HCI Group, Inc.
Form 10-K
February 22, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2016

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	**20-5961396**
(State of Incorporation)	**(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)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Shares, no par value	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange
8.00% Senior Notes due 2020	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company

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

The aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2016, computed by reference to the price at which the common stock was last sold on June 30, 2016, was $234,690,386.

The number of shares outstanding of the registrant s common stock, no par value, on February 14, 2017 was 10,282,438.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Form 10-K is incorporated by reference from the registrant s definitive proxy statement which will be filed not later than 120 days after the end of the fiscal year covered by this Form 10-K.

HCI GROUP, INC. AND SUBSIDIARIES

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PART I

ITEM 1 *Business*

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. Its principal business is property and casualty insurance. HCI was incorporated in 2006. References to we, our, us, the Company, or HC this Form 10-K generally refer to HCI Group, Inc. and its subsidiaries. Our principal executive offices are located at 5300 West Cypress Street, Suite 100, Tampa, Florida 33607, and our telephone number is (813) 849-9500.

Based on our organizational structure, revenue sources, and evaluation of financial and operating performances by management, we manage four operating divisions under one reporting segment, which includes the following operations:

a) Insurance Operations

Property and casualty insurance

Reinsurance

b) Other Operations

Real estate

Information technology

Insurance Operations

Property and Casualty Insurance

Our principal operating subsidiary, Homeowners Choice Property & Casualty Insurance Company, Inc. (HCPCI), was incorporated and began operations in 2007. Through HCPCI, we currently provide property and casualty insurance to homeowners, condominium owners and tenants on properties located in Florida. HCPCI s operations are supported by HCI and the following wholly owned subsidiaries of HCI:

Homeowners Choice Managers, Inc. acts as managing general agent and provides marketing, underwriting, claims settlement, accounting and financial services to HCPCI;

Southern Administration, Inc. provides policy administration services to HCPCI; and

Claddaugh Casualty Insurance Company Ltd. provides reinsurance to HCPCI. (See *Reinsurance* below)

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HCPCI began operations by participating in a take-out program through which we assumed insurance policies held by Citizens Property Insurance Corporation (Citizens), a Florida state-supported insurer. The take-out program is a legislatively mandated program designed to reduce the State s risk exposure by encouraging private companies to assume policies from Citizens. We have assumed policies in a series of separate transactions, which took place from July 2007 through November 2016. In addition, we acquired policies from one Florida carrier in November 2011. Substantially all of our premium revenue since inception has come from the policies acquired in these transactions and subsequent renewals. As of December 31, 2016, our premiums in force and policy count were approximately $375 million and 150,000, respectively.

Policyholders whose policies have been assumed by us or another insurance company have the option to opt out of the assumption and return to Citizens. With respect to our November 2013 through November 2016 assumptions, the opt-out provision was limited to the thirty-day period preceding and following the assumption date. Policyholders who stay with us may cancel their policies any time. Citizens has historically required us to offer renewals on the policies we acquire in the take-out program for a period of three years subsequent to their initial expiration. The policyholders have the option to renew with us or they may place their coverage with another insurance company. We strive to retain these policies by offering competitive rates and exceptional service to our policyholders. Opportunities to acquire large numbers of policies from Citizens meeting our strict underwriting criteria have diminished in recent years. We may, however, selectively pursue additional assumption transactions with Citizens as opportunities arise, provided the assumed policies meet our underwriting criteria. We also continually explore accretive opportunities to acquire business from other insurance companies.

HCPCI began writing flood coverage for Florida homeowners in January 2014 in response to the demand for an alternative to the Federal National Flood Insurance Program for Florida homeowners. The flood coverage is offered on a limited basis as a policy endorsement to eligible Florida customers who are most likely to be impacted by the significant rate increases that may result from the Biggert-Waters Flood Insurance Reform and Modernization Act of 2012. In October 2015, HCPCI was approved by the Florida Office of Insurance Regulation (FLOIR) to write standalone flood insurance policies for Florida homeowners. In addition, in 2016, we launched TypTap Insurance Company (TypTap), a Florida insurance subsidiary also approved by the FLOIR to write various insurance products for Florida homeowners. TypTap features an online platform for quoting and binding policies that is designed to be accessible by any Internet capable devices.

We plan to seek opportunities to enter the property and casualty insurance market and establish our presence in other states, especially with residential flood insurance. We previously had one Alabama domiciled insurance subsidiary, Homeowners Choice Assurance Company, Inc., which had not written any insurance policies and has been dissolved and its license surrendered as of December 31, 2016.

Our operating and growth strategies for our property and casualty insurance business are to continually optimize the existing book of business, manage our costs and expenses, diversify both geographically and with new product offerings, develop and deploy new technologies to streamline operations, including policy underwriting and production, and pursue accretive opportunities to acquire polices when they arise, whether from Citizens or other insurance companies.

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We face various challenges to implementing our operating and growth strategies. Since we currently write policies that cover Florida homeowners, condominium owners, and tenants, we cover losses that may arise from, among other things, catastrophes, which could have a significant adverse effect on our business, results of operations, and financial condition. To mitigate our risk of such catastrophic losses, we cede a portion of our exposure to reinsurers under contracts called catastrophe excess of loss reinsurance treaties. Reinsurance is by far the largest cost to our property and casualty insurance business. Even without catastrophic events, we may incur losses and loss adjustment expenses that deviate substantially from our estimates and that may exceed our reserves, in which case our net income and capital would decrease. Our operating and growth strategies may also be impacted by regulation of our business by the State of Florida and other states in which we may operate. Currently we are licensed to operate in only Florida. To operate in any other state we must first obtain a license from the insurance regulatory authorities in that state. Insurance regulators also must approve our policy forms and premium rates as well as monitor our compliance with financial and regulatory requirements. Additionally, we may compete with large, well-established insurance companies, possessing greater financial resources, larger agency networks, and greater name recognition. See Item 1A, Risk Factors, below.

Competition

We operate in highly competitive markets where we face competition from national, regional and residual market insurance companies and, in the case of flood insurance, the U.S. government. We believe that we have approximately 10 significant competitors writing homeowners property and casualty insurance in the state of Florida. Based on September 30, 2016 annualized premiums written data, from the FLOIR, excluding State Farm Florida Insurance Company, we are the fifth largest provider of homeowners property and casualty insurance in the state.

Our competitors may have larger financial capacities, greater resource availability, and more diversification in terms of insurance coverage. Our competitors include companies which market their products through agents, as well as companies which sell insurance directly to their customers. In addition, large national insurers that left the Florida market more than a decade ago after numerous hurricanes impacted the state, may reenter the Florida homeowners property and casualty insurance market and they may have certain competitive advantages such as increased name recognition, increased loyalty of their customer base, and reduced policy acquisition costs. We may also face competition from new or temporary entrants in our niche markets. In some cases, such entrants may, because of inexperience, desire for new business, or other reasons, price their insurance products below ours. This pricing pressure may lead to overall premium reductions across the Florida market. We did in fact implement a rate decrease in January 2016 for our new and renewal homeowners multi-peril business.

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Our competitive strategies focus on the following key areas:

Exceptional service We are committed to maintaining superior service to our policyholders and agents.

Claims settlement practices We focus on fair and timely settlement of policyholder claims.

Disciplined underwriting We analyze exposures and utilize available underwriting data to ensure policies meet our selective criteria.

New product offerings In addition to our flood-endorsed policies and wind-only program, we may cross-sell additional insurance products to our existing policyholders in order to broaden our lines of business and product mix or identify other lines of insurance to offer. Since the beginning of 2016, we have been offering flood-only policies to Florida customers.

Effective and efficient use of technology We strive to add or improve technology that can effectively and efficiently enhance service to our policyholders and agents. For instance, we currently use our internally developed application, *Exzeo*®, to increase the efficiency of our claims processing and settlement. In addition, our on-line platform for quoting and binding residential flood policies streamlines the underwriting and policy production processes.

Geographical expansion We continue to seek opportunities to expand our business within the state of Florida and perhaps into other states to increase overall geographic diversification.

Price In the case of flood insurance, our rates are typically below the rates of the National Flood Insurance Program administered by the Federal Emergency Management Agency, which is the dominant provider of flood insurance in the United States.

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. Moreover, with our reinsurance treaty years typically effective on 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.

Government Regulation

We are subject to the laws and regulations in any state in which we conduct our insurance business. The regulations cover all aspects of our business and are generally designed to protect

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the interests of insurance policyholders as opposed to the interests of shareholders. Such regulations relate to a wide variety of financial and non-financial matters including:

- authorized lines of business;
- capital and surplus requirements;
- approval of allowable rates and forms;
- approval of reinsurance contracts;
- investment parameters;
- underwriting limitations;
- transactions with affiliates;
- dividend limitations;
- changes in control; and
- market conduct.

Our failure to comply with certain provisions of applicable insurance laws and regulations could have a material, adverse effect on our business, results of operations or financial condition.

Regulatory Uncertainty

Certain states including Florida have adopted laws or are considering proposed legislation which, among other things, limits the ability of insurance companies to effect rate increases or to cancel, reduce or non-renew insurance coverage with respect to existing policies. The Florida legislature continuously considers bills affecting the Florida residential property insurance market. Current law penalizes insurers for noncompliance with the insurance code, establishes a private cause of action relating to claims payment practices, extends the notice period applicable to non-renewals of certain residential policies, prevents non-renewals and cancellation except for material misrepresentation and non-payment of premium and establishes procedures governing rate filings. Any changes in such laws and regulations could have a material, adverse effect on our operations or our ability to expand.

State Licensure and Approval

Most states, including Florida, require licensure and regulatory approval prior to the marketing of insurance products. Typically, licensure review is comprehensive and includes a review of a company s business plan, solvency, reinsurance, rates, and forms, the character of its officers and directors and other of its financial and non-financial aspects. The regulatory authorities may prevent entry into a new market by not granting a license. In addition, regulatory authorities may preclude or delay our entry into markets by disapproving or withholding approval of our product filings.

Statutory Reporting and Examination

All insurance companies must file quarterly and annual statements with certain regulatory agencies and are subject to regular and special examinations by those agencies. The National Association of Insurance Commissioners mandates that all insurance companies be examined

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once every five years. However, the FLOIR has the authority to conduct an examination whenever it is deemed appropriate. HCPCI s latest financial examination completed by the FLOIR related to the year ended December 31, 2010. The FLOIR is currently conducting its financial examination related to the five years ended December 31, 2015.

Liability for Losses and Loss Adjustment Expenses

Our liability for losses and loss adjustment expenses represents our estimate of the total cost of (i) claims that have been incurred, but not yet paid (case reserves), (ii) claims that have been incurred but not yet reported to us (IBNR), and (iii) loss adjustment expenses (LAE) which are intended to cover the ultimate cost of settling claims, including investigation and defense of lawsuits resulting from such claims. We base our estimates on various assumptions and actuarial data we believe to be reasonable under the circumstances. The process of estimating the liability is inherently subjective and is influenced by many variables such as past loss experience, current claim trends and the prevailing social, economic and legal environments.

Significant time can elapse between the occurrence of an insured loss, the reporting of the loss to us and our payment of that loss. Our liability for losses and LAE, which we believe represents the best estimate at a given point in time based on facts, circumstances and historical trends then known, may necessarily be adjusted to reflect additional facts that become available during the loss settlement period.

For a discussion and summary of the activity in the liability for losses and LAE for the years ended December 31, 2016, 2015 and 2014, see Note 15 Losses and Loss Adjustment Expenses to our consolidated financial statements under Item 8 of this Annual Report on Form 10-K.

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Loss Development

Our liability for losses and LAE represents estimated costs ultimately required to settle all claims for a given period. The following table illustrates development of the estimated liability for losses and LAE as of December 31 for the years 2007 (inception) through 2016 (amounts in thousands):

Schedule of Loss Development

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Original liability for losses and LAE[1]	$ 1,688	$ 14,763	$ 19,178	$ 22,146	$ 27,424	$ 41,168	$ 43,686	$ 48,908	$ 51,690	$ 70,492
Re-estimated losses and LAE[2] as of:										
1 year later	1,412	10,879	18,399	26,776	27,309	38,712	47,344	57,807	72,229	
2 years later	1,236	10,991	19,866	26,003	28,536	40,015	50,280	65,367		
3 years later	1,268	11,661	19,361	27,226	28,499	42,976	54,696			
4 years later	1,327	11,528	19,617	26,544	29,038	45,279				
5 years later	1,330	11,424	18,969	26,871	30,788					
6 years later	1,330	11,361	19,020	27,732						
7 years later	1,330	11,302	19,426							
8 years later	1,331	11,459								
9 years later	1,331									
Cumulative redundancy (deficiency)[3]	357	3,304	(248)	(5,586)	(3,364)	(4,111)	(11,010)	(16,459)	(20,539)	
Cumulative amount of liability paid as of:										
1 year later	760	7,725	10,481	16,833	15,652	22,365	26,595	33,347	41,053	
2 years later	1,108	9,229	15,336	20,708	21,707	31,824	38,695	49,122		
3 years later	1,108	10,339	17,065	23,732	25,350	37,041	45,655			
4 years later	1,327	10,947	17,992	25,063	26,772	40,152				
5 years later	1,330	11,121	18,375	25,681	28,052					
6 years later	1,330	11,167	18,465	26,238						
7 years later	1,330	11,302	18,506							
8 years later	1,331	11,305								
9 years later	1,331									
Gross premiums earned	$ 9,546	$ 61,925	$ 110,011	$ 119,757	$ 143,606	$ 233,607	$ 337,113	$ 365,488	$ 423,120	$ 378,678

1 Represents management s original estimated liability for (i) unpaid claims, (ii) IBNR, and (iii) loss adjustment expenses.

2 Represents the re-estimated liabilities in later years for unpaid claims, IBNR and loss adjustment expenses for each of the respective years.

3 Represents the difference between the latest re-estimate and the original estimate. A redundancy indicates the original estimate is higher than the current estimate whereas a deficiency indicates the original estimate is lower than the current estimate.

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For the years ended December 31, 2016, 2015 and 2014, revenues from insurance operations before intracompany elimination represented 95.5%, 97.5% and 97.2%, respectively, of total revenues of all operating segments. At December 31, 2016, 2015 and 2014, insurance operations total assets represented 87.9%, 91.8% and 94.1%, respectively, of the combined assets of all operating segments. There was no other operating division representing ten percent or more of our total revenues or combined assets. See Note 16 Segment Information to our consolidated financial statements under Item 8 of this Annual Report on Form 10-K.

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 to pay premiums to third party reinsurers. Claddaugh fully collateralizes its exposure to HCPCI by depositing funds into a trust account. Claddaugh also from time to time mitigates a portion of its risk through retrocession contracts.

Other Operations

Real Estate

Our real estate operations consist of multiple properties we own and operate.

Properties Used in Operations

Our real estate used in operations consists of our headquarters building in Tampa, Florida, and our secondary insurance operations site in Ocala, Florida. At our headquarters, we lease available space to non-affiliates at various terms. The Ocala location, in addition to day-to-day operational use, serves as our alternative site in the event we experience any significant disruption at our headquarters building.

Operations at Investment Properties

Our investment properties consist of a combined 24 acres of waterfront property, land and land improvements that include one full-service restaurant and two marinas as well as two recently acquired retail shopping centers. The combined marina facilities offer to the general public: a) one dry-stack boat storage facility with capacity for approximately 314 boats; b) approximately 74 wet slips; c) two fuel facilities; and d) open areas for parking and storage. Dry-stack boat storage space is generally rented on a monthly or annual basis while the wet slips are rented on a daily or monthly basis. We acquired the restaurant and marina operations in connection with our purchase of those properties and we continue to operate them to enhance the property values. We also lease available space to non-affiliates at one of these locations.

One retail shopping center with 61,400 square feet of net rentable space is located in Sorrento, Florida and is anchored by a large, well-known grocery retailer. It was formerly the subject of a real estate development and construction project in which we were involved through an acquisition, development and construction loan arrangement (ADC Arrangement).

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Under the ADC Arrangement, Greenleaf Capital, one of our wholly owned subsidiaries, had an option to purchase the property when the construction project was completed contingent upon tenant rental commitments for at least 90% of rentable space being secured by the developer. On August 16, 2016, we exercised the purchase option and acquired the property for a purchase price of $12,250,000, which resulted in a bargain purchase gain as of the acquisition date of approximately $2,071,000. See Note 6 Business Acquisitions to our consolidated financial statements under Item 8 of this Annual Report on Form 10-K.

Another retail shopping center with 49,995 square feet of net rentable space is located in Melbourne, Florida and also anchored by a large, well-known grocery retailer. In December 2016, we acquired full ownership of the property in which we had a 90% non-controlling interest, resulting in a gain on remeasurement of approximately $4,005,000. Subsequent to the acquisition, we incurred an impairment loss of $388,000 due to the unexpected closure of one tenant s business. This property had been developed through a limited liability company described elsewhere in this report for U.S. GAAP purposes as a joint venture. See *Investment in Unconsolidated Joint Venture* in Note 4 Investments to our consolidated financial statements under Item 8 of this Annual Report on Form 10-K.

Ongoing Investment Project

We have one real estate development project described as a joint venture arrangement under U.S. GAAP, which we consolidate with our operations. We believe this type of cooperation with experienced real estate developers will enable us to grow our real estate portfolio and diversify our future sources of income. See Note 4 Investments to our consolidated financial statements under Item 8 of this Annual Report on Form 10-K for additional information.

Information Technology

Our information technology operations include a team of experienced software developers with extensive knowledge in designing and creating web-based applications and products for mobile devices. The operations, which are located in Tampa, Florida and Noida, India, are focused on developing cloud-based, innovative products and services that support in-house operations as well as our third party relationships with our agency partners and claim vendors.

Proplet™

Proplet is an online platform for quoting homeowners policies for our subsidiary, HCPCI. This platform offers a map based solution for quoting.

TypTap™

TypTap is an online platform for quoting and binding residential flood policies for our subsidiary, TypTap Insurance Company. This platform focuses on simplifying the user experience, which is entirely online. It is designed to be accessible from a mobile phone or any other internet capable device.

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SAMS™

SAMS is an online platform for supporting back-office policy and claims management for both of our insurance subsidiaries, HCPCI and TypTap Insurance Company. *SAMS* processes the full life cycle of a policy from policy quoting and issuance to agency management, cash receipts/disbursements, claims reserving and claim payments.

Some of the technologies originally developed in-house for our own insurance operations have been launched for use by third parties. These technologies include the following:

Exzeo®

Exzeo is a cloud-based application available at Exzeo.com which provides a highly customizable environment to support automation and process management to high volume environments. Exzeo.com specifically supports property claim assignments, logistics, and accountability reporting with our third party partners. Exzeo.com has rich system integration through an application program interface (API), which allows hands-free data transfer from any API-capable applications such as *SAMS*.

Atlas Viewer™

Atlas Viewer is our interactive cloud-based data mapping and visualization application. An industry agnostic product, *Atlas Viewer* allows users to combine data from multiple sources and leverage location coordinates to make more informed business decisions. *Atlas Viewer* allows system to system integration through an API or allows users to upload documents to view and securely share data on a customized map. *Atlas Viewer* is offered as a subscription-based service.

CasaClue™

CasaClue is a large database containing residential property data points important to underwriting residential flood insurance. TypTap, described above, utilizes *CasaClue*.

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Financial Highlights

The following table summarizes our financial performance during the years ended December 31, 2016, 2015 and 2014:

(Amounts in millions except per share amounts)	2016	2015	2014
For the year ended December 31:			
Net premium earned	$ 243.6	$ 282.5	$ 252.1
Total revenue	$ 264.4	$ 286.0	$ 266.1
Losses and loss adjustment expenses	$ 124.7	$ 87.2	$ 79.5
Income before income taxes	$ 46.9	$ 106.2	$ 101.0
Net income	$ 29.0	$ 65.9	$ 62.7
Income available to common stockholders	$ 29.0	$ 65.9	$ 62.7
Earnings per share of common stock:			
Basic	$ 2.95	$ 6.51	$ 5.90
Diluted	$ 2.92	$ 5.90	$ 5.36
Dividends per common share	$ 1.20	$ 1.20	$ 1.10
Net cash provided by operating activities			