Heritage Insurance Holdings, Inc.
Form 10-Q
August 08, 2018

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 June 30, 2018

OR

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

001-36462

Heritage Insurance Holdings, Inc.

(Exact name of Registrant as specified in its charter)

Delaware	45-5338504
(State of Incorporation)	(IRS Employer Identification No.)

2600 McCormick Drive, Suite 300

Clearwater, Florida 33759

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

(727) 362-7200

(Registrant's telephone number, including area code)

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

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

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

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

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

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

The aggregate number of shares of the Registrant's Common Stock, $0.0001 par value, outstanding on August 6, 2018 was 26,569,804

HERITAGE INSURANCE HOLDINGS, INC.

Table of Contents

FORWARD-LOOKING STATEMENTS

Statements in this Quarterly Report on Form 10-Q (“Form 10-Q”) or in documents incorporated by reference that are not historical facts are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include statements about anticipated growth in revenue, earnings per share, estimated unpaid losses on insurance policies, investment returns and expectations about our liquidity, and our ability to meet our investment objectives and to manage and mitigate market risk with respect to our investments. These statements are based on current expectations, estimates and projections about the industry and market in which we operate, and management’s beliefs and assumptions. Without limiting the generality of the foregoing, words such as “may”, “will”, “expect”, “believe”, “anticipate”, “intend”, “could”, “would”, “estimate”, or “continue” or the negative variation comparable terminology are intended to identify forward-looking statements. Forward-looking statements are not guarantees of future performance and involve certain known and unknown risks and uncertainties that could cause actual results to differ materially from those expressed or implied by such statements. The risks and uncertainties include, without limitation:

- the possibility that actual losses may exceed reserves;
- the concentration of our business in coastal states, which could be impacted by hurricane losses or other significant weather-related events such as northeastern winter storms;
- our exposure to catastrophic weather events;
- the fluctuation in our results of operations;
- increased costs of reinsurance, non-availability of reinsurance, and non-collectability of reinsurance;
- our failure to effectively manage our growth and integrate acquired companies;
- increased competition, competitive pressures, and market conditions;
- our failure to accurately price the risks we underwrite;
- inherent uncertainty of our models and our reliance on such model as a tool to evaluate risk;
- the failure of our claims department to effectively manage or remediate claims;
- low renewal rates and failure of such renewals to meet our expectations;
- our failure to execute our diversification strategy;
- failure of our information technology systems and unsuccessful development and implementation of new technologies;
- a lack of redundancy in our operations;
- our failure to attract and retain qualified employees and independent agents or our loss of key personnel;
- our inability to generate investment income;
- our inability to maintain our financial stability rating;
- effects of emerging claim and coverage issues relating to legal, judicial, environmental and social conditions;
- the failure of our risk mitigation strategies or loss limitation methods; and
- changes in regulations and our failure to meet increased regulatory requirements.

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 or operating results.

These forward-looking statements are subject to numerous risks, uncertainties and assumptions about us described in our filings with the Securities and Exchange Commission (the “SEC”). The forward-looking statements we make in our Form 10-Q are valid only as of the date of our Form 10-Q and may not occur in light of the risks, uncertainties and assumptions that we describe from time to time in our filings with the SEC. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from our forward-looking statements is included in the section entitled “Risk Factors” in Part I, Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2017. Except as required by applicable law, we undertake no obligation and disclaim any obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I – FINANCIAL INFORMATION

Item 1 – Financial Statements

HERITAGE INSURANCE HOLDINGS, INC.

Condensed Consolidated Balance Sheets

(Amounts in thousands, except per share and share amounts)

	June 30, 2018	December 31, 2017
ASSETS	(unaudited)	
Fixed maturity securities, available for sale, at fair value (amortized cost of $519,875 and $552,458 in 2018 and 2017, respectively)	508,921	$549,796
Equity securities, available for sale, at fair value (cost of $17,070 and $17,548 in 2018 and 2017, respectively)	15,958	17,217
Total investments	524,879	567,013
Cash and cash equivalents	218,343	153,697
Restricted cash	16,884	20,833
Accrued investment income	4,306	5,057
Premiums receivable, net	68,168	67,757
Reinsurance recoverable on paid and unpaid claims	467,857	357,357
Prepaid reinsurance premiums	295,924	227,764
Income taxes receivable	42,492	37,338
Deferred policy acquisition costs, net	69,648	41,678
Property and equipment, net	18,329	18,748
Intangibles, net	88,371	101,626
Goodwill	152,459	152,459
Other assets	23,239	19,883
Total Assets	$1,990,899	$1,771,210
LIABILITIES AND STOCKHOLDERS' EQUITY		
Unpaid losses and loss adjustment expenses	$488,610	$470,083
Unearned premiums	485,230	475,334
Reinsurance payable	276,507	17,577
Long-term debt, net	177,257	184,405
Deferred income tax	15,350	34,333
Advance premiums	35,821	23,648
Accrued compensation	6,754	16,477
Accounts payable and other liabilities	119,290	169,537
Total Liabilities	$1,604,819	$1,391,394

Commitments and contingencies (Note 16)		
Stockholders' Equity:		
Common stock, $0.0001 par value, 50,000,000 shares authorized, 26,569,804 shares issued and 25,769,804 outstanding at June 30, 2018 and 26,560,004 shares issued and 25,885,004 outstanding at December 31, 2017	3	3
Additional paid-in capital	294,183	294,836
Accumulated other comprehensive loss	(8,348)	(3,064)
Treasury stock, at cost, 7,214,797 shares at June 30, 2018 and 7,099,597 shares at December 31, 2017	(89,185)	(87,185)
Retained earnings	189,427	175,226
Total Stockholders' Equity	386,080	379,816
Total Liabilities and Stockholders' Equity	$1,990,899	$1,771,210

See accompanying notes to unaudited condensed consolidated financial statements.

HERITAGE INSURANCE HOLDINGS, INC.

Condensed Consolidated Statements of Operations and Other Comprehensive Income

(Unaudited)

(Amounts in thousands, except per share and share amounts)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
REVENUES:				
Gross premiums written	$263,664	$159,255	$468,030	$301,490
Change in gross unearned premiums	(32,693)	(6,901)	(9,896)	5,472
Gross premiums earned	230,971	152,354	458,134	306,962
Ceded premiums	(119,767)	(61,902)	(240,822)	(124,334)
Net premiums earned	111,204	90,452	217,312	182,628
Net investment income	2,555	2,973	5,857	5,475
Net realized (losses) gains	(85)	(125)	(312)	646
Other revenue	4,298	3,638	7,141	7,482
Total revenues	117,972	96,938	229,998	196,231
EXPENSES:				
Losses and loss adjustment expenses	65,989	46,046	119,080	92,693
Policy acquisition costs, net of ceding commission income for the three and six months ended June 30, 2018, of $13,493 and $27,738 respectively	19,411	21,738	31,598	45,180
General and administrative expenses, net of ceding commission income for the three and six months ended June 30, 2018, of $4,498 and $9,246 respectively	24,422	16,092	46,352	33,406
Total expenses	109,822	83,876	197,030	171,279
Operating income	8,150	13,062	32,968	24,952
Interest expense, net	5,386	2,231	10,206	4,412
Other non-operating income, net	(542)	—	(542)	—
Income before income taxes	3,306	10,831	23,304	20,540
Provision for income taxes	898	4,189	6,066	7,915
Net income	$2,408	$6,642	$17,238	$12,625
OTHER COMPREHENSIVE INCOME				
Change in net unrealized (losses) gains on investments	(545)	3,899	(7,023)	7,880
Reclassification adjustment for net realized investment losses (gains)	85	125	312	(646)
Income tax (expense) benefit related to items of other comprehensive income	(239)	(1,549)	1,584	(2,785)
Total comprehensive income	$1,709	$9,117	$12,111	$17,074
Weighted average shares outstanding				
Basic	25,631,871	28,283,587	25,679,448	28,543,703
Diluted	26,316,597	28,283,587	26,480,707	28,543,703
Earnings per share				

Basic	$0.09	$0.23	$0.67	$0.44
Diluted	$0.09	$0.23	$0.65	$0.44

See accompanying notes to unaudited condensed consolidated financial statements.

HERITAGE INSURANCE HOLDINGS, INC.

Condensed Consolidated Statements of Stockholders' Equity

Six Months Ended June 30, 2018 and 2017

(Unaudited)

(Amounts in thousands, except share amounts)

	Common Shares	Par Value	Additional Paid-In Capital	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive (Loss) Income	Total Stockholders' Equity
Balance at December 31, 2017, as previously reported	25,885,004	$ 3	$ 294,836	$ 175,226	$ (87,185)	$ (3,064)	$ 379,816
Cumulative effect of change in accounting principle (ASU 2016-01), net of tax	—	—	—	(267)	—	267	—
Balance at December 31, 2017, as adjusted	25,885,004	3	294,836	174,959	(87,185)	(2,797)	379,816
Stock buy-back	(115,200)	—	—	—	(2,000)	—	(2,000)
Stock-based compensation	—	—	2,612	—	—	—	2,612
Convertible Option debt extinguishment, net of tax	—	—	(4,235)	—	—	—	(4,235)
Reclassification of income taxes upon early adoption of ASU 2018-02	—	—	—	424	—	(424)	—
Tax effect of warrant reclassification	—	—	970	—	—	—	970
Dividends declared on common stock	—	—	—	(3,194)	—	—	(3,194)
Net unrealized change in investments, net of tax	—	—	—	—	—	(5,127)	(5,127)
Net income	—	—	—	17,238	—	—	17,238
Balance at June 30, 2018	25,769,804	$ 3	$ 294,183	$ 189,427	$ (89,185)	$ (8,348)	$ 386,080

Common Shares	Par Value	Additional Paid-In Capital	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive (Loss)	Total Stockholders' Equity

						Income	
Balance at December 31, 2016	28,840,443	$ 3	$ 205,727	$ 182,809	$ (25,562)	$ (5,018)	$ 357,959
Stock buy-back	(684,022)	—	—	—	(8,607)	—	(8,607)
Stock-based compensation	—	—	2,408	—	—	—	2,408
Dividends declared on common stock	—	—	—	(3,567)	—	—	(3,567)
Net unrealized change in investments, net of tax	—	—	—	—	—	4,449	4,449
Net income	—	—	—	12,625	—	—	12,625
Balance at June 30, 2017	28,156,421	$ 3	$ 208,135	$ 191,867	$ (34,169)	$ (569)	$ 365,267

See accompanying notes to unaudited condensed consolidated financial statements.

HERITAGE INSURANCE HOLDINGS, INC.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(Amounts in thousands)

	For the Six Months Ended June 30, 2018	2017
OPERATING ACTIVITIES		
Net income	$17,238	$12,625
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Stock-based compensation	2,612	2,408
Bond amortization and accretion	3,454	4,492
Amortization of original issuance discount on debt	2,050	—
Depreciation and amortization	14,041	3,798
Net realized gains	312	(646)
Net gain on repurchase of debt	(542)	—
Deferred income taxes	(15,579)	(1,137)
Changes in operating assets and liabilities:		
Accrued investment income	751	(341)
Premiums receivable, net	(411)	3,760
Prepaid reinsurance premiums	(68,160)	(106,400)
Reinsurance premiums receivable and recoverable	(110,500)	—
Income taxes receivable	(5,154)	8,416
Deferred policy acquisition costs, net	(27,970)	987
Other assets	(3,356)	(1,422)
Unpaid losses and loss adjustment expenses	18,527	(17,353)
Unearned premiums	9,896	(5,472)
Reinsurance payable	258,930	128,140
Accrued interest	(3,148)	(3,938)
Accrued compensation	(9,723)	1,176
Advance premiums	12,173	7,320
Other liabilities	(47,109)	(3,438)
Net cash provided by operating activities	48,332	32,975
INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments available for sale	163,611	99,041
Purchases of investments available for sale	(132,306)	(93,862)
Cost of property and equipment acquired	(367)	(150)
Net cash provided by investing activities	30,938	5,029
FINANCING ACTIVITIES		
Mortgage loan payments	(131)	—

Repurchase of convertible note	(13,248)	—
Purchase of treasury stock	(2,000)	(8,607)
Cash dividends paid	(3,194)	(3,567)
Net cash used in financing activities	(18,573)	(12,174)
Increase in cash, cash equivalents, and restricted cash	60,697	25,830
Cash, cash equivalents and restricted cash, beginning of period	174,530	126,727
Cash, cash equivalents and restricted cash, end of period	$235,227	$152,557
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Income taxes paid	$5,406	$601
Interest paid	$8,317	$3,900

Reconciliation of cash, cash equivalents, and restricted cash to the condensed consolidated balance sheets

	June 30, 2018	December 31, 2017
	(in thousands)	
Cash and cash equivalents	$218,343	$153,697
Restricted cash	16,884	$20,833
Total cash, cash equivalents and restricted cash shown in the condensed consolidated statements of cash flows	$235,227	$174,530

See accompanying notes to unaudited condensed consolidated financial statements.

5

HERITAGE INSURANCE HOLDINGS, INC.

Notes to Unaudited Condensed Consolidated Financial Statements

NOTE 1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The condensed consolidated financial statements as of and for the three and six months ended June 30, 2018 and 2017 include Heritage Insurance Holdings, Inc. (“Parent Company”); its property and casualty insurance subsidiaries: Heritage Property & Casualty Insurance Company (“Heritage P&C”), Narragansett Bay Insurance Company (“NBIC”) and Zephyr Insurance Company, Inc. (“Zephyr”); Heritage MGA, LLC, the managing general agent that manages substantially all aspects of our Florida insurance subsidiary’s business; Contractors’ Alliance Network, LLC (“CAN”), our vendor network manager for Florida claims which includes BRC Restoration Specialists (“BRC”), our provider of restoration, emergency and recovery services; Skye Lane Properties, LLC, our property management subsidiary; First Access Insurance Group, LLC, our retail agency; Osprey Re Ltd. (“Osprey”), our reinsurance subsidiary that may provide a portion of the reinsurance protection purchased by our insurance subsidiaries; and Heritage Insurance Claims, LLC, an inactive subsidiary reserved for future development.

Through our insurance subsidiaries, Heritage P&C, Zephyr and NBIC, we write personal residential insurance for single-family homeowners and condominium owners, and rental property insurance in the states of Alabama, Connecticut, Florida, Georgia, Hawaii, Massachusetts, New Jersey, New York, North Carolina, Rhode Island and South Carolina. We also provide commercial residential insurance for Florida properties and are also licensed in the states of Mississippi and Pennsylvania. We are vertically integrated and control or manage substantially all aspects of insurance underwriting, customer service, actuarial analysis, distribution and claims processing and adjusting.

The condensed consolidated financial information included herein as of and for the three and six months ended June 30, 2018 and 2017 does not include all of the information and footnotes required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements. However, such information reflects all adjustments consisting of normal recurring accruals which are, in the opinion of management, necessary for a fair statement of the financial condition and results of operations for the interim periods. The results for the three and six months ended June 30, 2018 and 2017 are not indicative of annual results. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The December 31, 2017 consolidated balance sheet was derived from the Company’s audited consolidated financial statements as of and for the year ended December 31, 2017.

For further information, refer to the consolidated financial statements and footnotes thereto included in Heritage Insurance Holdings, Inc.’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (the “2017 Form 10-K”). References to “we”, “us”, “our”, or the “Company” refer to Heritage Insurance Holdings, Inc. and its consolidated subsidiaries.

Changes to significant accounting policies

We have made no material changes to our significant accounting policies as reported in our Annual Report on Form 10-K for the year ended December 31, 2017.

Reclassification

We have reclassified certain amounts in the 2017 statement of operations to conform to our 2018 presentation. Additionally, we reclassified certain amounts in the 2017 consolidated statement of cash flows to conform to the 2018 presentation, relating to the presentation of restricted cash and cash equivalents. This reclassification is a result of our adoption of Accounting Standards Update (ASU) 2016-18, Restricted Cash effective January 1, 2018.

Recently Adopted Accounting Pronouncements

In February 2018, the FASB issued ASU 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): The amendment allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (“Tax Act”). In addition, under ASU 2018-02, an entity will be required to provide certain disclosures regarding stranded tax effects. The new guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company early adopted the updated guidance effective January 1, 2018 and elected to reclassify the stranded income tax effects relating to the reduction in the federal corporate income tax rate from accumulated other comprehensive income (“AOCI”) to retained earnings at the beginning of the period of adoption. The net impact of the accounting change resulted in a $0.4 million decrease in AOCI comprised of income taxes associated with net unrealized losses on investments and a corresponding increase in retained earnings.

In May 2017, the FASB issued ASU No. 2017-09, Compensation–Stock Compensation (Topic 718): Scope of Modification Accounting, clarifying when a change to the terms or conditions of a share-based payment award must be accounted for as a modification. The new guidance requires modification accounting if the fair value, vesting condition or the classification of the award is not the same immediately before and after a change to the terms and conditions of the award. The new guidance was effective for the Company on a prospective basis beginning on January 1, 2018. This new guidance does not have an impact on the Company’s condensed consolidated financial statements as it is not the Company’s practice to change either the terms or conditions of share-based payment awards once they are granted.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805). Clarifying the Definition of a Business, which provides additional guidance on evaluating whether transactions should be accounted for as acquisitions of assets or businesses. The guidance requires an entity to evaluate if substantially all the fair value of the assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets. If this threshold is met, the new guidance would define this as an asset acquisition; otherwise, the entity then evaluates whether the asset meets the requirement that a business include, at a minimum, an input and substantive process that together significantly contribute to the ability to create outputs. The guidance was effective for the Company on a prospective basis beginning on January 1, 2018. The impact of this guidance will be determined by the terms of any future acquisitions.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments. ASU 2016-15 is a new accounting standard that will make eight targeted changes to how cash receipts and cash payments are presented and classified in the statement of cash flows. This updated guidance became effective on January 1, 2018 and requires adoption on a retrospective basis. The Company has not experienced any transactions that are within the scope of this guidance and accordingly will evaluate the effect of this guidance further if and when any such transactions occur.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows, which requires entities to include in their cash and cash-equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. The ASU does not define the terms “restricted cash” and “restricted cash equivalents.” To conform to the new guidance, the Company reclassified $20.8 million of restricted cash to the beginning period balance for cash, cash equivalents and restricted cash for the six months ended June 30, 2017.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. The ASU will significantly change the income statement impact of equity investments held by an entity and the recognition of changes in fair value of financial liabilities when the fair value option is elected. The guidance requires equity investments to be measured at fair value with changes in fair value recognized through net income. In February 2018, the FASB issued ASU 2018-03, “Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10)” to clarify certain aspects of ASU No. 2016-01. The updated guidance was effective for the quarter ended March 31, 2018. The adoption of this guidance resulted in the recognition of $0.4 million of net pre-tax unrealized loss on equity investments as a cumulative effect adjustment that decreased retained earnings as of January 1, 2018 and increased AOCI by the same amount. The Company elected to report changes in the fair value of equity investments in other revenue.

In May 2014, the FASB issued ASU Topic 2014-09, Revenue from Contracts with Customers. The ASU 2014-09 creates a new topic, Topic 606, to provide guidance on revenue recognition for entities that enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of nonfinancial assets. The updated guidance requires an entity to recognize revenue as performance obligations are met, in order to reflect the transfer of promised goods or services to customers in an amount that reflects the consideration the entity is entitled to receive for those goods or services. The standard became effective for the Company in the first quarter of 2018. The Company has determined that this pronouncement is not applicable to its insurance contracts and is not material to the Company’s condensed consolidated financial statements.

Accounting Pronouncements Not Yet Adopted

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

In March 2018, the FASB issued ASU 2018-04, Investments-Debt Securities (Topic 320) and Regulated Operations (Topic 980). Pursuant to SEC Staff Accounting Bulletin No. 177 and SEC Release No 33-9273, the amendment of ASU 2018-04 adds, amends and supersedes various paragraphs that contain SEC guidance in ASC 320, Investments-Debt Securities and ASC 980, Regulated Operations. The Company does not anticipate the adoption of ASU 2018-04 will have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles-Goodwill and Other. The amendments in ASU 2017-04 intend to simplify the subsequent measurement of goodwill, eliminating Step 2 from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. The standard is effective for the Company in the first quarter of 2020 on a prospective basis with early adoption permitted. The Company does not expect the adoption of this standard will have a material impact on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses Measurement of Credit Losses on Financial Instruments. The estimate of expected credit losses should consider historical information, current information, as well as reasonable and supportable forecasts, including estimates of prepayments. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset in order to present the net carrying value at the amount expected to be collected on the financial asset on the consolidated balance sheet. The guidance also amends the current accounting for other-than-temporary impairment model by requiring an estimate of the expected credit loss only when the fair value is below the amortized cost of the asset. The length of time the fair value of an available-for-sale debt security has been below the amortized cost will no longer impact the determination of whether a potential credit loss exists. The available-for-sale debt security model will also require the use of a valuation allowance as compared to the current practice of writing down the asset. The standard is effective for the Company in the first quarter of 2020 with early adoption permitted in the first quarter of 2019. The Company does not expect the adoption of this standard will have a material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Lease Accounting, which amends the accounting treatment for leases. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Lessees (for capital and operating leases) and lessors (for sales-type leases, direct financing leases, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. Early adoption is permitted.

To date, we have taken an inventory of all our operating leases, which consist primarily of auto, equipment and real estate owned and unowned by the Company, started our review of key lease agreements including contract review for embedded leases, and are currently evaluating lease terms, lease payments and appropriate discount rates to use in calculating the right-to-use asset and lease liability. In addition, we are currently evaluating the transition package of practical expedients permitted within the new standard, which among other things, allows us to use hindsight to determine the reasonably certain lease term for existing leases, and allows for the adoption of the new standard at the effective date without adjusting the comparative prior periods presented. We will be continuously assessing the impact of the new standard and the impact on our systems, processes and controls through January 1, 2019, our planned adoption date.

There are no other recently issued accounting standards that apply to the Company or that are expected to have a material impact on the Company's results of operations, financial condition, or cash flows.

NOTE 2. ACQUISITION

Acquisition of NBIC

On November 30, 2017, the Company completed the acquisition of all the outstanding capital stock of NBIC Holdings, Inc., the parent company of Narragansett Bay Insurance Company, a leading specialty underwriter of personal residential insurance products and services in several states in the northeastern United States for $250.0 million, including $210.0 million in cash, plus 2,222,215 shares of the Company's common stock with an aggregate fair value of $40.0 million. The completion of the NBIC acquisition represents a significant advancement in executing the Company's geographic diversification strategy by leveraging the Company's combined platform to accelerate growth along the Eastern region. The Company recognized goodwill of $106 million, attributable to expected growth and profitability, none of which is expected to be deductible for income tax purposes. Refer to the 2017 Form 10-K for additional information on this acquisition.

Unaudited Pro Forma Financial Information

The following unaudited pro forma results of operations assume that the NBIC acquisition occurred at the beginning of the periods presented. The pro forma amounts include certain adjustments, including depreciation and amortization expense and income taxes. The unaudited pro forma information assumes the acquisition had taken place January 1, 2017.

The unaudited pro forma effects for the three and six months ended June 30, 2017 is as follows:

	For the Three Months Ended June 30, 2017	For the Six Months Ended June 30, 2017
	(in thousands, except per share)	
Revenue	$111,252	$224,938
Net income	$10,056	$17,394
Basic, earnings per share	$0.36	$0.61
Diluted, earnings per share	$0.36	$0.61

NOTE 3. INVESTMENTS

The following table details the difference between cost or adjusted/amortized cost and estimated fair value, by major investment category, at June 30, 2018 and December 31, 2017:

	Cost or Adjusted/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
June 30, 2018				
U.S. government and agency securities	$30,537	$ 8	$ 875	$ 29,670
States, municipalities and political subdivisions	63,340	7	1,257	62,090
Special revenue				