

21ST CENTURY HOLDING CO
Form S-1
September 12, 2003

As filed with the Securities and Exchange Commission on September 12, 2003

Registration Statement No. 333-_____

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

21st CENTURY HOLDING COMPANY

(Exact name of Registrant as specified in its charter)

Florida	6331	65-0248866
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification No.)

4161 N.W. 5th Street

Plantation, FL 33317

(954) 581-9993

(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

Richard A. Widdicombe

Chief Executive Officer

21st Century Holding Company

4161 N.W. 5th Street

Plantation, FL 33317

(954) 581-9993

(Name, address, including zip code, and telephone number, including area code, of Registrant's principal executive offices and agent for service)

Copies of communications to:

A. Jeffry Robinson, P.A.

Broad and Cassel

201 South Biscayne Boulevard

Miami Center, Suite 3000

Miami, Florida 33131

Telephone: (305) 373-9400

Telecopier: (305) 373-9443

Approximate date of commencement of proposed sale to the public:

As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, check the following box:

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box.

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price per Unit	Proposed Maximum Aggregate Offering Price	Amount to be Registered
Common Stock, \$.01 par value (1)	625,000 shares	\$15.69 ⁽¹⁾	\$9,806,250	

Estimated solely for the purpose of calculating the registration fee in accordance with Rule 457 under the Securities Act.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. WE MAY NOT SELL THESE SECURITIES UNTIL THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND IT IS NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

SUBJECT TO COMPLETION, SEPTEMBER 12, 2003

PROSPECTUS

625,000 SHARES OF COMMON STOCK

21st CENTURY HOLDING COMPANY

This prospectus covers 625,000 shares of our common stock issuable by us from time to time as payment of principal and interest due on our 6% Senior Subordinated Notes due July 31, 2006. Principal and interest is due on the notes quarterly, on October 31, January 31, April 30 and July 31 of each year until the notes mature in 2006. The number of shares of our common stock issuable as payment of principal and interest will equal the total payment amount divided by 95% of the weighted-average volume on Nasdaq as reported by Bloomberg Financial Markets for the 20 consecutive trading days before the date of the payment.

Our common stock is traded on the Nasdaq National Market under the symbol TCHC. On September 9, 2003, the last reported sale price of the common stock on the Nasdaq National Market was \$15.03 per share.

The shares of common stock offered hereby involve a high degree of risk and should be considered only by such persons capable of bearing the economic risk of such investment. You should carefully consider the Risks of Investing in Our Shares section beginning on page 7 of this prospectus.

You should rely only on the information contained in this prospectus. No dealer, salesperson or other person is authorized to give any information that is not contained in this prospectus. This prospectus is not an offer to sell, nor is it seeking an offer to buy, these shares in any jurisdiction where the offer or sale is not permitted. The information contained in this prospectus is correct only as of the date of this prospectus, regardless of the time of the delivery of this prospectus or any sale of these shares.

Neither the SEC nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of the prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is September ____, 2003.

FORWARD-LOOKING STATEMENTS

We make statements in this prospectus that are not historical fact and 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, in could, would, estimate, or continue or the negative other variations thereof or comparable terminology are intended to identify forward-looking statements. The risks and uncertainties include, but are not limited to, the risks and uncertainties described in this prospectus or from time to time in our filings with the SEC.

These risks and uncertainties include, among others, those described under Prospectus Summary, Risk of Investing in Our Shares, Use of Proceeds, Management's Discussion and Analysis of Financial Condition and Results of Operations, Business and elsewhere in this prospectus. In light of these risks and uncertainties, the forward-looking events discussed in this prospectus might not occur. In addition, actual results could differ materially from those suggested by the forward-looking statements, and therefore you should not place undue reliance on the forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PROSPECTUS SUMMARY

This is only a summary and does not contain all of the information that may be important to you. You should read the more detailed information contained in this prospectus and all other information, including the financial information and statements with notes, of this prospectus.

Overview

We are a vertically integrated insurance holding company, which, through our subsidiaries, controls substantially all aspects of the insurance underwriting, distribution and claims process. We underwrite personal automobile insurance, general liability insurance, flood insurance, homeowners insurance and mobile home property and casualty insurance in the States of Florida and Georgia through our wholly owned subsidiaries, Federated National Insurance Company and American Vehicle Insurance Company. During the year ended December 31, 2002, 83.42%, 13.75% and 2.83% of the policies we underwrote were for personal automobile insurance, homeowners insurance and mobile home property and casualty insurance, respectively. We internally process claims made by our own and third party insureds through our wholly owned claims adjusting company, Superior Adjusting, Inc. We also offer premium financing to our own and third-party insureds through our wholly owned subsidiary, Federated Premium Finance, Inc.

We market and distribute our own and third-party insurers' products and our other services primarily in Central and South Florida, through a network of 23 agencies owned by Federated Agency Group, Inc., a wholly owned subsidiary,

42 franchised agencies, and approximately 125 independent agents. Through our wholly owned subsidiary, FedUSA, Inc., we franchise agencies under the FedUSA name. As of June 30, 2003, franchises were granted for 42 FedUSA agencies, of which 36 were operating. We intend to focus our future expansion efforts for our agency network on franchised agencies.

Assurance Managing General Agents, Inc., a wholly owned subsidiary, acts as Federated National's and American Vehicle's exclusive managing general agent. Assurance MGA currently provides all underwriting policy administration, marketing, accounting and financial services to Federated National, American Vehicle and our agencies, and participates in the negotiation of reinsurance contracts.

We offer electronic tax filing services through Express Tax Service, Inc., an 80%-owned subsidiary, as well as franchise opportunities for these services. As of June 30, 2003, there were 141 franchises granted in ten states. Revenue is generated through franchise sales, collection of royalties on tax preparation fees, incentives from business partners as well as fees from the preparation of income tax returns and income tax refund anticipation loans. In addition, Express Tax offers tax preparation services through more than 500 licensees nationwide, acting as sales representative.

We believe that we can be distinguished from our competitors because we generate revenue from substantially all aspects of the insurance underwriting, distribution and claims process. We provide quality service to both our agents and insureds by utilizing an integrated computer system, which links our insurance and service entities. Our computer and software systems allow for automated premium quotation, policy issuance, billing, payment and claims processing and enables us to continuously monitor substantially all aspects of our business.

Using these systems, our agents can access a customer's driving record, quote a premium, offer premium financing and, if requested, generate a policy on-site. We believe that these systems have facilitated our ability to market and underwrite insurance products on a cost-efficient basis, allow our owned and franchised agencies to be a one stop shop for insurance, tax preparation and other services, and will enhance our ability to expand in Florida and to other states.

Our primary products are nonstandard and standard personal automobile insurance. Of the total premiums we received in 2002, 96.7% were for nonstandard insurance policies and 3.3% were for standard insurance policies. The former is principally provided to insureds who present an average risk profile in terms of payment history, driving record, vehicle and other factors. The latter is principally provided to insureds who are unable to obtain preferred or standard insurance coverage because of their payment history, driving record, age, vehicle type or other factors, including market conditions for preferred or standard risks. We believe that industry-wide underwriting standards for standard

insurance coverage have become more restrictive, thereby requiring more drivers to seek coverage in the nonstandard automobile insurance market. We believe that these factors have contributed to an increase in the size of the nonstandard personal automobile insurance market.

We currently underwrite and sell insurance in Florida and Georgia; however, we intend to expand to other selected states and we have applied to obtain a license to underwrite and sell personal automobile insurance in Alabama and North Carolina. We have also applied in Louisiana for homeowner's and general liability programs. We will select additional states for expansion based on a number of criteria, including the size of the personal automobile insurance market, statewide loss results, competition and the regulatory climate. Our ability to expand into other states will be subject to receiving prior regulatory approval of each state. Certain states impose operating requirements upon licensee applicants, which may impose burdens on our ability to obtain a license to conduct insurance business in those other states. There can be no assurance that we will be able to obtain the required licenses, and the failure to do so would limit our ability to expand geographically.

Our executive offices are located at 4161 N.W. 5th Street, Plantation, Florida and our telephone number is (954) 581-9993.

The Offering

Common stock to be issued by 21st Century	625,000 shares
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Common stock outstanding after issuance	3,791,770 shares
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Use of proceeds	We will not receive cash proceeds from the issuance of these shares, although we will reduce the aggregate principal balance of our notes outstanding by issuing these shares.
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Risk factors

You should consider the risks discussed in Risks of Investing in Our Shares and elsewhere in this prospectus before deciding whether to invest in our common stock.

Nasdaq National Market symbol

TCHC

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Summary Financial Data

You should read the following summary historical financial data together with the Management's Discussion and Analysis of Financial Condition and Results of Operations section later in this prospectus as well as our financial statements and related notes also contained later in this prospectus.

	As of or for the year ended December 31,				
	2002	2001	2000	1999	1998
Operations Data:					
Revenue:					
Gross premiums written	\$ 63,036,468	\$ 34,271,338	\$ 32,073,768	\$ 19,273,561	\$ 21,195,1
Gross premiums ceded	(25,286,828)	(12,789,404)	(7,625,095)	(6,221,853)	(6,628,2
Net premiums written	37,749,640	21,481,934	24,448,673	13,051,708	14,566,8
Decrease (increase) in unearned premiums, net of					

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prepaid reinsurance premiums	(8,356,636)	(1,226,373)	(4,127,334)	404,640	(604,1
Net premiums earned	29,393,004	20,255,561	20,321,339	13,456,348	13,962,7
Commission income	1,905,936	2,828,779	2,780,869	4,410,856	2,036,6
Finance revenue	4,452,626	5,267,523	5,709,848	3,696,843	1,825,2
Managing general agent fees	1,970,226	5,871,388	5,410,500	963,797	971,7
Net investment income	1,253,765	1,066,641	1,225,413	853,659	983,5
Net realized investment gains					
(losses)	(1,369,961)	(2,911,658)	(109,256)	952,153	441,8
Other income	2,973,949	3,098,332	2,214,894	1,043,798	446,6
Total revenue	40,579,545	35,476,566	37,553,607	25,377,454	20,668,4
Expenses:					
Losses and loss adjustment					
expenses	15,987,125	16,154,902	14,990,118	8,094,677	9,133,3
Operating and underwriting					
expenses	10,778,990	11,644,183	11,892,577	7,032,428	4,291,6
Salaries and wages	8,004,694	8,478,771	9,375,775	7,474,572	4,042,2
Amortization of deferred					
acquisition costs, net	(2,064,314)	1,467,238	1,673,754	(18,563)	179,0
Amortization of goodwill		540,010	606,653	547,548	239,6
Total expenses	32,706,495	38,285,104	38,538,877	23,130,662	17,885,8
Income (loss) before					
provision for income tax					
expense and extraordinary					
gain	7,873,050	(2,808,538)	(985,270)	2,246,792	2,782,6
(Provision) benefit for					
income tax expense	(3,302,849)	630,553	462,396	(680,061)	(965,0
Net income (loss) before					
extraordinary gain	4,570,201	(2,177,985)	(522,874)	1,566,731	1,817,6
Extraordinary gain		1,185,895			
Net income (loss)	\$ 4,570,201	\$ (992,090)	\$ (522,874)	\$ 1,566,731	\$ 1,817,6

Basic net income (loss) per share before extraordinary gain	\$ 1.52	\$ (0.69)	\$ (0.15)	0.46	\$	0.
Extraordinary gain	\$	\$ 0.38	\$	\$	\$	
Basic net income (loss) per share	\$ 1.52	\$ (0.31)	\$ (0.15)	0.46	\$	0.
Cash dividends declared per share	\$ 0.15	\$ 0.08	\$ 0.02	\$	\$	

	As of or for the year ended December 31,				
	2002	2001	2000	1999	1998
Balance Sheet Data:					
Total assets	\$ 75,318,011	\$ 56,228,577	\$ 55,412,969	\$ 38,686,404	\$ 38,176,40
Investments	25,377,796	17,507,422	18,965,798	13,916,571	17,705,26
Finance contracts, consumer loans and pay advances receivable, net	7,217,873	10,813,881	13,792,791	9,642,163	7,093,59
Total liabilities	57,220,347	42,019,446	40,456,972	22,932,516	23,208,58
Unpaid losses and loss adjustment expenses	16,983,756	11,005,337	9,765,848	6,314,307	7,603,46

Unearned premiums	28,934,486	14,951,228	13,038,417	8,037,083	8,534,32
Revolving credit outstanding	4,312,420	6,676,817	8,091,034	4,650,026	2,062,94
Total shareholders equity	\$ 18,097,664	\$ 14,209,131	\$ 14,955,997	\$ 15,753,888	\$ 14,967,82
Book value per share	\$ 6.05	\$ 4.69	\$ 4.49	\$ 4.67	\$ 4.4

RISKS OF INVESTING IN OUR SHARES

You should carefully consider the following risks, in addition to the other information presented in this prospectus, before making an investment decision. If any of these risks or uncertainties actually occur, our business, results of operations, financial condition, or prospects could be substantially harmed, which would adversely affect your investment.

Risks Related to Our Business

Our revenues and operating performance may fluctuate with business cycles in the property and casualty insurance industry.

Historically, the financial performance of the property and casualty insurance industry has tended to fluctuate in cyclical patterns characterized by periods of significant competition in pricing and underwriting terms and conditions, which is known as a soft insurance market, followed by periods of lessened competition and increasing premium rates, which is known as a hard insurance market. Although an individual insurance company's financial performance is dependent on its own specific business characteristics, the profitability of most property and casualty insurance companies tends to follow this cyclical market pattern, with profitability generally increasing in hard markets and decreasing in soft markets. At present, we are experiencing a hard market in our automobile and property sectors. We cannot predict, however, how long these market conditions will persist.

If we are unable to continue our growth by expanding the insurance products we offer and expanding the markets in which we operate, our future financial results may suffer.

We have grown rapidly over the last few years. Our future growth will depend on our ability to underwrite and market additional insurance products and programs through our distribution network and our ability to further expand in the Florida market by franchising additional insurance agencies and establishing relationships with additional independent agents. Additionally, our goal is to expand our operations into other states. Whether we are able to accomplish these goals will depend on:

- the availability of adequate capital,
- our ability to obtain necessary regulatory approvals, and
- our ability to maintain our financial strength ratings.

Availability of Capital. We believe that our company is sufficiently capitalized to operate our business as it now exists. Our existing sources of funds include our revolving loan from Flatiron Funding Company LLC, sales of our securities such as our recent private placement of \$7,500,000 of our senior subordinated notes, and our earnings from operations and investments. Unexpected catastrophic events in our market areas could result in greater claims losses than anticipated, which could require us to limit or halt our growth while redeploying our capital to pay these unanticipated claims.

Regulatory Approvals. We have applied to the states of Alabama and North Carolina for licenses to underwrite and sell personal automobile insurance, as well as to the State of Louisiana for a license to write homeowner's and general liability insurance. Although we are unaware at this time of any issues that would prevent us from obtaining these licenses, the state insurance regulators may require additional information, may add conditions to the licenses that we find unacceptable, or may deny our license applications. This would delay or prevent us from operating in those states. If we want to operate in any additional states, we must file similar applications for licenses, which is a

time-consuming process that adds to our operating expenses.

Financial Strength Ratings. Third-party ratings agencies assess and rate the ability of insurers to pay its claims. These financial strength ratings are used by the insurance industry to assess the financial strength and quality of insurers. These ratings are based on criteria established by the rating agencies and reflect evaluations of each insurer's profitability, debt and cash levels, customer base, adequacy and soundness of reinsurance, quality and estimated market value of assets, adequacy of reserves, and management. Ratings are based upon factors of concern to agents, reinsurers and policyholders and are not directed toward the protection of investors, such as purchasers of our common stock.

In 2002, A.M. Best Company assigned Federated National a B rating (Fair, which is the seventh of 14 rating categories) and American Vehicle a B+ rating (Very Good, which is the sixth of 14 rating categories). Federated National and American Vehicle are rated A (Unsurpassed, which is first of six ratings) by Demotech, Inc. If our financial condition deteriorates, we may not maintain our ratings. A downgrade or withdrawal of our ratings could severely limit or prevent us from writing or renewing desirable insurance policies or from obtaining adequate reinsurance.

Although we follow the industry practice of reinsuring a portion of our risks, we may not be able to successfully alleviate risk through reinsurance arrangements.

We follow the insurance industry practice of reinsuring a portion of our risks and paying for that protection based upon premiums received on all policies subject to this reinsurance. Our business depends on our ability to transfer or cede significant amounts of risk insured by us. Reinsurance makes the assuming reinsurer liable to the extent of the risk ceded. Prevailing market conditions in the property insurance market have limited the availability and increased the cost of reinsurance, which has increased our costs and reduced our profitability. We are also subject to credit risk with respect to our current and future reinsurers, as the ceding of risk to reinsurers does not relieve us of liability to our insureds regarding the portion of the risk that has been reinsured, if the reinsurers fail to pay for any reason. The insolvency of any reinsurers or their inability to pay claims would increase the claims that we must pay, thereby also harming our results of operations.

Both Federated National and American Vehicle cede approximately 40% of their premiums from automobile insurance policies to Transatlantic Reinsurance Company. Federated National obtains reinsurance for its property insurance policies on the private market in Bermuda and London and through the Florida Hurricane Catastrophe Fund that reinsures Federated National for liabilities resulting from a storm of \$5.5 million to \$39.0 million in the aggregate.

Our investment portfolio may suffer reduced returns or losses, which would significantly reduce our earnings.

As do other insurance companies, we depend on income from our investment portfolio for a substantial portion of our earnings. A significant decline in investment yields in our investment portfolio caused by fluctuations in interest rates or volatility in the stock market, or a default by issuers of securities that we own, could adversely affect the value of our investment portfolio and the returns that we earn on our portfolio, thereby substantially harming our financial condition and results of operations. During the time that normally elapses between the receipt of insurance premiums and any payment of insurance claims, we invest the funds received, together with our other available capital, primarily in fixed-maturity investments, mortgage loans and equity securities in order to generate investment income. In 2002, our interest and dividends earned totaled \$1.3 million, or 27 % of our total net income of \$4.6 million.

We experienced net realized investment losses of \$1,369,961 for 2002, \$2,911,658 for 2001 and \$109,256 for 2000. The net realized losses experienced in 2001 and 2000 were primarily a function of the widely publicized declines in the industrial common stock valuations. As a result of the declines in the equity markets in 2001, we acquired securities in the more conservative and highly rated industrial bond markets in late 2001 and the first half of 2002. During 2002, we incurred a \$2,000,000 decline in value of our investment in WorldCom, Inc. bonds. This write down is reflected in the \$1,369,961 loss incurred in 2002. We have been experiencing a declining interest rate environment during the past three years. The effect on our bond portfolio of this declining interest rate environment has been to decrease our yields to maturity and the interest income generated accordingly.

Our loss reserves may be inadequate to cover our actual liability for losses, and as a result our results of operations could be adversely affected.

We maintain reserves to cover our estimated ultimate liabilities for loss and loss adjustment expenses. These reserves are estimates based on historical data and statistical projections of what we believe the settlement and administration of claims will cost based on facts and circumstances then known to us. Actual losses and loss adjustment expenses, however, may vary significantly from our estimates. For example, after the Company compared its reserve levels to its actual claims for the prior years, the Company increased its liability for loss and loss adjustment expenses by \$90,874 for 2002, by \$2,568,476 for 2001, and by \$1,444,556 for 2000. These increases reflected primarily the Company's loss experience under its personal automobile policies. Because of the uncertainties that surround estimated loss reserves, we cannot be certain that our reserves will be adequate to cover our actual losses. If our reserves for unpaid losses and loss adjustment expenses are less than actual losses and loss adjustment expenses, we will be required to increase our reserves with a corresponding reduction in our net income in the period in which the deficiency is identified. Future loss experience substantially in excess of our reserves for unpaid losses and loss adjustment expenses could substantially harm our results of operations and financial condition.

We are subject to significant government regulation, which can limit our growth and increase our expenses, thereby reducing our earnings.

We are subject to laws and regulations of Florida, our state of domicile, and Georgia, and will be subject to the laws of any state in which we conduct business in the future. These laws and

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regulations cover all aspects of our business and are generally designed to protect the interests of insurance policyholders. For example, these laws and regulations relate to authorized lines of business, capital surplus requirements, allowable rates and forms, investment parameters, underwriting limitations, restrictions upon transactions with affiliates, dividend limitations, changes in control, market conduct, and limitations on premium financing service charges. If we do not comply with the laws and regulations applicable to us, we may be subject to sanctions by the Florida Office of Insurance Regulation or monetary penalties. In addition, we may not be able to obtain necessary approvals to expand the types of insurance that we offer.

We rely on agents, most of whom are independent agents or franchisees, to write our insurance policies, and if we are not able to attract and retain independent agents and franchisees, our revenues would be negatively affected.

We currently market and distribute Federated National's, American Vehicle's and third-party insurers' products and our other services through a network of 23 agencies that we own, 42 agencies that we franchise to others, and approximately 125 independent agents. Approximately 51% of our insurance products are sold through agents employed by us and franchised agents and approximately 49% of our products are sold through independent agents. Many of our competitors also rely on independent agents. As a result, we must compete with other insurers for independent agents' business and other franchisors of insurance agencies for franchisees. Our competitors may offer a greater variety of insurance products, lower premiums for insurance coverage, or higher commissions to their agents. If our products, pricing and commissions do not remain competitive, we may find it more difficult to attract business from independent agents and to attract franchisees for our agencies to sell our products. A material reduction in the amount of our products that independent agents sell would negatively affect our revenues.

Our primary insurance product, nonstandard automobile insurance, historically has a higher frequency of claims than standard automobile insurance, thereby increasing our potential for loss exposure beyond what we would be likely to experience if we offered only standard automobile insurance.

Nonstandard automobile insurance, which is our primary product, is provided to insureds who are unable to obtain preferred or standard insurance coverage because of their payment histories, driving records, age, vehicle types, or prior claims histories. This type of automobile insurance historically has a higher frequency of claims than does preferred or standard automobile insurance policies, although the average dollar amount of the claims is usually smaller under nonstandard insurance policies. As a result, we are exposed to the possibility of increased loss exposure and higher claims experience than would be the case if we offered only standard automobile insurance.

Florida's personal injury protection insurance statute contains provisions that favor claimants, causing us to experience a higher frequency of claims than might otherwise be the case if we operated only outside of Florida.

Florida's personal injury protection insurance statute limits an insurer's ability to deny benefits for medical treatment that is unrelated to the accident, that is unnecessary, or that is fraudulent. In addition, the statute allows claimants to obtain awards for attorney's fees. Although this statute has been amended several times in recent years, primarily to address concerns over fraud, the Florida Legislature has been only marginally successful in

implementing effective mechanisms that allow insurers to combat fraud and other abuses. We believe that this statute contributes to a higher frequency of claims under nonstandard automobile insurance policies in Florida, as compared to claims under standard automobile insurance policies in Florida and nonstandard and standard automobile insurance policies in other states. Although we believe that we have successfully offset these higher costs with premium increases, because of competition, we may not be able to do so with as much success in the future.

Our business strategy is to avoid competition in our automobile insurance products based on price to the extent possible. This strategy, however, may result in the loss of business in the short term.

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, choosing instead to compete on the basis of underwriting criteria, our distribution network, and our superior service to our agents and insureds. We compete with respect to automobile insurance in Florida with more than 100 companies, including companies of comparable or smaller size, such as U.S. Security Insurance Company, United Automobile Insurance Company, Direct General Insurance Company and Security National, as well as major insurers such as Progressive Casualty Insurance Company. If we do not meet the prices offered by our competitors, we may lose business in the short term, which could also result in reduced revenues. We believe, however, that our strategy of avoiding price competition is best over the long term because it enables us to maintain the prices that we offer in line with our costs.

With operations concentrated in Florida, we could be adversely affected by unpredictable catastrophic events such as hurricanes and tropical storms.

We write insurance policies that cover automobile owners, homeowners and business owners for losses that result from catastrophes. Catastrophe losses can be caused by hurricanes, tropical storms, tornadoes, wind, hail, fires, riots and explosions, and their incidence and severity are inherently unpredictable. The extent of losses from a catastrophe is a function of two factors: the total amount of the insurance company's exposure in the area affected by the event and the severity of the event. Our policyholders are currently concentrated in South and Central Florida, which is especially subject to adverse weather conditions such as hurricanes and tropical storms. Although we have not experienced significant claims as a result of a recent hurricane or other weather event, the occurrence of a catastrophe in South Florida could substantially harm us by causing claims to exceed our anticipated reserve for losses.

Our president and chief executive officer, and our president and chief executive officer of our principal subsidiaries, are key to the strategic direction of our company. If we were to lose the services of either of them, our business could be harmed.

We depend, and will continue to depend, on the services of one of our founders and principal shareholders, Edward J. Lawson, who is also our president and chairman of the board, as well as Richard Widdicombe, who is our chief executive officer and president of Federated National, American Vehicle and Assurance MGA. We have entered into an employment agreement with each of them and we maintain \$3 million and \$1 million in key life insurance on

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the lives of Mr. Lawson and Mr. Widdicombe, respectively. Nevertheless, because of Mr. Lawson's and Mr. Widdicombe's role and involvement in developing and implementing our current business strategy, the loss of either of their services could substantially harm our business.

Risks Related to an Investment in Our Shares

The trading of warrants may negatively affect the trading prices of our common stock.

We intend to list certain warrants issued in a private offering for trading on the Nasdaq National Market. Each of the warrants to be listed entitles the holder to purchase one-half of one share of our common stock at an exercise price per share determined 60 trading days after the closing date of the private offering. The trading of the warrants may negatively affect the trading prices of our common stock due to certain potential investment strategies that may be utilized by certain holders of the warrants.

Our largest shareholders control approximately 32% of the voting power of our outstanding common stock, which could discourage potential acquirors and prevent changes in management.

Edward J. Lawson and Michele V. Lawson beneficially own approximately 32% of our outstanding common stock. As our largest shareholders, and our only shareholders owning more than 10% of our stock, the Lawsons have significant influence over the outcome of any shareholder vote. This voting power may discourage takeover attempts, changes in management or other changes in our corporate governance that other shareholders may desire.

We have authorized but unissued preferred stock, which could affect rights of holders of common stock.

Our articles of incorporation authorize the issuance of preferred stock with designations, rights and preferences determined from time to time by our board of directors. Accordingly, our board of directors is empowered, without shareholder approval, to issue preferred stock with dividends, liquidation, conversion, voting or other rights that could adversely affect the voting power or other rights of the holders of common stock. In addition, the preferred stock could be issued as a method of discouraging a takeover attempt. Although we do not intend to issue any preferred stock at this time, we may do so in the future.

Our articles of incorporation and bylaws and Florida law may discourage takeover attempts and changes in management.

Our articles of incorporation and bylaws contain provisions that may discourage takeover attempts and may prevent changes in management.

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Our board of directors is elected in classes, with only two or three of the directors elected each year. As a result, shareholders would not be able to change the membership of the board in its entirety in any one year.

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Our articles of incorporation prohibit shareholders from acting by written consent, meaning that shareholders will be required to conduct a meeting in order to vote on any proposals or take any action.

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Our bylaws require at least 60 days notice if a shareholder desires to submit a proposal for a shareholder vote or to nominate a person for election to our board of directors.

In addition, Florida has enacted legislation that may deter or frustrate takeovers of Florida corporations, such as our company.

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The Florida Control Share Act provides that shares acquired in a control share acquisition will not have voting rights unless the voting rights are approved by a majority of the corporation's disinterested shareholders. A control share acquisition is an acquisition, in whatever form, of voting power in any of the following ranges: (a) at least 20% but less than 33-1/3% of all voting power, (b) at least 33-1/3% but less than a majority of all voting power; or (c) a majority or more of all voting power.

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The Florida Affiliated Transactions Act requires supermajority approval by disinterested shareholders of certain specified transactions between a public corporation and holders of more than 10% of the outstanding voting shares of the corporation (or their affiliates).

As a holding company, we depend on the earnings of our subsidiaries and their ability to pay dividends to the holding company as the primary source of our income.

We are an insurance holding company whose primary assets are the stock of our subsidiaries. Our operations, and our ability to service our debt, are limited by the earnings of our subsidiaries and their payment of their earnings to us in the form of management fees, dividends, loans, advances or the reimbursement of expenses. These payments can be made only when our subsidiaries have adequate earnings. In addition, these payments made to us by our insurance subsidiaries are restricted by Florida law governing the insurance industry. Generally, Florida law limits the dividends payable by insurance companies under complicated formulas based on the subsidiary's available capital and earnings. Under these formulas, Federated National would be able to pay approximately \$200,000 in dividends in 2004 and American Vehicle would be able to pay approximately \$70,000 in dividends in 2004. Florida law does authorize the Florida Office of Insurance Regulation to approve dividends that exceed the formula amounts.

No dividends were declared or paid by our subsidiaries in 2002, 2001 or 2000. Whether our subsidiaries will be able to pay dividends in 2003 depends on the results of their operations and their expected needs for capital. If our subsidiaries continue to achieve net income at current levels and conditions in the insurance markets remain relatively consistent, then we anticipate that our subsidiaries will begin to pay dividends to our company in 2003.

Historically, our operations and financing obligations have required approximately \$40 million per year. We anticipate that some of our obligations will be met through future dividends from our subsidiaries and the remainder from our existing sources of capital, such as our line of credit. The most likely reason why we would not be able to meet our obligations is if a

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catastrophic event expected to occur no more often than once in every 100 years were actually to occur and simultaneously, our reinsurance arrangements were to fail. If we need additional sources of capital, we currently expect that we would offer our securities to investors or obtain financing secured by our assets.

USE OF PROCEEDS

The Company is issuing the shares of common stock covered by this prospectus directly to the holders of the Company's notes in payment of principal and interest due on the notes. As a result, the Company will not receive cash proceeds from the issuance of these shares, although the Company will reduce the outstanding aggregate principal balance of the notes by issuing these shares. The Company has agreed to bear the costs of registering these shares, which the Company estimates will total \$_____.

MARKET FOR OUR SECURITIES

Our common stock has been listed for trading on the Nasdaq National Market under the symbol TCHC since November 5, 1998. For the calendar quarters indicated, the table below sets forth the high and low closing prices per share of our common stock based on published financial resources.

Quarter Ended	High	Low
June 30, 2003	\$ 16.63	\$ 10.71

March 31, 2003	\$ 13.52	\$ 9.18
December 31, 2002	\$ 13.61	\$ 6.68
September 30, 2002	\$ 7.45	\$ 4.29
June 30, 2002	\$ 12.20	\$ 4.55
March 31, 2002	\$ 4.89	\$ 3.04
December 31, 2001	\$ 3.15	\$ 1.50
September 30, 2001	\$ 2.65	\$ 0.98
June 30, 2001	\$ 3.10	\$ 2.03
March 31, 2001	\$ 3.38	\$ 1.91

As of September 10, 2003, there were approximately 36 holders of record of our common stock. We believe that the number of beneficial owners of our common stock is in excess of 850.

DIVIDEND POLICY

We paid a quarterly dividend of \$0.02 per share on our common stock from the fourth quarter of 2000, until the third quarter of 2002. We declared a \$0.05 per share dividend in the third quarter of 2002, a \$0.06 per share dividend in the fourth quarter of 2002, a \$0.07 per share dividend in the first quarter of 2003 and a \$0.09 per share dividend in the second quarter of 2003. We currently expect to continue to pay a quarterly dividend in the future. However, payment of dividends in the future will depend on our earnings and financial position and such other factors, as our Board of Directors deems relevant. Moreover, our ability to continue to pay dividends may be restricted by regulatory limits on the amount of dividends that Federated National and American Vehicle are permitted to pay to us.

CAPITALIZATION

The following table sets forth as of June 30, 2003 the Company's unaudited actual and pro forma capitalization, to reflect (a) the issuance of the Company's 6% Senior Subordinated Notes due July 31, 2006, and (b) the issuance until the notes' maturity of up to 625,000 shares of common stock in payment of the quarterly principal and interest due on the notes.

		Pro Forma to Reflect Issuance of	Pro Forma to Reflect Principal and Interest Paid in Shares
	Actual	Notes	
Net cash and cash equivalents	\$ 4,662,430	\$ 11,662,430 (A)	\$ 11,662,430
Subsidiary Debt:			
Revolving credit line	3,765,476	3,765,476	3,765,476
Total subsidiary debt	3,765,476	3,765,476	3,765,476
Company Debt:			
Notes		7,500,000	
Total debt	3,765,476	11,265,476	3,765,476
Shareholders Equity:			
Book value of shareholders equity	23,512,241	23,512,241	30,512,241
Total capitalization	\$ 27,277,717	\$34,777,717	\$ 34,277,717
Underwriting Surplus Accounts:			
Federal National	10,442,553	10,442,553	10,442,553
American Vehicle	6,012,939	10,012,939	10,012,939
Total capital surplus	\$ 16,455,492	\$ 20,455,492	\$ 20,455,492

(A) Reflects the receipt of \$7,000,000 in net proceeds from the sale of the notes.

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The following selected financial data is qualified by reference to, and should be read in conjunction with, the Consolidated Financial Statements of the Company and related Notes thereto included in this prospectus and Management's Discussion and Analysis of Financial Condition and Results of Operations.

	As of or for the year ended December 31,				
	2002	2001	2000	1999	1998
Operations Data:					
Revenue:					
Gross premiums written	\$ 63,036,468	\$ 34,271,338	\$ 32,073,768	\$ 19,273,561	\$ 21,195,1
Gross premiums ceded	(25,286,828)	(12,789,404)	(7,625,095)	(6,221,853)	(6,628,2
Net premiums written	37,749,640	21,481,934	24,448,673	13,051,708	14,566,8
Decrease (increase) in unearned premiums, net of prepaid reinsurance premiums	(8,356,636)	(1,226,373)	(4,127,334)	404,640	(604,1
Net premiums earned	29,393,004	20,255,561	20,321,339	13,456,348	13,962,7
Commission income	1,905,936	2,828,779	2,780,869	4,410,856	2,036,6
Finance revenue	4,452,626	5,267,523	5,709,848	3,696,843	1,825,2
Managing general agent fees	1,970,226	5,871,388	5,410,500	963,797	971,7
Net investment income	1,253,765	1,066,641	1,225,413	853,659	983,5
Net realized investment gains (losses)	(1,369,961)	(2,911,658)	(109,256)	952,153	441,8
Other income	2,973,949	3,098,332	2,214,894	1,043,798	446,6
Total revenue	40,579,545	35,476,566	37,553,607	25,377,454	20,668,4
Expenses:					
Losses and loss adjustment expenses	15,987,125	16,154,902	14,990,118	8,094,677	9,133,3
Operating and underwriting expenses	10,778,990	11,644,183	11,892,577	7,032,428	4,291,6
Salaries and wages	8,004,694	8,478,771	9,375,775	7,474,572	4,042,2
Amortization of deferred					

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acquisition costs, net	(2,064,314)	1,467,238	1,673,754	(18,563)	179,0
Amortization of goodwill		540,010	606,653	547,548	239,6
Total expenses	32,706,495	38,285,104	38,538,877	23,130,662	17,885,8
Income (loss) before					
provision for income tax					
expense and extraordinary					
gain	7,873,050	(2,808,538)	(985,270)	2,246,792	2,782,6
(Provision) benefit for					
income tax expense	(3,302,849)	630,553	462,396	(680,061)	(965,0
Net income (loss) before					
extraordinary gain	4,570,201	(2,177,985)	(522,874)	1,566,731	1,817,6
Extraordinary gain		1,185,895			
Net income (loss)	\$ 4,570,201	\$ (992,090)	\$ (522,874)	\$ 1,566,731	\$ 1,817,6
Basic net income (loss) per					
share before extraordinary					
gain	\$ 1.52	\$ (0.69)	\$ (0.15)	\$ 0.46	\$ 0.
Extraordinary gain	\$	\$ 0.38	\$	\$	\$
Basic net income (loss) per					
share	\$ 1.52	\$ (0.31)	\$ (0.15)	\$ 0.46	\$ 0.
Cash dividends declared per					
share	\$ 0.15	\$ 0.08	\$ 0.02	\$	\$

	As of or for the year ended December 31,				
	2002	2001	2000	1999	1998
Balance Sheet Data:					
Total assets	\$ 75,318,011	\$ 56,228,577	\$ 55,412,969	\$ 38,686,404	\$ 38,176,400
Investments	25,377,796	17,507,422	18,965,798	13,916,571	17,705,260
Finance contracts, consumer loans and pay advances receivable, net	7,217,873	10,813,881	13,792,791	9,642,163	7,093,590
Total liabilities	57,220,347	42,019,446	40,456,972	22,932,516	23,208,580
Unpaid losses and loss adjustment expenses	16,983,756	11,005,337	9,765,848	6,314,307	7,603,460
Unearned premiums	28,934,486	14,951,228	13,038,417	8,037,083	8,534,320
Revolving credit outstanding	4,312,420	6,676,817	8,091,034	4,650,026	2,062,940
Total shareholders equity	\$ 18,097,664	\$ 14,209,131	\$ 14,955,997	\$ 15,753,888	\$ 14,967,820
Book value per share	\$ 6.05	\$ 4.69	\$ 4.49	\$ 4.67	\$ 4.44

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL
CONDITION AND RESULTS OF OPERATIONS**

Overview

The Company is a vertically integrated insurance holding company, which, through its subsidiaries, controls substantially all aspects of the insurance underwriting, distribution and claims process. The Company underwrites personal automobile insurance, general liability insurance, flood insurance, homeowners insurance and mobile home property and casualty insurance in the States of Florida and Georgia through its subsidiaries, Federated National and American Vehicle. The Company internally processes claims made by its own and third party insureds through a wholly owned claims adjusting company, Superior. The Company also offers premium financing to its own insureds through its wholly owned subsidiary, Federated Premium.

The Company markets and distributes its own and third-party insurers' products and its other services primarily in Central and South Florida, through a network of 23 agencies owned by Federated Agency Group, a wholly owned subsidiary, 42 franchised agencies and approximately 125 independent agents. The Company, through its wholly owned subsidiary, FedUSA, franchises agencies under the FedUSA name. The Company intends to focus its future expansion efforts for its agency network on franchised agencies.

Assurance MGA, a wholly owned subsidiary, acts as Federated National's and American Vehicle's exclusive managing general agent. Assurance MGA currently provides all underwriting policy administration, marketing, accounting and financial services to Federated National, American Vehicle and the Company's agencies and participates in the negotiation of reinsurance contracts.

Assurance MGA generates revenue through policy fee income and other administrative fees from the marketing of companies' products through the Company's distribution network. Although Assurance MGA recently replaced business from an unaffiliated insurance company with business from American Vehicle, and ceased acting as a third-party administrator for this company, Assurance MGA plans to establish relationships with additional carriers and add additional insurance products in the future.

The Company offers electronic tax filing services through Express Tax, an 80%-owned subsidiary, as well as franchise opportunities for these services. As of June 30, 2003, there were 141 franchises granted in ten states. Revenue is generated through franchise sales, collection of royalties on tax preparation fees, incentives from business partners as well as fees from the preparation of income tax returns and income tax refund anticipation loans. In addition, Express Tax offers tax preparation services through more than 500 licensees nationwide, acting as sales representatives.

The Company's 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 the Company's business, results of operations and financial condition. Also, if the Company's estimated liabilities for unpaid losses and loss adjustment expenses are less than actual losses and loss adjustment expenses, the Company will be required to increase reserves with a corresponding reduction in the Company's net income in the period in which the deficiency is identified.

The Company operates in a highly competitive market and faces competition from both national and regional insurance companies, many of whom are larger and have greater financial and other resources than the Company, have favorable A.M. Best ratings and offer more diversified insurance coverage. The Company's competitors include other 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. The Company may also face competition from new or temporary entrants in its niche markets. In some cases, such entrants may, because of inexperience, desire for new business or other reasons, price their insurance below the pricing structure of the Company. Although the Company's pricing is inevitably influenced to some degree by that of its competitors, management of the Company believes that it is generally not in the Company's best interest to compete solely on price, choosing instead to compete on the basis of underwriting criteria, its distribution network and superior service to its agents and insureds. The Company competes with respect to automobile insurance in Florida with more than 100 companies, which underwrite personal automobile insurance. Companies of comparable or smaller size, which compete with the Company in the personal automobile insurance industry, include U.S. Security Insurance Company, United Automobile Insurance Company, Direct General Insurance Company and Security National, as well as major insurers such as Progressive Casualty Insurance Company. Competition could have a material adverse effect on the Company's business, results of operations and financial condition.

Critical Accounting Policies

The Company's accounting policies are more fully described in Note 2 of the Notes to the Company's Consolidated Financial Statements included in this prospectus. As disclosed therein, the preparation of financial statements in conformity with Generally Accepted Accounting Principles (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 the Company's financial statements include estimates associated with management's evaluation of the determination of liability for unpaid losses and loss adjustment expense and the recoverability of goodwill. In addition, significant estimates form the basis for the Company's reserves with respect to finance contracts, premiums receivable and deferred income taxes. Various assumptions and other factors underlie the determination of these significant estimates. 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 loss adjustment expense, an actuarial valuation. Management constantly reevaluates these significant factors and makes adjustments where facts and circumstances dictate. See Note 2 of Notes to Consolidated Financial Statements.

Accounting Changes. In June 2000, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities -- an amendment of Financial Accounting Standards Board Statement No. 133, which because of the Company's early adoption of Statement of

Financial Accounting Standard No. 133, was effective for all fiscal quarters beginning after June 15, 2000. This statement amends the accounting and reporting standards of Statement of Financial Accounting Standard No. 133 for certain derivative instruments and certain hedging activities. Because the Company has limited involvement with derivative financial instruments and does not engage in the derivative market for hedging purposes, the adoption of Statement of Financial Accounting Standard No. 138 did not have a material effect on the Company's financial statements.

Effective January 1, 2000, the Company adopted Statement of Position 98-7, *Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk*. The Statement of Position provides guidance on accounting for insurance and reinsurance contracts that do not transfer insurance risk. All of the Company's reinsurance agreements are risk-transferring arrangements, accounted for according to Statement of Financial Accounting Standard No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*. The adoption of Statement of Position 98-7 had no effect on the Company's financial statements.

Effective July 1, 2000, the Company adopted Financial Accounting Standards Board Interpretation No. 44, *Accounting for Certain Transactions Including Stock Compensation (an Interpretation of Accounting Principles Board Opinion No. 25)*. Financial Accounting Standards Board Interpretation No. 44 clarifies the application of Accounting Principles Board Opinion No. 25 for only certain issues, such as: (a) the definition of employee for purposes of applying Accounting Principles Board Opinion No. 25; (b) the criteria for determining whether a plan qualifies as a noncompensatory plan; (c) the accounting consequence of various modifications to the terms of a previously fixed stock option or award; and (d) the accounting for an exchange of stock compensation awards in a business combination. The adoption of Financial Accounting Standards Board Interpretation No. 44 did not have a material effect on the Company's financial statements.

Effective December 31, 2000, the Company adopted Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements*. The Staff Accounting Bulletin summarizes the SEC staff's views on applying accounting principles generally accepted in the United States to the recognition of revenue in financial statements. The adoption of Staff Accounting Bulletin No. 101 had no effect on the Company's financial statements.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 141, *Business Combinations*, which became effective January 1, 2002. Statement of Financial Accounting Standard No. 141 requires all business combinations initiated after September 30, 2001 to be accounted for using the purchase method. Additionally, Statement of Financial Accounting Standard No. 141 requires an acquired intangible asset, whenever acquired, to be recognized separately from goodwill if the benefit of the intangible asset is obtained through contractual or other legal rights or if the intangible asset can be sold, transferred, licensed, rented, or exchanged, regardless of the acquirer's intent to do so. The adoption of Financial Accounting Standard No. 141 had no effect on the Company.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 142 *Goodwill and Other Intangible Assets*, which became effective January 1, 2002. Statement of Financial Accounting Standard No. 142 eliminates the

amortization of goodwill over its estimated useful life, but requires goodwill to be subject to at least an annual assessment for impairment by applying a fair-value-based test to determine recoverability. Upon adoption of Financial Accounting Standards No.142 January 1, 2002, the Company ceased amortization of goodwill. See footnote (t) GOODWILL for additional information.

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 143, Accounting for Asset Retirement Obligations, which became effective for fiscal years beginning after June 15, 2002. Statement of Financial Accounting Standard No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible, long-lived assets and the associated asset retirement costs. Adoption of this statement has had no material effect on the Company's financial statements.

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, which became effective for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. Statement of Financial Accounting Standard No. 144 revises and clarifies the existing professional guidance addressing: (a) recognition and measurement of the impairment of long-lived assets to be held and used; (b) the measurement of long-lived assets to be disposed of by sale; and (c) the reporting of discontinued operations and components of an entity that either has been disposed of (by sale, by abandonment, or in a distribution to owners) or is classified as held for sale. The adoption of Statement of Financial Accounting Standard No. 144 had no effect on the Company's financial statements.

In April 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 145, Rescission of Financial Accounting Standards Board Statements No. 4, 44 and 64, Amendment of Financial Accounting Standards Board Statement No. 13, and Technical Corrections, which became effective for fiscal years beginning after May 15, 2002. The rescission of Statement of Financial Accounting Standard No. 4, Reporting Gains and Losses from Extinguishment of Debt, and Statement of Financial Accounting Standard No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements, which had amended Statement of Financial Accounting Standard No. 4, will affect income statement classification of gains and losses from extinguishment of debt. Statement of Financial Accounting Standard No. 4 required material gains and losses from extinguishment of debt to be classified as extraordinary items. Under Statement of Financial Accounting Standard No. 145, extinguishment of debt is now considered a risk management strategy by the reporting enterprise, and the Financial Accounting Standards Board does not believe it should be considered extraordinary under the criteria in Accounting Principles Board Opinion No. 30, Reporting the Results of Operations--Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, unless the debt extinguishment meets the unusual-in-nature and infrequency-of-occurrence criteria in Accounting Principles Board Opinion No. 30. The adoption of Statement of Financial Accounting Standard No. 145 will have no effect on the Company's financial statements.

In July 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No.146, Accounting for Costs Associated with Exit or Disposal Activities. Statement of Financial Accounting Standard No. 146 supersedes Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). Statement of Financial Accounting Standard No. 146 requires that, in certain instances, costs

associated with an exit or disposal plan be recognized when incurred rather than at the date of a commitment to an exit or disposal plan. Statement of Financial Accounting Standard No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The adoption of Statement of Financial Accounting Standard No. 146 will have no effect on the Company's financial statements.

In October 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 147, *Acquisitions of Certain Financial Institutions*, which clarifies the accounting treatment for acquisitions of financial institutions. In addition, this Statement amends Statement of Financial Accounting Standard No. 144,

Accounting for the Impairment or Disposal of Long-Lived Assets, to include in its scope long-term customer-relationship intangible assets of financial institutions such as depositor- and borrower-relationship intangible assets and credit cardholder intangible assets. Statement of Financial Accounting Standard No. 147 is effective on October 1, 2002. The adoption of Statement of Financial Accounting Standard No. 147 will have no effect on the Company's financial statements.

In December 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure*, which amended Statement of Financial Accounting Standard No. 123, *Accounting for Stock-Based Compensation*. The new standard provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation.

Additionally, the statement amends the disclosure requirements of Statement of Financial Accounting Standard No. 123 to require prominent disclosures in the annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. This statement is effective for financial statements for fiscal years ending after December 15, 2002. In compliance with Statement of Financial Accounting Standard No. 148, the Company has elected to continue to follow the intrinsic value method in accounting for stock-based employee compensation arrangement as defined by Accounting Principles Board Opinion No. 25,

Accounting for Stock Issued to Employees, and have made the applicable disclosures in the *Stock-Based Compensation* section, see Note 16.

In April 2003, the FASB issued FAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under FAS Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. In general, this Statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of FAS No. 149 will not have a material effect on the financial statements of the Company.

In May 2003, the FASB issued FAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This Statement establishes standards for an issuer to classify and measure certain financial instruments with characteristics of both liabilities and equity. It requires an issuer to classify a financial instrument that meets certain characteristics as a liability (or an asset in some circumstances). This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of FAS No. 150 will not have a material effect on the financial statements of the Company.

Analysis of Financial Condition

As of June 30, 2003 as Compared to December 31, 2002

Investments. Investments increased \$11.0 million, or 43.3%, to \$36.4 million as of June 30, 2003 as compared to \$25.4 million as of December 31, 2002. Cash provided by operations amounted to \$10.4 million during the six months ended June 30, 2003. For further detail, see the section titled "Quantitative and Qualitative Disclosures About Market Risk," below.

Finance Contracts and Pay Advances Receivable. Finance contracts decreased \$2.3 million, or 31.9%, to \$4.9 million as of June 30, 2003. The continued decrease is due to the direct-bill feature offered by the insurance companies wherein the policyholder can renew and pay premiums directly to the insurance companies.

Prepaid Reinsurance Premiums. Prepaid reinsurance premiums decreased \$2.6 million, or 23.0%, to \$8.7 million as of June 30, 2003 from \$11.3 million as of December 31, 2002. The decrease is the result of a decrease in American Vehicle ceded quota-share reinsurance from 70% of its premiums written to 40% effective November 1, 2002. Federated National's ceded quota-share reinsurance changed from 40% of automobile premiums written in 2002 to 30% for automobile premiums written in the first quarter of 2003. Subsequent to the first quarter of 2003, the cession for Federated National was changed to 40%.

Reinsurance Recoverable. Reinsurance recoverable increased \$4.2 million to \$12.1 million as of June 30, 2003 from \$7.9 million as of December 31, 2002. This increase is the result of the increase in loss and loss adjustment expenses incurred and, to a lesser extent, the timing of settlements between the Company and its reinsurer. All amounts are considered current.

Deferred Acquisition Costs, Net. Deferred acquisition costs increased from \$7,721 as of December 31, 2002 to \$829,042 as of June 30, 2003. The December 31, 2002 balance was composed of commission expense offset by ceded commissions income, of approximately \$(422,920) and other expenses connected with the writing of premiums such as salaries, payroll taxes and premium taxes, and offset by policy fees of \$430,641. At June 30, 2003, commission expense net of commission income was \$417,351 and expenses connected with the writing of premiums such as

salaries and premium taxes, were further offset by policy fees of \$411,691. Deferred policy acquisition costs, net, increased primarily due to the decrease in ceded unearned commissions. The decrease in ceded unearned commissions relates to the decline in the decreased reliance of quota-share reinsurance associated with the insurance company's automobile premiums.

Unpaid Losses and Loss Adjustment Expenses. Unpaid loss and loss adjustment expenses increased \$7.1 million from \$17.0 million as of December 31, 2002 to \$24.1 million as of June 30, 2003. The increase is associated with an apparent increase in frequency and severity of claims activity associated with our automobile business. Federated National's reserves increased by \$3.1 million and represent 44.19% of the total reserve increase. American Vehicle's reserves increased by \$4.0 million and represent 55.81% of the total reserve increase. Factors that affect unpaid losses and loss adjustment expenses include the estimates made on a claim-by-claim basis known as case reserves coupled with bulk estimates known as incurred but not reported (IBNR). Interim estimates of the ultimate costs required to settle all claim files are based on all available information encompassing prior loss trends and current payment patterns.

Premium Deposits. Premium deposits represent premiums collected in advance of the policy's effective date of coverage and are generally associated with the Company's home and mobile home insurance policies. Premium deposits increased from \$656,000 as of December 31, 2002 to \$1.0 million as of June 30, 2003 primarily due to the additional home owners' policies written.

Accounts Payable and Accrued Expenses. Accounts payable and accrued expenses decreased by \$1.0 million primarily due to the Company's payment of its premium taxes and to a lesser extent a scheduled payment of contingent commissions.

As of December 31, 2002 as Compared to December 31, 2001

Investments. Investments increased \$7.9 million to \$25.4 million as of December 31, 2002 from \$17.5 million as of December 31, 2001 primarily as a result of an increase in insurance premiums written. An investment impairment of \$2.0 million was charged to operations in 2002 for WorldCom bonds held by the Company and reflecting WorldCom's bankruptcy. These bonds were marked to market from \$2.5 million to \$0.5 million based on the Company's estimate of the estimated net realizable value of the bonds. As a result of this occurrence, management more carefully monitors its investment concentrations, industries and asset allocations. There were no instances of significant concentrations of investment securities requiring write downs. The Company did not hold any non-traded investment securities during

2002 or 2001.

Below is a summary of unrecognized impairment loss at December 31, 2002 by investment category.

	Net
	Unrealized
	Gains (Losses)
December 31, 2002	
Fixed maturities:	
U.S. government obligations	\$ 425
Obligations of states and political subdivisions	33,610
Corporate securities:	
Communications	(332,383)
Financial	62,101
Other	28,703
	\$ (207,544)
Equity securities:	
Preferred stocks	\$ (316)
Common stocks	(23,843)
	\$ (24,159)
Total fixed and equity securities	\$ (231,704)

It is often difficult to anticipate the necessity for other than temporary mark downs. An issuer's delinquent interest payments and/or delinquent principal repayments, coupled with adverse news bulletins such as filing for bankruptcy, would indeed trigger the necessity to recognize a devaluation. Based on information known through the release of the issuers' respective financial statements, the Company determined, in its best judgment, that all other market values less than cost were temporary. Temporary timing differences between current market price and book value do not affect current earnings, but are treated as adjustments to the equity section of the Company's balance sheet. When the current market price of a security is less than book value and the timing differences are associated with other than temporary or permanent declines, then the resulting adjustment would have a negative impact on earnings and would be recognized in the current period earnings. Such adjustments cannot be subsequently revalued upward through earnings.

The following table relates to securities with an unrealized loss.

	2002		% of	2001		% of
	Carrying	Unrealized	Unrealized	Carrying	Unrealized	Unrealized
	Value	Gain (Loss)	Gain (Loss)	Value	Gain (Loss)	Gain (Loss)
			to			to
	Value	Gain (Loss)	Value	Value	Gain (Loss)	Value
Fixed maturities						
investment grade	\$ 24,400,348	\$ (294,803)	(1.21%)	\$ 16,915,642	\$ (202,231)	(1.20%)
Fixed maturities						
non-investment grade	\$ 500,243	\$ 87,257	17.44%	\$	\$	
Preferred stock	\$ 208,316	\$ (316)	(0.15%)	\$ 208,316	\$ (15,816)	(7.59%)
Common stock	\$ 355,549	\$ (23,843)	(6.71%)	\$	\$	
Total	\$ 25,464,456	\$ (231,705)		\$ 17,123,958	\$ (186,505)	

Of the securities held in the Company's investment portfolio, 97.3% and 95.5% were bonds, and 2.1% and 1.1% were equity securities at December 31, 2002 and 2001, respectively. Investment in mortgage loans were 0.6% and 3.4% at December 31, 2002 and 2001, respectively.

Of the total fair value and unrealized loss of the Company's investment portfolio, 19.64% and 0% of the fair value, and 0% and 0% of the unrealized loss at December 31, 2002 and 2001, respectively, were attributable to non-investment grade or non-rated securities.

As of December 31, 2002, there were no unrealized losses of individual material securities positions.

The following is a summary of the securities sold at a loss during 2002.

Description	Amount of Loss	Fair Value	Discussion:
Lucent Tech.	\$ (103,696)	\$ 794,256	During 2002, the telecommunications industry was adversely affected by the circumstances involving the investigation and discovery of fraud in companies such as WorldCom, Enron, etc. Lucent was acquired in May 2001 and has been at an unrealized loss since that time. The ability and intent to hold securities with unrealized losses until they mature or recover is not contradicted in this case because of the unusual and unpredictable circumstances which occurred during 2002.
Other fixed securities	\$ (59,549)	\$ 2,185,045	The numerous securities included here realized losses at a less material amount and occurred as a result of overall market declines.
Common	\$ (103,334)	\$ 923,908	The numerous securities included here realized losses at a less material amount and occurred as a result of overall market declines. Net gains were realized as a result of sales during 2002.

The following table shows the maturity dates for the fixed maturity securities in the Company's investment portfolio grouped by class:

	1 Year or Less	1-5 Years	5-10 Years	10-20 Years	+20 Years	Total
U.S. Government	\$	\$ 102,183	\$	\$	\$	\$ 102,183
Municipals	103,304	468,274	5,403,352	2,385,390	195,831	8,556,151

Corporate	2,272,263	12,371,401	1,598,594			16,242,258
Total	\$ 2,375,567	\$ 12,941,858	\$ 7,001,946	\$ 2,385,390	\$ 195,831	\$ 24,900,592
% of Total	9.54%	51.97%	28.12%	9.58%	0.79%	100%

For 2002, the Company's fixed maturities rate of return was 12% as compared to the Lehman Treasury Bond Fund of 10% and the Company's rate of return for stocks held was (5%) as compared to the S&P of (23%) for the same period.

Finance Contracts. Finance contracts receivable decreased \$3.6 million from \$10.8 million as of December 31, 2001 to \$7.2 million as of December 31, 2002 primarily because, beginning in the third quarter 2001, the Company now only finances contracts from Company owned agencies and Company franchised agencies and no longer finances contracts originated by third party agencies.

Prepaid Reinsurance Premiums. Prepaid reinsurance premiums increased \$5.7 million to \$11.3 million as of December 31, 2002 from \$5.6 million as of December 31, 2001 primarily due the acquisition of American Vehicle in November 2001.

Reinsurance Recoverable - Net. Reinsurance recoverable increased \$0.8 million to \$7.9 million as of December 31, 2002 from \$7.1 million as of December 31, 2001. This increase is the result of the addition of American Vehicle offset in part by the timing of settling monthly quota share treaties for the respective insurance companies.

Premiums Receivable. Premiums receivable were \$8.4 million as of December 31, 2002, an increase of \$6.8 million as compared to \$1.6 million outstanding as of December 31, 2001. This increase is the result of added emphasis placed on direct bill premium financing by both Federated National and American Vehicle.

Deferred Acquisition Costs - Net. Deferred acquisition costs decreased from \$12,000 as of December 31, 2001 to \$8,000 as of December 31, 2002. Included in the December 31, 2001 balance were deferred commissions of \$1.7 million offset by unearned ceded commissions of \$1.7 million. As of December 31, 2002, deferred commissions were \$3.0 million offset by unearned ceded commissions of \$3.0 million. The increase in unearned ceded commissions is related to the increase in reinsurance recoverable discussed above.

Deferred acquisition costs recognized for 2002 resulted in approximately \$2.1 million of income as compared to a net expense for 2001 of approximately \$1.5 million. The 2002 income recognized results primarily from the netting of ceded commissions earned against the costs amortized each year which exceeded such costs in 2002. The change in deferred policy acquisition costs, net of approximately \$3.5 million, from 2002 to 2001 occurred as a result of the increased ceded commissions written in 2002 over 2001 of approximately \$12.5 million, a reduction in the amount of commissions paid to independent agents as a result of in-house underwriting, recognition of unearned commissions related to third-party premium underwriting which was discontinued in late 2001, and the utilization of the available in-house underwriting capacity to absorb the increase in earned premiums from 2002 over 2001.

Deferred Income Taxes. The deferred income tax asset increased \$0.4 million to \$2.7 million as of December 31, 2002 from \$2.3 million as of December 31, 2001, primarily due to the increase of discounted unearned premiums from American Vehicle and the other than temporary write down of the Company's position held with WorldCom, Inc.

Goodwill. Goodwill remained unchanged during 2002 due to the adoption of SFAS 142 where-in the Company's assessment of goodwill indicated no impairment.

Unpaid Losses and Loss Adjustment Expenses. Unpaid loss and loss adjustment expenses increased \$6.0 million, from \$11.0 million at December 31, 2001 to \$17.0 million as of December 31, 2002. This increase is primarily due to the addition of American Vehicle's loss reserves, which represent a full year's experience for 2002.

Reserve estimation is an ongoing process in which management assesses reserve adequacy based on as much information as possible. Frequency and severity trends guide management to its conclusions as to the ultimate cost to close a claim file.

Comparing incurred loss and loss adjustment expenses for the first half of 2003 to 2002, the addition of American Vehicle accounts for 73% of the \$3.6 million increase to reserves. Mitigating this reserve increase is the increase in earned premiums of \$5.0 million for the same period, of which 67% of that increase can also be attributed to American Vehicle.

The loss reserves, net of reinsurance, increased \$747,000 over December 31, 2002. The increase in the reserve for the year represents a decrease for payments on outstanding claims as of December 31, 2001 of \$5,296,000 and a decrease in the reserve of \$4,579,000 for the amount necessary to adjust the reserve to the reevaluated amount of the reserve for accident years 2001 and prior. This increase in the reserve was necessary in management's judgment to reflect recent trends in the amount of claims settled as compared with the previous amount estimated to settle such claims.

The table below depicts the reserve balances by major line of business for the years ended December 31, 2002 and 2001.

Line of Business	2002	2001
Automobile liability	\$ 14,813,864	\$ 10,323,231
Automobile physical damage	1,165,008	87,241

Homeowner and mobile homeowner	1,004,884	594,865
Total unpaid loss and Loss adjustment expenses	\$ 16,983,756	\$ 11,005,337

The Company employs various statistical methodologies, including but not limited to, frequency and severity models, paid to ultimate models, and ultimate loss ratio methods, to determine management's best estimate of the unpaid losses and loss adjustment expense. Subsequently, the Company's data is submitted to an actuary who subjects the data experience to many actuarially accepted models. Based on all available information, the actuary issues a report setting forth his opinion regarding the reserve adequacy. The Company's actuary provides a separate report for each of the Company's insurance subsidiaries. Federated National carried reserves of \$12,129,000 at December 31, 2002, while the actuary's results concluded that of the possible range of outcomes, approximately \$9,900,000 would be the low estimate and \$16,800,000 would be the high estimate. American Vehicle carried reserves of \$5,799,000 at December 31, 2002, while the actuary's estimate of reserves was approximately \$4,700,000.

Federated National and American Vehicle do not insure asbestos-related illnesses, environmental remediation, product liability and other highly uncertain exposures.

Unearned Premium. Unearned premium increased \$14.0 million from \$15.0 million as of December 31, 2001 to \$29.0 million as of December 31, 2002. The balance of unearned premium is determined by the amount and timing of when policies are written. The increase in 2002 is primarily attributable to the addition of American Vehicle's operations.

Revolving Credit Outstanding. Revolving credit outstanding decreased \$2.4 million to \$4.3 million as of December 31, 2002 from \$6.7 million as of December 31, 2001. This decrease is related to the decrease in finance contracts due the Company's continued emphasis on direct bill insurance premiums in 2002.

Unearned Commissions. Unearned commissions declined in 2002 from \$1.2 million to \$19,000 due to the completion of Assurance MGA's underwriting an insurance program as a third party administrator.

Premium Deposits. Premium deposits were \$0.7 million as of December 31, 2002 as compared \$1.1 million as of December 31, 2001. This change is caused primarily by the timing of disbursements for cancelled policies and the timing of receipt of premium dollars as compared to the receipt of the policy from the agents.

Results of Operations

Six Months Ended June 30, 2003 Compared to Six Months Ended June 30, 2002

Gross Premiums Written. Gross premiums written increased \$3.4 million, or 11%, to \$34.1 million for the six months ended June 30, 2003, as compared to \$30.8 million for the comparable period in 2002. The increase is primarily due to additional marketing of its home-owners insurance product. The following table denotes gross premiums written by major product line.

	Six Months Ended June 30,			
	2003		2002	
Automobile	\$ 25,954,630	75.9 %	\$ 24,854,334	80.6 %
Homeowners	7,258,461	21.2 %	4,917,591	16.0 %
Mobile homeowners	977,483	2.9 %	1,039,784	3.4 %
Gross written premiums	\$ 34,190,574	100.0 %	\$ 30,811,709	100 %

Gross Premiums Ceded. Gross premiums ceded decreased from \$13.4 million for the six months ended June 30, 2002, to \$10.2 million for the six months ended June 30, 2003. For 2002, Federated National reinsured through a quota-share agreement 40% of its written automobile premiums and American Vehicle reinsured 70% of its written automobile premiums. In 2003, Federated National and American Vehicle reinsured 40% of their written automobile premiums. The amount of quota share reinsurance maintained by Federated National is determined by management, based on estimated annual written premiums and estimated year-end surplus, in order to comply with insurance regulations.

Decrease in Unearned Premiums, Net of Prepaid Reinsurance Premiums. The decrease in unearned premiums, net of prepaid reinsurance premiums, was \$2.6 million for the six months ended June 30, 2003 compared to \$5.5 million for the six months ended June 30, 2002. This decrease reflects the relatively unchanged balance of the unearned premium liability in conjunction with the modest increase in written premium for the comparable period.

Commission Income. Commission income is generated from the sale of other insurance company products by our captive agents. The decline in commission income is primarily due to the Company's emphasis on selling its own insurance products.

Managing General Agent Fees. Managing general agent fees increased \$374,000 to \$1.3 million for the six-month period ended June 30, 2003 from \$879,000 for the same period in 2002. The increase can be attributed to increased volume in the American Vehicle's automobile program and Federated National's homeowner program as compared to the same period last year.

Net Securities Gains (Losses). The Company experienced net losses of \$1.5 million for the six-month period ended June 30, 2002 compared to net gains of \$1.4 million for the same period in 2003. Realized gains for the six months ending June 30, 2003 totaled \$1.6 million and realized losses for the same period were \$0.2 million. In June 2002, the Company recorded a loss of \$1.5 million on its \$2.5 million investment in WorldCom bonds.

Losses and Loss Adjustment Expenses. The Company's loss ratio, as determined in accordance with GAAP, for the six-month period ended June 30, 2003 was 66.7% compared with 54.7% for the same period in 2002. Losses and loss adjustment expenses incurred increased \$7.8 million to \$14.3 million for the six-month period ended June 30, 2003 from \$6.5 million for the same period in 2002. The Company attributes the overall increase in the loss ratio primarily to its liability lines of insurance associated with automobile claims and the related estimates of the costs necessary to settle the claim files. The estimated cost to close all claim files, for accident years other than the current year and net of reinsurance recoveries has increased by a total of \$2.3 million over the estimates made as of December 31, 2002 primarily due to an increase in claims frequency and claims severity. The table below reflects the loss ratios by product line.

	Six Months	
	Ended June 30,	
	2003	2002
Automobile	83.77%	79.39%
Homeowner	14.64%	20.12%
Mobile homeowner	27.39%	11.80%
Totals	66.72%	54.65%

Losses and loss adjustment expenses, the Company's most significant expenses, represent actual payments made and changes in estimated future payments to be made to or on behalf of its policyholders, including expenses required to settle claims and losses.

Amortization of Deferred Policy Acquisition Costs. Amortization of deferred policy acquisition costs decreased from a credit of \$1.1 million for the six-month period ended June 30,

2002 to a credit \$1.0 million for the same period in 2003. Amortization of deferred policy acquisition costs consists of the actual policy acquisition costs, including commissions, payroll and premium taxes, less commissions earned on reinsurance ceded and policy fees earned. The decline is attributable to the decrease in ceded unearned commissions. The decrease in ceded unearned commissions relates to the decline in the decreased reliance of quota-share reinsurance associated with the insurance company's automobile premiums.

Provision for Income Tax Expense. The effective rate for income tax expense is 33.5% for the six months ended June 30, 2003 compared with 58.5% for the same period in 2002. The change to the effective rate reflects the Company's ability to generate realized gains and the benefit of netting capital losses incurred in 2001.

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Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Gross Premiums Written. Gross premiums written increased \$28.8 million, or 84%, to \$63.0 million for the year ended December 31, 2002 as compared to \$34.2 million in 2001. The increase is due to the addition of American Vehicle's operations composing \$19.9 million of the increase and \$8.9 in increased written premiums by Federated National, which were the result of increased premium volume due to additional capacity created by increased surplus.

Gross Premiums Ceded. Gross premiums ceded increased from \$12.8 million for the year ended December 31, 2001, to \$25.3 million for the year ended December 31, 2002. The increase of \$12.5 million is primarily due to the acquisition of American Vehicle and its 70% quota-share reinsurance treaty, which the Company entered into in order to maintain the ratio of premiums written to surplus mandated by the State of Florida.

Decrease (Increase) in Unearned Premiums, net of Prepaid Reinsurance Premiums. The increase in unearned premiums, net of prepaid reinsurance premiums, was \$7.1 million for the year ended December 31, 2002. The increase is primarily due to the addition of a full year of operations for American Vehicle as compared to two months of operations in 2001.

Managing General Agent Fees. Managing general agent fees are charged at a rate of \$25.00 per policy, which is the maximum currently permitted under Florida law. These fees declined \$3.9 million to \$2.0 million for the year ended 2002. The decline is a result of Assurance MGA's completion of underwriting insurance for an unaffiliated insurance company.

Net Realized Investment Gains (Losses). The Company experienced net losses of \$1.4 million for the year ended December 31, 2002 as compared to \$2.9 million for the same period in 2001. Once thought to be only a function of the equity market, segments of the highly rated bond market proved to be unsound in 2002. During 2002, the Company incurred an other than temporary decline in value of \$2.0 million in its investment in WorldCom, Inc. bonds.

Losses and Loss Adjustment Expenses. The Company's loss ratio, combining the results of both insurance companies, as determined in accordance with GAAP, for the year ended December 31, 2002 was 54.4% compared with 79.8% for 2001. Losses and loss adjustment expenses incurred decreased \$168,000 to \$16.0 million for 2002 from \$16.2 million for 2001. Losses and loss adjustment expenses, the Company's most significant expenses, represent

actual payments made and changes in estimated future payments to be made to or on behalf of its policyholders, including expenses required to settle claims and losses.

Deferred Policy Acquisition Costs. The Company's deferred policy acquisition costs declined by \$3.1 million to a credit balance of \$2.1 million as compared to a charge against income of \$1.0 million in 2001. The increase is associated with the shift in business underwritten by Assurance MGA away from an unaffiliated insurance company to American Vehicle.

Extraordinary Gain. In August 2001, the Company recorded an extraordinary gain of \$1.2 million which represents the excess of the fair value of the net assets purchased over the purchase price, when the Company acquired American Vehicle.

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Gross Premiums Written. Gross premiums written increased \$2.2 million, or 6.9%, to \$34.3 million for the year ended December 31, 2001 as compared to \$32.1 million in 2000. The increase is primarily due to an increase in homeowners premiums written, which increased to \$7.7 million in 2001 from \$4.6 million in 2000.

Gross Premiums Ceded. Gross premiums ceded increased from \$7.6 million for the year ended December 31, 2000, to \$12.8 million for the year ended December 31, 2001, reflecting in part the acquisition of American Vehicle in 2001. The Company ceded 70% of the premiums written by American Vehicle in order to maintain the ratio of premiums written to surplus mandated by the State of Florida. In addition, in 2000, the Company had 30% automobile quota-share reinsurance as compared to 50% automobile quota-share reinsurance in 2001 for premiums written by Federal National.

Decrease (Increase) in Unearned Premiums, net of Prepaid Reinsurance Premiums. The decrease in unearned premiums, net of prepaid reinsurance premiums, was \$1.2 million for the year ended December 31, 2001 compared to \$4.1 million for the year ended December 31, 2000. This decrease is due primarily to the change in quota-share reinsurance discussed above.

Net Realized Investment Gains (Losses). The Company experienced net losses of \$2.9 million for the year ended December 31, 2001 compared to \$109,000 for the same period in 2000. Realized gains or losses are primarily a function of the equity markets. In August 2001, the Company divested itself of its investments in common stock and does not intend to invest in common stock in the future.

Other Income. Other income increased \$883,000 to \$3.1 million for the year ended December 31, 2001 from \$2.2 million for 2000. This increase is primarily attributable to an increase in adjusting fees due to the addition in 2000 of two nonaffiliated insurance companies as claims adjusting customers.

Losses and Loss Adjustment Expenses. The Company's loss ratio, as determined in accordance with GAAP, for the year ended December 31, 2001 was 79.8% compared with 73.8% for 2000. Losses and loss adjustment expenses incurred increased \$1.2 million to \$16.2 million for 2001 from \$15.0 million for 2000. Losses and loss adjustment expenses, the Company's most significant expenses, represent actual payments made and changes in estimated future payments to be made to or on behalf of its policyholders, including expenses required to settle claims and losses. In 2001, the Company experienced a significant increase in lawsuits relating to automobile claims. Management believes this increase in lawsuits was in anticipation of the effective date of recent legislation passed by the Florida legislature. This legislation, which became effective October 1, 2001, includes the establishment of a pre-suit notice requirement for no fault claims, fee schedules for certain medical procedures, the licensing of health care clinics, and toughened criminal sanctions for fraud.

Extraordinary Gain. In August 2001, the Company recorded an extraordinary gain of \$1.2 million which represents the excess of the fair value of the net assets purchased over the purchase price, when the Company acquired American Vehicle.

Liquidity and Capital Resources

The Company's primary sources of capital are revenues generated from operations, investment income and borrowings under a revolving agreement discussed below. Because the Company is a holding company, it is largely dependent upon management fees and /or dividends from its subsidiaries for cash flow.

Federated Premium's operations are funded by a revolving loan agreement (Revolving Agreement) with FlatIron Funding Company LLC (FlatIron). The Revolving Agreement is structured as a sale of contracts receivable under a sale and assignment agreement with FPF, Inc. (a wholly-owned subsidiary of FlatIron), which gives FPF Inc. the right to sell or assign these contracts receivable. Federated Premium, which services these contracts, has recorded transactions under the Revolving Agreement as secured borrowings. The Revolving Agreement, which was amended and revised in October 2001, allowed for a maximum credit commitment of \$7.0 million plus an initial additional amount of \$700,000 for the transition from September 30, 2001 when the previous agreement expired. The line declined by \$100,000 each month beginning November 1, 2001. In September 2002 the line was amended and revised allowing for a maximum credit commitment of \$4.0 million. The maximum credit commitment under the revolving loan agreement was reduced by FlatIron due to the A.M. Best ratings of third party insurance carriers for which the Company was financing policies at the time. Simultaneously, the Company ceased financing policies underwritten by third party insurance carriers altogether and began financing only those policies underwritten by the Company's insurance carriers. Additionally, the Company implemented a direct bill program for policies underwritten by the Company's carriers. These changes markedly decreased credit risks and made the Company's reliance on the higher credit commitment previously offered by FlatIron unnecessary. Direct billing is where 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, either directly from the insured or from a premium finance company. The amount of FPF's advance is subject to availability under a borrowing base calculation, with maximum advances outstanding not to exceed the maximum credit commitment. The annual interest rate on advances under the Revolving Agreement is the prime rate plus

additional interest varying from 1.25% to 3.25% based on the prior month's ratio of contracts receivable related to insurance companies with an A.M. Best rating of B or worse to total contracts receivable. The Company's effective interest rate on this line of credit, based on the Company's average outstanding borrowings under the Revolving Agreement was 6.23%, 7.84% and 9.55% for the years ended December 31, 2002, 2001 and 2000, respectively. Currently the effective rate of interest for this arrangement is approximately 5.5%. The Revolving Agreement contains various operating and financial covenants, with which the Company was in compliance at June 30, 2002, December 31, 2002 and December 31, 2001. The Revolving Agreement, as amended, expires September 30, 2004. Outstanding borrowings under the Revolving Agreement as of December 31, 2002 and 2001 were approximately \$4.3 million and \$6.7 million, respectively. Outstanding borrowings under the Revolving Agreement as of June 30, 2003 and December 31, 2002 were approximately \$3.8 million and \$4.3 million, respectively. Outstanding borrowings in excess of the \$4.0 million commitment totaled \$312,420 and are permissible by reason of a compensating cash balance of \$352,433 held for the benefit of FPF, Inc. Interest expense on this revolving credit line for the six months ending June 30, 2003 and for the years ended December 31, 2002, 2001 and 2000 totaled approximately \$110,000, \$342,000, \$592,000 and \$643,000, respectively.

On July 31, 2003, the Company completed a private placement of its 6% Senior Subordinated Notes, which were offered and sold to accredited investors as units consisting of one note with a principal amount of \$1,000 and one warrant to purchase one-half of one share of the Company's Common Stock. The Company sold an aggregate of \$7.5 million of notes in this placement, which resulted in proceeds to the Company (net of placement agent fees of \$450,723.83 and offering expenses of \$110,778.10) of \$6,938,498.07.

The notes pay interest at the annual rate of 6%, are subordinated to senior debt of the Company, and mature on July 31, 2006. Quarterly payments of principal and interest due on the notes may be made in cash or, at the Company's option, in shares of the Company's common stock. If paid in shares of common stock, the number of shares to be issued is determined by dividing the payment due by 95% of the weighted-average volume price for the common stock on Nasdaq as reported by Bloomberg Financial Markets for the 20 consecutive trading days preceding the payment date.

The Company issued warrants to purchase shares of the Company's common stock to the purchasers of the Notes and to the placement agent in the offering, J. Giordano Securities, LLC (J Giordano). Each warrant entitles the holder to purchase one-half of one share of the Company's common stock. The total number of shares issuable upon exercise of warrants issued to the purchasers of the notes and to J. Giordano shall be determined after the expiration of 60 consecutive trading days following July 31, 2003, which was the date of closing of the offering. The number of shares issuable upon exercise of the warrants issued to purchasers will equal \$7.5 million divided by the exercise price of the warrants. The number of shares issuable upon exercise of the warrants issued to J. Giordano will equal \$300,000 divided by the exercise price of the warrants. The exercise price of the warrants will equal 115% of the weighted-average volume price of the common stock on Nasdaq as reported by Bloomberg for the 60 consecutive trading days following July 31, 2003, with a maximum of \$25.00 per share and a minimum of \$15.00 per share. The

terms of the warrants provide for adjustment of the exercise price and the number of shares issuable thereunder upon the occurrence of certain events typical for private offerings of this type. The warrants will be exercisable until July 31, 2006.

The Company will not issue shares in payment of principal or interest on the notes, nor will it issue shares upon exercise of the warrants, and the warrant exercise price will not be adjusted, if any of the foregoing would cause the Company to issue shares of common stock exceeding the number of shares that the Company could then issue in compliance with Section 4350(i) of the rules and regulations of Nasdaq, or any successor rule or regulation. Under this Nasdaq rule, a company may not issue shares, and may not issue securities convertible into shares, where the shares issued could in the aggregate equal 20% or more of the voting power of the shares outstanding, without obtaining shareholder approval. The Company has agreed to include a proposal for the issuance of the foregoing shares in the proxy statement for its 2004 annual meeting of shareholders. If, because the Company has not obtained the requisite shareholder approval and the Warrant exercise price and number of shares issuable upon exercise cannot be adjusted under the anti-dilution provisions of the Warrants as a result of specified issuances of common stock at less than fair market value, then the exercise price of the warrants will be reduced to the issuance price of the common stock that triggered the anti-dilution adjustment.

For the six months ended June 30, 2003, operations generated operating cash flow of \$10.6 million, which was primarily attributable to the increase in unpaid loss and loss adjustment expenses (\$7.1 million), the decline of outstanding finance contracts receivable (\$1.8 million) and the exercise of stock options (\$1.3 million). Uses of cash include \$4.2 million for the settlement of claims subject to reimbursement from the Company's reinsurer, \$1.0 million to reduce accounts payable and \$1.0 million for policy acquisition. The other uses of cash were offset by other provisions of cash, including \$2.5 million for the collection of premiums that are subject to reinsurance.

Operating cash flow is currently expected to be positive in both the short-term and the reasonably foreseeable future. In addition, the Company's investment portfolio is highly liquid as it consists almost entirely of readily marketable securities. Cash flow used in net investing activities was \$9.4 million for the six months ended June 30, 2003 as the Company invested the cash flow from operating activities. In the future, the Company expects a continued cash flow deficit from investing activities as the Company invests cash from operations. Cash deficit from financing activities was \$1.0 million for the six months ended June 30, 2003, as the Company paid \$0.5 million in dividends and the reduced the amount outstanding under its Revolving Agreement by \$0.5 million. The Company believes that its current capital resources, including the net proceeds from the sales of its Notes described above, together with cash flow from the Company's operations, will be sufficient to meet its currently anticipated working capital requirements. There can be no assurances, however, that such will be the case.

For the year ended December 31, 2002, operations generated a cash flow of \$15.0 million as compared to a cash flow deficit of \$946,000 in 2001. The Company's investment portfolio, which is highly liquid as it consists almost entirely of readily marketable securities, is available to offset any cash flow deficits. The cash flow deficit from investing activities from 2002 was \$6.9 million and used to enhance its portfolio. In 2001 the Company used \$2.5 million to offset deficits in operating and financing cash flows. Cash flow used by financing activities was \$5.7 million in 2002, as the Company reduced its revolving credit outstanding and purchased shares of its common stock in the open market. Future financing activities may use cash, if the Company believes its stock is undervalued and decides to continue to purchase shares in the open market. The Board of Directors has authorized the purchase in the open market of approximately \$1.0 million of additional shares. During 2002, the Company acquired 43,400 shares for a total cost of \$253,446. The Company believes that its current capital resources, together with cash flow from its operations and investing activities will be sufficient to meet its anticipated working capital requirements for the foreseeable future. There can be no assurances, however, that such will be the case.

The \$15.9 million increase in cash provided by operations for 2002 as compared to 2001 primarily reflects the growth resulting from the acquisition of American Vehicle, a provision for federal and state income taxes not requiring the use of cash during 2002, and increases in accounts payable and accrued expenses. With the introduction of American Vehicle during the last quarter of 2001, significant increases in operating cash for the period ended December 31, 2002 resulted most notably in the form of unearned premiums of \$12.1 million and \$4.8 million in increased unpaid loss and loss adjustment expenses. The change in deferred acquisition costs, net, gave rise to \$1.2 million of cash used, while unearned commissions used \$1.7 million of cash. The decline in premium deposits consumed \$1.2 million of cash. The increase in prepaid

reinsurance premiums and the offsetting decrease in reinsurance recoverable provided a net cash increase of \$50,000, net, virtually offset each other, and are related to the timing and settlement of the Company's quota-share reinsurance treaties. The increased focus on direct billing of policy holders for insurance premiums offset cash provided by operation by approximately \$6.97 million. The change in focus to direct billing from premium financing of insurance policies occurred to reduce bad debts and the Company's reliance on external financing for the premium finance operation.

Additionally, as a result of the profitable operations for the year ended December 31, 2002 as compared to net losses reported for the year ended December 31, 2001, the Company recorded federal and state income tax accruals, net of deferrals, which did not require the outlay of cash. This provided approximately \$930,000 of operating cash. Also, increases in accounts payable and accrued expense balances accounted for \$3.1 million of the increase in cash flow. Increased net income, net of other non-cash items, contributed \$6.3 million to the overall increase in cash provided by operation during 202.

Investing activities used cash of approximately \$6.9 million in 2002, whereas in 2001 these activities provided cash of approximately \$2.5 million. The change resulted primarily from purchases of investment securities partially offset by a decrease in finance contract receivables.

Financing activities used cash of approximately \$5.7 million in 2002, whereas in 2001 these activities used approximately \$2.0 million of cash. The increase in the use of cash was primarily due to the repayment of the revolving credit line and the use of cash to decrease bank overdrafts.

To retain its certificate of authority, the Florida insurance laws and regulations require that Federated National and American Vehicle maintain capital surplus equal to the greater of 10% of its liabilities or the 2002 statutory minimum capital and surplus requirement of \$3.25 million as defined in the Florida Insurance Code. The Companies are in compliance with this requirement. The Companies are also required to adhere to prescribed net premium-to-capital surplus ratios and for the year ended December 31, 2002, the Companies were in compliance with these ratios.

The maximum amount of dividends that can be paid by Florida insurance companies without prior approval of the Florida Commissioner, is subject to restrictions relating to statutory surplus. The maximum dividend that may be paid in 2003, by the insurance companies without prior approval is limited to the lesser of statutory net income from operations of the preceding calendar year or 10% of statutory unassigned capital surplus as of the preceding December 31. No dividends were paid by Federated National or American Vehicle during 2002, 2001 or 2000.

The Company is required to comply with the risk-based capital requirements of the National Association of Insurance Commissioners (NAIC). The NAIC s risk-based capital requirements are a method of measuring the amount of capital appropriate for an insurance company to support its overall business operations in light of its size and risk profile. NAIC s risk-based capital standards are used by regulators to determine appropriate regulatory actions relating to insurers who show signs of weak or deteriorating condition. As of December 31, 2002, based on calculations using the appropriate NAIC formula, the Company s total adjusted capital is in excess of ratios that would require any form of regulatory action. GAAP differs in

some respects from reporting practices prescribed or permitted by the Florida Department of Financial Services. Federated National s statutory capital surplus was approximately \$9.2 million as of December 31, 2002 and \$5.7 million as of December 31, 2001. Statutory net income was \$2.2 million, \$2.1 million, and \$1.4 million for the years ended December 31, 2002, 2001 and 2000, respectively. American Vehicle had statutory capital surplus of \$4.0 million for the year ended December 31, 2002 and approximately \$3.1 million as of December 31, 2001 and had statutory net income of \$135,000 and \$64,000 in 2002 and 2001, respectively.

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. The primary assets and liabilities of the Company are monetary in nature. As a result, interest rates have a more significant impact on the Company s 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 cost of paying losses and LAE.

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

Quantitative and Qualitative Disclosure About Market Risk

The Company's investment objective is to maximize total rate of return after federal income taxes while maintaining liquidity and minimizing risk. The Company's current investment policy limits investment in non-investment grade fixed maturity securities (including high-yield bonds), and limits total investments in preferred stock, common stock and mortgage notes receivable. The Company also complies with applicable laws and regulations, which further restrict the type, quality and concentration of 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.

The Company's investment policy is established by its Board of Directors or Investment Committee and is reviewed on a regular basis. Pursuant to this investment policy, as of December 31, 2002, approximately 97.3% of the Company's investments were in fixed income securities and short-term investments, which are considered to be available for sale, based upon the Company's intent at the time of purchase. Fixed maturities are considered available for sale and are marked to market. The Company may in the future also consider fixed maturities to be held to maturity and carried at amortized cost. The Company does not use any material swaps, options, futures or forward contracts to hedge or enhance its investment portfolio.

The Company's investment portfolio is managed by the Company's Investment Committee consisting of the Company's President and two directors, in accordance with guidelines established by the Florida Department of Financial Services.

A summary of the investment portfolio as of June 30, 2003 follows:

Amortized cost	Fair value	Unrealized
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					Gain (Loss)
Corporate securities					
Communications industry	\$ 1,177,031	3.23 %	\$ 1,451,223	3.99 %	\$ 274,192
Financial industry	3,814,797	10.47 %	3,867,057	10.63 %	52,260
All other industries	3,492,847	9.59 %	3,651,354	10.04 %	158,507
Total corporate securities	8,484,675	23.29 %	8,969,634	24.67 %	484,959
Obligations of state and municipal subdivisions	6,559,538	18.00 %	6,568,904	18.06 %	9,366
United States government and agencies	16,924,909	46.45 %	16,437,411	45.20 %	(487,498)
Total fixed maturities	31,969,122	87.74 %	31,975,949	87.93 %	6,827
Common stocks	4,327,858	11.88 %	4,248,423	11.68 %	(79,435)
Mortgage loan	140,506	0.38 %	140,506	0.39 %	
Total investments	\$ 36,437,486	100.00 %	\$ 36,364,878	100.00 %	\$ (72,602)

As of June 30, 2003, there were no concentrations greater than 5% of total investments in any single investment other than United States government obligations.

The table below sets forth investment results for the periods indicated.

	Years Ended December 31,		
	2002	2001	2000
	(Dollars In Thousands)		
Interest on fixed maturities	\$ 1,190	\$ 485	\$ 552
Dividends on equity securities	18	13	44
Interest on short-term investments	59	559	647
Other	17	39	10
Total investment income	1,284	1,096	1,253
Investment expense	(30)	(29)	(28)
Net investment income	\$ 1,254	\$ 1,067	\$ 1,225
Net realized gain (loss)	\$ (1,370)		