



EXPANDING OUR REACH
WITH NEW TECHNOLOGY

THE PHILADELPHIA
CONTRIBUTIONSHIP

262nd Annual Report

2014



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 predominantly urban 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 and Maryland. 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 the ninth largest security company in the United States. Vector provides electronic security to the commercial and residential markets including detection for fire and burglary, video, access control, environmental monitoring, home automation and commercial analytics. Subsidiary Vector Intelligent Solutions provides VISA PCI DDS validated customized managed network services. Product and service offerings include security, fire alarm, video, access control, electronic article surveillance, medical alerts, uniformed guards, asset tracking, broadband and broadband-enabled services, network deployment, network management and mobile applications. Vector has received numerous awards for its outstanding quality of service and has earned a reputation as an industry leader.

OUR MISSION

THE PHILADELPHIA CONTRIBUTIONSHIP

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is committed to providing insurance protection for the urban community and surrounding areas. We are dedicated to producing an underwriting profit by providing responsive insurance services to our members and policyholders as well as maintaining a stable market for our agency partners. We value our employees and are committed to providing them professional development opportunities. We will continue to support the community that we've been a part of since 1752.



LETTER TO POLICY HOLDERS

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Spread of risk and ease of doing business are fundamental components of our business. In 2014, The Philadelphia Contributionship combined both concepts into one important strategic step that is designed to reduce our enterprise risk. During the year, the insurance operation obtained approval to do business in Maryland, thus expanding our geographic footprint and, as we grow in Maryland, further diversifying our exposure. At the same time, our staff worked diligently to prepare a completely new technology platform that is designed to make it easier for our agency partners to place business with us and to improve our internal efficiency and effectiveness. And so, on June 2, 2014, exactly 262 years from the date we issued our first policy, we sold our first policy in Maryland. We did so using our new system, which we branded “The Key”.

Both expansion into Maryland and the initial introduction of The Key in a new state, were decisions that were grounded in our enterprise risk management approach. Continued geographic diversification brings a spread of risk that makes us less vulnerable to the impacts of localized severe weather. The introduction of new technology, initially in a new state, reduces implementation risk since there are no existing policies impacted and no existing agency behaviors that must be changed. We are pleased to report that the system launch in Maryland went smoothly.

We are also happy to report that the 2014 performance of The Philadelphia Contributionship’s insurance and security operations helped to further strengthen our already solid financial position. Net income from combined operations was \$18.5 million in 2014.

INSURANCE GROUP OPERATIONS

The winter of 2014 was harsh with heavy snow and severely cold temperatures that took its toll on our underwriting results. In total, we incurred nine catastrophic weather events in 2014 that generated nearly 3,000 claims and resulted in over \$21 million of losses and loss

adjustment expenses. Once again, The Philadelphia Contributionship answered the call and provided a high level of claims service to those policyholders that were impacted by these events.

Direct written premium grew 3.2% in 2014 to \$138.5 million in spite of a 3.5% decline in the number of policies we insured. That premium growth was generated primarily from rate increases and from expansion into territories that help to diversify our exposure. Net written premium in 2014 was \$123.7 million, up 3.5% over 2013. Net premiums earned for 2014 were \$121.9 million, up 4.3%.

Gross income from the investment portfolio was \$10.8 million in 2014 compared to \$10.5 million in 2013. Net realized gains on investments were \$27.3 million during 2014 compared to \$9.6 million in 2013.

In total, revenue from insurance operations for the year ending December 31, 2014 was \$160.0 million compared to \$136.9 million for 2013, an increase of 16.9%.

Losses and loss adjustment expenses were up 41.4% from the prior year due primarily to a significant increase in losses from weather catastrophes. In total, 2014 losses and loss adjustment expenses were \$101.1 million compared to \$71.5 million in 2013.

Underwriting expenses were up 1.2% in 2014 to \$34.1 million and investment expenses increased 9.0% to \$2.5 million consistent with the performance of our investment portfolio.

Finally, we continued our consistent record of returning capital to our members with dividend payments totaling \$1.0 million.

Overall, the insurance operation produced income before income taxes of \$21.8 million in 2014 compared to \$28.8 million in 2013.

The Philadelphia Contributionship's legacy of financial strength was again recognized by AM Best Company when, it affirmed our A+ (Superior) financial strength rating for the 14th consecutive year. With 92 consecutive years rated A (Excellent) or better, we stand ready to meet the commitments we make to our policyholders.

SECURITY GROUP OPERATIONS

Vector Security, Inc. experienced 12.5% revenue growth in 2014. Service, central station and managed network services segments all showed positive growth for the year. Installation revenue was down as a result of three large customers that cut back new store expansions and substantially reduced their year-over-year spending. We added twenty-four new retailers in 2014 which will allow us to continue to diversify our revenue sources in 2015 and the years that follow.

Total revenue for 2014 was \$288.2 million compared to revenue of \$256.2 million in 2013. Earnings before interest, taxes, depreciation and amortization (EBITDA) were \$53.6 million in 2014 compared to \$50.4 million in 2013. Income before taxes for the security operation in 2014 was \$4.4 million.

Due to declining margins and additional future costs associated with the Affordable Care Act, the decision was made to divest of our patrol business, The Jupiter Group, Inc., the entity that operated as Vector Security Patrol. The sale was made to United Alarm Security, LLC, whose primary business is providing guard services, resulting in all but three employees being retained post sale. The divestiture occurred in May and resulted in a \$2.9 million gain.

We continue to execute on our residential strategy of increasing organic growth through leased package systems. Our package offerings include security, fire, cameras, locks and thermostats. We launched our company store in 2014 to allow the purchase of alarm systems on-line for individuals that want professional installation and monitoring, but do not want the in-home sales experience.

We continue to integrate our managed network services entity, Vector Intelligent Solutions, with our National Accounts Division. The ability to provide the network infrastructure as part of a bundled solution

with our security products has been positively received by customers and prospects in the retail space. We continue to lead the security industry with this comprehensive offering, at a time when retailers are demanding more network capacity in order to deliver the omni-channel customer experience.

Our comprehensive offering of products and services for both the residential and commercial markets allows us to continue to be a competitive force in the growing security, home automation and managed service space.

CONSOLIDATED BALANCE SHEET

Our consolidated balance sheet gained strength in 2014. Total assets as of December 31, 2014 increased to \$787.6 million. Liabilities declined 3.1% to \$422.1 million. As a result, total equity as of December 31, 2014 is \$342.6 million —up 6.3% from the end of 2013.

The Philadelphia Contributionship is in outstanding financial condition and is well-positioned to meet the insurance and security needs of our members and all of our customers.

On behalf of the Board of Directors, our officers and our dedicated employees, we thank our loyal customers for placing their confidence in The Philadelphia Contributionship to meet your insurance and security needs.



Scott M. Jenkins
Chairman of the Board



Robert G. Whitlock, Jr., FCAS, MAAA
President and Chief Executive Officer



CONSOLIDATED FINANCIAL STATEMENTS

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CONSOLIDATED BALANCE SHEET
DECEMBER 31, 2014 AND 2013

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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ASSETS	2014	2013
INSURANCE GROUP ASSETS		
Investments:		
Fixed income securities	\$146,915	\$ 147,464
Convertible bonds	10,785	10,624
Preferred stocks	2,194	2,477
Convertible preferred stocks	1,665	1,564
Common stocks	236,359	243,176
Other invested assets	25,269	4,587
	423,187	409,892
Cash and cash equivalents	13,204	9,039
Reinsurance recoverable and receivable	18,428	29,250
Prepaid reinsurance premiums	1,957	2,018
Premiums receivable	9,101	9,197
Other receivables	763	675
Accrued income from investments	1,591	1,595
Deferred acquisition costs	13,728	13,136
Property and equipment, net	7,259	6,185
Other assets	732	238
Total Insurance Group assets	489,950	481,225
SECURITY GROUP ASSETS		
Current assets:		
Cash and cash equivalents	701	1,236
Trade accounts receivable, less allowance for doubtful accounts of \$1,420 in 2014 and \$1,239 in 2013	25,704	23,013
Unbilled revenue	10,624	11,904
Inventories	4,657	4,544
Prepaid expenses and other current assets	5,817	2,994
Deferred income taxes	1,093	—
Income taxes receivable	880	451
Total current assets	49,476	44,142
Property and equipment, net	23,216	22,194
Intangible assets, net	166,425	174,138
Goodwill	39,722	44,364
Deferred income taxes	17,226	15,431
Other noncurrent assets	1,600	2,148
Total Security Group assets	297,665	302,417
Total assets	\$ 787,615	\$783,642

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED BALANCE SHEET
DECEMBER 31, 2014 AND 2013

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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LIABILITIES AND EQUITY	2014	2013
INSURANCE GROUP LIABILITIES		
Unpaid losses and loss adjustment expenses	\$ 93,536	\$101,366
Unearned premiums	72,586	70,763
Advance premiums	2,871	3,060
Deposit premiums	16,352	16,297
Deferred income taxes	30,472	29,863
Income taxes payable	78	861
Ceded premium payable	296	311
Other liabilities	8,155	7,769
Total Insurance Group liabilities	224,346	230,290
SECURITY GROUP LIABILITIES		
Current liabilities:		
Current maturities of long-term debt	3,332	2,110
Accounts payable and accrued expenses	23,816	22,054
Customer deposits	1,134	932
Unearned revenue	10,070	9,934
Purchase holdbacks	3,983	2,901
Deferred income taxes	—	870
Total current liabilities	42,335	38,801
Long-term debt, less current maturities	150,892	160,608
Long-term purchase holdbacks	1,173	2,507
Interest rate swap payable	450	661
Other long-term liabilities	2,908	2,659
Total Security Group liabilities	197,758	205,236
Total liabilities	422,104	435,526
REDEEMABLE NONCONTROLLING INTEREST (NOTE 8)	22,919	25,710
EQUITY		
Unassigned equity	282,643	261,843
Accumulated other comprehensive income	59,949	60,563
Total equity	342,592	322,406
Total liabilities and equity	\$787,615	\$783,642

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENT OF OPERATIONS
YEARS ENDED DECEMBER 31, 2014 AND 2013

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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	2014	2013
INSURANCE GROUP		
Revenue:		
Net premiums earned	\$121,858	\$116,818
Gross investment income	10,757	10,461
Net realized gains on investments	27,340	9,595
Total revenue	159,955	136,874
Losses and expenses:		
Losses and loss adjustment expenses	101,085	71,509
Underwriting expenses	34,078	33,658
Investment expenses	2,496	2,289
Total losses and expenses	137,659	107,456
Income before other income, dividends to policyholders, and income tax expense	22,296	29,418
Other income, net	468	367
Dividends to policyholders	(993)	(993)
Insurance Group income before income tax expense	21,771	28,792
SECURITY GROUP		
Revenue	288,175	256,204
Cost of sales	173,569	146,470
Gross profit	114,606	109,734
Operating expenses:		
Selling, general, and administrative	64,080	59,616
Acquisition-related costs	39	877
Depreciation	8,528	7,738
Amortization and impairment of intangible assets and goodwill	35,459	30,763
Total operating expenses	108,106	98,994
Operating income	6,500	10,740
Other:		
Interest expense	(5,161)	(4,963)
Other income, net	161	265
Gain on business divestiture	2,888	—
	(2,112)	(4,698)
Security Group income before income tax expense	4,388	6,042
Income before income tax expense	26,159	34,834
Income tax expense	8,555	11,449
Net income	17,604	23,385
Less: Net loss attributable to redeemable noncontrolling interest	(911)	(313)
Net income attributable to the Company	\$ 18,515	\$ 23,698

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2014 AND 2013

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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	2014	2013
Net income	<u>\$ 17,604</u>	<u>\$23,385</u>
Other comprehensive income net of tax:		
Unrealized gains (losses) on securities available-for-sale:		
Unrealized net holding gains arising during the year (net of tax of \$9,563 in 2014 and \$15,552 in 2013)	17,760	28,883
Less: reclassification adjustment for net realized gains included in net income (net of tax of \$9,675 in 2014 and \$3,432 in 2013)	<u>17,968</u>	<u>6,374</u>
	<u>(208)</u>	<u>22,509</u>
Cash flow hedge:		
Change in fair value of cash flow hedge (net of tax of \$(143) in 2014 and \$(5) in 2013)	(266)	(9)
Less: reclassification adjustment for settlement of cash flow hedge included in net income (net of tax of \$(217) in 2014 and \$(206) in 2013)	<u>(403)</u>	<u>(382)</u>
	<u>137</u>	<u>373</u>
Defined benefit pension plan:		
Change in actuarial assumptions	(897)	532
Asset gain and amortization of net loss	237	618
Experience gain (loss)	<u>117</u>	<u>(38)</u>
Defined benefit pension plan, net actuarial gain (loss) arising during the year (net of tax of \$(292) in 2014 and \$599 in 2013)	<u>(543)</u>	<u>1,112</u>
Other comprehensive income (loss)	<u>(614)</u>	<u>23,994</u>
Comprehensive income	<u>16,990</u>	<u>47,379</u>
Less: Comprehensive loss attributable to redeemable noncontrolling interest	<u>(911)</u>	<u>(313)</u>
Comprehensive income attributable to the Company	<u><u>\$ 17,901</u></u>	<u><u>\$ 47,692</u></u>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENT OF EQUITY
YEARS ENDED DECEMBER 31, 2014 AND 2013

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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	Unassigned Equity	Accumulated Other Comprehensive Income	Total
BALANCE, JANUARY 1, 2013	\$238,458	\$36,569	\$275,027
Net income attributable to the Company (1)	23,698	—	23,698
Loss attributable to redeemable noncontrolling interest	(313)	—	(313)
Other comprehensive income, net of tax	—	23,994	23,994
BALANCE, DECEMBER 31, 2013	261,843	60,563	322,406
Net income attributable to the Company (1)	18,515	—	18,515
Unit adjustment of redeemable noncontrolling interest	2,285	—	2,285
Other comprehensive loss, net of tax	—	(614)	(614)
BALANCE, DECEMBER 31, 2014	<u>\$282,643</u>	<u>\$59,949</u>	<u>\$342,592</u>

(1) Net income for December 31, 2014 and 2013 excludes \$(911) and \$(313), respectively, allocable to the redeemable noncontrolling interest, which, is reported in the mezzanine section of the consolidated balance sheets at December 31, 2014 and 2013. See Note 8 to the consolidated financial statements for further detail.

CONSOLIDATED STATEMENT OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2014 AND 2013

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

	2014	2013
CASH FLOW FROM OPERATING ACTIVITIES		
Net income	\$ 17,604	\$23,385
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized gains on investments	(27,340)	(9,595)
Depreciation and amortization	46,568	40,707
Deferred income taxes	(2,816)	(2,583)
Gains on disposals of property and equipment	(149)	(172)
Gains on divestiture of business	(2,888)	—
Change in assets and liabilities, net of effects of acquisitions:		
Reinsurance recoverable and receivable	10,822	68,717
Prepaid reinsurance premiums	61	1
Premiums receivable	96	467
Accrued income from investments	4	(85)
Deferred acquisition costs	(592)	185
Unpaid losses and loss adjustment expenses	(7,830)	(68,315)
Unearned premiums	1,823	2,711
Advance premiums	(189)	752
Deposit premiums	55	(462)
Other liabilities and ceded premium payable	(1,210)	(4,112)
Income taxes and other receivables	(517)	338
Prepaid expenses and other assets	(3,134)	(823)
Trade accounts receivable, unbilled revenue, and inventories	(2,240)	(2,532)
Accounts payable, accrued expenses and purchase holdbacks	2,032	(100)
Unearned revenue and customer deposits	338	(1,315)
Net cash provided by operating activities	\$30,498	\$ 47,169

CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)
YEARS ENDED DECEMBER 31, 2014 AND 2013

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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	2014	2013
CASH FLOW FROM INVESTING ACTIVITIES		
Cash paid for acquisitions, net of cash received	\$(23,611)	\$(48,167)
Purchases of property, plant and equipment	(10,000)	(10,880)
Proceeds from disposals of property and equipment	174	187
Proceeds from divestiture of business, net	3,867	—
Purchases of fixed income securities	(17,177)	(50,072)
Purchases of convertible bonds	(5,182)	(6,747)
Purchases of common stocks	(50,630)	(55,584)
Purchases of convertible preferred stocks	(201)	(266)
Purchases of other invested assets	(20,599)	(764)
Proceeds from sales of fixed income securities	10,910	28,609
Proceeds from sales of convertible bonds	5,558	5,266
Proceeds from maturities/calls of fixed income securities	10,429	12,377
Proceeds from the sales of common stocks	79,023	50,067
Proceeds from the sales of convertible preferred stocks	121	371
Proceeds from capital distributions of other invested assets	406	416
Net cash used in investing activities	(16,912)	(75,187)
CASH FLOW FROM FINANCING ACTIVITIES		
Proceeds from revolving credit agreements	53,992	111,313
Payments on revolving credit agreements	(62,663)	(86,332)
Cash paid for debt issuance costs	—	(588)
Contributions from noncontrolling interest, net	405	—
Principal payments on capital leases	(1,690)	(1,478)
Net cash (used in) provided by financing activities	(9,956)	22,915
Net increase (decrease) in cash and cash equivalents	3,630	(5,103)
CASH AND CASH EQUIVALENTS, BEGINNING	10,275	15,378
CASH AND CASH EQUIVALENTS, ENDING	\$ 13,905	\$ 10,275
SUPPLEMENTARY CASH FLOWS INFORMATION		
Interest paid	\$ 4,414	\$ 4,516
Income taxes paid	\$ 10,510	\$ 11,000
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
In conjunction with acquisitions, the Security Group:		
Recorded purchase holdbacks	\$ 1,595	\$ 4,981
Recorded purchase price adjustments	\$ —	\$ (67)
Capital leases	\$ 1,867	\$ 2,079

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

(DOLLARS IN THOUSANDS UNLESS OTHERWISE NOTED)

Note 1: 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., The Jupiter Group, Inc. (Patrol), Vector International Holdings, Inc., Vector Security Canada, Inc., and Vector Security de Mexico, S.A. de C.V., as well as partially owned subsidiary Vector Intelligent Solutions, LLC (VIS), of which Vector owns 72% of the outstanding membership units (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 and Maryland. The Insurance Group had approximately 122,000 policyholders at December 31, 2014.

Vector sells, installs, services, and manages security systems 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 has approximately 288,000 residential and commercial customers as of December 31, 2014 located primarily in Pennsylvania, Ohio, New Jersey, Maryland, Virginia, New York, West Virginia, Delaware, Massachusetts, North Carolina, South Carolina, Florida, California, and Washington, DC to which it provides security monitoring services and other services. Vector also has several large national commercial accounts to which it provides equipment and installation and monitoring, and managed network services. No such customer accounted for more than 10% of the December 31, 2014 and 2013 trade accounts receivable balance, respectively.

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 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 calculated on the monthly pro rata basis.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2014 AND 2013

(DOLLARS IN THOUSANDS UNLESS OTHERWISE NOTED)

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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, 2014 and 2013 were determined to be recoverable.

Liability for Unpaid Losses and Loss Adjustment Expenses

The liability for unpaid losses and loss adjustment expenses includes management's best estimate for the ultimate net cost of all reported and unreported losses and loss adjustment expenses incurred through December 31.

The Insurance Group believes that the liability for losses and loss adjustment expenses is adequate to provide for the ultimate cost of losses and loss adjustment expenses, but this liability is necessarily based on estimates, and the amount ultimately paid may vary significantly from such estimates. Those estimates are subject to the effects of trends in loss severity and frequency. This liability is continually reviewed and changes in estimates are reflected in earnings currently.

Investments

All fixed income securities, preferred and common stocks 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 specifically identify individual securities that have incurred an other-than-temporary decline in fair value below cost or 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 and included as a component of accumulated other comprehensive income in the consolidated balance sheet. For preferred and common stocks, the cost of the security is adjusted and recognized as a realized loss in the statement of operations.

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.

Dividends and interest income are 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2014 AND 2013

(DOLLARS IN THOUSANDS UNLESS OTHERWISE NOTED)

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Other Invested Assets

Other invested assets consist of investments in limited partnerships that invest in oil and gas interests and equity securities of public and privately held companies. These investments are classified as available-for-sale investments and are carried at fair value. Net unrealized gains (losses) are reported as a component of accumulated other comprehensive income. See Note 3 for more information on the determination of fair value.

The Company reviews other invested assets in its investment portfolio on a periodic basis to specifically identify individual securities that have incurred an other-than-temporary decline in fair value below cost. This review encompasses, among other things, recent issuer activities, such as defaults, quarterly earnings announcements, and other pertinent financial news for the issuer, recent developments and economic outlooks for particular industries, rating agency actions, and the length of time and extent to which fair value has been less than cost. When management's review identifies an other-than-temporary impairment in the valuation of a security, a realized loss is recognized in the consolidated statement of operations.

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 and comprehensive income.

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 \$8,554 and \$7,371 at December 31, 2014 and 2013, respectively. Depreciation is provided using the straight-line method over the estimated useful lives of depreciable assets. Land is not subject to depreciation.

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:

	2014	2013
Land	\$ 200	\$ 200
Buildings and improvements	4,098	4,277
Home security package systems	32,936	30,259
Furniture and fixtures	4,437	4,939
Vehicles and equipment	19,231	20,340
Construction-in-progress	144	24
	61,046	60,039
Less accumulated depreciation	(37,830)	(37,845)
Total Property and Equipment	\$23,216	\$22,194

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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.

Vector's 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.

Inventories

Inventories, consisting primarily of security equipment, are stated at the lower of average cost or market.

Intangible Assets

Goodwill represents the excess purchase price over the fair value of the net identifiable assets acquired. Goodwill was tested for impairment as of December 31, 2014 and 2013, and no impairment was identified.

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 a long-lived 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 cash flows, an impairment is recognized to the extent that the carrying value exceeds its estimated fair value. Vector recorded impairment expense, through amortization, on their customer service agreements of \$2,499 and \$2,538 during 2014 and 2013, respectively.

Customer service agreements, which have been acquired through Vector's authorized dealer program or as a result of an acquisition, are amortized on a straight-line basis over periods ranging from 10 to 13 years.

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.

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

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

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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.

Redeemable Noncontrolling Interest

On August 15, 2013, Vector issued membership interest units to Industry Retail Group, LLC (IRG), the noncontrolling interest holder of VIS, that is redeemable either at the option of the holder or upon the occurrence of an event that is not solely within Vector's control. Under the terms of an agreement related to the IRG acquisition, the noncontrolling interest holder has the right to require Vector to purchase its 28% interest in Vector's subsidiary for an amount equal to a specified multiple of trailing twelve-month gross margin multiplied by the noncontrolling interest holder's percentage interest in Vector's subsidiary at the time of redemption. The noncontrolling interest becomes redeemable within 10 days after the earliest of the third anniversary of the date of the acquisition and every anniversary thereafter or the date on which certain principals of IRG no longer control IRG. The conditions for redemption of the noncontrolling interest had not been met as of December 31, 2014.

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, 2014 or 2013.

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 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.

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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.

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 loan fees and other related costs incurred in obtaining the debt financing currently in place, which are being amortized over the term of the related debts.

Comprehensive Income

Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale 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 reflected in the consolidated statement of comprehensive income.

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, 2013	\$39,807	\$(800)	\$(2,438)	\$36,569
Current year other comprehensive income	22,509	373	1,112	23,994
Balance, December 31, 2013	62,316	(427)	(1,326)	60,563
Other comprehensive income before reclassifications	17,760	540	(574)	17,726
Amounts reclassified from accumulated other comprehensive income	(17,968)	(403)	31	(18,340)
Balance, December 31, 2014	\$62,108	\$(290)	\$(1,869)	\$59,949

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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, 2014.

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	AMOUNT RECLAS- SIFIED FROM AC- CUMULATED OTHER COMPREHENSIVE INCOME	AFFECTED LINE ITEM IN THE CONSOLI- DATED STATEMENT OF OPERATIONS
Unrealized gain on securities available for sale		
Realized gains on sale of securities	\$ 27,635	NET REALIZED GAINS ON INVESTMENTS
Impairment charges	8	NET REALIZED GAINS ON INVESTMENTS
Gains on cash flow hedges		
Interest rate derivative contracts	620	INTEREST EXPENSE
Change in retirement plan liabilities adjustment		
Amortization of actuarial losses	(48)	(a)
Total reclassifications before income tax expense	<u>28,215</u>	
Less: Income tax expense	<u>9,875</u>	
Total reclassifications net of income tax expense	<u>\$ 18,340</u>	

(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

On January 1, 2014, the Company adopted the provisions of Financial Accounting Standards Board (FASB) issued ASU No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. ASU 2013-02 requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated comprehensive income by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. ASU 2013-02 does not change the requirements for reporting net income or other comprehensive income in financial statements. The adoption of ASU No. 2013-02 did not have an effect on the Company's consolidated financial statements.

On January 1, 2013, Vector adopted the provisions of FASB ASU No. 2014-02, Intangibles – Goodwill and Other (Topic 350): Accounting for Goodwill (a consensus of the Private Company Council). ASU No. 2014-02 allows private companies an alternative to amortize goodwill on a straight-line basis over a ten-year period, or less if the company demonstrates that another useful life is more appropriate. In addition, private companies are allowed to use a simplified impairment model to evaluate goodwill. The accounting alternative, which has been elected by Vector, should be applied prospectively to goodwill existing as of the beginning of the period of adoption and new goodwill. The adoption of ASU No. 2014-02 resulted in a \$4,642

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22 and \$2,056 reduction to goodwill in 2014 and 2013, respectively, with an offsetting amount recorded to amortization expense.

In January 2014, the FASB issued ASU No. 2014-03, Derivatives and Hedging (Topic 815): Accounting for Certain Receive Variable, Pay Fixed Interest Rate Swaps – Simplified Hedge Accounting Approach (a consensus of the Private Company Council). ASU 2014-03 provides private companies the option to apply the simplified hedge accounting approach for interest rate swaps that are entered into for the purpose of economically converting variable rate interest payments to fixed rate payments. The guidance will help reduce the cost and complexity associated with interest rate swaps and will reduce volatility in private companies' income statements. This alternative guidance is not permitted for public companies or not for profit organizations. Early application is permitted, including application to any period for which the entity's annual financial statements have not yet been made available for issuance. The Company has implemented the provisions of ASU 2014-03 as of January 1, 2014. The adoption of ASU 2014-03 did not have a material effect on the Company's consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements – Going Concern (Subtopic 205-40). ASU 2014-15 provides guidance to all entities on management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The guidance is effective for annual reporting periods ending after December 15, 2016. ASU 2014-15 did not have an effect on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 provides guidance to all entities in order to establish a common revenue standard for companies entering into contracts with customers for the transfer of goods or services or entering into contracts for the transfer of nonfinancial assets. The guidance in this update is that entities should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which entity expects to be entitled in exchange for those goods or services. The guidance is effective for annual reporting periods beginning after December 15, 2017. The Company is in the process of evaluating the impact of this guidance on contracts entered into with customers and future revenue recognition.

In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360). ASU 2014-08 provides guidance for entities which dispose of assets or components upon which the disposal represents a strategic shift that has or will have a major effect on an entity's operations, requiring those disposals to be presented as discontinued operations. The guidance is effective for disposals of an entity that occur within annual periods beginning on or after December 15, 2014. The Company considered ASU 2014-08 in its disposal of Patrol, determining the sale of assets of Patrol (Note 8) do not represent a strategic shift that will have a major impact on the Company's operations.

Subsequent Events

In preparing these consolidated financial statements, management has evaluated events and transactions for potential recognition or disclosure through March 2, 2015, the date the consolidated financial statements were available to be issued.

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Note 2: Investments

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

	2014			
	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	\$ 9,930	\$ 1,495	\$ (23)	\$ 11,402
Obligations of states and political subdivisions	54,246	3,563	(5)	57,804
Corporate securities	29,103	1,733	(31)	30,805
Mortgage-backed and asset- backed securities	45,233	1,888	(217)	46,904
Total fixed income securities	138,512	8,679	(276)	146,915
Preferred stocks	2,277	203	(286)	2,194
Common stocks	149,749	89,217	(2,607)	236,359
Other invested assets	24,649	620	—	25,269
Total	\$315,187	\$98,719	\$(3,169)	\$410,737
	2013			
	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	\$ 16,500	\$ 1,093	\$ (435)	\$ 17,158
Obligations of states and political subdivisions	50,850	2,465	(990)	52,325
Corporate securities	28,700	1,337	(174)	29,863
Mortgage-backed and asset- backed securities	47,213	1,699	(794)	48,118
Total fixed income securities	143,263	6,594	(2,393)	147,464
Preferred stocks	2,277	633	(433)	2,477
Common stocks	151,838	92,585	(1,247)	243,176
Other invested assets	4,456	131	—	4,587
Total	\$301,834	\$99,943	\$(4,073)	\$397,704

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The amortized cost and estimated fair value of fixed income securities and convertible bonds at December 31, 2014, 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.

	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	\$ 3,141	\$ 3,309
Due after one year through five years	22,921	23,701
Due after five years through ten years	38,603	41,576
Due after ten years	38,336	42,210
	<u>103,001</u>	<u>110,796</u>
Mortgage-backed and asset-backed securities	45,233	46,904
Total	<u><u>\$148,234</u></u>	<u><u>\$157,700</u></u>

Net realized gains on investments consisted of the following:

	2014	2013
Realized gains on investments	\$ 29,748	\$ 11,245
Realized losses on investments	(2,149)	(2,178)
Change in fair value of convertible securities	(247)	617
Foreign currency transaction gains	25	65
Foreign currency transaction losses	(29)	(57)
Other-than-temporary impairment charges	(8)	(97)
	<u><u>\$ 27,340</u></u>	<u><u>\$ 9,595</u></u>

All of the other-than-temporary impairment charges noted above were related to mortgage-backed and asset-backed securities.

The Company had on deposit, as required by various state regulatory agencies, fixed income securities with a fair value of \$3,232 and \$3,783 and cash equivalents of \$164 and \$152 at December 31, 2014 and 2013, respectively.

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As of December 31, 2014 and 2013, the Company's investment portfolio had gross unrealized losses of \$3,169 and \$4,073, 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:

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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
December 31, 2014:						
Fixed income securities:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 894	\$ (3)	\$ 1,437	\$ (20)	\$ 2,331	\$ (23)
Obligations of states and political subdivisions	272	—	1,085	(5)	1,357	(5)
Corporate securities	249	(27)	210	(4)	459	(31)
Mortgage-backed and asset-backed securities	1,547	(11)	13,540	(206)	15,087	(217)
Total fixed income securities	2,962	(41)	16,272	(235)	19,234	(276)
Preferred stocks	34	—	1,914	(286)	1,948	(286)
Common stocks	13,597	(1,921)	2,551	(686)	16,148	(2,607)
Total	\$16,593	\$(1,962)	\$20,737	\$(1,207)	\$37,330	\$(3,169)
	LESS THAN 12 MONTHS		12 MONTHS OR MORE		TOTAL	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES
December 31, 2013:						
Fixed income securities:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 6,117	\$ (283)	\$ (98)	\$ (152)	\$ 6,019	\$ (435)
Obligations of states and political subdivisions	12,170	(478)	2,674	(512)	14,844	(990)
Corporate securities	8,471	(157)	529	(17)	9,000	(174)
Mortgage-backed and asset-backed securities	18,478	(746)	423	(48)	18,901	(794)
Total fixed income securities	45,236	(1,664)	3,528	(729)	48,764	(2,393)
Preferred stocks	—	—	1,767	(433)	1,767	(433)
Common stocks	9,787	(973)	1,311	(274)	11,098	(1,247)
Total	\$55,023	\$(2,637)	\$ 6,606	\$(1,436)	\$61,629	\$(4,073)

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There were 82 and 81 fixed income securities in an unrealized loss position as of December 31, 2014 and 2013, respectively. In management's opinion, the unrealized losses on fixed income securities reflect general market conditions. Management believes that the unrealized losses are temporary. The Company does not intend to sell these securities prior to maturity or market recovery, and it is more likely than not the Company has the ability to hold these securities until maturity or market recovery. Management performed cash flow testing on its mortgage-backed and asset-backed securities and based on this cash flow testing all principal of these securities was deemed to be recoverable at December 31, 2014. There were 66 and 61 common and preferred stocks in an unrealized loss position as of December 31, 2014 and 2013, respectively. Management has the intent and ability to hold these common and preferred stocks to market price recovery of original cost.

Total other-than-temporary impairments for mortgage-backed and asset-backed securities for the years ended December 31, 2014 and 2013 were \$8 and \$97, respectively.

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:

- a. Quoted prices for similar assets or liabilities in active markets.
- b. 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 market makers (for example, some brokered markets) or in which little information is released publicly (for example, a principal-to-principal market).

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.

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Securities included in Level 3 are securities where inputs are based solely on a broker price or unobservable market data. The Company classifies its investment in other invested assets (limited partnership interests), 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, these investments are classified as Level 3 assets. Any withdrawal, transfer, or sale of the limited partnership interest is subject to the general partner's discretion. At December 31, 2014 and 2013, the fair value using net asset value for the Company's other invested assets were \$25,269 and \$4,587, respectively.

One investment in a limited partnership included in other invested assets comprising 81% 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 limited partnership included in other invested assets comprising 19% 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. 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.

There were no unfunded commitments related to any of the Company's limited partnership investments as of December 31, 2014 or 2013.

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The following table summarizes fair value measurements by level within the fair value hierarchy at December 31, 2014 and 2013 for assets and liabilities measured at fair value on a recurring basis:

2014				
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)
Assets				
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 11,402	\$ 7,512	\$ 3,890	\$ —
Obligations of states and political subdivisions	57,804	—	57,804	—
Corporate securities	30,805	—	30,805	—
Mortgage-backed and asset-backed securities	46,904	—	46,904	—
Total fixed income securities	146,915	7,512	139,403	—
Convertible bonds	10,785	—	3,076	7,709
Preferred stocks	2,194	—	1,636	558
Convertible preferred stocks	1,665	—	—	1,665
Common stocks	236,359	236,264	—	95
Other invested assets	25,269	—	—	25,269
	\$423,187	\$243,776	\$144,115	\$35,296
Liabilities				
Interest rate swap payable	\$ 450	\$ —	\$ 450	\$ —
2013				
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)
Assets				
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 17,158	\$ 13,666	\$ 3,492	\$ —
Obligations of states and political subdivisions	52,325	—	52,019	306
Corporate securities	29,863	—	29,863	—
Mortgage-backed and asset-backed securities	48,118	—	48,118	—
Total fixed income securities	147,464	13,666	133,492	306
Convertible bonds	10,624	—	376	10,248
Preferred stocks	2,477	—	1,928	549
Convertible preferred stocks	1,564	—	—	1,564
Common stocks	243,176	243,093	—	83
Other invested assets	4,587	—	—	4,587
	\$409,892	\$256,759	\$135,796	\$ 17,337
Liabilities				
Interest rate swap payable	\$ 661	\$ —	\$ 661	\$ —

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For fair value measurements using Level 3 inputs, a reconciliation of the beginning and ending balances is as follows at December 31:

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	2014						TOTAL
	FIXED INCOME SECURITIES	CONVERTIBLE BONDS	PREFERRED STOCKS	CONVERTIBLE PREFERRED STOCKS	COMMON STOCKS	OTHER INVESTED ASSETS	
Balance, January 1, 2014	\$306	\$10,248	\$549	\$1,564	\$83	\$ 4,587	\$ 17,337
Purchases	—	2,405	—	99	—	20,599	23,103
Sales	(292)	(4,192)	—	(113)	—	—	(4,597)
Distributions	—	—	—	—	—	(406)	(406)
Transfers in from Level 2	—	46	—	—	—	—	46
Transfers out to Level 2	—	(889)	—	—	—	—	(889)
Total gains (losses):							
Included in earnings (reported in net realized gains on investments)	(14)	91	—	115	—	—	192
Included in other comprehensive income	—	—	9	—	12	489	510
Balance, December 31, 2014	\$ —	\$ 7,709	\$558	\$1,665	\$95	\$25,269	\$ 35,296
	2013						TOTAL
	FIXED INCOME SECURITIES	CONVERTIBLE BONDS	PREFERRED STOCKS	CONVERTIBLE PREFERRED STOCKS	COMMON STOCKS	OTHER INVESTED ASSETS	
Balance, January 1, 2013	\$ —	\$ 7,704	\$435	\$1,559	\$76	\$ 3,874	\$ 13,648
Purchases	306	4,484	—	130	—	764	5,684
Sales	—	(3,515)	—	(337)	—	—	(3,852)
Distributions	—	—	—	—	—	(417)	(417)
Transfers in from Level 2	—	457	—	—	—	—	457
Transfers out to Level 2	—	(222)	—	—	—	—	(222)
Total gains:							
Included in earnings (reported in net realized gains on investments)	—	1,340	—	212	—	—	1,552
Included in other comprehensive income	—	—	114	—	7	366	487
Balance, December 31, 2013	\$306	\$10,248	\$549	\$1,564	\$83	\$ 4,587	\$ 17,337

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.

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The following table presents the carrying amounts and estimated fair values of the Company's financial instruments at December 31, 2014 and 2013. The fair value of a financial instrument is the amount that would be paid to transfer an asset or a liability in an orderly transaction between market participants at the measurement date.

	2014		2013	
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
Financial assets:				
Insurance Group				
Investments:				
Fixed income securities	\$146,915	\$146,915	\$ 147,464	\$ 147,464
Convertible bonds	10,785	10,785	10,624	10,624
Preferred stocks	2,194	2,194	2,477	2,477
Convertible preferred stocks	1,665	1,665	1,564	1,564
Common stocks	236,359	236,359	243,176	243,176
Other invested assets	25,269	25,269	4,587	4,587
Cash and cash equivalents	13,204	13,204	9,039	9,039
Other receivables	763	763	675	675
Accrued income from investments	1,591	1,591	1,595	1,595
Security Group:				
Cash and cash equivalents	701	701	1,236	1,236
Trade accounts receivable	25,704	25,704	23,013	23,013
Prepaid expenses and other current assets	5,817	5,817	2,994	2,994
Financial liabilities:				
Security Group:				
Accounts payable and accrued expenses	23,816	23,816	22,054	22,054
Customer deposits	1,134	1,134	932	932
Interest rate swap payable	450	450	661	661
Long-term debt and current maturities thereof	\$154,224	\$154,224	\$162,718	\$162,718

The carrying amounts shown in the table are included in the consolidated balance sheet under the indicated captions.

Cash and cash equivalents, other receivables, trade accounts receivable, accrued income from investments, accounts payable, and accrued expenses - the carrying amounts at face value approximate fair value because of the short maturity of these instruments.

Interest rate swap payable - Vector's determination of the fair value of its interest rate swap is calculated using a discounted cash flow analysis based on the terms of the swap contract and the observable interest rate curve (Level 2 inputs).

The fair values of the financial instruments shown in the above table as of December 31, 2014 and 2013 represent management's best estimates of the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the

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asset or liability at the measurement date, the fair value measurement reflects the Company's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Company based on the best information available in the circumstances.

The fair value of long-term debt is estimated by discounting the future cash flows of each issuance at rates that the Company could obtain similar debt instruments of comparable maturities.

The Company has assets and liabilities that are required to be recorded at fair value on a non-recurring basis when certain circumstances occur. In the case of intangible assets, upon the occurrence of an event or change in circumstance that may indicate that the fair value of a customer service agreement is less than its carrying value, the Company determines the fair value of the specific customer service agreement and records an impairment for the amount by which the carrying value exceeds the customer service agreement's fair value. The estimate of fair value of a customer service agreement is determined using Level 3 inputs, primarily an analysis of future expected cash flows. The Company recorded impairment expense, through amortization expense, on their customer service agreements of \$2,499 and \$2,538 during 2014 and 2013, respectively.

Note 4: Liability for Unpaid Losses and Loss Adjustment Expenses

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

	2014	2013
Balance as of January 1	\$101,366	\$169,681
Less reinsurance recoverable	<u>(27,304)</u>	<u>(92,322)</u>
Net balance at January 1	<u>74,062</u>	<u>77,359</u>
Incurred related to:		
Current year	104,893	81,216
Prior years	<u>(3,808)</u>	<u>(9,707)</u>
Total incurred	<u>101,085</u>	<u>71,509</u>
Paid related to:		
Current year	70,742	47,706
Prior years	<u>28,705</u>	<u>27,100</u>
Total paid	<u>99,447</u>	<u>74,806</u>
Net balance as of December 31	<u>75,700</u>	74,062
Plus reinsurance recoverable	<u>17,836</u>	<u>27,304</u>
Balance at December 31	<u>\$ 93,536</u>	<u>\$101,366</u>

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 2014 and 2013 by \$3,808 and \$9,707, respectively. The decrease in 2014 is due to better than expected development of losses incurred, primarily in the homeowners and special property lines of business, and primarily related to accident years 2012 and 2013. The decrease in 2013 is due to better than expected development of losses incurred, primarily in the homeowners and other liability lines of business, and primarily related to accident years 2011 and 2012.

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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 assumed premiums earned in 2014 and 2013 of \$57 and \$35, respectively, and ceded premiums earned in 2014 and 2013 of \$14,847 and \$14,686, respectively. Losses and loss adjustment expenses are net of reinsurance recoveries of \$(2,254) and \$22,463 in 2014 and 2013, respectively. Amounts paid to reinsurers related to the unexpired portion of reinsured contracts were \$1,957 and \$2,018 as of December 31, 2014 and 2013, respectively.

The Insurance Group had no significant concentration in risk from any one unaffiliated reinsurer as of December 31, 2014 and 2013.

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 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 2015, the maximum amount of dividends that can be paid by the Contributionship without such approval is \$24,497. The Contributionship paid no ordinary dividends during 2014 and 2013.

The surplus of the Contributionship and its subsidiaries, as determined in accordance with statutory accounting practices, is \$244,967 and \$234,838 at December 31, 2014 and 2013, respectively. The net income of the Contributionship and its subsidiaries, as determined in accordance with statutory accounting practices, is \$16,035 and \$20,130 for the years ended December 31, 2014 and 2013, 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, 2014 and 2013, the Contributionship and its subsidiaries maintained statutory-basis surplus in excess of the minimum prescribed risk-based capital requirements. As of December 31, 2014 and 2013, the Contributionship and its subsidiaries were in compliance with the minimum capital requirements under Commonwealth of Pennsylvania regulations.

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Note 7: Goodwill and Other Intangible Assets

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

	2014	2013
Balance as of January 1	\$44,364	\$ 5,044
Goodwill acquired during the year	—	41,376
Amortization	(4,642)	(2,056)
Balance as of December 31	<u>\$39,722</u>	<u>\$44,364</u>

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

	2014		2013	
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION
Customer service agreements	\$276,402	\$124,010	\$268,386	\$110,179
Customer relationships	10,460	1,106	10,460	302
Covenants not to compete	812	330	857	224
Covenants not to solicit	2,084	358	2,084	98
Technology	2,740	754	2,740	205
Trade Names	669	184	669	50
Other	—	—	342	342
Total	<u>\$293,167</u>	<u>\$126,742</u>	<u>\$285,538</u>	<u>\$111,400</u>

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

2015	\$32,942
2016	32,192
2017	30,926
2018	28,718
2019	25,569

Note 8: Acquisitions

Industry Retail Group

On August 15, 2013, Vector, through its VIS subsidiary, acquired selected assets of IRG. IRG provides virtual managed network services. As a result of the acquisition, Vector began cross-selling virtual managed network services to existing customers. Goodwill arising from the acquisition consisted largely of Vector's specific synergies related to cross-selling. The results of the IRG acquisition have been included in the consolidated financial statements since the acquisition date. The acquisition was accounted for as a business combination.

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

Consideration:	
Cash	\$27,737
Purchase holdback	3,227
Redeemable noncontrolling interest	25,710
	<hr/>
Fair value of total consideration transferred	<u>\$56,674</u>
Recognized amounts of identifiable acquired and liabilities assumed:	
Current assets	\$ 853
Intangible assets	16,561
Current liabilities	(2,116)
	<hr/>
Total identifiable net assets assumed	15,298
Goodwill	41,376
	<hr/>
Total	<u><u>\$56,674</u></u>

Of the acquired intangible assets, \$10,460 was assigned to customer relationships, which are amortized over 13 years, \$2,740 was assigned to technology, which is amortized over 5 years, \$2,084 was assigned to covenants not to solicit, which are amortized over 8 years, \$669 was assigned to trade names, which are amortized over 5 years, and \$608 was assigned to covenants not to compete, which are amortized over 5 years.

Funding for the acquisition consisted primarily of \$27,737 in borrowings on Vector's existing revolving credit facility, a purchase holdback with a fair value at the acquisition date of \$3,227, and issuance of 30% of the outstanding membership units of VIS to IRG (redeemable noncontrolling interest) with a fair value at the acquisition date of \$25,710. In August 2014, the purchase holdback was adjusted to \$3,558 based upon average monthly recurring charges billed to customers during the 12 months subsequent to the acquisition date. The payment of the purchase holdback is being made in 24 monthly installments of \$148 which began in September 2014.

In November 2014, IRG's membership units in VIS were decreased by 27,052 units based upon average monthly recurring charges billed to and collected from customers during the 12 months subsequent to the acquisition date, which resulted in an adjustment of \$2,285 to the redeemable noncontrolling interest with an offset to unassigned equity.

Included within Vector's membership units in VIS is a call option to purchase IRG's membership units based on a multiple of trailing twelve-month gross margin at the exercise date. Included within IRG's membership units in VIS is a put option to sell IRG's membership units based on a multiple of trailing twelve-month gross margin at the exercise date. The noncontrolling interest becomes redeemable within 10 days after the earliest of (i) the third anniversary of the date of the acquisition and every anniversary thereafter or (ii) the date on which certain principals of IRG no longer control IRG. Vector determined that the put/call option is embedded within the redeemable noncontrolling interest shares that are subject to the put/call option. Therefore, the put option is accounted for within redeemable noncontrolling interest in the consolidated balance sheet.

In accordance with ASC Topic 815, Vector initially measured the redeemable noncontrolling interest at fair value. The acquisition date fair value of IRG's redeemable noncontrolling interest in VIS was estimated by applying an income approach. This fair value measurement is based on significant inputs that are not observable in the market and thus represents a Level

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3 measurement. Key assumptions included a discount rate of 22.3% and the projected 12 month trailing gross margin on the third anniversary of the acquisition date.

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Subsequent measurement of the redeemable noncontrolling interest is the greater of the amount determined under ASC Subtopic 810-10 (adjusted carrying value) or ASC Section 480-10-S99 (redemption value). The noncontrolling interest was \$22,919 at December 31, 2014 as the adjusted carrying value exceeded the redemption value. During 2014, the carrying value of the redeemable noncontrolling interest was adjusted for the net loss of \$911 as well as contributions of \$450, tax distributions of \$45 related to IRG, and the unit adjustment of \$2,285 discussed above.

American Alert Corp and American Alert Monitoring Corp

On May 15, 2012, Vector acquired selected assets of American Alert Corp and American Alert Monitoring Corp (American) located in Geneva, Ohio for a purchase price of \$5,406. American provides residential and commercial security services. The results of American have been included in the consolidated financial statements since the acquisition date. The assets acquired represent approximately 5,000 customer accounts primarily in Geneva, Ohio. The acquisition was accounted for as a business combination.

The aggregate purchase price was \$5,406, which includes \$5,340 of intangible assets and \$226 of tangible and current assets, net of \$160 in current liabilities. Of the \$5,340 of intangible assets, \$5,338 was assigned to customer service agreements, which are amortized over 13 years, and \$2 was assigned to covenants not to compete, which are amortized over 5 years.

Funding for the acquisition consisted primarily of \$5,314 in borrowings on Vector's existing revolving credit facility and \$92 in the form of a purchase holdback. The payment of the purchase holdback is contingent upon attrition of accounts over the first six months with the payment to be made in January 2013. Any adjustment to the purchase price will result in a reduction to the intangible asset (customer service agreements) with an offsetting reduction to purchase holdbacks.

In 2013, Vector recorded a purchase price reduction of \$67 due to customer account attrition within the first six months, as provided in the asset purchase agreement. The adjustment was recorded as a \$67 reduction to intangible assets (customer service agreement) with an offsetting reduction to purchase holdbacks. Vector also paid \$25 to the sellers, which represented the final payment of the purchase holdback for the entire acquisition.

Certified Security Systems, LLC

On November 30, 2009, Vector acquired selected assets of Certified Security Systems, LLC (Certified) located in Jacksonville, Florida for a purchase price of \$16,023. Certified provides residential and commercial security services. The results of Certified have been included in the consolidated financial statements since the acquisition date. The assets acquired represent approximately 17,000 customer accounts primarily in Jacksonville, Ft. Lauderdale, and Tallahassee, Florida. The acquisition was accounted for as a business combination.

The aggregate purchase price was \$16,023, which included \$17,297 of intangible assets and \$382 of tangible and current assets, net of \$1,656 in current liabilities. Of the \$17,297 of intangible assets, \$17,247 was assigned to customer service agreements, which are amortized over 13 years, and \$50 was assigned to covenants not to compete, which are amortized over 5 years.

Funding for the acquisition consisted primarily of \$15,423 in borrowings on the Company's existing revolving credit facility and \$600 in the form of a purchase holdback. The payment of the purchase holdback was contingent upon attrition of accounts over the first year with the payment to be made in the first quarter of 2012. In the year of acquisition, Vector expensed the deal costs associated with this acquisition of \$559. Additionally, for four years following the closing of the transaction additional qualified monitoring contracts generated directly by the sellers will be purchased by the Company for a specified multiple of monthly recurring income. The sellers are

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under no obligation to generate any additional monitoring contracts under this provision. Vector will record any such future payments as additional customer service agreement intangible assets when such assets are acquired. On February 1, 2010, Vector acquired additional customer accounts (Supplemental Close) for an additional purchase price of \$1,309.

In 2011, Vector recorded a purchase price reduction of \$1,984 due to customer account attrition within the first year as provided in the asset purchase agreement. The adjustment was recorded as a reduction to intangible assets (customer service agreements) with a \$600 reduction to purchase holdbacks and a \$107 reimbursement for unearned revenue. Vector acquired additional customer accounts for an additional purchase price of \$786 with the payment applied against the purchase price reduction. Vector received a signed amendment to the asset purchase agreement that requires the sellers to repay the remaining \$491 in three equal annual installments.

In 2012, Vector acquired additional customer accounts for a purchase price of \$1,472 of which \$1,144 was paid to the sellers and \$328 was applied to the amount due from the sellers.

In 2013, Vector acquired additional customer accounts for a purchase price of \$145 with \$163 remaining due to Vector related to the 2011 purchase price reduction.

In 2014, Vector acquired additional customer accounts for a purchase price of \$2,380 of which \$2,217 was paid to the sellers and \$163 was applied to the amount due from sellers.

Others

Vector acquired selected accounts from various authorized dealers located in various states. The total purchase price for these accounts was \$20,515 and \$19,421 in 2014 and 2013, 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 14,000 accounts in 2014 and 14,000 accounts in 2013, and are primarily in Massachusetts, Pennsylvania, Maryland, Virginia, North Carolina, and South Carolina. The entire aggregate purchase price was assigned to customer service agreements, which are amortized over 10 years. Substantially all accounts are subject to a one-year holdback period in an amount equal to approximately 10% of the purchase price.

Patrol

On June 1, 2014, Vector sold certain assets and property of its wholly owned subsidiary Patrol to United American Security, LLC. Pursuant to the asset purchase agreement, Vector sold the interests of accounts receivable with a net book value of \$716 and certain property and equipment with a net book value of \$60 as of the closing date for a total purchase price of \$3,867. The following table summarizes the consideration received for assets of Patrol and their amounts of estimated fair value.

Consideration:	
Cash	\$3,357
Purchase holdback	510
	<hr/>
Fair value of total consideration transferred	\$3,867
	<hr/> <hr/>

Vector incurred \$203 in transaction related expenses which is recorded within gain on business divestitures in the consolidated statements of operations. As a result of the sale of certain assets and property, Vector recorded a gain of \$2,888 which is recorded within gain on business divestitures in the accompanying consolidated statements of operations.

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Note 9: Borrowings and Credit Arrangements

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

	2014	2013
Revolving credit facility - variable interest rate (2% as of December 31, 2014 and 2013)	\$151,013	\$159,684
Capital leases - bearing interest at rates ranging from 3% to 7% as of December 31, 2014 and 2013	3,211	3,034
	154,224	162,718
Less current maturities	(3,332)	(2,110)
Total long-term debt	\$150,892	\$160,608

During 2013, Vector refinanced its existing debt by obtaining a \$250,000 revolving credit facility that permits Vector to borrow, on a revolving basis, through July 31, 2018. Interest on the entire \$250,000 credit facility is computed at LIBOR plus a scaling interest rate premium based upon a total debt to cash flow ratio. Borrowings under this loan agreement are collateralized by Vector's assets, including the customer service agreements.

On August 1, 2012, Vector entered into a 47 month interest rate swap agreement with a notional amount of \$90,000. 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 of 0.835%. The fair value of the swap as of December 31, 2013 and 2012 was approximately \$450 and \$661, respectively, and was recorded as a liability in the consolidated financial statements. For the year ended December 31, 2014, \$620 was reclassified from accumulated other comprehensive income into interest expense.

Vector must pay a quarterly commitment fee of approximately 0.3% on the available unused portion of the credit facility. As of December 31, 2014, the available unused portion of the credit facility was \$96,239.

Under Vector's revolving credit facility, approximately \$2,748 were committed for outstanding letters of credit as of December 31, 2014 and 2013, respectively. There were no amounts drawn on the letters of credit as of December 31, 2014 and 2013.

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, 2014 and 2013, the Company was in compliance with all such covenants.

The aggregate maturities of debt principal for Vector as of December 31, 2014 are as follows:

2015	\$ 3,332
2016	1,112
2017	510
2018	149,270
2019	—
Total	\$154,224

The estimated fair value of Vector's long-term debt approximated the carrying value as of December 31, 2014.

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Note 10: Leases

Vector has various capital leases for equipment (Note 9) that expire at various dates during the next 40 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, 2014 are as follows:

2015	\$ 3,671
2016	3,537
2017	3,235
2018	2,500
2019	1,929
Thereafter	—
Total	<u>14,872</u>

Rent expense for leased equipment and office space totaled \$5,024 and \$4,532 for the years ended December 31, 2014 and 2013, respectively.

Note 11: Income Taxes

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

2014			2013		
<u>CURRENT</u>	<u>DEFERRED</u>	<u>TOTAL</u>	<u>CURRENT</u>	<u>DEFERRED</u>	<u>TOTAL</u>
<u>\$11,371</u>	<u>\$(2,816)</u>	<u>\$8,555</u>	<u>\$14,032</u>	<u>\$(2,583)</u>	<u>\$11,449</u>

The expected income tax expense for the years ended December 31 differed from the amounts computed by applying the U.S. federal income tax rate of 35% as follows:

	2014	2013
Computed "expected" income tax expense	\$9,162	\$12,196
Increase (decrease) in income taxes resulting from:		
Tax-exempt interest	(616)	(588)
Dividends received deduction	(962)	(892)
State taxes, net of federal benefit	259	313
Provision to return adjustments	295	47
Other, net	417	373
	<u>\$8,555</u>	<u>\$11,449</u>

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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:

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	2014	2013
Insurance Group:		
Deferred income tax asset components:		
Unearned premiums and advance premiums	\$ 5,145	\$ 5,026
Unpaid losses and loss adjustment expenses	1,585	1,858
Other-than-temporary impairments	1,376	1,501
Accrued pension liability	1,006	714
Deferred compensation	659	807
Other	207	217
Total deferred income tax asset	9,978	10,123
Deferred income tax liability components:		
Deferred acquisition costs	(4,805)	(4,598)
Unrealized investment gains	(33,441)	(33,555)
Unrealized investment gains on convertible securities	(473)	(559)
Other	(1,731)	(1,274)
Total deferred income tax liability	(40,450)	(39,986)
Net deferred income tax liability	\$(30,472)	\$(29,863)
Security Group:		
Deferred income tax asset components:		
Accrued expenses	\$ 2,732	\$ 2,682
Deferred rent	100	64
Inventories and accounts receivable	1,228	1,154
Interest rate swap	157	231
Intangible assets	20,930	18,940
Investments in VIS LLC	1,544	491
Total deferred tax asset	26,691	23,562
Deferred income tax liability components:		
Unbilled revenue	(3,968)	(4,516)
Property and equipment	(4,404)	(4,485)
Total deferred income tax liability	(8,372)	(9,001)
Net deferred income tax asset	\$ 18,319	\$ 14,561

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 taxable income during the periods in which those temporary differences become deductible. The amount of the deferred income tax asset considered realizable; however, could

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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.

Vector has no remaining state net operating loss carryforwards, as they have been utilized in offsetting state taxable income as of December 31, 2014.

The Company has no unrecognized tax benefits as of December 31, 2014.

There are no tax-related interest or penalties accrued on the consolidated balance sheet at December 31, 2014 and 2013, nor has any tax related interest or penalties been recognized in the consolidated statement of operations for the years ended December 31, 2014 and 2013.

The Company's federal income tax returns for tax years ended December 31, 2010 and prior are closed to examination.

Note 12: Employee Benefit Plans

Defined Benefit Pension Plan

The Insurance Group has a defined benefit pension plan (Plan) covering all employees meeting eligibility requirements. It is the Insurance Group's policy to fund pension costs in accordance with the funding requirements of the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code. The Insurance Group expects to pay contributions to the Plan during 2015 of \$300. The Insurance Group made \$271 and \$120 contributions to the Plan in 2014 and 2013, respectively.

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

	2014	2013
Interest cost	\$ 321	\$294
Expected return on plan assets	(458)	(391)
Amortization of net gain	48	122
Total net periodic benefit cost	<u>\$(89)</u>	<u>\$ 25</u>

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
DECEMBER 31, 2014 AND 2013

(DOLLARS IN THOUSANDS UNLESS OTHERWISE NOTED)

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:

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	<u>2014</u>	<u>2013</u>
Benefit obligation as of January 1	\$ 7,675	\$8,593
Interest cost	321	294
Distributions	(466)	(452)
Change due to change in assumptions and experience	1,200	(760)
	<u>8,730</u>	<u>7,675</u>
Benefit obligation as of December 31		
Plan assets as of January 1	6,679	5,791
Employer contributions	271	120
Actual return on assets	774	1,220
Distributions	(466)	(452)
	<u>7,258</u>	<u>6,679</u>
Plan assets as of December 31		
Funded status	<u>\$(1,472)</u>	<u>\$ (996)</u>

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

	<u>2014</u>	<u>2013</u>
	<u>\$ 2,875</u>	<u>\$2,040</u>

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

	<u>2014</u>	<u>2013</u>
Weighted-average discount rate	3.66%	4.44%
Expected long-term rate of return on assets	7.00	7.00
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 \$466 and \$452 of benefit payments made under the Plan in 2014 and 2013, respectively. Expected payments under the Plan in future years are as follows at December 31, 2014:

2015	\$ 490
2016	504
2017	496
2018	491
2019	487
2020 - 2024	\$2,539

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(DOLLARS IN THOUSANDS UNLESS OTHERWISE NOTED)

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The Plan had approximately 70% and 74% of its investments invested in common stocks, 20% and 18% invested in corporate bonds and the remainder invested in U.S. Government and mortgage-backed securities and cash and cash equivalents during 2014 and 2013, 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.

2014				
FAIR VALUE MEASUREMENTS USING:				
DESCRIPTION	TOTAL	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERV- ABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 225	\$ 170	\$ 55	\$—
Obligations of states and political subdivisions	109	—	109	—
Corporate securities	1,485	—	1,485	—
Mortgage-backed and asset-backed securities	63	—	63	—
Total fixed income securities	1,882	170	1,712	—
Common stocks	5,098	5,098	—	—
	\$6,980	\$5,268	\$1,712	\$—
2013				
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)
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 219	\$ 162	\$ 57	\$—
Obligations of states and political subdivisions	100	—	100	—
Corporate securities	1,224	—	1,224	—
Mortgage-backed and asset-backed securities	82	—	82	—
Total fixed income securities	1,625	162	1,463	—
Common stocks	4,939	4,939	—	—
	\$6,564	\$5,101	\$1,463	\$—

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2014 AND 2013

(DOLLARS IN THOUSANDS UNLESS OTHERWISE NOTED)

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

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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 \$2,177 in 2014 and \$2,063 in 2013.

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 \$301 and \$634 in 2014 and 2013, 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 \$76 in 2014 and \$74 in 2013. Amounts accrued under the plan were \$2,742 and \$2,437 as of December 31, 2014 and 2013, respectively.

The Company provides certain postretirement health care benefits. The following table sets forth the plan's funded status reconciled with the amount shown in the consolidated balance sheet in other liabilities as of December 31, 2014 and 2013:

	2014	2013
Benefit obligation for retirees and fully vested active plan participants	\$ 277	\$ 241
Plan assets at fair value	—	—
Accrued postretirement benefit cost	<u>\$ (277)</u>	<u>\$ (241)</u>

Net periodic postretirement benefit cost for 2014 and 2013 was \$23 and \$22, 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 3.66% and 4.44% in 2014 and 2013, respectively.



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 Company), which comprise the consolidated balance sheet as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive income, 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 did not audit the consolidated financial statements of Vector Security Holdings, Inc., a wholly-owned subsidiary, whose statements reflect total assets constituting 38% and 39%, respectively, of consolidated total assets at December 31, 2014 and 2013, and total revenues constituting 64% and 65%, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors whose report has been furnished to us and our opinion, insofar as it related to the amounts included for Vector Security Holdings, Inc. for the years ended December 31, 2014 and 2013, is based solely on the report of other such auditors. 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 auditor's 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, based on our audit and the report of the other auditors, 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, 2014 and 2013, 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.

Baker Tilly Vechow Krause, LLP

Philadelphia, Pennsylvania
March 2, 2015

DIRECTORS & OFFICERS

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General Partner, Jenkins Partners, L.P.

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Empire Abrasive Equipment Company
President & CEO, Delaware Car Company

Craig N. Johnson
Consultant

Ernest E. Jones, Esquire
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Quaker Chemical Corporation

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The Philadelphia Contributionship
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Robert G. Whitlock, Jr., *President & CEO*
Kevin L. Tate, *Vice President, CFO and*
Treasurer
Stephen A. McGowan, *Assistant Vice*
President, Controller and Assistant Treasurer
Stacey M. Manzo, *Secretary*

ANNUAL MEETING

The 263rd Annual meeting of the Members of the Company will be held on Monday, April 27, 2015, at 11:00 a.m. at the Company's office.



THE PHILADELPHIA CONTRIBUTIONSHIP

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