

# ensemble



FPIC Insurance Group, Inc.  
2000 Annual Report

## ABOUT THE COMPANY

FPIC Insurance Group, Inc. (the “Company”), through its subsidiary companies, is a leading provider of professional liability insurance for physicians, dentists and other healthcare providers, and for attorneys, primarily in Florida and Missouri. In addition, it provides third-party administration services both within and outside the healthcare industry and management and administration services to Physicians’ Reciprocal Insurers, a New York medical professional liability insurance reciprocal. The Company’s insurance subsidiaries, Florida Physicians Insurance Company, Inc., Anesthesiologists Professional Assurance Company, Intermed Insurance Company and Interlex Insurance Company, are rated A- (Excellent) by A.M. Best.

## ENSEMBLE

*A shared vision, symmetry of purpose, goals, objectives, and execution* - these are the foundational elements of the Company’s strategic plan that will allow it to continue to grow and strengthen. Much like a musical ensemble, enhancements to the Company’s overall performance result from a unified effort of all of its parts.

Just as musicians must collaborate to produce a sound that is stronger and better than any one instrument can produce alone, so the Company and its subsidiaries work together to pool their knowledge and resources in the creation of new and better products, services and business strategies.

Just as the musical elements of fine tuning, rhythm, melody, and harmony combine to make the whole musical ensemble more than just the sum of its parts, the Company’s strategic framework relies on a similar combination of elements. By growing the business, creating business solutions, remaining competitive, and focusing on fundamentals, the Company continues to function consistently, profitably, and harmoniously.

## FORWARD-LOOKING STATEMENTS

*The Private Securities Litigation Reform Act of 1995 provides a “safe harbor” for forward-looking statements. Any written or oral statements made by or on behalf of the Company may include forward-looking statements, which reflect the Company’s current views with respect to future events and financial performance. These forward-looking statements are subject to certain uncertainties and other factors that could cause actual results to differ materially from such statements. These uncertainties and other factors (which are described in more detail in documents filed by the Company with the Securities and Exchange Commission) include, but are not limited to, (i) uncertainties relating to government and regulatory policies (such as subjecting the Company to insurance regulation or taxation in additional jurisdictions or amending, revoking or enacting any laws, regulations or treaties affecting the Company’s current operations), (ii) the occurrence of insured or reinsured events with a frequency or severity exceeding the Company’s estimates, (iii) legal developments, (iv) the uncertainties of the loss reserving process, (v) the actual amount of new and renewal business and market acceptance of expansion plans, (vi) the loss of the services of any of the Company’s executive officers, (vii) changing rates of inflation and other economic conditions, (viii) the ability to collect reinsurance recoverables, (ix) the competitive environment in which the Company operates, related trends and associated pricing pressures and developments, (x) the impact of mergers and acquisitions, including the ability to successfully integrate acquired businesses and achieve cost savings, competing demands for the Company’s capital and the risk of undisclosed liabilities, and (xi) developments in global financial markets that could affect the Company’s investment portfolio and financing plans.*

*The words “believe,” “anticipate,” “estimate,” “project,” “plan,” “expect,” “intend,” “hope,” “will likely result” or “will continue” and variations thereof or similar expressions identify forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.*

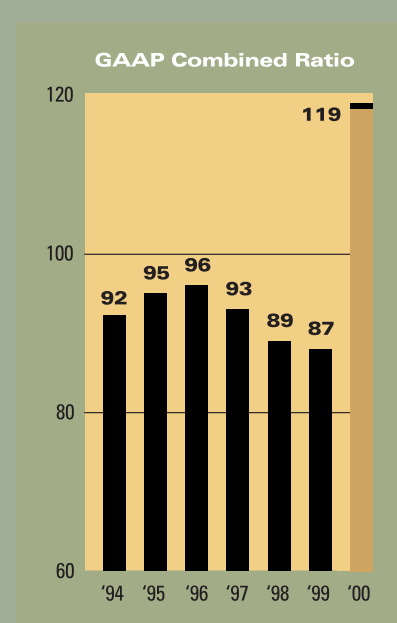
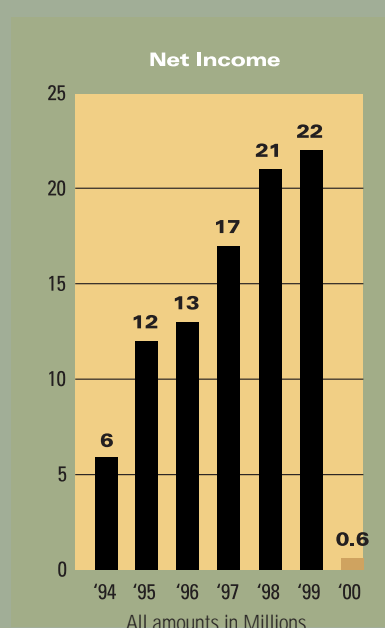
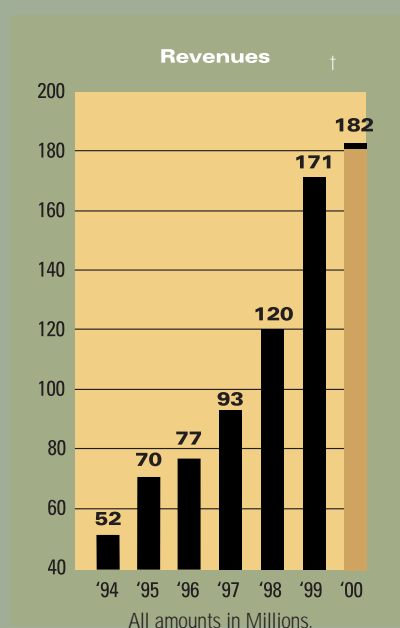
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# 7 Year Summary AND SELECTED FINANCIAL DATA

The selected financial data presented for the fiscal years ending December 31 should be read in conjunction with the Company's consolidated financial statements and the notes thereto, which are included elsewhere herein.

(In thousands except per share amounts)

<u>CONSOLIDATED</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>	<u>1995</u>	<u>1994</u>
Revenues	\$ 182,037	170,505	120,321	93,216	76,982	69,531	52,306
Operating earnings	\$ 673	21,641	20,718	16,536	13,371	11,529	10,420
Net income	\$ 614	21,869	20,693	16,557	13,324	11,686	5,877
<u>INVESTMENT ACTIVITY</u>							
Net investment income	\$ 24,743	19,024	17,549	15,979	14,704	12,740	10,928
Net realized investment gains (losses)	\$ (91)	351	(39)	32	(71)	238	(6,657)
<u>OTHER SELECTED FINANCIAL DATA</u>							
Total assets	\$ 652,369	587,920	479,378	352,850	303,553	276,699	244,266
Loss and loss adjustment expense ("LAE") reserves	\$ 281,295	273,092	242,377	188,086	172,738	164,506	152,268
Revolving credit facility	\$ 67,219	62,719	27,165	—	—	—	—
Shareholders' equity	\$ 172,527	166,379	150,931	120,064	96,411	81,556	61,606
Common shares outstanding	9,380	9,621	9,519	9,180	9,022	8,140	7,760
<u>PER SHARE DATA</u>							
Operating earnings	\$ .07 (*)	2.16 (*)	2.11	1.76	1.53	1.45	1.34
Diluted earnings	\$ .06	2.19	2.11	1.76	1.53	1.47	0.76
Book value	\$ 18.39	17.29	15.86	13.08	10.69	10.02	7.94
Year-end market price	\$ 9.19	16.69	47.81	29.13	13.50	(**)	(**)
Cash dividends	\$ —	—	—	—	.10	.10	.10
<u>UNDERWRITING</u>							
Direct and assumed premiums written	\$ 197,280 (†)	148,216	116,989	77,771	64,292	56,641	52,454
Consolidated statutory surplus	\$ 108,499	117,880	117,278	87,876	76,520	70,039	60,185
GAAP combined ratio:							
Loss and LAE ratio	102%	69%	75%	82%	84%	85%	83%
Underwriting expense ratio	17%	18%	14%	11%	12%	10%	9%
Combined ratio	119%	87%	89%	93%	96%	95%	92%



(\*) Operating earnings for the year 2000 were \$2.2 million, or \$.23 per diluted share, excluding the effects of non-recurring severance and restructuring costs. Operating earnings for the year 1999 were \$23.4 million, or \$2.32 per diluted share, excluding the effects of non-recurring severance costs.

(\*\*) The Company became publicly held in August 1996.

# Letter to Shareholders

FROM THE CHAIRMAN AND CEO



Robert O. Baratta, M.D.  
*Chairman*



## 2000 — A YEAR OF TRANSITION ... AND ACCOMPLISHMENTS

The year 2000 was one of transition for our Company, and for the professional liability insurance industry as a whole. It was also a year of initiatives and accomplishments for us.

During 2000, we focused our efforts on operating our businesses efficiently and prudently and positioned our Company for the challenges, and the opportunities, facing our industry. Among other things, we:

- Strengthened our balance sheet
- Divested ourselves of unprofitable products and non-core businesses
- Increased our insurance segment pricing
- Added management strength
- Improved our governance process at the board and management levels
- Implemented improved operating systems

In sum, after several years of acquisitions and rapid growth, we consolidated our focus on fundamentals.

We view the reserve strengthening we took in the fourth quarter of 2000 as the capstone of our efforts. We carefully monitor the Company's reserve position and believe our decision to strengthen reserves was a prudent step, reflecting the appropriate level of conservatism. While the reserve strengthening negatively impacted our fourth quarter earnings results, our first and foremost commitment is to maintain the financial strength of the Company. The strengthening allows us to move forward with a much higher degree of confidence in our reserve position and should allay any concerns in the marketplace regarding the adequacy of our reserves.

The other steps we took in 2000 also represent a focus on fundamentals and are intended to position us as a financially strong and profitable industry leader in the coming years.

For example, we divested ourselves of several non-core ventures that did not add to our bottom line, but required management time and attention. In addition, we began our withdrawal from our unprofitable health insurance business, which will be completed in 2001. We also began the consolidation of our third party administration businesses into a single operating unit and implemented organization-wide reporting and planning systems designed to focus our entire organization on common goals and objectives. These steps will allow us to maintain our focus on prudently and profitably operating our core businesses and will positively affect our financial results going forward.

During 2000, we implemented significant rate increases at each of our medical professional liability insurance companies and began to focus on reducing our levels of rate discounting. Our market position and long-term relationships with the medical community and our agency force allow us to take these steps to appropriately price our products without sacrificing our leadership position in the Florida market and our growing position in other markets.

Another area of focus for us during 2000 was the addition and efficient use of management talent at both the holding company and the operating companies. This talent, together with the abilities and experience of our staff



John R. Byers  
*President and  
Chief Executive Officer*

throughout our organization, is our greatest resource. With this talent in place, we are positioned to move our organization through the current challenging times in our industry and into the future.

In spite of the significant reserve charges we took in the fourth quarter, the consolidated statutory surplus of our insurance subsidiaries at year-end declined by only 8% from year-end 1999, remaining a healthy \$109 million. Our consolidated shareholders' equity at year-end actually increased to approximately \$173 million from \$166 million at year-end 1999 and revenues for the year grew to \$182 million. Our organization's financial strength is further demonstrated by the generation of net operating cash flows of nearly \$15 million for the year.

Overall, while 2000 was a challenging year for our Company from both an industry and a public market perspective and as the result of the changes within our organization, we emerged from the year with continued financial and operational strength, with a strong management team and solid franchises and in numerous ways more fundamentally sound and cohesive than ever in our history.

#### 2001 AND BEYOND

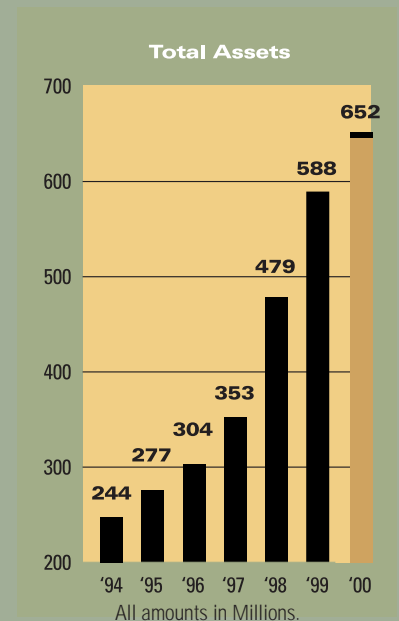
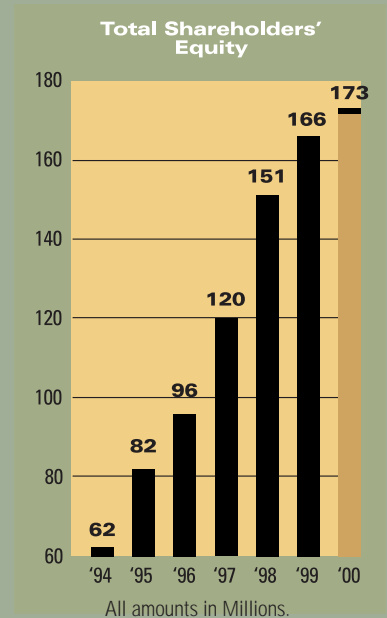
As we proceed into 2001, we recognize, and in no way minimize, the challenges in the marketplace in general and in our sector in particular. Having said this, our Company remains financially strong, is well positioned in major professional liability insurance markets, and is strategically diversified through its third-party administration and reciprocal management services. Furthermore, while the return of the public markets and our industry to strength remains a work in progress, we continue to see clear signs of a return to rationality and improvements in pricing in the medical professional liability insurance industry. We believe these factors, together with the actions taken by us in 2000, will begin to pay off in 2001.

During the year, we will continue to work to efficiently and prudently operate our businesses, carrying forward the improvements made during 2000. We will also continue to be open to the consideration of potential transactions that could benefit our Company and our shareholders. From a reserving and overall financial standpoint, we will proceed cautiously until we obtain a solid understanding of continuing claims and loss trends, with a view to maintaining the Company's financial strength. While we recognize this means margins may be lower in 2001 than in prior years, we believe we can accomplish this objective and remain profitable.

In sum, we believe we are well positioned to weather the challenges facing our industry and to maintain the financial strength and market position of our Company. Above all, we are committed to taking the necessary actions to maintain the strength of our organization and to create sustainable, long-term value for our shareholders.

Robert O. Baratta, M.D.  
Chairman

John R. Byers  
President and Chief  
Executive Officer



# Review of Operations

## YEAR 2000 & ORGANIZATIONAL CHART

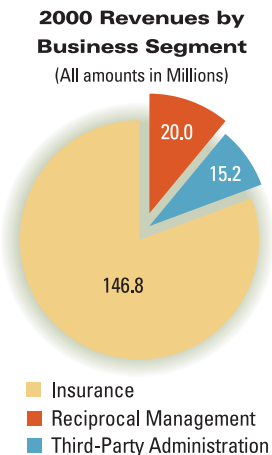
FPIC Insurance Group, Inc. (the "Company") has three reportable business segments.

The Company, through its insurance segment, specializes in professional liability insurance products and services for physicians, dentists and other healthcare providers, and for attorneys. The Company's insurance segment is made up of its four insurance subsidiaries, Florida Physicians Insurance Company, Inc. ("FPIC"), Anesthesiologists Professional Assurance Company ("APAC"), and The Tenere Group, Inc. ("Tenere") companies of Intermed Insurance Company ("Intermed") and Interlex Insurance Company ("Interlex").

In addition, the Company, through its third-party administration ("TPA") segment, markets and administers self-insured and fully insured plans for both large and small employers, including group accident and health ("A&H"), workers' compensation and general liability and property insurance. The Company's TPA operations also market alternative programs for non-traditional insurance needs. The Company's TPA segment is made up of its subsidiaries, McCreary Corporation ("McCreary") and Employers Mutual, Inc. ("EMI").

The Company also provides, through its reciprocal management ("RM") segment, management services for Physicians' Reciprocal Insurers ("PRI"), the second largest medical professional liability insurer in New York State. The Company's reciprocal management segment is made up of its New York subsidiary, Administrators for the Professions, Inc. ("AFP").

FPIC INSURANCE  
GROUP, INC.  
(THE COMPANY)  
*Florida Corp*  
(NASDAQ: FPIC)



The Company has adopted a four-part strategic framework by which it operates each of its business segments. The framework includes:

- Growing the business
- Creating business solutions
- Remaining competitive
- Focusing on fundamentals

FPIC INSURANCE AGENCY, INC.  
*Florida Corp (100% owned by the Company)*

MCCREARY CORPORATION (MCC)  
*Florida Corp (100% owned by the Company)*

APS INSURANCE SERVICES, INC.  
*Delaware Corp (20% owned by the Company)*

FLORIDA PHYSICIANS  
INSURANCE COMPANY, INC. (FPIC)  
*Florida Corp (100% owned by the Company)*

ANESTHESIOLOGISTS PROFESSIONAL  
ASSURANCE COMPANY  
*Florida Corp (100% owned by the Company)*

AMERICAN PROFESSIONAL  
ASSURANCE, Ltd. (APAL)  
*Cayman Islands Corp  
(9.9% owned by the Company)*

ADMINISTRATORS FOR  
THE PROFESSIONS, INC. (AFP)  
*New York Corp (100% owned by the Company)*

PROFESSIONAL, MEDICAL  
ADMINISTRATORS, LLC  
*New York LLC (70% owned by the Company)*

EMPLOYERS MUTUAL, INC. (EMI)  
*Florida Corp (100% owned by MCC)*

HCIF MANAGEMENT COMPANY  
*Minnesota Corp (13.2% owned by FPIC)*

THE TENERE GROUP, INC. (TENERE)  
*Missouri Corp (100% owned by FPIC)*

APA MANAGEMENT, INC.  
*Florida Corp (100% owned by APAL)*

GROUP DATA CORPORATION  
*New York Corp (100% owned by AFP)*

FPIC INTERMEDIARIES, INC.  
*New York Corp (100% owned by AFP)*

PROFESSIONAL STRATEGY OPTIONS, INC.  
*Florida Corp (100% owned by EMI)*

FPIC SERVICES, INC.  
*Florida Corp (87.5% owned by EMI)*

INTERMED INSURANCE  
COMPANY (INTERMED)  
*Missouri Corp (100%  
owned by TENERE)*

TROUT INSURANCE  
SERVICES, INC.  
*Missouri Corp (100%  
owned by INTERMED)*

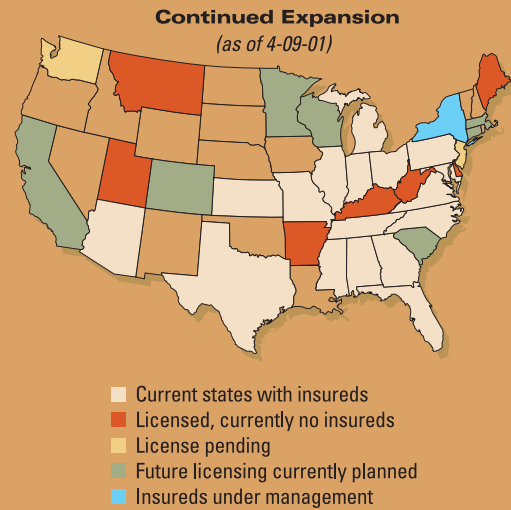
INTERLEX INSURANCE  
COMPANY  
*Missouri Corp (100%  
owned by INTERMED)*

INSURANCE SERVICES, INC.  
*Missouri Corp (100%  
owned by INTERMED)*



During 2000, the Company focused on growing its core businesses, the first part of its four-part strategic framework. Growth initiatives included promoting profitable top-line growth in the markets it serves, expanding into new geographic territories, expanding program business initiatives, and offering value-added products and services to its insureds.

The Company is currently licensed in twenty-four states, has license applications pending in two states and plans to make application for licensing in seven additional states. The Company



# Loud and Clear

GROWING THE BUSINESS

also has insureds under management in one additional state through its reciprocal management operation.

The Company's professional liability insurance segment currently serves approximately 12,100 policyholders. FPIC is the oldest and largest medical professional liability carrier in Florida, serving approximately 26% of the Florida market, and has earned endorsements from the Florida Medical Association, Florida Dental Association, Florida Obstetric & Gynecologic Society, and the Florida Chapter of ACP-ASIM. APAC is the leading insurance underwriter for anesthesiologists in Florida and was the first national insurance program designed by and for anesthesiologists. FPIC and APAC are the only remaining medical professional liability insurance carriers domiciled in the State of Florida. Tenere brings a new underwriting specialty to the Company, professional liability insurance for lawyers, while continuing to enhance the segment's medical professional liability business, as well. The Company's four insurance subsidiaries have an A- (Excellent) group rating from A. M. Best. The success of the insurance segment is based on providing the best medical professional liability coverage, earning and keeping the trust of its policyholders, using actuarially sound underwriting practices, targeting profitable specialties, aggressively managing claims and focusing on risk management. Growth initiatives in the insurance segment include increasing market share in the markets it serves, expansion into new geographic territories, expansion of program business initiatives, which include fronting relationships, and offering value-added products and services to its insureds.



workers' compensation programs. Management believes that its TPA business will continue to grow. The segment's success is indicative of its ability to continue to add new clients in a competitive business that rewards outstanding customer service. Growth initiatives for the segment include increasing market share in the markets it currently serves through the addition of new clients and by offering new products and services. Expansion into a broader geographical area is also planned. The segment is also expanding into alternative risk markets through the consulting services offered on risk management initiatives outside the traditional insured/insurer structure.

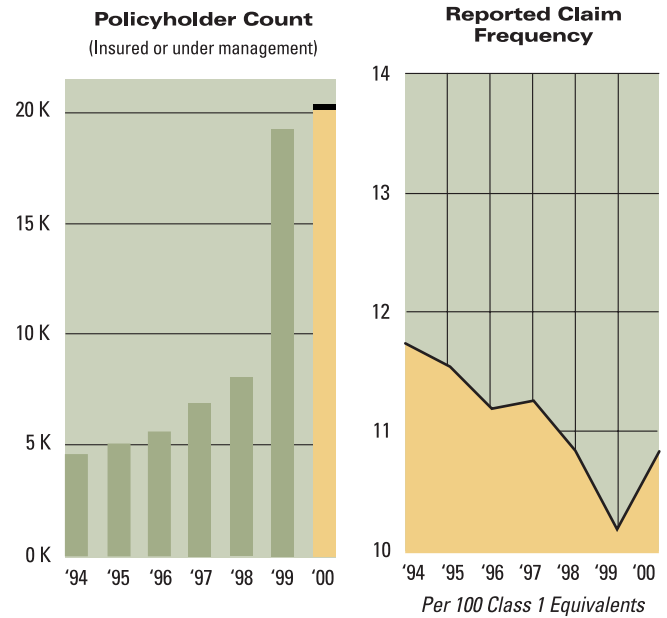
The Company's reciprocal management operations currently provide administrative services for approximately 8,200 professional liability policyholders, with approximately \$812 million of assets under management. The segment continues to build the reputation of PRI, the reciprocal it serves, as a company that "would rather fight than settle." PRI is the second largest insurer of medical professional liability in New York State, the largest and one of the most demanding markets in the world. During 2000, PRI introduced professional liability coverage for dentists and expanded its program business initiatives to include alternative risk financing mechanisms. Reciprocal management continues to use past successes as building blocks for future achievement, focusing on managing claims aggressively, proactive risk management, and exceptional service. Profitable growth is expected for PRI from the expansion of its products and services and by maintaining quality underwriting, while expanding the classes of medical professionals and other healthcare entities it serves. Growth initiatives for reciprocal management also include identifying opportunities to apply its administrative strengths in new business areas.

Third-party administration operations currently serve approximately 144,000 covered lives under employee benefit and



The second part of the Company's four-part strategic framework focuses on creating business solutions. During 2000, management worked to pool its knowledge and resources for the creation of new and better products, services and business strategies.

Simply adding policyholders is not enough to be competitive in the Company's insurance segment. This year, the segment has focused on preferred service and creative business solutions for its policyholders. Enhanced risk management programs, value-added products and services, technological enhancements, increased lobbying efforts, and accidental death and disability coverage for insureds are among the enhancements offered. Risk management programs have been developed to allow shared best practices among insured physicians. Value-added products and services offered to insureds include investigation defense coverage, Medicare/Medicaid fraud and abuse coverage, business office coverage and practice enhancement consulting. Management has also found ways to strengthen its relationship with its insureds, and to help resolve issues related to frequency and severity on its lines, by putting tomorrow's technology in the hands of its physicians today. Technological enhancements include



# Striking a Chord

CREATING BUSINESS SOLUTIONS

development of an e-business medical malpractice Internet site for on-line quotations, which will be used in the future for communications with insureds on risk management topics. In addition, lobbying efforts have been expanded. To the extent the legislature's agenda allows for medical professional liability issues to be heard, the Company has a lobbyist present and speaking on behalf of its insured physicians. Finally, up to \$100,000 of accidental death and disability coverage has been provided to insured physicians, with the opportunity for additional coverage at relatively low costs. The insurance segment has worked hard to earn and keep the trust of its policyholders.

The Company's TPA operations are in the process of enhancing their core administrative services with customer Internet access and an increase in "carve out" specialty services. During the past year, the Company invested in new technology and a web-based claims information system that will allow clients quick and easy access to claims data through a web browser. The segment has also focused on and increased its covered lives on "carve out" specialty services, which include claims payment administration for ambulance services. Through such investments and other service enhancements, management believes the TPA segment can differentiate itself and remain competitive within its markets.

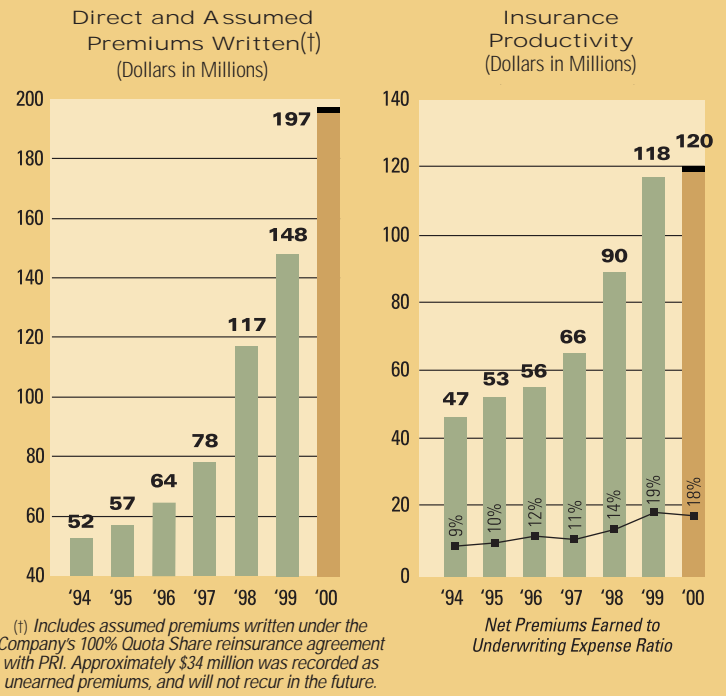


The reciprocal management segment is squarely focused on creating business solutions that meet and anticipate the needs of PRI's policyholders. Reciprocal management has positioned PRI as an exceptional risk manager, offering educational programs to its policyholders that provide in-depth, risk-reduction strategies. A risk-sharing program has also been offered for hospitals and large physician groups seeking greater participation in managing their medical professional liability exposures. By arranging for value added insurance coverage and foregoing commissions in key areas, reciprocal management has found creative ways to save money for PRI's policyholders. Through affinity relationships with other carriers, PRI is also able to offer guaranteed life insurance, homeowners and automobile coverages and long-term disability coverage. Innovative risk finance and risk transfer formats are both offered by PRI's healthcare facilities division through the use of a captive. PRI also introduced preferred banking products and services for its subscribers. During 2000, the reciprocal management segment was also able to offer the Company an opportunity for further diversification through participation as a reinsurer of PRI. A 100% quota share reinsurance agreement was finalized during 2000, whereby the Company's insurance subsidiaries have assumed the death, disability and retirement coverage provided under PRI's claims-made policies.



Being competitive is the third part of the Company's four-part strategic framework. During 2000, and with the benefit of signs that rational pricing is returning to the marketplace, the Company was able to increase its pricing and began reducing its levels of discounting, while achieving growth in its total base of insureds. The Company also focused on sound expense management and achieved targeted expense savings.

By taking advantage of its long-standing relationships and outstanding service reputation in Florida, FPIC has been able to maintain its leadership position in the market. FPIC increased its base insurance rates by an average of 11% effective January 1, 2001, in addition to rate increases taken of approximately 9% on higher limit policies, which went into effect June 1, 2000. APAC increased its base rates by 12.5% effective July 1, 2000 and Intermed implemented a 9% rate increase in November 2000. Each of the Company's insurance subsidiaries have seen their competitors file for significant rate increases during 1999 and 2000 and some competitors have taken two increases. In addition to the rate increases taken, other signs exist to confirm a firming trend in prices. Various industry analysts and observers



# Staying in Tune

REMAINING COMPETITIVE

report they are seeing a turn in the cycle and the Company's independent agents and brokers advise they are seeing rising prices. FPIC has been able to increase its pricing, maintaining its prices at or near the top of the list among its competitors in the majority of specialties it insures, and at the same time, achieve better than expected policyholder retention. Concurrently with increasing prices, management has focused on reducing its levels of discounting. Management also believes that it has improved the risk profile of its business through its targeted specialty programs. FPIC has accumulated data regarding loss experience by specialty that suggests that retention has been higher in targeted (lower loss ratio) specialties than non-targeted specialties. Accordingly, marketing efforts have targeted specialties where management has determined that the underlying risks are most acceptable and where actuarially appropriate pricing is achievable. Both the near-term and the long-term outlook for the insurance segment is positive and management believes the segment will emerge from this cycle well positioned to grow.



In addition to pricing considerations, the Company has focused during 2000 on capturing the cost savings that result from restructuring to achieve efficiencies and consolidating to eliminate redundant operations. Management implemented a restructuring plan in its Albuquerque, New Mexico TPA operations in an effort to reposition that operation to serve new accounts and to pursue other possible business opportunities in the Western U.S. The TPA downsized the Albuquerque operations from approximately 80 full-time employees to approximately 50 employees. The Company has also approved a plan to

consolidate its two TPA legal entities, McCreary and EMI, with EMI emerging as the surviving corporation. EMI will roll out a new marketing plan this spring and will look for additional platform consolidation opportunities in 2001.

Targeted expense savings in these and other operations in 2000, particularly in the insurance segment, have included salaries and benefits, reinsurance brokerage fees, group accident and health claims payment processes and outsourcing of investment accounting. Management expects that its consolidation, restructuring, and targeted expense savings will positively impact the Company's financial results going forward.

The Company has also achieved efficiencies in 2000 by utilizing the in-house reinsurance brokerage services of its New York affiliate and by beginning the upgrade of reciprocal management's database in order to maximize its ability to analyze claims, risk management, and underwriting data.

In addition to its decision to consolidate and restructure its TPA operations, the Company made the decision during 2000 to improve its balance sheet and positively affect earnings quality for the future by exiting several non-core ventures and certain customer and business relationships that were unprofitable, including SyMed Development, Polaris Insurance Group, FPIC Publishing, and as of January 31, 2001, Bexar Credentials Verification. In the last year the insurance segment also began exiting its A&H insurance business, which will be complete in November 2001.

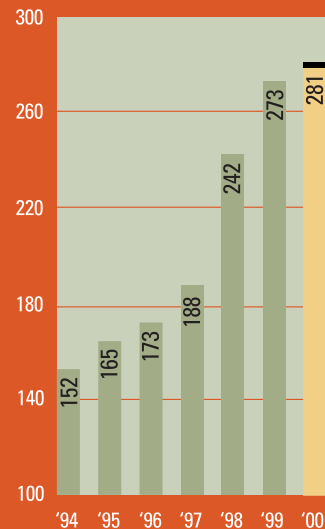


The fourth part of the strategic framework, and its foundation, is the Company's focus on its fundamentals. This part begins and ends with fundamental core values, for which there are no compromises, and encompasses the core foundational elements that are important to our businesses, including our people, our financial strength, prudent operating principles and superior operating systems.

In September 2000, John Byers was elected President and Chief Executive Officer of the Company. Since his election, the Company has added significant management strength at the holding company and its operating subsidiaries and has experienced insurance and corporate executives throughout. The integrity of the Company's management is its most fundamental core value. Management strives to achieve

**Loss and LAE Reserves**

(All amounts in Millions)



# A Steady Rhythm

## FOCUSING ON FUNDAMENTALS

excellence in everything it undertakes and is poised to meet the challenges of the markets and industries in which it operates.

Facing a competitive market, in 2000 management focused on the Company's highest priority — maintaining its balance sheet and financial strength. Substantial attention was given to both reserve adequacy and pricing. As the Company brought 2000 to a close and completed its year-end reserve study, it strengthened its balance sheet by increasing net reserves \$21 million, or approximately 10%, which covered all lines of business, all years, and all companies. The reserve strengthening placed the Company's booked reserves at the point estimate of its independent actuaries' range. For regulatory or statutory reporting purposes, the Company's aggregate reserves, including death, disability and retirement reserves, are within the upper portion of the independent actuaries' range. The Company carefully monitors its reserve position. Management believes its decision to strengthen reserves was a prudent step and that it reflects the appropriate level of conservatism in the Company's reserving. Thus, as the Company moves forward into 2001 and beyond, it does so with a much higher degree of confidence in the Company's reserve position.



Management also believes that not taking into account the positive effects of the Company's recent price increases in setting its 2001 reserves is a conservative decision that will provide an additional hedge against any unforeseen adverse developments and will reduce the likelihood of a need for another significant

strengthening. Management's highest priority is to maintain the adequacy of both the Company's pricing and its aggregate reserves for loss and LAE.

Management's decision to increase the Company's reserve levels can be viewed as the capstone of a year of transition. As a natural result of the reserve strengthening, net income for the year was reduced. However, the Company was able to report a profitable year for 2000 despite the reserve strengthening, and even though the Company will enter 2001 conservatively and margins will be lower than those reported in 1999, management believes the Company is well positioned to take advantage of its firming markets and to compete effectively and grow.

The Company also focused, during 2000, on improving its operating systems, including expanding its strategic planning efforts and its accounting and reporting procedures and enhancing its information systems. Interactive strategic planning sessions were held with each of the Company's business segments to facilitate the exchange of operational information for strategic planning and execution purposes. Accounting and reporting procedures were enhanced and will be further supported in 2001 by specialized accounting software applications, the implementation of which was begun in 2000. Information systems initiatives were undertaken to enhance infrastructure and operating systems. The Company's management remains committed to finding new and innovative ways to communicate and process information, share knowledge and leverage resources and best practices across Company lines.

# Board of Directors 2000



Robert O. Baratta, M.D.

*Chairman*



David M. Shapiro, M.D.

*Vice Chairman*



John R. Byers

*President and  
Chief Executive Officer*



Gaston J. Acosta-Rua, M.D.



Richard J. Bagby, M.D.



James W. Bridges, M.D.



Curtis E. Gause, D.D.S.



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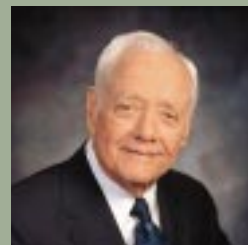
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# Financial Data 2000

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# Management's Discussion and Analysis

## of Financial Condition and Results of Operations

### GENERAL

FPIC Insurance Group, Inc. ("FIG" or the "Company") was formed in 1996 in connection with a reorganization (the "Reorganization") pursuant to which it became the parent company of Florida Physicians Insurance Company, Inc. ("FPIC") and McCreary Corporation ("McCreary"), a third party administrator. In connection with the Reorganization, FPIC's shareholders became the shareholders of the Company and received five shares of the Company's common stock for each of their shares of FPIC's common stock.

The Company has three main operating segments as follows: insurance, third party administration ("TPA") and reciprocal management ("RM"). The Company's primary sources of revenue are management fees and dividends received from its subsidiaries. The primary sources of revenues for these amounts are premiums earned and investment income derived from the insurance segment and fee and commission income from the TPA and RM segments.

Through the insurance segment, the Company specializes in professional liability insurance products and services for physicians, dentists, other healthcare providers and attorneys. The Company's medical professional liability ("MPL") insurance is written substantially on a "claims-made" basis (as opposed to an "occurrence" basis) providing protection to the insured only for those claims that arise out of incidents occurring, and of which notice to the insurer is given, while coverage is in effect. The Company also offers "tail coverage" for claims reported after the expiration of the policy for occurrences during the coverage period. The price of tail coverage is based on the length of time the insured has been covered under the Company's claims-made form. The Company provides free tail coverage for insured physicians who die or become disabled during the coverage period of the policy and for those who have been insured by the Company for at least five consecutive years and retire completely from the practice of medicine. The Company provides TPA services through its subsidiaries that market and administer self-insured and fully insured plans for both large and small employers, including group accident and health insurance, workers' compensation and general liability and property insurance. Through the RM segment, the Company provides management and administrative services and acts as attorney-in-fact for Physicians' Reciprocal Insurers ("PRI"), a New York medical professional liability insurance reciprocal.

The Company's financial position and results of operations are subject to fluctuations due to a variety of factors. Unexpected high frequency or severity of losses for the Company's insurance subsidiaries in any period, particularly in the Company's prior three policy years, could have a material adverse effect on the Company. In addition, reevaluations of the liability for loss and LAE could result in an increase or decrease in liabilities and a corresponding adjustment to earnings. The Company's historical results of operations are not necessarily indicative of future earnings.

### OVERVIEW

Fiscal year 2000 was a very challenging one for the Company and the entire medical malpractice sector. Net income declined to \$.6 million from \$21.9 million reported in 1999, primarily due to increases in the provision for losses and loss adjustment expenses ("LAE") reported in 2000, corresponding with rising loss costs in both 2000 and in recent prior years. Fully diluted earnings per share declined to \$.06 per share from \$2.19 per share in 1999.

Despite these challenges, the Company was able to grow both revenues and assets significantly in 2000, benefiting in large part from its acquisitions in 1998 and 1999. Total revenues increased 7% to \$182.0 million in 2000, from \$170.5 million in 1999. Revenues grew 42% in 1999 over 1998.

Not only have the Company's recent acquisitions provided growth, but also diversification, helping it to better withstand the risks associated with a downturn in its core medical malpractice business such as that experienced in 2000. During 1996, the year the Company went public, medical malpractice insurance comprised approximately 98% of the Company's direct premiums written, with 99% of the Company's direct MPL business in the state of Florida. In the year 2000, medical malpractice insurance comprised approximately 85% of the Company's direct premiums written, with 60% of the Company's direct MPL business in the state of Florida.

Management focused substantial efforts in 2000 towards the integration of its recent acquisitions, exiting certain small and unprofitable businesses and products, and other operating improvements, as the environment for strategic acquisitions substantially declined in 2000. As a result of these actions, total revenues are expected to decline slightly in 2001 from those reported in the year 2000. However, management believes that these actions have helped position the Company to more effectively compete, grow and remain profitable in the future. Furthermore, there are preliminary signs that prices in the Company's core medical professional liability business are beginning to increase in 2000 after several years of significant competition, particularly in Florida. It is, therefore, expected that the Company's revenues will return to growth in 2002 as market conditions improve for its core medical malpractice insurance business.

# Management's Discussion and Analysis continued

## INSURANCE SEGMENT

The underwriting results, other significant financial data and income or loss before taxes for the Company's insurance segment for the twelve months ended December 31, 2000, 1999 and 1998 are summarized in the table below. Dollar amounts are in thousands.

	2000	Percentage Change	1999	Percentage Change	1998
Direct and assumed premiums written . . . . .	\$ 197,280	33%	148,216	27%	116,989
Net premiums earned . . . . .	120,454	2%	118,189	32%	89,562
Losses and LAE incurred . . . . .	122,766	52%	80,968	20%	67,362
Other underwriting expenses . . . . .	20,514	(2)%	21,014	68%	12,513
Underwriting (loss) gain . . . . .	\$ (22,826)	(241)%	16,207	67%	9,687
Net investment income . . . . .	\$ 24,505	30%	18,832	8%	17,385
Net other expense . . . . .	\$ 185	(87)%	1,473	208%	(1,359)
(Loss) income before taxes . . . . .	\$ (3,570)	(112)%	30,000	8%	27,684

The increase in direct premiums written in 2000 is related to an increase in written premiums in Texas, Alabama, Missouri, Kansas, and Georgia, complimented by the acquisition of The Tenere Group, Inc. ("Tenere") on March 17, 1999, which was only included after such date for 1999.

In fiscal year 2000, total insureds grew to 12,150 at December 31, 2000, an increase of 832 or 7%, from 11,318 in 1999. Physician insureds increased to 8,195, an increase of 290 or 4%, from 7,905 in 1999. Dental insureds increased to 2,252 in 2000, an increase of 78 or 4%, from 2,174 in 1999. Growth was also achieved during 2000 in other product areas such as legal professional liability ("LPL") and accident and health ("A&H").

Assumed premiums written for fiscal year 2000 were \$64.3 million, an increase of \$30.3 million or 89%, from \$34.0 million in fiscal year 1999. The increase in assumed premiums is primarily related to the 100% quota share reinsurance agreement written in the first quarter of 2000 between the Company's insurance subsidiaries and PRI, whereby the Company assumed the death, disability and retirement ("DD&R") risks under PRI's claims-made insurance policies in exchange for cash and investments. Approximately \$34 million of this amount represents the portion of the initial consideration received corresponding with management's estimate of the reserves required for future benefits at the inception of the contract, which were recorded as unearned premium. This amount of assumed premiums written will, therefore, not recur in the future. In addition, the increase in assumed premiums was offset by experience adjustment accruals for business assumed from PRI. The experience adjustments represent an estimate of the amount of premium the Company will return to PRI in future years.

The increase in direct and assumed premiums written in 1999 was primarily due to the acquisitions of Anesthesiologists Professional Assurance Company ("APAC") and Tenere, which added \$6.1 million and \$6.2 million, respectively, and additional assumed premiums written of \$12.1 million associated with the Company's participation as an assuming reinsurer of PRI.

In fiscal year 1999, total insureds grew to 11,318, an increase of 2,793 or 33%, from 8,525 in 1998. Physician insureds grew 24%, to 7,905 in 1999, up from 6,383 in 1998. Dental insureds grew 18%, to 2,174 in 1999, up from 1,843 in 1998. Growth was also achieved during 1999 in other product areas such as legal defense for healthcare provider licensure investigations, group A&H insurance coverage and errors and omissions and directors and officers liability insurance for managed care organizations.

Net premiums earned increased \$2.2 million to \$120.4 for the twelve months ended December 31, 2000 from \$118.2 million for the twelve months ended December 31, 1999. The increase in net premiums earned is related to growth in assumed reinsurance, which contributed additional assumed premiums earned of \$3.1 million, and growth in direct premiums written at APAC and Tenere during the year 2000. The Company increased premium rates at FPIC and APAC in Florida and increased premium rates at Tenere in Missouri in 2000. As a result of the rate increases taken by FPIC, selective underwriting, and the competitive environment in Florida, net premiums earned have decreased in FPIC's core MPL business, and FPIC has experienced a decline in its physician insureds since 1998. APAC and Tenere have experienced relatively more favorable market conditions, which has allowed them to grow their earned premiums and policyholder counts. Such growth has offset some of the decline in net premiums earned at FPIC, and resulted in the overall increases in the Company's direct professional liability insureds since 1998.

Net premiums earned increased \$28.6 million to \$118.2 for the twelve months ended December 31, 1999 from \$89.6 million for the twelve months ended December 31, 1998. The increase in net premiums earned was primarily due to the acquisition of Tenere and the recognition of a full year of premiums earned at APAC. The Company also reported additional assumed MPL premiums of \$13.4 million and health premiums of \$4.7 million.

Net losses and LAE incurred increased \$41.8 million to \$122.8 million for the twelve months ended December 31, 2000 from \$81.0 million for the twelve months ended December 31, 1999. The loss ratios were 102% and 69% for the twelve months ended December 31, 2000 and December 31, 1999, respectively. A loss ratio is defined as the ratio of loss and LAE incurred to net premiums earned. The increase in net loss and LAE incurred is primarily due to an increase in the loss and LAE provision during 2000 resulting from a reserve strengthening of \$21.0 million, including an increase in the current year provision for MPL business of \$7.8 million. In addition, the 1999 results included reserve releases of approximately \$17.0 million resulting from favorable development in loss experience on business written in years prior to 1999, which did not recur during the year 2000.

Management closely monitors the adequacy of its liabilities for loss and LAE incurred and underlying claims trends, including having the Company's outside consulting actuaries perform calculations periodically. During 2000, the Company identified certain unfavorable trends in the underlying claims data with respect to FPIC's core physicians' MPL business, including an increase in the rate of claims closed with indemnity payment, a slowdown in the overall closure rate of pending claims, and an increase in the severity of indemnity payments made during 2000 relating to prior periods. The Company and its outside consulting actuary further analyzed these trends and determined that additional reserves were required. As a result, the Company's reserve strengthening included an increase in FPIC's liability for loss and LAE of approximately \$15.0 million.

Net loss and LAE incurred increased \$13.6 million to \$81.0 million for the twelve months ended December 31, 1999 from \$67.4 million for the twelve months ended December 31, 1998. The loss ratios were 69% and 75% for the twelve months ended December 31, 1999 and 1998, respectively. The positive trend in the Company's loss ratio from 1998 to 1999 was primarily due to favorable loss and LAE experience on the Company's core MPL business, the addition of assumed reinsurance, which carries a lower loss ratio than the core MPL business, offset to some extent by adverse results from the Company's group A&H business.

The Company previously reported its plan to exit the A&H business by the end of 2001. Despite some improvement during the second and third quarters of 2000, the Company experienced a pre-tax loss of \$3.5 million in the fourth quarter of 2000. The Company expects the business to continue to record pre-tax losses in the range of \$2.0 million to \$3.0 million through the end of 2001, with lessening impact after the non-renewal of the majority of FDA policies beginning on April 1, 2001 and the non-renewal of the majority of FMA policies beginning on July 1, 2001.

The liability for losses and LAE represents management's best estimate of the ultimate cost of all losses incurred but unpaid and considers prior loss experience, loss trends, the Company's loss retention levels and changes in the frequency and severity of claims. Competitive market conditions in recent years have lessened the Company's ability to underwrite and price its business on as favorable terms as in prior years. Consequently, the Company has significantly increased its provisions for loss and LAE in 2000.

The process of establishing reserves for property and casualty claims is a complex and uncertain process, requiring the use of informed estimates and judgments. The Company's estimates and judgments may be revised as additional experience and other data become available and are reviewed, as new or improved methodologies are developed or as current laws change. Any such revisions could result in future changes in the estimates of losses or reinsurance recoverables, and would be reflected in the Company's results of operations when the change occurs.

Other underwriting expenses decreased \$0.5 million to \$20.5 million for the twelve months ended December 31, 2000 from \$21.0 million for the twelve months ended December 31, 1999. The decline in other underwriting expenses is attributable to a decline in assumed reinsurance costs and the accretion of the deferred credit associated with the 100% DD&R quota share reinsurance agreement entered into during the first quarter of 2000.

Other underwriting expenses increased to \$21.0 million in 1999, up \$8.5 million or 68%, from \$12.5 million in 1998. The increase was primarily attributable to an increase in expenses related to assumed premiums of \$1.4 million, and the inclusion of other underwriting expenses at APAC and Tenere, which combined, added \$6.0 million. In addition, general and administrative expenses increased \$2.3 million including a non-recurring severance charge of \$1.9 million and the Company's health insurance products, which grew significantly in 1999 and have a higher expense structure than the Company's MPL products.

Net investment income increased to \$24.5 million for the year ended December 31, 2000, up \$5.7 million or 30%, from \$18.8 million in 1999. The increase is primarily due to the investments received in association with the 100% DD&R quota share reinsurance agreement between the Company's insurance subsidiaries and PRI. On a consolidated basis, the Company's total investment portfolio grew to \$405.0 million in 2000, up \$58.4 million or 17%, from \$346.6 million in 1999.

Net investment income increased to \$18.8 million in 1999, up \$1.4 million, or 8%, from \$17.4 million in 1998. The increase was primarily attributable to the inclusion of Tenere, which added approximately \$1.9 million of investment income.

### THIRD PARTY ADMINISTRATION ("TPA") SEGMENT

Significant financial data and income before taxes for the Company's TPA segment for the twelve months ended December 31, 2000, 1999 and 1998 are summarized in the table below. Dollar amounts are in thousands.

	2000	Percentage Change	1999	Percentage Change	1998
Claims administration and management fees . . . . . \$	12,854	31%	9,850	(0.1)%	9,861
Commission income . . . . .	2,179	25%	1,741	0.6%	1,731
Claims administration and management expenses . . . . .	15,420	30%	11,823	19%	9,938
Net other expense . . . . .	2,289	48%	1,543	201%	512
(Loss) income before taxes . . . . . \$	(2,340)	(47)%	(1,588)	(234)%	1,181

Claims administration and management fees increased \$3.0 million to \$12.9 million for the twelve months ended December 31, 2000 from \$9.9 million for the twelve months ended December 31, 1999. The growth in claims administration and management fees is attributable to the asset acquisition of Brokerage Services, Inc. ("BSI") and Group Brokerage, Inc. ("GBI"), by Employers Mutual, Inc. ("EMI") during the third quarter of 1999, and the resulting recognition of a full twelve months of revenue from the acquired operations during the current year.

During the fourth quarter of 2000, the Company began its consolidation of the TPA operations and reorganization of BSI in order to improve operating performance. The Company incurred a one-time pre-tax charge of \$0.5 million as a result of the restructuring.

# Management's Discussion and Analysis continued

Commission income increased \$0.5 million to \$2.2 million for the twelve months ended December 31, 2000 from \$1.7 million for the twelve months ended December 31, 1999. The increase in commission income is the result of growth in the placement of insurance and reinsurance by McCreary with external parties on behalf of its self-insured customers during 2000.

Claims administration expense increased \$3.6 million to \$15.4 million for the twelve months ended December 31, 2000 from \$11.8 million for the twelve months ended December 31, 1999. The growth in claims administration and management expense is also primarily attributable to the acquisition of assets by EMI during the third quarter of 1999.

## RECIPROCAL MANAGEMENT ("RM") SEGMENT

Significant financial data and income before taxes for the Company's RM segment for the twelve months ended December 31, 2000, 1999 and 1998 are summarized in the table below. Dollar amounts are in thousands.

	2000	Percentage Change	1999	Percentage Change	1998
Claims administration and management fees . . . . . \$	17,044	0.5%	16,955	—	—
Commission income . . . . .	991	48%	670	—	—
Claims administration and management expenses . . . . .	14,537	2%	14,304	—	—
Net other expense . . . . .	932	167%	349	—	—
Income before taxes . . . . . \$	2,939	5%	2,790	—	—

Commission income increased \$0.3 million to \$1.0 million for the twelve months ended December 31, 2000 from \$0.7 million for the twelve months ended December 31, 1999. The increase in commission income is attributable to a full year of brokerage income from FPIC Intermediaries, which was formed during the second quarter of 1999.

## SELECTED BALANCE SHEET ITEMS – YEARS ENDED DECEMBER 31, 2000 AND 1999

Bonds and U.S. government securities increased \$58.4 million to \$385.5 million at December 31, 2000 from \$327.1 million at December 31, 1999. The increase is attributable to securities received in conjunction with the 100% DD&R quota share reinsurance agreement with PRI and growth in the invested assets at APAC and Tenere as a result of an increase in business written.

Net premiums receivable decreased \$3.4 million to \$31.2 million for the twelve months ended December 31, 2000 from \$34.6 million for the twelve months ended December 31, 1999. The reduction in net premiums receivable is mainly related to an increase in the allowance for doubtful accounts by \$1.0 million, of which \$.6 million was for a specific hospital receivable.

Deferred policy acquisition costs increased \$3.3 million to \$6.1 million for the twelve months ended December 31, 2000 from \$2.8 million for the twelve months ended December 31, 1999. The increase in deferred acquisition costs is attributable to the 100% DD&R quota share reinsurance agreement with PRI.

Intangible assets and goodwill, net decreased \$12.9 million to \$61.0 million for the twelve months ended December 31, 2000 from \$73.9 million for the twelve months ended December 31, 1999. The decrease is due to the recognition of a deferred credit associated with the 100% DD&R quota share reinsurance agreement with PRI and the amortization of goodwill and other intangibles.

The liability for loss and LAE increased \$8.2 million to \$281.3 million for the twelve months ended December 31, 2000 from \$273.1 million for the twelve months ended December 31, 1999. The net increase in the liability for loss and LAE is primarily attributable to the reserve strengthening recorded during the fourth quarter of 2000 of \$21.0 million. In addition, the Company also reduced the amount of reserves released from prior report years, which accounted for approximately \$17.0 million of the net increase in net loss and LAE incurred from 1999 to 2000. The difference between the increase in the provisions for losses and LAE during 2000, and the net increase in the ending balance of aggregate reserves is the result of the payment and settlement of claims during 2000, as compared with 1999.

Unearned premiums increased \$39.2 million to \$100.5 million for the twelve months ended December 31, 2000 from \$61.3 million for the twelve months ended December 31, 1999. The increase in unearned premiums is primarily attributable to the 100% DD&R quota share reinsurance agreement with PRI.

Other liabilities increased \$4.6 million to \$20.2 million for the twelve months ended December 31, 2000 from \$15.6 million for the twelve months ended December 31, 1999. The increase in other liabilities is attributable to changes in salary assumptions used in the actuarial calculation of the Company's supplemental executive retirement program and an increase in the amounts accrued for employee benefits. Also, the Company recorded additional accruals in accordance with the purchase agreements of McCreary and its subsidiaries and a restructuring charge associated with the reorganization of the TPA operations during 2000.

## INVESTMENTS

The Company invests primarily in a diversified portfolio of high grade, taxable and tax-exempt, fixed-income securities, with a targeted duration of approximately five years. The majority of these securities are held as invested assets by the various insurance subsidiaries. At the close of 2000, approximately 46% of the fixed-income portfolio was invested in tax-exempt securities and approximately 54% in taxable securities.

Realized investment gains and losses are recorded when investments are sold, other-than-temporarily impaired or in certain situations, as required by generally accepted accounting principles ("GAAP"), when investments are marked-to-market with the corresponding gain or loss included in earnings. Variations in the amount and timing of realized investment gains and losses could cause significant variations in periodic net earnings.

Net investment income increased \$5.7 million to \$24.7 million for the twelve months ended December 31, 2000 from \$19.0 million for the twelve months ended December 31, 1999. On a consolidated basis, the Company's total investment portfolio grew \$58.4 million to \$405.0 million in 2000 from \$346.6 million in 1999. The increase in net investment income is directly related to interest earned on securities received in connection with the 100% DD&R quota share reinsurance agreement with PRI.

## STOCK REPURCHASE PLANS

On June 29, 1999 and September 11, 1999, the Company's Board of Directors (the "Board") approved stock repurchase plans pursuant to which the Company was authorized to repurchase, at management's discretion, up to 1,000,000 of its shares on the open market. On September 11, 2000, the second plan expired with 259,500 shares left unpurchased. The Company's Board approved a third stock repurchase plan on January 25, 2000 under which the Company could repurchase 500,000 additional shares prior to January 22, 2001. The Board subsequently approved an extension of the plan to January 22, 2002. As of December 31, 2000, the Company had repurchased approximately 853,500 shares at a cost of approximately \$16.0 million, leaving 387,000 shares available under the Company's stock repurchase plans.

## LIQUIDITY AND CAPITAL RESOURCES

The payment of losses, LAE and operating expenses in the ordinary course of business is the principal need for the Company's liquid funds. Cash provided by operating activities has been used to pay these items and was sufficient during 2000 to meet these needs. Management believes these sources will be sufficient to meet the Company's cash needs for operating purposes for at least the next twelve months. However, a number of factors could cause increases in the dollar amount of losses and LAE and may therefore adversely affect future reserve development and cash flow needs. Management believes these factors include, among others, inflation, changes in medical procedures, increased use of managed care and adverse legislative changes. In order to compensate for such risk, the Company: (i) maintains what management considers to be adequate reinsurance; (ii) conducts regular actuarial reviews of loss and LAE reserves; and (iii) maintains adequate asset liquidity (by managing its cash flow from operations coupled with the maturities from its fixed income portfolio investments).

The Company maintains a \$75.0 million revolving credit facility with four banks to meet certain non-operating cash needs as they may arise. As of December 31, 2000, \$67.2 million had been borrowed under this facility at an interest rate of approximately 7.46% per annum. The credit facility bears interest at various rates ranging from LIBOR plus 0.75% to Prime plus 0.50%. The credit facility terminates on January 4, 2002. The Company anticipates that before such time, it will either replace the existing credit facility with a similar facility or obtain alternative financing. The Company is not required to maintain compensating balances in connection with this credit facility but is charged a fee on the unused portion, which ranges from 20 to 30 basis points. Under the terms of the credit facility, the Company is required to meet certain financial covenants. Significant covenants are as follows: a) the Company's funded debt to total capital plus funded debt cannot exceed 0.35:1 and b) net premiums written to statutory capital and surplus cannot exceed 2.0:1. Effective January 1, 2001, the funded debt to total capital plus funded debt ratio cannot exceed 0.30:1. At December 31, 2000, the Company was in violation of two of the loan covenants. The Company has obtained a waiver for these violations bringing the Company into compliance with its debt covenants. The credit facility is guaranteed by and collateralized by the common stock of certain subsidiaries.

At December 31, 2000, the Company held approximately \$15.2 million in investments scheduled to mature during the next twelve months, which combined with net cash flows from operating activities, are expected to provide the Company with sufficient liquidity and working capital. As reported in the accompanying consolidated statements of cash flows, the Company has generated positive net cash from operations of \$14.8 million, \$14.3 million and \$30.2 million in 2000, 1999 and 1998, respectively.

Shareholder dividends payable by the Company's insurance subsidiaries are subject to certain limitations imposed by Florida and Missouri laws. In 2001, these subsidiaries are permitted, within insurance regulatory guidelines, to pay dividends of approximately \$11.6 million, without prior regulatory approval.

The NAIC has developed risk-based capital ("RBC") measurements for insurers, which have been adopted by the Florida and Missouri Departments of Insurance. RBC measurements provide state regulators with varying levels of authority based on the adequacy of an insurer's adjusted surplus. At December 31, 2000, the Company's insurance subsidiaries maintain adjusted surplus in excess of their required RBC thresholds.

## ACCOUNTING PRONOUNCEMENTS

In December 1999, the Securities Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 101 ("SAB 101"), Revenue Recognition in Financial Statements, which outlines the basic criteria that must be met to recognize revenue and provides guidance for presentation of revenue and for disclosure related to revenue recognition policies in financial statements filed with the SEC. In June 2000, the SEC issued SAB 101(B), which defers the implementation date of SAB 101 to no later than the fourth fiscal quarter of fiscal years commencing after December 15, 1999. The adoption of SAB 100 did not have a significant impact on the Company's consolidated financial position or results of operations.

Statement of Financial Accounting Standard ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," was issued in June 1998, and establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. As issued, SFAS No. 133 is effective for all fiscal quarters of all fiscal years beginning after June 15, 1999. SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement

# Management's Discussion and Analysis continued

No. 133," was issued in June 1999 and defers the effective date of SFAS No. 133. SFAS No. 133 is now effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. The adoption of SFAS No. 133 did not have a significant impact on the Company's consolidated financial position or results of operations.

In March 2000, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation: an Interpretation of APB Opinion No. 25" ("FIN 44"). FIN 44 establishes accounting guidance for stock option grants and modifications to existing stock option awards and is effective for option grants made after June 30, 2000. The adoption of FIN 44 did not have a material effect on the consolidated financial statements of the Company.

## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in market conditions, such as changes in interest rates, spreads among various asset classes, foreign currency exchange rates, and other relevant market rate or price changes. Market risk is directly influenced by the volatility and liquidity in the markets in which the related underlying assets are traded. The following is a discussion of the Company's primary market risk exposures and how those exposures are currently managed as of December 31, 2000. The Company's market risk sensitive instruments are entered into for purposes other than trading.

The fair value of the Company's debt and equity investment portfolio as of December 31, 2000 was approximately \$386.0 million. Approximately 95% of the investment portfolio was invested in fixed maturity securities. The fixed maturity portfolio currently maintains an average credit quality of AA with Moody's.

Generally, the Company does not invest in derivatives and does not currently use hedging strategies in its investment portfolio. However, the Company has invested in interest rate swaps to fix the interest rate in connection with its revolving credit facility.

As of December 31, 2000, the Company's investments in collateral mortgage obligations ("CMOs") and asset-backed securities represented less than 34% of debt and equity investments. The CMO's held by the Company were purchased to improve Company projections of future cash flows and decrease prepayment risk. The Company's investment portfolio is predominately fixed maturity with approximately 46% allocated to the municipal sector. The balance is diversified through investments in treasury, agency, corporate and mortgage-backed securities. The four market risks that can most directly affect the investment portfolio are changes in U.S. interest rates, credit risks, prepayment risks, and legislative changes, including changes in tax laws that might affect the taxation of the Company's invested securities.

From time to time discussion arises in the United States Congress relative to changing or modifying the tax-exempt status of municipal securities. The Company is diligent in its efforts to stay current on legislative acts that could adversely affect the tax-exempt status of municipal securities. It is uncertain as to whether these changes would ultimately affect valuation of municipal securities currently held in the portfolio. At present there are no hedging or other strategies being used to minimize this risk.

The Company manages the change in interest rate risk by attempting to manage the duration of its investments in relation to the duration of its anticipated liabilities (claim payments). The Company invests in securities with investment grade credit ratings, thereby helping control credit risks. Approximately 60.1% of the portfolio is AAA, 11.5% is AA, 9.3% is A, and 14.1% is BBB rated. A standard measure of interest rate sensitivity is effective duration, which takes into account, among other things, the effect that changing interest rates will have on prepayments and the re-investment of these funds. The effective duration of the Company's portfolio is 5.28 years. If interest rates were to increase 100 basis points, the fair value of the Company's fixed maturity securities would decrease approximately \$21.1 million.

There have been no significant changes to the Company's exposure to financial market risks during the year nor does the Company currently anticipate any significant changes in future reporting periods.

The amounts reported as cash flows in the table below for fixed maturities represent par values at maturity date. The fair values of fixed maturities are based upon quoted market prices or dealer quotes for comparable securities. The fair value of the credit facility is based on the amount of cash flows discounted over the applicable term at the Company's borrowing rate at December 31, 2000.

	Projected Cash Flows (in thousands)							December 31, 2000 Fair Value
	2001	2002	2003	2004	2005	Thereafter	Total	
<b>Assets</b>								
Fixed maturity securities, available for sale .....	\$ 15,109	7,705	21,224	15,711	44,725	279,413	383,887	385,513
<b>Liabilities</b>								
Credit facility .....	\$ —	67,219	—	—	—	—	67,219	63,181
<b>Weighted Average Interest Rate</b>								
Fixed maturity securities .....	5.41%	5.27%	5.83%	6.46%	5.38%	5.32%	5.40%	—
Credit facility .....	—	6.39%	—	—	—	—	—	—

## CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

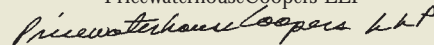
On April 28, 2000, the Company filed a form 8-K notifying the Securities and Exchange Commission of a change in its certifying accountant. The Company retained the services of PricewaterhouseCoopers LLP as its independent accountants and replaced KPMG LLP ("KPMG") effective April 24, 2000. No report of KPMG LLP on the financial statements of the Company for either of the past two years contained an adverse opinion, or disclaimer of opinion, or was qualified or modified as to uncertainty, audit scope, or accounting principles. Since the engagement of KPMG and through the date of replacement, there were no disagreements between the Company and KPMG on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure. The change in independent accountants was approved by the Audit Committee and the Board of Directors of the Company.

# Reports of Independent Certified Public Accountants

The Board of Directors and Shareholders of  
FPIC Insurance Group, Inc.:

In our opinion, the accompanying consolidated balance sheet as of December 31, 2000 and the related consolidated statement of income, comprehensive income, changes in shareholders' equity and cash flows, present fairly, in all material respects, the financial position of FPIC Insurance Group, Inc. and its subsidiaries at December 31, 2000, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. The financial statements of the Company as of December 31, 1999 and for the two years then ended were audited by other independent accountants whose report dated March 8, 2000 expressed an unqualified opinion on those statements.

PricewaterhouseCoopers LLP



Jacksonville, Florida  
February 20, 2001, except as to the  
matter discussed in the second  
paragraph of Note 10, as to which  
the date is March 30, 2001

The Board of Directors and Shareholders of  
FPIC Insurance Group, Inc.:

We have audited the accompanying consolidated balance sheet as of December 31, 1999 and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows of FPIC Insurance Group, Inc. and subsidiaries for the years ended December 31, 1999 and 1998. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of FPIC Insurance Group, Inc. and subsidiaries as of December 31, 1999 and the results of their operations and cash flows for the years ended December 31, 1999 and 1998, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP



Jacksonville, Florida  
March 8, 2000

# Consolidated Financial Statements

## Consolidated Balance Sheets As of December 31, 2000 and 1999 (in thousands, except share data)

	2000	1999
<b>Assets</b>		
Cash and cash equivalents	\$ 18,967	6,830
Bonds and U.S. Government securities, available for sale	385,513	327,076
Equity securities, available for sale	555	1,055
Other invested assets, at equity	3,134	3,549
Other invested assets, at cost	11,388	10,576
Real estate	4,398	4,333
Total cash and investments	423,955	353,419
Premiums receivable, net of allowance for doubtful accounts of \$1,659 and \$1,247 in 2000 and 1999, respectively	31,211	34,610
Accrued investment income	5,932	5,426
Reinsurance recoverable on paid losses	13,009	14,749
Due from reinsurers on unpaid losses and advance premiums	57,698	58,400
Ceded unearned premiums	10,107	6,283
Property and equipment, net	4,139	3,774
Deferred policy acquisition costs	6,136	2,789
Deferred income taxes	18,271	21,244
Finance charge receivable	471	482
Prepaid expenses	1,662	1,126
Goodwill and intangible assets, net	61,026	73,922
Federal income tax receivable	8,519	4,128
Other assets	10,233	7,568
Total assets	\$ 652,369	587,920
<b>Liabilities and Shareholders' Equity</b>		
Loss and loss adjustment expenses	\$ 281,295	273,092
Unearned premiums	100,462	61,314
Reinsurance payable	6,518	3,339
Paid in advance and unprocessed premiums	4,146	5,459
Revolving credit facility	67,219	62,719
Accrued expenses and other liabilities	20,202	15,618
Total liabilities	479,842	421,541
Commitments and contingencies (Note 16)		
Common stock, \$.10 par value, 50,000,000 shares authorized; 9,380,353 and 9,621,298 shares issued and outstanding at December 31, 2000 and 1999, respectively	938	962
Additional paid-in capital	37,827	41,858
Unearned compensation	(105)	(231)
Accumulated other comprehensive income (loss)	968	(8,495)
Retained earnings	132,899	132,285
Total shareholders' equity	172,527	166,379
Total liabilities and shareholders' equity	\$ 652,369	587,920

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Income**  
**For the Years Ended December 31, 2000, 1999 and 1998**  
(in thousands, except share data)

	<u>2000</u>	<u>1999</u>	<u>1998</u>
<b>Revenues</b>			
Net premiums earned	\$ 120,454	118,189	89,562
Net investment income	24,743	19,024	17,549
Net realized investment (losses) gains	(91)	351	(39)
Claims administration and management fees	29,898	26,805	9,861
Commission income	3,207	2,476	1,740
Finance charge and other income	3,826	3,660	1,648
Total revenues	<u>182,037</u>	<u>170,505</u>	<u>120,321</u>
<b>Expenses</b>			
Net losses and loss adjustment expenses	122,766	80,968	67,362
Other underwriting expenses	20,761	21,199	12,513
Claims administration and management expenses	29,957	26,128	9,937
Interest expense	4,291	3,981	844
Other expenses	7,233	7,026	801
Total expenses	<u>185,008</u>	<u>139,302</u>	<u>91,457</u>
(Loss) income before income taxes	(2,971)	31,203	28,864
Income tax (benefit) expense	<u>(3,585)</u>	<u>9,334</u>	<u>8,171</u>
Net income	<u>\$ 614</u>	<u>21,869</u>	<u>20,693</u>
Basic earnings per common share	<u>\$ 0.06</u>	<u>2.24</u>	<u>2.22</u>
Diluted earnings per common share	<u>\$ 0.06</u>	<u>2.19</u>	<u>2.11</u>
Basic weighted average common shares outstanding	<u>9,497</u>	<u>9,748</u>	<u>9,332</u>
Diluted weighted average common shares outstanding	<u>9,571</u>	<u>10,007</u>	<u>9,809</u>

*See accompanying notes to consolidated financial statements.*

# Consolidated Financial Statements continued

## Consolidated Statements of Comprehensive Income For the Years Ended December 31, 2000, 1999 and 1998 (in thousands)

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Net Income	\$ 614	21,869	20,693
Other Comprehensive Income			
Unrealized gains (losses) on securities			
Unrealized holding gains (losses) arising during period	\$ 14,697	(22,068)	3,097
Income tax benefit (expense) related to unrealized gains and losses on securities	<u>(5,234)</u>	<u>7,952</u>	<u>(1,110)</u>
Other comprehensive income (loss)	<u>9,463</u>	<u>(14,116)</u>	<u>1,987</u>
Comprehensive income	<u>\$ 10,077</u>	<u>7,753</u>	<u>22,680</u>

*See accompanying notes to consolidated financial statements.*

**Consolidated Statements of Changes in Shareholders' Equity**  
**For the Years Ended December 31, 2000, 1999 and 1998**  
(in thousands)

	Common Stock	Additional Paid-in capital	Accumulated Other Comprehensive Income	Retained Earnings	Unearned Compensation	Total
Balance, December 31, 1997	\$ 918	25,790	3,634	89,723	—	120,065
Net income	—	—	—	20,693	—	20,693
Compensation earned on option issue	—	—	—	—	(357)	(357)
Net unrealized gain on debt and equity securities	—	—	1,987	—	—	1,987
Issuance of shares, net	34	8,509	—	—	—	8,543
Balance, December 31, 1998	\$ 952	34,299	5,621	110,416	(357)	150,931
Net income	—	—	—	21,869	—	21,869
Compensation earned on option issue	—	—	—	—	126	126
Net unrealized loss on debt and equity securities	—	—	(14,116)	—	—	(14,116)
Issuance of shares, net	10	7,559	—	—	—	7,569
Balance, December 31, 1999	\$ 962	41,858	(8,495)	132,285	(231)	166,379
Net income	—	—	—	614	—	614
Compensation earned on option issue	—	—	—	—	126	126
Net unrealized gain on debt and equity securities	—	—	9,463	—	—	9,463
Repurchase of shares, net	(24)	(4,031)	—	—	—	(4,055)
Balance, December 31, 2000	\$ 938	37,827	968	132,899	(105)	172,527

*See accompanying notes to consolidated financial statements.*

# Consolidated Financial Statements continued

## Consolidated Statements of Cash Flows For the Years Ended December 31, 2000, 1999 and 1998 (in thousands)

	2000	1999	1998
<b>Cash flows from operating activities:</b>			
Net income	\$ 614	21,869	20,693
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	4,426	5,908	2,256
Realized (gain) loss on investments	91	(350)	39
Realized loss on sale of property and equipment	46	16	11
Noncash compensation	126	126	21
Net loss (earnings) from equity investments	192	339	(300)
Deferred income tax (benefit) expense	(3,276)	1,097	(361)
Writedown of goodwill to net realizable value	—	436	—
Bad debt expense	1,139	352	227
Changes in assets and liabilities:			
Premiums receivable, net	2,436	965	(19,136)
Accrued investment income, net	(506)	(25)	(831)
Due from reinsurers, net	1,799	(4,880)	5,080
Deferred policy acquisition costs	(3,347)	(526)	(590)
Prepaid expenses and finance charge receivable	(524)	(652)	(311)
Other assets	(3,081)	340	(1,621)
Loss and loss adjustment expenses	8,203	(6,790)	14,881
Unearned premiums	8,159	3,234	11,373
Paid in advance and unprocessed premiums	(1,312)	(308)	349
Federal income tax receivable / payable	(4,390)	(3,857)	(3,007)
Accrued expenses and other liabilities	4,048	(2,951)	1,456
Net cash provided by operating activities	14,843	14,343	30,229
<b>Cash flows from investing activities:</b>			
Proceeds from sale or maturity of bonds and U.S. Government securities	59,373	69,471	44,018
Purchase of bonds and U.S. Government securities	(59,351)	(61,578)	(83,056)
Proceeds from sale of equity securities	966	236	300
Purchase of equity securities	—	—	(7,681)
Proceeds from sale of real estate investments	302	—	—
Purchase of real estate investments	—	(902)	(377)
Purchase of other invested assets	(813)	(704)	(2,172)
Purchases of property and equipment, net	(1,913)	(1,556)	(1,215)
Proceeds from sale of subsidiary	185	—	—
Purchase of subsidiary's net other assets and stock	(5)	(50)	(2,434)
Purchase of goodwill and intangible assets	(1,895)	(50,986)	(11,559)
Net cash used in investing activities	(3,151)	(46,069)	(64,176)
<b>Cash flows from financing activities:</b>			
Receipt of revolving credit facility	4,500	39,054	25,165
Payment on revolving credit facility	—	(3,500)	—
Buyback of common stock outstanding	(4,055)	(8,272)	—
Issuance of common stock	—	4,211	8,165
Net cash provided by financing activities	445	31,493	33,330
Net increase (decrease) in cash and cash equivalents	12,137	(233)	(617)
Cash and cash equivalents at beginning of period	6,830	7,063	7,680
Cash and cash equivalents at end of period	\$ 18,967	6,830	7,063

See accompanying notes to consolidated financial statements.

**Consolidated Statements of Cash Flows**  
**For the Years Ended December 31, 2000, 1999 and 1998**  
(in thousands)

	2000	1999	1998
Supplemental disclosure of cash flow activities:			
Interest paid	\$ 3,769	4,016	844
Federal income taxes paid	\$ 3,556	6,634	9,816

Supplemental schedule of noncash investing and financing activities:

Effective January 1, 2000, the Company's insurance subsidiaries entered into a 100% quota share reinsurance agreement to assume the death, disability, and retirement ("DD&R") risks under Physicians' Reciprocal Insurers' ("PRI") claims made insurance policies. The Company received cash and bonds in exchange for business assumed from PRI recorded as follows:

Assumed unearned premium	\$ 33,749	—	—
Reduction in net goodwill and intangible assets	13,205	—	—
Receipt of bonds at market	(44,194)	—	—
Net cash received	\$ 2,760	—	—

Effective January 1, 1999, the Company purchased all of the capital stock of Administrators For The Professions, Inc. for \$53,830 and a 70% equity interest in a limited liability company for \$2,500. In conjunction with the acquisitions, common stock was issued as follows:

Common stock issued and related additional paid-in-capital	\$ —	11,630	—
Goodwill and other tangible assets acquired	—	(56,330)	—
Net cash paid	\$ —	(44,700)	—

*See accompanying notes to consolidated financial statements.*

# Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts and elsewhere as noted)

## 1. Organization and Nature of Operations

FPIC Insurance Group, Inc. ("FIG" or the "Company") is an insurance holding company. As of December 31, 2000, the Company's principal direct and indirect subsidiaries include: Florida Physicians Insurance Company, Inc. ("FPIC"), Anesthesiologists' Professional Assurance Company ("APAC"), FPIC Insurance Agency, Inc., Administrators For The Professions, Inc. ("AFP") and its two subsidiaries: Group Data Corporation and FPIC Intermediaries, Inc., The Tenere Group, Inc. ("Tenere") and its four subsidiaries: Intermed Insurance Company ("Intermed"), Interlex Insurance Company ("Interlex"), Trout Insurance Services, Inc. and Insurance Services, Inc., McCreary Corporation ("McCreary") and its subsidiary, Employers Mutual, Inc. ("EMI"), and its two subsidiaries: FPIC Services, Inc. and Professional Strategy Options, Inc.

FPIC is a licensed casualty insurance carrier and writes professional liability insurance for physicians, dentists, hospitals, and other healthcare providers. APAC is a licensed casualty insurance carrier and writes professional liability insurance for anesthesiologists. Intermed and Interlex are licensed casualty insurance carriers and write professional liability insurance for physicians and attorneys, respectively.

Through McCreary and its subsidiary, EMI, the Company offers third party administration services ("TPA"), which it operates as a separate industry segment. McCreary specializes in the administration of self-insured plans for large employers. The lines of insurance that McCreary primarily administers are group accident and health, workers' compensation, general liability, and property. The main service provided by EMI is administration of self-insured plans for emerging managed care organizations.

Effective January 1, 1999, the Company purchased AFP. AFP is the manager and attorney-in-fact for Physicians' Reciprocal Insurers ("PRI"), the second largest MPL insurer for physicians in the state of New York. As such, AFP's primary business is the management and administration of PRI on behalf of its physician members. The subsidiaries of AFP provide various brokerage services to the Company's insurance subsidiaries and PRI.

The Company's three industry segments are insurance, third party administration services and reciprocal management. For financial information relating to the Company's operations and industry segments, see Note 19.

The Company, through FPIC, APAC, Intermed, and Interlex, operates in the property and casualty insurance industry and is a provider of medical professional liability ("MPL") and legal professional liability ("LPL") insurance in Florida, Texas, Missouri, and Georgia. The Company is also licensed to write insurance in Alabama, Arkansas, Kentucky, Illinois, Indiana, Maryland, Michigan, Mississippi, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, and West Virginia. In addition, the Company is subject to regulation by the Departments of Insurance in these states. Following is a description of the most significant risks facing property and casualty insurers.

*Legal/Regulatory Risk* is the risk that changes in the legal or regulatory environment in which an insurer operates will change and create additional loss costs or expenses not anticipated by the insurer in pricing its products. That is, regulatory initiatives designed to reduce insurer profits or new legal theories may create costs for the insurer beyond those currently recorded in the consolidated financial statements. This risk is concentrated in Florida, where the Company writes approximately 73% of its business, but may expand to other states as it begins writing in those states.

*Credit Risk* is the risk that issuers of securities owned by the Company will default, or other parties, including reinsurers that owe the Company money, will not pay. Financial instruments that potentially expose the Company to concentrations of credit risk consist primarily of fixed maturity investments, premiums receivable and deposits with reinsurers. The Company typically requires that deposits with reinsurers be held in trust or collateralized by irrevocable letters of credit. The Company has not experienced significant losses related to such deposits.

*Market Risk* is the risk that a change in interest rates will cause a decrease in the value of an insurer's investments. To the extent that liabilities come due more quickly than assets mature, an insurer would have to sell assets prior to maturity and recognize a gain or loss.

## 2. Significant Accounting Policies

**Basis of Presentation.** The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). These financial statements include the accounts of the Company and all of its wholly-owned and majority-owned subsidiaries. Majority-owned entities in which the Company has at least a 20% interest are reported on the equity basis. Intercompany transactions and balances have been eliminated in consolidation.

**Use of Estimates.** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The estimates most susceptible to change are those used in determining the liability for losses and loss adjustment expenses ("LAE"). Although considerable variability is inherent in these estimates, management believes that these liabilities are adequate. These amounts are continually reviewed and adjusted as necessary in current operations. Actual results could differ from those estimates.

**Cash and Cash Equivalents.** For purposes of the consolidated statements of cash flows, the Company considers all demand deposits, overnight investments and instruments with a maturity when purchased of three months or less to be cash equivalents.

**Investments.** The Company accounts for its investments in debt and equity securities under Statement of Financial Accounting Standard ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Under the provisions of SFAS No. 115, the Company is required to classify investments in debt and equity securities into one of three categories: held-to-maturity, available-for-sale, or trading. All of the Company's investments in debt and equity securities are classified as available-for-sale on the consolidated balance sheet, with the change in fair value during the period excluded from earnings and recorded net of tax as a component of other comprehensive income.

Market values for debt and equity securities were based on quoted market prices. Where a quoted market price was not available, fair value was measured utilizing quoted market prices for similar securities or by using discounted cash flow methods.

Other invested assets include investments in three limited partnerships and a joint venture. Two of the partnerships invest in stocks and other financial securities of both public and non-publicly traded companies, primarily in the insurance and financial services industries. The third partnership is a diversified real estate fund. The Company accounts for these investments based on the cost method.

In addition, the Company also has an interest in a corporation and another limited partnership. These investments are accounted for under the equity method of accounting due to the significance of the Company's investment.

Income on investments is net of amortization of premium and accretion of discount on the yield-to-maturity method relating to debt securities acquired at other than par value. Realized investment gains and losses are determined on the basis of specific identification. Declines in the fair value of securities considered to be other than temporary, if any, would be recorded as realized losses in the consolidated statements of income.

Real estate investments consist of a building, various rental units and developed land. These investments are carried at cost less accumulated depreciation. Depreciation is computed over the estimated useful lives of the property (exclusive of land, which is nondepreciable), using the straight-line method. Estimated useful lives range from twenty-seven to thirty-nine years. Rental income and expenses are included in net investment income.

**Reinsurance.** The Company records its reinsurance contracts under the provisions of SFAS No. 113, "Accounting and Reporting for Reinsurance on Short-Duration and Long-Duration Contracts." In the ordinary course of business, the Company's insurance subsidiaries assume and cede business with other insurance companies. These arrangements provide greater diversification of business and minimize the net loss potential arising from large risks. For 1999 and prior, the Company reinsured risks under the MPL policies issued by its four insurance subsidiaries in excess of \$0.5 million per loss, except on the Company's anesthesiology program in which the Company reinsured risks in excess of \$0.75 million. The Company reinsured risks associated with these policies under treaties pursuant to which reinsurers agreed to assume those risks insured by the Company in excess of its individual risk retention level and up to its maximum individual policy limit offered.

During 2000, the Company changed its MPL ceded reinsurance program to reinsure risks in excess of \$.25 million per loss subject to an annual aggregate deductible of \$9 million, except for the Company's anesthesiology program in which the Company reinsured risks in excess of \$0.4 million.

Reinsurance recoverables include the balances due from reinsurance companies for paid and unpaid losses and loss expense that will be recovered from reinsurers, based on contracts in force. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance contracts do not relieve the Company from its primary obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of reinsurers and monitors concentrations of credit risk with respect to the individual reinsurers, which participate in its ceded programs to minimize its exposure to significant losses from reinsurer insolvencies. The Company holds collateral in the form of letters of credit or trust accounts for amounts recoverable from reinsurers that are not designated as authorized reinsurers by the domiciliary Departments of Insurance.

**Property and Equipment.** The cost of property and equipment is depreciated over the estimated useful lives of the related assets ranging from three to fifteen years. Depreciation is computed on the straight-line basis. Equipment and leasehold improvements are stated at cost less accumulated depreciation and amortization. Gains and losses upon asset disposal are taken into income in the year of disposition.

**Deferred Policy Acquisition Costs.** Deferred policy acquisition costs consist primarily of commissions and premium taxes that vary with and are primarily related to the production of new and renewal insurance business. Acquisition costs are deferred and amortized over the period in which the related premium is earned. Deferred policy acquisition costs are reviewed to determine if they are recoverable from future income, including investment income. If such costs are estimated to be unrecoverable, they are expensed. Commissions and brokerage fee expenses incurred by the Company's non-insurance businesses are expensed as incurred.

**Income Taxes.** The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance against deferred tax assets is recorded if it is more likely than not, that all or some portion of the benefits related to the deferred tax assets will not be realized.

**Goodwill and Intangible Assets.** Goodwill represents the aggregate cost of companies acquired over the fair value of net assets at the date of acquisition and is being amortized into income using the straight-line method over periods ranging from ten to twenty-five years. Management regularly reviews the carrying value of goodwill by determining whether the amortization of the goodwill can be recovered through undiscounted future operating cash flows of the acquired operation.

Intangible assets represent trade secrets acquired and non-compete agreements entered into in connection with business combinations. These assets are being amortized into income over periods corresponding with their terms or useful lives that range from three to ten years using the straight-line method. Management regularly reviews the carrying value of intangible assets by determining whether the amortization of the intangible assets can be recovered through undiscounted future operating cash flows of the acquired operation. See Note 9 for additional information.

# Notes to Consolidated Financial Statements continued

*(Dollars in thousands, except per share amounts and elsewhere as noted)*

In the event an asset is impaired, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the asset. Fair value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved. Losses on assets to be disposed of are determined in a similar manner, except that fair values are reduced for the cost of disposal.

**Revenue Recognition.** Premiums are earned and recognized as revenues on a monthly pro rata basis over the terms of the underlying policies. Policy terms generally do not exceed one year. Unearned premiums represent the portion of written premiums, which relate to future periods. Premiums received in advance of the policy year are recorded as premiums collected in advance in the consolidated balance sheet. Claims administration and management fee income is recognized when earned over the life of the contracts.

**Loss and Loss Adjustment Expenses.** As more fully described in Note 12, the Company estimates its liability for loss and LAE using actuarial projections of ultimate losses and LAE and other quantitative and qualitative analyses of conditions expected to effect the future development of claims and related expenses. The estimated liability for losses is based upon paid and case base estimates for losses reported, adjusted through formula calculations for ultimate loss expectations; estimates of incurred but not reported losses based on past experience and projected future trends; deduction of amounts for reinsurance placed with reinsurers; and estimates received related to assumed reinsurance. Amounts attributable to ceded reinsurance derived in estimating the liability for loss and LAE are reclassified as assets in the consolidated balance sheets as required by SFAS No. 113. The liability for LAE is provided by estimating future expenses to be incurred in settlement of claims provided for in the liability for losses and is estimated using similar actuarial techniques.

The liabilities for losses and LAE and the related estimation methods are continually reviewed and revised to reflect current conditions and trends. The resulting adjustments are reflected in the operating results of the current year. While management believes the liabilities for losses and LAE are adequate to cover the ultimate liability, the actual ultimate loss costs may vary from the amounts presently provided.

**Per Share Data.** Basic earnings per share are calculated by dividing net income by the weighted average number of common shares outstanding during the year. Diluted earnings per common share are calculated giving effect to common stock equivalents.

**Accounting for Stock-based Compensation.** SFAS No. 123, "Accounting for Stock-based Compensation" requires the fair value of stock options and other stock-based compensation issued to employees to either be recognized as compensation expense in the income statement, or be disclosed as a pro forma effect on net income and earnings per share in the footnotes to the Company's consolidated financial statements. The Company elected to adopt SFAS No. 123 on a disclosure basis only and will continue to measure stock-based compensation in accordance with Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," using intrinsic values with appropriate disclosures under the fair value based method as required by SFAS 123.

**Commitments and Contingencies.** Liabilities for loss contingencies arising from claims, assessments, litigation, fines and penalties, and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated.

**Interest Rate Swap.** The Company uses a derivative financial instrument, specifically interest rate swaps, to manage market risks related to changes in interest rates associated with its revolving credit facility. The derivatives are off-balance-sheet and therefore have no carrying value. The differential to be paid or received as interest rates change is accrued and recognized as an adjustment on interest expense related to the debt. The related amount payable to or receivable from the counter parties are included as adjustments to accrued interest. See Note 4 for additional information related to the interest rate swaps. The Company does not currently hold or issue any other derivative financial instruments for trading purposes.

**Reclassification.** Certain amounts for 1999 and 1998 have been reclassified to conform to the 2000 presentation.

**New Accounting Pronouncements.** In December 1999, the Securities Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 101 ("SAB"), Revenue Recognition in Financial Statements, which outlines the basic criteria that must be met to recognize revenue and provides guidance for presentation of revenue and for disclosure related to revenue recognition policies in financial statements filed with the SEC. In June 2000, the SEC issued SAB 101(B), which defers the implementation date of SAB 101 to no later than the fourth fiscal quarter of fiscal years commencing after December 15, 1999. The adoption of SAB 101 did not have a material effect on the consolidated financial statements of the Company.

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," was issued in June 1998, and establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. As issued, SFAS No. 133 is effective for all fiscal quarters of all fiscal years beginning after June 15, 1999. SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133," was issued in June 1999 and defers the effective date of SFAS No. 133. SFAS No. 133 is now effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. The adoption of SFAS No. 133 did not have a significant impact on the Company's consolidated financial position or results of operations.

In March 2000, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation: an Interpretation of APB Opinion No. 25" ("FIN 44"). FIN 44 establishes accounting guidance for stock option grants and modifications to existing stock option awards and is effective for option grants made after June 30, 2000. The adoption of FIN 44 did not have a material effect on the consolidated financial statements of the Company.

### 3. Business Acquisitions

On March 22, 2000, the Company entered into agreements (the "New Agreements") with the sellers of McCreary and EMI to fix the remaining payments due under their respective acquisition agreements, and thereby effectively eliminate the contingent terms under those agreements. Under the new agreements, the Company paid the sellers of McCreary \$1.7 million on July 31, 2000, and agreed to pay the sellers of EMI \$227 and \$538 on March 27, 2000 and March 1, 2001, respectively. These payments increased the original purchase price and the recorded goodwill, accordingly.

#### 1999 Business Acquisitions

Effective January 1, 1999, the Company purchased all of the outstanding capital stock of AFP and a 70% interest in Professional Medical Administrators, LLC. ("PMA") for aggregate consideration equal to \$56.3 million, paid in cash of \$44.7 million and Company common stock. AFP is the manager and attorney-in-fact for PRI, the second largest medical professional liability insurer for physicians in the state of New York. The earnings of PMA are not material to the consolidated results of the Company.

For the year ended December 31, 1999, the purchase had the following impact, which is included in the consolidated financial statements. Had AFP been included in the consolidated results of operations for the Company for the year ended December 31, 1998, the following increases and (decreases) would have resulted:

	<b>Actual</b>	<b>Pro forma</b>
	<b>1999</b>	<b>1998</b>
Revenues .....	\$ 20,650	16,210
Expenses .....	18,552	17,944
Net income (loss) .....	1,011	(95)
Earnings (loss) per share .....	.10	(.01)

On March 17, 1999, the Company's subsidiary, FPIC, purchased all of the outstanding common stock of Tenere for \$19.6 million in cash. Included in the net assets acquired was approximately \$14.0 million in cash. Tenere, headquartered in Springfield, Missouri, is a stock holding company, with two primary insurance subsidiaries, Intermed and Interlex. Intermed and Interlex provide MPL and LPL insurance. For the nine and a half months ended December 31, 1999, the purchase had the following impact, which is included in the consolidated financial statements:

	<b>1999</b>
Revenues .....	\$ 8,217
Expenses .....	9,303
Net loss .....	(689)
Loss per share .....	(.07)

Had Tenere been included in the consolidated results of operations for the Company for the years ended December 31, 1999 and 1998, the following increases and (decreases) would have resulted:

	<b>Pro forma</b>	<b>Pro forma</b>
	<b>1999</b>	<b>1998</b>
Revenues .....	\$ 9,565	9,586
Expenses .....	13,920	14,088
Net loss .....	(2,484)	(2,991)
Loss per share .....	(.25)	(.30)

On August 6, 1999, the Company's subsidiary, EMI, purchased all of the assets of Brokerage Services, Inc. ("BSI") and Group Brokerage, Inc. ("GBI"), related corporations headquartered in Albuquerque, New Mexico. BSI and GBI provided third party administration services for self-insured and fully insured health plans. The consideration paid by EMI for such assets aggregated approximately \$1.0 million. For the five months ended December 31, 1999, the purchase had the following impact, which is included in the consolidated financial statements:

	<b>1999</b>
Revenues .....	\$ 1,364
Expenses .....	1,705
Net (loss) .....	(223)
Loss per share .....	(.02)

Had the assets of BSI and GBI been included in the consolidated results of operations for the Company for the years ended December 31, 1999 and 1998, the following increases and (decreases) would have resulted:

	<b>Pro forma</b>	<b>Pro forma</b>
	<b>1999</b>	<b>1998</b>
Revenues .....	\$ 3,825	5,472
Expenses .....	4,661	4,978
Net (loss) income .....	(543)	297
(Loss) earnings per share .....	(.05)	.03

# Notes to Consolidated Financial Statements continued

*(Dollars in thousands, except per share amounts and elsewhere as noted)*

## 1998 Business Acquisitions

On July 1, 1998, the Company purchased all of the outstanding common stock of APAC, a medical malpractice insurance company, for \$18.0 million. Additionally, \$3.5 million was paid in non-compete agreements and other fees to certain key employees. These amounts are recorded as intangible assets in the consolidated balance sheet.

Concurrent with the purchase of APAC, the Company purchased a 9.9% interest in American Professional Assurance Ltd. ("APAL"), a Cayman Islands captive reinsurer, for \$5.5 million. The Company's investment in APAL is being accounted for under the cost method.

On July 1, 1998, EMI purchased all of the outstanding stock of SyMed Development, Inc. ("SyMed"), a software development and consulting company located in Nashville, Tennessee, for a cost of \$400 plus certain additional payments based upon future earnings. During 1999, goodwill of \$436 related to the acquisition of SyMed was written off. In April of 2000, the Company sold SyMed and recognized a loss of \$131 on the sale.

On November 6, 1998, the Company's subsidiary, FPIC Services, Inc. ("Services"), a Florida corporation, formed Bexar Credentials, Inc. ("Bexar") with a Texas corporation and a Texas self insurance trust association. Services' cost for its one-third ownership was \$900. In December 2000, the Company's investment in Bexar was written down to \$75 and effective January 31, 2001, the Company's stock in Bexar was redeemed for \$70 in cash and notes.

## **4. Fair Value of Financial Instruments**

Fair value estimates are made as of a specific point in time based on the characteristics of the financial instruments and the relevant market information. Where available, quoted market prices are used. In other cases, fair values are based on estimates using valuation techniques, such as discounting estimated future cash flows using a rate commensurate with the risks involved or other acceptable methods. These techniques involve uncertainties and are significantly affected by the assumptions used and the judgments made regarding risk characteristics of various financial instruments, prepayments, discount rates, estimates of future cash flows, future anticipated loss experience and other factors. Changes in assumptions could significantly affect these estimates. Independent market data may not be available to validate those fair value estimates that are based on internal valuation techniques. Moreover, such fair value estimates may not be indicative of the amounts that could be realized in an immediate sale of the instrument. Also, because of differences in methodologies and assumptions used to estimate fair value, the Company's fair values should not be compared to those of other companies.

Fair value estimates are based on existing financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company. For certain assets and liabilities, the information required is supplemented with additional information relevant to an understanding of the fair value.

The Company has two interest rate swap agreements to fix interest rates on variable rate debt and reduce certain exposures to market fluctuations. The interest rate swaps have a notional principal amount of \$60.0 million and \$7.0 million with a fixed interest rate of 5.27% and 6.68%, respectively, at December 31, 2000. The agreements terminate on January 2, 2004. However, the counter parties have the option to call the interest rate swap as of December 31, 2001. The Company is required to make payments at the variable LIBOR rate, plus or minus differences between that rate and the fixed rate as specified in the agreement. The Company is exposed to credit loss in the event of the nonperformance by the counter parties to the swap agreement. However, the Company does not anticipate nonperformance by the counter parties.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents – The carrying value approximates the fair value because of the short maturity of these instruments.

Bonds and equity securities – The fair value was estimated based on bid prices published in financial newspapers or by using discounted cash flow methods.

Other invested assets – The fair value was estimated based on the percentage of net assets owned at December 31, 2000.

Revolving credit facility – The fair value was estimated based on the amount of cash flows discounted over the applicable term at the Company's borrowing rate at December 31, 2000.

Interest rate swaps – The fair value is estimated using quotes from brokers and represents the cash requirement if the existing agreement had been settled at year-end.

The following table presents the carrying values and estimated fair values of the Company's financial instruments:

	December 31, 2000		December 31, 1999	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial Assets:				
Cash and cash equivalents	\$ 18,967	18,967	6,830	6,830
Bonds	385,513	385,513	327,076	327,076
Equity securities	555	555	1,055	1,055
Other invested assets	14,522	11,657	14,125	14,797
Total financial assets	\$ 419,557	416,692	349,086	349,758
Off Balance Sheet Instruments:				
Interest rate swaps	\$ —	123	—	1,561
Financial Liabilities:				
Revolving credit facility	\$ 67,219	63,181	62,719	56,559
Total financial liabilities	\$ 67,219	63,181	62,719	56,559

## 5. Investments

The amortized cost and estimated fair value of investments in debt and equity securities as of December 31, 2000 and 1999 were as follows:

	2000	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Bonds:					
United States Government agencies and authorities	\$	67,617	801	275	68,143
States, municipalities and political subdivisions		182,303	3,562	956	184,909
Corporate securities		85,354	998	4,405	81,947
Mortgage-backed securities		48,711	1,976	173	50,514
Total bonds	\$	383,985	7,337	5,809	385,513
Equity securities:					
Common stocks	\$	5	—	—	5
Preferred stocks		450	100	—	550
Total equity securities	\$	455	100	—	555
Total securities available-for-sale	\$	384,440	7,437	5,809	386,068
	1999	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Bonds:					
United States Government agencies and authorities	\$	70,499	65	2,490	68,074
States, municipalities and political subdivisions		151,792	448	6,386	145,854
Corporate securities		65,408	45	3,304	62,149
Mortgage-backed securities		52,211	326	1,538	50,999
Total bonds	\$	339,910	884	13,718	327,076
Equity securities:					
Common stocks	\$	290	69	4	355
Preferred stocks		1,000	—	300	700
Total equity securities	\$	1,290	69	304	1,055
Total securities available-for-sale	\$	341,200	953	14,022	328,131

# Notes to Consolidated Financial Statements continued

(Dollars in thousands, except per share amounts and elsewhere as noted)

The Company's other invested assets include investments in three limited partnerships and a joint venture. These assets are recorded at a cost of \$11,388 and \$10,576 at December 31, 2000 and 1999, respectively. The Company also has a significant interest in two corporations and another limited partnership. These investments are recorded under the equity method at \$3,134 and \$3,549 at December 31, 2000 and 1999, respectively.

The amortized cost and estimated fair value of debt securities at December 31, 2000 by contractual maturity are shown below. Expected maturities will differ from contractual maturities, because borrowers have the right to call or prepay these obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due in one year or less	\$ 15,185	15,236
Due after one year through five years	102,504	101,543
Due after five years through ten years	62,442	62,065
Due after ten years	203,854	206,669
	<u>\$ 383,985</u>	<u>385,513</u>

Investment securities and cash with a carrying value of \$13,630 and a market value of \$16,666 were on deposit with the Insurance Departments in various states as of December 31, 2000, as required by law.

Net investment income earned for the years ended December 31, 2000, 1999 and 1998 was as follows:

	2000	1999	1998
Bonds	\$ 23,005	19,340	18,132
Equity securities	43	72	51
Real estate	206	596	452
Short-term investments	551	266	113
Other invested assets	1,130	206	552
Cash on hand and on deposit	903	297	83
	<u>25,838</u>	<u>20,777</u>	<u>19,383</u>
Less investment expenses	(1,095)	(1,753)	(1,834)
Net investment income	<u>\$ 24,743</u>	<u>19,024</u>	<u>17,549</u>

Proceeds from sales and maturities of bonds were \$59,373, \$69,471, and \$44,018, for the years ended December 31, 2000, 1999, and 1998 respectively. Proceeds from sales of equity securities were \$966, \$236 and \$300 for the years ended December 31, 2000, 1999 and 1998, respectively. Gross gains of \$168 were realized on sales of debt and equity securities for the year ended December 31, 2000. Gross gains of \$353, and \$10, and gross losses of \$3, and \$50, were realized on sales of debt and equity securities for the years ended December 31, 1999, and 1998, respectively.

## 6. Real Estate Investments

At December 31, 2000 and 1999, real estate investments consisted of the following:

	2000	1999
Land and building	\$ 5,170	4,670
Rental units	261	461
Other	38	38
	<u>5,469</u>	<u>5,169</u>
Accumulated depreciation	(1,071)	(836)
Net real estate investments	<u>\$ 4,398</u>	<u>4,333</u>

Total depreciation expense on real estate investments was \$256, \$249, and \$339, in 2000, 1999, and 1998, respectively.

## 7. Property and Equipment

At December 31, 2000 and 1999, property and equipment consisted of the following:

	<u>2000</u>	<u>1999</u>
Furniture, fixtures and equipment .....	\$ 3,544	3,244
Data processing equipment and software .....	4,938	3,815
Leasehold improvements .....	1,167	1,058
Automobiles .....	223	211
	<u>9,872</u>	<u>8,328</u>
Accumulated depreciation .....	(5,733)	(4,554)
Net property and equipment .....	<u>\$ 4,139</u>	<u>3,774</u>

Total depreciation expense on property and equipment was \$1,455, \$1,174, and, \$700 in 2000, 1999, and 1998, respectively.

## 8. Deferred Policy Acquisition Costs

Changes in deferred policy acquisition costs for the years ended December 31, 2000, 1999, and 1998, were as follows:

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Beginning balance .....	\$ 2,789	2,001	1,411
Additions .....	8,964	7,515	5,450
Amortization expense .....	(5,617)	(6,727)	(4,860)
Ending balance .....	<u>\$ 6,136</u>	<u>2,789</u>	<u>2,001</u>

## 9. Goodwill and Intangible Assets

At December 31, 2000, 1999 and 1998, goodwill and intangible assets consisted of the following:

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Beginning balance .....	\$ 73,922	16,587	7,174
Additions at cost .....	2,507	61,341	11,559
Reductions at cost .....	—	(436)	(1,500)
Deferred credit .....	(13,200)	—	—
Amortization expense .....	(2,203)	(3,570)	(646)
Ending balance .....	<u>\$ 61,026</u>	<u>73,922</u>	<u>16,587</u>

Effective January 1, 2000, the Company's insurance subsidiaries entered into a 100% quota share reinsurance agreement with PRI, to assume the death, disability and retirement ("DD&R") risks under PRI's claims-made insurance policies in exchange for cash and investments. The Company completed a GAAP valuation of the underlying liability during 2000 and a deferred credit in the amount of \$13.2 million was recognized and classified with goodwill and intangible assets. The deferred credit, which will be amortized into income over 20 years, represents the difference between the GAAP valuation of the underlying liabilities and the initial premium received. The liability was calculated using benefit assumptions and elements of pension actuarial models (i.e. mortality, morbidity, retirement, interest and inflation rate assumptions).

## 10. Borrowing Arrangements

The Company maintains a \$75.0 million revolving credit facility with four banks to meet certain non-operating cash needs as they arise. As of December 31, 2000 and 1999, \$67.2 million and \$62.7 million, respectively, had been borrowed under this credit facility at a per annum rate of approximately 7.46% and 6.4%, respectively. The credit facility terminates on January 4, 2002 and bears interest at various rates, primarily based upon the LIBOR rate plus an applicable margin, which ranges from .75% to 1.75%. As of December 31, 2000, the interest rate was 7.78%.

Under the terms of the credit facility, the Company is required to meet certain financial covenants. Significant covenants are as follows: a) the Company's funded debt to total capital plus funded debt ratio cannot exceed 0.35:1 and b) net premiums written to statutory capital and surplus ratio cannot exceed 2.0:1. Effective January 1, 2001, the funded debt to total capital plus funded debt ratio cannot exceed 0.30:1. At December 31, 2000, the Company was in violation of two of the Company's loan covenants. The Company has obtained a waiver for these violations bringing it into compliance with its debt covenants. At December 31, 1999, the Company's subsidiary, Intermed, was in violation of one of the Company's loan covenants. The Company obtained a waiver for the violation bringing Intermed and the Company into compliance.

The credit facility is guaranteed by, and collateralized by the common stock of certain subsidiaries. The Company is not required to maintain compensating balances in connection with this credit facility.

# Notes to Consolidated Financial Statements continued

(Dollars in thousands, except per share amounts and elsewhere as noted)

## 11. Reinsurance

To the extent that any reinsurer might be unable to meet its obligations, the Company would be liable for such defaulted amounts. At December 31, 2000 and 1999, amounts due from a single reinsurer, APAL, an affiliated company, on reinsurance recoverables had a carrying value of \$16.8 million, and \$15.3 million respectively, all of which was fully collateralized by letters of credit, trust accounts, and ceded balances payable. Of the total amount due from reinsurers on reinsurance recoverables at December 31, 2000 and 1999, \$43.5 million and \$35.8 million, respectively, was due from three reinsurers, of which \$43.8 million in 2000 and \$29.5 million in 1999 was collateralized by letters of credit, trust accounts, and ceded balances payable.

The effect of reinsurance on premiums written and earned for the years ended December 31, 2000, 1999, and 1998 was as follows:

	2000		1999		1998	
	Written	Earned	Written	Earned	Written	Earned
Direct and assumed .....	\$ 197,280	153,977	148,216	144,530	116,989	105,617
Ceded .....	(35,349)	(33,523)	(26,089)	(26,341)	(15,512)	(16,055)
Net .....	\$ 161,931	120,454	122,127	118,189	101,477	89,562

## 12. Liability for Losses and Loss Adjustment Expenses ("LAE")

The liability for losses and LAE is generally determined on the basis of individual claims and actuarially determined estimates of future claims based upon the Company's actual experience, assumptions and projections as to claims frequency, severity and inflationary trends and settlement payments. Such estimates may vary significantly from the eventual outcome. The ranges of reasonably expected ultimate unpaid losses and LAE are estimated by the Company's external consulting actuaries on an undiscounted basis. The assumptions used in making such estimates and for establishing the resulting liabilities are continually reviewed and updated based upon current circumstances, and any adjustments resulting therefrom are reflected in current income.

Activity in the liability for loss and LAE for the years ended December 31, 2000, 1999, and 1998 was as follows:

	2000	1999	1998
Gross balance, January 1 .....	\$ 273,092	242,377	188,086
Less reinsurance recoverables .....	58,400	41,614	14,115
Net balance, January 1 .....	\$ 214,692	200,763	173,971
Reserves of entities acquired .....	—	24,591	23,406
Incurred related to:			
Current year .....	116,246	99,523	81,694
Prior year .....	6,520	(18,555)	(14,332)
Total incurred .....	122,766	80,968	67,362
Paid related to:			
Current year .....	22,592	15,338	14,279
Prior year .....	91,269	76,292	49,697
Total paid .....	113,861	91,630	63,976
Net balance, December 31 .....	\$ 223,597	214,692	200,763
Plus reinsurance recoverables .....	57,698	58,400	41,614
Gross balance, December 31 .....	\$ 281,295	273,092	242,377

Incurred losses and LAE for claims relating to prior years reflects the change in the estimate of the liability charged or credited to earnings in each year with respect to the liabilities established as of the beginning of that year. Information regarding incurred losses and LAE is revealed over time and the estimates of liability are revised accordingly, resulting in gains or losses in the period revisions are made. The Company's management closely monitors the adequacy of its liability for loss and LAE incurred and underlying claims trends, including having the Company's outside actuaries perform calculations periodically.

Incurred losses and LAE related to prior years, net of reinsurance recoveries, was \$6.5 million for the twelve months ended December 31, 2000. The increase in prior years liability for loss and LAE includes a reserve strengthening resulting from the identification of certain unfavorable trends in the underlying claim data with respect to FPIC's core physician's MPL business, including an increase in the rate of claims closed with indemnity payment, a slowdown in the overall closure rate of pending claims, and an increase in the severity of indemnity payments made during 2000 relating to prior periods. The Company and its outside consulting actuary further analyzed these trends and determined that additional reserves were required. As a result, the Company increased its liability for loss and LAE by approximately \$21.0 million.

The net reductions of \$18.6 million and \$14.3 million in incurred loss and LAE related to prior years for the twelve months ended December 31, 1999 and 1998, respectively, are the result of reevaluations of the liability for loss and LAE and reflect overall favorable underwriting results and lower than expected losses and LAE.

### 13. Stock Option Plans

The Company has a stock option plan for officers and key employees (the "employee plan") and a plan for non-employee directors (the "director plan"). Under the director plan, only nonqualified stock options may be issued. Under the employee plan, both incentive stock options and nonqualified stock options may be granted to the same individual. The option price of an incentive stock option may not be less than 100% of the fair market value of shares on the grant date. The option price of a nonqualified option shall not be less than 50% of the fair market value of shares on the grant date. Under the terms of the director plan, 5,000 shares are granted to each director on the date that person becomes a director, and on a discretionary basis at future dates as approved by the Board, at a price not less than 100% of the fair market value of the underlying stock on the grant date.

During 2000, the Company offered a stock purchase incentive program (the "incentive plan") to eligible employees, including executive officers, to encourage ownership of the Company's stock. Under the incentive plan, employees who purchased shares of the Company's common stock in the open market during the term of the incentive plan were granted matching nonqualified stock options on a one-for-one basis, up to the maximum of 5,000 options per employee. The incentive plan began January 2000 and ended April 28, 2000. Option grants under the incentive plan were made as of May 1, 2000 at an exercise price equal to the closing market price of the Company's common stock as of May 1, 2000. Options granted under the incentive plan will vest in three equal annual installments commencing on the one-year anniversary of their grant. Options under this plan were granted under the employee plan.

During 2000, 72,300 nonqualified stock options were issued under the director plan and 219,597 nonqualified stock options and 218,901 incentive stock options were issued under the employee plan. In addition, 184,377 nonqualified stock options and 24,300 incentive stock options were forfeited under the employee plan and 45,000 restricted options, which were not part of any plan, were forfeited.

During 1999, 130,000 nonqualified stock options were issued under the director plan, 416,283 nonqualified stock options and 86,217 incentive stock options were issued under the employee plan, and 25,900 nonqualified stock options were issued under the incentive plan. In addition, 110,000 nonqualified stock options and 15,000 incentive stock options were forfeited under the employee plan and 25,000 restricted options, which were not part of any plan, were forfeited.

During 1998, 116,688 nonqualified stock options and 3,312 incentive stock options were issued under the employee plan. An additional 70,000 restricted options, which were not part of either plan, were issued in connection with acquisitions during the year. During 1997, 120,000 nonqualified stock options were granted under the director plan, and 265,000 nonqualified stock options were issued under the employee plan. During 1996, 320,000 incentive stock options and 335,000 nonqualified stock options were issued under both plans. Of the 1998 nonqualified stock options issued, 50,000 were issued to an employee with an exercise price lower than the fair market value on the date of the grant. This difference in price of \$7.55 per option is considered noncash compensation and is being amortized over the period in which the options vest and of which \$126 has been recognized as an expense in both 2000 and 1999. Options generally vest over the three years and have a maximum term of ten years. Options granted under the plans are exercisable at such dates as are determined in connection with their issue, but not later than ten years after the date of grant.

At December 31, 2000 and 1999, 571,307 and 539,500, respectively, shares of the Company's common stock were reserved for issuance in connection with the stock option plans.

The Company also maintains an employee stock purchase plan that allows employees to purchase the Company's common stock at 85% of the market value on the first or last day of the offering period, whichever was lower.

A summary of the status of the Company's stock options as of December 31, 2000 is presented below:

	Options	Weighted Avg Exercise Price	Options Exercisable	Weighted Avg Exercise Price
Balance, December 31, 1997	991,500	\$ 14.71	—	\$ —
Granted	190,000	30.78	—	—
Exercised	(86,832)	11.91	—	—
Cancelled	—	—	—	—
Balance, December 31, 1998	1,094,668	\$ 17.72	581,556	\$ 20.16
Granted	658,400	30.65	—	—
Exercised	(201,823)	10.97	—	—
Cancelled	(150,000)	39.36	—	—
Balance, December 31, 1999	1,401,245	\$ 22.47	886,170	\$ 20.64
Granted	510,798	12.19	—	—
Exercised	(119,500)	9.10	—	—
Cancelled	(253,677)	35.07	—	—
Balance, December 31, 2000	1,538,866	\$ 17.99	730,832	\$ 19.39

# Notes to Consolidated Financial Statements continued

(Dollars in thousands, except per share amounts and elsewhere as noted)

The following table summarizes information for options outstanding and exercisable at December 31, 2000:

Range of Prices Per Share	Number of Options	Weighted Avg Remaining Life of Outstanding Options	Weighted Avg Exercise Price	Options Exercisable	
				Number	Weighted Avg Exercise Price
\$ 8-11	597,336	8.20 years	\$ 9.89	236,336	\$ 9.16
12-15	355,898	8.90 years	14.95	93,027	14.88
16-19	84,800	9.06 years	18.09	8,995	18.95
20-35	400,000	7.03 years	25.22	359,200	25.23
36-60	100,832	8.15 years	45.20	33,274	45.20
	<u>1,538,866</u>	<u>8.10 years</u>	<u>\$ 17.99</u>	<u>730,832</u>	<u>\$ 19.39</u>

On a pro forma basis, assuming compensation expense for the Company's stock options had been recognized based on their fair values on the grant date under the methodology prescribed by SFAS No.123, the Company's net income, tax expense and diluted earnings per share for the three years ended December 31, 2000, 1999 and 1998, would have been impacted as shown in the following table:

	2000	1999	1998
Pro Forma Net Income	\$ (1,114)	18,289	19,117
Pro Forma Tax Expense (Benefit)	\$ (4,666)	7,093	7,184
Pro Forma Diluted Earnings (Loss) Per Share	\$ (.12)	1.83	2.05

The fair value of options granted, which is amortized to expense over the option vesting period in determining the pro forma impact, is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2000	1999	1998
Expected Life of Options	5 years	5 years	5 years
Risk Free Interest Rate	5.50%	5.20%	5.20%
Expected Volatility of Stock	42.17%	38.96%	36.01%

The weighted average fair value of options granted during 2000, 1999 and 1998 are as follows:

	2000	1999	1998
Fair Value of Options Granted	\$ 5.50	8.84	13.49
Total Fair Value of all Options Granted	\$ 2,809	5,821	2,563
Expected dividends	\$ —	—	—
Total Number of Options Granted	510,798	658,400	190,000

In accordance with FAS 123, the weighted average fair value of stock options granted is required to be based on a theoretical statistical model using the preceding Black-Scholes assumptions. In actuality, because the Company's incentive stock options are not traded on any exchange, employees can receive no value nor derive any benefit from holding stock options under these plans without an increase in the market price of the Company's stock. Such an increase in stock price would benefit all stockholders commensurately.

## 14. Income Taxes

The provision (benefit) for income taxes consisted of the following:

	2000	1999	1998
Current expense (benefit)			
Federal	\$ (935)	6,306	6,974
State	626	1,931	1,559
Total	\$ (309)	8,237	8,533
Deferred expense (benefit)			
Federal	\$ (2,943)	973	(309)
State	(333)	124	(53)
Total	\$ (3,276)	1,097	(362)
Net income tax expense (benefit)	\$ (3,585)	9,334	8,171

The provision for income taxes differs from the statutory corporate tax rate of 35% for 2000, 1999, and 1998 as follows:

	2000	1999	1998
Computed "expected" tax (benefit) expense . . . . .	\$ (1,040)	10,889	10,102
Municipal bond interest . . . . .	(2,851)	(2,579)	(2,521)
State income taxes, net of Federal benefit . . . . .	190	1,422	979
Other, net . . . . .	116	(398)	(389)
Actual expense (benefit) . . . . .	\$ (3,585)	9,334	8,171

At December 31, 2000 and 1999, the significant components of the net deferred tax asset were as follows:

	2000	1999
Deferred tax assets arising from:		
Loss reserve discounting . . . . .	\$ 10,756	11,528
Unearned premium reserves . . . . .	8,585	4,088
Net operating loss carryforward . . . . .	2,122	2,711
Unrealized losses on securities . . . . .	—	4,574
Other . . . . .	1,785	1,067
Total deferred tax assets . . . . .	\$ 23,248	23,968
Deferred tax liabilities arising from:		
Unrealized gains on securities . . . . .	\$ 660	—
Deferred policy acquisition costs . . . . .	2,346	1,555
Other . . . . .	1,971	1,169
Total deferred tax liabilities . . . . .	\$ 4,977	2,724
Net deferred tax asset . . . . .	\$ 18,271	21,244

Net deferred tax assets and Federal income tax expense in future years can be significantly affected by changes in enacted tax rates or by unexpected adverse events that would influence management's conclusions as to the ultimate realizability of deferred tax assets.

## 15. Employee Benefit Plans

FIG employees are covered by a qualified defined benefit plan and a defined contribution pension plan sponsored by the Company. The benefits of the defined benefit plan are based on years of service and the employee's compensation. The actuarially computed net periodic pension cost for December 31, 2000, 1999, and 1998 included the following:

	2000	1999	1998
Service cost of benefits earned during the period . . . . .	\$ 146	173	138
Interest cost on projected benefit obligation . . . . .	159	147	125
Expected return on plan assets . . . . .	(135)	(112)	(107)
Recognized net actuarial loss . . . . .	—	38	—
Net amortization and deferral . . . . .	26	26	26
Net periodic pension cost . . . . .	\$ 196	272	182

### Actuarial Present Value of Benefit Obligation

Accumulated benefit obligation . . . . .	\$ (1,693)	(1,522)	(1,585)
Projected benefit obligation for service rendered to date . . . . .	(2,685)	(2,466)	(2,691)
Plan assets at fair value . . . . .	1,693	1,471	1,220
Projected benefit obligation in excess of plan assets . . . . .	(992)	(995)	(1,471)
Unrecognized net loss past experience different from that assumed . . . . .	11	104	747
Prior service cost not yet recognized in net periodic pension cost . . . . .	(36)	(40)	(44)
Unrecognized net obligation at inception recognized over 15.29 years . . . . .	223	254	284
Accrued pension cost . . . . .	\$ (794)	(677)	(484)

# Notes to Consolidated Financial Statements continued

(Dollars in thousands, except per share amounts and elsewhere as noted)

The following table sets forth the plan's funded status for the fiscal years ending December 31, 2000 and 1999, respectively.

	2000	1999
<b><u>Change in Benefit Obligation</u></b>		
Benefit Obligation, January 1 .....	\$ 2,466	2,691
Service Cost .....	146	173
Interest Cost .....	159	147
Actuarial Gain .....	(45)	(514)
Benefits Paid .....	(41)	(31)
	\$ 2,685	2,466
<b><u>Change in Plan Assets</u></b>		
Fair Value of Plan Assets, January 1 .....	\$ 1,471	1,220
Actual Return on Plan Assets .....	181	204
Employer Contributions .....	82	78
Benefits Paid .....	(41)	(31)
	\$ 1,693	1,471

Assumptions used in the accounting for net periodic pension cost at December 31, 2000, 1999, and 1998, were as follows:

	2000	1999	1998
Discount rates .....	6.75%	6.50%	5.50%
Rate of increase in compensation levels .....	5.17%	5.19%	5.23%
Return on assets .....	9.00%	9.00%	9.00%

The FIG defined contribution plan has two parts. The first part is a profit-sharing plan. The second part allows employees to contribute up to 5.0% of their annual compensation, of which 2.5% is matched 100% by the Company. The Company's policy is to fully fund the liability at the end of each year. At December 31, 2000 and 1999, the fair market value of plan assets was \$3.9 million and \$5.9 million, respectively. The expense for this plan amounted to \$896, \$516, and \$435, in 2000, 1999, and 1998, respectively.

The Company also has a supplemental executive retirement plan ("SERP") that provides certain executives with income at retirement equal to 60% of pre-retirement base compensation, less qualified pension plan benefits paid by the Company and all predecessor plans and Social Security benefits. The projected benefit obligation at December 31, 2000 was \$1.3 million using a discount rate of 6.75%. The plan has no vesting prior to age 55. The Company had a net periodic pension cost of approximately \$395, \$188, and \$95, to cover any liability under this plan in 2000, 1999, and 1998, respectively. The total liability included in the financial statements for this plan amounted to approximately \$1.3 million and \$533 as of December 31, 2000 and 1999, respectively.

AFP maintains a noncontributory defined benefit pension plan (the "Plan") covering substantially all of its employees. The benefits under the Plan are based on years of service and the employee's compensation during such years of service. AFP's funding policy is to contribute amounts sufficient to meet the minimum funding requirements set forth in the Employee Retirement Income Security Act of 1974, plus such additional amounts as AFP may determine to be appropriate from time to time. Contributions are intended to provide amounts sufficient to cover the costs of benefits attributed to service to date, as well as for those expected to be earned in the future. AFP contributed \$650 to the Plan in 2000 and \$1.0 million in 1999. The Plan's invested assets consist of investments in various types and categories of stocks and bonds. At December 31, 2000 and 1999, the fair market value of plan assets was \$5.7 million and \$5.1 million, respectively.

Effective January 1, 2000 Group Data Corporation and FPIC Intermediaries, Inc., which are subsidiaries of AFP, adopted the AFP plan. Pension costs for the years 2000 and 1999 amounted to approximately \$748 and \$831, respectively.

The benefits of the defined benefit plan are based on years of service and the employee's compensation. The actuarially computed net periodic pension cost for December 31, 2000 and 1999, included the following:

	2000	1999
Service cost of benefits earned during the period .....	\$ 662	708
Interest cost on projected benefit obligation .....	381	341
Actual return on plan assets .....	66	(659)
Recognized net actuarial loss .....	—	—
Net amortization and deferral .....	(361)	441
	\$ 748	831

<u>Actuarial Present Value of Benefit Obligation</u>		
Accumulated benefit obligation .....	\$	(4,870) (3,916)
Projected benefit obligation for service rendered to date .....	\$	6,771 5,445
Plan assets at fair value .....		5,733 5,065
Projected benefit obligation in excess of plan assets .....		(1,038) (380)
Unrecognized net loss from past experience different from that assumed .....		1,070 791
Prior service cost not yet recognized in net periodic pension cost ..		289 —
Unrecognized net obligation at inception recognized over 15.29 years .....		23 30
Prepaid pension cost .....	\$	344 441

The following table sets forth the plan's funded status for the fiscal year ending December 31, 2000 and 1999, respectively:

<u>Change in Benefit Obligation</u>	<u>2000</u>	<u>1999</u>
Benefit Obligation, January 1 .....	\$ 5,445	6,092
Acquisition related assets .....	620	—
Service Cost .....	662	708
Interest Cost .....	381	341
Actuarial Gain .....	—	—
Benefits Paid .....	(337)	(1,696)
Benefit Obligation, December 31 .....	\$ 6,771	5,445
 <u>Change in Plan Assets</u>		
Fair Value of Plan Assets, January 1 .....	\$ 5,065	5,103
Acquisition Related Assets .....	421	—
Actual Return on Plan Assets .....	(66)	659
Employer Contributions .....	650	999
Benefits Paid .....	(337)	(1,696)
Fair Value of Plan Assets, December 31 .....	\$ 5,733	5,065

Assumptions used in the accounting for net periodic pension cost at December 31, 2000 and 1999 were as follows:

	<u>2000</u>	<u>1999</u>
Discount rates .....	6.50%	6.50%
Rate of increase in compensation levels .....	5.00%	5.00%
Return on assets .....	6.50%	6.50%

## 16. Commitments and Contingencies

The future minimum annual rentals under noncancellable leases are as follows:

2001 .....	\$ 2,602
2002 .....	2,355
2003 .....	2,053
2004 .....	2,064
Thereafter .....	9,424
Total .....	\$ 18,498

Total rental expense was \$1,425, \$2,381, and \$371, for 2000, 1999, and 1998, respectively.

The Company is involved in numerous legal actions arising primarily from claims under insurance policies. The legal actions arising from claims under insurance policies have been considered by the Company in establishing its liability for losses and LAE. The Company has also been involved in one or more legal actions not involving claims under its insurance policies from time to time. The Company's management is not aware of any such actions that in their opinion will have a material adverse effect on the Company's financial position or results of operations.

# Notes to Consolidated Financial Statements continued

(Dollars in thousands, except per share amounts and elsewhere as noted)

The Company's insurance subsidiaries are subject to assessment by the Financial Guaranty Associations in the states in which they conduct business for the provision of funds necessary for the settlement of covered claims under certain policies of insolvent insurers. Generally, these associations can assess member insurers on the basis of written premiums in their particular states.

In addition to standard assessments, the Florida and Missouri Legislatures may also levy special assessments to settle claims caused by certain catastrophic losses. The Company would be assessed on a basis of premium written. No provision for special assessments was made in the 2000 or 1999 financial statements. However, damages caused by future catastrophic losses, such as a hurricane, could subject the Company to additional assessments.

## 17. Statutory Accounting

FPIC, APAC, Intermed and Interlex are required to file statutory financial statements with state insurance regulatory authorities. The insurance subsidiaries are restricted under the Florida and Missouri Insurance Codes as to the amount of dividends they may pay without regulatory consent. In 2001, dividends of \$11.6 million can be paid without regulatory consent. Restricted net assets of FPIC, APAC, and Intermed and Interlex as of December 31, 2000 were \$109.5 million, \$14.9 million and \$20.8 million, respectively.

The statutory capital and surplus for the Company's insurance subsidiaries at December 31, 2000, 1999, and 1998, is shown in the table below.

	2000	1999	1998
FPIC .....	\$ 91,594	97,578	104,357
APAC .....	15,923	18,141	12,921
Intermed .....	20,923	13,685	—
Interlex .....	4,354	5,294	—
Combined statutory surplus .....	132,794	134,698	117,278
Less: Intercompany eliminations .....	(24,295)	(16,818)	—
Consolidated statutory surplus .....	\$ 108,499	117,880	117,278

For the years ended December 31, 2000, 1999 and 1998, the statutory net income or loss for the Company's insurance subsidiaries was as follows:

	2000	1999	1998
FPIC .....	\$ (6,792)	14,233	16,265
APAC .....	(1,088)	5,051	2,190
Intermed .....	608	159	—
Interlex .....	(692)	(405)	—
Total statutory income (loss) .....	\$ (7,964)	19,038	18,455

In March 1998, the NAIC adopted the Codification of Statutory Accounting Principles Project (the "Codification") as the NAIC supported basis of accounting. Codification affects all statutory financial statements issued after the adoption date of January 1, 2001. The Codification was approved with a provision allowing for discretion by each state's Department of Insurance in determining appropriate statutory accounting for insurers. Accordingly, such discretion will continue to allow prescribed or permitted accounting practices that may differ from state to state. The Codification does not affect the Company's consolidated financial statements, which have been prepared in accordance with GAAP. The Company expects that statutory surplus after adoption will continue to be in excess of the current regulatory and risk-based capital requirements.

## 18. Reconciliation of Basic and Diluted Earnings Per Share

	2000	1999	1998
Net income and income from continuing operations .....	\$ 614	21,869	20,693
Basic weighted average shares outstanding .....	9,497	9,748	9,332
Common stock equivalents .....	74	259	477
Diluted weighted average shares outstanding .....	9,571	10,007	9,809
Basic earnings per share .....	\$ .06	2.24	2.22
Diluted earnings per share .....	\$ .06	2.19	2.11

## 19. Segment Information

Under the provisions of SFAS No. 131, the Company has determined that it has three reportable operating segments, which are insurance, third party administration ("TPA"), and reciprocal management ("RM"). The insurance segment provides a variety of insurance products for participants in the healthcare industry including MPL insurance for medical professionals, managed care liability insurance, professional and comprehensive general liability insurance for healthcare facilities, provider stop loss insurance, workers' compensation insurance, and group accident and health coverage. The TPA segment provides third party administration services such as the administration of self-insurance plans for large employers. The reciprocal management segment provides insurance administration services to an insurance reciprocal.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates a segment's performance based on net income or loss and accounts for intersegment sales and transfers as if the sales or transfers were to a third party. Holding Company operations are included within the insurance segment due to the size and prominence of the segment and the substantial attention devoted to it. Intersegment revenues for transactions between the segments are based on actual costs incurred and are similar to services that may have been obtained from an unrelated third party. All segments are managed separately because each business requires different technology and marketing strategies.

Selected financial information by industry segment follows:

For the year ended December 31, 2000						
	Insurance	TPA	RM	Total Segment	Intercompany Elimination	Consolidated Total
Operating revenue	\$ 147,874	16,724	25,240	189,838	(7,801)	182,037
Interest revenue	25,599	239	—	25,838	—	25,838
Interest expense	4,291	—	—	4,291	—	4,291
Net income (loss)	(2,925)	(821)	4,360	614	—	614
Identifiable assets	989,324	16,734	63,476	1,069,534	(417,165)	652,369
Depreciation and amortization	147	1,236	3,043	4,426	—	4,426

For the year ended December 31, 1999						
	Insurance	TPA	RM	Total Segment	Intercompany Elimination	Consolidated Total
Operating revenue	\$ 138,786	13,555	20,792	173,133	(2,628)	170,505
Interest revenue	19,916	189	3	20,108	—	20,108
Interest expense	3,981	—	—	3,981	—	3,981
Net income (loss)	19,776	(205)	2,298	21,869	—	21,869
Identifiable assets	676,215	10,851	58,310	745,376	(157,456)	587,920
Depreciation and amortization	2,513	889	2,506	5,908	—	5,908

For the year ended December 31, 1998						
	Insurance	TPA	RM	Total Segment	Intercompany Elimination	Consolidated Total
Operating revenue	\$ 108,407	12,627	—	121,034	(713)	120,321
Interest revenue	18,716	164	—	18,880	—	18,880
Interest expense	844	—	—	844	—	844
Net income	19,699	994	—	20,693	—	20,693
Identifiable assets	512,246	10,801	—	523,047	(43,669)	479,378
Depreciation and amortization	1,548	708	—	2,256	—	2,256

The following table provides a reconciliation of reportable segment assets to the Company's consolidated totals:

Assets:	2000	1999	1998
Total assets for reportable segments	\$ 1,069,534	745,376	523,047
Investments in equity method investees	(249,659)	(119,225)	(42,670)
Intercompany receivables	(167,506)	(38,231)	(999)
Total consolidated assets	\$ 652,369	587,920	479,378

# Notes to Consolidated Financial Statements continued

*(Dollars in thousands, except per share amounts and elsewhere as noted)*

## 20. Related Party Transactions

Effective June 30, 1998, the Company entered into a management services agreement with APA Management, Inc. ("APAM") to provide the Company with all necessary insurance management and administrative services for APAC, a wholly owned subsidiary of the Company. The Company has an indirect financial interest in APAM through its 9.9% interest in APAL, an affiliate of APAC, which owns 100% of APAM. The agreement terminates on December 31, 2002, unless extended until December 31, 2003, and provides that APAM will receive an annual fee of 14.5% of direct premiums (net of refunds) consisting of an annual 10.5% service fee and 4% claims management fee. The agreement also provides that anesthesiologist business produced by FPIC or its respective agents will be transferred to APAC upon renewal, assuming the insured agrees, and that APAM will receive an annual 1% service fee on such business. The Company incurred \$1.6 million, \$1.4 million, and \$0.6 million in management fees related to its agreement with APAM during the years ended December 31, 2000, 1999 and 1998, respectively.

On July 1, 1998, FPIC began assuming reinsurance from PRI, a writer of medical malpractice insurance in the state of New York. PRI is managed by an attorney-in-fact, AFP, which effective January 1, 1999 was acquired by and became a wholly owned subsidiary of the Company. Under one contract, which reinsures PRI for policies with limits of \$1.0 million in excess of \$1.0 million, FPIC assumes losses only and pays PRI a ceding commission on the premium assumed. Under the second contract, FPIC reinsures PRI for losses of \$.25 million on each claim in excess of \$0.5 million on each loss. During 2000, 1999 and 1998, the Company assumed written premiums of approximately \$16.3 million, \$22.0 million and \$8.7 million, respectively, of which approximately \$16.7 million, \$15.0 million and \$4.4 million, respectively, was earned under these contracts. The net premium written under these agreements was reduced during the fourth quarter of 2000 due to the accrual of charges for experience adjustments. The accrual represents an estimate of the amount of premium the Company will return in future years. The Company has incurred approximately \$18.6 million, \$6.7 million and \$2.7 million in losses related to these reinsurance agreements with PRI for the years ending December 31, 2000, 1999 and 1998, respectively. Premiums on these contracts are paid by PRI on a quarterly basis. As of December 31, 2000, 1999 and 1998, the amount due from PRI under these contracts was approximately \$1.1 million, \$4.3 million and \$4.5 million, respectively.

Effective January 1, 2000, FPIC entered into a 100% quota share reinsurance agreement with PRI to assume PRI's death, disability and retirement risks under its claims-made insurance policies in exchange for cash and investments in the amount of \$47.0 million. During 2000, a GAAP valuation of the underlying liability was completed and a deferred credit in the amount of \$13.2 million was recognized and classified as goodwill and intangible assets. The deferred credit, which will be amortized into income over 20 years, represents the difference between the GAAP valuation of the liability and the initial premium received. The liability was calculated using benefit assumptions and elements of pension actuarial models (i.e. mortality, morbidity, retirement, interest and inflation rate assumptions). In connection with the agreement, FPIC recognized a 5% ceding commission expense, which is being deferred and amortized as premiums are earned under the agreement.

In accordance with a management agreement, AFP performs underwriting, administrative and investment functions on PRI's behalf for which it receives compensation. Compensation under the agreement is based upon PRI's direct written premium and statutory operating results. Total revenues earned under the agreement were \$18.6 million for both 2000 and 1999. The management agreement also provides that AFP is to be reimbursed by PRI for certain expenses paid by AFP on PRI's behalf. The expenses reimbursed by PRI consist principally of the salaries and related payroll and overhead costs of AFP's claims, legal, and risk management course personnel who work on PRI's behalf. These directly reimbursed expenses amounted to \$10.6 million and \$10.9 million in 2000 and 1999, respectively, and are not reported in the accompanying consolidated financial statements. The management agreement was reviewed and approved by the New York Insurance Department and is effective January 1, 1999 through December 31, 2008.

## 21. Restructuring

During the fourth quarter of 2000, the Company recorded a pre-tax restructuring charge of \$500 in connection with exiting a product line and restructuring its third party administrative operations in Albuquerque, New Mexico. The exit plan is expected to be completed by April 30, 2001.

Under the plan, the Company will exit a fully insured line of business in which it performed the marketing, underwriting, claims processing and administrative services for a major insurance carrier. The Company also canceled a selected number of self-funded groups that were not profitable. As a result of the plan, thirty employees that serviced these clients were terminated prior to December 31, 2000. This reduction represents 12% of the TPA workforce and 35% of the New Mexico office. All terminated employees were located in the Albuquerque, New Mexico office. Restructuring activity for fiscal 2000 was as follows:

		Severance & Benefits	Facilities	Travel	Total
Fiscal 2000 restructuring charge	\$	360	90	50	500
Amount utilized in 2000		(10)	(27)	(33)	(70)
Balance, December 31, 2000	\$	350	63	17	430

## 22. Quarterly Results of Operations

The following is a summary of unaudited quarterly results of the Company's operations for the years ended December 31, 2000 and 1999:

<u>2000</u>	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>
Premiums written and assumed . . . . .	\$ 76,033 <sup>(1)</sup>	35,046	54,610	31,591 <sup>(1)</sup>
Premiums earned . . . . .	29,148	\$33,468	29,868	27,970
Net investment income . . . . .	6,017	6,133	6,396	6,197
Total revenues . . . . .	44,287	47,813	46,997	42,940
Net income (loss) . . . . .	4,712	5,143	4,926	(14,167)
Basic earnings per share . . . . .	.49	.54	.52	(1.49)
Diluted earning per share . . . . .	.49	.54	.51	(1.49)
<u>1999</u>	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>
Premiums written and assumed . . . . .	\$ 37,522	38,160	45,698	26,836
Premiums earned . . . . .	27,584	26,550	33,170	30,885
Net investment income . . . . .	4,452	4,880	5,010	4,682
Total revenues . . . . .	39,928	39,279	47,203	44,095
Net income . . . . .	7,234	7,402	2,662	4,571
Basic earnings per share . . . . .	.74	.75	.27	.47
Diluted earning per share . . . . .	.70	.71	.26	.45

(1) Excludes the effect of the reclassification of a portion of the statutory assumed reinsurance premiums written in the amount of \$13.2 million related to the 100% Quota Share reinsurance agreement with PRI. This amount was finalized, reclassified and reported directly as a deferred credit in the balance sheet account, "Goodwill and other intangibles" during the second quarter of 2000, after the initial reporting of the contract in the first quarter. This reclassification had no effect on revenues or income previously reported.

# Corporate Information

## CORPORATE OFFICERS

**John R. Byers**

*President and Chief Executive Officer*

**Kim D. Thorpe**

*Executive Vice President and Chief Financial Officer*

**Kurt J. Cetin**

*Senior Vice President - Chief Marketing Officer*

**Roberta Goes Cown, Esq.**

*Senior Vice President - Investor Relations*

*Corporate Counsel*

*Secretary of the Corporation*

**Gary M. Dallerio**

*Senior Vice President - Operations*

**Pamela D. Deyo**

*Vice President and Controller*

**Charles Divita, III**

*Vice President - Finance, Strategic Planning and Execution*

## CORPORATE LEGAL COUNSEL

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Jacksonville, Florida 32202

## INDEPENDENT ACCOUNTANTS

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## CONSULTING ACTUARIES

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Two Commerce Square

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Philadelphia, PA 19103-7096

Tillinghast-Towers Perrin

200 W. Madison Street

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## ANNUAL MEETING

The 2001 shareholders' meeting will be held on

Wednesday, June 6, 2001 at 10:00 a.m. at the Omni

Hotel, 245 Water Street, Jacksonville, Florida 32202

## FORM 10-K

A copy of the Annual Report on Form 10-K for the

fiscal year ended December 31, 2000, as filed with the Securities and Exchange Commission, is available upon written request from:

Investor Relations

FPIC Insurance Group, Inc.

225 Water Street, Suite 1400

Jacksonville, FL 32202

(904) 354-2482 Ext 3287

## FINANCIAL PUBLICATIONS

Information about FPIC Insurance Group, Inc.,

including copies of the Annual Report to

Shareholder and the Annual Report on Form 10-K

may be requested through the Company's web site

Questions and Comments section at

<http://www.fpic.com> or via e-mail at

[parks@fpic.com](mailto:parks@fpic.com), or by calling Investor Relations

at (904) 354-2482 Ext. 3287 or by writing to:

Investor Relations

FPIC Insurance Group, Inc.

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Jacksonville, FL 32202

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Our web site also provides access to our interactive e-mail notification service by simply adding your e-mail address to the "join mail" section of our web site. You will automatically be alerted to any new press releases, earnings reports and SEC filings via e-mail.

## TRANSFER AGENT

SunTrust Bank, Atlanta

Stock Transfer Department

Mail Code 258

P.O. Box 4625

Atlanta, Georgia 30302

1-800-568-3476

## FPIC ON THE INTERNET

[www.fpic.com](http://www.fpic.com)

#### FPIC STOCK DATA



The Company's Common Stock is publicly traded on the NASDAQ National Market System under the symbol FPIC. The following table sets forth, for the periods indicated, the high and low bid quotations as reported. Such quotations reflect inter-dealer bids and offers, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

<u>2000</u>	<u>High Bid</u>	<u>Low Bid</u>
First Quarter	\$19.94	\$15.00
Second Quarter	\$18.88	\$10.38
Third Quarter	\$18.38	\$10.92
Fourth Quarter	\$16.88	\$8.44

<u>1999</u>	<u>High Bid</u>	<u>Low Bid</u>
First Quarter	\$49.13	\$37.88
Second Quarter	\$49.88	\$40.25
Third Quarter	\$50.63	\$14.25
Fourth Quarter	\$22.38	\$14.88

As of March 15, 2001, the Company estimated that there were approximately 6,400 beneficial owners of the Company's common stock.

The Company did not pay cash dividends on its common stock during 2000 or 1999. The Company does not anticipate paying any cash dividends in the foreseeable future. For information regarding restrictions on the ability of the Company's subsidiaries to transfer funds to the Company in the form of cash dividends, see Footnote 17 Statutory Accounting in the Notes to Consolidated Financial Statements found on page 44.



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