

# The Philadelphia Contributionship

*267th Annual Report*

# 2019

WEATHER THE STORM



# The Philadelphia Contributionship Mutual Holding Company

TPC Holdings, Inc.

Vector Security Holdings, Inc.

The Philadelphia Contributionship  
for the Insurance of Houses from Loss by Fire, Inc.

The Philadelphia Contributionship Insurance Company

Germantown Insurance Company

First Insurance Company Of America

Franklin Agency, Inc.

## ***At A Glance***

**The Philadelphia Contributionship Mutual Holding Company** is a mutual holding company serving as the ultimate controlling parent in the corporate structure. The principal business of The Philadelphia Contributionship Mutual Holding Company is to hold the stock of TPC Holdings, Inc.

**TPC Holdings, Inc.** is a stock holding company whose principal business is to hold the stock of The Philadelphia Contributionship for the Insurance of Houses from Loss by Fire, Inc. and Vector Security Holdings, Inc.

**The Philadelphia Contributionship for the Insurance of Houses from Loss by Fire, Inc.** is the oldest successful property and casualty insurance company in the United States, having been founded in 1752. The company was converted from a mutual company to a stock company in 2009.

**The Philadelphia Contributionship** is our group of insurance companies writing residential business in urban and suburban communities. Our Company was founded by Benjamin Franklin and his fellow fire-fighters to provide insurance to urban Philadelphia homeowners. We provide homeowners, fire and liability insurance to customers in New Jersey, Pennsylvania, Delaware, Maryland and Virginia. We have earned the distinction of A rating or higher from A.M. Best Company for over 90 years.

**Vector Security Holdings, Inc.**, our residential and commercial security subsidiary, is one of the top ten security providers in North America. Vector provides electronic security services to commercial and residential markets including fire and burglary detection, video, access control, environmental monitoring, home automation and commercial analytics. The Vector Security Networks Division operates exclusively in the commercial space offering electronic security services, as well as, customized managed network services including broadband and broadband-enabled services, SD-WAN, network deployment, network management and mobile applications.



## OUR VISION

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To be the most reliable partner  
for people seeking  
to protect  
their homes and their futures.



## OUR MISSION

We provide insurance protection that puts  
people first, through uniquely personal service,  
strong partnerships and an unmatched history  
of financial stability.





In 2019, as The Philadelphia Contributionship (TPC) completed its 268th year serving our customers, we faced numerous challenges, changes, and an increased volume of claims. However, through the perseverance of the entire TPC team, we “weathered the storm” and finished 2019 stronger than we started.

The foundation of TPC is our commitment to providing financial security along with an unparalleled customer experience. Both our insurance and security businesses continued to grow in 2019 as the result of high-quality service and backed by the financial strength that underscores our dependability and longevity.

## INSURANCE GROUP OPERATIONS

2019 presented its own set of challenges for the insurance operations. Our operating territory experienced severe weather conditions including sub-freezing temperatures, followed by record precipitation, and a significant hail storm. Overall, we were impacted by 12 weather catastrophes generating 2,300 claims and nearly \$20 million in losses – more than double the expected amount. In addition, we incurred an unusual number of fire losses. In the face of those extraordinary circumstances, our Claims team persisted, allowing us to meet the needs of our customers during their most difficult times.

Direct written premium was \$168.8 million in 2019, up 6.8% from 2018. Net premiums earned grew 7.2% in 2019 to \$143.6 million. Gross investment income for the year was \$11.6 million, down 0.2% from 2018. Net gains on investments were \$74.6 million including \$65.6 million relating to the change in fair value of equity securities and other invested assets. Total revenue from insurance operations for the year was \$229.7 million.

Losses and loss adjustment expenses, at \$132.3 million, were up significantly in 2019 due primarily to the weather-related and fire claims. Underwriting expenses were modestly higher in 2019, consistent with our growth in policy counts. In total, losses and expenses were \$177.6 million for the year. Overall, after paying \$0.9 million of dividends to our members, the insurance operation produced income before income taxes of \$51.4 million.

### **SOME 2019 HIGHLIGHTS:**

Early in the year, TPC's financial strength rating from the A.M. Best Company was affirmed as A (Excellent) in recognition of our outstanding financial position.

TPC was, once again, named to Philly.com's list of Top Workplaces. This distinction is based solely on staff feedback and affirms the fact TPC remains an employer of choice.

In December, we said farewell to our President and CEO, Robert G. Whitlock, Jr., when he retired. Bob spent the last decade developing a culture of collaboration and open communication while expanding the company's geographic footprint. Under his leadership, he turned TPC into a Mid-Atlantic regional carrier known for its ease of doing business built on the core principal of maintaining strong relationships with our business partners. Bob's leadership has set the Company up to meet the rapidly changing demands of the customers we serve.

### **SECURITY GROUP OPERATIONS**

Vector Security, Inc. generated revenues for the year of \$360.3 million for a 19.1% increase over 2018. Earnings before interest, taxes, depreciation and amortization were \$45.6 million. 2019 results were impacted by the acquisition of ADS Security, LLP and related transaction costs, the adoption of Financial Accounting Standards Board Accounting Standard Codification Topic 606, Revenue from Contracts with Customers, as well as nonrecurring legal costs. ADS Security, headquartered in Nashville, TN, complements existing Vector coverage in Florida, Kentucky and North Carolina, and new geographic locations in Tennessee, Georgia, Mississippi, Alabama and South Carolina.

The Vector Security and ADS Security branches serve residential, commercial and regional multi-site businesses. Offerings to the residential market utilize an integrated platform which combines home automation functionality (locks, doorbells, garage door controls, thermostats, cameras and lighting) with life safety and security equipment. Commercial product offerings include intrusion protection, fire monitoring, access control and video monitoring. Vector Security Networks, our national account brand, is a leader in the retail, quick-serve and healthcare industries. Services provided to these markets include network services, intrusion protection, fire



monitoring, access control, video monitoring, environmental and shooter detection. Keeping pace with rapidly changing technology, Vector continues to introduce and support reliable products and services that provide value to our customers.

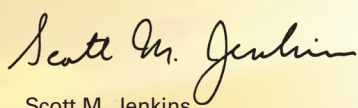
### CONSOLIDATED BALANCE SHEET

Total assets as of December 31, 2019 were \$1,028.9 million, up 36.2% from 2018. Total liabilities increased 59.8% to \$656.0 million. Total equity as of December 31, 2019 was \$372.9 million, up 8.2% from 2018. The strength of TPC's financial condition is intact and the company is well-positioned to meet our commitments for the long run.

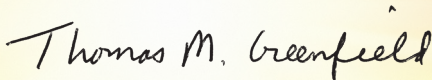
### IN MEMORIAM

Sadly, the Board of Directors recently lost one of its members with the passing of Christina T. Webber. Chris joined TPC in 1983 and held various positions until being appointed President and CEO in 1996. She retired in 2006, and she became a valued member of the Board of Directors where she freely shared her insurance knowledge. In addition, she was appointed Chairperson of Vector Security, which has continued to thrive and grow under her direction. Chris' valuable contributions will be missed by all.

Our Directors, officers and employees recognize you have choices when selecting an insurer and security provider. Thank you for choosing The Philadelphia Contributionship. We will continue to work hard to both earn and maintain your trust and confidence.



Scott M. Jenkins  
*Chairman of the Board*



Thomas M. Greenfield  
*President and Chief Executive Officer*

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CONSOLIDATED BALANCE SHEETS  
DECEMBER 31, 2019 AND 2018  
(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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<b>ASSETS</b>	<b>2019</b>	<b>2018</b>
<b>INSURANCE GROUP ASSETS</b>		
Investments:		
Fixed income securities	\$ 163,507	\$ 154,022
Convertible bonds	19,170	15,142
Preferred stocks	472	634
Convertible preferred stocks	663	1,425
Common stocks	298,100	231,338
Other invested assets	39,926	36,448
	<u>521,838</u>	<u>439,009</u>
Cash and cash equivalents	13,100	20,732
Reinsurance recoverable and receivable	20,122	14,240
Prepaid reinsurance premiums	3,164	2,793
Premiums receivable	9,788	9,887
Accrued income from investments	1,493	1,453
Income tax recoverable	6,602	2,738
Deferred acquisition costs	17,915	16,838
Property and equipment, net	2,816	3,393
Prepaid pension	899	—
Other assets	769	626
<b>Total Insurance Group assets</b>	<u>598,506</u>	<u>511,709</u>
<b>SECURITY GROUP ASSETS</b>		
Current assets:		
Cash and cash equivalents	2,631	613
Trade accounts receivable, less allowance for doubtful accounts of \$1,698 in 2019 and \$1,403 in 2018	33,077	22,886
Unbilled revenue	18,719	12,737
Contract assets	816	—
Inventories	6,322	4,618
Prepaid expenses and other current assets	2,723	7,418
Income taxes receivable	—	117
<b>Total current assets</b>	<u>64,288</u>	<u>48,389</u>
Property and equipment, net	36,268	31,473
Intangible assets, net	136,578	112,626
Goodwill, net	145,684	21,154
Deferred income taxes	25,482	18,095
Contract assets, noncurrent	1,973	—
Other noncurrent assets	3,126	842
Deferred charges	16,986	10,034
Interest rate swap receivable	—	947
<b>Total Security Group assets</b>	<u>430,385</u>	<u>243,560</u>
<b>Total assets</b>	<u>\$ 1,028,891</u>	<u>\$ 755,269</u>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.



CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2019 AND 2018

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

<b>LIABILITIES AND EQUITY</b>	<b>2019</b>	<b>2018</b>
<b>INSURANCE GROUP LIABILITIES</b>		
Unpaid losses and loss adjustment expenses	\$ 114,164	\$ 96,558
Unearned premiums	88,762	83,872
Advance premiums	2,035	2,906
Deposit premiums	15,288	15,431
Deferred income taxes	28,243	12,351
Ceded premium payable	990	771
Other liabilities	12,511	11,203
<b>Total Insurance Group liabilities</b>	<b>261,993</b>	<b>223,092</b>
<b>SECURITY GROUP LIABILITIES</b>		
Current liabilities:		
Current maturities of long-term debt	2,063	1,489
Accounts payable and accrued expenses	51,356	37,819
Customer deposits	996	760
Unearned revenue	22,112	12,018
Contract liabilities	20	—
Purchase holdbacks	1,337	1,114
<b>Total current liabilities</b>	<b>77,884</b>	<b>53,200</b>
Long-term debt, less current maturities	303,975	123,521
Unearned revenue	1,843	6,027
Contract liabilities, noncurrent	215	—
Interest rate swap payable	1,673	—
Other long-term liabilities	8,424	4,757
<b>Total Security Group liabilities</b>	<b>394,014</b>	<b>187,505</b>
<b>Total liabilities</b>	<b>656,007</b>	<b>410,597</b>
<b>EQUITY</b>		
Unassigned equity	369,458	291,132
Accumulated other comprehensive income	3,426	53,540
<b>Total equity</b>	<b>372,884</b>	<b>344,672</b>
<b>Total liabilities and equity</b>	<b>\$ 1,028,891</b>	<b>\$ 755,269</b>

CONSOLIDATED STATEMENTS OF OPERATIONS  
YEARS ENDED DECEMBER 31, 2019 AND 2018

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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	2019	2018
<b>INSURANCE GROUP</b>		
Revenue:		
Net premiums earned	\$ 143,577	\$ 133,881
Gross investment income	11,567	11,592
Net realized gains on investments	74,575	7,957
<b>Total revenue</b>	<b>229,719</b>	<b>153,430</b>
Losses and expenses:		
Losses and loss adjustment expenses	132,257	110,783
Underwriting expenses	42,818	40,806
Investment expenses	2,553	2,645
<b>Total losses and expenses</b>	<b>177,628</b>	<b>154,234</b>
<b>Income (loss) before other income, dividends to policyholders, and income tax expense</b>	<b>52,091</b>	<b>(804)</b>
Other income, net	213	202
Dividends to policyholders	(927)	(884)
<b>Insurance Group income (loss) before income tax expense (benefit)</b>	<b>51,377</b>	<b>(1,486)</b>
<b>SECURITY GROUP</b>		
Revenue	360,262	302,430
Cost of sales	216,581	177,035
<b>Gross profit</b>	<b>143,681</b>	<b>125,395</b>
Operating expenses:		
Selling, general, and administrative	96,292	74,051
Acquisition-related costs	1,838	—
Depreciation	10,932	11,491
Amortization and impairment of intangible assets and goodwill	41,919	35,928
<b>Total operating expenses</b>	<b>150,981</b>	<b>121,470</b>
<b>Operating (loss) income</b>	<b>(7,300)</b>	<b>3,925</b>
Other:		
Interest expense	(10,724)	(6,051)
Other income, net	8	21
<b>Security Group loss before income tax benefit</b>	<b>(18,016)</b>	<b>(2,105)</b>
Income (loss) before income tax expense (benefit)	33,361	(3,591)
Income tax expense (benefit)	3,066	(1,554)
<b>Net income (loss)</b>	<b>\$ 30,295</b>	<b>\$ (2,037)</b>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.



CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
YEARS ENDED DECEMBER 31, 2019 AND 2018

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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	2019	2018
Net income (loss)	<u>\$ 30,295</u>	<u>\$ (2,037)</u>
Other comprehensive income (loss), net of tax:		
Unrealized gains (losses) on securities available-for-sale:		
Unrealized net holding gains (losses) arising during the year (net of tax of \$1,085 in 2019 and \$(6,762) in 2018)	4,083	(25,437)
Less: reclassification adjustment for net realized gains included in net income (net of tax of \$134 in 2019 and \$2,112 in 2018)	<u>502</u>	<u>7,944</u>
	<u>3,581</u>	<u>(33,381)</u>
Cash flow hedge:		
Change in fair value of cash flow hedge (net of tax of (\$600) in 2019 and \$143 in 2018)	(2,258)	539
Less: reclassification adjustment for settlement of cash flow hedge included in net income (net of tax of (\$84) in 2019 and \$43 in 2018)	<u>(317)</u>	<u>160</u>
	<u>(1,941)</u>	<u>379</u>
Defined benefit pension plan:		
Change in actuarial assumptions	(391)	382
Asset gain (loss) and amortization of net loss	973	(190)
Experience gain (loss)	<u>68</u>	<u>(59)</u>
Defined benefit pension plan, net actuarial gain arising during the year (net of tax of \$173 in 2019 and \$35 in 2018)	<u>650</u>	<u>133</u>
Other comprehensive income (loss)	<u>2,290</u>	<u>(32,869)</u>
Comprehensive income (loss)	<u>\$ 32,585</u>	<u>\$ (34,906)</u>

CONSOLIDATED STATEMENTS OF EQUITY  
YEARS ENDED DECEMBER 31, 2019 AND 2018

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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	Unassigned Equity	Accumulated Other Comprehensive Income	Total
<b>BALANCE, JANUARY 1, 2018</b>	\$ 293,169	\$ 86,409	\$ 379,578
Net loss	(2,037)	—	(2,037)
Other comprehensive loss, net of tax	—	(32,869)	(32,869)
<b>BALANCE, DECEMBER 31, 2018</b>	<b>291,132</b>	<b>53,540</b>	<b>344,672</b>
Net income	30,295	—	30,295
Adoption of accounting standard, net of tax	(4,373)	—	(4,373)
Reclassification of unrealized gain on equity securities and other invested assets, net of tax	52,404	(52,404)	—
Other comprehensive income, net of tax	—	2,290	2,290
<b>BALANCE, DECEMBER 31, 2019</b>	<b>\$ 369,458</b>	<b>\$ 3,426</b>	<b>\$ 372,884</b>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.



CONSOLIDATED STATEMENTS OF CASH FLOWS  
YEARS ENDED DECEMBER 31, 2019 AND 2018

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

	2019	2018
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>		
Net income (loss)	<b>\$30,295</b>	\$ (2,037)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Net realized gains on investments	<b>(74,575)</b>	(7,957)
Depreciation and amortization	<b>55,127</b>	49,977
Deferred income taxes	<b>10,322</b>	(1,606)
Gains on disposals of property and equipment	<b>(207)</b>	(155)
Change in assets and liabilities, net of effects of acquisitions:		
Reinsurance recoverable and receivable	<b>(5,882)</b>	(515)
Prepaid reinsurance premiums	<b>(371)</b>	(405)
Premiums receivable	<b>99</b>	(189)
Accrued income from investments	<b>(40)</b>	251
Deferred acquisition costs	<b>(1,077)</b>	(1,017)
Unpaid losses and loss adjustment expenses	<b>17,606</b>	6,106
Unearned premiums	<b>4,890</b>	6,659
Advance premiums	<b>(871)</b>	829
Deposit premiums	<b>(143)</b>	(19)
Other liabilities	<b>840</b>	(46)
Income taxes and other receivables	<b>(3,747)</b>	(890)
Prepaid expenses and other assets	<b>(3,670)</b>	(116)
Trade accounts receivable, unbilled revenue, and inventories	<b>(11,316)</b>	(3,276)
Accounts payable, accrued expenses and purchase holdbacks	<b>6,742</b>	5,868
Unearned revenue and customer deposits	<b>6,981</b>	1,053
Deferred charges	<b>1,527</b>	(1,657)
<b>Net cash provided by operating activities</b>	<b>\$ 32,530</b>	\$ 50,858

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)  
YEARS ENDED DECEMBER 31, 2019 AND 2018

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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	2019	2018
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>		
Cash paid for acquisitions, net of cash received	\$ (202,502)	\$ (11,660)
Purchases of property, plant and equipment	(11,640)	(12,304)
Proceeds from disposals of property and equipment	214	156
Purchases of fixed income securities	(58,021)	(90,034)
Purchases of convertible bonds	(9,910)	(14,822)
Purchases of common stocks	(60,373)	(100,937)
Purchases of convertible preferred stocks	(178)	(122)
Purchases of other invested assets	(714)	(5,376)
Proceeds from sales of fixed income securities	34,977	71,820
Proceeds from sales of convertible bonds	8,734	14,526
Proceeds from maturities/calls of fixed income securities	18,346	16,559
Proceeds from the sales of common stocks	61,497	114,610
Proceeds from the sales of convertible preferred stocks	1,202	211
<b>Net cash used in investing activities</b>	<b>(218,368)</b>	<b>(17,373)</b>
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>		
Proceeds from revolving credit agreements	322,651	111,341
Payments on revolving credit agreements	(143,777)	(133,658)
Principal payments on capital leases	(2,018)	(1,727)
Cash paid for debt issuance costs	3,368	—
<b>Net cash provided by (used in) financing activities</b>	<b>180,224</b>	<b>(24,044)</b>
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>(5,614)</b>	<b>9,441</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING</b>	<b>21,345</b>	<b>11,904</b>
<b>CASH AND CASH EQUIVALENTS, ENDING</b>	<b>\$ 15,731</b>	<b>\$ 21,345</b>
<b>SUPPLEMENTARY CASH FLOWS INFORMATION</b>		
Interest paid	\$ 9,787	\$ 5,659
Income taxes paid	\$ —	\$ 3,113
<b>SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES</b>		
In conjunction with acquisitions, the Security Group:		
Recorded purchase holdbacks	\$ 866	\$ 940
Capital leases	\$ 1,890	\$ 977

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

**Note 1 Nature of Operations and Summary of Significant Accounting Policies:**

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**Basis of Presentation**

The accompanying consolidated financial statements include the accounts of The Philadelphia Contributionship Mutual Holding Company (the Company), a mutual holding company, and its wholly-owned subsidiaries: TPC Holdings, Inc., The Philadelphia Contributionship for the Insurance of Houses from Loss by Fire, Inc. (The Contributionship), and Vector Security Holdings, Inc. (Vector).

The consolidated financial statements include the accounts of The Contributionship, a stock company, and its wholly-owned subsidiaries, The Philadelphia Contributionship Insurance Company, Germantown Insurance Company, First Insurance Company of America, and Franklin Agency, Inc. (collectively, the Insurance Group), and Vector. Vector is the parent company of the following wholly-owned subsidiaries: Vector Security, Inc., Vector International Holdings, Inc., Vector Security Canada, Inc., and Vector Security de Mexico, S.A. de C.V., Vector Intelligent Solutions, LLC (VIS), and ADS Security, LLC (ADS) (collectively, the Security Group). The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), which differ in some regard from those followed in reports to insurance regulatory authorities. All significant inter-company transactions and balances have been eliminated.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known which could impact the amounts reported and disclosed herein.

The Insurance Group writes property and casualty insurance for homeowners and multi-family dwellings principally in urban communities in Pennsylvania, New Jersey, Delaware, Maryland, and Virginia. The Insurance Group had approximately 169,000 policyholders at December 31, 2019.

Vector sells, installs, services, and manages intelligent security and home automation products and solutions and provides security monitoring services as well as network services through advanced electronic systems designed to detect intrusion, as well as fire, water, temperature, and medical emergencies. Vector also does business with large national commercial accounts to which it provides equipment and installation, monitoring, and managed network services. Vector's customers are located throughout North America. Vector has approximately 383,000 residential and commercial customers as of December 31, 2019. No such customer accounted for more than 10% of the December 31, 2019 and 2018 trade accounts receivable balance or revenue for the years then ended.

**Premiums**

The Contributionship issues perpetual fire and homeowners insurance policies. When a perpetual policy is issued, a deposit premium is received, which is reflected as a liability. The deposit premium is returned if coverage terminates.

The Insurance Group also issues term policies for property and casualty coverage. Premiums on such policies are reflected in income over the effective period of the policies. Unearned premiums are computed on either a monthly pro rata basis or a daily basis over the term of the policy.

**Reinsurance**

Prospective reinsurance premiums, losses, and loss adjustment expenses are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

The Contributionship cedes reinsurance to other insurance companies to minimize the net loss potential arising from large losses and as well as from an aggregation of losses. An



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2019 AND 2018

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

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allowance is established for amounts deemed uncollectible and losses are charged against the allowance when the uncollectibility of amounts recoverable from reinsurers is confirmed. There was no such allowance recorded as of December 31, 2019 or 2018, respectively.

### **Acquisition Costs**

Acquisition costs, such as commissions, premium taxes, and certain other underwriting and agency expenses that vary with and are directly related to the successful acquisition of new and renewal business, are deferred and amortized over the effective period of the related insurance policies. The Insurance Group determines whether acquisition costs are recoverable considering future losses and loss adjustment expenses, policy maintenance costs and anticipated investment income. To the extent that acquisition costs are determined not to be recoverable, the difference is charged to income in the period identified. All deferred acquisition costs at December 31, 2019 and 2018 were determined to be recoverable.

### **Liability for Unpaid Losses and Loss Adjustment Expenses**

The reserving process for the unpaid loss and loss adjustment expenses ("LAE") provides for the Insurance Group's best estimate at a particular point in time of the ultimate unpaid cost of all losses and loss adjustment expenses incurred, including settlement and administration of claims, and is based on facts and circumstances known and includes losses that have been incurred but not yet reported. The process includes using actuarial methodologies to assist in establishing these estimates, judgments relative to estimates of future claims severity and frequency, the length of time before claims will develop to their ultimate level and the possible changes in the law and other external factors that are often beyond the Insurance Group's control. The methods used to select the estimated claim reserves include the loss ratio method, loss development methods, frequency-severity methods, the Bornhuetter-Ferguson (B-F) method, and the Berquist-Sherman (B-S) method. The process produces carried reserves set by management's best estimate and is the result of numerous best estimates made by line of business, accident year, and broken out between losses and loss adjustment expenses. The amount of loss and loss adjustment expense reserves for reported claims is based primarily upon a case-by-case evaluation of coverage, liability, injury severity, and any other information considered pertinent to estimating the exposure presented by the loss. The amounts of loss and loss adjustment expense reserves for unreported claims are determined using historical information by line of insurance as adjusted to current conditions.

Due to the inherent uncertainty associated with the reserving process, the ultimate liability may differ, perhaps substantially, from the original estimate. Such estimates are regularly reviewed and updated and any resulting adjustments are included in the current year's results. These liabilities are closely monitored and are recomputed periodically using the most recent information on reported claims and a variety of statistical techniques. Specifically, on at least a quarterly basis, the Insurance Group reviews, by line of business, existing reserves, new claims, changes to existing case reserves and paid claims with respect to the current and prior years.

### **Investments**

Prior to the adoption of Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, as of January 1, 2019, investments in equity securities and limited partnerships were classified as available-for-sale securities, stated at fair value, and unrealized holding gains and losses, net of related tax effects, were recorded directly to accumulated other comprehensive income (loss). With the adoption of ASU 2016-01, investments in equity securities and limited partnerships are still stated at fair value but unrealized holding gains and losses are credited or charged through net realized gains on investments to net income (loss) as incurred.

### **Fixed Income Securities**

All fixed income securities are classified as available-for-sale and are carried at fair value. Management reviews the securities in its investment portfolio on a periodic basis to

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

specifically identify individual securities that have incurred an other-than-temporary decline in fair value below amortized cost. As part of its periodic review process, management utilizes information received from its outside professional asset manager to assess each issuer's current credit situation. When management's review identifies an other-than-temporary impairment in the valuation of a fixed income security, it compares its projected discounted cash flows to the amortized cost in order to determine the credit related portion and the non-credit related portion of the loss. The credit related portion is recorded as a charge in the consolidated statement of operations while the non-credit related portion is recorded through other comprehensive income (loss) and included as a component of accumulated other comprehensive income in the consolidated balance sheets.

For structured securities, management projects cash flows using loss adjusted cash flows that contemplate current market factors such as prepayment assumptions, expected default assumptions, and the current condition of the guarantor of the security. For structured securities, the discount rate used in the present value calculation is the security's current effective interest rate. The discount rate used for other fixed income securities is the security's effective interest rate at the date of acquisition.

In addition to issuer-specific financial information, general economic data and management's projections of discounted cash flows, management also assesses whether it has the intent to sell a particular security or whether it is more-likely-than-not it will be required to sell the security before its anticipated recovery. When management determines that it either intends to sell or is no longer more likely than not to hold the security until its anticipated recovery, a realized loss is recorded in the consolidated statement of operations for the full amount of the difference between fair value and amortized cost.

Interest income is recognized when earned. Premiums and discounts on fixed income securities are amortized or accreted based upon the effective-interest method. Realized gains and losses on investments are determined by the specific identification method.

### **Convertible Bonds and Preferred Stocks**

The Company's investments in convertible bonds and convertible preferred stocks are considered hybrid financial instruments and are carried at estimated fair value, with changes in estimated fair value reported in net realized gains on investments in the consolidated statements of operations.

### **Preferred & Common Stocks**

Preferred and common stocks are carried at estimated fair value with changes in estimated fair value reported in net realized gains on investments in the consolidated statements of operations.

### **Other Invested Assets**

Other invested assets consist of investments in limited partnerships that invest in oil and gas interests, commercial and residential real estate and equity and debt securities of public and privately held companies. These investments are carried at fair value and the changes in estimated fair value are reported in net realized gains on investments on the consolidated statements of operations.

### **Property and Equipment - Insurance Group**

Property and equipment, which primarily consist of the Insurance Group's home office, electronic data processing equipment, furniture and fixtures, a software license and related implementation costs, are stated at cost, less accumulated depreciation of \$15,423 and \$14,463 at December 31, 2019 and 2018, respectively. Depreciation is provided using the straight-line method over the estimated useful lives of depreciable assets. Estimated useful lives range from 3 to 15 years with the exception of buildings, which are depreciated over approximately 25 years. Land is not subject to depreciation. Depreciation expense for the years ending December 31, 2019 and 2018 was \$961 and \$1,418, respectively.

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### Property and Equipment - Security Group

Property and equipment are stated at cost less accumulated depreciation. Equipment under capital leases is stated at the present value of minimum lease payments. Vector provides for depreciation over the estimated useful lives of the related assets utilizing the straight-line method. Estimated useful lives range from 3 to 12 years, with the exception of buildings, which are depreciated over approximately 25 years.

Vector installs certain home security package systems in residences if the customer commits to a monitoring arrangement for a minimum period of time. These security systems remain the property of Vector. The costs of the security systems, including costs of installation, are capitalized and depreciated over their estimated useful life of 7 years.

Balances consist of the following as of December 31:

	2019	2018
Land	\$ 200	\$ 200
Buildings and improvements	5,950	4,508
Home security package systems	37,736	49,730
Furniture and fixtures	6,180	4,511
Vehicles and equipment	30,400	21,255
Construction-in-progress	2,541	126
	<b>83,007</b>	80,330
Less accumulated depreciation	<b>(46,739)</b>	(48,857)
Total Property and Equipment	<b>\$ 36,268</b>	<b>\$ 31,473</b>

### Revenue Recognition

Vector's major sources of revenue are equipment sales, installation, monitoring and managed network services as described above. While Vector frequently sells these elements in a bundled arrangement, it also sells each element individually, with no discounts given for the elements included in a bundled arrangement. Accordingly, when elements are included in a bundled arrangement, each element is treated as a separate unit of accounting. The revenue recognition policy with respect to each of the three major elements is as follows:

- Installation and equipment revenue - Recognized as services are performed on a percentage-of-completion basis calculated on a cost-to-cost comparison.
- Service revenue - Recognized as services are performed for time and material agreements and recognized ratably over the service period for those agreements entered into under a fixed fee arrangement.
- Monitoring and managed network revenue - Recognized ratably over the service period with amounts billed in advance of service delivery deferred and amortized over the applicable period of service.

In accordance with Accounting Standards Update (ASU) 2009-13, *Revenue Recognition (Topic 605): Multiple Deliverable Revenue Arrangements* (EITF Issue No. 08-1, *Revenue Arrangements with Multiple Deliverables*), the overall arrangement fee for bundled arrangements is allocated to each element (both delivered and undelivered items) based on their relative selling prices, regardless of whether those selling prices are evidenced by vendor specific objective evidence or third party evidence or are based on the entity's estimated selling price. Application of the "residual method" of allocating an overall arrangement fee between delivered and undelivered elements is not permitted.

As part of Vector's residential business, they offer certain packages, whereby they bundle a free or low cost equipment package with a long term monitoring contract, which is generally



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three to five years. Vector retains ownership of the system for the duration of the monitoring contract. These packages are priced so that the additional monitoring and other fees generated over the life of the contract will exceed the cost of the equipment and related direct costs. Under these arrangements, Vector's performance obligations include monitoring and related services (such as maintenance agreements) as well as a right to use the security system. Revenue associated with the monitoring and related service performance obligation is recognized as those services are provided. Revenue associated with the right to use the security system is recognized over the life of the contract.

In transactions in which the security system is sold outright to the customer, Vector's performance obligations include monitoring and related services as well as the sale and installation of the security system. For such arrangements, Vector allocates the transaction price to each performance obligation based on a relative standalone selling price. Revenue associated with the sale and installation of security system performance obligation is recognized as the installation is completed. Revenue associated with the monitoring and related service performance obligation is recognized as those services are provided.

As part of its managed network service offerings, Vector's performance obligations include provision of internet access and network management services, as well as installation of computer and communications equipment to customers. For such arrangements, Vector allocates the transaction price to each performance obligation based on a relative standalone selling price. Revenue associated with the sale and installation of equipment is recognized as the installation is completed. Revenue associated with the network management services is recognized as those services are provided.

Vector incurs certain incremental contract costs (primarily sales commissions) related to acquiring customers and records these costs as deferred charges on its consolidated balance sheet. Amortization expense relating to these deferred charges was \$7,217 and \$3,450 for the years ended December 31, 2019 and 2018, respectively, and is included in selling, general and administrative expense on the consolidated statements of operations.

The impact from the adoption of ASC 606 on the consolidated financial statements as of and for the year ended December 31, 2019 was as follows:

Statement of Operations	AS REPORTED	BALANCES WITHOUT ADOPTION OF STANDARD	EFFECT OF ADOPTION INCREASE (DECREASE)
Revenue	\$ 360,262	\$ 359,462	\$ 800
Cost of sales	216,581	213,381	3,200
<b>Gross profit</b>	<b>143,681</b>	<b>146,081</b>	<b>(2,400)</b>
Selling, general and administrative	96,292	94,526	1,766
Acquisition-related costs	1,838	1,838	—
Depreciation	10,932	13,644	(2,712)
Amortization and impairment	41,919	41,919	—
<b>Operating loss</b>	<b>(7,300)</b>	<b>(5,846)</b>	<b>(1,454)</b>
Interest income	3	3	—
Interest expense	(10,724)	(10,724)	—
Other income, net	5	5	—
<b>Loss before income taxes</b>	<b>\$ (18,016)</b>	<b>\$ (16,562)</b>	<b>\$ (1,454)</b>

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<b>Balance Sheet</b>	<b>AS REPORTED</b>	<b>BALANCES WITHOUT ADOPTION OF STANDARD</b>	<b>EFFECT OF ADOPTION INCREASE (DECREASE)</b>
<b>Assets:</b>			
Unbilled revenue	\$ 18,719	\$ 18,880	\$ (161)
Contract assets	816	—	816
Prepaid expense and other current assets	2,723	5,783	(3,060)
Property and equipment	83,007	99,038	(16,031)
Accumulated depreciation	(46,739)	(54,181)	7,442
Deferred income taxes	25,482	23,447	2,035
Contract assets, noncurrent	1,973	—	1,973
Deferred charges	16,986	14,692	2,294
<b>Liabilities:</b>			
Accounts payable and accrued expenses	51,356	50,210	1,146
Unearned revenue	22,112	21,140	972
Contract liabilities	20	—	20
Unearned revenue, noncurrent	1,843	5,420	(3,577)
Contract liabilities, noncurrent	215	—	215
Other long-term liabilities	8,424	6,446	1,978

### **Inventories**

Inventories, consisting primarily of security and home automation products, are stated at the lower of average cost and net realizable value.

### **Intangible Assets**

In accordance with ASC Topic 350, *Intangibles – Goodwill and Other*, as of January 1, 2013, goodwill is amortized over 10 years and tested when a triggering event occurs. A triggering event draws into question whether the fair value of the entity may be below its carrying amount.

In accordance with Impairment or Disposal of Long Lived Assets subsections of ASC Subtopic 360-10, *Property, Plant, and Equipment – Overall*, long lived assets, such as property, plant, and equipment, and purchased intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long lived asset or asset group be tested for possible impairment, Vector first compares the undiscounted future cash flows of that asset or asset group to its carrying value. If the carrying value of the long lived asset or asset group is greater than the undiscounted future cash flows, an impairment is recognized to the extent that the carrying value exceeds its estimated fair value. Vector recorded impairment expense, through amortization expense, on their customer service agreements of \$1,039 and \$1,999 during 2019 and 2018, respectively.

Customer service agreements include newly acquired customer service agreements, that have been purchased through Vector's authorized dealer program or through other acquisitions and are being amortized on a straight-line basis over periods ranging from seven to thirteen years, which reflects Vector's historical attrition rates.

Customer relationships, which were recorded in connection with acquisitions, are amortized on a straight-line basis over a period of 13 years.

Covenants not-to-compete are generally amortized on a straight-line basis over periods ranging from 3 to 5 years, depending upon the length of the agreement. All intangible assets have been recorded in connection with acquisitions.

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Covenants not to solicit, which were recorded in connection with acquisitions, are amortized on a straight-line basis over a period of 8 years.

Trade names, which were recorded in connection with acquisitions, are amortized on a straight-line basis over a period of 5 years.

Technology, which was recorded in connection with acquisitions, is amortized on a straight-line basis over a period of 5 years.

All fully amortized intangible assets are removed from Vector's asset system in the year following full amortization.

### **Income Taxes**

Deferred income taxes are recognized in the consolidated financial statements for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases. Deferred income tax expense is the result of changes in deferred tax assets and liabilities. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred income tax asset will not be realized.

A tax position is recognized as a benefit at the largest amount that is more likely than not to be sustained in a tax examination solely on its merits. An uncertain tax position will not be recognized if it has a less than 50% likelihood of being sustained. The Company recognizes interest and penalties accrued related to uncertain tax positions as a component of income tax expense. The Company has no such uncertain tax positions as of December 31, 2019 or 2018.

### **Cash Equivalents**

Cash equivalents consist of highly liquid short-term investments with an expected maturity at date of purchase of three months or less.

### **Credit Risk**

The Company maintains cash balances in major financial institutions in excess of the federally insured limit of \$250 by the Federal Deposit Insurance Corporation (FDIC). The Company has not experienced any losses and believes it is not exposed to any significant credit risk on cash and cash equivalents.

### **Derivative Instruments and Hedging Activities**

Vector accounts for derivatives and hedging activities in accordance with ASC Topic 815, *Derivatives and Hedging*, which requires entities to recognize all derivative instruments as either assets or liabilities in the balance sheet at their respective fair values.

Vector only enters into derivative contracts that it intends to designate as a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge). For all hedging relationships, Vector formally documents the hedging relationship and its risk-management objective and strategy for undertaking the hedge, the hedging instrument, the hedged item, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed prospectively and retrospectively, and a description of the method of measuring ineffectiveness. Vector also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting cash flows of hedged items. For derivative instruments that are designated and qualify as a cash-flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.



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Vector discontinues hedge accounting prospectively when it determines that the derivative is no longer effective in offsetting cash flows of the hedged item, the derivative expires or is sold, terminated, or exercised, the derivative is designated as a hedging instrument because it is unlikely that a forecasted transaction will occur, or management determines that designation of the derivative as a hedging instrument is no longer appropriate.

In all situations in which hedge accounting is discontinued and the derivative is retained, Vector continues to carry the derivative at its fair value on the balance sheet and recognizes any subsequent changes in its fair value in earnings. When it is probable that a forecasted transaction will not occur, Vector discontinues hedge accounting and recognizes immediately in earnings gains and losses that were accumulated in other comprehensive income.

## Deferred Financing Costs

Deferred financing costs represent debt insurance costs and other related costs incurred in obtaining the debt financing currently in place, which are being amortized over the term of the related debts and are recorded within prepaid expenses and other current assets and other noncurrent assets on the consolidated balance sheets.

## Accumulated Comprehensive Income

Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale debt investments, changes in fair value of certain hedges, defined benefit pension plans, and unrealized losses related to factors other than credit on fixed income securities are reported as a separate component on the equity section of the consolidated balance sheet. Such items, along with net income, are components of comprehensive income and are reflected in the consolidated statement of comprehensive income (loss).

Changes in the balances of each component of accumulated other comprehensive income, net of tax, at December 31 are as follows:

	UNREALIZED GAINS ON AVAILABLE-FOR- SALE SECURITIES	CASH FLOW HEDGE	DEFINED BENEFIT PENSION PLAN	ACCUMULATED OTHER COMPREHENSIVE INCOME
Balance, January 1, 2018	\$ 88,026	\$ 369	\$ (1,986)	\$ 86,409
Other comprehensive income (loss) before reclassifications	(25,437)	219	66	(25,152)
Amounts reclassified from accumulated other comprehensive income (loss)	(7,944)	160	67	(7,717)
Balance, December 31, 2018	54,645	748	(1,853)	53,540
Other comprehensive income (loss) before reclassifications	4,083	(1,624)	583	3,042
Reclassification of unrealized gain on equity securities and other invested assets	(52,404)	—	—	(52,404)
Amounts reclassified from accumulated other comprehensive income (loss)	(502)	(317)	67	(752)
<b>Balance, December 31, 2019</b>	<b>\$ 5,822</b>	<b>\$ (1,193)</b>	<b>\$ (1,203)</b>	<b>\$ 3,426</b>

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The following table presents the effect of the reclassification of significant items out of accumulated other comprehensive income on the respective line items in the consolidated statement of operations for year ended December 31.

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	AMOUNT RECLASSIFIED FROM ACCUMULATED OTHER COMPREHENSIVE INCOME		AFFECTED LINE ITEM IN THE CONSOLIDATED STATEMENT OF OPERATIONS
	2019	2018	
Unrealized gain on securities available for sale			
Realized gains on sale of securities	\$ 636	\$ 10,056	NET REALIZED GAINS ON INVESTMENTS
Gain (loss) on cash flow hedges			
Interest rate derivative contracts	401	(203)	INTEREST EXPENSE
Change in retirement plan liabilities adjustment			
Amortization of actuarial losses	(85)	(85)	(a)
Total reclassifications before income tax expense	952	9,768	
Less: Income tax expense	200	2,051	
<b>Total reclassifications net of income tax expense</b>	<b>\$ 752</b>	<b>\$ 7,717</b>	

(a) These accumulated other comprehensive income components are included in the computation of net periodic pension cost. See Note 12 to the consolidated financial statements for further detail.

## Legal Matters

The Company is involved in various 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 the Company's consolidated financial position, results of operations, or liquidity.

## Recently Issued Accounting Pronouncements

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments (Topic 326), which requires financial assets measured at amortized cost to be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This ASU is effective for annual periods beginning after December 15, 2022. The Company is currently assessing the effect that this ASU will have on its results of operations, financial position and cash flows.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which provides new guidance on how an entity should account for leases and recognize associated lease assets and liabilities. This ASU requires lessees to recognize assets and liabilities that arise from financing and operating leases on the consolidated balance sheet. The implementation of this standard will require application of the new guidance at the beginning of the earliest comparative period presented, once adopted. This ASU is effective for the Company beginning in fiscal year 2021, with early adoption is permitted. The Company is in the process of assessing the impact this ASU will have on its consolidated financial statements.

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## Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASC Subtopic 606 (ASC 606), Revenue from Contracts with Customers, which sets forth a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. Vector generates revenue primarily through installation, monitoring, service, and managed network services. Vector adopted this standard and its related amendments effective on January 1, 2019 using the modified retrospective transition method, whereby the cumulative effect of initially applying the new standard is recognized as an adjustment to the opening balance of equity. Results for reporting periods beginning on or after January 1, 2019 are presented under this new standard, while prior period amounts are not adjusted and continue to be reported under the accounting standards in effect for the prior period. The largest impact from the new standard relates to the timing of recognition of the upfront fees, other direct costs and non-incremental selling costs associated with arrangements where the Company retains ownership of the system. Under standards in effect for the prior period, upfront fees were amortized to revenue over the expected life of the customer relationship, and other direct costs and non-incremental selling costs were capitalized. Under the new standard, upfront fees are amortized over the contract life, and other direct costs and non-incremental selling costs are no longer capitalized but rather expensed as incurred. In addition, there is an impact from the adoption of the new standard related to the timing of recognition of certain incremental selling costs (primarily sales commissions) associated with acquiring new customers. Under the new standard, these costs will be deferred and amortized over the expected life of the customer relationship, which is generally seven years, rather than the initial contract term (generally three to five years). To a lesser extent, the adoption of the new standard impacted the identification of performance obligations and the allocation of transaction price to those performance obligations for certain sales of security systems sold outright to customers. As of January 1, 2019, due to the cumulative impact of adopting this new standard, the Company recorded a net decrease to opening balance of equity of \$4,373, which is net of tax of \$1,654.

The impact to the line items in the consolidated balance sheet were as follows:

	BALANCE AT DECEMBER 31, 2018	REVENUE STANDARD ADOPTION ADJUSTMENT	BALANCE AT JANUARY 1, 2019
<b>Assets</b>			
Contact assets	\$ —	\$ 570	\$ 570
Prepaid expense and other current assets	7,418	(2,673)	4,745
Property and equipment	80,330	(14,788)	65,642
Accumulated depreciation	(48,857)	6,777	(42,080)
Contract assets, noncurrent	—	773	773
Deferred income taxes	18,095	1,654	19,749
Deferred charges	10,034	5,068	15,102
<b>Liabilities</b>			
Accounts payable and accrued expenses	37,819	828	38,647
Unearned revenue	12,018	(146)	11,872
Contract liabilities	—	135	135
Unearned revenue, noncurrent	6,027	(2,969)	3,058
Contract liabilities, noncurrent	—	125	125
Other long-term liabilities	4,757	3,781	8,538

Refer to Note 1 Summary of Significant Accounting Policies - Revenue Recognition for further discussion related to the impact of adopting this standard.

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In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities. The Company adopted the provisions of ASU 2016-01 for the year ended December 31, 2019. The amendments in this ASU require among other things that equity investments to be measured at fair value (excluding those equity securities measured at fair value using net asset value as a practical expedient) with changes in fair value recognized in net income, simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, require an entity to present separately in other comprehensive income the portion of the total change in the fair value of the liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements, and clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. With the adoption of ASU 2016-01, a cumulative effect of unrealized holding gains and losses on previously classified available-for-sale equity securities and other alternative investments included in accumulated other comprehensive income at January 1, 2019 are to be reclassified to retained earnings. At January 1, 2019, unrealized holding gains in equity securities and other invested assets, net of tax effect, of \$52,404 were reclassified from accumulated other comprehensive income to retained earnings as presented in the accompanying consolidated statement of equity for the year ended December 31, 2019.

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## Subsequent Events

In preparing these consolidated financial statements, management has evaluated events and transactions for potential recognition or disclosure through March 2, 2020, the date the consolidated financial statements were available to be issued.

## Note 2: Investments

The cost or amortized cost and estimated fair values of investments at December 31 are as follows:

	2019			
	COST OR AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 3,747	\$ 76	\$ —	\$ 3,823
Obligations of states and political subdivisions	36,752	3,031	(16)	39,767
Corporate securities	48,368	2,013	(10)	50,371
Mortgage-backed and asset- backed securities	67,482	2,131	(67)	69,546
<b>Total fixed income securities</b>	<b>156,349</b>	<b>7,251</b>	<b>(93)</b>	<b>163,507</b>
Preferred stocks	472	—	—	472
Common stocks	165,770	133,707	(1,377)	298,100
<b>Total</b>	<b>\$ 322,591</b>	<b>\$ 140,958</b>	<b>\$ (1,470)</b>	<b>\$ 462,079</b>



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	2018			
	COST OR AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 11,211	\$ 63	\$ (8)	\$ 11,266
Obligations of states and political subdivisions	41,579	1,901	(41)	43,439
Corporate securities	37,452	255	(152)	37,555
Mortgage-backed and asset- backed securities	61,158	955	(351)	61,762
<b>Total fixed income securities</b>	151,400	3,174	(552)	154,022
Preferred stocks	623	147	(136)	634
Common stocks	161,668	74,769	(5,099)	231,338
<b>Total</b>	<b>\$ 313,691</b>	<b>\$ 78,090</b>	<b>\$ (5,787)</b>	<b>\$ 385,994</b>

Convertible securities carried at fair value in the consolidated balance sheet as follows:

	COST		ESTIMATED FAIR VALUE	
	2019	2018	2019	2018
Convertible bonds	\$ 17,398	\$ 15,875	\$ 19,170	\$ 15,142
Convertible preferred stocks	\$ 663	\$ 1,399	\$ 663	\$ 1,425

Other investments in limited partnerships carried at fair value in the consolidated balance sheet as follows:

	COST		ESTIMATED FAIR VALUE	
	2019	2018	2019	2018
Other Invested Assets	\$ 40,648	\$ 40,082	\$ 39,926	\$ 36,448

The amortized cost and estimated fair value of fixed income securities and convertible bonds at December 31, 2019, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or repayment penalties.

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	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	\$ 2,802	\$ 2,839
Due after one year through five years	60,354	64,177
Due after five years through ten years	19,952	21,780
Due after ten years	23,335	24,335
	<b>106,443</b>	<b>113,131</b>
Mortgage-backed and asset-backed securities	67,482	69,546
<b>Total</b>	<b>\$ 173,925</b>	<b>\$ 182,677</b>

Net realized gains on investments consisted of the following:

	2019	2018
Realized gains on sales of investments	\$ 10,436	\$ 24,656
Realized losses on sales of investments	(3,762)	(14,404)
Change in fair value of convertible securities	2,624	(2,071)
Change in fair value of equity securities	62,660	—
Change in fair value of other invested assets	2,912	—
Other-than-temporary impairment charges	(295)	(224)
	<b>\$ 74,575</b>	<b>\$ 7,957</b>

The Company had on deposit, as required by various state regulatory agencies, fixed income securities with a fair value of \$2,896 and \$3,101 and cash equivalents of \$842 and \$706 at December 31, 2019 and 2018, respectively.

As of December 31, 2019 and 2018, the Company's investment portfolio had gross unrealized losses of \$93 and \$552, respectively. For securities that were in an unrealized loss position as of December 31, the lengths of time that such securities have been in an unrealized loss position, as measured by their year-end fair values, are as follows:

	LESS THAN 12 MONTHS		12 MONTHS OR MORE		TOTAL	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES
<b>December 31, 2019:</b>						
Fixed income securities:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Obligations of states and political subdivisions	2,346	(16)	—	—	2,346	(16)
Corporate securities	1,795	(10)	—	—	1,795	(10)
Mortgage-backed and asset-backed securities	3,027	(34)	3,895	(33)	6,922	(67)
<b>Total fixed income securities</b>	<b>\$ 7,168</b>	<b>\$ (60)</b>	<b>\$ 3,895</b>	<b>\$ (33)</b>	<b>\$ 11,063</b>	<b>\$ (93)</b>

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	LESS THAN 12 MONTHS		12 MONTHS OR MORE		TOTAL	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES
<b>December 31, 2018:</b>						
Fixed income securities:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 1,337	\$ (8)	\$ —	\$ —	\$ 1,337	\$ (8)
Obligations of states and political subdivisions	2,012	(37)	79	(4)	2,091	(41)
Corporate securities	9,384	(133)	1,010	(19)	10,394	(152)
Mortgage-backed and asset-backed securities	23,895	(296)	2,466	(55)	26,361	(351)
<b>Total fixed income securities</b>	<b>\$ 36,628</b>	<b>\$ (474)</b>	<b>\$ 3,555</b>	<b>\$ (78)</b>	<b>\$ 40,183</b>	<b>\$ (552)</b>

**Note 3: Fair Value Measurements**

The Company measures fair value by categorizing assets and liabilities based upon the level of judgment associated with the inputs to measure their fair value. These levels are:

Level 1 - Inputs that are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.

Level 2 - Inputs other than quoted process included in Level 1 that are observable for the asset or liability through corroboration with market data at the measurement date.

Level 3 - Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The fair values for securities included in Level 1 are based on observable inputs either directly or indirectly, such as quoted prices in markets that are active, quoted prices for similar securities at the measurement date; quoted prices in markets that are not active; or other inputs that are observable. The Company classifies its investment in U.S. Treasury securities and common stocks as Level 1 assets.

The fair values for securities included in Level 2 are based upon fair values generated by external pricing models that vary by asset class and incorporate available trade, bid and other market information, as well as price quotes from other independent market participants which reflect fair value of that particular security. The Company considers its investments in U.S. government agency bonds, municipal bonds, corporate bonds, mortgage-backed and asset-backed securities, and one convertible bond as Level 2 assets.

In classifying the mortgage-backed and asset-backed securities owned as Level 2 securities, the Company considers the inputs as follows:

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in markets that are not active, that is, markets in which there are few transactions for the assets or liabilities, the prices are not current, or price quotations vary substantially either over time or among

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market makers (for example, some brokered markets) or in which little information is released publicly (for example, a principal-to-principal market).

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The Company's determination of the fair value of its interest rate swap as Level 2 is calculated using a discounted cash flow analysis based on the terms of the swap contract and the observable interest rate curve.

Securities included in Level 3 are securities where inputs are based solely on a broker price or unobservable market data. The Company classifies its investments in certain convertible bonds, convertible preferred stocks, and a closely held equity security as Level 3 assets.

The fair value of the other invested assets (limited partnership interests) is determined by the investment company and is based upon fair value policies established by management of the underlying fund. Fair value policies at the underlying fund generally require the fund to utilize pricing/valuation information; however, in some instances current valuation information, for illiquid securities or securities in markets that are not active, may not be available from any third party source, or fund management may conclude that the valuations available from third party sources are not reliable. In these instances fund management may perform model-based analytical valuations that may be used to value these investments. The Company uses net asset value (NAV) per share (or its equivalent), as a practical expedient to estimate the fair value of its other invested assets, if NAV is calculated consistent with accounting principles generally accepted in the United States of America and sale of the investment at an amount different than NAV is not probable. The Company considered the nature, risk, and probability for the sale of the investment (at amounts different from NAV). The Company's considerations included (but were not limited to):

- Unfunded commitments (for additional investment)
- Redemption eligibility and frequency
- Required redemption notice

Based upon these considerations, the Company concluded that NAV for the other invested assets is calculated consistent with accounting principles generally accepted in the United States of America.

Investments carried at NAV may be adjusted based upon management's assumptions; therefore, any withdrawal, transfer, or sale of the limited partnership interest is subject to the general partner's discretion. At December 31, 2019 and 2018, the fair value using net asset value for the Company's other invested assets were \$39,926 and \$36,448, respectively.

One investment in a limited partnership included in other invested assets comprising 49% of other invested assets is subject to certain lock up provisions. This investment provides that the Company may not withdraw a capital contribution for 12 months following the date of its initial investment. Following this one year lock up period, the Company, in order to make a withdrawal, must provide 90 days' prior notice as of the last date of each calendar quarter to the general partner. Withdrawals made by the Company less than 36 months from initial contribution are subject to a 3% early withdrawal charge. These restrictions may be waived by the general partner in the case of certain events or at the discretion of the general partner. This partnership does not have a finite life.

One investment in a master limited partnership included in other invested assets comprising 31% of other invested assets contains a stipulation that redemptions by the Company within 12 months following its initial investment are subject to a 1% early withdrawal charge. This restriction may be waived by the managing member. The Company can make a withdrawal as of the last business day of the month by providing notice to the managing member at least 30 days in advance of the withdrawal. This partnership does not have a finite life.



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One investment in a limited partnership comprising 14% of other invested assets has a term of seven years after the final closing, with an option for up to three additional one year periods at the discretion of the general partner.

One investment in a limited partnership included in other invested assets comprising 5% of other invested assets has a term of 10 years from the initial closing, with an option for up to two consecutive one year extensions at the general partner's election. A 90% in interest of the limited partners may elect to terminate the fund at any time. This limited partnership is not subject to lock up provisions.

One investment in a limited partnership included in other invested assets comprising 1% of other invested assets has a term of 10 years from the initial closing. This limited partnership is not subject to lock up provisions.

The following table summarizes fair value measurements by level within the fair value hierarchy at December 31, 2019 and 2018 for assets and liabilities measured at fair value on a recurring basis:

		2019		
		FAIR VALUE MEASUREMENTS USING:		
DESCRIPTION	TOTAL	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)
<b>Assets</b>				
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 3,823	\$ 3,823	\$ —	\$ —
Obligations of states and political subdivisions	39,767	—	39,767	—
Corporate securities	50,371	—	50,371	—
Mortgage-backed and asset-backed securities	69,546	—	69,546	—
<b>Total fixed income securities</b>	<b>163,507</b>	<b>3,823</b>	<b>159,684</b>	<b>—</b>
Convertible bonds	19,170	—	14,156	5,014
Preferred stocks	472	—	—	472
Convertible preferred stocks	663	—	—	663
Common stocks	298,100	297,990	—	110
<b>Total bonds and stocks</b>	<b>\$ 481,912</b>	<b>\$ 301,813</b>	<b>\$ 173,840</b>	<b>\$ 6,259</b>

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		2018		
		FAIR VALUE MEASUREMENTS USING:		
DESCRIPTION	TOTAL	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)
<b>Assets</b>				
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 11,266	\$ 11,266	\$ —	\$ —
Obligations of states and political subdivisions	43,439	—	43,439	—
Corporate securities	37,555	—	37,555	—
Mortgage-backed and asset-backed securities	61,762	—	61,762	—
<b>Total fixed income securities</b>	<b>154,022</b>	<b>11,266</b>	<b>142,756</b>	<b>—</b>
Convertible bonds	15,142	—	8,782	6,360
Preferred stocks	634	—	—	634
Convertible preferred stocks	1,425	—	—	1,425
Common stocks	231,338	231,228	—	110
<b>Total bonds and stocks</b>	<b>\$ 402,561</b>	<b>\$ 242,494</b>	<b>\$ 151,538</b>	<b>\$ 8,529</b>
Interest rate swap receivable	\$ 947	\$ —	\$ 947	\$ —

The Company's policy is to transfer assets and liabilities into and out of Level 3 at the beginning of the reporting period when the circumstance is such that significant inputs can or cannot be corroborated with market observable data.

## Note 4: Liability for Unpaid Losses and Loss Adjustment Expenses

Activity in unpaid losses and loss adjustment expenses is summarized as follows:

	2019	2018
<b>Balance as of January 1</b>	<b>\$ 96,558</b>	<b>\$ 90,452</b>
Less reinsurance recoverable	(13,299)	(12,730)
Net balance at January 1	<b>83,259</b>	<b>77,722</b>
Incurred related to:		
Current year	<b>136,199</b>	115,858
Prior years	(3,942)	(5,075)
Total incurred	<b>132,257</b>	110,783
Paid related to:		
Current year	<b>87,497</b>	77,885
Prior years	<b>32,633</b>	27,361
Total paid	<b>120,130</b>	105,246
Net balance as of December 31	<b>95,386</b>	83,259
Plus reinsurance recoverable	<b>18,778</b>	13,299
<b>Balance at December 31</b>	<b>\$ 114,164</b>	<b>\$ 96,558</b>

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Due to changes in estimates of insured events in prior years, the Insurance Group decreased the liability for unpaid losses and loss adjustment expenses relative to prior accident years in 2019 and 2018 by \$3,942 and \$5,075, respectively. The decrease in 2019 is due to better than expected development of losses incurred, primarily in the homeowners liability and other liability segments, and primarily related to the 2014, 2015, and 2018 accident years. The decrease in 2018 is due to better than expected development of losses incurred, primarily in the homeowners liability and other liability segments, and primarily related to the 2014, 2016 and 2017 accident years.

The following tables present information about incurred and paid claims development as of December 31, 2019 net of reinsurance, as well as cumulative claim frequency and the total of IBNR reserves plus expected development on reported claims that the Insurance Group included in unpaid losses and loss adjustment expenses as of December 31, 2019. The tables include unaudited information about incurred and paid claims development for the years ended December 31, 2013 through 2018, which is presented as required supplementary information.

## Homeowners

### Incurred Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance

ACCIDENT YEAR	UNAUDITED							AS OF DECEMBER 31, 2019	
	2013	2014	2015	2016	2017	2018	2019	TOTAL IBNR PLUS EXPECTED ON REPORTED	CUMULATIVE NUMBER OF REPORTED CLAIMS
2013	49,259	47,510	44,736	45,123	44,610	44,338	44,364	185	4,838
2014		67,879	64,035	64,722	64,678	63,785	63,662	276	7,020
2015			59,902	55,851	54,839	54,783	54,029	505	5,556
2016				51,560	51,007	49,720	50,084	1,974	5,401
2017					52,190	52,034	52,087	3,171	6,209
2018						78,829	78,111	4,234	10,001
2019							94,843	13,405	8,444
					Total		<u>\$ 437,180</u>		

### Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance

ACCIDENT YEAR	UNAUDITED						
	2013	2014	2015	2016	2017	2018	2019
2013	29,281	39,921	41,195	42,637	43,946	43,867	43,862
2014		48,758	56,644	59,671	62,226	63,191	63,386
2015			40,780	49,251	51,165	52,116	53,002
2016				35,608	44,198	45,782	47,152
2017					33,973	44,966	47,173
2018						55,747	70,668
2019							63,357
					Total		<u>\$ 388,600</u>
					All outstanding liabilities before 2013, net of reinsurance		<u>8,770</u>
					Liabilities for losses and loss adjustment expenses, net of reinsurance		<u>\$ 57,350</u>

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## Other Liability

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### Incurred Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance

							AS OF DECEMBER 31, 2019		
ACCIDENT YEAR	UNAUDITED						TOTAL IBNR PLUS EXPECTED ON REPORTED	CUMULATIVE NUMBER OF REPORTED CLAIMS	
	2013	2014	2015	2016	2017	2018	2019		
2013	7,333	7,133	7,562	7,678	7,869	7,968	7,879	30	246
2014		6,909	8,493	10,031	10,554	10,242	9,921	86	264
2015			7,888	8,125	8,108	8,016	7,649	505	267
2016				7,264	7,171	6,851	7,279	990	211
2017					6,792	6,464	6,098	1,788	190
2018						6,685	6,732	3,417	161
2019							7,408	5,711	116
					Total		\$ 52,966		

## Other Liability

### Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance

	UNAUDITED						
ACCIDENT YEAR	2013	2014	2015	2016	2017	2018	2019
2013	191	770	2,357	5,473	7,282	7,800	7,800
2014		20	1,484	4,338	8,209	9,474	9,825
2015			174	904	3,414	5,559	7,004
2016				167	1,146	2,819	5,220
2017					75	770	2,425
2018						104	869
2019							86
						Total	\$ 33,229
						All outstanding liabilities before 2013, net of reinsurance	3,210
						Liabilities for losses and loss adjustment expenses, net of reinsurance	\$ 22,947



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The reconciliation of the net incurred and paid loss development tables to the liability for losses and loss adjustment expenses in the consolidated balance sheets is as follows:

	DECEMBER 31, 2019
Net outstanding liabilities	
Homeowners	\$ 57,350
Other liability	22,947
Other short-duration insurance lines	10,135
Liabilities for unpaid losses and allocated loss adjustment expenses, net of reinsurance	90,432
Reinsurance recoverable on unpaid claims	
Homeowners	13,943
Other liability	1,870
Other short-duration insurance lines	2,965
Total reinsurance recoverable on unpaid losses	18,778
Unallocated loss adjustment expenses	4,954
Total gross liability for unpaid losses and loss adjustment expenses	<u>\$ 114,164</u>

The methods used to select the estimated claim reserves include the loss ratio method, loss development methods, frequency-severity methods, the Bornhuetter-Ferguson (B-F) method, and the Berquist-Sherman (B-S) method, applied to paid losses and incurred losses. Cumulative claim frequency was calculated using the sum of all individual claimants. Claims that were presented to the Company, investigated, and ultimately closed without any loss or loss adjustment expense payments would be included the cumulative claim frequency information shown above.

There were no changes in methodology from the prior year.

The following is supplementary information about average historical claims duration as of December 31, 2019.

### Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance

	UNAUDITED						
Years	1	2	3	4	5	6	7
Homeowners	72.2%	17.4%	3.7%	3.1%	2.2%	0.4%	0.1%
Other Liability	0.6%	12.1%	22.6%	32.5%	17.0%	4.3%	1.7%

### Note 5: Reinsurance

The Insurance Group purchases quota share and per risk and catastrophic excess of loss reinsurance. The Insurance Group remains contingently liable in the event that the reinsurer is unable to meet its obligations assumed under the reinsurance agreements.

The Insurance Group had no assumed premiums earned in 2019 and 2018 and had ceded premiums earned in 2019 and 2018 of \$20,347 and \$17,460, respectively. Losses and loss adjustment expenses are net of reinsurance recoveries of \$15,586 and \$7,413 in 2019 and 2018, respectively. Amounts paid to reinsurers related to the unexpired portion of reinsured contracts were \$3,164 and \$2,793 as of December 31, 2019 and 2018, respectively.

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The Insurance Group had no significant concentration in risk from any one unaffiliated reinsurer as of December 31, 2019 and 2018.

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### Note 6: Dividends from Subsidiaries and Statutory Financial Information

The Contributionship and its subsidiaries prepare statutory financial statements in accordance with accounting practices prescribed or permitted by the Pennsylvania Insurance Department. The Commonwealth of Pennsylvania requires that insurance companies domiciled in the Commonwealth of Pennsylvania prepare their statutory financial statements in accordance with the National Association of Insurance Commissioners *Accounting Practices and Procedures* manual, subject to any deviations prescribed or permitted by the Commonwealth of Pennsylvania Insurance Commissioner. Permitted statutory accounting practices encompass all accounting practices that are not prescribed; such practices differ from state to state, may differ from company to company within a state, and may change in the future.

The Contributionship and its subsidiaries are restricted by law as to the amount of dividends they may pay without the approval of regulatory authorities. During 2020, the maximum amount of dividends that can be paid by the Contributionship without such approval is \$31,204. The Contributionship paid no ordinary dividends during 2019 and 2018.

The surplus of the Contributionship and its subsidiaries, as determined in accordance with statutory accounting practices, is \$312,037 and \$270,422 at December 31, 2019 and 2018, respectively. The net loss of the Contributionship and its subsidiaries, as determined in accordance with statutory accounting practices, is \$10,843 and \$112 for the years ended December 31, 2019 and 2018, respectively.

Risk-based capital is designed to measure the acceptable amount of capital an insurer should have based on the inherent risks of the insurer's business. Insurers failing to meet adequate capital levels may be subject to insurance department scrutiny and ultimately rehabilitation or liquidation. As of December 31, 2019 and 2018, the Contributionship and its subsidiaries maintained statutory-basis surplus in excess of the minimum prescribed risk-based capital requirements. As of December 31, 2019 and 2018, the Contributionship and its subsidiaries were in compliance with the minimum capital requirements under Commonwealth of Pennsylvania regulations.

### Note 7: Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the years ended December 31 are as follows:

	2019	2018
Balance as of January 1	\$ 21,154	\$ 25,796
Goodwill acquired during the year	137,176	—
Amortization	(12,646)	(4,642)
Balance as of December 31	<u>\$ 145,684</u>	<u>\$ 21,154</u>

The amortization period for goodwill is 10 years.

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The following summarizes the gross carrying amount and accumulated amortization of intangible assets as of December 31:

	2019		2018	
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION
Customer service agreements	\$ 256,349	\$ 143,387	\$ 252,490	\$ 146,752
Customer relationships	10,460	5,130	10,460	4,325
Covenants not to compete	121	57	728	659
Covenants not to solicit	2,084	1,661	2,084	1,400
Technology	—	—	2,740	2,740
Trade Names	20,150	2,351	669	669
<b>Total</b>	<b>\$ 289,164</b>	<b>\$ 152,586</b>	<b>\$ 269,171</b>	<b>\$ 156,545</b>

Amortization expense, excluding impairment charges, for other intangible assets was \$28,234 and \$29,287 for the years ended December 31, 2019 and 2018, respectively.

The estimated amortization expense for goodwill and other intangible assets for each of the five succeeding fiscal years is as follows:

2020	\$ 48,790
2021	47,036
2022	43,406
2023	36,475
2024	26,866
Thereafter	79,689
<b>Total</b>	<b>\$ 282,262</b>

### Note 8: Acquisitions

#### ADS Security, L.P.

On June 3, 2019, Vector, through its subsidiary, acquired 100% of the membership units of ADS Security, L.P. for \$190,000. Following the closing date, Vector converted ADS Security, L.P. to a limited liability company, under the name ADS Security, LLC. The ADS acquisition provides Vector the ability to continue to expand its market presence in the security industry by leveraging the ADS brand name and other best practices throughout the Southeastern region of the United States. Funding for the acquisition consisted primarily of borrowings on Vector's newly refinanced revolving credit facility (see Note 9). The consolidated financial statements reflect the operations of the acquired business starting from the effective date of the acquisition. Expenses related to business acquisition are recognized as incurred and are included in acquisition-related costs in the consolidated statements of operations and comprehensive loss.

Vector accounted for this business combination under the acquisition method of accounting. The assets acquired and liabilities assumed in connection with business acquisition were recorded at the date of acquisition at their estimated fair values, with any excess of the purchase price over the estimated fair values of the net assets acquired recorded as goodwill, which Vector expects will be deductible for tax purposes. Significant judgment is required in estimating the fair value of assets acquired and liabilities assumed. Accordingly, Vector engaged a third-party valuation specialist to assist in these determinations. The fair value estimates are based on available historical information and on future expectations and assumptions deemed reasonable by management but are inherently uncertain.

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The following table summarizes the consideration paid for the ADS acquisition and the amounts of estimated fair value of the assets acquired, and liabilities assumed at the acquisition date.

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Cash	\$ 260
Trade accounts receivable	5,168
Unbilled revenue	1,002
Prepaid expenses and other current assets	2,217
Net fixed assets	10,599
Deferred charges	3,411
Debt-capital leases	(2,283)
Accounts payable and accrued expenses	(5,637)
Unearned revenue	(2,060)
Other noncurrent liabilities	(223)
Customer service agreements	20,220
Trade names	20,150
Goodwill	137,176
Total	<u>\$ 190,000</u>

The transaction is subject to two post-closing adjustment calculations as defined in the purchase agreement. The first calculation was prepared sixty-days post-closing based on closing net working capital, funded debt, and transaction expenses, as defined in the purchase agreement. No further consideration was transferred as a result of this sixty-day post-closing calculation. A second post-closing calculation was required to be completed by January 31, 2020 based on year-end bonuses, as defined in the purchase agreement. This second calculation resulted in additional purchase price consideration of approximately \$177 which was paid to the seller in January 2020.

### **Duncan Security Systems, Inc.**

On July 2, 2019, Vector acquired selected assets and assumed certain liabilities of Duncan Security Systems, Inc. (Duncan) located in Tennessee for a purchase price of \$2,176. The results of Duncan have been included in the consolidated financial statements since the acquisition date. The assets acquired represent approximately 2,500 customer accounts. The transaction was accounted for as an asset acquisition.

The aggregate purchase price of \$2,176 included \$2,306 of intangible assets and \$58 of tangible and current assets, net of \$188 in current liabilities. The intangible asset was assigned to customer service agreements, which are amortized over 13 years.

Funding for the acquired assets and assumed liabilities consisted primarily of \$2,042 in borrowings on Vector's existing revolving credit facility and \$134 in the form of a purchase holdback. The payment of the purchase holdback is contingent upon attrition of accounts over the first year with any payment to be made in the third quarter of 2020.

### **Others**

Vector acquired selected accounts from various Company authorized dealers located in various states. The total purchase price for these accounts was \$10,514 and \$10,753 in 2019 and 2018, respectively. The revenue and associated costs from the monitoring contracts acquired in these transactions have been included in the consolidated financial statements since the acquisition dates. The assets acquired represent approximately 6,200 accounts in 2019 and 6,900 accounts in 2018. The entire aggregate purchase price was assigned to customer service agreements, which are amortized over 7 years. Substantially all accounts are subject to a one year holdback period of approximately 10% of the purchase price. The transaction was accounted for as an asset acquisition.

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**Note 9: Borrowings and Credit Arrangements**

Long-term debt as of December 31 consists of the following:

	2019	2018
Revolving credit facility - variable interest rate (approximately 3.5% and 4.0% as of December 31, 2019 and 2018, respectively)	\$ 301,500	\$ 122,627
Capital leases - bearing interest at rates ranging from 3% to 7% as of December 31, 2019 and 2018	4,538	2,383
	<b>306,038</b>	125,010
Less current maturities	(2,063)	(1,489)
<b>Total long-term debt</b>	<b>\$ 303,975</b>	<b>\$ 123,521</b>

During 2019, Vector refinanced its existing debt by obtaining a \$450,000 revolving credit facility that permits Vector to borrow, on a revolving basis, through June 3, 2024. Interest on the entire \$450,000 credit facility is computed at either a base rate or LIBOR rate plus a scaling interest rate spread based upon a total consolidated indebtedness to eligible recurring monthly revenue ratio (Leverage Ratio), as defined in the agreement. Borrowings under this loan agreement are collateralized by Vector's assets, including the customer service agreements.

On January 13, 2017, Vector entered into a 48 month interest rate swap agreement with a notional amount of \$70,000. On January 22, 2019, Vector entered into a 36 month interest rate swap agreement with a notional amount of \$25,000. On June 3, 2019, Vector entered into a 48 month interest rate swap agreement with a notional amount of \$100,000. These derivatives are designated as cash flow hedges and are recognized on the consolidated balance sheet at fair value. This derivative was designated as a cash flow hedge and is recognized on the consolidated balance sheet at its fair value. Changes in fair value are recorded in other comprehensive income, net of taxes. Under the terms of the swap agreement, Vector receives variable rate interest payments based on 30 day LIBOR and makes fixed rate payments ranging from 1.81% to 2.63%. The fair value of the swap as of December 31, 2019 and 2018 was (\$1,673) and \$947, respectively and was recorded as a (liability) asset in the consolidated financial statements.

Vector must pay a quarterly commitment fee based on the Leverage Ratio that ranges from 0.15% to 0.30%. At December 31, 2019, Vector was paying a quarterly commitment fee of approximately 0.25% on the available unused portion of the revolving credit facility. As of December 31, 2019, the available unused portion of the revolving credit facility was \$144,084.

Under Vector's revolving credit facility, approximately \$2,545 and \$2,471 were committed for outstanding letters of credit as of December 31, 2019 and 2018. There were no amounts drawn on the letters of credit as of December 31, 2019 and 2018.

The credit agreement contains covenants with respect to, among other things, the maintenance of specified financial ratios. These provisions, if violated, could terminate the agreement and cause an acceleration of the maturity date. As of December 31, 2019 and 2018, Vector was in compliance with all such covenants.

The aggregate maturities of debt principal for Vector as of December 31, 2019 are as follows:

2020	\$ 2,063
2021	1,397
2022	893
2023	185
2024	301,500
Total	<b>\$ 306,038</b>



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2019 AND 2018

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### Note 10: Leases

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Vector has various capital leases for equipment (Note 9) that expire at various dates during the next 48 months. Amortization of assets held under capital leases is included with depreciation expense.

Vector leases certain equipment and office space under various operating leases. The future minimum rental commitments for all such noncancelable leases as of December 31, 2019 are as follows:

2020	\$ 4,594
2021	3,276
2022	2,900
2023	2,352
2024	1,503
Thereafter	<u>245</u>
Total	<u>\$ 14,870</u>

Rent expense for leased equipment and office space totaled \$7,031 and \$6,234 for the years ended December 31, 2019 and 2018, respectively.

### Note 11: Income Taxes

Income tax expense (benefit) for the years ended December 31 consists of:

2019			2018		
CURRENT	DEFERRED	TOTAL	CURRENT	DEFERRED	TOTAL
<u>\$ (6,643)</u>	<u>\$ 9,709</u>	<u>\$ 3,066</u>	<u>\$ 52</u>	<u>\$ (1,606)</u>	<u>\$ (1,554)</u>

The expected income tax (benefit) expense for the years ended December 31 differed from the amounts computed by applying the U.S. federal income tax rate of 21% as follows:

	2019	2018
Computed "expected" income tax expense (benefit)	<b>\$ 7,006</b>	\$ (756)
Decrease in income taxes resulting from:		
Tax-exempt interest	(161)	(276)
Dividends received deduction	(357)	(332)
State taxes, net of federal benefit	(923)	239
Provision to return adjustments	(123)	(357)
Tax rate differential	(2,498)	—
Other, net	<u>122</u>	<u>(72)</u>
	<u><b>\$ 3,066</b></u>	<u>\$ (1,554)</u>

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31 are as follows:

	2019	2018
<b>Insurance Group:</b>		
Deferred income tax asset components:		
Unearned premiums and advance premiums	\$ 3,681	\$ 3,527
Unpaid losses and loss adjustment expenses	1,179	1,086
Other-than-temporary impairments	915	986
Accrued pension liability	320	493
Deferred compensation	986	839
Other	364	319
<b>Total deferred income tax asset</b>	<b>7,445</b>	<b>7,250</b>
Deferred income tax liability components:		
Deferred acquisition costs	(3,763)	(3,536)
Unrealized investment gains	(29,598)	(14,419)
Other	(2,327)	(1,646)
<b>Total deferred income tax liability</b>	<b>(35,688)</b>	<b>(19,601)</b>
<b>Net deferred income tax liability</b>	<b>\$ (28,243)</b>	<b>\$ (12,351)</b>
<b>Security Group:</b>		
Deferred income tax asset components:		
Accrued expenses	\$ 3,657	\$ 2,463
Deferred rent	50	31
Net operating loss	2,214	—
Inventories and accounts receivable	1,034	759
Intangible assets	27,770	23,787
Unearned revenue	529	1,188
Contract liabilities	810	—
Interest rate swap	480	—
Research & development credit	67	—
<b>Total deferred tax asset</b>	<b>36,611</b>	<b>28,228</b>
Deferred income tax liability components:		
Unbilled revenue	(1,289)	(1,924)
Interest rate swap	—	(199)
Plant and equipment	(5,119)	(4,840)
Deferred charges	(4,612)	(3,170)
Prepaid expenses	(109)	—
<b>Total deferred income tax liability</b>	<b>(11,129)</b>	<b>(10,133)</b>
<b>Net deferred income tax asset</b>	<b>\$ 25,482</b>	<b>\$ 18,095</b>

In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized. Management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The ultimate realization of deferred income tax assets is dependent upon the generation of future

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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taxable income during the periods in which those temporary differences become deductible. The amount of the deferred income tax asset considered realizable; however, could be reduced in the near term if estimates of future taxable income or statutory tax rates are reduced during the carryforward period. Management has determined that it was not required to establish a valuation allowance against the net deferred income tax asset.

As of December 31, 2019 Vector has net operating loss carryforwards for state income tax purposes which begin to expire in 2024.

As of December 31, 2019 and 2018, the liability for unrecognized tax benefits was \$298 and \$184, respectively. The net change in liability was the result of Research and Development credits being claimed for the current and prior periods, as well as an associated accrual for interest. Vector recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. In 2019, Vector accrued approximately \$25 of interest (net of federal benefit) related to Research and Development credits. As of December 31, 2019 and 2018, a total of \$25 and \$0, respectively, were accrued related to interest and penalties.

There are no tax-related interest or penalties accrued on the consolidated balance sheet at December 31, 2019 and 2018, nor has any tax related interest or penalties been recognized in the consolidated statement of operations for the years ended December 31, 2019 and 2018.

The Company's federal income tax returns for tax years ended December 31, 2015 and prior are closed to examination.

### Note 12: Employee Benefit Plans

#### Defined Benefit Pension Plan

The Insurance Group made no contributions to the Plan in 2019 and 2018, respectively.

The components of the net periodic benefit cost are as follows:

	2019	2018
Interest cost	\$ 239	\$ 262
Expected return on plan assets	(397)	(504)
Amortization of net loss	85	85
Total net periodic benefit cost before settlement	(73)	(157)
Effect of settlement	—	326
Total net periodic benefit cost after settlement	\$ (73)	\$ 169

On December 13, 2006, the Board of Directors of the Company voted to freeze the benefits of the participants in the Plan effective April 1, 2007.

The Insurance Group recognizes the overfunded or underfunded status of its defined benefit pension plan as an asset (other assets) or liability (other liabilities) in the consolidated balance sheet. Changes in the funded status during any given period of time are recognized as a change in other comprehensive income.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The table set forth below reconciles the defined benefit pension plan's funded status reconciled with the amount in the consolidated balance sheet as of December 31:

	2019	2018
Benefit obligation as of January 1	\$ 6,376	\$ 8,027
Interest cost	239	262
Distributions	(478)	(1,504)
Change due to change in assumptions and experience	409	(409)
Benefit obligation as of December 31	6,546	6,376
Plan assets as of January 1	6,379	8,030
Employer contributions	—	—
Actual return on assets	1,544	(147)
Distributions	(478)	(1,504)
Plan assets as of December 31	7,445	6,379
Funded status	\$ 899	\$ 3

The net actuarial loss recognized in accumulated other comprehensive income, pre-tax in the consolidated balance sheet as of December 31 is as follows:

	2019	2018
	\$ 1,523	\$ 2,346

Assumptions used in determining the actuarial present value of the projected benefit obligation were as follows at December 31:

	2019	2018
Weighted-average discount rate	2.85%	3.96%
Expected long-term rate of return on assets	6.50	6.50
Rate of increase in compensation levels	N/A	N/A

The expected long-term rate of return on assets reflects the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation. The selected rate considers the historical and expected future investment trends of the present and expected assets in the Plan.

There were \$478 and \$1,504 of benefit payments made under the Plan in 2019 and 2018, respectively. Expected payments under the Plan in future years are as follows at December 31, 2019:

2020	\$ 476
2021	479
2022	477
2023	464
2024	450
2025 – 2029	2,066

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The Plan had approximately 69% and 66% of its investments invested in common stocks, 18% and 20% invested in corporate bonds and the remainder invested in U.S. Government and mortgage-backed securities and cash and cash equivalents for the year ending 2019 and 2018, respectively.

The following table provides the fair value measurements of the Plan assets by level within the fair value hierarchy at December 31. These assets are measured at fair value on a recurring basis.

DESCRIPTION	TOTAL	2019		
		FAIR VALUE MEASUREMENTS USING:		
		QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 438	\$ 438	\$ —	\$ —
Obligations of states and political subdivisions	261	—	261	—
Corporate securities	1,370	—	1,370	—
<b>Total fixed income securities</b>	<b>2,069</b>	<b>438</b>	<b>1,631</b>	<b>—</b>
Common stocks	5,135	5,135	—	—
Mutual funds	50	50	—	—
	<b>\$ 7,254</b>	<b>\$ 5,623</b>	<b>\$ 1,631</b>	<b>\$ —</b>

DESCRIPTION	TOTAL	2018		
		FAIR VALUE MEASUREMENTS USING:		
		QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 454	\$ 454	\$ —	\$ —
Obligations of states and political subdivisions	254	—	254	—
Corporate securities	1,273	—	1,273	—
<b>Total fixed income securities</b>	<b>1,981</b>	<b>454</b>	<b>1,527</b>	<b>—</b>
Common stocks	4,182	4,182	—	—
	<b>\$ 6,163</b>	<b>\$ 4,636</b>	<b>\$ 1,527</b>	<b>\$ —</b>



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2019 AND 2018

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See Note 3 for additional information regarding the Company's categorization of fair value of financial instruments.

The remainder of Plan assets not included above are comprised of cash and cash equivalents.

The objective of the portfolio is to maximize the total rate of return while controlling investment risk and to ensure sufficient funding status of the Plan as actuarially determined by the total return objective.

The Plan's investment guidelines are as follows:

- No more than 5% of fixed income securities rated below "A" by either Standard and Poor's or Moody's may be purchased. None may be rated below "Baa."
- Average duration of bonds will range from 4 to 7 years, depending on the market outlook.
- Prohibitions
  - a) Unincorporated businesses
  - b) Private placements or direct mortgages without approval
  - c) Financial guarantees

**Other Benefit Plans**

The Company maintains other benefit plans, including defined contribution plans (401(k)), with a cash or deferred arrangement covering all employees meeting eligibility requirements. Participants may elect to contribute, on a pretax basis, up to the Internal Revenue Service limit. The Company's matching contributions were \$3,119 in 2019 and \$2,711 in 2018.

The Company has a voluntary deferred compensation plan for certain employees meeting Plan eligibility requirements (the Participants) under which salaries and annual incentive awards can be deferred. The Participants deferred receipt of \$1,674 and \$1,085 in 2019 and 2018, respectively. The Participants have the option of being paid at termination of employment or on the fifth March 1st immediately following the date on which the annual compensation or base salary would have been payable. The Company made payments of \$109 in 2019 and \$0 in 2018. Amounts accrued under the plan were \$8,124 and \$5,943 as of December 31, 2019 and 2018, respectively.

The Company provides certain postretirement health care benefits. Net periodic postretirement benefit cost for 2019 and 2018 was \$33 and \$18, respectively.

For measurement purposes, health care cost trend increases do not affect the Company's costs due to the fact that the Company has limited the maximum dollar amount of benefits that will be paid. The weighted average discount rate used was 2.85% and 3.96% in 2019 and 2018, respectively.

## Independent Auditors' Report

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Board of Directors

The Philadelphia Contributionship Mutual Holding Company

### *Report on the Consolidated Financial Statements*

We have audited the accompanying consolidated financial statements of The Philadelphia Contributionship Mutual Holding Company and its subsidiaries (the Contributionship) which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of operations, comprehensive income (loss), equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Philadelphia Contributionship Mutual Holding Company and its subsidiaries as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Emphasis of Matters*

As discussed in Note 1 to the consolidated financial statements, on January 1, 2019, the Company adopted Accounting Standards Codification Topic 606 as required by Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606) and its related amendments as well as Accounting Standards Codification Topic 825 as required by Accounting Standards Update 2016-01, Financial Instruments. Our opinion is not modified with respect to these matters.

*Report on Required Supplemental Information*

Accounting principles generally accepted in the United States of America require that the certain information for years 2013 – 2018 related to the Contributionship's liability for losses and loss expense reserves, included in Note 4 on pages 33 – 36 supplement the financial statements. Such information is required by the Financial Accounting Standards Board who considers it to be an essential part of financial reporting for placing the consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's response to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



Philadelphia, Pennsylvania

March 2, 2020

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## DIRECTORS & OFFICERS

### DIRECTORS

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*President, S. M. Jenkins & Co.*  
*General Partner, Jenkins Partners, L.P.*

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*Founder, Eastern Insurance*  
*Holdings, Inc.*

Ira H. Fuchs  
*President, BITNET, LLC*

Phoebe A. Haddon, J.D., LL.M.  
*Chancellor, Rutgers University —*  
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*President & CEO, Empire Abrasive*  
*Equipment Company*  
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Andrew L. Lewis, IV  
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*Corporation*

Alfred W. Putnam, Jr.  
*Chairman Emeritus, Drinker Biddle*  
*and Reath LLP*

Christina T. Webber  
*Former President & CEO, The*  
*Philadelphia Contributionship*  
*Consultant*

Marna C. Whittington, Ph.D.  
*Retired Investment Executive*

### HONORARY DIRECTORS

Craig N. Johnson  
Mary Patterson McPherson, Ph.D.  
Thomas B. Morris, Jr., Esquire  
Kaighn Smith, M.D.  
Bernard C. Watson, Ph.D.  
Minturn T. Wright, III, Esquire

### OFFICERS

Scott M. Jenkins,  
*Chairman*

Thomas Greenfield,  
*President & CEO*

Kevin L. Tate,  
*Vice President, CFO and Treasurer*

Stephen A. McGowan,  
*Assistant Vice President, Controller*  
*and Assistant Treasurer*

Stacey M. Manzo,  
*Assistant Vice President, Secretary*

### ANNUAL MEETING

*The 268th Annual meeting of the*  
*Members of the Company will be*  
*held on Monday, April 27, 2020, at*  
*11:00 a.m. at the Company's office.*



# The Philadelphia Contributionship

DEPENDABLE INSURANCE PARTNERS SINCE 1752

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