199,890,092             |

As of September 30, 2009 and December 31, 2008, UPCIC did not have any unsecured recoverables from unauthorized reinsurers exceeding 3% of UPCIC's statutory surplus.

*Stock Compensation.* The compensation expense for the stock compensation plans that has been charged against income before income taxes was \$1,421,332 and \$3,372,832 for the nine-month periods ended September 30, 2009 and 2008, respectively, with a corresponding deferred income tax benefit of \$548,279 and \$1,301,070, respectively. As of September 30, 2009 the total unrecognized compensation cost related to nonvested share-based compensation granted under the stock compensation plans was



\$341,661. The cost is expected to be recognized over a weighted average period of 1.0 years. The Company periodically issues restricted common stock as compensation. These restricted stock awards are expensed ratably over their respective vesting periods.

### **Recent Accounting Pronouncements**

In April 2009, the Financial Accounting Standards Board (“FASB”) issued guidance on “Recognition and Presentation of Other-than-Temporary Impairments”, which amends the criteria for the recognition of other-than-temporary impairments (“OTTI”) for debt securities and requires that credit losses be recognized in earnings and losses resulting from factors other than credit of the issuer be recognized in other comprehensive income. Prior to adoption, all OTTI was recorded in earnings in the period of recognition. This guidance is effective for interim and annual periods ending after June 15, 2009, and requires a cumulative effect adjustment to the opening balance of retained earnings with a corresponding adjustment to accumulated other comprehensive income. The Company adopted this guidance in the second quarter of 2009. The adoption of this guidance did not have an effect on the results of operations or financial position of the Company.

In April 2009, the FASB issued guidance on “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly.” Under this guidance, if an entity determines that there has been a significant decrease in the volume and level of activity for the asset or the liability in relation to the normal market activity for the asset or liability (or similar assets or liabilities), then transactions or quoted prices may not accurately reflect fair value. In addition, if there is evidence that the transaction for the asset or liability is not orderly, the entity shall place little, if any, weight on that transaction price as an indicator of fair value. This guidance is effective for interim and annual periods ending after June 15, 2009, and shall be applied prospectively. The Company adopted this guidance in the second quarter of 2009. The adoption of this guidance did not have an effect on the results of operations or financial position of the Company.

In April 2009, the FASB issued guidance on “Interim Disclosures about Fair Value of Financial Instruments”, which requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This guidance requires fair value disclosures on a quarterly basis, providing qualitative and quantitative information about fair value estimates for all those financial instruments not measured on the balance sheet at fair value. This guidance is effective for interim reporting periods ending after June 15, 2009 and was adopted by the Company in the second quarter of 2009. The adoption of this guidance did not have an effect on the results of operations or financial position of the Company.

In May 2009, the FASB issued guidance on “Subsequent Events”, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued, and requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date – that is, whether that date represents the date the financial statements were issued or were available to be issued. This guidance is effective for interim and annual periods ending after June 15, 2009 and was adopted by the Company in the second quarter of 2009. The adoption of this guidance did not have an effect on the results of operations or financial position of the Company.

In June 2009, the FASB issued guidance on “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles”, which establishes the FASB Accounting Standards Codification as the sole source of authoritative U.S. GAAP recognized by the FASB to be applied to nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (“SEC”) promulgated under the authority of the federal securities laws are also sources of

authoritative GAAP for SEC registrants. This guidance is effective for financial statements issued for interim and annual periods ending after September 15, 2009 and was adopted by the Company in the third quarter of 2009. The FASB Accounting Standards Codification supersedes all existing non-SEC accounting and reporting standards. The adoption of this guidance changed the Company's references to U.S. GAAP accounting standards but did not have an effect on the results of operations or financial position of the Company.

### 3. Insurance Operations

Unearned premiums represent amounts that UPCIC would be required to refund policyholders if their policies were canceled. UPCIC determines unearned premiums by calculating the pro-rata amount that would be due to the policyholders at a given point in time based upon the premiums due for the full policy term. At September 30, 2009, UPCIC was servicing approximately 536,000 homeowners' and dwelling fire insurance policies with direct unearned premiums totaling \$293,494,305 and in-force premiums of approximately \$563,000,000. At December 31, 2008, UPCIC was servicing 461,000 homeowners' and dwelling fire insurance policies with direct unearned premiums totaling \$258,489,460 and in-force premiums of approximately \$518,200,000.

The wind mitigation discounts mandated by the Florida legislature to be effective June 1, 2007 for new business and August 1, 2007 for renewal business have had a significant negative effect on UPCIC's premiums and net income. The following table reflects the effect of wind mitigation credits received by UPCIC policyholders:

| Date       | Percentage of UPCIC policyholders receiving credits | Reduction of in-force premium (only policies including wind coverage) |                  |  |
|------------|---|---|------------------|--|
|            |   | Total credits   | In-force premium | Percentage reduction of in-force premium |
| 06/01/2007 | 1.90%   | \$ 6,284,697  | \$ 487,866,319   | 1.27%                                    |
| 12/31/2007 | 11.80%  | \$ 31,951,623   | \$ 500,136,287   | 6.00%                                    |
| 03/31/2008 | 16.90%  | \$ 52,398,215   | \$ 501,523,343   | 9.46%                                    |
| 06/30/2008 | 21.30%  | \$ 74,185,924   | \$ 508,411,721   | 12.73%                                   |
| 09/30/2008 | 27.28%  | \$ 97,802,322   | \$ 515,560,249   | 15.95%                                   |
| 12/31/2008 | 31.10%  | \$ 123,524,911  | \$ 514,011,138   | 19.38%                                   |
| 03/31/2009 | 36.30%  | \$ 158,229,542  | \$ 530,029,572   | 22.99%                                   |
| 06/30/2009 | 40.40%  | \$ 188,053,342  | \$ 544,646,437   | 25.67%                                   |
| 09/30/2009 | 43.04%  | \$ 210,291,783  | \$ 554,378,761   | 27.50%                                   |

### 4. Reinsurance

Amounts recoverable from reinsurers are estimated in accordance with the reinsurance contracts. Reinsurance premiums, losses and loss adjustment expenses ("LAE") are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

UPCIC limits the maximum net loss that can arise from large risks or risks in concentrated geographic areas of exposure by reinsuring (ceding) certain levels of risks with other insurers or reinsurers on an automatic basis under general reinsurance contracts known as "treaties." The reinsurance arrangements are intended to provide UPCIC with the ability to maintain its exposure to loss within its capital resources. Such reinsurance includes quota share, excess of loss and catastrophe forms of reinsurance.





The Company submits the UPCIC reinsurance program for regulatory review to the Florida Office of Insurance Regulation (“OIR”).

UPCIC’s in-force policyholder coverage for windstorm exposures as of September 30, 2009 was approximately \$114.7 billion. In the normal course of business, UPCIC also seeks to reduce the risk of loss that may arise from catastrophes or other events that cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers.

## **2009 Reinsurance Program**

### **Quota Share**

Effective June 1, 2009, UPCIC entered into a quota share reinsurance treaty with Everest Reinsurance Company (“Everest Re”). Everest Re has the following ratings from each of the rating agencies: A+ from A.M. Best Company, A+ from Standard and Poor’s Rating Services and Aa3 from Moody’s Investors Service, Inc. Under the quota share treaty, through May 31, 2010, UPCIC cedes 50% of its gross written premiums, losses and LAE for policies with coverage for wind risk, with a ceding commission payable to UPCIC equal to 25% of ceded gross written premiums. In addition, the quota share treaty has a limitation for any one occurrence of 58% of gross premiums earned, not to exceed \$160,000,000 (of which UPCIC’s net liability in a first event scenario is \$50,000,000 (\$75,000,000 net of \$25,000,000 retained by the Company under the excess catastrophe contract, effective June 12, 2009, described in the “Excess Catastrophe” section below), in a second event scenario is \$16,000,000 and in a third event scenario is \$16,000,000) and a limitation from losses arising out of events that are assigned a catastrophe serial number by the Property Claims Services (“PCS”) office of 175% of gross premiums earned, not to exceed \$480,000,000.

### **Excess Per Risk**

Effective June 1, 2009 through May 31, 2010, UPCIC entered into a multiple line excess per risk agreement with various reinsurers. Under the multiple line excess per risk agreement, UPCIC obtained coverage of \$1,400,000 in excess of \$600,000 ultimate net loss for each risk and each property loss, and \$1,000,000 in excess of \$300,000 for each casualty loss. A \$7,000,000 aggregate limit applies to the term of this agreement.

Effective June 1, 2009 through May 31, 2010, UPCIC entered into a property per risk excess agreement covering ex-wind only policies. Under the property per risk excess agreement, UPCIC obtained coverage of \$400,000 in excess of \$200,000 for each property loss. A \$2,400,000 aggregate limit applies to the term of the contract.

The total cost of UPCIC’s multiple line excess reinsurance program effective June 1, 2009 through May 31, 2010 is \$3,000,000 of which UPCIC’s cost is 50%, or \$1,500,000, and the quota share reinsurers’ cost is the remaining 50%. The total cost of UPCIC’s property per risk reinsurance program effective June 1, 2009 through May 31, 2010 is \$400,000.

### **Excess Catastrophe**

Effective June 1, 2009 through May 31, 2010, under excess catastrophe contracts, UPCIC obtained catastrophe coverage of \$627,000,000 in excess of \$160,000,000 covering certain loss occurrences including hurricanes. The coverage of \$627,000,000 in excess of \$160,000,000 has a second full limit

available to UPCIC; additional premium is calculated pro rata as to amount and 100% as to time, as applicable.

Effective June 1, 2009 through May 31, 2010, UPCIC purchased a reinstatement premium protection contract which reimburses UPCIC for its cost to reinstate the catastrophe coverage of the first \$352,000,000 (part of \$627,000,000) in excess of \$160,000,000.

Effective June 12, 2009 through May 31, 2010, under an excess catastrophe contract, UPCIC obtained catastrophe coverage of \$50,000,000 in excess of \$110,000,000 (placed 50%) covering certain loss occurrences including hurricanes. Loss occurrence is defined as all individual losses directly occasioned by any one disaster, accident or loss or series of disasters, accidents or losses arising out of one event, which occurs in the State of Florida. The Company is the reinsurer under this contract through a segregated account set up by an unrelated company. Accordingly, the Company's aggregate net liability in a first event scenario is UPCIC's \$50,000,000 (as noted above in the "Quota Share" section) and the \$25,000,000 coverage provided by the Company. The intercompany transactions relating to the contract have been eliminated in consolidation.

Effective June 1, 2009 through May 31, 2010, UPCIC also obtained subsequent catastrophe event excess of loss reinsurance to cover certain levels of UPCIC's net retention through two catastrophe events including hurricanes, as follows:

|  | <u>2<sup>nd</sup> Event</u>   | <u>3<sup>rd</sup> Event</u>  |
|--|---|--|
| Coverage                               | \$118,000,000 in excess of \$42,000,000 each loss occurrence subject to an otherwise recoverable amount of \$118,000,000 (placed 50%) | \$128,000,000 in excess of \$32,000,000 each loss occurrence subject to an otherwise recoverable amount of \$256,000,000 (placed 100%) |
| Deposit premium (100%)                 | \$21,240,000  | \$10,240,000   |
| Minimum premium (100%)                 | \$16,992,000  | \$8,192,000  |
| Premium rate -% of total insured value | 0.019309%   | 0.009309%  |

UPCIC also obtained coverage from the Florida Hurricane Catastrophe Fund ("FHCF"), which is administered by the Florida State Board of Administration ("SBA"). Under the reimbursement agreement, FHCF would reimburse UPCIC, for each loss occurrence during the contract year for 90% of the ultimate loss paid by UPCIC in excess of its retention plus 5% of the reimbursed losses to cover loss adjustment expenses. A covered event means any one storm declared to be a hurricane by the National Hurricane Center for losses incurred in Florida, both while it is a hurricane and through subsequent downgrades. For the contract year June 1, 2009 to May 31, 2010, UPCIC purchased the traditional FHCF coverage and did not purchase the Temporary Increase in Coverage Limit Option offered to insurers by the FHCF. The

estimated coverage is 90% of \$1,134,600,000 in excess of \$429,000,000. The estimated premium for this coverage is \$64,232,626.

Also at June 1, 2009, the FHCF made available, and UPCIC obtained, \$10,000,000 of additional catastrophe excess of loss coverage with one free reinstatement of coverage to carriers qualified as Limited Apportionment Companies or companies that participated in the Insurance Capital Build-Up Incentive Program (the "ICBUI Program") offered by the FHCF, such as UPCIC. This particular layer of coverage at June 1, 2009 is \$10,000,000 in excess of \$28,200,000. The premium for this coverage is \$5,000,000.

On October 30, 2009, the SBA published its most recent estimate of the FHCF's loss reimbursement capacity in the *Florida Administrative Weekly*. The SBA estimated that the FHCF's total loss reimbursement capacity under current market conditions for the 2009 - 2010 contract year is projected to be \$18.998 billion over the 12-month period following the estimate. The SBA also referred to its report entitled, "October 2009 Estimated Claims Paying Capacity Report" ("Report") as providing greater detail regarding the FHCF's loss reimbursement capacity. The Report estimated that the FHCF's minimum 12-month loss reimbursement capacity is \$14.998 billion and its maximum 12-month loss reimbursement capacity is \$21.998 billion. UPCIC elected to purchase the FHCF Mandatory Layer of Coverage for the 2009 - 2010 contract year, which corresponds to FHCF loss reimbursement capacity of \$17.175 billion. By law, the FHCF's obligation to reimburse insurers is limited to its actual claims-paying capacity. In addition, the cost of UPCIC's reinsurance program may increase should UPCIC deem it necessary to purchase additional private market reinsurance due to reduced estimates of the FHCF's loss reimbursement capacity.

The total cost of UPCIC's private catastrophe reinsurance program effective June 1, 2009 through May 31, 2010 is \$155,258,800 of which UPCIC's cost is 50%, or \$77,629,400, and the quota share reinsurers' cost is the remaining 50%. The total cost of UPCIC's private catastrophe reinsurance layer effective June 12, 2009 through May 31, 2010 is \$17,500,000 which is eliminated in consolidation. In addition, UPCIC purchases reinstatement premium protection as described above which amounts to \$22,312,747. The cost of subsequent event catastrophe reinsurance is \$15,740,000. The estimated premium UPCIC plans to cede to the FHCF for the 2009 hurricane season is \$64,232,626 of which UPCIC's cost is 50%, or \$32,116,313, and the quota share reinsurers' cost is the remaining 50%. UPCIC is also participating in the additional coverage option for Limited Apportionment Companies or companies that participated in the ICBUI Program, the premium for which is \$5,000,000, of which UPCIC's cost is 50%, or \$2,500,000, and the quota share reinsurers' cost is the remaining 50%.

Effective June 1, 2009 through December 31, 2009, the Company obtained \$60,000,000 of coverage via a catastrophe risk-linked transaction contract in the event UPCIC's catastrophe coverage is exhausted. The total cost of the Company's risk-linked transaction contract is \$11,100,000.

UPCIC is responsible for losses related to catastrophic events with incurred losses in excess of coverage provided by UPCIC's reinsurance program and for losses that otherwise are not covered by the reinsurance program, which could have a material adverse effect on UPCIC's and the Company's business, financial condition and results of operations. As of June 30, 2009, UPCIC had coverage to approximately the 114-year Probable Maximum Loss (PML). PML is a general concept applied in the insurance industry for defining high loss scenarios that should be considered when underwriting insurance risk. Catastrophe models produce loss estimates that are qualified in terms of dollars and probabilities. Probability of exceedance or the probability that the actual loss level will exceed a particular threshold is a standard catastrophe model output. For example, the 100-year PML represents a 1.00% Annual Probability of Exceedance (the 114-year PML represents a 0.877% Annual Probability of Exceedance). It

is estimated that the 100-year PML is likely to be equaled or exceeded in one year out of 100 on average, or 1 percent of the time. It is the 99th percentile of the annual loss distribution.

## 2008 Reinsurance Program

### Quota Share

Effective June 1, 2008, UPCIC entered into a quota share reinsurance treaty with Everest Re. Under the quota share treaty, through May 31, 2009, UPCIC ceded 50% of its gross written premiums, losses and LAE for policies with coverage for wind risk, with a ceding commission payable to UPCIC equal to 31% of ceded gross written premiums. In addition, the quota share treaty has a limitation for any one occurrence of 55% of gross premiums earned, not to exceed \$150,000,000 (of which UPCIC's net liability in a first event scenario is \$70,000,000, in a second event scenario is \$14,800,000 and in a third event scenario is \$15,000,000) and a limitation from losses arising out of events that are assigned a catastrophe serial number by the PCS office of 164% of gross premiums earned, not to exceed \$450,000,000.

### Excess Per Risk

Effective June 1, 2008 through May 31, 2009, UPCIC entered into a multiple line excess per risk agreement with various reinsurers. Under the multiple line excess per risk agreement, UPCIC obtained coverage of \$1,300,000 in excess of \$500,000 ultimate net loss for each risk and each property loss, and \$1,000,000 in excess of \$300,000 for each casualty loss. A \$7,800,000 aggregate limit applies to the term of this agreement. Additionally under this agreement, no property claim shall be made until UPCIC has retained the first \$1,300,000 of potential recovery.

Effective June 1, 2008 through May 31, 2009, UPCIC entered into a property per risk excess agreement covering ex-wind only policies. Under the property per risk excess agreement, UPCIC obtained coverage of \$300,000 in excess of \$200,000 for each property loss. A \$2,100,000 aggregate limit applies to the term of the contract.

The total cost of UPCIC's multiple line excess reinsurance program effective June 1, 2008 through May 31, 2009 is \$2,058,270 of which UPCIC's cost is 50%, or \$1,029,135, and the quota share reinsurers' cost is the remaining 50%. The total cost of UPCIC's property per risk reinsurance program effective June 1, 2008 through May 31, 2009 is \$394,562.

### Excess Catastrophe

Effective June 1, 2008 through May 31, 2009, under an excess catastrophe contract, UPCIC obtained catastrophe coverage of \$399,000,000 in excess of \$150,000,000 covering certain loss occurrences including hurricanes.

|                 | <u>First Layer</u>   | <u>Second Layer</u>  | <u>Third Layer</u>   |
|-----------------|--|--|--|
| Coverage        | \$140,000,000 in excess of<br>\$150,000,000 each loss<br>occurrence<br>(placed 100%) | \$134,000,000 in excess of<br>\$290,000,000 each loss<br>occurrence<br>(placed 100%) | \$125,000,000 in excess of<br>\$424,000,000 each loss<br>occurrence<br>(placed 100%) |
| Deposit premium | \$48,300,000   | \$24,120,000   | \$14,375,000   |



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|  |              |              |              |
|--|--------------|--------------|--------------|
| Minimum premium                        | \$38,640,000 | \$19,296,000 | \$11,500,000 |
| Premium rate -% of total insured value | 0.050837%    | 0.025387%    | 0.015130%    |

Loss occurrence is defined as all individual losses directly occasioned by any one disaster, accident or loss or series of disasters, accidents or losses arising out of one event, which occurs in the State of Florida. The contract contains a provision for one reinstatement in the event coverage is exhausted. An additional premium will be calculated pro rata as to amount and 100% as to time.

Effective June 1, 2008 through May 31, 2009, UPCIC purchased a reinstatement premium protection contract which reimburses UPCIC for its cost to reinstate the catastrophe coverage of the first \$274,000,000 in excess of \$150,000,000.

Also, effective June 1, 2008, UPCIC also obtained subsequent catastrophe event excess of loss reinsurance to cover certain levels of UPCIC's net retention through two catastrophe events including hurricanes, as follows:

|  | <u>2<sup>nd</sup> Event</u>   | <u>3<sup>rd</sup> Event</u>   |
|--|---|---|
| Coverage                               | \$110,400,000 in excess of \$39,600,000 each loss occurrence subject to an otherwise recoverable amount of \$110,400,000 (placed 50%) | \$120,000,000 in excess of \$30,000,000 each loss occurrence subject to an otherwise recoverable amount of \$240,000,000 (placed 50%) |
| Deposit premium (100%)                 | \$16,560,000  | \$7,800,000   |
| Minimum premium (100%)                 | \$13,248,000  | \$6,240,000   |
| Premium rate -% of total insured value | 0.017430%   | 0.008210%   |

UPCIC also obtained coverage from the FHCF, which is administered by the SBA. Under the reimbursement agreement, FHCF would reimburse UPCIC, with respect to each loss occurrence during the contract year for 90% of the ultimate loss paid by UPCIC in excess of its retention plus 5% of the reimbursed losses to cover loss adjustment expenses. A covered event means any one storm declared to be a hurricane by the National Hurricane Center for losses incurred in Florida, both while it is a hurricane and through subsequent downgrades. For the contract year June 1, 2008 to May 31, 2009, the SBA made available through the 2007 passage of House Bill 1A an additional \$12 billion (Temporary Increase in Coverage Limit - TICL) of Florida Hurricane Catastrophe Fund coverage for the 2008 wind season. UPCIC purchased both the traditional FHCF coverage as well as the TICL FHCF coverage for the contract year June 1, 2008 to May 31, 2009. As of December 31, 2008, the estimated coverage is 90% of \$1,514,348,584 in excess of \$305,438,476. The premium for this coverage is \$59,077,813.

Also at June 1, 2008, the FHCF made available, and UPCIC obtained, \$10,000,000 of additional catastrophe excess of loss coverage with one free reinstatement of coverage to carriers qualified as Limited Apportionment Companies or companies that participated in the UCBUI Program offered by the FHCF, such as UPCIC. This particular layer of coverage at June 1, 2008 is \$10,000,000 in excess of \$29,600,000. The premium for this coverage is \$5,000,000.

The total cost of UPCIC's underlying catastrophe private reinsurance program effective June 1, 2008 through May 31, 2009 is \$86,795,000 of which UPCIC's cost is 50%, or \$43,397,500, and the quota share reinsurers' cost is the remaining 50%. In addition, UPCIC purchases reinstatement premium protection as described above which amounts to \$12,266,483. The cost of subsequent event catastrophe reinsurance is \$12,180,000. The estimated premium UPCIC plans to cede to the FHCF for the 2008 hurricane season is \$59,077,813 of which UPCIC's cost is 50%, or \$29,538,907, and the quota share reinsurers' cost is the remaining 50%. UPCIC is also participating in the additional coverage option for Limited Apportionment Companies or companies that participated in the ICBUI Program, the premium for which is \$5,000,000, of which UPCIC's cost is 50%, or \$2,500,000, and the quota share reinsurers' cost is the remaining 50%.

Effective June 1, 2008 through December 31, 2008, the Company obtained \$60,000,000 of coverage via a catastrophe risk-linked transaction contract in the event UPCIC's catastrophe coverage is exhausted or UPCIC is unable to successfully collect from the FHCF for losses involving the Temporary Increase in Coverage Limits. The total cost of the Company's risk-linked transaction contract is \$10,260,000.

Effective July 1, 2008 through May 31, 2009, under an excess catastrophe contract, UPCIC obtained an additional \$90,000,000 of catastrophe coverage via a new top layer of 90% of \$100,000,000 in excess of \$549,000,000 covering certain loss occurrences including hurricanes. The contract contains a provision for one reinstatement in the event coverage is exhausted; additional premium is calculated pro rata as to amount and 100% as to time. The total cost of this new top layer is \$7,200,000 of which UPCIC's cost is 50%, or \$3,600,000, and the quota share reinsurers' cost is the remaining 50%.

Also effective July 1, 2008 through May 31, 2009, UPCIC secured an additional \$80,000,000 of third event catastrophe coverage via a new layer of 80% of \$100,000,000. The total cost of this new layer is \$4,000,000 of which UPCIC's cost is 50%, or \$2,000,000, and the quota share reinsurers' cost is the remaining 50%.

UPCIC is responsible for losses related to catastrophic events with incurred losses in excess of coverage provided by UPCIC's reinsurance program and for losses that otherwise are not covered by the reinsurance program, which could have a material adverse effect on UPCIC's and the Company's business, financial condition and results of operations. At the start of the hurricane season on June 1, 2008, UPCIC had coverage to approximately the 133-year PML. With the additional catastrophic coverage via the new top layer effective July 1, 2008, UPCIC would have had coverage to approximately the 145-year PML. PML is a general concept applied in the insurance industry for defining high loss scenarios that should be considered when underwriting insurance risk. Catastrophe models produce loss estimates that are qualified in terms of dollars and probabilities. Probability of exceedance or the probability that the actual loss level will exceed a particular threshold is a standard catastrophe model output. For example, the 100-year PML represents a 1.00% Annual Probability of Exceedance (the 133-year PML represents a 0.752% Annual Probability of Exceedance and the 145-year PML represents a 0.690% Annual Probability of Exceedance). It is estimated that the 100-year PML is likely to be equaled or exceeded in one year out of 100 on average, or 1 percent of the time. It is the 99th percentile of the annual loss distribution.

The Company's reinsurance arrangements had the following effect on certain items in the Condensed Consolidated Statements of Operations:



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Nine Months Ended September 30, 2009

Nine Months Ended September 30, 2008

|        | Premiums<br><u>Written</u> | Premiums<br><u>Earned</u> | Loss and Loss<br>Adjustment<br><u>Expenses</u> | Premiums<br><u>Written</u> | Premiums<br><u>Earned</u> | Loss and Loss<br>Adjustment<br><u>Expenses</u> |
|--------|----------------------------|---------------------------|--|----------------------------|---------------------------|--|
| Direct | \$436,610,689              | \$401,605,845             | \$139,259,179                                  | \$394,304,531              | \$378,280,937             | \$107,105,622                                  |
| Ceded  | (328,518,186)              | (293,713,719)             | (70,563,627)                                   | (275,284,862)              | (268,940,799)             | (53,244,177)                                   |
| Net    | \$108,092,503              | \$107,892,126             | \$ 68,695,552                                  | \$119,019,669              | \$109,340,138             | \$ 53,861,445                                  |

Three Months Ended September 30, 2009

Three Months Ended September 30, 2008

|        | Premiums<br><u>Written</u> | Premiums<br><u>Earned</u> | Loss and<br>Loss<br>Adjustment<br><u>Expenses</u> | Premiums<br><u>Written</u> | Premiums<br><u>Earned</u> | Loss and<br>Loss<br>Adjustment<br><u>Expenses</u> |
|--------|----------------------------|---------------------------|---|----------------------------|---------------------------|---|
| Direct | \$ 134,626,400             | \$139,207,538             | \$ 48,330,038                                     | \$124,718,631              | \$128,626,371             | \$ 46,907,087                                     |
| Ceded  | (104,152,022)              | (106,449,802)             | (24,561,309)                                      | (91,295,102)               | (90,543,483)              | (23,287,670)                                      |
| Net    | \$ 30,474,378              | \$ 32,757,736             | \$ 23,768,729                                     | \$ 33,423,529              | \$ 38,082,888             | \$ 23,619,417                                     |

**Other Amounts:**

Prepaid reinsurance premiums and reinsurance recoverables as of September 30, 2009 and December 31, 2008 were as follows:

|  | As of September 30,<br>2009 | As of December 31,<br>2008 |
|--|-----------------------------|----------------------------|
| Prepaid reinsurance premiums                     | \$ 207,851,243              | \$ 173,046,776             |
| Reinsurance recoverable on unpaid losses and LAE | \$ 48,223,623               | \$ 43,228,416              |
| Reinsurance recoverable on paid losses           | 407,738                     | 781,431                    |
| Reinsurance recoverables                         | \$ 48,631,361               | \$ 44,009,847              |

The Company has determined that a right of offset exists between UPCIC and its reinsurers, under its quota share reinsurance treaties. Reinsurance payable to reinsurers has been offset by ceding commissions and inuring premiums receivable from reinsurers as follows:

|   | As of September 30,<br>2009 | As of December 31,<br>2008 |
|---|-----------------------------|----------------------------|
| Reinsurance payable, net of ceding commissions<br>due from reinsurers | \$ 134,622,833              | \$ 60,099,512              |
| Inuring premiums receivable   | (54,674,502)                | (36,115,264)               |
| Reinsurance payable, net  | \$ 79,948,331               | \$ 23,984,248              |

**5. Investments**

Major sources of net investment income, are summarized as follows:

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|                           | <u>For the Nine Months Ended September 30,</u> |              |
|---------------------------|--|--------------|
|                           | <u>2009</u>                                    | <u>2008</u>  |
| Cash and cash equivalents | \$ 253,073                                     | \$ 3,757,365 |
| Fixed maturities          | 1,136,568                                      | 38,889       |
| Equity securities         | 634,362  | -            |
| Total investment income   | 2,024,003                                      | 3,796,254    |
| Less investment expenses  | (638,996)                                      | (167,782)    |
| Net investment income     | \$ 1,385,007                                   | \$ 3,628,472 |

As of September 30, 2009 and December 31, 2008, the Company's investments consisted of cash, cash equivalents, and investments with carrying values of \$364,403,855 and \$262,613,412, respectively.

Concentrations of credit risk with respect to cash on deposit are limited by the Company's policy of investing excess cash in money market accounts and repurchase agreements backed by the US Government and US Government Agency Securities with major national banks. These accounts are held by the Institutional Trust & Custody division of U.S. Bank, the Trust Department of SunTrust Bank and Evergreen Investment Management Company, LLC.

Cash and cash equivalents consisted of checking, repurchase and money market accounts with carrying values of \$275,042,884 and \$256,964,637 as of September 30, 2009 and December 31, 2008, respectively, held at the following financial institutions:

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As of September 30, 2009

| Financial Institution                           | Cash      | Money Market Funds | Total       | %      |
|---|-----------|--------------------|-------------|--------|
| U. S. Bank IT&C (1)                             | 0         | 38,800,321         | 38,800,321  | 43.9%  |
| Evergreen Investment Management Company, L.L.C. | 0         | 401,901            | 401,901     | 2.1%   |
| SunTrust Bank                                   | 425,436   | 0                  | 425,436     | 0.5%   |
| SunTrust Bank Institutional Asset Services      | 0         | 217,151,927        | 217,151,927 | 47.3%  |
| Wachovia Bank, N.A.                             | 893,392   | 0                  | 893,392     | 0.3%   |
| The Bank of New York Mellon                     | 0         | 12,269,581         | 12,269,581  | 4.8%   |
| All Other Banking Institutions                  | 501,312   | 4,599,014          | 5,100,326   | 1.1%   |
|   | 1,820,140 | 273,222,744        | 275,042,884 | 100.0% |

(1) Funds invested with Evergreen Investment Management Company, L.L.C.

As of December 31, 2008

| Financial Institution                           | Cash    | Money Market Funds | Total       | %      |
|---|---------|--------------------|-------------|--------|
| U. S. Bank IT&C (1)                             | 0       | 161,072,107        | 161,072,107 | 62.7%  |
| Evergreen Investment Management Company, L.L.C. | 0       | 10,575,615         | 10,575,615  | 4.1%   |
| SunTrust Bank Institutional Asset Services      | 0       | 81,703,268         | 81,703,268  | 31.8%  |
| All Other Banking Institutions                  | 417,830 | 3,195,817          | 3,613,647   | 1.4%   |
|   | 417,830 | 256,546,807        | 256,964,637 | 100.0% |

(1) Funds invested with Evergreen Investment Management Company, L.L.C.

Investments are classified into three categories: held to maturity, trading securities or available for sale. Investments classified as held to maturity include debt securities that the Company has the positive intent and ability to hold to maturity. Held to maturity securities are reported at amortized cost. Investments classified as available for sale include debt and equity securities that are not classified as held to maturity or as trading security investments. Available for sale securities are reported at fair value, with unrealized gains and losses excluded from earnings and reported in a separate component of shareholders' equity, namely Other Comprehensive Income. The Company did not hold any trading securities at September 30, 2009 or December 31, 2008.

During the nine-month period ended September 30, 2009, the Company sold US Treasury Notes, originally intended to be held to maturity, and purchased US Treasury Inflation Index Bonds in order to reduce the effects of inflation on the Company's overall investment portfolio. These US Treasury Notes had a carrying value of \$4,170,864, were sold for \$4,244,851 and a gain of \$73,987 was recognized. The Company reclassified its held to maturity securities being carried at an amortized cost of \$57,773,720 to available for sale securities and recorded net unrealized losses of \$85,965 concurrently with the sale of the US Treasury Notes.

The following table shows the realized gains for fixed maturities and equity securities for the nine-month and three-month periods ended September 30, 2009. There were no realized gains for the nine-month and three-month

periods ended September 30, 2008.

| Nine Months Ended                    |                |                    |
|--------------------------------------|----------------|--------------------|
| September 30, 2009                   |                |                    |
|                                      | Gains (Losses) | Fair Value at Sale |
| Fixed maturities, available for sale | \$ 5,369,899   | \$ 203,451,920     |
| Equity securities                    | 12,284,782     | 56,425,089         |
| Total realized gains                 | \$ 17,654,681  | \$ 259,877,009     |
| Equity securities                    | (4,066,000)    | 28,031,251         |
| Total realized losses                | \$ (4,066,000) | \$ 28,031,251      |
| Net realized gains on investments    | \$ 13,588,681  | \$ 287,908,260     |

| Three Months Ended                   |                |                    |
|--------------------------------------|----------------|--------------------|
| September 30, 2009                   |                |                    |
|                                      | Gains (Losses) | Fair Value at Sale |
| Fixed maturities, available for sale | \$ 5,295,912   | \$ 199,207,068     |
| Equity securities                    | 10,906,160     | 45,028,907         |
| Total realized gains                 | \$ 16,202,072  | \$ 244,235,975     |
| Equity securities                    | (4,066,000)    | 28,031,251         |
| Total realized losses                | \$ (4,066,000) | \$ 28,031,251      |
| Net realized gains on investments    | \$ 12,136,072  | \$ 272,267,226     |

A summary of the amortized cost, estimated fair value, gross unrealized gains and losses of fixed maturities and equity securities at September 30, 2009 and December 31, 2008 follows.

| September 30, 2009                          |                |                        |                         |                      |
|---|----------------|------------------------|-------------------------|----------------------|
|   | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Fixed maturities - available for sale:      |                |                        |                         | \$                   |
| US government and agency obligations        | \$ 18,554,508  | \$ 36,315              | \$ (15,800)             | 18,575,023           |
| Total fixed maturities - available for sale | \$ 18,554,508  | \$ 36,315              | \$ (15,800)             | 18,575,023           |
| Equity securities                           | \$ 63,251,989  | \$ 8,111,338           | \$ (577,379)            | 70,785,948           |
|   |                |                        |                         | \$                   |
| December 31, 2008                           |                |                        |                         |                      |
|   | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Fixed maturities - held to maturity:        |                |                        |                         |                      |

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|   |              |            |          |              |
|---|--------------|------------|----------|--------------|
| US government and agency obligations      | \$ 4,334,405 | \$ 125,760 | \$ -     | \$ 4,460,165 |
| Total fixed maturities - held to maturity | \$ 4,334,405 | \$ 125,760 | \$ -     | \$ 4,460,165 |
| Equity securities                         | \$ 1,273,941 | \$ 40,738  | \$ (309) | \$ 1,314,370 |

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The table below reflects the Company's unrealized investment losses by investment class, aged for length of time in an unrealized loss position as of September 30, 2009.

|   | Less than 12 months |                      |                   | 12 months or longer |             |                   |
|---|---------------------|----------------------|-------------------|---------------------|-------------|-------------------|
|   | Number of issues    | Fair value           | Unrealized losses | Number of issues    | Fair value  | Unrealized losses |
| <b>Fixed maturities, available for sale:</b>      |                     |                      |                   |                     |             |                   |
| US government and agency obligations              | 1                   | \$ 8,098,015         | \$ 15,800         | -                   | \$ -        | \$ -              |
| <b>Total fixed maturities, available for sale</b> | <b>1</b>            | <b>\$ 8,098,015</b>  | <b>\$ 15,800</b>  | <b>-</b>            | <b>\$ -</b> | <b>\$ -</b>       |
| <b>Equity securities:</b>                         |                     |                      |                   |                     |             |                   |
| Common stocks                                     | 30                  | \$ 19,662,342        | \$ 577,379        | -                   | \$ -        | \$ -              |
| <b>Total equity securities</b>                    | <b>30</b>           | <b>\$ 19,662,342</b> | <b>\$ 577,379</b> | <b>-</b>            | <b>\$ -</b> | <b>\$ -</b>       |

Unrealized losses on fixed maturities, available for sale, are principally related to rising interest rates and changes in credit spreads. Unrealized losses on equity securities are primarily related to equity market fluctuations. The Company has performed an evaluation of its investment portfolio and concluded that it holds no securities for which an other-than-temporary impairment adjustment to carrying value is warranted.

Below is a summary of fixed maturities at September 30, 2009 and December 31, 2008 by contractual or expected periods.

|  | September 30, 2009 |                      | December 31, 2008   |                      |
|--|--------------------|----------------------|---------------------|----------------------|
|  | Amortized Cost     | Estimated Fair Value | Amortized Cost      | Estimated Fair Value |
| <b><u>Held-to-maturity</u></b>         |                    |                      |                     |                      |
| Due in one year or less                | \$ -               | \$ -                 | \$ 2,626,958        | \$ 2,674,230         |
| Due after one year through five years  | -                  | -                    | 1,707,447           | 1,785,935            |
| Due after five years through ten years | -                  | -                    | -                   | -                    |
| Due after ten years                    | -                  | -                    | -                   | -                    |
| <b>Total</b>                           | <b>\$ -</b>        | <b>\$ -</b>          | <b>\$ 4,334,405</b> | <b>\$ 4,460,165</b>  |

|  | September 30, 2009 |                      | December 31, 2008 |                      |
|--|--------------------|----------------------|-------------------|----------------------|
|  | Amortized Cost     | Estimated Fair Value | Amortized Cost    | Estimated Fair Value |
| <b><u>Available-for-Sale</u></b>       |                    |                      |                   |                      |
| Due in one year or less                | \$ -               | \$ -                 | \$ -              | \$ -                 |
| Due after one year through five years  | 176,944            | 182,589              | -                 | -                    |
| Due after five years through ten years | 18,377,564         | 18,392,434           | -                 | -                    |
| Due after ten years                    | -                  | -                    | -                 | -                    |

|       |               |               |      |      |
|-------|---------------|---------------|------|------|
| Total | \$ 18,554,508 | \$ 18,575,023 | \$ - | \$ - |
|-------|---------------|---------------|------|------|

The Company has made an assessment of its invested assets for fair value measurement as further described in Note 12 – Fair Value Disclosure.

**6. Loans Payable and Long-Term Debt**

**Surplus Note**

On November 9, 2006, UPCIC entered into a \$25.0 million surplus note with the SBA under the ICBUI Program. Under the ICBUI Program, which was implemented by the Florida legislature to encourage insurance companies to write additional residential insurance coverage in Florida, the SBA matched UPCIC's funds of \$25.0 million that were earmarked for participation in the program. The surplus note brings the current capital and surplus of UPCIC to approximately \$102.7 million. The \$25.0 million is invested in a U.S. treasury money market account.

The surplus note has a twenty-year term and accrues interest at a rate equivalent to the 10-year U.S. Treasury Bond rate, adjusted quarterly based on the 10-year Constant Maturity Treasury rate. For the first three years of the term of the surplus note, UPCIC is required to pay interest only, although principal payments can be made during this period. Any payment of principal or interest by UPCIC on the surplus note must be approved by the Commissioner of the OIR. Principal repayments are scheduled to be made in equal quarterly installments of \$367,647. The first scheduled principal payment is due January 1, 2010.

As of September 30, 2009 and December 31, 2008, the balances due under the surplus note are shown in the Company's Condensed Consolidated Balance Sheets as Long-Term Debt with carrying values of \$25,000,000.

Repayments of the principal balance of the surplus note are due as follows:

|            |    |              |
|------------|----|--------------|
| 2009       | \$ | 0            |
| 2010       |    | 1,470,588    |
| 2011       |    | 1,470,588    |
| 2012       |    | 1,470,588    |
| 2013       |    | 1,470,588    |
| Thereafter |    | 19,117,648   |
| Total      |    | \$25,000,000 |

In May 2008, the Florida legislature passed a law providing participants in the Program an opportunity to amend the terms of their surplus notes based on law changes. The new law contains methods for calculating compliance with the writing ratio requirements that are more favorable to UPCIC than prior law and the prior terms of the existing surplus note. On November 6, 2008, UPCIC and the SBA executed an addendum to the surplus note ("the addendum") that reflects these law changes. The terms of the addendum were effective July 1, 2008. In addition to other less significant changes, the addendum modifies the definitions of Minimum Required Surplus, Minimum Writing Ratio, Surplus, and Gross Written Premium, respectively, as defined in the original surplus note.

Prior to the effective date of the addendum, UPCIC was in compliance with each of the loan's covenants as implemented by rules promulgated by the SBA. UPCIC currently remains in compliance with each of the loan's covenants as implemented by rules promulgated by the SBA. An event of default will occur under the surplus note, as amended, if UPCIC: (i) defaults in the payment of the surplus note; (ii) drops below a net written premium to surplus of 1:1 for three consecutive quarters beginning January 1, 2010 and drops below a gross written premium to surplus ratio of 3:1 for three consecutive quarters beginning January 1, 2010; (iii) fails to submit quarterly filings to the OIR; (iv) fails to maintain at least \$50 million of surplus during the term of the surplus note, except for certain situations; (v) misuses proceeds of the surplus note; (vi) makes any misrepresentations in the application for the program; (vii) pays any dividend when principal or interest payments are past due under the surplus note; or (viii) fails to maintain a level of surplus and reinsurance sufficient to cover in excess of UPCIC's 1-in-100 year

probable maximum loss as determined by a hurricane loss model accepted by the Florida Commission on Hurricane Loss Projection Methodology as certified by the OIR annually.

The original surplus note provided for increases in interest rates for failure to meet the Minimum Writing Ratio. Under the terms of the surplus note agreement, at December 31, 2007, the interest rate on the note was increased by 450 basis points. As of June 30, 2008, the additional interest rate on the note was decreased from 450 basis points to 25 basis points. Under the terms of the surplus note, as amended, the net written premium to surplus requirement and gross written premium to surplus requirement have been modified. As of September 30, 2009, UPCIC's net written premium to surplus ratio and gross written premium to surplus ratio were in excess of the required minimums and, therefore, UPCIC was not subject to increases in interest rates.

### **Finance Facility**

In November 2007, the Company commenced offering premium finance services through Atlas Premium Finance Company, a wholly-owned subsidiary. To fund its operations, Atlas agreed to a Sale and Assignment Agreement with Flatiron Capital Corp., a premier funding partner to the commercial property and casualty insurance industry owned by Wells Fargo Bank, N.A. The agreement provides for Atlas' sale of eligible premium finance receivables to Flatiron.

### **Interest Expense**

Interest expense, comprised primarily of interest on the surplus note, was \$573,323 and \$1,338,993, respectively, for the nine-month periods ended September 30, 2009 and 2008, and \$235,786 and \$283,774, respectively, for the three-month periods ended September 30, 2009 and 2008.

## **7. Related Party Transactions**

Downes and Associates, a multi-line insurance adjustment corporation based in Deerfield Beach, Florida performs certain claims adjusting work for UPCIC. Downes and Associates is owned by Dennis Downes, who is the father of Sean P. Downes, Chief Operating Officer and Senior Vice President of UPCIC. During the nine-month periods ended September 30, 2009 and 2008, the Company expensed claims adjusting fees of \$345,000 and \$200,000, respectively, to Downes and Associates.

## **8. Income Tax Provision**

Deferred income taxes as of September 30, 2009 and December 31, 2008 represent the temporary differences between financial reporting basis and the tax basis of the Company's assets and liabilities. The tax effects of temporary differences are as follows:

|  | As of September<br>30,<br>2009 | As of December 31,<br>2008 |
|--|--------------------------------|----------------------------|
| <b>Deferred income tax assets:</b>           |                                |                            |
| Unearned premiums                            | \$ 6,607,362                   | \$ 6,591,903               |
| Advanced premiums                            | 1,172,728                      | 886,088                    |
| Unpaid losses                                | 1,475,535                      | 1,290,615                  |
| Regulatory assessments                       | 151,165                        | 1,662,854                  |
| Executive compensation                       | -                              | 269,942                    |
| Shareholder compensation                     | 312,005                        | 409,351                    |
| Stock option expense                         | 3,037,700                      | 2,519,346                  |
| Accrued wages                                | 414,493                        | 251,948                    |
| Allowance for uncollectible receivables      | 947,646                        | 540,049                    |
| Restricted stock grant                       | 80,120                         | -                          |
| <b>Total deferred income tax assets</b>      | <b>14,198,754</b>              | <b>14,422,096</b>          |
| <b>Deferred income tax liabilities:</b>      |                                |                            |
| Property and equipment                       | -                              | (26,617)                   |
| Deferred policy acquisition costs, net       | (3,516,548)                    | (157,365)                  |
| Restricted stock grant                       | -                              | (109,056)                  |
| Unrealized gains on investments              | (2,898,692)                    | (15,595)                   |
| <b>Total deferred income tax liabilities</b> | <b>(6,415,240)</b>             | <b>(308,633)</b>           |
| <b>Net deferred income tax asset</b>         | <b>\$ 7,783,514</b>            | <b>\$ 14,113,463</b>       |

A valuation allowance is deemed unnecessary as of September 30, 2009 and December 31, 2008, respectively because management believes it is probable that the Company will generate substantial taxable income sufficient to realize the tax benefits associated with the net deferred income tax asset shown above in the near future.

Included in income tax is State of Florida income tax at a statutory tax rate of 5.5%.

The Company's earliest open tax year for purposes of examination of its Federal and State of Florida income tax liability due to taxing authorities is the year ended December 31, 2006. The Company's U.S. Corporation Income Tax Return for the 2006 tax year is currently undergoing examination by the Internal Revenue Service.

## 9. Stockholders' Equity

### Cumulative Preferred Stock

Each share of Series A Preferred Stock is convertible by the Company into 2.5 shares of Common Stock, into an aggregate of 49,875 common shares. Each share of Series M Preferred Stock is convertible by the Company into 1.25 shares of Common Stock, into an aggregate of 110,863 common shares. The Series A Preferred Stock pays a cumulative dividend of \$.25 per share per quarter.

### Stock Options



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A summary of the option activity for the nine-month period ended September 30, 2009 is presented below:

|                                | <u>Options Exercisable</u> |                        |             |                 | Aggregate<br>Intrinsic<br>Value |
|--------------------------------|----------------------------|------------------------|-------------|-----------------|---------------------------------|
|                                | Number<br>of Shares        | Option Price per Share |             |                 |                                 |
|                                |                            | <u>Low</u>             | <u>High</u> | <u>Weighted</u> |                                 |
| Outstanding December 31, 2008  | 6,650,000                  | \$ 0.50                | \$ 6.50     | \$ 3.15         | \$ 3,795,250                    |
| Granted                        | -                          |                        |             |                 |                                 |
| Exercised                      | (65,000)                   |                        |             | \$ 3.00         |                                 |
| Expired                        | -                          |                        |             |                 |                                 |
| Outstanding September 30, 2009 | 6,585,000                  | \$ 0.50                | \$ 6.50     | \$ 3.15         | \$ 14,685,300                   |

### Common Stock

The following table summarizes the activity relating to shares of the Company's common stock during the nine-month period ended September 30, 2009:

|  | Issued<br>Shares | Treasury<br>Shares | Shares<br>held in trust | Outstanding<br>Shares |
|--|------------------|--------------------|-------------------------|-----------------------|
| Balance, as of December 31, 2008                     | 40,158,019       | (1,709,847)        | (906,000)               | 37,542,172            |
| Options exercised                                    | 20,000           |                    | 45,000                  | 65,000                |
| Shares applied to exercise price and/or income taxes |                  | (38,136)           |                         | (38,136)              |
| Preferred stock conversion                           | 75,000           |                    |                         | 75,000                |
| Balance, as of September 30, 2009                    | 40,253,019       | (1,747,983)        | (861,000)               | 37,644,036            |

### Stock Issuances

On March 9, 2009, preferred stockholders converted 30,000 shares of Series A Preferred Stock into 75,000 shares of Common Stock.

On August 26, 2009, the Company issued 20,000 shares of restricted common stock at a price of \$1.10 per share to Reed Slogoff, a Director of the Company, pursuant to Mr. Slogoff's exercise of stock options.

On September 25, 2009, the Company released from the Stock Grantor Trust ("SGT") 25,000 and 20,000 shares of restricted common stock at prices of \$3.80 and \$3.90 per share, respectively, to an employee of the Company, pursuant to an exercise of stock options on a "cashless" basis. Of the 45,000 common shares released from the SGT, 6,864 shares of common stock were issued to the individual exercising stock options and 38,136 shares of common stock were retained by the Company as treasury shares.

## 10. Earnings Per Share

Basic earnings per share ("EPS") is based on the weighted average number of shares outstanding for the period, excluding any dilutive common share equivalents. Diluted EPS reflects the potential dilution that could occur if securities to issue common stock were exercised.

The following table reconciles the numerator (i.e., income) and denominator (i.e., shares) of the basic and diluted earnings per share computations for net income for the nine-month and three-month periods ended September 30, 2009 and 2008.





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|  | Nine Months Ended<br><u>September 30, 2009</u> |            |                  | Nine Months Ended<br><u>September 30, 2008</u> |            |                  |
|--|--|------------|------------------|--|------------|------------------|
|  | Income Available to Common Stockholders        | Shares     | Per-Share Amount | Income Available to Common Stockholders        | Shares     | Per-Share Amount |
| Net income   | \$31,590,908                                   |            |                  | \$32,879,120                                   |            |                  |
| Less: preferred stocks dividends                               | (22,463)                                       |            |                  | (37,463)                                       |            |                  |
| Income available to common stockholders                        | \$31,568,445                                   | 37,601,409 | \$0.84           | \$32,841,657                                   | 37,448,000 | \$0.88           |
| Effect of dilutive securities:                                 |  |            |                  |  |            |                  |
| Stock options and warrants                                     | -  | 2,593,855  | (0.05)           | -  | 2,514,000  | (0.06)           |
| Preferred stock  | 22,463   | 179,145    | (0.01)           | 37,463   | 568,000    | (0.01)           |
| Income available to common stockholders and assumed conversion | \$31,590,908                                   | 40,374,409 | \$0.78           | \$32,879,120                                   | 40,530,000 | \$0.81           |

|  | Three Months Ended<br><u>September 30, 2009</u> |            |                  | Three Months Ended<br><u>September 30, 2008</u> |            |                  |
|--|---|------------|------------------|---|------------|------------------|
|  | Income Available to Common Stockholders         | Shares     | Per-Share Amount | Income Available to Common Stockholders         | Shares     | Per-Share Amount |
| Net income   | \$11,514,520                                    |            |                  | \$ 7,372,654                                    |            |                  |
| Less: preferred stocks dividends                               | (4,988)   |            |                  | (12,488)  |            |                  |
| Income available to common stockholders                        | \$11,509,532                                    | 37,625,013 | \$ 0.31          | \$ 7,360,166                                    | 37,500,000 | \$0.20           |
| Effect of dilutive securities:                                 |   |            |                  |   |            |                  |
| Stock options and warrants                                     | -   | 2,885,758  | (0.03)           | -   | 1,858,000  | (0.01)           |
| Preferred stock  | 4,988   | 160,738    | -                | 12,488  | 568,000    | 0.00             |
| Income available to common stockholders and assumed conversion | \$11,514,520                                    | 40,671,509 | \$ 0.28          | \$ 7,372,654                                    | 39,926,000 | \$0.19           |

**11. Other Comprehensive Income**

The components of other comprehensive income on a pretax and after-tax basis for the nine-month and three-month periods ended September 30, 2009 are as follows:

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|   | For the Nine Months      |                 |               | For the Three Months     |              |                 |
|---|--------------------------|-----------------|---------------|--------------------------|--------------|-----------------|
|   | Ended September 30, 2009 |                 |               | Ended September 30, 2009 |              |                 |
|   | Pretax                   | Tax             | After-tax     | Pretax                   | Tax          | After-tax       |
| Unrealized gains (losses), net  | \$ 27,219,627            | \$ (10,499,971) | \$ 16,719,656 | \$ (24,197,472)          | \$ 9,367,335 | \$ (14,830,137) |
| Less: reclassification adjustments of realized gains on investments         | 13,588,681               | (5,241,834)     | 8,346,847     | 12,136,072               | (4,681,490)  | 7,454,582       |
| Less: reclassification adjustments of foreign currency gains on investments | 6,156,945                | (2,375,042)     | 3,781,903     | 6,084,629                | (2,347,146)  | 3,737,483       |
| Change in net unrealized gains (losses) on investments                      | 7,474,001                | (2,883,096)     | 4,590,905     | (5,976,771)              | 2,338,700    | (3,638,071)     |
| Other comprehensive income  | \$ 7,474,001             | \$ (2,883,096)  | \$ 4,590,905  | \$ (5,976,771)           | \$ 2,338,700 | \$ (3,638,071)  |

## 12. Subsequent Events

The Company has evaluated subsequent events through November 6, 2009, the date of issuance of these condensed financial statements.

On October 19, 2009, UPCIC received approval for a premium rate increase for its homeowner's program within the State of Florida. The premium rate increase, which will average approximately 14.6 percent statewide, was approved by the OIR. The effective dates for the premium rate increase are October 22, 2009 for new business and December 11, 2009 for renewal business.

On November 3, 2009, UPCIC received approval for a premium rate increase for its dwelling fire program within the State of Florida. The premium rate increase, which will average approximately 14.8 percent statewide, was approved by the OIR. The effective dates for the premium rate increase are November 5, 2009 for new business and December 29, 2009 for renewal business.

On November 3, 2009, the Company declared a dividend of \$.20 per share on its outstanding Common Stock of the Company to be paid on December 4, 2009 to the shareholders of record of the Company at the close of business on November 16, 2009. The company expects to pay an aggregate dividend of approximately \$7,528,808.

## 13. Fair Value Disclosure

Financial assets and financial liabilities recorded on the Condensed Consolidated Balance Sheets at fair value as of September 30, 2009 are categorized in the fair value hierarchy based on the observability of inputs to the valuation techniques as follows:

*Level 1:* Financial assets and financial liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company can access.

*Level 2:* Financial assets and financial liabilities whose values are based on inputs that utilize other than quoted prices included in Level I that are observable for similar assets, or unobservable inputs that are corroborated by market data.

*Level 3:* Financial assets and financial liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect the Company's estimates of the assumptions that market participants would use in valuing the financial assets and financial liabilities.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset.

The following table presents information about the Company's invested assets measured at fair value on a recurring basis as of September 30, 2009, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

|  | Fair Value Measurements |             |             |                      |
|--|-------------------------|-------------|-------------|----------------------|
|  | Level 1                 | Level 2     | Level 3     | Total                |
| US government obligations and agencies | \$ 18,575,023           | \$ -        | \$ -        | \$ 18,575,023        |
| Equity securities                      | 70,785,948              | -           | -           | 70,785,948           |
| <b>Total invested assets</b>           | <b>\$ 89,360,971</b>    | <b>\$ -</b> | <b>\$ -</b> | <b>\$ 89,360,971</b> |

The fair value of the equity securities determined to be Level I inputs are derived from readily available market prices.

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

The following discussion and analysis by management of the Company's Condensed Consolidated financial condition and results of operations should be read in conjunction with the Company's Condensed Consolidated Financial Statements and Notes thereto.

### **Forward-Looking Statements**

Certain statements made by the Company's management may be considered to be "forward-looking statements" within the meaning of the Private Securities Reform Litigation Act of 1995. Forward-looking statements are based on various factors and assumptions that include known and unknown risks and uncertainties. The words "believe," "expect," "anticipate," and "project," and similar expressions, identify forward-looking statements, which speak only as of the date the statement was made. Such statements may include, but not be limited to, projections of revenues, income or loss, expenses, plans, as well as assumptions relating to the foregoing. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified. Future results could differ materially from those described in forward-looking statements as a result of the risks set forth in the following discussion and in the section below entitled "Factors Affecting Operation Results and Market Price of Stock," among others.

### **Overview**

The Company was originally organized as Universal Heights, Inc. in 1990. The Company changed its name to Universal Insurance Holdings, Inc. on January 12, 2001. In April 1997, the Company organized its subsidiary UPCIC as part of its strategy to take advantage of what management believed to be profitable business and growth opportunities in the marketplace. UPCIC was formed to participate in the transfer of homeowners' insurance policies from the Florida Residential Property and Casualty Joint



Underwriting Association (“JUA”). UPCIC’s application to become a Florida licensed property and casualty insurance company was filed with the OIR on May 14, 1997 and approved on October 29, 1997. UPCIC’s proposal to begin operations through the acquisition of homeowners’ insurance policies issued by the JUA was approved by the JUA on May 21, 1997, subject to certain minimum capitalization and other requirements.

The Company has since evolved into a vertically integrated insurance holding company, which through its various subsidiaries, covers substantially all aspects of insurance underwriting, distribution and claims processing. The Company’s primary product is homeowners’ insurance. The Company’s criteria for selecting insurance policies includes, but is not limited to, the use of specific policy forms, coverage amounts on buildings and contents and required compliance with local building codes. Also, to improve underwriting and manage risk, the Company utilizes standard industry modeling techniques for hurricane and windstorm exposure. UPCIC’s portfolio as of September 30, 2009 includes approximately 526,000 policies with coverage for wind risks and 10,000 policies without wind risks. The average premium for a policy with wind coverage is approximately \$1,061 and the average premium for a policy without wind coverage is approximately \$464. UPCIC had in-force premiums of approximately \$563.0 million as of September 30, 2009.

The OIR requires applicants to have a minimum capitalization of \$5.0 million to be eligible to operate as an insurance company in the State of Florida. Upon being issued an insurance license, companies must maintain capitalization of the greater of ten percent of the insurer’s total liabilities or \$4.0 million. If an insurance company’s capitalization falls below the minimum requirements, then the company will be deemed out of compliance with OIR requirements, which could result in revocation of the participant’s license to operate as an insurance company in the State of Florida. UPCIC’s statutory capital and surplus was \$102,653,241 at September 30, 2009 and exceeded the minimum capital and surplus requirements. UPCIC is also required to adhere to prescribed premium-to-capital surplus ratios.

The Company has continued to implement its plan to become a financial services company and, through its wholly-owned insurance subsidiaries, has sought to position itself to take advantage of what management believes to be profitable business and growth opportunities in the marketplace.

In an effort to further grow its insurance operations, in 1998 the Company began to solicit business actively in the open market. Through renewal of JUA business combined with business solicited in the market through independent agents, UPCIC was servicing approximately 536,000 homeowners’ and dwelling fire insurance policies as of September 30, 2009. To improve underwriting and manage risk, the Company utilizes standard industry modeling techniques for hurricane and windstorm exposure. To diversify UPCIC’s product lines, UPCIC underwrites inland marine policies. In February 2008, UPCIC filed a request with the National Flood Insurance Program (“NFIP”) to become authorized to write and service flood insurance policies under the WYO Program. Management may consider underwriting other types of policies in the future. Any such program will require OIR approval. See Item 2 below, Competition under “Factors Affecting Operating Results and Market Price of Stock” for a discussion of the material conditions and uncertainties that may affect UPCIC’s ability to obtain additional policies.

UPCIC applied for expansion to write homeowners’ insurance policies in four additional states. Those states are Hawaii, Georgia, South Carolina and North Carolina. On July 16, 2008, August 18, 2008, September 30, 2008, and January 29, 2009, UPCIC was licensed to transact insurance business within the States of South Carolina, Hawaii, North Carolina, and Georgia, respectively. The State of North Carolina Department of Insurance has restricted UPCIC to writing no more than \$12.0 million of direct premiums in each of the first two full calendar years after which such restriction may be lifted. UPCIC has commenced writing homeowners policies in South Carolina, North Carolina and Hawaii.

On May 8, 2009, the Company filed an application to the Texas Department of Insurance to form a separate property and casualty insurance subsidiary to write homeowners coverage in that state.

The Company joined the Russell 3000® Index on June 26, 2009. According to publicly available information provided on Russell's Web site, annual reconstitution of Russell's U.S. indices captures the 3,000 largest U.S. stocks as of the end of May, ranking them by total market capitalization. Membership in the Russell 3000, which remains in place for one year, means automatic inclusion in the large-cap Russell 1000® Index or small-cap Russell 2000® Index as well as the appropriate growth and value style indices. Russell determines membership for its equity indices primarily by objective, market-capitalization rankings and style attributes. Russell indices are widely used by investment managers and institutional investors for index funds and as benchmarks for both passive and active investment strategies. The Company believes that its inclusion in the Russell 3000® Index will lead to additional visibility in the investment community.

### **Critical Accounting Policies and Estimates**

Management has reassessed the critical accounting policies as disclosed in the Company's 2008 Annual Report on Form 10-K, as amended, and determined that no changes, additions or deletions are needed to the policies as disclosed. Also there were no significant changes in the Company's estimates associated with those policies.

The Company's financial statements are combined with those of its subsidiaries and are presented on a consolidated basis in accordance with GAAP. UPCIC makes estimates and assumptions that can have a significant effect on amounts and disclosures reported in the Company's financial statements. The most significant estimate relates to the reserves for property and casualty insurance unpaid losses and loss adjustment expenses. While the Company believes the estimates are appropriate, the ultimate amounts may differ from the estimates provided. The Company reviews these estimates on, at least, a quarterly basis and reflects any adjustment considered necessary in its current results of operations.

### **Analysis of Financial Condition - As of September 30, 2009 Compared to December 31, 2008**

The source of liquidity for possible claim payments consists of the collection of net premiums after deductions for expenses, reinsurance recoverables and short-term loans. The Company held cash and cash equivalents at September 30, 2009 and December 31, 2008 of \$275,042,884 and \$256,964,637, respectively.

The Company believes that premiums will be sufficient to meet the Company's working capital requirements for at least the next twelve months. The Company's policy is to invest amounts considered to be in excess of current working capital requirements.

The Company used cash and cash equivalents to increase its aggregate fixed maturities and equity securities to \$89,360,971 as of September 30, 2009 from \$5,648,775 as of December 31, 2008 in order to more conservatively limit its exposure to the volatility in the current banking environment.

The following table summarizes, by type, the carrying values of the Company's investments:



| <u>Type of Investment</u>             | As of September 30,<br><u>2009</u> | As of December 31,<br><u>2008</u> |
|---------------------------------------|------------------------------------|-----------------------------------|
| Cash and cash equivalents             | \$ 275,042,884                     | \$ 256,964,637                    |
| Fixed maturities, held to maturity    | -                                  | 4,334,405                         |
| Fixed maturities, available for sale  | 18,575,023                         | -                                 |
| Equity securities, available for sale | 70,785,948                         | 1,314,370                         |
| Real estate                           | 3,322,298                          | 3,399,609                         |
|                                       | \$ 367,726,153                     | \$ 266,013,021                    |

UPCIC's liability for Reinsurance Payable increased \$55,964,083 to \$79,948,331 during the nine-month period ended September 30, 2009 from \$23,984,248 as of year-end 2008, primarily due to changes in UPCIC's reinsurance program effective June 1, 2009 and the timing of settlements with reinsurers.

As of September 30, 2009 and December 31, 2008, the Company had federal and state income taxes recoverable of \$907,597 and \$2,482,923, respectively. The change in the recoverable consisted primarily of the current year provision for income taxes in the amount of \$16,127,712 and estimated tax payments of \$14,149,000.

### **Results of Operations - Nine Months Ended September 30, 2009 Compared to Nine Months Ended September 30, 2008**

Net income decreased 3.9% to \$31,590,908 for the nine-month period ended September 30, 2009 from \$32,879,120 for the nine-month period ended September 30, 2008. The Company's earnings per diluted share were \$0.78 for the 2009 period versus \$0.81 in the same period last year. Even though there was an increase in the number of homeowners' and dwelling fire insurance policies serviced by the Company and increases in direct premiums written during the nine-month period ending September 30, 2009, the Company experienced a decrease in net income during this period due primarily to increases in ceded premiums earned and losses and loss adjustment expenses incurred as described below.

Comprehensive income increased 10.0% to \$36,181,813 for the nine-month period ended September 30, 2009 from \$32,879,120 for the nine-month period ended September 30, 2008 as a result of the aforementioned decrease in net income and an increase in the change in net unrealized gains on investments, net of tax, of \$4,590,905 that comprises an increase in net unrealized gains of \$7,474,001, net of taxes of \$2,883,096. The change in net unrealized gains on investments, net of tax, relate to market value fluctuations within the Company's investment portfolio during the nine-month period ended September 30, 2009. The Company had no realized gains on investments or changes in unrealized gains on investments during the three-month period ended September 30, 2008 as the Company did not hold any fixed maturities or equity securities during that period.

Direct premiums written increased 10.7% to \$436,610,689 during the nine-month period ending September 30, 2009 from \$394,304,531 in the same period of 2008. As of September 30, 2009 and December 31, 2008, UPCIC was servicing approximately 536,000 and 461,000 homeowners' and dwelling fire insurance policies, respectively, with in-force premiums of approximately \$563,000,000 and \$518,200,000, respectively.

Net premiums earned decreased 1.3% to \$107,892,126 for the nine-month period ended September 30, 2009 from \$109,340,138 for the nine-month period ended September 30, 2008. The decrease is due to a decrease in net premiums written. The higher volume of state-

required wind mitigation premium discounts had a significant negative effect on the Company's premium volume and net income.

On October 19, 2009, UPCIC received approval for a premium rate increase for its homeowner's program within the State of Florida. The premium rate increase, which will average approximately 14.6 percent statewide, was approved by the OIR. The effective dates for the premium rate increase are October 22, 2009 for new business and December 11, 2009 for renewal business. UPCIC expects the approved premium rate increases to have a favorable effect on premiums written and earned in future months as new and renewal policies are written at the higher rates.

On November 3, 2009, UPCIC received approval for a premium rate increase for its dwelling fire program within the State of Florida. The premium rate increase, which will average approximately 14.8 percent statewide, was approved by the OIR. The effective dates for the premium rate increase are November 5, 2009 for new business and December 29, 2009 for renewal business. UPCIC expects the approved premium rate increases to have a favorable effect on premiums written and earned in future months as new and renewal policies are written at the higher rates.

Although total direct premiums earned increased 6.2% in the nine-month 2009 period compared to the same period in 2008, the average premium per policy decreased significantly due to the previously described rate decreases and wind mitigation credits. As of September 30, 2009, UPCIC was servicing approximately 536,000 homeowners' and dwelling fire insurance policies with in-force premiums of approximately \$563,000,000, or an average of \$1,050 per policy. The comparable average in-force premium per policy as of September 30, 2008 was \$1,151. Consequently, as a result of increased losses and LAE in connection with the servicing of additional policies, the direct loss and LAE ratio increased significantly for the 2009 period. The Company expects the aforementioned premium rate increases approved by OIR to favorably effect the amount of in-force premium per policy as new and renewal policies are written at the higher rates.

Net investment income decreased 61.8% to \$1,385,007 for the nine-month period ended September 30, 2009 from \$3,628,472 for the nine-month period ended September 30, 2008. Net investment income is comprised primarily of interest and dividends. The decrease is primarily due to a change in the composition of the Company's investment portfolio during the nine-month period ended September 30, 2009.

Realized gains on investments increased to \$13,588,681 for the nine-month period ended September 30, 2009 from \$0 for the nine-month period ended September 30, 2008. The increase is due to the expansion of the Company's investment portfolio into fixed maturities and equity securities and the related sales of certain of these securities.

Foreign currency gains on investments increased to \$6,156,945 for the nine-month period ended September 30, 2009 from \$0 for the nine-month period ended September 30, 2008. The increase is due to the expansion of the Company's investment portfolio into foreign-denominated fixed maturities and equity securities and the related sales of certain of these securities.

Commission revenue increased 14.1% to \$23,413,086 for the nine-month period ended September 30, 2009 from \$20,526,922 for the nine-month period ended September 30, 2008. Commission revenue is comprised principally of the managing general agent's policy fee income and service fee income on all new and renewal insurance policies, reinsurance commission sharing agreements, and commissions generated from agency operations. The increase is primarily attributable to an increase in managing general agent's policy fee income of approximately \$1,786,000 and an increase in reinsurance commission sharing of \$1,116,000.

Other revenue increased 15.2% to \$4,214,347 for the nine-month period ended September 30, 2009 from \$3,658,373 for the nine-month period ended September 30, 2008. The increase is primarily due to a higher volume of fees earned on payment plans offered to policyholders by UPCIC.

Net losses and LAE increased 27.5% to \$68,695,552 for the nine-month period ended September 30, 2009 from

\$53,861,445 for the nine-month period ended September 30, 2008. During the third quarter of 2008, the Company incurred net losses and LAE of approximately \$2.9 million related to tropical storm Fay. While there was an absence of incurred net losses and LAE related to adverse weather events during the third quarter of 2009, the Company incurred an increase in net losses and LAE in connection with the servicing of additional policies.

The net loss and LAE ratios, or net losses and LAE as a percentage of net earned premiums, were 63.7% and 49.3% during the nine-month periods ended September 30, 2009 and 2008, respectively, and were comprised of the following components:



| <u>Nine months ended September 30, 2009</u> |               |               |               |
|---|---------------|---------------|---------------|
|   | <u>Direct</u> | <u>Ceded</u>  | <u>Net</u>    |
| Loss and loss adjustment expenses           | \$139,259,179 | \$70,563,627  | \$68,695,552  |
| Premiums earned                             | \$401,605,845 | \$293,713,719 | \$107,892,126 |
| Loss & LAE ratios                           | 34.7%         | 24.0%         | 63.7%         |

| <u>Nine months ended September 30, 2008</u> |               |               |               |
|---|---------------|---------------|---------------|
|   | <u>Direct</u> | <u>Ceded</u>  | <u>Net</u>    |
| Loss and loss adjustment expenses           | \$107,105,622 | \$53,244,177  | \$53,861,445  |
| Premiums earned                             | \$378,280,937 | \$268,940,799 | \$109,340,138 |
| Loss & LAE ratios                           | 28.3%         | 19.8%         | 49.3%         |

The ceded loss and LAE ratio for the nine-month period ended September 30, 2009 was 24.0% compared to 19.8% for the nine-month period ended September 30, 2008. The ceded loss and LAE ratio was influenced by greater direct incurred loss and LAE ceded under the Company's quota share reinsurance treaty and higher total reinsurance costs in the 2009 period compared to the 2008 period.

Catastrophes are an inherent risk of the property-liability insurance business which may contribute to material year-to-year fluctuations in UPCIC's and the Company's results of operations and financial position. During the nine-month periods ended September 30, 2009 and 2008, neither UPCIC nor the Company experienced any catastrophic events. The level of catastrophe loss experienced in any year cannot be predicted and could be material to the results of operations and financial position of UPCIC and the Company. While management believes UPCIC's and the Company's catastrophe management strategies will reduce the severity of future losses, UPCIC and the Company continue to be exposed to catastrophic losses, including catastrophic losses that may exceed the limits of UPCIC's reinsurance program.

General and administrative expenses increased 25.5% to \$36,789,168 for the nine-month period ended September 30, 2009 from \$29,316,796 for the nine-month period ended September 30, 2008. The increase in general and administrative expenses was primarily due to increased salaries for existing employees and

higher employee count due to business growth. Also, ceding commissions decreased as a result of the quota share reinsurance commission rate reduction to 25% for the 2009 - 2010 contract year from 31% for the 2008 - 2009 contract year. Deferred policy acquisition costs were also affected by this rate reduction.

Federal and state income taxes decreased 7.2% to \$19,574,564 for the nine-month period ended September 30, 2009 from \$21,096,544 for the nine-month period ended September 30, 2008. Federal and state income taxes were 38.3% of pretax income for the nine-month period ended September 30, 2009, and 39.1% for the nine-month period ended September 30, 2008. The decrease is primarily due to lower income before income taxes.

### **Results of Operations - Three Months Ended September 30, 2009 Compared to Three Months Ended September 30, 2008**

Net income increased 56.2% to \$11,514,520 for the three-month period ended September 30, 2009 from \$7,372,654 for the three-month period ended September 30, 2008. The Company's earnings per diluted share were \$0.28 for the 2009 period versus \$0.19 in the same period last year. There was an increase in the number of homeowners' and dwelling fire insurance policies serviced by the Company and increases in direct premiums written during the three-month period ending September 30, 2009.

Comprehensive income increased 6.8% to \$7,876,449 for the three-month period ended September 30, 2009 from \$7,372,654 for the three-month period ended September 30, 2008 as a result of the aforementioned increase in net income and a decrease in net unrealized gains on investments, net of tax, of \$3,638,071. Certain unrealized gains on investments, as of June 30, 2009, were realized in the third quarter as those securities were sold and the gains were then realized. Additionally, the change in net unrealized gains on investments, net of tax, was also impacted by market value fluctuations within the Company's investment portfolio during the three-month period ended September 30, 2009. Net unrealized gains as of September 30, 2009 were \$7,474,001 as compared to \$13,450,772 as of June 30, 2009, a decrease of \$5,976,771. Income taxes on unrealized gains as of September 30, 2009 were \$2,883,096 as compared to \$5,221,796 as of June 30, 2009, a decrease of \$2,338,700. The Company had no realized gains on investments or changes in unrealized gains on investments during the three-month period ended September 30, 2008 as the Company did not hold any fixed maturities or equity securities during that period.

Direct premiums written increased 7.9% to \$134,626,400 during the three-month period ending September 30, 2009 from \$124,718,631 in the same period of 2008. As of September 30, 2009 and December 31, 2008, UPCIC was servicing approximately 536,000 and 461,000 homeowners' and dwelling fire insurance policies, respectively, with in-force premiums of approximately \$563,000,000 and \$518,200,000, respectively.

Net premiums earned decreased 14.0% to \$32,757,736 for the three-month period ended September 30, 2009 from \$38,082,888 for the three-month period ended September 30, 2008. The decrease is due to a decrease in net premiums written. The higher volume of state-required wind mitigation premium discounts had a significant negative effect on the Company's premium volume and net income.

On October 19, 2009, UPCIC received approval for a premium rate increase for its homeowner's program within the State of Florida. The premium rate increase, which will average approximately 14.6 percent statewide, was approved by the OIR. The effective dates for the premium rate increase are October 22, 2009 for new business and December 11, 2009 for renewal business. UPCIC expects the approved

premium rate increases to have a favorable effect on premiums written and earned in future months as new and renewal policies are written at the higher rates.

On November 3, 2009, UPCIC received approval for a premium rate increase for its dwelling fire program within the State of Florida. The premium rate increase, which will average approximately 14.8 percent statewide, was approved by the OIR. The effective dates for the premium rate increase are November 5, 2009 for new business and December 29, 2009 for renewal business. UPCIC expects the approved premium rate increases to have a favorable effect on premiums written and earned in future months as new and renewal policies are written at the higher rates.

Although total direct premiums earned increased 8.2% in the three-month 2009 period compared to the same period in 2008, the average premium per policy decreased significantly due to the previously described rate decreases and wind mitigation credits. As of September 30, 2009, UPCIC was servicing approximately 536,000 homeowners' and dwelling fire insurance policies with in-force premiums of approximately \$563,000,000, or an average of \$1,050 per policy. The comparable average in-force premium per policy as of September 30, 2008 was \$1,151. The Company expects the aforementioned premium rate increases approved by OIR to favorably effect the amount of in-force premium per policy as new and renewal policies are written at the higher rates.

Net investment income decreased 47.1% to \$586,525 for the three-month period ended September 30, 2009 from \$1,109,770 for the three-month period ended September 30, 2008. Net investment income is comprised primarily of interest and dividends. The decrease is primarily due to a change in the composition of the Company's investment portfolio during the three-month period ended September 30, 2009.

Realized gains on investments increased to \$12,136,072 for the three-month period ended September 30, 2009 from \$0 for the three-month period ended September 30, 2008. The increase is due to the expansion of the Company's investment portfolio into fixed maturities and equity securities and the related sales of certain of these securities.

Foreign currency gains on investments increased to \$6,084,629 for the three-month period ended September 30, 2009 from \$0 for the three-month period ended September 30, 2008. The increase is due to the expansion of the Company's investment portfolio into foreign-denominated fixed maturities and equity securities and the related sales of certain of these securities.

Commission revenue increased 21.4% to \$8,105,468 for the three-month period ended September 30, 2009 from \$6,677,703 for the three-month period ended September 30, 2008. Commission revenue is comprised principally of the managing general agent's policy fee income and service fee income on all new and renewal insurance policies, reinsurance commission sharing agreements, and commissions generated from agency operations. The increase is primarily attributable to an increase in reinsurance commission sharing of approximately \$1,130,000, and an increase in managing general agent's policy fee income of approximately \$303,000.

Other revenue increased 0.6% to \$1,312,617 for the three-month period ended September 30, 2009 from \$1,304,663 for the three-month period ended September 30, 2008. The increase is primarily due to a higher volume of fees earned on payment plans offered to policyholders by UPCIC.

Net losses and LAE increased 0.6% to \$23,768,729 for the three-month period ended September 30, 2009 from \$23,619,417 for the three-month period ended September 30, 2008. During the third quarter of 2008, the Company incurred net losses and LAE of approximately \$2.9 million related to tropical storm Fay. While there was an absence of incurred net losses and LAE related to adverse weather events during the third quarter of 2009, the Company incurred an increase in net losses and LAE in connection with the servicing of additional policies.

The net loss and LAE ratios, or net losses and LAE as a percentage of net earned premiums, were 72.6% and 62.0% during the three-month periods ended September 30, 2009 and 2008, respectively, and were comprised of the following components:

| <u>Three months ended September 30, 2009</u> |               |                |               |
|--|---------------|----------------|---------------|
|  | <u>Direct</u> | <u>Ceded</u>   | <u>Net</u>    |
| Loss and loss adjustment expenses            | \$ 48,330,038 | \$ 24,561,309  | \$ 23,768,729 |
| Premiums earned                              | \$139,207,538 | \$ 106,449,802 | \$ 32,757,736 |
| Loss & LAE ratios                            | 34.7%         | 23.1%          | 72.6%         |



|                                   | <u>Three months ended September 30, 2008</u> |              |              |
|-----------------------------------|--|--------------|--------------|
|                                   | <u>Direct</u>                                | <u>Ceded</u> | <u>Net</u>   |
| Loss and loss adjustment expenses | \$46,907,087                                 | \$23,287,670 | \$23,619,417 |
| Premiums earned                   | \$128,626,371                                | \$90,543,483 | \$38,082,888 |
| Loss & LAE ratios                 | 36.5%  | 25.7%        | 62.0%        |

The ceded loss and LAE ratio for the three-month period ended September 30, 2009 was 23.1% compared to 25.7% for the three-month period ended September 30, 2008. The ceded loss and LAE ratio was influenced by greater direct incurred loss and LAE ceded under the Company's quota share reinsurance treaty and higher total reinsurance costs in the 2009 period compared to the 2008 period.

General and administrative expenses increased 57.8% to \$18,674,744 for the three-month period ended September 30, 2009 from \$11,832,474 for the three-month period ended September 30, 2008. The increase in general and administrative expenses was due to several factors, including increased salaries for existing employees and higher employee count due to business growth. Also, ceding commissions decreased as a result of the quota share reinsurance commission rate reduction to 25% for the 2009 - 2010 contract year from 31% for the 2008 - 2009 contract year. Deferred policy acquisition costs were also affected by this rate reduction.

Federal and state income taxes increased 61.5% to \$7,025,054 for the three-month period ended September 30, 2009 from \$4,350,479 for the three-month period ended September 30, 2008. Federal and state income taxes were 37.9% of pretax income for the three-month period ended September 30, 2009, and 37.1% for the three-month period ended September 30, 2008. The increase is primarily due to higher income before income taxes.

## **Liquidity and Capital Resources**

### **Overview**

The Company's primary sources of cash flow are the receipt of premiums, commissions, policy fees investment income, reinsurance recoverables and short-term loans.

The Company expects that its current capital resources will be sufficient to meet anticipated working capital requirements for the next twelve months. There can be no assurances, however, that such will be the case.

### **Cash Flows Provided by Operating Activities**

For the nine-month periods ended September 30, 2009 and 2008, cash flows provided by operating activities were \$77,483,962 and \$73,019,637, respectively. The increase in cash flows provided by operating activities relate primarily to the following reasons.

Adjustments to reconcile net income to net cash provided by operating activities for realized gains on investments and foreign currency gains on investments were \$13,588,681 and \$6,108,112 for the nine month period ended September 30, 2009 and \$0 for the nine month period ended September 30, 2008. The increase in realized gains and foreign currency gains on investments relate to sales of fixed maturities and equity securities sold during the 2009 period.

The decrease in cash provided by operating activities from net changes in prepaid reinsurance premiums were \$34,804,467 and \$6,344,061 for the nine-month periods ended September 30, 2009 and 2008, respectively. The increase of \$28,460,406 relates primarily to additional catastrophe reinsurance coverage purchased by the Company during the 2009 period.

The increase in cash provided by operating activities from net changes in unearned premiums were \$35,004,845 and \$16,023,592 for the nine-month periods ended September 30, 2009 and 2008, respectively. The increase of \$18,981,253 relates primarily to an increase in direct written premiums.

The increase in cash provided by operating activities from net changes in reinsurance payable were \$55,964,083 and \$31,616,636 for the nine-month periods ended September 30, 2009 and 2008, respectively. The increase of \$24,347,447 relates primarily to the timing of the settlement of balances with UPCIC's reinsurers.

Cash flows provided by operating activities are expected to be positive in both the short-term and reasonably foreseeable future. In addition, the Company's investment portfolio is highly liquid as it consists of cash, cash equivalents, and readily-marketable securities.

### **Cash Flows Used in Investing Activities**

For the nine-month periods ended September 30, 2009 and 2008, cash flows used in investing activities were \$55,692,975 and \$4,812,814, respectively. The following table summarizes the activity in investments during the nine-month periods ended September 30, 2009 and 2008:



|   | <u>Nine months ended</u>  |                           |
|---|---------------------------|---------------------------|
|   | <u>September 30, 2009</u> | <u>September 30, 2008</u> |
| Beginning Balance - January 1             | \$ 5,648,775              | \$ -                      |
| Purchases of fixed maturities             | 206,473,797               | 4,369,500                 |
| Purchases of equity securities            | 138,139,475               | -                         |
| Net amort of prem / accretion of discount | (203,653)                 | (20,911)                  |
| Sales of fixed maturities                 | (203,451,919)             | -                         |
| Sales of equity securities                | (84,456,340)              | -                         |
| Realized gains on investments             | 13,588,679                | -                         |
| Foreign currency gains on investments     | 6,108,112                 | -                         |
| Unrealized gains                          | 7,514,045                 | -                         |
| Ending Balance - September 30             | \$ 89,360,971             | \$ 4,348,589              |

The amounts presented in the Statement of Cash Flows for purchases and sales of equity securities differ from the amounts shown in the table above by \$8,182,205 and \$5,386,709, respectively. These amounts represent securities with trade dates on or before September 30, 2009 that settled in October 2009.

The Company's purchases and sales of fixed maturities and equity securities increased significantly in the 2009 period as compared to the 2008 period. As previously described, the Company benefited from realized gains and foreign currency gains on the sales of these securities as the Company took advantage of opportunities presented in the financial markets.

#### **Cash Flows Used in / Provided by Financing Activities**

For the nine-month periods ended September 30, 2009 and 2008, cash flows used in financing activities were \$3,712,740 and cash flows provided by financing activities were \$8,196,063, respectively. The decrease in cash flows provided by financing activities relate primarily to a decrease of \$12,413,792 in the amount provided by bank overdrafts. The Company's bank overdrafts relate primarily to outstanding checks for loss and LAE payments and premium refunds to policyholders not yet presented for payment on the Company's bank accounts as compared to cash balances on deposit in those accounts.

#### **Available Cash**

The Company held cash and cash equivalents at September 30, 2009 of \$275,042,884. Of that amount, \$239,839,166 was held by UPCIC, most of which is available to pay claims or relates to policyholder surplus. Accordingly, cash and cash equivalents in UPCIC are not available to buy back Company stock or pay Company dividends. A portion of those claims paid by the Company would be recoverable through the Company's catastrophic reinsurance upon presentation to the reinsurer of evidence of claim payment. As of December 31, 2008, the Company held cash and cash equivalents of \$256,964,637.

#### **Cash Dividends**

On January 16, 2009, the Company's Board of Directors declared a dividend of \$0.10 per share on its outstanding common stock. The dividend was paid on March 4, 2009 to stockholders of record as of February 12, 2009 in the aggregate amount of \$3,754,217. On March 4, 2009, the Company's Board of



Directors declared a dividend of \$0.12 per share on its outstanding common stock. The dividend was paid on May 4, 2009 to stockholders of record as of April 9, 2009 in the aggregate amount of \$4,514,061. On June 16, 2009, the Company's Board of Directors declared a dividend of \$0.12 per share on its outstanding common stock. The dividend was paid on October 23, 2009 to stockholders of record as of September 3, 2009 in the aggregate amount of \$4,516,461.

On November 3, 2009, the Company declared a dividend of \$.20 per share on its outstanding Common Stock of the Company to be paid on December 4, 2009 to the shareholders of record of the Company at the close of business on November 16, 2009. The company expects to pay an aggregate dividend of approximately \$7,528,808.

### **Contractual Obligations**

There have been no material changes during the period covered by this report, outside of the ordinary course of the Company's business, to the contractual obligations specified in the table of contractual obligations included in the section "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in the Company's Annual Report on Form 10-K, for the year ended December 31, 2008.

### **Factors Affecting Operation Results and Market Price of Stock**

The Company and its subsidiaries operate in a rapidly changing environment that involves a number of uncertainties, some of which are beyond the Company's control. This report contains, in addition to historical information, forward looking statements that involve risks and uncertainties. The words "expect," "estimate," "anticipate," "believe," "intend," "and similar expressions and variations thereof are intended to identify forward-looking statements. The Company's actual results could differ materially from those set forth in or implied by any forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those uncertainties discussed below as well as those discussed elsewhere in this report.

#### *Nature of the Company's Business*

Factors affecting the sectors of the insurance industry in which the Company operates may subject the Company to significant fluctuations in operating results. These factors include competition, catastrophe losses and general economic conditions including interest rate changes, as well as legislative initiatives, the regulatory environment, the frequency of litigation, the size of judgments, severe weather conditions, climate changes or cycles, the role of federal or state government in the insurance market, judicial or other authoritative interpretations of laws and policies, and the availability and cost of reinsurance. Specifically, the homeowners' insurance market, which comprises the bulk of the Company's current operations, is influenced by many factors, including state and federal laws, market conditions for homeowners' insurance and residential plans. Additionally, an economic downturn could result in fewer home sales and less demand for new homeowners seeking insurance.

Historically, the financial performance of the property and casualty insurance industry has tended to fluctuate in cyclical patterns of soft markets followed by hard markets. Although an individual insurance company's financial performance is dependent on its own specific business characteristics, the profitability of most property and casualty insurance companies tends to follow this cyclical market pattern.

The Company believes that a substantial portion of its future growth will depend on its ability, among other things, to successfully implement its business strategy, including expanding the Company's product

offering by underwriting and marketing additional insurance products and programs through its distribution network, further penetrating the Florida market by establishing relationships with additional independent agents in order to expand its distribution network and to further disperse its geographic risk and expanding into other geographical areas outside the State of Florida. Any future growth is contingent on various factors, including the availability of adequate capital, the Company's ability to hire and train additional personnel, regulatory requirements, the competitive environment, and rating agency considerations. There is no assurance that the Company will be successful in expanding its business, that the existing infrastructure will be able to support additional expansion or that any new business will be profitable. Moreover, as the Company expands its insurance products and programs and the Company's mix of business changes, there can be no assurance that the Company will be able to maintain or improve its profit margins or other operating results. There can also be no assurance that the Company will be able to obtain the required regulatory approvals to offer additional insurance products. UPCIC also is required to maintain minimum surplus to support its underwriting program. The surplus requirement affects UPCIC's potential growth.

#### *Management of Exposure to Catastrophic Losses*

UPCIC is exposed to potentially numerous insured losses arising out of single or multiple occurrences, such as natural catastrophes. As with all property and casualty insurers, UPCIC expects to and will incur some losses related to catastrophes and will price its policies accordingly. UPCIC's exposure to catastrophic losses arises principally out of hurricanes and windstorms. Through the use of standard industry modeling techniques that are susceptible to change, UPCIC manages its exposure to such losses on an ongoing basis from an underwriting perspective. UPCIC also protects itself against the risk of catastrophic loss by obtaining reinsurance coverage as of the beginning of hurricane season on June 1 of each year. UPCIC's reinsurance program consists of excess of loss, quota share and catastrophe reinsurance for multiple hurricanes. UPCIC's catastrophe reinsurance program currently covers three events, subject to the terms and limitations of the reinsurance contracts. However, UPCIC may not buy enough reinsurance to cover multiple storms going forward or be able to timely obtain reinsurance. In addition, UPCIC is responsible for losses related to catastrophic events with incurred losses in excess of coverage provided by UPCIC's reinsurance program and for losses that otherwise are not covered by the reinsurance program, and such losses could have a material adverse effect on the business, financial condition and results of operations of UPCIC and the Company.

#### *Reliance on Third Parties and Reinsurers*

UPCIC is dependent upon third parties to perform certain functions including, but not limited to the purchase of reinsurance and risk management analysis. UPCIC also relies on reinsurers to limit the amount of risk retained under its policies and to increase its ability to write additional risks. UPCIC's intention is to limit its exposure and therefore protect its capital, even in the event of catastrophic occurrences, through reinsurance agreements. At the start of hurricane season on June 1, 2008, UPCIC has coverage to approximately the 133-year PML. With the additional catastrophe coverage via the new top layer effective July 1, 2008, UPCIC would have had coverage to approximately the 145-year PML. At the start of the hurricane season on June 1, 2009, UPCIC had coverage to approximately the 111-year PML. As of June 30, 2009, UPCIC had coverage to approximately the 114-year PML. UPCIC is responsible for losses related to catastrophic events with incurred losses in excess of coverage provided by UPCIC's reinsurance program and for losses that otherwise are not covered by the reinsurance program, which could have a material adverse effect on the Company's business, financial condition and results of operations should catastrophe losses exceed these amounts.

*Reinsurance*

The property and casualty reinsurance industry is subject to the same market conditions as the direct property and casualty insurance market, and there can be no assurance that reinsurance will be available to UPCIC to the same extent and at the same cost as currently in place for UPCIC. Future increases in catastrophe reinsurance costs are possible and could adversely affect UPCIC's results. Reinsurance does not legally discharge an insurer from its primary liability for the full amount of the risks it insures, although it does make the reinsurer liable to the primary insurer. Therefore, UPCIC is subject to credit risk with respect to its reinsurers. In addition, UPCIC obtains a significant portion of its reinsurance coverage from the FHCF. There is no guaranty the FHCF will be able to honor its obligations. In addition, the cost of UPCIC's reinsurance program may increase should UPCIC deem it necessary to purchase additional private market reinsurance due to reduced estimates of the FHCF's claims-paying capacity.

Management 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. A reinsurer's insolvency or inability to make payments under a reinsurance treaty could have a material adverse effect on the financial condition and profitability of UPCIC and the Company. While ceding premiums to reinsurers reduces UPCIC's risk of exposure in the event of catastrophic losses, it also reduces UPCIC's potential for greater profits should such catastrophic events fail to occur. The Company believes that the extent of UPCIC's reinsurance is typical of a company of its size in the homeowners' insurance industry.

*Adequacy of Liabilities for Losses*

The liabilities for losses and loss adjustment expenses periodically established by UPCIC are estimates of amounts needed to pay reported and unreported claims and related loss adjustment expenses. The estimates necessarily will be based on certain assumptions related to the ultimate cost to settle such claims. There is an inherent degree of uncertainty involved in the establishment of liabilities for losses and loss adjustment expenses and there may be substantial differences between actual losses and UPCIC's liabilities estimates. UPCIC relies on industry data, as well as the expertise and experience of independent actuaries in an effort to establish accurate estimates and adequate liabilities. Furthermore, factors such as storms and weather conditions, climate change and patterns, inflation, claim settlement patterns, legislative activity and litigation trends may have an impact on UPCIC's future loss experience. Accordingly, there can be no assurance that UPCIC's liabilities will be adequate to cover ultimate loss developments. The profitability and financial condition of UPCIC and the Company could be adversely affected to the extent that its liabilities are inadequate.

UPCIC is directly liable for loss and LAE payments under the terms of the insurance policies that it writes. In many cases, several years may elapse between the occurrence of an insured loss and UPCIC's payment of that loss. As required by insurance regulations and accounting rules, UPCIC reflects its liability for the ultimate payment of all incurred losses and LAE by establishing a liability for those unpaid losses and LAE for both reported and unreported claims, which represent estimates of future amounts needed to pay claims and related expenses.

When a claim involving a probable loss is reported, UPCIC establishes a liability for the estimated amount of UPCIC's ultimate loss and LAE payments. The estimate of the amount of the ultimate loss is based upon such factors as the type of loss, jurisdiction of the occurrence, knowledge of the circumstances surrounding the claim, severity of injury or damage, potential for ultimate exposure, estimate of liability on the part of the insured, past experience with similar claims and the applicable policy provisions.



All newly reported claims received are set up with an initial average liability. That claim is then evaluated and the liability is adjusted upward or downward according to the facts and damages of that particular claim.

In addition, management provides for a liability on an aggregate basis to provide for losses incurred but not reported. UPCIC utilizes independent actuaries to help establish its liability for unpaid losses and LAE. UPCIC does not discount the liability for unpaid losses and LAE for financial statement purposes.

The estimates of the liability for unpaid losses and LAE are subject to the effect of trends in claims severity and frequency and are continually reviewed. As part of this process, UPCIC reviews historical data and considers various factors, including known and anticipated 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 liability for unpaid losses and LAE. Adjustments are reflected in results of operations in the period in which they are made and the liabilities may deviate substantially from prior estimates.

Among the classes of insurance underwritten by UPCIC, the homeowners' liability claims historically tend to have longer time lapses between the occurrence of the event, the reporting of the claim to UPCIC and the final settlement than do homeowners' property claims. Liability claims often involve third parties filing suit and the ensuing litigation. By comparison, property damage claims tend to be reported in a relatively shorter period of time with the vast majority of these claims resulting in an adjustment without litigation.

There can be no assurance that UPCIC's liability for unpaid losses and LAE will be adequate to cover actual losses. If UPCIC's liability for unpaid losses and LAE proves to be inadequate, UPCIC will be required to increase the liability with a corresponding reduction in UPCIC's net income in the period in which the deficiency is identified. Future loss experience substantially in excess of established liability for unpaid losses and LAE could have a material adverse effect on UPCIC's and the Company's business, results of operations and financial condition.

#### *Government Regulation*

Florida insurance companies, such as UPCIC, are subject to regulation and supervision by the OIR. The OIR has broad regulatory, supervisory and administrative powers. Such powers relate, among other things, to the granting and revocation of licenses to transact business; the licensing of agents (through the Florida Department of Financial Services); the standards of solvency to be met and maintained; the nature of, and limitations on, investments; approval of policy forms and rates; review of reinsurance contracts; periodic examination of the affairs of insurance companies; and the form and content of required financial statements. Such regulation and supervision are primarily for the benefit and protection of policyholders and not for the benefit of investors.

In addition, the Florida legislature and the NAIC from time to time consider proposals that may affect, among other things, regulatory assessments and reserve requirements. The Company cannot predict the effect that any proposed or future legislation or regulatory or administrative initiatives may have on the financial condition or operations of UPCIC or the Company.

UPCIC will become subject to other states' laws and regulations as it seeks authority to transact business in states other than Florida. In addition, UPCIC may be affected by proposals for increased regulatory involvement by the federal government.

#### *Legislative Initiatives*

The State of Florida operates Citizens to provide insurance to Florida homeowners in high-risk areas and others without private insurance options. As of September 30, 2009, there were 1,064,287 Citizens policies in force. In January 2007, the State of Florida passed legislation that froze property insurance rates for Citizens customers at December 2006 levels through December 31, 2008 and permitted insurance customers to opt into Citizens when the price of a private policy is 15% more than the Citizens rate, compared to the previous opt-in threshold of 25%. In May 2008, the Florida legislature extended a freeze on Citizens rates through January 2010. These initiatives, together with any future initiatives that seek to further relax eligibility requirements or reduce premium rates for Citizens customers, could adversely affect the ability of UPCIC and the Company to do business profitably. In addition, the Florida legislature in 2007 expanded the capacity of the FHCF, with the intent of reducing the cost of reinsurance otherwise purchased by residential property insurers. If the expanded FHCF coverage expires or if the law providing for the expanded coverage is otherwise modified, or if UPCIC purchases additional private market reinsurance due to reduced estimates of the FHCF's claims-paying capacity, the cost of UPCIC's reinsurance program may increase, which could affect UPCIC's profitability until such time as UPCIC can obtain approval of appropriate rate changes. State and federal legislation relating to insurance is affected by a number of political and economic factors that are beyond the control of UPCIC and the Company, and the Florida legislature and the NAIC from time to time consider proposals that may affect, among other things, regulatory assessments and reserve requirements. The Company cannot predict the effect that any proposed or future legislation or regulatory or administrative initiatives may have on the financial condition or operations of UPCIC or the Company.

In January 2007, the Florida legislature passed a law designed to reduce residential catastrophe reinsurance costs and required insurance companies to offer corresponding rate reductions to policyholders. The new law expanded the amount of reinsurance available from the FHCF, which is a state-run entity providing hurricane reinsurance to residential insurers at premiums less than the private reinsurance market. The legislature intended for the new law to reduce residential insurers' reinsurance costs by allowing them to directly replace some of their private market reinsurance with less costly FHCF reinsurance. In addition, prices in the private reinsurance market have fallen as reinsurers have had capital displaced by the expanded FHCF.

Florida's legislature also has implemented strategies to improve the ability of residential structures to withstand hurricanes. New construction must meet stronger building codes, and existing homes are eligible for an inspection program that allows homeowners to determine how their homes may be upgraded to mitigate storm damage. An increasing number of insureds are likely to qualify for insurance premium discounts as new homes are built and existing homes are retrofitted. These premium discounts result from homes' reduced vulnerability to hurricane losses due to the mitigation efforts, which UPCIC takes into account in its underwriting and profitability models.

#### *Product Pricing*

The rates charged by UPCIC generally are subject to regulatory review and approval before they may be implemented. UPCIC periodically submits its rate revisions to regulators as required by law or deemed by the Company and UPCIC to be necessary or appropriate for UPCIC's business. UPCIC prepares these filings based on objective data relating to its business and on judgment exercised by its management or employees and by retained professionals. There is no assurance that the objective data incorporated in UPCIC's filings based on its past experience will be reflective of UPCIC's future business. In addition, there is no assurance that UPCIC's business will develop consistently with the judgments reflected in its filings. The Company and UPCIC likewise cannot be assured that regulatory authorities will evaluate UPCIC's data and judgments in the same manner as UPCIC. UPCIC's filings also might be affected by political or regulatory factors outside of UPCIC's control, which might result in disapproval of UPCIC's

filings or in negotiated compromises resulting in approved rates that differ from rates initially filed by UPCIC or that the Company and UPCIC otherwise would consider more appropriate for its business.

#### *Dependence on Key Individuals*

UPCIC's operations depend in large part on the efforts of Bradley I. Meier, who serves as President of UPCIC. Mr. Meier has also served as President, Chief Executive Officer and Director of the Company since its inception in November 1990. In addition, UPCIC's operations have become materially dependent on the efforts of Sean P. Downes, who serves as Chief Operating Officer of UPCIC. Mr. Downes has also served as Chief Operating Officer, Senior Vice President and Director of the Company since January 2005 and as a Director of UPCIC since May 2003. The loss of the services provided by Mr. Meier or Mr. Downes could have a material adverse effect on UPCIC's and the Company's financial condition and results of operations.

#### *Competition*

The insurance industry is highly competitive and many companies currently write homeowners' property and casualty insurance. Additionally, the Company and its subsidiaries must compete with companies that have greater capital resources and longer operating histories as well as start-up companies. Increased competition from other private insurance companies as well as Citizens could adversely affect the Company's ability to do business profitably. Although the Company's pricing is inevitably influenced to some degree by that of its competitors, management of the Company believes that it is generally not in the Company's best interest to compete solely on price, choosing instead to compete on the basis of underwriting criteria, its distribution network and high quality service to its agents and insureds.

#### *Financial Stability Rating*

Financial stability ratings are an important factor in establishing the competitive position of insurance companies and may impact an insurance company's sales. Demotech, Inc. maintains a letter scale financial stability rating system ranging from A\*\* (A double prime) to L (licensed by state regulatory authorities). Demotech, Inc. has assigned UPCIC a financial stability rating of A, which is two rating levels below the highest level assigned by Demotech, Inc. According to Demotech, Inc., A ratings are assigned to insurers that have "exceptional ability to maintain liquidity of invested assets, quality reinsurance, acceptable financial leverage and realistic pricing while simultaneously establishing loss and loss adjustment expense reserves at reasonable levels." With a financial stability rating of A, the Company expects that UPCIC's property insurance policies will be acceptable to the secondary mortgage marketplace and mortgage lenders. The rating of UPCIC is subject to at least annual review by, and may be revised downward by, or revoked at, the sole discretion of, Demotech, Inc.

UPCIC's failure to maintain a commercially acceptable financial stability rating could have a material adverse effect on the Company's ability to retain and attract policyholders and agents. Many of the Company's competitors have ratings higher than that of UPCIC. A downgrade in the financial stability rating of UPCIC could have an adverse impact on its ability to effectively compete with other insurers with higher ratings. Additionally, a withdrawal of the rating could cause UPCIC's insurance policies to no longer be acceptable to the secondary marketplace and mortgage lenders, which could cause a material adverse effect of the Company's results of operations and financial position.

Demotech, Inc. bases its ratings on factors that concern policyholders and not upon factors concerning investor protection. Such ratings are subject to change and are not recommendations to buy, sell or hold securities.

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

The Company's investment objective is to maximize total rate of return after federal income taxes while maintaining liquidity and minimizing risk. The Company's current investment policy limits investment in non-investment grade fixed maturity securities (including high-yield bonds), and limits total investments in preferred stock and common stock. The Company complies with applicable laws and regulations, which further restrict the type, quality and concentration of investments. In general, these laws and regulations permit investments, within specified limits and subject to certain qualifications, in federal, state and municipal obligations, corporate bonds, preferred and common equity securities and real estate mortgages.

The Company's investment policy is established by the Board of Directors Investment Committee and is reviewed on a regular basis. As of September 30, 2009, the Company held approximately 20.8% of investments in fixed income available for sale securities and 79.2% in equity securities considered available for sale. The Company may in the future consider additional fixed maturities to be held to maturity and carried at amortized cost. The Company does not use any swaps, options, futures or forward contracts to hedge or enhance the investment portfolio at this time. In the future, the Company may use swaps, options, futures or forward contracts to hedge unrealized gains.

The investment portfolio is managed by the Investment Committee consisting of all current directors in accordance with guidelines established by the Florida OIR.

The table below sets forth investment results for the nine-month periods ended September 30, 2009 and 2008:



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|                           | Nine-Months Ended September 30, |              |
|---------------------------|---------------------------------|--------------|
|                           | 2009                            | 2008         |
| Cash and cash equivalents | \$ 253,073                      | \$ 3,757,365 |
| Fixed maturities          | 1,136,568                       | 38,889       |
| Equity securities         | 634,362                         | -            |
| Total investment income   | 2,024,003                       | 3,796,254    |
| Less investment expenses  | (638,996)                       | (167,782)    |
| Net investment income     | \$ 1,385,007                    | \$ 3,628,472 |

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The following table summarizes, by type, the Company's investments as of September 30, 2009 and December 31, 2008:

|   | September 30, 2009   |                  | December 31, 2008   |                  |
|---|----------------------|------------------|---------------------|------------------|
|   | Carrying Amount      | Percent of Total | Carrying Amount     | Percent of Total |
| Fixed maturities, held to maturity, at amortized cost:      |                      |                  |                     |                  |
| US government and agency obligations                        | \$ -                 | 0.0%             | \$ 4,334,405        | 76.7%            |
| Total fixed maturities, held to maturity, at amortized cost | -                    | 0.0%             | 4,334,405           | 76.7%            |
| Fixed maturities, available for sale, at fair value:        |                      |                  |                     |                  |
| US government and agency obligations                        | 18,575,023           | 20.8%            | -                   | 0.0%             |
| Equity securities, at market                                | 70,785,948           | 79.2%            | 1,314,370           | 23.3%            |
| <b>Total investments</b>                                    | <b>\$ 89,360,971</b> | <b>100.0%</b>    | <b>\$ 5,648,775</b> | <b>100.0%</b>    |

Fixed maturities, held to maturity, are carried on the balance sheet at amortized cost. Fixed maturities, available for sale, are carried on the balance sheet at fair value. At September 30, 2009, the fixed maturities had quality ratings ranging from AAA to Aaa by Moody's Investors Service, Inc. and AAA by Standard and Poors' Company.

Below is a summary of fixed maturities at September 30, 2009 and December 31, 2008 by contractual or expected periods.

|  | September 30, 2009 |                      | December 31, 2008   |                      |
|--|--------------------|----------------------|---------------------|----------------------|
|  | Amortized Cost     | Estimated Fair Value | Amortized Cost      | Estimated Fair Value |
| <b><u>Held-to-Maturity</u></b>         |                    |                      |                     |                      |
| Due in one year or less                | \$ -               | \$ -                 | \$ 2,626,958        | \$ 2,674,230         |
| Due after one year through five years  | -                  | -                    | 1,707,447           | 1,785,935            |
| Due after five years through ten years | -                  | -                    | -                   | -                    |
| Due after ten years                    | -                  | -                    | -                   | -                    |
| <b>Total</b>                           | <b>\$ -</b>        | <b>\$ -</b>          | <b>\$ 4,334,405</b> | <b>\$ 4,460,165</b>  |





|  | September 30, 2009   |                      | December 31, 2008 |                      |
|--|----------------------|----------------------|-------------------|----------------------|
|  | Amortized Cost       | Estimated Fair Value | Amortized Cost    | Estimated Fair Value |
| <b>Available-for-Sale</b>              |                      |                      |                   |                      |
| Due in one year or less                | \$ -                 | \$ -                 | \$ -              | \$ -                 |
| Due after one year through five years  | 176,944              | 182,589              | -                 | -                    |
| Due after five years through ten years | 18,377,564           | 18,392,434           | -                 | -                    |
| Due after ten years                    | -                    | -                    | -                 | -                    |
| <b>Total</b>                           | <b>\$ 18,554,508</b> | <b>\$ 18,575,023</b> | <b>\$ -</b>       | <b>\$ -</b>          |

At September 30, 2009, the weighted average maturity of the fixed maturities portfolio was approximately 7.51 years.

The Company's market risk generally represents the risk of gain or loss that may result from the potential change in the fair value of the Company's investment portfolio as a result of fluctuations in prices, interest rates and, to a lesser extent, the Company's debt obligations. As previously described in Note 6 "Loan Payable and Long-Term Debt", of the notes to Condensed Consolidated financial statements, the Company's surplus note accrues interest at an adjustable rate based on the 10-year Constant Maturity Treasury rate.

#### ITEM 4. CONTROLS AND PROCEDURES

The Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 as of the period covered by this report. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that disclosure controls and procedures were effective as of September 30, 2009 to ensure that information required to be disclosed by the Company in its reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. There was no change in the Company's internal controls over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II -- OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The Company is involved in certain lawsuits. In the opinion of management, none of these lawsuits (1) involve claims for damages exceeding 10% of the Company's cash and invested assets, (2) involve matters that are not routine litigation incidental to the claims aspect of its business, (3) involve bankruptcy, receivership or similar proceedings, (4) involve material Federal, state, or local environmental laws, (5) potentially involve more than \$100,000 in sanctions and a governmental authority is a party, or (6) are material proceedings to which any director, officer, affiliate of the Company, beneficial owner of more than 5% of any class of voting securities of the Company, or security holder is a party adverse to the Company or has a material interest adverse to the Company.

### ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors previously disclosed in Item 1A, Risk Factors, in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.



**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

| <u>Exhibit No.</u> | <u>Exhibit</u>   |
|--------------------|--|
| 3.1                | Registrant's Restated Amended and Restated Certificate of Incorporation (1)  |
| 3.2                | Certificate of Designation for Series A Convertible Preferred Stock dated October 11, 1994 (2)                                 |
| 3.3                | Certificate of Designations, Preferences, and Rights of Series M Convertible Preferred Stock dated August 13, 1997 (3)         |
| 3.4                | Certificate of Amendment of Amended and Restated Certificate of Incorporation dated October 19, 1998 (2)                       |
| 3.5                | Certificate of Amendment of Amended and Restated Certificate of Incorporation dated December 18, 2000 (2)                      |
| 3.6                | Certificate of Amendment of Certificate of Designations of the Series A Convertible Preferred Stock dated October 29, 2001 (2) |
| 3.7                | Certificate of Amendment of Amended and Restated Certificate of Incorporation dated December 7, 2005 (4)                       |
| 3.8                | Certificate of Amendment of Amended and Restated Certificate of Incorporation dated May 18, 2007 (4)                           |
| 3.9                | Amended and Restated Bylaws (5)  |
| 31.1               | Certification of Chief Executive Officer Pursuant to Rule 13a-   |

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- 31.2 14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  
Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a), as  
Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Title  
18, United States Code, Section 1350, as Adopted Pursuant to Section 906 of the  
Sarbanes-Oxley Act of 2002
- 99.1 Schedule of Investments
- (1) Incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No.  
33-51546) declared effective on December 14, 1992
- (2) Incorporated by reference to the Registrant's Annual Report on Form 10-KSB for the year ended  
December 31, 2002
- (3) Incorporated by reference to the Registrant's Annual Report on Form 10-KSB/A for the year  
ended April 30, 1997
- (4) Incorporated by reference to the Registrant's Quarterly Report on Form 10-QSB for period ended  
June 30, 2007
- (5) Incorporated by reference to the Registrant's Current Report on Form 8-K dated January 8, 2007

**SIGNATURES**

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

UNIVERSAL INSURANCE HOLDINGS, INC.

Date: November 6, 2009

/s/ Bradley I. Meier  
Bradley I. Meier, President and Chief Executive Officer

/s/ James M. Lynch  
James M. Lynch, Chief Financial Officer (Principal  
Accounting Officer)