

HCI Group, Inc.
Form 10-Q
November 07, 2018
[Table of Contents](#)

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

Form 10-Q

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

For the quarterly period ended September 30, 2018

OR

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

Commission File Number

001-34126

HCI Group, Inc.

(Exact name of Registrant as specified in its charter)

Florida
(State of
Incorporation)

20-5961396
(IRS Employer
Identification No.)

5300 West Cypress Street, Suite 100
Tampa, FL 33607

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

(813) 849-9500
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the Registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate number of shares of the Registrant's Common Stock, no par value, outstanding on October 29, 2018 was 9,175,636.

Table of Contents

HCI GROUP, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

| | Page |
|---|-------------|
| <u>PART I FINANCIAL INFORMATION</u> | |
| Item 1 <u>Financial Statements</u> | |
| <u>Consolidated Balance Sheets: September 30, 2018 (unaudited) and December 31, 2017</u> | 1-2 |
| <u>Consolidated Statements of Income: Three and nine months ended September 30, 2018 and 2017 (unaudited)</u> | 3 |
| <u>Consolidated Statements of Comprehensive Income: Three and nine months ended September 30, 2018 and 2017 (unaudited)</u> | 4 |
| <u>Consolidated Statements of Cash Flows: Nine months ended September 30, 2018 and 2017 (unaudited)</u> | 5-6 |
| <u>Consolidated Statements of Stockholders' Equity: Nine months ended September 30, 2018 and 2017 (unaudited)</u> | 7-8 |
| <u>Notes to Consolidated Financial Statements (unaudited)</u> | 9-41 |
| Item 2 <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 42-56 |
| Item 3 <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 57-58 |
| Item 4 <u>Controls and Procedures</u> | 59 |
| <u>PART II OTHER INFORMATION</u> | |
| Item 1 <u>Legal Proceedings</u> | 59 |
| Item 1A <u>Risk Factors</u> | 59 |
| Item 2 <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 60-61 |
| Item 3 <u>Defaults upon Senior Securities</u> | 61 |
| Item 4 <u>Mine Safety Disclosures</u> | 61 |
| Item 5 <u>Other Information</u> | 61 |
| Item 6 <u>Exhibits</u> | 62 |
| <u>Signatures</u> | 69 |
| Certifications | |

Table of Contents**PART I FINANCIAL INFORMATION****Item 1 Financial Statements****HCI GROUP, INC. AND SUBSIDIARIES****Consolidated Balance Sheets****(Dollar amounts in thousands)**

| | September 30, 2018 (Unaudited) | December 31, 2017 |
|--|---|------------------------------|
| Assets | | |
| Fixed-maturity securities, available for sale, at fair value (amortized cost: \$147,193 and \$235,633, respectively) | \$ 145,719 | \$ 237,484 |
| Equity securities, at fair value (cost: \$44,184 and \$54,282, respectively) | 45,311 | 59,956 |
| Short-term investments, at fair value | 87,778 | |
| Limited partnership investments, at equity | 28,944 | 23,184 |
| Investment in unconsolidated joint venture, at equity | 860 | 1,304 |
| Real estate investments (Note 4 Consolidated Variable Interest Entity) | 63,892 | 58,358 |
| Total investments | 372,504 | 380,286 |
| Cash and cash equivalents | 249,083 | 255,884 |
| Restricted cash | 700 | 809 |
| Accrued interest and dividends receivable | 1,527 | 1,983 |
| Income taxes receivable | 3,005 | 16,192 |
| Premiums receivable | 25,461 | 17,807 |
| Prepaid reinsurance premiums | 27,458 | 22,286 |
| Reinsurance recoverable: | | |
| Paid losses and loss adjustment expenses | 22,200 | 2,344 |
| Unpaid losses and loss adjustment expenses | 50,895 | 100,760 |
| Deferred policy acquisition costs | 20,669 | 16,712 |
| Property and equipment, net | 13,183 | 12,465 |
| Intangible assets, net | 4,951 | 4,995 |
| Other assets (Note 4 Consolidated Variable Interest Entity) | 24,701 | 9,741 |
| Total assets | \$ 816,337 | \$ 842,264 |

(continued)

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Consolidated Balance Sheets - continued****(Dollar amounts in thousands)**

| | September 30, 2018 (Unaudited) | December 31, 2017 |
|--|---|------------------------------|
| Liabilities and Stockholders Equity | | |
| Losses and loss adjustment expenses | \$ 138,414 | \$ 198,578 |
| Unearned premiums | 199,050 | 164,896 |
| Advance premiums | 10,350 | 4,948 |
| Assumed reinsurance balances payable | 142 | 15 |
| Accrued expenses (Note 4 Consolidated Variable Interest Entity) | 11,759 | 6,035 |
| Reinsurance recovered in advance on unpaid losses | | 13,885 |
| Deferred income taxes, net | 2,221 | 1,890 |
| Long-term debt | 248,544 | 237,835 |
| Other liabilities (Note 4 Consolidated Variable Interest Entity) | 13,722 | 20,207 |
| Total liabilities | 624,202 | 648,289 |
| Commitments and contingencies (Note 16) | | |
| Stockholders equity: | | |
| 7% Series A cumulative convertible preferred stock (no par value, 1,500,000 shares authorized, no shares issued or outstanding) | | |
| Series B junior participating preferred stock (no par value, 400,000 shares authorized, no shares issued or outstanding) | | |
| Preferred stock (no par value, 18,100,000 shares authorized, no shares issued or outstanding) | | |
| Common stock (no par value, 40,000,000 shares authorized, 8,368,188 and 8,762,416 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively) | | |
| Additional paid-in capital | | |
| Retained income | 193,236 | 189,409 |
| Accumulated other comprehensive (loss) income, net of taxes | (1,101) | 4,566 |
| Total stockholders equity | 192,135 | 193,975 |
| Total liabilities and stockholders equity | \$ 816,337 | \$ 842,264 |

See accompanying Notes to Consolidated Financial Statements

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Consolidated Statements of Income****(Unaudited)****(Dollar amounts in thousands, except per share amounts)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|--------------------|--|--------------------|
| | 2018 | 2017 | 2018 | 2017 |
| Revenue | | | | |
| Gross premiums earned | \$ 86,163 | \$ 88,669 | \$ 257,854 | \$ 270,376 |
| Premiums ceded | (31,986) | (44,705) | (97,190) | (101,529) |
| Net premiums earned | 54,177 | 43,964 | 160,664 | 168,847 |
| Net investment income | 5,054 | 2,878 | 11,671 | 8,522 |
| Net realized investment gains (losses) | 1,626 | (226) | 6,520 | 2,276 |
| Net unrealized investment (losses) gains | (390) | 74 | (4,547) | 74 |
| Net other-than-temporary impairment losses | | (474) | (80) | (864) |
| Policy fee income | 843 | 905 | 2,563 | 2,721 |
| Other | 433 | 369 | 1,504 | 1,207 |
| Total revenue | 61,743 | 47,490 | 178,295 | 182,783 |
| Expenses | | | | |
| Losses and loss adjustment expenses | 25,769 | 89,231 | 67,227 | 142,425 |
| Policy acquisition and other underwriting expenses | 9,829 | 9,926 | 29,148 | 29,645 |
| Impairment loss | | 38 | | 38 |
| General and administrative personnel expenses | 6,781 | 6,672 | 20,904 | 21,021 |
| Interest expense | 4,552 | 4,408 | 13,527 | 12,328 |
| Loss on repurchases of senior notes | | | | 743 |
| Other operating expenses | 2,889 | 3,233 | 9,242 | 9,154 |
| Total expenses | 49,820 | 113,508 | 140,048 | 215,354 |
| Income (loss) before income taxes | 11,923 | (66,018) | 38,247 | (32,571) |
| Income tax expense (benefit) | 2,926 | (25,472) | 12,056 | (13,587) |
| Net income (loss) | \$ 8,997 | \$ (40,546) | \$ 26,191 | \$ (18,984) |
| Basic earnings (loss) per share | \$ 1.08 | \$ (4.44) | \$ 3.29 | \$ (2.05) |
| Diluted earnings (loss) per share | \$ 1.00 | \$ (4.44) | \$ 3.03 | \$ (2.05) |
| Dividends per share | \$ 0.375 | \$ 0.35 | \$ 1.10 | \$ 1.05 |

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

HCI GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
(Unaudited)
(Amounts in thousands)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| Net income (loss) | \$ 8,997 | \$ (40,546) | \$ 26,191 | \$ (18,984) |
| Other comprehensive (loss) income: | | | | |
| Change in unrealized gain (loss) on investments: | | | | |
| Net unrealized gain (loss) arising during the period | 35 | 2,155 | (2,658) | 4,822 |
| Other-than-temporary impairment loss charged to income | | 474 | 80 | 864 |
| Call and repayment losses charged to investment income | (19) | | (15) | 9 |
| Reclassification adjustment for net realized loss (gain) | (71) | 226 | (732) | (2,276) |
| Net change in unrealized (loss) gain | (55) | 2,855 | (3,325) | 3,419 |
| Deferred income taxes on above change | 13 | (1,101) | 842 | (1,319) |
| Total other comprehensive (loss) income, net of income taxes | (42) | 1,754 | (2,483) | 2,100 |
| Comprehensive income (loss) | \$ 8,955 | \$ (38,792) | \$ 23,708 | \$ (16,884) |

See accompanying Notes to Consolidated Financial Statements.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows****(Unaudited)****(Amounts in thousands)**

| | Nine Months Ended September 30, | |
|---|--|---------------|
| | 2018 | 2017 |
| Cash flows from operating activities: | | |
| Net income (loss) | \$ 26,191 | \$ (18,984) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Stock-based compensation | 3,274 | 3,362 |
| Net amortization of debt securities | 344 | 884 |
| Depreciation and amortization | 8,195 | 6,945 |
| Deferred income tax expense (benefit) | 1,173 | (3,822) |
| Net realized investment gains | (6,520) | (2,276) |
| Net unrealized investment losses (gains) | 4,547 | (74) |
| Other-than-temporary impairment losses | 80 | 864 |
| Income from unconsolidated joint venture | (320) | (126) |
| Distribution received from unconsolidated joint venture | 68 | 147 |
| Net income from limited partnership interests | (2,816) | (1,724) |
| Distributions received from limited partnership interests | 1,495 | 854 |
| Loss on repurchases of senior notes | | 743 |
| Foreign currency remeasurement loss (gain) | 200 | (31) |
| Other | | 172 |
| Changes in operating assets and liabilities: | | |
| Accrued interest and dividends receivable | 456 | (587) |
| Income taxes | 13,187 | (21,270) |
| Premiums receivable | (7,654) | (9,903) |
| Prepaid reinsurance premiums | (5,172) | (3,798) |
| Reinsurance recoverable | 30,009 | (213,746) |
| Deferred policy acquisition costs | (3,957) | (4,511) |
| Other assets | 1,829 | 2,550 |
| Losses and loss adjustment expenses | (60,164) | 274,180 |
| Unearned premiums | 34,154 | 30,371 |
| Advance premiums | 5,402 | 5,597 |
| Assumed reinsurance balances payable | 127 | (3,051) |
| Reinsurance recovered in advance on unpaid losses | (13,885) | 9,882 |
| Accrued expenses and other liabilities | (794) | (1,146) |
| Net cash provided by operating activities | 29,449 | 51,502 |
| Cash flows from investing activities: | | |

Edgar Filing: HCI Group, Inc. - Form 10-Q

| | | |
|---|-----------|-----------|
| Investments in limited partnership interests | (4,823) | (2,623) |
| Distributions received from limited partnership interests | 384 | 11,758 |
| Distribution from unconsolidated joint venture | 696 | 417 |
| Purchase of property and equipment | (1,654) | (1,872) |
| Purchase of real estate investments | (6,685) | (2,095) |
| Purchase of intangible assets | (409) | |
| Purchase of fixed-maturity securities | (58,098) | (105,258) |
| Purchase of equity securities | (41,844) | (36,019) |
| Purchase of short-term investments | (155,252) | |
| Proceeds from sales of fixed-maturity securities | 78,540 | 9,638 |
| Proceeds from calls, repayments and maturities of fixed-maturity securities | 52,843 | 8,786 |
| Proceeds from sales of equity securities | 55,879 | 26,309 |
| Proceeds from sales, redemptions and maturities of short-term investments | 67,867 | |
| Proceeds from sales of derivative instruments | 124 | |
| Net cash used in investing activities | (12,432) | (90,959) |

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Consolidated Statements of Cash Flows, continued****(Unaudited)****(Amounts in thousands)**

| | Nine Months Ended September 30, | |
|--|--|-------------|
| | 2018 | 2017 |
| Cash flows from financing activities: | | |
| Cash dividends paid | (8,371) | (10,512) |
| Cash dividends received under share repurchase forward contract | 896 | 788 |
| Proceeds from exercise of common stock options | | 75 |
| Proceeds from issuance of long-term debt | 6,000 | 143,859 |
| Repurchases of senior notes | | (40,250) |
| Repayment of long-term debt | (804) | (718) |
| Repurchases of common stock | (941) | (30,636) |
| Repurchases of common stock under share repurchase plan | (19,867) | (6,189) |
| Purchase of non-controlling interest | (539) | |
| Debt issuance costs | (105) | (4,975) |
| Net cash (used in) provided by financing activities | (23,731) | 51,442 |
| Effect of exchange rate changes on cash | (196) | 31 |
| Net (decrease) increase in cash, cash equivalents, and restricted cash | (6,910) | 12,016 |
| Cash, cash equivalents, and restricted cash at beginning of period | 256,693 | 281,131 |
| Cash, cash equivalents, and restricted cash at end of period | \$ 249,783 | \$ 293,147 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for income taxes | \$ 3,625 | \$ 11,506 |
| Cash paid for interest | \$ 10,403 | \$ 8,647 |
| Non-cash investing and financing activities: | | |
| Unrealized (loss) gain on investments in available-for-sale securities, net of tax | \$ (2,483) | \$ 2,100 |
| Conversion of revolving credit facility to long-term debt | \$ | \$ 9,441 |
| Receivable from sales of equity securities | \$ 1,978 | \$ 3,034 |
| Payable on purchases of equity securities | \$ | \$ 3,014 |

Edgar Filing: HCI Group, Inc. - Form 10-Q

| | | |
|---|-----------|----|
| Receivable from sales and maturities of fixed-maturity securities | \$ 15,070 | \$ |
| Addition to property and equipment under capital lease | \$ 61 | \$ |

See accompanying Notes to Consolidated Financial Statements.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Consolidated Statement of Stockholders Equity****For the Nine Months Ended September 30, 2018****(Unaudited)****(Dollar amounts in thousands)**

| | Common Stock | | Additional | Retained | Accumulated | Total |
|---|--------------|--------|------------|------------|-------------|--------------|
| | Shares | Amount | Paid-In | Income | Other | Stockholders |
| | | | Capital | | Income | Equity |
| | | | | | (Loss), | |
| | | | | | Net of Tax | |
| Balance at December 31, 2017 | 8,762,416 | \$ | \$ | \$ 189,409 | \$ 4,566 | \$ 193,975 |
| Net income | | | | 26,191 | | 26,191 |
| Total other comprehensive loss, net of income taxes | | | | | (2,483) | (2,483) |
| Cumulative effect adjustments for adoption of new accounting standards: | | | | | | |
| Reclassification of after-tax net unrealized holding gains related to equity securities | | | | 4,168 | (4,168) | |
| Reclassification of stranded tax effects related to available-for-sale fixed-maturity and equity securities | | | | (984) | 984 | |
| Issuance of restricted stock | 189,860 | | | | | |
| Forfeiture of restricted stock | (52,452) | | | | | |
| Repurchase and retirement of common stock | (23,346) | | (941) | | | (941) |
| Repurchase and retirement of common stock under share repurchase plan | (508,290) | | (19,867) | | | (19,867) |
| Purchase of noncontrolling interest | | | (539) | | | (539) |
| Common stock dividends | | | | (7,475) | | (7,475) |
| Stock-based compensation | | | 3,274 | | | 3,274 |
| Additional paid-in capital shortfall allocated to retained income | | | 18,073 | (18,073) | | |
| Balance at September 30, 2018 | 8,368,188 | \$ | \$ | \$ 193,236 | \$ (1,101) | \$ 192,135 |

Edgar Filing: HCI Group, Inc. - Form 10-Q

See accompanying Notes to Consolidated Financial Statements.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Consolidated Statement of Stockholders Equity - continued****For the Nine Months Ended September 30, 2017****(Unaudited)****(Dollar amounts in thousands)**

| | Common Stock | | Additional Paid-In Capital | Retained Income | Accumulated Other Comprehensive Income (Loss), Net of Tax | Total Stockholders Equity |
|---|---------------------|---------------|---|----------------------------|--|--|
| | Shares | Amount | | | | |
| Balance at December 31, 2016 | 9,662,761 | \$ | \$ 8,139 | \$ 232,964 | \$ 2,643 | \$ 243,746 |
| Net income | | | | (18,984) | | (18,984) |
| Total other comprehensive income, net of income taxes | | | | | 2,100 | 2,100 |
| Exercise of common stock options | 30,000 | | 75 | | | 75 |
| Issuance of restricted stock | 154,936 | | | | | |
| Forfeiture of restricted stock | (23,218) | | | | | |
| Repurchase and retirement of common stock | (434,505) | | (21,236) | | | (21,236) |
| Repurchase and retirement of common stock under share repurchase plan | (163,265) | | (6,189) | | | (6,189) |
| Repurchase of common stock under prepaid forward contract | (191,100) | | (9,400) | | | (9,400) |
| Equity component on 4.25% convertible senior notes (net of offering costs of \$543) | | | 15,151 | | | 15,151 |
| Deferred taxes on debt discount | | | (5,845) | | | (5,845) |
| Common stock dividends | | | | (9,724) | | (9,724) |
| Stock-based compensation | | | 3,362 | | | 3,362 |
| Additional paid-in capital shortfall allocated to retained income | | | 15,943 | (15,943) | | |
| Balance at September 30, 2017 | 9,035,609 | \$ | \$ | \$ 188,313 | \$ 4,743 | \$ 193,056 |

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

HCI GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (unaudited)

(Amounts in thousands, except share and per share amounts, unless otherwise stated)

Note 1 Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited, consolidated financial statements for HCI Group, Inc. and its majority-owned and controlled subsidiaries (collectively, the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. 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 consolidated financial statements prepared in accordance with U.S. GAAP have been omitted pursuant to such rules and regulations. However, in the opinion of management, the accompanying consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the Company's financial position as of September 30, 2018 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, 2018. The accompanying unaudited consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2017 included in the Company's Form 10-K, which was filed with the SEC on March 7, 2018.

In preparing the interim unaudited consolidated financial statements, management was required to make certain judgments, assumptions, and estimates 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 are related to the Company's losses and loss adjustment expenses, which include amounts estimated for claims incurred but not yet reported. The Company uses various assumptions and actuarial data it believes to be reasonable under the circumstances to make these estimates. In addition, accounting policies specific to reinsurance with retrospective provisions, reinsurance recoverable, deferred income taxes, and stock-based compensation expense involve significant judgments and estimates material to the Company's consolidated financial statements.

All significant intercompany balances and transactions have been eliminated.

Adoption of New Accounting Standards

The Company adopted the following accounting standards effective January 1, 2018.

Accounting Standards Update No. 2014-09 (ASU 2014-09), Revenue from Contracts with Customers (Topic 606). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Company elected to use a modified retrospective method for transition to the new revenue recognition standard. The impact is limited to certain revenue generating activities that are not

material to the Company's results of operations.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)**

(Amounts in thousands, except share and per share amounts, unless otherwise stated)

Accounting Standards Update No. 2016-01 (ASU 2016-01), Financial Instruments Overall (Subtopic 825-10). ASU 2016-01 amends the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. ASU 2016-01 requires all equity investments other than those accounted for under the equity method of accounting or those that result in consolidation of the investee to be measured at fair value with changes in the fair value recognized through income. ASU 2016-01 also supersedes the guidance that requires classification of equity securities with readily determinable fair values into either trading or available-for-sale. Upon adoption of this standard, the after-tax net unrealized holding gains of \$4,168 in accumulated other comprehensive income at December 31, 2017, which pertain to available-for-sale equity securities and represent a cumulative-effect amount, were reclassified to beginning retained income. Any subsequent changes in the fair value of equity securities have now been recognized in the Company's consolidated statement of income rather than in accumulated other comprehensive income. In addition, previously reported available-for-sale and trading equity securities of \$58,911 and \$1,045, respectively, at December 31, 2017 are combined and presented as equity securities on the comparative balance sheet. Certain prior-period disclosures related to equity securities are reorganized to conform with current period presentation.

Accounting Standards Update No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. ASU 2016-18 amends guidance on the classification and presentation of restricted cash in the statement of cash flows. Upon adoption of this standard, restricted cash is now included with cash and cash equivalents when the Company reconciles the beginning-of-period and end-of-period total amounts shown on the consolidated statement of cash flows. In addition, the consolidated statement of cash flows for the prior period presented is retrospectively restated to comply with the new standard. This change in classification and presentation of restricted cash increases the previously reported cash flows from operating activities for the nine months ended September 30, 2017 from \$51,393 to \$51,502.

Accounting Standards Update No. 2017-09 (ASU 2017-09), Compensation – Stock Compensation (Topic 718): Scope of Modification Accounting. ASU 2017-09 provides guidance about which changes to the terms or conditions of a share-based payment award require an application of modification accounting. The adoption of this standard will impact the Company's accounting for any future modification of its existing share-based awards.

Accounting Standards Update No. 2018-02 (ASU 2018-02), Income Statement – Reporting Comprehensive Income (Topic 220). ASU 2018-02 primarily allows a reclassification from accumulated other comprehensive income to retained income for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017. The Company elected to early adopt this standard in the first quarter of 2018. As a result, the Company decreased beginning retained income and increased accumulated other comprehensive income by \$984 of the net deferred tax effects pertaining to available-for-sale fixed-maturity and equity securities as of December 31, 2017.

Equity Securities

Equity securities represent ownership interests held by the Company in entities for investment purposes. Prior to January 1, 2018, these equity securities were classified as either available-for-sale or trading and were carried at fair

value on the Company's consolidated balance sheet. Unrealized holding gains and losses from the changes in the fair values of available-for-sale equity securities were reported in accumulated other comprehensive income. Effective January 1, 2018, unrealized holding gains and losses are reported in the consolidated statement of income as net unrealized investment gains and losses. As a result, other-than-temporary impairments will no longer be considered for equity securities. Realized investment gains and losses from sales are recorded on the trade date and are determined using the first-in first-out method (see *Equity Securities* in Note 4 – Investments).

Table of Contents

HCI GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (unaudited)

(Amounts in thousands, except share and per share amounts, unless otherwise stated)

Short-Term Investments

Short-term investments include certificates of deposit issued by financial institutions and commercial paper with original maturities of more than three months but less than one year at date of acquisition. These short-term investments are carried at cost or amortized cost, which approximates fair value.

Reclassifications

Certain reclassifications of prior year amounts have been made to conform to the current year presentation. Certain payroll-related costs such as share-based compensation expense, payroll taxes and employee benefits, which were previously reported in other operating expenses totaling \$2,067 and \$5,970 for the three and nine months ended September 30, 2017, respectively, were reclassified to general and administrative personnel expenses to conform with the 2018 presentation.

Note 2 Recent Accounting Pronouncements

Accounting Standards Update No. 2018-13. In August 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2018-13 (ASU 2018-13), Fair Value Measurement (Topic 820): Disclosure Framework, which removes, modifies and adds certain disclosure requirements about recurring and nonrecurring fair value measurements. ASU 2018-13 is effective for the Company beginning with the first quarter of 2020. Early adoption is permitted. This guidance will impact the Company's future fair value disclosures in the notes to financial statements.

Accounting Standard to be Adopted in Fiscal Year 2019

In February 2016, the FASB issued Accounting Standards Update No. 2016-02 (ASU 2016-02), Leases (Topic 842). The guidance establishes new principles that lessees and lessors will apply to report useful information to users of financial statements about the amount, timing, and uncertainty of cash flows arising from a lease. ASU 2016-02 supersedes accounting for leases prescribed in Topic 840, Leases. ASU 2016-02 leaves lessor accounting substantially unchanged. The key change affecting the Company is the requirement that operating leases be recorded on the balance sheet. The Company was initially required to use a modified retrospective method and apply this standard at the beginning of the earliest comparative period presented in the financial statements. The FASB later issued Accounting Standards Update No. 2018-11, Transition and Lessor Improvements, which provides a new alternative transition method. Under the alternative transition method, the Company is permitted to apply this standard at the beginning of the adoption period. The Company has identified lease contracts that will be affected by this standard and chosen to apply the practical expedients related to the identification and classification of leases that commenced before the effective date, initial direct cost for leases that commenced before the effective date, and the ability to use hindsight in evaluating lessee options to extend or terminate a lease. The Company has elected to use the alternative transition method. The Company does not anticipate a material impact on its financial position.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)**

(Amounts in thousands, except share and per share amounts, unless otherwise stated)

Note 3 Cash, Cash Equivalents, and Restricted Cash

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the Company's consolidated balance sheets that sum to the total of the same such amounts shown in the statements of cash flows.

| | September 30, 2018 | December 31, 2017 |
|---------------------------|-------------------------------|------------------------------|
| Cash and cash equivalents | \$ 249,083 | \$ 255,884 |
| Restricted cash | 700 | 809 |
| Total | \$ 249,783 | \$ 256,693 |

Restricted cash primarily represents funds held by certain states in which the Company's insurance subsidiaries conduct business to meet regulatory requirements. In August 2018, \$109 of a deposit related to a mortgage loan with one regional bank was released to the Company.

Note 4 Investments***a) Available-for-Sale Fixed-Maturity Securities***

The Company holds investments in fixed-maturity securities that are classified as available-for-sale. At September 30, 2018 and December 31, 2017, the cost or amortized cost, gross unrealized gains and losses, and estimated fair value of the Company's available-for-sale securities by security type were as follows:

| | Cost or Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Estimated Fair Value |
|---|---------------------------------------|--------------------------------------|--------------------------------------|-------------------------------------|
| <i>As of September 30, 2018</i> | | | | |
| U.S. Treasury and U.S. government agencies | \$ 56,632 | \$ 1 | \$ (388) | \$ 56,245 |
| Corporate bonds | 67,222 | 258 | (1,645) | 65,835 |
| State, municipalities, and political subdivisions | 12,773 | 105 | (6) | 12,872 |
| Exchange-traded debt | 10,499 | 253 | (53) | 10,699 |
| Redeemable preferred stock | 67 | 1 | | 68 |
| Total | \$ 147,193 | \$ 618 | \$ (2,092) | \$ 145,719 |

As of December 31, 2017

| | | | | |
|---|-------------------|-----------------|-------------------|-------------------|
| U.S. Treasury and U.S. government agencies | \$ 42,313 | \$ 1 | \$ (287) | \$ 42,027 |
| Corporate bonds | 106,897 | 1,110 | (904) | 107,103 |
| State, municipalities, and political subdivisions | 78,954 | 1,816 | (75) | 80,695 |
| Exchange-traded debt | 7,469 | 197 | (7) | 7,659 |
| Total | \$ 235,633 | \$ 3,124 | \$ (1,273) | \$ 237,484 |

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

Expected maturities will differ from contractual maturities as borrowers may have the right to call or prepay obligations with or without penalties. The scheduled contractual maturities of fixed-maturity securities as of September 30, 2018 and December 31, 2017 are as follows:

| | Cost or Amortized Cost | Estimated Fair Value |
|--|---------------------------------------|-------------------------------------|
| <u>As of September 30, 2018</u> | | |
| Due in one year or less | \$ 51,805 | \$ 51,690 |
| Due after one year through five years | 75,395 | 73,977 |
| Due after five years through ten years | 15,405 | 15,381 |
| Due after ten years | 4,588 | 4,671 |
| | \$ 147,193 | \$ 145,719 |

| | Cost or Amortized Cost | Estimated Fair Value |
|--|---------------------------------------|-------------------------------------|
| <u>As of December 31, 2017</u> | | |
| Due in one year or less | \$ 35,386 | \$ 35,364 |
| Due after one year through five years | 116,378 | 115,766 |
| Due after five years through ten years | 57,415 | 58,984 |
| Due after ten years | 26,454 | 27,370 |
| | \$ 235,633 | \$ 237,484 |

Sales of Available-for-Sale Fixed-Maturity Securities

Proceeds received, and the gross realized gains and losses from sales of available-for-sale fixed-maturity securities, for the three and nine months ended September 30, 2018 and 2017 were as follows:

| | Proceeds | Gross Realized Gains | Gross Realized Losses |
|---------------------------------------|-----------------|-------------------------------------|--------------------------------------|
| Three months ended September 30, 2018 | \$ 771 | \$ 71 | \$ |
| Three months ended September 30, 2017 | \$ 2,765 | \$ 97 | \$ (23) |
| Nine months ended September 30, 2018 | \$ 78,540 | \$ 1,232 | \$ (500) |
| Nine months ended September 30, 2017 | \$ 9,638 | \$ 126 | \$ (45) |

Other-than-temporary Impairment

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

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

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)**

(Amounts in thousands, except share and per share amounts, unless otherwise stated)

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

general market conditions and industry or sector specific factors and other qualitative factors;

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

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

There was no impairment loss recognized for the three months ended September 30, 2018 and 2017. For the nine months ended September 30, 2018, the Company recognized \$80 of impairment loss on one fixed-maturity security. For the nine months ended September 30, 2017, the Company recognized impairment losses of \$100 attributable to the sale of two intent-to-sell fixed-maturity securities. At September 30, 2018, one fixed-maturity security was considered other-than-temporarily impaired versus two fixed-maturity securities at September 30, 2017.

The following table presents a rollforward of the cumulative credit losses in other-than-temporary impairments recognized in income from available for sale fixed-maturity securities.

| | | |
|---|-------------|-------------|
| | 2018 | 2017 |
| Balance at January 1 | \$ | \$ 475 |
| Additional credit impairments on previously impaired securities | | |
| Balance at September 30 | \$ | \$ 475 |

Securities with gross unrealized loss positions at September 30, 2018 and December 31, 2017, aggregated by investment category and length of time the individual securities have been in a continuous loss position, are as follows:

| | Less Than Twelve Months | | Twelve Months or Longer | | Total | |
|--------------------------|-------------------------|----------------------|-------------------------|----------------------|-----------------------|----------------------|
| | Gross Unrealized Loss | Estimated Fair Value | Gross Unrealized Loss | Estimated Fair Value | Gross Unrealized Loss | Estimated Fair Value |
| As of September 30, 2018 | \$ (144) | \$ 19,321 | \$ (244) | \$ 35,921 | \$ (388) | \$ 55,242 |

Edgar Filing: HCI Group, Inc. - Form 10-Q

| | | | | | | |
|---|-----------------|------------------|-------------------|------------------|-------------------|-------------------|
| U.S. Treasury and U.S. government agencies | | | | | | |
| Corporate bonds | (228) | 11,465 | (1,417) | 38,104 | (1,645) | 49,569 |
| State, municipalities, and political subdivisions | (6) | 2,027 | | | (6) | 2,027 |
| Exchange-traded debt | (53) | 2,563 | | 47 | (53) | 2,610 |
| Total | \$ (431) | \$ 35,376 | \$ (1,661) | \$ 74,072 | \$ (2,092) | \$ 109,448 |

At September 30, 2018, there were 79 securities in an unrealized loss position. Of these securities, 27 securities had been in an unrealized loss position for 12 months or longer.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

| As of December 31, 2017 | Less Than Twelve Months | | Twelve Months or Longer | | Total | |
|---|-------------------------|----------------------|-------------------------|----------------------|-----------------------|----------------------|
| | Gross Unrealized Loss | Estimated Fair Value | Gross Unrealized Loss | Estimated Fair Value | Gross Unrealized Loss | Estimated Fair Value |
| U.S. Treasury and U.S. government agencies | \$ (246) | \$ 40,587 | \$ (41) | \$ 1,938 | \$ (287) | \$ 42,525 |
| Corporate bonds | (174) | 40,627 | (730) | 30,563 | (904) | 71,190 |
| State, municipalities, and political subdivisions | (30) | 9,775 | (45) | 2,297 | (75) | 12,072 |
| Exchange-traded debt | (6) | 2,481 | (1) | 36 | (7) | 2,517 |
| Total available-for-sale securities | \$ (456) | \$ 93,470 | \$ (817) | \$ 34,834 | \$ (1,273) | \$ 128,304 |

At December 31, 2017, there were 77 securities in an unrealized loss position. Of these securities, 15 securities had been in an unrealized loss position for 12 months or longer.

b) Equity Securities

The Company holds investments in equity securities measured at fair values which are readily determinable. At September 30, 2018 and December 31, 2017, the cost, gross unrealized gains and losses, and estimated fair value of the Company's equity securities were as follows:

| | Cost | Gross Unrealized Gain | Gross Unrealized Loss | Estimated Fair Value |
|--------------------|-----------|-----------------------|-----------------------|----------------------|
| September 30, 2018 | \$ 44,184 | \$ 2,543 | \$ (1,416) | \$ 45,311 |
| December 31, 2017 | \$ 54,282 | \$ 6,383 | \$ (709) | \$ 59,956 |

The table below presents the portion of unrealized gains and losses in the Company's consolidated statement of income for the periods related to equity securities still held.

| | Three Months Ended September 30, 2018 | Nine Months Ended September 30, 2018 |
|----------------------|---------------------------------------|--------------------------------------|
| Net gains recognized | \$ 1,097 | \$ 1,167 |

Edgar Filing: HCI Group, Inc. - Form 10-Q

| | | |
|---|----------|------------|
| Less: Net realized gains recognized for securities sold | 1,487 | 5,714 |
| Net unrealized losses recognized* | \$ (390) | \$ (4,547) |

* Unrealized holding gains and losses for the corresponding periods in 2017 were reported in accumulated other comprehensive income. See *Adoption of New Accounting Standards* in Note 1 Summary of Significant Accounting Policies for additional information.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)****Sales of Equity Securities***

Proceeds received, and the gross realized gains and losses from sales of equity securities, for the three and nine months ended September 30, 2018 and 2017 were as follows:

| | Proceeds | Gross Realized Gains | Gross Realized Losses |
|---------------------------------------|-----------------|-------------------------------------|--------------------------------------|
| Three months ended September 30, 2018 | \$ 15,443 | \$ 1,926 | \$ (439) |
| Three months ended September 30, 2017 | \$ 5,407 | \$ 235 | \$ (535) |
| Nine months ended September 30, 2018 | \$ 55,879 | \$ 6,897 | \$ (1,183) |
| Nine months ended September 30, 2017 | \$ 26,309 | \$ 3,070 | \$ (875) |

c) Short-Term Investments

Short-term investments consist of the following at September 30, 2018. The Company did not have short-term investments at December 31, 2017.

| | |
|------------------------------|------------------|
| Certificates of deposit | \$ 35,437 |
| Zero-coupon commercial paper | 52,341 |
| Total | \$ 87,778 |

d) Limited Partnership Investments

The Company has interests in limited partnerships that are not registered or readily tradeable on a securities exchange. These partnerships are private equity funds managed by general partners who make decisions with regard to financial policies and operations. As such, the Company is not the primary beneficiary and does not consolidate these partnerships. In February 2018, the Company entered into a subscription agreement to invest \$5,000 with a limited partnership specializing in real estate private equity funds and portfolios. Subsequently, in September 2018, the Company increased its aggregate investment commitment with this limited partnership to \$10,000. The following table provides information related to the Company's investments in limited partnerships:

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

| | September 30, 2018 | | | December 31, 2017 | | |
|---|--------------------|------------------|--------|-------------------|------------------|--------|
| | Carrying Value | Unfunded Balance | (%)(a) | Carrying Value | Unfunded Balance | (%)(a) |
| Investment Strategy | | | | | | |
| Primarily in senior secured loans and, to a limited extent, in other debt and equity securities of private U.S. lower-middle-market companies. (b)(c)(e) | \$ 9,690 | \$ 2,853 | 15.37 | \$ 7,276 | \$ 5,505 | 15.37 |
| Value creation through active distressed debt investing primarily in bank loans, public and private corporate bonds, asset-backed securities, and equity securities received in connection with debt restructuring. (b)(d)(e) | 9,295 | | 1.76 | 7,951 | 1,745 | 1.76 |
| High returns and long-term capital appreciation through investments in the power, utility and energy industries, and in the infrastructure sector. (b)(f)(g) | 8,169 | 2,329 | 0.18 | 7,509 | 2,512 | 0.18 |
| Value-oriented investments in less liquid and mispriced senior and junior debts of private equity-backed companies. (b)(h)(i) | 1,458 | 3,481 | 0.47 | 448 | 4,566 | 0.47 |
| Value-oriented investments in mature real estate private equity funds and portfolios globally. (b)(j) | 332 | 10,000 | 3.28 | | | |
| Total | \$ 28,944 | \$ 18,663 | | \$ 23,184 | \$ 14,328 | |

- (a) Represents the Company's percentage investment in the fund at each balance sheet date.
- (b) Except under certain circumstances, withdrawals from the funds or any assignments are not permitted. Distributions, except income from late admission of a new limited partner, will be received when underlying investments of the funds are liquidated.
- (c) Expected to have a ten-year term and the capital commitment is expected to expire on September 3, 2019.
- (d) Expected to have a three-year term from June 30, 2018.
- (e) At the fund manager's discretion, the term of the fund may be extended for up to two additional one-year periods.
- (f) Expected to have a ten-year term and the capital commitment is expected to expire on June 30, 2020.
- (g) With the consent of a supermajority of partners, the term of the fund may be extended for up to three additional one-year periods.
- (h) Expected to have a six-year term from the commencement date, which can be extended for up to two additional one-year periods with the consent of either the advisory committee or a majority of limited partners.
- (i) Unless extended or terminated for reasons specified in the agreement, the capital commitment is expected to expire on December 1, 2018.
- (j) Expected to have an eight-year term after the final fund closing date, which has yet to be determined.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)**

(Amounts in thousands, except share and per share amounts, unless otherwise stated)

The following is the summary of aggregated unaudited financial information of limited partnerships included in the investment strategy table above, which in certain cases is presented on a three-month lag due to the unavailability of information at the Company's respective balance sheet dates. In applying the equity method of accounting, the Company uses the most recently available financial information provided by the general partner of each of these partnerships. The financial statements of these limited partnerships are audited annually.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------|---|-------------|--|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| <i>Operating results:</i> | | | | |
| Total income | \$ 959,721 | \$ 71,854 | \$ 1,168,751 | \$ 301,604 |
| Total expenses | (30,192) | (24,663) | (115,887) | (78,482) |
| Net income (loss) | \$ 929,529 | \$ 47,191 | \$ 1,052,864 | \$ 223,122 |

| | September 30, 2018 | December 31, 2017 |
|-----------------------|-------------------------------|------------------------------|
| <i>Balance Sheet:</i> | | |
| Total assets | \$ 6,679,069 | \$ 4,381,321 |
| Total liabilities | \$ 585,780 | \$ 382,310 |

For the three and nine months ended September 30, 2018, the Company recognized net investment income of \$1,964 and \$2,816, respectively, for these investments. During the three and nine months ended September 30, 2018, the Company received total cash distributions of \$1,156 and \$1,879, respectively. Cash distributions representing return on investment were \$886 and \$1,495 for the three and nine months ended September 30, 2018, respectively.

For the three and nine months ended September 30, 2017, the Company recognized net investment income of \$392 and \$1,724, respectively. During the three months ended September 30, 2017, the Company received in cash a return on investment of \$428. During the nine months ended September 30, 2017, the Company received total cash distributions of \$12,612, representing \$11,758 of returned capital and \$854 of return on investment. At September 30, 2018 and December 31, 2017, the Company's cumulative contributed capital to the partnerships at each respective balance sheet date totaled \$25,995 and \$21,172, respectively, and the Company's maximum exposure to loss aggregated \$28,944 and \$23,184, respectively.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)****e) Investment in Unconsolidated Joint Venture***

The Company has an equity investment in FMKT Mel JV (FMJV), which is a limited liability company treated as a joint venture under U.S. GAAP. In June 2018, FMJV sold one of its outparcels for \$849 and recognized a gain of \$438. At September 30, 2018 and December 31, 2017, the Company's maximum exposure to loss relating to the variable interest entity was \$860 and \$1,304, respectively, representing the carrying value of the investment. There were no cash distributions during the three months ended September 30, 2018 and 2017. During the nine months ended September 30, 2018, the Company received a cash distribution of \$764, representing a combined distribution of \$68 in earnings and \$696 in capital. During the nine months ended September 30, 2017, the Company received a cash distribution of \$564, representing a combined distribution of \$147 in earnings and \$417 in capital. There was no undistributed income at September 30, 2018 and December 31, 2017. The following tables provide FMJV's summarized unaudited financial results and unaudited financial positions:

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2018 | 2017 | 2018 | 2017 |
| Operating results: | | | | |
| Total revenues and gain | \$ | \$ | \$ 438 | \$ 331 |
| Total expenses | (12) | (18) | (83) | (83) |
| Net (loss) income | \$ (12) | \$ (18) | \$ 355 | \$ 248 |
| The Company's share of net (loss) income* | \$ (10) | \$ (16) | \$ 320 | \$ 126 |

* Included in net investment income in the Company's consolidated statements of income. Gain from the sale of an outparcel in 2017 was allocated in accordance with the method specified in the operating agreement.

| | September 30, | December 31, |
|--------------------------------------|----------------------|---------------------|
| | 2018 | 2017 |
| Balance Sheet: | | |
| Construction in progress real estate | \$ | \$ 27 |
| Real estate investments, net | 793 | 1,199 |
| Cash | 167 | 236 |
| Other | 5 | 5 |
| Total assets | \$ 965 | \$ 1,467 |

Edgar Filing: HCI Group, Inc. - Form 10-Q

| | | | | |
|---|----|-----|----|-------|
| Other liabilities | \$ | 10 | \$ | 18 |
| Members' capital | | 955 | | 1,449 |
| Total liabilities and members' capital | \$ | 965 | \$ | 1,467 |
| Investment in unconsolidated joint venture, at equity** | \$ | 860 | \$ | 1,304 |

** Includes the 90% share of FMKT Mel JV's operating results.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)****f) Real Estate Investments***

Real estate investments consist of the following as of September 30, 2018 and December 31, 2017.

| | September 30, 2018 | December 31, 2017 |
|---|-------------------------------|------------------------------|
| Land | \$ 30,510 | \$ 26,315 |
| Land improvements | 9,928 | 9,904 |
| Buildings | 21,357 | 21,284 |
| Tenant and leasehold improvements | 1,350 | 1,204 |
| Other | 5,331 | 3,050 |
| Total, at cost | 68,476 | 61,757 |
| Less: accumulated depreciation and amortization | (4,584) | (3,399) |
| Real estate investments | \$ 63,892 | \$ 58,358 |

On June 13, 2018, the Company, through a wholly owned subsidiary, acquired commercial real estate in Clearwater, Florida, including assumed liabilities of \$35, for a purchase price of \$6,766. The real estate consisted of land, one in-place lease agreement which was recorded in intangible assets, and commercial structures that are currently under renovation. This transaction was accounted for as an asset acquisition.

Depreciation and amortization expense related to real estate investments was \$389 and \$374 for the three months ended September 30, 2018 and 2017, respectively, and \$1,185 and \$1,062 for the nine months ended September 30, 2018 and 2017, respectively.

g) Consolidated Variable Interest Entity

On January 26, 2018, Greenleaf Essence, LLC, a wholly owned subsidiary and a member of the limited liability company treated under U.S. GAAP as a joint venture which the Company used to consolidate as the primary beneficiary, purchased the interest of the only noncontrolling member for \$539 which was reported in the Company's consolidated statement of stockholders' equity. The purchase, which was accounted for as an equity transaction, gave the Company full ownership of this limited liability company. No gain or loss was recognized as there was no change in control. The following table summarizes the assets and liabilities related to this variable interest entity which are included in the accompanying consolidated balance sheet as of December 31, 2017.

Edgar Filing: HCI Group, Inc. - Form 10-Q

| | |
|-------------------------|----------|
| Real estate investments | \$ 4,680 |
| Other assets | \$ 152 |
| Accrued expenses | \$ 21 |
| Other liabilities | \$ 160 |

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)***h) Net Investment Income**

Net investment income, by source, is summarized as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|----------|-------------------|----------|
| | September 30, | | September 30, | |
| | 2018 | 2017 | 2018 | 2017 |
| Available-for-sale fixed-maturity securities | \$ 1,273 | \$ 1,532 | \$ 3,538 | \$ 4,172 |
| Equity securities | 486 | 790 | 1,634 | 2,461 |
| Investment expense | (137) | (176) | (447) | (526) |
| Limited partnership investments | 1,964 | 392 | 2,816 | 1,724 |
| Real estate investments | 22 | (292) | 239 | (856) |
| Income (loss) from unconsolidated joint venture | (10) | (16) | 320 | 126 |
| Cash and cash equivalents | 889 | 648 | 2,531 | 1,415 |
| Short-term investments | 567 | | 1,040 | |
| Other | | | | 6 |
| Net investment income | \$ 5,054 | \$ 2,878 | \$ 11,671 | \$ 8,522 |

Note 5 Comprehensive (Loss) Income

Comprehensive (loss) income includes net income or loss and other comprehensive income or loss, which for the Company includes changes in unrealized gains or losses of available-for-sale investments carried at fair value and changes in the unrealized other-than-temporary impairment losses related to these investments. Reclassification adjustments for realized (gains) losses are reflected in net realized investment gains (losses) on the consolidated statements of income. The components of other comprehensive income or loss and the related tax effects allocated to each component were as follows:

| | Three Months Ended | | | Three Months Ended | | |
|---|--------------------|-------------------|------------|--------------------|-------------------|------------|
| | September 30, 2018 | | | September 30, 2017 | | |
| | Income Tax | | | Income Tax | | |
| | Before Tax | Expense (Benefit) | Net of Tax | Before Tax | Expense (Benefit) | Net of Tax |
| Unrealized gain arising during the period | \$ 35 | \$ 9 | \$ 26 | \$ 2,155 | \$ 831 | \$ 1,324 |
| Other-than-temporary impairment loss | | | | 474 | 183 | 291 |

Edgar Filing: HCI Group, Inc. - Form 10-Q

| | | | | | | |
|---|---------|---------|---------|----------|----------|----------|
| Call and repayment gains charged to investment income | (19) | (5) | (14) | | | |
| Reclassification adjustment for realized (gains) losses | (71) | (17) | (54) | 226 | 87 | 139 |
| Total other comprehensive (loss) gain | \$ (55) | \$ (13) | \$ (42) | \$ 2,855 | \$ 1,101 | \$ 1,754 |

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

| | Nine Months Ended September 30, 2018 | | | Nine Months Ended September 30, 2017 | | |
|--|---|----------------------|---------------|---|----------------------|---------------|
| | Before Tax | Expense (Benefit) | Net of Tax | Before Tax | Expense (Benefit) | Net of Tax |
| Unrealized (loss) gain arising during the period | \$ (2,658) | \$ (673) | \$ (1,985) | \$ 4,822 | \$ 1,860 | \$ 2,962 |
| Other-than-temporary impairment loss | 80 | 20 | 60 | 864 | 333 | 531 |
| Call and repayment (gains) losses charged to investment income | (15) | (4) | (11) | 9 | 4 | 5 |
| Reclassification adjustment for realized gains | (732) | (185) | (547) | (2,276) | (878) | (1,398) |
| Total other comprehensive (loss) gain | \$ (3,325) | \$ (842) | \$ (2,483) | \$ 3,419 | \$ 1,319 | \$ 2,100 |

Note 6 Fair Value Measurements

The Company records and discloses certain financial assets at their estimated fair value. The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels as follows:

- Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 Other inputs that are observable for the asset, either directly or indirectly such as quoted prices for identical assets that are not observable throughout the full term of the asset.
- Level 3 Inputs that are unobservable.

Valuation Methodology*Cash and cash equivalents*

Cash and cash equivalents primarily consist of money-market funds. Their carrying value approximates fair value due to the short maturity and high liquidity of these funds.

Short-term investments

Short-term investments consist of certificates of deposit and zero-coupon commercial paper maturing within one year. Due to their short maturity, the carrying value approximates fair value.

Fixed-maturity and equity securities

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

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

The estimated fair values for securities that do not trade on a daily basis are determined by management, utilizing prices obtained from an independent pricing service and information provided by brokers, which are level 2 inputs. Management reviews the assumptions and methods utilized by the pricing service and then compares the relevant data and pricing to broker-provided data. The Company gains assurance of the overall reasonableness and consistent application of the assumptions and methodologies and compliance with accounting standards for fair value determination through ongoing monitoring of the reported fair values.

Limited Partnership Investments

As described in Note 4 Investments under *Limited Partnership Investments*, the Company has interests in limited partnerships which are private equity funds. Pursuant to U.S. GAAP, these funds are required to use fair value accounting; therefore, the estimated fair value approximates the carrying value of these funds.

Long-term debt

The following table summarizes components of the Company's long-term debt and methods used in estimating their fair values:

| | Maturity Date | Valuation Methodology |
|---------------------------------|--------------------------|--|
| 3.875% Convertible Senior Notes | 2019 | Quoted price |
| 4.25% Convertible Senior Notes | 2037 | Quoted price |
| 3.95% Promissory Note | 2020 | Discounted cash flow method/Level 3 inputs |
| 4% Promissory Note | 2031 | Discounted cash flow method/Level 3 inputs |
| 3.75% Callable Promissory Note | 2036 | Discounted cash flow method/Level 3 inputs |
| 4.55% Promissory Note | 2036 | Discounted cash flow method/Level 3 inputs |

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)**Assets Measured at Estimated Fair Value on a Recurring Basis*

The following table presents information about the Company's financial assets measured at estimated fair value on a recurring basis. The table indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value as of September 30, 2018 and December 31, 2017:

| | Fair Value Measurements Using | | | Total |
|---|-------------------------------|-----------|-----------|------------|
| | (Level 1) | (Level 2) | (Level 3) | |
| <u>As of September 30, 2018</u> | | | | |
| Financial Assets: | | | | |
| <i>Cash and cash equivalents</i> | \$ 249,083 | \$ | \$ | \$ 249,083 |
| <i>Short-term investments</i> | 87,778 | | | 87,778 |
| <i>Fixed-maturity securities:</i> | | | | |
| U.S. Treasury and U.S. government agencies | 54,745 | 1,500 | | 56,245 |
| Corporate bonds | 65,835 | | | 65,835 |
| State, municipalities, and political subdivisions | | 12,872 | | 12,872 |
| Exchange-traded debt | 10,699 | | | 10,699 |
| Redeemable preferred stock | 68 | | | 68 |
| Total available-for-sale securities | 131,347 | 14,372 | | 145,719 |
| <i>Equity securities</i> | 45,311 | | | 45,311 |
| Total | \$ 513,519 | \$ 14,372 | \$ | \$ 527,891 |

| | Fair Value Measurements Using | | | Total |
|---|-------------------------------|-----------|-----------|------------|
| | (Level 1) | (Level 2) | (Level 3) | |
| <u>As of December 31, 2017</u> | | | | |
| Financial Assets: | | | | |
| <i>Cash and cash equivalents</i> | \$ 255,884 | \$ | \$ | \$ 255,884 |
| <i>Fixed-maturity securities:</i> | | | | |
| U.S. Treasury and U.S. government agencies | 40,527 | 1,500 | | 42,027 |
| Corporate bonds | 106,109 | 994 | | 107,103 |
| State, municipalities, and political subdivisions | | 80,695 | | 80,695 |

Edgar Filing: HCI Group, Inc. - Form 10-Q

| | | | |
|-------------------------------------|------------|-----------|------------|
| Exchange-traded debt | 7,659 | | 7,659 |
| Total available-for-sale securities | 154,295 | 83,189 | 237,484 |
| <i>Equity securities</i> | 59,956 | | 59,956 |
| Total | \$ 470,135 | \$ 83,189 | \$ 553,324 |

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)**Assets and Liabilities Carried at Other Than Estimated Fair Value*

The following tables present fair value information for assets and liabilities that are carried on the balance sheet at amounts other than fair value as of September 30, 2018 and December 31, 2017:

| | Carrying Value | Fair Value Measurements Using (Level 1) | (Level 2) | (Level 3) | Estimated Fair Value |
|--|-------------------|---|------------|--------------|----------------------------|
| <u>As of September 30, 2018</u> | | | | | |
| Financial Assets: | | | | | |
| <i>Limited partnership investments</i> | \$ 28,944 | \$ | \$ | \$ 28,944 | \$ 28,944 |
| Financial Liabilities: | | | | | |
| <i>Long-term debt:</i> | | | | | |
| 3.875% Convertible senior notes | \$ 88,216 | \$ | \$ 89,315 | \$ | \$ 89,315 |
| 4.25% Convertible senior notes | 129,177 | | 142,133 | | 142,133 |
| 3.95% Promissory note | 9,126 | | | 9,144 | 9,144 |
| 4% Promissory note | 7,853 | | | 7,739 | 7,739 |
| 3.75% Promissory note | 8,236 | | | 7,850 | 7,850 |
| 4.55% Promissory note | 5,878 | | | 5,903 | 5,903 |
| Total long-term debt | \$ 248,486 | \$ | \$ 231,448 | \$ 30,636 | \$ 262,084 |

| | Carrying Value | Fair Value Measurements Using (Level 1) | (Level 2) | (Level 3) | Estimated Fair Value |
|--|-------------------|---|-----------|--------------|----------------------------|
| <u>As of December 31, 2017</u> | | | | | |
| Financial Assets: | | | | | |
| <i>Limited partnership investments</i> | \$ 23,184 | \$ | \$ | \$ 23,184 | \$ 23,184 |
| Financial Liabilities: | | | | | |
| <i>Long-term debt:</i> | | | | | |
| 3.875% Convertible senior notes | \$ 85,436 | \$ | \$ 90,827 | \$ | \$ 90,827 |
| 4.25% Convertible senior notes | 126,454 | | 124,444 | | 124,444 |
| 3.95% Promissory note | 9,270 | | | 9,227 | 9,227 |
| 4% Promissory note | 8,206 | | | 7,894 | 7,894 |

Edgar Filing: HCI Group, Inc. - Form 10-Q

| | | | | | |
|-----------------------|------------|----|------------|-----------|------------|
| 3.75% Promissory note | 8,469 | | 7,820 | 7,820 | |
| Total long-term debt | \$ 237,835 | \$ | \$ 215,271 | \$ 24,941 | \$ 240,212 |

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)***Note 7 Other Assets**

The following table summarizes the Company's other assets.

| | September 30, 2018 | December 31, 2017 |
|--|-------------------------------|------------------------------|
| Receivables from sales and maturities of investment securities | \$ 17,048 | \$ 255 |
| Benefits receivable related to retrospective reinsurance contracts | 2,858 | 2,393 |
| Prepaid expenses | 2,124 | 1,741 |
| Lease acquisition costs, net | 644 | 723 |
| Other | 2,027 | 4,629 |
| Total other assets | \$ 24,701 | \$ 9,741 |

Note 8 Long-Term Debt

The following table summarizes the Company's long-term debt.

| | September 30, 2018 | December 31, 2017 |
|---|-------------------------------|------------------------------|
| 3.875% Convertible Senior Notes, due March 15, 2019 | \$ 89,990 | \$ 89,990 |
| 4.25% Convertible Senior Notes, due March 1, 2037 | 143,750 | 143,750 |
| 3.95% Promissory note, due through February 17, 2020 | 9,185 | 9,360 |
| 4% Promissory note, due through February 1, 2031 | 7,981 | 8,348 |
| 3.75% Promissory note, due through September 1, 2036 | 8,372 | 8,613 |
| 4.55% Promissory note, due through August 1, 2036 | 5,982 | |
| Capital lease obligation, due through August 15, 2023 | 58 | |

Edgar Filing: HCI Group, Inc. - Form 10-Q

| | | |
|---|------------|------------|
| Total principal amount | 265,318 | 260,061 |
| Less: unamortized discount and issuance costs | (16,774) | (22,226) |
| Total long-term debt | \$ 248,544 | \$ 237,835 |

The following table summarizes future maturities of long-term debt as of September 30, 2018, which takes into consideration the assumption that the 4.25% Convertible Senior Notes are repurchased at the earliest call date.

| | |
|--|------------|
| Due in 12 months following September 30, | |
| 2018 | \$ 91,302 |
| 2019 | 10,058 |
| 2020 | 1,160 |
| 2021 | 144,958 |
| 2022 | 1,258 |
| Thereafter | 16,582 |
| Total | \$ 265,318 |

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

Information with respect to interest expense related to long-term debt is as follows:

| | Three Months Ended | | Nine Months Ended | |
|--------------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2018 | 2017 | 2018 | 2017 |
| Interest Expense: | | | | |
| Contractual interest | \$ 2,717 | \$ 2,662 | \$ 8,024 | \$ 7,766 |
| Non-cash expense (a) | 1,888 | 1,746 | 5,556 | 4,623 |
| Capitalized interest (b) | (53) | | (53) | (61) |
| | \$ 4,552 | \$ 4,408 | \$ 13,527 | \$ 12,328 |

(a) Includes amortization of debt discount and issuance costs.

(b) Interest was capitalized for construction projects which are intended for lease.

Convertible Senior Notes

3.875% Convertible Notes. Since January 2015, the Company's cash dividends on common stock have exceeded \$0.275 per share, resulting in adjustments to the conversion rate of the 3.875% Convertible Notes. Accordingly, as of September 30, 2018, the conversion rate of the Company's 3.875% Convertible Notes was 16.3317 shares of common stock for each \$1 in principal amount, which was the equivalent of approximately \$61.23 per share.

4.25% Convertible Notes. Since May 2018, the Company has paid cash dividend on common stock that exceeds \$0.35 per share, resulting in adjustments to the conversion rate of the 4.25% Convertible Notes. Accordingly, as of September 30, 2018, the conversion rate of the Company's 4.25% Convertible Notes was 16.2834 shares of common stock for each \$1 in principal amount, which was the equivalent of approximately \$61.41 per share.

The effective interest rates for the 3.875% Convertible Notes and the 4.25% Convertible Notes, taking into account both cash and non-cash components, approximate 8.3% and 7.6%, respectively. As of September 30, 2018, the remaining amortization periods of the debt discounts were expected to be 5.5 months for the 3.875% Convertible Notes and 3.4 years for the 4.25% Convertible Notes.

4.55% Promissory Note

On July 6, 2018, Century Park Holdings, LLC, a subsidiary of the Company, entered into a 18-year secured loan agreement for proceeds of \$6,000. The loan is collateralized by the Company's Tampa, Florida real estate, which is owned by Century Park Holdings, and the lease agreement associated with this property. The loan bears a fixed annual

interest rate of 4.55%. Approximately \$41 of principal and interest is payable in 216 monthly installments. The promissory note may be repaid in full or in part after September 1, 2020 as long as the Company provides at least 30 days written notice and pays a prepayment consideration as specified in the loan agreement. The proceeds were used for real estate development projects or other general business purposes.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)**

(Amounts in thousands, except share and per share amounts, unless otherwise stated)

Note 9 Reinsurance

The Company cedes a portion of its insurance exposure to other entities under catastrophe excess of loss reinsurance contracts and one quota share reinsurance agreements. The Company remains liable for claims payments in the event that any reinsurer is unable to meet its obligations under the reinsurance agreements. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. The Company contracts with a number of reinsurers to secure its annual reinsurance coverage, which generally becomes effective June 1st each year. The Company purchases reinsurance each year taking into consideration probable maximum losses and reinsurance market conditions.

The impact of the reinsurance contracts on premiums written and earned is as follows:

| | Three Months Ended | | Nine Months Ended | |
|--------------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2018 | 2017 | 2018 | 2017 |
| Premiums Written: | | | | |
| Direct | \$ 90,370 | \$ 94,935 | \$ 292,986 | \$ 301,930 |
| Assumed | (10) | (63) | (107) | (1,184) |
| Gross written | 90,360 | 94,872 | 292,879 | 300,746 |
| Ceded | (31,986) | (44,704) | (97,190) | (101,528) |
| Net premiums written | \$ 58,374 | \$ 50,168 | \$ 195,689 | \$ 199,218 |
| Premiums Earned: | | | | |
| Direct | \$ 85,804 | \$ 87,118 | \$ 255,840 | \$ 259,698 |
| Assumed | 359 | 1,551 | 2,014 | 10,678 |
| Gross earned | 86,163 | 88,669 | 257,854 | 270,376 |
| Ceded | (31,986) | (44,705) | (97,190) | (101,529) |
| Net premiums earned | \$ 54,177 | \$ 43,964 | \$ 160,664 | \$ 168,847 |

During the three and nine months ended September 30, 2018, ceded losses of \$27 and \$58,493, respectively, were recognized as a reduction in losses and loss adjustment expenses. During the three and nine months ended September 30, 2017, ceded losses of \$5 were deducted from losses incurred. At September 30, 2018 and

December 31, 2017, there were 38 and 37 reinsurers, respectively, participating in the Company's reinsurance program. Amounts receivable with respect to reinsurers at September 30, 2018 and December 31, 2017 were \$73,095 and \$103,104, respectively. Approximately 30.7% of the reinsurance recoverable balance for paid losses and loss adjustment expenses at September 30, 2018 was concentrated in two reinsurers. Based on the insurance ratings, the payment history and the financial strength of the reinsurers, management believes there was no significant credit risk associated with its reinsurers' obligations to perform on any prepaid reinsurance contract and to fund any reinsurance recoverable balance as of September 30, 2018.

Certain of the reinsurance contracts include retrospective provisions that adjust premiums, increase the amount of future coverage, or result in a profit commission in the event losses are minimal or zero. For the three months ended September 30, 2018, the Company recognized a reduction in ceded premiums of \$600 related to these adjustments. For the nine months ended September 30, 2018, the Company recognized a net increase in ceded premiums of \$115. Included in the three and nine months ended September 30, 2018 were \$0 and \$448, respectively, attributable to the Company's contract with Oxbridge Reinsurance Limited (Oxbridge), a related party. In contrast, these adjustments were reflected in the consolidated statements of income as net increases in ceded premiums of \$12,465 and \$5,509 for the three and nine months ended September 30, 2017, respectively, of which \$2,415 and \$903 related to the Company's contract with Oxbridge.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)**

(Amounts in thousands, except share and per share amounts, unless otherwise stated)

In addition, adjustments related to retrospective provisions are reflected in other assets. At September 30, 2018 and December 31, 2017, other assets included \$2,858 and \$2,393, respectively, of which \$0 and \$479 related to the contract with Oxbridge. See Note 17 Related Party Transaction regarding the termination of the Company's reinsurance contract with Oxbridge. Management believes the credit risk associated with the collectability of these accrued benefits is minimal as the amount receivable is concentrated with one reinsurer and the Company monitors the creditworthiness of this reinsurer based on available information about the reinsurer's financial condition.

Note 10 Losses and Loss Adjustment Expenses

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

The Company primarily writes insurance in the state of Florida, which could be exposed to hurricanes or other natural catastrophes. The occurrence of a major catastrophe could have a significant effect on the Company's quarterly results and cause a temporary disruption of the normal operations of the Company. However, the Company is unable to predict the frequency or severity of any such events that may occur in the near term or thereafter.

Activity in the liability for unpaid losses and loss adjustment expenses is summarized as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------------|-----------------|--------------------------|-----------------|
| | September 30, | | September 30, | |
| | 2018 | 2017 | 2018 | 2017 |
| Net balance, beginning of period* | \$ 89,389 | \$ 73,084 | \$ 97,818 | \$ 70,492 |
| Incurred, net of reinsurance, related to: | | | | |
| Current period | 21,250 | 78,337 | 61,657 | 123,710 |
| Prior period | 4,519 | 10,894 | 5,570 | 18,715 |
| Total incurred, net of reinsurance | 25,769 | 89,231 | 67,227 | 142,425 |
| Paid, net of reinsurance, related to: | | | | |
| Current period | (14,397) | (20,888) | (28,554) | (40,392) |
| Prior period | (13,242) | (10,484) | (48,972) | (41,582) |
| Total paid, net of reinsurance | (27,639) | (31,372) | (77,526) | (81,974) |
| Net balance, end of period | 87,519 | 130,943 | 87,519 | 130,943 |
| Add: reinsurance recoverable | 50,895 | 213,729 | 50,895 | 213,729 |

| | | | | |
|------------------------------|------------|------------|------------|------------|
| Gross balance, end of period | \$ 138,414 | \$ 344,672 | \$ 138,414 | \$ 344,672 |
|------------------------------|------------|------------|------------|------------|

* Net balance represents beginning-of-period liability for unpaid losses and loss adjustment expenses less beginning-of-period reinsurance recoverable for unpaid losses and loss adjustment expenses.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)**

(Amounts in thousands, except share and per share amounts, unless otherwise stated)

The establishment of loss reserves is an inherently uncertain process and changes in loss reserve estimates are expected as these estimates are subject to the outcome of future events. Changes in estimates, or differences between estimates and amounts ultimately paid, are reflected in the operating results of the period during which such estimates are adjusted. During the three and nine months ended September 30, 2018, the Company established loss reserves of \$4,519 and \$5,570, respectively, which resulted from unfavorable development in the prior loss years primarily attributable to claims involving assignment of insurance benefits and related litigation, and adverse development of approximately \$980 related to Hurricane Matthew. During the nine months ended September 30, 2018, the Company increased its estimated gross losses related to Hurricane Irma from \$267,000 to \$326,000. The increase of \$59,000 had no impact to the Company's results of operations as these additional losses were entirely ceded. The increase in estimated gross losses was attributable to an increased number of claims and lawsuits.

Note 11 Segment Information

The Company identifies its operating divisions based on organizational structure and revenue source. Currently, the Company has three reportable segments: insurance operations, real estate operations, and corporate and other. Due to their economic characteristics, the Company's property and casualty insurance division and reinsurance division are grouped together into one reportable segment under insurance operations. The real estate operations segment includes companies engaged in operating commercial properties the Company owns for investment purposes or for use in its own operations. The corporate and other segment represents the activities of the holding companies, the information technology division, and other companies that do not meet the quantitative thresholds for a reportable segment. The determination of segments may change over time due to changes in operational emphasis, revenues, and results of operations. The Company's chief executive officer, who serves as the Company's chief operating decision maker, evaluates each division's financial and operating performance based on revenue and operating income.

For the three months ended September 30, 2018 and 2017, revenues from the Company's insurance operations before intracompany elimination represented 95.3% and 96.1%, respectively, of total revenues of all operating segments. For the nine months ended September 30, 2018 and 2017, revenues from the Company's insurance operations before intracompany elimination represented 95.3% and 96.4%, respectively, of total revenues of all operating segments. At September 30, 2018 and December 31, 2017, insurance operations' total assets represented 85.5% and 87.1%, respectively, of the combined assets of all operating segments. In addition, there was no other operating division representing ten percent or more of the greater, in absolute amount, of the combined profits of all operating divisions reporting a profit or the combined losses of all operating divisions reporting a loss. The following tables present segment information reconciled to the Company's consolidated statements of income. Intersegment transactions are not eliminated from segment results. However, intracompany transactions are eliminated in segment results below.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

| For Three Months Ended September 30, 2018 | Insurance Operations | Real Estate(a) | Corporate/ Other(b) | Reclassification/ Elimination | Consolidated |
|---|---------------------------------|---------------------------|--------------------------------|--|---------------------|
| Revenue: | | | | | |
| Net premiums earned | \$ 54,177 | \$ | \$ | \$ | \$ 54,177 |
| Net investment income | 2,777 | | 2,377 | (100) | 5,054 |
| Net realized investment gains | 1,227 | | 399 | | 1,626 |
| Net unrealized investment (losses) gains | (478) | | 88 | | (390) |
| Policy fee income | 843 | | | | 843 |
| Other | 80 | 2,318 | 1,214 | (3,179) | 433 |
| Total revenue | 58,626 | 2,318 | 4,078 | (3,279) | 61,743 |
| Expenses: | | | | | |
| Losses and loss adjustment expenses | 25,769 | | | | 25,769 |
| Amortization of deferred policy acquisition costs | 8,996 | | | | 8,996 |
| Interest expense | | 393 | 4,270 | (111) | 4,552 |
| Depreciation and amortization | 32 | 592 | 242 | (540) | 326 |
| Other | 6,187 | 1,166 | 5,452 | (2,628) | 10,177 |
| Total expenses | 40,984 | 2,151 | 9,964 | (3,279) | 49,820 |
| Income (loss) before income taxes | \$ 17,642 | \$ 167 | \$ (5,886) | \$ | \$ 11,923 |
| Total revenue from non-affiliates(c) | \$ 58,626 | \$ 1,935 | \$ 3,806 | | |

- (a) Other revenue under real estate primarily consisted of rental income from investment properties.
(b) Other revenue under corporate and other primarily consisted of revenue from restaurant and marina businesses.
(c) Represents amounts before reclassification to conform with an insurance company's presentation.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

| For Three Months Ended September 30, 2017 | Insurance Operations | Real Estate(a) | Corporate/ Other(b) | Reclassification/ Elimination | Consolidated |
|--|---------------------------------|---------------------------|--------------------------------|--|---------------------|
| Revenue: | | | | | |
| Net premiums earned | \$ 43,964 | \$ | \$ | \$ | \$ 43,964 |
| Net investment income | 2,563 | 2 | 658 | (345) | 2,878 |
| Net realized investment losses | (226) | | | | (226) |
| Net unrealized investment gain | | | 74 | | 74 |
| Net other-than-temporary impairment losses | (464) | | (10) | | (474) |
| Policy fee income | 905 | | | | 905 |
| Other | 85 | 1,761 | 1,068 | (2,545) | 369 |
| Total revenue | 46,827 | 1,763 | 1,790 | (2,890) | 47,490 |
| Expenses: | | | | | |
| Losses and loss adjustment expenses | 89,231 | | | | 89,231 |
| Amortization of deferred policy acquisition costs | 9,031 | | | | 9,031 |
| Interest expense | | 318 | 4,128 | (38) | 4,408 |
| Depreciation and amortization | 33 | 535 | 250 | (494) | 324 |
| Impairment loss | | 38 | | | 38 |
| Other | 7,155 | 983 | 4,696 | (2,358) | 10,476 |
| Total expenses | 105,450 | 1,874 | 9,074 | (2,890) | 113,508 |
| Income (loss) before income taxes | \$ (58,623) | \$ (111) | \$ (7,284) | \$ | \$ (66,018) |
| Total revenue from non-affiliates(c) | \$ 46,827 | \$ 1,381 | \$ 1,620 | | |

(a) Other revenue under real estate primarily consisted of rental income from investment properties.

(b) Other revenue under corporate and other primarily consisted of revenue from restaurant and marina businesses.

(c) Represents amounts before reclassification to conform with an insurance company's presentation.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

| For Nine Months Ended September 30, 2018 | Insurance Operations | Real Estate(a) | Corporate/ Other(b) | Reclassification/ Elimination | Consolidated |
|---|---------------------------------|---------------------------|--------------------------------|--|---------------------|
| Revenue: | | | | | |
| Net premiums earned | \$ 160,664 | \$ | \$ | \$ | \$ 160,664 |
| Net investment income | 7,520 | 1 | 3,941 | 209 | 11,671 |
| Net realized investment gains | 4,982 | | 1,538 | | 6,520 |
| Net unrealized investment losses | (3,985) | | (562) | | (4,547) |
| Net other-than-temporary impairment losses | | | (80) | | (80) |
| Policy fee income | 2,563 | | | | 2,563 |
| Other | 452 | 6,965 | 3,948 | (9,861) | 1,504 |
| Total revenue | 172,196 | 6,966 | 8,785 | (9,652) | 178,295 |
| Expenses: | | | | | |
| Losses and loss adjustment expenses | 67,227 | | | | 67,227 |
| Amortization of deferred policy acquisition costs | 26,506 | | | | 26,506 |
| Interest expense | | 1,176 | 12,700 | (349) | 13,527 |
| Depreciation and amortization | 98 | 1,788 | 751 | (1,638) | 999 |
| Other | 20,135 | 3,202 | 16,117 | (7,665) | 31,789 |
| Total expenses | 113,966 | 6,166 | 29,568 | (9,652) | 140,048 |
| Income (loss) before income taxes | \$ 58,230 | \$ 800 | \$ (20,783) | \$ | \$ 38,247 |
| Total revenue from non-affiliates(c) | \$ 172,196 | \$ 5,818 | \$ 7,945 | | |

- (a) Other revenue under real estate primarily consisted of rental income from investment properties.
- (b) Other revenue under corporate and other primarily consisted of revenue from restaurant and marina businesses.
- (c) Represents amounts before reclassification to conform with an insurance company's presentation.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

| For Nine Months Ended September 30, 2017 | Insurance Operations | Real Estate(a) | Corporate/ Other(b) | Reclassification/ Elimination | Consolidated |
|---|---------------------------------|---------------------------|--------------------------------|--|---------------------|
| Revenue: | | | | | |
| Net premiums earned | \$ 168,847 | \$ | \$ | \$ | \$ 168,847 |
| Net investment income | 7,153 | 5 | 2,188 | (824) | 8,522 |
| Net realized investment gains | 2,193 | | 83 | | 2,276 |
| Net unrealized investment gains | | | 74 | | 74 |
| Net other-than-temporary impairment losses | (854) | | (10) | | (864) |
| Policy fee income | 2,721 | | | | 2,721 |
| Other | 428 | 4,964 | 3,452 | (7,637) | 1,207 |
| Total revenue | 180,488 | 4,969 | 5,787 | (8,461) | 182,783 |
| Expenses: | | | | | |
| Losses and loss adjustment expenses | 142,425 | | | | 142,425 |
| Amortization of deferred policy acquisition costs | 26,668 | | | | 26,668 |
| Interest expense | | 880 | 11,543 | (95) | 12,328 |
| Loss on extinguishment of debt | | | 743 | | 743 |
| Impairment loss | | 38 | | | 38 |
| Depreciation and amortization | 94 | 1,551 | 676 | (1,425) | 896 |
| Other | 22,601 | 2,634 | 13,962 | (6,941) | 32,256 |
| Total expenses | 191,788 | 5,103 | 26,924 | (8,461) | 215,354 |
| Income (loss) before income taxes | \$ (11,300) | \$ (134) | \$ (21,137) | \$ | \$ (32,571) |
| Total revenue from non-affiliates(c) | \$ 180,488 | \$ 3,824 | \$ 5,266 | | |

(a) Other revenue under real estate primarily consisted of rental income from investment properties.

(b) Other revenue under corporate and other primarily consisted of revenue from restaurant and marina businesses.

(c) Represents amounts before reclassification to conform with an insurance company's presentation.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

The following table presents segment assets reconciled to the Company's total assets in the consolidated balance sheets.

| | September 30, 2018 | December 31, 2017 |
|-------------------------------|-------------------------------|------------------------------|
| Segment: | | |
| Insurance Operations | \$ 611,053 | \$ 652,754 |
| Real Estate Operations | 85,497 | 80,152 |
| Corporate and Other | 155,156 | 127,822 |
| Consolidation and Elimination | (35,369) | (18,464) |
| Total assets | \$ 816,337 | \$ 842,264 |

Note 12 Income Taxes

During the three months ended September 30, 2018, the Company recorded approximately \$2,926 of income taxes, which resulted in an effective tax rate of 24.5%. During the three months ended September 30, 2017, the Company recorded approximately \$25,472 of income tax benefits, which resulted in an effective tax rate of 38.6%. The decrease in the effective tax rate in 2018 as compared with the corresponding period in the prior year was primarily attributable to the reduction of the federal corporate income tax rate from 35% to 21%. During the nine months ended September 30, 2018, the Company recorded approximately \$12,056 of income taxes, which resulted in an effective tax rate of 31.5%. During the nine months ended September 30, 2017, the Company recorded approximately \$13,587 of income tax benefits, resulting in an effective tax rate of 41.7%. The decrease in the effective tax rate in 2018 as compared with the corresponding period in the prior year was primarily attributable to the aforementioned reduction of the federal corporate income tax rate, offset by the negative effect of the derecognition of deferred tax assets of \$1,620 for restricted stock awards of which market conditions will not be met prior to their expiry date, the disallowance of the deductibility of the \$1,727 expense representing dividends cumulatively paid on such restricted stock awards which were reclassified from retained income (see *Restricted Stock Awards* in Note 15 – Stock-Based Compensation), and an increase in nondeductible compensation expenses due to the elimination of the deductibility of most performance-based compensation, resulting from the enactment of the Tax Cuts and Jobs Act in 2017. The Company's estimated annual effective tax rate differs from the statutory federal tax rate due to state and foreign income taxes as well as certain nondeductible and tax-exempt items.

Effective August 27, 2018, the Internal Revenue Service notified the Company that the examination of the Company's 2015 federal income tax return was completed with no change to the Company's reported tax.

Note 13 Earnings Per Share

U.S. GAAP requires the Company to use the two-class method in computing basic earnings per share since holders of the Company's restricted stock have the right to share in dividends, if declared, equally with common stockholders. These participating securities affect the computation of both basic and diluted earnings per share during periods of net income or loss.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

A summary of the numerator and denominator of the basic and diluted earnings per common share is presented below.

| | Three Months Ended September 30, 2018 | | | Three Months Ended September 30, 2017 | | |
|--|--|-------------------------|---------------------|--|-------------------------|---------------------|
| | Income (Numerator) | Shares (Denominator) | Per Share Amount | Income (Numerator) | Shares (Denominator) | Per Share Amount |
| Net income (loss) | \$ 8,997 | | | \$ (40,546) | | |
| Less: (Income) loss attributable to participating securities | (591) | | | 2,737 | | |
| Basic Earnings (Loss) Per Share: | | | | | | |
| Income (loss) allocated to common stockholders | 8,406 | 7,791 | \$ 1.08 | (37,809) | 8,519 | \$ (4.44) |
| Effect of Dilutive Securities: | | | | | | |
| Stock options | | 17 | | | | |
| Convertible senior notes | 3,188 | 3,808 | | | | |
| Diluted Earnings (Loss) Per Share: | | | | | | |
| Income (loss) available to common stockholders and assumed conversions | \$ 11,594 | 11,616 | \$ 1.00 | \$ (37,809) | 8,519 | \$ (4.44) |
| | | | | | | |
| | Nine Months Ended September 30, 2018 | | | Nine Months Ended September 30, 2017 | | |
| | Income (Numerator) | Shares (Denominator) | Per Share Amount | Income (Numerator) | Shares (Denominator) | Per Share Amount |
| Net income (loss) | \$ 26,191 | | | \$ (18,984) | | |
| Less: (Income) loss attributable to participating securities* | (92) | | | 1,236 | | |
| Basic Earnings (Loss) Per Share: | | | | | | |
| Income (loss) allocated to common stockholders | 26,099 | 7,931 | \$ 3.29 | (17,748) | 8,648 | \$ (2.05) |

Effect of Dilutive Securities:

| | | |
|--------------------------|-------|-------|
| Stock options | | 17 |
| Convertible senior notes | 9,481 | 3,803 |

Diluted Earnings (Loss) Per Share:

| | | | | | | |
|--|-----------|--------|---------|------------|-------|-----------|
| Income (loss) available to common stockholders and assumed conversions | \$ 35,580 | 11,751 | \$ 3.03 | \$(17,748) | 8,648 | \$ (2.05) |
|--|-----------|--------|---------|------------|-------|-----------|

* Income attributable to participating securities for the nine months ended September 30, 2018 included the reclassification of cumulative dividends paid on certain restricted stock with market based vesting conditions from retained income to expense. See *Restricted Stock Awards* in Note 15 *Stock-Based Compensation* for additional information.

Table of Contents

HCI GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (unaudited)

(Amounts in thousands, except share and per share amounts, unless otherwise stated)

Note 14 Stockholders Equity

Common Stock

In December 2017, the Company's Board of Directors authorized a plan to repurchase up to \$20,000 of the Company's common shares before commissions and fees. During the three months ended September 30, 2018, the Company repurchased and retired a total of 148,768 shares at a weighted average price per share of \$41.35 under this authorized repurchase plan. The total cost of shares repurchased, inclusive of fees and commissions, during the three months ended September 30, 2018 was \$6,156, or \$41.38 per share. During the nine months ended September 30, 2018, the Company repurchased and retired a total of 508,290 shares at a weighted average price per share of \$39.06. The total cost of shares repurchased, inclusive of fees and commissions, during the nine months ended September 30, 2018 was \$19,867, or \$39.09 per share.

In December 2016, the Company's Board of Directors authorized a plan to repurchase up to \$20,000 of the Company's common shares before commissions and fees. During the three months ended September 30, 2017, the Company repurchased and retired a total of 124,849 shares at a weighted average price per share of \$36.79 under this authorized repurchase plan. The total cost of shares repurchased, inclusive of fees and commissions, during the three months ended September 30, 2017 was \$4,599, or \$36.83 per share. During the nine months ended September 30, 2017, the Company repurchased and retired a total of 163,265 shares at a weighted average price per share of \$37.86. The total cost of shares repurchased, inclusive of fees and commissions, during the nine months ended September 30, 2017 was \$6,189, or \$37.91 per share.

Note 15 Stock-Based Compensation

Incentive Plans

The Company currently has outstanding stock-based awards granted under the 2007 Stock Option and Incentive Plan and the 2012 Omnibus Incentive Plan. Only the 2012 Plan is active and available for future grants. At September 30, 2018, there were 1,748,247 shares available for grant.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)**

(Amounts in thousands, except share and per share amounts, unless otherwise stated)

Stock Options

Stock options granted and outstanding under the incentive plans vest over periods ranging from immediately vested to five years and are exercisable over the contractual term of ten years.

A summary of the stock option activity for the three and nine months ended September 30, 2018 and 2017 is as follows (option amounts not in thousands):

| | Number of Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|-----------------------------------|------------------------------|--|--|--|
| Outstanding at January 1, 2018 | 130,000 | \$ 34.82 | 8.2 years | \$ 472 |
| Granted | 110,000 | \$ 40.00 | | |
| Outstanding at March 31, 2018 | 240,000 | \$ 37.19 | 8.8 years | \$ 637 |
| Outstanding at June 30, 2018 | 240,000 | \$ 37.19 | 8.6 years | \$ 749 |
| Outstanding at September 30, 2018 | 240,000 | \$ 37.19 | 8.3 years | \$ 1,574 |
| Exercisable at September 30, 2018 | 47,500 | \$ 25.81 | 6.0 years | \$ 852 |
| Outstanding at January 1, 2017 | 50,000 | \$ 4.02 | 2.3 years | \$ 1,773 |
| Granted | 110,000 | \$ 40.00 | | |
| Outstanding at March 31, 2017 | 160,000 | \$ 28.76 | 7.4 years | \$ 2,591 |
| Exercised | (30,000) | \$ 2.50 | | |
| Outstanding at June 30, 2017 | 130,000 | \$ 34.82 | 8.7 years | \$ 1,675 |
| Outstanding at September 30, 2017 | 130,000 | \$ 34.82 | 8.5 years | \$ 639 |
| Exercisable at September 30, 2017 | 20,000 | \$ 6.30 | 3.9 years | \$ 639 |

There were no options exercised during the three and nine months ended September 30, 2018. The aggregate intrinsic value and realized tax benefits of the options exercised during the nine months ended September 30, 2017 were

\$1,319 and \$509. For the three months ended September 30, 2018 and 2017, the Company recognized \$138 and \$79, respectively, of compensation expense which was included in general and administrative personnel expenses. For the nine months ended September 30, 2018 and 2017, the Company recognized \$384 and \$228, respectively, of compensation expense. Deferred tax benefits related to stock options were \$20 and \$30 for the three months ended September 30, 2018 and 2017, respectively, and \$59 and \$88 for the nine months ended September 30, 2018 and 2017, respectively. At September 30, 2018 and December 31, 2017, there was \$1,496 and \$941, respectively, of unrecognized compensation expense related to nonvested stock options. The Company expects to recognize the remaining compensation expense over a weighted-average period of 2.8 years.

The following table provides assumptions used in the Black-Scholes option-pricing model to estimate the fair value of the stock options granted during the nine months ended September 30, 2018 and 2017:

| | 2018 | 2017 |
|--------------------------|-------------|-------------|
| Expected dividend yield | 4.00% | 3.53% |
| Expected volatility | 42.22% | 42.86% |
| Risk-free interest rate | 2.57% | 1.92% |
| Expected life (in years) | 5 | 5 |

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)****Restricted Stock Awards***

From time to time, the Company has granted and may grant restricted stock awards to its executive officers, other employees and nonemployee directors in connection with their service to the Company. The terms of the Company's outstanding restricted stock grants may include service, performance and market-based conditions. The fair value of the awards with market-based conditions is determined using a Monte Carlo simulation method, which calculates many potential outcomes for an award and then establishes fair value based on the most likely outcome. The determination of fair value with respect to the awards containing only performance or service-based conditions is based on the market value of the Company's common stock on the grant date.

Information with respect to the activity of unvested restricted stock awards during the three and nine months ended September 30, 2018 and 2017 is as follows:

| | Number of Restricted Stock Awards | Weighted Average Grant Date Fair Value |
|---------------------------------|--|---|
| Nonvested at January 1, 2018 | 597,690 | \$ 32.82 |
| Granted | 40,000 | \$ 34.92 |
| Vested | (28,643) | \$ 45.17 |
| Forfeited | (17,905) | \$ 38.55 |
| Nonvested at March 31, 2018 | 591,142 | \$ 31.53 |
| Granted | 143,360 | \$ 43.83 |
| Vested | (59,974) | \$ 40.09 |
| Forfeited | (27,115) | \$ 32.76 |
| Nonvested at June 30, 2018 | 647,413 | \$ 33.41 |
| Granted | 6,500 | \$ 39.80 |
| Forfeited | (7,432) | \$ 41.60 |
| Nonvested at September 30, 2018 | 646,481 | \$ 33.38 |
| Nonvested at January 1, 2017 | 542,503 | \$ 30.81 |
| Granted | 45,000 | \$ 40.15 |
| Vested | (20,109) | \$ 48.42 |

Edgar Filing: HCI Group, Inc. - Form 10-Q

| | | | |
|---------------------------------|----------|----|-------|
| Forfeited | (926) | \$ | 35.52 |
| Nonvested at March 31, 2017 | 566,468 | \$ | 30.92 |
| Granted | 109,936 | \$ | 44.05 |
| Vested | (45,874) | \$ | 34.51 |
| Forfeited | (9,948) | \$ | 40.90 |
| Nonvested at June 30, 2017 | 620,582 | \$ | 32.82 |
| Forfeited | (12,344) | \$ | 32.34 |
| Nonvested at September 30, 2017 | 608,238 | \$ | 32.83 |

The Company recognized compensation expense related to restricted stock, which is included in general and administrative personnel expenses, of \$1,231 and \$1,144 for the three months ended September 30, 2018 and 2017, respectively, and \$2,890 and \$3,134 for the nine months ended September 30, 2018 and 2017, respectively. At September 30, 2018 and December 31, 2017, there was approximately \$12,597 and \$9,101, respectively, of total unrecognized compensation expense related to nonvested restricted stock arrangements. The Company expects to recognize the remaining compensation expense over a weighted-average period of 2.9 years. The following table summarizes information about deferred tax benefits recognized and tax benefits realized related to restricted stock awards and paid dividends, and the fair value of vested restricted stock for the three and nine months ended September 30, 2018 and 2017.

Table of Contents**HCI GROUP, INC. AND SUBSIDIARIES****Notes to Consolidated Financial Statements (unaudited)***(Amounts in thousands, except share and per share amounts, unless otherwise stated)*

| | Three Months Ended | | Nine Months | |
|---|---------------------------|-------------|----------------------|-------------|
| | September 30, | | Ended | |
| | 2018 | 2017 | September 30, | 2017 |
| Deferred tax benefits recognized | \$ 264 | \$ 403 | \$ 600 | \$ 1,097 |
| Tax benefits realized for restricted stock and paid dividends | \$ 68 | \$ 49 | \$ 916 | \$ 1,232 |
| Fair value of vested restricted stock | \$ | \$ | \$ 3,698 | \$ 2,557 |

In May 2018, the Company reclassified from retained income dividends of \$1,727 cumulatively paid on unvested restricted stock awards with market based vesting conditions to general and administrative personnel expenses for \$1,346 and to other operating expenses for \$381. These awards, of which the market conditions will not be met, were granted to the Company's employee and nonemployee directors in 2013. The awards will lapse in May 2019. Any future dividend payment associated with these awards will be expensed when declared. As a result, for the three months ended September 30, 2018, the Company recognized dividends of \$98 related to these awards in general and administrative personnel expenses for \$80 and in other operating expenses for \$18. For the nine months ended September 30, 2018, dividends totaling \$1,825 were recognized in general and administrative personnel expenses for \$1,426 and in other operating expenses for \$399.

Note 16 Commitments and Contingencies**Obligations under Multi-Year Reinsurance Contract**

As of September 30, 2018, the Company has a contractual obligation related to one multi-year reinsurance contract. This contract may be cancelled only with the other party's consent. The table below presents the future minimum aggregate premium amounts payable to the reinsurer.

| | |
|--|-----------------|
| Due in 12 months following September 30, 2018* | \$ 3,469 |
| 2019* | 2,602 |
| Total | \$ 6,071 |

* Premiums payable after December 31, 2018 are estimated.

Capital Commitment

As described in Note 4 Investments under *Limited Partnership Investments*, the Company is contractually committed to capital contributions for four limited partnership interests. At September 30, 2018, there was an aggregate unfunded balance of \$18,663.

Table of Contents

HCI GROUP, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements (unaudited)

(Amounts in thousands, except share and per share amounts, unless otherwise stated)

Note 17 Related Party Transactions

On May 28, 2018, Claddaugh Casualty Insurance Company Ltd (Claddaugh), the Company's wholly owned subsidiary, terminated its multi-year reinsurance contract with Oxbridge, a related party, effective June 1, 2018. Upon termination, Claddaugh agreed to pay Oxbridge a settlement fee of \$600 and derecognized the benefits accrued in connection with retrospective provisions. The settlement fee and the derecognition of the \$622 accrued benefits were recorded in premiums ceded.

During the first quarter of 2018, the Company purchased six-month certificates of deposit totaling approximately \$15,094 from First Home Bank, a local bank in the Tampa Bay area where two of the Company's directors are members of the bank's board of directors. These certificates of deposit had a fixed interest rate of 1.95% with interest payable at maturity. The interest rate and terms of the certificates were comparable to those offered to other clients of the bank. In May 2018, the Company moved the entire funds from a certificate of deposit account to a money market account.

Note 18 Subsequent Events

On October 10, 2018, Hurricane Michael made landfall and caused significant property damage in the Florida Panhandle. On October 22, 2018, the Company announced its initial estimated range for gross losses was between \$6,000 and \$18,000. As of October 31, 2018, the Company had received approximately 525 claims and had case incurred losses of approximately \$6,500. The Company estimates the ultimate loss for this event will fall below the top of its initial estimated range. Any losses caused by wind above a retention level of \$16,000 are recoverable from the Company's third-party reinsurers. Estimating losses is an inherently uncertain process and actual losses may differ materially from estimated losses.

On October 18, 2018, the Company's Board of Directors declared a quarterly dividend of \$0.375 per common share. The dividends are payable on December 21, 2018 to stockholders of record on November 16, 2018.

On November 5, 2018, Greenleaf Capital, LLC, the Company's wholly-owned subsidiary, listed its 10-acre waterfront property in Treasure Island, Florida for sale for an asking price of \$40,000. This property is owned by the real estate division and is reported under real estate investments in the Company's consolidated balance sheet. At September 30, 2018, the property had a carrying value of approximately \$9,700.

On November 7, 2018, the Company elected the physical settlement method for any conversions of its 3.875% Convertible Senior Notes occurring on or after January 1, 2019. The Company will settle such conversions, if any, by delivering shares of its common stock.

Table of Contents

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

You should read the following discussion under this Item 2 in conjunction with our consolidated financial statements and related notes and information included elsewhere in this quarterly report on Form 10-Q and in our Form 10-K filed with the Securities and Exchange Commission (SEC) on March 7, 2018. Unless the context requires otherwise, as used in this Form 10-Q, the terms HCI, we, us, our, the Company, our company, and similar references refer to HCI Group, Inc., a Florida corporation incorporated in 2006, and its subsidiaries. All dollar amounts in this Management's Discussion and Analysis of Financial Condition and Results of Operations are in whole dollars unless specified otherwise.

Forward-Looking Statements

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

OVERVIEW General

HCI Group, Inc. is a Florida-based company that, through its subsidiaries, is engaged in a variety of business activities, including property and casualty insurance, reinsurance, real estate and information technology. Based on our organizational structure, revenue sources, and evaluation of financial and operating performances by management, we manage the following operating divisions:

a) Insurance Operations

Property and casualty insurance

Reinsurance

b) Real Estate Operations

c) Other Operations

Information technology

Other auxiliary operations

42

Table of Contents

For the three months ended September 30, 2018 and 2017, revenues from insurance operations before intracompany elimination represented 95.3% and 96.1%, respectively, of total revenues of all operating segments. For the nine months ended September 30, 2018 and 2017, revenues from insurance operations before intracompany elimination represented 95.3% and 96.4%, respectively, of total revenues of all operating segments. At September 30, 2018 and December 31, 2017, insurance operations' total assets represented 85.5% and 87.1%, respectively, of the combined assets of all operating segments. See Note 11 Segment Information to our unaudited consolidated financial statements under Item 1 of this Quarterly Report on Form 10-Q for additional information.

Insurance Operations***Property and Casualty Insurance***

Our insurance business is operated through two insurance subsidiaries: Homeowners Choice Property & Casualty Insurance Company, Inc. (HCPCI), our principal operating subsidiary, and TypTap Insurance Company (TypTap). We provide various forms of residential insurance products such as homeowners insurance, fire insurance, flood insurance and wind-only insurance. We are authorized to write residential property and casualty insurance in the states of Arkansas, California, Florida, Maryland, North Carolina, New Jersey, Ohio, Pennsylvania, South Carolina and Texas. Florida is currently our only major market. Our growth since inception has resulted primarily from a series of policy assumptions from Citizens Property Insurance Corporation, a Florida state-supported insurer. This growth track has been beneficial to us although there are fewer policies available for assumption today as a result of increased competition in the Florida market. We expect the flood insurance products offered by TypTap and HCPCI to become significant contributors to future financial results.

Reinsurance

We have a Bermuda domiciled wholly-owned reinsurance subsidiary, Claddaugh Casualty Insurance Company Ltd. We selectively retain risk in Claddaugh, displacing the need for HCPCI or TypTap to pay premiums to third party reinsurers. Claddaugh fully collateralizes its exposure to our insurance subsidiaries by depositing funds into a trust account. Claddaugh may mitigate a portion of its risk through retrocessional reinsurance contracts. Currently, Claddaugh does not provide reinsurance to non-affiliates or others.

Real Estate Operations

Our real estate operations consist of properties we own and use for our own operations and multiple properties we own and operate for investment purposes. Properties used in operations consist of our Tampa headquarters building and a secondary insurance operations site in Ocala, Florida. We also have investment properties consisting of a combined 24 acres of waterfront properties that include one full-service restaurant and two marinas, two retail shopping centers, and one office building. In January 2018, we acquired full ownership of one limited liability company which owns commercial real estate in Riverview, Florida. See *Consolidated Variable Interest Entity* in Note 4 Investments to our unaudited consolidated financial statements under Item 1 of this Quarterly Report on Form 10-Q for additional information. In addition, we acquired commercial real estate in Clearwater, Florida for lease to retail businesses in June 2018. See *Real Estate Investments* in Note 4 Investments to our unaudited consolidated financial statements under Item 1 of this Quarterly Report on Form 10-Q for additional information.

Table of Contents

Other Operations

Information Technology

Our information technology operations include a team of experienced software developers with extensive knowledge in developing web-based products and applications for mobile devices. The operations, which are in Tampa, Florida and Noida, India, are focused on developing cloud-based, innovative products or services that support in-house operations as well as our third-party relationships with our agency partners and claim vendors. These products include *Proplet™*, *TypTap™*, *SAMS™*, *CasaClue™*, *Exzeo®*, and *Atlas Viewer™*.

Recent Events

On October 10, 2018, Hurricane Michael made landfall and caused significant property damage in the Florida Panhandle. On October 22, 2018, we announced our initial estimated range for gross losses was between \$6,000,000 and \$18,000,000. As of October 31, 2018, we had received approximately 525 claims and had case incurred losses of approximately \$6,500,000. We estimate the ultimate loss for this event will fall below the top of our initial estimated range. Any losses caused by wind above a retention level of \$16,000,000 are recoverable from our third-party reinsurers. Estimating losses is an inherently uncertain process and actual losses may differ materially from estimated losses. See Critical Accounting Policies and Estimates.

On October 18, 2018, our Board of Directors declared a quarterly dividend of \$0.375 per common share. The dividends are payable on December 21, 2018 to stockholders of record on November 16, 2018.

On November 5, 2018, Greenleaf Capital, LLC, the Company's wholly-owned subsidiary, listed its 10-acre waterfront property in Treasure Island, Florida for sale for an asking price of \$40,000,000. This property is owned by the real estate division and is reported under real estate investments in our consolidated balance sheet. At September 30, 2018, the property had a carrying value of approximately \$9,700,000.

On November 7, 2018, we elected the physical settlement method for any conversions of our 3.875% Convertible Senior Notes occurring on or after January 1, 2019. We will settle such conversions, if any, by delivering shares of our common stock.

Table of Contents**RESULTS OF OPERATIONS**

The following table summarizes our results of operations for the three and nine months ended September 30, 2018 and 2017 (dollar amounts in thousands, except per share amounts):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|--------------------|--|--------------------|
| | 2018 | 2017 | 2018 | 2017 |
| Operating Revenue | | | | |
| Gross premiums earned | \$ 86,163 | \$ 88,669 | \$ 257,854 | \$ 270,376 |
| Premiums ceded | (31,986) | (44,705) | (97,190) | (101,529) |
| Net premiums earned | 54,177 | 43,964 | 160,664 | 168,847 |
| Net investment income | 5,054 | 2,878 | 11,671 | 8,522 |
| Net realized investment gains (losses) | 1,626 | (226) | 6,520 | 2,276 |
| Net unrealized investment (losses) gains | (390) | 74 | (4,547) | 74 |
| Net other-than-temporary impairment losses | | (474) | (80) | (864) |
| Policy fee income | 843 | 905 | 2,563 | 2,721 |
| Other income | 433 | 369 | 1,504 | 1,207 |
| Total operating revenue | 61,743 | 47,490 | 178,295 | 182,783 |
| Operating Expenses | | | | |
| Losses and loss adjustment expenses | 25,769 | 89,231 | 67,227 | 142,425 |
| Policy acquisition and other underwriting expenses | 9,829 | 9,926 | 29,148 | 29,645 |
| Impairment loss | | 38 | | 38 |
| General and administrative personnel expenses* | 6,781 | 6,672 | 20,904 | 21,021 |
| Interest expense | 4,552 | 4,408 | 13,527 | 12,328 |
| Loss on repurchases of senior notes | | | | 743 |
| Other operating expenses | 2,889 | 3,233 | 9,242 | 9,154 |
| Total operating expenses | 49,820 | 113,508 | 140,048 | 215,354 |
| Income (loss) before income taxes | 11,923 | (66,018) | 38,247 | (32,571) |
| Income tax expense (benefit) | 2,926 | (25,472) | 12,056 | (13,587) |
| Net income (loss) | \$ 8,997 | \$ (40,546) | \$ 26,191 | \$ (18,984) |
| Ratios to Net Premiums Earned: | | | | |
| Loss Ratio | 47.56% | 202.96% | 41.84% | 84.35% |
| Expense Ratio | 44.39% | 55.22% | 45.33% | 43.19% |
| Combined Ratio | 91.95% | 258.18% | 87.17% | 127.54% |

Ratios to Gross Premiums Earned:

| | | | | |
|----------------|--------|---------|--------|--------|
| Loss Ratio | 29.91% | 100.63% | 26.07% | 52.68% |
| Expense Ratio | 27.91% | 27.38% | 28.24% | 26.97% |
| Combined Ratio | 57.82% | 128.01% | 54.31% | 79.65% |

Earnings Per Share Data:

| | | | | |
|---------|---------|-----------|---------|-----------|
| Basic | \$ 1.08 | \$ (4.44) | \$ 3.29 | \$ (2.05) |
| Diluted | \$ 1.00 | \$ (4.44) | \$ 3.03 | \$ (2.05) |

* For the three and nine months ended September 30, 2017, we reclassified certain payroll-related costs such as share-based compensation expense, payroll taxes and employee benefits previously reported in other operating expenses to general and administrative personnel expenses to conform with our 2018 presentation.

Table of Contents***Comparison of the Three Months ended September 30, 2018 to the Three Months ended September 30, 2017***

Our results of operations for the three months ended September 30, 2018 reflect income available to common stockholders of approximately \$8,997,000, or \$1.00 earnings per diluted share, compared with a net loss of approximately \$40,546,000, or \$4.44 loss per share, for the three months ended September 30, 2017. The quarter-over-quarter increase was primarily due to a \$63,462,000 decrease in losses and loss adjustment expenses, a \$12,719,000 decrease in premiums ceded, and a net increase of \$4,038,000 in income from investment activities, offset by a \$2,506,000 decrease in gross premiums earned. Specifically, our 2017 results included \$54,000,000 of losses incurred as a result of Hurricane Irma and \$12,465,000 of unfavorable adjustments to ceded premiums related to retrospective provisions. These factors contributed to a net favorable change in pre-tax income of \$77,941,000. In addition, our income tax expense in 2018 was positively impacted by a lower federal corporate income tax rate effective January 1, 2018.

Revenue

Gross Premiums Earned for the three months ended September 30, 2018 and 2017 were approximately \$86,163,000 and \$88,669,000, respectively. The decrease in 2018 compared with the third quarter of the prior year was primarily attributable to a net decrease in policies in force.

Premiums Ceded for the three months ended September 30, 2018 and 2017 were approximately \$31,986,000 and \$44,705,000, respectively, representing 37.1% and 50.4%, respectively, of gross premiums earned. The \$12,719,000 decrease was primarily attributable to an unfavorable adjustment of \$12,465,000 to premiums ceded in the third quarter of 2017. This adjustment was made in connection with retrospective provisions under certain reinsurance contracts due to losses incurred by Hurricane Irma.

Our premiums ceded represent costs of reinsurance to cover losses from catastrophes that exceed the retention levels defined by our catastrophe excess of loss reinsurance contracts or to assume a proportional share of losses as defined in a quota share agreement. The rates we pay for reinsurance are based primarily on policy exposures reflected in gross premiums earned. For the three months ended September 30, 2018, premiums ceded included a net reduction of approximately \$600,000 related to retrospective provisions. For the three months ended September 30, 2017, premiums ceded reflected a net increase of approximately \$12,465,000. See *Economic Impact of Reinsurance Contracts with Retrospective Provisions* under *Critical Accounting Policies and Estimates*.

Net Premiums Written for the three months ended September 30, 2018 and 2017 totaled approximately \$58,374,000 and \$50,168,000, respectively. Net premiums written represent the premiums charged on policies issued during a fiscal period less any applicable reinsurance costs. The \$8,206,000 increase in 2018 resulted from the decrease in premiums ceded as described above combined with a decrease in gross premiums written during the period due to policy attrition. We had approximately 128,000 policies in force at September 30, 2018 as compared with approximately 141,000 policies in force at September 30, 2017.

Net Premiums Earned for the three months ended September 30, 2018 and 2017 were approximately \$54,177,000 and \$43,964,000, respectively, and reflect the gross premiums earned less reinsurance costs as described above.

Table of Contents

The following is a reconciliation of our total Net Premiums Written to Net Premiums Earned for the three months ended September 30, 2018 and 2017 (amounts in thousands):

| | Three Months Ended September 30, | |
|-------------------------------|---|------------------|
| | 2018 | 2017 |
| Net Premiums Written | \$ 58,374 | \$ 50,168 |
| Increase in Unearned Premiums | (4,197) | (6,204) |
| Net Premiums Earned | \$ 54,177 | \$ 43,964 |

Net Investment Income for the three months ended September 30, 2018 and 2017 was approximately \$5,054,000 and \$2,878,000, respectively. The quarter-over quarter increase was primarily attributable to an increase of approximately \$1,572,000 in income from limited partnership investments.

Net Realized Investment Gains for the three months ended September 30, 2018 were approximately \$1,626,000 as opposed to approximately \$226,000 of net realized investment losses for the three months ended September 30, 2017. The gains in 2018 resulted primarily from sales to rebalance our investment portfolio.

Net Unrealized Investment Losses for the three months ended September 30, 2018 were approximately \$390,000 versus approximately \$74,000 of net unrealized investment gains for the three months ended September 30, 2017. Net unrealized investment gains or losses represent the net change in the fair value of equity securities. The increase in 2018 primarily resulted from the adoption of the new accounting standard with regard to equity securities as described in Note 1 Summary of Significant Accounting Policies to our unaudited consolidated financial statements under Item 1 of this Quarterly Report on Form 10-Q.

Expenses

Our *Losses and Loss Adjustment Expenses* amounted to approximately \$25,769,000 and \$89,231,000 for the three months ended September 30, 2018 and 2017, respectively. In 2017, our losses and loss adjustment expenses were impacted by \$54,000,000 of losses incurred as a result of Hurricane Irma, adverse development on prior year losses of approximately \$2,500,000 related to Hurricane Matthew, and unfavorable adjustments to loss reserves in response to trends involving assignment of insurance benefits and related litigation. See Reserves for Losses and Loss Adjustment Expenses under Critical Accounting Policies and Estimates.

Net Other-Than-Temporary Impairment Losses for the three months ended September 30, 2017 were approximately \$474,000, specific to four equity securities which had been in an unrealized loss position for a length of time with no near-term prospect of recovery.

Income Tax Expense for the three months ended September 30, 2018 was approximately \$2,926,000 for state, federal, and foreign income taxes. In contrast, an income tax benefit of approximately \$25,472,000 was recorded for the three months ended September 30, 2017 on a pre-tax operating loss of \$66,018,000 primarily due to losses sustained from Hurricane Irma. The effective tax rate was 24.5% for 2018 and 38.6% for 2017. The decrease in rate was primarily attributable to a lower federal corporate income tax rate effective January 1, 2018.

Table of Contents**Ratios:**

The loss ratio applicable to the three months ended September 30, 2018 (losses and loss adjustment expenses incurred related to net premiums earned) was 47.6% compared with 203.0% for the three months ended September 30, 2017. The decrease in 2018 was primarily attributable to the losses incurred by Hurricane Irma during the third quarter of 2017.

The expense ratio applicable to the three months ended September 30, 2018 (defined as underwriting expenses, general and administrative personnel expenses, interest and other operating expenses related to net premiums earned) was 44.4% compared with 55.2% for the three months ended September 30, 2017. The decrease in our expense ratio was primarily attributable to lower net premiums earned in 2017.

The combined ratio (total of all expenses in relation to net premiums earned) is the measure of overall underwriting profitability before other income. Our combined ratio for the three months ended September 30, 2018 was 92.0% compared with 258.2% for the three months ended September 30, 2017.

Due to the impact our reinsurance costs have on net premiums earned from period to period, our management believes the combined ratio measured to gross premiums earned is more relevant in assessing overall performance. The combined ratio to gross premiums earned for the three months ended September 30, 2018 was 57.8% compared with 128.0% for the three months ended September 30, 2017. The decrease was primarily attributable to the combined impact of decreased losses from catastrophe claims and decreased premiums ceded as described earlier.

Comparison of the Nine Months ended September 30, 2018 to the Nine Months ended September 30, 2017

Our results of operations for the nine months ended September 30, 2018 reflect income available to common stockholders of approximately \$26,191,000, or \$3.03 earnings per diluted share, compared with a net loss of approximately \$18,984,000, or \$2.05 loss per share, for the nine months ended September 30, 2017. The period-over-period increase was primarily due to a \$75,198,000 decrease in losses and loss adjustment expenses and a net \$3,556,000 increase in income from investment activities, offset by a net \$8,183,000 decrease in net premiums earned and a \$1,199,000 increase in interest expense, which contributed to an increase in pre-tax income of \$70,818,000. In addition, our income tax expense in 2018 was negatively impacted by the derecognition of deferred tax assets of \$1,620,000 related to unvested restricted stock with market conditions and the nondeductible expense of \$1,727,000 associated with the reclassified dividends on such restricted stock awards, offset by a lower federal corporate income tax rate effective January 1, 2018.

Revenue

Gross Premiums Earned for the nine months ended September 30, 2018 and 2017 were approximately \$257,854,000 and \$270,376,000, respectively. The decrease in 2018 compared with the corresponding period in 2017 was primarily attributable to a net decrease in policies in force.

Premiums Ceded for the nine months ended September 30, 2018 and 2017 were approximately \$97,190,000 and \$101,529,000, respectively, representing 37.7% and 37.6%, respectively, of gross premiums earned. The \$4,339,000 decrease was primarily attributable to the unfavorable adjustment during the third quarter of 2017 as described earlier, offset by the recognition of additional premiums ceded of approximately \$1,222,000 resulting from the termination of one reinsurance contract during the second quarter of 2018. See Note 17 *Related Party Transactions* to our unaudited consolidated financial statements under Item 1 of this Quarterly Report on Form 10-Q for additional information.

Table of Contents

For the nine months ended September 30, 2018 and 2017, premiums ceded included net increases of approximately \$115,000 and \$5,509,000, respectively, related to retrospective provisions. See *Economic Impact of Reinsurance Contracts with Retrospective Provisions* under *Critical Accounting Policies and Estimates*.

Net Premiums Written for the nine months ended September 30, 2018 and 2017 totaled approximately \$195,689,000 and \$199,218,000, respectively. The decrease in 2018 resulted primarily from a decrease in gross premiums written during the period due to policy attrition, offset by the decrease in premiums ceded as described above.

Net Premiums Earned for the nine months ended September 30, 2018 and 2017 were approximately \$160,664,000 and \$168,847,000, respectively, and reflect the gross premiums earned less reinsurance costs as described above.

The following is a reconciliation of our total Net Premiums Written to Net Premiums Earned for the nine months ended September 30, 2018 and 2017 (amounts in thousands):

| | Nine Months Ended | |
|-------------------------------|--------------------------|-------------------|
| | September 30, | |
| | 2018 | 2017 |
| Net Premiums Written | \$ 195,689 | \$ 199,218 |
| Increase in Unearned Premiums | (35,025) | (30,371) |
| Net Premiums Earned | \$ 160,664 | \$ 168,847 |

Net Investment Income for the nine months ended September 30, 2018 and 2017 was approximately \$11,671,000 and \$8,522,000, respectively. The period-over period increase was primarily attributable to an increase of approximately \$1,095,000 in income from real estate investments combined with an increase in income from limited partnership investments of approximately \$1,092,000.

Net Realized Investment Gains for the nine months ended September 30, 2018 and 2017 were approximately \$6,520,000 and \$2,276,000, respectively. The gains in 2018 resulted primarily from sales intended to rebalance our investment portfolio to mitigate the impact from the rising interest rate trend and to decrease our holdings in municipal bonds as they become less attractive in a low tax rate environment.

Net Unrealized Investment Losses for the nine months ended September 30, 2018 were approximately \$4,547,000 versus approximately \$74,000 of net unrealized investment gains for the nine months ended September 30, 2017. The increase in 2018 was primarily attributable to the adoption of the new accounting standard as described earlier.

Expenses

Our *Losses and Loss Adjustment Expenses* amounted to approximately \$67,227,000 and \$142,425,000 for the nine months ended September 30, 2018 and 2017, respectively. During the nine-month period of 2018, we had fewer non-catastrophe claims as compared with the corresponding period in 2017. Loss reserves established during the nine-month period of 2018 primarily pertained to claims in the 2018 loss year, whereas our 2017 losses and loss adjustment expenses were significantly impacted by the losses incurred by Hurricane Irma and Hurricane Matthew and unfavorable adjustments to loss reserves in response to trends involving assignment of insurance benefits and related litigation. See *Reserves for Losses and Loss Adjustment Expenses* under *Critical Accounting Policies and Estimates*.

Table of Contents

General and Administrative Personnel Expenses for the nine months ended September 30, 2018 and 2017 were approximately \$20,904,000 and \$21,021,000, respectively. Our general and administrative personnel expenses include salaries, wages, payroll taxes, share-based compensation expenses, and employee benefit costs. Factors such as merit increases, changes in headcount, and periodic restricted stock grants, among others, cause fluctuations in this expense. In addition, our personnel expenses are decreased by the capitalization of payroll costs related to a project to develop software for internal use and the payroll costs associated with the processing and settlement of Hurricane Irma claims which are recoverable from reinsurers under reinsurance contracts. The period-over-period decrease of \$117,000 was primarily attributable to recoverable Hurricane Irma payroll costs and lower share-based compensation expense during 2018, offset by the recognition of approximately \$1,426,000 of cumulative dividends paid on unvested restricted stock awards of which market conditions will not be met.

Interest Expense for the nine months ended September 30, 2018 and 2017 was approximately \$13,527,000 and \$12,328,000, respectively. The increase primarily resulted from the 4.25% convertible debt offering completed in March 2017.

Loss on repurchases of Senior Notes for the nine months ended September 30, 2017 was approximately \$743,000, resulting from the early extinguishment of our 8% senior notes.

Income Tax Expense for the nine months ended September 30, 2018 was approximately \$12,056,000 for state, federal, and foreign income taxes compared with income tax benefit of approximately \$13,587,000 for the nine months ended September 30, 2017, resulting in an effective tax rate of 31.5% for 2018 and 41.7% for 2017. The decrease was primarily attributable to the positive impact from a lower federal corporate income tax rate effective January 1, 2018, offset by the negative effect of the derecognition of deferred tax assets of approximately \$1,620,000 and the nondeductible expense of approximately \$1,727,000, both of which related to restricted stock awards with market conditions that will not be met. (see *Restricted Stock Awards* in Note 15 *Stock-Based Compensation* to our unaudited consolidated financial statements under Item 1 of this Quarterly Report on Form 10-Q).

Ratios:

The loss ratio applicable to the nine months ended September 30, 2018 was 41.8% compared with 84.3% for the nine months ended September 30, 2017. The decrease was primarily due to a decrease in losses and loss adjustment expenses as described previously.

The expense ratio applicable to the nine months ended September 30, 2018 was 45.4% compared with 43.2% for the nine months ended September 30, 2017. The increase in our expense ratio was primarily attributable to the decrease in net premiums earned.

The combined ratio is the measure of overall underwriting profitability before other income. Our combined ratio for the nine months ended September 30, 2018 was 87.2% compared with 127.5% for the nine months ended September 30, 2017. The decrease was primarily to the decrease in losses and loss adjustment expenses as described earlier.

Table of Contents

Due to the impact our reinsurance costs have on net premiums earned from period to period, our management believes the combined ratio measured to gross premiums earned is more relevant in assessing overall performance. The combined ratio to gross premiums earned for the nine months ended September 30, 2018 was 54.3% compared with 79.7% for the nine months ended September 30, 2017. The decrease in 2018 was primarily attributable to the decrease in losses and loss adjustment expenses.

Seasonality of Our Business

Our insurance business is seasonal as hurricanes and tropical storms affecting Florida typically occur during the period from June 1 through November 30 each year. Also, with our reinsurance treaty year typically effective June 1 each year, any variation in the cost of our reinsurance, whether due to changes in reinsurance rates or changes in the total insured value of our policy base, will occur and be reflected in our financial results beginning June 1 each year.

LIQUIDITY AND CAPITAL RESOURCES

Throughout our history, our liquidity requirements have been met through issuances of our common and preferred stock, debt offerings and funds from operations. We expect our future liquidity requirements will be met by funds from operations, primarily the cash received by insurance subsidiaries from premiums written and investment income. We may consider raising additional capital through debt and equity offerings to support our growth and future investment opportunities.

Our insurance subsidiary requires liquidity and adequate capital to meet ongoing obligations to policyholders and claimants and to fund operating expenses. In addition, we attempt to maintain adequate levels of liquidity and surplus to manage any differences between the duration of our liabilities and invested assets. In the insurance industry, cash collected for premiums from policies written is invested, interest and dividends are earned thereon, and losses and loss adjustment expenses are paid out over a period of years. This period of time varies by the circumstances surrounding each claim. Substantially all of our losses and loss adjustment expenses are fully settled and paid within 100 days of the claim receipt date. Additional cash outflow occurs through payments of underwriting costs such as commissions, taxes, payroll, and general overhead expenses.

We believe that we maintain sufficient liquidity to pay claims and expenses, as well as to satisfy commitments in the event of unforeseen events such as reinsurer insolvencies, inadequate premium rates, or reserve deficiencies. We maintain a comprehensive reinsurance program at levels management considers adequate to diversify risk and safeguard our financial position.

In the future, we anticipate our primary use of funds will be to pay claims, reinsurance premiums, interest, and dividends and to fund operating expenses and real estate acquisitions. Furthermore, we expect to repay the holders of our 3.875% Convertible Senior Notes an aggregate amount of \$89,990,000 on the maturity date, March 15, 2019, unless the notes are converted into stock in accordance with their terms.

Table of Contents***Senior Notes, Promissory Notes, and Capital Lease Obligation***

The following table summarizes the principal and interest payment obligations of our long-term debt at September 30, 2018:

| | Maturity Date | Payment Due Date |
|---------------------------------|------------------------|--|
| 3.875% Convertible Senior Notes | March 2019 | March 15 and September 15 |
| 4.25% Convertible Senior Notes | March 2037 | March 1 and September 1 |
| 4% Promissory Note | Through February 2031 | 1 st day of each month |
| 3.75% Callable Promissory Note | Through September 2036 | 1 st day of each month |
| 3.95% Promissory Note | Through February 2020 | 17 th of each month |
| 4.55% Promissory Note | Through August 2036 | 1 st day of each month |
| Capital Lease | Through August 2023 | February 15, May 15, August 15, November 15 |

See Note 8 Long-Term Debt to our unaudited consolidated financial statements under Item 1 of this Quarterly Report on Form 10-Q.

Limited Partnership Investments

Our limited partnership investments consist of five private equity funds managed by their general partners. Four of these funds have unexpired capital commitments which are callable at the discretion of the fund's general partner for funding new investments or expenses of the fund. At September 30, 2018, there was an aggregate unfunded capital balance of \$18,663,000. See *Limited Partnership Investments* under Note 4 Investments to our unaudited consolidated financial statements under Item 1 of this Quarterly Report on Form 10-Q for additional information.

Share Repurchase Plan

In December 2017, our Board of Directors approved a one-year plan to repurchase up to \$20,000,000 of common shares under which we may purchase shares of common stock in open market purchases, block transactions and privately negotiated transactions in accordance with applicable federal securities laws. At September 30, 2018, there was approximately \$148,000 available under the plan. See Note 14 Stockholders Equity to our unaudited consolidated financial statements under Item 1 of this Quarterly Report on Form 10-Q.

Sources and Uses of Cash***Cash Flows for the Nine Months Ended September 30, 2018***

Net cash provided by operating activities for the nine months ended September 30, 2018 was approximately \$29,450,000, which consisted primarily of cash received from net premiums written and reinsurance recoveries less cash disbursed for operating expenses, losses and loss adjustment expenses and interest payments. Net cash used in investing activities of \$12,433,000 was primarily due to the purchases of fixed-maturity and equity securities of \$99,942,000, the purchases of short-term investments of \$155,252,000, the purchases of real estate investments of \$6,685,000, and the limited partnership investments of \$4,823,000, offset by the proceeds from sales of fixed-maturity and equity securities of \$134,418,000, the proceeds from redemptions and maturities of fixed-maturity securities of \$52,843,000, and the proceeds from sales and maturities of short-term investments of \$67,867,000. Net cash used in financing activities totaled \$23,731,000, which was primarily due to \$20,808,000 used in our share repurchases and

\$7,475,000 of net cash dividend payments, offset by the proceeds from issuance of 4.55% promissory note of \$6,000,000.

Table of Contents*Cash Flows for the Nine Months Ended September 30, 2017*

Net cash provided by operating activities for the nine months ended September 30, 2017 was approximately \$51,502,000, which consisted primarily of cash received from net premiums written less cash disbursed for operating expenses, losses and loss adjustment expenses, reinsurance recovered in advance, and interest payments. Net cash used in investing activities of \$90,959,000 was primarily due to the purchases of fixed-maturity and equity securities of \$141,277,000, the limited partnership investments of \$2,623,000, and the real estate investments of \$2,095,000, offset by the distributions of \$11,758,000 from limited partnership investments, the proceeds from sales of fixed-maturity and equity securities of \$35,947,000, and the redemptions and repayments of fixed-maturity securities of \$8,786,000. Net cash provided by financing activities totaled \$51,442,000, which was primarily due to the proceeds from issuance of 4.25% Convertible Senior Notes of \$143,750,000, offset by \$40,250,000 used in the repurchases of our 8% senior notes, \$4,975,000 of related underwriting and issuance costs, \$30,636,000 used in our share repurchases and \$9,724,000 of net cash dividend payments.

Investments

The main objective of our investment policy is to maximize our after-tax investment income with a reasonable level of risk given the current financial market. Our excess cash is invested primarily in money market accounts, certificates of deposit, and fixed-maturity and equity securities.

At September 30, 2018, we had \$191,030,000 of fixed-maturity and equity investments, which are carried at fair value. Changes in the general interest rate environment affect the returns available on new fixed-maturity investments. While a rising interest rate environment enhances the returns available on new investments, it reduces the market value of existing fixed-maturity investments and thus the availability of gains on disposition. A decline in interest rates reduces the returns available on new fixed-maturity investments but increases the market value of existing fixed-maturity investments, creating the opportunity for realized investment gains on disposition.

In addition, we had short-term investments of \$87,778,000 at September 30, 2018. These investments consisted of certificates of deposit and zero-coupon commercial paper. Our shift toward more short-term investments during 2018 was primarily to reduce the impact of a rising interest rate environment.

In the future, we may alter our investment policy as to investments in federal, state and municipal obligations, preferred and common equity securities and real estate mortgages, as permitted by applicable law, including insurance regulations.

OFF-BALANCE SHEET ARRANGEMENTS

As of September 30, 2018, we had unexpired capital commitments for four limited partnerships in which we hold interests. Such commitments are not recognized in the financial statements but are required to be disclosed in the notes to the financial statements. See Note 16 *Commitments and Contingencies* to our unaudited consolidated financial statements under Item 1 of this Quarterly Report on Form 10-Q and *Contractual Obligations and Commitment* below for additional information.

Table of Contents**CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

The following table summarizes our material contractual obligations and commitments as of September 30, 2018 (amounts in thousands):

| | Total | Payment Due by Period | | | More than 5 Years |
|----------------------------------|------------|-----------------------|-----------|-----------|----------------------|
| | | Less than 1 Year | 1-3 Years | 3-5 Years | |
| Operating lease (1) | \$ 818 | 279 | 505 | 34 | |
| Service agreement (1) | 75 | 22 | 47 | 6 | |
| Reinsurance contracts (2) | 6,071 | 3,469 | 2,602 | | |
| Unfunded capital commitments (3) | 18,663 | 18,663 | | | |
| Long-term debt obligations (4) | 302,355 | 102,654 | 25,229 | 153,777 | 20,695 |
| Total | \$ 327,982 | 125,087 | 28,383 | 153,817 | 20,695 |

- (1) Represents the lease for office space in Miami Lakes, Florida and the lease and maintenance service agreement for office space in Noida, India. Liabilities related to our India operations were converted from Indian rupees to U.S. dollars using the October 1, 2018 exchange rate.
- (2) Represents the minimum payment of reinsurance premiums under one multi-year reinsurance contract. Reinsurance premiums payable after December 31, 2018 are estimated and subject to subsequent revision as the premiums are determined on a quarterly basis based on the premiums associated with the applicable flood total insured value on the last day of the preceding quarter.
- (3) Represents the unfunded balance of capital commitments under the subscription agreements related to four limited partnerships in which we hold interests.
- (4) Amounts represent principal and interest payments over the lives of various long-term debt obligations. See Note 8 Long-Term Debt to our unaudited consolidated financial statements under Item 1 of this Quarterly Report on Form 10-Q.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

We have prepared our consolidated financial statements and related disclosures in accordance with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements and related disclosures requires us to make judgments, assumptions and estimates to develop amounts reflected and disclosed in our consolidated financial statements. Management bases its estimates on historical experience and on various other assumptions it believes to be reasonable under the circumstances. Actual results may differ from these estimates and such differences may be material.

We believe our critical accounting policies and estimates are those related to losses and loss adjustment expenses, reinsurance recoverable, reinsurance with retrospective provisions, deferred income taxes, and stock-based compensation expense. These policies are critical to the portrayal of our financial condition and operating results. They require management to make judgments and estimates about inherently uncertain matters. Material estimates that are particularly susceptible to significant change in the near term are related to our losses and loss adjustment expenses, which include amounts estimated for claims incurred but not yet reported and reinsurance contracts with retrospective provisions.

Reserves for Losses and Loss Adjustment Expenses

Our liability for losses and loss adjustment expense (Reserves) is specific to property insurance, which is our insurance division's only line of business. The Reserves include both case reserves on reported claims and our reserves for incurred but not reported (IBNR) losses. At each period end date, the balance of our Reserves is based on our best estimate of the ultimate cost of each claim for those known cases and the IBNR loss reserves are estimated based primarily on our historical experience. Changes in the estimated liability are charged or credited to operations as the losses and loss adjustment expenses are adjusted.

Table of Contents

The IBNR represents our estimate of the ultimate cost of all claims that have occurred but have not been reported to us, and in some cases may not yet be known to the insured, and future development of reported claims. Estimating the IBNR component of our Reserves involves considerable judgment on the part of management. At September 30, 2018, \$101,213,000 of the total \$138,414,000 we have reserved for losses and loss adjustment expenses is attributable to our estimate of IBNR. The remaining \$37,201,000 relates to known cases which have been reported but not yet fully settled in which case we have established a reserve based on currently available information and our best estimate of the cost to settle each claim. At September 30, 2018, \$31,140,000 of the \$37,201,000 in reserves for known cases relates to claims incurred during prior years.

Our Reserves decreased from \$198,578,000 at December 31, 2017 to \$138,414,000 at September 30, 2018. The \$60,164,000 decrease is comprised of net reductions in our Reserves of \$79,647,000 for 2017 and \$13,620,000 for 2016 and prior loss years offset by \$33,103,000 in reserves established for claims occurring in the 2018 loss year. The \$33,103,000 in Reserves established for 2018 claims is primarily driven by an allowance for those claims that have been incurred but not reported to the company as of September 30, 2018. The decrease of \$93,267,000 specific to our 2017 and prior loss-year reserves is due to settlement of claims related to those loss years.

Based on all information known to us, we consider our Reserves at September 30, 2018 to be adequate to cover our claims for losses that have occurred as of that date including losses yet to be reported to us. However, these estimates are continually reviewed by management as they are subject to significant variability and may be impacted by trends in claim severity and frequency or unusual exposures that have not yet been identified. As part of the process, we review historical data and consider various factors, including known and anticipated regulatory and legal developments, changes in social attitudes, inflation and economic conditions. As experience develops and other data becomes available, these estimates are revised, as required, resulting in increases or decreases to the existing unpaid losses and loss adjustment expenses. Adjustments are reflected in the results of operations in the period in which they are made and the liabilities may deviate substantially from prior estimates.

Economic Impact of Reinsurance Contracts with Retrospective Provisions

Certain of our reinsurance contracts include retrospective provisions that adjust premiums, increase the amount of future coverage, or result in a profit commission in the event losses are minimal or zero. In accordance with accounting principles generally accepted in the United States of America, we will recognize an asset in the period in which the absence of loss experience gives rise to an increase in future coverage or obligates the reinsurer to pay cash or other consideration under the contract. In the event that a loss arises, we will derecognize such asset in the period in which a loss arises. Such adjustments to the asset, which accrue throughout the contract term, will negatively impact our operating results when a catastrophic loss event occurs during the contract term.

For the three months ended September 30, 2018, we recognized a net increase in accrued benefits of \$279,000 versus a net decrease in accrued benefits of \$9,300,000 for the three months ended September 30, 2017 due to the impact of Hurricane Irma. For the three months ended September 30, 2018, we decreased recognition of \$321,000 in ceded premiums due to an adjustment in coverage. In contrast, for the three months ended September 30, 2017, we recognized a net increase in ceded premiums of \$3,164,000, including the reversal of a majority of reinsurance costs deferred in prior periods. In combination, for the three months ended September 30, 2018, we recognized a net reduction in ceded premiums of \$600,000 as opposed to a net increase in ceded premiums of \$12,464,000 for the three months ended September 30, 2017.

Table of Contents

For the nine months ended September 30, 2018, we recognized a net increase in accrued benefits of \$465,000 versus a net decrease in accrued benefits of \$3,841,000 for the nine months ended September 30, 2017. We recognized a net increase in ceded premiums of \$580,000 for the nine months ended September 30, 2018. For the nine months ended September 30, 2017, we recognized a net increase in ceded premiums of \$1,667,000, including the reversal of a majority of previously deferred reinsurance costs. In combination, for the nine months ended September 30, 2018 and 2017, we recognized a net increase in ceded premiums of \$115,000 and \$5,508,000, respectively

As of September 30, 2018, we had \$2,858,000 of accrued benefits, the amount that would be charged to earnings in the event we experience a catastrophic loss that exceeds the coverage limits provided under such agreements and in the period that the increased coverage is applicable, respectively. At December 31, 2017, we had \$2,393,000 of accrued benefits related to these agreements.

We believe the credit risk associated with the collectability of these accrued benefits is minimal based on available information about the individual reinsurer's financial position.

The above and other accounting estimates and their related risks that we consider to be our critical accounting estimates are more fully described in our Annual Report on Form 10-K, which we filed with the SEC on March 7, 2018. For the nine months ended September 30, 2018, there have been no material changes with respect to any of our critical accounting policies.

RECENT ACCOUNTING PRONOUNCEMENTS

For information with respect to recent accounting pronouncements and the impact of these pronouncements on our consolidated financial statements, see Note 2 to our Notes to Unaudited Consolidated Financial Statements.

Table of Contents**ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our investment portfolios at September 30, 2018 included fixed-maturity and equity securities, the purposes of which are not for speculation. Our main objective is to maximize after-tax investment income and maintain sufficient liquidity to meet our obligations while minimizing market risk, which is the potential economic loss from adverse fluctuations in securities prices. We consider many factors including credit ratings, investment concentrations, regulatory requirements, anticipated fluctuation of interest rates, durations and market conditions in developing investment strategies. Our investment securities are managed primarily by outside investment advisors and are overseen by the investment committee appointed by our board of directors. From time to time, our investment committee may decide to invest in low risk assets such as U.S. government bonds.

Our investment portfolios are exposed to interest rate risk, credit risk and equity price risk. Fiscal and economic uncertainties caused by any government action or inaction may exacerbate these risks and potentially have adverse impacts on the value of our investment portfolios.

We classify our fixed-maturity securities as available-for-sale and report any unrealized gains or losses, net of deferred income taxes, as a component of other comprehensive income within our stockholders' equity. As such, any material temporary changes in their fair value can adversely impact the carrying value of our stockholders' equity. In addition, we recognize any unrealized gains and losses related to our equity securities in our statement of income. As a result, our results of operations can be materially affected by the volatility in the equity market.

Interest Rate Risk

Our fixed-maturity securities are sensitive to potential losses resulting from unfavorable changes in interest rates. We manage the risk by analyzing anticipated movement in interest rates and considering our future capital needs.

The following table illustrates the impact of hypothetical changes in interest rates to the fair value of our fixed-maturity securities at September 30, 2018 (amounts in thousands):

| Hypothetical Change in Interest Rates | Estimated Fair Value | Change in Estimated Fair Value | Percentage Increase (Decrease) in Estimated Fair Value |
|--|-----------------------------|---------------------------------------|---|
| 300 basis point increase | \$ 136,054 | \$ (9,665) | (6.63)% |
| 200 basis point increase | 139,274 | (6,445) | (4.42)% |
| 100 basis point increase | 142,495 | (3,224) | (2.21)% |
| 100 basis point decrease | 148,944 | 3,225 | 2.21% |
| 200 basis point decrease | 152,169 | 6,450 | 4.43% |
| 300 basis point decrease | 155,161 | 9,442 | 6.48% |

Credit Risk

Credit risk can expose us to potential losses arising principally from adverse changes in the financial condition of the issuers of our fixed-maturity securities. We mitigate the risk by investing in fixed-maturity securities that are generally investment grade, by diversifying our investment portfolio to avoid concentrations in any single issuer or business sector, and by continually monitoring each individual security for declines in credit quality. While we emphasize

credit quality in our investment selection process, significant downturns in the markets or general economy may impact the credit quality of our portfolio.

Table of Contents

The following table presents the composition of our fixed-maturity securities, by rating, at September 30, 2018 (amounts in thousands):

| Comparable Rating | Cost or Amortized Cost | % of Total Amortized Cost | Estimated Fair Value | % of Total Estimated Fair Value |
|--------------------------|-------------------------------|----------------------------------|-----------------------------|--|
| AAA | \$ 1,805 | 1.2 | \$ 1,776 | 1.2 |
| AA+, AA, AA- | 62,298 | 42.3 | 61,716 | 42.4 |
| A+, A, A- | 43,940 | 29.9 | 42,860 | 29.4 |
| BBB+, BBB, BBB- | 25,267 | 17.2 | 25,258 | 17.3 |
| BB+, BB, BB- | 5,424 | 3.7 | 5,522 | 3.8 |
| B+, B, B- | 901 | 0.6 | 897 | 0.6 |
| CCC+, CC and Not rated | 7,558 | 5.1 | 7,690 | 5.3 |
| Total | \$ 147,193 | 100.0 | \$ 145,719 | 100.0 |

Equity Price Risk

Our equity investment portfolio at September 30, 2018 included common stocks, perpetual preferred stocks, mutual funds and exchange traded funds. We may incur losses due to adverse changes in equity security prices. We manage the risk primarily through industry and issuer diversification and asset mix.

The following table illustrates the composition of our equity securities at September 30, 2018 (amounts in thousands):

| | Estimated Fair Value | % of Total Estimated Fair Value |
|--|-----------------------------|--|
| Stocks by sector: | | |
| Financial | \$ 20,473 | 45 |
| Consumer | 5,263 | 12 |
| Industrial | 4,631 | 10 |
| Technology | 2,925 | 6 |
| Energy | 2,106 | 5 |
| Other (1) | 4,178 | 9 |
| | 39,576 | 87 |
| Mutual funds and exchange traded funds by type: | | |
| Debt | 4,711 | 10 |
| Equity | 1,024 | 3 |

| | | |
|--------------|------------------|------------|
| | 5,735 | 13 |
| Total | \$ 45,311 | 100 |

(1) Represents an aggregate of less than 5% sectors.

Foreign Currency Exchange Risk

At September 30, 2018, we did not have any material exposure to foreign currency related risk.

Table of Contents

ITEM 4 CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our chief executive officer (our principal executive officer) and our chief financial officer (our principal financial and accounting officer), we have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report, and, based on this evaluation, our chief executive officer and our chief financial officer have concluded that these disclosure controls and procedures are effective.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal controls over financial reporting during the quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Effectiveness of Controls and Procedures

In designing and evaluating the disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, implementation of possible controls and procedures depends on management's judgment in evaluating their benefits relative to costs.

PART II OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

The Company is a party to claims and legal actions arising routinely in the ordinary course of our business. Although we cannot predict with certainty the ultimate resolution of the claims and lawsuits asserted against us, we do not believe that any currently pending legal proceedings to which we are a party will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

ITEM 1A RISK FACTORS

There have been no material changes from the risk factors previously disclosed in the section entitled "Risk Factors" in our Form 10-K, which was filed with the SEC on March 7, 2018.

Table of Contents**ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS***(a) Sales of Unregistered Securities and Use of Proceeds*

None

(b) Repurchases of Securities

The table below summarizes the number of common shares repurchased during the three months ended September 30, 2018 under the repurchase plan approved by our Board of Directors in December 2017 (dollar amounts in thousands, except share and per share amounts):

| For the Month Ended | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Dollar Value of Shares That May Yet Be Purchased Under The Plans or Programs (a) |
|----------------------------|---|---|---|---|
| July 31, 2018 | 51,601 | \$ 41.93 | 51,601 | \$ 4,136 |
| August 31, 2018 | 60,542 | \$ 40.84 | 60,542 | \$ 1,664 |
| September 30, 2018 | 36,625 | \$ 41.38 | 36,625 | \$ 148 |
| | 148,768 | \$ 41.35 | 148,768 | |

(a) Represents the balances before commissions and fees at the end of each month.

Working Capital Restrictions and Other Limitations on Payment of Dividends

We are not subject to working capital restrictions or other limitations on the payment of dividends. Our insurance subsidiaries, however, are subject to restrictions on the dividends they may pay. Those restrictions could impact HCI's ability to pay future dividends.

Under Florida law, a domestic insurer may not pay any dividend or distribute cash or other property to its stockholder except out of that part of its available and accumulated capital and surplus funds which is derived from realized net operating profits on its business and net realized capital gains. Additionally, a Florida domestic insurer may not make dividend payments or distributions to its stockholder without prior approval of the Florida Office of Insurance Regulation if the dividend or distribution would exceed the larger of (1) the lesser of (a) 10.0% of its capital surplus or (b) net income, not including realized capital gains, plus a two year carry forward, (2) 10.0% of capital surplus with dividends payable constrained to unassigned funds minus 25% of unrealized capital gains or (3) the lesser of (a) 10.0% of capital surplus or (b) net investment income plus a three year carry forward with dividends payable constrained to unassigned funds minus 25% of unrealized capital gains.

Table of Contents

Alternatively, a Florida domestic insurer may pay a dividend or distribution without the prior written approval of the Florida Office of Insurance Regulation (1) if the dividend is equal to or less than the greater of (a) 10.0% of the insurer's capital surplus as regards policyholders derived from realized net operating profits on its business and net realized capital gains or (b) the insurer's entire net operating profits and realized net capital gains derived during the immediately preceding calendar year, (2) the insurer will have policy holder capital surplus equal to or exceeding 115.0% of the minimum required statutory capital surplus after the dividend or distribution, (3) the insurer files a notice of the dividend or distribution with the Florida Office of Insurance Regulation at least ten business days prior to the dividend payment or distribution and (4) the notice includes a certification by an officer of the insurer attesting that, after the payment of the dividend or distribution, the insurer will have at least 115% of required statutory capital surplus as to policyholders. Except as provided above, a Florida domiciled insurer may only pay a dividend or make a distribution (1) subject to prior approval by the Florida Office of Insurance Regulation or (2) 30 days after the Florida Office of Insurance Regulation has received notice of such dividend or distribution and has not disapproved it within such time.

During the nine months ended September 30, 2018, our insurance subsidiaries paid dividends of \$15,000,000 to HCI.

ITEM 3 *DEFAULTS UPON SENIOR SECURITIES*

None.

ITEM 4 *MINE SAFETY DISCLOSURES*

None.

ITEM 5 *OTHER INFORMATION*

None.

Table of Contents

ITEM 6 EXHIBITS

The following documents are filed as part of this report:

| EXHIBIT NUMBER | DESCRIPTION |
|---------------------------|--|
| 3.1 | <u>Articles of Incorporation, with amendments. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed August 7, 2013.</u> |
| 3.1.1 | <u>Articles of Amendment to Articles of Incorporation designating the rights, preferences and limitations of Series B Junior Participating Preferred Stock. Incorporated by reference to Exhibit 3.1 to our Form 8-K filed October 18, 2013.</u> |
| 3.2 | <u>Bylaws. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed August 7, 2013.</u> |
| 4.1 | <u>Form of common stock certificate. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed November 7, 2013.</u> |
| 4.8 | <u>Indenture, dated December 11, 2013, between HCI Group, Inc. and The Bank of New York Mellon Trust Company, N.A. (including Global Note). Incorporated by reference to Exhibit 4.1 to our Form 8-K filed December 12, 2013.</u> |
| 4.9 | See Exhibits <u>3.1</u> , <u>3.1.1</u> and <u>3.2</u> of this report for provisions of the Articles of Incorporation, as amended, and our Bylaws, as amended, defining certain rights of security holders. |
| 4.10 | <u>Indenture, dated March 3, 2017, between HCI Group, Inc. and The Bank of New York Mellon Trust Company, N.A. Incorporated by reference to Exhibit 4.1 of our Form 8-K filed March 3, 2017.</u> |
| 4.11 | <u>Form of Global 4.25% Convertible Senior Note due 2037 (included in Exhibit 4.1). Incorporated by reference to Exhibit 4.1 of our Form 8-K filed March 3, 2017.</u> |
| 10.5** | <u>Restated HCI Group, Inc. 2012 Omnibus Incentive Plan. Incorporated by reference to Exhibit 99.1 of our Form 8-K filed March 23, 2017.</u> |
| 10.6** | <u>HCI Group, Inc. (formerly known as Homeowners Choice, Inc.) 2007 Stock Option and Incentive Plan. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed August 29, 2008.</u> |
| 10.7** | <u>Executive Employment Agreement dated November 23, 2016 between Mark Harmsworth and HCI Group, Inc. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2017.</u> |

Table of Contents

- 10.8 Working Layer Catastrophe Excess of Loss Reinsurance Contract, effective: June 1, 2016, issued to Homeowners Choice Property & Casualty Insurance Company, Inc. by subscribing reinsurers (National Fire). Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-Q filed August 3, 2016.
- 10.17 Property Catastrophe Excess of Loss Reinsurance Contract effective June 1, 2017 issued to Homeowners Choice Property & Casualty Insurance Company, Inc. by subscribing reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the corresponding number exhibit to our Form 10-Q filed August 3, 2017.
- 10.18 Property Catastrophe Second Event Excess of Loss Reinsurance Contract effective June 1, 2017 issued to Homeowners Choice Property & Casualty Insurance Company, Inc. by subscribing reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2017.
- 10.19 Reinstatement Premium Protection Reinsurance Contract effective June 1, 2017 issued to Homeowners Choice Property & Casualty Insurance Company, Inc. by subscribing reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2017.
- 10.20 Property Catastrophe Excess of Loss Reinsurance Contract effective June 1, 2018 issued to Homeowners Choice Property & Casualty Insurance Company, Inc. and TypTap Insurance Company by subscribing reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2018.
- 10.21 Property Catastrophe Fifth Excess of Loss Reinsurance Contract (Odyssey Re) effective June 1, 2018 issued to Homeowners Choice Property & Casualty Insurance Company, Inc. and TypTap Insurance Company by subscribing reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2018.
- 10.22 Property Catastrophe First Excess of Loss Reinsurance Contract (Endurance) effective June 1, 2018 issued to Homeowners Choice Property & Casualty Insurance Company, Inc. and TypTap Insurance Company by subscribing reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2018.

Table of Contents

- 10.23 Assumption Agreement effective October 15, 2014 by and between Homeowners Choice Property & Casualty Insurance Company, Inc. and Citizens Property Insurance Corporation. Incorporated by reference to Exhibit 10.1 of our Form 8-K filed January 28, 2015.
- 10.24 Assumption Agreement effective November 9, 2017 by and between Homeowners Choice Property & Casualty Insurance Company, Inc. and Citizens Property Insurance Corporation. Incorporated by reference to Exhibit 10.24 of our Form 8-K filed December 21, 2017.
- 10.25 Property Catastrophe First Excess of Loss Reinsurance Contract (Ren Re) effective June 1, 2018 issued to Homeowners Choice Property & Casualty Insurance Company, Inc. and TypTap Insurance Company by subscribing reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2018.
- 10.26 Reinstatement Premium Protection Reinsurance Contract (For First Excess Cat U8GR0006) effective June 1, 2018 issued to Homeowners Choice Property & Casualty Insurance Company, Inc. and TypTap Insurance Company by subscribing reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2018.
- 10.27 Reinstatement Premium Protection Reinsurance Contract (For Working Layer Cat U8GR0008) effective June 1, 2018 issued to Homeowners Choice Property & Casualty Insurance Company, Inc. and TypTap Insurance Company by subscribing reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2018.
- 10.28 Reinstatement Premium Protection Reinsurance Contract effective June 1, 2018 issued to Homeowners Choice Property & Casualty Insurance Company, Inc. and TypTap Insurance Company by subscribing reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2018.
- 10.29 Working Layer Catastrophe Excess of Loss Reinsurance Contract (Endurance) effective June 1, 2018 issued to Homeowners Choice Property & Casualty Insurance Company, Inc. and TypTap Insurance Company by subscribing reinsurers. Portions of this exhibit have been omitted pursuant to a request for confidential treatment. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2018.

Table of Contents

- 10.30 Reimbursement Contract effective June 1, 2018 between Homeowners Choice Property & Casualty Insurance Company and the State Board of Administration which administers the Florida Hurricane Catastrophe Fund. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2018.
- 10.34** Restricted Stock Agreement dated May 16, 2013 whereby HCI Group, Inc. (formerly known as Homeowners Choice, Inc.) issued 400,000 shares of restricted common stock to Paresh Patel. Incorporated by reference to Exhibit 10.34 of our Form 8-K filed May 21, 2013. See Exhibit 10.90
- 10.35** Restricted Stock Agreement dated May 16, 2013 whereby HCI Group, Inc. (formerly known as Homeowners Choice, Inc.) issued 24,000 shares of restricted common stock to Sanjay Madhu. Incorporated by reference to Exhibit 10.35 of our Form 8-K filed May 21, 2013. See Exhibit 10.91
- 10.36** Restricted Stock Agreement dated May 16, 2013 whereby HCI Group, Inc. (formerly known as Homeowners Choice, Inc.) issued 24,000 shares of restricted common stock to George Apostolou. Incorporated by reference to Exhibit 10.36 of our Form 8-K filed May 21, 2013. See Exhibit 10.92
- 10.37** Restricted Stock Agreement dated May 16, 2013 whereby HCI Group, Inc. (formerly known as Homeowners Choice, Inc.) issued 24,000 shares of restricted common stock to Harish Patel. Incorporated by reference to Exhibit 10.37 of our Form 8-K filed May 21, 2013. See Exhibit 10.93
- 10.38** Restricted Stock Agreement dated May 16, 2013 whereby HCI Group, Inc. (formerly known as Homeowners Choice, Inc.) issued 24,000 shares of restricted common stock to Gregory Politis. Incorporated by reference to Exhibit 10.38 of our Form 8-K filed May 21, 2013. See Exhibit 10.94
- 10.39** Restricted Stock Agreement dated May 16, 2013 whereby HCI Group, Inc. (formerly known as Homeowners Choice, Inc.) issued 24,000 shares of restricted common stock to Anthony Saravanos. Incorporated by reference to Exhibit 10.39 of our Form 8-K filed May 21, 2013. See Exhibit 10.95
- 10.53** Restricted Stock Agreement dated November 12, 2013 whereby HCI Group, Inc. issued 24,000 shares of restricted common stock to Wayne Burks. Incorporated by reference to Exhibit 10.11 of our Form 8-K filed November 13, 2013. See Exhibit 10.97
- 10.54** Restricted Stock Agreement dated November 12, 2013 whereby HCI Group, Inc. issued 24,000 shares of restricted common stock to James J. Macchiarola. Incorporated by reference to Exhibit 10.12 of our Form 8-K filed November 13, 2013. See Exhibit 10.98

Table of Contents

- 10.56 Prepaid Forward Contract, dated December 5, 2013 and effective as of December 11, 2013, between HCI Group, Inc. and Deutsche Bank AG, London Branch. Incorporated by reference to Exhibit 10.1 of our Form 8-K filed December 12, 2013.
- 10.57 Form of executive restricted stock award contract. Incorporated by reference to Exhibit 10.57 of our Form 10-Q for the quarter ended March 31, 2014 filed May 1, 2014.
- 10.58 Purchase Agreement, dated February 28, 2017, by and between HCI Group, Inc. and JMP Securities LLC and SunTrust Robinson Humphrey, Inc., as representatives of the several initial purchasers named therein. Incorporated by reference to Exhibit 10.1 of our Form 8-K filed February 28, 2017.
- 10.59 Prepaid Forward Contract, dated February 28, 2017 and effective as of March 3, 2017, between HCI Group, Inc. and Societe Generale. Incorporated by reference to Exhibit 10.1 of our Form 8-K filed March 3, 2017.
- 10.88** Nonqualified Stock Option Agreement between Paresh Patel and HCI Group, Inc. dated January 7, 2017. Incorporated by reference to exhibit 99.2 to our Form 8-K filed January 11, 2017.
- 10.89** Employment Agreement between Paresh Patel and HCI Group, Inc. dated December 30, 2016. Incorporated by reference to the exhibit numbered 99.1 to our Form 8-K filed December 30, 2016.
- 10.90** Amendment dated March 2, 2016 to Restricted Stock Award Contract between Paresh Patel and HCI Group, Inc. dated May 16, 2013. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 4, 2016.
- 10.91** Amendment dated March 2, 2016 to Restricted Stock Award Contract between Sanjay Madhu and HCI Group, Inc. dated May 16, 2013. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 4, 2016.
- 10.92** Amendment dated March 2, 2016 to Restricted Stock Award Contract between George Apostolou and HCI Group, Inc. dated May 16, 2013. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 4, 2016.
- 10.93** Amendment dated March 2, 2016 to Restricted Stock Award Contract between Harish Patel and HCI Group, Inc. dated May 16, 2013. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 4, 2016.

Table of Contents

| | |
|----------|--|
| 10.94** | <u>Amendment dated March 2, 2016 to Restricted Stock Award Contract between Gregory Politis and HCI Group, Inc. dated May 16, 2013. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 4, 2016.</u> |
| 10.95** | <u>Amendment dated March 2, 2016 to Restricted Stock Award Contract between Anthony Saravanos and HCI Group, Inc. dated May 16, 2013. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 4, 2016.</u> |
| 10.97** | <u>Amendment dated March 2, 2016 to Restricted Stock Award Contract between Wayne Burks and HCI Group, Inc. dated November 12, 2013. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 4, 2016.</u> |
| 10.98** | <u>Amendment dated March 2, 2016 to Restricted Stock Award Contract between Jim Macchiarola and HCI Group, Inc. dated November 12, 2013. Incorporated by reference to the correspondingly numbered exhibit to our Form 10-K filed March 4, 2016.</u> |
| 10.99** | <u>Restricted Stock Award Contract between Paresh Patel and HCI Group, Inc. dated January 7, 2017. Incorporated by reference to exhibit 99.1 to our Form 8-K filed January 11, 2017.</u> |
| 10.100** | <u>Restricted Stock Award Contract between Mark Harmsworth and HCI Group, Inc. dated December 5, 2016. Incorporated by reference to the corresponding numbered exhibit to our Form 10-Q filed August 3, 2017.</u> |
| 10.101** | <u>Restricted Stock Award Contract between Paresh Patel and HCI Group, Inc. dated February 8, 2018. Incorporated by reference to exhibit 99.1 to our Form 8-K filed February 14, 2018.</u> |
| 10.102** | <u>Nonqualified Stock Option Agreement between Paresh Patel and HCI Group, Inc. dated February 8, 2018. Incorporated by reference to exhibit 99.2 to our Form 8-K filed February 14, 2018.</u> |
| 31.1 | <u>Certification of the Chief Executive Officer</u> |
| 31.2 | <u>Certification of the Chief Financial Officer</u> |
| 32.1 | <u>Written Statement of the Chief Executive Officer Pursuant to 18 U.S.C.ss.1350</u> |
| 32.2 | <u>Written Statement of the Chief Financial Officer Pursuant to 18 U.S.C.ss.1350</u> |
| 101.INS | XBRL Instance Document. |
| 101.SCH | XBRL Taxonomy Extension Schema. |

Table of Contents

| | |
|---------|--|
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase. |
| 101.DEF | XBRL Definition Linkbase. |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase. |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase. |

**Management contract or compensatory plan.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, who has signed this report on behalf of the Company.

HCI GROUP, INC.

November 7, 2018

By: /s/ Paresh Patel
Paresh Patel
Chief Executive Officer
(Principal Executive Officer)

November 7, 2018

By: /s/ James Mark Harmsworth
James Mark Harmsworth
Chief Financial Officer
(Principal Financial and Accounting Officer)

A signed original of this document has been provided to HCI Group, Inc. and will be retained by HCI Group, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.