MEDAmerica
An Excellus Company

2003 Annual Report

Raising the bar

Mission

To provide affordable, dignified access to needed and effective long term care services.

- MedAmerica's heritage and future direction are built on a strong foundation of community service and social consciousness.
- MedAmerica stands for access to high-quality, affordable long term care services and strives at all times to actively improve the quality of life of our policyholders.
- MedAmerica encourages wellness and healthy lifestyles for seniors and provides educational opportunities for healthcare professionals on the difficult issue of elder abuse.

Company profile

MedAmerica Insurance Company, MedAmerica Insurance Company of New York, Excellus Reinsurance Company (Cayman) Ltd., and Excellus Insurance Agency, Inc., comprise the long term care business of MedAmerica. Both MedAmerica companies are subsidiaries of Excellus Health Plan Inc., which is part of The Lifetime Healthcare Companies Inc., a $4 billion health insurer with more than 65 years of financing and delivering health care services headquartered in Rochester, New York.

MedAmerica insurers have a Best's rating of A– "Excellent," and are rated A– "Strong," by Standard & Poor's. These long term care insurance companies are recognized nationally for financial and rate stability and for maintaining the highest levels of service and customer satisfaction.

President's letter

I am pleased to share with you a review of 2003, a defining year for MedAmerica.

We continued to build a strong financial base with positive operating results for the 13th consecutive year. We have accomplished this with a disciplined approach to pricing and risk management that has allowed us to operate for 17 years without any rate increases. Premium revenue grew by a record $20.8 million, while profits grew by a record 243%, and assets topped half a billion dollars. This outstanding financial performance advances our position as a major player in the industry.

We are pleased with the expansion of our employer-sponsored business. The State of Tennessee Employee and Retiree Long Term Care Insurance Plan, with 70,000 eligibles, was launched in 2003, adding more than 2,500 new policies and $2.4 million in new premium. We also added a number of small and midsized employer groups that helped push our group enrollment to nearly 50% of our total in-force contracts. The employer-sponsored market will continue to grow, and we are well positioned to take advantage of this exciting market opportunity.

The development of our new cash product, CareDirections Simplicity®, was a strategic focus for 2003. Our goal—to create a product that responds to the needs of baby boomers—was accomplished with a product design that we believe will redefine long term care insurance. Simplicity is already receiving rave reviews. In a rating by SellingLTC.com, Simplicity received the highest product rating *ever*, exceeding the next-ranked competitor by a solid 13 points. Never before has a new LTCi product created so much excitement.

We continue to execute a distribution strategy that will drive our growth going forward. We partner with some of the industry's top LTCi distributors and continue to add quality agencies to expand our presence across the country. We now do business with 34 BlueCross BlueShield plans with the addition of eight new plans through a major acquisition from ERC Long Term Care Solutions, Inc., last year. We appointed more than 5,000 new agents and expect to at least double that number in 2004. By offering world-class service, superior technology, and a revolutionary new product, we are proving that our distribution partners can count on us for the long term.

Finally, as part of a not-for-profit health care company dedicated to a mission of serving the community, we are committed to making a difference in the lives of those we serve. For example, in 2003 we introduced the Care Directions® Compass program. This program offers savings on value-added programs and services for insureds and their families that can measurably improve their quality of life. We also continued our efforts to educate audiences around the country on elder abuse and the threat this growing societal problem poses to seniors.

We are proud of our accomplishments, yet we know there is still much to be done. With our new Simplicity product and our mission to make a difference, we are out to transform our industry. We raised the bar in 2003 and will continue to do so for many years to come.

I'd like to close by extending a sincere "thank you" to our producers, customers, and employees. Our success would not be possible without you.

Christopher D. Perna
President and Chief Operating Officer

2003 at a glance

We're securing our position as an industry leader by building a strong financial base, setting new industry standards for product design and service, and focusing our distribution strategy on building strong partnerships.

Building a strong financial base

Strong growth.

- Grew premium revenue by 32% to $86.5 million.
- Grew total policies in force by 40% to 85,360.
- Grew assets by $141 million to $511 million.
- Added Tennessee as the sixth state to choose MedAmerica to underwrite and administer its employee long term care plan with more than 2,500 policies generating $2.4 million in annual premium.
- Added 18,000 policies and $14 million in annual premium revenue with a major acquisition from ERC Long Term Care Solutions, Inc.

Record financial performance.

- Net income increased by 243% to $9.3 million.
- Accumulated equity increased by 58%.
- Thirteen consecutive years of positive operating results accomplished without rate increases.

First-class ratings.

- MedAmerica has a Best's rating of A– "Excellent" and is rated A– "Strong" by Standard & Poor's.

Setting new industry standards for product design and service

Redefining long term care insurance.

- Developed state-of-the-art long term care insurance product—CareDirections Simplicity®
  - Prospective cash payment feature puts customers in control.
  - Received highest product rating ever by SellingLTC.com. Rating of 91 exceeded closest competitor by 13 solid points in a feature-by-feature comparison of over 40 companies and 116 products.

Setting the gold standard for service.

- Average processing time for new applications: 22 calendar days.
- Customer Service average response time: 10 seconds.
- Average turnaround for claims payment: 4 calendar days.
- Implemented same-day appointment process for agents, as permitted by statute.

Focusing our distribution strategy on building strong partnerships

Expanded partnerships with top LTCi distributors.

- Entered into new partnerships with several leading LTCi distributors and significantly increased our national distribution capacity.
- Selected as one of four endorsed carriers by the National LTC Network.
- A projected 20,000 agents nationally soon will be contracted to sell MedAmerica products.

Affinity partnerships with BlueCross BlueShield plans.

- Partnering with 34 Blues plans to bring affordable, quality LTCi to their millions of members around the country.

Working to make a difference in the lives of those we serve

Making a difference.

- Introduced Care Directions® Compass, our innovative value-added program that offers programs and services to enhance quality of life.
- Selected to co-sponsor New York State Elder Abuse Summit that will take place in May of 2004.
- Continued to provide elder abuse prevention and detection education to health care professionals throughout the U.S.

Redefining the product

In 2003, we created a new cash-model product—CareDirections Simplicity—that breaks from traditional long term care insurance products with an innovative design that enables insureds to have control over where, how, and by whom care is provided. It's an ideal product for the baby boomer market that favors self-direction.

"This is not your parents' long term care insurance," states Christopher Perna, president. "We've redefined long term care insurance for a generation who has defined life on their own terms. Simplicity offers the ultimate individualization so when long term care services are needed, a person's lifestyle doesn't have to be interrupted."

It's cash, not confusion!

Designed to be tax-qualified, Simplicity pays eligible insureds their applicable Monthly Benefit in cash without regard to services used or amounts spent. Simplicity doesn't define the services insureds can receive; it gives them the means to obtain the services they need.

Highest rated product on the market

In a ranking of long term care insurance policies by SellingLTC.com, whose product ratings are an industry standard, Simplicity came in on top!

With an all-time high rating of 91, Simplicity surpassed the next-ranked competitor by a significant margin of 13 points. This rating is unique because it is based on actual contract language and definitions that gauge the quality of the product. Phillip W. Sullivan, president of SellingLTC.com, comments:

"We have never had a product rate this high. MedAmerica has set a new standard in long term care policy design. It is exactly what consumers and advocates have been looking for. Simplicity is truly an innovative product."

Simplicity is designed to be the ultimate producer- and customer-friendly product, with straightforward language and great flexibility. All new branding and marketing materials have been developed to support Simplicity. They are as unique as the product, with a fresh airy approach that conveys the product's simplicity.

Easy to sell, easy to buy!

Simplicity is one policy with riders to enhance or simplify coverage. This design allows for ease of selling Comprehensive, Facility Only, or Community Only coverage to individuals as well as employer and affiliation programs—all with one set of forms, marketing materials, and rate program. Simplicity is what producers and consumers alike have been asking for.

"Producer input throughout the product development process helped us design a fresh new product that is easy to *sell* and easy to *buy,"* states Gail Holubinka, vice president of business development.

Our distribution partners are excited about the uniqueness of Simplicity and are hailing it as a product that responds to consumer demand. "It takes a very strong company to offer a product this unique," states John Hennessey, manager of American Independent Marketing.

Simplicity is being filed in all 50 states and will launch in January 2004. We expect to have the product available for distribution in most states by June 2004. Given this time frame, we will have completed the development, filing, and rollout of our new product in just over a year. This is truly a remarkable accomplishment.

CareDirections Simplicity®

Key features

Simplicity is a tax-qualified **cash-model LTCi product** designed to fit every lifestyle.

CASH IN HAND FEATURE

Benefits paid prospectively. Monthly cash benefit *without regard to services used or amounts spent.* Eligibles can use their monthly cash benefit as they choose for the care they want, however and from whomever they want, wherever they want—anywhere in the world!

NO PAPERWORK

No submission of third-party bills for reimbursement and no limits.

PLUG 'N PLAY DESIGN

- **Three products:** Comprehensive, Facility Only, Community Only
- **Three programs:** Individual, Employer Program, and Affiliation
- **One set of forms**

PRODUCT OVERVIEW

- Monthly benefits: $2,100 and up. **No limits** (except in New York)
- **Calendar day** elimination period
- Lifetime max: 24, 36, 48, 60, 84 or unlimited months
- Attractive nonforfeiture riders including Full Return of Premium
- Four flexible payment options
- Four inflation protection options

Leading the employer-sponsored market

MedAmerica continues to be a recognized leader in the employer-sponsored LTCi market. We wrote our first employer-sponsored plan in 1988, and we now administer more than 150 employer groups, including six state group offerings, ranging in size from five to over 300,000 eligibles.

In 2003, nearly 50% of our in-force policies and 40% of our premium revenue originated from employer-sponsored sales. We plan to expand our share of this market segment with the launch of Simplicity.

Simplicity will offer a combination of benefit, underwriting, and commission options to fit virtually any employer-sponsored sales opportunity. This product's flexibility, along with innovative marketing materials and web-based enrollment technology, shows how MedAmerica is again raising the bar.

Helping employers meet

State of Tennessee Employee and Retiree Long Term Care Insurance Plan—LTC-TN

The State of Tennessee made the decision to offer long term care insurance after assessing the risk of their employees needing costly long term care services. After a year-long competitive procurement process, MedAmerica was selected to develop, market, insure, and administer their long term care insurance plan—LTC-TN.

Profile

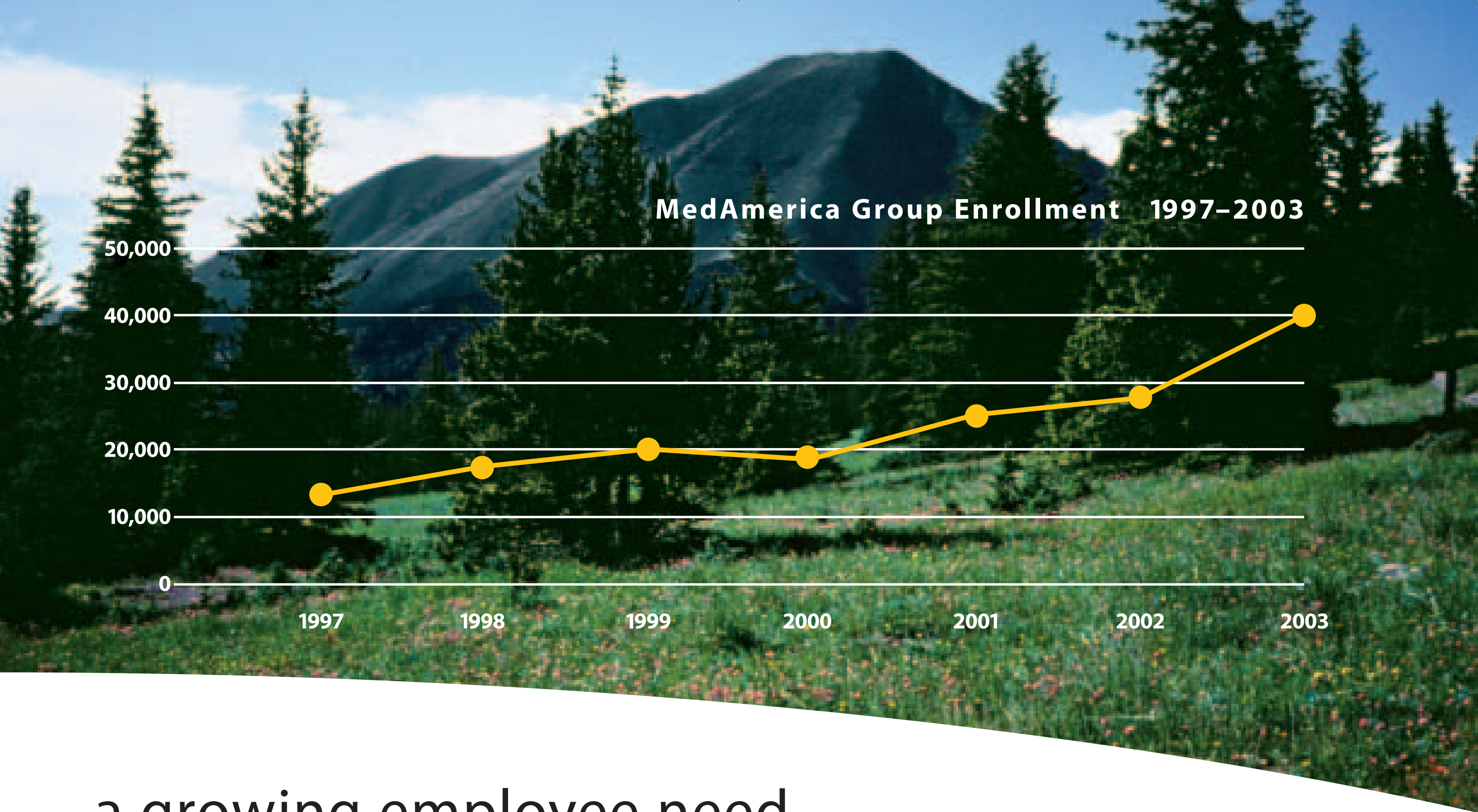
- State employer group
- Offered to employees, retirees and eligible family members
- More than 2,500 insureds
- Voluntary employee-pay-all offering

The LTC-TN offering was a huge success. During the three-month open enrollment that began in April, close to 90 seminars were conducted with over 3,600 attendees. The sale of more than 2,500 new policies representing over $2.4 million annual premium exceeded everyone's expectations.

According to Richard Chapman, of Tennessee's Division of Insurance Administration, "Recognizing the future cost of services that are covered by long term care is key to understanding how meaningful this opportunity is to employees. The State of Tennessee assessed this exposure and determined that providing access to this type of insurance represents a significant improvement in the State's benefit package. We encourage employees, retirees, and eligible family members to consider enrolling in this coverage as it provides protection for major risks and access to essential services when they are necessary."

MedAmerica prevailed in Tennessee's competitive procurement of long term care coverage. When reflecting on the program implementation, Chapman stated:

"Like most public sector purchasing processes, our rules are rigorous. We're pleased with the results. MedAmerica has been a responsive partner during the initial enrollment and with working through all of the administrative details any start-up requires. We have traditionally relied upon printed materials; with MedAmerica, we expanded our package of communication tools to include greater electronic provision of enrollment information and got some very positive comments from our employees. This was particularly important for an employer who has workers stationed from Memphis to Mountain City."



a growing employee need

Howell Township Public Schools Long Term Care Insurance Plan, Howell, NJ

When the Howell Township Board of Directors and Employee Union began considering long term care insurance as an enhancement to their employee benefit plan, they focused on finances and demographics. With the cost of long term care services on the rise and elder care rapidly replacing child care as a top employee concern, long term care insurance was a viable solution.

Profile

- Employer group offering
- Offered to employees, retirees and eligible family members
- Employer-paid base plan for employees
- Voluntary plan for retirees and family members
- Approximately 1,000 eligibles

The Board made slight modifications to their benefits program to add the long term care coverage without increasing their annual benefits budget. Because no additional cost was incurred, they were able to extend an employer-paid long term care insurance plan to all employees.

According to Herbert Massa, of Howell Township Public Schools, "At Howell, we were ahead of the curve. We realized the need for long term care coverage for our employees before it gained popularity as an employee benefit. MedAmerica helped us develop a plan that fit our business objectives and met our employees' needs. With demographics the way they are and with tax incentives, group rates, and favorable underwriting, offering long term care insurance makes good business sense."

Partnering with the best

Partnerships with expert producers are important for the MedAmerica brand. MedAmerica is proud to recognize Bob Burke as one of our Top Producing Agents of 2003.

Burke has over 13 years experience in financial planning and long term care insurance sales. In addition to his background as an insurance professional, he has experienced firsthand what it means to have a loved one need long term care.

"A few years ago, my grandmother went through a health crisis that left her in need of round-the-clock care," recalls Burke. "It was a stressful and emotional time for my family, especially for my aunt who was her primary caregiver. With years of long term care sales behind me, it was this event that changed my approach to selling. Now when I'm on a sales call, I reflect on the experience with my grandmother. It allows me to put myself in the shoes of the consumer, and most importantly, it reaffirms my faith in what I do every day."

Burke's concentration is in the employer-sponsored market. In the four years he has been with MedAmerica, he has acquired 20 accounts and produced more than 730 new policies totaling nearly $800,000 in annualized premium.

"Selling is easy when you've got a great product and first-rate support behind you," says Burke. "The people at MedAmerica go above and beyond. When I call in with a question, there's virtually no wait time, and everyone is so knowledgeable and helpful. It really simplifies the sales process."

Burke is excited about MedAmerica's future direction and the launch of Simplicity.

"MedAmerica's dedication to the employer-sponsored market really impresses me," says Burke. "And with a product like Simplicity on the horizon, the possibilities for sales success are endless."

First-rate sales support

We go the extra mile to serve those who serve us!

- **Underwriting HOTLINE** provides direct access to experienced underwriters.
- **Agent Web site** provides up-to-date application status and commission reporting.
- **Flexible commission contracting** to accommodate various distribution arrangements.
- Comprehensive **new proposal program** provides rate quotes and sales illustrations.
- **Rapid** agent contracting.
- **Web-based ordering system** ships agent supplies within 48 hours.

Management's report on responsibility for financial reporting

The management of MedAmerica Insurance Company of New York, MedAmerica Insurance Company, Excellus Reinsurance Company, Ltd., and Excellus Insurance Agency, Inc. (the Company), are responsible for preparing the combined financial statements and other financial information in this Annual Report. This responsibility includes maintaining the integrity and objectivity of financial data and the presentation of the Company's results of operations, financial position, and cash flows in accordance with accounting principles generally accepted in the United States of America. The financial statements include amounts that are based on management's best estimates and judgments.

The Company's combined financial statements have been audited by Deloitte & Touche LLP, whose report appears in this Annual Report. Their audits were conducted in accordance with auditing standards generally accepted in the United States of America which include consideration of internal controls and tests of transactions to the extent necessary to form an independent opinion on the combined financial statements prepared by management.

The Company maintains a system of internal controls that provides reasonable assurance that its records reflect its transactions in all material respects and that significant misuse or loss of assets is prevented. There are limits inherent in all systems of internal control based on the recognition that the cost of such systems should be related to the benefits to be derived. Management believes that the costs of internal control systems do not exceed the benefits obtained and are adequate to accomplish its objectives on a continuous basis. The Company maintains a strong internal auditing program that independently assesses the effectiveness of internal controls and takes appropriate actions to respond to these recommendations.

The Board of Directors, acting through its Audit and Finance Committee composed solely of nonemployee directors, is responsible for determining that management fulfills its responsibilities in the preparation of the combined financial statements and the maintenance of internal controls. In fulfilling its responsibility, the Audit and Finance Committee recommends independent auditors to the Board of Directors for appointment. The committee also reviews the combined financial statements and adequacy of internal controls. The Audit and Finance Committee meets regularly with management, Corporate Audit, and the independent auditors. Both the independent auditors and Corporate Audit have full and free access to the Audit and Finance Committee, without management representatives present, to discuss the scope and results of their audits and their views on the adequacy of internal controls and the quality of financial reporting.

It is the business philosophy of the Company and its affiliates to obey the law and to require that their employees conduct their activities according to the highest standards of business ethics. Management reinforces this philosophy by numerous actions, including issuing a Code of Business Conduct and Compliance Program to support compliance with the Company's policies.

Christopher D. Perna, President and Chief Operating Officer

Emil D. Duda, Treasurer and Chief Financial Officer

Management's discussion and analysis

Overview

2003 marked the 13th consecutive year of positive operating results, with net income increasing from $2.7 million in 2002 to $9.3 million. Total revenues during 2003 increased to $114.9 million and assets grew to $511.1 million. Based on its strong financial position and proven business strategy, the long term care business of MedAmerica (the Company) maintained an A– rating from both A.M. Best and Standard and Poor's during 2003.

The Company continues to focus exclusively on underwriting, servicing and reinsuring long term care insurance and related products. The CareDirections family of long term care insurance products is sold in all 50 states and the District of Columbia. The Company has never needed or requested a premium rate increase for any of its products.

Results of operations

Sales—Premium revenue increased 32% from $65.6 million in 2002 to $86.5 million in 2003. Premiums earned during 2001 totaled $53.7 million. Contracts in-force reached 85,360 by the end of 2003, and new policy sales added $14.7 million annualized premium.

Premiums were directly written in all 50 states during 2003. New York continues to be the main source of sales, accounting for 30% of new premiums, with Tennessee (19%), New Jersey (9%) and North Dakota (7%) comprising other areas of high market penetration.

The number of appointed agents grew from 9,233 to 11,133 by the end of 2003, with a 12% increase in the number of agents who placed a MedAmerica policy. Distribution channels include national marketing organizations (NMOs), general agencies, career agencies, and salaried employees. The Company continues to expand its sales capacity by contracting other forms of distribution, including group brokers and telesales organizations.

The Company developed and began filing its 14th generation of long term care insurance products during 2003. CareDirections Simplicity® is an innovative product that is strategically focused on the needs of baby boomers. The product received the highest product rating ever by SellingLTC.com, and is uniquely designed to provide consumers with cash and control over service delivery. Initial market feedback on the product's quality and affordability affirms the Company's high expectations for the Simplicity product.

Entry into new markets on the strength of BlueCross and BlueShield brand recognition continues to be a core strategy for the Company. By the end of 2003, agreements were in place with 34 BlueCross BlueShield Plans. This represents approximately 83% of BlueCross BlueShield organizations nationwide. Eight new BlueCross BlueShield relationships were acquired from ERC Long Term Care Solutions, Inc., during 2003.

The Company continues to be a leader in the group long term care insurance market. In 2003, MedAmerica conducted an open enrollment for over 70,000 eligible employees of the State of Tennessee, achieving $2.4 million in in-force premium. Group business now accounts for 40% of MedAmerica's in-force premiums.

Expenses—Benefits expenses are actuarially determined based upon assumptions as to utilization, mortality, lapses and investment yields. Liabilities for policy and contract claims are computed using the net level premium method. Incurred claims continue to be lower than expected. With favorable claims experience for policies in force for more than 15 years, the Company remains confident with its pricing assumptions and underwriting discipline.

Operating expenses, including commissions, decreased from 36% of premium in 2002 to 35% of premium in 2003. The company manages expenses to pricing assumptions and is beginning to recognize administrative efficiencies as a result of sustained growth.

Acquisition

Acquisitions continue to provide a viable source of growth and stability for the Company. During 2003, 17,073 contracts were acquired from ERC Long Term Care Solutions, Inc. The acquired business increased MedAmerica's in-force contracts by 22% and added $14 million annualized premium. The business contributed $2.3 million in new sales post-acquisition, and offers several growth opportunities going forward.

Investments

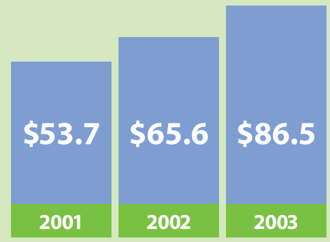
The Company's cash and investments, consisting of bonds and cash, ended the year at $429.8 million, an increase of $134.9 million or 46% over the $294.9 million held at the end of 2002. Interest and dividend income, net of investment expense, totaled $13.4 million, an increase of $0.9 million, or 7.2% over the $12.5 million recorded in 2002. Realized gains increased from $4.3 million in 2002 to $12.2 million in the current year. The investment portfolio's total 2003 return was 7.1% compared to 8.6% in 2002.

The asset allocation of the Company's portfolio was 83.8% bonds and 16.2% cash, including cash utilized for operating purposes. The fixed income portion of the portfolio was held in U.S. Treasury securities (3.2%) and corporate bonds (96.8%). It is the Company's policy to invest only in bonds rated A– or better by a nationally recognized rating agency. The Company does not invest in real estate, and it is the opinion of Management that the Company has no significant concentration of credit risk.

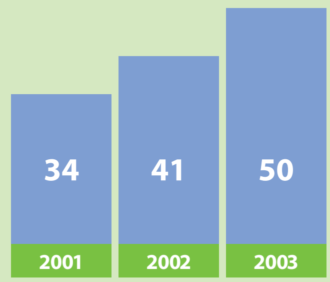
Liquidity and capital resources

The Companies' liquidity position remained strong. The Companies have no outstanding debt and ended the year with stockholders' equity of $72.8 million.

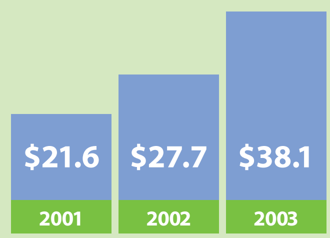
Insurance law requires that the Company maintain a minimum statutory surplus which complies with the Risk-Based Capital Formula promulgated by the National Association of Insurance Commissioners (NAIC). The formula includes components for asset risk, liability risk, interest rate exposure and other factors. The Company exceeded the authorized control level for 2003.



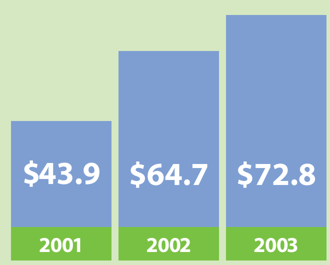
Premium revenue
(in millions)



Number of states with in-force policies



Group in-force premiums
(in millions)



GAAP equity
(in millions)

Combined balance sheets

(Amounts in thousands)

December 31, 2003 and 2002	2003	2002
Assets		
Cash and cash equivalents	$ 69,690	$ 35,574
Investments	360,141	259,333
Receivables	23,026	24,605
Deferred policy acquisition costs	56,444	48,399
Other assets	1,775	2,230
Total assets	**$511,076**	**$370,141**
Liabilities and stockholders' equity		
Aggregate liability for policy and contract claims	$397,306	$263,731
Premium deposits and unearned premiums	25,932	19,949
Deferred income tax liabilities	1,673	5,051
Accounts payable and accrued expenses	13,329	16,666
Total liabilities	**438,240**	**305,397**
Stockholders' equity:		
Common stock	4,314	4,314
Additional paid-in capital	32,667	32,667
Accumulated other comprehensive income	10,458	11,676
Accumulated equity	25,397	16,087
Total stockholders' equity	**72,836**	**64,744**
Total liabilities and stockholders' equity	**$511,076**	**$370,141**

See notes to combined financial statements.

Combined statements of income

(Amounts in thousands)

Years Ended December 31, 2003 and 2002	2003	2002
Revenue:		
Premiums earned	$ 86,455	$65,635
Investment income—net	28,437	13,511
Total	**114,892**	**79,146**
Expenses:		
Benefits	72,962	52,188
Operating	30,292	23,568
Total	**103,254**	**75,756**
Income before income taxes	11,638	3,390
Income taxes	2,328	678
Net income	**$ 9,310**	**$ 2,712**

See notes to combined financial statements.

Combined statements of changes in stockholders' equity

(Amounts in thousands)

Years Ended December 31, 2003 and 2002	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Comprehensive Income	Accumulated Equity
BALANCE—January 1, 2002	$ 4,313	$20,667	$ 5,533		$13,375
Paid in surplus	1	12,000			
Comprehensive income:					
Net income				$ 2,712	2,712
Unrealized gain on investment:					
Unrealized holding gains during period—net of tax			8,952	8,952	
Less: reclassification adjustment for gain included in net income—net of tax			(2,809)	(2,809)	
Total comprehensive income				**$ 8,855**	
BALANCE—December 31, 2002	**$ 4,314**	**$32,667**	**$11,676**		**$16,087**
Paid in surplus					
Comprehensive income:					
Net income				9,310	9,310
Unrealized gain on investment:					
Unrealized holding gains during period—net of tax			6,695	6,695	
Less: reclassification adjustment for gain included in net income—net of tax			(7,913)	(7,913)	
Total comprehensive income				**$ 8,092**	
BALANCE—December 31, 2003	**$ 4,314**	**$32,667**	**$10,458**		**$25,397**

See notes to combined financial statements.

Combined statements of cash flows

(Amounts in thousands)

Years Ended December 31, 2003 and 2002	2003	2002
Operating activities:		
Net income	$ 9,310	$ 2,712
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of bond discount and other	(3,197)	225
Net realized gain on investments	(12,174)	(4,322)
Decrease (increase) in receivables	1,579	(4,758)
Increase in deferred policy acquisition costs	(8,045)	(5,443)
Decrease (increase) in other assets	455	(104)
Increase in aggregate liability for policy and contract claims	133,575	40,649
Increase in premium deposits and unearned premiums	5,983	2,812
(Decrease) increase deferred income tax liabilities	(3,378)	2,269
(Decrease) increase in accounts payable and accrued expenses	(3,337)	7,303
Net cash provided by operating activities	**120,771**	**41,343**
Investing activities:		
Proceeds from sales and maturities of investments	227,686	73,892
Purchases of investments	(314,341)	(108,403)
Net cash used by investing activities	**(86,655)**	**(34,511)**
Financing activities:		
Proceeds from sale of common stock and paid in surplus		12,001
Net increase in cash and cash equivalents	**34,116**	**18,833**
Cash and cash equivalents—beginning of year	35,574	16,741
Cash and cash equivalents—end of year	**$69,690**	**$35,574**

See notes to combined financial statements.

Notes
to combined financial statements

Years ended December 31, 2003 and 2002
(Dollar amounts in thousands)

note 1

Description of business and summary of significant accounting policies

Organization—The combined financial statements include MedAmerica Insurance Company of New York ("MedAmerica NY"), MedAmerica Insurance Company ("MedAmerica"), Excellus Reinsurance Company (Cayman), Ltd., and Excellus Insurance Agency, Inc. (together "the Company"). The Company underwrites long term care insurance which provides coverage for care at nursing homes and private residences. The Company is licensed to issue policies for long term care coverage in 50 states and the District of Columbia. MedAmerica NY and MedAmerica are wholly owned subsidiaries of MedAmerica, Inc., which in turn, is wholly owned by Excellus Health Plan, Inc., an entity that provides health and medical insurance coverage to subscribers.

Excellus Reinsurance Company (Cayman), Ltd. ("Excellus Re"), a captive reinsurer, and Excellus Insurance Agency, Inc. are wholly owned subsidiaries of Excellus Ventures, Inc. Excellus Re reinsures policies issued or reinsured by MedAmerica. Excellus Health Plan, Inc. and Excellus Ventures, Inc. are members of Lifetime Healthcare, Inc., a holding company. Excellus Ventures also owns stock in MedAmerica.

Basis of combination—The combined financial statements have been prepared on the basis of accounting principles generally accepted in the United States of America which differs from the basis of accounting followed in reporting to insurance regulatory authorities (see Note 8). All significant intercompany balances and transactions have been eliminated in combination. The preparation of financial statements in accordance 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. Actual results could differ from those estimates.

Cash and cash equivalents—All highly liquid debt instruments purchased with an original maturity of three months or less are considered to be cash equivalents.

Investments—All investments are considered available for sale and are recorded at fair value, based on quoted market prices. The net unrealized holding gain or loss on purchased call options is recorded in the combined statement of income. The net unrealized holding gain or loss on all other investments, net of deferred income taxes, is included as a separate component of stockholders' equity. A decline in the fair value of any investment below cost, that is deemed other-than-temporary, is charged to earnings resulting in a new cost basis for the security. Costs of investments sold are determined on the basis of specific identification.

Deferred policy acquisition costs—Acquisition costs, consisting of costs which vary with and are directly related to policy acquisition, are deferred and amortized generally in proportion to the ratio of annual revenue to estimated total revenue over the contract periods. Such costs are regularly subjected to recoverability tests. In the event it is determined that these costs will not be recovered from future revenue and profits, they are written off at that time. For the years ended December 31, 2003 and 2002, amortization was $8,099 and $6,720, respectively.

Aggregate liability for policy and contract claims— These liabilities represent management's estimate of future obligations on policies currently in force. The liability has been computed using the net level premium method and is based upon assumptions as to future investment yield, mortality, utilization and withdrawal. These assumptions, which are consistent with those used for pricing purposes, have been developed from information provided by an independent consulting actuary.

Management believes that the aggregate liability for policy and contract claims at December 31, 2003 and 2002 is appropriately established in the aggregate and is adequate to cover the ultimate net cost of reported and unreported claims arising from losses which had occurred by those dates. The establishment of appropriate liabilities is an inherently uncertain process. Such liabilities are necessarily based on estimates and the ultimate net cost may vary from such estimates. These estimates are regularly reviewed and updated using the most current information available. Any resulting adjustments are reflected in current operations.

Premium deposits—These amounts represent deposits which are retained by the Company until medical underwriting is complete. Upon acceptance or denial of a policy, deposits are recorded as unearned premiums or refunded to the applicant.

Premium revenues—Premiums, which are generally billed in advance, are recognized as revenue during the respective periods of coverage. Premiums applicable to the unexpired portion of coverage are reflected in the balance sheet as premium deposits and unearned premiums.

Income taxes—MedAmerica NY, MedAmerica and Excellus Insurance Agency, Inc. are included in the consolidated federal tax return of Lifetime Healthcare, Inc. Income tax expense and benefit are allocated to each member based on the return that would be filed if not part of a consolidated group. The Company recognizes deferred taxes for revenues and expenses that are reported in different periods for tax and financial statement purposes.

Excellus Reinsurance Company (Cayman), Ltd. is also a taxable entity but files a separate life insurance company return.

Comprehensive income—Comprehensive income includes all changes in stockholders' equity during a period except those resulting from investments by owners and distributions to owners. The Company's comprehensive income includes net income and unrealized gains or losses on certain investments.

Use of estimates—The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications—Certain reclassifications have been made to the 2002 combined financial statements to conform with classifications used in 2003.

note 2 Reinsurance and third-party administration

The Company operates under agreements to reinsure 25%–100% of the risk for certain long term care insurance policies issued by other insurance companies (the "Reinsureds"). As a result of transactions with the Reinsureds, the combined financial statements included the following:

	2003	2002
Combined Balance Sheets:		
Premiums receivable	$ 3,402	$ 2,516
Aggregate liability for policy and contract claims	$184,867	$96,909
Combined Statements of Income—Premiums earned	$ 35,982	$24,524

The Company has also entered into agreements to cede reinsurance of certain of its long term care insurance policies to other insurance companies (the "Reinsurers"). As a result of transactions with the Reinsurers, the Company's financial statements include the following:

	2003	2002
Gross reinsurance premiums earned	$35,982	$25,552
Gross direct premiums earned	54,184	43,950
Statements of operations—premiums ceded	(3,711)	(3,867)
Net premiums earned	**$86,455**	**$65,635**

note 3
Investments

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

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
2003				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 10,870	$ 729	$ 10	$ 11,589
Other debt securities	338,625	12,082	2,155	348,552
Total	**$ 349,495**	**$12,811**	**$ 2,165**	**$360,141**
2002				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 11,200	$ 1,043	$ —	$ 12,243
Other debt securities	238,812	12,963	4,685	247,090
Total	**$ 250,012**	**$14,006**	**$ 4,685**	**$259,333**

The Company abides by applicable State Insurance Laws which place restrictions on the type, amount and quality of investments, as well as internal corporate policies which place additional restrictions on investment activity. Management does not believe that the Company has any significant concentrations of credit risk.

The amortized cost and estimated fair value of debt securities at December 31, 2003, by contractual maturity, are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
Due within one year	$ 6,318	$ 6,379
Due after one year through five years	70,097	61,664
Due after five years through ten years	38,920	53,141
Due after ten years	234,160	238,957
Total	**$349,495**	**$ 360,141**

Unrealized gains or losses are excluded as non-cash transactions in the accompanying combined statements of cash flows.

Proceeds from sales of investments during 2003 and 2002 were $227,686 and $73,892, respectively. Gross realized gains and losses on those sales were as follows:

	2003	2002
Realized gains	$ 13,189	$ 4,334
Realized losses	(1,015)	(12)
Total	**$ 12,174**	**$ 4,322**

Investment securities available for sale in an unrealized loss position as of December 31, 2003 are summarized as follows:

	Less than 12 months		More than 12 months		Total	
	Market Value	Unrealized Losses	Market Value	Unrealized Losses	Market Value	Unrealized Losses
U.S. Treasury securities and obligations of U.S. government corporations and agencies	$ 538	$ (10)	$ —	$ —	$ 538	$ (10)
Other debt securities	41,459	(743)	52,500	(1,412)	93,959	(2,155)
Total	**$ 41,997**	**$ (753)**	**$52,500**	**$ (1,412)**	**$94,497**	**$ (2,165)**

The Company holds a diversified portfolio of investments in the general investment categories shown above. There are 45 securities in an unrealized loss position. This temporary impairment is generally due either to changes in market interest rates since the security was acquired or, in the case of convertible bonds, due to changes in the market price of the underlying stock. The Company has the ability to hold these securities to maturity and thereby avoid any loss, if necessary. Accordingly, the Company does not believe there to be any other-than-temporary impairments.

note 4 Aggregate liability for policy and contract claims

Activity in the aggregate liability for policy and contract claims, which includes a reserve for claim adjustment expenses, is summarized as follows:

	2003	2002
Balance at January 1	$263,731	$223,122
Reinsurance reserve transfers	80,066	1,683
Mod-co reserve adjustment	5,998	528
Claim administration expense	3,572	856
Change in reinsurance recoverable	(1,498)	1,922
Incurred related to:		
Current year	73,983	62,422
Prior year	(1,021)	(10,234)
Total incurred	**72,962**	**52,188**
Paid related to:		
Current year	(8,221)	(5,608)
Prior year	(19,304)	(10,960)
Total paid	**(27,525)**	**(16,568)**
Balance at December 31	**$397,306**	**$263,731**

As a result of changes in estimates of insured events in prior years, the aggregate liability for policy and contract claims decreased by $1,021 in 2003 and by $10,234 in 2002 because actual lengths of stay for active claimants and reported claims differed from those anticipated.

During 2003 and 2002, the Company entered into certain indemnity reinsurance agreements of long term care business. Pursuant to these agreements, the reserves established for outstanding policy liabilities of $80,066 and $1,683 were transferred to the Company during the years ended December 31, 2003 and 2002, respectively.

During 2003, Mod-co reserves held by another insurance carrier decreased by $5,998 from $13,118 to $7,120 at December 31, 2002 and 2003, respectively. This decrease was due to assumption insurance on a portion of the prior year Mod-co.

note 5 Stockholders' equity

The separate components of the Company's common stock and additional paid-in capital at December 31, 2003 and 2002 are as follows:

2003	MedAmerica, Inc.	MedAmerica NY	MedAmerica	Excellus Re	Excellus Insurance Agency	Total
Common stock:						
Par value per share (whole dollars)	$ .001	$ 300	$ 13.32	$ 1	$ .01	**n/a**
Shares outstanding (whole amounts)	10,000,000	6,000	187,758	3,000	1,000	**n/a**
Amount outstanding	$ 10	$ 1,800	$ 2,501	$ 3	$ —	**$ 4,314**
Additional paid-in capital	$ —	$ 8,567	$ 23,803	$ 297	$ —	**$32,667**
2002						
Common stock:						
Par value per share (whole dollars)	$ .001	$ 300	$ 13.32	$ 1	$ .01	**n/a**
Shares outstanding (whole amounts)	10,000,000	6,000	$187,758	3,000	1,000	**n/a**
Amount outstanding	$ 10	$ 1,800	$ 2,501	$ 3	$ —	**$ 4,314**
Additional paid-in capital	$ —	$ 8,567	$ 23,803	$ 297	$ —	**$32,667**

note 6 Related party transactions

The Company reimburses or is reimbursed by Lifetime Healthcare, Inc. for income taxes paid on its behalf. Amounts due (to) from Lifetime Healthcare, Inc. as a result of this transaction were $(2,907) at December 31, 2003 and $935 at December 31, 2002. The amounts are included in accounts payable and accrued expenses and receivables in the accompanying combined balance sheets for the years then ended, respectively.

The Company has an administrative service agreement with Excellus Health Plan, Inc. As part of the agreement, the Company reimburses Excellus Health Plan, Inc. for the full amount of operating expenses paid on its behalf. Amounts due to Excellus Health Plan, Inc. as a result of these transactions were $39 and $107 at December 31, 2003 and 2002, respectively, and are included in accounts payable and accrued expenses in the accompanying combined balance sheets. Also under this agreement, the Company participates in the non-contributory defined benefit pension plan and the defined contribution 401(k) plan of Excellus Health Plan, Inc. The Company incurred $787 and $556 for the years ended December 31, 2003 and 2002, respectively, as part of these plans.

note 7

Income taxes

Components of the Company's 2003 and 2002 income taxes are as follows:

	2003	2002
Federal:		
Current	$ 5,706	$ (573)
Deferred	(3,378)	1,251
Total	**$ 2,328**	**$ 678**

A reconciliation of the expected federal income tax at 35% to the actual income tax provision is as follows:

	2003	2002
Expected Federal income tax expense	$ 4,074	$ 1,186
Consolidated group rate benefit	(1,746)	(508)
Total	**$ 2,328**	**$ 678**

Components of the company's net deferred income tax liability at December 31, 2003 and 2002 are as follows:

	2003	2002
Deferred tax assets:		
Reserves	$ 3,839	$ 3,360
Unearned premium	727	688
Deferred compensation	869	957
Total	**$ 5,435**	**$ 5,005**
Deferred tax liabilities:		
Unamortized DAC	(4,332)	(7,514)
Comprehensive income items	(2,149)	(1,864)
Other	(627)	(678)
Total	**(7,108)**	**(10,056)**
Net deferred tax liabilities	**$(1,673)**	**$ (5,051)**

note 8

Statutory accounting practices

The combined financial statements of the Company included herein have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). MedAmerica NY and MedAmerica report to various regulators using statutory accounting practices ("SAP"), which may differ in certain respects from GAAP. The significant accounting policies prescribed or permitted under SAP which differ from GAAP are as follows:

Cash and Cash Equivalents—All highly liquid debt instruments purchased with an original maturity of one year or less are considered to be cash equivalents.

Investments—Debt securities are stated at amortized cost. The carrying value of investments sold is determined on a specific identification basis. Purchased call options embedded in convertible debt securities are not recognized for SAP purposes.

Nonadmitted Assets—Statutory accounting principles do not allow certain assets to be included in statutory financial statements. Such assets include premiums and other receivables over 90 days past due, prepaid expenses, and agents' balances. The net change in nonadmitted assets is charged directly to accumulated equity.

Policy Acquisition Costs—Policy acquisition costs are expensed as incurred.

Aggregate Liability for Policy and Contract Claims— These amounts represent the estimated liability for future policy benefits. The liability is calculated using either a one- or two-year preliminary term method and is based upon assumptions as to investment yield, mortality, utilization and withdrawal.

Interest Maintenance Reserve (IMR)—Realized gains and losses on the sale of fixed income investments, net of federal income taxes, which resulted from market interest rate changes are not reported immediately as a component of net income, but rather are deferred by means of an IMR and are amortized into income based on the remaining term to maturity of the investments sold.

Income Taxes—Income tax expense is based upon income reported for tax purposes on a separate company basis. Deferred tax assets and liabilities are recognized for temporary differences between statutory accounting and tax basis of assets and liabilities. Deferred tax assets are admitted to a limited extent based on reversal and realizability within one year, not to exceed 10% of statutory capital and surplus, plus the offset of remaining deferred tax assets against existing deferred tax liabilities. The change in deferred tax assets and liabilities is recognized as a separate component of gains/losses in capital and surplus.

A reconciliation between combined stockholders' equity and combined net income on a GAAP and SAP basis as of and for the years ended December 31, 2003 and 2002 is as follows:

	2003	2002
Stockholders' equity—GAAP basis	$72,836	$ 64,744
Aggregate liability for policy and contract claims	14,525	5,170
Unearned premiums	5,503	4,361
Investments	(10,645)	(9,321)
Deferred income tax	2,387	4,274
Other assets	1,031	392
IMR	(10,832)	(3,945)
Other liabilities	(4,392)	(1,702)
Deferred policy acquisition costs	(56,444)	(48,399)
Goodwill	552	—
Computer software	(399)	(1,959)
Stockholders' equity—SAP basis	**$14,122**	**$ 13,615**
Net income—GAAP basis	$ 9,310	$ 2,712
Reserving of premium	82,415	(459)
Reserving of realized/unrealized gains	(9,794)	891
Reserving method for future policy benefits	(74,089)	(10,799)
Policy acquisition costs	(6,637)	(7,698)
Income taxes	(3,064)	1,365
Net loss—SAP basis	**$ (1,859)**	**$ (13,988)**

note 9 Statutory restrictions

The Company follows the National Association of Insurance Commissioners (NAIC) Risk-Based Capital (RBC) formula. This formula requires the insurer to calculate its total adjusted capital and RBC requirement and provides for an insurance commissioner to intervene if the insurer experiences financial difficulty. The formula includes components for asset risk, liability risk, interest rate exposure and other factors.

The Company is required to maintain minimum paid-in capital amounts and is subject to certain restrictions regarding the payment of dividends. The Company must also maintain restricted deposits, as required by various state insurance departments. In addition, the Company is required to maintain certain financial statement ratios.

Independent auditor's report

To the Boards of Directors of the Long Term Care Business of MedAmerica

We have audited the accompanying combined balance sheets of The Long Term Care Business of MedAmerica as of December 31, 2003 and 2002, and the related combined statements of income, changes in stockholders' equity, and cash flows for the years then ended. 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 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, such financial statements present fairly, in all material respects, the combined financial position of The Long Term Care Business of MedAmerica as of December 31, 2003 and 2002, and the combined results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Deloitte & Touche LLP
Rochester, NY
March 3, 2004

Officers And Directors

Joseph F. Kurnath, MD
Chairman

David H. Klein
Chief Executive Officer

Christopher D. Perna
President and Chief Operating Officer

Emil D. Duda
Treasurer and Chief Financial Officer

Officers

Cheryl L. Bush
Vice President,
Long Term Care Operations

William E. Jones, Jr.
Vice President, Sales

Ralph W. Cox
Assistant Secretary

William L. Naylon
Vice President,
Finance and Capital Markets

Del L. Winkelman
Actuary

Directors

Mary Alice Bellardini
Randall L. Clark
Thomas S. Coughlin
Daniel S. Fuleihan, MD
David T. Griffith
Kirk B. Hinman
William A. Johnson, Jr.
David H. Klein
Joseph F. Kurnath, MD
James L. Magavern, Esq.
Thomas L. Mahoney, MD
Geraldine C. Ochocinska
Sandra A. Parker
Carol Raphael
David D. Reh
E. Philip Saunders
Casper F. Sedgwick
Mary Ann Shaw
Albert J. Simone, PhD
William F. Streck, MD
William E. Whitehill, Jr., EdD

The MedAmerica Companies

MedAmerica Insurance Company
Home Office: Pittsburgh, PA

MedAmerica Insurance Company of New York
Home Office: Rochester, NY

Excellus Insurance Agency, Inc.
Home Office: Rochester, NY

Excellus Reinsurance Company (Cayman), Ltd.
Home Office: Grand Cayman, Cayman Islands

THE MEDAmerica COMPANIES

MedAmerica Insurance Company
Home Office: Pittsburgh, PA

MedAmerica Insurance Company of New York
Home Office: Rochester, NY

Excellus Insurance Agency, Inc.
Home Office: Rochester, NY

Excellus Reinsurance Company (Cayman), Ltd.
Home Office: Grand Cayman, Cayman Islands

Count on us for the long term.

www.MedAmericaLTC.com
165 Court Street, Rochester, New York 14647