

Bybee, Cressinda

From: Feather, Karen
Sent: Friday, December 02, 2016 3:14 PM
To: Frances R. Roggenbaum (froggenbaum@saul.com)
Cc: Bybee, Cressinda; Frantz, Jodi (Insurance)
Subject: Saucon valuation analysis
Attachments: 16_11_29 Saucon valuation.pdf; 16_12_02 Saucon Valuation scan.pdf

Fran,

Attached is the valuation analysis of the Saucon Mutual Insurance Company performed by StoneRidge Advisors, as well as a PDF of the cover letter accompanying it. Hard copies are going out in today's mail.

Karen M. Feather | Special Assistant, Insurance Company Licensing
Insurance Department | Office of Corporate & Financial Regulation
1345 Strawberry Square | Harrisburg, PA 17120
Phone: 717.214.4113 | Fax: 717.787.8557 | Email: kfeather@pa.gov
www.insurance.pa.gov
Twitter: [@PAINsuranceDept](https://twitter.com/PAINsuranceDept)
Facebook: [Facebook.com/PAINsuranceDepartment](https://facebook.com/PAINsuranceDepartment)



December 2, 2016

Ms. Frances R. Roggenbaum
Saul Ewing LLP
2 North Second Street
Harrisburg, PA 17101-1619

Dear Ms. Roggenbaum:

Enclosed please find the final valuation analysis of Saucon Mutual Insurance Company prepared by StoneRidge Advisors, LLC.

We look forward to receiving correspondence from the company regarding plans for proceeding with this new information.

Please do not hesitate to contact me with any questions or concerns.

Sincerely,

A handwritten signature in blue ink that reads "Karen M. Feather". The signature is written in a cursive style with a large initial "K".

Karen M. Feather
Special Assistant
Insurance Company Licensing

Presentation to:

Pennsylvania Insurance Department

Saucon Mutual Insurance Company

Valuation Analysis

November 29, 2016

STONERIDGE
ADVISORS, LLC

Disclaimer

This summary is not a complete description of the analyses performed by StoneRidge but contains the material elements of its analyses. The preparation of a valuation analysis is a complex process and is not necessarily susceptible to partial analysis or summary description. In arriving at its valuation range, StoneRidge considered the results of all such analyses as a whole and did not attribute any particular weight to any analysis or factor considered by it. No company or transaction used in the analyses as a comparison is directly comparable to Saucon Mutual Insurance Company (“Saucon” or the “Company”).

The analyses were prepared for purposes of providing a report to the Pennsylvania Insurance Department and do not purport to be appraisals or necessarily reflect the prices at which businesses or securities actually may be sold. In performing its analyses, StoneRidge made numerous assumptions with respect to industry performance, general business and economic conditions and other matters. The analyses performed by StoneRidge are not necessarily indicative of actual future results, which may be significantly more or less favorable than suggested by such analyses. Because such analyses are inherently subject to uncertainty, being based upon numerous factors or events beyond the control of the parties or their respective advisors, none of Saucon or StoneRidge or any other person assumes responsibility if future results are materially different from those forecast.

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I. Executive Summary

Situation Overview

- ▶ Saucon Mutual Insurance Company (“Saucon” or the “Company”) elected to explore a demutualization as a result of several factors including:
 - Lack of profitability of perpetual insurance product due to low interest rate environment; Saucon ceased writing new perpetual policies in 2005
 - Limited existing infrastructure and distribution network to re-enter direct insurance underwriting business
 - Pursuit of other strategic alternatives, such as a merger with a mutual partner, met with little success

- ▶ Saucon’s Board of Directors initially filed a plan of demutualization on September 2, 2014, has filed revised plans of demutualization with the Pennsylvania Insurance Department (the “Department”) and is considering filing another revised plan.

- ▶ StoneRidge Advisors, LLC (“StoneRidge”) has been engaged by the Pennsylvania Insurance Department to conduct an independent valuation analysis of Saucon using an appropriate methodology for a potential demutualization of the Company.

- ▶ This valuation analysis is not an analysis of any specific transaction or potential demutualization plan.

Process Overview

- ▶ As part of its due diligence and review of the Company, StoneRidge reviewed extensive information and performed other due diligence, including the following:
 - Reviewed the Company’s audited statutory financials for 2010-2015
 - Reviewed information on the Department website
 - Reviewed information in Company’s online data room
 - Met with three members of the Board of Directors and the CEO of the Company at Saucon headquarters to discuss the Company’s business and future prospects
 - Had numerous calls and exchanged emails with the Chairman of the Company

- ▶ StoneRidge based its valuation primarily on the following valuation methodologies:
 - Sum of parts analysis
 - Discounted cash flow analysis

- ▶ Based upon the average of these two valuation methodologies, StoneRidge Advisors selected a valuation range for Saucon of between \$2.4 million and \$3.2 million.

- ▶ Additionally, StoneRidge considered comparable public companies and comparable M&A transactions. StoneRidge determined that these comparable analyses were not relevant because the lack of comparability to the specific circumstances of Saucon which has not issued new policies in the last 10 years and has focused on the perpetual homeowners insurance market.

II. Historical Financials

Historical Income Statement

Saucon Statutory Income Statements

	2010	2011	2012	2013	2014	2015	2016 YTD thru 9/30
Net premiums earned/(ceded)	(\$90,904)	(\$89,795)	(\$77,324)	(\$80,573)	(\$84,662)	(\$83,332)	(\$67,682)
Less underwriting deductions							
Losses incurred	\$31,966	\$123,340	\$92,931	\$96,475	\$144,001	\$36,606	\$318,675
Loss expenses incurred	9,245	22,657	29,032	52,155	37,757	25,524	54,041
Other underwriting expenses incurred	545,529	553,929	725,779	770,157	1,245,117	966,001	559,948
Net underwriting loss	(\$677,644)	(\$789,721)	(\$925,066)	(\$999,360)	(\$1,511,537)	(\$1,111,463)	(\$1,000,346)
Investment gain							
Net investment income earned	\$338,164	\$327,296	\$374,284	\$274,602	\$317,082	\$330,990	\$123,216
Net realized capital gains	730,124	738,679	786,079	989,233	1,280,772	916,980	589,123
Net investment gain	\$1,068,288	\$1,065,975	\$1,160,363	\$1,263,835	\$1,597,854	\$1,247,970	\$712,339
Other income	-	6,107	-	-	-	5,435	-
Agency reimbursement Income	29,489	-	18,720	30,751	82,139	67,150	31,539
Income before federal income tax	\$420,133	\$282,361	\$254,017	\$295,226	\$168,456	\$209,092	(\$256,468)
Federal income tax benefit	4,000	7,420	(3,236)	-	-	-	-
Net income	\$416,133	\$274,941	\$257,253	\$295,226	\$168,456	\$209,092	(\$256,468)
Surplus, beginning	\$13,344,106	\$14,077,298	\$13,894,648	\$14,506,527	\$16,434,269	\$16,733,609	\$15,860,583
(Decrease) Increase in unrealized gains	415,798	(486,902)	383,209	1,906,945	185,579	(1,234,158)	353,618
(Increase) Decrease in nonadmitted assets	(36,340)	(59,084)	44,292	11,093	9,580	(69,002)	(36,144)
(Increase) Decrease in deferred taxes	(62,399)	88,395	(72,875)	(285,522)	(64,275)	221,042	(46,891)
Surplus, ending	\$14,077,298	\$13,894,648	\$14,506,527	\$16,434,269	\$16,733,609	\$15,860,583	\$15,874,698

Source: Saucon audited financial statements; YTD statements not audited

Historical Balance Sheet

Saucon Statutory Balance Sheets

	As of December 31,						As of September 30,
	2010	2011	2012	2013	2014	2015	2016
Admitted Assets							
Investments							
Bonds	\$1,699,380	\$1,654,521	\$1,477,101	\$902,219	\$656,544	\$555,521	\$605,426
Common Stocks	14,448,117	14,408,814	15,568,039	17,595,603	17,854,118	17,018,027	17,326,102
Total Investments	\$16,147,497	\$16,063,335	\$17,045,140	\$18,497,822	\$18,510,662	\$17,573,548	\$17,931,528
Cash and cash equivalents	978,345	661,453	399,277	1,073,632	1,485,389	1,358,369	1,463,938
Interest and dividends due and accrued	39,692	39,366	42,845	40,437	44,423	42,466	13,493
Reinsurance losses recoverable	3,646	7,949	2,500	17,614	1,241	-	5,610
Receivable from related party	-	197,206	181,105	155,797	100,517	61,260	20,365
Electronic data processing equipment, net	1,741	23,899	22,204	15,630	9,057	2,689	980
Other assets	1,491	-	5,963	5,963	5,963	5,963	5,963
Total Admitted Assets	\$17,172,412	\$16,993,208	\$17,699,034	\$19,806,895	\$20,157,252	\$19,044,295	\$19,441,877
Liabilities and Surplus							
Liabilities							
Loss reserves	\$19,000	\$88,127	\$120,000	\$55,401	\$86,401	\$41,500	\$345,000
Loss adjustment expenses	-	2,812.00	12,000.00	7,000.00	12,000.00	7,000.00	32,500.00
Unearned premiums	10,160	8,747	6,024	5,367	5,590	4,404	2,184
Amounts withheld/retained for account of others	-	10,965	5,983	5,275	8,039	6,637	4,404
Perpetual deposits reserved for policyholders	2,333,767	2,355,494	2,343,098	2,286,264	2,234,993	2,230,571	3,851
Deferred taxes	649,628	561,233	634,108	919,630	983,905	762,863	2,180,781
Accrued expenses	51,402	65,547	64,000	88,000	87,000	125,000	809,753
Federal income taxes payable	4,000	5,000	5,000	5,000	5,000	5,000	183,095
Ceded reinsurance premiums payable	25,000						4,874
Advance premium	2,157	635	2,294	689	715	737	737
Total liabilities	\$3,095,114	\$3,098,560	\$3,192,507	\$3,372,626	\$3,423,643	\$3,183,712	\$3,567,179
Surplus							
Unassigned funds- policyholder surplus	\$14,077,298	\$13,894,648	\$14,506,527	\$16,434,269	\$16,733,609	\$15,860,583	\$15,874,698
Total Liabilities and Surplus	\$17,172,412	\$16,993,208	\$17,699,034	\$19,806,895	\$20,157,252	\$19,044,295	\$19,441,877

Source: Saucon audited financial statements; YTD statements not audited

III. Valuation Analysis

Overview of Valuation Methodologies

Valuation Methodologies

Primary Methodologies:

DCF

- ▶ Captures the intrinsic value of the Company based on future cash flows generated by the operations of the entity
- ▶ Discounted management projections of net income for the business back to the present using a range of discount rates and business assumptions
- ▶ Projected cash flows for 60 years and calculated a terminal value as a net present value of 50% of surplus in Year 60
- ▶ Discount rates of 8.0% to 10.0% utilized based upon WACC analysis

Sum of Parts

- ▶ Adjusted statutory surplus to approximate fair market value as of September 30, 2016
- ▶ Estimated the unrecorded liabilities for Saucon, including a deferred tax liability and liability for future loss costs on perpetual policies
- ▶ Projected net investment income on existing deposits
- ▶ Estimated expenses of maintaining the insurance company to support the existing policyholders and discount to surplus for lack of liquidity

Other Considered Methodologies:

Comparable Analyses

- ▶ Analysis of valuation multiples paid for similar insurance company transactions, as well as selected demutualization transactions
- ▶ May encompass premiums paid for synergies and gain of control, as well as certain market conditions present at the time of transaction
- ▶ Public market comparables were analyzed, but deemed not very relevant given the lack of comparability in light of Saucon's size and dormant business operations

Valuation Summary

Valuation Summary

(\$ in thousands)

	Selected Valuation Range			Estimated Equity Valuation Range (in millions)							
	Low	Mid	High	\$ 0.5	\$ 1.5	\$ 2.5	\$ 3.5	\$ 4.5	\$ 5.5	\$ 6.5	\$ 7.5
Discounted Cash Flow	\$1,027.6	\$2,208.8	\$4,164.8								
Sum of Parts	\$1,097.8	\$3,369.8	\$5,900.1								
Average Valuation Range	\$1,062.7	\$2,789.3	\$5,032.4								
Selected Valuation Range	\$2,370.9	\$2,789.3	\$3,207.7								

Note: Selected valuation range reflects 15.0% discount and premium to midpoint of average valuation range. Valuation is based on current market data at the time of analysis; valuation may materially differ based on market movements and economic conditions; see following pages for details on each valuation methodology

Sum of Parts Analysis

- ▶ A Sum of the Parts analysis yields a valuation range of approximately \$1.1 million to \$5.9 million.

Sum of Parts Valuation Range			
	(Scenario 1) Low	(Scenario 2) Medium	(Scenario 3) High
Surplus as of September 30, 2016	\$15,874,698	\$15,874,698	\$15,874,698
Discount for Regulated Entity ⁽¹⁾	(\$2,381,205)	(\$1,984,337)	(\$1,587,470)
Estimated Net Future Liability of Existing Policies ⁽²⁾	(\$1,853,367)	(\$1,853,367)	(\$1,853,367)
Deposit Net Investment Income Offset ⁽³⁾	\$1,107,551	\$1,107,551	\$1,107,551
Deferred Tax Liability	(\$1,488,725)	(\$1,488,725)	(\$1,488,725)
Net Present Value of Maintaining Infrastructure ⁽⁴⁾	(\$10,161,157)	(\$8,285,993)	(\$6,152,624)
Pro Forma Value	\$1,097,794	\$3,369,826	\$5,900,062

- (1) Assumes discount of 15.0% under Scenario 1, 12.5% under Scenario 2, and 10.0% under Scenario 3, based upon lack of liquidity due to need to maintain surplus in insurance company
- (2) Projected out 60 years at 9.0% discount rate. See page 26 for detailed calculation
- (3) Net investment income projected for 60 years. See page 27 for detailed calculation
- (4) NPV of management expense projected for 60 years

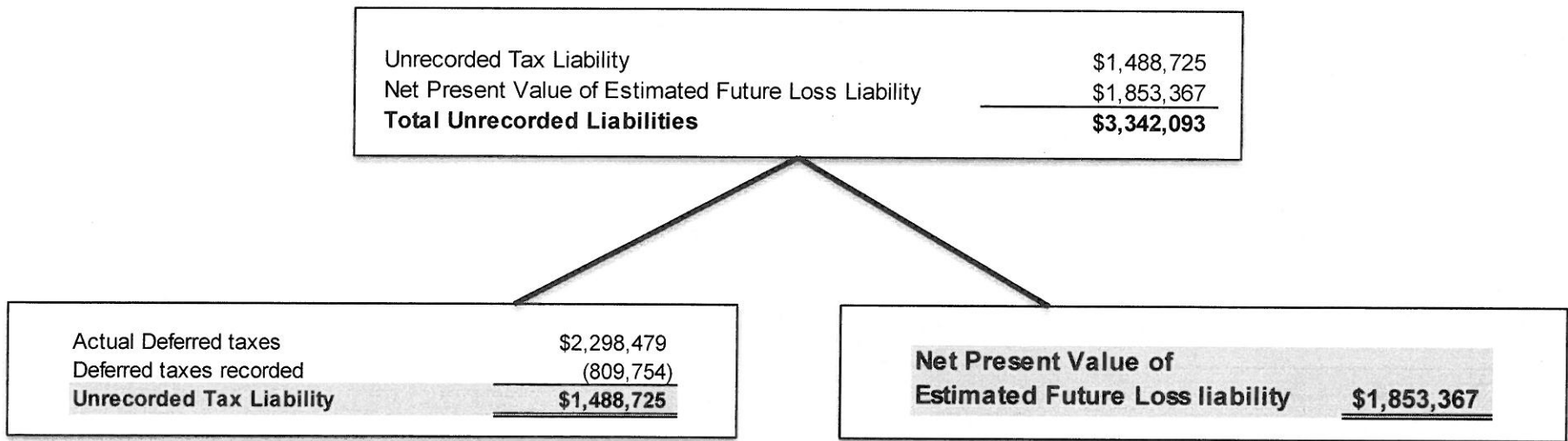
Source: Historical statutory filings and financial trends, management commentary and analyses

Sum of the Parts Analysis

- ▶ In approaching a Sum of the Parts analysis, we have applied three categories of discounts to surplus to arrive at an adjusted book value, including:
 - Potential liabilities Saucon may face that are not currently reflected on the Company's balance sheet
 - Present value of ongoing losses to maintain existing infrastructure

- ▶ Saucon's capital and surplus is subject to two meaningful off-balance sheet liabilities that decrease its valuation:
 - The Company's perpetual exposure to its legacy product. For purposes of this valuation, we assume Saucon's perpetual policyholder base continues to shrink at the historical rate and that associated losses incurred, based on a Pennsylvania industry average, continue at a uniform rate.
 - While the Company's investment portfolio has experienced significant appreciation, tax liabilities associated with these investment gains are currently understated. As such, a deferred tax liability was factored into our "Sum of the Parts" valuation.

Overview of Saucon Liabilities



Estimated Future Liability of Perpetual Policies

- ▶ To estimate the present value of the future liability of Saucon’s outstanding perpetual policies we have made a number of assumptions, namely:
 - Deposit premiums shrink at an annual rate in line with historical rates of perpetual policy expiration (i.e. 3.0%)
 - An annual premium equivalent was calculated for each year based on projected premium deposits (see page 26 for details)
 - Losses for each year were calculated as a percentage of annual premium equivalent. Loss and LAE ratios are based on a Pennsylvania industry average of 60.5%

Summary Analysis of Perpetual Policy Liability

Underlying Assumptions:

Perpetual Policyholder Deposits as of September 30, 2016	\$2,180,781
Term Premium Equivalent (Perpetual Policies with Deposit)	\$229,011
Term Premium Equivalent (Perpetual Policies without a Deposit) (est.)	\$171,758
Total Term Premium Equivalent for Year 1	\$400,769
Industry Average Loss and LAE Ratio	60.50%
Cancellation Rate (Deposits Returned)	3.0%
Discount Rate	9.0%
Net Present Value of Estimated Future Loss liability	\$1,853,367

Source: Saucon financials and management representations
 Note: See page 26 in Appendix for detail on liability analysis

Estimated Future Deferred Tax Liability

- ▶ The Company has represented that deferred taxes for Saucon have been recorded at 15% rather than the combined effective tax rate of 41.5%, implying a deferred tax liability of approximately \$1.5 million.

Calculation of Deferred Tax Liability

Pennsylvania Corporate Tax Rate	10.0%
Benefit based on 35.0% Federal Tax Rate	-3.5%
Federal Tax rate	35.0%
Total Effective Tax rate	41.5%

Unrealized Appreciation on Investments as of 9/30/16	\$5,539,372
Total Effective Tax rate	x 41.5%
Actual Deferred taxes	\$2,298,479
Deferred taxes recorded	(809,754)
Unrecorded Tax Liability	\$1,488,725

Cost of Maintaining Infrastructure

- ▶ StoneRidge considered three underwriting expense scenarios to arrive at a Sum of the Parts valuation range:
 - **Scenario 1:** Assumes expense components grow at 3.0% annual inflation to a maximum of \$1.25 million
 - **Scenario 2:** Assumes expense remains fixed at \$750,000 per year
 - **Scenario 3:** Assumes expense declines at a projected rate of 5.0% to a minimum of \$500,000 annual underwriting expense as the Company moves to a captive manager

Underwriting Expense Scenario Analysis							
Total Underwriting Expenses				Total Underwriting Expenses			
Year	Scenario 1	Scenario 2	Scenario 3	Year	Scenario 1	Scenario 2	Scenario 3
1	767,103	750,000	712,500	31	1,250,000	750,000	500,000
2	784,725	750,000	676,875	32	1,250,000	750,000	500,000
3	802,883	750,000	643,031	33	1,250,000	750,000	500,000
4	746,594	750,000	610,880	34	1,250,000	750,000	500,000
5	765,875	750,000	580,336	35	1,250,000	750,000	500,000
6	785,744	750,000	551,319	36	1,250,000	750,000	500,000
7	806,221	750,000	523,753	37	1,250,000	750,000	500,000
8	827,325	750,000	500,000	38	1,250,000	750,000	500,000
9	849,075	750,000	500,000	39	1,250,000	750,000	500,000
10	871,493	750,000	500,000	40	1,250,000	750,000	500,000
11	894,600	750,000	500,000	41	1,250,000	750,000	500,000
12	918,418	750,000	500,000	42	1,250,000	750,000	500,000
13	942,971	750,000	500,000	43	1,250,000	750,000	500,000
14	968,281	750,000	500,000	44	1,250,000	750,000	500,000
15	994,374	750,000	500,000	45	1,250,000	750,000	500,000
16	1,021,274	750,000	500,000	46	1,250,000	750,000	500,000
17	1,049,008	750,000	500,000	47	1,250,000	750,000	500,000
18	1,077,603	750,000	500,000	48	1,250,000	750,000	500,000
19	1,107,087	750,000	500,000	49	1,250,000	750,000	500,000
20	1,137,489	750,000	500,000	50	1,250,000	750,000	500,000
21	1,168,838	750,000	500,000	51	1,250,000	750,000	500,000
22	1,201,166	750,000	500,000	52	1,250,000	750,000	500,000
23	1,234,505	750,000	500,000	53	1,250,000	750,000	500,000
24	1,250,000	750,000	500,000	54	1,250,000	750,000	500,000
25	1,250,000	750,000	500,000	55	1,250,000	750,000	500,000
26	1,250,000	750,000	500,000	56	1,250,000	750,000	500,000
27	1,250,000	750,000	500,000	57	1,250,000	750,000	500,000
28	1,250,000	750,000	500,000	58	1,250,000	750,000	500,000
29	1,250,000	750,000	500,000	59	1,250,000	750,000	500,000
30	1,250,000	750,000	500,000	60	1,250,000	750,000	500,000
				NPV @ 9.0%	(\$10,161,157)	(\$8,285,993)	(\$6,152,624)

Note: See appendix for underwriting expense component detail for Scenario 1; depreciation expense omitted from underwriting expense

DCF Assumptions & Discussion

- ▶ As part of its discounted cash flow valuation analysis, StoneRidge partially relied on management's projections of underwriting losses, historical and projected cancellation rates, and investment returns among other assumptions.
- ▶ StoneRidge analyzed three cases of different underwriting expense scenarios:
 - Components of expense grow at annual inflation rate of 3.0%, subject to a maximum of \$1.25 million
 - Total underwriting expense assumed to be flat a \$750,000 per year
 - Total underwriting expense declines at 5.0% annual rate as Saucon tightens expense structure; underwriting expense floor of \$500,000
- ▶ Other assumptions based upon the Company's estimates and projections include:
 - Perpetual policies without a deposit entail approximately 75% of outstanding perpetual policies
 - An annual policy cancellation rate of 3.0%, based on historical averages
 - Effective Loss & LAE ratio of approximately 60.0% including reinsurance costs, in line with the industry average of 60.5%
 - 6.5% blended investment return on both policy deposits and surplus
 - Annual income/management fee to Saucon from its agency subsidiary assumed flat at \$45,000
- ▶ The discounted cash flow valuation analysis assumed that projected net income is representative of the free cash flow of the business; other assumptions included:
 - 8.0% - 10.0% range of discount rates
 - Terminal value assumes net present value of 50% of surplus in Year 60 discounted at 9.0%

DCF Valuation Summary: Inflation Case

Discounted Cash Flow Model

	Projected									
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Statutory net income ⁽¹⁾	\$173,777	\$159,361	\$144,346	\$128,716	\$187,459	\$170,557	\$152,995	\$134,757	\$115,824	\$96,180
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$159,428	\$134,131	\$111,461	\$91,186	\$121,835	\$101,697	\$83,694	\$67,630	\$53,329	\$40,628
	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036
Statutory net income ⁽¹⁾	\$75,805	\$54,680	\$32,784	\$10,096	(\$13,406)	(\$38,561)	(\$66,112)	(\$96,228)	(\$129,092)	(\$164,897)
Distribution rate	100.0%	100.0%	100.0%	100.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Discounted cash flow	\$29,377	\$19,441	\$10,693	\$3,021	\$0	\$0	\$0	\$0	\$0	\$0
	2037	2038	2039	2040	2041	2042	2043	2044	2045	2046
Statutory net income ⁽¹⁾	(\$203,851)	(\$246,174)	(\$292,102)	(\$341,884)	(\$376,899)	(\$398,597)	(\$421,656)	(\$446,160)	(\$472,195)	(\$499,853)
Distribution rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Discounted cash flow	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
	2047	2048	2049	2050	2051	2052	2053	2054	2055	2056
Statutory net income ⁽¹⁾	(\$529,233)	(\$560,439)	(\$593,580)	(\$628,775)	(\$666,146)	(\$705,827)	(\$747,957)	(\$792,685)	(\$840,168)	(\$890,574)
Distribution rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Discounted cash flow	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
	2057	2058	2059	2060	2061	2062	2063	2064	2065	2066
Statutory net income ⁽¹⁾	(\$944,079)	(\$1,000,874)	(\$1,061,156)	(\$1,125,139)	(\$1,193,047)	(\$1,265,119)	(\$1,341,609)	(\$1,422,785)	(\$1,508,933)	(\$1,600,355)
Distribution rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Discounted cash flow	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
	2067	2068	2069	2070	2071	2072	2073	2074	2075	2076
Statutory net income ⁽¹⁾	(\$1,697,373)	(\$1,800,327)	(\$1,909,578)	(\$2,025,511)	(\$2,148,532)	(\$2,279,074)	(\$2,417,594)	(\$2,564,579)	(\$2,720,545)	(\$2,886,039)
Distribution rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Discounted cash flow	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Sum of cash flows	\$1,027,551									
Terminal Value	-									
DCF Enterprise Value	\$1,027,551									

(1) Includes assumed \$45,000 of agency net income; income is not tax-effected

Source: Management projections, historical statutory filings, and Company management commentary

Note: Analysis assumes 3% annual underwriting expense inflation; cost of equity is computed based on the CAPM formula; negative terminal value omitted, based on net present value of 50% of Year 60 surplus at 9.0% discount rate; analysis assumes that all cash flows are available for distribution

DCF Valuation Summary: Flat Expenses

Discounted Cash Flow Model

	Projected									
	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Statutory net income ⁽¹⁾	\$173,777	\$176,464	\$179,071	\$181,600	\$184,052	\$186,431	\$188,739	\$190,978	\$193,149	\$195,255
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$159,428	\$148,526	\$138,276	\$128,650	\$119,621	\$111,163	\$103,247	\$95,845	\$88,931	\$82,478
	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036
Statutory net income ⁽¹⁾	\$197,298	\$199,280	\$201,202	\$203,067	\$204,876	\$206,630	\$208,332	\$209,983	\$211,584	\$213,137
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$76,460	\$70,851	\$65,628	\$60,767	\$56,246	\$52,044	\$48,140	\$44,515	\$41,151	\$38,030
	2037	2038	2039	2040	2041	2042	2043	2044	2045	2046
Statutory net income ⁽¹⁾	\$214,644	\$216,105	\$217,523	\$218,898	\$220,231	\$221,525	\$222,780	\$223,997	\$225,178	\$226,323
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$35,137	\$32,455	\$29,971	\$27,670	\$25,540	\$23,569	\$21,745	\$20,059	\$18,499	\$17,058
	2047	2048	2049	2050	2051	2052	2053	2054	2055	2056
Statutory net income ⁽¹⁾	\$227,434	\$228,512	\$229,557	\$230,571	\$231,555	\$232,509	\$233,434	\$234,332	\$235,203	\$236,047
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$15,727	\$14,496	\$13,360	\$12,311	\$11,343	\$10,449	\$9,625	\$8,864	\$8,162	\$7,515
	2057	2058	2059	2060	2061	2062	2063	2064	2065	2066
Statutory net income ⁽¹⁾	\$236,867	\$237,661	\$238,432	\$239,180	\$239,905	\$240,609	\$241,291	\$241,953	\$242,595	\$243,218
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$6,919	\$6,369	\$5,862	\$5,395	\$4,964	\$4,568	\$4,202	\$3,866	\$3,556	\$3,271
	2067	2068	2069	2070	2071	2072	2073	2074	2075	2076
Statutory net income ⁽¹⁾	\$243,822	\$244,408	\$244,977	\$245,528	\$246,063	\$246,582	\$247,085	\$247,573	\$248,047	\$248,506
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$3,008	\$2,767	\$2,544	\$2,339	\$2,151	\$1,977	\$1,818	\$1,671	\$1,536	\$1,412
Sum of cash flows	\$2,163,745									
Terminal Value	\$45,091									
DCF Enterprise Value	\$2,208,835									

(1) Includes assumed \$45,000 of agency net income; income is not tax-effected

Source: Management projections, historical statutory filings, and Company management commentary

Note: Analysis assumes flat \$750k underwriting expense over the period; cost of equity is computed based on the CAPM formula; terminal value calculated as net present value of 50% of Year 60 surplus at 9.0% discount rate; analysis assumes that all cash flows are available for distribution

DCF Valuation Summary: Reduced Expenses

Discounted Cash Flow Model

	2017	2018	2019	2020	Projected		2023	2024	2025	2026
					2021	2022				
Statutory net income ⁽¹⁾	\$173,777	\$213,964	\$252,196	\$288,568	\$323,173	\$356,096	\$387,420	\$417,225	\$443,149	\$445,255
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$159,428	\$180,089	\$194,742	\$204,429	\$210,040	\$212,328	\$211,932	\$209,391	\$204,038	\$188,081
	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036
Statutory net income ⁽¹⁾	\$447,298	\$449,280	\$451,202	\$453,067	\$454,876	\$456,630	\$458,332	\$459,983	\$461,584	\$463,137
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$173,343	\$159,735	\$147,173	\$135,579	\$124,881	\$115,011	\$105,908	\$97,513	\$89,773	\$82,638
	2037	2038	2039	2040	2041	2042	2043	2044	2045	2046
Statutory net income ⁽¹⁾	\$464,644	\$466,105	\$467,523	\$468,898	\$470,231	\$471,525	\$472,780	\$473,997	\$475,178	\$476,323
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$76,061	\$70,000	\$64,416	\$59,271	\$54,532	\$50,167	\$46,147	\$42,446	\$39,038	\$35,901
	2047	2048	2049	2050	2051	2052	2053	2054	2055	2056
Statutory net income ⁽¹⁾	\$477,434	\$478,512	\$479,557	\$480,571	\$481,555	\$482,509	\$483,434	\$484,332	\$485,203	\$486,047
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$33,014	\$30,356	\$27,910	\$25,660	\$23,589	\$21,685	\$19,932	\$18,320	\$16,838	\$15,475
	2057	2058	2059	2060	2061	2062	2063	2064	2065	2066
Statutory net income ⁽¹⁾	\$486,867	\$487,661	\$488,432	\$489,180	\$489,905	\$490,609	\$491,291	\$491,953	\$492,595	\$493,218
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$14,221	\$13,068	\$12,008	\$11,033	\$10,137	\$9,314	\$8,556	\$7,861	\$7,221	\$6,633
	2067	2068	2069	2070	2071	2072	2073	2074	2075	2076
Statutory net income ⁽¹⁾	\$493,822	\$494,408	\$494,977	\$495,528	\$496,063	\$496,582	\$497,085	\$497,573	\$498,047	\$498,506
Distribution rate	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Discounted cash flow	\$6,093	\$5,596	\$5,140	\$4,721	\$4,336	\$3,982	\$3,657	\$3,358	\$3,084	\$2,832
Sum of cash flows	\$4,119,661									
Terminal Value	\$45,091									
DCF Enterprise Value	\$4,164,751									

(1) Includes assumed \$45,000 of agency net income; income is not tax-effected

Source: Management projections, historical statutory filings, and Company management commentary

Note: Analysis assumes 5.0% decline in underwriting expenses to a minimum \$500k; cost of equity is computed based on the CAPM formula; terminal value calculated as net present value of 50% of Year 60 surplus at 9.0% discount rate; analysis assumes that all cash flows are available for distribution

DCF Valuation Summary: Sensitivity Analyses

Scenario 1: Inflation Case

		Enterprise Value
Cost of equity	8.00%	\$1,076,073
	9.00%	\$1,027,551
	10.00%	\$982,443

Scenario 2 – Flat Expenses

		Enterprise Value
Cost of equity	8.00%	\$2,491,468
	9.00%	\$2,208,835
	10.00%	\$1,981,295

Scenario 3 – Reduced Expenses

		Enterprise Value
Cost of equity	8.00%	\$4,757,534
	9.00%	\$4,164,751
	10.00%	\$3,688,001

IV. Appendices

M&A Transaction Comparables

Precedent Pennsylvania Insurance Company Transactions

(\$ in thousands)

Announcement Date	Buyer	Target	Gross Offering Proceeds			Surplus	Implied Enterprise Value / Statutory Surplus		
			Minimum	Midpoint	Maximum		Minimum	Midpoint	Maximum
9/2/2009	Penn Millers Holding Corporation	Penn Millers Mutual	\$45,050.0	\$53,000.0	\$60,950.0	\$44,188.0	1.02x	1.20x	1.38x
10/29/2008	ProAssurance Corporation (NYSE:PRA)	Podiatry Insurance Company of America (PICA)	135,000.0	135,000.0	135,000.0	75,043.0	1.80x	1.80x	1.80x
9/9/2008	Mutual Benefit Insurance Company	Select Risk Insurance Company	NA	NA	NA	NA	NA	NA	NA
6/7/2008	Mutual Management Company, LLC	Philanthropic Mutual Fire Insurance Company	NA	NA	NA	NA	NA	NA	NA
6/7/2008	Hanover Fire Holdings, Inc.	Hanover Mutual Fire Insurance Co.	NA	NA	NA	NA	NA	NA	NA
1/20/2006	Eastern Insurance Holdings, Inc. (NasdaqGS:EIHI)	Educators Mutual Life Insurance Company	55,250.0	65,000.0	74,750.0	56,691.0	0.97x	1.15x	1.32x
9/4/2003	Donegal Group Inc.	Le Mars Mutual Insurance Company of Iowa	8,200.0	8,200.0	8,200.0	7,200.0	1.14x	1.14x	1.14x
1/25/1999	Mercer Insurance Group, Inc.	Mercer Mutual Insurance Company	25,100.0	29,500.0	33,900.0	21,323.0	1.18x	1.38x	1.59x
1/15/1997	Old Guard Group, Inc.	Old Guard Mutual	28,535.0	33,570.0	38,606.0	30,265.0	0.94x	1.11x	1.28x

All transactions

Mean:	1.18x	1.30x	1.42x
Median:	1.08x	1.17x	1.35x
High :	1.80x	1.80x	1.80x
Low:	0.94x	1.11x	1.14x

Public Market Comparables – Personal Lines

Publicly-Traded Comparable Companies

(Dollars in millions, except per share items)

Company	Price 11/29/2016	Dividend Yield	Price Change		Market Cap	P/E Multiples			Price / BV	Price / TBV	ROAE		Debt / Total Cap	Market Cap- Adjusted Debt / Total Cap
			1 Month	1 Year		LTM	2016	2017			2016	2017		
Donegal Group Inc.	\$16.20	0.0%	7.2%	16.0%	\$431	16.6x	15.4x	12.5x	1.03x	1.04x	6.5%	7.7%	15.8%	15.5%
Federated National Holding Company	17.71	1.8%	0.3%	-39.1%	244	8.6x	6.2x	36.9x	1.04x	1.04x	15.6%	2.4%	1.8%	2.0%
HCI Group, Inc.	33.65	3.6%	27.2%	-9.7%	350	10.8x	5.4x	20.5x	1.49x	1.49x	24.7%	5.8%	34.9%	28.3%
Heritage Insurance Holdings, Inc.	14.91	1.6%	27.7%	-34.3%	454	7.4x	5.0x	15.2x	1.23x	1.56x	22.2%	6.4%	0.0%	0.0%
Kingstone Companies, Inc.	12.70	2.0%	23.3%	27.1%	100	12.9x	13.7x	11.5x	1.83x	1.89x	12.7%	13.5%	0.0%	0.0%
Safety Insurance Group Inc.	70.75	3.9%	6.2%	26.0%	1,072	18.3x	NM	17.7x	1.64x	1.64x	NM	9.7%	0.0%	0.0%
State Auto Financial Corp.	25.49	1.5%	10.8%	9.4%	1,062	NM	18.6x	NM	1.29x	1.29x	6.8%	NM	10.0%	10.3%
United Insurance Holdings Corp.	13.88	1.8%	-0.3%	-25.9%	298	8.8x	14.0x	33.4x	1.20x	1.28x	8.3%	3.3%	9.0%	7.8%
Universal Insurance Holdings Inc.	24.65	2.8%	17.9%	21.8%	864	7.6x	8.6x	9.2x	2.52x	2.52x	25.8%	19.9%	4.4%	1.8%
Mean:		2.1%	13.4%	-1.0%		11.4x	10.9x	19.6x	1.48x	1.53x	15.3%	8.6%	8.4%	7.3%
Median:		1.8%	10.8%	9.4%		9.8x	11.1x	16.5x	1.29x	1.49x	14.1%	7.0%	4.4%	2.0%

(1) Earnings metrics exclude realized investment gains.

(2) Book value metrics exclude FAS 115.

(3) Excluding market capitalization and total capitalization, all metrics based on a diluted share count.

Weighted Average Cost of Capital Calculation

Cost of Equity

$$K_e = R_f + \beta * (\text{equity risk premium})$$

Risk free rate (Rf)	2.21%
Estimated unlevered beta	0.95
Implied levered beta (β)	0.95
Equity risk premium	6.00%
Additional risk premium for size	1.00%
Cost of equity	9.85%

Weighted Average Cost of Capital (WACC)

After-tax cost of debt	4.69%
Debt weighting	7.50%
Cost of equity	9.85%
Equity weighting	92.50%
WACC	9.46%

Cost of Equity Sensitivity

Risk free rate	Unlevered beta		
	0.85	0.95	1.05
2.71%	9.15%	9.89%	10.63%
2.21%	8.69%	9.43%	10.17%
1.71%	8.22%	8.96%	9.70%

Source: Public market data, equity research, and Company management's commentary

Note: The risk free rate was based on the yield of a 10-year US treasury security; beta was derived by assessing the Company's peers; market risk premium has historically ranged between 5.5%-6.0% excluding additional risk for size of enterprise and industry

Estimated Future Liability of Perpetual Policies

Projected Runoff and Associated Losses of Existing Perpetual Policy Base

Year	Deposit Premiums	Annual Premium Equivalent	Loss & LAE	Year	Deposit Premiums	Annual Premium Equivalent	Loss & LAE
1	\$2,180,781	\$400,769	\$222,607	31	901,555	165,682	89,267
2	2,180,781	400,769	215,929	32	874,509	160,711	86,589
3	2,115,358	388,746	209,451	33	848,273	155,890	83,991
4	2,051,897	377,084	203,168	34	822,825	151,213	81,472
5	1,990,340	365,771	197,073	35	798,140	146,677	79,028
6	1,930,630	354,798	191,161	36	774,196	142,277	76,657
7	1,872,711	344,154	185,426	37	750,970	138,008	74,357
8	1,816,530	333,830	179,863	38	728,441	133,868	72,126
9	1,762,034	323,815	174,467	39	706,588	129,852	69,963
10	1,709,173	314,100	169,233	40	685,390	125,956	67,864
11	1,657,897	304,677	164,156	41	664,829	122,178	65,828
12	1,608,161	295,537	159,231	42	644,884	118,512	63,853
13	1,559,916	286,671	154,454	43	625,537	114,957	61,937
14	1,513,118	278,071	149,821	44	606,771	111,508	60,079
15	1,467,725	269,729	145,326	45	588,568	108,163	58,277
16	1,423,693	261,637	140,966	46	570,911	104,918	56,529
17	1,380,982	253,788	136,737	47	553,784	101,771	54,833
18	1,339,553	246,174	132,635	48	537,170	98,718	53,188
19	1,299,366	238,789	128,656	49	521,055	95,756	51,592
20	1,260,385	231,625	124,797	50	505,423	92,883	50,044
21	1,222,574	224,676	121,053	51	490,261	90,097	48,543
22	1,185,896	217,936	117,421	52	475,553	87,394	47,087
23	1,150,319	211,398	113,898	53	461,286	84,772	45,674
24	1,115,810	205,056	110,482	54	447,448	82,229	44,304
25	1,082,336	198,904	107,167	55	434,024	79,762	42,975
26	1,049,866	192,937	103,952	56	421,003	77,369	41,686
27	1,018,370	187,149	100,833	57	408,373	75,048	40,435
28	987,818	181,535	97,808	58	396,122	72,797	39,222
29	958,184	176,089	94,874	59	384,239	70,613	38,045
30	929,438	170,806	92,028	60	372,711	68,494	36,904

Estimated Net Investment Income on Deposits

Projected Net Investment Income on Deposits

Year	Investment Income on Deposits	Deposit Investment Expense	Net Investment Income	Year	Investment Income on Deposits	Deposit Investment Expense	Net Investment Income
1	\$141,751	\$8,723	\$133,028	31	\$56,843	\$3,498	\$53,345
2	\$137,498	\$8,461	\$129,037	32	\$55,138	\$3,393	\$51,745
3	\$133,373	\$8,208	\$125,166	33	\$53,484	\$3,291	\$50,192
4	\$129,372	\$7,961	\$121,411	34	\$51,879	\$3,193	\$48,687
5	\$125,491	\$7,723	\$117,768	35	\$50,323	\$3,097	\$47,226
6	\$121,726	\$7,491	\$114,235	36	\$48,813	\$3,004	\$45,809
7	\$118,074	\$7,266	\$110,808	37	\$47,349	\$2,914	\$44,435
8	\$114,532	\$7,048	\$107,484	38	\$45,928	\$2,826	\$43,102
9	\$111,096	\$6,837	\$104,260	39	\$44,550	\$2,742	\$41,809
10	\$107,763	\$6,632	\$101,132	40	\$43,214	\$2,659	\$40,555
11	\$104,530	\$6,433	\$98,098	41	\$41,917	\$2,580	\$39,338
12	\$101,395	\$6,240	\$95,155	42	\$40,660	\$2,502	\$38,158
13	\$98,353	\$6,052	\$92,300	43	\$39,440	\$2,427	\$37,013
14	\$95,402	\$5,871	\$89,531	44	\$38,257	\$2,354	\$35,903
15	\$92,540	\$5,695	\$86,845	45	\$37,109	\$2,284	\$34,826
16	\$89,764	\$5,524	\$84,240	46	\$35,996	\$2,215	\$33,781
17	\$87,071	\$5,358	\$81,713	47	\$34,916	\$2,149	\$32,767
18	\$84,459	\$5,197	\$79,261	48	\$33,869	\$2,084	\$31,784
19	\$81,925	\$5,042	\$76,883	49	\$32,853	\$2,022	\$30,831
20	\$79,467	\$4,890	\$74,577	50	\$31,867	\$1,961	\$29,906
21	\$77,083	\$4,744	\$72,340	51	\$30,911	\$1,902	\$29,009
22	\$74,771	\$4,601	\$70,169	52	\$29,984	\$1,845	\$28,138
23	\$72,528	\$4,463	\$68,064	53	\$29,084	\$1,790	\$27,294
24	\$70,352	\$4,329	\$66,022	54	\$28,212	\$1,736	\$26,475
25	\$68,241	\$4,199	\$64,042	55	\$27,365	\$1,684	\$25,681
26	\$66,194	\$4,073	\$62,121	56	\$26,544	\$1,633	\$24,911
27	\$64,208	\$3,951	\$60,257	57	\$25,748	\$1,584	\$24,163
28	\$62,282	\$3,833	\$58,449	58	\$24,976	\$1,537	\$23,439
29	\$60,413	\$3,718	\$56,696	59	\$24,226	\$1,491	\$22,735
30	\$58,601	\$3,606	\$54,995	60	\$23,499	\$1,446	\$22,053

Expense Components

Scenario 1 - Underwriting Expense Component Detail

Year	Boards & Bureaus	Director Fees	Employee Benefits	Insurance D&O	Professional Fees	Software	Office Expense	Rent	Salaries	Contracted Services	Pennsylvania DOI Exam	Misc.	Total
2016	\$17,500	\$77,000	\$21,500	\$142,900	\$62,000	\$25,000	\$36,400	\$67,500	\$243,500	\$35,000	\$11,700	\$10,000	\$750,000
1	18,025	77,770	22,575	142,900	63,860	25,750	37,492	69,525	250,805	36,050	12,051	10,300	767,103
2	18,566	78,548	23,704	142,900	65,776	26,523	38,617	71,611	258,329	37,132	12,413	10,609	784,725
3	19,123	79,333	24,889	142,900	67,749	27,318	39,775	73,759	266,079	38,245	12,785	10,927	802,883
4	19,696	80,127	26,133	67,900	69,782	28,138	40,969	75,972	274,061	39,393	13,168	11,255	746,594
5	20,287	80,928	27,440	67,900	71,875	28,982	42,198	78,251	282,283	40,575	13,564	11,593	765,875
6	20,896	81,737	28,812	67,900	74,031	29,851	43,464	80,599	290,752	41,792	13,970	11,941	785,744
7	21,523	82,554	30,253	67,900	76,252	30,747	44,767	83,016	299,474	43,046	14,390	12,299	806,221
8	22,168	83,380	31,765	67,900	78,540	31,669	46,110	85,507	308,459	44,337	14,821	12,668	827,325
9	22,834	84,214	33,354	67,900	80,896	32,619	47,494	88,072	317,712	45,667	15,266	13,048	849,075
10	23,519	85,056	35,021	67,900	83,323	33,598	48,919	90,714	327,244	47,037	15,724	13,439	871,493

Source: Company data; based upon budget for 2016 excluding any demutualization-related costs