McVey Richard M
Form 4
February 02, 2018

# FORM 4

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

**STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES**

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

| | |
|---|---|
| OMB Number: | 3235-0287 |
| Expires: | January 31, 2005 |
| Estimated average burden hours per response... | 0.5 |

(Print or Type Responses)

1. Name and Address of Reporting Person *
McVey Richard M

(Last) (First) (Middle)

C/O MARKET AXESS HOLDINGS, INC., 299 PARK AVENUE

(Street)

NEW YORK, NY 10171

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
MARKETAXESS HOLDINGS INC [MKTX]

3. Date of Earliest Transaction (Month/Day/Year)
01/31/2018

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Chairman & CEO

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

**Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned**

| 1.Title of Security (Instr. 3) | 2. Transaction Date (Month/Day/Year) | 2A. Deemed Execution Date, if any (Month/Day/Year) | 3. Transaction Code (Instr. 8) | | 4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5) | | | 5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4) | 6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4) | 7. Nature of Indirect Beneficial Ownership (Instr. 4) |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Code | V | Amount | (A) or (D) | Price | | | |
| Common Stock, par value $0.003 per share | 01/31/2018 | | F (1) | | 4,095 | D | $ 196.21 | 1,123,503 | D | |
| Common Stock, par value $0.003 per share | 01/31/2018 | | F (1) | | 2,949 | D | $ 196.21 | 1,120,554 | D | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Common Stock, par value $0.003 per share | 01/31/2018 | | F[(1)] | 1,318 | D | $ 196.21 | 1,119,236 | D |
| Common Stock, par value $0.003 per share | 01/31/2018 | | F[(1)] | 1,156 | D | $ 196.21 | 1,118,080 | D |
| Common Stock, par value $0.003 per share | 01/31/2018 | | A | 5,177 | A | [(2)] | 1,123,257 | D |

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

**Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned**
**(*e.g.*, puts, calls, warrants, options, convertible securities)**

| 1. Title of Derivative Security (Instr. 3) | 2. Conversion or Exercise Price of Derivative Security | 3. Transaction Date (Month/Day/Year) | 3A. Deemed Execution Date, if any (Month/Day/Year) | 4. Transaction Code (Instr. 8) | | 5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5) | | 6. Date Exercisable and Expiration Date (Month/Day/Year) | | 7. Title and Amount of Underlying Securities (Instr. 3 and 4) | | 8. Price of Derivative Security (Instr. 5) | 9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Code | V | (A) | (D) | Date Exercisable | Expiration Date | Title | Amount or Number of Shares | | |

# Reporting Owners

| Reporting Owner Name / Address | Relationships | | | |
|---|---|---|---|---|
| | Director | 10% Owner | Officer | Other |
| McVey Richard M<br>C/O MARKET AXESS HOLDINGS, INC.<br>299 PARK AVENUE<br>NEW YORK, NY 10171 | X | | Chairman & CEO | |

## Signatures

| /s/ Ori Solomon, as Attorney-in-Fact for Richard M. McVey | 02/02/2018 |
|---|---|
| **Signature of Reporting Person | Date |

## Explanation of Responses:

| | |
|---|---|
| * | If the form is filed by more than one reporting person, *see* Instruction 4(b)(v). |
| ** | Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a). |
| **(1)** | Represents the surrender of shares to the Company to satisfy Mr. McVey's tax withholding obligation upon the vesting of shares of restricted stock previously granted to Mr. McVey |
| **(2)** | Settlement of performance shares granted January 15, 2017 pursuant to the Issuer's 2012 Incentive Plan, which were settled based on the achievement by the Issuer of adjusted pre-tax operating income targets during the performance period and are payable in shares of restricted stock. The shares of restricted stock will vest in two equal installments on January 31, 2019 and January 31, 2020. |

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74,252

Provision for income taxes

22,538

57,778

27,155

Net income

$

33,865

$

92,512

$

47,097

Earnings per share

Explanation of Responses:

Basic

$

1.14

$

3.08

$

1.92

Diluted

$

1.14

$

3.05

$

1.82

Selected Other Data

Explanation of Responses:

Book value per share

$

12.41

$

11.71

$

8.56

Growth in book value per share

Explanation of Responses:

6.0

%

36.8

%

18.9

%

Return on average equity

9.5

%

30.2

%

26.5

%

Key Components of our Results of Operations

Revenue

Gross premiums written. Gross premiums written represent, with respect to a period, the sum of assumed premiums written (premiums from policies that we assumed from Citizens, net of opt-outs, as well as policies acquired from SSIC) plus direct premiums written (premiums from subsequent renewals of Citizens' policies and voluntary policies written during the period, net of any midterm cancellations), in each case prior to ceding premiums to reinsurers.

Gross premiums earned. Gross premiums earned represent the total premiums earned during a period from policies assumed from Citizens, net of opt-outs, as well as policies acquired from SSIC, subsequent renewals of such policies and voluntary policies. Premiums associated with assumed policies are earned ratably over the remaining term of the policy and premiums associated with voluntary and renewed policies are earned ratably over the twelve-month term of the policy.

Ceded premiums. Ceded premiums represent the cost of our reinsurance during a period. We recognize the cost, excluding premiums ceded to Osprey, of our reinsurance program ratably over the twelve month term of the arrangement. In most cases, our reinsurance contracts are effective June 1 and run through May 31 of the following year.

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Net premiums earned. Net premiums earned reflect gross premiums earned less ceded premiums during the period.

Net investment income. Net investment income represents interest earned from fixed maturity securities, short term securities and other investments, dividends on equity securities, and the gains or losses from the sale of investments.

Other revenue. Other revenue represents rental income due under non-cancelable leases for space at the Company's commercial property in Clearwater, Florida that we acquired in April 2013, and all policy and pay-plan fees. We charge policyholders a policy fee on each policy written; these fees are not subject to refund, and the Company recognizes the income immediately when collected. The Company also charges pay-plan fees to policyholders that pay its premiums in more than one installment and record the fees as income when collected. In addition, the Company records revenue earned from its restoration subsidiary for non-insurance construction as services performed using the percentage of completion method. We do not expect the revenue generated from non-insurance contracts to be material in nature and non-insurance construction revenue is expected to decline in 2017.

Expenses

Losses and loss adjustment expenses. Losses and loss adjustment expenses reflect losses paid, expenses paid to resolve claims, such as fees paid to adjusters, attorneys and investigators, and changes in our reserves for unpaid losses and loss adjustment expenses during the period, in each case net of losses ceded to reinsurers. Our reserves for unpaid losses and loss adjustment expenses represent the estimated ultimate cost of resolving all reported claims plus all losses we incurred related to insured events that we assume have occurred as of the reporting date, but that policyholders have not yet reported to us (which are commonly referred to as incurred but not reported, or "IBNR"). We estimate our reserves for unpaid losses using individual case-based estimates for reported claims and actuarial estimates for IBNR losses. We continually review and adjust our estimated losses as necessary based on industry development trends, our evolving claims experience and new information obtained. If our unpaid losses and loss adjustment expenses are considered deficient or redundant, we increase or decrease the liability in the period in which we identify the difference and reflect the change in our current period results of operations.

Policy acquisition costs. Policy acquisition costs consist of the following items: (i) commissions paid to outside agents at the time of policy issuance, (ii) policy administration fees paid to a third-party administrator at the time of policy issuance, (iii) premium taxes and (iv) inspection fees. We recognize policy acquisition costs ratably over the term of the underlying policy. Until renewed, policies assumed from Citizens have no associated policy acquisition costs. Policy acquisition costs also include the costs to acquire the SSIC policies. We recognize these costs ratably over the term of the unearned premium acquired in the transaction.

General and administrative expenses. General and administrative expenses include compensation and related benefits, professional fees, office lease and related expenses, information system expenses, corporate insurance, and other general and administrative costs.

Provision for income taxes. Provision for income taxes historically consisted of income taxes associated with our subsidiaries that are taxed as corporations. On May 22, 2014, we converted from a limited liability company to a corporation. As a corporation, we are subject to typical corporate U.S. federal and state income tax rates which we expect to result in a statutory tax rate of approximately 38.575% under current tax law.

Ratios

Ceded premium ratio. Our ceded premium ratio represents ceded premiums as a percentage of gross premiums earned.

Gross loss ratio. Our gross loss ratio represents losses and loss adjustment expenses as a percentage of gross premiums earned.

Net loss ratio. Our net loss ratio represents losses and loss adjustment expenses as a percentage of net premiums earned.

Gross expense ratio. Our gross expense ratio represents policy acquisition costs and general and administrative expenses as a percentage of gross premiums earned.

Net expense ratio. Our net expense ratio represents policy acquisition costs and general and administrative expenses as a percentage of net premiums earned.

Combined ratios. Our combined ratio on a gross basis represents the sum of ceded premiums, losses and loss adjustment expenses, policy acquisition costs and general and administrative expenses as a percentage of gross premiums earned. Our combined ratio on a net basis represents the sum of losses and loss adjustment expenses, policy acquisition costs and general and administrative expenses as a percentage of net premiums earned.

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The combined ratio is the key measure of underwriting performance traditionally used in the property and casualty industry. A combined ratio under 100% generally reflects profitable underwriting results.

Due to the impact our reinsurance costs have on net premiums earned from period to period, our management believes the combined ratio on a gross basis is more relevant in assessing overall performance.

Results of Operations – Year Ended December 31, 2016 Compared to Year Ended December 31, 2015

Revenue

Gross premiums written

Gross premiums written increased to $626.7 million for the year ended December 31, 2016 from $586.1 million for the year ended December 31, 2015. The increase in gross premiums written relates primarily to the additional premium generated by the acquisition of Zephyr on March 21, 2016. A full year of revenue associated with the Zephyr transaction will be realized in 2017.

Gross premiums earned

Gross premiums earned increased to $640.5 million for the year ended December 31, 2016 from $524.7 million for the year ended December 31, 2015. 60% of the increase relates to Heritage P&C and 40% relates to the acquisition of Zephyr. Heritage P&C’s increase is primarily due to the impact of policies assumed from Citizens during 2015, particularly the assumptions that occurred in the second half of the year. Heritage P&C’s premium in force increased throughout 2015; a greater portion of the 2015 written premium was earned in 2016 as the policies were in force throughout 2016 and only part of 2015.

Ceded premiums

Ceded premiums increased to $228.8 million for the year ended December 31, 2016 from $148.5 million for the year ended December 31, 2015. The increase in ceded premiums correlates to the increase in policies in force, including an increase in Florida commercial residential business and the addition of Florida and Hawaii wind only policies, which have a higher cost of reinsurance, partially offset by reinsurance synergies on the combined multistate program. On June 1, 2016, we placed a new catastrophe reinsurance program for the 2016 hurricane season, as described in our audited consolidated financial statements included elsewhere in this Form 10-K. Due to our significant growth, including commercial residential and wind only business in Florida and the acquisition of ZAC in Hawaii, we purchased approximately $3 billion of total coverage compared to approximately $2.2 billion of total coverage in 2015. The cost of the catastrophe coverage for the 2016 program was approximately $247 million compared to approximately $180 million for the 2015 program. The costs of the annual reinsurance are amortized over the twelve months beginning June 1. Accordingly, the reinsurance costs for the year ended December 31, 2016 are significantly higher than for the year ended December 31, 2015.

Net premiums earned

Net premiums earned increased to $411.7 million for the year ended December 31, 2016 from $376.3 million for the year ended December 31, 2015. The increase in net premiums earned in the comparable periods is primarily attributable to the increase in the number of policies in force during the year ended December 31, 2016 as compared to the year ended December 31, 2015, including the growth in policy count experienced in the second half of 2015 partially offset by increased ceded earned premiums.

Net investment income

Net investment income, inclusive of net realized investment gains and losses, increased to $10.9 million for the year ended December 31, 2016 from $8.9 million for the year ended December 31, 2015. The increase in net investment income is due to the increase in invested assets from $400.1 million at December 31, 2015 to $603 million at December 31, 2016. The increase resulted primarily from policy growth and the acquisition of Zephyr.

Other revenue

Other revenue increased to $16 million for the year ended December 31, 2016 from $9.6 million for the year ended December 31, 2015. The increase in other revenue between the comparable periods is primarily attributable to the policy fees and pay plan fees generated by our growing portfolio of policies, including the renewal of policies previously assumed from Citizens, coupled with policy fee and pay plan income associated with Zephyr. Revenue earned from non-insurance claims generated by our restoration subsidiary also contributed to the increase.

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Total revenue

Total revenue increased to $439 million for the year ended December 31, 2016 to $394.8 million for the year ended December 31, 2015. The increase in total revenue was due primarily to the growth in gross premiums earned by Heritage P&C due to timing of the increase in premium written during 2015 as well as the increase in the number of policies in force associated with the Zephyr acquisition, partially offset by the increased ceded premiums earned.

Expenses

Losses and loss adjustment expenses

Losses and loss adjustment expenses increased to $238.9 million for the year ended December 31, 2016 from $141.2 million for the year ended December 31, 2015. The increase in losses and loss adjustment expenses resulted primarily from non-catastrophe unfavorable development on prior year loss reserves, an increase in our non-catastrophe loss ratio, the impact of Hurricanes Hermine and Matthew and growth of our business. Losses and loss adjustment expenses for the year ended December 31, 2016 includes losses paid of $157.6 million and a $56.4 million increase in unpaid losses and loss adjustment expenses, which includes the addition of $36.8 million of IBNR reserves. As of December 31, 2016, we reported $140.1 million in unpaid losses and loss adjustment expenses, which included $83.6 million attributable to IBNR, or 59.7% of total reserves for unpaid losses and loss adjustment expenses.

The Company's losses incurred during the years ended December 31, 2016 and 2015 reflect a prior year deficiency of $18.8 million and a redundancy of $5.3 million, respectively, associated with management's best estimate of the actuarial loss and LAE reserves with consideration given to Company specific historical loss experiences. Substantially all of the unfavorable development in 2016 was from personal lines. Also, a majority of the unfavorable development in 2016 has been isolated to the tri-county region of Florida (the counties of Miami-Dade, Broward and Palm Beach). Most of the unfavorable development in 2016 came from the second, third and fourth quarters of 2015, primarily related to claims involving litigation and claims that were represented by attorneys, public adjusters or others (sometimes referred to as Assignment of Benefits). At December 31, 2015, we estimated that the personal lines ultimate loss and LAE ratio, which includes the associated IBNR would be 34.5% for the loss (accident) year 2015. As of December 31, 2016 we have revised the estimated personal lines ultimate loss ratio to be 39% for the loss year 2015, based on the re-estimation of IBNR, a 4.5 percentage point increase.

Additionally, the increase in losses and loss adjustment expenses resulted from the impact of 2016 weather events, including two named hurricanes and to the continued challenges, especially in South Florida, related to the assignment of benefit and litigated claims activity. Approximately $22 million of the increase relates to Hurricanes Hermine and Matthew. Approximately $40 million of the increase relates to elevated non-hurricane weather losses that occurred during the first quarter of 2016 and the assignment of benefit and litigation issues. Approximately $16 million of the increase in losses and loss adjustment expenses is attributable to the growth of our business.

Policy acquisition costs

Policy acquisition costs increased to $84.4 million for the year ended December 31, 2016 from $57.2 million for the year ended December 31, 2015. Approximately $9 million of the increase is attributable to the inclusion of policy acquisition costs, including amortization of certain intangibles associated with the acquisition of Zephyr. The remainder of the increase relates to the renewal of policies assumed from Citizens as well as new voluntary policies written during 2016, which have associated commissions and administration fees paid to outside agents and administrators at the time of policy issuance, premium taxes and inspection fees, none of which are associated with policies assumed from Citizens prior to their renewal. The impact of amortization of certain intangible costs associated with the Zephyr transaction increased the policy acquisition ratio by approximately 1% from 2015.

General and administrative expenses

General and administrative expenses increased to $58.9 million for the year ended December 31, 2016 from $46.1 million for the year ended December 31, 2015. The increase in 2016 was due to general and administrative expenses associated with Zephyr of approximately $4 million coupled with the growth in our infrastructure to manage the growing number of policies which results in greater costs associated with our personnel, enhancement of IT systems facilities and overall business activity. General and administrative expenses in 2016 includes amortization of certain intangible costs associated with the Zephyr acquisition.

Provision for income taxes

Provision for income taxes was $22.5 million and $57.8 million for the years ended December 31, 2016 and 2015, respectively. Our effective tax rates for the years ended December 31, 2016 and 2015 were 40% and 38.5%, respectively. The increase in the effective tax rate is primarily a result of permanent items as more fully described in Note 12 – Income Taxes to our consolidated

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financial statements included elsewhere in this Form 10-K. The tax rate is further impacted overall due to the magnitude of pre-tax income which amplifies the impact of effective tax rate items due to lower income levels compared to the prior year.

Net Income

For the year ended December 31, 2016, we generated net income of $33.9 million, or $1.14 earnings per diluted common share, compared to net income of $92.5 million, or $3.05 earnings per diluted common share, for the year ended December 31, 2015. The weighted average shares outstanding on a diluted basis decreased from 30.3 million shares to 29.6 million shares as of December 31, 2016, primarily due to shares purchased under our Repurchase Program. The decrease in net income is primarily due to the increase in the ceded premium ratio and the increase in our 2016 loss ratio. The primary driver for the increase in the ceded premium ratio is described below. The primary drivers for the increase in the loss ratio derived from unfavorable development on prior year loss reserves coupled with the impact of Hurricanes Hermine and Matthew and current market conditions in Florida, especially South Florida, by which assignment of benefits claims and attorney represented claims have escalated and driven up loss costs. Additionally unfavorable loss development from the prior loss year was recorded in 2016 while favorable development for 2014 was recorded in 2015. The acquisition of ZAC was completed on March 21, 2016.

Ratios – Year Ended December 31, 2016 Compared to Year Ended December 31, 2015

Due to the impact our reinsurance costs have on net premiums earned from period to period, our management believes the ratios discussed below are more meaningful when viewed on a gross basis.

| | Year Ended December 31, | |
|---|---|---|
| | 2016 | 2015 |
| Ratios to Gross Premiums Earned: | (unaudited) | |
| Ceded premium ratio | 35.7% | 28.3% |
| Loss ratio | 37.3% | 26.9% |
| Expense ratio | 22.4% | 19.7% |
| Combined ratio | 95.4% | 74.9% |
| | | |
| Ratios to Net Premiums Earned: | | |
| Loss ratio | 58.0% | 37.5% |
| Expense ratio | 34.8% | 27.5% |
| Combined ratio | 92.8% | 65.0% |

Ceded premium ratio

Our ceded premium ratio increased to 35.7% for the year ended December 31, 2016 compared to 28.3% for the year ended December 31, 2015. The ceded premium ratio for the year ended December 30, 2015 benefited significantly from large Citizens depopulation activity in the fourth quarter of 2014 and first quarter of 2015, for which we incurred no additional reinsurance costs until June 1, 2015. Additionally, the 2016 reinsurance program, which was effective June 1, 2016, included coverage for an increase in commercial residential policies and the addition of Zephyr and Heritage wind only polices, all of which have a higher ceded premium ratio.

Gross loss ratio

Our gross loss ratio increased to 37.3% for the year ended December 31, 2016 from 26.9% for the year ended December 31, 2015, as a result of severe weather activity, primarily in the first quarter, Hurricanes Hermine and

Matthew, unfavorable development on prior year loss reserves and current market conditions for Florida personal lines multi-peril business with respect to litigated and attorney represented claims, particularly in the tri-county area in South Florida. Additionally, favorable development on 2014 losses was recorded in 2015, while unfavorable development in 2015 losses was recorded in 2016.

Net loss ratio

Our net loss ratio increased to 58.0% for the year ended December 31, 2016 from 37.5% for the year ended December 31, 2015, primarily as a result of the items discussed above combined with the increase in the ceded premium ratio.

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Gross expense ratio

Our gross expense ratio increased to 22.4% for the year ended December 31, 2016 from 19.7% for the year ended December 31, 2015, primarily due to the larger Citizens take-out activity favorably impacting the prior year acquisition costs, coupled with an increase in the general and administration expense ratio. Amortization of intangibles associated with the Zephyr transaction added 1.1% to the gross expense ratio.

Net expense ratio

Our net expense ratio increased to 34.8% for the year ended December 31, 2016 from 27.5% for the year ended December 31, 2015, primarily due to the increase in the gross expense ratio discussed above, coupled with the higher ceded premium ratio.

Combined ratio

Our combined ratio on a gross basis increased to 95.4% for the year ended December 31, 2016 from 74.9% for the year ended December 31, 2015. Our combined ratio on a net basis increased to 92.8% for the year ended December 31, 2016 from 65% for the year ended December 31, 2015. The increase in the combined ratio is the result of the significant benefit to our ceded premium ratio and acquisition expense ratio for the year ended December 30, 2015 from the much larger Citizens take-outs in the fourth quarter of 2014 and first quarter of 2015, reducing the 2015 reinsurance and acquisition expense ratio, and the much higher gross loss ratio in the year ended December 30, 2016 due to the severe weather activity, unfavorable prior year development, and a higher loss ratio due to the current market conditions in Florida previously discussed.

Results of Operations – Year Ended December 31, 2015 Compared to Year Ended December 31, 2014

Revenue

Gross premiums written

Gross premiums written increased to $586.1 million for the year ended December 31, 2015 from $436.4 million for the year ended December 31, 2014. The increase in gross premiums written was due to the renewal of a significant number of policies previously assumed from Citizens and SSIC, the growing number of new voluntary policies written and the assumption of approximately 68,200 personal residential policies from Citizens, as well as approximately 100 commercial residential policies from Citizens in 2015. Of our gross premiums written for the year ended December 31, 2015, $487.6 million represents direct premiums written and $98.5 million represents assumed premiums written. Of the $487.6 million of direct premiums written, renewals of policies previously assumed from Citizens accounted for $393.5 million and renewals of policies previously assumed from SSIC accounted for $41.4 million, while voluntary business accounted for $92.7 million. The assumed premiums written of $98.5 million was comprised of policies assumed from Citizens.

Gross premiums earned

Gross premiums earned increased to $524.7 million for the year ended December 31, 2015 from $311.5 million for the year ended December 31, 2014. Our policies in force as of December 31, 2015 and 2014 were approximately 257,100 and 209,400, respectively, and this increase had a favorable impact on our gross premiums earned. Additionally, we experienced significant growth during the second half of 2014, including the acquisition of SSIC policies in June 2014 and the introduction of commercial residential business during the fourth quarter of 2014. This business generated earned premiums for the full year for 2015, while only generating earned premiums for partial year of 2014. Gross earned premiums from commercial residential was $97.2 million for 2015, as compared to $18.9 million for 2014.

Ceded premiums

Ceded premiums increased to $148.5 million for the year ended December 31, 2015 from $87.9 million for the year ended December 31, 2014. The increase in ceded premiums is primarily a result of the significant increase in the policies in force noted above, in particular the introduction of commercial residential business which has higher reinsurance costs as measured against gross earned premium than personal residential. The increase in ceded premiums was partially offset by lower reinsurance costs due to favorable reinsurance market conditions and the availability of lower cost reinsurance related to $477.5 million of catastrophe bonds issued by Citrus Re, and improved geographic spread of risk.



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Net premiums earned

Net premiums earned increased to $376.3 million for the year ended December 31, 2015 from $223.6 million for the year ended December 31, 2014. The increase in net premiums earned in the comparable periods is primarily attributable to the increase in the number of policies in force during the year ended December 31, 2015 as compared to the year ended December 31, 2014, the growth in policy count experienced in the second half of 2014, partially offset by increased ceded earned premiums.

Net investment income

Net investment income, inclusive of net realized investment gains and losses, increased to $8.9 million for the year ended December 31, 2015 from $4.2 million for the year ended December 31, 2014. The increase in net investment income is due to the increase in invested assets to $400.1 million at December 31, 2015 from $331.2 million at December 31, 2014. The increase resulted primarily from policy growth and an increase in net realized gains to $1.5 million in 2015 from $0.3 million in 2014, resulting from the Company being reactive to market conditions.

Other revenue

Other revenue increased to $9.6 million for the year ended December 31, 2015 from $6.1 million for the year ended December 31, 2014. The increase in other revenue between the comparable periods is primarily attributable to the policy fees generated by our growing portfolio of new and renewed policies. Also, the rental income received pursuant to non-cancelable leases for our commercial property in Clearwater, Florida, and revenue earned from non-insurance claims generated by our restoration subsidiary contributed to the increase.

Total revenue

Total revenue increased to $394.8 million for the year ended December 31, 2015 from $233.8 million for the year ended December 31, 2014. The increase in total revenue was due primarily to the growth in net premiums earned resulting from the significant increase in the number of policies in force throughout the year ended December 31, 2015 as compared to the prior year.

Expenses

Losses and loss adjustment expenses

Losses and loss adjustment expenses increased to $141.2 million for the year ended December 31, 2015 from $89.6 million for the year ended December 31, 2014. The increase in losses and loss adjustment expenses resulted primarily from an increase in the number of policies in force between the respective periods, partially offset by a 1.8 percentage point decrease in the gross loss ratio. Losses and loss adjustment expenses for the year ended December 31, 2015 include losses paid of $57.5 million and a $32.3 million increase in unpaid losses and loss adjustment expenses, including the addition of $16.8 million of IBNR reserves. As of December 31, 2015, we reported $83.7 million in unpaid losses and loss adjustment expenses which included $46.9 million attributable to IBNR, or 56% of total reserves for unpaid losses and loss adjustment expenses.

Policy acquisition costs

Policy acquisition costs increased to $57.2 million for the year ended December 31, 2015 from $36.5 million for the year ended December 31, 2014. The increase is primarily attributable to the significant increase in new and renewed policies, which have associated commissions and administration fees paid to outside agents and administrators at the time of policy issuance, premium taxes and inspection fees, none of which are associated with policies assumed from Citizens prior to their renewal. This was partially offset by the fact that, $7.6 million of the $10 million SSIC policy

acquisition fee was amortized during the year ended December 31, 2014, compared to only $2.4 million during the year ended December 31, 2015.

General and administrative expenses

General and administrative expenses increased to $46.1 million for the year ended December 31, 2015 from $33.5 million for the year ended December 31, 2014. The increase in 2015 was due primarily to the growth in our infrastructure resulting in greater costs associated with our personnel, facilities and overall business activity.

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Provision for income taxes

Provision for income taxes was $57.8 million and $27.2 million for the years ended December 31, 2015 and 2014, respectively. Our effective tax rates for the years ended December 31, 2015 and 2014 were 38.6% and 36.6%, respectively. The increase in the effective tax rate is a result of prior period adjustments and more favorable permanent differences in 2014.

Net Income

For the year ended December 31, 2015 we generated net income of $92.5 million, or $3.05 earnings per diluted common share, compared to net income of $47.1 million, or $1.82 earnings per diluted common share, for the year ended December 31, 2014. The weighted average shares outstanding on a diluted basis increased from 25.8 million shares to 30.3 million shares as of December 31, 2015, primarily due to the issuance of IPO shares mid-year 2014 causing 2014 diluted shares to be lower.

Ratios – Year Ended December 31, 2015 Compared to Year Ended December 31, 2014

Due to the impact our reinsurance costs have on net premiums earned from period to period, our management believes the ratios discussed below are more meaningful when viewed on a gross basis.

| | Year Ended December 31, | |
|---|---|---|
| | 2015 | 2014 |
| Ratios to Gross Premiums Earned: | (unaudited) | |
| Ceded premium ratio | 28.3% | 28.2% |
| Loss ratio | 26.9% | 28.7% |
| Expense ratio | 19.7% | 22.5% |
| Combined ratio | 74.9% | 79.4% |
| | | |
| Ratios to Net Premiums Earned: | | |
| Loss ratio | 37.5% | 40.1% |
| Expense ratio | 27.5% | 31.3% |
| Combined ratio | 65.0% | 71.4% |

Ceded premium ratio

Our ceded premium ratio was relatively unchanged at 28.3% for the year ended December 31, 2015 compared to 28.2% for the year ended December 31, 2014.

Gross loss ratio

Our gross loss ratio decreased to 26.9% for the year ended December 31, 2015 from 28.7% for the year ended December 31, 2014, primarily due to the introduction of commercial residential business during the quarter ended December 31, 2014, which has a significantly lower loss ratio then personal residential. Commercial residential represented 18.5% of total gross earned premiums in 2015 compared to 6.1% in 2014.

Net loss ratio

Our net loss ratio decreased to 37.5% for the year ended December 31, 2015 from 40.1% for the year ended December 31, 2014, primarily as a result of the increase in commercial residential business in 2015.

Gross expense ratio

Our gross expense ratio decreased to 19.7% for the year ended December 31, 2015 from 22.5% for the year ended December 31, 2014, primarily as a result of general and administrative expenses increasing at significantly slower pace than gross premiums earned.

Net expense ratio

Our net expense ratio decreased to 27.5% for the year ended December 31, 2015 from 31.3% for the year ended December 31, 2014, primarily as a result of general and administration expenses increasing at significantly slower pace than gross premiums earned.

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Combined ratio

Our combined ratio on a gross basis decreased to 74.9% for the year ended December 31, 2015 from 79.4% for the year ended December 31, 2014. Our combined ratio on a net basis decreased to 65% for the year ended December 31, 2015 from 71.4% for the year ended December 31, 2014. The changes in our combined ratio, on both a gross and net basis, are primarily as a result of the improvement of the loss and expense ratios to earned premiums, as discussed above.

Liquidity and Capital Resources

As of December 31, 2016, we had $105.8 million of cash and cash equivalents, which primarily consisted of cash and money market accounts. We intend to hold substantial cash balances during hurricane season to meet seasonal liquidity needs and the collateral requirements of Osprey, our captive reinsurance company described below. We also had $20.9 million in restricted cash to meet our contractual obligations related to the Catastrophe bonds issued by Citrus Re.

Osprey is required to maintain a collateral trust account equal to the risk that it assumes from our insurance company affiliates, less amounts collateralized through a letter of credit. As of December 31, 2016, $12.8 million was held in Osprey’s trust account, $12.7 million was collateralized with a letter of credit, and there was a net premium receivable from Heritage P&C of $14.6 million which was paid on February 7, 2017. At December 31, 2016, Osprey provided $20 million excess $20 million of reinsurance coverage to Heritage P&C and Zephyr and $20 million excess $0 to Heritage P&C under two different reinsurance programs.

Although we can provide no assurances, we believe that we maintain sufficient liquidity to pay our insurance company affiliate’s claims and expenses, as well as to satisfy commitments in the event of unforeseen events such, 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.

As of December 31, 2016, we had 28,840,443 shares of common stock outstanding, options to purchase 1,149,923 shares of common stock, at a weighted average price of $16.28 and 900,000 unvested shares of restricted common stock, reflecting total paid-in capital of $205.7 million as of such date.

We believe our current capital resources, together with cash provided from our operations, will be sufficient to meet currently anticipated working capital requirements. We cannot provide assurance, however, that such will be the case in the future.

On December 15, 2016, we issued Senior Notes in the aggregate principal amount of $79.5 million which consisted of a 7 year term note payable to 6 accredited investors. See Note 11 — “Note Payable” to our consolidated financial statements under Item 8 of this Annual Report on Form 10-K.

Statement of Cash Flows

The net increases (decreases) in cash and cash equivalents are summarized in the following table:

| | For the Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2016 | 2015 | 2014 | 2016 vs 2015 Change | 2015 vs 2014 Change |
| Net cash provided by (used in): | (in thousands) | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Operating activities | $75,130 | $153,121 | $194,196 | $(77,991 ) | $(41,075 ) |
| Investing activities | (249,416) | (86,964 ) | (200,047) | (162,452) | 113,083 |
| Financing activities | 43,826 | 9,639 | 101,273 | 34,187 | (91,634 ) |
| Net increase (decrease) in cash and cash equivalents | $(130,460) | $75,796 | $95,422 | $(206,256) | $(19,626 ) |

Operating Activities

Net cash provided by operating activities for December 31, 2016 was $75.1 million as compared to $153.1 million cash provided during the year ended December 31, 2015. The decrease resulted primarily from the timing of assumed premium payments from Citizens, reinsurance premium payments, claim payments, and tax deposit payments.

Investing Activities

Net cash used in investing activities for the year ended December 31, 2016 was $249.4 million as compared to $86.9 million for the year ended December 31, 2015, reflecting the investment of funds provided by operating activities including the acquisition of Zephyr.

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Financing Activities

Net cash provided by financing activities for the year ended December 31, 2016 was $43.8 million, as compared to $9.6 million for the year ended December 31, 2015. In December 2016, the Company entered into a debt arrangement providing net proceeds in the amount of $77.9 million. This was partially offset by payment of dividends to shareholders and purchase of treasury stock in 2016.

Taxation

Deferred Tax Liability and Current Tax Receivable

In prior years we reported a deferred tax asset arising from the portion (20%) of unearned premiums that are otherwise recognized as taxable income in advance of being earned for financial reporting purposes. In 2016, there was a shift to a deferred tax liability. The deferred tax liability is created from purchase accounting for the Zephyr acquisition which created temporary differences due to the timing of tax deductions related to the purchased intangibles. In prior years we reported a net deferred tax asset which was driven primarily by the deferred tax asset arising from the portion (20%) of unearned premiums that are otherwise recognized as taxable income in advance of being earned for financial reporting purposes which was partially offset by deferred tax liabilities associated with policy acquisition costs deferred and amortized for financial statement purposes, but deducted currently for tax. In 2016, the Company reported a net deferred tax liability. The change from 2015 was primarily driven by an increase in deferred tax liabilities associated with Zephyr purchased intangibles for which the Company has no tax basis. Furthermore, the Company had recorded deferred tax liabilities associated with partnership investments for which the book basis is greater than the corresponding tax basis largely due to accelerated taxable losses being recorded in the current year. Our current year income taxes recoverable reflects excess estimated tax deposits over the tax to be remitted to the US Treasury. The excess payments are largely the result of the estimation process required by the Internal Revenue Service throughout the year to pay estimated quarterly deposits which indicated larger annualized tax liability than was actually realized at December 31. Our current year income taxes recoverable reflect this temporary difference between taxable income and earned income reported in our financial statements.

Conversion to a Corporation

On May 22, 2014, Heritage Insurance Holdings, Inc. was converted from a limited liability company to a corporation. As a limited liability company, Heritage Insurance was treated as a partnership for tax purposes, and accordingly was not subject to entity-level federal or state income taxation. Our income tax provision generally consists of income taxes payable by our separate subsidiaries that are taxed as corporations and which have been taxed as such since our inception. As such, our effective tax rate as a limited liability company has historically been driven primarily by the taxable income recognized by our subsidiaries. As a corporation, we are subject to typical corporate U.S. federal and state income tax rates which we generally expect to result in a statutory tax rate of approximately 38.575% under current tax law.

Contractual Obligations and Commitments

The following table summarizes our material contractual obligations and commitments as of December 31, 2016:

| | Total | Less than 1 year | 1-3 Years | 3-5 years | More than 5 years |
|---|---|---|---|---|---|
| | (in thousands) | | | | |
| Long-term debt [1] | $124,495 | $7,390 | $24,437 | $25,407 | $67,261 |

| | | | | | |
|---|---|---|---|---|---|
| Reinsurance contracts | 96,667 | 96,667 | — | — | — |
| Total | $221,162 | $104,057 | $24,437 | $25,407 | $67,261 |

1. Amount differs from the balance presented on the consolidated balance sheet at December 31, 2016 because the long term debt amount above includes interest and excludes issuance costs.

Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements requires us to make judgments and estimates that may have a significant impact upon our financial results. Note 1, under Item 8, Financial Statements and Supplementary Data — Notes to Consolidated Financial Statements, of this Annual Report contains a summary of our significant accounting policies, many of which require the use of estimates and assumptions. We believe that the following areas are particularly subject to management’s judgments and estimates and could materially affect our results of operations and financial position.

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Premiums. We recognize direct and assumed premiums written as revenue, net of ceded amounts, on a daily pro rata basis over the contract period of the related policies that are in force. For any portion of premiums not earned at the end of the reporting period, we record an unearned premium liability.

Premiums receivable represents amounts due from our policyholders for billed premiums and related policy fees. We perform a policy-level evaluation to determine the extent to which the balance of the premium receivable exceeds the balance of the unearned premium. We then age any resulting exposure based on the last date the policy was billed to the policyholder, and we establish an allowance account for credit losses for any amounts outstanding for more than 90 days. When we receive payments on amounts previously charged off, we credit bad debt expense in the period we receive the payment. Balances in premiums receivable and the associated allowance account are removed upon cancellation of the policy due to non-payment. We recorded an allowance of $0 and $250,000 for uncollectible premiums at December 31, 2016 and 2015, respectively.

When we receive premium payments from policyholders prior to the effective date of the related policy, we record an advance premium liability. On the policy effective date, we reduce the advance premium liability and record the premiums as described above.

Reserves for Unpaid Losses and Loss Adjustment Expenses. Reserves for unpaid losses and loss adjustment expenses, also referred to as loss reserves, represent the most significant accounting estimate inherent in the preparation of our financial statements. These reserves represent management’s best estimate of the amount we will ultimately pay for losses and loss adjustment expenses and we base the amount upon the application of various actuarial reserve estimation techniques as well as considering other material facts and circumstances known at the balance sheet date.

We establish two categories of loss reserves as follows:

- Case reserves—When a claim is reported, we establish an initial estimate of the losses that will ultimately be paid on the reported claim. Our initial estimate for each claim is based upon the judgment of our claims professionals who are familiar with property and liability losses associated with the coverage offered by our policies. Then, our claims personnel perform an evaluation of the type of claim involved, the circumstances surrounding each claim and the policy provisions relating to the loss and adjust the reserve as necessary. As claims mature, we increase or decrease the reserve estimates as deemed necessary by our claims department based upon additional information we receive regarding the loss, the results of on-site reviews and any other information we gather while reviewing the claims.
- IBNR reserves—Our IBNR reserves include true IBNR reserves plus “bulk” reserves. True IBNR reserves represent amounts related to claims for which a loss occurred on or before the date of the financial statements but which have not yet been reported to us. Bulk reserves represent additional amounts that cannot be allocated to particular claims, but which are necessary to estimate ultimate losses on known claims. We estimate our IBNR reserves by projecting our ultimate losses using industry accepted actuarial methods and then deducting actual loss payments and case reserves from the projected ultimate losses. We review and adjust our IBNR reserves on a quarterly basis based on information available to us at the balance sheet date.

When we establish our reserves, we analyze various factors such as the evolving historical loss experience of the insurance industry as well as our experience, claims frequency and severity, our business mix, our claims processing procedures, legislative enactments, judicial decisions and legal developments in imposition of damages, and general economic conditions, including inflation. A change in any of these factors from the assumptions implicit in our estimates will cause our ultimate loss experience to be better or worse than indicated by our reserves, and the difference could be material. Due to the interaction of the foregoing factors, there is no precise method for evaluating the impact of any one specific factor in isolation, and an element of judgment is ultimately required. Due to the uncertain nature of any future projections, the ultimate amount we will pay for losses will be different from the reserves we record.

We determine our ultimate loss reserves by selecting an estimate within a relevant range of indications that we calculate using generally accepted actuarial techniques. Our selection of the point estimate is influenced by the

analysis of our paid losses and incurred losses since inception, as well as industry information relevant to the population of exposures drawn from Citizens.

Our chief actuary evaluated the adequacy of our reserves as of December 31, 2016 and concluded that total reserves ranging from a low of $129.4 million to a high of 145.9 million would meet the requirements of the insurance laws of Florida, be consistent with reserves computed in accordance with accepted loss reserving standards and principles, and make a reasonable provision for all unpaid loss and loss adjustment expense obligations under the terms of our contracts and agreements. In addition to $56.5 million of recorded case reserves, we recorded $83.6 million of IBNR reserves as of December 31, 2016 to achieve overall gross reserves of $140.1 million.

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The process of establishing our reserves is complex and inherently imprecise, as it involves using judgment that is affected by many variables. We believe a reasonably likely change in almost any of the factors we evaluate as part of our loss reserve analysis could have an impact on our reported results, financial position and liquidity.

The following table quantifies the pro forma impact of hypothetical changes in our loss reserves on our net income, stockholders' equity and liquidity as of and for the year ended December 31, 2016 (in thousands).

| | Actual | Low Estimate | % Change from Actual | | High Estimate | % Change from Actual | |
|---|---|---|---|---|---|---|---|
| Loss Reserves | $140,137 | $ 129,388 | | | $ 145,944 | | |
| | | | | | | | |
| Impact on: | | | | | | | |
| Net income | $33,865 | $ 40,469 | 19.5 | % | $ 30,299 | -10.5 | % |
| Stockholders' equity | $357,959 | $ 364,562 | 1.8 | % | $ 354,392 | -1.0 | % |
| Cash, cash equivalents and investments | $708,799 | $ 708,799 | — | | $ 708,799 | — | |
| Adjusted cash, cash equivalents and investments | $622,720 | $ 629,322 | 1.1 | % | $ 619,152 | -0.6 | % |

(1) Adjusted cash, cash equivalents and investments is intended to present a measure of future liquidity and consists of cash, cash equivalents and investments, less loss reserves, net of taxes, assuming a 38.575% tax rate.

Policy Acquisition Costs. We incur policy acquisition costs that vary with, and are directly related to, the production of new business. Policy acquisition costs consist of the following four items: (i) commissions paid to outside agents at the time of policy issuance, (ii) policy administration fees paid to a third-party administrator at the time of policy issuance, (iii) premium taxes and (iv) inspection fees. We capitalize policy acquisition costs to the extent recoverable, then we amortize those costs over the contract period of the related policy.

At each reporting date, we determine whether we have a premium deficiency. A premium deficiency would result if the sum of our expected losses, deferred policy acquisition costs and policy maintenance costs (such as costs to store records and costs incurred to collect premiums and pay commissions) exceeded our related unearned premiums plus investment income. Should we determine that a premium deficiency exists, we would write off the unrecoverable portion of deferred policy acquisition costs.

Reinsurance. We follow industry practice of reinsuring a portion of our risks. Reinsurance involves transferring, or "ceding", all or a portion of the risk exposure on policies we write to another insurer, known as a reinsurer. To the extent that our reinsurers are unable to meet the obligations they assume under our reinsurance agreements, we remain liable for the entire insured loss.

Our reinsurance agreements are short-term, prospective contracts. We record an asset, prepaid reinsurance premiums, and a liability, reinsurance payable, for the entire contract amount upon commencement of our new reinsurance agreements. We amortize our prepaid reinsurance premiums over the 12-month contract period.

In the event that we incur losses recoverable under our reinsurance program, we record amounts recoverable from our reinsurers on paid losses plus an estimate of amounts recoverable on unpaid losses. The estimate of amounts recoverable on unpaid losses is a function of our liability for unpaid losses associated with the reinsured policies; therefore, the amount changes in conjunction with any changes to our estimate of unpaid losses. In the event that we

incur losses recoverable under the reinsurance program, the estimate of amounts recoverable from reinsurers on unpaid losses may change at any point in the future because of its relation to our reserves for unpaid losses.

We estimate uncollectible amounts receivable from reinsurers based on an assessment of factors including the creditworthiness of the reinsurers and the adequacy of collateral obtained, where applicable. We recorded no uncollectible amounts under our reinsurance program or bad debt expense related to reinsurance for the years ended December 31, 2016 and December 31, 2015.

Investments. We currently classify all of our investments in fixed maturity securities and equity securities as available-for-sale, and report them at fair value. We classified our investment in a mortgage loan as held to maturity and report it at amortized cost. Subsequent to our acquisition of available-for-sale securities, we record changes in value through the date of disposition as unrealized holding gains and losses, net of tax effects, and include them as a component of other comprehensive income. We include realized gains and losses, which we calculate using the specific-identification method for determining the cost of securities sold, in net income. We amortize any premium or discount on investments over the remaining maturity period of the related investments using the effective interest method, and we report the amortization in net investment income. We recognize dividends and interest income when earned.

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Quarterly, we perform an assessment of our investments to determine if any are "other-than-temporarily" impaired. An investment is impaired when the fair value of the investment declines to an amount less than the cost or amortized cost of that investment. As part of our assessment process, we determine whether the impairment is temporary or "other-than-temporary". We base our assessment on both quantitative criteria and qualitative information, considering a number of factors including, but not limited to: how long the security has been impaired; the amount of the impairment; whether, in the case of equity securities, we intend to hold, and have the ability to hold, the security for a period sufficient for us to recover our cost basis, or whether, in the case of debt securities, we intend to sell the investment or it is more likely than not that we will have to sell the investment before we recover the amortized cost; the financial condition and near-term prospects of the issuer; whether the issuer is current on contractually-obligated interest and principal payments; key corporate events pertaining to the issuer and whether the market decline was affected by macroeconomic conditions.

If we were to determine that an equity security has incurred an "other-than-temporary" impairment, we would permanently reduce the cost of the security to fair value and recognize an impairment charge. If a debt security loan is impaired and we either intend to sell the security loan or it is more likely than not that we will have to sell the security loan before we are able to recover the amortized cost, then we would record the full amount of the impairment in our net income.

A large portion of our investment portfolio consists of fixed maturity securities, which may be adversely affected by changes in interest rates as a result of governmental monetary policies, domestic and international economic and political conditions and other factors beyond our control. A rise in interest rates would decrease the net unrealized holding gains of our investment portfolio, offset by our ability to earn higher rates of return on funds reinvested. Conversely, a decline in interest rates would increase the net unrealized holding gains of our investment portfolio, offset by lower rates of return on funds reinvested.

Fair Value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (an exit price). When reporting the fair values of the Company's financial instruments, the Company prioritizes those fair value measurements into one of three levels based on the nature of the inputs, as follows:

- Level 1—Assets and liabilities with values based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company is able to access;
- Level 2—Asset and liabilities with values based on quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets in markets that are not active; or valuation models with inputs that are observable, directly or indirectly for substantially the term of the asset or liability.
- Level 3—Assets and liabilities with values that are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. Unobservable inputs reflect the Company's estimates of the assumptions that market participants would use in valuing the assets and liabilities.

We estimate the fair value of our investments using the closing prices on the last business day of the reporting period, obtained from active markets. For securities for which quoted prices in active markets are unavailable, we use observable inputs such as quoted prices in inactive markets, quoted prices in active markets for similar instruments, benchmark interest rates, broker quotes and other relevant inputs. We do not have any investments in our portfolio which require us to use unobservable inputs. Our estimates of fair value reflect the interest rate environment that existed as of the close of business on December 31, 2016 and December 31, 2015. Changes in interest rates subsequent to December 31, 2016 may affect the fair value of our investments.

The carrying amounts for the following financial instruments approximate their fair values at December 31, 2016 and December 31, 2015 because of their short-term nature: cash and cash equivalents, accrued investment income, premiums receivable, reinsurance payable, and accounts payable and accrued expenses.

Our non-financial assets, such as goodwill, purchased intangible assets, and property and equipment are carried at cost until there are indicators of impairment, and are recorded at fair value only when an impairment charge is recognized.

Stock-Based Compensation. We recognize compensation expense under ASC 718 for stock-based payments based on the fair value of the awards. The Company grants stock options at exercise prices equal to the fair market value of the Company's stock on the dates the options are granted. The options have a maximum term of ten years from the date of grant and vest primarily in equal annual installments over a range of one to five year periods following the date of grant for employee options. If a participant's employment relationship ends, the participant's vested awards will remain exercisable for the shorter of a period of 30 days or the period ending on the latest date on which such award could have been exercisable. The fair value of each option grant is separately estimated for each grant date. The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the award and each vesting date. The Company estimates the fair value of all stock option awards as of the date of the grant by applying the Black-Scholes-Merton multiple-option pricing valuation model. The application of this valuation model involves assumptions that

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are judgmental and highly sensitive in the determination of compensation expense. The fair value of restricted stock awards are estimated by the market price at the date of grant and amortized on a straight-line basis to expense over the period of vesting. We recorded $3.1 million, $2.6 million and $3.3 million of stock-based compensation in 2016, 2015 and 2014, respectively.

Long-term Debt and Debt issuance costs. On December 15, 2016, the Company entered into a Senior Secured Note (the “Notes”) with six accredited investors. The Notes has a total debt capacity of $80.0 million. The Company received net proceeds from the Note of $77.9 million. The Notes have a maturity date of December 15, 2023 and bear interest at a rate equal to a three-month average of LIBOR plus 8.75% per annum. The Company incurred 2% of gross proceeds in debt issuance costs or $1.6 million which consist of fees and expenses incurred in connection with the Note issuance, including legal, accounting and other related fees and a 6% one-time finders’ fee of $4.8 million. The debt issuance costs are amortized using the effective interest method over the terms of the debt issuance. The amortization expense is included in interest expense in the Company’s Consolidated Statements of Income and Comprehensive Income. Under the guidance of ASU No. 2015-03, the debt financing costs related to recognized debt liabilities is required to be presented on our balance sheet as a direct reduction, or contra liability, from the carrying value of the debt. At December 31, 2016, the Company has recorded on its balance sheet the net debt liability of $72.9 million. For the years ended December 31, 2016 and 2015, the Company capitalized $6.6 million and $0, in total capitalized debt insurance costs, respectively.

Interest. Costs associated with the refinancing or issuance of debt, as well as debt discounts or premiums, are recorded as interest over the term of its related debt. The Company may enter into interest rate exchange agreements; the amount to be paid or received under such agreements is accrued and recognized over the life of the agreements as an adjustment to interest expense.

Income taxes. On May 22, 2014, the Company converted from a limited liability company to a corporation. As a limited liability company, the Company was treated as a partnership for tax purposes, and accordingly was not subject to entity-level federal or state income taxation. The Company’s income tax provision generally consisted of income taxes payable by its separate subsidiaries that are taxed as corporations. As such, the Company’s effective tax rate as a limited liability company has historically been driven primarily by the taxable income recognized with respect to gross premiums written. As a corporation, the Company is subject to typical corporate U.S. federal and state income tax rates on a consolidated basis which it expects to result in a statutory tax rate of approximately 38.575% under current tax law.

We recognize deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. We measure deferred tax assets and liabilities using enacted tax rates expected to apply to taxable income in the years in which we expect to recover or settle those temporary differences. Should a change in tax rates occur, we recognize the effect on deferred tax assets and liabilities in operations in the period that includes the enactment date. Realization of our deferred income tax assets depends upon our generation of sufficient future taxable income.

We recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more likely than not threshold, the amount recognized in the consolidated financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant taxing authority.

We record any income tax penalties and income tax-related interest as income tax expense in the period incurred. We did not incur any material tax penalties or income tax-related interest during the years ended December 31, 2016, 2015 and 2014.

Recent Accounting Pronouncements Adopted

In April 2015, the Financial Accounting Standards Board ("FASB") issued guidance for Simplifying the Presentation of Debt Issuance Costs. This guidance requires debt issuance costs (deferred financing costs) related to a recognized debt liability to be presented on the balance sheet as a direct deduction from the related debt liability, similar to the presentation of debt discounts. The update is effective for fiscal years beginning after December 15, 2015 and interim periods within those fiscal years. Additionally, in August 2015, the FASB issued additional guidance, which provides further clarification on the same topic and states that the SEC would not object to the deferral and presentation of debt issuance costs as an asset and subsequent amortization of the deferred costs over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. This guidance does not have a material effect on our consolidated financial statements as it results only in a reclassification on the Consolidated Statements of Assets and Liabilities. Accordingly, there was no impact on net asset value or net increase in net assets resulting from operations as a result of adoption of this guidance.

In May 2015, issued guidance addressing enhanced disclosure requirements for insurers relating to short-duration insurance contract claims and the unpaid claims liability rollforward for short-duration contracts. The disclosures are intended to provide users of financial statements with more transparent information about an insurance entity's initial claim estimates and subsequent

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adjustments to those estimates, the methodologies and judgments used to estimate claims, and the timing, frequency, and severity of claims. The guidance is effective for annual reporting periods beginning after December 15, 2015. Early application is permitted. The Company adopted this guidance effective January 1, 2016. The adoption of this guidance results in additional disclosures but did not impact the Company's results of operations, financial position or liquidity.

Recent Accounting Pronouncements Not Yet Effective

The Company describes the recent pronouncements that have had or may have a significant effect on its financial statements or on its disclosures. The Company does not discuss recent pronouncements that a) are not anticipated to have an impact on, or b) are unrelated to its financial condition, results of operations, or related disclosures. For accounting pronouncements not yet adopted, refer to "Note 1.  Basis of Presentation, Nature of Business and Significant Accounting Policies and Practices" in the notes to the consolidated financial statements.

Seasonality of our Business

Our insurance business is seasonal as hurricanes typically occur during the period from June 1 through November 30 each year. With our reinsurance program effective on June 1 each year, any variation in the cost of our reinsurance, whether due to changes to 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 of each year, subject to certain adjustments.

Off-Balance Sheet Arrangements

We obtained a $12.7 million irrevocable letter of credit from a financial institution to secure Osprey's obligations arising from our reinsurance program. We collateralized this letter of credit facility with otherwise unencumbered real estate. The letter of credit terminates on May 31, 2017.

JOBS Act

We qualify as an "emerging growth company" under the JOBS Act. Section 107 of the JOBS Act provides that an emerging growth company can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. In other words, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have irrevocably elected not to avail ourselves of this extended transition period and, as a result, we will adopt new or revised accounting standards on the relevant dates on which adoption of such standards is required for other public companies.

We are in the process of evaluating the benefits of relying on other exemptions and reduced reporting requirements provided by the JOBS Act. Subject to certain conditions set forth in the JOBS Act, if as an emerging growth company we choose to rely on such exemptions, we may not be required to, among other things, (i) provide an auditor's attestation report on our systems of internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, (ii) provide all of the compensation disclosure that may be required of non-emerging growth public companies under the Dodd-Frank Wall Street Reform and Consumer Protection Act, (iii) comply with any requirement that may be adopted by the Public Company Accounting Oversight Board regarding mandatory audit firm rotation or a supplement to the auditor's report providing additional information about the audit and the financial statements (auditor discussion and analysis), and (iv) disclose certain executive compensation-related items such as the correlation between executive compensation and performance and comparisons of the Chief Executive Officer's compensation to median employee compensation. These exemptions will apply until we no longer meet the requirements of being an emerging growth company. We will remain an emerging growth company until the earlier of

(1) the last day of the year (a) following the fifth anniversary of the completion of our initial public offering, (b) in which we have total annual gross revenue of at least $1 billion or (c) in which we are deemed to be a large accelerated filer, which means the market value of our common stock that is held by non-affiliates exceeds $700 million as of the last business day of our prior second quarter, and (2) the date on which we have issued more than $1 billion in non-convertible debt during the prior three-year period.

Impact of Inflation and Changing Prices

The consolidated financial statements and related data presented herein have been prepared in accordance with generally accepted accounting principles which require the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. Our primary assets are monetary in nature. As a result, interest rates have a more significant impact on our performance than the effects of the general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the cost of paying losses and LAE.

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Insurance premiums are established before we know the amount of loss and LAE and the extent to which inflation may affect such expenses. Consequently, we attempt to anticipate the future impact of inflation when establishing rate levels. While we attempt to charge adequate rates, we may be limited in raising our premium levels for competitive and regulatory reasons. Inflation also affects the market value of our investment portfolio and the investment rate of return. Any future economic changes which result in prolonged and increasing levels of inflation could cause increases in the dollar amount of incurred loss and LAE and thereby materially adversely affect future liability requirements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Our investment portfolios at December 31, 2016 included fixed-maturity and equity securities, the purposes of which are not for trading or speculation. Our main objective is to maximize after-tax investment income and maintain sufficient liquidity to meet policyholder 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. Investment securities are managed by a group of nationally recognized asset managers and are overseen by the investment committee appointed by our board of directors. Our investment portfolios are primarily exposed to interest rate risk, credit risk and equity price risk. We classify our fixed-maturity and equity 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.

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 December 31, 2016 (in thousands):

| Hypothetical Change in Interest rates | Estimated Fair Value After Change | Change In Estimated Fair Value | Percentage Increase (Decrease) in Estimated Fair Value |
|---|---|---|---|
| 300 basis point increase | $ 515,571 | $ (55,440) | (10)% |
| 200 basis point increase | $ 534,048 | $ (36,963) | (6)% |
| 100 basis point increase | $ 552,529 | $ (18,482) | (3)% |
| 100 basis point decrease | $ 589,635 | $ 18,624 | 3% |
| 200 basis point decrease | $ 606,742 | $ 35,731 | 6% |
| 300 basis point decrease | $ 616,578 | $ 45,567 | 8% |

Credit risk can expose us to potential losses arising principally from adverse changes in the financial condition of the issuer of our fixed maturities. We mitigate this risk by investing in fixed-maturities that are generally investment grade and by diversifying our investment portfolio to avoid concentrations in any single issuer or market sector.

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Explanation of Responses:

The following table presents the composition of our fixed-maturity portfolio by rating at December 31, 2016 (in thousands):

| Comparable Rating | Amortized Cost | % of Total Amortized Cost | | Fair Value | % of Total Fair Value | |
|---|---|---|---|---|---|---|
| AAA | $ 223,540 | 39 | % | $ 221,563 | 39 | % |
| AA+ | $ 64,060 | 11 | % | $ 62,892 | 11 | % |
| AA | $ 70,242 | 12 | % | $ 69,192 | 12 | % |
| AA- | $ 44,276 | 8 | % | $ 43,606 | 8 | % |
| A+ | $ 47,733 | 8 | % | $ 47,107 | 8 | % |
| A | $ 48,132 | 9 | % | $ 47,832 | 8 | % |
| A- | $ 35,385 | 6 | % | $ 35,317 | 6 | % |
| BBB+ | $ 30,300 | 5 | % | $ 30,414 | 5 | % |
| BBB | $ 7,414 | 1 | % | $ 7,367 | 1 | % |
| BBB- | $ 2,613 | 1 | % | $ 2,551 | 1 | % |
| BB+ | $ 491 | 0 | % | $ 465 | 0 | % |
| BB- | $ 1,104 | 0 | % | $ 1,107 | 0 | % |
| B | $ 476 | 0 | % | $ 472 | 0 | % |
| NA and NR | $ 1,145 | 0 | % | $ 1,126 | 0 | % |
| Total | $ 576,911 | 100 | % | $ 571,011 | 100 | % |

Our equity investment portfolio at December 31, 2016 consists of common stocks and redeemable and nonredeemable preferred stocks. We may incur potential losses due to adverse changes in equity security prices. We manage this risk primarily through industry and issuer diversification and asset allocation techniques.

The following table illustrates the composition of our equity portfolio at December 31, 2016 (in thousands):

| | Estimated Fair Value | % of Total Estimated Fair value | |
|---|---|---|---|
| Stocks by sector: | | | |
| Financial | $ 4,214 | 13 | % |
| Energy | 12,905 | 41 | % |
| Other | 14,688 | 46 | % |
| Subtotal | $ 31,807 | 100 | % |
| Mutual Funds and ETF By type: | | | |
| Equity | $ 164 | 0 | % |
| Subtotal | 164 | 0 | % |
| Total | $ 31,971 | 100 | % |

Foreign Currency Exchange Risk

At December 31, 2016, we did not have any material exposure to foreign currency related risk.

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Item 8. Financial Statements and Supplementary Data
HERITAGE INSURANCE HOLDINGS, INC.

INDEX OF CONSOLIDATED FINANCIAL STATEMENTS


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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

Heritage Insurance Holdings Inc.

We have audited the accompanying consolidated balance sheets of Heritage Insurance Holdings, Inc. (a Delaware corporation) and subsidiaries (the "Company") as of December 31, 2016 and 2015, and the related consolidated statements of income and comprehensive income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heritage Insurance Holdings, Inc. and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America.

/s/ GRANT THORNTON LLP

Tampa, Florida

March 15, 2017



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HERITAGE INSURANCE HOLDINGS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

| | December 31, | |
|---|---|---|
| | 2016 | 2015 |
| ASSETS | | |
| Fixed maturity securities, available for sale, at fair value (amortized cost of $576,911 and $370,967 in 2016 and 2015, respectively) | $571,011 | $371,783 |
| Equity securities, available for sale, at fair value (cost of $34,190 and $32,439 in 2016 and 2015, respectively) | 31,971 | 28,313 |
| Total investments | 602,982 | 400,096 |
| Cash and cash equivalents | 105,817 | 236,277 |
| Restricted cash | 20,910 | 13,085 |
| Accrued investment income | 4,764 | 3,409 |
| Premiums receivable, net | 42,720 | 30,565 |
| Prepaid reinsurance premiums | 106,609 | 78,517 |
| Income taxes receivable | 10,713 | — |
| Deferred income taxes | — | 7,964 |
| Deferred policy acquisition costs, net | 42,779 | 34,800 |
| Property and equipment, net | 17,179 | 17,111 |
| Intangibles, net | 26,542 | 2,120 |
| Goodwill | 46,454 | 8,028 |
| Other assets | 5,775 | 5,426 |
| Total Assets | $1,033,244 | $837,398 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Unpaid losses and loss adjustment expenses | $140,137 | $83,722 |
| Unearned premiums | 318,024 | 302,493 |
| Reinsurance payable | 96,667 | 60,210 |
| Note payable, net of issuance costs | 72,905 | — |
| Deferred income taxes | 3,003 | — |
| Income tax payable | — | 2,092 |
| Advance premiums | 18,565 | 12,138 |
| Accrued compensation | 4,303 | 2,305 |
| Other liabilities | 21,681 | 17,885 |
| Total Liabilities | $675,285 | $480,845 |
| Commitments and contingencies (Note 14) | | |
| | | |
| Stockholders' Equity: | | |
| Common stock, $0.0001 par value, 50,000,000 shares authorized, 29,740,441 shares issued and 28,840,443 outstanding at December 31, 2016 and 30,441,410 issued and outstanding at December 31, 2015 | 3 | 3 |
| Additional paid-in capital | 205,727 | 202,628 |
| Accumulated other comprehensive loss | (5,018) | (2,033) |

| | | |
|---|---|---|
| Treasury stock, at cost, 1,759,330 shares at December 31, 2016 | (25,562 ) | — |
| Retained earnings | 182,809 | 155,955 |
| Total Stockholders' Equity | 357,959 | 356,553 |
| Total Liabilities and Stockholders' Equity | $1,033,244 | $837,398 |

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

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HERITAGE INSURANCE HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(In thousands, except share and per share data)

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| REVENUES: | | | |
| Gross premiums written | $626,704 | $586,098 | $436,407 |
| Change in gross unearned premiums | 13,814 | (61,358) | (124,893) |
| Gross premiums earned | 640,518 | 524,740 | 311,514 |
| Ceded premiums | (228,797) | (148,472) | (87,902) |
| Net premiums earned | 411,721 | 376,268 | 223,612 |
| Net investment income | 9,181 | 7,421 | 3,849 |
| Net realized gains | 1,733 | 1,508 | 304 |
| Other revenue | 16,323 | 9,595 | 6,055 |
| Total revenues | 438,958 | 394,792 | 233,820 |
| EXPENSES: | | | |
| Losses and loss adjustment expenses | 238,862 | 141,191 | 89,560 |
| Policy acquisition costs | 84,421 | 57,186 | 36,510 |
| General and administrative expenses | 58,910 | 46,125 | 33,498 |
| Total expenses | 382,193 | 244,502 | 159,568 |
| Operating income | 56,765 | 150,290 | 74,252 |
| Interest expense, net | 321 | — | — |
| Amortization of debt issuance costs | 41 | — | — |
| Income before income taxes | 56,403 | 150,290 | 74,252 |
| Provision for income taxes | 22,538 | 57,778 | 27,155 |
| Net income | 33,865 | 92,512 | 47,097 |
| OTHER COMPREHENSIVE INCOME: | | | |
| Change in net unrealized (losses) gains on investments | (3,120) | (4,606) | 4,395 |
| Reclassification adjustment for net realized investment gain | (1,733) | (1,508) | (304) |
| Income tax (expense) benefit related to items of other comprehensive income | 1,868 | 2,358 | (1,578) |
| Total comprehensive income | $30,880 | $88,756 | $49,610 |
| Weighted average shares outstanding | | | |
| Basic | 29,632,171 | 30,056,491 | 24,568,876 |
| Diluted | 29,634,349 | 30,326,468 | 25,816,560 |
| Earnings per share | | | |
| Basic | $1.14 | $3.08 | $1.92 |
| Diluted | $1.14 | $3.05 | $1.82 |

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

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HERITAGE INSURANCE HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except share and per share data)

| | Common Stock | | Additional Paid-In | Retained | Treasury | Accumulated Other Comprehensive Income | Total Stockholders' |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Capital | Earnings | Stock | (Loss) | Equity |
| Balance at December 31, 2013 | 14,007,150 | $ 1 | $ 62,849 | $ 17,924 | $— | $ (790) | $ 79,984 |
| Temporary equity reclassified to equity | 2,338,350 | — | 20,921 | — | — | — | 20,921 |
| Issuance of equity | 17,850 | — | 88 | — | — | — | 88 |
| Net unrealized change in investments, net of tax | — | — | — | — | — | 2,513 | 2,513 |
| Issuance of common stock equity in initial public offering and private placement, net of discount fee and direct costs of issuance of $6,530 | 6,909,091 | 1 | 69,469 | — | — | — | 69,470 |
| Issuance of common stock to underwriters for over allotment, net of discount fee and direct costs of issuance of $700 | 900,000 | — | 9,200 | — | — | — | 9,200 |
| Exercise of warrants | 5,622,519 | 1 | 22,514 | — | — | — | 22,515 |
| Stock-based compensation | — | — | 3,301 | — | — | — | 3,301 |
| Net income | — | — | — | 47,097 | — | — | 47,097 |
| Balance at December 31, 2014 | 29,794,960 | 3 | 188,342 | 65,021 | — | 1,723 | 255,089 |
| Net unrealized change in investments, net of tax | — | — | — | — | — | (3,756) | (3,756) |
| Issuance of 79,850 shares of stock in connection with the acquisition of BRC Restoration | 79,850 | — | 2,000 | — | — | — | 2,000 |
| Exercise of stock options and warrants | 566,600 | — | 8,900 | — | — | — | 8,900 |
| Stock-based compensation | — | — | 2,647 | — | — | — | 2,647 |
| Excess tax benefit on stock-based compensation | — | — | 739 | — | — | — | 739 |
| Dividends declared on common stock | — | — | — | (1,578) | — | — | (1,578) |
| Net income | — | — | — | 92,512 | — | — | 92,512 |
| Balance at December 31, 2015 | 30,441,410 | 3 | 202,628 | 155,955 | — | (2,033) | 356,553 |
| Net unrealized change in investments, net of tax | — | — | — | — | — | (2,985) | (2,985) |
| Stock buy-back | (1,759,330) | — | — | — | (25,562) | — | (25,562) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Shares tendered for income tax withholding | (66,637) | — | (977) | — | — | — | (977) |
| Stock-based compensation on vested restricted stock | 225,000 | — | 4,815 | — | — | — | 4,815 |
| Dividends declared on common stock | — | — | — | (7,011) | — | — | (7,011) |
| Excess tax expense on stock-based compensation | — | — | (739) | — | — | — | (739) |
| Net income | — | — | — | 33,865 | — | — | 33,865 |
| Balance at December 31, 2016 | 28,840,443 | $ 3 | $ 205,727 | $ 182,809 | $ (25,562) | $ (5,018) | $ 357,959 |

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

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HERITAGE INSURANCE HOLDINGS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| OPERATING ACTIVITIES | | | |
| Net income | $33,865 | $92,512 | $47,097 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Stock-based compensation | 4,815 | 2,647 | 3,301 |
| Amortization of bond discount | 8,016 | 6,246 | 2,531 |
| Depreciation and amortization | 8,976 | 1,350 | 777 |
| Bad debt expense | — | (250) | 250 |
| Net realized gains | (1,733) | (1,508) | (304) |
| Deferred income taxes, net of acquired | 3,103 | 1,016 | (3,764) |
| Changes in operating assets and liabilities: | | | |
| Accrued investment income | (1,355) | (792) | (1,646) |
| Premiums receivable, net | (10,754) | (10,287) | (9,931) |
| Restricted cash | (7,825) | (8,746) | (4,339) |
| Prepaid reinsurance premiums | (23,300) | (35,369) | (11,896) |
| Reinsurance premiums receivable | — | — | 5,337 |
| Income taxes receivable | (10,713) | — | 5,073 |
| Deferred policy acquisition costs, net | (7,979) | (10,430) | (14,605) |
| Other assets | 177 | (2,594) | (2,554) |
| Unpaid losses and loss adjustment expenses | 56,415 | 32,253 | 32,125 |
| Unearned premiums | (13,814) | 61,358 | 124,893 |
| Reinsurance payable | 36,457 | 43,097 | (12,478) |
| Income taxes payable | (2,092) | (10,716) | 10,003 |
| Accrued compensation | 779 | 1,863 | (63) |
| Advance premiums | 4,336 | 6,995 | 1,314 |
| Other liabilities | (2,244) | (15,524) | 23,075 |
| Net cash provided by operating activities | 75,130 | 153,121 | 194,196 |
| INVESTING ACTIVITIES | | | |
| Proceeds from sales and maturities of investments available for sale | 180,190 | 151,307 | 38,738 |
| Purchases of investments available for sale | (317,666) | (237,946) | (231,070) |
| Proceeds from sale of investment in mortgage loan | — | 6,849 | (786) |
| Acquisition of a business, net of cash acquired | (110,319) | (6,000) | — |
| Cost of property and equipment acquired | (1,621) | (1,174) | (6,929) |
| Net cash used in investing activities | (249,416) | (86,964) | (200,047) |
| FINANCING ACTIVITIES | | | |
| Proceeds from issuance of equity and redeemable shares | — | — | 88 |
| Proceeds from debt, net of issuance costs | 77,910 | — | — |
| Excess tax (expense) benefit on stock-based compensation | (739) | 739 | — |
| Shares tendered for income tax withholding | (977) | — | — |
| Purchase of treasury stock | (25,562) | — | — |

| | | | |
|---|---|---|---|
| Dividends | (6,806 ) | — | — |
| Proceeds from issuance of equity from initial public offering, | | | |
| net of discount fee and expense | — | — | 78,670 |
| Proceeds from exercise of stock options and warrants | — | 8,900 | 22,515 |
| Net cash provided by financing activities | 43,826 | 9,639 | 101,273 |
| (Decrease)/increase in cash and cash equivalents | (130,460) | 75,796 | 95,422 |
| Cash and cash equivalents, beginning of period | 236,277 | 160,481 | 65,059 |
| Cash and cash equivalents, end of period | $105,817 | $236,277 | $160,481 |
| Supplemental Cash Flows Information: | | | |
| Income taxes paid, net | $31,912 | $68,824 | $13,038 |
| Temporary equity reclassified to equity | $— | $— | $20,921 |
| Supplemental Disclosure of Non-Cash Investing and Financing Activities | | | |
| Issuance of shares for consideration in the acquisition of a business | $— | $2,000 | $— |

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

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HERITAGE INSURANCE HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation, Nature of Business and Significant Accounting Policies and Practices

Business Description

Heritage Insurance Holdings, Inc. (the “Company”, “we”, “our”, “us”) was initially formed as a Florida limited liability company in 2012. On January 1, 2014, the Company formed a Delaware limited liability company, also named Heritage Insurance Holdings, LLC and merged with it in order to domicile the Company in Delaware. Effective May 22, 2014, Heritage Insurance Holdings, LLC converted into a Delaware corporation named Heritage Insurance Holdings, Inc. As used in these consolidated financial statements, the terms “the Company”, “we”, “our” and “us” also refer to Heritage Insurance Holdings, LLC and its consolidated subsidiaries prior to our conversion to a Delaware corporation.

Our insurance subsidiaries are Heritage Property & Casualty Insurance Company (“Heritage P&C”) and Zephyr Insurance Company (“Zephyr”). Our other subsidiaries include: Heritage MGA, LLC (“MGA”), the managing general agent that manages substantially all aspects of our insurance subsidiaries’ business; Contractors’ Alliance Network, LLC, our vendor network manager, which includes BRC Restoration Specialists, Inc., our restoration service; Skye Lane Properties, LLC, our property management subsidiary; First Access Insurance Group, LLC, our retail agency; Osprey Re Ltd,; our reinsurance subsidiary that provides a portion of the reinsurance protection purchased by our insurance subsidiaries; and Zephyr Acquisition Company (“ZAC”) and its wholly-owned subsidiary Heritage Insurance Claims, LLC, an inactive subsidiary reserved for future development.

Our primary products are personal and commercial residential insurance, which we currently offer in Florida, North Carolina, South Carolina, Georgia and through the Zephyr acquisition, Hawaii. We conduct our operations under a single reporting segment.

Basis of Presentation

The consolidated financial statements include the accounts of Heritage Insurance Holdings, Inc. and its wholly-owned subsidiaries. The accompanying consolidated financial statements include the accounts of the Company and all other entities in which the Company has a controlling financial interest (none of which are variable interest entities). All intercompany accounts and transactions have been eliminated in consolidation.

The Company qualifies as an “emerging growth company” as defined in Section 2(a)(19) of the Securities Act, as modified by the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”). As a result, the Company is eligible for certain exemptions from various reporting requirements applicable to other public companies that are not emerging growth companies. The Company intends to continue to take advantage of some, but not all, of the exemptions available to emerging growth companies until such time that it is no longer an emerging growth company. The Company has, however, irrevocably elected not to take advantage of the extended transition period afforded by the JOBS Act for the implementation of new or revised accounting standards. As a result, the Company will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for non-emerging growth companies.

Use of Estimates

The preparation of consolidated financial statements in conformity with United States Generally Accepted Accounting Principles (“U.S. GAAP”) requires us to make estimates and assumptions about future events that affect the amounts reported in our consolidated financial statements and accompanying notes. We evaluate our estimates on an ongoing basis when updated information related to such estimates becomes available. We base our estimates on historical experience and information available to us at the time these estimates are made. Actual results could differ materially from these estimates.

Cash and Cash Equivalents

The Company’s cash and cash equivalents include demand deposits with financial institutions and short-term, highly-liquid financial instruments with original maturities of three months or less when purchased. The carrying amounts reported in the consolidated balance sheets for interest bearing deposits approximate their fair value because of the short maturity of these financial instruments.



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Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation. Such classifications include goodwill and intangibles from other assets in the accompanying consolidated balance sheets.

Restricted Cash

As of December 31, 2016 and 2015, restricted cash was $20.9 million and $13.1 million, respectively. Heritage P&C holds approximately $19.3 million relating to a reinsurance agreement with an entity that issued catastrophe (“CAT”) bonds, as Heritage P&C is contractually required to deposit two installments of reinsurance premiums into a trust account.

Investments

The Company classifies all of its investments in fixed maturity securities and equity securities as available-for-sale, and reports them at fair value. Subsequent to its acquisition of available-for-sale securities, the Company records changes in value through the date of disposition as unrealized holding gains and losses, net of tax effects, and includes them as a component of other comprehensive income. The Company includes realized gains and losses, which it calculates using the specific-identification method for determining the cost of securities sold, in net income. The Company amortizes any premium or discount on fixed maturities over the remaining maturity period of the related securities using the effective interest method, and reports the amortization in net investment income. The Company recognizes dividends and interest income when earned.

Quarterly, the Company performs an assessment of its investments to determine if any are “other-than-temporarily” impaired. An investment is impaired when the fair value of the investment declines to an amount less than the cost or amortized cost of that investment. As part of the assessment process, the Company determines whether the impairment is temporary or “other-than-temporary”. The Company bases its assessment on both quantitative criteria and qualitative information, considering a number of factors including, but not limited to: how long the security has been impaired; the amount of the impairment; whether, in the case of equity securities, the Company intends to hold, and have the ability to hold, the security for a period sufficient for us to recover our cost basis, or whether, in the case of debt securities and participations in mortgage loans, the Company intends to sell the investment or it is more likely than not that the Company will have to sell the investment before it recovers the amortized cost or cost; the financial condition and near-term prospects of the issuer; whether the issuer is current on contractually-obligated interest and principal payments; key corporate events pertaining to the issuer and whether the market decline was affected by macroeconomic conditions.

If the Company were to determine that an equity security has incurred an “other-than-temporary” impairment, the Company would permanently reduce the cost of the security to fair value and recognize an impairment charge in its consolidated statements of operations and comprehensive income. If a debt security or participation in a commercial mortgage loan was impaired and the Company either intends to sell the investment or it is more likely than not that the Company will have to sell the investment before it is able to recover the amortized cost or cost, then the Company would record the full amount of the impairment in its consolidated statement of operations and other comprehensive income.

A large portion of the Company’s investment portfolio consists of fixed maturity securities, which may be adversely affected by changes in interest rates as a result of governmental monetary policies, domestic and international economic and political conditions and other factors beyond its control. A rise in interest rates would decrease the net unrealized holding gains of our investment portfolio, offset by the Company’s ability to earn higher rates of return on funds reinvested. Conversely, a decline in interest rates would increase the net unrealized holding gains of our investment portfolio, offset by lower rates of return on funds reinvested.

Accumulated other comprehensive income consists solely of unrealized gains and loss investments and is presented net of income tax.

Fair Value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (an exit price). When reporting the fair values of the Company's financial instruments, the Company prioritizes those fair value measurements into one of three levels based on the nature of the inputs, as follows:

- Level 1—Assets and liabilities with values based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company is able to access;
- Level 2—Asset and liabilities with values based on quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets in markets that are not active; or valuation models with inputs that are observable, directly or indirectly for substantially the term of the asset or liability.

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- Level 3—certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the Company's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date based on the best information available in the circumstances.

The Company estimates the fair value of its investments using the closing prices on the last business day of the reporting period, obtained from active markets such as the NYSE and NASDAQ. For securities for which quoted prices in active markets are unavailable, the Company uses observable inputs such as quoted prices in inactive markets, quoted prices in active markets for similar instruments, benchmark interest rates, broker quotes and other relevant inputs. The Company does not have any investments in its portfolio which require the use of unobservable inputs. The Company's estimate of fair value reflects the interest rate environment that existed as of the close of business on December 31, 2016. Changes in interest rates subsequent to December 31, 2016 may affect the fair value of the Company's investments.

The Company believes the carrying amounts of its cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, and other current liabilities approximate their fair values at December 31, 2016 and December 31, 2015, due to the immediate or short term maturity of these instruments. The Company believes the carrying value of notes payable approximates fair value due to the recent nature of the transaction and its variable market rate of interest.

The Company's non-financial assets, such as goodwill and property, plant and equipment are carried at cost until there are indicators of impairment, and are recorded at fair value only when an impairment charge is recognized.

Premiums

The Company records assumed premiums written (premiums from policies that the Company assumed from Sunshine State Insurance Company ("SSIC") and from Citizens Property Insurance Corporation ("Citizens"), net of opt-outs and direct premiums written (premiums from subsequent renewals of Citizens' and SSIC policies and voluntary policies written during the period) as revenue, net of ceded amounts, on a daily pro rata basis over the contract period of the related policies that are in force. For any portion of premiums not earned at the end of the reporting period, the Company records an unearned premium liability. As a one-time only transaction on June 27, 2014, the Company assumed approximately $58.9 million of annualized premiums from SSIC. The Company acquired 32,000 SSIC policies and as of December 31, 2016 have approximately 19,600 of those policies in force.

Premiums receivable represents amounts due from our policyholders for billed premiums and related policy fees. We perform a policy-level evaluation to determine the extent to which the balance of premiums receivable exceeds the balance of unearned premiums. We then age any resulting exposure based on the last date the policy was billed to the policyholder, and we establish an allowance for credit losses for any amounts outstanding for more than 90 days. When we receive payments on amounts previously charged off, we reduce bad debt expense in the period we receive the payment. Balances in premiums receivable and the associated allowance account are removed upon cancellation of the policy due to non-payment. We recorded no allowance for the years ended December 31, 2016 and 2015, respectively. Bad debt expense recovery related to uncollectible premiums was $0, $(250) thousand and $250 thousand for the years ended December 31, 2016, 2015 and 2014, respectively.

When the Company receives premium payments from policyholders prior to the effective date of the related policy, the Company records an advance premiums liability. On the policy effective date, the Company reduces the advance premium liability and records the premiums as described above.

Policy Acquisition Costs

The Company incurs policy acquisition costs that vary with, and are directly related to, the production of new business. Policy acquisition costs consist of the following four items: (i) commissions paid to outside agents at the time of policy issuance; (ii) policy administration fees paid to a third-party administrator at the time of policy issuance; (iii) premium taxes; and (iv) inspection fees. The Company capitalizes policy acquisition costs to the extent recoverable, then the Company amortizes those costs over the contract period of the related policy.

At each reporting date, the Company determines whether it has a premium deficiency. A premium deficiency would result if the sum of the Company's expected losses, deferred policy acquisition costs, and policy maintenance costs (such as costs to store records and costs incurred to collect premiums and pay commissions) exceeded the Company's related unearned premiums plus investment income. Should the Company determine that a premium deficiency exists, the Company would write off the unrecoverable portion of deferred policy acquisition cost.

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Long-Lived Assets—Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation is calculated on a straight-line basis over the estimated useful lives as follows: building—40 years; computer hardware and software 3—years; office and furniture equipment—3 to 7 years. Leasehold improvements are amortized over the shorter of the lease term or the asset's useful life. Expenditures for improvements are capitalized to the property accounts. Replacements and maintenance and repairs that do not improve or extend the life of the respective assets are expensed as incurred.

Business Acquisition

The application of the purchase method of accounting for business combinations requires the use of significant estimates and assumptions in determining the fair value of assets acquired and liabilities assumed in order to properly allocate the fair value of the acquired business. The estimates of the fair value of the assets acquired and liabilities assumed are based upon assumptions believed to be reasonable using established valuation techniques that consider a number of factors and when appropriate, valuations performed by independent third party appraisers. Assets acquired and liabilities assumed in connection with business combinations are recorded based on their respective fair values at the date of acquisition.

Goodwill and Intangible Assets

Goodwill represents the excess of costs over the fair value of net assets acquired. Goodwill is subject to evaluation for impairment using a fair value based test. This evaluation is performed annually, during the fourth quarter or more frequently if facts and circumstances warrant. The Company uses a qualitative approach to test goodwill for impairment by first assessing qualitative factors to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The Company applies this qualitative approach as of October 1 annually to any and all reporting units. If required following the qualitative assessment, the first step in the goodwill impairment test involves comparing the fair value of each of a reporting unit to the carrying value of a reporting unit. If the carrying value of a reporting unit exceeds the fair value of the reporting unit, the Company is required to proceed to the second step. In the second step, the fair value of the reporting unit would be allocated to the assets (including unrecognized intangibles) and liabilities of the reporting unit, with any residual representing the implied fair value of goodwill. An impairment loss would be recognized if, and to the extent that, the carrying value of goodwill exceeded the implied value. The Company reviews amortizable intangible assets for impairment whenever events or circumstances indicate that carrying amounts may not be recoverable. If the Company concludes that impairment exists, the carrying amount is reduced to fair value.

Impairment of Long-Lived Assets Including Intangible Assets Subject to Amortization

The Company assesses the recoverability of long-lived assets when events or circumstances indicate that the assets might have become impaired. The Company determines whether the assets can be recovered from undiscounted future cash flows and, if not recoverable, the Company recognizes impairment to reduce the carrying value to fair value. Recoverability of long lived assets is dependent upon, among other things, the Company's ability to maintain profitability, so as to be able to meet its obligations when they become due. No impairment was recognized in any period presented.

Unpaid Losses and Loss Adjustment Expenses

The Company’s reserves for unpaid losses and loss adjustment expenses represent the estimated ultimate cost of settling all reported claims plus all claims we incurred related to insured events that have occurred as of the reporting date, but that policyholders have not yet reported to the Company (incurred but not reported, or “IBNR”).

The Company estimates its reserves for unpaid losses and loss adjustment expenses using individual case-based estimates for reported claims and actuarial estimates for IBNR losses. The Company continually reviews and adjusts its estimated losses as necessary based on industry development trends, the Company’s evolving claims experience and new information obtained. If the Company’s unpaid losses and loss adjustment expenses are considered to be deficient or redundant, the Company increases or decreases the liability in the period in which it identifies the difference and reflects the change in its current period results of operations. Though the Company’s estimate of the ultimate cost of settling all reported and unreported claims may change at any point in the future, a reasonable possibility exists that its estimate may vary significantly in the near term from the estimated amounts included in the Company’s consolidated financial statements.

The Company reports its reserves for unpaid losses and loss adjustment expenses gross of the amounts related to unpaid losses recoverable from reinsurers and reports losses net of amounts ceded to reinsurers. The Company does not discount its loss reserves for financial statement purposes.



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Other revenue

Other revenue represents rental income due under non-cancelable leases for space at the Company's commercial property in Clearwater, Florida that was acquired in April 2013, and all policy and pay-plan fees. Our insurance affiliates charge policyholders a policy fee on each policy written; these fees are not subject to refund, and the Company recognizes the income immediately when collected. The Company also charges pay-plan fees to policyholders that pay its premiums in more than one installment and records the fees as income when collected. In addition, the Company records revenue earned from its restoration subsidiary for non-insurance construction as services are performed.

Reinsurance

The Company follows industry practice of reinsuring a portion of our risks. Reinsurance involves transferring, or "ceding", all or a portion of the risk exposure on policies the Company writes to another insurer, known as a reinsurer. To the extent that the Company's reinsurers are unable to meet the obligations they assume under the Company's reinsurance agreements, the Company remains liable for the entire insured loss.

The Company's reinsurance agreements are short-term, prospective contracts. The Company records an asset, prepaid reinsurance premiums, and a liability, reinsurance payable, for the entire contract amount upon commencement of new reinsurance agreements. The Company amortizes its prepaid reinsurance premiums over the 12-month contract period.

In the event that the Company incurs losses recoverable under its reinsurance program, the Company records amounts recoverable from its reinsurers on paid losses plus an estimate of amounts recoverable on unpaid losses. The estimate of amounts recoverable on unpaid losses is a function of the Company's liability for unpaid losses associated with the reinsured policies; therefore, the amount changes in conjunction with any changes to the estimate of unpaid losses. Given that an estimate of amounts recoverable from reinsurers on unpaid losses may change at any point in the future because of its relation to the Company's reserves for unpaid losses, a reasonable possibility exists that an estimated recovery may change significantly from initial estimates.

The Company estimates uncollectible amounts receivable from reinsurers based on an assessment of factors including the creditworthiness of the reinsurers and the adequacy of collateral obtained, where applicable. The Company recorded no uncollectible amounts under its reinsurance program or bad debt expense related to reinsurance for the years ended December 31, 2016, 2015 and 2014.

Assessments

Guaranty fund and other insurance-related assessments imposed upon the Company are recorded as policy acquisition costs in the period the regulatory agency imposes the assessment. To recover Florida Insurance Guaranty Association ("FIGA")/Hawaii Insurance Guaranty Association ("HIGA") assessments, the Company in turn submits a plan for recoupment to the Insurance Commissioner for approval and upon approval, begins collecting a policy surcharge that will allow it to collect the prior years assessments over a 12-month period, based on an estimate of the number of policies the Company expects to write. The Company then submits an information only filing, pursuant to Florida Statute 631.57(3)(h)/Hawaii Statute 431:16-115(b), to the insurance regulatory authority requesting formal approval of the policy FIGA/HIGA surcharge. The process may be repeated in successive 12-month periods until the Company recoups all assessments. The Company records the recoveries as revenue in the period that it collects the cash. While current regulations allow the Company to recover from policyholders the amount of assessments imposed upon the Company, the Company's payment of the assessments and recoveries may not offset each other in the same year. There were no such assessments during the periods presented.

The Company collects other assessments imposed upon policyholders as a policy surcharge and records the amounts collected as a liability until the Company remits the amounts to the regulatory agency that imposed the assessment.

Accrued Bonus Compensation

Our Board of Directors determined in 2013 that the bonus pool based on earnings before interest, taxes, depreciation and amortization ("EBITDA") was appropriate. For the year ended December 31, 2016 the Board of Directors approved an EBITDA bonus of approximately $4.4 million to be paid to officers and employees of which approximately $800 thousand was paid out in cash as of December 31, 2016. For the year ended December 31, 2015, the Company recognized employee bonus compensation expense of approximately $14.1 million, which the Company paid out in cash of approximately $12.1 million as of December 31, 2015 and the remainder during 2016. For the year ended December 31, 2014, the company recognized employee bonus compensation of $7.2 million.

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Debt Issuance Costs

On December 15, 2016, the Company issued $79.5 million in Senior Secured Notes to six accredited investors. In connection with the issuance of debt the Company incurred $6.6 million in debt issuance costs. Debt issuance costs is reflected on the balance sheet as a net of note payable, and amortized using the effective interest method over the life of the underlying debt instrument.

Income Taxes

On May 22, 2014, the Company converted from a limited liability company to a corporation. As a limited liability company, the Company was treated as a partnership for tax purposes, and accordingly was not subject to entity-level federal or state income taxation. The Company's income tax provision generally consisted of income taxes payable by its separate subsidiaries that are taxed as corporations. As such, the Company's effective tax rate as a limited liability company was historically driven primarily by the taxable income recognized by its taxable subsidiaries. As a corporation, the Company is subject to typical corporate U.S. federal and state income tax rates on a consolidated basis which it expects to result in a combined federal and state statutory tax rate of approximately 38.575% under current tax law.

The Company recognizes deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The Company measures deferred tax assets and liabilities using enacted tax rates expected to apply to taxable income in the years in which it expects to recover or settle those temporary differences. Should a change in tax rates occur, the Company recognizes the effect on deferred tax assets and liabilities in operations in the period that includes the enactment date. Realization of the Company's deferred income tax assets depends upon our generation of sufficient future taxable income.

The Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more likely than not threshold, the amount recognized in the consolidated financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant taxing authority.

The Company records any income tax penalties and income-tax-related interest as income tax expense in the period incurred. The Company did not incur any material tax penalties or income-tax-related interest for the years ended December 31, 2016, 2015, and 2014, respectively.

Stock-Based Compensation

The Company measures stock-based compensation at the grant date based on the fair value of the award and recognizes stock-based compensation expense over the requisite vesting period. Determining the fair value of stock option awards requires judgment, including estimating stock price volatility, forfeiture rates and expected option life. Restricted stock awards are valued based on the fair value of the stock on the grant date and the related compensation expense is recognized over the vesting period.

Advertising Costs

The Company expenses all advertising costs when it incurs those costs. For the years ended December 31, 2016, 2015 and 2014, the Company incurred advertising costs of $94 thousand $27 thousand, and $14 thousand, respectively.

Earnings Per Share

The Company reports both basic earnings per share and diluted earnings per share. To calculate basic earnings per share, the Company divides net income attributable to common shareholders by the weighted-average number of shares outstanding during the period, including vested restricted shares. The Company calculates diluted earnings per share by dividing net income attributable to common shareholders by the weighted-average number of shares, and the effect of share equivalents, and vested and unvested restricted shares outstanding during the period using the treasury stock method to calculate common stock equivalents.



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Concentrations of Risk

The Company's current operations subject us to the following concentrations of risk:

- Revenue—The Company writes residential property and liability policies exclusively.
- Geographic—The Company writes its premium in Florida, North Carolina, South Carolina and Hawaii, with approximately 90% of the premium written in Florida.
- Group concentration of credit risk—All of the Company's reinsurers engage in similar activities and have similar economic characteristics that could cause their ability to repay us to be similarly affected by changes in economic or other conditions.
- Credit risk—The Company chooses to deposit all its cash at twelve financial institutions.

The Company mitigates its geographic and group concentrations of risk by entering into reinsurance contracts with highly rated, financially-stable reinsurers, and by securing irrevocable letters of credit from reinsurers when necessary.

With regard to cash, the Company had $123.4 million and $243.7 million in excess of Federal Deposit Insurance Corporation ("FDIC") insurance limits at December 31, 2016 and December 31, 2015, respectively. Deposits held in non- interest-bearing transaction accounts are combined with interest-bearing accounts and are insured up to $250 thousand.

Accounting Pronouncements

The Company describes below recent pronouncements that may have a significant effect on its consolidated financial statements or on its disclosures upon future adoption. The Company does not discuss recent pronouncements that are not anticipated to have an impact on, or are unrelated to, its financial condition, results of operations, or related disclosures.

In January 2017, the Financial Accounting Standards Board ("FASB") issued updated guidance on goodwill impairment testing requiring entities to calculate the implied fair value of goodwill through a hypothetical purchase price allocation. Under the updated guidance, impairment will now be recognized as the amount by which a reporting unit's carrying value exceeds its fair value. The standard is effective for us in the first quarter of 2020 on a prospective basis with early adoption permitted. The Company does not expect the adoption of this standard will have a material impact on the consolidated financial statements.

In November 2016, the FASB issued guidance regarding the presentation of changes in restricted cash in the statement of cash flows. The updated guidance is effective for the Company in the first quarter of 2018 with early adoption permitted. The updated guidance should be applied retrospectively, unless it is impracticable to do so, at which point the guidance should be applied prospectively. The Company currently recognizes changes in restricted cash in operating activities on the consolidated statement of cash flows. Upon adoption of this updated guidance, such changes will be reflected in the same manner as other cash and cash equivalents.

In August 2016, the FASB issued guidance clarifying the classification of certain cash receipts and cash payments that will make eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. This updated guidance is effective on January 1, 2018, and will require adoption on a retrospective basis with early adoption permitted. The Company has not experienced any transactions that are within the scope of this guidance and accordingly will evaluate the effect of this guidance further if and when any such transactions occur.

In June 2016, the FASB issued guidance on the accounting for credit losses of financial instruments that are measured at amortized cost, including held to maturity securities and reinsurance recoverables, by applying an approach based on the current expected credit losses. The estimate of expected credit losses should consider historical information,

current information, as well as reasonable and supportable forecasts, including estimates of prepayments. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset in order to present the net carrying value at the amount expected to be collected on the financial asset on the consolidated balance sheet. The guidance also amends the current accounting for other-than-temporary impairment model by requiring an estimate of the expected credit loss only when the fair value is below the amortized cost of the asset. The length of time the fair value of an available for sale debt security has been below the amortized cost will no longer impact the determination of whether a potential credit loss exists. The available for sale debt security model will also require the use of a valuation allowance as compared to the current practice of writing down the asset. The standard is effective for the Company in the first quarter of 2020 with early adoption permitted in the first quarter of 2019. The Company is in the early stages of evaluating the effect that the updated standard will have on its consolidated financial statements and related disclosures.



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In March 2016, the FASB issued guidance which requires recognition of the excess tax benefits or deficiencies of share-based awards through net income rather than through additional paid in capital. Additionally, the guidance allows for an election to account for forfeitures related to share-based payments either as they occur or through an estimation method. The Company will adopt this guidance beginning with the first quarter of 2017 and will recognize the excess tax benefits (deficiencies) within our results of operations. The calculation of the excess tax benefits and deficiencies is based on the difference between the market value of a stock award at the date of vesting, or at the time of exercise for a stock option, compared to the grant date fair value recognized as compensation expense in the consolidated statements of operations. The Company has determined that the financial statements in future periods will be affected by this new guidance principally when excess tax benefit or deficiencies occur, given that all such future items will be recognized as income tax benefits or expense in the consolidated statements of income and comprehensive income. The value of such transactions is not currently determinable because such amounts will vary based upon the value of the Company’s common stock on the date of vesting of restricted stock or exercise of stock options. Additionally, the amounts recognized will be presented as operating activities in the consolidated statement of cash flows, whereas such amounts are currently classified as financing activities.

In February 2016, the FASB issued guidance that affects the recognition, measurement, presentation and disclosure of leases. The new guidance requires substantially all leases to be reported on the balance sheet as right-to-use assets and lease liabilities, as well as additional disclosures. The standard is effective as of January 1, 2019, and early adoption is permitted. While the Company has limited leasing activities, the Company is in the early stages of evaluating the impact of the new guidance on its consolidated financial statements.

In January 2016, the FASB issued guidance that affects the recognition, measurement, presentation, and disclosure of financial instruments. The guidance requires equity investments to be measured at fair value with changes in fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee) and an assessment of a valuation allowance on deferred tax assets related to unrealized losses of available for sale debt securities in combination with other deferred tax assets. The standard is effective for the Company in the first quarter of 2018. The Company is in the early stages of evaluating the effect that the updated standard will have on its consolidated financial statements and related disclosures. The effect of adopting this guidance will be principally affected by the level of unrealized gains or losses associated with equity investments with readily determinable market values. Such unrealized gains or losses will be recognized upon adoption as a cumulative-effect adjustment with future unrealized gains or losses reflected in the statement of income and comprehensive income. Refer to Note 3 for the current status of such unrealized gains and losses levels that are currently recognized as other comprehensive income.

In May 2014, the FASB issued an accounting standard that supersedes most existing revenue recognition guidance. The standard excludes from its scope the accounting for insurance contracts, leases, financial instruments, and certain other agreements that are governed under other GAAP guidance, but could affect the revenue recognition for certain of our claims management and risk control services. The updated guidance requires an entity to recognize revenue as performance obligations are met, in order to reflect the transfer of promised goods or services to customers in an amount that reflects the consideration the entity is entitled to receive for those goods or services. This guidance is not applicable to insurance contracts. The standard is effective for the Company in the first quarter of 2018 with early adoption permitted. Accordingly, while the Company is in the early stages of evaluating the effect of adopting this new guidance, the Company believes the application of this guidance will be less complex in relation to any non-insurance contracts.

No other new accounting pronouncement issued or effective during the fiscal year had or is expected to have a material impact on our consolidated financial statements or disclosures.

Note 2. Business Acquisition

On July 31, 2015, the Company acquired BRC Restoration Specialists, Inc., a Florida based provider of restoration services and emergency and recovery assistance for a purchase price in aggregate of $8 million in cash and common stock. The Company issued 79,850 shares of its common stock to BRC at a fair value of $2.0 million as part of the purchase price and paid in cash $6.0 million. For the purchase price allocation the Company utilized a third party to calculate the valuation. The purchase consideration for the BRC acquisition has been allocated to the estimated fair market value of the net assets acquired, including approximately $2.2 million in identifiable intangibles assets (brand, customer relations and non-compete), and a residual amount of goodwill of approximately $5.7 million.

On March 21, 2016, the Company acquired 100% of the outstanding stock of ZAC and its wholly-owned subsidiary, Zephyr, in exchange for approximately $110.3 million, net of cash acquired. Zephyr is a specialty property insurance provider that offers policies for residential customers in Hawaii that only cover the peril of windstorm-hurricane events.



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The purchase consideration for this acquisition has been allocated to the estimated fair market value of the net assets acquired, including approximately $31.8 million in identifiable intangibles assets (primarily value of business acquired (“VOBA”), customer relationships and trade name), and a residual amount of goodwill of approximately $38.4 million. This acquisition furthers the Company’s strategic push to diversify business operations and achieve potential reinsurance synergies while expanding growth opportunities outside of Florida.

During the quarter ended December 31, 2016, the Company finalized its purchase price allocation during the measurement period. The facts and circumstances that existed at the date of the acquisition, if known, would have affected the measurement of the amounts recognized at that date. In accordance with ASC 805, Business Combinations, measurement period adjustments are not included in current earnings, but recognized as of the date of the acquisition with a corresponding adjustment to goodwill resulting from the change in preliminary amounts. As a result, the Company adjusted the preliminary allocation of the purchase price initially recorded at the acquisition date to reflect these measurement period adjustments.

Based on the finalized valuation report received during the quarter ended December 31, 2016, the Company revised the preliminary purchase allocation for ZAC as disclosed in the first quarter of 2016. As a result, $1.8 million was recorded to reduce goodwill offset by an increase of $42 thousand in intangible assets and an increase of $2.6 million relating to VOBA, and corresponding increase of deferred tax liability of $1.0 million

The table below details the purchase consideration and allocation of assets and liabilities assumed for the ZAC acquisition:

| | |
|---|---|
| Purchase Consideration | |
| Cash, net of cash acquired | $110,319 |
| | |
| Assets acquired | |
| Investments | $76,543 |
| Premiums and agent's receivable | 1,403 |
| Other assets | 526 |
| Prepaid reinsurance premiums | 4,792 |
| Intangible assets – value of business acquired | 7,600 |
| Intangible assets | 24,245 |
| Total assets acquired | $115,109 |
| Total liabilities assumed | $(43,216 ) |
| | |
| Net assets acquired | $71,893 |
| Goodwill | 38,426 |
| Total purchase price | $110,319 |

At December 31, 2015, the Company recorded goodwill and intangibles, net in Other assets.

The following table summarizes the results of the acquired ZAC operations since the acquisition date that have been included within our consolidated statement of operations.

| (in thousands) | March 21, 2016 to December 31, 2016 |
| --- | --- |
| Total revenue | $ 27,537 |
| Net income | $ 8,900 |

The following table (all amounts in thousands, except for per share data) provides supplemental unaudited pro forma consolidated information for the years ended December 31, 2016 and 2015, as if ZAC had been acquired as of January 1, 2015. The unaudited pro forma consolidated financial statements are presented solely for informational purposes and are not necessarily indicative of the consolidated results of operations that might have been achieved had the transaction been completed as of the date indicated, nor are they meant to be indicative of any anticipated consolidated future results of operations that the combined company will experience after the transaction.

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| | For the Years Ended December 31, | |
|---|---|---|
| | 2016 | 2015 |
| | (unaudited) | |
| Revenue | $447,780 | $432,070 |
| Net income | $36,817 | $104,722 |
| Basic, earnings per share | $1.24 | $3.48 |
| Diluted, earnings per share | $1.24 | $3.45 |

Note 3. Investments

The following table details the difference between cost or adjusted/amortized cost and estimated fair value, by major investment category, at December 31, 2016 and December 31, 2015:

| | Cost or Adjusted / Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| | (In thousands) | | | |
| December 31, 2016 | | | | |
| U.S. government and agency securities | $107,968 | $ 29 | $ 449 | $107,548 |
| States, municipalities and political subdivisions | 281,935 | 298 | 4,872 | 277,361 |
| Special revenue | 53,726 | 29 | 759 | 52,996 |
| Industrial and miscellaneous | 129,687 | 535 | 577 | 129,645 |
| Redeemable preferred stocks | 3,595 | 15 | 149 | 3,461 |
| Total fixed maturities | 576,911 | 906 | 6,806 | 571,011 |
| Nonredeemable preferred stocks | 14,935 | 40 | 460 | 14,515 |
| Equity securities | 19,255 | 1,197 | 2,996 | 17,456 |
| Total equity securities | 34,190 | 1,237 | 3,456 | 31,971 |
| Total investments | $611,101 | $ 2,143 | $ 10,262 | $602,982 |

| | Cost or Adjusted / Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| | (In thousands) | | | |
| December 31, 2015 | | | | |
| U.S. government and agency securities | $25,474 | $ 16 | $ 387 | $25,103 |
| States, municipalities and political subdivisions | 184,145 | 2,107 | 137 | 186,115 |
| Special revenue | 42,593 | 19 | 204 | 42,408 |
| Industrial and miscellaneous | 115,313 | 294 | 932 | 114,675 |
| Redeemable preferred stocks | 3,442 | 61 | 21 | 3,482 |
| Total fixed maturities | 370,967 | 2,497 | 1,681 | 371,783 |
| Nonredeemable preferred stocks | 12,443 | 338 | 43 | 12,738 |
| Equity securities | 19,996 | 398 | 4,819 | 15,575 |
| Total equity securities | 32,439 | 736 | 4,862 | 28,313 |

| | | | | |
|---|---|---|---|---|
| Total investments | $403,406 | $ 3,233 | $ 6,543 | $400,096 |

Special revenue instruments include U.S. government associated mortgage backed securities.

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The Company calculates the gain or loss realized on the sale of investments by comparing the sales price (fair value) to the cost or adjusted/amortized cost of the security sold. The Company determines the cost or adjusted/amortized cost of the security sold using the specific-identification method. The following tables detail the Company's realized gains (losses) by major investment category as of December 31, 2016 and 2015, respectively:

| | 2016 Gains (Losses) | 2016 Fair Value at Sale | 2015 Gains (Losses) | 2015 Fair Value at Sale |
|---|---|---|---|---|
| | (In thousands) | | | |
| Year Ended December 31, | | | | |
| Fixed maturities | $2,782 | $ 70,728 | $1,318 | $ 78,161 |
| Equity securities | 108 | 8,337 | 448 | 24,100 |
| Total realized gains | 2,890 | 79,065 | 1,766 | 102,261 |
| Fixed maturities | (253) | 15,496 | (133) | 13,343 |
| Equity securities | (904) | 5,098 | (125) | 1,616 |
| Total realized losses | (1,157) | 20,594 | (258) | 14,959 |
| Net realized gains | $1,733 | $ 99,659 | $1,508 | $ 117,220 |

The table below summarizes the Company's fixed maturities at December 31, 2016 by contractual maturity periods. Actual results may differ as issuers may have the right to call or prepay obligations, with or without penalties, prior to the contractual maturity of those obligations.

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | Cost or Amortized Cost (In thousands) | Percent of Total | Fair Value (In thousands) | Percent of Total |
| Due in one year or less | $158,517 | 28 % | $ 158,496 | 28 % |
| Due after one year through five years | 173,221 | 30 % | 172,309 | 30 % |
| Due after five years through ten years | 145,299 | 25 % | 142,259 | 25 % |
| Due after ten years | 99,874 | 17 % | 97,947 | 17 % |
| Total | $576,911 | 100 % | $ 571,011 | 100 % |

| | December 31, 2015 | | | |
|---|---|---|---|---|
| | Cost or Amortized Cost (In thousands) | Percent of Total | Fair Value (In thousands) | Percent of Total |
| Due in one year or less | $34,162 | 9 % | $ 34,165 | 9 % |
| Due after one year through five years | 146,616 | 40 % | 146,211 | 40 % |
| Due after five years through ten years | 79,380 | 21 % | 79,887 | 21 % |
| Due after ten years | 110,809 | 30 % | 111,520 | 30 % |
| Total | $370,967 | 100 % | $ 371,783 | 100 % |

The following table summarizes the Company's net investment income by major investment category for the years ended December 31, 2016, 2015 and 2014, respectively:

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| | (In thousands) | | |
| Fixed maturities | $8,709 | $6,960 | $3,100 |
| Equity securities | 1,955 | 1,811 | 1,159 |
| Cash, cash equivalents and short-term investments | 226 | 258 | 181 |
| Other investments | 21 | 259 | 243 |
| Net investment income | 10,911 | 9,289 | 4,683 |
| Investment expenses | 1,730 | 1,868 | 834 |
| Net investment income, less investment expenses | $9,181 | $7,421 | $3,849 |

During the Company's quarterly evaluations of its securities for impairment, the Company determined that none of its investments in debt and equity securities that reflected an unrealized loss position were other-than-temporarily impaired. The issuers of the debt securities in which the Company invests continue to make interest payments on a timely basis and have not suffered any credit rating reductions. The Company does not intend to sell, nor is it likely that it would be required to sell, the debt securities before the Company recovers its amortized cost basis. All the issuers of the equity securities it owns had near-term prospects that indicated

the Company could recover its cost basis, and the Company also has the ability and the intent to hold these securities until the value equals or exceeds its cost.

The following table presents an aging of the Company's unrealized investment losses by investment class as of December 31, 2016 and December 31, 2015:

| | Less Than Twelve Months | | | Twelve Months or More | | |
|---|---|---|---|---|---|---|
| | Number of Securities | Gross Unrealized Losses | Fair Value | Number of Securities | Gross Unrealized Losses | Fair Value |
| | (In thousands) | | | | | |
| December 31, 2016 | | | | | | |
| U.S. government and agency securities | 35 | $ 448 | $ 24,649 | 2 | $ 1 | $ 200 |
| States, municipalities and political subdivisions | 265 | 4,869 | 220,034 | 2 | 3 | 1,497 |
| Industrial and miscellaneous | 161 | 571 | 56,996 | 2 | 6 | 974 |
| Special revenue | 189 | 631 | 44,712 | 11 | 129 | 1,828 |
| Redeemable preferred stocks | 19 | 143 | 2,425 | 1 | 6 | 212 |
| Total fixed maturities | 669 | 6,662 | 348,816 | 18 | 145 | 4,711 |
| Nonredeemable preferred stocks | 77 | 439 | 11,298 | 5 | 20 | 234 |
| Equity securities | 26 | 191 | 2,542 | 29 | 2,805 | 7,317 |
| Total equity securities | 103 | $ 630 | $ 13,840 | 34 | $ 2,825 | $ 7,551 |
| Total | 772 | $ 7,292 | $ 362,656 | 52 | $ 2,970 | $ 12,262 |

| | Less Than Twelve Months | | | Twelve Months or More | | |
|---|---|---|---|---|---|---|
| | Number of Securities | Gross Unrealized Losses | Fair Value | Number of Securities | Gross Unrealized Losses | Fair Value |
| | (In thousands) | | | | | |
| December 31, 2015 | | | | | | |
| U.S. government and agency securities | 19 | $ 385 | $ 19,849 | 2 | $ 3 | $ 397 |
| States, municipalities and political subdivisions | 14 | 50 | 10,979 | 1 | 3 | 164 |
| Industrial and miscellaneous | 141 | 870 | 73,312 | 5 | 61 | 1,318 |
| Special revenue | 134 | 279 | 60,203 | 10 | 9 | 1,646 |
| Redeemable preferred stocks | 9 | 21 | 950 | — | — | — |
| Total fixed maturities | 317 | 1,605 | 165,293 | 18 | 76 | 3,525 |
| Nonredeemable preferred stocks | 19 | 29 | 1,560 | 5 | 14 | 250 |
| Equity securities | 48 | 2,975 | 8,416 | 20 | 1,844 | 2,680 |
| Total equity securities | 67 | $ 3,004 | $ 9,976 | 25 | $ 1,858 | $ 2,930 |
| Total | 384 | $ 4,609 | $ 175,269 | 43 | $ 1,934 | $ 6,455 |

The Company is required to maintain assets on deposits with various regulatory authorities to support its insurance and reinsurance operations.

Note 4. Goodwill and Other Intangible Assets

As of December 31, 2016 and December 31, 2015 goodwill was $46.5 million and $8 million, respectively, and intangible assets were $26.5 million and $2.1 million, respectively. The Company has determined the useful life of the value of business acquired (see Note 2) to be one year. The Company has determined the useful life of the other intangible assets to range between 2-15 years. The Company has recorded $175 thousand relating to an insurance license and classified as an indefinite lived intangible which is subject to annual impairment testing.

Goodwill
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| | Goodwill (in thousands) |
|---|---|
| Balance as of December 31, 2014 | $ 2,350 |
| Goodwill acquired | 5,678 |
| Impairment | — |
| Balance as of December 31, 2015 | $ 8,028 |
| Goodwill acquired | 38,426 |
| Impairment | — |
| Balance as of December 31, 2016 | $ 46,454 |

Other intangible assets

Our intangible assets resulted primarily from the acquisition of Zephyr and consist of brand, agent relationships, renewal rights, customer relations, trade names, non-compete and insurance license. Finite-lived intangibles assets are amortized over their useful lives from one to fifteen years.

The tables below detail the finite-lived intangible assets, net as of December 31, 2016 and 2015, respectively (amounts in thousands):

| December 31, 2016 | Weighted -average Amortization (years) | Gross Carrying Amount | Accumulated Amortization | Intangible Assets, net [1] |
|---|---|---|---|---|
| Brand | 15 | $ 1,210 | $ (114 ) | $ 1,096 |
| Agent relationships | 12 | 4,800 | (300 ) | 4,500 |
| Renewal rights | 15 | 16,600 | (830 ) | 15,770 |
| Customer relations | 10 | 870 | (123 ) | 747 |
| Trade names | 10 | 2,000 | (150 ) | 1,850 |
| Value of business acquired | 1 | 7,600 | (5,700 ) | 1,900 |
| Non-compete | 2.5 | 790 | (286 ) | 504 |
| Total intangible assets | | $ 33,870 | $ (7,503 ) | $ 26,367 |

(1) Excludes insurance license valued at $175 thousand and classified as an indefinite lived intangible which is subject to annual impairment testing and not amortized.

| December 31, 2015 | Weighted -average Amortization (years) | Gross Carrying Amount | Accumulated Amortization | Intangible Assets, net |
|---|---|---|---|---|
| Brand | 15 | $ 1,210 | $ (34 ) | $ 1,176 |
| Customer relations | 10 | 870 | (36 ) | 834 |
| Non-compete | 5 | 120 | (10 ) | 110 |
| Total intangible assets | | $ 2,200 | $ (80 ) | $ 2,120 |

Estimated annual pretax amortization of intangible assets for each of the next five years and thereafter is as follows (in thousands):

| Year | Amount (1) |
|---|---|
| 2017 | $4,133 |
| 2018 | 1,982 |
| 2019 | 1,898 |
| 2020 | 1,888 |
| 2021 | 1,875 |
| Thereafter | 14,591 |
| | $26,367 |

(1) Excludes insurance license valued at $175 thousand classified as an indefinite lived intangible which is subject to annual impairment testing and not amortized.

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Amortization expense of intangible assets was $7.4 million and $80 thousand for the year ended December 31, 2016 and 2015, respectively.

Note 5. Earnings Per Share

The following table sets forth the computation of basic and diluted EPS for the periods indicated.

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| Basic earnings per share: | | | |
| Net income attributable to common stockholders (000's) | $33,865 | $92,512 | $47,097 |
| Weighted average shares outstanding | 29,632,171 | 30,056,491 | 24,568,876 |
| Basic earnings per share: | $1.14 | $3.08 | $1.92 |
| | | | |
| Diluted earnings per share: | | | |
| Net income attributable to common stockholders (000's) | $33,865 | $92,512 | $47,097 |
| Weighted average shares outstanding | 29,632,171 | 30,056,491 | 24,568,876 |
| Weighted average dilutive shares | 2,178 | 269,977 | 1,247,684 |
| Total weighted average dilutive shares | 29,634,349 | 30,326,468 | 25,816,560 |
| Diluted earnings per share: | $1.14 | $3.05 | $1.82 |

Note 6. Fair Value Measurements

For the Company's investments in U.S. government securities that do not have prices in active markets, agency securities, state and municipal governments, and corporate bonds, the Company obtains the fair values from its third-party valuation service and we evaluate the relevant inputs, assumptions, methodologies and conclusions associated with such valuations. The valuation service calculates prices for the Company's investments in the aforementioned security types on a month-end basis by using several matrix-pricing methodologies that incorporate inputs from various sources. The model the valuation service uses to price U.S. government securities and securities of states and municipalities incorporates inputs from active market makers and inter-dealer brokers. To price corporate bonds and agency securities, the valuation service calculates non-call yield spreads on all issuers, uses option-adjusted yield spreads to account for any early redemption features, then adds final spreads to the U.S. Treasury curve as of quarter end. The inputs the valuation service uses in their calculations are not quoted prices in active markets, but are observable inputs, and therefore represent Level 2 inputs.

The following table presents information about the Company's assets measured at fair value on a recurring basis. The Company assesses the levels for the investments at each measurement date, and transfers between levels are recognized on the actual date of the event or change in circumstances that caused the transfer in accordance with the Company's accounting policy regarding the recognitions of transfers between levels of the fair value hierarchy. For the years ended December 31, 2016 and 2015, there were no transfers in or out of Level 1, 2, and 3.

| December 31, 2016 | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| | (in thousands) | | | |
| Fixed maturities investments: | | | | |
| U.S. government and agency securities | $107,548 | $103,997 | $3,551 | $ — |
| States, municipalities and political subdivisions | 277,361 | — | 277,361 | — |
| Special revenue | 52,996 | — | 52,996 | — |

| | | | | |
|---|---|---|---|---|
| Industrial and miscellaneous | 129,645 | — | 129,645 | — |
| Redeemable preferred stocks | 3,461 | 3,461 | — | — |
| Total fixed maturities investments | $571,011 | $107,458 | $463,553 | $ — |
| Nonredeemable preferred stocks | 14,515 | 14,515 | — | — |
| Equity securities | 17,456 | 17,456 | — | — |
| Total equity securities | $31,971 | $31,971 | $— | $ — |
| Total investments | $602,982 | $139,429 | $463,553 | $ — |

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| December 31, 2015 | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| | (in thousands) | | | |
| Assets: | | | | |
| Certificate of deposits [1] | $3,300 | $3,300 | $— | $ — |
| Fixed maturities investments: | | | | |
| U.S. government and agency securities | $25,103 | $22,361 | $2,742 | $ — |
| States, municipalities and political subdivisions | 186,115 | — | 186,115 | — |
| Special revenue | 42,408 | — | 42,408 | — |
| Industrial and miscellaneous | 114,675 | — | 114,675 | — |
| Redeemable preferred stocks | 3,482 | 3,482 | — | — |
| Total fixed maturities investments | $375,083 | $29,143 | $345,940 | $ — |
| Nonredeemable preferred stocks | 12,738 | 12,738 | — | — |
| Equity securities | 15,575 | 15,575 | — | — |
| Total equity securities | $28,313 | $28,313 | $— | $ — |
| Total investments | $403,396 | $57,456 | $345,940 | $ — |

[1] Includes commercial paper with a maturity of three months or less at the time of purchase of $3.3 million classified in cash and cash equivalents.

We believe the carrying amounts of our cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, and other current liabilities approximate their fair values at December 31, 2016 and December 31, 2015, due to the immediate or short term maturity of these instruments. We believe the carrying value of notes payable approximates fair value due to the recent nature of the transaction and its variable market rate of interest.

Non-recurring fair value measurements

Assets and liabilities that are measured at fair value on a non-recurring basis include intangible assets and goodwill which are recognized at fair value during the period in which an acquisition is completed, from updated estimates and assumptions during the measurement period, or when they are considered to be impaired. These non-recurring fair value measurements, primarily for intangible assets acquired, were based on Level 3 unobservable inputs. During 2016 these non-recurring fair values inputs consisted of customer relations, non-compete, brand name and goodwill. In the event of an impairment, we determine the fair value of the goodwill and intangible assets using a combination of a discounted cash flow approach and market approaches, which contain significant unobservable inputs and therefore is considered a Level 3 fair value measurement. The unobservable inputs in the analysis generally include future cash flow projections and a discount rate.

There were no non-recurring fair value adjustments to intangible assets and goodwill during 2016, 2015 and 2014 except for certain fair value measurements during 2016 and 2015 following the acquisition of Zephyr and BRC, respectively. The measurement period may be up to one year from the acquisition date. We record any measurement period adjustments to the fair value of assets acquired and liabilities assumed, with the corresponding offset to goodwill.

Note 7. Property and Equipment

Property and equipment, net consists of the following at December 31, 2016 and 2015 (in thousands):

| | December 31, 2016 | December 31, 2015 |
|---|---|---|
| | (In thousands) | |
| Land | $ 2,582 | $ 2,582 |
| Building | 10,301 | 9,599 |
| Computer hardware and software | 3,113 | 2,502 |
| Office furniture and equipment | 759 | 634 |
| Tenant and leasehold improvements | 3,334 | 3,300 |
| Vehicle fleet | 842 | 693 |
| Total, at cost | 20,931 | 19,310 |
| Less: accumulated depreciation and amortization | 3,752 | 2,199 |
| Property and equipment, net | $ 17,179 | $ 17,111 |

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Depreciation expense for the years ended December 31, 2016, 2015 and 2014 was $1.6 million, $1.3 million, $0.8 million, respectively. The Company's real estate consists of 14 acres of land, four buildings with a gross area of 191,000 square feet and a parking garage.

The Company currently leases space to non-affiliates and occupies space in one of the buildings.

Expected annual rental income due under non-cancellable operating leases for our real estate properties is as follows (in thousands):

| Year | Amount |
|---|---|
| January 1 to December 31, 2017 | $2,604 |
| January 1 to December 31, 2018 | 2,643 |
| January 1 to December 31, 2019 | 2,492 |
| January 1 to December 31, 2020 | 2,498 |
| January 1 to December 31, 2021 | 2,551 |
| Thereafter | 3,632 |
| | $16,420 |

Note 8. Deferred Policy Acquisition Costs

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

The Company anticipates that its DPAC costs will be fully recoverable in the near term. The table below depicts the activity with regard to DPAC for the years ended December 31, 2016 and 2015:

| | For the Year Ended December 31, | |
|---|---|---|
| | 2016 | 2015 |
| | (In thousands) | |
| Beginning Balance | $34,800 | $24,370 |
| Policy acquisition costs deferred | 92,400 | 67,616 |
| Amortization | (84,421) | (57,186) |
| Ending Balance | $42,779 | $34,800 |

Note 9. Reinsurance

The Company's reinsurance program is designed, utilizing the Company's risk management methodology, to address its exposure to catastrophes or large non-catastrophic losses. The Company's program provides reinsurance protection for catastrophes including hurricanes, tropical storms and tornadoes. The Company's reinsurance agreements are part of its

catastrophe management strategy, which is intended to provide its stockholders an acceptable return on the risks assumed in its property business, and to reduce variability of earnings, while providing protection to the Company's policyholders.

2016 - 2017 Reinsurance Program

The Company placed its reinsurance program for the period from June 1, 2016 through May 31, 2017 during the second quarter of 2016. This reinsurance program incorporates the catastrophe risk of our two insurance subsidiaries, Heritage P&C, a Florida based insurer and Zephyr, a Hawaii based insurer, into one reinsurance structure. The programs are incorporated into one reinsurance structure and are allocated amongst traditional reinsurers, catastrophe bonds issued by Citrus Re Ltd., a Bermuda special purpose insurer formed in 2014 ("Citrus Re"), and the Florida Hurricane Catastrophe Fund ("FHCF").Coverage is shared by both insurers unless otherwise noted. The 2016-2017 reinsurance program provides, including retention, first event coverage up to $1.9 billion in Florida, first event coverage up to $1.1 billion in Hawaii, and multiple event coverage up to $3.1 billion.

The reinsurance program, which is segmented into layers of coverage, protects the Company for excess property catastrophe losses and loss adjustment expenses. The Company's 2016-2017 reinsurance program incorporates the mandatory coverage required by law to be placed with FHCF, which is available only for Florida catastrophe risk. For the 2016 hurricane season, the Company reduced its selected participation percentage in the FHCF from 75% to 45%. The Company also purchased private reinsurance below,

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alongside and above the FHCF layer, as well as aggregate reinsurance coverage. The following describes the various layers of the Company's June 1, 2016 to May 31, 2017 reinsurance program.

- The Company's Retention. If a first catastrophic event strikes Florida, the Company has a primary retention of the first $40 million of losses and loss adjustment expenses, of which Osprey is responsible for $20 million. If a first catastrophic event strikes Hawaii, the Company has a primary retention of the first $30 million of losses and loss adjustment expenses, of which Osprey is responsible for $15 million. If a second event strikes Florida, Heritage P&C's primary retention decreases to $15 million and the remainder of the losses are ceded to third parties. If a second event strikes Hawaii, Zephyr's primary retention decreases to $5 million. In the second event only for a loss exceeding $190 million, there is an additional Company co-participation of 5.4% subject to a maximum co-participation of $11.6 million. Heritage P&C and Zephyr each have a $5 million primary retention for events beyond the second catastrophic event. Osprey has no primary retention beyond the first catastrophic event in Florida or Hawaii. Additionally, Osprey is responsible for payment of up to $5.3 million of reinstatement premium, depending on the amount of losses incurred.

- Shared Layers above retention and below FHCF. Immediately above the retention, the Company has purchased $374 million of reinsurance from third party reinsurers. Through the payment of a reinstatement premium, the Company is able to reinstate the full amount of this reinsurance one time. To the extent that $374 million or a portion thereof is exhausted in a first catastrophic event, the Company has purchased reinstatement premium protection insurance to pay the required premium necessary for the reinstatement of this coverage.

- FHCF Layer. The Company's FHCF program provides coverage for Florida events only and includes an estimated maximum provisional limit of 45% of $1.5 billion, in excess of its retention of $460 million. The limit and retention of the FHCF coverage is subject to upward or downward adjustment based on, among other things, submitted exposures to FHCF by all participants. The Company has purchased coverage alongside from third party reinsurers and through reinsurance agreements with Citrus Re. To the extent the FHCF coverage is adjusted, this private reinsurance with third party reinsurers and Citrus Re will adjust to fill in any gaps in coverage up to the reinsurers' aggregate limits for this layer. The FHCF coverage cannot be reinstated once exhausted, but it does provide coverage for multiple events.

- Layers alongside the FHCF. The Florida reinsurance program includes third party layers alongside the FHCF. These include 2015 C and 2015 B series catastrophe bonds, which cover Florida only for the 2016 season, and 2016 D and 2016 E catastrophe bond series issued by Citrus Re, which total $377.5 million of coverage, as discussed below, as well as a traditional reinsurance layer providing $200 million of coverage. Through a reinstatement, the Company is able to reinstate the full amount of the $200 million of reinsurance one time. These 2016 catastrophe bonds and the traditional reinsurance layer provide coverage for both Florida and Hawaii catastrophe losses.
- 2016 Class D and E Notes: During February 2016, Heritage P&C and Zephyr entered into two catastrophe reinsurance agreements with Citrus Re. The agreements provide for three years of coverage from catastrophic losses caused by named storms, including hurricanes, beginning on June 1, 2016. Heritage P&C and Zephyr pay a periodic premium to Citrus Re during this three-year risk period. Citrus Re issued an aggregate of $250 million of principal-at-risk variable notes due February 2019 to fund the reinsurance trust account and its obligations to Heritage P&C and Zephyr under the reinsurance agreements. The Class D notes provide $150 million of coverage and the Class E notes provide $100 million of coverage. The Class D and Class E notes provide reinsurance coverage for a sliver of the catastrophe coverage that had previously been provided by the FHCF. The limit of coverage is fully collateralized by a reinsurance trust account for the benefit of Heritage P&C and Zephyr. The maturity date of the notes may be extended up to two additional years to satisfy claims for catastrophic events occurring during the three-year term of the reinsurance agreements.

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- 2015 Class B and C Notes: During April 2015, Heritage P&C entered into catastrophe reinsurance agreements with Citrus Re. The 2015 notes do not provide coverage for Zephyr for the 2016 hurricane season. The agreements provide for three years of coverage from catastrophic losses caused by named storms, including hurricanes, beginning on June 1, 2015. Heritage P&C pays a periodic premium to Citrus Re during this three-year risk period. Citrus Re issued principal-at-risk variable notes due April 2018 to fund the reinsurance trust account and its obligations to Heritage P&C under the reinsurance agreements. The Class B notes provide $97.5 million of coverage, and the Class C notes provide $30 million of coverage. The Class B and Class C notes provide reinsurance coverage for a sliver of the catastrophe coverage that had previously been provided by the FHCF. The limit of coverage is fully collateralized by a reinsurance trust account for the benefit of Heritage P&C. The maturity date of the notes may be extended up to two additional years to satisfy claims for catastrophic events occurring during the three-year term of the reinsurance agreements.

Layers above the FHCF - Florida program

- 2015 Class A Notes: During April 2015, Heritage P&C entered into catastrophe reinsurance agreements with Citrus Re. The 2015 notes do not provide coverage for Zephyr for the 2016 hurricane season. The agreements provide for three years of coverage from catastrophic losses caused by named storms, including hurricanes, beginning on June 1, 2015. Heritage P&C pays a periodic premium to Citrus Re during this three-year risk period. Citrus Re issued principal-at-risk variable notes due April 2018 to fund the reinsurance trust account and its obligations to Heritage P&C under the reinsurance agreements. The Class A notes provide $150 million of coverage for a layer above the FHCF. The limit of coverage is fully collateralized by a reinsurance trust account for the benefit of Heritage P&C. The maturity date of the notes may be extended up to two additional years to satisfy claims for catastrophic events occurring during the three-year term of the reinsurance agreements.

- 2014 Class A Notes: Coverage immediately below and above the 2015 Class A notes is provided by the 2014 reinsurance agreements entered into with Citrus Re. The first contract with Citrus Re provides $150 million of coverage immediately below 2015 Class A, and the second contract provides an additional $50 million of coverage which sits immediately above 2015 Class A. During April 2014, Heritage P&C entered into two catastrophe reinsurance agreements with Citrus Re. The 2014 notes do not provide coverage for Zephyr for the 2016 hurricane season. The agreements provide for three years of coverage from catastrophe losses caused by certain named storms, including hurricanes, beginning on June 1, 2014. The limit of coverage of $200 million is fully collateralized by a reinsurance trust account for the benefit of Heritage P&C. Heritage P&C pays a periodic premium to Citrus Re during this three-year risk period. Citrus Re issued $200 million of principal-at-risk variable notes due April 2017 to fund the reinsurance trust account and its obligations to Heritage P&C under the reinsurance agreements. The maturity date of the notes may be extended up to two additional years to satisfy claims for catastrophic events occurring during the three-year term of the reinsurance agreements.

- Multi-Zonal Layers – The Company purchased additional layers which provide coverage for Florida for a second event and both first and second event coverage for Hawaii. The first event coverage for Hawaii is a counterpart to the Florida-only catastrophe bond layers and FHCF layer. There is a total of $282 million of reinsurance coverage purchased on this basis, with $260 million having a prepaid reinstatement. The multi-zonal occurrence layer provides first and second event coverage of $260 million for Hawaii and second event coverage of $260 million for Florida. A top and drop multi-zonal layer provides first and subsequent event coverage of $22 million for Hawaii and second or subsequent event coverage of $22 million for Florida.

- Aggregate Coverage. In addition to what is described above, much of the reinsurance is structured in a way to provide aggregate coverage. $682 million of limit is structured on this basis. To the extent that this coverage is not fully exhausted in the first catastrophic event, it provides coverage commencing at its reduced retention for second

and subsequent events where underlying coverage has been previously exhausted. $460 million has a reinstatement, which is prepaid.

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For a first catastrophic event striking Florida, our reinsurance program provides coverage for $1.9 billion of losses and loss adjustment expenses, including our retention, and we are responsible for all losses and loss adjustment expenses in excess of such amount. For a first catastrophic event striking Hawaii, our reinsurance program provides coverage for $1.1 billion of losses and loss adjustment expenses, including our retention, and we are responsible for all losses and loss adjustment expenses in excess of such amount. For subsequent catastrophic events, our total available coverage depends on the magnitude of the first event, as we may have coverage remaining from layers that were not previously fully exhausted. $860 million of limit purchased in 2016 includes a reinstatement, with $825 million being prepaid. In total, we have purchased $3 billion of potential reinsurance coverage, including our retention, for multiple catastrophic events. Our ability to access this coverage, however, will be subject to the severity and frequency of such events.

2015 – 2016 Reinsurance Program

During the second quarter of 2015, the Company placed its reinsurance program for the period from June 1, 2015 through May 31, 2016. The Company's 2015-2016 reinsurance program incorporated the mandatory coverage required by law to be placed with FHCF. For the 2015 hurricane season, the Company selected 75% participation in the FHCF. The Company also purchased private reinsurance below, alongside and above the FHCF layer, as well as aggregate reinsurance coverage. The following describes the various layers of the Company's June 1, 2015 to May 31, 2016 reinsurance program.

- The Company's Retention. For the first catastrophic event, the Company had a primary retention of the first $35 million of losses and loss adjustment expenses, of which Osprey was responsible for $20 million. For a second event, Heritage P&C's primary retention decreased to $5 million and Osprey is responsible for $10 million. To the extent that there is reinsurance coverage remaining, Heritage P&C has a $5 million primary retention for events beyond the second catastrophic event. Osprey had no primary retention beyond the second catastrophic event.

- Layers Below FHCF. Immediately above the Company's retention, the Company purchased $440 million of reinsurance from third party reinsurers. Through the payment of a reinstatement premium, the Company was able to reinstate the full amount of this reinsurance one time. To the extent that $440 million or a portion thereof was exhausted in a first catastrophic event, the Company had purchased reinstatement premium protection insurance to pay the required premium necessary for the reinstatement of this coverage. A portion of this coverage wrapped around the FHCF and provided coverage alongside and above the FHCF.

- FHCF Layer. The Company's FHCF coverage included an estimated maximum provisional limit of 75% of $920 million, or $690 million, in excess of its retention and private reinsurance of $336 million. The limit and retention of the FHCF coverage was subject to upward or downward adjustment based on, among other things, submitted exposures to FHCF by all participants. The Company had purchased coverage alongside from third party reinsurers and through reinsurance agreements with Citrus Re. To the extent the FHCF coverage was adjusted, this private reinsurance with third party reinsurers and Citrus Re would adjust to fill in any gaps in coverage up to the reinsurers' aggregate limits for this layer. The FHCF coverage could not be reinstated once exhausted, but it did provide coverage for multiple events.

- CAT Bond Layer alongside the FHCF. During April 2015 Heritage P&C entered into three catastrophe reinsurance agreements with Citrus Re. The agreements provided for three years of coverage from catastrophic losses caused by named storms, including hurricanes, beginning on June 1, 2015. Heritage P&C paid periodic premiums to Citrus Re during the three-year risk period. Citrus Re issued an aggregate of $277.5 million of principal-at-risk variable notes due April 2017 to fund the reinsurance trust account and its obligations to Heritage P&C under the reinsurance agreements. These notes were issued in three classes. The Class A notes provide $150 million of coverage for the

layer immediately above the FHCF. The Class B notes provided $97.5 million of coverage, and the Class C notes provided $30 million of coverage. The Class B and Class C notes provided reinsurance coverage for a sliver of the catastrophe coverage that had previously been provided by the FHCF. The limit of coverage was fully collateralized by a reinsurance trust account for the benefit of Heritage P&C. The maturity date of the notes may be extended up to two additional years to satisfy claims for catastrophic events occurring during the three-year term of the reinsurance agreements.

- CAT Bond Layer above the FHCF. Immediately above the FHCF layer had the coverage provided by the 2015 reinsurance agreement entered into with Citrus Re. The Citrus Re 2015 Class A notes provided up to $150 million of coverage immediately above the FHCF layer. Coverage immediately above the 2015 Class A notes was provided by the 2014 reinsurance agreements entered into with Citrus Re. The first contract with Citrus Re provided $150 million of coverage and the second contract provided an additional $50 million of coverage.

- Aggregate Coverage. In addition to the layers described above, the Company also purchased $125 million of aggregate reinsurance coverage for losses and loss adjustment expenses in excess of $1.7 billion for a first catastrophic event. To the extent that this coverage was not fully exhausted in the first catastrophic event, it provided coverage commencing at its reduced retention for second and subsequent events and where underlying coverage had been previously exhausted. There was no reinstatement of the aggregate reinsurance coverage once exhausted, but it did provide coverage for multiple events.

For a first catastrophic event, our 2015-2016 reinsurance program provided coverage for $1.8 billion of losses and loss adjustment expenses, including our retention, and were responsible for all losses and loss adjustment expenses in excess of such amount. For subsequent catastrophic events, our total available coverage depended on the magnitude of the first event, as we may have had coverage remaining from layers that were not previously fully exhausted. We also purchased reinstatement premium protection insurance to provide an additional $440 million of coverage. Our aggregate reinsurance layer also provided coverage for second and subsequent events to the extent not exhausted in prior events. In total, we purchased $2.3 billion of reinsurance coverage, including our retention, for multiple catastrophic events for the 2015-2016 hurricane season

Property Per Risk Coverage

The Company also purchased property per risk coverage for losses and loss adjustment expenses in excess of $1 million per claim. The limit recovered for an individual loss is $9 million and total limit for all losses is $27 million. There are two reinstatements available with additional premium due based on the amount of the layer exhausted. In addition, the Company purchased facultative reinsurance in excess of $10 million for any commercial properties it insured that the total insured value exceeded $10 million.

2014 – 2015 Reinsurance Program

During the second quarter of 2014, the Company placed its reinsurance program for the period from June 1, 2014 through May 31, 2015. The Company’s 2014-2015 reinsurance program incorporated the mandatory coverage required by law to be placed with FHCF. The Company also purchased private reinsurance below, alongside and above the FHCF layer, as well as aggregate reinsurance coverage. The following describes the various layers of the Company’s June 1, 2014 to May 31, 2015 reinsurance program.

- The Company’s Retention. For the first catastrophic event, the Company had a primary retention of the first $15 million of losses and loss adjustment expenses, of which Osprey was responsible for $6 million. For a second event, Heritage P&C’s primary retention decreased to $2 million and Osprey was responsible for $4 million. To the extent that there was reinsurance coverage remaining, Heritage P&C had a $2 million primary retention for events beyond the third catastrophic event. Osprey had no primary retention beyond the second catastrophic event.

- Layers Below FHCF. Immediately above the Company’s retention, the Company purchased $185 million of reinsurance from third party reinsurers. Through the payment of a reinstatement premium, the Company was able to reinstate the full amount of this reinsurance one time. To the extent that $185 million or a portion thereof was exhausted in a first catastrophic event, the Company purchased reinstatement premium protection insurance to pay

the required premium necessary for the reinstatement of this coverage. A portion of this coverage wrapped around the FHCF and provided coverage alongside the FHCF.

- FHCF Layer. The Company's FHCF coverage included an estimated maximum provisional limit of 90% of $484 million, or $436 million, in excess of its retention and private reinsurance of $181 million. The limit and retention of the FHCF coverage was subject to upward or downward adjustment based on, among other things, submitted exposures to FHCF by all participants. The Company purchased coverage alongside from third party reinsurers. The layer alongside was in the amount of $48 million. To the extent the FHCF coverage was adjusted, this private reinsurance would adjust to fill in any gaps in coverage up to the reinsurers' aggregate limits for this layer. The FHCF coverage could not be reinstated once exhausted, but it did provide coverage for multiple events.



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- CAT Bond Layer. Immediately above the FHCF layer was the coverage provided by the reinsurance agreements entered into with Citrus Re. The first contract with Citrus Re provided $150 million of coverage and the second contract provided an additional $50 million of coverage. Osprey provided $25 million of coverage alongside the second contract.

- Aggregate Coverage. In addition to the layers described above, the Company purchased $105 million of aggregate reinsurance coverage for losses and loss adjustment expenses in excess of $825 million for a first catastrophic event. To the extent that this coverage was not fully exhausted in the first catastrophic event, it provided coverage commencing at its reduced retention levels for second and subsequent events and where underlying coverage had been previously exhausted. There was no reinstatement of the aggregate reinsurance coverage once exhausted, but it did provide coverage for multiple events. Osprey provided $20 million of protection in the layer above $940 million.

For a first catastrophic event, the Company's 2014-2015 reinsurance program provided coverage for $990 million of losses and loss adjustment expenses, including its retention, and the Company was responsible for all losses and loss adjustment expenses in excess of such amount. For subsequent catastrophic events, the Company's total available coverage depended on the magnitude of the first event, as the Company may have had coverage remaining from layers that were not previously fully exhausted. The Company purchased reinstatement premium protection insurance to provide an additional $185 million of coverage. The Company's aggregate reinsurance layer also provided coverage for second and subsequent events to the extent not exhausted in prior events.

Assumption Transactions and Assumed Premiums Written

The following table depicts written premiums, earned premiums and losses, showing the effects that the Company's assumption transactions have on these components of the Company's consolidated statements of income and comprehensive income:

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| | (In thousands) | | |
| Premium written: | | | |
| Direct | $618,932 | $487,583 | $283,295 |
| Assumed | 7,772 | 98,515 | 153,112 |
| Ceded | (252,113) | (183,841) | (99,798) |
| Net premium written | $374,591 | $402,257 | $336,609 |
| Change in unearned premiums: | | | |
| Direct | $(29,480) | $(103,138) | $(80,617) |
| Assumed | 43,294 | 41,780 | (44,276) |
| Ceded | 23,316 | 35,369 | 11,896 |
| Net decrease (increase) | $37,130 | $(25,989) | $(112,997) |
| Premiums earned: | | | |
| Direct | $589,452 | $384,445 | $202,678 |
| Assumed | 51,066 | 140,295 | 108,836 |
| Ceded | (228,797) | (148,472) | (87,902) |
| Net premiums earned | $411,721 | $376,268 | $223,612 |
| Losses and LAE incurred: | | | |
| Direct | $214,362 | $107,552 | $64,686 |
| Assumed | 26,361 | 33,639 | 24,874 |
| Ceded | (1,861) | — | — |
| Net losses and LAE incurred | $238,862 | $141,191 | $89,560 |

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Explanation of Responses:

The following table highlights the effects that the Company's assumption transactions have on unpaid losses and loss adjustment expenses and unearned premiums:

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| | (In thousands) | | |
| Unpaid losses and loss adjustment expenses: | | | |
| Direct | $119,339 | $60,223 | $34,420 |
| Assumed | 20,798 | 23,499 | 17,049 |
| Gross unpaid losses and LAE | $140,137 | $83,722 | $51,469 |
| Unearned premiums: | | | |
| Direct | $317,579 | $258,754 | $155,617 |
| Assumed | 445 | 43,739 | 85,519 |
| Gross unearned premiums | 318,024 | 302,493 | 241,136 |
| Ceded | (106,609) | (78,517) | (43,148) |
| Net unearned premiums | $211,415 | $223,976 | $197,988 |

Note 10. Reserve For Unpaid Losses

The Company determines the reserve for unpaid losses on an individual-case basis for all incidents reported. The liability also includes amounts for which are commonly referred to as incurred but not reported, or "IBNR", claims as of the balance sheet date.

The table below summarizes the activity related to the Company's reserve for unpaid losses:

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| | | | |
| Balance, beginning of period | $83,722 | $51,469 | $19,344 |
| Less: reinsurance recoverable on paid losses | — | — | — |
| Net balance, beginning of period | 83,722 | 51,469 | 19,344 |
| Incurred related to: | | | |
| Current year | 220,071 | 146,484 | 89,783 |
| Prior years | 18,791 | (5,293) | (223) |
| Total incurred | 238,862 | 141,191 | 89,560 |
| Paid related to: | | | |
| Current year | 120,626 | 81,673 | 45,618 |
| Prior years | 62,407 | 27,265 | 11,817 |
| Total paid | 183,033 | 108,938 | 57,435 |
| Net balance, end of period | 139,551 | 83,722 | 51,469 |
| Plus: reinsurance recoverable on unpaid losses | 586 | — | — |
| Balance, end of period | $140,137 | $83,722 | $51,469 |

The Company writes insurance in the states of Florida, North Carolina, South Carolina, Hawaii and Georgia, which could be exposed to hurricanes or other natural catastrophes. Although the occurrence of a major catastrophe could have a significant effect on our monthly or quarterly results, such an event is unlikely to be so material as to disrupt

our overall normal operations. However, the Company is unable to predict the frequency or severity of any such events that may occur in the near term or thereafter. The Company believes that the reserve for unpaid losses reasonably represents the amount necessary to pay all claims and related expenses which may arise from incidents that have occurred as of the balance sheet date.

The Company's losses incurred for the years ended December 31, 2016 and 2015 reflecting a prior year deficiency of $18.8 million and a redundancy of $5.3 million, respectively, associated with management's best estimate of the actuarial loss and LAE reserves with consideration given to Company specific historical loss experience. Most of the unfavorable development was from personal lines. Also, most of the unfavorable emergence came from the second, third and fourth quarters of 2015, primarily related to claims involving litigation and claims that were represented by attorneys, public adjusters or others (sometimes referred to as Assignment of Benefits). Also, a majority of the unfavorable development in 2016 has been isolated to the tri-county region of Florida (the counties of Miami-Dade, Broward and Palm Beach).



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The Company writes insurance in the states of Florida, North Carolina, South Carolina and Hawaii, 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 yearly 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.

The following is information about incurred and paid claims development as of December 31, 2016, net of reinsurance, as well as cumulative claim frequency and the total of incurred-but-not-reported liabilities plus expected development on reported claims included within the net incurred claims amounts.

Incurred Loss and Allocated Loss Adjustment Expenses, Net of Reinsurance
(in thousands, except number of claims)

Unaudited

| Accident year | 2012 | 2013 | 2014 | 2015 | 2016 | Net IBNR Reserves | Reported Claims |
|---|---|---|---|---|---|---|---|
| 2012 | $1,396 | $851 | $811 | $784 | $797 | $ 6 | 125 |
| 2013 | | 37,005 | 35,819 | 37,212 | 37,090 | 531 | 3,607 |
| 2014 | | | 91,839 | 86,508 | 86,634 | 2,155 | 7,770 |
| 2015 | | | | 141,125 | 159,899 | 13,637 | 11,068 |
| 2016 | | | | | 207,183 | 65,884 | 14,603 |
| | | | | Total | $491,603 | $ 82,213 | |

Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance

Unaudited

| Accident year | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|
| 2012 | $ 12 | $615 | $695 | $756 | $766 |
| 2013 | | 18,625 | 29,023 | 32,414 | 35,322 |
| 2014 | | | 47,408 | 70,932 | 79,341 |
| 2015 | | | | 76,310 | 130,267 |
| 2016 | | | | | 107,771 |
| | | | | Total | $353,467 |

Reconciliation of Reserve Balances to Liability for Unpaid Loss and Loss Adjustment Expenses

| | |
|---|---|
| Unpaid Loss and Allocated Loss Adjustment Expense, Net of Reinsurance | $138,136 |
| Ceded Unpaid Loss and Allocated Loss Adjustment Expense | 586 |
| Unpaid Unallocated Loss Adjustment Expense | 1,415 |
| Unpaid losses and loss adjustment expenses | $140,137 |

Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance as of December 31, 2016

| | Year - 1 | Year - 2 | Year - 3 | Year - 4 | Year - 5 | Thereafter |
|---|---|---|---|---|---|---|
| Percentage | 53% | 29% | 9% | 4% | 1% | 4% |

Note 11. Note Payable

On December 15, 2016, we issued Senior Secured Notes ("Secured Notes") in the aggregate amount of $79.5 million, 7-year term note payable to six accredited investors. The Secured Notes bears interest of 8.75% plus 0.95% of the three month average of LIBOR. Principal and interest is paid quarterly, interest payments commence on March 15, 2017, the quarterly principal payments commence on December 31, 2018. At December 31, 2016, we owed $72.9 million, net of issuance costs. In addition, the Company incurred approximately $6.6 million of debt issuance costs

Long-term debt at December 31, 2016, consisted of the following:

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| | Principal | Unamortized Debt Issuance Costs |
|---|---|---|
| | (in thousands) | |
| Senior Secured Notes, due December 15, 2023 (interest computed at 8.75% plus 3 month Libor average, at December 31, 2016) | $79,500 | $ 6,595 |

The Secured Notes contain customary restrictive covenants relating to merger, modification of the indenture, subordination, issuance of debt securities and sale of assets, the most significant of which include limitations with respect to certain designated subsidiaries on the incurrence of additional indebtedness or guarantees secured by any security interest on any shares of their capital stock. The Secured Notes covenants also limit the Company's ability to sell or otherwise dispose of any shares of capital stock of such designated subsidiaries. The Secured Notes do not have the benefit of any sinking funds. They also contain customary limitations and lien provisions as well as customary events of default provisions, which breached, could result in the accelerated maturity of the Secured Notes. The Company was in compliance with the senior notes covenants for the year ended December 31, 2016.

Subject to replacement capital covenant, the Secured Notes may be redeemable, in whole or in part, at any time on or after December 15, 2018, based on the quarterly payment date, at the following redemption prices (as a percentage of outstanding principal amount of the notes to be redeemed) plus accrued and unpaid interest and principal of the Secured Notes: 2018 – 103%; 2019 – 102%; 2020 – 101% and thereafter at 100%. If there is a change in control offer that Holder has the right to require the Company to purchase such Holder's Secured Notes based on the redemption terms stated above.

The effective interest rate, taking into account the stated interest expense and amortization of debt issuance costs, approximates 9.7%.

Expected annual principal payments due by Heritage Insurance under the Senior Secured Note agreement is as follows:

| Year | Amount (in thousands) |
|---|---|
| 2017 | $ — |
| 2018 | 1,988 |
| 2019 | 7,465 |
| 2020 | 6,746 |
| 2021 | 6,097 |
| Thereafter | 57,204 |
| | $ 79,500 |

As of December 31, 2016, we recorded interest expense on debt liabilities and amortization of debt issuance costs of $321 thousand and $41 thousand, respectively.

Note 12. Income Taxes

The following table summarizes the provision for income taxes:

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| | (In thousands) | | |
| Federal: | | | |
| Current | $16,575 | $48,524 | $26,440 |
| Deferred | 2,735 | 970 | (3,219 ) |
| Provision for Federal income tax expense | 19,310 | 49,494 | 23,221 |
| State: | | | |
| Current | 2,893 | 8,238 | 4,479 |
| Deferred | 335 | 46 | (545 ) |
| Provision for State income tax expense | 3,228 | 8,284 | 3,934 |
| Provision for income taxes | $22,538 | $57,778 | $27,155 |

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The following table sets forth the components of income before income taxes for the years ended December 31, 2016, 2015 and 2014 (in thousands):

| | 2016 | 2015 | 2014 |
|---|---|---|---|
| Pass-through entities (Through May 22, 2014) | $— | $— | $2,668 |
| Non-pass through entities | 56,403 | 150,290 | 71,584 |
| Income before income taxes | $56,403 | $150,290 | $74,252 |

The actual income tax expense differs from the expected income tax expense computed by applying the combined applicable effective federal and state tax rates to income before the provision for income taxes as follows:

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| Expected income tax expense at federal rate | 35.0% | 35.0% | 35.0% |
| State tax expense, net of federal tax benefits | 3.7 % | 3.6 % | 3.6 % |
| Permanent items | 1.4 % | -1.0 % | 0.0 % |
| Other | -0.1 % | 0.9 % | -2.0 % |
| Reported income tax expense | 40.0% | 38.5% | 36.6% |

The effective income tax rate differs from the statutory income tax rate in 2016, 2015 and 2014 primarily due to state income taxes and the fact that a portion of the Company's consolidated pre-tax income through May 22, 2014 was earned at our limited liability companies that had elected to be taxed under the Partnership provisions of the Internal Revenue Code. Accordingly, all income or losses and applicable tax credits generated by these entities through that date are reported on the common shareholders' individual tax returns, and no federal income taxes were recorded by the Company prior to May 22, 2014.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

The table below summarizes the significant components of our net deferred tax assets (liabilities):

| | For the Year Ended December 31, | |
|---|---|---|
| | 2016 | 2015 |
| Deferred tax assets: | (In thousands) | |
| Unearned premiums | $17,209 | $17,979 |
| Tax-related discount on loss reserve | 1,829 | 1,140 |
| Unrealized loss | 3,113 | 1,277 |
| Stock-based compensation | 1,604 | 1,617 |
| Prepaid expenses | 1,482 | — |
| Other | 312 | 256 |

| | | |
|---|---|---|
| Total deferred tax asset | 25,549 | 22,269 |
| Deferred tax liabilities: | | |
| Deferred acquisition costs | 16,377 | 13,424 |
| Unrealized gain | — | — |
| Property and equipment | 355 | 473 |
| Basis in purchased investments | 1,697 | — |
| Basis in purchased intangibles | 9,791 | — |
| Other | 332 | 408 |
| Total deferred tax liabilities | 28,552 | 14,305 |
| Less: valuation allowance | — | — |
| Net deferred tax (liability) asset | $(3,003 ) | $7,964 |

In assessing the net carrying amount of deferred tax assets, we consider whether it is more likely than not that we will not realize some portion or all of the deferred tax assets. The ultimate realization of deferred tax assets depends upon the generation of future taxable income during the periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. The remaining goodwill

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from asset purchases that is deductible for tax purposes over the future years totaled $7 million and $7.6 million for the years ended December 31, 2016 and 2015, respectively.

The statute of limitations related to our federal and state income tax returns remains open from our first filings for 2013 through 2015. For the 2014 tax year, the federal income tax return was examined by the tax authority resulting no material adjustment.  Currently, no taxing authorities are examining any of our federal or state income tax returns.

The reinsurance affiliate, which is based in Bermuda, made an irrevocable election under section 953(d) of the U.S. Internal Revenue Code of 1986, as amended, to be treated as a domestic insurance company for U.S. Federal income tax purposes. As a result of this election, our reinsurance subsidiary is subject to United States income tax as if it were a U.S. corporation.

As of December 31, 2016, the Company had no uncertain tax positions or unrecognized tax benefits that, if recognized, would impact the effective income tax rate.

## Note 13. Statutory Accounting and Regulations

State laws and regulations, as well as national regulatory agency requirements, govern the operations of all insurers such as our insurance subsidiaries. The various laws and regulations require that insurers maintain minimum amounts of statutory surplus and risk-based capital; restrict insurers' ability to pay dividends; restrict the allowable investment types and investment mixes, and subject the Company's insurers to assessments.

The Company's insurance subsidiaries are required to file with state insurance regulatory authorities an "Annual Statement" which reports, among other items, net income and surplus as regards policyholders, which is called stockholder's equity under GAAP. Combined results of the Company's insurance subsidiaries reported statutory net income of $567 thousand and $45.6 million for the years ended December 31, 2016 and 2015, respectively. The Company's insurance subsidiaries must maintain capital and surplus ratios or balances as determined by the regulatory authority of the states in which they are domiciled. Heritage P&C is required to maintain capital and surplus equal to the greater of $15 million or 10% of their respective liabilities. Zephyr is required to maintain a deposit of $750 thousand in a federally insured financial institution. The Company's combined statutory surplus was $276 million and $216.6 million at December 31, 2016 and December 31, 2015, respectively. State law also requires the Company's insurance subsidiaries to adhere to prescribed premium-to-capital surplus ratios, with which the Company is in compliance. At December 31, 2016, our insurance subsidiaries met the financial and regulatory requirements of the states in which they do business.

In 2014, the Florida legislature passed Senate Bill 1308, which was signed into law by the Governor. Among other things, this bill incorporates the National Association of Insurance Commissioners ("NAIC") recommendations with regard to expansion of the regulation of insurers to include non-insurance entity affiliates. Specifically, the new law permits the Office of Insurance Regulation to examine affiliated entities within an insurance holding company system in order to ascertain the financial condition of the insurer. The law also provides for certain disclosures with regard to enterprise risk, which are satisfied by the provision of related information filed with the SEC. This legislation was designed to bolster regulation for insurer solvency and governance and became effective January 1, 2015.

The NAIC published risk-based capital guidelines for insurance companies that are designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policy holders. Most states, including Florida, have enacted the NAIC guidelines as statutory requirements, and insurers having less statutory surplus than required will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy. State insurance regulatory authorities could require an insurer to cease operations in the event the insurer fails to maintain the required statutory capital.

The level of required risk-based capital (“RBC”) is calculated and reported annually. There are five outcomes to the RBC calculation set forth by the NAIC which are as follows:

1. No Action Level—If RBC is greater than 200%, no further action is required.
2. Company Action Level—If RBC is between 150%-200%, the insurer must prepare a report to the regulator outlining a comprehensive financial plan that identifies conditions that contributed to the insurer’s financial condition and proposes corrective actions.
3. Regulatory Action Level—If RBC is between 100%-150%, the state insurance commissioner is required to perform any examinations or analyses to the insurer’s business and operations that he or she deems necessary as well as issuing appropriate corrective orders.

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4. Authorized Control Level—If RBC is between 70%-100%, this is the first point that the regulator may take control of the insurer even if the insurer is still technically solvent and is in addition to all the remedies available at the higher action levels.
5. Mandatory Control Level—If RBC is less than 70%, the regulator is required to take steps to place the insurer under its control regardless of the level of capital and surplus.

At December 31, 2016, the ratio of adjusted capital to authorized control level risk based capital for each of our insurance company subsidiaries was above 300%.

State law for Florida and Hawaii permits an insurer to pay dividends or make distributions out of that part of statutory surplus derived from net operating profit and net realized capital gains. The law further provides calculations to determine the amount of dividends or distributions that can be made without the prior approval of the insurance regulatory authority and the amount of dividends or distributions that would require prior approval of the insurance regulatory authority. Statutory risk-based capital requirements may further restrict our insurance subsidiaries ability to pay dividends or make distributions if the amount of the intended dividend or distribution would cause statutory surplus to fall below minimum risk-based capital requirements. However, the consent order authorizing our commencement of operations precludes us from paying dividends without the prior approval of FLOIR until July 31, 2017.

Florida law limits an insurer's investment in equity instruments and also restricts investments in medium to low quality debt instruments. The Company was in compliance with all investment restrictions at December 31, 2016 and 2015.

Governmental agencies or certain quasi-governmental entities can levy assessments upon the Company in the states in which the Company writes policies. See Note 1 for a description of how the Company recovers assessments imposed upon it.

Governmental agencies or certain quasi-governmental entities can also levy assessments upon policyholders, and the Company collects the amount of the assessments from policyholders as surcharges for the benefit of the assessing agency. There are currently no assessments to be collected from policyholders and remitted to any governmental or quasi-governmental entities. If an assessment becomes levied the Company would multiply the premium written on each policy by these assessment percentages to determine the additional amount that it will collect from the policyholder and remit to the assessing agencies.

The Company reported its insurance subsidiaries' assets, liabilities and results of operations in accordance with GAAP, which varies from statutory accounting principles prescribed or permitted by state laws and regulations, as well as by general industry practices. The following items are principal differences between statutory accounting and GAAP:

- Statutory accounting requires that the Company excluded certain assets, called non-admitted assets, from the balance sheet.
- Statutory accounting requires the Company to expense policy acquisition costs when incurred, while GAAP allows the Company to defer and amortize policy acquisition costs over the estimated life of the policies.
- Statutory accounting dictates how much of a deferred income tax asset the Company can admit on a statutory balance sheet.
- Statutory accounting requires that the Company record certain investments at cost or amortized cost, while the Company records other investments at fair value; however, GAAP requires that we record all available for sale investments at fair value.
- Statutory accounting requires that surplus notes, also known as surplus debentures, be recorded in statutory surplus, while GAAP requires the Company to record surplus notes as a liability.
- Statutory accounting allows bonds to be carried at amortized cost or fair value based on the rating received from the Securities Valuation Office of the NAIC, while they are recorded at fair value for GAAP if designated as available for sale.
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Statutory accounting allows ceding commission income to be recognized when written if the cost of acquiring and renewing the associated business exceeds the ceding commissions, but under GAAP such income is deferred and recognized over the coverage period.

- Statutory accounting requires that unearned premiums and loss reserves be presented net of related reinsurance rather than on a gross basis under GAAP.

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- Statutory accounting requires a provision for reinsurance liability be established for reinsurance recoverable on paid losses aged over ninety days and for unsecured amounts recoverable from unauthorized reinsurers. Under GAAP there is no charge for uncollateralized amounts ceded to a company not licensed in the insurance affiliate's domiciliary state and a reserve for uncollectable reinsurance is charged through earnings rather than surplus or equity.
- Statutory accounting requires an additional admissibility test outlined in Statements on Statutory Accounting Principles, No. 101 and the change in deferred income tax is reported directly in capital and surplus, rather than being reported as a component of income tax expense under GAAP.

The table below reconciles the Company's consolidated GAAP net income to statutory net income of its insurance subsidiaries (in thousands):

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| Consolidated GAAP net income | $33,865 | $92,512 | $47,097 |
| Increase (decrease) due to: | | | |
| Deferred income taxes | 6,069 | 1,755 | (3,764) |
| Deferred policy acquisition costs | (7,979) | (10,430) | (14,605) |
| Surplus note interest | — | (347) | (1,445) |
| Non-statutory subsidiaries | (32,874) | (36,569) | (16,788) |
| Investment basis difference | 540 | — | — |
| Pre-acquisition income | 3,755 | — | — |
| Equity compensation | (2,107) | (1,074) | (1,106) |
| Allowance for doubtful accounts | — | (250) | 250 |
| Other | (702) | — | 199 |
| Statutory net income of insurance subsidiaries | $567 | $45,597 | $9,838 |

The Company's reinsurance subsidiary, Osprey, which was incorporated on April 23, 2013, is licensed as a Class 3a Insurer under The Bermuda Insurance Act 1978 and related regulations. Osprey is required to maintain statutory capital and surplus of at least $1.0 million and maintain liquid resources or have access to liquid resources equal to its maximum obligation for which it is responsible under the terms of any reinsurance arrangement to which it is a party. In May 2013, the Company contributed $1.7 million in cash to Osprey. Osprey secures its reinsurance obligations to our insurance subsidiaries with an irrevocable letter of credit in the amount of $12.7 million. These resources, in addition to premiums ceded to it by our insurance subsidiaries are sufficient to comply with regulatory requirements as of December 31, 2016. Bermuda's standard for financial statement reporting is U.S. GAAP.

Note 14. Commitments and Contingencies

The Company is involved in claims-related legal actions arising in the ordinary course of business. The Company accrues amounts resulting from claims-related legal actions in unpaid losses and loss adjustment expenses during the period that it determines an unfavorable outcome becomes probable and it can estimate the amounts. Management makes revisions to its estimates based on its analysis of subsequent information that the Company receives regarding various factors, including: (i) per claim information; (ii) company and industry historical loss experience; (iii) judicial decisions and legal developments in the awarding of damages; and (iv) trends in general economic conditions, including the effects of inflation. When determinable, the Company discloses the range of possible losses in excess of those accrued and for reasonably possible losses.

Note 15. Other Liabilities

At December 31, 2016 and 2015, Other liabilities included approximately $0.2 million and $4.9 million related to amounts owed to Citizens for policies assumed by the Company, where the policyholder subsequently opted-out of the assumption program. Also, included in other liabilities for the years ended December 31, 2016 and 2015 was $6.2 million and $5.8 million for commission payables, $5.6 million and $3.9 million for accounts payable and other payables, and $6.9 million and $0 for payments in connection with the issuance of debt, $1.8 million and $1.6 million for dividends payable and $1 million and $1.2 million for unearned revenue, respectively.

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Note 16. Accrued Bonus Compensation

For the year ended December 31, 2016, the Company recognized employee bonus compensation expense of approximately $4.4 million based on EBITDA goals, which the Company paid out in cash of approximately $0.8 million as of December 31, 2016. For the year ended December 31, 2015, the Company recognized employee bonus compensation expense of approximately $14.1 million, which the Company paid out in cash of approximately $12.1 million as of December 31, 2015 and the remainder was paid in 2016. For the year ended December 31, 2014, the Company accrued bonuses of $7.2 million based on 8.5% of earnings before interest, taxes, depreciation and amortization, which was paid out in cash as of December 31, 2014

Note 17. Related Party Transactions

The Company has been party to various related party transactions involving certain of its officers, directors and significant stockholders as set forth below. The Company has entered into these arrangements without obligation to continue its effect in the future and the associated expense was immaterial to its results of operations or financial position as of December 31, 2016, 2015 and 2014.

- The Company has entered into an agreement with a real estate management company controlled by one of its directors to manage its Clearwater office space. Management services are provided at a fixed fee, plus ordinary and necessary out of pocket expenses. Fees for additional services, such as the oversight of construction activity, are provided for on an as-needed basis. For the years ended December 31, 2016, 2015 and 2014, the Company paid the management service company approximately $118 thousand, $113 thousand and $93thousand, respectively.

- The Company leased the space that it had occupied through March 2014 at 700 Central Avenue, Ste. 500 St. Petersburg, Florida from a real estate management company controlled by a stockholder. The Company leased the space without obligation to continue doing so in the future. For the years ended December 31, 2016, 2015 and 2014 the Company incurred rent expense of approximately $0, $0 and $70 thousand respectively.

Note 18. Employee Benefit Plan

The Company provides a 401(k) plan for its employees. The Company contributes 3% of employees' salary, up to the maximum allowable contribution, regardless of the employees' level of participation in the plan. For the years ended December 31, 2016 and 2015, the Company's contributions to the plan on behalf of the participating employees were $685 thousand and $276 thousand respectively.

The Company provides for its employees a partially self-insured healthcare plan and benefits. For the years ended December 31, 2016 and 2015, the Company incurred medical premium costs in the aggregate of $2.4 million and $1.4 million, respectively. The Company also recorded approximately $309 thousand as unpaid claims as of December 31, 2016. A stop loss reinsurance policy caps the maximum loss that could be incurred by the Company under the self-insured plan. The Company's stop loss coverage per employee is $60 thousand for which any excess cost would be covered by the reinsurer. There is an aggregate limit for losses of $1.5 million which would provide up to $1 million of coverage. Any excess of the $1.5 million retention and the $1 million of aggregate coverage would be borne by the Company. The aggregate stop loss commences once our expenses exceed 125% of the annual aggregate expected claims.

Note 19. Equity

The total amount of authorized capital stock consists of 50,000,000 shares of common stock and 5,000,000 shares of preferred stock. As of December 31, 2016, the Company had 28,840,443 shares of common stock outstanding, 1,759,330 treasury shares of common stock and 900,000 unvested restricted common stock issued reflecting total paid-in capital of $205.7 million as of such date.

Common Stock

Holders of common stock are entitled to one vote for each share held on all matters subject to a vote of stockholders, subject to the rights of holders of any outstanding preferred stock. Accordingly, holders of a majority of the shares of common stock entitled to vote in any election of directors may elect all of the directors standing for election, subject to the rights of holders of any outstanding preferred stock. Holders of common stock will be entitled to receive ratably any dividends that the board of directors may declare out of funds legally available therefor, subject to any preferential dividend rights of outstanding preferred stock. Upon the Company's liquidation, dissolution or winding up, the holders of common stock will be entitled to receive ratably its net assets available after the payment of all debts and other liabilities and subject to the prior rights of holders of any outstanding preferred stock. Holders of common stock have no preemptive, subscription, redemption or conversion rights. There are no redemption or sinking fund provisions



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applicable to the common stock. All outstanding shares of the Company's capital stock (excluding restricted stock) are fully paid and nonassessable.

Stock Repurchase Program

On September 14, 2015, the Company announced that the Company's Board of Directors, authorized a stock repurchase program authorizing the Company to repurchase up to $20 million of the Company's common stock. On May 4, 2016, the Board of Directors authorized an additional stock repurchase of up to $50 million of the Company's common stock through December 31, 2017. For the year ended December 31, 2016, the Company has purchased in aggregate 1,759,330 shares of common stock at a cost of $25.6 million through open market or private transactions.

Dividends

For the year ended December 31, 2016, we recorded quarterly cash dividends of approximately $7 million as follows:

| | Quarter Ended | | | |
|---|---|---|---|---|
| | March 31, 2016 | June 30, 2016 | September 30, 2016 | December 31, 2016 |
| Cash dividend per common share | $0.05 | $0.06 | $0.06 | $0.06 |
| Total cash dividends paid | $1,578,320 | $1,840,455 | $1,808,505 | $1,784,426 |
| Record date | March 15, 2016 | June 15, 2016 | September 15, 2016 | December 15, 2016 |
| Payment date | April 5, 2016 | July 1, 2016 | October 3, 2016 | January 4, 2017 |

On December 17, 2015, the Company announced a cash dividend of $0.05 per share or $1.5 million on the Company's common stock, payable on January 13, 2016 to stockholders of record as of the close of business on December 31, 2015.

On March 2, 2017, the Company's Board of Directors declared a $0.06 per share quarterly dividend payable on April 4, 2017, to shareholders of record March 15, 2017.

Cash dividends declared on our outstanding weighted average number of basic common shares for the periods presented were approximately as follows:

| | For the Years Ended December 31, | |
|---|---|---|
| | 2016 | 2015 |

| Cash dividends per common share | $0.23 | $0.05 |
|---|---|---|

Note 20. Stock-Based Compensation

The Company has adopted the Heritage Insurance Holdings, Inc., Omnibus Incentive Plan (the "Plan") effective on May 22, 2014. The Plan authorized 2,981,737 shares of common stock for issuance under the Plan for future grants.

At December 31, 2016 and 2015, there were 170,814 shares available for grant under the Plan.

The Company recognizes compensation expense under ASC 718 for its stock-based payments based on the fair value of the awards. The Company grants stock options at exercise prices equal to the fair market value of the Company's stock on the dates the options are granted. The options have a maximum term of ten years from the date of grant and vest primarily in equal annual installments over a range of one to five year periods following the date of grant for employee options. If a participant's employment relationship ends, the participant's vested awards will remain exercisable for the shorter of a period of 30 days or the period ending on the latest date on which such award could have been exercisable. The fair value of each option grant is separately estimated for each grant date. The fair value of each option is amortized into compensation expense on a straight-line basis between the grant date for the award and each vesting date. The Company estimates the fair value of all stock option awards as of the date of the grant by applying the Black-Scholes-Merton multiple-option pricing valuation model. The application of this valuation model involves assumptions that are judgmental and highly sensitive in the determination of compensation expense.

Stock Options

On September 24, 2014, the Company granted options to purchase 359,000 shares to certain employees and directors. No stock options were granted in the years ending December 31, 2015 and 2016. These options were awarded with the strike price set at the fair market value at the grant date, and vested on March 15, 2015 with an expiration date of September 24, 2017. The fair value of each



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option grant, which was $2.70 per option granted in 2014, was estimated on the date of grant using the Black-Scholes option-pricing model. The fair value of options vested during the year ended December 31, 2014 was $2.5 million.

On December 2, 2014, the Company granted options to purchase 1,326,923 shares to certain employees and directors. The employee options were awarded with the strike price set at the fair market value at the grant date, and vest at 50 percent upon grant and 50 percent on April 30, 2015 with an expiration date of December 2, 2017. The directors' options were awarded with the strike price set at the fair market value at the grant date, and vest quarterly commencing on January 1, 2015 with an expiration date of December 2, 2017. The fair value of each option grant, which ranged from $3.07 to $3.54 per option granted in 2014, is estimated on the date of grant using the Black-Scholes option-pricing model. The fair value options that vested as of December 31, 2015 was $2.7 million.

The following table provides the assumptions utilized in the Black-Scholes model for options granted during the year ended December 31, 2014. No options were granted during the years ended December 31, 2016 and 2015.

| | December 2, 2014 | | September 24, 2014 | |
|---|---|---|---|---|
| Weighted-average risk-free interest rate | 0.51 | | 0.42 | |
| Expected term of option in years | 1.60 | | 1.70 | |
| Weighted-average volatility | 35.56 | % | 36.47 | % |
| Dividend yield | 0 | % | 0 | % |
| Weighted average grant date fair value per share | $ 3.19 | | $ 2.70 | |

A summary of information related to stock options outstanding at December 31, 2016 is as follows:

| | Shares | Weighted-Average Grant Date Fair Value |
|---|---|---|
| Balance at December 31, 2014 | 1,685,923 | |
| Granted | — | |
| Exercised | (536,000 ) | $ 4.29 |
| Forfeited | — | |
| Balance at December 31, 2015 | 1,149,923 | $ 2.99 |
| Granted | — | |
| Exercised | — | |
| Balance at December 31, 2016 | 1,149,923 | $ 2.99 |
| Vested and exercisable as of December 31, 2016 | 1,149,923 | $ 2.99 |

| | Options Outstanding | | | Options Exercisable | | |
|---|---|---|---|---|---|---|
| Range of Exercise Price | Number Outstanding | Average Remaining Contractual Life (in years) | Weighted Average Exercise Price | Number Exercisable | Average Remaining Contractual Life (in years) | Weighted Average Exercise Price |
| $ 14.02 | 243,000 | 0.75 | $ 14.02 | 243,000 | 0.75 | $ 14.02 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 16.89 | 906,923 | 1.00 | | 16.89 | 906,923 | 1.00 | | 16.89 |
| $ 16.28 | 1,149,923 | 0.88 | $ | 16.28 | 1,149,923 | 0.88 | $ | 16.28 |

No compensation expense was recognized for stock options granted above during the year December 31, 2016. The Company has recognized $1.9 million and $3.3 million of compensation expense during the years ended December 31, 2015 and 2014 relative to the stock options granted above.

Restricted Stock

The Company has also granted shares of its common stock subject to certain restrictions under the Plan. Restricted stock awards granted to employees vest in equal installments generally over a five year period from the grant date subject to the recipient's continued employment. The fair value of restricted stock awards are estimated by the market price at the date of grant and amortized on a straight-line basis to expense over the period of vesting. Recipients of restricted stock awards have the right to receive dividends. No restricted stock was granted during the year ended December 31, 2016. Restricted stock activity during the year ended December 31, 2016 is as follows:

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| | Number of shares | Weighted-Average Grant-Date Fair Value per Share |
|---|---|---|
| Non-vested, at December 31, 2015 | 1,125,000 | $ 21.40 |
| Granted | — | — |
| Vested | (158,363 ) | $ 14.67 |
| Canceled and forfeited | (66,637 ) | $ 14.67 |
| Non-vested, at December 31, 2016 | 900,000 | $ 18.82 |

Awards are being amortized to expense over the five year vesting period. Relating to the restricted stock the Company recognized $3.8 million and $749 thousand of compensation expense for the years ended December 31, 2016 and 2015, respectively. At December 31, 2016, there was approximately $18.5 million, representing unrecognized compensation expense related to the non-vested restricted stock. The Company expects to recognize the remaining compensation expense over a weighted average period of 3.9 years.

The following table summarizes information about deferred tax benefits recognized and tax benefits realized to restricted stock awards and related paid dividends, and the fair value of vested restricted stock for the year ended December 31, 2016 and 2015, respectively.

| For the Year Ended December 31, | 2016 | 2015 |
|---|---|---|
| Deferred tax benefit recognized | $— | $76 |
| Tax benefit realized for restricted stock and paid dividends | — | 357 |
| Fair value of vested restricted stock | 3,301 | — |

Note 21. Condensed Financial Information of Heritage Insurance Holdings, Inc.
The following summarizes the major categories of Heritage Insurance Holdings, Inc.'s financial statements (in thousands, except share and per share data):

| | As of December 31, 2016 | 2015 |
|---|---|---|
| | (In thousands) | |
| ASSETS | | |
| Fixed maturity securities, available for sale, at fair value | $77,922 | $— |
| Cash and cash equivalents | 7,368 | 36,762 |
| Investment in and advances to subsidiaries | 334,983 | 312,047 |
| Other assets | 19,055 | 7,355 |
| Total Assets | $439,328 | $356,164 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Other liabilities | 81,369 | 349 |
| Total Liabilities | $81,369 | $349 |

| | | |
|---|---|---|
| Total Stockholders' Equity | $357,959 | $355,815 |
| Total Liabilities and Stockholders' Equity | $439,328 | $356,164 |

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| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| | (In thousands, except share and per share amounts) | | |
| Revenue: | | | |
| Other revenue | $1,403 | $1,129 | $1,896 |
| Total revenue | 1,403 | 1,129 | 1,896 |
| Expenses: | | | |
| General and administrative expense | 11,558 | 9,036 | 6,649 |
| Amortization of debt issuance cost | 41 | — | — |
| Interest expense, net | 321 | — | — |
| Total expenses | $11,920 | $9,036 | $6,649 |
| Loss before income taxes and equity in net income of subsidiaries | (10,517) | (7,907) | (4,753) |
| Benefit from income taxes | — | (2,227) | (801) |
| Loss before equity in net income of subsidiaries | (10,517) | (5,680) | (3,952) |
| Equity in net income of subsidiaries | 2,034 | 98,192 | 51,049 |
| Net income | $(8,483) | $92,512 | $47,097 |

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | 2016 | 2015 | 2014 |
| | (In thousands) | | |
| Net cash (used in) provided by operating activities | $(6,045) | $7,196 | $1,280 |
| Investing Activities | | | |
| Purchases of investment available for sale | (77,910) | — | — |
| Dividends received from subsidiaries | 85,096 | 21,400 | 16,099 |
| Investments and advances to subsidiaries | (74,361) | (32,400) | (98,469) |
| Net cash used in investing activities | (73,220) | (3,804) | (82,370) |
| Financing Activities | | | |
| Proceeds from issuance of equity from IPO and private placement, net of discount fee and direct costs of issuance | — | — | 78,670 |
| Proceeds from exercise of stock options and warrants | — | 8,900 | 22,515 |
| Proceeds from issuance of note payable, net of issuance costs | 77,910 | — | — |
| Proceeds from issuance of equity and redeemable shares | — | — | 88 |
| Excess tax (expense) benefit on stock-based compensation | (739) | 739 | — |
| Shares tendered for income tax withholdings | (977) | — | — |
| Purchase of treasury stock | (25,562) | — | — |
| Dividends | (6,806) | — | — |
| Net cash provided by financing activities | 43,826 | 9,639 | 101,273 |
| (Decrease)/increase in cash and cash equivalents | (29,394) | 5,835 | 20,183 |

| | | | |
|---|---|---|---|
| Cash and cash equivalents, beginning of period | 36,762 | 30,927 | 10,744 |
| Cash and cash equivalents, end of year | $7,368 | $36,762 | $30,927 |

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Explanation of Responses:

Note 22. Quarterly Results for 2016 and 2015 (unaudited)

The following table provides a summary of unaudited quarterly results for the periods presented (in thousands, except per share data):

| For the year ended December 31, 2016 | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| Net premiums earned | $ 106,342 | $ 108,918 | $ 101,555 | $ 94,906 |
| Investment income | $ 2,037 | $ 2,223 | $ 2,326 | $ 2,595 |
| Total revenues | $ 111,565 | $ 115,281 | $ 109,306 | $ 102,806 |
| Total expenses | $ 99,525 | $ 85,524 | $ 90,694 | $ 106,450 |
| Net income | $ 7,423 | $ 18,368 | $ 10,930 | $ (2,856) |
| Basic earnings per share | $ 0.24 | $ 0.62 | $ 0.37 | $ (0.09) |
| Diluted earnings per share | $ 0.24 | $ 0.62 | $ 0.37 | $ (0.09) |

| For the year ended December 31, 2015 | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| Net premiums earned | $ 101,489 | $ 94,846 | $ 82,361 | $ 97,572 |
| Investment income | $ 1,633 | $ 2,090 | $ 1,973 | $ 1,725 |
| Total revenues | $ 105,128 | $ 99,088 | $ 89,244 | $ 101,332 |
| Total expenses | $ 56,836 | $ 58,098 | $ 61,529 | $ 68,039 |
| Net income | $ 30,056 | $ 25,400 | $ 16,813 | $ 20,243 |
| Basic earnings per share | $ 1.01 | $ 0.85 | $ 0.56 | $ 0.66 |
| Diluted earnings per share | $ 1.00 | $ 0.84 | $ 0.55 | $ 0.66 |

Note 23. Subsequent Events

On March 2, 2017, the Company’s Board of Directors declared a $0.06 per share quarterly cash dividends totaling approximately $1.9 million payable on April 4, 2017, to stockholders of record on March 15, 2017.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure
None

Item 9A. Controls and Procedures
Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) that are designed to assure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

As required by Exchange Act Rule 13a-15(b), as of the end of the period covered by this Annual Report, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2016.

Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, do not expect that our disclosure controls and procedures will prevent all errors and fraud. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable, not absolute, assurance of achieving the desired control objectives. Further, the design of a control system must reflect the fact that there are resource constraints, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management's override of the control.

The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Internal control over financial reporting is a process designed under the supervision and with the participation of our management, including our principal executive officer and principle financial officer, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

As of December 31, 2016, our management assessed the effectiveness of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal

Control-Integrated Framework, or 2013 Framework. Based on this assessment, our management concluded that, as of December 31, 2016, our internal control over financial reporting was effective based on those criteria.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal controls over financial reporting during our most recent quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Item 9B. Other Information

Not applicable.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information regarding directors of the Company standing for election at the 2017 annual stockholders meeting is incorporated in this Item 10 by reference to the descriptions in the Proxy Statement under the captions "Corporate Governance – Proposal 1. Election of Directors."

Information regarding our audit committee and audit committee financial experts is incorporated in this Item 10 by reference to the information under the caption "Corporate Governance – Board Meetings and Committees" in the Proxy Statement.

Information regarding compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated in this Item 10 by reference to "Stock Ownership Information – Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement.

Information regarding executive officers of the Company is incorporated in this Item 10 by reference to Part I, Item 1 of this report under the caption "Executive Officers of the Registrant."

Item 11. Executive Compensation

The information regarding executive compensation is incorporated herein by reference to our definitive Proxy Statement for the 2017 Annual Meeting of our Stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2016.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information regarding security ownership of certain beneficial owners and management is incorporate in this Item 12 by reference to the sections of the Proxy Statement with the following captions:

- Stock Ownership Information – Security Ownership of Directors and Executive Officers
- Stock Ownership Information – Security Ownership of Certain Beneficial Owners

The following table includes information as of December 31, 2016, with respect to the Company's equity compensation plans:

| Plan Category | No. of Securities to | Weighted-Average Exercise Price of | No. of Securities |
|---|---|---|---|

| | be Issued upon Exercise of Outstanding Options and Rights | | Outstanding Options and Rights | Remaining Available for Future Issuance under Equity Compensation Plan (Excluding Securities in Column (a)) |
|---|---|---|---|---|
| | (a) | | (b) | (c) |
| Equity Compensation Plan Approved by Shareholders [1] | 2,049,923 | (2) | $ 15.46 | 170,814 |

1. Consists of the Omnibus Incentive Plan adopted on May 22, 2014.

2. As of December 31, 2016, 900,000 shares of restricted stock and 1,149,923 stock options were outstanding. The weighted-average exercise price of outstanding options and rights does not take into account the restricted stock, which have no exercise price.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information regarding certain relationship and related transactions, and director independence is incorporated herein by reference to our definitive Proxy Statement for the 2017 Annual Meeting of our Stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2016.

Item 14. Principal Accountant Fees and Services

Information regarding principal accountant fees and services is incorporated herein by reference to our definitive Proxy Statement for the 2017 Annual Meeting of our Stockholders to be filed with the SEC within 120 days after the end of our fiscal year ended December 31, 2016.

PART IV

Item 15. Exhibits, Financial Statements Schedules

The following documents are filed as part of this Annual Report on Form 10-K:

(a) The following documents are filed as part of this report.

(1) Financial Statements

The following consolidated financial statements of the Company and the reports of independent auditors thereon are filed with this report:

Report of Independent Registered Public Accounting Firm (Grant Thornton LLP)

Consolidated Balance Sheets

Consolidated Statements of Operations and Comprehensive Income

Consolidated Statements of Changes in Stockholders’ Equity

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

(2) Financial Statement Schedules

All financial statement schedules have been omitted because the required information is not present or not present in amounts sufficient to require the submission of schedules, or because the information required is included in our Consolidated Financial Statements and Notes thereto.

(3) List of Exhibits

The Following is a list of exhibits filed or incorporated by reference as part of this Annual Report on Form 10-K

| Exhibit Number | Description |
|---|---|
| 3.1 | Certificate of Incorporation of Heritage Insurance Holdings, Inc. (incorporated by reference to Exhibit 3.1 to the Company’s Quarterly Report on Form 10-Q filed on August 6, 2014) |
| 3.2 | By-laws of Heritage Insurance Holdings, Inc. (incorporated by reference to Exhibit 3.2 to the Company’s Quarterly Report on Form 10-Q filed on August 6, 2014) |
| 4.1 | Form of Stock Certificate (Incorporated by reference to Exhibit 4.1 to the Company’s Registration Statement on Form S-1 (File No. 333-195409) filed on April 30, 2014) |

| | |
|---|---|
| 4.2 | Form of Warrant (Incorporated by reference to Exhibit 4.2 to the Company’s Registration Statement on Form S-1 (File No. 333-195409) filed on April 30, 2014) |
| 10.1 | Property Catastrophe Excess of Loss Reinsurance Contract, effective June 1, 2013, issued to Heritage Property & Casualty Insurance Company by the Subscribing Reinsurers (incorporated by reference to Exhibit 10.1 to the Company’s Quarterly Report on Form 10-Q filed on August 6, 2014) |
| 10.2 | Catastrophe Excess of Loss and Aggregate Reinsurance Contract, effective June 1, 2013, issued to Heritage Property & Casualty Insurance Company by the Subscribing Reinsurers (incorporated by reference to Exhibit 10.2 to the Company’s Quarterly Report on Form 10-Q filed on August 6, 2014) |
| 10.3 | Second Aggregate Catastrophic Excess of Loss Reinsurance Contract, effective June 1, 2013, issued to Heritage Property & Casualty Insurance Company by the Subscribing Reinsurers (incorporated by reference to Exhibit 10.3 to the Company’s Quarterly Report on Form 10-Q filed on August 6, 2014) |

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| Exhibit Number | Description |
| --- | --- |
| 10.4 | Second Catastrophe Excess of Loss and Aggregate Reinsurance Contract, effective June 1, 2013, issued to Heritage Property & Casualty Insurance Company by the Subscribing Reinsurers (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014) |
| 10.5 | Underlying Property Catastrophe Excess of Loss Reinsurance Contract, effective June 1, 2013, issued to Heritage Property & Casualty Insurance Company by Osprey Re Ltd (incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014) |
| 10.6 | Property Catastrophe Excess of Loss Reinsurance Contract, effective December 4, 2012, issued to Heritage Property & Casualty Insurance Company by the Subscribing Reinsurers (incorporated by reference to Exhibit 10.6 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014) |
| 10.7 | Property Catastrophe Excess of Loss Reinsurance Contract, effective April 17, 2014, by and among Heritage Property & Casualty Insurance Company and Citrus Re Ltd (incorporated by reference to Exhibit 10.30 to the Company's Registration Statement on Form S-1 (File No. 333-195409) filed on April 30, 2014) |
| 10.8 | Property Catastrophe Excess of Loss Reinsurance Contract, effective April 24, 2014, by and among Heritage Property & Casualty Insurance Company and Citrus Re Ltd (incorporated by reference to Exhibit 10.31 to the Company's Registration Statement on Form S-1 (File No. 333-195409) filed on April 30, 2014) |
| 10.9 | Common Stock Purchase Agreement, dated May 9, 2014, by and between Heritage Insurance Holdings, LLC and Ananke Ltd (incorporated by reference to Exhibit 10.32 to the Company's Registration Statement on Form S-1 (File No. 333-195409) filed on May 16, 2014) |
| 10.10 | Insurance Policy Acquisition and Transition Agreement, dated as of June 13, 2014, by and among Heritage Property & Casualty Insurance Company, the Florida Department of Financial Services, as Receiver for Sunshine State Insurance Company, and the Florida Insurance Guaranty Association (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 19, 2014) |
| 10.11+ | $4,000,000 XS $2,000,000 XS $4,000,000 Underlying Property Catastrophe Excess of Loss Reinsurance Contract, effective June 1, 2014, between Heritage Property & Casualty Insurance Company and the Subscribing Reinsurers (incorporated by reference to Exhibit 10.11 to the Company's Current Report on Form 10-Q filed on August 06, 2014) |
| 10.12+ | $6,000,000 XS $9,000,000 Underlying Property Catastrophe Excess of Loss Reinsurance Contract, effective June 1, 2014, between Heritage Property & Casualty Insurance Company and the Subscribing Reinsurers (incorporated by reference to Exhibit 10.12 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014) |
| 10.13+ | Multi-Year First & Second Property Catastrophe Excess of Loss Reinsurance Contract, effective June 1, 2014, between Heritage Property & Casualty Insurance Company and the Subscribing Reinsurers (incorporated by reference to Exhibit 10.13 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014) |
| 10.14+ | First & Second Property Catastrophe Reinstatement Premium Protection Reinsurance Contract, effective June 1, 2014, between Heritage Property & Casualty Insurance Company and the Subscribing Reinsurers |

(incorporated by reference to Exhibit 10.14 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014)

10.15+ Fourth Property Catastrophe Excess of Loss Reinsurance Contract, effective June 1, 2014, between Heritage Property & Casualty Insurance Company and the Subscribing Reinsurers (incorporated by reference to Exhibit 10.15 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014)

10.16+ Fifth Property Catastrophe Excess of Loss Reinsurance Contract, effective June 1, 2014, between Heritage Property & Casualty Insurance Company and the Subscribing Reinsurers (incorporated by reference to Exhibit 10.16 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014)

10.17+ Sixth Property Catastrophe Excess of Loss Reinsurance Contract, effective July 1, 2014, between Heritage Property & Casualty Insurance Company and the Subscribing Reinsurers (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014)

10.18+ Reimbursement Contract, effective June 1, 2014, between Heritage Property & Casualty Insurance Company and the State Board of Administration of the State of Florida (incorporated by reference to Exhibit 10.18 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014)

10.19+ Property Excess Per Risk Reinsurance Contract, effective June 27, 2014, between Heritage Property & Casualty Insurance Company and the Subscribing Reinsurers (incorporated by reference to Exhibit 10.19 to the Company's Quarterly Report on Form 10-Q filed on August 6, 2014)



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| Exhibit Number | Description |
| --- | --- |
| 10.20 | Separation Agreement and General Release, dated December 22, 2014, by and between Heritage Insurance Holdings, Inc. and Kent Linder. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 22, 2014) |
| 10.21 | Amended and Restated Employment Agreement, dated November 04, 2015, by and between Heritage Insurance Holdings, Inc. and Bruce Lucas. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on November 6, 2015) |
| 10.22 | Amended and Restated Employment Agreement, dated November 04, 2015, by and between Heritage Insurance Holdings, Inc. and Richard Widdicombe. (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on November 6, 2015) |
| 10.23 | Amended and Restated Employment Agreement, dated November 04, 2015, by and between Heritage Insurance Holdings, Inc. and Stephen Rohde. (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on November 6, 2015) |
| 10.24 | Employment Agreement, dated April 28, 2016, by and between Heritage Insurance Holdings, Inc. and Steven C. Martindale. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 2, 2016) |
| 10.25 | Indenture, dated December 15, 2016, by and among Heritage Insurance Holdings, Inc., The Bank of New York Mellon, The Bank of New York Mellon, London Branch, and The Bank of New York Mellon (Luxembourg) S.A. (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on December 16, 2016) |
| 23.1 | Consent of Grant Thornton LLP* |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 * |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 * |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.SC. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002** |
| 101.INS | XBRL Instance Document * |
| 101.SCH | XBRL Taxonomy Extension Schema. * |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase. * |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase. * |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase. * |

101.PRE XBRL Taxonomy Extension Presentation Linkbase.*

*Filed herewith
**Furnished herewith
+Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a request for confidential treatment, and this exhibit has been filed separately with the SEC.

Item 16. FORM 10-K SUMMARY

None



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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HERITAGE INSURANCE HOLDINGS, INC. (Registrant)

Date: March 15, 2017 By: /s/ BRUCE LUCAS
Chairman and Chief Executive Officer
(on behalf of the Registrant and as Principal Executive Officer)

POWERS OF ATTORNEY

KNOW ALL BY THESE PRESENT, that each person whose signature appears below constitutes and appoints Bruce Lucas as his true and lawful attorney-in-fact and agent, he with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, full power and authority to do and perform each and every act and thing requisite or necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ BRUCE LUCAS<br>Bruce Lucas | Chairman and Chief Executive Officer<br>(Principal Executive Officer) | March 15, 2017 |
| /s/ STEVEN MARTINDALE<br>Steven Martindale | Chief Financial Officer<br>(Principal Financial Officer and Principal Accounting Officer) | March 15, 2017 |
| /s/ RICHARD WIDDICOMBE<br>Richard Widdicombe | President and Director | March 15, 2017 |
| /s/ PANAGIOTIS APOSTOLOU<br>Panagiotis Apostolou | Director | March 15, 2017 |
| /s/ TRIFON HOUVARDAS<br>Trifon Houvardas | Director | March 15, 2017 |
| /s/ NICHOLAS PAPPAS<br>Nicholas Pappas | Director | March 15, 2017 |

| | | |
|---|---|---|
| /s/ JOSEPH VATTAMATTAM<br>Joseph Vattamattam | Director | March 15, 2017 |
| /s/ IRINI BARLAS<br>Irini Barlas | Director | March 15, 2017 |
| /s/ VIJAY WALVEKAR<br>Vijay Walvekar | Director | March 15, 2017 |
| /s/ JAMES MASIELLO<br>James Masiello | Director | March 15, 2017 |