

Homeowners Choice, Inc.
Form 10-Q
November 13, 2012
[Table of Contents](#)

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

Form 10-Q

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

For the quarterly period ended September 30, 2012

OR

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

Commission File Number

001-34126

Homeowners Choice, Inc.

(Exact name of Registrant as specified in its charter)

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Florida
(State of Incorporation)

20-5961396
(IRS Employer

Identification No.)

5300 West Cypress Street, Suite 100

Tampa, FL 33607

(Address, including zip code, of principal executive offices)

(813) 405-3600

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

The aggregate number of shares of the Registrant's Common Stock, no par value, outstanding on November 5, 2012 was 10,187,277.

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

	Page
<u>PART I FINANCIAL INFORMATION</u>	
ITEM 1 <u>FINANCIAL STATEMENTS</u>	
<u>Condensed Consolidated Balance Sheets, September 30, 2012 (unaudited) and December 31, 2011</u>	1
<u>Condensed Consolidated Statements of Income Three and nine months ended September 30, 2012 and 2011 (unaudited)</u>	2
<u>Condensed Consolidated Statements of Comprehensive Income Three and nine months ended September 30, 2012 and 2011 (unaudited)</u>	3
<u>Condensed Consolidated Statements of Cash Flows Nine months ended September 30, 2012 and 2011 (unaudited)</u>	4-5
<u>Condensed Consolidated Statement of Stockholders' Equity Nine months ended September 30, 2012 (unaudited)</u>	6
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	7-27
ITEM 2 <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	28-40
ITEM 3 <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	40
ITEM 4 <u>CONTROLS AND PROCEDURES</u>	40
<u>PART II OTHER INFORMATION</u>	
ITEM 1 <u>LEGAL PROCEEDINGS</u>	40
ITEM 1a <u>RISK FACTORS</u>	41
ITEM 2 <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	41
ITEM 6 <u>EXHIBITS</u>	42-47
<u>SIGNATURES</u>	48
<u>CERTIFICATIONS</u>	

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

	September 30, 2012 (Unaudited)	December 31, 2011
Assets		
Fixed-maturity securities, available-for-sale, at fair value (amortized cost \$38,624 and \$34,147)	\$ 41,397	34,642
Equity securities, available-for-sale, at fair value	9,522	5,207
Time deposits	7,267	12,427
Other investments	15,696	6,483
Total investments	73,882	58,759
Cash and cash equivalents	141,922	100,355
Accrued interest and dividends receivable	334	408
Premiums receivable	17,499	12,222
Assumed reinsurance balances receivable		1,687
Prepaid reinsurance premiums	21,781	14,169
Deferred policy acquisition costs	12,548	12,321
Property and equipment, net	10,840	10,499
Goodwill	161	161
Income taxes receivable	1,495	
Deferred income taxes		2,368
Other assets	1,849	1,869
Total assets	\$ 282,311	214,818
Liabilities and Stockholders Equity		
Losses and loss adjustment expenses	\$ 38,726	27,424
Unearned premiums	120,845	108,677
Advance premiums	6,702	2,132
Assumed reinsurance balances payable	1,329	
Accrued expenses	5,053	3,478
Deferred income taxes	977	
Dividends payable	98	218
Income taxes payable		4,956
Other liabilities	7,494	4,103
Total liabilities	181,224	150,988
Stockholders equity:		
7% Series A cumulative convertible preferred stock (liquidation preference \$10.00 per share), no par value, 1,500,000 shares authorized, 331,525 and 1,247,700 shares issued and outstanding in 2012 and 2011, respectively		
Preferred stock (no par value, 18,500,000 shares authorized, no shares issued or outstanding)		
Common stock, (no par value, 40,000,000 shares authorized, 9,601,019 and 6,202,485 shares issued and outstanding in 2012 and 2011, respectively)		

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Additional paid-in capital	53,209	29,636
Retained earnings	46,045	33,986
Accumulated other comprehensive income	1,833	208
Total stockholders' equity	101,087	63,830
Total liabilities and stockholders' equity	\$ 282,311	214,818

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenue				
Gross premiums earned	\$ 53,109	31,741	161,579	93,855
Premiums ceded	(22,506)	(13,211)	(53,475)	(41,607)
Net premiums earned	30,603	18,530	108,104	52,248
Net investment income	47	486	871	1,557
Policy fee income	624	424	2,167	1,278
Realized investment (losses) gains	(4)	123	26	416
Gain on bargain purchase			179	936
Other	211	150	641	808
Total revenue	31,481	19,713	111,988	57,243
Expenses				
Losses and loss adjustment expenses	15,017	10,431	50,382	31,357
Policy acquisition and other underwriting expenses	6,611	3,529	19,690	10,572
Other operating expenses	4,728	2,447	13,401	6,932
Total expenses	26,356	16,407	83,473	48,861
Income before income taxes	5,125	3,306	28,515	8,382
Income taxes	2,299	1,232	11,459	3,214
Net income	\$ 2,826	2,074	17,056	5,168
Preferred stock dividends	(42)	(218)	(286)	(596)
Income available to common stockholders	\$ 2,784	1,856	16,770	4,572
Basic earnings per common share	\$ 0.30	\$ 0.30	\$ 2.08	\$ 0.75
Diluted earnings per common share	\$ 0.27	\$ 0.27	\$ 1.79	\$ 0.70
Dividends per common share	\$ 0.20	\$ 0.10	\$ 0.55	\$ 0.30

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net income	\$ 2,826	2,074	17,056	5,168
Other comprehensive income:				
Change in unrealized gain (loss) on investments:				
Unrealized gain arising during the period	1,223	(111)	2,672	156
Reclassification adjustment for realized (losses) gains	4	(123)	(26)	(416)
Net change in unrealized gain (loss)	1,227	(234)	2,646	(260)
Deferred income taxes on above change	(474)	96	(1,021)	106
Total other comprehensive income (loss)	753	(138)	1,625	(154)
Comprehensive income	\$ 3,579	1,936	18,681	5,014

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$ 17,056	5,168
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation	522	22
Net amortization of premiums on investments in fixed-maturity securities	222	115
Depreciation and amortization	1,023	325
Deferred income taxes	2,324	975
Realized gains on sales of investments	(26)	(416)
Gain on bargain purchase	(179)	(936)
Changes in operating assets and liabilities:		
Premiums receivable	(5,277)	(4,228)
Assumed reinsurance balances receivable	1,687	(37)
Advance premiums	4,570	3,470
Prepaid reinsurance premiums	(7,612)	559
Accrued interest and dividends receivable	74	(64)
Income taxes receivable	(1,495)	(774)
Other assets	(149)	(189)
Assumed reinsurance balances payable	1,329	
Deferred policy acquisition costs	(227)	(1,750)
Losses and loss adjustment expenses	11,302	1,547
Unearned premiums	12,168	13,255
Income taxes payable	(4,956)	(310)
Accrued expenses and other liabilities	4,966	1,776
Net cash provided by operating activities	37,322	18,508
Cash flows from investing activities:		
Cash consideration paid for acquired business, net of cash acquired	(8,157)	(5,110)
Purchase of property and equipment, net	(952)	(3,021)
Purchase of other investments	(1,119)	
Purchase of fixed-maturity securities	(9,601)	(29,396)
Purchase of equity securities	(6,018)	(5,568)
Proceeds from sales, calls and repayments of fixed-maturity securities	4,936	22,847
Proceeds from sales of equity securities	2,063	1,524
Decrease (increase) in time deposits, net	5,160	(409)
Net cash used in investing activities	(13,688)	(19,133)
Cash flows from financing activities:		
Net proceeds from the issuance of common stock	20,082	
Net proceeds from the issuance of preferred stock		11,307
Proceeds from the exercise of common stock options		388
Proceeds from the exercise of common stock warrants	2,524	

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Cash dividends paid	(5,118)	(2,212)
Repurchases of common stock		(1,887)
Excess tax benefit from common stock options exercised	445	136
Net cash provided by financing activities	17,933	7,732
Net increase in cash and cash equivalents	41,567	7,107
Cash and cash equivalents at beginning of period	100,355	54,849
Cash and cash equivalents at end of period	\$ 141,922	61,956

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

	Nine Months Ended September 30,	
	2012	2011
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$ 15,140	3,176
Cash paid for interest	\$	
Non-cash investing activities:		
Unrealized gain (loss) on investments in available-for-sale securities, net of tax	\$ 1,625	(154)
Fair value of net assets acquired in connection with business acquisition	\$ 8,267	5,685
See accompanying Notes to Condensed Consolidated Financial Statements.		

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

	Preferred Stock		Common Stock		Additional	Retained	Accumulated Other Comprehensive	Total
	Shares	Amount	Shares	Amount	Paid-In Capital	Earnings	Income	
Balance at December 31, 2011	1,247,700	\$	6,202,485	\$	\$ 29,636	\$ 33,986	\$ 208	\$ 63,830
Net Income						17,056		17,056
Change in unrealized gain on available-for-sale securities, net of income taxes							1,625	1,625
Exercise of common stock options			154,411					
Exercise of common stock warrants			287,948		2,524			2,524
Excess tax benefit from stock options exercised					445			445
Conversion of preferred stock to common stock	(916,175)		916,175					
Issuance of restricted stock			200,000		459			459
Issuance of common stock			1,840,000		20,082			20,082
Common stock dividends						(4,711)		(4,711)
Preferred stock dividends						(286)		(286)
Stock-based compensation					63			63
Balance at September 30, 2012	331,525	\$	9,601,019	\$	\$ 53,209	\$ 46,045	\$ 1,833	\$ 101,087

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1 Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited, condensed consolidated financial statements for Homeowners Choice, Inc. and its subsidiaries (collectively, the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information, and the Securities and Exchange Commission (SEC) rules for interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, in the opinion of management, the accompanying financial statements reflect all normal recurring adjustments necessary to present fairly the Company's financial position as of September 30, 2012 and the results of operations and cash flows for the periods presented. The results of operations for the interim periods presented are not necessarily indicative of the results of operations to be expected for any subsequent interim period or for the fiscal year ending December 31, 2012. The accompanying unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2011 included in the Company's Form 10-K, which was filed with the SEC on March 30, 2012.

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

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

All significant intercompany balances and transactions have been eliminated.

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

(continued)

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1 Summary of Significant Accounting Policies, continued

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

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

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

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

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

(continued)

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 2 Recent Accounting Pronouncements

Accounting Standards Update No. 2012-02. In July 2012, the FASB issued Accounting Standard Update No. 2012-12 (ASU 2012-12), *Intangibles Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment*. The objective of ASU 2012-02 is to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by simplifying how an entity tests those assets for impairment and to improve consistency in impairment testing guidance among long-lived asset categories. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30, *Intangibles Goodwill and Other General intangibles Other than Goodwill*. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. The amendments in ASU 2012-12 are effective for annual and interim impairment tests performed for the fiscal years beginning after September 15, 2012. Early adoption is permitted. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

Accounting Standards Update No. 2011-11. In December 2011, the FASB issued Accounting Standards Update No. 2011-11 (ASU 2011-11), *Balance Sheet (Topic 210), Disclosures about Offsetting Assets and Liabilities*. ASU 2011-11 requires entities to disclose information about offsetting and related arrangements of financial and derivative instruments. ASU 2011-11 is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by ASU 2011-11 retrospectively for all comparative periods presented. The adoption of this guidance is not expected to have a material effect on the Company's consolidated financial statements.

Accounting Standards Update No. 2010-26. In October 2010, the FASB issued Accounting Standards Update No. 2010-26 (ASU 2010-26), *Financial Services Insurance (ASC Topic 944), Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*. The objective of the amendments in ASU 2010-26 is to address diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The amendments in ASU 2010-26 specify which costs should be capitalized. The amendments in ASU 2010-26 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011 and can be applied prospectively upon adoption. Retrospective or prospective application is permitted. Early adoption is permitted, but only at the beginning of an entity's annual reporting period. The Company adopted ASU 2010-26 effective January 1, 2012 on a prospective basis. As such, the Company recognized additional amortization expense of \$1.2 million with a corresponding decrease in deferred acquisition costs as of the date of adoption. This one-time adjustment reduced our net income for the nine months ended September 30, 2012 by approximately \$741,000, or \$0.09 earnings per diluted common share. In addition, certain direct marketing, compensation, and other administrative costs will no longer be deferred. Rather, such costs will be expensed as incurred beginning January 1, 2012.

(continued)

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

The Company holds investments in fixed-maturity securities as well as equity securities, which are classified as available-for-sale. At September 30, 2012 and December 31, 2011, the amortized cost, gross unrealized gains and losses, and estimated fair value of the Company's available-for-sale securities by security type were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
<u>As of September 30, 2012</u>				
<i>Fixed-maturity securities</i>				
U.S. Treasury and U.S. government agencies	\$ 496	86		582
Corporate bonds	16,222	954	(17)	17,159
Commercial mortgage-backed securities	10,840	873		11,713
State, municipalities, and political subdivisions	10,205	872		11,077
Other	861	5		866
Total	\$ 38,624	2,790	(17)	41,397
<i>Equity securities</i>	\$ 9,311	451	(240)	9,522
<u>As of December 31, 2011</u>				
<i>Fixed-maturity securities</i>				
U.S. Treasury and U.S. government agencies	\$ 509	47		556
Corporate bonds	10,199	58	(417)	9,840
Commercial mortgage-backed securities	10,574	314	(14)	10,874
State, municipalities, and political subdivisions	9,982	393	(3)	10,372
Other	2,883	117		3,000
Total	\$ 34,147	929	(434)	34,642
<i>Equity securities</i>	\$ 5,364	133	(290)	5,207

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

	Amortized Cost	Fair Value
Available-for-sale		
Due in one year or less	\$ 1,696	1,717
Due after one year through five years	10,619	11,057
Due after five years through ten years	10,227	11,027
Due after ten years	5,242	5,883
Commercial mortgage-backed securities	10,840	11,713
Total	\$ 38,624	41,397

(continued)

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

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

	Proceeds	Gross Realized Gains	Gross Realized Losses
<u>Three months ended September 30, 2012</u>			
Fixed-maturity securities	\$ 2,517	1	(4)
Equity securities	\$ 551	30	(31)
<u>Three months ended September 30, 2011</u>			
Fixed-maturity securities	\$ 3,233	154	(24)
Equity securities	\$ 418	17	(24)
<u>Nine months ended September 30, 2012</u>			
Fixed-maturity securities	\$ 4,936	41	(7)
Equity securities	\$ 2,063	38	(46)
<u>Nine months ended September 30, 2011</u>			
Fixed-maturity securities	\$ 22,847	523	(62)
Equity securities	\$ 1,524	122	(167)

Amounts reported for the three and nine months ended September 30, 2011 include the gross realized gains and losses from equity option contracts. During the three and nine months ended September 30, 2011, the Company entered into equity contracts for exchange traded call and put options to meet certain investment objectives. With respect to these option contracts, the Company received net proceeds of \$11,000 and \$84,000 and realized gains of \$11,000 and \$84,000 for the three and nine months ended September 30, 2011, respectively, which is included in the realized investment gains in the Condensed Consolidated Statements of Income. There were no open option contracts at September 30, 2011. The Company held no option contracts during the three and nine months ended September 30, 2012.

(continued)

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

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

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

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

general market conditions and industry or sector specific factors;

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

the Company's intent and ability to hold the investment for a period of time sufficient to allow for the recovery of costs.

Securities with gross unrealized loss positions at September 30, 2012, aggregated by investment category and length of time the individual securities have been in a continuous loss position, are as follows (in thousands):

	Less Than Twelve Months		Twelve Months or Greater		Total	
	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value
As of September 30, 2012						
<i>Fixed-maturity securities</i>						
Corporate bonds	\$		(17)	971	(17)	971
<i>Equity securities</i>	(41)	1,279	(199)	413	(240)	1,692
Total available-for-sale securities	\$ (41)	1,279	(216)	1,384	(257)	2,663

(continued)

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

The Company believes there are no fundamental issues such as credit losses or other factors with respect to any of its available-for-sale securities. The unrealized losses on investments in fixed-maturity securities were caused by interest-rate changes. It is expected that the securities will not be settled at a price less than the par value of the investments. In determining whether equity securities are other than temporarily impaired, the Company considers its intent and ability to hold a security for a period of time sufficient to allow for the recovery of cost. Because the decline in fair value is attributable to changes in interest rates or market conditions and not credit quality, and because the Company has the ability and intent to hold its available-for-sale investments until a market price recovery or maturity, the Company does not consider any of its investments to be other-than-temporarily impaired at September 30, 2012.

Other Investments

Other investments consist primarily of real estate and the related assets and operations of the marina acquired in 2011 and the real estate and related assets of the marina and restaurant facilities acquired in April 2012 (see Note 5 Business Acquisition). In addition, on May 21, 2012 the Company purchased approximately one-half acre of land adjacent to the existing Treasure Island, Florida property for a total purchase price of approximately \$378,000. Operating activities related to the Company's real estate investments include leasing of office and retail space to tenants, wet and dry boat storage, a restaurant, and fuel services with respect to marina clients and recreational boaters.

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

	September 30, 2012	December 31, 2011
Building	\$ 2,788	1,418
Land	10,619	4,438
Land improvements	1,326	283
Other	1,209	404
Total, at cost	15,942	6,543
Less: accumulated depreciation and amortization	(246)	(60)
Other investments	\$ 15,696	6,483

(continued)

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 4 Fair Value Measurements

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

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

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

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

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

Level 3 Inputs that are unobservable.

(continued)

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

The following table presents information about the Company's available-for-sale securities measured at fair value as of September 30, 2012 and December 31, 2011, and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
<u>As of September 30, 2012</u>				
<i>Fixed-maturity securities</i>				
U.S. Treasury and U.S. government agencies	\$ 582			582
Corporate bonds	17,159			17,159
Commercial mortgage-backed securities		11,713		11,713
State, municipalities, and political subdivisions	11,077			11,077
Other		866		866
Total fixed-maturity securities	28,818	12,579		41,397
<i>Equity securities</i>	9,522			9,522
Total available-for-sale securities	\$ 38,340	12,579		50,919
<u>As of December 31, 2011</u>				
<i>Fixed-maturity securities</i>				
U.S. Treasury and U.S. government agencies	\$ 556			556
Corporate bonds	9,840			9,840
Commercial mortgage-backed securities		10,874		10,874
State, municipalities, and political subdivisions	10,372			10,372
Other	2,735	265		3,000
Total fixed-maturity securities	23,503	11,139		34,642
<i>Equity securities</i>	5,207			5,207
Total available-for-sale securities	\$ 28,710	11,139		39,849

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

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

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

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

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

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

For the nine months ended September 30, 2012 and the three and nine months ended September 30, 2011, the effects of this acquisition were not material to the Company's condensed consolidated financial statements and basic and diluted earnings per share and, as such, pro forma information has not been presented.

(continued)

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Premiums Written:				
Direct	\$ 53,676	39,409	175,518	109,370
Assumed	(150)	90	(1,770)	(2,261)
Gross written	53,526	39,499	173,748	107,109
Ceded	(22,506)	(13,211)	(53,475)	(41,607)
Net premiums written	\$ 31,020	26,288	120,273	65,502
Premiums Earned:				
Direct	\$ 46,048	31,041	119,219	88,188
Assumed	7,061	700	42,360	5,667
Gross earned	53,109	31,741	161,579	93,855
Ceded	(22,506)	(13,211)	(53,475)	(41,607)
Net premiums earned	\$ 30,603	18,530	108,104	52,248

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

(continued)

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Balance, beginning of period	\$ 37,313	24,973	27,424	22,146
Incurred related to:				
Current period	16,787	14,951	51,188	30,383
Prior period	(1,770)	(4,520)	(806)	974
Total incurred	15,017	10,431	50,382	31,357
Paid related to:				
Current period	(11,867)	(5,419)	(24,949)	(13,547)
Prior period	(1,737)	(6,292)	(14,131)	(16,263)
Total paid	(13,604)	(11,711)	(39,080)	(29,810)
Balance, end of period	\$ 38,726	23,693	38,726	23,693

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

(continued)

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

During the three and nine months ended September 30, 2012, the Company recorded approximately \$2.3 million and \$11.5 million, respectively, of income taxes, which resulted in estimated annual effective tax rates of approximately 45% and 40%, respectively. During the three and nine months ended September 30, 2011, the Company recorded approximately \$1.2 million and \$3.2 million, respectively, of income taxes, which resulted in estimated annual effective tax rates of approximately 37% and 38%, respectively. The Company's estimated annual effective tax rate differs from the statutory federal income tax rate due to state and foreign income taxes, stock-based compensation and other nondeductible items.

Note 9 Earnings Per Share

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

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

	Three Months Ended September 30, 2012			Three Months Ended September 30, 2011		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Net income	\$ 2,826			\$ 2,074		
Less: Preferred stock dividends	(42)			(218)		
Less: Income attributable to participating securities	(18)					
Basic Earnings Per Share						
Income allocated to common stockholders basic earnings per share	2,766	9,238	\$ 0.30	1,856	6,108	\$ 0.30
Effect of Dilutive Securities						
Stock options		222			298	
Convertible preferred stock	42	441		218	1,248	
Warrants		584				
Diluted Earnings Per Share						
Income available to common stockholders and assumed conversions	\$ 2,808	10,485	\$ 0.27	\$ 2,074	7,654	\$ 0.27

(continued)

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

	Nine Months Ended September 30, 2012			Nine Months Ended September 30, 2011		
	Income (Numerator)	Shares (Denominator)	Per Share Amount	Income (Numerator)	Shares (Denominator)	Per Share Amount
Net income	\$ 17,056			\$ 5,168		
Less: Preferred stock dividends	(286)			(596)		
Less: Income attributable to participating securities	(171)					
Basic Earnings Per Share						
Income allocated to common stockholders basic earnings per share	16,599	7,968	\$ 2.08	4,572	6,117	\$ 0.75
Effect of Dilutive Securities						
Stock options		230			378	
Convertible preferred stock	286	783		596	864	
Warrants		453				
Diluted Earnings Per Share						
Income available to common stockholders and assumed conversions	\$ 16,885	9,434	\$ 1.79	\$ 5,168	7,359	\$ 0.70

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

Note 10 Stockholders Equity**Common Stock**

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

(continued)

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

Effective March 18, 2009, the Company's Board of Directors authorized a plan to repurchase up to \$3.0 million (inclusive of commissions) of the Company's common shares. The repurchase plan allowed the Company to repurchase shares from time to time through March 19, 2010. This repurchase plan was supplemented in December 2009 upon approval by the Board of Directors to extend the repurchase authority by an additional \$3.0 million and continue until the repurchase plan is terminated by the Company or the maximum number of dollars has been expended. During the three months ended March 31, 2011, the Company repurchased and retired a total of 83,594 shares at an average price of \$8.23 per share and a total cost, inclusive of fees and commissions, of \$693,000, or \$8.29 per share.

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

Common Stock Warrants

At September 30, 2012, the Company has reserved 1,055,928 shares of common stock for issuance upon the exercise of its common stock warrants. A summary of the warrants outstanding at September 30, 2012 is presented below:

	Number Of Warrants Outstanding	Number of Common Shares Issuable Upon Conversion of Warrants Outstanding
Warrants issued with IPO units	1,666,668	833,334
Warrants issued to the Company's placement agents net of forfeitures and repurchases	71,667	71,667
Warrants issued in 2011*	1,000,000	500,000
Warrants outstanding at December 31, 2011	2,738,335	1,405,001
Exercise of warrants issued with IPO units	(554,812)	(277,402)
Adjustment for fractional shares		(4)
Forfeiture of placement agent warrants	(5,000)	(5,000)
Exercise of placement agent warrants	(66,667)	(66,667)
Warrants outstanding at September 30, 2012	2,111,856	1,055,928

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

The warrants issued prior to 2011 may be exercised at an exercise price equal to \$9.10 per share on or before July 30, 2013. At any time after January 30, 2009 and before the expiration of the warrants, the Company at its option may cancel the warrants in whole or in part, provided that the closing price per share of the Company's common stock has exceeded \$11.38 for at least ten trading days within any period of twenty consecutive trading days, including the last trading day of the period. The placement agents also have the option to effect a cashless exercise in which the warrants would be exchanged for the number of shares which is equal to the intrinsic value of the warrant divided by the current value of the underlying shares.

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

During the nine months ended September 30, 2012, 10,546 shares of common stock were issued upon the cashless exercise of 66,667 placement agent warrants in February. As of September 30, 2012, there are no placement agent warrants outstanding.

On September 26, 2012, the Company announced its Board of Directors had fixed October 27, 2012 as the cancellation date for the IPO warrants. As such, the record holders of the IPO warrants have no further rights under the warrants on and after October 27, 2012.

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

Expected dividend yield	5.0%
Expected volatility	52%
Risk-free interest rate	0.23%
Expected life (in years)	1.75
Per share grant date fair value of warrants issued	\$ 0.754

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

Preferred Stock

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

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

(continued)

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 10 Stockholders Equity, continued

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

During the three and nine months ended September 30, 2012, holders of 260,799 and 916,175 shares of Series A Preferred converted their Series A Preferred shares to 260,799 and 916,175 shares of common stock, respectively. There were no preferred stock conversions during the three and nine months ended September 30, 2011. As of September 30, 2012, 331,525 shares of Series A Preferred remain outstanding.

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

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

In addition, the Company is authorized to issue up to an additional 18,500,000 shares of preferred stock, no par value. The authorized but unissued and undesignated preferred stock may be issued in one or more series and the shares of each series shall have such rights as determined by the Company's Board of Directors subject to the rights of the holders of the Series A Preferred.

On September 19, 2012, the Company's Board of Directors declared a cash dividend on its Series A Preferred shares in the amount of \$0.05833 per share for each of the months of September, October, and November 2012. The September 2012 dividend was paid on October 29, 2012 to shareholders of record at the close of business on October 1, 2012. The October 2012 dividend is payable on November 27, 2012 to shareholders of record at the close of business on November 1, 2012. The November 2012 dividend is payable on December 27, 2012 to shareholders of record at the close of business on December 3, 2012.

(continued)

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

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

The Company's 2007 Stock Option and Incentive Plan (2007 Plan) provided for granting of stock-based compensation to employees, directors, consultants, and advisors of the Company. Under the 2007 Plan, an aggregate of 6,000,000 shares of the Company's common stock could be granted, including through the grant of stock options and restricted stock. On April 20, 2012, the Company's Board of Directors adopted, subject to shareholder approval, the 2012 Omnibus Incentive Plan (the 2012 Plan). The 2012 Plan was approved by the Company's shareholders effective as of May 24, 2012, at which time the 2007 Plan was terminated and the remaining 4,604,800 shares reserved for future issuance under the 2007 Plan were cancelled. The aggregate number of shares of the Company's common stock reserved and available for issuance pursuant to awards granted under the 2012 Plan is 5,000,000 of which only 4,000,000 shares may be issued upon the exercise of incentive stock options. At September 30, 2012, no shares have been granted under the 2012 Plan and 5,000,000 shares are available for grant under the 2012 Plan.

Stock Options

Outstanding stock options granted under the 2007 Plan vest over periods ranging from immediately vested to five years and are exercisable over the contractual term of ten years.

A summary of the activity in the Company's 2007 Plan is as follows (dollars in thousands, except per share amounts):

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2011	620,000	\$ 2.97		
Exercised	(227,003)	3.29		
Outstanding at September 30, 2012	392,997	2.79	5.0 years	\$ 8,139
Exercisable at September 30, 2012	372,997	\$ 2.60	4.8 years	\$ 7,795

At September 30, 2012, there was approximately \$30,000 of unrecognized compensation expense related to nonvested stock-based compensation related to stock options granted under the 2007 Plan, which the Company expects to recognize over a weighted-average period of 19 months. The total fair value of shares vesting and recognized as compensation expense was approximately \$5,000 and \$63,000, respectively, for the three and nine month periods ended September 30, 2012.

(continued)

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

There was no associated income tax benefit recognized in 2012 with respect to the compensation expense related to stock options. During the nine months ended September 30, 2012, a total of 227,003 options were exercised and net settled by surrender of 72,592 shares. The total intrinsic value of the options exercised during the nine months ended September 30, 2012 was \$1,652,071 and the associated income tax benefit recognized was approximately \$445,000. The total fair value of shares vesting and recognized as compensation expense was approximately \$3,000 and \$22,000, respectively, for the three and nine month periods ended September 30, 2011. There was no associated income tax benefit recognized with respect to the share compensation expense in 2011. The total intrinsic value of the 155,200 options exercised during the nine months ended September 30, 2011 was \$727,000 and the income tax benefit recognized was \$136,000.

No stock options were granted during the three and nine month periods ended September 30, 2012. In 2011, 30,000 options were granted on August 26, 2011, with fair value estimated on the date of grant using the following assumptions and the Black-Scholes option pricing model:

Expected dividend yield	6.3%
Expected volatility	53.3%
Risk-free interest rate	0.97%
Expected life (in years)	5.00
Per share grant date fair value of options issued	\$ 1.70

Restricted Stock Awards

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

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

	Number of Restricted Stock Awards	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2011		
Issued	200,000	\$ 12.91
Outstanding at September 30, 2012	200,000	\$ 12.91

At September 30, 2012, there was approximately \$2.1 million of total unrecognized compensation expense related to nonvested restricted stock arrangements granted under the Company's 2007 Plan.

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 11 Stock-Based Compensation, continued

The Company expects to recognize the remaining compensation expense over a weighted-average period of 37 months. No restricted stock was granted during the three and nine months ended September 30, 2011.

Note 12 Commitments and Contingencies

In connection with the Company's April 20, 2011 acquisition of the marina property located in Pinellas County, Florida, the Company assumed the liability to complete a site assessment and remediation of environmental contamination that resulted from a petroleum release at the marina site in late 2009. The Company and its environmental consultants have assumed the remedial action work plan developed by prior management and its environmental consultant, which consists of completing the site assessment, performing soil excavation, and installing wells for collection of groundwater and soil samples throughout the monitoring phase of the project. At acquisition, the Company recorded a liability of \$150,000 with respect to the planned remedial action. Such liability was determined based on reasonably estimable costs of completing the actions defined in the existing ongoing work plan. As of September 30, 2012, a total of \$53,000 has been expended with respect to the site assessment and the remaining \$97,000 accrued at acquisition is included in other liabilities in the accompanying condensed consolidated balance sheets. Although the Company has accrued all reasonably estimable costs of completing the actions defined in the current ongoing work plan, it is possible that additional testing and additional environmental monitoring and remediation will be required as part of the Company's ongoing discussions with the Florida Department of Health, the agency contracted by the Florida Department of Environmental Protection to administer cases of petroleum contamination in Pinellas County, in which case additional expenses could exceed the current estimated liability. However, based on information known at September 30, 2012, the Company does not expect that such additional expenses would have a material adverse effect on the liquidity or financial condition of the Company.

Note 13 Related Party Transaction

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

(continued)

Table of Contents

HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 14 Subsequent Events

On October 19, 2012, the Company's Board of Directors declared quarterly and special dividends on its common shares of \$0.225 and \$0.10 per share, respectively. Both dividends will be paid on December 21, 2012 to shareholders of record at the close of business November 16, 2012.

On November 6, 2012, the Company assumed approximately 60,000 policies from Citizens Property Insurance Corporation representing approximately \$150 million in additional annualized premiums.

Table of Contents

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

You should read the following discussion in conjunction with our condensed consolidated financial statements and related notes and information included under this Item 2 and elsewhere in this quarterly report on Form 10-Q and in our Form 10-K filed with the Securities and Exchange Commission (SEC) on March 30, 2012. Unless the context requires otherwise, as used in this Form 10-Q, the terms HCI, we, us, our, the Company, our company, and similar references refer to Homeowners Choice, Inc. and its subsidiaries.

Forward-Looking Statements

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

OVERVIEW

General

Homeowners Choice, Inc. is a property and casualty insurance holding company incorporated in Florida in 2006. Through our subsidiaries, we provide property and casualty homeowners insurance, condominium-owners insurance, and tenants insurance to individuals owning property in Florida. We offer these insurance products at competitive rates, while pursuing profitability using selective underwriting criteria. Our principal revenues are earned premiums, which are reported net of reinsurance costs, and investment income. We cede a substantial portion of our earned premiums to reinsurers to mitigate risks primarily associated with hurricanes and other catastrophic events. Our principal expenses are claims from policyholders, policy acquisition costs, and other underwriting expenses. As of September 30, 2012, we had total assets of \$282.3 million and stockholders equity of \$101.1 million. Our net income was approximately \$2.8 million and \$17.1 million, respectively, for the three and nine months ended September 30, 2012. Income available to common stockholders was approximately \$2.8 million and \$16.8 million, respectively, for the three and nine months ended September 30, 2012.

We began operations in June of 2007 by participating in a take-out program through which we assumed insurance policies held by Citizens Property Insurance Corporation (Citizens), a Florida state-supported insurer. The take-out program is a legislatively mandated program designed to reduce the state's risk exposure by encouraging private companies to assume policies from Citizens. Policies were assumed in eight separate assumption transactions which took place from July 2007 through December 2010 and one additional assumption transaction which was completed in November 2012 (see Recent Developments). In November 2011, we completed an assumption transaction with HomeWise Insurance Company (HomeWise) through which we acquired the Florida policies of HomeWise. Substantially all of our premium revenue since inception has come from the policies acquired in these assumption transactions. Through the Citizens assumptions and the HomeWise acquisition, we have been able to increase our geographic diversification within the state of Florida.

Table of Contents

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

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

Recent Developments

Effective November 6, 2012, we assumed approximately 60,000 policies upon completion of our ninth assumption transaction with Citizens representing approximately \$150 million in additional annualized premiums.

On October 25, 2012, shares of our common stock began trading on the New York Stock Exchange under the ticker symbol HCI.

On October 19, 2012, our Board of Directors declared quarterly and special dividends on its common shares of \$0.225 and \$0.10 per share, respectively. Both dividends will be paid on December 21, 2012 to shareholders of record at the close of business November 16, 2012.

On September 26, 2012, our Board of Directors fixed October 27, 2012 as the cancellation date for the warrants issued with our IPO shares. As such, record holders of the IPO warrants had no further rights under the warrants on and after October 27, 2012.

Table of Contents**RESULTS OF OPERATIONS**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Operating Revenue				
Gross premiums earned	\$ 53,109	31,741	161,579	93,855
Premiums ceded	(22,506)	(13,211)	(53,475)	(41,607)
Net premiums earned	30,603	18,530	108,104	52,248
Net investment income	47	486	871	1,557
Policy fee income	624	424	2,167	1,278
Realized investment (losses) gains	(4)	123	26	416
Gain on bargain purchase			179	936
Other income	211	150	641	808
Total operating revenue	31,481	19,713	111,988	57,243
Operating Expenses				
Losses and loss adjustment expenses	15,017	10,431	50,382	31,357
Policy acquisition and other underwriting expenses	6,611	3,529	19,690	10,572
Other operating expenses	4,728	2,447	13,401	6,932
Total operating expenses	26,356	16,407	83,473	48,861
Income before income taxes	5,125	3,306	28,515	8,382
Income taxes	2,299	1,232	11,459	3,214
Net income	\$ 2,826	2,074	17,056	5,168
Preferred stock dividends	(42)	(218)	(286)	(596)
Income available to common stockholders	\$ 2,784	1,856	16,770	4,572
Ratios to Net Premiums Earned:				
Loss Ratio	49.07%	56.29%	46.61%	60.02%
Expense Ratio	37.05%	32.25%	30.61%	33.50%
Combined Ratio	86.12%	88.54%	77.22%	93.52%
Ratios to Gross Premiums Earned:				
Loss Ratio	28.28%	32.86%	31.18%	33.41%
Expense Ratio	21.35%	18.83%	20.48%	18.65%
Combined Ratio	49.63%			