

## American Coastal Insurance Corp (ACIC) Double Down

### Incredibly High-Quality Insurer Trading at ~5.5x forward P/E

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In August of 2023, Jon Cukierwar posted his pitch on American Coastal on his website. Soon after publishing his pitch, we reached out to him, looking to get insights on certain parts of the company that we did not fully understand. The insights we gained from Jon sparked a multi-month long journey researching the company's ins and outs. We suggest that everyone read the original pitch that Jon created as Jon's research formed the entire foundation of our analysis below. Jon deserves full credit for finding and researching, in our opinion, one of the best pitches in recent years. We hope our research below can be useful to those looking for additional information on American Coastal.

**Executive Summary:** To provide a quick summary of American Coastal (AmCo), it is a small-cap property and casualty insurer based in St. Petersburg, Florida. It is almost exclusively focused on garden-style condominiums with above-average risk characteristics, selling windstorm insurance policies to the HOAs that represent them. Over the last decade, AmCo has been able to average combined ratios below 70% with no years of unprofitability. This has been possible due to AmCo's underwriting superiority, which is derived from its exclusive relationship with AmRisc, strong underwriting discipline, and focus on niche markets. Until a few quarters ago, AmCo had been consolidated with UPC, a lower-quality personal lines insurer, whose losses in the past have been subsidized by AmCo's underwriting profits (loss sharing agreement). However, UPC recently entered runoff, leaving AmCo as a highly profitable standalone company. Again, for those looking for a more comprehensive overview of the pitch, please refer to Jon's writeup on his website (<https://sohrapeakcapital.com/research/>).

We believe that ACIC trades at a forward PE of ~5.5x, with a payback period of just 4.5 years and strong growth thereafter. Not accounting for the potential of a new MGA that AmCo plans to create to compete in the personal lines brokerage market, conservative top line growth, and a modest 10x PE exit multiple, we get an intrinsic value per share of ~\$27. This leads us to the belief that AmCo is the most undervalued insurer in Florida.

For this write-up, our goal is to present our research on a few key topics that we believe to be especially important and insightful. These topics are: hurricane risk, reinsurance, the hard market environment, management, equity offering, and NY personal lines exposure. The mediums through which we conducted our research were interviews with multiple P&C insurance experts, review of the most recent quarterly earnings and filings, asking management questions during the Q3 earnings call, discussions with HOAs, extensive simulations, academic papers, calls with fund managers who own ACIC, and interviews with management (refer to Daikoku Capital's substack for a summary of our conversation with Brad Martz, the CFO of AmCo).

### Reinsurance

We had the opportunity to speak to Professor Woollams of Columbia University about reinsurance. He is an expert in the management of commercial property and casualty insurance claims, spending nearly two decades at AIG as President of Global Commercial Claims. In addition, we spoke to Shiwen Jiang, an insurance actuary at Berkshire Hathaway Specialty Insurance who has over three decades of experience in the actuarial sciences for P&C insurance. Shiwen was also able to provide general insight on Berkshire's P&C reinsurance strategy.

### High Reinsurance Capacity with Low Attachment Points

A major determining factor in the risk of an insurance business is the quality of their reinsurance stack. We were of the belief that the two most important numbers to pay attention to when analyzing the reinsurance stack (Figure 2) was the size of the stack at the upper end (approx. \$1 billion for ACIC) and the risk of the stack being depleted (1 in 167 year hurricane event for AmCo). However, after further due diligence, we have identified new metrics that can be used to evaluate the quality of a reinsurance stack.

AmCo has an attachment/retention point of \$10 million per event. This means that for each event, AmCo pays the first \$10 million in claims and then the reinsurance kicks in. In most years, we can expect AmCo to spend their full \$10 million

retention. For example, this year management has stated that even with the impacts of Idalia, which crossed over Florida in August 2023, current loss estimates are well below the annual reinsurance retention limit.

An actuarial expert suggested that we compare each insurance company’s attachment/retention limit to their policyholder/equity surplus. Currently, AmCo, even with a low equity base because of the loss-sharing agreement with UPC, has a 12x equity to retention limit, which is far above average in Florida but still below the very best catastrophe insurance companies in the US. Figure 1 below shows the equity to retention limits for various competitors in the Florida P&C market. We included Palomar as it is a high-quality comp on the West Coast that insures against earthquakes and hurricanes.

Equity to Retention					
Publicly Traded Florida Insurers (\$mm)	ACIC	ACIC 24e	Palomar	UVE	HRTG
Equity	120.65	202.34	383.25	288.00	151.00
Retention Limit	10.00	12.50	17.50	45.00	70.00
Equity to Retention Limit	12.06	16.19	21.90	6.40	2.16

Figure 1: Equity to Retention Table

(source: Arcata Capital, Daikoku Capital, and Company Filings)

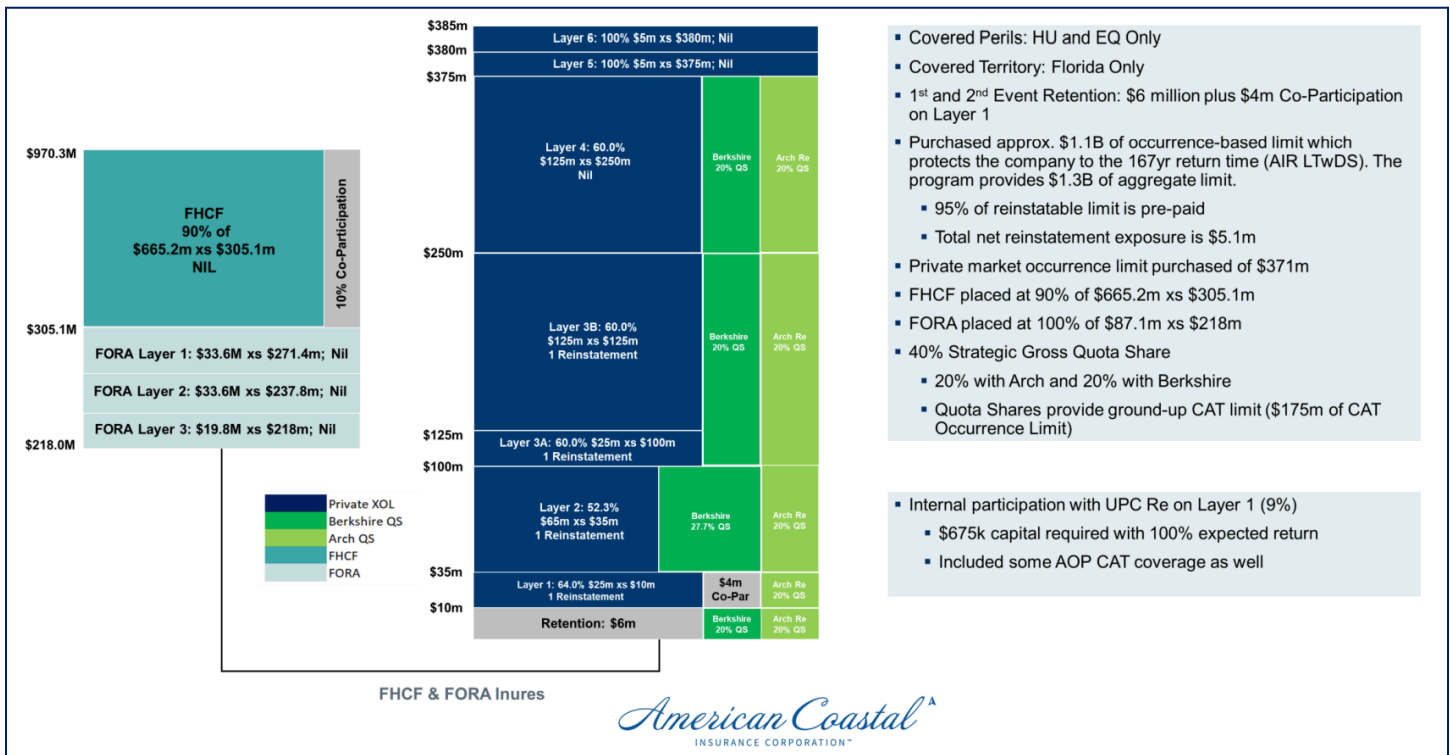


Figure 2: American Coastal Reinsurance Stack

(source: ACIC IR Presentation)

Additionally, Shiwon Jiang explained to us the 3-module actuarial simulation used for insurance and reinsurance to calculate the 1 in 167-year probability in Figure 2. The first module is the event/hurricane simulation, which allows actuaries to model the formation, movement, and dynamics of hurricanes. The simulation varies the diameter, wind speed, pressure, and location of hurricanes over many years (>100,000 in some cases). The data used in these simulations is almost entirely historical with minimal future considerations. Since reinsurance agreements are only in place for 1-year at a time, past data has a very strong correlation with hurricane risk for the next year. Therefore, the 1 in 167 year number only accurately indicates the risk of the

reinsurance stack being fully utilized for the next few years. This number should not be used to extrapolate any further than a few years as the effects of climate change along with other unforeseeable factors will introduce variability into the model. Shiwen Jiang instead suggested that we compare this 1 in 167 number across competitors to evaluate how AmCo's stack stacks up. For the competitors we looked at, the least comprehensive stack implied a 1 in 100 probability while the most comprehensive stack (Palomar) implied a 1 in 250-year probability. AmCo sits comfortably in the middle. In addition, AmCo's superior performance during large hurricane events and disciplined insurance strategy (remember that AmCo has never turned a loss in their 15-year operating history due to their focus on garden style condominiums) leads us to believe that management is potentially being conservative on AmCo's exposure to catastrophic hurricane risk.

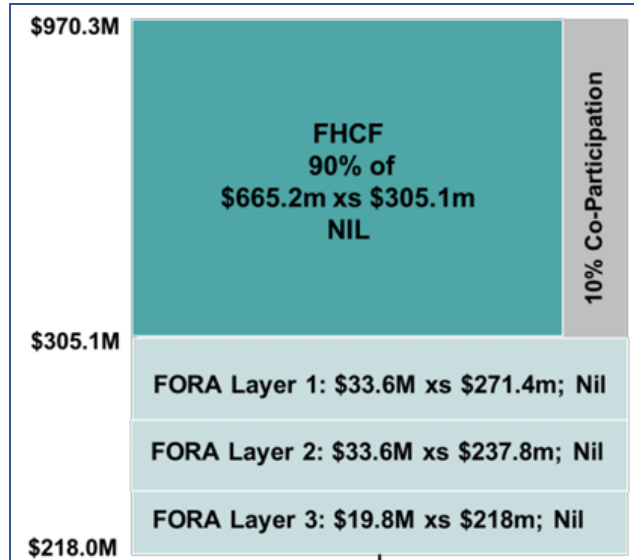
Reinsurers consider a variety of factors when selling reinsurance to specific P&C insurance companies. These considerations, simulated using the 3-module model, include the construction type of the insured properties, location, etc. In addition, reinsurers have close relationships with insurers. While these relationships tend to be stronger the larger the client as a percentage of total insurance book, reinsurers will often have the same actuaries underwriting the same insurance companies year after year. For example, one actuary may be tasked with just managing the insurance book for AmCo and a handful of other insurers. The fact that reinsurers likely have an established relationship with AmCo means that AmCo will get reinsurance rates that consider the company's low total value insured at risk.

Coming into reinsurance negotiations, management often has a plan as to what type of reinsurance stack they want. For example, they will likely have a target max size, retention/attachment point, percent quota share versus excess loss, and approximate price. If AmCo is not able to negotiate the exact terms that they want the first time around, they can always renegotiate at a higher price. If after final negotiations, AmCo does not have a reinsurance stack that sufficiently covers the risk they are exposed to, management always has the option to underwrite lower levels for that year. Because of the long-track record of underwriting discipline that Dan Peed has shown, his firm understanding of risk created through founding and running AmRisc, and low combined ratios, we believe that Dan Peed would decrease gross premiums written if a poor reinsurance stack was negotiated. The quality of the insurance stack has been integrated into our financial model in both direct and indirect ways. Directly we have assumed 1 named event per year causing 12.5 million in retention to be used up. Additionally, we have modeled private XOL reinsurance expenses as a percent of GPW increasing from 19% in 2024 to 23% in the out year. Using Crystal Ball, we have simulated both retention points and private XOL reinsurance costs across 1,000+ scenarios with even 3 standard deviation results leading to extremely strong upside (indicates lack of model sensitivity to these rates).

### **Dynamic Rate Adjustability in Response to Reinsurance Market Trends**

One concern that we had with AmCo was how non-Florida catastrophic events would affect reinsurance capacity in Florida (e.g., hurricane in Japan). Leading on from this question, we were concerned that this could lead to a set of circumstances where overall reinsurance costs rise but rates do not rise in Florida.

The first answer is that a significant portion of American Coastal's reinsurance stack is obtained from the Florida Optional Reinsurance Assistance Program (FORA) and the Florida Hurricane Catastrophe Fund (FHCF). They have insured reinsurance from FORA and FHCF. The FHCF reinsurance is particularly significant given that it covers them for up to \$665.2 million in losses in excess of \$305.1 million in losses (\$665.2m vs \$305.1m) visualized in Figure 3. Both these reinsurance programs are inherently Florida-focused and thus are not impacted by CAT events in the rest of the world.



**Figure 3: FORA/FHCF Reinsurance Stack**

*(source: ACIC IR Presentation)*

One of the concerns Professor Woollams brought up was whether programs like FORA/FHCF are sustainable both in terms of durability and ability to pay after a black swan event. To address that concern, we spent more time looking at how FHCF is funded and maintained.

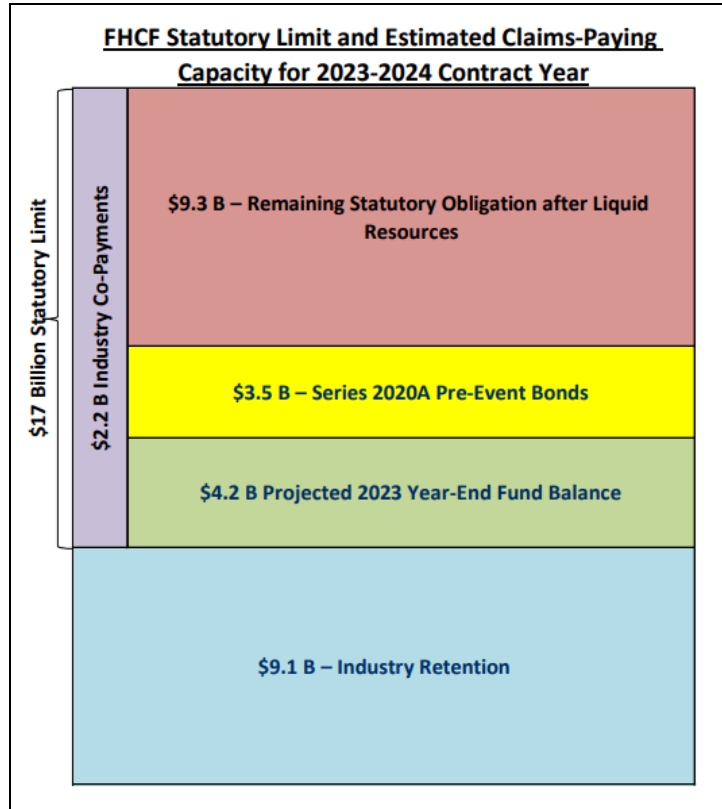
The FHCF is a tax-exempt trust fund created by the State of Florida in 1993 that is designed to be self-supporting and self-funded. The FHCF is administered by the State Board of Administration of Florida under Section 215.555 of the Florida Statutes. All participating insurers, like AmCo, pay the FHCF annual reimbursement premiums as consideration for the reimbursement coverage that FHCF provides. The reimbursement premiums are based on insured values of covered properties (as reported annually to the FHCF).

The annual reimbursement contract provides for reimbursement of a percentage of an insurer's residential hurricane losses in excess of its retention which is determined under a statutory formula. Reimbursement is provided at one of three percentage levels (90%, 75%, or 45%) which is selected in advance by the insurer seeking coverage. This means that once an insurer's losses from residential hurricane damage exceed their retention level, the FHCF will cover either 90%, 75%, or 45% of the additional losses, depending on what level the insurer has chosen.

The FHCF obtains its funding from the following available potential sources:

- 1) Accumulated and current year reimbursement premiums
- 2) Recoveries from reinsurance and other risk-transfer mechanisms
- 3) Pre-event bond proceeds and other pre-event liquidity resources
- 4) Proceeds of post-event revenue bonds or bank loans issued
- 5) Investment earnings or accumulated reimbursement premiums

It is important to note that the actual and potential obligations of the FHCF are limited by statute. For the contract year June 1, 2023 – May 31, 2024, the maximum potential liability of the FHCF is \$17 billion, with projected available total liquid resources of approximately \$7.7 billion. These liquid resources consist of \$4.2 billion of project year-end fund balance and \$3.5 billion of pre-event bond proceeds.



**Figure 4: FHCF Statutory Limits & Estimated Claims-Paying**  
*(source: FHCF Filings)*

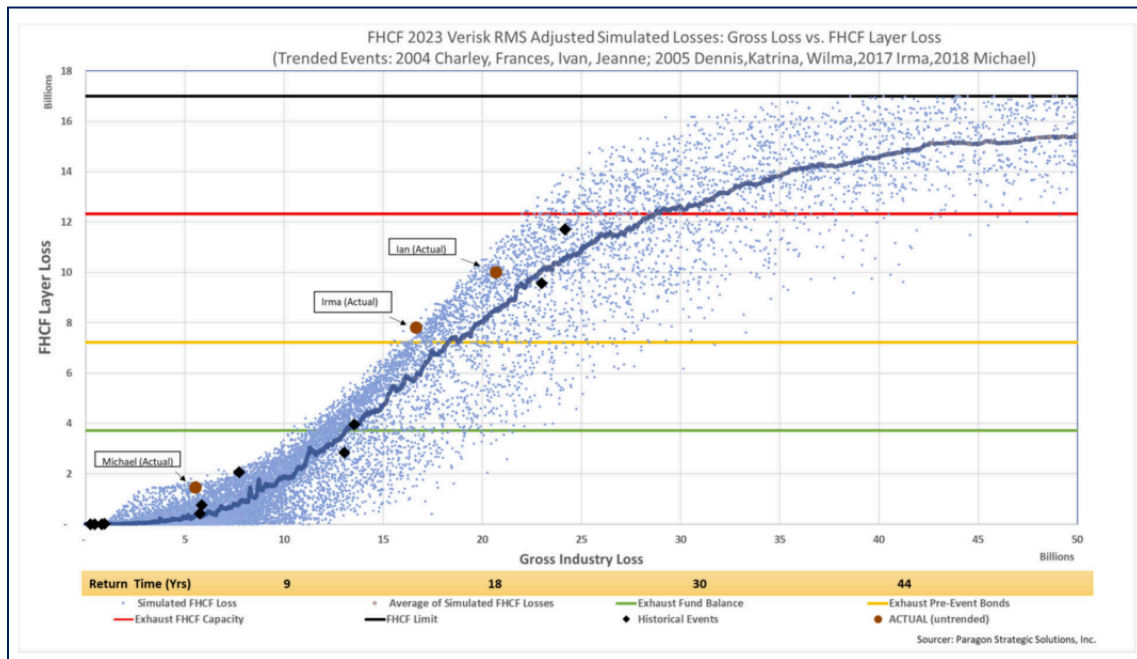
Verisk and RMS are companies that provide catastrophe modeling services. Their models are used to estimate potential losses from hurricanes for insurance companies. Verisk uses company-by-company data including analysis based on model results by ZIP code, type of business, individual company retention, company limit, and coverage selection. The data depicted in Figure 5 below pertain to approximately 150 participating insurers, each with its own retention and coverage limits. Consequently, every participating insurer possesses unique probabilities of triggering its FHCF coverage and reaching its FHCF coverage limit.

Layer	FHCF Layer Loss (\$ in B)	Ground Up Losses for Average Verisk, RMS Company Retention Limit (\$ in B)	Return Times (Yrs) for Aggregate Verisk, RMS Company Retention Limit
\$1bn FHCF Layer	1.00	7.90	8.00
Projected Fund Balance Exhausted	4.20	14.10	13.00
\$5bn FHCF Layer	5.00	15.20	14.00
Pre-Event Bonds Exhausted	7.70	19.30	17.00
\$10bn FHCF Layer (Ian Level)	10.00	23.30	21.00
Maximum Statutory Limit	17.00	98.20	240.00

**Figure 5: FHCF Projected Return Times & Ground Up Losses**

(source: Arcata Capital, Daikoku Capital, FHCF Filings)

In the context of Figure 5, the “Return Times” column is the estimated number of years between hurricane events that cause losses equal to the corresponding number in the column named “FHCF Layer Loss”. The “Ground Up Losses for Average Verisk” is the predetermined amount of loss that the average insurance company is responsible for covering before the FHCF’s coverage begins.



**Figure 6: FHCF Adjusted Simulated Losses**

(source: FHCF Filings)

While looking at Figure 4 there appears to be a funding shortfall of \$9.3bn in the FHCF (red portion of Figure 4 or area between the red and black line in Figure 6). There is also \$3.5bn in outstanding pre-event bonds that eventually need to be repaid (yellow part of Figure 4 or area between yellow and red line in Figure 6). The reason both are not concerns is because FHCF can levy emergency assessments on all property and casualty insurance lines across the state. One can think of the emergency levy as a non-recurring 6-10% statewide sales tax on a product with perfectly inelastic demand and an underlying premium base of \$72.6 billion. According to an FHCF report published in October of 2023, “While the FHCF statute does limit the amount of assessment that can be levied – 6% for losses attributable to one contract year and 10% for losses attributable to all years – these percentages, when applied to the current assessment base of \$72.6 billion, mean the FHCF could levy annual assessments of as much as \$4.36bn for losses from hurricanes occurring in one contract year and as much as \$7.26bn for losses from hurricanes occurring over all contract years.”

The strength of this revenue stream is the primary reason the three major rating agencies – Moody's, Standard & Poor's and Fitch – rate FHCF's current debt as Aa3, AA, and AA, respectively.

FHCF Post-Event Estimated Borrowing Capacity						
(\$ in Billions)	BofA	Citi	JPM	MS	WF	Average
<b>Borrowing Estimates</b>						
Tax-Exempt:						
0-12 Months	1.75	2.25	4.50	4.24	3.50	3.25
12-24 Months	2.50	2.25	4.50	3.00	2.50	2.95
<b>Total tax-exempt</b>	<b>4.25</b>	<b>4.50</b>	<b>9.00</b>	<b>7.24</b>	<b>6.00</b>	<b>6.20</b>
Taxable:						
0-12 Months	4.00	3.25	5.50	6.00	3.50	4.45
12-24 Months	4.00	3.25	5.50	4.00	2.50	3.85
<b>Total Taxable</b>	<b>8.00</b>	<b>6.50</b>	<b>11.00</b>	<b>10.00</b>	<b>6.00</b>	<b>8.30</b>

**Figure 7: Expected Post-Event Borrowing Capacity**

*(source: Arcata Capital, Daikoku Capital, FHCF Filings)*

The FHCF's finances will be significantly stretched next year if we have any hurricane comparable to Irma or worse. This would most likely wipe out the entirety of their "equity" and a portion of their \$3.5bn Series A 2020 bonds. This interpolation is based on Figure 6. Running out of surplus, while not ideal, would not be disastrous. If this were to occur, FHCF would be forced to rely on their post-event bonds. In the case of Hurricane Wilma, FHCF was able to raise approximately \$30bn of post-event bonds from the market, meaning they could do this again in theory. The post-event borrowing is somewhat constrained by the post-event borrowing estimated by banks and highlighted in Figure 7.

Note that FHCF's low fund balance is a short-term issue that will incrementally resolve as FHCF collects reimbursement premiums each year.

In our recent interview with Brad Martz, former CFO and current president of AmCo, he said that while the risk of FHCF financing being put under pressure is certainly possible, it is seen as remote. He emphasized that if FHCF were to falter, it would inevitably translate into increased costs for Floridians. Martz highlighted AmCo's capability to replace the coverage limit on the open market, albeit at elevated prices. However, he underscored the state's reluctance to witness such a scenario unfold, citing Florida's paramount concern for affordability. He emphasized that the CAT fund plays a crucial role in subsidizing insurance costs, thereby maintaining a low cost of living for Floridians. FHCF is also implicitly backed by the state, which is AAA rated and had a record surplus for FY 2021-2022 of \$22.8bn USD.

We do not see FHCF posing any idiosyncratic risk to AmCo, but rather a potential systemic risk to the industry.



## Strategic Risk Mitigation through Quota Share with Reinsurers

From 2019 to 2021, AmCo was in a loss-sharing agreement with UPC. This loss-sharing agreement caused AmCo's equity base to fall to a low of approximately 70 to 80 million dollars. Because of this low equity base, AmCo was forced to enter into a strategic quota share agreement with Berk Re and Arch Re. A quota share agreement is a type of reinsurance unique from the standard excess of loss agreement. One can think of it as reinsurance companies purchasing temporary equity in AmCo although keep in mind that this analogy is far from perfect. Mechanically, AmCo cedes a portion of their gross premiums earned and the reinsurance companies agree to pay an equal portion of the losses and expenses.

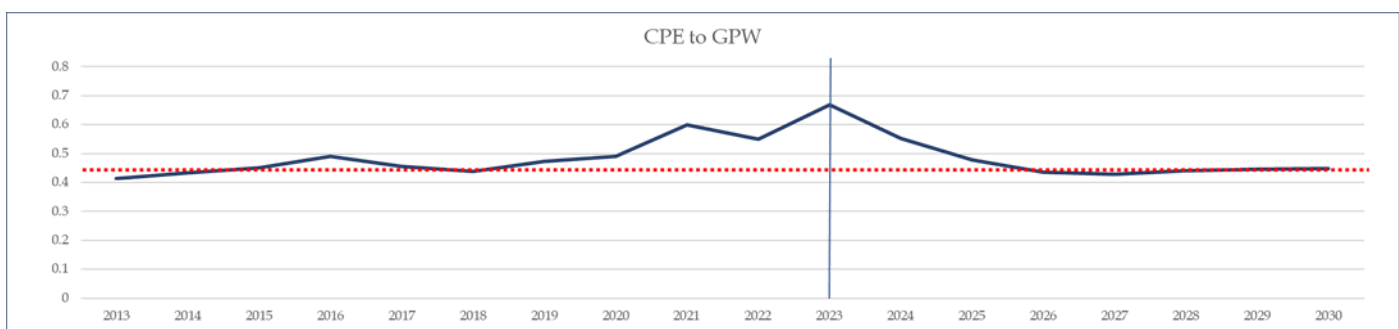
Currently, AmCo is in a ~40% quota share agreement, 20% of which is with ArchRe and the other 20% with Berkshire. This quota share agreement would be destructive to shareholder value if maintained for long periods of time. This is especially true during hard markets where catastrophe insurance prices are very attractive. However, with AmCo's recent equity offering and increased profitability in years to come, we believe that AmCo should be able to return to a purely excess of loss reinsurance stack by 2026e. To determine when AmCo would be able to reduce their quota share agreement, we forecasted the net premiums earned (NPE, total premiums written less reinsurance costs) to retained earnings ratio. One can think of NPE / retained earnings as a rough measure of the risk that an insurance company is taking on. HCI, the second highest quality P&C insurer in Florida, has a NPE to retained earnings ratio in normalized years of 2x. Palomar, a very high-quality catastrophe insurance comp on the east coast, has a ratio of just .5x today with a lower ratio in soft market years. Management at AmCo as well as insurance analysts would like to see a ratio below 2x and preferably closer to 1x in the long term. Using LTM data, AmCo has an NPE to equity ratio of 2.7x, which is far above the 2x target. This was the core reasoning behind implementing the quota share agreement. Figure 8 shows these ratios across the comp set.

NPE to Equity	2014	2015	2016	2017	2018	2019	2020	2021	2022	Average
ACIC	1.9x	1.5x	1.2x	0.9x	0.9x	1.0x	1.9x	-5.5x	-1.9x	1.3x
UVE	12.7x	5.3x	3.9x	3.7x	4.1x	4.2x	4.1x	4.9x	10.6x	5.9x
HCI	2.1x	1.5x	1.1x	1.0x	1.1x	1.2x	1.5x	1.7x	1.9x	1.5x
HRTG	1.3x	1.6x	1.3x	0.9x	0.9x	0.8x	0.9x	1.0x	1.1x	1.1x
Palomar			0.1x	0.1x	0.1x	0.2x	0.3x	0.4x	0.5x	0.3x

**Figure 8: NPE to Equity Comps Table**

(source: Arcata Capital, Daikoku Capital, Company Filings)

Looking forward, we believe that AmCo, with a 40% quota share, will accumulate around \$200 million in equity and a NPE to equity ratio of just 1.2x by the end of 2023e (12 months ending in July 2024), far below the industry standard in Florida and safely below management's upper bound. It is this drastic drop in NPE to equity ratio in 2023e that is allowing us to forecast a decrease in the quota share as % of GPE from approximately 35% in 2023-2024 to 25% in 2024-2025, 15% in 2025-2026, and 5% in 2026-2027. We have sanity checked these numbers using the ceding ratio, illustrated in Figure 9 below.



**Figure 9: Historical CPE to GPW for American Coastal**

(source: Forecasts from Arcata Capital & Daikoku Capital using Historical Company Filings)

As we hinted at briefly in the introduction, AmCo is currently issuing equity. While issuing equity at a time when the share price of ACIC is extremely undervalued is destructive of value, management believes that this additional equity will lead to value creation by allowing AmCo to exit its quota share agreement faster than currently expected. Below we have conducted an analysis to determine whether this equity offering creates value or not. We simply compared the value of ACIC's shares with and without the equity offering, attempting to keep the risk between the two scenarios equal by adjusting the quota share accordingly.

While there were many measures of risk that we could have used, we determined that looking at NPE to equity was the most logical choice. In both scenarios, we would expect management to target reaching a NPE to equity ratio below 1x by 2025e. This is the factor that we will be trying to hold constant in the two scenarios with the independent variable being the quota share percentage.

The two scenarios are compared in Figure 10 below. The first shows what we believe the quota share agreement will be after the \$20,000,000 equity offering. In this scenario, we can see that AmCo will be able to return to an NPE to equity ratio below 1x between FY 2024 and 2025. The second scenario shows what the quota share agreement would have to be when accounting for the lower level of net income caused by no equity raise. We also included the ceding ratios which can be sanity checked against Figure 9. As an investor, you would want to see the ceding ratio come back down to normalized levels such as those from 2013 to 2019.

When comparing the valuations between the two scenarios (Figure 11), we can see that the equity offering does not substantially decrease the intrinsic value of ACIC after accounting for the share dilution. This exercise shows that the equity offering does not destroy significant value, something that the market likely thinks is true and/or sees as a sign of weakness in the company.

Equity Offering & Quota Share Analysis	2022	2023	2024	2025	2026	2027	2028	2029	2030
<b>With Equity Offering</b>									
Quota Share Amount	0%	35%	25%	15%	5%	0%	0%	0%	0%
NPE to Equity	2.7x	1.2x	1.1x	0.8x	0.6x	0.5x	0.5x	0.4x	0.4x
Ceding Ratio (sanity check)	-55%	72%	63%	58%	44%	43%	44%	44%	45%
<b>Without Equity Offering (adj. quota share)</b>									
Quota Share Amount	0%	40%	32.5%	25%	5%	0%	0%	0%	0%
NPE to Equity	2.7x	1.2x	1.2x	0.9x	0.8x	0.6x	0.6x	0.5x	0.5x
Ceding Ratio (sanity check)	55%	72%	63%	58%	44%	43%	44%	44%	45%

**Figure 10: Historical CPE to GPW for American Coastal**

(source: Arcata Capital, Daikoku Capital)

ACIC Value		ACIC Value	
Equity Value	1,167,900,140	Equity Value	1,230,444,947
DSO (w/o equity offering) <span style="color:red">▼</span>	42,478,686	DSO (with equity offering) <span style="color:red">▼</span>	45,058,744
<b>Equity Value per Share</b>	<b>27.49</b>	<b>Equity Value per Share</b>	<b>27.31</b>
Current Share Price	12.55	Current Share Price	12.55
<b>Upside</b> <span style="color:green">▲</span>	<b>119.07%</b>	<b>Upside</b> <span style="color:green">▲</span>	<b>117.59%</b>

**Figure 11: Equity Offering Analysis**

(source: Arcata Capital, Daikoku Capital)

We are aware that management at American Coastal may be able to decrease the quota share agreement at a quicker pace than we are currently forecasting. Specifically, Brad Martz has indicated that American Coastal may potentially convert Berkshire to an excess of loss contract by 6/1/2024 whereas we have it as 25% for 2024e beginning June. This is enabled by the fact that Berkshire does not have the option to stay on the quota share agreement whereas ArchRe, their other partner, does have a

multi-year option.. However, because of the uncertainty involved in transitioning back to an excess of loss contract, we have maintained the quota share at 25% for 2024e.

## **Hurricane Risk**

Hurricanes clearly pose the largest risk for the company and investment going forward. While almost all of this risk has been accounted for by the analysis we did on the reinsurance stack, we wanted to further clarify the risk by analyzing the effects of past and current hurricanes and how they impacted ACIC. To do this, we have created a simple simulation that allows us to see the impact of named events on our financial model over the forecasting period.

### **General Hurricane Trends**

There are many misconceptions that people hold about hurricanes. Some of the common misconceptions are that destructive hurricanes occur frequently (availability bias), their frequency is increasing rapidly because of warming temperatures in the Atlantic (misinformation), and that Florida hurricanes cause state-wide damage.

What is true is that the average number of named category 3, 4, and 5 hurricanes is .31 per year in Florida (National Hurricane Center, Hurricane database), their frequency has remained unchanged over the last 200 years with no apparent trend due to warming oceans (Nature Climate Change, peer reviewed paper), and that hurricanes take specific paths that cause centralized damage (ex. Idalia, Michael, Ian, etc).

Importantly though, hurricanes are increasing in severity due to both higher wind speeds and increased population density in coastal areas. According to a recent study, the chance of a “Katrina-like TV and a Harvey-like TV impacting the United States within 15 days of each other is non-existent in the control simulation for over 1,000 years ... but is projected to have an annual occurrence probability of 1% by the end of the century under the high emission scenario.”

Figure 12 below was used to calculate the hurricane frequency by decade in Florida (data sourced from HURDAT and HRD). As per the data, the average number of category 3, 4, and 5 hurricanes per year making landfall in Florida is just .31. Florida has been hit by a total of just 26 category 3, 4, and 5 hurricanes in the past 100 years. We have not included category 1 and 2 hurricanes as they have a low to nonexistent potential to severely damage infrastructure although occasionally they can cause major damage. These hurricanes typically dissipate by the time they make landfall and are less tracked than the larger ones.

Hurricane Frequency by Decade in Florida				
Semi-Decades	Category 3	Category 4	Category 5	Total
1923-1928	0	2	0	2
1929-1934	1	0	0	1
1935-1940	0	0	1	1
1941-1946	1	1	0	2
1947-1952	1	4	0	5
1953-1958	0	0	0	0
1959-1964	0	1	0	1
1965-1970	2	0	0	2
1971-1976	1	0	0	1
1977-1982	0	0	0	0
1983-1988	1	0	0	1
1989-1994	0	0	1	1
1995-2000	0	0	0	0
2001-2006	4	1	0	5
2007-2012	0	0	0	0
2013-2018	0	1	1	2
2019-2023	1	1	0	2
Average per 5 Years	0.71	0.65	0.18	1.53
Average per Year	0.14	0.13	0.04	0.31
Standard Deviation	1.0	1.1	0.4	1.5

**Figure 12: Hurricane Frequency by Decade in Florida**

(source: Arcata Capital, Daikoku Capital, HURDAT, HRD)

The second misconception that most people have is that hurricanes are occurring more often. This is not true. In Figure 13, we can see the number of hurricanes per decade in the US over the last 175 years (data sourced from HURDAT and HRD). Both the per decade rolling average of hurricanes from categories 1,2, 3, 4, and 5 and categories 3, 4, and 5 in the US have not changed meaningfully over our observed time frame.

Hurricane Frequency by Decade in US					
Decades	Category (1,2,3,4,5)	Rolling Average (3 Decade)	Category (3,4,5)	Rolling Average (3 Decade)	
1851-1860	20		6		
1861-1870	15		1		
1871-1880	20	▲	7	▲	4
1881-1890	21	▲	4	▲	5.5
1891-1900	21	▲	8	▲	6
1901-1910	18	▲	4	▲	6
1911-1920	20	▲	7	▲	5.5
1921-1930	14	▲	5	▲	6
1931-1940	21	▲	5	▲	5
1941-1950	24	▲	10	▲	7.5
1951-1960	17	▲	6	▲	8
1961-1970	12	▲	6	▲	6
1971-1980	12	▲	4	▲	5
1981-1990	15	▲	5	▲	4.5
1991-2000	14	▲	5	▲	5
2001-2010	18	▲	7	▲	6
2011-2020	19	▲	4	▲	5.5
2021-2023	3	▲	2	▲	3
Average	16.9		5.3		

**Figure 13: Hurricane Frequency by Decade in the US**

(source: Arcata Capital, Daikoku Capital, HURDAT, HRD)

## Specific Hurricane Analysis

In this section, we look to provide analysis as to specific hurricanes that have impacted AmCo and Florida. We will go in chronological order for the hurricanes starting with Irma in 2017 and finishing with Idalia which occurred this year.

The key aspects that we want to emphasize while presenting this analysis are the strength of the hurricanes, the paths they took, the damage that those two aspects caused, and their impacts on AmCo.

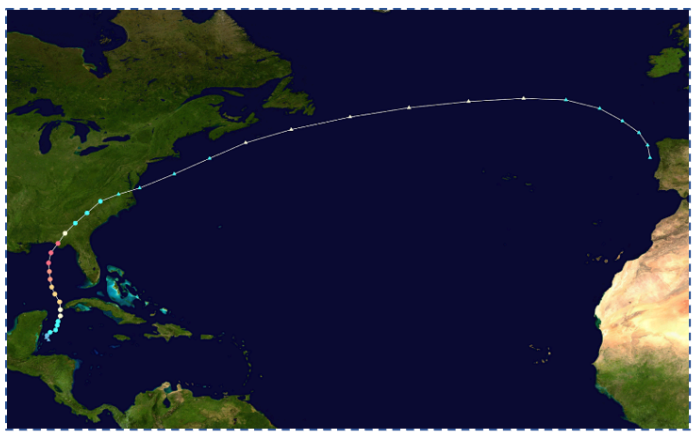
### Irma (September 2017)

Hurricane Irma was the most damaging hurricane since Andrew in 1992. Below is an image of the path that Irma took. Orange dots signify category 3 and 4 while red signifies category 5. Looking at Figure 14, the hurricane took a unique path, traveling near vertically along the west coast of Florida as a category 1, 2, and 3 hurricane and then entering the Atlantic as a category 5. Irma caused \$50 billion dollars in damage. By comparison, Hurricane Sandy caused \$70 billion in damage to the US and Katrina caused \$160 billion, putting Irma in the same ballpark as the most damaging US hurricanes.

While it is difficult to estimate what percent of the reinsurance stack was used up in Hurricane Irma's case, AmCo was still able to maintain a combined ratio of 78% in its aftermath, 15 to 20% below the average combined ratio in the industry.



**Figure 14: Hurricane Irma's Path**



**Figure 15: Hurricane Michael's Path**

### Hurricane Michael (October 2018)

Hurricane Michael was a very damaging hurricane that took a more unique path across the Florida panhandle, making landfall in the region as a category 5 hurricane (Figure 15). Michael caused approximately 18.4 billion dollars in losses, compared to Irma, which caused \$50 billion dollars in loss. Clearly, the path of the hurricane is highly correlated with the severity of the damage it causes.

During 2018, ACIC reported a combined ratio of 86% which is far below the industry average.

### Hurricane Ian (September 2022)

Ian was a large category 5 hurricane which passed directly over highly populated areas of Florida where ACIC does business. Look to Figure 16 to see the path of Ian. It surpassed Katrina and Sandy to be the costliest Florida weather disaster on record and the deadliest disaster to hit Florida since 1935. The hurricane caused \$110 billion in damage in Florida, 75% more than Irma and twice that of Michael. The period between 2019 and 2021 exemplifies that hurricanes do not have to happen every year. However, a lack of hurricanes in past years doesn't stop sudden and large hurricanes from forming in the future.

While Ian passed over ACIC-insured areas and was of extreme strength, the hurricane only used up 20% of the reinsurance stack, according to management. This is quite incredible and indicates that management is targeting properties with a very low total insured value at risk.

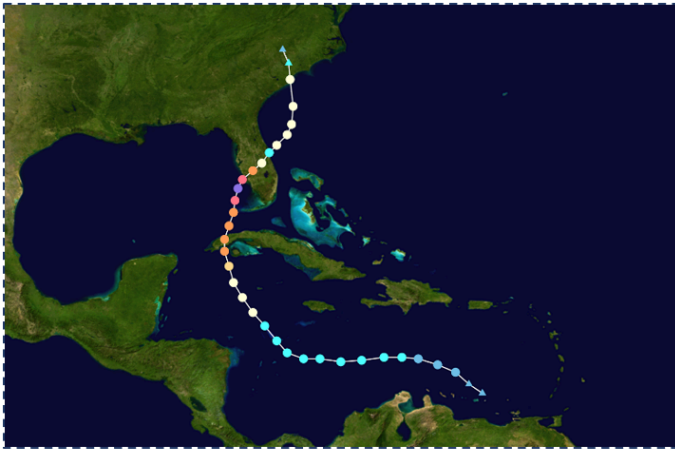


Figure 16: Hurricane Ian's Path

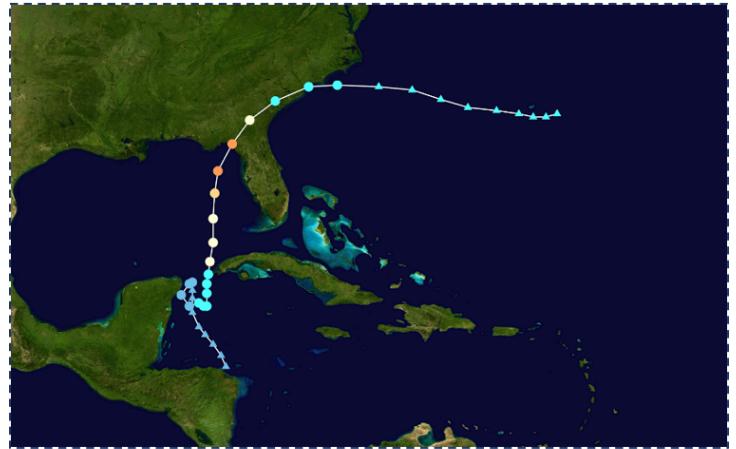


Figure 17: Hurricane Idalia's Path

### Hurricane Idalia (August 2023)

Idalia made landfall in Florida as a category 4. The hurricane missed most of the highly populated regions, taking a similar path to that of Michael. Early projections put the losses at \$3 to \$5 billion.

According to management, "American Coastal was largely unimpacted by Idalia with our current loss estimate well below the reinsurance attachment point of \$10 million. American Coastal's commercial segment underlying combined ratio was 48.9% in the third quarter and 54.3% year-to-date, down from 57.7% and 66.1%, respectively, year-over-year. Hurricane Idalia represented a gross loss incurred of approximately \$4 million and \$2.5 million net of reinsurance with the remaining \$3.3 million of catastrophe losses stemming from a couple of current year PCS events."

### Summary

The path and intensity of a hurricane are important when determining the impact to ACIC. However, even in cases where category 5 hurricanes pass over highly populated areas of Florida, ACIC tends to be highly protected because of their large reinsurance stack, low retention points, and low total value insured at risk because of the building codes that they target.

### 3 Event Scenario

A reinsurance stack consists of multiple layers of reinsurance where each layer is typically reinsured by a different party. Figure 18 below provides an example reinsurance stack that we created for visual purposes. This stack is not meant to be a representation of AmCo's stack.

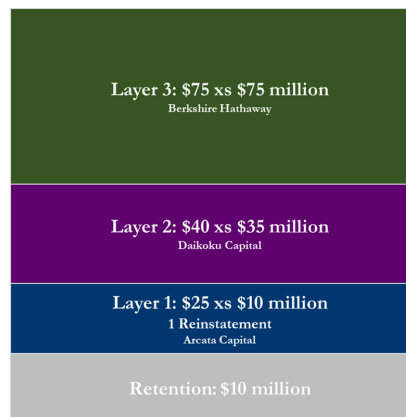
At the very bottom of the stack we have the \$10 million retention layer. This means that the consumer facing insurance company would be liable for the first \$10 million in losses caused by a hurricane. In layer 1 of the stack (blue portion), we can see that reinsurance is provided by Arcata Capital and protects \$25 million in excess of \$10 million. So, if a hurricane hit the insurance company's insured properties and caused \$15 million in damage, that would use up, first, the \$10 million retention part of the stack and then, second, eat into \$5 million of layer 1 (protects up to \$25 million).

Now let's say that a second hurricane hits the insurance company's insured properties causing \$35 million in total damages. Similar to what occurred during the first hurricane, the insurance company would be liable for the first \$10 million in damages. One may think that the reinsurance provided by Arcata Capital in layer 1 of the stack would protect against the remaining \$25 million in damages since it says "\$25 xs \$10 million". However, this is not quite how it would work, as a portion of layer 1 of the stack was "used up" from the first hurricane. Specifically, \$5 million of layer 1 was used up leaving \$20 million in protection from the first layer. Therefore, the insurance company would be liable for an additional \$5 million with the reinsurer only protecting against \$20 million in excess of \$15 million.

Now let us say that a third hurricane hits Florida that same year causing \$150 million in damages to the insurance company's properties. At this point, all of layer 1 of the stack has been used up with \$5 million being used up from hurricane 1 and another \$20 million being used up from hurricane 2. So when this third hurricane hits, you might expect the insurance company to be liable for the retention as well as all of layer 1 with the reinsurance kicking in for layer 2 and 3. However, this is not how it would work as if you look closely at layer 1 in the visualization, there is a line saying "1 reinstatement". A reinstatement allows for that part of the layer to be reinstated once it is fully used up (in some cases a reinstatement could reinstate a layer if it is partially used up). So instead of the insurance company being on the line for the first \$35 million (retention + layer 1), they are only liable for the retention with the reinsurers protecting all remaining losses of \$140 million.

Referring back to Figure 2 which visualizes AmCo's stack for this year, AmCo has reinstatements across the lower layers of the stack including the \$25m xs \$10m, \$65m xs \$35, \$25m xs \$100m, and \$125m xs \$125m. This means that AmCo is protected for up to two named events this year for \$250m of their stack.

Even in the case that two events occurred, Brad Martz explained that AmCo has the ability to purchase additional reinsurance throughout the year to protect against a third event. We would caveat this by saying that if two hurricanes occur in a single year, a fairly uncommon occurrence, the reinsurance markets may dry up.



**Figure 18: Example Reinsurance Stack**  
(source: Arcata Capital, Daikoku Capital)



To evaluate the risk of a 3-event year, we ran a simulation using Crystal Ball that calculates the probability of a 3-hurricane scenario occurring over the next 7 years (forecasting period). We utilized a Poisson distribution (Figure 20) with a mean of .31 to estimate the number of hurricanes that would occur per year. After running our model over 10,000 trials, we estimate that a 3-hurricane scenario would occur <3% of the time. This means that only 3% of the time will a 3-event scenario occur over the next 7 years. If we look just at the next 3 years the probability is lowered to just 1%. In fact, there is a 10% chance that no category 3, 4, or 5 hurricane hits Florida over the next 7 years. This analysis does not include various tropical storms or category 1 or 2 hurricanes that could hit Florida as these are insignificant events in relation to the \$1 billion reinsurance stack.

## Simulation

In addition to the smaller simulations that we ran, we ran a larger simulation for our financial model. The key variable that we sensitized was the # of named events per year in Florida. We then tried to evaluate what other variables in our model were correlated with the number of named events per year. We came to the conclusion that there were 5 other key variables in our model that we wanted to sensitize and correlate. Figure 19 shows these variables.

Simulation Variables	
<b># of Named Events</b>	
Relevance in Model	In our model, we have built in functionality to change the number of cat event per year. This is the core assumption we want to sensitize. Many of the other assumptions we are sensitizing are either correlated significantly with the number of events.
Simulation Inputs/ Assumptions	Poisson distribution with rate of .31. This assumes 73% chance of 0 hurricanes, 23% of 1, 3.5% of 2, and .4% of 3.
<b>Change in Property Market Valuations</b>	
Relevance in Model	Increases or decreases in property values is one factor that determines rates on insurance. There has been a studied positive correlation between the size and number of hurricanes and property market values in Florida.
Simulation Inputs/ Assumptions	Normal distribution with mean of 0-3% depending on year and standard deviation of 1%. We positively correlated these values for each year with the last 3 years of # of named events.
<b>Changes in Hard/Soft Market Pricing</b>	
Relevance in Model	Due to changes in reinsurance capacity, the insurance market has cyclical pricing. The largest driver of hard/ soft market pricing is the severity and frequency of named events in the future. 3 hurricanes --> higher chance of hard market.
Simulation Inputs/ Assumptions	Maximum extreme distribution with scale of 2% and likeliest values of 0% in 2024, -15% in 2025, -20% in 2026, -10% in 2027, and 0% thereafter. We positively correlated these values for each year with the last 3 years of # of named events.
<b>Private Excess of Loss Reinsurance Expense</b>	
Relevance in Model	Forecasting private XOL expense as a percentage of gross premiums written (GPE) with the assumption that as # of named events increases, reinsurance costs should increase (supply-side).
Simulation Inputs/ Assumptions	Normal distribution centered around 19% to 25% of GPE depending on year with a standard deviation of 1%.
<b>Per Event Retention</b>	
Relevance in Model	The retention is the \$ value at which the reinsurance kicks in. Any losses below this point are paid directly by A/CIC. We believe there is minimal correlation between the retention point at # of named events.
Simulation Inputs/ Assumptions	Lognormal distribution with location of 8, mean of \$12.5 million, and standard deviation of \$5 million.
<b>Per-Event Loss Adjustment Expenses</b>	
Relevance in Model	Per-Event LAE provides an estimate for the costs of assessing damages per hurricane. This cost has averaged \$15 million reaching highs of around \$27.5 for large hurricanes such as Ian.
Simulation Inputs/ Assumptions	Lognormal distribution with location of 0, mean of \$15 million, and standard deviation of \$7.5 million.

**Figure 19: Simulation Variables Summarized**

(source: Arcata Capital, Daikoku Capital)

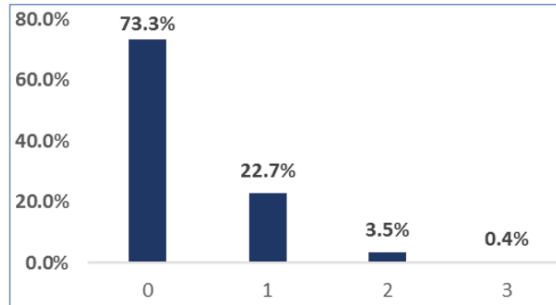
In our model, we assumed that a three-event year over the forecasting period would wipe out the entire company and all of its past earnings leading to total loss on the investment. We believe that this assumption is highly conservative and unrealistic as in reality the third hurricane would likely be covered by the remainder of the insurance stack or could be small like Idalia. Secondly, the assumption that a third hurricane, regardless of the year it occurs, would lead to a total loss on the investment is unrealistic as the company will have likely built up or paid out past year retained earnings. Lastly, Brad Martz explained that AmCo could fairly easily go out in the market and replenish the lower levels of the stack if two events occurred.

Our model also attempts to consider extreme hurricane events that use up the entire stack. We did this by assuming that if one of these extreme hurricanes (1/167-year events) occurred anytime over the 7-year forecasting period, it would lead to total loss



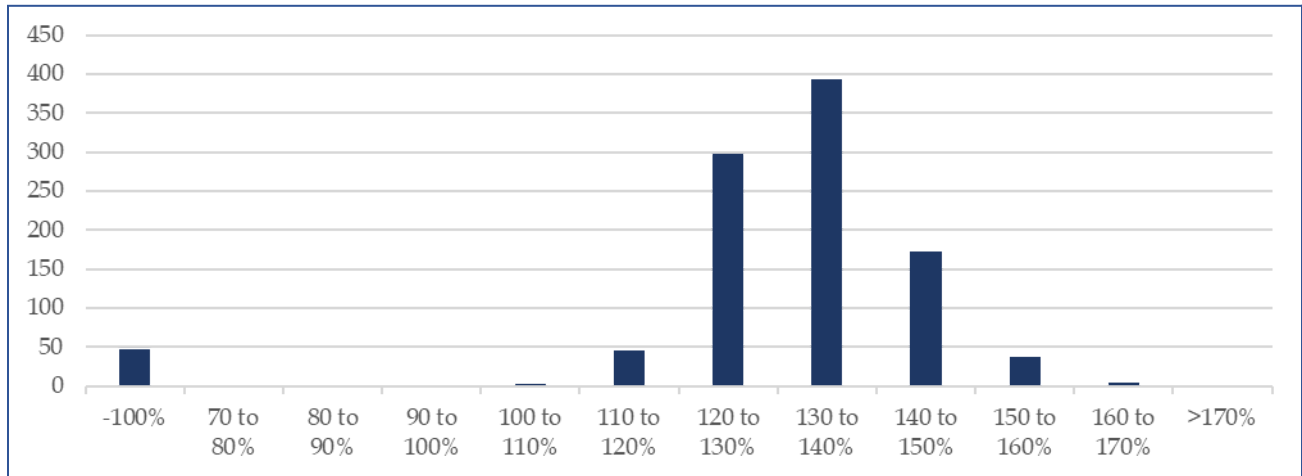
on the investment. For the same reasons that the three-event year scenario wiping out the entire company is unrealistic, we believe that a 1/167 year hurricane wiping out the entire investment is also unrealistic. This is because AmCowould have additional equity balances to be able to pay out these claims and would have likely paid out a substantial amount of money by later years. Additionally, we believe that AmCo targets customers who are uniquely protected from such extreme events.

We ran our simulation over 1000 trials. Figure 21 shows the distribution of outcomes for our investment in various scenarios. The mean upside was approximately 120%. The left tail represents the outcomes where there is either a 1/167 hurricane or 3 event year anytime over the forecasting period. For the reasons described above, we believe that our model significantly overstates the downside potential in these scenarios.



**Figure 20: Poisson Distribution Representing Hurricanes per Year in Florida**

*(source: Arcata Capital, Daikoku Capital)*



**Figure 21: 1000 Trial Simulation of Upside**

*(source: Arcata Capital, Daikoku Capital)*

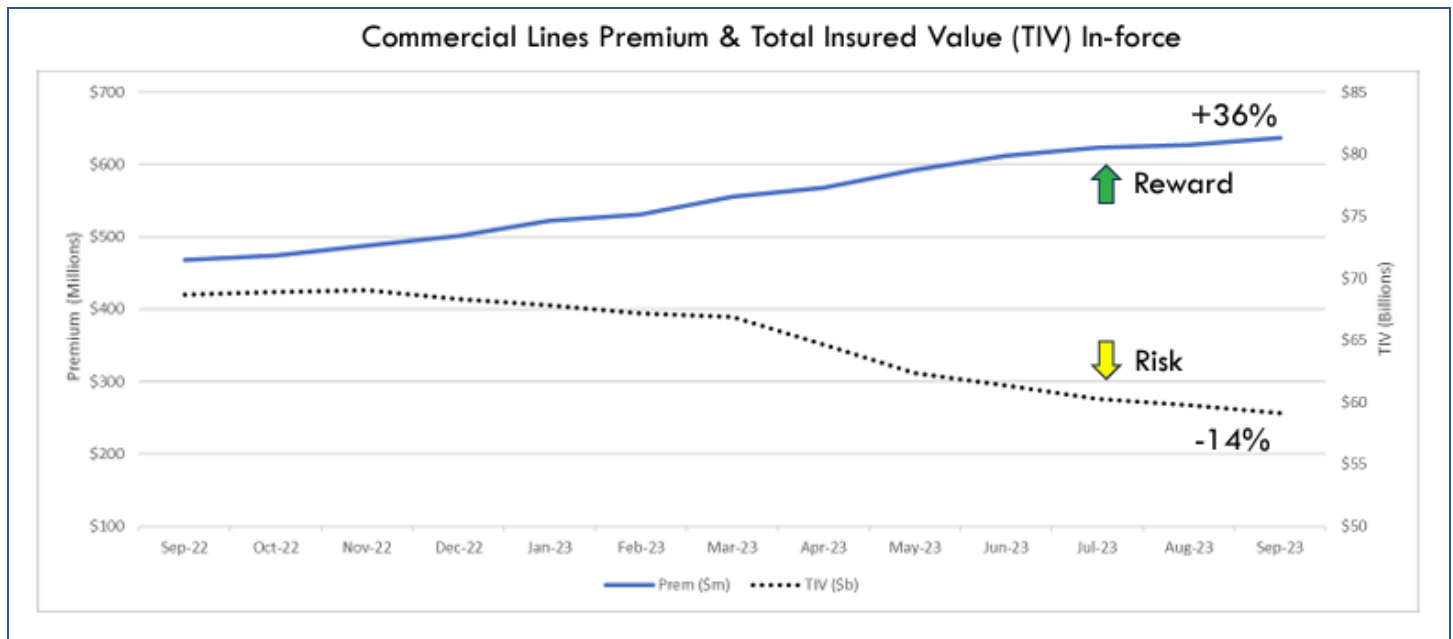
## Hard Market Conditions

### Hard Market Conditions Continue to Persist

Professor Woollams made it very clear that no market participant in the insurance market can know exactly how long a hard market will last. According to past data, hard markets last an average of four years whereas soft markets can last for up to 8 years.

Dan Peed continues to see Florida as a hard insurance market. He expects that to remain the case in both the near and intermediate term. He also sees the commercial segment being an earnings leader for the foreseeable future.

*“While the hard market creates challenges it also creates excellent opportunities for ACIC.”* – Dan Peed, CEO of American Coastal



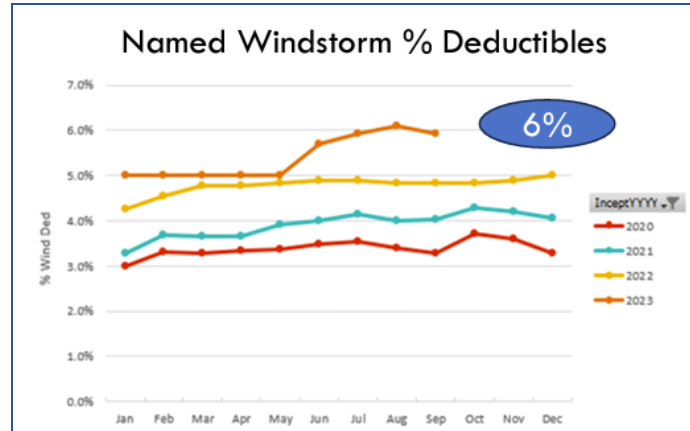
**Figure 22: Q3 2023 Commercial Lines Premium & Total Insured Value**

*(source: ACIC IR Presentation)*

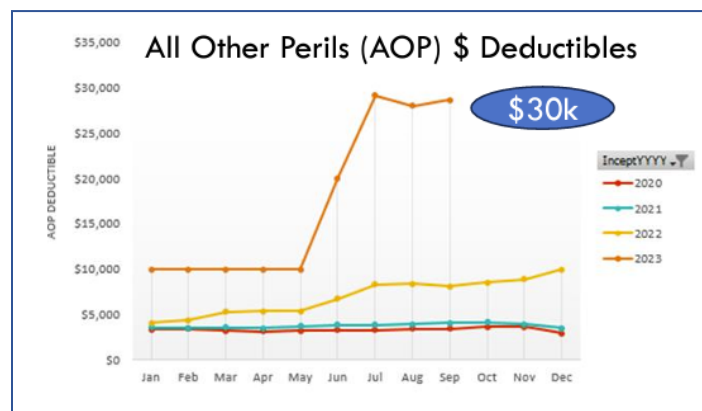
For the commercial lines segment (AmCo), gross written premiums were up 22.3% in Q3 of 2023. We sought to understand whether this growth was driven by price or volume. According to Figure 22 from the Q3 IR deck, AmCo was actually able to insure less homes (indicated by lower total insured value at risk) while collecting significantly more premiums.

*“The volume is down, which is reflected by the TIV. It is down 14% and the rates are up around 35-6%.”* - Dan Peed

Thus, we were further convinced that Florida is in a hard market, giving AmCo a pricing power edge. We also gained further conviction in Dan Peed’s underwriting discipline as it shows that he is willing to insure less homes to reduce risk.



**Figure 23: Trend in Named Windstorm Deductibles**  
*(source: ACIC IR Presentation)*



**Figure 24: Trend in All Other Perils Deductibles**  
*(source: ACIC IR Presentation)*

This argument is further supported by looking at the increasing deductibles that HOAs are being forced to take for both AOP and Named Windstorms (Figure 23 and 24). Deductibles are the amount of money that the insured party must pay before their insurance policy starts paying.

Our view and data were also confirmed by Shiwen Jiang. Shiwen currently sees no sign that rates will go down immediately. They might go up at a slower rate but are only expected to further harden.

We also thought it would be useful to assess how AmCo’s primary competitors HRTG, UVE and HCI are doing in these market conditions. Below are some of the rough notes we took on these competitors’ Q3 earnings calls.

**HRTG:**

- Net loss in Q3 driven by the losses following Hurricane Idalia in the Florida Panhandle.
- Losses were close to \$40m net for both Maui wildfires.
- \$1.3bn of premiums in force overall.
- Looking to diversify out of Florida, they emphasize that 73.5% of the total insured value falls outside Florida.
- However, for Q3 they grew their commercial residential premiums-in-force by 75.3%.
- They do want to grow in commercial residential properties in Florida.
- They continually mention that they are focused on making sure that they are not overly concentrated in any one area in Florida.

UVE:

- 
- They lost money in Q3 2023, the loss per share was \$0.16/share.
- Hurricane Idalia made Florida landfall, all losses were comfortably absorbed by UVE's retention.
- They have started to slowly increase new business in additional territories.
- Idalia was recorded as a \$45m loss, that is combined with another \$10-\$15m in losses elsewhere.

HCI:

- For Q3 they reported pretax income of \$20m.
- HCI is also a significant beneficiary of the hard market in Florida with higher average premium policy being the main driver of improved earnings.
- They acquired UPC's book in Georgia, North Carolina, South Carolina, Connecticut, New Jersey, Massachusetts and Rhode Island so they are not a pure play Florida CAT insurer.
- HCI is looking to enter the commercial residential insurance space, but they are awaiting regulatory approval. They are aiming to commence operations in early 2024. This is primarily due to the lucrative nature of commercial residential properties in these hard market conditions.

## Unwavering Confidence in American Coastal's Leadership

Many that we have talked to have questioned our faith in management. The biggest question these doubters have is why Dan Peed could have agreed to the loss-sharing agreement with UPC which led to subpar financial results and was inherently detrimental for American Coastal.

To better understand the dynamic, it is important to provide more background on Dan. Dan Peed founded AmRisc, the business AmCo currently partners with, in 2000 as a specialty MGA to underwrite commercial property catastrophe insurance. He then grew AmRisc from a claim sheet business plan to writing close to \$2.5 billion of premium, growing AmRisc into the largest windstorm MGA and the fourth largest MGA overall in America. He was the President, CEO, and finally Vice Chairman for his final year at AmRisc until he retired at the end of 2019.

While at AmRisc, Dan founded AmCo as a subsidiary of AmRisc. Jon Cukierwar explains that “In 2004 and 2005, Florida experienced an unlucky string of major hurricanes, which caused a great deal of damage in a short period of time. Many of the major insurance carriers, and smaller carriers as well, writing windstorm policies, were either no longer comfortable underwriting hurricane risk or realized they hadn’t developed the proper underwriting skills to underwrite hurricane risk under state-admitted guidelines, and as a result stopped offering admitted policies to certain segments of the market. This created a large void in P&C insurance supply, particularly for personal lines and low-rise commercial-residential lines, because policies in these segments carried premiums that were deemed too small by the major carriers for them to be interested in dealing with the associated hurricane risk. This quickly became problematic for many property owners across the state, because purchasing property insurance is either required or prudent, and suddenly they were left with no attractive options. Most property owners were forced to resort to purchasing P&C insurance from state-owned insurer Citizen’s, whose policies offer less than desirable coverage and whose government-led customer service was subpar.

From his perch at AmRisc, Dan saw this void developing in real time. Specifically, he noticed that within the commercial-residential property insurance sector, there was a large gap forming in the property insurance market for 1-to-6 story garden style condominium and homeowner association properties. While demand for high-rise commercial policies with large premiums was being better met by major carriers, garden style premiums of ~\$50,000/year were not large enough to attract new entrants”.

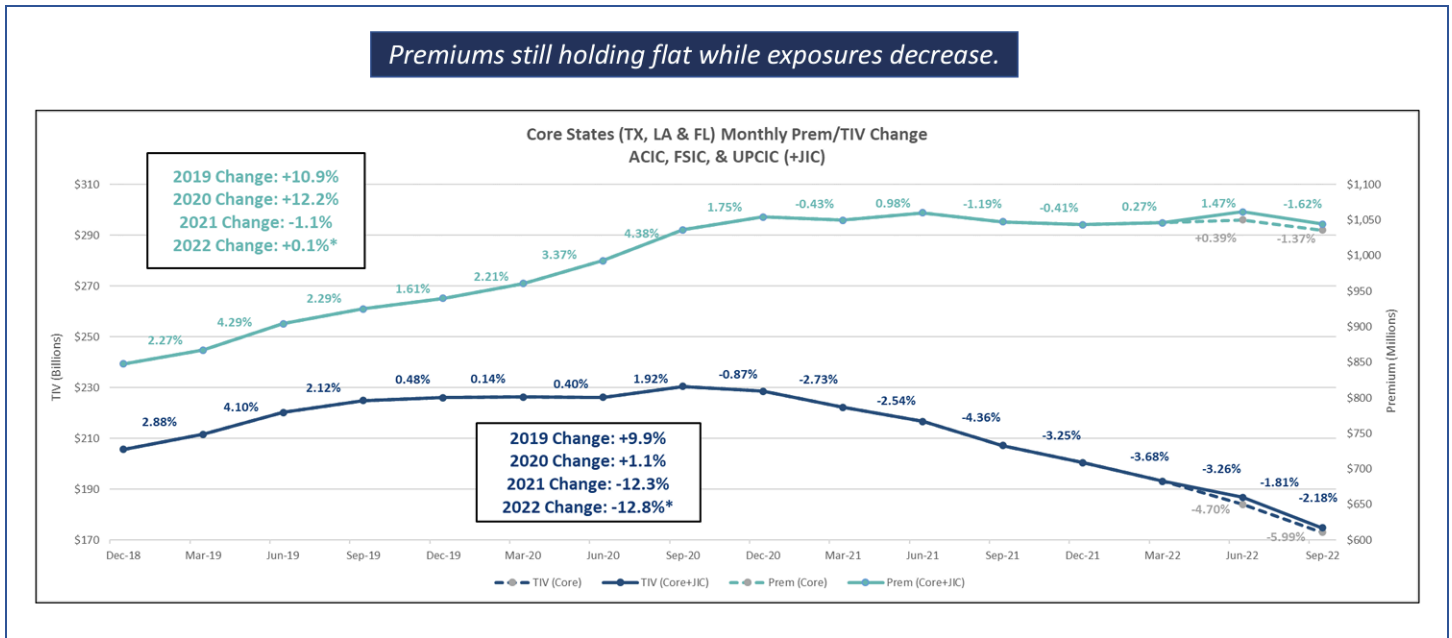
Since its founding, AmRisc raised significant sums of capital from BB&T to help fuel growth. Thus, BB&T had become the majority shareholder by 2012 with Dan Peed only owning a small portion of AmRisc. In May 2015, BB&T agreed to sell American Coastal Insurance Company to Dan Peed and other members of the AmRisc management team.

As part of this management-led buyout, it was agreed that AmRisc would remain AmCo’s exclusive MGA serving the Florida condominium property insurance market. The management team continued to manage the operations of AmCo while staying on at AmRisc. Most importantly, while the shared management team averages more than twenty years of insurance experience, their distinctive competence in the underwriting of condominium association business comes from the fact that the team is dominated by structural engineers. In their previous careers, many of them were involved in the development, inspection and approval of loss prevention systems for condominiums and other commercial property structures. According to a Demotech article, “When AmRisc was initially formed, the principals leveraged their engineering knowledge and related structural evaluation expertise to evaluate secondary and tertiary characteristics of the structural aspects of condominiums in addition to the primary ones that insurance professionals review.”

It is not entirely clear as to why Dan Peed agreed to the merger of effective equals between AmCo and UPC. According to a call in August of 2016 which preceded the merger, the likely rationale for the merger was that UPC and AmCo would have lots of synergies leading to an enhanced earnings profile and improved margins for the combined entity. This was primarily driven by increased scale, as the merger would put the combined entity over the \$1 billion mark in premiums, which would help optimize reinsurance spend. While in hindsight it is very easy to see how this merger was not particularly favorable to AmCo, at the moment it would have been impossible for Dan Peed to predict UPC’s strategic shift towards becoming an ‘InsurTech’ company. This is arguably what led to UPC’s demise. Dan Peed was obviously very committed to the merger - he voluntarily agreed to adopt a 3-year lockup for the stock he received in the transaction.

As part of the merger, Dan Peed had no purview over UPC and was solely restricted to AmCo. However, he was on the Board of Directors as Vice Chair. Only in June of 2020 did Dan act along with the support of the board of directors to oust John Forney, the previous CEO. As soon as Dan took over, there was a marked change in the way that UIHC was run. In the Q2 2020 earnings call there was a clear shift of focus towards generating an underwriting profit.

Dan was committed to generating a consistent non-CAT underwriting profit before pursuing any kind of topline growth. This meant that a significant number of unprofitable lines were cut. This is clearly demonstrated in the figure below showing the TIV of the combined entity decreasing while rates were increasing, attributed to just fewer policies being written in the UPC business.



**Figure 25: Investor Presentation from November 2022**

(source: ACIC IR Presentation)

While Dan tried to turn around UPC, it was too late - UPC's fate caught up two years later with the company being put into runoff and receivership. The runoff process was consummated in February of 2023 when the Florida Department of Financial Services (DFS) agreed to carve out UPC and all of its liabilities from the UIHC parent and leave UIHC with its two current subsidiaries, AmCo and IIC.

We think that the most important factor in assessing management is the alignment of incentives with shareholders. In AmCo, the incentives are very clearly aligned given that Dan Peed and his family own ~48% of all outstanding shares.

CEO Compensation		
Publicly Traded Florida Insurers	2021	2022
<b>Company</b>		
United Insurance Holdings Corp.	\$0	\$0
Universal Insurance Holdings	\$3,540,547	\$3,578,393
HCI Group	\$7,736,699	\$1,031,115
Heritage Insurance Holdings	\$3,014,296	\$2,365,485

**Figure 26: Comps' CEO Compensation**

(source: SEC Filings and Sobra Peak)

This is further affirmed by Figure 26 breaking down the compensation of the CEOs of all Florida-focused P&C comps - Dan Peed is the only CEO who does not take a salary. While Dan certainly makes plenty of money from his large equity stake in the company, the fact that he has chosen not to take a salary when he clearly deserves it is a testament to his character.

We also see a strong capital allocation framework within AmCo. Brad Martz, the President of American Coastal, sees three buckets for any excess cash that develops at the HoldCo level.

*“The financial engineering elements are in that whether it’s stock repurchase, debt repurchase, whatever can generate the highest return. And we’ll look at continuing to provide capital to American Coastal so that we can get off the quota share and retain more of the underwriting profit. All three of those are fuel for earnings growth and higher returns on capital.”* – Brad Martz, President of American Coastal

It is reassuring to see management being clear about what retained earnings will be used for going forward.

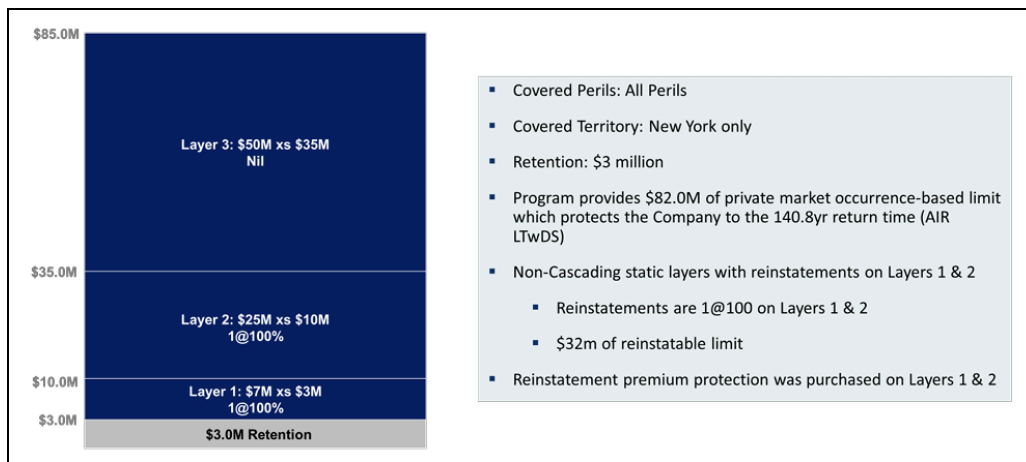
In summary, Dan Peed has historically run ACIC (the company he had purview over) very well, took swift action to control and contain UPC losses when he took over, and is closely aligned with public minority shareholders.

## Interboro Insurance Company

We have not covered AmCo's continued operation of Interboro Insurance Company (hereon referred to as IIC) up to this point, as it is a small part of the business that remains largely irrelevant to our analysis. However, to provide more background, IIC is a personal lines insurer that was a remnant of UIHC and had not been divested along with the Florida business that was put into runoff. IIC's policies are written exclusively in New York with roughly 18,000 policies focused on homeowners and fire insurance products. This segment was excluded throughout the pitch because it only accounts for 7% of gross premiums earned for the AmCo+IIC entity (as of September 30th, 2023).

We were somewhat concerned by IIC as it had contributed over \$8.7mm in losses in the 9 months ending September 30th 2023. However, in the Q3 earnings call, we got greater clarity on the future of IIC. AmCo has executed a non-binding term sheet with a third party to acquire IIC at GAAP book value at the time of closing. Management expects the sale to close within 5 months of today.

Management indicated that the current GAAP book value of IIC is \$23mm. With 2 more quarters of earnings to go, we think it would be conservative to extrapolate another \$3m in losses (size of their retention shown in Figure 27) and, therefore, a sale at BV of \$20 million. This is the most conservative figure, given that we are not factoring in the 13% rate increases that IIC has filed for with the New York Insurance Legislator. Management also expects some slight appreciation in the book value of IIC.



**Figure 27: Interboro Insurance Company Reinsurance Stack**

*(source: ACIC IR Presentation)*

Management is very inclined to pursue a sale of this segment and is confident that they will be able to, and we concur that it will not be a drag on earnings from Q1 2024 onwards.



## New Managing General Agent

As was mentioned in the prior section covering management, Dan Peed was the founder and longtime CEO of AmRisc. Now that the deconsolidation of UPC is finally complete, Dan has indicated that he is in the early stages of creating a new MGA business under the American Coastal corporate umbrella. While there is very little information on this in the public domain, we had the opportunity to talk to Jon Cukierwar. Jon Cukierwar has had the opportunity to meet Dan Peed multiple times and has said that Dan Peed is “100% in on the MGA idea”.

*“There are tremendous opportunities in any type of property, habitational or non-habitational, especially in Florida because of the capacity constraints. And the lack of disciplined, experienced CAT property underwriting.” – Brad Martz, CFO of American Coastal*

We also have gotten clarity from an interview we conducted with Brad Martz, the president of AmCo that this new MGA would not compete in any way with AmRisc, as doing so could potentially jeopardize their current exclusivity agreement with AmRisc. Dan Peed plans to leverage his expertise and AmCo’s IT assets and historical data from both the commercial and personal lines segments to underwrite windstorm policies for one or several new verticals. This would be strictly as an MGA meaning that AmCo would not be taking on additional policy risk. Instead, the policies would be sold to partner carriers in exchange for commission revenue.

*“It would always be AmCo’s intent to be clear with AmRisc about anything they are doing outside of the relationship. The relationship is exclusive in Florida for only the admitted condo market. So, it does not cover E&S and does not cover any other line of business or any other state. AmCo has plans to take advantage of other opportunities where capacity is constrained in Florida. In other markets where AmRisc does not have a strong market presence.” – Brad Martz, President of American Coastal*

Jon Cukierwar indicated to us that this MGA could underwrite \$300m in GPW. When talking to Jon Cukierwar, he said that Dan particularly saw a gap in MGAs for the residential market for homes worth between \$750k to \$3mm. Based on our discussion with Brad Martz, there is also a gap in small business owner and commercial package policies. Both Dan and Brad see a lot of opportunity, especially in the smaller owner-occupied type of buildings that might be under the radar for larger carriers currently in that space writing that business.

Over time, as the fee income accounts for a greater percentage of the bottom line, AmCo should start to re-rate and trade at a higher multiple because of the ‘predictability premium.’ This is something that Fred Liu (Hayden Capital) talks about in his most recent Q3 letter. While Fred focuses on software companies switching to recurring fee models via subscriptions, leading to multiple expansion, we think the same can be said for fee income. We can also look at the multiples that broker businesses like WTW or BRO trade at, which serve as a loose and broad framework for looking at the fee income side of AmCo’s business that will soon emerge. This fee income from the MGA is something that we have decided not to model out given we are not certain of exact timelines, but rather see it as a very strong call option. Our estimates for the NPV of this MGA range from \$300m to \$400m or an additional ~\$7.5 per share in value.

## Historical Statements:

### 3<sup>rd</sup> Quarter 2023 Results

	Three Months Ended Sep 30, 2023				Nine Months Ended Sep 30, 2023			
	Commercial Lines	Personal Lines	Other	Total	Commercial Lines	Personal Lines	Other	Total
Gross Premiums Earned	157.80	8.00		165.80	435.60	32.80		468.40
Ceded Premiums Earned	(107.50)	(2.40)		(109.90)	(232.70)	(9.50)		-242.1
Net Premiums Earned	<b>50.30</b>	<b>5.60</b>		<b>55.90</b>	<b>202.90</b>	<b>23.40</b>		226.3
Investment & Other Revenue	1.90	0.80		2.70	(1.20)	2.40		1.2
Unrealized G(L) on Equities	0.20	0.00		0.20	0.80	0.00		0.8
<b>Total Revenue</b>	<b>52.40</b>	<b>6.40</b>		<b>58.80</b>	<b>202.50</b>	<b>25.80</b>		<b>228.3</b>
Underlying Loss & LAE	8.00	3.20		11.30	38.00	9.80		47.8
Current year CAT Loss & LAE	4.90	1.00		5.80	13.20	1.80		15
Prior year development	(3.10)	(0.20)		(3.30)	(11.20)	(0.50)		-11.7
Total Loss	9.80	4.00		13.80	40.00	11.10		51.1
Operating & Interest Expense	16.60	7.70	3.00	27.20	72.20	24.80	9.00	106
<b>Total Expenses</b>	<b>26.40</b>	<b>11.70</b>	<b>3.00</b>	<b>41.10</b>	<b>112.20</b>	<b>35.90</b>	<b>9.00</b>	<b>157.1</b>
Other Income (Loss)	0.00	(0.20)		(0.20)	0.00	1.40	0.20	1.2
<b>Income (Loss) before Tax</b>	<b>25.90</b>	<b>(5.50)</b>	<b>(3.00)</b>	<b>17.50</b>	<b>90.20</b>	<b>(8.70)</b>	<b>(9.20)</b>	<b>72.4</b>
Income tax expense (benefit)				3.10				7.3
Net Income (Loss) From Continuing Operations				<b>14.40</b>				<b>65.1</b>
Net Loss Ratio	19.50%	71.20%		24.70%	19.70%	47.60%		22.60%
Net Expense Ratio	33%	138.10%		44.00%	35.60%	105.90%		43.20%
<b>Combined Ratio</b>	<b>52.50%</b>	<b>209.30%</b>		<b>68.70%</b>	<b>55.30%</b>	<b>153.50%</b>		<b>65.80%</b>
CAT Loss	9.70%	17.20%		10.50%	6.50%	7.80%		6.60%
PY Development (F)/U	-6.20%	-4.40%		-6.00%	-5.50%	-1.90%		-5.20%
<b>Underlying Combined Ratio</b>	<b>48.90%</b>	<b>196.50%</b>		<b>64.20%</b>	<b>54.30%</b>	<b>147.70%</b>		<b>64.40%</b>

In the 3<sup>rd</sup> quarter, the book value per share increased to \$2.78. Net income for the quarter was \$14.4mm. The personal lines segment which we talked about was a drag on earnings and contributed to a pre-tax loss of \$5.5mm. Another important thing to note is that operating expenses are down 45.7% year over year on a quarterly basis given that they are ceding a higher proportion of their gross premiums earned. This is exactly what we had modeled out.

## ACIC Historical Unconsolidated Statements

							Imma	Michael	Loss Sharing Period with UPC			Ian
	2013A	2014A	2015A	2016A	2017A	2018A	2019A	2020A	2021A	2022A		
Gross Premiums Written	285,547,000	308,170,000	312,964,000	275,322,000	235,202,000	249,187,000					463,070,000	
Ceded Premiums Earned	(117,714,000)	(133,410,000)	(140,843,000)	(135,138,000)	(107,241,000)	(108,892,000)					(253,088,000)	
<b>Net Premiums Earned</b>	<b>167,833,000</b>	<b>174,760,000</b>	<b>172,121,000</b>	<b>140,184,000</b>	<b>127,961,000</b>	<b>140,295,000</b>					<b>209,982,000</b>	
<b>Losses Incurred</b>												
(1) Direct Business	12,924,610	8,373,018	22,783,711	36,104,050	51,173,258	136,944,805					109,279,695	
(2) Reinsurance Assumed	0	0	0	0	0	0					81,232,464	
(3) Resinsurance Recovered	8,138,869	329,950	14,327,388	12,296,744	11,207,303	105,644,684					132,172,659	
<b>(4) Net Payments (1 + 2 - 3)</b>	<b>4,785,741</b>	<b>8,043,068</b>	<b>8,456,323</b>	<b>23,807,306</b>	<b>39,965,955</b>	<b>31,300,121</b>					<b>58,339,500</b>	
(5) Net Losses Unpaid Current Year	9,446,345	11,941,166	19,904,323	26,714,000	31,429,773	36,861,991					77,254,739	
(6) Net Losses Unpaid Prior Year	11,611,071	9,446,345	6,182,179	19,904,323	26,713,980	31,429,773					87,308,025	
<b>(7) Losses Incurred Current Year (4 + 5 - 6)</b>	<b>2,621,015</b>	<b>10,537,089</b>	<b>22,178,467</b>	<b>30,616,983</b>	<b>44,681,748</b>	<b>36,732,339</b>					<b>48,286,214</b>	
Claims Ratio	1.56%	6.03%	12.89%	21.84%	34.92%	26.18%					23.00%	
<b>Loss Adjustment Expenses</b>												
Direct											79,540,873	
Reinsurance Ceded											52,346,528	
<b>Net LAE</b>	<b>16,594,727</b>	<b>17,106,772</b>	<b>20,412,400</b>	<b>17,303,602</b>	<b>2,251,309</b>	<b>15,032,244</b>					<b>27,194,345</b>	
<b>Other Underwriting Expenses</b>												
Commission and Brokerage	42,167,715	42,751,047	45,531,807	17,018,840	32,318,969	44,924,539					51,184,513	
\$G&A	26,710,070	31,690,103	27,674,473	20,976,024	22,092,890	19,337,446					45,943,892	
Taxes, Licenses & Fees	9,153,730	2,037,185	6,670,908	7,802,818	4,913,229	3,307,110					11,652,406	
Miscellaneous Expenses				174,768	1,298,974	1,802,414					58,146	
<b>Total Expenses</b>	<b>78,031,515</b>	<b>76,478,335</b>	<b>79,877,188</b>	<b>63,276,052</b>	<b>62,875,371</b>	<b>84,403,753</b>					<b>136,033,302</b>	
Expense Ratio	46.49%	43.76%	46.41%	45.14%	49.14%	60.16%					64.78%	
<b>Underwriting Result</b>	<b>70,585,743</b>	<b>70,637,004</b>	<b>49,652,945</b>	<b>46,290,965</b>	<b>20,403,881</b>	<b>19,158,908</b>					<b>25,662,484</b>	
Combined Ratio	48.06%	49.79%	59.29%	66.98%	84.05%	86.34%					87.78%	
<b>Investment Income</b>												
Net Investment Income Eamed	2,013,563	1,948,180	2,667,062	4,333,372	5,649,424	7,259,924					5,199,171	
Net Realized Capital Gains (Losses) Less Capital Gains	0	0	2,233	9,082	65,053	(173,214)					(5,156,927)	
<b>Net Investment Gain (Loss)</b>	<b>2,013,563</b>	<b>1,948,180</b>	<b>2,669,295</b>	<b>4,342,454</b>	<b>5,714,477</b>	<b>7,086,710</b>					<b>42,244</b>	
<b>Other Income</b>												
Net Gain (Loss) From Agents' or Premium Balances Che	0	0	0	0	(5,926)	1,000					(9,943)	
Finance and Service Charges Not Included in Premiums	0	0	0	0	0	0					0	
Aggregate Write-Ins for Miscellaneous Income	0	0	0	0	0	2,295					1,179,531	
<b>Total Other Incomes</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>(5,926)</b>	<b>3,295</b>					<b>1,169,588</b>	
<b>Net Income Before Dividends, After Cap Gains Tax &amp;</b>	<b>72,599,306</b>	<b>72,585,184</b>	<b>52,322,240</b>	<b>50,633,419</b>	<b>26,112,432</b>	<b>26,248,913</b>					<b>26,874,316</b>	
<b>Federal &amp; Foreign Income Taxes Incurred</b>	<b>25,739,335</b>	<b>24,385,078</b>	<b>18,156,037</b>	<b>15,031,945</b>	<b>8,430,796</b>	<b>5,345,921</b>					<b>10,358,775</b>	
<b>Net Income</b>	<b>46,859,971</b>	<b>48,200,106</b>	<b>34,166,203</b>	<b>35,601,474</b>	<b>17,681,636</b>	<b>20,902,992</b>					<b>16,515,541</b>	

\*NB: 2019-2021 Financials Excluded Due to UPC Loss Sharing Agreement

## Valuation

### Operating Build

Operating Build (Fiscal Year Beginning June)	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Stub	0.50	1.50	2.50	3.50	4.50	5.50	6.50	7.50
Gross Premium Written	736,281,300	802,546,617	734,330,155	627,852,282	598,320,407	622,986,427	654,135,748	686,842,536
% Change Attribution to Δ in Property Valuations		0.00%	0.00%	2.00%	2.50%	3.00%	3.00%	3.00%
% Change Attribution to Δ in Market Share		9.00%	6.50%	3.50%	2.00%	2.00%	2.00%	2.00%
% Change Attribution to Δ in Hard/Soft Market Pricing		0.00%	-15.00%	-20.00%	-10.00%	0.00%	0.00%	0.00%
<b>% Change YoY in Gross Premiums Written</b>	<b>59%</b>	<b>9.00%</b>	<b>-8.50%</b>	<b>-14.50%</b>	<b>-5.50%</b>	<b>5.00%</b>	<b>5.00%</b>	<b>5.00%</b>
<b>Gross Premium Earned</b>	<b>736,281,300</b>	<b>802,546,617</b>	<b>734,330,155</b>	<b>627,852,282</b>	<b>598,320,407</b>	<b>622,986,427</b>	<b>654,135,748</b>	<b>686,842,536</b>
% Change YoY								
Private XDL Reinsurance Expense	(133,728,477)	(149,096,924)	(143,138,535)	(138,127,502)	(142,396,898)	(155,746,607)	(163,533,937)	(171,710,634)
% of GPE	-18%	-19%	-19%	-22%	-24%	-25%	-25%	-25%
One-Time FDRA Price Negotiation			10,000,000					
YoY Change in TIV								
FDRA/FHCF Reinsurance Expense	(100,000,000)	(94,000,000)	(96,820,000)	(104,081,500)	(111,367,205)	(119,162,909)	(127,504,313)	(136,429,615)
		-6%	3%	8%	7%	7%	7%	7%
Total XDL Reinsurance Expense	(233,728,477)	(243,096,924)	(239,958,535)	(242,209,002)	(253,764,103)	(274,909,516)	(291,038,250)	(308,140,249)
Quota Share Reinsurance Expense	(257,698,455)	(200,636,654)	(110,149,523)	(31,392,614)	0	0	0	0
% of Gross Premium Earned	35.00%	25.00%	15.00%	5.00%	0.00%	0.00%	0.00%	0.00%
<b>Net Premiums Earned</b>	<b>244,854,368</b>	<b>358,813,038</b>	<b>394,222,096</b>	<b>354,250,666</b>	<b>339,556,304</b>	<b>348,076,911</b>	<b>363,097,498</b>	<b>378,702,287</b>
<b>Reinsurance % (Insurance Ceded)</b>	<b>67%</b>	<b>55%</b>	<b>46%</b>	<b>44%</b>	<b>43%</b>	<b>44%</b>	<b>44%</b>	<b>45%</b>
Less: Commission and Brokerage Costs to AmRisk	184,070,325	200,636,654	183,582,539	156,963,071	148,330,102	155,746,607	163,533,937	171,710,634
% Commission & Brokerage Paid	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%	25.00%
Add: Ceding Commissions from QS	87,617,475	68,216,462	37,450,838	10,673,489	0	0	0	0
% of QS	34.00%	34.00%	34.00%	34.00%	34.00%	34.00%	34.00%	34.00%
<b>Net Policy Acquisition Costs</b>	<b>96,452,850</b>	<b>132,420,192</b>	<b>146,131,701</b>	<b>146,289,582</b>	<b>148,330,102</b>	<b>155,746,607</b>	<b>163,533,937</b>	<b>171,710,634</b>
Attritional Losses, Gross before Quota Share	(55,221,098)	(60,190,996)	(55,074,762)	(47,088,921)	(44,499,030)	(46,723,982)	(49,060,181)	(51,513,190)
% of GPE	-7.5%	-7.5%	-7.5%	-7.5%	-7.5%	-7.5%	-7.5%	-7.5%
Attritional Losses, Losses Borne by QS Reinsurers	19,327,384	15,047,749	8,261,214	2,354,446	0	0	0	0
% of GPE	2.6%	1.9%	1.1%	0.4%	0.0%	0.0%	0.0%	0.0%
<b>Less: Attritional Losses</b>	<b>(35,893,713)</b>	<b>(45,143,247)</b>	<b>(46,813,547)</b>	<b>(44,734,475)</b>	<b>(44,499,030)</b>	<b>(46,723,982)</b>	<b>(49,060,181)</b>	<b>(51,513,190)</b>
<b>CAT Losses</b>								
Number of Named Events	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
(1) CAT Losses, Direct	50,000,000	52,000,000	53,560,000	57,577,000	61,607,390	65,919,907	70,534,301	75,471,702
(2) American Coastal per-event Retention	7,500,000	12,500,000	12,500,000	12,500,000	12,500,000	12,500,000	12,500,000	12,500,000
(3) American Coastal per-event LAE	15,000,000	15,000,000	15,000,000	15,000,000	15,000,000	15,000,000	15,000,000	15,000,000
(4) CAT Losses, Losses Borne by Reinsurance, XDL	(20,000,000)	(27,000,000)	(28,560,000)	(32,577,000)	(36,607,390)	(40,919,907)	(45,534,301)	(45,534,301)
(5) CAT Losses, Losses Borne by Reinsurance, Quota Share	(7,875,000)	(6,875,000)	(4,125,000)	(1,375,000)	0	0	0	0
<b>Less: Net CAT Losses Borne by American Coastal (2 + 3 + 4 + 5)</b>	<b>(14,625,000)</b>	<b>(20,625,000)</b>	<b>(23,375,000)</b>	<b>(26,125,000)</b>	<b>(27,500,000)</b>	<b>(27,500,000)</b>	<b>(27,500,000)</b>	<b>(27,500,000)</b>
<b>Investment Income</b>	<b>12,487,573</b>	<b>16,361,875</b>	<b>16,990,972</b>	<b>14,665,978</b>	<b>14,261,365</b>	<b>14,688,846</b>	<b>15,322,714</b>	<b>15,905,496</b>
interest rate%	5.2%	4.6%	4.3%	4.1%	4.2%	4.2%	4.2%	4.2%
<b>Interest Expense</b>	<b>11,250,000</b>	<b>11,250,000</b>	<b>11,250,000</b>	<b>11,250,000</b>	<b>11,250,000</b>	<b>11,250,000</b>	<b>11,250,000</b>	<b>11,250,000</b>
<b>Pre-Tax Income</b>	<b>99,120,377</b>	<b>165,736,474</b>	<b>183,642,821</b>	<b>140,517,587</b>	<b>122,238,537</b>	<b>121,545,168</b>	<b>127,076,094</b>	<b>132,633,959</b>
<b>Federal &amp; Foreign Income Taxes Incurred</b>	<b>20,815,279</b>	<b>34,804,660</b>	<b>38,564,992</b>	<b>29,508,698</b>	<b>25,670,093</b>	<b>25,524,485</b>	<b>26,685,980</b>	<b>27,853,131</b>
<b>Net Income</b>	<b>78,305,098</b>	<b>130,931,814</b>	<b>145,077,828</b>	<b>81,008,889</b>	<b>96,568,444</b>	<b>96,020,683</b>	<b>100,390,115</b>	<b>104,780,827</b>

\*Inspiration for modeling structure taken from frostybluebird

## Net Income Valuation

ACIC Net Income Valuation								
As of 2/17/2024								
Year	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Period	0.50	1.50	2.50	3.50	4.50	5.50	6.50	7.50
Net Income	39,152,549	130,931,814	145,077,828	111,008,893	96,568,444	96,020,683	100,390,115	104,780,827
PV Of Net Income	37,764,531	117,494,445	121,121,515	86,223,594	69,783,328	64,554,918	62,791,895	60,973,702
<b>PV of Stage 1</b>	<b>620,707,927</b>							
<b>Final-Year Net Income</b>	<b>104,780,827</b>							
<b>Exit Multiple</b>	<b>10x</b>							
<b>Terminal Value</b>	<b>1,047,808,275</b>							
<b>PV of TV</b>	<b>609,737,020</b>							

ACIC Value	
Equity Value	1,230,444,947
DSO (with equity offering)	45,058,744
<b>Equity Value per Share</b>	<b>27.31</b>
Current Share Price	12.55
<b>Upside</b>	<b>117.59%</b>

- We utilized a discounted net income valuation as converting from net income to cash flow is time consuming to do and add little incremental insight.
- We utilized an exit PE multiple of 10x, in line with HCI. However, ACIC could very reasonably deserve to trade at a higher multiple due to them being a vastly higher quality insurer. For example, in 2022 AmCo has a combined ratio of 87% compared to HCI which had a combined ratio of 123%.

## Appendix

### **Exhibit 1:** Thank You Message

We would like to thank Jon Cukierwar immensely for his research on American Coastal which has both enabled us and inspired us to pursue further research. We are also extremely grateful to Jon for having taken the time out of his day on multiple occasions to talk to us or answer our questions.

- Nithin Mantena and Aryann Gupta

### **Exhibit 2:** Trip to American Coastal Headquarters in St. Petersburg, Florida

