

21ST CENTURY HOLDING CO
Form 10-Q
May 12, 2006

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

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2006

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____.

Commission file number 0-2500111

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

Florida
(State or Other Jurisdiction of
Incorporation
or Organization)

65-0248866
(IRS Employer
Identification No.)

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

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

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

Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

Yes ☐ No ☒

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

Common Stock, \$.01 par value - 7,420,819 outstanding as of May 10, 2006.

21ST CENTURY HOLDING COMPANY

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PART I: FINANCIAL INFORMATION**Item 1**21ST CENTURY HOLDING COMPANY
CONSOLIDATED BALANCE SHEETS

	March 31, 2006	December 31, 2005
ASSETS		
Investments		
Fixed maturities, available for sale, at fair value	\$ 79,345,703	\$ 69,787,809
Fixed maturities, held to maturity, at amortized cost	19,685,847	19,691,937
Equity securities, available for sale, at fair value	8,578,837	10,606,663
Total investments	107,610,387	100,086,409
Cash and cash equivalents	28,367,811	6,071,460
Finance contracts, net of allowance for credit losses of \$282,484 in 2006 and \$419,445 in 2005, and net of unearned finance charges of \$217,663 in 2006 and \$379,212 in 2005	4,839,079	7,312,736
Prepaid reinsurance premiums	3,462,162	12,133,734
Premiums receivable, net of allowance for credit losses of \$173,151 and \$158,151, respectively	10,284,594	7,505,631
Reinsurance recoverable, net	51,874,304	136,675,703
Deferred policy acquisition costs	9,827,913	9,183,654
Deferred income taxes, net	4,310,424	2,703,978
Property, plant and equipment, net	1,391,745	3,901,385
Other assets	5,111,466	4,580,063
Total assets	\$ 227,079,885	\$ 290,154,753
LIABILITIES AND SHAREHOLDERS' EQUITY		
Unpaid losses and LAE	\$ 53,797,413	\$ 154,038,543
Unearned premiums	66,969,112	61,839,051
Premiums deposits	2,535,176	2,144,863
Revolving credit outstanding	57,376	196,943
Bank overdraft	30,714,130	12,237,735
Funds held under reinsurance treaties	1,544,544	1,544,544
Income taxes payable	4,211,950	3,019,696
Subordinated debt	8,541,666	10,208,333
Deferred gain from sale of property	2,789,379	—
Accounts payable and accrued expenses	2,705,869	4,157,675
Total liabilities	173,866,615	249,387,383
Shareholders' equity:		
Common stock, \$0.01 par value. Authorized 37,500,000 shares; issued 7,364,838 and		

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7,468,713 shares, respectively; Outstanding 7,364,838 and 6,771,864, respectively

	73,650	74,688
Additional paid-in capital	38,872,092	31,825,053
Accumulated other comprehensive (deficit)	(1,266,875)	(1,537,243)
Retained earnings	15,534,403	10,404,872
Total shareholders' equity	53,213,270	40,767,370
Total liabilities and shareholders' equity	\$ 227,079,885	\$ 290,154,753

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

21ST CENTURY HOLDING COMPANY
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended	
	March 31, 2006	March 31, 2005
Revenue:		
Gross premiums written	\$ 35,609,073	\$ 30,097,044
Gross premiums ceded	—	(2,901,291)
Net premiums written	35,609,073	27,195,753
Decrease in prepaid reinsurance premiums	(8,671,572)	(2,675,295)
(Increase) in unearned premiums	(5,130,061)	(5,685,560)
Net change in prepaid reinsurance premiums and unearned premiums	(13,801,633)	(8,360,855)
Net premiums earned	21,807,440	18,834,898
Finance revenue	636,026	1,104,530
Managing general agent fees	657,968	632,315
Net investment income	1,196,265	892,871
Net realized investment gains	196,211	159,523
Other income	620,799	242,469
Total revenue	25,114,709	21,866,606
Expenses:		
Loss and loss adjustment expense	7,568,843	6,909,997
Operating and underwriting expenses	2,304,245	1,582,531
Salaries and wages	1,837,961	1,578,581
Interest expense	228,884	430,144
Policy acquisition costs, net of amortization	3,918,052	3,825,601
Total expenses	15,857,985	14,326,854
Income from continuing operations before provision for income tax expense	9,256,724	7,539,752
Provision for income tax expense	3,243,412	2,754,076
Net income from continuing operations	6,013,312	4,785,676
Discontinued operations:		
Income from discontinued operations (including gain on disposal of \$0 and \$1,630,000, respectively)	—	1,630,000
Provision for income tax expense	—	595,396
Income from discontinued operations	—	1,034,604
Net income	\$ 6,013,312	\$ 5,820,280

Basic net income per share from continuing operations	\$	0.88	\$	0.78
Basic net income per share from discontinued operations	\$	—	\$	0.17
Basic net income per share	\$	0.88	\$	0.95
Fully diluted net income per share from continuing operations	\$	0.83	\$	0.73
Fully diluted net income per share from discontinued operations	\$	—	\$	0.16
Fully diluted net income per share	\$	0.83	\$	0.89
Weighted average number of common shares outstanding		6,844,859		6,152,548
Weighted average number of common shares outstanding (assuming dilution)		7,238,311		6,532,023
Dividends declared per share	\$	0.12	\$	0.08

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	Three months ended March 31	
	2006	2005
		Restated - See note 10
Cash flow from operating activities:		
Net income	\$ 6,013,312	\$ 4,785,676
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Amortization of investment discount, net	(67,385)	(53,210)
Depreciation and amortization of property plant and equipment, net	90,846	120,725
Net realized investment gains	196,211	213,756
Common Stock issued for interest on Notes	—	315,625
Provision for credit losses, net	30,524	393,762
Provision (recovery) for uncollectible premiums receivable	15,000	(374,470)
Non-cash compensation	156,694	—
Tax benefit related to non-cash compensation	(58,964)	—
Changes in operating assets and liabilities:		
Premiums receivable	(2,793,963)	(1,745,075)
Prepaid reinsurance premiums	8,671,572	2,675,295
Due from reinsurers, net	84,801,399	2,224,287
Income taxes recoverable	—	4,066,684
Deferred income tax expense	(1,606,446)	726,008
Policy acquisition costs, net of amortization	(644,259)	(742,237)
Finance contracts receivable	2,443,133	(1,831,904)
Other assets	2,257,976	297,067
Unpaid losses and loss adjustment expenses	(100,241,130)	(19,804,284)
Unearned premiums	5,130,061	5,685,560
Premium deposits	390,313	1,006,983
Income taxes payable	1,192,254	—
Bank overdraft	18,476,396	(3,691,368)
Accounts payable and accrued expenses	(1,451,807)	(1,088,794)
Net cash provided by (used for) operating activities - continuing operations	23,001,737	(6,819,914)
Net cash provided by (used for) operating activities - discontinued operations	—	(1,380,265)
Net cash provided by (used for) operating activities	23,001,737	(8,200,179)
Cash flow (used in) provided by investing activities:		
Proceeds from sale of investment securities available for sale	103,867,819	81,245,978
Purchases of investment securities available for sale	(111,406,949)	(77,438,691)
Purchases of property and equipment	(244,136)	(104,749)
Proceeds from sale of assets	2,662,930	—
Net cash (used in) provided by investing activities - continuing operations	(5,120,336)	3,702,538
Net cash (used in) provided by investing activities - discontinued operations	—	1,689,129
Net cash (used in) provided by investing activities	(5,120,336)	5,391,667

Cash flow provided by financing activities:

Subordinated debt repaid	(1,666,667)	—
Exercised stock options	1,081,815	994,078
Dividends paid	(883,781)	(506,749)
Exercised warrants, net	5,964,186	—
Tax benefit related to non-cash compensation	58,964	—
Revolving credit outstanding	(139,567)	(125,301)
Net cash provided by financing activities - continuing operations	4,414,950	362,028
Net increase (decrease) in cash and cash equivalents	22,296,351	(2,446,484)
Cash and cash equivalents at beginning of period	6,071,460	6,127,706
Cash and cash equivalents at end of period	\$ 28,367,811	\$ 3,681,222

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

(continued)	Three months ended March 31,	
Supplemental disclosure of cash flow information:	2006	2005
Cash paid during the period for:		
Interest	\$ 156,824	\$ 36,188
Non-cash investing and finance activities:		
Accrued dividends payable	\$ 761,809	\$ 445,103
Retirement of subordinated debt by Common Stock issuance	\$ —	\$ 1,666,667
Stock issued to pay interest on subordinated debt	\$ —	\$ 315,625

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

21st Century Holding Company
Notes to Consolidated Financial Statements

(1) Organization and Business

The accompanying unaudited consolidated financial statements of 21st Century Holding Company (the “Company”) have been prepared in accordance with generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions for Form 10-Q and Rule 10-01 of Regulation S-X. These financial statements do not include all information and notes required by GAAP for complete financial statements, and should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2005. The December 31, 2005 year-end balance sheet data was derived from audited financial statements but does not include all disclosures required by GAAP. The financial information furnished reflects all adjustments, consisting only of normal recurring accruals, which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented. The results of operations are not necessarily indicative of the results of operations that may be achieved in the future.

21st Century Holding Company (“21st Century,” “the Company”, “we,” “us”) is an insurance holding company, which, through our subsidiaries and our contractual relationships with our independent agents and general agents, controls substantially all aspects of the insurance underwriting, distribution and claims process. We are authorized to underwrite personal automobile insurance, commercial general liability insurance, homeowners’ property and casualty insurance and mobile home property and casualty insurance in various states with various lines of authority through our wholly owned subsidiaries, Federated National Insurance Company (“Federated National”) and American Vehicle Insurance Company (“American Vehicle”).

Federated National is authorized to underwrite personal automobile insurance, homeowners’ property and casualty insurance and mobile home property and casualty insurance in Florida as an admitted carrier. American Vehicle is authorized to underwrite personal and commercial automobile insurance and commercial general liability insurance in Florida as an admitted carrier. In addition, American Vehicle is authorized to underwrite commercial general liability insurance in Georgia, Kentucky, South Carolina and Virginia as a surplus lines carrier and in Texas, Louisiana and Alabama as an admitted carrier. American Vehicle operations in Florida, Georgia and Louisiana are on-going. American Vehicle operations in Texas, Alabama, Kentucky, South Carolina and Virginia are expected to begin this year. American Vehicle has pending applications, in various stages of approval, to be authorized as a surplus lines carrier in the states of Connecticut, Illinois, Missouri, Nevada, New Mexico, West Virginia, California and Arkansas.

During the three months ended March 31, 2006, 64.9%, 23.1% and 12.0% of the premiums we underwrote were for homeowners’ property and casualty insurance, commercial general liability insurance and personal automobile insurance, respectively. During the three months ended March 31, 2005, 52.9%, 17.1% and 30.0% of the premiums we underwrote were for homeowners’ property and casualty insurance, commercial general liability insurance and personal automobile insurance, respectively. We internally process claims made by our own and third-party insureds through our wholly owned claims adjusting company, Superior Adjusting, Inc. (“Superior”). We also offer premium financing to our own and third-party insureds through our wholly owned subsidiary, Federated Premium.

We market and distribute our own and third-party insurers’ products and our other services primarily in Central and South Florida, through contractual relationships with a network of approximately 1,500 independent agents and a select number of general agents.

Assurance Managing General Agents, Inc. (“Assurance MGA”), a wholly owned subsidiary, acts as Federated National’s and American Vehicle’s exclusive managing general agent in the state of Florida. As American Vehicle continues its

expansion into other states we expect to contract with other managing general agents to market our commercial general liability insurance product beyond the state of Florida. Assurance MGA currently provides all underwriting policy administration, marketing, accounting and financial services to Federated National and American Vehicle, and participates in the negotiation of reinsurance contracts. Assurance MGA generates revenue through a 6% commission fee from the insurance company's net written premium, policy fee income of \$25 per policy and other administrative fees from the marketing of companies' products through the Company's distribution network. The 6% commission fee from Federated National and American Vehicle was made effective January 1, 2005. Assurance MGA plans to establish relationships with additional carriers and add additional insurance products in the future.

21st Century Holding Company
Notes to Consolidated Financial Statements

(2) Summary of Significant Accounting Policies and Practices

(A) Critical Accounting Policies

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

The most significant accounting estimates inherent in the preparation of our financial statements include estimates associated with management's evaluation of the determination of liability for unpaid loss and loss adjustment expense ("LAE"), the amount and recoverability of amortization of deferred policy acquisition costs. In addition, significant estimates form the bases for our reserves with respect to finance contracts, premiums receivable and deferred income taxes. Various assumptions and other factors underlie the determination of these significant estimates. 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 loss and LAE, an actuarial valuation. Management regularly reevaluates these significant factors and makes adjustments where facts and circumstances dictate. In selecting the best estimate, we utilize up to 6 different actuarial methodologies. Each of these methodologies is designed to forecast the number of claims we will be called upon to pay and the amounts we will pay on average to settle those claims. In arriving at our best estimate, our actuaries consider the likely predictive value of the various loss development methodologies employed in light of underwriting practices, premium rate changes and claim settlement practices that may have occurred, and weight the credibility of each methodology. Our actuarial methodologies take into account various factors, including, but not limited to, paid losses, liability estimates for reported losses, paid allocated loss adjustment expenses, salvage and other recoveries received, reported claim counts, open claim counts and counts for claims closed with and without payment of loss.

Accounting for loss contingencies pursuant to Statements of Financial Accounting Standards ("SFAS"), No.5 involves the existence of a condition, situation or set of circumstances involving uncertainty as to possible loss that will ultimately be resolved when one or more future event(s) occur or fail to occur. Additionally, accounting for a loss contingency requires management to assess each event as probable, reasonably possible or remote. Probable is defined as the future event or events are likely to occur. Reasonably possible is defined as the chance of the future event or events occurring is more than remote but less than probable, while remote is defined as the chance of the future event or events occurring is slight. An estimated loss in connection with a loss contingency shall be recorded by a charge to current operations if both of the following conditions are met: First, the amount can be reasonably estimated; and second, the information available prior to issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability.

(B) Impact of New Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ("FASB") revised SFAS No. 123, Share-Based Payments ("SFAS No. 123R"). This statement eliminates the option to apply the intrinsic value measurement provisions of the Accounting Principles Board ("APB") No. 25 to stock compensation awards issued to employees. Rather, SFAS No. 123R requires companies to measure the cost of employee services received in exchange for an award of equity

instruments based on the grant date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award the requisite service period (usually the vesting period). SFAS No. 123R will also require companies to measure the cost of employee services received in exchange for employee stock purchase plan awards. SFAS No. 123R was effective for 21st Century's fiscal year beginning January 1, 2006 as subsequently extended by the SEC pursuant to its April 13, 2005 announcement. We have determined that the pretax charge to earnings for the year ending 2006 will total approximately \$0.6 million, of which approximately \$0.2 million was charged to income from continuing operations before provision for income taxes for the three months ending March 31, 2006. The effect on earnings per share for the period ended March 31, 2006 for both undiluted and fully diluted was approximately \$0.01 per share. For a more detailed discussion, please see Footnote 8, titled Stock Compensation Plans.

21st Century Holding Company
Notes to Consolidated Financial Statements

(C) Stock Options

At March 31, 2006, the Company has three stock-based employee compensation plans, which are described later in footnote 8, Stock Compensation Plans. Prior to January 1, 2006, we accounted for those plans under the recognition and measurement provisions of stock-based compensation using the intrinsic value method prescribed by APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Under these provisions, no stock-based employee compensation cost was recognized in the Statement of Operations for the year ended December 31, 2005 as all options granted under those plans had an exercise price equal to or less than the market value of the underlying common stock on the date of grant. Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123R using the modified-prospective-transition method. Under that transition method, compensation cost recognized in the first quarter of 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair-value estimated in accordance with the provisions of SFAS No. 123R. Results for prior periods have not been restated. There were no stock options granted during the three months ended March 31, 2006 and additional stock option awards are not anticipated in future years. For a further discussion regarding the provisions of SFAS No. 123R and its effect on our operations, please refer to footnote 8, Stock Compensation Plans.

(D) Earnings Per Share

Basic earnings per share ("Basic EPS") is computed by dividing net income by the weighted average number of common shares outstanding during each period presented. Diluted earnings per share ("Diluted EPS") is computed by dividing net income by the weighted average number of shares of common stock and common stock equivalents outstanding during the period presented; outstanding warrants and stock options are considered common stock equivalents and are included in the calculation using the treasury stock method. Additionally, when applicable, we include in our computation of the weighted average number of common shares outstanding all common stock issued in connection with the repayment of our Subordinated note.

(E) Reclassifications

Certain amounts in 2005 financial statements have been reclassified to conform to the 2006 presentation.

(3) Revolving Credit Outstanding

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 Westchester Premium Acceptance Corporation ("WPAC"), a wholly-owned subsidiary of FlatIron, which gives WPAC 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 amounts of WPAC's advances are 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 equals 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 lower, to total contracts receivable. The effective interest rate on this line of credit, based on our average outstanding borrowings under the Revolving Agreement, was 11.64% and 6.94% for the three months ended March 31, 2006 and 2005,

respectively.

Outstanding borrowings under the Revolving Agreement as of March 31, 2006 were approximately \$57,000. Outstanding borrowings as of December 31, 2005 were approximately \$197,000. Interest expense on this revolving credit line for the three months ended March 31, 2006 and March 31, 2005 totaled approximately \$3,700 and \$36,000, respectively.

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21st Century Holding Company
Notes to Consolidated Financial Statements

(4) Commitments and Contingencies

We are involved in other claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

As a direct premium writer in the State of Florida, we are required to participate in certain insurer solvency association under Florida Statutes 631.57(3) (a). Participation in these pools is based on our written premium by line of business to total premiums written statewide by all insurers. Participation may result in assessments against us. There was no assessment made for the year ended December 31, 2005 or through the date of this report.

Federated National and American Vehicle are also required to participate in an insurance apportionment plan under Florida Statutes Section 627.351, which is referred to as a JUA Plan. The JUA Plan provides for the equitable apportionment of any profits realized, or losses and expenses incurred, among participating motor vehicle insurers. In the event of an underwriting deficit incurred by the JUA Plan which is not recovered through the policyholders in the JUA Plan, such deficit shall be recovered from the companies participating in the JUA Plan in the proportion that the net direct written premiums of each such member during the preceding calendar year bear to the aggregate net direct premiums written in this state by all members of the JUA Plan. Federated National and American Vehicle were assessed \$44,350 and \$1,615, respectively by the JUA Plan based on its July 2005 Cash Activity Report. Future assessments by this association are undeterminable at this time.

During its regularly scheduled meeting on August 17, 2005, the Board of Governors of Citizens Property Insurance Corporation "Citizens" determined a 2004 plan year deficit existed in the High Risk Account. The Board decided that a \$515 million Regular Assessment is in the best interest of Citizens and consistent with Florida Statutes. On this basis, the Board certified for a Regular Assessment. Federated National's participation in this assessment totaled \$2.0 million. Provisions contained in our excess of loss reinsurance policies provide for their participation totaling \$1.5 million. Pursuant to Section 627.3512, Florida Statutes, insurers are permitted to recoup the assessment by adding a surcharge to policies in an amount not to exceed the amount paid by the insurer to Citizens. Federated National is currently underwriting the recoupment in connection with this assessment began in March 2006. As noted above, Federated National is entitled to recoup this assessment, and will subrogate \$1.5 million to our reinsurers.

The Florida Office of Insurance Regulation ("OIR") issued OIR-06-008M dated Mayth42006 to all property and casualty, Surplus lines Insurers, and Surplus Lines Agents in the state of Florida placing them on notice of an anticipated Florida Hurricane Catastrophic Fund ("FHCF") assessment. Sighting the unprecedented hurricane seasons of 2004 and 2005, the FHCF has exhausted nearly all of the \$6 billion in reserves it has accumulated since its inception in 1993. The OIR anticipates the Florida State Board of Administration, the body that oversees the FHCF, will issue its directive to levy an emergency assessment upon all property and casualty business in the state of Florida near the end of May 2006.

Effective on or about March 1, 2006, 21st Century sold its interest in the Lauderdale Lakes property to an unrelated party. As part of this transaction, 21st Century has agreed to lease the same facilities for a six year term. Our lease for this office space expires in December 2011.

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

21st Century Holding Company
Notes to Consolidated Financial Statements

Fiscal Year	Lease payments
2006	\$ 418,187
2007	557,583
2008	557,583
2009	557,583
2010	557,583
Thereafter	557,583
Total	\$ 3,206,102

(5) Comprehensive Income

For the three months ended March 31, 2006 and 2005, comprehensive income consisted of the following:

	For the three months ended March 31,	
	2006	2005
Net income	\$ 6,013,312	\$ 5,820,280
Change in net unrealized gains on investments available for sale	182,260	(737,566)
Comprehensive income, before tax	6,195,572	5,082,714
Income tax (expense) benefit related to items of other comprehensive income	(68,585)	278,520
Comprehensive income	\$ 6,126,987	\$ 5,361,234

(6) Segment Information

FASB Statement No. 131, Disclosures About Segments of an Enterprise and Related Information, requires that the amount reported for each segment item be based on what is used by the chief operating decision maker in formulating a determination as to how many resources to assign to a segment and how to appraise the performance of that segment. The term chief operating decision maker may apply to the chief executive officer or chief operating officer or to a group of executives. Note: The term of chief operating decision maker may apply to a function and not necessarily to a specific person. This is a management approach rather than an industry approach in identifying segments. The segments are based on the company's organizational structure, revenue sources, nature of activities, existence of responsible managers, and information presented to the Board of Directors.

If any one of the following exists, a segment must be reported on:

- Revenue, including unaffiliated and inter-segment sales or transfers, is 10% or more of total revenue of all operating segments.
- Operating profit or loss is 10% or more of the greater, in absolute amount, of the combined operating profit (or loss) of all industry segments with operating profits (or losses).
 - Identifiable assets are 10% or more of total assets of all operating segments.

Operating segments that are not reportable should be combined and disclosed in the "all other" category. Disclosure should be made of the sources of revenue for these segments.

Accordingly, we have discontinued our segment disclosures due to the finance segment not exceeding the 10% threshold for revenues, earnings or assets.

(7) Reinsurance Agreements

We follow industry practice of reinsuring a portion of our risks and paying for that protection based upon premiums received on all policies subject to such reinsurance. Reinsurance involves an insurance company transferring or "ceding" all or a portion of its exposure on insurance underwritten by it to another insurer, known as a "reinsurer." The ceding of insurance does not legally discharge the insurer from its primary liability for the full amount of the policies. If the reinsurer fails to meet its obligations under the reinsurance agreement, the ceding company is still required to pay the loss.

21st Century Holding Company
Notes to Consolidated Financial Statements

For the 2005-2006 hurricane season, the excess of loss treaties will insure us for approximately \$64.0 million, with the Company retaining the first \$3.0 million of loss and LAE. The treaties have one full reinstatement provision for each excess layer with 100% additional premium as to time and pro rata as to amount. In addition, we purchased, from the private sector, Reinstatement Premium Protection which will reimburse the Company 100% of the cost of reinstatement for the second event. Unused coverage from the first two events carries forward to events beyond the second, in conjunction with a lowered attachment point (as explained below) afforded by the FHCF.

In addition to the excess of loss reinsurance policies (described above), we continue to participate in the FHCF to protect our interest in the insurable risks associated with our homeowner and mobile home owner insurance products. For the first two events, FHCF coverage begins after the Company's retention of \$3.0 million and its excess of loss reinsures retention of approximately \$40.3 million.

Maximum coverage afforded from the combined policies of our FHCF and excess of loss policies in effect for varying dates from June 1, 2005 to June 30, 2006 total approximately \$194.8 million. FHCF will retain approximately \$131.0 million, our excess of loss reinsurance policies will retain \$64.0 million, and the Company will retain the first \$3 million of insurable losses for two events. For events beyond the second largest catastrophic event during the policy term, FHCF coverage attaches after the Company and its excess of loss reinsures collective retention of approximately \$15.0 million. Additionally, unused coverage from our excess of loss reinsurance treaties may be carried forward and totals \$20.0 million. However, loss and LAE incurred up to approximately \$15.0 million for each hurricane subsequent to Hurricane Wilma in October 2005 and through June 30, 2006 and deemed to be a catastrophic event would be the responsibility of the Company. To date, no such catastrophic events have occurred.

As a result of the loss and LAE incurred in connection with the hurricane activity that occurred in 2004 and 2005, the Company has reflected in its operations the effects of each storm as follows:

2004 Hurricanes	Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
(Dollars in millions)				
Charley (August 13)	2,567	\$ 59.5	\$ 49.5	\$ 10.0
Frances (September 3)	3,805	50.2	40.2	10.0
Ivan (September 14)	1,061	21.0	-	21.0
Jeanne (September 25)	1,557	13.1	-	13.1
Total Loss Estimate	8,990	\$ 143.8	\$ 89.7	\$ 54.1

2005 Hurricanes	Claim Count	Gross Losses	Reinsurance Recoveries	Net Losses
(Dollars in millions)				
Dennis (July 10)	320	\$ 2.7	-	\$ 2.7
Katrina (August 25)	2,094	14.6	11.6	3.0
Rita (September 20)	19	0.2	-	0.2
Wilma (October 24)	11,038	137.8	134.8	3.0
Total Loss Estimate	13,471	\$ 155.3	\$ 146.4	\$ 8.9

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

During 2005 and 2004 American Vehicle did not reinsure any of its insurance products.

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(8) Stock Compensation Plans

We implemented a stock option plan in November 1998 that provides for the granting of stock options to officers, key employees and consultants. The objectives of this plan include attracting and retaining the best personnel, providing for additional performance incentives, and promoting our success by providing employees the opportunity to acquire common stock. Options outstanding under this plan have been granted at prices which are either equal to or above the market value of the stock on the date of grant, vest over a four-year period, and expire ten years after the grant date. Under this plan, we are authorized to grant options to purchase up to 900,000 common shares, and, as of March 31, 2006 and December 31, 2005, we had outstanding exercisable options to purchase 69,750 and 97,650 shares, respectively.

In 2001, we implemented a franchisee stock option plan that provides for the granting of stock options to individuals purchasing Company owned agencies which are then converted to franchised agencies. The purpose of the plan is to advance our interests by providing an additional incentive to encourage managers of Company owned agencies to purchase the agencies and convert them to franchises. Options outstanding under the plan have been granted at prices which are above the market value of the stock on the date of grant, vest over a ten-year period, and expire ten years after the grant date. Under this plan, we are authorized to grant options to purchase up to 988,500 common shares, though in connection with our sale of our franchise operations we do not anticipate additional options to be granted under this plan. As of March 31, 2006 and December 31, 2005, we had outstanding exercisable options to purchase -0- and 15,000 shares, respectively.

In 2002, we implemented the 2002 Option Plan. The purpose of this Plan is to advance our interests by providing an additional incentive to attract, retain and motivate highly qualified and competent persons who are key to the Company, including key employees, consultants, independent contractors, and Officers and Directors, upon whose efforts and judgment our success is largely dependent, by authorizing the grant of options to purchase Common Stock to persons who are eligible to participate hereunder, thereby encouraging stock ownership by such persons, all upon and subject to the terms and conditions of the Plan. Options outstanding under the plan have been granted at prices which are above the market value of the stock on the date of grant, vest over a five-year period, and expire six years after the grant date. Under this plan, the Company is authorized to grant options to purchase up to 1,800,000 common shares, and, as of March 31, 2006 and December 31, 2005, we had outstanding exercisable options to purchase 727,589 and 818,608 shares, respectively.

Activity in the Company's stock option plans for the period from January 1, 2005 to March 31, 2006, is summarized below:

	1998 Plan		2001 Franchisee Plan		2002 Plan	
	Number of Shares	Weighted Average Option Exercise Price	Number of Shares	Weighted Average Option Exercise Price	Number of Shares	Weighted Average Option Exercise Price
Outstanding at January 1, 2005	198,275	\$ 6.67	15,000	\$ 9.17	906,300	\$ 10.80
Granted	—		—		446,500	\$ 14.39
Exercised	(96,875)	\$ 6.67	—	\$ —	(271,542)	\$ 8.96
Cancelled	(3,750)	\$ 6.67	—		(262,650)	\$ 14.00

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Outstanding at January 1, 2006	97,650	\$	6.67	15,000	\$	9.17	818,608	\$	12.35
Granted	—			—			—	\$	—
Exercised	(27,900)	\$	6.67	(15,000)	\$	9.17	(82,319)	\$	9.22
Cancelled	—	\$	6.67	—			(8,700)	\$	10.35
Outstanding at March 31, 2006	69,750	\$	6.67	—	\$	—	727,589	\$	12.72

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Options outstanding as of March 31, 2006 are exercisable as follows:

	1998 Plan		2001 Franchisee Plan		2002 Plan	
		Weighted Average Option Exercise Price		Weighted Average Option Exercise Price		Weighted Average Option Exercise Price
Options Exercisable at:	Number of Shares		Number of Shares		Number of Shares	
March 31, 2006	68,250	\$ 6.67	—	\$ —	283,489	\$ 12.72
December 31, 2006	1,500	\$ 6.67	—		112,600	\$ 12.72
December 31, 2007	—		—		120,700	\$ 12.72
December 31, 2008	—		—		87,100	\$ 12.72
December 31, 2009	—		—		75,100	\$ 12.72
December 31, 2010	—		—		48,600	\$ 12.72
Thereafter	—		—		—	
Total options exercisable	69,750		—		727,589	

At March 31, 2006, the Company has three stock-based employee compensation plans, which are described above. Prior to January 1, 2006, we accounted for those plans under the recognition and measurement provisions of stock-based compensation using the intrinsic value method prescribed by APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation*. Under these provisions, no stock-based employee compensation cost was recognized in the Statement of Operations for the years ended December 31, 2005 or 2004 as all options granted under those plans had an exercise price equal to or less than the market value of the underlying common stock on the date of grant. Effective January 1, 2006, the Company adopted the fair value recognitions provisions of FASB Statement No. 123 (R) using the modified-prospective-transition method. Under that transition method, compensation cost recognized in the first quarter of 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair-value estimated in accordance with the provisions of SFAS No. 123R. Results for prior periods have not been restated.

As a result of adopting SFAS No. 123R on January 1, 2006, the Company's income from continuing operations before provision for income taxes and net income for the three months ended March 31, 2006, are lower by approximately \$157,000 and \$98,000, respectively, than if it had continued to account for share-base compensation under ABP Opinion No. 25. Basic and diluted earnings per share for the three month period ended March 31, 2006 for both basic and diluted would have been \$0.89 and \$0.84, respectively, if the Company had not adopted SFAS No. 123R, compared to reported basic and diluted earnings per share of \$0.88 and \$0.83, respectively.

Because the change in income taxes payable includes the effect of excess tax benefits, those excess tax benefits also must be shown as a separate operating cash outflow so that operating cash flows exclude the effect of excess tax benefits. SFAS No. 123R requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement 123 to options granted under our stock option plans in the period presented. For purposes of this provision disclosure and comparability, the value of the options were estimated using the Black-Scholes option-pricing model and amortized to expense over the options vesting periods.

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