

21ST CENTURY HOLDING CO  
Form 10-Q  
November 15, 2010

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED September 30, 2010  
OR

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

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission File number 0-2500111

21st Century Holding Company  
(Exact name of registrant as specified in its charter)

Florida  
(State or Other Jurisdiction of  
Incorporation or Organization)

65-0248866  
(IRS Employer  
Identification Number)

3661 West Oakland Park Boulevard, Suite 300, Lauderdale Lakes, Florida 33311  
(Address of principal executive offices) (Zip Code)

954-581-9993  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has electronically submitted and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

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

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

Yes  No

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

Common Stock, \$.01 par value -7,946,384 outstanding as of November 15, 2010

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## 21ST CENTURY HOLDING COMPANY

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## PART I: FINANCIAL INFORMATION

## Item 1 Financial Statements

21st CENTURY HOLDING COMPANY  
CONSOLIDATED BALANCE SHEETS  
(UNAUDITED)

|   | Period Ending          |                   |
|---|------------------------|-------------------|
|   | September 30, 2010     | December 31, 2009 |
|   | (Dollars in Thousands) |                   |
| <b>ASSETS</b>   |                        |                   |
| Investments   |                        |                   |
| Debt maturities, available for sale, at fair value  | \$ 85,512              | \$ 91,513         |
| Debt maturities, held to maturity, at amortized cost  | 5,782                  | 2,650             |
| Equity securities, available for sale, at fair value  | 19,654                 | 20,056            |
| <b>Total investments</b>  | <b>110,948</b>         | <b>114,219</b>    |
| Cash and short term investments   |                        |                   |
| Prepaid reinsurance premiums  | 34,555                 | 28,197            |
| Premiums receivable, net of allowance for credit losses of \$99 and \$24, respectively                                      | 3,285                  | 10,319            |
| Reinsurance recoverable, net  | 5,789                  | 10,311            |
| Deferred policy acquisition costs   | 10,230                 | 15,302            |
| Deferred income taxes, net  | 7,675                  | 8,267             |
| Income taxes receivable   | 5,687                  | 4,675             |
| Property, plant and equipment, net  | 2,260                  | 7,069             |
| Other assets  | 698                    | 859               |
| <b>Total assets</b>   | <b>\$ 183,418</b>      | <b>\$ 202,889</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                        |                   |
| Unpaid losses and LAE   | \$ 63,455              | \$ 70,611         |
| Unearned premiums   | 47,850                 | 50,857            |
| Premiums deposits and customer credit balances  | 2,467                  | 2,129             |
| Bank overdraft  | 6,050                  | 8,251             |
| Deferred gain from sale of property   | 633                    | 1,006             |
| Accounts payable and accrued expenses   | 1,090                  | 2,593             |
| <b>Total liabilities</b>  | <b>121,545</b>         | <b>135,447</b>    |
| Shareholders' equity:   |                        |                   |
| Common stock, \$0.01 par value. Authorized 25,000,000 shares; issued and outstanding 7,946,384 and 7,953,384, respectively. | 79                     | 80                |
| Preferred stock, \$0.01 par value. Authorized 1,000,000 shares; none issued or outstanding                                  | -                      | -                 |
| Additional paid-in capital  | 50,506                 | 50,185            |
| Accumulated other comprehensive income  | 1,158                  | 2,026             |
| Retained earnings   | 10,130                 | 15,151            |

|  |            |            |
|--|------------|------------|
| Total shareholders' equity                 | 61,873     | 67,442     |
| Total liabilities and shareholders' equity | \$ 183,418 | \$ 202,889 |

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 21ST CENTURY HOLDING COMPANY

CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

|  | Three Months Ended September 30,                              |               | Nine Months Ended September 30, |               |
|--|---|---------------|---------------------------------|---------------|
|  | 2010  | 2009          | 2010                            | 2009          |
|  | (Dollars in Thousands except EPS and share and dividend data) |               |                                 |               |
| <b>Revenue:</b>  |   |               |                                 |               |
| Gross premiums written   | \$ 17,698   | \$ 12,917     | \$ 72,317                       | \$ 74,949     |
| Gross premiums ceded   | (29,526)  | (36,804)      | (51,352)                        | (56,720)      |
| Net premiums written   | (11,828)  | (23,887)      | 20,965                          | 18,229        |
| Increase in prepaid reinsurance premiums                         | 16,194  | 22,300        | 9,555                           | 24,535        |
| Decrease (Increase) in unearned premiums                         | 7,255   | 11,098        | 3,008                           | (5,084)       |
| Net change in prepaid reinsurance premiums and unearned premiums | 23,449  | 33,398        | 12,563                          | 19,451        |
| Net premiums earned  | 11,621  | 9,511         | 33,528                          | 37,680        |
| Commission income  | 399   | 117           | 1,343                           | 738           |
| Finance revenue  | 110   | 62            | 286                             | 236           |
| Managing general agent fees                                      | 310   | 308           | 1,243                           | 1,216         |
| Net investment income  | 925   | 925           | 2,871                           | 2,389         |
| Net realized investment gains                                    | 1,864   | 1,550         | 5,688                           | 1,082         |
| Regulatory assessments recovered                                 | 115   | 294           | 682                             | 2,029         |
| Other income   | 135   | 232           | 653                             | 614           |
| <b>Total revenue</b>   | <b>15,479</b>   | <b>12,999</b> | <b>46,294</b>                   | <b>45,984</b> |
| <b>Expenses:</b>   |   |               |                                 |               |
| Losses and LAE   | 8,669   | 11,119        | 27,930                          | 28,965        |
| Operating and underwriting expenses                              | 2,542   | 2,500         | 8,271                           | 6,959         |
| Salaries and wages   | 2,146   | 1,961         | 6,394                           | 5,766         |
| Policy acquisition costs - amortization                          | 3,913   | 3,818         | 10,408                          | 9,477         |
| <b>Total expenses</b>  | <b>17,270</b>   | <b>19,398</b> | <b>53,003</b>                   | <b>51,167</b> |
| Loss before provision for income tax benefit                     | (1,791)   | (6,398)       | (6,709)                         | (5,182)       |
| Income tax benefit   | (523)   | (2,404)       | (2,165)                         | (2,276)       |

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|  |    |           |    |           |    |           |    |           |
|--|----|-----------|----|-----------|----|-----------|----|-----------|
| Net loss   | \$ | (1,268)   | \$ | (3,994)   | \$ | (4,544)   | \$ | (2,906)   |
| Net loss per share - basic   | \$ | (0.16)    | \$ | (0.50)    | \$ | (0.57)    | \$ | (0.36)    |
| Net loss per share - diluted   | \$ | (0.16)    | \$ | (0.50)    | \$ | (0.57)    | \$ | (0.36)    |
| Weighted average number<br>of common shares<br>outstanding - basic   |    | 7,946,384 |    | 8,013,894 |    | 7,946,384 |    | 8,013,894 |
| Weighted average number<br>of common shares<br>outstanding - diluted |    | 7,946,384 |    | 8,013,894 |    | 7,946,384 |    | 8,013,894 |
| Dividends paid per share   | \$ | -         | \$ | 0.06      | \$ | 0.06      | \$ | 0.30      |

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

21ST CENTURY HOLDING COMPANY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

|   | Nine Months Ended September 30, |            |
|---|---------------------------------|------------|
|   | 2010                            | 2009       |
|   | (Dollars in Thousands)          |            |
| <b>Cash flow from operating activities:</b>   |                                 |            |
| Net loss  | \$ (4,544)                      | \$ (2,906) |
| <b>Adjustments to reconcile net loss to net cash (used) provided by operating activities:</b> |                                 |            |
| Amortization of investment premium (discount), net  | 660                             | (433)      |
| Depreciation and amortization of property plant and equipment, net                            | 165                             | 137        |
| Net realized investment (gains) losses  | (5,688)                         | 1,082      |
| Provision for credit losses, net  | 2                               | 34         |
| (Recovery) provision for uncollectible premiums receivable                                    | (75)                            | 92         |
| Non-cash compensation   | 209                             | 255        |
| <b>Changes in operating assets and liabilities:</b>   |                                 |            |
| Premiums receivable   | 4,596                           | (895)      |
| Prepaid reinsurance premiums  | 7,034                           | (8,087)    |
| Reinsurance recoverable, net  | 5,072                           | 5,374      |
| Income taxes recoverable  | 4,810                           | (4,802)    |
| Deferred income tax expense, net of other comprehensive income                                | (489)                           | 6,097      |
| Policy acquisition costs, net of amortization   | 592                             | (1,480)    |
| Other assets  | 1,005                           | (766)      |
| Unpaid losses and LAE   | (7,155)                         | 1,510      |
| Unearned premiums   | (3,008)                         | 5,084      |
| Premium deposits and customer credit balances   | 337                             | 348        |
| Bank overdraft  | (2,201)                         | 2,776      |
| Accounts payable and accrued expenses   | (1,503)                         | (1,235)    |
| Net cash (used) provided by operating activities  | (181)                           | 2,185      |
| <b>Cash flow provided (used) by investing activities:</b>                                     |                                 |            |
| Proceeds from sale of investment securities   | 111,805                         | 51,476     |
| Purchases of investment securities available for sale   | (104,897)                       | (128,808)  |
| Purchases of property and equipment   | (4)                             | (13)       |
| Net cash provided (used) by investing activities  | 6,904                           | (77,345)   |
| <b>Cash flow used by financing activities:</b>  |                                 |            |
| Dividends paid  | (477)                           | (1,443)    |
| Tax benefit related to non-cash compensation  | 112                             | 123        |
| Net cash used by financing activities   | (365)                           | (1,320)    |
| Net increase (decrease) in cash and short term investments                                    | 6,358                           | (76,480)   |
| Cash and short term investments at beginning of period  | 28,197                          | 124,577    |
| Cash and short term investments at end of period  | \$ 34,555                       | \$ 48,097  |

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS





21ST CENTURY HOLDING COMPANY  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (UNAUDITED)

| (continued)  | Nine Months Ended September 30, |        |
|--|---------------------------------|--------|
|  | 2010                            | 2009   |
|  | (Dollars in Thousands)          |        |
| <b>Supplemental disclosure of cash flow information:</b> |                                 |        |
| Cash paid during the period for:                         |                                 |        |
| Income taxes   | \$ -                            | \$ 178 |
| Non-cash investing and finance activities:               |                                 |        |
| Accrued dividends payable                                | \$ -                            | \$ 481 |

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

21st Century Holding Company  
Notes to Condensed Consolidated Financial Statements

(1) Organization and Business

In this Quarterly Report on Form 10-Q, “21st Century” and the terms “Company”, “we”, “us” and “our” refer to 21st Century Holding Company and its subsidiaries, unless the context indicates otherwise.

21st Century is an insurance holding company, which, through our subsidiaries and our contractual relationships with our independent agents and general agents, controls substantially all aspects of the insurance underwriting, distribution and claims processes. We are authorized to underwrite homeowners’ multi-peril (“homeowners”), personal umbrella, commercial general liability, following form commercial excess liability, personal and commercial automobile, fire, allied lines, workers’ compensation, business personal property and commercial inland marine insurance. We are authorized to underwrite in various states on behalf of our wholly owned subsidiaries, Federated National Insurance Company (“Federated National”) and American Vehicle Insurance Company (“American Vehicle”) and other insurance carriers. We market and distribute our own and third-party insurers’ products and our other services through a network of independent agents. We also utilize a select number of general agents for the same purpose.

Federated National is licensed as an admitted carrier in Florida. Through contractual relationships with a network of approximately 4,200 independent agents, of which approximately 300 actively sell and service our products, Federated National is authorized to underwrite homeowners’, fire, allied lines and personal automobile insurance in Florida.

American Vehicle is licensed as an admitted carrier in Florida, and underwrites commercial general liability, and personal and commercial automobile insurance. American Vehicle is also licensed as an admitted carrier in Alabama, Louisiana, Georgia and Texas, and underwrites commercial general liability insurance in those states. American Vehicle operates as a non-admitted carrier in Arkansas, California, Kentucky, Maryland, Missouri, Nevada, Oklahoma, South Carolina, Tennessee and Virginia, and can underwrite commercial general liability insurance in all of these states.

An admitted carrier is an insurance company that has received a license from the state department of insurance giving the company the authority to write specific lines of insurance in that state. These companies are also bound by rate and form regulations, and are strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud. Admitted carriers are also required to financially contribute to the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders.

A non-admitted carrier is not licensed by the state, but is allowed to do business in that state and is strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud. Sometimes, non-admitted carriers are referred to as “excess and surplus” lines carriers. Non-admitted carriers are subject to considerably less regulation with respect to policy rates and forms. Non-admitted carriers are not required to financially contribute to and benefit from the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders.

During the nine months ended September 30, 2010, 77.6%, 13.6%, 4.3% and 4.5% of the premiums we underwrote were for homeowners’, commercial general liability, federal flood, and personal automobile insurance, respectively. During the nine months ended September 30, 2009, 79.3%, 16.7%, 3.7% and 0.3% of the premiums we underwrote were for homeowners’, commercial general liability, federal flood, and personal automobile insurance, respectively.

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

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21st Century Holding Company  
Notes to Condensed Consolidated Financial Statements

We internally process claims made by our insureds through our wholly owned claims adjusting company, Superior Adjusting, Inc. (“Superior”). We also offer premium financing to our own and third-party insureds through our wholly owned subsidiary, Federated Premium Finance, Inc. (“Federated Premium”).

We are focusing our marketing efforts on continuing to expand our distribution network and market our products and services throughout Florida and in other states by establishing relationships with additional independent agents and general agents. As this occurs, we will seek to replicate our distribution network in those states. For example, American Vehicle became an admitted insurer in the state of Georgia during the quarter ended September 30, 2010. There can be no assurance, however, that we will be able to obtain the required regulatory approvals to offer additional insurance products or expand into other states.

Until this year, both Federated National and American Vehicle were licensed in the state of Florida to write commercial automobile related lines of business. Currently, American Vehicle has a relatively small amount of commercial automobile premium in-force. However, Federated National has not written any commercial automobile related business in several years and as such has surrendered its authority to write this line of business in Florida. This decision is not expected to have any effect on operations.

Assurance Managing General Agents, Inc. (“Assurance MGA”), a wholly owned subsidiary of the Company, acts as Federated National’s and American Vehicle’s exclusive managing general agent in the state of Florida and is also licensed as a managing general agent in the states of Alabama, Arkansas, Georgia, Illinois, Louisiana, North Carolina, Mississippi, Missouri, New York, Nevada, South Carolina, Texas and Virginia. During 2009, Assurance MGA contracted with several unaffiliated insurance companies to sell commercial general liability, workers compensation and inland marine insurance through Assurance MGA’s existing network of agents. This process will continue throughout 2010 as Assurance MGA benefits from the arrangement by receiving commission revenue from policies sold by its insurance partners, while minimizing its risks.

Assurance MGA earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. Assurance MGA earns a \$25 per policy fee, and a 6% commission fee from its affiliates Federated National and American Vehicle.

Insure-Link, Inc. (“Insure-Link”) was formed in March 2008 to serve as an independent insurance agency. The insurance agency markets direct to the public to provide a variety of insurance products and services to individual clients, as well as business clients, by offering a full line of insurance products including, but not limited to, homeowners’, personal and commercial automobile, commercial general liability and workers’ compensation insurance through their agency appointments with over fifty different carriers. Insure-Link will expand its business through marketing and by acquiring other insurance agencies.

## (2) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements for the Company and its subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America referred to as Generally Accepted Accounting Principles (“GAAP”) for interim financial information, and the Securities and Exchange Commission (“SEC”) rules for interim financial reporting. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. However, in the opinion of management, the accompanying financial statements reflect all normal recurring adjustments necessary to present fairly the Company’s financial position as of

September 30, 2010 and the results of operations and cash flows for the periods presented. The results of operations for the interim periods presented are not necessarily indicative of the results of operations to be expected for any subsequent interim period or for the fiscal year ending December 31, 2010. The accompanying unaudited condensed consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2009 included in the Company's Form 10-K, which was filed with the SEC on March 26, 2010.

In preparing the interim unaudited condensed consolidated financial statements, management was required to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures at the financial reporting date and throughout the periods being reported upon. Certain of the estimates result from judgments that can be subjective and complex and consequently actual results may differ from these estimates.

21st Century Holding Company  
Notes to Condensed Consolidated Financial Statements

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of loss and LAE, ceded reinsurance balances payable, the recoverability of Deferred Policy Acquisition Costs (“DPAC”), the determination of federal income taxes, and the net realizable value of reinsurance recoverables. Although considerable variability is inherent in these estimates, management believes that the amounts provided are reasonable. These estimates are continually reviewed and adjusted as necessary. Such adjustments are reflected in current operations.

All significant intercompany balances and transactions have been eliminated. Certain reclassifications have been made to the prior-period balances to conform to the current-period presentation.

(3) Summary of Significant Accounting Policies and Practices

(A) Critical Accounting Policies

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

The most significant accounting estimates inherent in the preparation of our financial statements include estimates associated with management’s evaluation of the determination of (i) liability for unpaid losses and LAE, (ii) the amount and recoverability of amortization of DPAC, and (iii) estimates for our reserves with respect to finance contracts, premiums receivable and deferred income taxes. Various assumptions and other factors underlie the determination of these significant estimates, which are described in greater detail in Footnote 2 of the Company’s audited consolidated financial statements for the fiscal year ended December 31, 2009, which we included in the Company’s Annual Report on Form 10-K which was filed with the SEC on March 26, 2010.

We believe that there were no significant changes in those critical accounting policies and estimates during the first nine months of fiscal 2010. Senior management has reviewed the development and selection of our critical accounting policies and estimates and their disclosure in this Form 10-Q with the Audit Committee of our Board of Directors.

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

Accounting for loss contingencies pursuant to Financial Accounting Standards Board (“FASB”) issued guidance involves the existence of a condition, situation or set of circumstances involving uncertainty as to possible loss that

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

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21st Century Holding Company  
Notes to Condensed Consolidated Financial Statements

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

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

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

A decline in the fair value of an available-for-sale security below cost that is deemed other-than temporary results in a charge to income, resulting in the establishment of a new cost basis for the security. Premiums and discounts are amortized or accreted, respectively, over the life of the related debt security as an adjustment to yield using a method that approximates the effective interest method. Dividends and interest income are recognized when earned. Realized gains and losses are included in earnings and are derived using the specific-identification method for determining the cost of securities sold.

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

The fair value of our investments is estimated based on prices published by financial services or quotations received from securities dealers and is reflective of the interest rate environment that existed as of the close of business on September 30, 2010 and December 31, 2009. Changes in interest rates subsequent to September 30, 2010 and December 31, 2009 may affect the fair value of our investments.

The carrying amounts for the following financial instrument categories approximate their fair values at September 30, 2010 and December 31, 2009 because of their short-term nature: cash and short term investments, premiums

receivable, finance contracts, due from reinsurers, revolving credit outstanding, bank overdraft, accounts payable and accrued expenses.

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21st Century Holding Company  
Notes to Condensed Consolidated Financial Statements

(B) Impact of New Accounting Pronouncements

In April 2009, the FASB issued FASB Staff Position (“FSP”) FAS 115-2 and FSP FAS 124-2, “Recognition and Presentation of Other-Than Temporary Impairments” (“FSP FAS 115-2 and FSP FAS 124-2”) related to the recognition and presentation of other-than temporary impairments. In April 2009, the SEC also adopted similar guidance with Staff Accounting Bulletin (“SAB”) No. 111 (“SAB 111”) on Other-Than Temporary Impairment. FSP FAS 115-2 and FSP FAS 124-2 establishes a new method of recognizing and reporting other-than temporary impairments of debt securities and contains additional disclosure requirements related to debt and equity securities. For debt securities, the “ability and intent to hold” provision is eliminated, and impairment is considered to be other-than temporary if an entity (i) intends to sell the security, (ii) more likely than not will be required to sell the security before recovering its cost, or (iii) does not expect to recover the security’s entire amortized cost basis (even if the entity does not intend to sell).

This new framework does not apply to equity securities (i.e., impaired equity securities will continue to be evaluated under previously existing guidance). The “probability” standard relating to the collectability of cash flows is eliminated, and impairment is now considered to be other-than temporary if the present value of cash flows expected to be collected from the debt security is less than the amortized cost basis of the security. FSP FAS 115-2 and FSP FAS 124-2 provides that for debt securities which (i) an entity does not intend to sell and (ii) it is not more likely than not that the entity will be required to sell before the anticipated recovery of its remaining amortized cost basis, the impairment is separated into the amount related to estimated credit losses and the amount related to all other factors. The amount of the total impairment related to all other factors is recorded in other comprehensive loss and the amount related to estimated credit loss is recognized as a charge against current period earnings. FSP FAS 115-2 and FSP FAS 124-2 expands disclosure requirements for both debt and equity securities and requires a more detailed, risk-oriented breakdown of security types and related information, and requires that the annual disclosures be made in interim periods. FSP FAS 115-2 and FSP FAS 124-2 is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted. At the time of adoption, the Company did not have any Other-Than Temporary Impairments for debt securities, and, the adoption of this guidance did not have a material impact on the Company’s consolidated financial statements.

In April 2009, the FASB issued FSP FAS 157-4, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly” (“FSP FAS 157-4”). FSP FAS 157-4 is related to determining fair value when the volume and level of activity for an asset or liability have significantly decreased and identifying transactions that are not orderly. The guidance indicates that if an entity determines that either the volume and/or level of activity for an asset or liability has significantly decreased (from normal conditions for that asset or liability) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. The guidance is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted and must be applied prospectively. The adoption of FSP FAS 157-4 did not have a material impact on the Company’s financial statements or condition.

In May 2009, the FASB issued Statement of Financial Accounting Standards (“SFAS”) No. 165, “Subsequent Events” (“SFAS No. 165”), which is now part of Accounting Standard Update (“ASU”) ASU Topic 855, Subsequent Events. In SFAS No. 165, the FASB establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued. Our adoption of SFAS No. 165 on April 1, 2009 did not have a material impact on the Company’s consolidated financial statements.

In January 2010, the FASB issued Accounting Standard Update (“ASU”) ASU No. 2010-06: Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements. The amendments in ASU

2010-06 require additional disclosures about fair value measurements, including transfers in and out of Levels 1 and 2 and activity in Level 3 on a gross basis, and clarifies certain other existing disclosure requirements including level of disaggregation and disclosures around inputs and valuation techniques. The provisions of the new standards are effective for interim or annual reporting periods beginning after December 15, 2009, except for the additional Level 3 disclosures, which will become effective for fiscal years beginnings after December 15, 2010. These standards are disclosure only in nature and do not change accounting requirements. Accordingly, adoption of the new standard had no impact on the Company's consolidated financial position, results of operations or cash flows.

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In February 2010, the FASB issued ASU No. 2010-09: Amendments to Certain Recognition and Disclosure Requirements, an amendment to Topic 855 Subsequent Events, to address potentially conflicting interactions of the requirements in this Topic with the SEC's reporting requirements. This update amends Topic 855 as follows: i) an entity that either is a SEC filer or a conduit bond obligor is required to evaluate subsequent events through the date that the financial statements are issued, if the entity does not meet either of these criteria then it should evaluate subsequent events through the date the financial statements are available to be issued; and ii) an SEC filer is not required to disclose the date through which subsequent events have been evaluated. All amendments in this ASU are effective upon issuance of this ASU, except for the use of the issued date for conduit debt obligors which effective date is for interim and annual periods ending after June 15, 2010. The Company's subsequent events disclosure will reflect the new guidance.

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

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

(C) Stock Options

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB-issued guidance using the modified-prospective-transition method. Under that transition method, compensation cost recognized during the nine months ended September 30, 2010 includes compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the guidance.

(D) Earnings per Share

Basic earnings per share ("Basic EPS") is computed by dividing net income by the weighted average number of common shares outstanding during the period presented. Diluted earnings per share ("Diluted EPS") is computed by dividing net income by the weighted average number of shares of common stock and common stock equivalents outstanding during the period presented; outstanding warrants and stock options are considered common stock equivalents and are included in the calculation using the treasury stock method.

(E) Reclassifications

No reclassification of the 2009 financial statements was necessary to conform to the 2010 presentation.

(4) Commitments and Contingencies

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

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(A) Insured Claim Activity

We are involved in claims and legal actions arising in the ordinary course of business. Revisions to our estimates are based on our analysis of subsequent information that we receive regarding various factors, including: (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages; and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

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

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

(B) Assessment Related Activity

We operate in a regulatory environment where certain entities and organizations have the authority to require us to participate in assessments. Currently these entities and organizations include, but are not limited to, Florida Insurance Guaranty Association ("FIGA"), Citizens Property Insurance Corporation ("Citizens"), Florida Hurricane Catastrophe Fund ("FHCF") and Florida Joint Underwriters Insurance Company ("JUA").

As a direct premium writer in the state of Florida, we are required to participate in certain insurer solvency associations under Florida Statutes Section 631.57(3) (a), administered by FIGA. Participation in these pools is based on our written premium by line of business to total premiums written statewide by all insurers. Participation has resulted in assessments against us, as it had in 2006 and 2007, and again on October 30, 2009. There were no assessments made during the nine months ended September 30, 2010 or for the year ended December 31, 2008. Through 2007, we have been assessed \$6.6 million and in 2009 we were assessed an additional \$0.6 million in connection with the insolvencies of domestic insurance companies. For statutory accounting these assessments are not charged to operations; in contrast, GAAP treatment is to charge current operations for the assessments. Through policyholder surcharges, as approved by the Florida Office of Insurance Regulation ("Florida OIR"), we have since recouped \$6.9 million in connection with these assessments.

The State Board of Administration ("SBA") and the FHCF Financing Corporation agreed to a resolution that would authorize the issuance and sale of FHCF post-event revenue bonds not to exceed \$710 million. The proceeds of the bonds would be used for the reimbursement of insurance companies for additional claims due to hurricanes during the

2005 season. These bonds will have fixed interest rates, be exempt from federal income taxes and be secured by not yet implemented emergency assessments and reimbursement premiums. The inability to issue these bonds could result in the FHCF's need to accelerate additional assessments. We have not recorded any liability in connection with this initiative.

During its regularly scheduled meeting on August 17, 2005, the Board of Governors of Citizens determined a 2004 plan year deficit existed in the High Risk Account. Citizens decided that a \$515 million Regular Assessment was in the best interest of Citizens and consistent with Florida Statutes. On this basis, Citizens certified for a Regular Assessment. Federated National's participation in this assessment totaled \$2.0 million.

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During a subsequent regularly scheduled meeting on or about December 18, 2006, Citizens Board determined an additional 2004 plan year deficit existed in the High Risk Account. Citizens decided that a \$515 million Regular Assessment was in the best interest of Citizens and consistent with Florida Statutes. On this basis, Citizens certified for a Regular Assessment. Federated National's participation in this assessment totaled \$0.3 million.

Pursuant to Florida Statutes Section 627.3512, Federated National has since recouped the assessments by adding a surcharge to policies. Provisions contained in our excess of loss reinsurance policies provided for participation of our reinsurers totaling \$1.8 million of the \$2.3 million in assessments. There was no assessment made during the years 2007-2010.

The Florida OIR issued Information Memorandum OIR-06-008M, titled Notice of Anticipated Florida Hurricane Catastrophe Fund Assessment, and dated May 4, 2006, to all property and casualty insurers, surplus lines insurers, and surplus lines agents in the state of Florida placing them on notice of an anticipated FHCF assessment. Sighting the unprecedented hurricane seasons of 2004 and 2005, the FHCF exhausted nearly all of the \$6 billion in reserves it had accumulated since its inception in 1993. The Florida SBA issued its directive to levy an emergency assessment upon all property and casualty business in the state of Florida. There is no statutory requirement that policyholders be notified of the FHCF assessment. The FHCF and Florida OIR are, however, recommending that insurers include the FHCF assessment in a line item on the declaration page for two reasons: (1) this is a multi-year assessment and (2) there may be concurrent assessments and the insureds should know what amount is for which assessment. The assessment became effective on all policies effective after January 1, 2007 and will be remitted to the administrator of the assessment as collected.

Florida OIR issued an Order April 29, 2010, levying an increase to the emergency assessment to 1.3% from 1.0%, of direct written premium on all property and casualty lines of business written in the state of Florida for the benefit of the FHCF. The assessment was approved by the Florida SBA to fund FHCF losses stemming from the 2005 hurricane season. This order requires insurers to begin collecting the emergency assessment for policies issued or renewed on or after January 1, 2011. The FHCF emergency assessment will be remitted to the administrator of the assessment as collected and therefore accounted for in a manner such that amounts collected or receivable are not recorded as revenues and amounts due or paid are not expensed. Previously and still in effect, the Florida OIR issued a similar order dated January 11, 2007, levying an emergency assessment of 1.4% of direct written premium on all property and casualty lines of business written in the state of Florida for the benefit of Citizens' High Risk Account. This order requires insurers to collect the emergency assessment for policies issued or renewed on or after July 1, 2007. Similar to the FHCF assessment discussed above, the Citizens emergency assessment is remitted to the administrator of the assessment as collected and therefore accounted for in a manner such that amounts collected or receivable are not recorded as revenues and amounts due or paid are not expensed.

Federated National and American Vehicle are also required to participate in an insurance apportionment plan under Florida Statutes Section 627.351, which is referred to as a JUA Plan. The JUA Plan provides for the equitable apportionment of any profits realized, or losses and expenses incurred, among participating automobile insurers. In the event of an underwriting deficit incurred by the JUA Plan which is not recovered through the policyholders in the JUA Plan, such deficit shall be recovered from the companies participating in the JUA Plan in the proportion that the net direct written premiums of each such member during the preceding calendar year bear to the aggregate net direct premiums written in this state by all members of the JUA Plan. Neither Federated National nor American Vehicle was assessed by the JUA Plan during 2010, 2009 or 2008. Future assessments by this association are undeterminable at this time.

(C) Operational Matters

The Company's consolidated federal income tax returns for 2009, 2008, 2007, 2006 and 2005 are open for review by the Internal Revenue Service ("IRS"). The federal income tax returns for 2003 and 2002 have been examined by the IRS. The IRS concluded its examination for 2003 and 2002 and there were no material changes in the tax liability for those years. The 2004 income tax return remains open due to net operating loss carryforward to open years.

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The Company's consolidated Florida income tax returns for 2007, 2006, 2005 and 2004 were under examination by the Florida Department of Revenue as of September 31, 2010. The audit was settled and closed in early November 2010 with no change to tax years 2007, 2006 and 2005. The audit resulted in an immaterial adjustment to the 2004 tax year. The Florida income tax returns for 2008 and 2009 are open for review.

The Company has recorded a net deferred tax asset of \$5.7 million as of September 30, 2010. Realization of net deferred tax asset is dependent on generating sufficient taxable income in future periods. Management believes that it is more likely than not that the deferred tax assets will be realized and as such no valuation allowance has been recorded against the net deferred tax asset. When assessing the need for valuation allowances, the Company considers future taxable income and ongoing prudent and feasible tax planning strategies. Should a change in circumstances lead to a change in judgment about the realizability of deferred tax assets in future years, the Company would record valuation allowances as deemed appropriate in the period that the change in circumstances occurs, along with a corresponding increase or charge to net income. The resolution of tax reserves and changes in valuation allowances could be material to the Company's results of operations for any period, but is not expected to be material to the Company's financial position.

Relative to the Company's commitments stemming from operational matters, we sold our interest in the building housing our operations in Lauderdale Lake on or about March 1, 2006 to an unrelated party. As part of this transaction, we agreed to lease the same facilities for a five-year term. We amended the lease agreement and the note receivable on September 1, 2010. As part of the amendment, we discounted the note receivable and have discontinued the interest on the note. In consideration, we will pay a reduced lease payment for the remainder of the lease. Our lease for this office space expires in December 2011.

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

| Fiscal Year  | Lease payments<br>(Dollars in<br>Thousands) |
|--------------|---|
| 2010         | \$ 182                                      |
| 2011         | 732   |
| <b>Total</b> | <b>\$ 914</b>                               |

The Company is not currently involved in any legal actions arising from the ordinary course of business that are not related to the insured claims activity. Please see the Company's Form 10-Q for the quarter ended March 31, 2010 for information regarding the settlement of the previously reported pending securities class action.

#### (5) Investments

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

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

to carry them at fair value with unrealized holding gains and losses included in current period operations. Investments classified as available-for-sale include debt and equity securities that are not classified as held-to-maturity or as trading security investments. The accounting treatment for available-for-sale securities is to carry them at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders' equity, namely "Other Comprehensive Income".

Total investments decreased \$3.3 million, or 2.9%, to \$110.9 million as of September 30, 2010, compared with \$114.2 million as of December 31, 2009.

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The debt and equity securities that are available-for-sale and carried at fair value represent 95% of total investments as of September 30, 2010, compared with 98% as of December 31, 2009.

We did not hold any trading investment securities during the nine months ended September 30, 2010.

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

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

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

In reaching a conclusion that a security is either other-than temporarily or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as Standard and Poor's and Moody's Investors Service, Inc. ("Moody's"), as well as information released via the general media channels. During the nine months ended September 30, 2010, in connection with this process, we have not charged any net realized investment loss to operations.

As of September 30, 2010, all of our securities are in good standing and not impaired as defined by FASB-issued guidance, compared with \$0.4 million as of December 31, 2009.

The investments held as of September 30, 2010 and December 31, 2009, were comprised mainly of corporate bonds held in various industries and municipal and United States government bonds. As of September 30, 2010, 75% of the debt portfolio is in diverse industries and 25% is in United States government bonds. As of September 30, 2010, approximately 89% of the equity holdings are in equities related to diverse industries and 11% are in mutual funds.

As of September 30, 2010, 39% of the investment portfolio is in corporate bonds, 21% is in obligations of states and political subdivisions, and 21% is in United States government bonds. Approximately 10% of the common stock holdings are related to foreign entities.

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During the three months ended March 31, 2010, we re-classified \$3.1 million of our bond portfolio from available-for-sale to held-to-maturity.

During the three months ended June 30, 2010, we did not reclassify any of our bond portfolio from available-for-sale to held-to-maturity.

During the three months ended September 30, 2010, we did not reclassify any of our bond portfolio from available-for-sale to held-to-maturity.

As of September 30, 2010 and December 31, 2009, we have classified \$5.8 million and \$2.7 million, respectively, of our bond portfolio as held-to-maturity. We only classify bonds as held-to-maturity to support securitization of credit requirements. Fully funded trust agreements or outstanding irrevocable letters of credit, used for such purposes, total \$3.1 million for the period ended September 30, 2010 and December 31, 2009, respectively.

During April 2006, American Vehicle finalized a \$15.0 million irrevocable letter of credit in conjunction with the 100% Quota Share Reinsurance Agreement with Republic Underwriters Insurance Company (“Republic”) which was terminated in April 2007. As of December 31, 2007, the letter of credit in favor of Republic totaled \$10.0 million. As of December 31, 2008, the letter of credit in favor of Republic totaled \$3.0 million. As of December 31, 2009, the letter of credit in favor of Republic totaled \$1.0 million. As of September 30, 2010, the letter of credit in favor of Republic totaled zero, and was replaced by a fully funded trust agreement that totaled \$1.0 million.

(A) Debt and Equity Securities

The following table summarizes, by type, our investments as of September 30, 2010 and December 31, 2009.

|  | September 30, 2010 |                     | December 31, 2009  |                     |
|--|--------------------|---------------------|--------------------|---------------------|
|  | Carrying<br>Amount | Percent<br>of Total | Carrying<br>Amount | Percent<br>of Total |
| (Dollars in Thousands)                               |                    |                     |                    |                     |
| <b>Debt securities, at market:</b>                   |                    |                     |                    |                     |
| United States government obligations and authorities | \$ 17,296          | 15.59%              | \$ 10,152          | 8.89%               |
| Obligations of states and political subdivisions     | 23,005             | 20.73%              | 39,269             | 34.38%              |
| Corporate  | 43,160             | 38.90%              | 42,092             | 36.85%              |
| International  | 2,051              | 1.85%               | -                  | 0.00%               |
|  | 85,512             | 77.07%              | 91,513             | 80.12%              |
| <b>Debt securities, at amortized cost:</b>           |                    |                     |                    |                     |
| United States government obligations and authorities | 5,782              | 5.22%               | 2,650              | 2.32%               |
| <b>Total debt securities</b>                         | <b>91,294</b>      | <b>5.22%</b>        | <b>94,163</b>      | <b>2.32%</b>        |
| <b>Equity securities, at market:</b>                 |                    |                     |                    |                     |
|  | 19,654             | 17.71%              | 20,056             | 17.56%              |
| <b>Total investments</b>                             | <b>\$ 110,948</b>  | <b>100.00%</b>      | <b>\$ 114,219</b>  | <b>100.00%</b>      |

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The following table shows the realized gains for debt and equity securities for the three months ended September 30, 2010 and 2009.

|                                   | Three Months Ended September 30, |                       |                   |                       |
|-----------------------------------|----------------------------------|-----------------------|-------------------|-----------------------|
|                                   | 2010                             |                       | 2009              |                       |
|                                   | Gains<br>(Losses)                | Fair Value<br>at Sale | Gains<br>(Losses) | Fair Value<br>at Sale |
|                                   | (Dollars in Thousands)           |                       |                   |                       |
| Debt securities                   | \$ 2,201                         | \$ 25,432             | \$ 194            | \$ 9,964              |
| Equity securities                 | 194                              | 2,579                 | 1,943             | 10,250                |
| Total realized gains              | 2,395                            | 28,011                | 2,137             | 20,214                |
| Debt securities                   | (19)                             | 318                   | (441)             | 2,165                 |
| Equity securities                 | (512)                            | 2,258                 | (146)             | 1,376                 |
| Total realized losses             | (531)                            | 2,576                 | (587)             | 3,541                 |
| Net realized gains on investments | \$ 1,864                         | \$ 30,587             | \$ 1,550          | \$ 23,755             |

The following table shows the realized gains for debt and equity securities for the nine months ended September 30, 2010 and 2009.

|                                   | Nine Months Ended September 30, |                       |                   |                       |
|-----------------------------------|---------------------------------|-----------------------|-------------------|-----------------------|
|                                   | 2010                            |                       | 2009              |                       |
|                                   | Gains<br>(Losses)               | Fair Value<br>at Sale | Gains<br>(Losses) | Fair Value<br>at Sale |
|                                   | (Dollars in Thousands)          |                       |                   |                       |
| Debt securities                   | \$ 4,068                        | \$ 81,704             | \$ 212            | \$ 26,089             |
| Equity securities                 | 2,856                           | 20,626                | 1,942             | 11,352                |
| Total realized gains              | 6,924                           | 102,330               | 2,154             | 37,441                |
| Debt securities                   | (59)                            | 2,884                 | (669)             | 9,509                 |
| Equity securities                 | (1,177)                         | 6,139                 | (403)             | 3,040                 |
| Total realized losses             | (1,236)                         | 9,023                 | (1,072)           | 12,549                |
| Net realized gains on investments | \$ 5,688                        | \$ 111,353            | \$ 1,082          | \$ 49,990             |



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A summary of the amortized cost, estimated fair value, gross unrealized gains and losses of debt and equity securities at September 30, 2010 and December 31, 2009 is as follows.

|  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
|--|-------------------|------------------------------|-------------------------------|-------------------------|
| (Dollars in Thousands)                               |                   |                              |                               |                         |
| <b>September 30, 2010</b>                            |                   |                              |                               |                         |
| <b>Debt Securities - Available-For-Sale:</b>         |                   |                              |                               |                         |
| United States government obligations and authorities | \$ 17,138         | \$ 191                       | \$ 33                         | \$ 17,296               |
| Obligations of states and political subdivisions     | 22,368            | 657                          | 20                            | 23,005                  |
| Corporate  | 41,780            | 1,419                        | 39                            | 43,160                  |
| International  | 2,005             | 49                           | 3                             | 2,051                   |
|  | \$ 83,291         | \$ 2,316                     | \$ 95                         | \$ 85,512               |
| <b>Debt Securities - Held-To-Maturity:</b>           |                   |                              |                               |                         |
| United States government obligations and authorities | \$ 5,782          | \$ 277                       | \$ 12                         | \$ 6,047                |
| Corporate  | -                 | -                            | -                             | -                       |
|  | \$ 5,782          | \$ 277                       | \$ 12                         | \$ 6,047                |
| Equity securities - common stocks                    | \$ 20,018         | \$ 971                       | \$ 1,335                      | \$ 19,654               |
| <b>December 31, 2009</b>                             |                   |                              |                               |                         |
| <b>Debt Securities - Available-For-Sale:</b>         |                   |                              |                               |                         |
| Obligations of states and political subdivisions     | \$ 49,041         | \$ 695                       | \$ 315                        | \$ 49,421               |
| Corporate  | 40,350            | 1,798                        | 56                            | 42,092                  |
|  | \$ 89,391         | \$ 2,493                     | \$ 371                        | \$ 91,513               |
| <b>Debt Securities - Held-To-Maturity:</b>           |                   |                              |                               |                         |
| United States government obligations and authorities | \$ 2,650          | \$ 148                       | \$ 5                          | \$ 2,793                |
| Corporate  | -                 | -                            | -                             | -                       |
|  | \$ 2,650          | \$ 148                       | \$ 5                          | \$ 2,793                |
| Equity securities - common stocks                    | \$ 18,927         | \$ 1,840                     | \$ 711                        | \$ 20,056               |

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The table below reflects our unrealized investment gains (losses) by investment class, aged for length of time in a continuous unrealized gain (loss) position as of September 30, 2010.

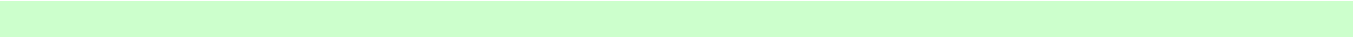
|  | Unrealized Gains<br>(Losses) | Less than 12<br>months | 12 months or<br>longer |
|--|------------------------------|------------------------|------------------------|
| (Dollars in Thousands)                               |                              |                        |                        |
| <b>Debt securities:</b>                              |                              |                        |                        |
| United States government obligations and authorities | \$ 158                       | \$ 64                  | \$ 94                  |
| Obligations of states and political subdivisions     | 636                          | 243                    | 393                    |
| Corporate  | 1,381                        | 523                    | 858                    |
| International  | 46                           | 23                     | 23                     |
|  | 2,221                        | 853                    | 1,368                  |
| <b>Equity securities:</b>                            |                              |                        |                        |
| Common stocks  | (364)                        | (96)                   | (268)                  |
| <b>Total debt and equity securities</b>              | <b>\$ 1,857</b>              | <b>\$ 757</b>          | <b>\$ 1,100</b>        |

The table below reflects our unrealized investment losses by investment class, aged for length of time in a continuous unrealized loss position as of December 31, 2009.

|  | Unrealized<br>Losses | Less than 12<br>months | 12 months or<br>longer |
|--|----------------------|------------------------|------------------------|
| (Dollars in Thousands)                               |                      |                        |                        |
| <b>Debt securities:</b>                              |                      |                        |                        |
| United States government obligations and authorities | \$ (120)             | \$ (120)               | \$ -                   |
| Obligations of states and political subdivisions     | (4)                  | -                      | (4)                    |
| Corporate  | -                    | -                      | -                      |
|  | (124)                | (120)                  | (4)                    |
| <b>Equity securities:</b>                            |                      |                        |                        |
| Common stocks  | (237)                | -                      | (237)                  |
| <b>Total debt and equity securities</b>              | <b>\$ (361)</b>      | <b>\$ (120)</b>        | <b>\$ (241)</b>        |

Below is a summary of debt securities at September 30, 2010 and December 31, 2009, by contractual or expected maturity periods. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

|                                  | September 30, 2010 |                         | December 31, 2009 |                         |
|----------------------------------|--------------------|-------------------------|-------------------|-------------------------|
|                                  | Amortized<br>Cost  | Estimated<br>Fair Value | Amortized<br>Cost | Estimated<br>Fair Value |
| (Dollars in Thousands)           |                    |                         |                   |                         |
| Due in one year or less          | \$ 8,863           | \$ 8,911                | \$ 1,602          | \$ 1,615                |
| Due after one through five years | 47,690             | 48,621                  | 49,821            | 50,885                  |
| Due after five through ten years | 26,581             | 27,758                  | 26,177            | 27,217                  |
| Due after ten years              | 5,938              | 6,269                   | 14,441            | 14,589                  |



|       |    |        |    |        |    |        |    |        |
|-------|----|--------|----|--------|----|--------|----|--------|
| Total | \$ | 89,072 | \$ | 91,559 | \$ | 92,041 | \$ | 94,306 |
|-------|----|--------|----|--------|----|--------|----|--------|

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Notes to Condensed Consolidated Financial Statements

United States Treasury notes with a book value of \$1,037,000 and \$1,042,000, both maturing in 2012, were on deposit with the Florida OIR as of September 30, 2010, as required by law for American Vehicle and Federated National respectively, and are included with other investments held until maturity.

The table below sets forth investment results for the three months ended September 30, 2010 and 2009.

|                                       | Three Months Ended September 30, |                 |
|---------------------------------------|----------------------------------|-----------------|
|                                       | 2010                             | 2009            |
|                                       | (Dollars in Thousands)           |                 |
| Interest on debt securities           | \$ 739                           | \$ 811          |
| Dividends on equity securities        | 180                              | 97              |
| Interest on cash and cash equivalents | 6                                | 17              |
| <b>Total investment income</b>        | <b>\$ 925</b>                    | <b>\$ 925</b>   |
| <b>Net realized gains</b>             | <b>\$ 1,864</b>                  | <b>\$ 1,550</b> |

Proceeds from sales of debt and equity securities during the three months ended September 30, 2010 and 2009, were approximately \$30.6 million and \$24.5 million, respectively.

The table below sets forth investment results for the nine months ended September 30, 2010 and 2009.

|                                       | Nine Months Ended September 30, |                 |
|---------------------------------------|---------------------------------|-----------------|
|                                       | 2010                            | 2009            |
|                                       | (Dollars in Thousands)          |                 |
| Interest on debt securities           | \$ 2,510                        | \$ 1,868        |
| Dividends on equity securities        | 350                             | 315             |
| Interest on cash and cash equivalents | 11                              | 206             |
| <b>Total investment income</b>        | <b>\$ 2,871</b>                 | <b>\$ 2,389</b> |
| <b>Net realized gains</b>             | <b>\$ 5,688</b>                 | <b>\$ 1,082</b> |

Proceeds from sales of debt and equity securities during the nine months ended September 30, 2010 and 2009, were approximately \$111.7 million and \$51.5 million, respectively.

The table below sets forth a summary of net realized investment gains during the three months ended September 30, 2010 and 2009.

|                                    | Three Months Ended September 30, |          |
|------------------------------------|----------------------------------|----------|
|                                    | 2010                             | 2009     |
|                                    | (Dollars in Thousands)           |          |
| <b>Net realized gains (losses)</b> |                                  |          |
| Debt securities                    | \$ 2,182                         | \$ (247) |
| Equity securities                  | (318)                            | 1,797    |

|       |    |       |    |       |
|-------|----|-------|----|-------|
| Total | \$ | 1,864 | \$ | 1,550 |
|-------|----|-------|----|-------|

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21st Century Holding Company  
Notes to Condensed Consolidated Financial Statements

The table below sets forth a summary of realized investment gains (losses) during the nine months ended September 30, 2010 and 2009.

|                                    | Nine Months Ended September 30, |                 |
|------------------------------------|---------------------------------|-----------------|
|                                    | 2010                            | 2009            |
|                                    | (Dollars in Thousands)          |                 |
| <b>Net realized gains (losses)</b> |                                 |                 |
| Debt securities                    | \$ 4,009                        | \$ (457)        |
| Equity securities                  | 1,679                           | 1,539           |
| <b>Total</b>                       | <b>\$ 5,688</b>                 | <b>\$ 1,082</b> |

A summary of net unrealized gains (losses) follows.

|                                      | As of September 30, 2010 of December 31, 2009 |                 |
|--------------------------------------|---|-----------------|
|                                      | (Dollars in Thousands)                        |                 |
| <b>Net unrealized gains (losses)</b> |   |                 |
| Debt securities                      | \$ 2,221                                      | \$ 2,122        |
| Equity securities                    | (364)   | 1,128           |
| <b>Total</b>                         | <b>\$ 1,857</b>                               | <b>\$ 3,250</b> |

#### (6) Fair Value Disclosure

In April 2009, the FASB-issued accounting guidance that if an entity determines that either the volume and/or level of activity for an investment security has significantly decreased (from normal conditions for that investment security) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. This guidance was effective for interim and annual periods ending after June 15, 2009, with early adoption permitted. This guidance was applied prospectively. The adoption of this guidance did not have an impact on the Company's financial statements or condition.

In October 2008, the FASB-issued accounting guidance to clarify the application of GAAP in determining fair value of financial instruments in a market that is not active. The guidance was effective upon issuance, including prior periods for which financial statements had not been issued. Our adoption of this guidance does not have a material effect on our financial position, results of operations, cash flows or disclosures.

In September 2006, FASB issued accounting guidance that defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants on the measurement date. This guidance also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance also categorizes assets and liabilities at fair value into one of three different levels depending on the observation of the inputs employed in the measurement, as follows:

Level 1 — inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market.

Level 2 — inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs are observable for an asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

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Notes to Condensed Consolidated Financial Statements

Level 3 — inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Securities available-for-sale: The fair value of securities available-for-sale is determined by obtaining quoted prices on nationally recognized security exchanges.

Assets measured at fair value on a recurring basis as of September 30, 2010, presented in accordance with this guidance, are as follows.

|  | As of September 30, 2010 |                  |             | Total             |
|--|--------------------------|------------------|-------------|-------------------|
|  | Level 1                  | Level 2          | Level 3     |                   |
| (Dollars in Thousands)                               |                          |                  |             |                   |
| <b>Debt securities:</b>                              |                          |                  |             |                   |
| United States government obligations and authorities | \$ -                     | \$ 17,296        | \$ -        | \$ 17,296         |
| Obligations of states and political subdivisions     | -                        | 23,005           | -           | 23,005            |
| Corporate  | 43,160                   | -                | -           | 43,160            |
| International  | -                        | 2,051            | -           | 2,051             |
|  | 43,160                   | 42,352           | -           | 85,512            |
| <b>Equity securities:</b>                            |                          |                  |             |                   |
| Common stocks  | 19,654                   | -                | -           | 19,654            |
|  | 19,654                   | -                | -           | 19,654            |
| <b>Total debt and equity securities</b>              | <b>\$ 62,814</b>         | <b>\$ 42,352</b> | <b>\$ -</b> | <b>\$ 105,166</b> |

Assets measured at fair value on a recurring basis as of December 31, 2009, presented in accordance with this guidance, are as follows.

|  | As of December 31, 2009 |                  |             | Total             |
|--|-------------------------|------------------|-------------|-------------------|
|  | Level 1                 | Level 2          | Level 3     |                   |
| (Dollars in Thousands)                               |                         |                  |             |                   |
| <b>Debt securities:</b>                              |                         |                  |             |                   |
| United States government obligations and authorities | \$ -                    | \$ 10,152        | \$ -        | \$ 10,152         |
| Obligations of states and political subdivisions     | -                       | 39,269           | -           | 39,269            |
| Corporate  | 42,092                  | -                | -           | 42,092            |
|  | 42,092                  | 49,421           | -           | 91,513            |
| <b>Equity securities:</b>                            |                         |                  |             |                   |
| Common stocks  | 20,056                  | -                | -           | 20,056            |
|  | 20,056                  | -                | -           | 20,056            |
| <b>Total debt and equity securities</b>              | <b>\$ 62,148</b>        | <b>\$ 49,421</b> | <b>\$ -</b> | <b>\$ 111,569</b> |



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Notes to Condensed Consolidated Financial Statements

## (7) Comprehensive Loss

For the three and nine months ended September 30, 2010 and 2009, comprehensive loss consisted of the following.

|   | Three Months Ended September 30, |            | Nine Months Ended September 30, |            |
|---|----------------------------------|------------|---------------------------------|------------|
|   | 2010                             | 2009       | 2010                            | 2009       |
|   | (Dollars in Thousands)           |            | (Dollars in Thousands)          |            |
| Net loss  | \$ (1,268)                       | \$ (3,993) | \$ (4,544)                      | \$ (2,906) |
| Change in net unrealized gains (losses) on investments available for sale | 1,224                            | 3,106      | (1,393)                         | 4,655      |
| Comprehensive (loss) income, before tax                                   | (44)                             | (887)      | (5,937)                         | 1,749      |
| Income tax (expense) benefit related to items of other comprehensive loss | (461)                            | (1,218)    | 524                             | (1,801)    |
| Comprehensive loss  | \$ (505)                         | \$ (2,105) | \$ (5,413)                      | \$ (52)    |

## (8) Reinsurance Agreements

Financing risk generally involves a combination of risk retention and risk transfer techniques. Retention, similar to a deductible, involves financing losses by funds internally generated. Transfer involves the existence of a contractual arrangement designed to shift financial responsibility to another party in exchange for premium. Secondary to the primary risk-transfer agreements there are reinsurance agreements. Following reinsurance agreements there are also retro-cessionary reinsurance agreements; each designed to shift financial responsibility based on predefined conditions. Generally, there are three separate kinds of reinsurance structures – quota share, excess of loss, and facultative, each considered either proportional or non-proportional. Our reinsurance structures are maintained to protect our insurance subsidiaries against the severity of losses on individual claims or unusually serious occurrences in which the frequency and or the severity of claims produce an aggregate extraordinary loss from catastrophic events.

As is common practice within the insurance industry, we transfer a portion of the risks insured under our policies to other companies through the purchase of reinsurance. We utilize reinsurance to reduce exposure to catastrophic and non-catastrophic risks and to help manage the cost of capital. Reinsurance techniques are designed to lessen earnings volatility, improve shareholder return, and to support the required statutory surplus requirements. Additional rationale to secure reinsurance includes an arbitrage of premium rate, availability of reinsurer's expertise, and improved management of a profitable portfolio of insureds by way of enhanced analytical capacities.

Although reinsurance does not discharge us from our primary obligation to pay for losses insured under the policies we issue, reinsurance does make the assuming reinsurer liable to the insurance subsidiary for the reinsured portion of the risk. A credit risk exposure exists with respect to ceded losses to the extent that any reinsurer is unable or unwilling to meet the obligations assumed under the reinsurance contracts. The collectability of reinsurance is subject to the solvency of the reinsurers, interpretation of contract language and other factors. A reinsurer's insolvency or inability to make payments under the terms of a reinsurance contract could have a material adverse effect on our results of operations and financial condition. Our reinsurance structure has significant risks, including the fact that the FHCF may not be able to raise sufficient money to pay its claims or impair its ability to pay its claims in a timely manner. This could result in significant financial, legal and operational challenges to all property and casualty companies associated with FHCF, including our company.

The availability and costs associated with the acquisition of reinsurance will vary year to year. These fluctuations, which can be significant, are not subject to our control and may limit our ability to purchase adequate coverage. For example, FHCF has restricted its very affordable reinsurance capacity for the 2010–2011 and 2009–2010 hurricane seasons and is expected to continue constricting its claim paying capacity for future seasons. This gradual restriction is requiring us to replace that capacity with more expensive private market reinsurance. The recovery of increased reinsurance costs through rate action is not immediate and cannot be presumed, as it is subject to Florida OIR approval. Our reinsurance program is subject to approval by the Florida OIR and review by Demotech, Inc. (“Demotech”).

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Notes to Condensed Consolidated Financial Statements

Our property lines of business include homeowners' and fire. For the 2010-2011 hurricane season, the excess of loss and FHCF treaties will insure the property lines for approximately \$360.7 million of aggregate catastrophic losses and LAE with a maximum single event coverage totaling approximately \$285.5 million, with the Company retaining the first \$5.0 million of losses and LAE for each event. Our reinsurance program includes coverage purchased from the private market, which affords optional reinstatement premium protection that provides coverage beyond the first event, along with any remaining coverage from the FHCF. Coverage afforded by the FHCF totals approximately \$220.4 million, or 61.1% of the \$360.7 million of aggregate catastrophic losses and LAE. The FHCF affords coverage for the entire season, subject to maximum payouts, without regard to any particular insurable event.

The estimated cost to the Company for the excess of loss reinsurance products for the 2010-2011 hurricane season, inclusive of approximately \$19.1 million payable to the FHCF and the prepaid automatic premium reinstatement protection, is approximately \$46.5 million.

The cost and amounts of reinsurance were originally based on management's analysis of Federated National's exposure to catastrophic risk as of June 30, 2010. Our data was subjected to exposure level analysis as of September 30, 2010. This analysis of our exposure level in relation to the total exposures to the FHCF and excess of loss treaties produced changes in limits and reinsurance premiums because of increase in our exposure level. The September 30, 2010 change to limits total limits was an increase of \$10.3 million or 2.9% and the change to reinsurance premiums was an increase of \$3.7 million or 8.7%. The change to management's June 30, 2010 analysis will be amortized over the remaining balance of the underlying policy term. The Company's retention did not change.

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Notes to Condensed Consolidated Financial Statements

The 2010-2011 private reinsurance companies and their respective A.M. Best Company (“A.M. Best”) rating are listed in the table as follows.

| Reinsurer   | A.M. Best Rating |   |     |
|---|------------------|---|-----|
| <b>UNITED STATES</b>                                    |                  |   |     |
| American Agricultural Insurance                         | A                |   | (2) |
| Everest Reinsurance Company                             | A+               |   | (2) |
| Munich Reinsurance America, Inc.                        | A+               |   | (2) |
| QBE Reinsurance Corporation                             | A                |   | (2) |
| <b>BERMUDA</b>  |                  |   |     |
| ACE Tempest Reinsurance Ltd.                            | A+               | * | (2) |
| Actua Re Limited  | NR               | * | (1) |
| Amlin Bermuda Limited                                   | A                |   | (2) |
| Ariel Reinsurance Company Limited                       | A-               | * |     |
| DaVinci Reinsurance Limited                             | A                | * | (2) |
| Flagstone Reinsurance Limited                           | A-               |   |     |
| Montpelier Reinsurance Ltd.                             | A-               |   | (2) |
| Nephila/ Allianz Risk Trnsfr Zurich (BDA)               | NR-5             | * | (2) |
| Renaissance Reinsurance Limited                         | A+               | * | (2) |
| Torus Insurance (Bermuda) Limited                       | A-               | * |     |
| <b>UNITED KINGDOM</b>                                   |                  |   |     |
| Antares Syndicate No. 1274 (AUL)                        | A                |   | (2) |
| Broadgate Underwriting Limited Syndicate No. 1301 (BGT) | A                |   | (2) |
| Arrow Syndicate No. 1910 (ARW)                          | A                | * | (2) |
| Amlin Syndicate No. 2001 (AML)                          | A                |   | (2) |
| Novae Syndicate No. 2007 (NVA)                          | A                |   | (2) |
| Houson Casualty Co. (UK Branch)                         | A+               |   | (2) |
| <b>EUROPE</b>   |                  |   |     |
| Lansforsakringar Sak Forsakringsaktiebolag              | NR-5             |   | (2) |
| Liberty Syndicates Paris/Syndicate 4472                 | A                |   | (2) |

\* Reinstatement Premium Protection Program  
Participants

(1) Participant has funded a trust agreement for their exposure with approximately \$3.8 million of cash and U.S. Government obligations of American institutions at fair market value.

(2) Standard & Poor's rated "A" or higher (investment grade - economic situation can affect finance)

For the 2009-2010 hurricane season, the excess of loss and FHCF treaties insured the property lines for approximately \$456.6 million of aggregate catastrophic losses and LAE with a maximum single event coverage totaling

approximately \$349.7 million, with the Company retaining the first \$5.0 million of losses and LAE for each event. Our reinsurance program included coverage purchased from the private market, which afforded optional reinstatement premium protection that provided coverage beyond the first event, along with coverage from the FHCF. Coverage afforded by the FHCF totaled approximately \$259.0 million, or 56.7% of the \$456.6 million of aggregate catastrophic losses and LAE. The FHCF affords coverage for the entire season, subject to maximum payouts, without regard to any particular insurable event.

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Notes to Condensed Consolidated Financial Statements

The 2009-2010 private reinsurance companies and their respective A.M. Best rating are listed in the table as follows.

| Reinsurer   | A.M. Best Rating |   |     |
|---|------------------|---|-----|
| <b>UNITED STATES</b>  |                  |   |     |
| Everest Reinsurance Company   | A+               |   | **  |
| Munich Reinsurance America, Inc.  | A+               |   | **  |
| QBE Reinsurance Corporation   | A                |   | **  |
| <b>BERMUDA</b>  |                  |   |     |
| ACE Tempest Reinsurance Limited   | A+               | * |     |
| Amlin Bermuda Limited   | A                |   |     |
| Ariel Reinsurance Company Limited   | A-               | * |     |
| DaVinci Reinsurance Limited   | A                | * |     |
| Flagstone Reinsurance Limited   | A-               |   |     |
| Hiscox Insurance Company Limited  | A                | * |     |
| Montpelier Reinsurance Limited  | A-               |   |     |
| Platinum Underwriters Bermuda Limited   | A                | * |     |
| Renaissance Reinsurance Limited   | A+               | * |     |
| Torus Insurance (Bermuda) Limited   | A-               | * |     |
| <b>LONDON &amp; EUROPE</b>  |                  |   |     |
| Amlin Syndicate No. 2001 (AML)  | A+               |   | **  |
| Antares Syndicate No. 1274 (AUL)  | A                |   | **  |
| Arrow Syndicate No. 1910 (ARW)  | A                | * | **  |
| Broadgate Syndicate No. 1301 (BGT)  | A                |   | **  |
| Liberty Syndicates Services Limited, Paris<br>for and on behalf of Lloyd's Syndicate No. 4472 (LIB) | A                |   | **  |
| Novae Syndicate No. 2007 (NVA)  | A                |   | **  |
| SCOR Switzerland AG   | A-               |   |     |
| <b>HEDGE FUNDS / COLLATERALIZED</b>   |                  |   |     |
| Actua Re Limited  | NR               | * | (1) |
| Allianz Risk Transfer AG (Bermuda Branch)   | NR-5             | * | (2) |

\* 2009 Reinstatement Premium Protection Program  
Participants

\*\* Admitted in Florida as a reinsurer, whether through  
licensing, accreditation or other means.

(Blank) Non admitted reinsurer in Florida.

(1) Participant has funded a trust agreement for their participation with approximately \$6.4 million of cash and U.S. Government obligations of American institutions at fair market value.

(2) Standard & Poor's rated "AA" (Obligor's capacity to meet its financial commitment on the obligation is very strong)

American Vehicle and Federated National entered into an 80% quota share treaty with Scor Reinsurance Company effective May 1, 2010 for all private passenger automobile policies in effect on May 1, 2010. This treaty included a ceding of unearned premium to the reinsurers. Our insurance companies will retain 20% of the policy risk for the term of the quota share agreement.

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American Vehicle became an admitted insurer in the state of Georgia during the quarter ended September 30, 2010. As part of the ramp-up of our business in Georgia, we entered into an arrangement to write non-standard private passenger automobile insurance through a reputable managing general agent familiar with the Georgia market. A quota share treaty will cede 100% of the risk and be fully collateralized for unearned premium and unpaid loss and LAE.

Pursuant to commutation provisions contained in the original 2004 FHCF agreement, on August 10, 2010 Federated National and FHCF negotiated such a commutation agreement for the 2004 contract year. The terms of the agreement provide that Federated National release the FHCF from all its obligations under the original reinsurance agreement for a negotiated consideration as a final payment for all unpaid claims subject to the treaty. This negotiation resulted in a final commutation payment received by us for a total of \$0.75 million, which the Company believes is adequate to pay loss and LAE including incurred but not yet reported (“IBNR”) for the subject losses. The benefit of the FHCF treaty inures to the benefit of the private reinsurers participating in the treaty. Should our estimations for unpaid loss and LAE exceed our commutation with the FHCF and ultimately prove inadequate, our coverage in the private market will continue to indemnify us. We do not expect the private market coverage to be exhausted. Additionally, this commutation agreement did not have an effect on operational net income.

As a direct premium writer in the state of Florida, we are required to participate in certain insurer solvency associations under Florida Statutes Section 631.57(3) (a), administered by FIGA. Participation in these pools is based on our written premium by line of business to total premiums written statewide by all insurers. Participation has resulted in assessments against us, as it had in 2006 and 2007, and again on October 30, 2009. There were no assessments made during the nine months ended September 30, 2010 or for the year ended December 31, 2008. Through 2007, we were assessed \$6.6 million and in 2009 we were assessed an additional \$0.6 million in connection with the insolvencies of domestic insurance companies. For statutory accounting these assessments are not charged to operations, in contrast, GAAP treatment is to charge current operations for the assessments. Through policyholder surcharges, as approved by the Florida OIR, we have since recouped \$6.9 million in connection with these assessments.

The SBA and the FHCF Financing Corporation agreed to a resolution that would authorize the issuance and sale of FHCF post-event revenue bonds not to exceed \$710 million. The proceeds of the bonds would be used for the reimbursement of insurance companies for additional claims due to hurricanes during the 2005 season. These bonds will have fixed interest rates, be exempt from federal income taxes and be secured by not yet implemented emergency assessments and reimbursement premiums. The inability to issue these bonds could result in the FHCF's need to accelerate additional assessments. We have not recorded any liability in connection with this initiative.

The FHCF reimbursement contract and addendums are all effective June 1, 2010, and the private excess of loss type treaties are all effective July 1, 2010; all treaties have a term of one year. Our reinsurance treaty with the FHCF has a significant credit risk, including the fact that the FHCF may not be able to raise sufficient money to pay their claims or impair their ability to pay their claims in a timely manner. This could result in significant financial, legal and operational challenges to all companies, including ours. Additionally, the FHCF treaty contains an exclusion for “Losses in excess of the sum of the Balance of the Fund as of December 31 of the Contract Year and the amount the SBA is able to raise through the issuance of revenue bonds or by the use of other financing mechanisms, up to the limit pursuant to Section 215.555(4) (c), Florida Statutes.” This credit risk is mitigated by a fund cash buildup due to the absence of covered events in recent years.

To date, there have been no claims asserted against the reinsurers in connection with the 2010–2011 and 2009–2010 excess of loss and FHCF treaties.



As regards to the commercial multi-peril property program that began recording premium on August 28, 2009, we have secured an automatic facultative reinsurance agreement with Munich Reinsurance America, Inc. and Ascot Underwriting Limited for bound risks with total insured values not to exceed \$10.0 million, with additional coverage in excess of \$10.0 million available upon submission and subjected to underwriting guidelines. This coverage excludes catastrophic wind-storm risk. A.M. Best ratings for Munich Re and Ascot are A+ and A, respectively.

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During 2009, the Company secured casualty reinsurance affording coverage totaling \$4.0 million in excess of \$1.0 million. This reinsurance also protects the Company against extra contractual obligations and losses in excess of policy limits. Any loss occurrence that involves liability exposure written by either Federated National or American Vehicle or a combination of both will be covered. The cost of this coverage totaled approximately \$0.4 million.

In order to expand our commercial business, American Vehicle has entered into various quota share reinsurance agreements whereby American Vehicle is the assuming reinsurer. On March 26, 2009, we announced that American Vehicle received approval from the Florida OIR to enter into a reinsurance relationship allowing the opportunity to market and underwrite commercial insurance through a company that has an "A" rating with A.M. Best. This agreement is designed to enable the deployment of commercial general liability and other commercial insurance products in most of the contiguous 48 states to policyholders who require their commercial insurance policy to come from an insurance company with an A- or better A.M. Best rating. Operations began during the quarter ended June 30, 2009.

The quota share retrocessionaire reinsurance agreements require American Vehicle to securitize credit, regulatory and business risk. As of September 30, 2010, irrevocable letters of credit fully collateralized by American Vehicle and further guaranteed by the parent company, 21st Century, were replaced by fully funded trust agreements. Fully funded trust agreements and outstanding irrevocable letters of credit totaled \$3.1 million as of September 30, 2010 and December 31, 2009, respectively.

We are selective in choosing reinsurers and consider numerous factors, the most important of which are the financial stability of the reinsurer, their history of responding to claims and their overall reputation. In an effort to minimize our exposure to the insolvency of a reinsurer, we evaluate the acceptability and review the financial condition of the reinsurer at least annually.

(9) Stock Compensation Plans

We implemented a stock option plan in September 1998, which expired in September 2008, and provided for the granting of stock options to officers, key employees and consultants. The objectives of this plan included attracting and retaining the best personnel, providing for additional performance incentives, and promoting our success by providing employees the opportunity to acquire common stock. Options outstanding under this plan were granted at prices either equal to or above the market value of the stock on the date of grant, typically vest over a four-year or five-year period and expire six or ten years after the grant date. Under this plan, we were authorized to grant options to purchase up to 900,000 common shares, and, as of September 30, 2010 and December 31, 2009, we had outstanding exercisable options to purchase 119,599 and 124,599 shares, respectively.

In 2002, we implemented the 2002 Stock Option Plan. The purpose of this plan is to advance our interests by providing an additional incentive to attract, retain and motivate highly qualified and competent persons who are key to the Company, including employees, consultants, independent contractors, officers and directors. Our success is largely dependent upon their efforts and judgment; therefore, by authorizing the grant of options to purchase common stock, we encourage stock ownership. Options outstanding under the plan were granted at prices either equal to or above the market value of the stock on the date of grant, typically vest over a five-year period, and expire six or ten years after the grant date. Under this plan, we are authorized to grant options to purchase up to 1,800,000 common shares, and, as of September 30, 2010 and December 31, 2009, we had outstanding exercisable options to purchase 702,685 and 736,951 shares, respectively.



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Notes to Condensed Consolidated Financial Statements

Activity in our stock option plans for the period from January 1, 2008 to September 30, 2010 is summarized below.

|                                   | 1998 Plan           |   | 2002 Plan           |   |
|-----------------------------------|---------------------|---|---------------------|---|
|                                   | Number of<br>Shares | Weighted<br>Average<br>Option<br>Exercise Price | Number of<br>Shares | Weighted<br>Average<br>Option<br>Exercise Price |
| Outstanding at January 1, 2008    | 152,599             | \$ 14.92  | 660,309             | \$ 13.78  |
| Granted                           | 4,500               | \$ 8.67   | 162,500             | \$ 8.92   |
| Exercised                         | (13,500)            | \$ 6.67   | (141,458)           | \$ 8.81   |
| Cancelled                         | (13,500)            | \$ 10.03  | (23,200)            | \$ 12.60  |
| Outstanding at January 1, 2009    | 130,099             | \$ 16.07  | 658,151             | \$ 13.69  |
| Granted                           | -                   | \$ -  | 147,000             | \$ 4.37   |
| Exercised                         | -                   | \$ -  | -                   | \$ -  |
| Cancelled                         | (5,500)             | \$ 20.23  | (68,200)            | \$ 11.58  |
| Outstanding at January 1, 2010    | 124,599             | \$ 15.88  | 736,951             | \$ 12.03  |
| Granted                           | -                   | \$ -  | 104,500             | \$ 3.60   |
| Exercised                         | -                   | \$ -  | -                   | \$ -  |
| Cancelled                         | (5,000)             | \$ 13.70  | (138,766)           | \$ 15.36  |
| Outstanding at September 30, 2010 | 119,599             | \$ 15.97  | 702,685             | \$ 10.12  |

Options outstanding as of September 30, 2010 are exercisable as follows.

| Options Exercisable at:   | 1998 Plan           |   | 2002 Plan           |   |
|---------------------------|---------------------|---|---------------------|---|
|                           | Number of<br>Shares | Weighted<br>Average<br>Option<br>Exercise Price | Number of<br>Shares | Weighted<br>Average<br>Option<br>Exercise Price |
| September 30, 2010        | 72,589              | \$ 15.97  | 326,337             | \$ 10.12  |
| December 31, 2010         | 8,970               | \$ 15.97  | 60,910              | \$ 10.12  |
| December 31, 2011         | 18,670              | \$ 15.97  | 113,549             | \$ 10.12  |
| December 31, 2012         | 18,670              | \$ 15.97  | 89,489              | \$ 10.12  |
| December 31, 2013         | 700                 | \$ 15.97  | 56,200              | \$ 10.12  |
| December 31, 2014         | -                   | \$ 15.97  | 35,300              | \$ 10.12  |
| Thereafter                | -                   | \$ 15.97  | 20,900              | \$ 10.12  |
| Total options exercisable | 119,599             |   | 702,685             |   |

Prior to January 1, 2006, we accounted for the plans under the recognition and measurement provisions of stock-based compensation using the intrinsic value method prescribed by the Accounting Principles Board (“APB”) and related Interpretation, as permitted by FASB-issued guidance. Under these provisions, no stock-based employee compensation cost was recognized in the Statement of Operations as all options granted under those plans had an exercise price equal to or less than the market value of the underlying common stock on the date of grant.

Upon the exercise of options, the Company issues authorized shares.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB-issued guidance using the modified-prospective-transition method. Under that transition method, compensation costs recognized during 2010 and 2009 include the following.

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- Compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FASB-issued guidance, and
- Compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair-value estimated in accordance with the provisions of FASB-issued guidance. Results for prior periods have not been restated, as not required to be by the pronouncement.

As a result of adopting FASB-issued guidance on January 1, 2006, the Company's income from continuing operations before provision for income taxes and net income for the three months ended September 30, 2010 are lower by approximately \$99,000 and \$62,000, respectively, than if it had continued to account for share-based compensation under APB guidance.

As a result of adopting FASB-issued guidance on January 1, 2006, the Company's income from continuing operations before provision for income taxes and net income for the nine months ended September 30, 2010 are lower by approximately \$297,000 and \$185,000, respectively, than if it had continued to account for share-based compensation under APB guidance.

As a result of adopting FASB-issued guidance on January 1, 2006, the Company's income from continuing operations before provision for income taxes and net income for the three months ended September 30, 2009 are lower by approximately \$96,000 and \$60,000, respectively, than if it had continued to account for share-based compensation under APB guidance.

As a result of adopting FASB-issued guidance on January 1, 2006, the Company's income from continuing operations before provision for income taxes and net income for the nine months ended September 30, 2009 are lower by approximately \$326,000 and \$203,000, respectively, than if it had continued to account for share-based compensation under APB guidance.

Basic and diluted earnings per share for the three months ended September 30, 2010 would have been (\$0.15), if the Company had not adopted FASB-issued guidance, compared with reported basic and diluted earnings per share of (\$0.16). Basic and diluted earnings per share for the nine months ended September 30, 2010 would have been (\$0.55), if the Company had not adopted FASB-issued guidance, compared with reported basic and diluted earnings per share of (\$0.57).

Basic and diluted earnings per share for the three months ended September 30, 2009 would have been (\$0.49), if the Company had not adopted FASB-issued guidance, compared with reported basic and diluted earnings per share of (\$0.50). Basic and diluted earnings per share for the nine months ended September 30, 2009 would have been (\$0.34), if the Company had not adopted FASB-issued guidance, compared with reported basic and diluted earnings per share of (\$0.36).

Because the change in income taxes payable includes the effect of excess tax benefits, those excess tax benefits also must be shown as a separate operating cash outflow so that operating cash flows exclude the effect of excess tax benefits. FASB-issued guidance requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows.

The weighted average fair value of options granted during the three months ended September 30, 2010 was \$1.62 and during the same period 2009 was \$1.29, estimated on the date of grant using the Black-Scholes option-pricing model.



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The fair value of options granted is estimated on the date of grant using the following assumptions.

|                          | September 30, 2010 | September 30, 2009 |
|--------------------------|--------------------|--------------------|
| Dividend yield           | 1.78% -<br>5.80%   | 5.90% -<br>17.30%  |
| Expected volatility      | 74.62% -<br>82.36% | 57.54% -<br>82.65% |
| Risk-free interest rate  | 0.99% -<br>1.33%   | 1.22% -<br>1.50%   |
| Expected life (in years) | 3.06 - 3.78        | 3.45 - 4.16        |

Summary information about the Company's stock options outstanding at September 30, 2010 follows.

|           | Range of<br>Exercise Price | Outstanding at<br>September 30, 2010 | Contractual<br>Periods in Years | Weighted Average<br>Exercise Price | Weighted<br>Average Exercise Price | Exercisable at<br>September 30, 2010 |
|-----------|----------------------------|--------------------------------------|---------------------------------|------------------------------------|------------------------------------|--------------------------------------|
| 1998 Plan | \$ 6.67 -<br>\$27.79       | 119,599                              | 2.59                            | \$ 15.97                           | \$ 15.97                           | 72,589                               |
| 2002 Plan | \$ 3.03 -<br>\$18.21       | 702,685                              | 3.81                            | \$ 10.12                           | \$ 10.12                           | 326,337                              |

#### (10) Stockholders' Equity

##### Capital Stock

The Company's authorized capital consists of 1,000,000 shares of preferred stock, par value \$0.01 per share, and 25,000,000 shares of common stock, par value \$0.01 per share. As of September 30, 2010, there were no preferred shares issued or outstanding and there were 7,946,384 shares of common stock outstanding.

#### (11) Subsequent Events

The Company has determined that there are no events or transactions occurring subsequent to September 30, 2010, that would have a material impact on the Company's results of operations or financial condition as of September 30, 2010.



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General information about 21st Century Holding Company can be found at [www.21stcenturyholding.com](http://www.21stcenturyholding.com); however, the information that can be accessed through our web site is not part of our report. We make our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports filed or furnished pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934 available free of charge on our web site, as soon as reasonably practicable after they are electronically filed with the SEC.

Item 2

Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion in conjunction with our condensed consolidated financial statements and related notes and information included under this Item 2 and elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K filed with the Securities and Exchange Commission ("SEC") on March 26, 2010 ("Form 10-K"). Unless the context requires otherwise, as used in this Form 10-Q, the terms "21st Century" "Company," "we," "us" and "our," refers to 21st Century Holding Company and its subsidiaries.

Forward-Looking Statements

Statements in this Quarterly Report on Form 10-Q for the nine months ended September 30, 2010 ("Form 10-Q") or in documents that are incorporated by reference that are not historical fact are forward-looking statements that are subject to certain risks and uncertainties that could cause actual events and results to differ materially from those discussed herein. Without limiting the generality of the foregoing, words such as "may," "will," "expect," "believe," "anticipate," "intend," "could," "would," "estimate," or "continue" or the negative other variations thereof or comparative terminology are intended to identify forward-looking statements. The risks and uncertainties include, without limitation, uncertainties related to estimates, assumptions and projections relating to unpaid losses and loss adjustment expenses and other accounting policies, losses from the nine hurricanes that occurred in fiscal years 2005 and 2004 and in other estimates, assumptions and projections contained in this Form 10-Q; inflation and other changes in economic conditions (including changes in interest rates and financial markets); the impact of new regulations adopted in Florida which affect the property and casualty insurance market; the costs of reinsurance, assessments charged by various governmental agencies; pricing competition and other initiatives by competitors; our ability to obtain regulatory approval for requested rate changes and the timing thereof; legislative and regulatory developments; the outcome of various litigation matters pending against us, including the terms of any settlements; risks related to the nature of our business; dependence on investment income and the composition of our investment portfolio; the adequacy of our liability for loss and loss adjustment expense; insurance agents; claims experience; ratings by industry services; catastrophe losses; reliance on key personnel; weather conditions (including the severity and frequency of storms, hurricanes, tornadoes and hail); changes in driving patterns and loss trends; acts of war and terrorist activities; court decisions and trends in litigation and health care and auto repair costs; and other matters described from time to time by us in this report, and in our other filings with the SEC, including the Company's Form 10-K.

You are cautioned not to place reliance on these forward-looking statements, which are valid only as of the date they were made. The Company undertakes no obligation to update or revise any forward-looking statements to reflect new information or the occurrence of unanticipated events or otherwise. In addition, readers should be aware that Generally Accepted Accounting Principles ("GAAP") prescribes when a company may reserve for particular risks, including litigation exposures. Accordingly, results for a given reporting period could be significantly affected when a reserve is established for a major contingency. Reported results may therefore appear to be volatile in certain

accounting periods.

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Overview

21st Century is an insurance holding company, which, through our subsidiaries and our contractual relationships with our independent agents and general agents, controls substantially all aspects of the insurance underwriting, distribution and claims processes. We are authorized to underwrite homeowners' multi-peril ("homeowners"), personal umbrella, commercial general liability, following form commercial excess liability, personal and commercial automobile, fire, allied lines, workers' compensation, business personal property and commercial inland marine insurance. We are authorized to underwrite in various states on behalf of our wholly owned subsidiaries, Federated National Insurance Company ("Federated National") and American Vehicle Insurance Company ("American Vehicle") and other insurance carriers. We market and distribute our own and third-party insurers' products and our other services through a network of independent agents. We also utilize a select number of general agents for the same purpose.

We operate in certain states as an admitted carrier, meaning that we are licensed by those states and are subject to comprehensive regulation by them. Admitted carriers are typically required to contribute financially to any state guarantee funds, such as in Florida. In other states, we operate as a non-admitted carrier, which is sometimes also referred to as an "excess and surplus lines carrier." Non-admitted carriers are generally subject to less regulation by the states and typically are not required to contribute to state guarantee funds.

Federated National is licensed as an admitted carrier in Florida. Through contractual relationships with a network of approximately 4,200 independent agents, of which approximately 300 actively sell and service our products, Federated National is authorized to underwrite homeowners', fire, allied lines and personal automobile insurance in Florida.

American Vehicle is licensed as an admitted carrier in Florida, and underwrites commercial general liability, and personal and commercial automobile insurance. American Vehicle is also licensed as an admitted carrier in Alabama, Louisiana, Georgia and Texas, and underwrites commercial general liability insurance in those states. American Vehicle operates as a non-admitted carrier in Arkansas, California, Kentucky, Maryland, Missouri, Nevada, Oklahoma, South Carolina, Tennessee and Virginia, and can underwrite commercial general liability insurance in all of these states.

We internally process claims made by our insureds through our wholly owned claims adjusting company, Superior Adjusting, Inc. ("Superior"). We also offer premium financing to our own and third-party insureds through our wholly owned subsidiary, Federated Premium Finance, Inc. ("Federated Premium").

Assurance Managing General Agents, Inc. ("Assurance MGA"), a wholly owned subsidiary of the Company, acts as Federated National's and American Vehicle's exclusive managing general agent in the state of Florida and is also licensed as a managing general agent in the states of Alabama, Arkansas, Georgia, Illinois, Louisiana, North Carolina, Mississippi, Missouri, New York, Nevada, South Carolina, Texas and Virginia. During 2009, Assurance MGA contracted with several unaffiliated insurance companies to sell commercial general liability, workers compensation and inland marine insurance through Assurance MGA's existing network of agents. This process will continue throughout 2010 as Assurance MGA benefits from the arrangement by receiving commission revenue from policies sold by its insurance partners, while minimizing its risks.

Assurance MGA earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. Assurance MGA earns a \$25 per

policy fee, and a 6% commission fee from its affiliates Federated National and American Vehicle.

Insure-Link, Inc. (“Insure-Link”) was formed in March 2008 to serve as an independent insurance agency. The insurance agency markets direct to the public to provide a variety of insurance products and services to individual clients as well as business clients by offering a full line of insurance products including, but not limited to, homeowners’, personal and commercial automobile, commercial general liability and workers compensation insurance through their agency appointments with over fifty different carriers. Insure-Link will expand its’ business through marketing and by acquiring other insurance agencies.

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During the nine months ended September 30, 2010, 77.6%, 13.6%, 4.3% and 4.5% of the premiums we underwrote were for homeowners', commercial general liability, federal flood, and personal automobile insurance, respectively. During the nine months ended September 30, 2009, 79.3%, 16.7%, 3.7% and 0.3% of the premiums we underwrote were for homeowners', commercial general liability, federal flood, and personal automobile insurance, respectively.

Our business, results of operations and financial condition are subject to fluctuations due to a variety of factors. Abnormally high severity or frequency of claims in any period could have a material adverse effect on our business, results of operations and financial condition. When our estimated liabilities for unpaid losses and loss adjustment expenses ("LAE") are less than actual losses and LAE, we increase reserves with a corresponding reduction in our net income in the period in which the deficiency is identified. Conversely, when our estimated liabilities for unpaid losses and LAE are greater than actual losses and LAE, we decrease reserves with a corresponding increase in our net income in the period in which the deficiency is identified.

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

We operate in highly competitive markets and face competition from national, regional and residual market insurance companies in the homeowners', commercial residential property, commercial general liability, and automobile markets, many of whom are larger, have greater financial and other resources, and offer more diversified insurance coverage. Our competitors include companies that market their products through agents, as well as companies that sell insurance directly to their customers. Large national writers may have certain competitive advantages over agency writers, including increased name recognition, increased loyalty of their customer base and reduced policy acquisition costs.

Significant competition also emerged because of fundamental changes in 2007 made to the property and casualty insurance business in Florida, which resulted in a multi-pronged approach to address the cost of residential property insurance in Florida. First, the law increased the capacity of reinsurance that stabilized the reinsurance market to the benefit of the insurance companies writing properties lines in Florida. Secondly, the law provided for rate relief to all policyholders. The law also authorized the state-owned insurance company, Citizens Property Insurance Corporation ("Citizens"), which is free of many of the restraints on private carriers such as surplus, ratios, income taxes and reinsurance expense, to reduce its premium rates and begin competing against private insurers in the residential property insurance market and expands the authority of Citizens to write commercial insurance. We believe that these aggressive marketplace changes in 2007 forced some carriers to pursue market share based on "best case" pricing models that may ultimately prove unprofitable from an underwriting perspective.

For example, during 2009 we noted that the Florida Office of Insurance Regulation ("Florida OIR") placed at least four property and casualty insurance companies in some form of receivership while several other Florida domiciled insurance companies have recapitalized in order to remain viable in the Florida market. The insolvency of these companies poses a risk to all other remaining carriers in the state including Federated National and American Vehicle in terms of assessments to support those failed companies. Through September 30, 2010, we are not aware of any such assessments in connection with the takeovers during 2009; however, no guarantee can be made that no assessments will be imposed.

In recent years, approximately two-dozen new homeowner insurance companies received authority by the Florida OIR to commence business as admitted carriers in the state.

In 2006, the state of Florida created the Insurance Capital Build-Up Incentive Program in response to the catastrophic events that occurred during 2004 and 2005. This program provided matching capital funds to any new or existing carrier licensed to write homeowners' insurance in the state of Florida under certain conditions. This program resulted in a significant erosion of our homeowners' insurance market since 2007. We did not participate in the Insurance Capital Build-Up Incentive Program. Although our pricing is inevitably influenced to some degree by that of our competitors, we believe that it is generally not in our shareholders' best interest to compete solely on price.

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We face increased competition from existing carriers and new entrants in our niche markets. As mentioned earlier, in an effort to foster competition after the hurricanes of 2004 and 2005, the State of Florida loaned money to multiple carriers with certain debt covenants, including the maintenance of minimum written premium. Our competition has attempted to gain market share through aggressive pricing and generous policy acquisition costs, which has had an adverse affect on our ability to maintain market share. Although our pricing is inevitably influenced to some degree by that of our competitors, we believe that it is generally not in our best interest to compete solely on price. We compete based on underwriting criteria, our distribution network and superior service to our agents and insureds.

In Florida, more than 200 companies are authorized to underwrite homeowners' insurance. National and regional companies that compete with us in the homeowners' market include Castle Key (formerly Allstate Floridian) Indemnity Insurance Company and Fidelity National Insurance Company. In addition to these nationally recognized companies, we also compete with several Florida domestic property and casualty companies such as, but not limited to, Universal Property and Casualty Insurance Company, Royal Palm Insurance Company, Edison Insurance Company, St. Johns Insurance Company, Cypress Property and Casualty Insurance Company, and American Strategic Insurance Company.

Companies, which compete with us nationally in the commercial general liability insurance market, include Century Surety Insurance Company, Atlantic Casualty Insurance Company, Colony Insurance Company and Burlington/First Financial Insurance Companies.

Comparable companies in the personal automobile insurance market include Kingsway Amigo Insurance Company, United Automobile Insurance Company, Direct General Insurance Company, and Ocean Harbor Insurance Company, as well as national insurers such as Progressive Casualty Insurance Company and GEICO.

We reported decreased gross written premium for the nine months ended September 30, 2010, and continue to face difficult economic conditions that affected our earnings. Performance during the three and nine months ended September 30, 2010, was affected by our increased reinsurance costs and reduced earned premium due to mitigation credits.

Our executive offices are located at 3661 West Oakland Park Boulevard, Suite 300, Lauderdale Lakes, Florida, 33311 and our telephone number is (954) 581-9993.

#### Critical Accounting Policies

See Note 3, "Summary of Significant Accounting Policies" in the Notes to the Company's condensed consolidated financial statements for the quarter ended September 30, 2010 included in Item 1 of this Report on Form 10-Q for a discussion of the Company's critical accounting policies.

#### New Accounting Pronouncements

See Note 3, "Summary of Significant Accounting Policies" in the Notes to the Company's condensed consolidated financial statements for the quarter ended September 30, 2010 included in Item 1 of this Report on Form 10-Q for a discussion of recent accounting pronouncements and their effect, if any, on the Company.





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## Analysis of Financial Condition

As of September 30, 2010 Compared with December 31, 2009

## Total Investments

The Financial Accounting Standards Board ("FASB") issued guidance that addresses accounting and reporting for (a) investments in equity securities that have readily determinable fair values and (b) all investments in debt securities. The guidance requires that these securities be classified into one of three categories: (i) held-to-maturity, (ii) trading securities or (iii) available-for-sale.

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

Total investments decreased \$3.3 million, or 2.9%, to \$110.9 million as of September 30, 2010, compared with \$114.2 million as of December 31, 2009.

The debt and equity securities that are available-for-sale and carried at fair value represent 95% of total investments as of September 30, 2010, compared with 98% as of December 31, 2009.

We did not hold any trading investment securities during the nine months ended September 30, 2010.

Below is a summary of net unrealized gains and losses as of September 30, 2010 and December 31, 2009, by category.

|  | Unrealized Gains and (Losses) |                   |
|--|-------------------------------|-------------------|
|  | September 30, 2010            | December 31, 2009 |
|  | (Dollars in Thousands)        |                   |
| <b>Debt securities:</b>                              |                               |                   |
| United States government obligations and authorities | \$ 158                        | \$ (120)          |
| Obligations of states and political subdivisions     | 636                           | 500               |
| Corporate  | 1,381                         | 1,742             |
| International  | 46                            | -                 |
|  | 2,221                         | 2,122             |
| <b>Equity securities:</b>                            |                               |                   |
| Common stocks  | (364)                         | 1,128             |
| <b>Total debt and equity securities</b>              | <b>\$ 1,857</b>               | <b>\$ 3,250</b>   |

The Company's investment in marketable equity securities consist primarily of investments in common stock in diverse industries. The \$0.4 million unrealized losses are from common stocks held in these diverse industries as of September 30, 2010. The Company evaluated the near-term prospects in relation to the severity and duration of the impairment. Based on this evaluation and, the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider these investments to be other-than-temporarily impaired at September 30, 2010.

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

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Management's Discussion and Analysis of Financial Condition and Results of Operations

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

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

In reaching a conclusion that a security is either other-than-temporarily or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as Standard and Poor's and Moody's Investors Service, Inc. ("Moody's"), as well as information released via the general media channels. During the nine months ended September 30, 2010, in connection with this process, we have not charged any net realized investment loss to operations.

As of September 30, 2010, all of our securities are in good standing and not impaired, compared with \$0.4 million of securities that were considered impaired as of December 31, 2009.

During the nine months ended September 30, 2010, in connection with the other-than-temporarily or permanently impaired process, we did not charge any net realized investment loss to operations.

The investments held as of September 30, 2010 were comprised mainly of corporate bonds held in various industries, municipal bonds and United States government bonds. The investments held as of December 31, 2009, were comprised mainly of corporate bonds held in various industries, municipal bonds and United States government bonds. As of September 30, 2010, 75% of the debt portfolio is in diverse industries and 25% is in United States government bonds. As of September 30, 2010, approximately 89% of the equity holdings are in equities related to diverse industries and 11% are in mutual funds.

As of September 30, 2010, 39% of the investment portfolio is in corporate bonds, 21% is in obligations of states and political subdivisions, and 21% is in United States government bonds. Approximately 10% of the common stock holdings are related to foreign entities.



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The following table summarizes, by type, our investments as of September 30, 2010 and December 31, 2009.

|  | September 30, 2010 |                     | December 31, 2009  |                     |
|--|--------------------|---------------------|--------------------|---------------------|
|  | Carrying<br>Amount | Percent<br>of Total | Carrying<br>Amount | Percent<br>of Total |
| (Dollars in Thousands)                               |                    |                     |                    |                     |
| <b>Debt securities, at market:</b>                   |                    |                     |                    |                     |
| United States government obligations and authorities | \$ 17,296          | 15.59%              | \$ 10,152          | 8.89%               |
| Obligations of states and political subdivisions     | 23,005             | 20.73%              | 39,269             | 34.38%              |
| Corporate  | 43,160             | 38.90%              | 42,092             | 36.85%              |
| International  | 2,051              | 1.85%               | -                  | 0.00%               |
|  | 85,512             | 77.07%              | 91,513             | 80.12%              |
| <b>Debt securities, at amortized cost:</b>           |                    |                     |                    |                     |
| United States government obligations and authorities | 5,782              | 5.22%               | 2,650              | 2.32%               |
| <b>Total debt securities</b>                         | <b>91,294</b>      | <b>5.22%</b>        | <b>94,163</b>      | <b>2.32%</b>        |
| <b>Equity securities, at market:</b>                 | <b>19,654</b>      | <b>17.71%</b>       | <b>20,056</b>      | <b>17.56%</b>       |
| <b>Total investments</b>                             | <b>\$ 110,948</b>  | <b>100.00%</b>      | <b>\$ 114,219</b>  | <b>100.00%</b>      |

As of September 30, 2010 and December 31, 2009, we have classified \$5.8 million and \$2.7 million, respectively, of our bond portfolio as held-to-maturity. We only classify bonds as held-to-maturity to support securitization of credit requirements. Fully funded trust agreements or outstanding irrevocable letters of credit, used for such purposes, total \$3.1 million for the period ended September 30, 2010 and December 31, 2009, respectively.

During April 2006, American Vehicle finalized a \$15.0 million irrevocable letter of credit in conjunction with the 100% Quota Share Reinsurance Agreement with Republic Underwriters Insurance Company ("Republic") which was terminated in April 2007. As of December 31, 2007, the letter of credit in favor of Republic totaled \$10.0 million. As of December 31, 2008, the letter of credit in favor of Republic totaled \$3.0 million. As of December 31, 2009, a letter of credit in favor of Republic totaled \$1.0 million. As of September 30, 2010, the letter of credit in favor of Republic was replaced by a fully funded trust agreement that totaled \$1.0 million.

#### Cash and Short-Term Investments

Cash and short-term investments, which include cash, certificates of deposits, and money market accounts, increased \$6.4 million, or 22.6%, to \$34.6 million as of September 30, 2010, compared with \$28.2 million as of December 31, 2009. The increase in cash and short-term investments is from normal portfolio turnover wherein investments were sold; we evaluate on an ongoing basis long and short-term investment options for the best yields that match our liquidity needs.

#### Prepaid Reinsurance Premiums

Prepaid reinsurance premiums decreased \$7.0 million, or 68.2%, to \$3.3 million as of September 30, 2010, compared with \$10.3 million as of December 31, 2009. The change is due to our payments and amortization of prepaid reinsurance premiums associated with our homeowners' insurance book of business. We believe concentrations of credit risk associated with our prepaid reinsurance premiums are not significant.

Premiums Receivable, Net of Allowance for Credit Losses

Premiums receivable, net of allowance for credit losses, decreased \$4.5 million, or 43.9%, to \$5.8 million as of September 30, 2010, compared with \$10.3 million as of December 31, 2009.

Our homeowners' insurance premiums receivable decreased \$6.0 million, or 66.6%, to \$3.0 million as of September 30, 2010, compared with \$9.0 million as of December 31, 2009. The balance at December 31, 2009 included \$5.4 million receivable in connection with our Citizens' assumed policies.

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Our commercial general liability insurance premiums receivable increased \$0.8 million, or 94.0%, to \$1.7 million as of September 30, 2010, compared with \$0.9 million as of December 31, 2009.

Premiums receivable in connection with our automobile line of business increased \$0.7 million, or 159.1%, to \$1.2 million as of September 30, 2010, compared with \$0.5 million as of December 31, 2009. See "Results of Operations-Nine Months Ended September 30, 2010" for a discussion regarding the increase in the Company's sale of auto insurance during 2010.

Our allowance for credit losses remained unchanged at approximately \$0.1 million as of September 30, 2010, compared with as of December 31, 2009.

Reinsurance Recoverable, Net

Reinsurance recoverable, net, decreased \$5.1 million, or 33.1%, to \$10.2 million as of September 30, 2010, compared with \$15.3 million as of December 31, 2009. The change is due to payment patterns by our reinsurers. All amounts are current and deemed collectable. We believe concentrations of credit risk associated with our reinsurance recoverables, net, are not significant.

Deferred Policy Acquisition Costs ("DPAC")

DPAC decreased \$0.6 million, or 7.2%, to \$7.7 million as of September 30, 2010, compared with \$8.3 million as of December 31, 2009. The change is due to decreased homeowners' and commercial general liability written and unearned premium.

Deferred Income Taxes, Net

Deferred income taxes, net, increased \$1.0 million, or 21.7%, to \$5.7 million as of September 30, 2010, compared with \$4.7 million as of December 31, 2009. Deferred income taxes, net, is comprised of approximately \$7.6 million and \$9.1 million of deferred tax assets, net of approximately \$1.9 million and \$4.4 million of deferred tax liabilities as of September 30, 2010 and December 31, 2009, respectively.

Income Taxes Receivable

Income taxes receivable decreased \$4.8 million, or 68.0%, to \$2.3 million as of September 30, 2010, compared with \$7.1 million as of December 31, 2009. The change is due to the receipt of our prior year refund, net of our loss as discussed within "Results of Operations-Nine Months Ended September 30, 2010".

Other Assets

Other assets decreased \$1.4 million, or 37.6%, to \$2.3 million as of September 30, 2010, compared with \$3.7 million as of December 31, 2009. Major components of other assets are shown in the following table; the accrued interest income receivable is primarily investment related.

September 30, 2010                      December 31, 2009  
(Dollars in Thousands)

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|                                    |    |       |    |       |
|------------------------------------|----|-------|----|-------|
| Accrued interest income receivable | \$ | 886   | \$ | 1,162 |
| Notes receivable                   |    | 456   |    | 599   |
| Deposits                           |    | 287   |    | 334   |
| Prepaid expenses                   |    | 355   |    | 644   |
| Receivable for investments sold    |    | -     |    | 567   |
| Other                              |    | 307   |    | 365   |
| Total                              | \$ | 2,291 | \$ | 3,671 |

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### Unpaid Losses and LAE

Unpaid losses and LAE decreased \$7.1 million, or 10.1%, to \$63.5 million as of September 30, 2010, compared with \$70.6 million as of December 31, 2009. The composition of unpaid losses and LAE by product line is as follows.

|                              | September 30, 2010     |           |           | December 31, 2009      |           |           |
|------------------------------|------------------------|-----------|-----------|------------------------|-----------|-----------|
|                              | Case                   | Bulk      | Total     | Case                   | Bulk      | Total     |
|                              | (Dollars in Thousands) |           |           | (Dollars in Thousands) |           |           |
| Homeowners'                  | \$ 6,987               | \$ 14,728 | \$ 21,715 | \$ 8,705               | \$ 19,298 | \$ 28,003 |
| Commercial General Liability | 7,781                  | 27,230    | 35,011    | 7,885                  | 29,346    | 37,231    |
| Automobile                   | 3,481                  | 3,248     | 6,729     | 2,612                  | 2,765     | 5,377     |
| Total                        | \$ 18,249              | \$ 45,206 | \$ 63,455 | \$ 19,202              | \$ 51,409 | \$ 70,611 |

Factors that affect unpaid losses and LAE include the estimates made on a claim-by-claim basis known as "case reserves" coupled with bulk estimates known as incurred but not yet reported ("IBNR"). Periodic estimates by management of the ultimate costs required to settle all claim files are based on the Company's analysis of historical data and estimations of the impact of numerous factors such as (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation.

Management revises its estimates based on the results of its analysis. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors.

### Unearned Premium

Unearned premiums decreased \$3.1 million, or 5.9%, to \$47.8 million as of September 30, 2010, compared with \$50.9 million as of December 31, 2009. The change was due to a \$3.9 million decrease in unearned homeowners' insurance premiums, a \$0.6 million decrease in unearned commercial general liability premiums, a \$0.3 million increase in unearned flood insurance premiums, and a \$1.1 million increase in unearned automobile premiums. Generally, as is in this case, a decrease in unearned premium directly relates to a decrease in written premium on a rolling twelve-month basis. Competition could negatively affect our unearned premium.

### Premium Deposits and Customer Credit Balances

Premium deposits and customer credit balances increased \$0.4 million, or 15.8%, to \$2.5 million as of September 30, 2010, compared with \$2.1 million as of December 31, 2009. Premium deposits are monies received on policies not yet in-force as of September 30, 2010.

### Bank Overdraft

Bank overdraft decreased \$2.2 million, or 26.7%, to \$6.1 million as of September 30, 2010, compared with \$8.3 million as of December 31, 2009. The bank overdraft relates primarily to losses and LAE disbursements paid but not

presented for payment by the policyholder or vendor. The change relates to our payment patterns in relationship to the rate at which those cash disbursements are presented to the bank for payment.

#### Deferred Gain from Sale of Property

Deferred gain from sale of property decreased \$0.4 million, or 37.1%, to \$0.6 million as of September 30, 2010, compared with \$1.0 million as of December 31, 2009. As required by FASB guidance, we are amortizing the deferred gain over the term of the leaseback, which is scheduled to end in December 2011.

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### Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses decreased \$1.5 million, or 57.9%, to \$1.1 million as of September 30, 2010, compared with \$2.6 million as of December 31, 2009.

### Results of Operations

Three Months Ended September 30, 2010 Compared with Three Months Ended September 30, 2009

### Gross Premiums Written

Gross premiums written increased \$4.8 million, or 37.0%, to \$17.7 million for the three months ended September 30, 2010, compared with \$12.9 million for the three months ended September 30, 2009. The following table denotes gross premiums written by major product line. This increase reflected primarily an increase in the sale of homeowners' policies.

|                              | Three Months Ended September 30,<br>2010 |            | 2009      |            |
|------------------------------|--|------------|-----------|------------|
|                              | Amount                                   | Percentage | Amount    | Percentage |
| Homeowners'                  | \$ 12,860                                | 72.67%     | \$ 7,815  | 60.51%     |
| Commercial General Liability | 3,075                                    | 17.37%     | 4,072     | 31.52%     |
| Federal Flood                | 1,239                                    | 7.00%      | 983       | 7.61%      |
| Automobile                   | 524                                      | 2.96%      | 47        | 0.36%      |
| Gross written premiums       | \$ 17,698                                | 100.00%    | \$ 12,917 | 100.00%    |

On September 30, 2009, Federated National announced it received approval from the Florida OIR for a premium rate increase for its voluntary homeowners' program within the state of Florida. The premium rate increase, which averaged approximately 19%, was deployed on policies with effective dates of November 1, 2009 and December 1, 2009, for new and renewals, respectively.

On April 16, 2010, Federated National announced it received approval from the Florida OIR for a premium rate increase for its assumed homeowners' program from Citizens within the state of Florida. The premium rate increase, which averaged approximately 15%, was implemented on Citizens take-out policies only with an effective date of July 1, 2010.

We continue to offer premium discounts for wind mitigation efforts by policyholders, as required by Florida law. These discounts have had a significant effect on both written and earned premium. Wind mitigation credits are 25.8% of the pre-credit premium, or \$26.4 million, as of September 30, 2010, as compared with 27.7% of the pre-credit premium, or \$23.6 million, as of September 30, 2009.

During the three months ended September 30, 2010 and 2009, the change to the cumulative wind mitigation credits afforded our policyholders totaled (\$0.6) million and \$0.3 million, respectively. As of September 30, 2010, 59.5% of our in-force homeowners' policyholders were receiving wind mitigation credits totaling approximately \$26.4 million (a 25.8% reduction of in-force premium), while 62.2% of our in-force homeowners' policyholders were receiving wind

mitigation credits totaling approximately \$23.6 million, (a 27.7 % reduction of in-force premium), as of September 30, 2009.

The Company's increase in the sale of homeowners' policies by \$5.1 million, or 64.6%, to \$12.9 million for the three months ended September 30, 2010, compared with \$7.8 million for the three months ended September 30, 2009 is gross of reinsurance costs and net of Florida's mandated homeowners' wind mitigation discounts. Our number of in-force homeowners' policies increased by approximately 7,400, or 20.9%, to approximately 43,000 as of September 30, 2010, as compared with approximately 35,600 as of September 30, 2009.

We are required to report write-your-own flood premiums on a direct and 100% ceded basis.

Federated National and American Vehicle are currently rated by Demotech, Inc. ("Demotech") as "A" ("Exceptional"), which is the third of seven ratings, and defined as "Regardless of the severity of a general economic downturn or deterioration in the insurance cycle, insurers earning a Financial Stability Rating ("FSR") of "A" possess "Exceptional" financial stability related to maintaining surplus as regards to policyholders". Demotech's ratings are based upon factors of concern to agents, reinsurers and policyholders and are not primarily directed toward the protection of investors. Our Demotech rating could be jeopardized by factors including adverse development and various surplus related ratio exceptions. On March 31, 2010, Demotech reaffirmed Federated National's FSR of "A" ("Exceptional") subject to a \$10.0 million infusion of capital into Federated National.

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This infusion was completed effective March 31, 2010 and was in the form of a \$5.0 million capital contribution from the Company and a \$5.0 million loan from American Vehicle to Federated National evidenced by a \$5.0 million subordinated surplus debenture due from Federated National to American Vehicle. The capital infusion was approved by the Florida OIR. In a subsequent letter dated August 31, 2010, Demotech affirmed the company's current FSR of A. The withdrawal of our ratings could limit or prevent us from writing or renewing desirable insurance policies, from competing with insurers who have higher ratings, and from obtaining adequate reinsurance, or from borrowing on a line of credit. The withdrawal of our ratings could have a material adverse effect on the Company's results of operations and financial position because the Company's insurance products might no longer be acceptable to the secondary marketplace and mortgage lenders. Furthermore, a withdrawal of our ratings could prevent independent agents from selling and servicing our insurance products.

The Company's sale of commercial general liability policies decreased by \$1.0 million to \$3.1 million for the three months ended September 30, 2010, compared with \$4.1 million for the three months ended September 30, 2009. The primary factor for this decrease has been the slowdown in the economy, which had a dramatic impact on the artisan contractor portfolio written by American Vehicle. An additional factor is our decision to restrict underwriting authority within specific commercial general liability classes and geographic areas.

The following table sets forth the amounts and percentages of our gross premiums written in connection with our commercial general liability program by state.

| State      | Three Months Ended September 30,<br>2010 |            | 2009     |            |
|------------|--|------------|----------|------------|
|            | Amount                                   | Percentage | Amount   | Percentage |
|            | (Dollars in Thousands)                   |            |          |            |
| Alabama    | \$ 6                                     | 0.20%      | \$ 11    | 0.27%      |
| Arkansas   | -  | 0.00%      | 1        | 0.02%      |
| California | 21                                       | 0.68%      | -        | 0.00%      |
| Florida    | 2,654                                    | 86.31%     | 3,584    | 88.03%     |
| Georgia    | 17                                       | 0.55%      | 76       | 1.87%      |
| Louisiana  | 208                                      | 6.76%      | 199      | 4.89%      |
| Oklahoma   | 4  | 0.13%      | -        | 0.00%      |
| Texas      | 163                                      | 5.30%      | 201      | 4.92%      |
| Virginia   | 2  | 0.07%      | -        | 0.00%      |
| Total      | \$ 3,075                                 | 100.00%    | \$ 4,072 | 100.00%    |

The Company's sale of auto insurance policies increased to \$0.5 million for the three months ended September 30, 2010, compared with less than \$0.1 million for the three months ended September 30, 2009. The Company's sale of auto insurance included new and renewal policies during the three months ended September 30, 2010, but was limited to renewal policies during the three months ended September 30, 2009.

#### Gross Premiums Ceded

Gross premiums ceded decreased to \$29.5 million for the three months ended September 30, 2010, compared with \$36.8 million for the three months ended September 30, 2009, due to our decreased cost of reinsurance. Gross premiums ceded to the Florida Hurricane Catastrophe Fund ("FHCF") totaled \$28.2 million, gross premiums ceded to

the write-your-own flood program totaled \$1.2 million and gross premiums ceded relating to our commercial automobile program totaled less than \$0.1 million for the three months ended September 30, 2010.

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#### Increase in Prepaid Reinsurance Premiums

The increase in prepaid reinsurance premiums was \$16.2 million for the three months ended September 30, 2010, compared with \$22.3 million for the three months ended September 30, 2009. The decreased charge to written premium is associated with our decreased cost of reinsurance and the timing of our reinsurance payments measured against the term of the underlying reinsurance policies.

#### Decrease in Unearned Premiums

The decrease in unearned premiums was \$7.3 million for the three months ended September 30, 2010, compared with \$11.1 million for the three months ended September 30, 2009. The change was due to a \$6.9 million decrease in unearned homeowners' insurance premiums, a \$0.2 million decrease in unearned commercial general liability premiums, a \$0.4 million decrease in unearned automobile premiums, net of a \$0.2 million increase in unearned flood premiums during the three months ended September 30, 2010. These changes are a result of differences in written premium volume during this period as compared with the same period last year. See "Gross Premiums Written" above.

#### Net Premiums Earned

Net premiums earned increased \$2.1 million, or 22.2%, to \$11.6 million for the three months ended September 30, 2010, compared with \$9.5 million for the three months ended September 30, 2009.

The following table denotes net premiums earned by product line.

|                              | Three Months Ended September 30, |            | 2009     |            |
|------------------------------|----------------------------------|------------|----------|------------|
|                              | 2010                             |            | 2009     |            |
|                              | Amount                           | Percentage | Amount   | Percentage |
|                              | (Dollars in Thousands)           |            |          |            |
| Homeowners'                  | \$ 7,912                         | 68.08%     | \$ 4,861 | 51.11%     |
| Commercial General Liability | 3,271                            | 28.15%     | 4,587    | 48.23%     |
| Automobile                   | 438                              | 3.77%      | 63       | 0.66%      |
| Net premiums earned          | \$ 11,621                        | 100.00%    | \$ 9,511 | 100.00%    |

The change in homeowners' net premiums earned is due to a \$5.0 million increase in gross written premium as discussed, a \$7.6 million decrease in gross premiums ceded and a \$9.6 million decrease in the net change to prepaid reinsurance premiums and unearned premium.

The change in commercial general liability net premiums earned is a result of a \$1.0 million decrease in gross written premium, reflecting the impact of the economic slowdown on the artisan contractor portfolio written by American Vehicle and our decision to restrict underwriting authority within specific commercial general liability classes and geographic areas. The change is also a result of a \$0.3 million decrease in the net change to unearned premium.

The change in automobile net premiums earned is a result of a \$0.5 million increase in gross written premium as discussed, a \$0.1 million decrease in gross premiums ceded and a less than \$0.1 million decrease in the change to unearned premium.

Commission Income

Commission income increased \$0.3 million, or 240.2%, to \$0.4 million for the three months ended September 30, 2010, compared with \$0.1 million for the three months ended September 30, 2009. The primary sources of our commission income are our managing general agent services, write-your-own flood premiums and our independent insurance agency, Insure-Link.

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### Net Investment Income

Net investment income remained unchanged at \$0.9 million for the three months ended September 30, 2010, compared with \$0.9 million for three months ended September 30, 2009. Our investment yield, net and gross of investment expenses, excluding equities and including cash, were 2.2% and 2.5%, respectively, for the three months ended September 30, 2010. Our investment yield, net and gross of investment expenses, excluding equities and including cash, were 2.2% and 2.4%, respectively, for the three months ended September 30, 2009.

Our investment yield, net and gross of investment expenses measured against debt securities, excluding equities and cash, were 3.2% and 3.5%, respectively, for the three months ended September 30, 2010. Our investment yield, net and gross of investment expenses measured against debt securities, excluding equities and cash, were 3.3% and 3.6%, respectively, for the three months ended September 30, 2009.

See also "Analysis of Financial Condition As of September 30, 2010 Compared with December 31, 2009 – Investments" for a further discussion on our investment portfolio.

### Net Realized Investment Gains

Net realized investment gains were \$1.9 million for the three months ended September 30, 2010, compared with \$1.6 million for the three months ended September 30, 2009. Realized investment gains recognized for the three months ended September 30, 2010 were higher in 2010 than in 2009 because of an overweight in corporate bonds, which have performed well during 2010, and were sold to lock in gains and bolster surplus.

During the three months ended September 30, 2010 and 2009, we did not mark any equity investments to market value pursuant to guidelines prescribed in FASB-issued guidance. In reaching a conclusion that a security is either other than temporarily or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as Standard and Poor's and Moody's, as well as information released via the general media channels.

The table below depicts the net realized investment gains by investment category during the three months ended September 30, 2010 and 2009.

|  | Three Months Ended September 30, |                 |
|--|----------------------------------|-----------------|
|  | 2010                             | 2009            |
|  | (Dollars in Thousands)           |                 |
| <b>Realized gains:</b>                   |                                  |                 |
| Debt securities                          | \$ 2,201                         | \$ 194          |
| Equity securities                        | 194                              | 1,943           |
| <b>Total realized gains</b>              | <b>2,395</b>                     | <b>2,137</b>    |
| <b>Realized losses:</b>                  |                                  |                 |
| Debt securities                          | (19)                             | (441)           |
| Equity securities                        | (512)                            | (146)           |
| <b>Total realized losses</b>             | <b>(531)</b>                     | <b>(587)</b>    |
| <b>Net realized gains on investments</b> | <b>\$ 1,864</b>                  | <b>\$ 1,550</b> |

Other Income

Other income decreased \$.01 million, or 41.9%, to \$0.1 million for the three months ended September 30, 2010, compared with \$0.2 million for the three months ended September 30, 2009. The major component of other income for the three months ended September 30, 2010 is approximately \$0.1 million in partial recognition of our gain on the sale of our Lauderdale Lakes property.

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### Losses and LAE

Losses and LAE, our most significant expense, represent actual payments made and changes in estimated future payments to be made to or on behalf of our policyholders, including expenses required to settle claims and losses. We revise our estimates based on the results of analysis of estimated future payments to be made. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events.

Losses and LAE decreased by \$2.4 million, or 22.0%, to \$8.7 million for the three months ended September 30, 2010, compared with \$11.1 million for the three months ended September 30, 2009. The overall change includes a \$1.4 million decrease in our homeowners' program and a \$2.1 million decrease in our commercial general liability program; these decreases are due to favorable experience in these markets based in part on enhanced underwriting and claim processing techniques. The overall increase also includes a \$1.1 million increase in connection with our re-launched automobile program which has experienced adverse development in its' initial phase.

We continue to revise our estimates of the ultimate financial impact of claims made resulting from past storms. The revisions to our estimates are based on our analysis of subsequent information that we receive regarding various factors, including: (i) per claim information; (ii) Company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and (iv) trends in general economic conditions, including the effects of inflation.

The composition of unpaid losses and LAE by product line is as follows.

|                              | September 30, 2010     |           |           | December 31, 2009      |           |           |
|------------------------------|------------------------|-----------|-----------|------------------------|-----------|-----------|
|                              | Case                   | Bulk      | Total     | Case                   | Bulk      | Total     |
|                              | (Dollars in Thousands) |           |           | (Dollars in Thousands) |           |           |
| Homeowners'                  | \$ 6,987               | \$ 14,728 | \$ 21,715 | \$ 8,705               | \$ 19,298 | \$ 28,003 |
| Commercial General Liability | 7,781                  | 27,230    | 35,011    | 7,885                  | 29,346    | 37,231    |
| Automobile                   | 3,481                  | 3,248     | 6,729     | 2,612                  | 2,765     | 5,377     |
| Total                        | \$ 18,249              | \$ 45,206 | \$ 63,455 | \$ 19,202              | \$ 51,409 | \$ 70,611 |

Factors that affect unpaid losses and LAE include the estimates made on a claim-by-claim basis known as "case reserves" coupled with bulk estimates known as IBNR. Periodic estimates by management of the ultimate costs required to settle all claim files are based on the Company's analysis of historical data and estimations of the impact of numerous factors such as (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation.

Management revises its estimates based on the results of its analysis. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors. Because of our process, reserves were decreased by approximately \$7.2 million during the three months ended September 30, 2010. This overall change includes a \$6.3 million decrease in our homeowners' program and a \$2.2 million decrease in our commercial general liability program; these decreases are due to favorable experience in these markets based in

part on enhanced underwriting and claim processing techniques. The overall increase also includes a \$1.3 million increase in connection with our re-launched automobile program which has experienced adverse development in its' initial phase.

In accordance with GAAP and for the reasons discussed above, our loss ratio is computed as losses and LAE divided by net premiums earned. A lower loss ratio generally results in higher operating income. Our loss ratio for the three-month period ended September 30, 2010 was 73.6% compared with 118.7% for the same period in 2009.

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The table below reflects the loss ratios by product line.

|                              | Three Months Ended September 30, |         |
|------------------------------|----------------------------------|---------|
|                              | 2010                             | 2009    |
| Homeowners'                  | 84.74%                           | 156.40% |
| Commercial General Liability | 38.48%                           | 80.80%  |
| Automobile                   | 222.10%                          | -68.80% |
| Fire                         | 12.29%                           | 0.00%   |
| Inland Marine                | 33.57%                           | 0.00%   |
| All lines                    | 74.60%                           | 116.91% |

#### Operating and Underwriting Expenses

Operating and underwriting expenses remained unchanged at \$2.5 million for the three months ended September 30, 2010, compared with \$2.5 million for the three months ended September 30, 2009.

#### Salaries and Wages

Salaries and wages increased \$0.1 million, or 9.5%, to \$2.1 million for the three months ended September 30, 2010, compared with \$2.0 million for the three months ended September 30, 2009. The increase is due to staffing for additional lines of business.

The charge to operations for stock-based compensation, in accordance with FASB guidance, remained unchanged at approximately \$0.1 million during the three months ended September 30, 2010 compared with approximately \$0.1 million for the three months ended September 30, 2009.

#### Policy Acquisition Costs - Amortization

Policy acquisition costs - amortization, increased \$0.1 million, or 2.5%, to \$3.9 million for the three months ended September 30, 2010, compared with \$3.8 million for the three months ended September 30, 2009.

Policy acquisition costs - amortization, consists of the actual policy acquisition costs, including commissions, payroll and premium taxes, less commissions earned on reinsurance ceded and policy fees earned.

#### Income Tax Benefit

The income tax benefit was \$0.5 million for the three months ended September 30, 2010, compared with \$2.4 million for the three months ended September 30, 2009. The effective rate for income taxes was 29.2% for the three months ended September 30, 2010 and 37.6% for the three months ended September 30, 2009.

#### Net Loss

As a result of the foregoing, the Company's net loss for the three months ended September 30, 2010 was \$1.3 million compared with \$4.0 million for the three months ended September 30, 2009.



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## Results of Operations

Nine Months Ended September 30, 2010 Compared with Nine Months Ended September 30, 2009

## Gross Premiums Written

Gross premiums written decreased \$2.6 million, or 3.5%, to \$72.3 million for the nine months ended September 30, 2010, compared with \$74.9 million for the nine months ended September 30, 2009. The following table denotes gross premiums written by major product line. This decline reflected primarily decreases in the sale of homeowners' and commercial general liability policies, offset by an increase in the sale of automobile policies, as described below.

|                              | Nine Months Ended September 30, |            |           |            |
|------------------------------|---------------------------------|------------|-----------|------------|
|                              | 2010                            |            | 2009      |            |
|                              | (Dollars in Thousands)          |            |           |            |
|                              | Amount                          | Percentage | Amount    | Percentage |
| Homeowners'                  | \$ 56,164                       | 77.66%     | \$ 59,503 | 79.40%     |
| Commercial General Liability | 9,814                           | 13.57%     | 12,490    | 16.66%     |
| Federal Flood                | 3,101                           | 4.29%      | 2,737     | 3.65%      |
| Automobile                   | 3,238                           | 4.48%      | 219       | 0.29%      |
| Gross written premiums       | \$ 72,317                       | 100.00%    | \$ 74,949 | 100.00%    |

See "Results of Operations-Three Months Ended September 30, 2010" for a discussion of our recently approved rate increases.

We continue to offer premium discounts for wind mitigation efforts by policyholders, as required by Florida law. These discounts have had a significant effect on both written and earned premium. Wind mitigation credits are 25.8% of the pre-credit premium, or \$26.4 million, as of September 30, 2010, as compared with 27.7% of the pre-credit premium, or \$23.6 million, as of September 30, 2009.

During the nine months ended September 30, 2010 and 2009, the change to the cumulative wind mitigation credits afforded our policyholders totaled (\$1.2) million and \$5.8 million, respectively. As of September 30, 2010, 59.5% of our in-force homeowners' policyholders were receiving wind mitigation credits totaling approximately \$26.4 million (a 25.8% reduction of in-force premium), while 62.2 % of our in-force homeowners' policyholders were receiving wind mitigation credits totaling approximately \$23.6 million (a 27.7 % reduction of in-force premium), as of September 30, 2009.

Due in part to Florida's mandated homeowners' wind mitigation discounts, the Company's sale of homeowners' policies decreased \$3.3 million, or 5.6%, to \$56.2 million for the nine months ended September 30, 2010, compared with \$59.5 million for the nine months ended September 30, 2009, gross of reinsurance costs. Our number of in-force homeowners' policies decreased by approximately 9,600, or 18.3%, to approximately 43,000 as of September 30, 2010, as compared with approximately 52,600 as of December 31, 2009.

See "Results of Operations-Three Months Ended September 30, 2010" for a description of Federated National's capital infusion and Demotech rating.

The Company's sale of commercial general liability policies decreased by \$2.7 million to \$9.8 million for the nine months ended September 30, 2010, compared with \$12.5 million for the nine months ended September 30, 2009. The primary factor for this decrease has been the slowdown in the economy, which had a dramatic impact on the artisan contractor portfolio written by American Vehicle. An additional factor is our decision to restrict underwriting authority within specific commercial general liability classes and geographic areas.

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The following table sets forth the amounts and percentages of our gross premiums written in connection with our commercial general liability program by state.

| State                  | Nine Months Ended September 30,<br>2010 |                | 2009             |                |
|------------------------|---|----------------|------------------|----------------|
|                        | Amount                                  | Percentage     | Amount           | Percentage     |
| (Dollars in Thousands) |   |                |                  |                |
| Alabama                | \$ 35                                   | 0.36%          | \$ 58            | 0.46%          |
| Arkansas               | 1                                       | 0.01%          | 4                | 0.03%          |
| California             | 28                                      | 0.29%          | 51               | 0.41%          |
| Florida                | 8,212                                   | 83.67%         | 10,041           | 80.39%         |
| Georgia                | 66                                      | 0.67%          | 230              | 1.84%          |
| Kentucky               | -                                       | 0.00%          | 1                | 0.01%          |
| Louisiana              | 894                                     | 9.11%          | 1,426            | 11.42%         |
| Oklahoma               | 8                                       | 0.08%          | -                | 0.00%          |
| South Carolina         | 1                                       | 0.01%          | 2                | 0.02%          |
| Texas                  | 567                                     | 5.78%          | 676              | 5.41%          |
| Virginia               | 2                                       | 0.02%          | 1                | 0.01%          |
| <b>Total</b>           | <b>\$ 9,814</b>                         | <b>100.00%</b> | <b>\$ 12,490</b> | <b>100.00%</b> |

The Company's sale of auto insurance policies increased by \$3.0 million to \$3.2 million for the nine months ended September 30, 2010, compared with \$0.2 million for the nine months ended September 30, 2009. The Company's sale of auto insurance included new and renewal policies during the nine months ended September 30, 2010, but was limited to renewal policies during the nine months ended September 30, 2009.

#### Gross Premiums Ceded

Gross premiums ceded decreased to \$51.4 million for the nine months ended September 30, 2010, compared with \$56.7 million for the nine months ended September 30, 2009, due to our decreased cost of reinsurance. Gross premiums ceded to the FHCF totaled \$46.7 million, gross premiums ceded to the write-your-own flood program totaled \$3.1 million and gross premiums ceded relating to our commercial automobile program totaled \$1.6 for the nine months ended September 30, 2010.

#### Increase in Prepaid Reinsurance Premiums

The increase in prepaid reinsurance premiums was \$9.6 million for the nine months ended September 30, 2010, compared with \$24.5 million for the nine months ended September 30, 2009. The increased charge to written premium is primarily associated with the timing of our reinsurance payments measured against the term of the underlying reinsurance policies.

#### Decrease (Increase) in Unearned Premiums

The decrease in unearned premiums was \$3.0 million for the nine months ended September 30, 2010, compared with an increase of \$5.1 million for the nine months ended September 30, 2009. The change was due to a \$3.9 million decrease in unearned homeowners' insurance premiums, a \$0.5 million decrease in unearned commercial general

liability premiums, and a \$1.1 million increase in unearned automobile premiums, net of a \$0.3 million increase in unearned flood premiums during the nine months ended September 30, 2010. These changes are a result of differences in written premium volume during this period as compared with the same period last year. See “Gross Premiums Written” discussion above.

#### Net Premiums Earned

Net premiums earned decreased \$4.2 million, or 11.0%, to \$33.5 million for the nine months ended September 30, 2010, compared with \$37.7 million for the nine months ended September 30, 2009.

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The following table denotes net premiums earned by product line.

|                              | Nine Months Ended September 30, |            |           |            |
|------------------------------|---------------------------------|------------|-----------|------------|
|                              | 2010                            |            | 2009      |            |
|                              | Amount                          | Percentage | Amount    | Percentage |
|                              | (Dollars in Thousands)          |            |           |            |
| Homeowners'                  | \$ 21,977                       | 65.54%     | \$ 22,375 | 59.38%     |
| Commercial General Liability | 10,244                          | 30.56%     | 15,091    | 40.05%     |
| Automobile                   | 1,307                           | 3.90%      | 214       | 0.57%      |
| Net premiums earned          | \$ 33,528                       | 100.00%    | \$ 37,680 | 100.00%    |

The change in homeowners' net premiums earned is due to a \$3.3 million decrease in gross written premium as discussed, a \$7.2 million decrease in gross premiums ceded and a \$4.3 million decrease in the net change to prepaid reinsurance premiums and unearned premium.

The change in commercial general liability net premiums earned is due to a \$2.7 million decrease in gross written premium, reflecting the impact of the economic slowdown on the artisan contractor portfolio written by American Vehicle and our decision to restrict underwriting authority within specific commercial general liability classes and geographic areas. The change is also a result of a \$2.2 million decrease in the net change to unearned premium.

The change in automobile net premiums earned is a result of a \$3.0 million increase in gross written premium as discussed, a \$1.5 million increase in gross premiums ceded and a \$0.4 million increase in the change to unearned premium.

#### Commission Income

Commission income increased \$0.6 million, or 81.9%, to \$1.3 million for the nine months ended September 30, 2010, compared with \$0.7 million for the nine months ended September 30, 2009. The primary sources of our commission income are our managing general agent services, write-your-own flood premiums and our independent insurance agency, Insure-Link.

#### Net Investment Income

Net investment income increased \$0.5 million, or 20.2%, to \$2.9 million for the nine months ended September 30, 2010, compared with \$2.4 million for nine months ended September 30, 2009. Our investment yield, net and gross of investment expenses, excluding equities and including cash, were 2.6% and 2.8%, respectively, for the nine months ended September 30, 2010. Our investment yield, net and gross of investment expenses, excluding equities and including cash, were 1.9% and 2.0%, respectively, for the nine months ended September 30, 2009.

Our investment yield, net and gross of investment expenses measured against debt securities, excluding equities and cash, were 3.6% and 3.9%, respectively, for the nine months ended September 30, 2010. Our investment yield, net and gross of investment expenses measured against debt securities, excluding equities and cash, were 3.6% and 3.7%, respectively, for the nine months ended September 30, 2009.

See also “Analysis of Financial Condition As of September 30, 2010 Compared with December 31, 2009 – Investments” for a further discussion of our investment portfolio.

#### Net Realized Investment Gains

Net realized investment gains were \$5.7 million for the nine months ended September 30, 2010, compared with \$1.1 million for the nine months ended September 30, 2009. Realized investment gains recognized for the nine months ended September 30, 2010 were higher in 2010 than in 2009 because of an overweight in corporate bonds, which have performed well during 2010, and were sold to lock in gains and bolster surplus.

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During the nine months ended September 30, 2010 and 2009, we did not mark any equity investments to market value pursuant to guidelines prescribed by FASB. See "Results of Operations-Three Months Ended September 30, 2010" for a discussion of the factors we consider when determining the need to mark investments to market value.

The table below depicts the net realized investment gains (losses) by investment category during the nine months ended September 30, 2010 and 2009.

|  | Nine Months Ended September 30, |                 |
|--|---------------------------------|-----------------|
|  | 2010                            | 2009            |
|  | (Dollars in Thousands)          |                 |
| <b>Realized gains:</b>                   |                                 |                 |
| Debt securities                          | \$ 4,068                        | \$ 212          |
| Equity securities                        | 2,856                           | 1,942           |
| <b>Total realized gains</b>              | <b>6,924</b>                    | <b>2,154</b>    |
| <b>Realized losses:</b>                  |                                 |                 |
| Debt securities                          | (59)                            | (669)           |
| Equity securities                        | (1,177)                         | (403)           |
| <b>Total realized losses</b>             | <b>(1,236)</b>                  | <b>(1,072)</b>  |
| <b>Net realized gains on investments</b> | <b>\$ 5,688</b>                 | <b>\$ 1,082</b> |

#### Regulatory Assessments Recovered

Regulatory assessments recovered decreased \$1.3 million, or 66.4%, to \$0.7 million for the nine months ended September 30, 2010, compared with \$2.0 million for the nine months ended September 30, 2009. The unfavorable prior year variance is due to the exhaustion of the FIGA3 recovery, overall reduction of recovery rates and refund of prior year over-collections. The FIGA3 recovery was completed during 2009; there has been no recovery during 2010. The Florida OIR has approved lesser rates of recovery for the remaining assessments. Therefore, a lesser recovery is being realized during 2010. Prior year over-collections have been refunded and the amounts reported for 2010 are net of these refunds.

#### Other Income

Other income increased \$0.1 million, or 6.4%, to \$0.7 million for the nine months ended September 30, 2010, compared with \$0.6 million for the nine months ended September 30, 2009.

The major components of other income for the nine months ended September 30, 2010 include approximately \$0.4 million in partial recognition of our gain on the sale of our Lauderdale Lakes property and \$0.2 million in recognition of our gain on the sale of a vacant retail property.

#### Losses and LAE

Losses and LAE decreased by \$1.1 million, or 3.6%, to \$27.9 million for the nine months ended September 30, 2010, compared with \$29.0 million for the nine months ended September 30, 2009. The overall change includes a \$1.3 million increase in our homeowners' program, a \$4.6 million decrease in our commercial general liability program and a \$2.2 million increase in connection with our automobile program. See "Results of Operations-Three Months Ended

September 30, 2010” for a further explanation of losses and LAE.

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The composition of unpaid losses and LAE by product line is as follows.

|                              | September 30, 2010     |           |           | December 31, 2009      |           |           |
|------------------------------|------------------------|-----------|-----------|------------------------|-----------|-----------|
|                              | Case                   | Bulk      | Total     | Case                   | Bulk      | Total     |
|                              | (Dollars in Thousands) |           |           | (Dollars in Thousands) |           |           |
| Homeowners'                  | \$ 6,987               | \$ 14,728 | \$ 21,715 | \$ 8,705               | \$ 19,298 | \$ 28,003 |
| Commercial General Liability | 7,781                  | 27,230    | 35,011    | 7,885                  | 29,346    | 37,231    |
| Automobile                   | 3,481                  | 3,248     | 6,729     | 2,612                  | 2,765     | 5,377     |
| Total                        | \$ 18,249              | \$ 45,206 | \$ 63,455 | \$ 19,202              | \$ 51,409 | \$ 70,611 |

Reserves for unpaid losses and LAE decreased by approximately \$7.1 million during the nine months ended September 30, 2010, as a result of our process of estimating claims. See "Results of Operations-Three Months Ended September 30, 2010" for a further explanation of losses and LAE.

Our loss ratio for the nine-month period ended September 30, 2010 was 82.4% compared with 77.2% for the same period in 2009.

The table below reflects the loss ratios by product line.

|                              | Nine Months Ended September 30, |        |
|------------------------------|---------------------------------|--------|
|                              | 2010                            | 2009   |
| Homeowners'                  | 92.50%                          | 84.00% |
| Commercial General Liability | 55.87%                          | 68.50% |
| Automobile                   | 180.16%                         | -7.30% |
| Fire                         | 13.92%                          | 0.00%  |
| Inland Marine                | 42.60%                          | 0.00%  |
| All lines                    | 83.30%                          | 76.87% |

#### Operating and Underwriting Expenses

Operating and underwriting expenses increased \$1.3 million, or 18.9%, to \$8.3 million for the nine months ended September 30, 2010, compared with \$7.0 million for the nine months ended September 30, 2009. The change is primarily due to \$0.2 million increases in consulting fees, surveys and underwriting reports, actuarial fees and licenses and fees, and immaterial increases in other expenses.

#### Salaries and Wages

Salaries and wages increased \$0.6 million, or 10.9%, to \$6.4 million for the nine months ended September 30, 2010, compared with \$5.8 million for the nine months ended September 30, 2009. The increase is due to staffing for additional lines of business.

The charge to operations for stock-based compensation, in accordance with FASB guidance, was approximately \$297,000 during the nine months ended September 30, 2010 compared with approximately \$326,000 for the nine months ended September 30, 2009.

Policy Acquisition Costs - Amortization

Policy acquisition costs - amortization, increased \$0.9 million, or 9.8%, to \$10.4 million for the nine months ended September 30, 2010, compared with \$9.5 million for the nine months ended September 30, 2009.

Policy acquisition costs - amortization, consists of the actual policy acquisition costs, including commissions, payroll and premium taxes, less commissions earned on reinsurance ceded and policy fees earned.

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The increase to policy acquisition costs, net of amortization, is due to increased commissions related to our automobile program, offset by decreased commissions related to our homeowners' and commercial general liability programs. These changes to commissions are due to related changes in gross written premium.

#### Income Tax Benefit

The income tax benefit was \$2.2 million for the nine months ended September 30, 2010, compared with an income tax benefit of \$2.3 million for the nine months ended September 30, 2009. The effective rate for income taxes was 32.3% for the nine months ended September 30, 2010. The 43.9% effective rate for income taxes for the nine months ended September 30, 2009 was primarily due to our tax-exempt interest and dividend received deduction.

#### Net Loss

As a result of the foregoing, the Company's net loss for the nine months ended September 30, 2010 was \$4.5 million compared with a net loss of \$2.9 million for the nine months ended September 30, 2009.

#### Liquidity and Capital Resources

During the nine months ended September 30, 2010, our primary sources of capital included proceeds from the sale of investment securities, decreased prepaid reinsurance premiums, decreased reinsurance recoverable, net, decreased income taxes recoverable, decreased premiums receivable, decreased other assets and amortization of investment premium. Additional sources of capital included decreased policy acquisition costs, net of amortization, increased premium deposits and customer credit balances, non-cash compensation, depreciation and amortization and a tax benefit related to non-cash compensation.

During the nine months ended September 30, 2010, operations used net operating cash flow of \$0.2 million, compared with having provided net operating cash flow of \$2.2 million for the nine months ended September 30, 2009.

During the nine months ended September 30, 2010, operations generated \$24.5 million of gross cash flow, due to a \$7.0 million decrease in prepaid reinsurance premiums, a \$5.1 million decrease in reinsurance recoverable, net, a \$4.8 million decrease in income taxes recoverable, a \$4.6 million decrease in premiums receivable and a \$1.0 million decrease in other assets. Additional sources of cash included \$0.7 million of amortization of investment premium, a \$0.6 million decrease in policy acquisition costs, net of amortization, a \$0.3 million increase in premium deposits and customer credit balances, \$0.2 million of non-cash compensation and \$0.2 million of depreciation and amortization.

During the nine months ended September 30, 2010, operations used \$24.7 million of gross cash flow, due to a \$7.3 million decrease in unpaid losses and LAE, \$5.7 million net realized investment gains and a \$3.0 million decrease in unearned premiums. Additional uses of cash included a \$2.2 million decrease in bank overdraft, a \$1.5 million decrease in accounts payable and accrued expenses and a \$0.5 million increase in deferred income tax expense, all in conjunction with a \$4.5 million net loss.

During the nine months ended September 30, 2010, net cash provided by investing activities was \$6.9 million, compared with net cash used by investing activities of \$77.3 million during the nine months ended September 30, 2009. Our available-for-sale investment portfolio is highly liquid as it consists entirely of readily marketable securities. During the nine months ended September 30, 2010, investing activities generated \$111.8 million and used \$104.9 million.

During the nine months ended September 30, 2010, net financing activities used \$0.4 million, as compared with \$1.3 million during the nine months ended September 30, 2009. In 2010, the sources of cash in connection with financing activities included a \$0.1 million tax benefit related to non-cash compensation. The uses of cash in connection with financing activities included \$0.5 million in dividends paid.

In response to the capital infusion from American Vehicle, the Florida OIR has required that the Company not expend capital on the payment of dividends or the buyback of the Company's common stock until Federated National experiences two consecutive quarters with an underwriting profit. Please see "Results of Operations—Nine Months Ended September 30, 2010 Compared with Nine Months Ended September 30, 2009—Gross Premiums Written".

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We offer direct billing in connection with our automobile and homeowner programs. Direct billing is an agreement in which the insurance company accepts from the insured, as a receivable, a promise to pay the premium, as opposed to requiring the full amount of the policy at policy inception, either directly from the insured or from a premium finance company. The advantage of direct billing a policyholder by the insurance company is that we are not reliant on a credit facility, but remain able to charge and collect interest from the policyholder.

We believe that our current capital resources will be sufficient to meet currently anticipated working capital requirements. There can be no assurances, however, that such will be the case.

As of September 30, 2010, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as "structured finance" or "special purpose" entities, which were established for the purpose of facilitating off-balance-sheet arrangements or other contractually narrow or limited purposes. As such, management believes that we currently are not exposed to any financing, liquidity, market or credit risks that could arise if we had engaged in transactions of that type requiring disclosure herein.

#### Impact of Inflation and Changing Prices

The consolidated financial statements and related data presented herein have been prepared in accordance with GAAP, which requires 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 and liabilities are monetary in nature. As a result, interest rates have a more significant impact on performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the inflationary effect on the cost of paying losses and LAE.

Insurance premiums are established before we know the amount of losses 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 premiums, we may be limited in raising 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 that result in prolonged and increasing levels of inflation could cause increases in the dollar amount of incurred losses and LAE and thereby materially adversely affect future liability requirements.

## 21st Century Holding Company

## Item 3

## Quantitative and Qualitative Disclosures about Market Risk

Our investment objective is to maximize total rate of return after federal income taxes while maintaining liquidity and minimizing risk. Our current investment policy limits investment in non-investment-grade debt securities (including high-yield bonds), and limits total investments in preferred stock, common stock and mortgage notes receivable. We also comply with applicable laws and regulations that further restrict the type, quality and concentration of our investments. In general, these laws and regulations permit investments, within specified limits and subject to certain qualifications, in federal, state and municipal obligations, corporate bonds, preferred and common equity securities and real estate mortgages.

Our investment policy is established by our Board's Investment Committee and is reviewed on a regular basis. Pursuant to this investment policy, as of September 30, 2010, approximately 87% of investments were in debt securities and cash and cash equivalents, which are considered to be either held until maturity or available for sale, based upon our estimates of required liquidity. Approximately 94% of the debt securities are considered available for sale and are marked to market. We may in the future consider additional debt securities to be held to maturity and carried at amortized cost. We do not use any swaps, options, futures or forward contracts to hedge or enhance our investment portfolio.

The following table summarizes, by type, our investments as of September 30, 2010 and December 31, 2009.

|  | September 30, 2010     |                  | December 31, 2009 |                  |
|--|------------------------|------------------|-------------------|------------------|
|  | Carrying Amount        | Percent of Total | Carrying Amount   | Percent of Total |
|  | (Dollars in Thousands) |                  |                   |                  |
| <b>Debt securities, at market:</b>                   |                        |                  |                   |                  |
| United States government obligations and authorities | \$ 17,296              | 15.59%           | \$ 10,152         | 8.89%            |
| Obligations of states and political subdivisions     | 23,005                 | 20.73%           | 39,269            | 34.38%           |
| Corporate  | 43,160                 | 38.90%           | 42,092            | 36.85%           |
| International  | 2,051                  | 1.85%            | -                 | 0.00%            |
|  | 85,512                 | 77.07%           | 91,513            | 80.12%           |
| <b>Debt securities, at amortized cost:</b>           |                        |                  |                   |                  |
| United States government obligations and authorities | 5,782                  | 5.22%            | 2,650             | 2.32%            |
| Total debt securities                                | 91,294                 | 5.22%            | 94,163            | 2.32%            |
| <b>Equity securities, at market:</b>                 |                        |                  |                   |                  |
| Total investments                                    | \$ 110,948             | 100.00%          | \$ 114,219        | 100.00%          |

Available-for-sale debt securities are carried on the balance sheet at market and held-to-maturity debt securities are carried on the balance sheet at amortized cost. As of September 30, 2010 and December 31, 2009, debt securities had the following quality ratings by Moody's or, if not rated by Moody's, by Standard and Poor's Company or Fitch.

| September 30, 2010     |                  | December 31, 2009 |                  |
|------------------------|------------------|-------------------|------------------|
| Carrying Amount        | Percent of Total | Carrying Amount   | Percent of Total |
| (Dollars in Thousands) |                  |                   |                  |

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|           |    |        |         |    |        |         |
|-----------|----|--------|---------|----|--------|---------|
| AAA       | \$ | 38,873 | 42.58%  | \$ | 40,390 | 42.90%  |
| AA        |    | 14,905 | 16.33%  |    | 18,619 | 19.77%  |
| A         |    | 28,300 | 31.00%  |    | 24,286 | 25.79%  |
| BBB       |    | 8,089  | 8.86%   |    | 9,954  | 10.57%  |
| Not rated |    | 1,127  | 1.23%   |    | 914    | 0.97%   |
|           | \$ | 91,294 | 100.00% | \$ | 94,163 | 100.00% |

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The following table summarizes, by maturity, the debt securities as of September 30, 2010 and December 31, 2009.

|                        | September 30, 2010 |                  | December 31, 2009 |                  |
|------------------------|--------------------|------------------|-------------------|------------------|
|                        | Carrying Amount    | Percent of Total | Carrying Amount   | Percent of Total |
| (Dollars in Thousands) |                    |                  |                   |                  |
| <b>Matures In:</b>     |                    |                  |                   |                  |
| One year or less       | \$ 8,910           | 9.76%            | \$ 1,615          | 1.72%            |
| One year to five years | 48,376             | 52.99%           | 50,781            | 53.93%           |
| Five years to 10 years | 27,727             | 30.37%           | 27,178            | 28.86%           |
| More than 10 years     | 6,281              | 6.88%            | 14,589            | 15.49%           |
| Total debt securities  | \$ 91,294          | 100.00%          | \$ 94,163         | 100.00%          |

At September 30, 2010, the weighted average maturity of the debt portfolio was approximately 4.1 years.

The following table provides information about the financial instruments as of September 30, 2010 that are sensitive to changes in interest rates. The table presents principal cash flows and the related weighted average interest rate by expected maturity date based upon par values.

|  | 2010     | 2011      | 2012      | 2013      | 2014      | 2015     | Thereafter | Total     | Carrying Amount |
|--|----------|-----------|-----------|-----------|-----------|----------|------------|-----------|-----------------|
| (Dollars in Thousands)                               |          |           |           |           |           |          |            |           |                 |
| <b>Principal amount by expected maturity:</b>        |          |           |           |           |           |          |            |           |                 |
| United States government obligations and authorities | \$ -     | \$ 4,850  | \$ 3,500  | \$ 2,500  | \$ 500    | \$ -     | \$ 1,840   | \$ 13,190 | \$ 19,489       |
| Obligations of states and political subdivisions     | 1,125    | 225       | 1,755     | 2,750     | 3,340     | 685      | 10,410     | 20,290    | 23,005          |
| Corporate securities                                 | -        | 6,050     | 7,315     | 2,559     | 4,020     | 980      | 15,842     | 36,766    | 43,160          |
| International securities                             | -        | 650       | -         | 438       | 350       | -        | 405        | 1,843     | 2,051           |
| Collateralized mortgage obligations                  | -        | -         | 3,502     | 3,570     | 3,667     | 280      | 320        | 11,339    | 3,589           |
| Equity securities, at market                         | -        | -         | -         | -         | -         | -        | -          | -         | 19,654          |
| All investments                                      | \$ 1,125 | \$ 11,775 | \$ 16,072 | \$ 11,817 | \$ 11,877 | \$ 1,945 | \$ 28,817  | \$ 83,428 | \$ 110,948      |

|  |       |       |       |       |       |       |       |       |
|--|-------|-------|-------|-------|-------|-------|-------|-------|
| Weighted<br>average<br>interest rate<br>by expected<br>maturity: |       |       |       |       |       |       |       |       |
| United States<br>government<br>obligations<br>and<br>authorities | 0.00% | 1.18% | 2.93% | 3.66% | 1.75% | 0.00% | 3.69% | 2.49% |
| Obligations of<br>states and<br>political<br>subdivisions        | 5.11% | 5.50% | 5.20% | 3.93% | 4.96% | 5.00% | 5.29% | 5.03% |
| Corporate<br>securities  | 0.00% | 3.68% | 3.75% | 3.70% | 5.50% | 4.67% | 6.28% | 5.04% |
| International<br>securities                                      | 0.00% | 6.98% | 0.00% | 5.56% | 4.20% | 0.00% | 7.33% | 6.19% |
| Collateralized<br>mortgage<br>obligations                        | 0.00% | 0.00% | 5.27% | 5.05% | 4.50% | 4.94% | 5.81% | 4.96% |
| Equity<br>securities, at<br>market                               | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| All<br>investments   | 5.11% | 2.87% | 4.06% | 4.22% | 4.84% | 4.83% | 5.77% | 4.65% |

21st Century Holding Company

Item 4

Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act 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 our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934, as of September 30, 2010. Based upon their evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures, as of September 30, 2010, were effective to provide reasonable assurance that information required to be disclosed by us in the reports filed or submitted by it under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and to provide reasonable assurance that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no changes during the first nine months of 2010 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.



21st Century Holding Company

Part II: OTHER INFORMATION

Item 1

Legal Proceedings

See Item 1 of Part I, “Financial Statements – Note 4 – Commitments and Contingencies.”

Item 1A

Risk Factors

There have been no material changes from the risk factors previously disclosed in Item 1, Risk Factors, in the Company’s Form 10-K for the fiscal year ended December 31, 2009.

Additional Risk Factors

The risks described in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 2

(a)

During the three months ended September 30, 2010, we have issued an aggregate of 74,500 options to certain executive and non-executive employees of the Company under our 2002 stock option plan. The options have an exercise price of \$3.30 per share, vest over five years and expire ten years from the grant date.

(b)

None

(c)

Market for the Company’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

During the nine months ended September 30, 2010, the Company did not repurchase any common stock under the stock repurchase plan authorized in 2009, because the Company suspended the shares purchase program, as directed by the Florida OIR. Under the Company’s repurchase plan announced in 2009 and its prior plan announced in 2007, the company is authorized to purchase a total of \$4.8 million of its common stock in addition to the \$4.2 million previously purchased.

Item 3

Defaults upon Senior Securities

None

Item 4

(Removed and Reserved)

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21st Century Holding Company

Item 5

Other Information

None

Item 6

Exhibits

- 10.1 Excess Catastrophe Reinsurance Contract, effective July 1, 2010, issued to Federated National Insurance Company.\*
- 10.2 Excess Catastrophe Reinsurance Contract Private Layer 1, effective July 1, 2010, issued to Federated National Insurance Company. \*
- 10.3 Excess Catastrophe Reinsurance Contract Private Layer 2, effective July 1, 2010, issued to Federated National Insurance Company. \*
- 10.4 Reinstatement Premium Protection Contract, effective July 1, 2010, issued to Federated National Insurance Company. \*
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act. \*
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act. \*
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act. \*
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act. \*

\*Filed herewith

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21st Century Holding Company

Signatures

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

21st CENTURY HOLDING COMPANY

By: /s/ Michael H. Braun  
Michael H. Braun, Chief Executive  
Officer  
(Principal Executive Officer)

/s/ Peter J. Prygelski,  
III  
Peter J. Prygelski, III, Chief  
Financial Officer  
(Principal Financial Officer)

Date: November 15, 2010

21st Century Holding Company

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