UNIVERSAL INSURANCE HOLDINGS, INC.
Form 10-Q
November 04, 2013
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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended September 30, 2013**

**or**

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

**For the transition period from __________ to __________**

**Commission File Number 001-33251**

**UNIVERSAL INSURANCE HOLDINGS, INC.**

**(Exact name of registrant as specified in its charter)**

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

**1110 W. Commercial Blvd., Fort Lauderdale, Florida 33309**

**(Address of principal executive offices)**

**(954) 958-1200**

**(Registrant s telephone number, including area code)**

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer | ¨ | Accelerated filer | x |
| Non-accelerated filer | ¨ (Do not check if a smaller reporting company) | 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 x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 35,111,172 shares of common stock, par value $0.01 per share, outstanding on October 31, 2013.

**UNIVERSAL INSURANCE HOLDINGS, INC.**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To The Board of Directors and Stockholders of

Universal Insurance Holdings, Inc. and Subsidiaries

Fort Lauderdale, Florida

We have reviewed the accompanying condensed consolidated balance sheet of **Universal Insurance Holdings, Inc. (the Company ) and its Subsidiaries** as of September 30, 2013 and the related condensed consolidated statements of income and comprehensive income for the three and nine-month periods ended September 30, 2013 and September 30, 2012, the related condensed consolidated statement of stockholders equity for the nine months ended September 30, 2013 and the related condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2013 and 2012. These interim financial statements are the responsibility of the Company s management.

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

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial statements as of September 30, 2013 and for the three and nine-month periods then ended for them to be in conformity with accounting principles generally accepted in the United States of America.

/s/ Plante & Moran, PLLC

Chicago, Illinois

November 4, 2013

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## PART I FINANCIAL INFORMATION

### Item 1. Financial Statements

### UNIVERSAL INSURANCE HOLDINGS, INC. AND SUBSIDIARIES

### CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

**(in thousands, except per share data)**

| | As of September 30, 2013 | As of December 31, 2012 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents | $ 137,286 | $ 347,392 |
| Restricted cash and cash equivalents | 2,600 | 33,009 |
| Fixed maturities (trading), at fair value | | 4,009 |
| Equity securities (trading), at fair value | | 85,041 |
| Fixed maturities (available for sale), at fair value | 298,504 | |
| Equity securities (available for sale), at fair value | 70,862 | |
| Prepaid reinsurance premiums | 250,506 | 239,921 |
| Reinsurance recoverable | 74,900 | 89,191 |
| Reinsurance receivable, net | 24,268 | 24,334 |
| Premiums receivable, net | 52,399 | 50,125 |
| Receivable from securities sold | | 1,096 |
| Other receivables | 3,446 | 2,017 |
| Property and equipment, net | 9,300 | 8,968 |
| Deferred policy acquisition costs, net | 16,953 | 17,282 |
| Income taxes recoverable | 14,498 | 2,594 |
| Deferred income tax asset, net | 13,756 | 19,178 |
| Other assets | 3,066 | 1,578 |
| Total assets | $ 972,344 | $ 925,735 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| LIABILITIES: | | |
| Unpaid losses and loss adjustment expenses | $ 157,374 | $ 193,241 |
| Unearned premiums | 407,443 | 388,071 |
| Advance premium | 23,692 | 15,022 |
| Accounts payable | 3,863 | 4,368 |
| Bank overdraft | 22,209 | 25,994 |
| Payable for securities purchased | | 1,275 |
| Reinsurance payable, net | 118,573 | 85,259 |
| Income taxes payable | 1,450 | 699 |

| | | |
|---|---|---|
| Other liabilities and accrued expenses | 33,982 | 28,071 |
| Long-term debt | 37,356 | 20,221 |
| Total liabilities | 805,942 | 762,221 |
| Commitments and Contingencies (Note 13) | | |
| STOCKHOLDERS EQUITY: | | |
| Cumulative convertible preferred stock, $.01 par value | 1 | 1 |
| Authorized shares 1,000 | | |
| Issued shares 64 and 108 | | |
| Outstanding shares 64 and 108 | | |
| Minimum liquidation preference, $2.66 per share | | |
| Common stock, $.01 par value | 434 | 419 |
| Authorized shares 55,000 | | |
| Issued shares 43,387 and 41,889 | | |
| Outstanding shares 35,111 and 40,871 | | |
| Treasury shares, at cost 8,276 and 1,018 | (35,467) | (3,101) |
| Additional paid-in capital | 40,631 | 38,684 |
| Accumulated other comprehensive income, net of taxes | (488) | |
| Retained earnings | 161,291 | 127,511 |
| Total stockholders equity | 166,402 | 163,514 |
| Total liabilities and stockholders equity | $ 972,344 | $ 925,735 |

The accompanying notes to condensed consolidated financial statements are an integral part of these statements.

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**UNIVERSAL INSURANCE HOLDINGS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (unaudited)**

**(in thousands, except per share data)**

| | Three Months Ended September 30, 2013 | Three Months Ended September 30, 2012 | Nine Months Ended September 30, 2013 | Nine Months Ended September 30, 2012 |
|---|---|---|---|---|
| PREMIUMS EARNED AND OTHER REVENUES | | | | |
| Direct premiums written | $ 186,079 | $ 192,986 | $ 610,164 | $ 605,557 |
| Ceded premiums written | (124,961) | (132,776) | (400,175) | (398,643) |
| Net premiums written | 61,118 | 60,210 | 209,989 | 206,914 |
| Change in net unearned premium | 7,809 | (698) | (8,787) | (43,068) |
| Premiums earned, net | 68,927 | 59,512 | 201,202 | 163,846 |
| Net investment income (expense) | 382 | 215 | 530 | 163 |
| Net realized gains (losses) on investments | 56 | (3,142) | (15,982) | (12,296) |
| Net change in unrealized gains (losses) on investments | 15 | 8,091 | 7,912 | 11,490 |
| Net foreign currency gains (losses) on investments | | | | 23 |
| Commission revenue | 4,180 | 4,822 | 14,437 | 15,494 |
| Policy fees | 3,231 | 3,461 | 10,737 | 11,434 |
| Other revenue | 1,577 | 1,578 | 4,743 | 4,558 |
| Total premiums earned and other revenues | 78,368 | 74,537 | 223,579 | 194,712 |
| OPERATING COSTS AND EXPENSES | | | | |
| Losses and loss adjustment expenses | 28,335 | 36,301 | 80,018 | 91,912 |
| General and administrative expenses | 24,920 | 24,262 | 68,998 | 59,605 |
| Total operating costs and expenses | 53,255 | 60,563 | 149,016 | 151,517 |
| INCOME BEFORE INCOME TAXES | 25,113 | 13,974 | 74,563 | 43,195 |
| Income taxes, current | 9,142 | 624 | 25,440 | 10,484 |
| Income taxes, deferred | 1,564 | 5,094 | 5,728 | 6,805 |
| Income taxes, net | 10,706 | 5,718 | 31,168 | 17,289 |
| NET INCOME | $ 14,407 | $ 8,256 | $ 43,395 | $ 25,906 |
| Basic earnings per common share | $ 0.43 | $ 0.21 | $ 1.18 | $ 0.65 |
| Weighted average common shares outstanding Basic | 33,658 | 39,679 | 36,628 | 39,579 |

| | | | | |
|---|---|---|---|---|
| Fully diluted earnings per common share | $ 0.40 | $ 0.20 | $ 1.13 | $ 0.64 |
| Weighted average common shares outstanding Diluted | 35,611 | 40,450 | 38,352 | 40,458 |
| Cash dividend declared per common share | $ 0.10 | $ 0.08 | $ 0.26 | $ 0.26 |

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Net income | $ 14,407 | $ 8,256 | $ 43,395 | $ 25,906 |
| Change in net unrealized gains (losses) on available for sale investments, net of tax | 2,120 | | (488) | |
| Comprehensive income (loss) | $ 16,527 | $ 8,256 | $ 42,907 | $ 25,906 |

The accompanying notes to condensed consolidated financial statements are an integral part of these statements.

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**UNIVERSAL INSURANCE HOLDINGS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY (unaudited)**

**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2013**

**(in thousands)**

| | Common Shares Issued | Preferred Shares Issued | Common Stock Amount | Preferred Stock Amount | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income | Treasury Stock | Total Stockholders Equity |
|---|---|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2012** | 41,889 | 108 | $ 419 | $ 1 | $ 38,684 | $ 127,511 | $ | $ (3,101) | $ 163,514 |
| Conversion of preferred stock | 220 | (44) | 2 | | (2) | | | | |
| Stock option exercises | 2,060 | | 21 | | 8,279 | | | (11,028) | (2,728) |
| Restricted stock awards | 1,000 | | 10 | | (10) | | | | |
| Purchases of treasury stock | | | | | | | | (32,366) | (32,366) |
| Retirement of treasury shares | (1,782) | | (18) | | (11,010) | | | 11,028 | |
| Stock-based compensation | | | | | 4,638 | | | | 4,638 |
| Net income | | | | | | 43,395 | | | 43,395 |
| Change in net unrealized gains (losses) (2) | | | | | | | (488) | | (488) |
| Excess tax benefit (shortfall), net (1) | | | | | 52 | | | | 52 |
| Declaration of dividends | | | | | | (9,615) | | | (9,615) |
| **Balance, September 30, 2013** | 43,387 | 64 | $ 434 | $ 1 | $ 40,631 | $ 161,291 | $ (488) | $ (35,467) | $ 166,402 |

(1) Excess tax benefits are related to stock-based compensation.

(2) Represents change in fair value of AFS investments for the period presented, net of tax benefit of $306 thousand.

The accompanying notes to condensed consolidated financial statements are an integral part of these statements.

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**UNIVERSAL INSURANCE HOLDINGS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

**(in thousands)**

| | Nine Months Ended September 30, 2013 | Nine Months Ended September 30, 2012 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net Income | $ 43,395 | $ 25,906 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Bad debt expense | 363 | 224 |
| Depreciation | 745 | 625 |
| Amortization of stock-based compensation | 4,639 | 2,559 |
| Amortization of original issue discount | 349 | |
| Accretion of deferred credit | (349) | |
| Net realized (gains) losses on investments | 15,982 | 12,296 |
| Net change in unrealized (gains) losses on investments | (7,912) | (11,490) |
| Loss (gain) on disposal of assets | 5 | |
| Net foreign currency (gains) losses on investments | | (23) |
| Amortization of premium/accretion of discount, net | 1,063 | (5) |
| Deferred income taxes | 5,728 | 6,806 |
| Excess tax (benefits) shortfall from stock-based compensation | (52) | 1,765 |
| Net change in assets and liabilities relating to operating activities: | | |
| Restricted cash and cash equivalents | 30,409 | (16,823) |
| Prepaid reinsurance premiums | (10,585) | (5,804) |
| Reinsurance recoverables | 14,291 | 4,906 |
| Reinsurance receivables, net | 66 | 24,677 |
| Premiums receivable, net | (2,634) | (10,414) |
| Accrued investment income | (898) | 274 |
| Other receivables | (535) | (766) |
| Income taxes recoverable | (11,904) | (406) |
| Deferred policy acquisition costs, net | 329 | (5,023) |
| Purchase of trading securities | (26,009) | (254,270) |
| Proceeds from sales of trading securities | 102,661 | 310,943 |
| Other assets | (1,453) | 362 |
| Unpaid losses and loss adjustment expenses | (35,867) | (14,541) |
| Unearned premiums | 19,372 | 48,872 |
| Accounts payable | (505) | (62) |
| Reinsurance payable, net | 33,314 | 36,437 |
| Income taxes payable | 803 | (14,482) |
| Other liabilities and accrued expenses | 4,124 | 3,274 |
| Advance premium | 8,670 | (922) |
| Net cash provided by (used in) operating activities | 187,605 | 144,895 |

| | | | | |
|---|---|---|---|---|
| Cash flows from investing activities: | | | | |
| Proceeds from sale of property and equipment | | 5 | | 18 |
| Purchase of property and equipment | | (1,086) | | (2,365) |
| Purchases of equity securities, available for sale | | (70,351) | | |
| Purchases of fixed maturities, available for sale | | (306,169) | | |
| Proceeds from sales of equity securities, available for sale | | 390 | | |
| Proceeds from sales of fixed maturities, available for sale | | | | |
| Maturities of fixed maturity securities, available for sale | | 9,021 | | |
| Net cash provided by (used in) investing activities | | (368,190) | | (2,347) |
| Cash flows from financing activities: | | | | |
| Bank overdraft increase (decrease) | | (3,785) | | 3,713 |
| Preferred stock dividend | | (15) | | (264) |
| Common stock dividend | | (9,576) | | (7,225) |
| Issuance of common stock | | | | 207 |
| Purchase of treasury stock | | (32,365) | | |
| Payments related to tax withholding for share-based compensation | | (2,728) | | (121) |
| Excess tax benefits (shortfall) from stock-based compensation | | 51 | | (1,765) |
| Repayment of debt | | (1,103) | | (1,103) |
| Proceeds from borrowings | | 20,000 | | |
| Net cash provided by (used in) financing activities | | (29,521) | | (6,558) |
| Net increase (decrease) in cash and cash equivalents | | (210,106) | | 135,990 |
| Cash and cash equivalents at beginning of period | | 347,392 | | 229,685 |
| Cash and cash equivalents at end of period | $ | 137,286 | $ | 365,675 |
| Supplemental cash and non-cash flow disclosures: | | | | |
| Interest paid | $ | 742 | $ | 327 |
| Income taxes paid | $ | 36,564 | $ | 22,453 |
| Non-cash transfer of investments from trading to available for sale portfolio | $ | 4,004 | $ | |

The accompanying notes to condensed consolidated financial statements are an integral part of these statements.

**UNIVERSAL INSURANCE HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

## 1. Nature of Operations and Basis of Presentation

### Nature of Operations

Universal Insurance Holdings, Inc. ( UIH ) is a Delaware corporation originally incorporated as Universal Heights, Inc. in November 1990. UIH and its wholly-owned subsidiaries (collectively, the Company ) are a vertically integrated insurance holding company performing all aspects of insurance underwriting, distribution and claims. Through its wholly-owned subsidiaries, including Universal Property & Casualty Insurance Company ( UPCIC ) and American Platinum Property and Casualty Insurance Company ( APPCIC ), collectively referred to as the Insurance Entities , the Company is principally engaged in the property and casualty insurance business offered primarily through a network of independent agents. Risk from catastrophic losses is managed through the use of reinsurance agreements. The Company s primary product is homeowners insurance offered in seven states as of September 30, 2013, including Florida, which comprises the vast majority of the Company s in-force policies. See Note 5 (Insurance Operations) for more information regarding the Company s insurance operations.

The Company generates revenues primarily from the collection of premiums and the investment of available funds in excess of those retained for claims-paying obligations and insurance operations. Other significant sources of revenue include commissions collected from reinsurers and policy fees collected from policyholders through the Company s affiliated managing general agent.

### Basis of Presentation

The Company has prepared the accompanying unaudited Condensed Consolidated Financial Statements ( Financial Statements ) in accordance with the rules and regulations of the United States Securities and Exchange Commission ( SEC ) for interim financial information. Accordingly, they do not include all of the information and footnotes required by United States Generally Accepted Accounting Principles ( GAAP ) for complete financial statements. Therefore, the Financial Statements should be read in conjunction with the audited Consolidated Financial Statements contained in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2012, filed with the SEC on March 8, 2013. The condensed consolidated balance sheet at December 31, 2012, was derived from audited financial statements, but does not include all disclosures required by GAAP. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation have been included in the Financial Statements. The results for interim periods do not necessarily indicate the results that may be expected for any other interim period or for the full year.

The Financial Statements include the accounts of UIH and its wholly owned subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation.

Management must make estimates and assumptions that affect amounts reported in the Company s Financial Statements and in disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

**2. Significant Accounting Policies**

The Company reported Significant Accounting Policies in its Annual Report on Form 10-K for the year ended December 31, 2012. The following are new or revised disclosures or disclosures required on a quarterly basis.

*Concentrations of Credit Risk.* The Company is exposed to concentrations of credit risk, consisting principally of cash and cash equivalents, restricted cash and cash equivalents, debt securities, premiums receivable, prepaid reinsurance premiums, reinsurance receivable and reinsurance recoverable.

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The Company maintains depository relationships with SunTrust Bank, Wells Fargo Bank N.A., Deutsche Bank Securities, Inc., and State Street Bank and Trust Company and invests excess cash with custodial institutions that invest primarily in money market accounts consisting of or collateralized by short-term U.S. Treasury securities and other U.S. government guaranteed securities. These accounts are held primarily by SunTrust Bank, Deutsche Bank Securities, Inc., and State Street Bank and Trust Company. The Company regularly evaluates the financial strength of the institutions with which it maintains depository relationships. The following table presents the ratings from each of the rating agencies:

| | Current Ratings | |
|---|---|---|
| **Institution** | Standard and Poor s Rating Services | Moody s Investors Service, Inc. |
| Sun Trust Bank | BBB+ | A3 |
| Wells Fargo Bank N.A. | AA- | Aa3 |
| Deutsche Bank Securities, Inc. | A | A2 |
| State Street Bank and Trust Company | AA- | Aa2 |

Restricted cash and cash equivalents are maintained in money market accounts consisting of U.S. Treasury and government agency securities.

The following table presents the amount of cash and cash equivalents as of the periods presented (in thousands):

| | Cash and cash equivalents | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | As of September 30, 2013 | | | | As of December 31, 2012 | | | |
| Institution | Cash | Money Market Funds | Total | % by institution | Cash | Money Market Funds | Total | % by institution |
| U.S. Bank IT&C | $ | $ | $ | | $ | $ 40,463 | $ 40,463 | 11.6% |
| SunTrust Bank | 528 | 3,696 | 4,224 | 3.1% | 773 | 1,055 | 1,828 | 0.5% |
| SunTrust Bank Escrow Services | | 93,794 | 93,794 | 68.3% | | 300,843 | 300,843 | 86.6% |
| Wells Fargo Bank N.A. | 2,701 | | 2,701 | 2.0% | 1,991 | 3 | 1,994 | 0.6% |
| Deutsche Bank Securities, Inc. | | 21,042 | 21,042 | 15.3% | 1,796 | 468 | 2,264 | 0.7% |
| State Street Bank and Trust Company | | 14,800 | 14,800 | 10.8% | | | | |
| All Other Banking Institutions | 725 | | 725 | 0.5% | | | | |
| Total | $ 3,954 | $ 133,332 | $ 137,286 | 100.0% | $ 4,560 | $ 342,832 | $ 347,392 | 100.0% |

The following table presents the amount of restricted cash and cash equivalents as of the periods presented (in thousands):

| | Restricted cash and cash equivalents | | | |
|---|---|---|---|---|
| | As of September 30, 2013 | | As of December 31, 2012 | |
| Institution | State Deposits | % by institution | State Deposits | % by institution |
| U.S. Bank IT&C | $ 800 | 30.8% | $ 800 | 2.4% |
| Florida Department of Financial Services | 1,800 | 69.2% | 32,209 | 97.6% |
| Total | $ 2,600 | 100.0% | $ 33,009 | 100.0% |

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

In order to reduce credit risk for amounts due from reinsurers, the Insurance Entities seek to do business with financially sound reinsurance companies and regularly evaluate the financial strength of all reinsurers used.

The following table presents the unsecured amounts due from the Company s reinsurers whose aggregate balance exceeded 3% of the Company s stockholders equity as of the periods presented (in thousands):

| | | Current Ratings | | As of | |
|---|---|---|---|---|---|
| **Reinsurer** | AM Best Company | Standard and Poor s Rating Services | Moody s Investors Service, Inc. | September 30, 2013 | December 31, 2012 |
| Everest Reinsurance Company | A+ | A+ | A1 | $ 84,387 | $ 44,392 |
| Florida Hurricane Catastrophe Fund | n/a | n/a | n/a | | 31,970 |
| Odyssey Reinsurance Company | A | A- | A3 | 151,600 | 192,096 |
| Total (1) | | | | $ 235,987 | $ 268,458 |

(1) Amounts represent prepaid reinsurance premiums, reinsurance receivables, and net recoverables for paid and unpaid losses, including incurred but not reported reserves, loss adjustment expenses, and offsetting reinsurance payables.

n/a No rating available

*Recently Issued Accounting Pronouncements*

In July 2013, the Financial Accounting Standards Board (FASB) issued accounting guidance on the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. Under this guidance, an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should generally be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward. This guidance is effective for fiscal years and interim periods beginning after December 15, 2013, but earlier adoption is permitted. We plan to adopt the standard prospectively on its required effective date of January 1, 2014 and are assessing the effect of adopting the standard on our Condensed Consolidated Balance Sheets, Statements of Income and Statements of Cash Flows.

In June 2011, the FASB updated its guidance to the Comprehensive Income Topic 220 of the FASB Accounting Standards Codification ( ASC ) and in February 2013, the FASB further amended such topic. This February 2013 guidance requires disclosure about amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement of operations or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional detail about those amounts. This guidance is to be applied prospectively to interim and annual reporting periods beginning after December 15, 2012. The Company adopted this guidance effective January 1, 2013. The adoption of this guidance will result in additional disclosure but did not impact the Company s results of operations, cash flows or financial position. The updated guidance provided by the FASB in June 2011 increases the prominence of items reported in other comprehensive income by eliminating the option of presenting components of other comprehensive income as part of the statement of changes in stockholders equity. The guidance requires that total comprehensive income (including both the net income components and other comprehensive income components) be reported in either a single continuous statement of comprehensive income (the approach currently used in the Company s financial statements), or two separate but consecutive statements. This guidance is to be applied retrospectively to fiscal years (and interim periods within those years) beginning after December 15, 2011. The Company adopted this guidance effective January 1, 2012. The adoption did not have an impact on the presentation of the Company s financial statements and notes herein, as the Company has presented amounts of other comprehensive income consistent with this updated guidance.

In May 2011, the FASB updated its guidance related to the Fair Value Measurement, Topic 820 of the ASC, to achieve common fair value measurement and disclosure requirements with International Financial Reporting Standards. The amendments change the wording used to describe many of the requirements under GAAP, to clarify the intent of application of existing fair value measurement and disclosure requirements, and to change particular principles or requirements for measuring and disclosing fair value measurements. The amendments are to be applied prospectively to

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interim and annual reporting periods beginning after December 15, 2011. The Company adopted this guidance effective January 1, 2012. The adoption of this guidance resulted in additional disclosure but did not impact the Company s results of operations, cash flows or financial position.

In September 2010, the FASB issued guidance related to accounting for costs associated with acquiring or renewing insurance contracts. This guidance defines allowable deferred policy acquisition costs as costs incurred by insurance entities for the successful acquisition of new and renewal contracts. Such costs result directly from and are essential to the contract transaction(s) and would not have been incurred by the insurance entity had the contract(s) not occurred. This guidance is effective for periods beginning after December 15, 2011, with early adoption permitted. The Company adopted this guidance prospectively effective January 1, 2012. Under the new guidance, the Company s net deferred policy acquisition costs were reduced from $13.0 million to $11.4 million, a difference of 13% at December 31, 2011. The resulting $1.6 million difference was charged directly to earnings during the three months ended March 31, 2012. This charge represents a charge-off of capitalized costs existing at December 31, 2011, which would have been amortized to earnings within a twelve-month period under the old guidance.

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### 3. Investments

The Company liquidated its trading portfolio of equity securities and transferred the fixed maturities that were outstanding at December 31, 2012 into its portfolio of securities available for sale effective March 1, 2013. The unrealized gain (loss) associated with the fixed maturities trading portfolio was recognized in earnings up to the date of transfer.

The following table presents the Company s investment holdings by type of instrument as of the periods presented (in thousands):

| | As of September 30, 2013 | | | As of December 31, 2012 | | |
|---|---|---|---|---|---|---|
| | Cost or Amortized Cost | Fair Value | Carrying Value | Cost or Amortized Cost (4) | Fair Value | Carrying Value |
| Cash and cash equivalents (1) | $ 137,286 | $ 137,286 | $ 137,286 | $ 347,392 | $ 347,392 | $ 347,392 |
| Restricted cash and cash equivalents | 2,600 | 2,600 | 2,600 | 33,009 | 33,009 | 33,009 |
| **Trading portfolio:** | | | | | | |
| Fixed maturities: | | | | | | |
| U.S. government obligations and agencies | | | | 3,192 | 4,009 | 4,009 |
| Equity securities: (4) | | | | | | |
| Common stock: | | | | | | |
| Metals and mining | | | | 31,113 | 26,130 | 26,130 |
| Energy | | | | 12,053 | 10,868 | 10,868 |
| Other | | | | 8,416 | 8,215 | 8,215 |
| Exchange-traded and mutual funds: | | | | | | |
| Metals and mining | | | | 22,687 | 21,989 | 21,989 |
| Agriculture | | | | 10,705 | 10,265 | 10,265 |
| Energy | | | | 4,992 | 5,068 | 5,068 |
| Indices | | | | 2,827 | 2,506 | 2,506 |
| Non-hedging derivative asset (liability), net (2) | | | | 69 | (21) | (21) |
| Other investments (3) | | | | 517 | 317 | 317 |
| Total trading portfolio investments | | | | 96,571 | 89,346 | 89,346 |
| **Available for sale portfolio:** | | | | | | |
| Fixed maturities: | | | | | | |
| U.S. government obligations and agencies | 105,265 | 104,532 | 104,532 | | | |
| Corporate bonds | 99,659 | 98,978 | 98,978 | | | |
| Mortgage-backed and asset-backed securities | 95,220 | 94,994 | 94,994 | | | |
| Equity securities: | | | | | | |
| Common stock | 19,126 | 20,057 | 20,057 | | | |
| Mutual funds | 50,891 | 50,805 | 50,805 | | | |
| Total available for sale investments | 370,161 | 369,366 | 369,366 | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total investments | $ 510,047 | $ 509,252 | $ 509,252 | $ 476,972 | $ 469,747 | $ 469,747 |

(1) Cash and cash equivalents include short-term debt securities consisting of direct obligations of the U.S. Treasury or money-market accounts that invest in or are collateralized by direct obligations of the U.S. Treasury and other U.S. government guaranteed securities.

(2) Derivatives are included in Other assets and Other liabilities and accrued expenses in the Consolidated Balance Sheets.

(3) Other investments represent physical metals held by the Company and are included in Other assets in the Consolidated Balance Sheets.

(4) The cost for equity securities as of December 31, 2012 has been restated from the amounts reported on Form 10-K for the year ended December 31, 2012. The amounts previously reported represented the cost determined under a statutory basis of accounting. The restatement does not affect any amounts reported in the consolidated financial statements including the carrying amount of equity securities reported in the consolidated balance sheet as of December 31, 2012 and unrealized gains and losses reported in the consolidated statement of income for the year ended December 31, 2012.

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The Company has made an assessment of its invested assets for fair value measurement as further described in Note 14 (Fair Value Measurements) .

The following table presents the components of net investment income, comprised primarily of interest and dividends, for the periods presented (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Cash and cash equivalents (1) | $ 135 | $ 243 | $ 377 | $ 483 |
| Fixed maturities | 439 | 42 | 409 | 53 |
| Equity securities | 363 | 95 | 729 | 313 |
| Total investment income | 937 | 380 | 1,515 | 849 |
| Less investment expenses | (555) | (165) | (985) | (686) |
| Net investment (expense) income | $ 382 | $ 215 | $ 530 | $ 163 |

(1) Includes interest earned on restricted cash and cash equivalents.

*Trading Portfolio*

The following table provides the effect of trading activities on the Company s results of operations for the periods presented by type of instrument and by line item in the Condensed Consolidated Statements of Income (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Realized gains (losses) on investments: | | | | |
| Fixed maturities | $ | $ | $ | $ |
| Equity securities | | (3,299) | (15,969) | (12,728) |
| Derivatives (non-hedging instruments) (1) | | 157 | (68) | 432 |
| Total realized gains (losses) on trading portfolio | | (3,142) | (16,037) | (12,296) |
| Change in unrealized gains (losses) on investments: | | | | |
| Fixed maturities | | 55 | 13 | 192 |
| Equity securities | | 8,119 | 7,758 | 11,291 |
| Derivatives (non-hedging instruments) (1) | | (55) | 89 | 62 |
| Other | | (28) | 14 | (55) |
| Total change in unrealized gains (losses) on trading portfolio | | 8,091 | 7,874 | 11,490 |

| | | | | |
|---|---|---|---|---|
| Net gains (losses) recognized on trading portfolio | $ | $ 4,949 | $ (8,163) | $ (806) |

(1) This table provides the alternative quantitative disclosures permitted for derivatives that are not used as hedging instruments and are included in the trading portfolio.

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*Securities Available for Sale*

The following table provides the cost or amortized cost and fair value of securities available for sale as of the period presented (in thousands):

| | September 30, 2013 | | | |
|---|---|---|---|---|
| | Cost or Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Fixed Maturities: | | | | |
| US government and agency obligations | $ 105,265 | $ 2 | $ (735) | $ 104,532 |
| Corporate bonds | 99,659 | 263 | (944) | 98,978 |
| Mortgage-backed and asset-backed securities | 95,220 | 125 | (351) | 94,994 |
| Equity Securities: | | | | |
| Common stock | 19,126 | 1,214 | (283) | 20,057 |
| Mutual funds | 50,891 | 986 | (1,072) | 50,805 |
| Total | $ 370,161 | $ 2,590 | $ (3,385) | $ 369,366 |

The following table summarizes the fair value and gross unrealized losses on securities available for sale, aggregated by major investment category and length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2013 (in thousands):

| | Less than 12 months | | | 12 months or longer | | |
|---|---|---|---|---|---|---|
| | Number of issues | Fair value | Unrealized losses | Number of issues | Fair value | Unrealized losses |
| Fixed maturities: | | | | | | |
| US government and agency obligations | 7 | $ 92,376 | $ (735) | | $ | $ |
| Corporate bonds | 68 | 81,640 | (944) | | | |
| Mortgage-backed and asset-backed securities | 17 | 73,630 | (351) | | | |
| Equity securities: | | | | | | |
| Common stock | 22 | 6,449 | (284) | | | |
| Mutual funds | 5 | 20,430 | (1,071) | | | |
| Total | 119 | $ 274,525 | $ (3,385) | | $ | $ |

At September 30, 2013, we held fixed maturity and equity securities that were in an unrealized loss position as presented in the table above. Since the Company liquidated its trading portfolio and transferred the remaining fixed maturities into its portfolio of securities available for sale effective March 1, 2013, there were no positions held in our portfolio of securities available for sale for longer than 12 months. For fixed maturity securities with significant declines in value, we perform fundamental credit analysis on a security-by-security basis, which includes consideration of credit quality and credit ratings, review of relevant industry analyst reports and other available market data. For fixed maturity and equity securities, the Company considers whether it has the intent and ability to hold the securities for a period of time sufficient to recover its cost basis. Where the Company lacks the intent and ability to hold to recovery, or believes the recovery period is extended, the security s decline in fair value is considered other than temporary and is recorded in earnings. Based upon the relative severity and duration of the unrealized losses combined with management s intent and ability to hold the securities until recovery and its credit analysis of the individual issuers of the securities, management has no reason to believe the unrealized losses for securities available for sale at September 30, 2013 are other than temporary.

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The following table presents the amortized cost and fair value of fixed maturities available for sale by contractual maturity as of September 30, 2013 (in thousands):

| | Fixed Maturities Securities Available for Sale | |
|---|---|---|
| | Amortized Cost | Fair Value |
| Due in one year or less | $ 5,807 | $ 5,804 |
| Due after one year through five years | 193,942 | 192,804 |
| Due after five years through ten years | 5,175 | 4,902 |
| Due after ten years | | |
| Mortgage-backed and asset-backed securities | 95,220 | 94,994 |
| Total | $ 300,144 | $ 298,504 |

The following table provides certain information related to securities available for sale during the periods presented (in thousands):

| | Three Months Ended September 30, 2013 | Nine Months Ended September 30, 2013 |
|---|---|---|
| Sales proceeds (fair value) | $ 376 | $ 390 |
| Gross realized gains | $ 56 | $ 56 |
| Gross realized losses | $ | $ (1) |
| Other than temporary losses | $ | $ |

**4. Reinsurance**

The Company seeks to reduce its risk of loss by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers, generally, as of the beginning of the hurricane season on June 1 of each year. The Company s reinsurance program consists of excess of loss, quota share and catastrophe reinsurance, subject to the terms and conditions of the applicable agreements. The Company is responsible for insured losses related to catastrophes and other events in excess of coverage provided by its reinsurance program. The Company also remains responsible for the settlement of insured losses in the event of the failure of any of its reinsurers to make payments otherwise due to the Company. The estimated insured value of the Company s in-force policyholder coverage for windstorm exposures as of September 30, 2013 was approximately $122.8 billion.

The Company has reduced the percentage of premiums ceded by UPCIC to its quota share reinsurers to 45% beginning with the reinsurance program effective June 1, 2012, from 50% under the prior year quota share contract effective June 1, 2011 through May 31, 2012. The Company s two quota share reinsurance contracts were effective June 1, 2013. One quota share reinsurance contract provides coverage to UPCIC through May 31, 2014 and the other provides coverage to UPCIC through May 31, 2015. By ceding 5% less premium to its quota share reinsurers, the Company intends to increase its profitability. The reduction of cession rate also decreases the amount of losses and loss adjustment expenses ( LAE ) that may be ceded by UPCIC and effectively increases the amount of risk retained by UPCIC and the Company. The reduction of cession rate also reduces the amount of ceding commissions earned from the Company s quota share reinsurer during the contract term and decreases the amount of deferred ceding commission, as of September 30, 2013, that is a component of net deferred policy acquisition costs.

Amounts recoverable from reinsurers are estimated in a manner consistent with the reinsurance contracts. Reinsurance premiums, losses and LAE are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Deferred ceding commissions are netted against policy acquisition costs and amortized over the effective period of the related insurance policies.

The Company s reinsurance arrangements had the following effect on certain items in the Condensed Consolidated Statements of Income for the periods presented (in thousands):

| | Three Months Ended September 30, 2013 | | | Nine Months Ended September 30, 2013 | | |
|---|---|---|---|---|---|---|
| | Premiums Written | Premiums Earned | Loss and Loss Adjustment Expenses | Premiums Written | Premiums Earned | Loss and Loss Adjustment Expenses |
| Direct | $ 186,079 | $ 199,323 | $ 53,600 | $ 610,164 | $ 590,792 | $ 154,547 |
| Ceded | (124,961) | (130,396) | (25,265) | (400,175) | (389,590) | (74,529) |
| Net | $ 61,118 | $ 68,927 | $ 28,335 | $ 209,989 | $ 201,202 | $ 80,018 |

| | Three Months Ended September 30, 2012 | | | Nine Months Ended September 30, 2012 | | |
|---|---|---|---|---|---|---|
| | Premiums Written | Premiums Earned | Loss and Loss Adjustment Expenses | Premiums Written | Premiums Earned | Loss and Loss Adjustment Expenses |
| Direct | $ 192,986 | $ 191,225 | $ 68,286 | $ 605,557 | $ 556,685 | $ 177,425 |
| Ceded | (132,776) | (131,713) | (31,985) | (398,643) | (392,839) | (85,513) |
| Net | $ 60,210 | $ 59,512 | $ 36,301 | $ 206,914 | $ 163,846 | $ 91,912 |

The following prepaid reinsurance premiums and reinsurance recoverable and receivable are reflected in the Condensed Consolidated Balance Sheets as of the periods presented (in thousands):

| | As of September 30, 2013 | As of December 31, 2012 |
|---|---|---|
| Prepaid reinsurance premiums | $ 250,506 | $ 239,921 |
| Reinsurance recoverable on unpaid losses and LAE | $ 63,202 | $ 81,415 |
| Reinsurance recoverable on paid losses | 11,698 | 7,776 |
| Reinsurance receivable, net | 24,268 | 24,334 |
| Reinsurance recoverable and receivable | $ 99,168 | $ 113,525 |

**5. Insurance Operations**

The Company s primary product is homeowners insurance currently offered by APPCIC in one state (Florida) and by UPCIC in seven states, including Florida.

The following table provides the percentage of concentrations with respect to the Insurance Entities nationwide policies-in-force as of the periods presented:

| | As of September 30, 2013 | As of December 31, 2012 |
|---|---|---|
| Percentage of Policies-In-Force: | | |
| In Florida | 94% | 96% |
| With wind coverage | 98% | 98% |
| With wind coverage in South Florida (1) | 27% | 28% |

(1) South Florida is comprised of Miami-Dade, Broward and Palm Beach counties.

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*Deferred Policy Acquisition Costs, net*

The Company defers certain costs in connection with written policies, called Deferred Policy Acquisition Costs ( DPAC ), net of corresponding amounts of ceded reinsurance commissions, called Deferred Reinsurance Ceding Commissions ( DRCC ). Net DPAC is amortized over the effective period of the related insurance policies.

The following table presents the beginning and ending balances and the changes in DPAC, net of DRCC, for the periods presented (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| DPAC, beginning of period (1) | $ 59,033 | $ 56,922 | $ 54,431 | $ 50,200 |
| Capitalized Costs | 26,382 | 26,849 | 85,315 | 82,529 |
| Amortization of DPAC | (27,888) | (26,606) | (82,219) | (75,564) |
| DPAC, end of period | $ 57,527 | $ 57,165 | $ 57,527 | $ 57,165 |
| DRCC, beginning of period (1) | $ 41,792 | $ 39,178 | $ 37,149 | $ 38,845 |
| Ceding Commissions Written | 21,319 | 21,082 | 69,853 | 65,857 |
| Earned Ceding Commissions | (22,537) | (21,114) | (66,428) | (65,556) |
| DRCC, end of period | $ 40,574 | $ 39,146 | $ 40,574 | $ 39,146 |
| DPAC (DRCC), net, beginning of period (1) | $ 17,241 | $ 17,744 | $ 17,282 | $ 11,355 |
| Capitalized Costs, net | 5,063 | 5,767 | 15,462 | 16,672 |
| Amortization of DPAC (DRCC), net | (5,351) | (5,492) | (15,791) | (10,008) |
| DPAC (DRCC), net, end of period | $ 16,953 | $ 18,019 | $ 16,953 | $ 18,019 |