FEDERATED NATIONAL HOLDING CO
Form 10-Q
May 15, 2013

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 March 31, 2013
OR

o 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 0-2500111

Federated National Holding Company
(Exact name of registrant as specified in its charter)

Florida (State or Other Jurisdiction of Incorporation or Organization)	65-0248866 (IRS Employer Identification Number)

14050 N.W. 14th Street, Suite 180, Sunrise, Florida 33323
(Address of principal executive offices) (Zip Code)

954-581-9993
(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 x No o

Indicate by check mark whether the registrant has electronically submitted and posted on its corporate website, 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 o

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 o Accelerated filer o Non-accelerated filer o Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes oNo x

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

Common Stock, $.01 par value –8,120,423 outstanding as of May 9, 2013

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PART I: FINANCIAL INFORMATION
Item 1 Financial Statements

FEDERATED NATIONAL HOLDING COMPANY
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	Period Ending March 31, 2013	December 31, 2012
ASSETS	(Dollars in Thousands)	
Investments		
Debt maturities, available for sale, at fair value	$107,764	$ 101,755
Debt maturities, held to maturity, at amortized cost	6,849	7,359
Equity securities, available for sale, at fair value	27,108	20,982
Total investments	141,721	130,096
Cash and short term investments	28,193	21,143
Prepaid reinsurance premiums	4,063	7,045
Premiums receivable, net of allowance for credit losses of $69 and $69, respectively	12,683	8,023
Reinsurance recoverable, net	3,586	3,503
Deferred policy acquisition costs	10,140	8,479
Deferred income taxes, net	2,637	4,338
Income taxes receivable	-	39
Property, plant and equipment, net	883	564
Other assets	2,120	2,658
Total assets	$206,026	$ 185,888
LIABILITIES AND SHAREHOLDERS' EQUITY		
Unpaid losses and LAE	$47,565	$ 49,908
Unearned premiums	73,293	59,006
Premiums deposits and customer credit balances	3,722	2,458
Bank overdraft	6,350	5,987
Income taxes payable	77	-
Accounts payable and accrued expenses	6,350	2,624
Total liabilities	137,357	119,983
Shareholders' equity:		
Common stock, $0.01 par value. Authorized 25,000,000 shares; issued and outstanding 7,984,922 and 7,979,488, respectively	80	80
Preferred stock, $0.01 par value. Authorized 1,000,000 shares; none issued or outstanding	-	-
Additional paid-in capital	51,445	51,356
Accumulated other comprehensive income		
Unrealized net gains on investments, available for sale	4,806	4,067
Total accumulated other comprehensive income	4,806	4,067

Retained earnings	12,338	10,402
Total shareholders' equity	68,669	65,905
Total liabilities and shareholders' equity	$206,026	$ 185,888

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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FEDERATED NATIONAL HOLDING COMPANY
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
	(Dollars in Thousands)	
Revenue:		
Gross premiums written	$45,826	$31,274
Gross premiums ceded	(2,834)	(1,858)
Net premiums written	42,992	29,416
Decrease in prepaid reinsurance premiums	(9,914)	(9,849)
Increase in unearned premiums	(14,286)	(6,749)
Net change in prepaid reinsurance premiums and unearned premiums	(24,200)	(16,598)
Net premiums earned	18,792	12,818
Commission income	507	307
Finance revenue	146	114
Managing general agent fees	689	533
Net investment income	794	961
Net realized investment gains (losses)	813	(10)
Regulatory assessments recovered	-	-
Other income	125	20
Total revenue	21,866	14,743
Expenses:		
Losses and LAE	9,321	5,728
Operating and underwriting expenses	2,727	2,411
Salaries and wages	2,333	2,211
Policy acquisition costs - amortization	3,753	2,748
Total expenses	18,134	13,098
Income before provision for income tax expense	3,732	1,645
Provision for income tax expense	1,397	573
Net income	$2,335	$1,072
Net income per share - basic	$0.29	$0.13
Net income per share - diluted	$0.29	$0.13
Weighted average number of common shares outstanding - basic	7,982,934	7,946,384

Weighted average number of common shares outstanding - diluted	8,126,721	7,962,295
Dividends paid per share	$0.02	$-

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FEDERATED NATIONAL HOLDING COMPANY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
	(Dollars in Thousands)	
Net income	$2,335	$1,072
Change in net unrealized gains on investments available for sale	1,185	1,883
Comprehensive income before tax	3,520	2,955
Income tax expense related to items of other comprehensive income	(446)	(708)
Comprehensive income	$3,074	$2,247

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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FEDERATED NATIONAL HOLDING COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended March 31, 2013	2012
	(Dollars in Thousands)	
Cash flow from operating activities:		
Net income	$2,335	$1,072
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of investment premium discount, net	337	323
Depreciation and amortization of property plant and equipment, net	53	48
Net realized investment (gains) losses	(813)	10
Provision for credit losses, net	-	0
Recovery for uncollectible premiums receivable	-	(2)
Non-cash compensation	48	42
Changes in operating assets and liabilities:		
Premiums receivable	(4,660)	(1,732)
Prepaid reinsurance premiums	2,983	3,220
Reinsurance recoverable, net	(83)	307
Income taxes recoverable	39	-
Deferred income tax expense, net of other comprehensive income	1,255	504
Policy acquisition costs, net of amortization	(1,661)	(869)
Other assets	538	(2,854)
Unpaid losses and LAE	(2,342)	(4,675)
Unearned premiums	14,283	6,749
Premium deposits and customer credit balances	1,264	358
Income taxes payable	77	48
Bank overdraft	363	(706)
Accounts payable and accrued expenses	3,726	(740)
Net cash provided by operating activities	17,742	1,103
Cash flow used by investing activities:		
Proceeds from sale of investment securities	44,167	18,257
Purchases of investment securities available for sale	(54,130)	(19,090)
Purchases of property and equipment	(372)	(20)
Net cash used by investing activities	(10,335)	(853)
Cash flow (used) provided by financing activities:		
Exercised stock options	17	-
Dividends paid	(399)	-
Tax benefit related to non-cash compensation	25	21
Net cash (used) provided by financing activities	(357)	21
Net increase in cash and short term investments	7,050	271
Cash and short term investments at beginning of period	21,143	15,205
Cash and short term investments at end of period	$27,186	$15,476

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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FEDERATED NATIONAL HOLDING COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(continued)	Three Months Ended March 31, 2013	2012
	(Dollars in Thousands)	
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$20	$-
Non-cash investing and finance activities:		
Accrued dividends payable	$399	$-

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Federated National Holding Company
Notes to Condensed Consolidated Financial Statements

(1) Organization and Business

In this Quarterly Report on Form 10-Q, "FNHC" and the terms "Company", "we", "us" and "our" refer to Federated National Holding Company and its subsidiaries, unless the context indicates otherwise. We changed our name on September 11, 2012, pursuant to approval received at our annual shareholders' meeting, from 21st Century Holding Company so that our parent company and other subsidiary companies' names are consistent with our primary insurance subsidiary and the name under which we have been writing insurance for more than 20 years.

FNHC is an insurance holding company that controls substantially all steps in the insurance underwriting, distribution and claims processes through our subsidiaries and our contractual relationships with our independent agents and general agents.

We are authorized to underwrite, and/or place through our wholly owned subsidiaries, homeowners' multi-peril ("homeowners"), commercial general liability, federal flood, personal auto and various other lines of insurance in Florida and various other states. We market and distribute our own and third-party insurers' products and our other services through a network of independent agents. We also utilize a select number of general agents for the same purpose.

Our insurance subsidiary is Federated National Insurance Company ("FNIC"). FNIC is licensed as an admitted carrier in Florida. An admitted carrier is an insurance company that has received a license from the state insurance regulator for authority to write specific lines of insurance in that state. Through contractual relationships with a network of approximately 3,300 independent agents, of which approximately 1,200 actively sell and service our products, FNIC is authorized to underwrite homeowners', commercial general liability, fire, allied lines and personal and commercial automobile insurance in Florida. FNIC is also licensed as an admitted carrier in Alabama, Louisiana, Georgia and Texas, and underwrites commercial general liability insurance in those states and personal automobile insurance in Georgia and Texas.

FNIC operates as a non-admitted carrier in Arkansas, Kentucky, Missouri, Nevada, Oklahoma, South Carolina and Tennessee, and can underwrite commercial general liability insurance in all of these states. A non-admitted carrier, sometimes referred to as a "excess and surplus lines" carrier, is permitted to do business in a state and, although it is strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud, non-admitted carriers are subject to considerably less regulation with respect to policy rates and forms. Non-admitted carriers are not required to financially contribute to and benefit from the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders.

In January 2011, we merged FNIC and our other wholly owned insurance subsidiary, American Vehicle Insurance Company ("American Vehicle"), with FNIC continuing the operations of both entities. As part of its approval of the merger between FNIC and American Vehicle, the Florida Office of Insurance Regulation ("Florida OIR"), the Company, FNIC and American Vehicle entered into a consent order with the Florida OIR dated January 25, 2011 (the "Consent Order"), which was amended in February 2013, due to FNIC's statutory underwriting profit during 2012. Pursuant to the amended Consent Order, the Company and the resulting company in the merger (the "Merged Company") have agreed to the following:

- The Merged Company retained the following licenses: (010) Fire, (020) Allied Lines, (040) Homeowners Multi Peril, (050) Commercial Multi Peril, (090) Inland Marine, (170) Other Liability, (192) Private Passenger Auto Liability, (194) Commercial Auto Liability, (211) Private Passenger Auto Physical Damage and (212) Commercial

Auto Physical Damage.

- The Merged Company will not write commercial multi peril policy premium without prior approval from the Florida OIR. The Merged Company has no commercial multi peril policy premium in force.

- The Merged Company surrendered its surety license. The Merged Company has no surety policy premium in force.

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Federated National Holding Company
Notes to Condensed Consolidated Financial Statements

- The Merged Company will not write new commercial habitation condominium associations without prior approval from the Florida OIR. The current commercial habitation book of business is fully earned.

- The Merged Company agreed to maintain the total number of its homeowners' policies in Miami-Dade, Broward and Palm Beach counties (the "Tri-County Area") to no more than 35% of its entire homeowners' book. As of March 31, 2013, the Company had approximately 19.1% of its homeowners' policies located within Tri-County Area.

- The managing general agency fees payable by the Merged Company to Federated National Underwriters, Inc. ("FNU"), formerly known as Assurance Managing General Agents, Inc., a wholly owned subsidiary of the Company, which were traditionally 6% of gross written premium, were reduced and will not exceed 4% without prior approval from the Florida OIR. The Merged Company has lowered the fee to amounts varying between 2% and 4% of gross written to further support the FNIC results of operations. This will have no impact on the Company's consolidated financial results.

- The claims service fees payable by the Merged Company to Federated National Adjusting, Inc. ("FNA"), formerly known as Superior Adjusting, Inc., were reduced from the traditional 4.5% of gross earned premium to 3.6% of gross earned premium. This will have no impact on the Company's consolidated financial results.

The merger of FNIC and American Vehicle will be an ongoing transition, many aspects of which will take effect over time. References to the companies contained herein are intended to be references to the operations of FNIC following the January 2011 merger. References to the historical activities of American Vehicle are appropriately identified throughout this document.

During the three months ended March 31, 2013, 86.5%, 5.9%, 2.8% and 4.8% of the premiums we underwrote were for homeowners', commercial general liability, federal flood, and automobile insurance, respectively. During the three months ended March 31, 2012, 86.6%, 7.7%, 3.5% and 2.2% of the premiums we underwrote were for homeowners', commercial general liability, federal flood, and automobile insurance, respectively.

Our business, results of operations and financial condition are subject to fluctuations due to a variety of factors. Abnormally high severity or frequency of claims in any period could have a material adverse effect on us. When our estimated liabilities for unpaid losses and loss adjustment expenses ("LAE") are less than the actuarially determined amounts, we increase the expense in the current period. Conversely, when our estimated liabilities for unpaid losses and LAE are greater than the actuarially determined amounts, we decrease the expense in the current period.

We are focusing our marketing efforts on continuing to expand our distribution network while maintaining our commitment to long-term relationships. We market our products and services throughout Florida and in other states by establishing relationships with additional independent agents and general agents. There can be no assurance, however, that we will be able to obtain the required regulatory approvals to offer additional insurance products or expand into other states.

FNU acts as FNIC's exclusive managing general agent in Florida and is also licensed as a managing general agent in the States of Alabama, Georgia, Louisiana, Mississippi, Missouri, North Carolina, Nevada, South Carolina, Texas and Virginia. FNU has contracted with several unaffiliated insurance companies to sell commercial general liability, workers compensation, personal umbrella, inland marine and other various lines of insurance through FNU's existing network of agents.

FNU earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. FNU earns a $25 per policy fee and traditionally a 6% commission fee from its affiliate, FNIC. During the fourth quarter of 2010, FNU, pursuant to the Consent Order as discussed above, reduced its fee, to earn amounts varying between 2% and 4%, which we anticipate will return to 6% at an unknown future date with approval from the Florida OIR. A formal agreement reflecting this fee modification was executed during January 2011.

Federated National Holding Company
Notes to Condensed Consolidated Financial Statements

We internally process claims made by our insureds through our wholly owned claims adjusting company, FNA. Our agents have no authority to settle claims or otherwise exercise control over the claims process. Furthermore, we believe that the retention of independent adjusters, in addition to the employment of salaried claims personnel, results in reduced ultimate loss payments, lower LAE and improved customer service for our claimants and policyholders. We also employ an in-house Litigation Manager to cost effectively manage claims-related litigation and to monitor our claims handling practices for efficiency and regulatory compliance.

Insure-Link, Inc. serves as an independent insurance agency. The insurance agency markets direct to the public to provide a variety of insurance products and services to individual clients, as well as business clients, by offering a full line of insurance products including, but not limited to, homeowners', flood, personal and commercial automobile, commercial general liability and workers' compensation insurance through their agency appointments with over thirty different carriers.

(2) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements for the Company and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America referred to as Generally Accepted Accounting Principles ("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 March 31, 2013 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, 2013. 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, 2012 included in the Company's Form 10-K, which was filed with the SEC on April 1, 2013.

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 LAE, ceded reinsurance balances payable, the recoverability of Deferred Policy Acquisition Costs ("DPAC"), the determination of federal income taxes, and the net realizable value of reinsurance recoverables. 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. No reclassifications have been made to the prior-period balances to conform to the current-period presentation.

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Federated National Holding Company
Notes to Condensed Consolidated Financial Statements

(3) Summary of Significant Accounting Policies and Practices

(A) Critical Accounting Policies

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements.

The most significant accounting estimates inherent in the preparation of our financial statements include estimates associated with management's evaluation of the determination of (i) liability for unpaid losses and LAE, (ii) the amount and recoverability of amortization of DPAC, (iii) the valuation of investments and (iv) estimates for our reserves with respect to finance contracts, premiums receivable and deferred income taxes. Various assumptions and other factors underlie the determination of these significant estimates, which are described in greater detail in Footnote 2 of the Company's audited consolidated financial statements for the fiscal year ended December 31, 2012, which we included in the Company's Annual Report on Form 10-K which was filed with the SEC on April 1, 2013.

We believe that there were no significant changes in those critical accounting policies and estimates during the first three months of fiscal 2013. Senior management has reviewed the development and selection of our critical accounting policies and estimates and their disclosure in this Form 10-Q with the Audit Committee of our Board of Directors.

The process of determining significant estimates is fact-specific and takes into account factors such as historical experience, current and expected economic conditions, and in the case of unpaid losses and LAE, an actuarial valuation. Management regularly reevaluates these significant factors and makes adjustments where facts and circumstances dictate. In selecting the best estimate, we utilize various actuarial methodologies. Each of these methodologies is designed to forecast the number of claims we will be called upon to pay and the amounts we will pay on average to settle those claims. In arriving at our best estimate, our actuaries consider the likely predictive value of the various loss development methodologies employed in light of underwriting practices, premium rate changes and claim settlement practices that may have occurred, and weight the credibility of each methodology. Our actuarial methodologies take into account various factors, including, but not limited to, paid losses, liability estimates for reported losses, paid allocated LAE, salvage and other recoveries received, reported claim counts, open claim counts and counts for claims closed with and without payment for loss.

Accounting for loss contingencies pursuant to Financial Accounting Standards Board ("FASB") issued guidance involves the existence of a condition, situation or set of circumstances involving uncertainty as to possible loss that will ultimately be resolved when one or more future event(s) occur or fail to occur. Additionally, accounting for a loss contingency requires management to assess each event as probable, reasonably possible or remote. Probable is defined as the future event or events are likely to occur. Reasonably possible is defined as the chance of the future event or events occurring is more than remote but less than probable, while remote is defined as the chance of the future event or events occurring is slight. An estimated loss in connection with a loss contingency shall be recorded by a charge to current operations if both of the following conditions are met: First, the amount can be reasonably estimated, and second, the information available prior to issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability.

We are required to review the contractual terms of all our reinsurance purchases to ensure compliance with FASB issued guidance. The guidance establishes the conditions required for a contract with a reinsurer to be accounted for as reinsurance and prescribes accounting and reporting standards for those contracts. Contracts that do not result in the reasonable possibility that the reinsurer may realize a significant loss from the insurance risk assumed generally do not meet the conditions for reinsurance accounting and must be accounted for as deposits. The guidance also requires us to disclose the nature, purpose and effect of reinsurance transactions, including the premium amounts associated with reinsurance assumed and ceded. It also requires disclosure of concentrations of credit risk associated with reinsurance receivables and prepaid reinsurance premiums.

Federated National Holding Company
Notes to Condensed Consolidated Financial Statements

FASB issued guidance addresses accounting and reporting for (a) investments in equity securities that have readily determinable fair values and (b) all investments in debt securities. The guidance requires that these securities be classified into one of three categories: Held-to-maturity, Trading, or Available-for-sale securities.

Investments classified as held-to-maturity include debt securities wherein the Company's intent and ability are to hold the investment until maturity. The accounting treatment for held-to-maturity investments is to carry them at amortized cost without consideration to unrealized gains or losses.

Investments classified as trading securities include debt and equity securities bought and held primarily for the sale in the near term. The accounting treatment for trading securities is to carry them at fair value with unrealized holding gains and losses included in current period operations.

Investments classified as available-for-sale include debt and equity securities that are not classified as held-to-maturity or as trading security investments. The accounting treatment for available-for-sale securities is to carry them at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders' equity, namely "Other Comprehensive Income" and the components of other comprehensive income are presented in a statement separate from and consecutive with the statement of operations. A decline in the fair value of an available-for-sale security below cost that is deemed other-than temporary results in a charge to income, resulting in the establishment of a new cost basis for the security.

Premiums and discounts are amortized or accreted, respectively, over the life of the related debt security as an adjustment to yield using a method that approximates the effective interest method. Dividends and interest income are recognized when earned. Realized gains and losses are included in earnings and are derived using the specific-identification method for determining the cost of securities sold.

Financial instruments, which potentially expose us to concentrations of credit risk, consist primarily of investments, premiums receivable, amounts due from reinsurers on paid and unpaid losses and finance contracts. We have not experienced significant losses related to premiums receivable from individual policyholders or groups of policyholders in a particular industry or geographic area. We believe no credit risk beyond the amounts provided for collection losses is inherent in our premiums receivable or finance contracts. In order to reduce credit risk for amounts due from reinsurers, we seek to do business with financially sound reinsurance companies and regularly review the financial strength of all reinsurers used. Additionally, our credit risk in connection with our reinsurers is mitigated by the establishment of irrevocable clean letters of credit in favor of FNIC.

The fair value of our investments is estimated based on prices published by financial services or quotations received from securities dealers and is reflective of the interest rate environment that existed as of the close of business on March 31, 2013 and December 31, 2012. Changes in interest rates subsequent to March 31, 2013 and December 31, 2012 may affect the fair value of our investments.

The carrying amounts for the following financial instrument categories approximate their fair values at March 31, 2013 and December 31, 2012 because of their short-term nature: cash and short term investments, premiums receivable, finance contracts, due from reinsurers, revolving credit outstanding, bank overdraft, accounts payable and accrued expenses.

(B) Impact of New Accounting Pronouncements

In February 2013, the FASB issued Accounting Standard Update ("ASU") No. 2013-02: Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. The objective of this ASU is to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments require an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety in net income. For other amounts that are not required to be reclassified to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. The amendments in the ASU do not change the current requirements for reporting net income or other comprehensive income in financial statements. The ASU is effective prospectively for reporting periods beginning after December 15, 2012. The adoption of these amendments will not have a material impact on our financial condition, results of operations or cash flows.

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In January 2013, the FASB issued ASU No. 2013-01: Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The objective of this ASU is to clarify the scope of offsetting disclosures and to address implementation issues with ASU No. 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. The amendments clarify that the scope of ASU 2011-11 applies to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions. An entity is required to apply the amendments for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods. The adoption of these amendments will not have a material impact on our financial condition, results of operations or cash flows.

In July 2012, the FASB issued ASU No. 2012-02: Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. The objective of the amendments in this ASU 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. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Upon adoption, these amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012; early adoption is permitted. The adoption of these amendments did not have a material impact on our financial condition, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05: Comprehensive Income (Topic 220): Presentation of Comprehensive Income. The guidance in this ASU is intended to increase the prominence of items reported in other comprehensive income in the financial statements by presenting the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The guidance in this ASU does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. Upon adoption, this update is to be applied retrospectively and is effective during interim and annual periods beginning after December 15, 2011. Early adoption is permitted. The adoption of this ASU did not have a material impact on our financial condition, results of operations or cash flows.

In December 2011, the FASB issued ASU No. 2011-12: Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. The guidance defers certain provisions contained in ASU No. 2011-05 requiring the requirement to present components of reclassifications of other comprehensive income on the face of the income statement or in the notes to the financial statements. However, this deferral does not impact the other requirements contained in the new standard on comprehensive income as described above. This ASU is effective during interim and annual periods beginning after December 15, 2011. The adoption of this ASU did not have a material impact on our financial condition, results of operations or cash flows.

In September 2011, the FASB issued ASU No. 2011-08: Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment, which amends ASC Topic 350, Intangibles-Goodwill and Other. The guidance in this ASU permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in ASC Topic 350. Under the amendments in this ASU, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. The adoption of this ASU did not have a material impact on our financial condition, results of operations or cash flows.

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In December 2011, the FASB issued ASU No. 2011-11: Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities, which requires new disclosure requirements mandating that entities disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position as well as instruments and transactions subject to an agreement similar to a master netting arrangement. In addition, the standard requires disclosure of collateral received and posted in connection with master netting agreements or similar arrangements. This ASU is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this ASU will not have a material impact on our financial condition, results of operations or cash flows.

In October 2010, the FASB issued ASU No. 2010-26: Financial Services – Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts, a consensus of FASB Emerging Issues Task Force. The amendments in this update modify the definition of the types of costs incurred by insurance entities that can be capitalized in the acquisition of new and renewal contracts. The amendments in this update specify that the costs must be based on successful efforts (that is, acquiring a new or renewal contract). The amendments also specify that advertising costs should be included as deferred acquisition costs under certain circumstances. The amendments in this update are effective for fiscal years, and interim period within those fiscal years, beginning after December 15, 2011. The amendments in this update should be applied prospectively upon adoption. Retrospective application to all prior periods presented upon the date of adoption also is permitted. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

Other recent accounting pronouncements issued by FASB, the American Institute of Certified Public Accountants ("AICPA"), and the SEC did not or are not believed by management to have a material impact on the Company's present or future financial statements.

(C) Stock Options

Pursuant to FASB issued guidance, compensation cost recognized during the three months ended March 31, 2013 includes compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the guidance.

(D) Earnings (Loss) per Share

Basic earnings (loss) per share ("Basic EPS") is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period presented. Diluted earnings per share ("Diluted EPS") is computed by dividing net income by the weighted average number of shares of common stock and common stock equivalents outstanding during the period presented. Diluted loss per share would be antidilutive, therefore in accordance with GAAP basic and diluted loss per share is the same.

(E) Reclassifications

No reclassification of the 2012 financial statements was necessary to conform to the 2013 presentation.

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(4) Commitments and Contingencies

Management has a responsibility to continually measure and monitor its commitments and its contingencies. The nature of the Company's commitments and contingencies can be grouped into three major categories: insured claim activity, assessment related activities and operational matters.

(A) Insured Claim Activity

We are involved in claims and legal actions arising in the ordinary course of business. The amount of liability for these claims and lawsuits is uncertain. Revisions to our estimates are based on our analysis of subsequent information that we receive regarding various factors, including: (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages; and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors. In the opinion of management, the ultimate disposition of these matters may have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

The Company's subsidiaries are, from time to time, named as defendants in various lawsuits incidental to their insurance operations. Legal actions relating to claims made in the ordinary course of seeking indemnification for a loss covered by the insurance policy are considered by the Company in establishing loss and LAE reserves.

The Company also faces, in the ordinary course of business, lawsuits that seek damages beyond policy limits. The Company continually evaluates potential liabilities and reserves for litigation of these types using the criteria established by FASB issued guidance. Under this guidance, reserves for a loss are recorded if the likelihood of occurrence is probable and the amount can be reasonably estimated. If a loss, while not probable, is judged to be reasonably possible, management will make an estimate of a possible range of loss or state that an estimate cannot be made. Management considers each legal action using this guidance and records reserves for losses as warranted.

(B) Assessment Related Activity

We operate in a regulatory environment where certain entities and organizations have the authority to require us to participate in assessments. Currently these entities and organizations include, but are not limited to, Florida Insurance Guaranty Association ("FIGA"), Citizens Property Insurance Corporation ("Citizens"), Florida Hurricane Catastrophe Fund ("FHCF") and Florida Joint Underwriters Insurance Association ("JUA"). As a direct premium writer in the state of Florida, we are required to participate in certain insurer solvency associations under Florida Statutes Section 631.57(3)(a), administered by FIGA.

During December 2012, the Company was assessed $0.8 million by FIGA relating to the recent failures of Florida domestic property and casualty insurance companies. Future assessments are likely, although the impact of these assessments on our balance sheet, results of operations or cash flow are undeterminable at this time.

FNIC is also required to participate in an insurance apportionment plan under Florida Statutes Section 627.351, which is referred to as a JUA Plan. The JUA Plan provides for the equitable apportionment of any profits realized, or losses and expenses incurred, among participating automobile insurers. In the event of an underwriting deficit incurred by the JUA Plan which is not recovered through the policyholders in the JUA Plan, such deficit shall be recovered from the companies participating in the JUA Plan in the proportion that the net direct written premiums of each such member during the preceding calendar year bear to the aggregate net direct premiums written in this state by all members of the JUA Plan. FNIC was not assessed by the JUA Plan during 2013 or 2012. Future assessments by this association are undeterminable at this time.

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(C) Operational Matters

The Company's consolidated federal and state income tax returns for 2009-2011 are open for review by the Internal Revenue Service ("IRS") and various state taxing authorities. The 2012 federal and state income tax returns have been extended and will be filed by the extended due date in the third quarter of 2013. The 2005 and 2006 income tax returns and net operating loss carry-back from tax year 2009 have been reviewed by the Joint Committee on Taxation. The Joint Committee on Taxation completed its consideration in September 2011 and took no exception to the conclusions reached by the IRS regarding the net operating loss carry-back from tax year 2009.

The Company has recorded a net deferred tax asset of $2.6 million and $4.3 million as of March 31, 2013 and December 31, 2012, respectively. Realization of net deferred tax asset is dependent on generating sufficient taxable income in future periods. Management believes that it is more likely than not that the deferred tax assets will be realized and as such no valuation allowance has been recorded against the net deferred tax asset. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. At March 31, 2013, based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences. When assessing the need for valuation allowances, the Company considers future taxable income and ongoing prudent and feasible tax planning strategies. Should a change in circumstances lead to a change in judgment about the realizability of deferred tax assets in future years, the Company would record valuation allowances as deemed appropriate in the period that the change in circumstances occurs, along with a corresponding increase or charge to net income. The resolution of tax reserves and changes in valuation allowances could be material to the Company's results of operations for any period, but is not expected to be material to the Company's financial position.

Our executive offices are located at 14050 N.W. 14th Street, Suite 180, Sunrise, Florida 33323 in an 18,500 square foot office facility. All of our operations are consolidated within this facility. We believe that the facilities are well maintained, in substantial compliance with environmental laws and regulations, and adequately covered by insurance. We also believe that these leased facilities are not unique and could be replaced, if necessary, at the end of the lease term. Our lease for this office space will expire in May 2017.

The expected future payments in connection with this lease are as follows.

Fiscal Year	Payments (Dollars in Thousands)
2013	280
2014	380
2015	388
2016	395
2017	151
Total	$ 1,594

The Company is not currently involved in any material legal actions arising from the ordinary course of business that are not related to the insured claims activity.

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(5) Investments

FASB issued guidance addresses accounting and reporting for (a) investments in equity securities that have readily determinable fair values and (b) all investments in debt securities. The guidance requires that these securities be classified into one of three categories: Held-to-maturity, Trading, or Available-for-sale securities.

Investments classified as held-to-maturity include debt securities wherein the Company's intent and ability are to hold the investment until maturity. The accounting treatment for held-to-maturity investments is to carry them at amortized cost without consideration to unrealized gains or losses. Investments classified as trading securities include debt and equity securities bought and held primarily for the sale in the near term. The accounting treatment for trading securities is to carry them at fair value with unrealized holding gains and losses included in current period operations. Investments classified as available-for-sale include debt and equity securities that are not classified as held-to-maturity or as trading security investments. The accounting treatment for available-for-sale securities is to carry them at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders' equity, namely "Other Comprehensive Income".

Total investments increased $11.6 million, or 8.9%, to $141.7 million as of March 31, 2013, compared with $130.1 million as of December 31, 2012.

The debt and equity securities that are available for sale and carried at fair value represent 95% of total investments as of March 31, 2013, compared with 94% as of December 31, 2012.

We did not hold any trading investment securities during the three months ended March 31, 2013.

The FASB issued guidance also addresses the determination as to when an investment is considered impaired, whether that impairment is other-than temporary, and the measurement of an impairment loss. The Company's policy for the valuation of temporarily impaired securities is to determine impairment based on the analysis of the following factors.

- rating downgrade or other credit event (eg., failure to pay interest when due);
- length of time and the extent to which the fair value has been less than amortized cost;
- financial condition and near term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology or discontinuance of a business segment;
- prospects for the issuer's industry segment;
- intent and ability of the Company to retain the investment for a period of time sufficient to allow for anticipated recovery in market value;
- historical volatility of the fair value of the security.

Pursuant to FASB issued guidance, the Company records the unrealized losses, net of estimated income taxes that are associated with that part of our portfolio classified as available-for-sale through the shareholders' equity account titled "Other Comprehensive Income". Management periodically reviews the individual investments that comprise our portfolio in order to determine whether a decline in fair value below our cost either is other-than temporarily or permanently impaired. Factors used in such consideration include, but are not limited to, the extent and length of time over which the market value has been less than cost, the financial condition and near-term prospects of the issuer and our ability and intent to keep the investment for a period sufficient to allow for an anticipated recovery in market value.

In reaching a conclusion that a security is either other-than-temporarily or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as Standard and Poor’s (“S&P”) and Moody’s Investors Service, Inc. (“Moody’s”), as well as information released via the general media channels. In connection with this process, we have not charged net realized losses to operations during the three months ended March 31, 2013.

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As of March 31, 2013 and December 31, 2012, respectively, all of our securities are in good standing and not impaired as defined by FASB issued guidance.

As of March 31, 2013 and December 31, 2012, our investments consisted primarily of corporate bonds held in various industries, municipal bonds and United States government bonds. As of March 31, 2013, 74% of our debt portfolio was in diverse industries and 26% was in United States government bonds. As of March 31, 2013, approximately 89% of our equity holdings were in equities related to diverse industries and 11% were in mutual funds. As of December 31, 2012, 69% of our debt portfolio was in diverse industries and 31% is in United States government bonds. As of December 31, 2012, approximately 87% of our equity holdings were in equities related to diverse industries and 13% were in mutual funds.

As of March 31, 2013 and December 31, 2012, we have classified $6.9 million and $7.4 million, respectively, of our bond portfolio as held-to-maturity. We classify bonds as held-to-maturity to support securitization of credit requirements.

During the three months ended March 31, 2013 and 2012, respectively, we did not re-classify any of our bond portfolio between available-for-sale and held-to-maturity.

During April 2006, American Vehicle finalized a $15.0 million irrevocable letter of credit in conjunction with the 100% Quota Share Reinsurance Agreement with Republic Underwriters Insurance Company ("Republic") which was terminated in April 2007. During 2010, the letter of credit in favor of Republic was replaced by a fully funded trust agreement. As of March 31, 2013 and December 31, 2012 respectively, the amount held in trust was $1.0 million.

(A) Debt and Equity Securities

The following table summarizes, by type, our investments as of March 31, 2013 and December 31, 2012.

	March 31, 2013			December 31, 2012		
	Carrying Amount	Percent of Total		Carrying Amount	Percent of Total	
	(Dollars in Thousands)					
Debt securities, at market:						
United States government obligations and authorities	$24,844	17.53	%	$27,392	21.06	%
Obligations of states and political subdivisions	3,862	2.73	%	3,939	3.03	%
Corporate	75,800	53.49	%	67,313	51.74	%
International	3,258	2.30	%	3,111	2.39	%
	107,764	76.05	%	101,755	78.22	%
Debt securities, at amortized cost:						
United States government obligations and authorities	4,737	3.34	%	6,016	4.62	%
Corporate	2,000	1.41	%	1,203	0.92	%
International	112	0.08	%	140	0.11	%
	6,849	4.83	%	7,359	5.65	%
Total debt securities	114,613	80.88	%	109,114	83.87	%
Equity securities, at market:	27,108	19.12	%	20,982	16.13	%
Total investments	$141,721	100.00	%	$130,096	100.00	%

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The following table shows the realized gains (losses) for debt and equity securities for the three months ended March 31, 2013 and 2012.

	Three Months Ended March 31,			
	2013		2012	
	Gains (Losses)	Fair Value at Sale	Gains (Losses)	Fair Value at Sale
	(Dollars in Thousands)			
Debt securities	$1,133	$22,601	$233	$6,496
Equity securities	189	1,079	516	3,073
Total realized gains	1,322	23,680	749	9,569
Debt securities	(409)	16,476	(206)	5,042
Equity securities	(100)	623	(553)	1,666
Total realized losses	(509)	17,099	(759)	6,708
Net realized gains (losses) on investments	$813	$40,779	$(10)	$16,277

During the three months ended March 31, 2013 the investment committee decided to shorten the duration of the bond portfolio by approximately one year to prepare for the eventuality of rising interest rates over the next several years. Interest rates and bond prices move inversely, so any rise in interest rates adversely impacts the value of our fixed income portfolio. This impact is magnified when the portfolio is positioned with a longer duration. This decision generated a majority of the approximately $0.8 million in realized gains and also explains the drop in investment income for the quarter measured against the same three month period last year.

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A summary of the amortized cost, estimated fair value and gross unrealized gains and losses of debt and equity securities at March 31, 2013 and December 31, 2012 is as follows.

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(Dollars in Thousands)			
March 31, 2013				
Debt Securities - Available-For-Sale:				
United States government obligations and authorities	$24,352	$502	$10	$24,844
Obligations of states and political subdivisions	3,664	199	1	3,862
Corporate	73,216	2,622	38	75,800
International	3,258	25	25	3,258
	$104,490	$3,348	$74	$107,764
Debt Securities - Held-To-Maturity:				
United States government obligations and authorities	$4,737	$124	$-	$4,861
Corporate	2,000	37	-	2,037
International	112	-	1	111
	$6,849	$161	$1	$7,009
Equity securities - common stocks	$22,676	$4,953	$521	$27,108
December 31, 2012				
Debt Securities - Available-For-Sale:				
United States government obligations and authorities	$26,825	$632	$65	$27,392