The Plymouth Rock Company
695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 8, 2021

To Our Shareholders:

The year just ended, 2020, will be likely remembered as the Year of the Covid Pandemic, though for now I prefer to call it the Year from Hell. As if the virus wasn't enough, it was also the year of an American presidential election that brought to the fore deeply fundamental concerns about our democracy. To mangle a phrase from Charles Dickens, these have been the worst of times and nothing like the best of times. The world, the country, the economy, and many, many individuals shared the year's pain. Only the most elderly still among us, those who endured the Great Depression and World War II, have lived through a time more frightening and tragic. This was a disappointing year for Plymouth Rock as well, though our wounds were largely self-inflicted. Income for the entire enterprise before unrealized gains on common stock investments was up 44%, from $126 million in 2019 to $181 million. Our enterprise's fully consolidated comprehensive income, though, reflecting unrealized equity performance as well as the more narrowly defined income, was down dramatically - from $341 million the prior year to $117 million. The yawning gap in comprehensive income from year to year highlights the distinction between a truly spectacular year for our stock portfolio and a markedly substandard year. While I warned in last year's letter that the felicitous 2019 results were unlikely to be repeated any time soon, I did not anticipate so striking a retreat. At the same time, we can thank our lucky stars that we are not a restaurant, a movie theatre, or a gym. After netting all the various offsetting vectors, our business in 2020 had a year shy of its long-term goals but by no means disastrously so.

The performance numbers cited above apply to our enterprise as a whole, combining the results for premium we underwrite, and backed by your capital, with the premium we manage, backed by policyholders' capital. Looking more narrowly at the stockholder-owned companies, you can see that net income before considering the changes in unrealized gains was $132 million, slightly better than what was earned a year earlier. Because of our poor stock market performance, though, 2020 comprehensive income for the shareholders, reflecting the unrealized equity portfolio results, was only $108 million, a full $100 million less than in the prior year. The reciprocal group we manage did less well. It recorded $49 million in net income before changes in equity values and only $9 million in 2020 comprehensive income. Book equity for our shareholders rose during the year by $48 million. This measure, of course, understates the true economic gain by the amount of the dividends that were paid out to you, and it also excludes changes in the appraised value of our real estate holdings. The latter of these items ran negative in 2020, although because our real estate portfolio was in flux and Covid created unparalleled rental uncertainties, we did not seek appraisal numbers for all of the properties. With an educated estimate of the drag from real estate, we view the economic return for 2020 as having been 10.4%. As I repeat often, I see the acceptable shareholder return corridor for any normal year as bounded on the weak side by 10% and on the strong side by 20%. This last year's results came in just over the lower borderline. But don't be too downhearted. The 36-year compounded annual rate of return on shareholder book value, including both retained earnings and dividends but without benefit of unrealized real estate gains, is still over 18%, and there is little reason to fear that the difficulties faced in 2020 portend a long-term drought. Growth of our enterprise was a major factor in producing the disappointing results, and its damage should be containable over time. The scale of the Plymouth Rock Group, as measured by direct underwritten and managed premiums in force, is now approaching $1.7 billion.

The largest of our Company's three operating units is Mary Boyd's Independent Agency Group. That group, responsible for that auto insurance channel in all six of the states in which we operate, also accounted for the lion's share of our operating profits. Written premium for the Independent Agency Group rose by nearly 3% to over $840 million, with growth notched upward in five of our six states. The performance story, although favorable in the aggregate, was more varied than the volume tale. Put succinctly, profits were good in Massachusetts, modest in New Jersey, and minimal in Connecticut and New Hampshire. The bulk of the expansion was in New York and Pennsylvania, though, where all the ink was bright red. Without the benefit of reduced driving owing to the pandemic, of course, the results would have been worse in all six states.

Since the pandemic influenced auto insurers like us everywhere, it is worthwhile to examine its broad impacts before looking more deeply at our specific performance by state. According to the U.S. Department of Transportation, miles driven by Americans in 2020 were down over 13% from 2019. In the Northeast region, the drop was only modestly steeper. It always seemed to me, when I experienced the traffic firsthand, that the decrease was steeper than that, but observational impressions can be misleading. While the attenuation in road mileage surely helped our results, the benefit was not a simple function of the mileage decrease. For one thing, we returned to our policyholders in forgone premium increases or refunds a good portion of the potential gain. An increase in the severity of accidents, due to higher driving speeds, swallowed another chunk of it. Among the causes of the severity bump was a relative decrease in the proportion of total mileage related to commuting activity, which tends to generate high-frequency, low-severity accident events. We expect there to be a directionally similar Covid impact on our industry's 2021 results as well, at least for the first half of the year. Again, though, wherever rates are overall adequate, we expect to return in refunds or reflect in premium charges much of the otherwise available gain.

Massachusetts this past year was our biggest and best-performing independent agency state. The combined ratio here in the Bay State, even Covid-adjusted, was securely in the mid-90's, where it rightly belongs. When we compare ourselves to our Massachusetts independent agency channel peers in recent years, we look to be doing pretty well in both premium growth and loss ratio performance. We can thank our unusually strong product and claims teams for much of this success. Growth has been bolstered by our continuing excellence in customer service and by the marketing advantages of our sports franchise alliances. We have had productive arrangements with the Boston Bruins and the New England Patriots for some time. Mary signed up the Red Sox this past year, so we are now well fixed in this sports-loving region for all seasons of the year. Agents and customers alike enjoy the benefits these relationships provide, and the advertising exposure we get through visibly supporting our teams helps to attract future customers.

Plymouth Rock's Independent Agency exposure to New Hampshire and Connecticut risks remains comparatively meager. These two states together give us about $54 million in annual premium, and both project relatively slow growth in 2021. Absent Covid, New Hampshire would have provided us a small profit on our automobile insurance book. Connecticut would have yet again handed us a small loss. After Massachusetts, the largest state for Plymouth Rock independent agents is New Jersey. The auto insurance results in the Garden State were not impressive. Our 2020 accident year loss ratio for Independent Agency business there was about half a dozen points higher than in Massachusetts. And approved premium rates are not keeping up with trends, so we are concerned that the situation will deteriorate before it improves. New Jersey has been good to us over the years, and we will work hard to strengthen our resources there and improve our communications with the regulatory authorities. Restoring New Jersey profitability in the post-Covid era ranks high on Mary's task agenda for the coming year.

While Massachusetts and New Jersey and the smaller states provide the Independent Agency Group with over 85% of its premium, it is the new jurisdictions, New York and Pennsylvania, that present the greatest trials. A fast start in New York boosted the Independent Agency Group's written premium to almost $100 million in our two new states. Our Pinstripes Perks program with the New York Yankees probably helped. Both states, though, are losing us money and would have cost us much more without the year's reduction in road mileage. While we anticipated that we would bear some monetary burdens of growth in our new geographies, it is clear in retrospect that we went into the two new jurisdictions with inadequacy in our rate levels, underwriting discipline, and claims handling resources. It will take time to repair the damage. Consequently, Hal Belodoff and I decided to slow down New York and Pennsylvania growth, constraining our scale somewhat until we have restored strong confidence in the adequacy of our premiums and solidity of our defenses against claims inflation. You should expect to see the wrong color of ink again in those two states during this new year, but hopefully a good bit less than you have seen so far. New York and Pennsylvania, with their large populations, still represent our most promising venues for future expansion on both the top and bottom lines.

We trust that the Independent Agency Group's issues are short-term in nature. The toughest long-term task in the Company may belong to Jeff Briglia, who is just finishing his first year as president of the Direct Group. Jeff's long-horizon opportunities for triumphs, however, are as outsized as the challenges. Jeff has oversight responsibilities in two sub-channels, the Exclusive Agency business we have written in partnership with Prudential for seventeen years and the Direct Response book we have been building for over ten years now. The total premium written by the Direct Group now exceeds $535 million, 9% more than in the prior year. The Prudential business is anchored by a well-seasoned legacy book which is reliably profitable in both its automobile and homeowners components. Up to this time, the legacy book has remained healthy enough to help pay for the not-yet-accretive new auto volume from Pru agents as well as losses from our immature direct-to-the-consumer business. The legacy business, alas, naturally erodes by attrition over time and will eventually become a minor factor for us. As that book shrinks, it will be necessary for Jeff to turn the bottom line for new Prudential business positive and to earn money, rather than continue to expend it, on the emergent Direct Response book. Meanwhile, the Direct Response channel's contribution to the volume has passed the $200 million mark.

This, of course, was not an ordinary year. The loss ratio for the Direct Response channel was satisfactory in 2020, but it is not clear that it would have been acceptable absent the Covid-driven reduction in driving mileage. Just as telling, we are concerned that the Direct Response business is not yet meeting a more critical economic test. The first-year cost of writing a policy in that channel is always greater than the first-year revenue. The objective is to have profitable enough renewal years, and enough of those profitable renewal years, to cover the initial acquisition costs and provide a fair profit to boot. So far our Direct Response book of business has not demonstrated sufficient profitability in its renewal years, while its persistency would be inadequate to pay for its acquisition cost even with an adequate level of renewal profits. The tasks involved in finding Direct Response gold in the ore that's out there include reduction of both acquisition and general expenses and a simultaneous boosting of average policy tenure. And all of this must be accomplished while keeping the loss ratio under control.

Over the years, despite a dozen or more attempts, very few national companies have been able to realize this quest. USAA began the journey in 1922, with a more select audience than anyone else has ever been able to find. GEICO was founded by a USAA veteran in 1936, who saw the chance to expand the market beyond military officers while maintaining the concept of writing only for a pre-qualified audience. GEICO kept expanding its target market over the years, causing it to become nearly insolvent in the 1970's. It found its impressive current footing only under Warren Buffett's guidance. Progressive is the sole agency writer to have successfully reinvented itself and become a giant in the Direct Response channel. I recall talking to that company's impresario, the late Peter B. Lewis, a few decades ago as he doggedly committed Progressive profits from that company's non-standard agency business to orchestrating the metamorphosis. Quite a few other insurers, fainter of heart or shorter of resources, abandoned similar initiatives, but Progressive prevailed handsomely. We hope we can soon prove to you that it is possible to build a similar version of success in our smaller footprint - lacking the head start USAA enjoyed, condensing the stretch of time it took GEICO, and without matching Progressive's investment. We certainly have a first-rate team now, and, if this past year is an indicator, the Direct Group has a long enough runway. The Direct Group's overall loss and loss adjustment expense ratio for 2020 was 66%. While these results would have been worse absent Covid, they would have been better without the same correctable entry stumbles in New York and Pennsylvania that plagued its Independent Agency Group sibling. The Direct Group's volume in those states alone is now about $85 million.

Our Home Insurance Group, led by Bill Martin, had a somewhat mixed year, with no reason to reinterpret its recorded numbers through Covid-corrected lenses. Although growth was superlative, net income before unrealized equity impact was just above the water line. I would like to think the growth reflects a long-term strength while the diminutive 2020 profit margin is owing largely to passing circumstances. Backing the story up a bit, you may recall from prior letters that I have long predicted an eventual diminution of automobile insurance premiums as a consequence of the long march toward better automobile safety technologies. While I believe this trend will not create an adverse environment for Plymouth Rock any time soon, its inevitability in the long run was among the forces impelling us to expand our homeowners writings, where no exogenous force is likely to contract premium. Our favorable experience as a founding investor in Homesite also helped build Plymouth Rock's skills and confidence in this line of business. So, we brought Bill on as president with a green light to aggressively expand our homeowners book. He and his teammates have taken their charge seriously and, with impressive customer-friendly innovations, they have nearly tripled our writings over the last three years. In-force premium volume now stands at just over $250 million, having grown by 47% during this past year. Bill is hoping we will be listed among the ten largest homeowners carriers in the Northeast very soon. And all of the growth was accomplished without forfeiting the Home Insurance Group's contribution to profit over the period. Yes, there was a cost to the growth this past year, but not so much that it swallowed all the profits. In addition to growth costs, we had to pay for 18 identified weather-related catastrophes that befell the northeast region during 2020, about twice the number the average year has thrust upon us in this century. While no individual catastrophe, with the possible exception of August's Isaias, was destructive enough to make the history books, their cumulative effect was to consume Bill's 2020 catastrophe provision and then some.

There is an ample and attractive path ahead of us in the homeowners line. By the time our Home Insurance Group has reached its full potential, Plymouth Rock's market share in homes should approximate our auto market share in each of our states. Not only do we encourage many of our own customers to buy package policies combining home and auto from us, we also expect to write quite a few customers of partnering personal lines insurers who are interested in limiting potential weather-driven exposure. Evidence and logic tell us that many customers would prefer to buy both home and auto products from us or purchase our easy-to-bind homeowners policies alongside another trusted auto insurance partner company. But we must eschew the temptation to seek full congruence between auto and homeowners profiles. That would risk taking on too much coastal exposure and concentration in compact geographical areas. An irony of our business is that the more a book of auto insurance is clustered, the better we expect it to do. In a tight cluster we get to know the territory and the repair shops, and auto insurance writers have relatively little to fear from coastal exposure. Insuring a highly concentrated book of homes in a coastal zone, on the other hand, can be disastrous. Bill understands all this, and he has taken two important steps to safeguard our enterprise as he continues on our ambitious growth path. One innovation is a differential commission structure that pays agents for business in a manner that reflects long-term catastrophe exposure as well as normal year results. The other is a concentration model that explicitly keeps track of clustering and limits our appetite for business where we already write all we can prudently handle. The risks in home insurance cannot be vanquished completely, but with these protective measures now in use and with the back-up provided by the sophisticated multi-year reinsurance program already in place, Hal and I are comfortable keeping the home light green.

Marc Buro, who has been leading our national brokerage operation, InsuraMatch, for over six years, has just lived through an unforgettable year. Marc, Hal, and I all came to believe during the year that the national insurance giant Travelers, with whom Marc was working on some creative marketing initiatives, could do more over any short time frame with what we had built than we could. In early December, therefore, Plymouth Rock signed a Stock Purchase Agreement to sell InsuraMatch to Travelers. The closing has just occurred, and Marc and his team are going to Travelers along with the purchased entity. We will miss Marc and his unusually talented crew. They won't be far away, though; their offices will remain in our building. While the sale means that we will no longer own a state-of-the-art national broker, Plymouth Rock retains its traditional New England agency, Encharter. Our agreement with Travelers allows us to re-enter the national space after a short pause, and Encharter can serve nicely as a foundation for rebuilding a new national enterprise. The selling price for InsuraMatch was $40 million, which both parties thought fair given that InsuraMatch has great promise but has earned no profits as yet. Plymouth Rock is almost never a seller of its component entities, but this transaction makes sense for all involved. I am confident Marc will do well at Travelers. Hal and I both remain as committed as ever to the notion that enhancing our enterprise's expertise in modern technology-driven insurance marketing is a must for the future.

The most unseemly numbers this past year came from the investment side of our business. Our three-billion-dollar investment portfolio can influence outcomes for the enterprise as much as our underwriting proficiency. Just a year ago, I described 2019 as the best investment year we had ever had. This past year, 2020, our equities handed us the poorest performance we have ever seen by comparison with the market indices. Taking all of our common equity investment returns together, including both dividends and price changes, our return was an embarrassing 1%. Excluding the insurance industry stocks we hold, Plymouth Rock's core equity portfolio always consists of no more than ten stocks, each one bought to be held over a long holding period. This core investment portfolio produced in 2020 a total rate of return, including dividends, that rounded to the same single percentage point as the aggregate portfolio. Our insurance sector stocks, generally out of favor with investors this past year, performed worse than the core equities, and the investment funds we originated or participate in, constituting about 15% of our overall stock market exposure, underperformed as well. Had we just passively held the Standard & Poor's 500 Index, the equity return to the Company would have been more like 18%. Let me say right away that Jim Bailey, Rick Childs, and I are the sole responsible parties if we erred. Obviously, the results merit some reflection. Our conclusion to date is that neither the fund composition nor the insurance stocks should give us cause for reconsideration going forward. The decisions of concern in our current discussions involve the makeup of the core equity investment portfolio, which constitutes more than two-thirds of our stock holdings by market value.

At a fundamental level, the poor performance in 2020 can be mainly attributed to our long-held preference for value stocks over the high-flying glamour stocks that soared especially skyward during this year of virtual house arrest. For better or worse, Jim and I continue to find comfort investing in stocks of profitable companies with strong products and prospects that we believe are unreasonably and temporarily out of favor. That said, 2020 was not a good year for our approach. Other than one big winner (Microsoft, which was once a bargain and bought before it was in its current phase of rapid growth), most of our stocks simply turned in sluggish performances. There were two specific stocks in our long-term core portfolio, however, that suffered particularly last year. One of these was Intel and the other was ExxonMobil, both holdings we have owned for many years. Intel shares produced for us about $5 million in 2020 dividends while running up almost $40 million in capital losses. Keeping in mind that Intel shares, even considering this past year, have made Plymouth Rock well over $100 million since our first purchase, Jim and I are now asking ourselves whether gratitude has kept us loyal for too long. The future of the chip industry, with technological, competitive, and geopolitical strategic considerations to weigh, is hard to read. We have trimmed our oversized Intel holdings somewhat already, and we will let you know our conclusions concerning the rest of the Intel position later this year.

Our ExxonMobil shares produced a 2020 total return loss for us of $43 million, an even worse showing than delivered by Intel. Our from-inception return on Exxon is negative by about $11 million. But Jim and I are not ready to abandon the oil and gas industry altogether for two reasons. One is that the coming switch to cleaner, more sustainable alternatives may be a great deal slower than others apparently expect. The second is that the existing energy giants may employ their massive capitalizations and unquestioned expertise to become leaders in the energy changes to come. Having said that, we decided not to stick around and wait for Exxon's recovery. We became convinced that ExxonMobil will not be as agile and skillful at transition as its competitor, Royal Dutch Shell, so we liquidated our Exxon position and invested the proceeds in Shell. Had we moved more expeditiously in the fall to reinvest the Exxon sale proceeds, we would have enjoyed a large gain in Shell and would have recouped most of our Exxon losses for the year. Nonetheless, we are comfortable with the switch and consider that Shell is now a core holding.

In modest self-defense, Jim and I could ask that you look at the two-year returns on the core equities. Our two-year average equity return for 2019 and 2020 exceeded 15%. Or, alternatively, consider our twenty-five-year inception-to-date rate of return on marketable equities. At 14.5% per annum, our return still handily beats the most commonly used market indices, and that extra return has handsomely enriched shareholders' equity. But these exculpations do not let us off the hook. The year in progress will be a busy one on the investment side.

The 2020 bond story is what you would expect it to be. As I have repeatedly written, we hold bonds, now in magnitudes approaching a billion and a half dollars, only because of rating agency and regulatory pressure to do so. The risk-reward tradeoff is not attractive to us anywhere along the fixed-income maturity spectrum. So, we take relatively little duration risk and settle for low bond returns. The tax-adjusted 2020 return on our bond portfolio was just over 3%. Unlike in the case of the equities, this paltry result isn't following on a record year we can average it with, and there is no hint of a promise of rich returns in the foreseeable future. We will need to increase our risk tolerance if we are to do any better with respect to current returns. Extending credit risk a little is more comfortable for us than taking on too much duration risk. So last year we modified our guidelines to allow holding more investment grade BBB-rated bonds as a fraction of the portfolio. With A-rated bonds threatening to return about nothing, and relatively thin markets for A-rated securities other than those of financial sector issuers, we believe Plymouth Rock's strong capital position allows the acceptance of a modicum of additional volatility and risk that will come with increasing again the proportion of triple-B's we hold. Jim and I can repeat our assurance that bonds in the double-B range, or otherwise below investment grade, do not hold similar allure.

This was yet another active year for our real estate holdings. The market is skittish now about the future of commercial real estate in the post-Covid era. As a consequence, we see the value of our properties as down by something more than 10%. A number of companies intend to make permanent, in varying degrees, the work-from-home experiments that the pandemic necessitated. Not being in that camp, we used the opportunity to acquire another office building that our team can occupy. In 2019, we purchased the building bordering our 695 Atlantic Avenue headquarters in Boston. That building now carries our highly visible signage. This last year's purchase was of a larger building in Woodbridge, New Jersey, right on the Northeast Corridor Amtrak path. We were already the anchor tenant there, and our lighted top-floor signage is hard to miss at the intersection of the New Jersey Turnpike and the Garden State Parkway. The two purchases bring the value of our real estate holdings to over $200 million, and they should permit us to fulfill our space needs in our two major jurisdictions for many years to come. In another arena, I can report that our private equity investments in Lindsay Goldberg funds (where I continue to play a role) are looking stronger by the year, bolstered by exceptionally impressive returns on Lindsay Goldberg Fund IV and a fast start for Fund V.

I often take advantage of my opportunity to write this letter by allocating some room to political economy. This year the news and the conversations have been so relentlessly full of politics that I sense most folks may want a break from that topic. My principal recommendation at this moment in history is to breathe a sigh of relief. While our health, our economy, and our democracy were endangered and tested during this past year, and seriously so, I am optimistic that we have passed the most hazardous of the perils, with the wounds now on the mend. We should give credit where credit is due. Praise for defending us from the Covid pandemic is owed principally to modern science. Only a short while ago, the treatments and vaccines that will defeat this viral enemy would have been inconceivable. Our democracy was secured by a great many contributors. Greatest single thanks, in my view, should be bestowed on our nation's robust Constitution. That document, however subject to criticism by today's standards for its imperfections, was and remains a marvel. It was written at the right time in history, and by the right people, to have given us a sound basis on which to build a market economy and establish protection against both the despotism of individual autocrats and the equally merciless tyranny of intolerant majorities. With respect to the U.S. economy post-pandemic, I remain basically bullish. Some pessimists are saying that the American century is behind us now. And while it is true that our nation's status after World War II as the world's sole, unrivaled economic power became unsustainable long ago, I surely wouldn't go betting that our future placement will be below the summit. The American traditions of entrepreneurship, inventive creativity, and, importantly, a willingness to criticize those in authority and improve upon how they do things, are strengths that endure. No other nation can match us in those strengths.

Covid-19 was the dominant external operant on our Company in 2020. It will continue to be important for at least for the first half of 2021. We have so far weathered it intact as a business. Almost all of our employees have been working from home since March, so our offices have not suffered from epidemic spread risk. Those few, under 2% of our overall staff complement, who have been in the offices are volunteers and exceptionally well protected by strict rules of conduct and physical improvements in our workspaces. But working from home, needless to say, doesn't protect people from acquiring Covid by community spread. Our nearly two thousand people appear to have suffered proportionally less illness than the population as a whole, but our team has not been entirely spared. Tragically, we have lost two valued employees to untimely Covid-related deaths. Case numbers are up this winter almost everywhere, and based on projections of vaccine availability, I can't imagine that we will see even half-full offices again before the warm weather returns. Meanwhile, Hal and I would describe our Company's work-at-home performance as reassuring. Our claims and customer service staffs have strived valiantly, and we have tried to express our gratitude in videotaped messages throughout the year. Service levels in those areas have been maintained surprisingly well under tough conditions. The technical support our IT folks has been able to provide for remote work has been superlative. Our brave administrative team, many from that unit continuing to work on site, has functioned as well as if the pandemic had never occurred. Hal and I continued throughout 2020 to work principally from the office, but we are lonely. I cannot express how much I long for the full return to our offices of the entire Plymouth Rock workforce. There is every reason to think 2021 will be a better year for all of us.

James M. Stone