

Homeowners Choice, Inc.
Form 10-Q
November 13, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549

Form 10-Q

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

For the quarterly period ended 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.

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HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

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

	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

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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.

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HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 1 Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited, condensed consolidated financial statements for Homeowners Choice, Inc. and its subsidiaries (collectively, the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information, and the Securities and Exchange Commission (SEC) rules for interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, in the opinion of management, the accompanying financial statements reflect all normal recurring adjustments necessary to present fairly the Company's financial position as of 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.

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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.

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HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 2 Recent Accounting Pronouncements

Accounting Standards Update No. 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
	\$ 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.

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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

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HOMEOWNERS CHOICE, INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited)

Note 4 Fair Value Measurements

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

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

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

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

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

Level 3 Inputs that are unobservable.

(continued)

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