The Plymouth Rock Company

695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 8, 2017

To Our Shareholders:

Your Company is back in the zone. But don't overreact to my word choice. We're not in that Zen-like zone where impenetrable concentration produces flawless results. The zone to which we returned in 2016 is instead that fairly wide corridor in which we can call our profitability satisfactory. After a couple of years in less impressive territory, we are once again within the familiar boundaries that should make you comfortable with Plymouth Rock's return on equity. There is a second pleasing zone we have re-entered as well, a psychological zone replete with the entrepreneurial atmospheric vapors on which Hal and I thrive. More on the entrepreneurial rekindling will come throughout this missive.

I described in my annual letter last year our three-engine rocket ship: a fee-based business managing a New Jersey reciprocal insurer and providing services for third-party insurance clients, a personal lines underwriting business here in New England, and a substantial investment business. By this tripartite description, we fired up properly on two and a half of the burners this past year. Two of the components – investments and the management companies – met their profit expectations, while the third – New England underwriting – produced results below target. Net income for your stockholder-owned enterprise rose from $29.3 million in 2015 to $42.1 million in the year just concluded, a 43% jump. Net income, though, is far from the whole performance story; it's more like the beginning of a chain. In this case, it overstates the uptick. One measure we might all consider more meaningful is the group's fully consolidated net income, which adds the reciprocal insurer's results to those of the stockholder-owned entity. By this count, the improvement was more like 11%, the tempered percentage rise owing to New Jersey's stronger 2015 base. A more informative index still is the group's gain in book value, which captures unrealized gains and losses in our securities portfolio as well as everything in the consolidated net income. This yardstick showed a 12% gain.

From an owner's point of view, there is always another number that counts. To understand the true economic gain you enjoyed, one needs to consider the change in shareholders' equity plus dividends paid out to you as shareholders during the year (all of which could have been kept as equity) and our real estate gains (which are ignored in generally accepted accounting principles). Dividends to shareholders were $11.6 million this year, and after-tax real estate gains based on independent appraisals were $6.0 million. On a per-share basis, these two adjustments add $143.09 per share to the book value shown in the financial statements. The

year-to-year increase in economic book value (as opposed to the reported book value without adjustments) is 17.9%. This is the basis of my comment on our welcome return to the proper numerical zone. Plymouth Rock's normalized and desirable return corridor, as I have defined it, is bounded on the weak side by 10% and on the strong side by 20%. Returns we see above or below these borders are either sorely disappointing or cause for celebration. This past year's 17.9% is nicely within the comfort zone, which makes it a good year but not a great year. Great years occur only when we smash through the upper wall. The thirty-three year compounded internal rate of return on book value for your Company's owners, excluding real estate gains, barely budges as a result of these 2016 results. It is now 18.0%.

The Plymouth Rock group's underwritten and managed premium volume, before reinsurance, now rounds to $1.2 billion, up about 4% from a year ago. Most of the growth in the year gone by came from New England. Massachusetts automobile insurance has long been our mainstay here, representing about 75% of total New England premiums written. And it is in Massachusetts automobile insurance that Chris Olie and his team found both their fastest growth and their toughest challenge. At the end of 2015, Plymouth Rock Assurance had filed a new set of rates. This was a major product redesign meant to increase pricing refinement and to better attract new business. It seems that the new product overshot the mark on the latter goal. You may recall that I expressed concern about running hot on new volume when I wrote last year's letter. The unease grew with the incoming volume. We like new business growth, of course, but not when it indicates that we have become a magnet for some class of customers written at inadequate prices. That is exactly what Chris decided was happening as the year began, and by midyear Plymouth Rock filed a set of adjustments to the new rate plan to tamp down an influx of underpriced customers. The impact of the original miscalculation had been to add upward thrust to volume and put downward pressure on profits. The correction is already having the opposite impact. As of yearend, Chris reported that Massachusetts auto insurance volume was up 5.9% for the twelve-month period, but that profits were below budgeted levels – reflecting a combined ratio of about 100%.

The weather in 2016, fortunately, was kind to us. Unlike the prior two wintry slogs, both Jack Frost record-breakers in their own ways, this last winter was rather mild. There were no hurricanes or other major storms in the summer or fall. Pushing in the other direction, a restored economy and low gasoline prices have encouraged more driving than in recent years. While the long-term trend toward safer cars and shared transport modes may cut the number of accidents as time goes on, there was no decline in the costs of accidents nationally during this most recent year. As we move into 2017, we do not expect to see any dramatic change in the short-term trend for the industry as a whole, but our marketing department has concerns that, just as our 2015 rate filings may have encouraged too much new business, our correction may have overshot its mark as well, this time in the dampening direction. It is marketing's job to worry in this manner, but I accept that such undershoots and overshoots are endemic to the fine-tuning of insurance prices. We are doing the job at least as well as our competitors here, and that's what counts the most. Meanwhile, the marketing folks on Keith Jensen's team should be cheered by the continued success of Plymouth Rock's proprietary AARP program in the Bay State as well as the new marketing initiative they launched jointly with the amazing, triumphant New England Patriots. Several of our agents went to the Super Bowl as a feature of that program.

Plymouth Rock's New Hampshire business grew by 8% in 2016 and returned a modest profit. We are not dissatisfied with the results, and we expect the new year to bring both growth and profits again, but there is still no breakthrough plan on the table to make that state's numbers a major factor in our group's overall performance. Connecticut growth was an impressive 26%, bringing us to just over $40 million in premiums there. But there is always a new-business penalty when so much unseasoned business is added in one year. The consequence was a Connecticut loss for the year a bit larger than we had hoped for and a delay on the predicted glide path to profitability. On the other hand, we are more confident now than in the past about our pricing and our agent relationships in that state, and we intend to keep growing.

Bunker Hill took on a whole new shape in 2016. Nowhere in our entire enterprise is the spirit of entrepreneurship felt more than in homeowners. In the early years of the Company, Plymouth Rock regarded insuring homes as something of an accommodation for our agents who, quite constructively, wanted to boost customer loyalty by linking sales of auto and home coverages. We were worried about the lack of spread for a one-state writer of homes subject to random weather events. Compounding this, the industry-wide economic track record of this understudied business had long been discouraging. We also saw automobile insurance as the best place to grow and to beat the other players through mathematical sophistication. Our attitude had evolved a bit by the 1990's and, as you well know, we founded Homesite Insurance Group in partnership with Morgan Stanley Private Equity to take advantage of opportunities in the home insurance business without risking Plymouth Rock capital. Homesite was a wonderful success and now, as a subsidiary of American Family Mutual, it has annual premiums of just over a billion dollars. But, although it is still run by the redoubtable Fabian Fondriest, it is gone from our orbit. So, Hal and I took a hard look at our traditional posture with respect to writing homes and decided it was time for a change. We are no longer a one-state company; by the close of 2017 we will be writing in five states. Through our Homesite experience, moreover, we have become much more confident in our mastery of sophisticated tools for managing and reinsuring catastrophe risk. The industry economics have improved as well, largely as national premium totals have grown. When the Company was young, the average premium for a home was less than half the average automobile premium. Now, the average home costs more than the average car to insure, and while the environment for automobile insurance points to lower costs and premiums over time, the cost of insuring a home will almost certainly keep rising. In addition, the situation with respect to mathematical sophistication has reversed itself 180 degrees. Auto writers have fully caught on to the use of mathematics, statistics, and data mining, so it is in homeowners that the application of advanced analytical work will hold the greater competitive advantage.

This logic has led us to embark on a new course with respect to homeowners. We have hired a new chief executive for our home insurance business. Bill Martin comes with the necessary skills to build capacity for greatly expanded – but well protected – writings in the Northeast financed by our own capital, and to explore with us the possibility of writing in the other states throughout the country with the help of financial partners. Bill has already taken charge of Bunker Hill's operations in New England and will be adding to his domain responsibility for almost all of the homeowners business in our other jurisdictions, the only exception being the legacy book of New Jersey homeowners business we inherited from Prudential. Change is

in the wind, and it is all to the good. Meanwhile our existing independent agency and direct homeowners business had quite a good year. Premiums written rose by 7% to about $82 million. And New England and New Jersey homeowners, both regions having enjoyed the benefits of the gentle winter, together returned over $9 million in after-tax profits to the group.

Pilgrim Insurance Company, our subsidiary servicing other insurers in specialized tasks, continues to grow. Under Bill Hartranft's leadership, Pilgrim added another personal auto residual market client starting in January 2017, bringing Pilgrim's total number of Massachusetts Automobile Insurance Plan clients to thirteen. While the recent trend in this state has been toward a smaller residual market, the Massachusetts assigned risk market unexpectedly grew by nearly 10% during 2016, with a positive impact on Pilgrim's fee revenue. The coming year looks better still. For many years, Pilgrim acted as a designated servicing carrier in the Massachusetts commercial automobile residual market. Then we lost that privilege for a time, when market need was diminishing and the number of servicing carriers was reduced. Now we have it again. Bill expects this will add at least $35 million to Pilgrim's scale in 2017. Participating in the commercial program not only pays a fee but also gives Plymouth Rock Assurance a look at business that might fit its voluntary underwriting appetite. Serviced premiums at Pilgrim were over $30 million in 2016, and gross revenues were about $18 million.

The story in New Jersey for 2016 was one of decent profits and disappointing volume. Overall, the profits of the management company and the reciprocal insurer, taken together, and counting both auto and home insurance in all three distribution channels, were $45 million, just about our budget for the year. The all-lines combined ratio rounded to 95%, which is fully satisfactory. The expense ratio component of this total fell, in line with our stated goal, by a point for the second consecutive year. On the other hand, while the year's change in our in-force premiums was a positive number, this was entirely due to rate increases. The number of automobiles insured dropped by about 2.7% and the number of residences insured declined by 6%. As I have said before, rising crop yields won't sustain a farmer indefinitely if the bank keeps foreclosing on acreage every year. This is the overview, but the story of our New Jersey business cannot be told instructively without breaking out the numbers by line and channel.

Despite herculean efforts on the part of Gerry Wilson, our New Jersey czar, his automobile insurance business has hovered close to breakeven profitability for some time now. While the situation is bearable indefinitely, and homeowners profits have fully made up for loss years in automobile lines, we are not in business to break even on a large segment of our writings. The independent agency portion of our automobile book remains under pressure from the direct response giants who had shunned New Jersey for decades. In a short period of time, they have turned New Jersey from among the states with the lowest direct response market shares to the state with the highest direct penetration. We are the second largest independent agency carrier in the Garden State these days, but we need to do more to revive growth. There are at least two interesting innovations in play that should help. One is a quick and easy renters endorsement customers can add to their Plymouth Rock auto policies, and another is a pending coverage offering for vehicles used by their owners as part of

transportation networks, an increasingly needed protection that many other carriers have been reluctant to offer.

The largest of our New Jersey distribution channels is the exclusive agency business written through the Prudential agent network. Many of the Prudential policies are of long duration with us or with Pru, and are faithfully profitable, but the book is shrinking gradually. Prudential agents no longer sell automobile insurance at a rate that prevents natural attrition and exits from eroding the total. Our contract with Pru, moreover, excludes us from access to new homeowners business in the state, a situation we preferred at the start of our relationship but are now open to reconsidering. Based on the current situation, hopes of resuming substantial growth in New Jersey must be pinned primarily on the direct response book. Annual premium volume in that channel, built first under the leadership of Marc Buro and ably managed today by Tom Lyons, is now close to $115 million. It grew by more than 10% during 2016, and Tom expects to see faster growth in 2017. The direct book – where almost all the business is unseasoned by tenure – is not yet profitable, but 2016 was the best year so far in that respect. Hal and I consider the expansion of the direct response business the most advanced and established of the various projects on the entrepreneurial front burner at this time. At the nascent stage of development is another front burner initiative – our entry into Pennsylvania, where we have just been licensed. Gerry expects to be writing automobile business in the second half of 2017, and Bill is on a similar schedule with respect to homeowners policies. This is our first new state in many years, and we will work hard there to grow both a direct book and an independent agency book as rapidly as responsibly possible.

The reason Marc Buro is no longer working on the direct business is that he moved on at our request in 2015 to take charge of Plymouth Rock's relatively young insurance brokerage subsidiary, InsuraMatch. Marc works fast, and InsuraMatch will likely look back on 2016 as a memorable take-off year. Marc and Hal negotiated over the last few months an innovative contract for the renewal rights on a large book of business to be shed by one of the most respected national carriers. This transaction should allow InsuraMatch to more than double its volume of business placed, which now stands at about $35 million in annual premium. At the same time, it will provide the scale enhancement to build out a first-rate technology platform, including the powerful national online quoting (and, ultimately, binding) capability that Marc expects will be a signature feature of InsuraMatch. The challenge now for that team is to maintain the upward momentum. Marc is well aware that a one-off deal for renewal rights, however large, is not the same as a permanent endogenous growth engine. His focus now is on turning the spurt into a flow.

Plymouth Rock's investment results in 2016 were pleasing. Bonds once again under-performed the standard of decent risk-adjusted returns. Fixed income has always been about my least favorite asset class – but rating agency tradition forces us to hold nearly half of our $2 billion group portfolio in bonds. This is the case, even though bonds in an era of artificially depressed interest rates pay only paltry coupons while embodying an inevitable risk of capital losses if interest rates edge up toward historical levels. This past year our total return on bonds, with capital losses devouring much of the meager coupon yield, was less than a point. It would have been worse if we had succumbed to lengthening durations in a

stretch for yield enhancement. Financial institutions with long-maturity bonds are deeply vulnerable these days to interest rate correction, while earning insufficient yield to justify that risk. The comfort that bonds can be carried at artificial "amortized value" and held to maturity ignores the true economics of the situation. We are always surprised at how many insurers allow themselves to hang out there. We will continue to keep durations short, and, if we shift our bond-buying behavior at all in 2017, the shift will be to contract durations still further.

The investments we cherish, in contrast, are our common stocks. Over the nearly two and a half decades since Jim Bailey and I started investing in marketable equities, our internal rate of return on common stocks has averaged 15.2%. We have lost money on only one of our seventeen stock picks in those years; and that loss, trivial compared to our gains, is on a stock we still own. The Plymouth Rock track record has considerably outrun the Standard & Poor's Index for the period (which returned just under 12% per annum), handily beats the performance of our other major asset classes, and quietly outperforms all but a few more famous money managers. Our marketable equity picks are few and well-considered, and our holding periods extremely long. We eschew leverage (or, more accurately, I do, and perhaps more than is entirely rational, while Jim Bailey has no comparable disinclination), but you can do the math and think longingly about what we could have earned had we aped the hedge funds and doubled the portfolio size by borrowing. The gain on our ever-undiversified portfolio of marketable common stocks (no more than ten holdings at any one time) was over 15% in 2016, three hundred and fifty basis points better than the S&P. Our alternative equities, the descriptor we use for hedge fund and private equity investments, had a lackluster, but far from disastrous, year. They returned about 4%. Real estate continued strong. Our operating income on the buildings we own in Boston, added to the appraisal increases, produced a return of 12%. The combined appraisal value for our two downtown Boston office buildings is now $101 million. Since the trough of the 2009 recession, the value of our buildings has very nearly tripled. We actually bought them in the prior downturn of the mid-1990's, but the point is the same. Real estate is subject to exaggerated cycles, and downturns quite often call for courageous purchasing. Panicked selling and paralysis in a depressed market are generally foolish reactions, and forced selling underscores, too late, the hazards of reckless leverage.

Last year's letter contained a self-flagellating paragraph about our purchases of Master Limited Partnerships engaged in continental U.S. fuel transmission. Although we were well below water in those investments at yearend 2015, Jim and I decided to stay with them rather than bail. As of the most recent yearend, a partial recovery in price and a rich dividend stream have together improved our MLP position. The inception-to-date pretax MLP loss is now about $2 million, a relatively mild hit on an investment of just over $100 million in a $2 billion portfolio. We continue to hold the MLP's, and Jim and I still expect that time will erase the losses entirely. Any self-flagellation from here on should be less owing to losses than to our having been drawn into a vehicle whose underlying economics we didn't thoroughly understand. I remain embarrassed about that.

Never in my lifetime has the political and macro-economic environment been so chock full of uncertainties. No prior president has assumed the office without years of experience in public

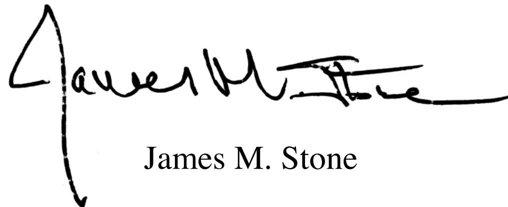
service, but few presidents, if any, have promised to rock the boat more quickly and vigorously. Both houses of Congress are also of a potentially radical composition these days, and the population as a whole is deeply divided and on edge. While I am not pessimistic about any immediate impact on Plymouth Rock's business, defined narrowly, there is plenty to worry about with respect to the state of the world, the nation, and the economy. There are hopes we can share as well, but the concerns, at least for the short term, dominate the stage. Plymouth Rock enjoys some insulation because foreign affairs have little direct impact on personal lines underwriting, and national politics are nearly as removed from our state-centric industry. Foreign and domestic policies can touch our people on a personal level, of course, and we must be particularly sensitive to their needs at this time. Ultimately, societal values are more important than markets. At least for now, however, the financial performance impact of national and international events on our Company is likely to be limited primarily to our investments. Since we are not market timers, we accept those risks, and Plymouth Rock will stay fully invested despite all of the uncertainty. I have little or no trust, by the way, that month-to-month or year-to-year variations in stock market prices are accurate predictors of the nation's long-term economic course. One should always feel free to be apprehensive about macro-economic prospects when the market is as pricey as it is now and, conversely, bullish on the economy when markets sag. Here are a few economic matters to follow as the new regime in Washington takes over.

I urged in my 2016 book Five Easy Theses that spending paid for by large deficits be limited to investments for which our offspring will thank us and meet the requirements of short-term stimulus during tough times. A major infrastructure investment program that shores up our schools, roads, bridges, and water facilities could meet the offspring gratitude standard. But if this is coupled with a tax cut mainly enjoyed by the wealthy, it will not only swell the deficit but accelerate inequality, which in turn reduces aggregate demand by shifting income from those with a high propensity to spend toward people and corporations with lower spending propensities. Extreme inequality is not just a slap at pluralistic democracy and justice, but also a depressant for economic growth. And, believe it or not, from 2003 to 2013, more than 110 percent of the new wealth total created in this country went to the upper 10 percent of earners. (Yes, that's more than all the new wealth.) If tax cuts are enacted that increase already worrisome and rising disparities, we should expect more voter anger, sluggish consumer demand, and an attenuated long-term growth path.

A serious new commitment to vocational education, conducted in partnership with businesses that have actual jobs to offer, would be a plus. Eviscerating the public education system in favor of vouchers, though, could be a profound negative for the economy. It will be an economic benefit if policymakers can halt the expansion of health care costs as a percentage of GNP with, for example, more competition in drug pricing, tort reforms that curb defensive medicine, and an introduction of consumer choice and rationality into end-of-life care. It is folly to believe that lasting systemic savings can emerge from a withdrawal of universality. Given my background, I would especially welcome a new round of financial sector reforms rooted in more disclosure and less leverage. We would all be economically safer if large bank capital requirements were raised, if every derivatives position had to be backed with a suitable reserve, and if hedge funds were governed under the same disclosure rules as mutual funds. I wish I had even a modicum of confidence that the upcoming changes in financial regulation

would improve its targeting and provide these safeguards. All of these topics are on the table right now, with positive outcomes on all of them far from assured. I cannot recall an equally unpredictable, and perilous, moment in my lifetime.

By now, I hope I have conveyed a sense of the entrepreneurial spirit that enhances our workplace these days. Hal and I had been talking about our company's readiness for renewed entrepreneurship ever since the absorption of the Prudential personal lines business – with relatively little consequence. Prior to that, of course, we had launched numerous new business forays. Plymouth Rock and I were involved in the 1993 formation of CAT Ltd., a successful Bermuda reinsurer now part of the Chubb insurance group. This was around the same time that Hal was just getting us going in New Jersey with the birth of the Palisades reciprocal. It was a few years later that Peter Wood, Plymouth Rock, and I founded Response Insurance, which was sold to Kemper in 2009. Then, in 1997, we organized Homesite Group, purchased at the close of 2013 by American Family Mutual. It was about six years after Homesite's launch, and well before the sales of Response and Homesite, that we inked the contract with Prudential and doubled the size of our core enterprise. It seemed then that we had enough on our plates, so a number of quiet years followed, during which the entrepreneurial companies matured. Now, counting InsuraMatch, the homeowners expansion initiative, the building of the New Jersey direct business, and our entry into Pennsylvania, there are four entrepreneurial projects cooking. The internal teams that run these efforts have especially exciting and challenging jobs these days. It is sharing their zone that gives Hal and me the little extra spring in our steps. We feel blessed to have a cornucopia of new growth prospects more than sufficient to challenge the whole team.



James M. Stone