The Plymouth Rock Company

695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 8, 2023

To Our Shareholders:

"When it rains, it pours." So says an old slogan. And it certainly poured on us in 2022. Had I listed some years back every misfortune I would not want to befall Plymouth Rock in one year, my list would have included price inflation, falling stock and bond market prices, increased automobile traffic, unusually high employee turnover, mistakes of our own making, and catastrophic weather conditions. This past year we were paid visits by all of these, with bad weather waiting to clock in for a last minute appearance as Elliott, the Yuletide storm. The overall consequence was that losses paint our bottom line red in 2022, this being the first year of that color ink since our 1984 launch. Comprehensive income, which unites all of our underwriting and managed entities and marks to market the valuation of our investment portfolio, was a dreadful $327 million in the negative. We owe $316 million of that to adverse investment returns on our equity and debt portfolios.

It is probably useful to examine the cold rain showers one by one. Inflation, as measured by the broad Consumer Price Index, was 6.5% for the year. The cost increases we care most about, those affecting automobile and home repairs, were more onerous. If the insurance premiums charged to customers could rise in parallel with the relevant inflation, there would be no drag on earnings, but regulated rates tend to lag rising claims costs. And, in some jurisdictions, political reluctance to increase the financial burdens on already stressed voters added extra delays to otherwise justified rate approvals. Our premiums, and those of the rest of the personal lines insurance carriers, simply couldn't keep up with inflationary cost increases in 2022. State Farm, the colossus of personal lines insurers, reported a property-casualty group combined ratio of 118%, which implies it paid in claims and expenses $1.18 for every premium dollar it brought in. Our number of 105% was not bad if you grade on the curve, but the absolute result was no source of smiles on Atlantic Avenue. Andy McElwee, our new president, and I are dismayed to see combined ratios over 100%, and we won't be pleased until we do several points better than that.

The stock market's calamitous performance in 2022 is, of course, already familiar to just about everybody. We owned about $2 billion in common stocks at the start of the year, so it's no surprise that our portfolio losses were measured in hundreds of millions of dollars. The mathematics of the bond market ensure that bond prices fall when interest rates rise, so the Federal Reserve's monetary tightening inevitably cost us capital there as well. We hold close to a billion dollars' worth of bonds. I think you get the picture.

The painfully high employee turnover was part and parcel of what is sometimes called the Great Resignation. The U.S. labor force participation ratio, having begun the present millennium at just over 67%, ended 2022 at about 62%. This decline is part of the explanation for today's deceptively low unemployment index, the product of a survey which includes only those actively seeking work. Covid-19, of course, accelerated the exodus from office-centric jobs. We lost people not only in response to national employment trends but also to competitors in our industry who look more favorably on working from home. We have always been proud of experiencing lower staff turnover than our competitors — and we work hard to provide an amenable workplace that encourages long tenures. This year our turnover was similar to the industry's. Notwithstanding the immediate problems of increased turnover, Andy and I hold emphatically to our view that minimizing remote work will give us a competitive advantage in training, collegiality, and creativity over the long run. The total number of insurance jobs isn't raised by turnover, so the job churn should dissipate as soon as enough people settle into the jobs that suit them. And inflationary pressures will also push some labor force dropouts back to paid employment. Meanwhile, the churn is hitting our middle ranks harder than entry-level positions near the bottom of the pay scale or officer positions near the top.

Customer service standards at Plymouth Rock held up well despite the strains on personnel. Our claims departments were harder pressed, due to greater dependence on experienced, case-seasoned staff at the supervisory level. It didn't help the claims teams, moreover, that traffic congestion was on the rise. Nationally, the number of miles driven in 2022 grew by more than a nearly unbelievable 35 billion miles from the prior year's equivalent total. Among the contributors I might list are reluctance to use public transit, increased gig delivery driving, and perhaps remote work. When everyone works from the office, many a car sits idle between rush hours. When people work from home, they find themselves drawn by domestic pressure to run errands and provide child transportation during the midday. On top of all of these depressants were problems of our own making. These were mainly borne of our setting inadequate premiums for home coverages and direct auto insurance as we grew in footprint and expanded products. I'll comment on the unforced errors in the sections on our individual groups.

Even a quick glance at our enterprise's comprehensive income shows you the consequence of 2022's various impediments to profitability. Enterprise comprehensive income, which neared record-high levels in the previous year, ran deeply in the red. The scarlet ink spread unevenly across our business components. The results for our stockholder-owned companies, dominated by the Independent Agency Group, were better than those in our managed reciprocal, where Direct Auto and Home insurance play larger roles. The stockholder-owned companies posted a net income, before adverse changes in accumulated unrealized gains, of $63 million. Comprehensive shareholder income, which adds unrealized portfolio losses to net income, was a negative $111 million. This compares, wistfully in our minds, to a positive $237 million in stockholder comprehensive income for 2021. The reciprocal group suffered a minus $74 million in net income and, after its unrealized investment losses, a negative $216 million in 2022 comprehensive income. Fortunately, we are quite large enough and more than sufficiently capitalized to withstand adversities like these.

Equity for our shareholders fell by 17%, which you can contrast to its 21% rise in 2021. While our enterprise book value also fell, it remains over $1.3 billion. As I always remind readers, book value growth is an incomplete measure of owners' rate of return because it ignores your cash dividends over the years as well as changes in the value of our real estate. Book value growth thus systematically understates the true economic appreciation in shareholder worth. Despite the adverse results in this last year, the 38-year compounded annual rate of return on shareholder book value, including your dividends, but without the benefit of rather substantial real estate valuation gains, remains a tad over 18%. The scale of the entire Plymouth Rock Assurance group of companies, as measured by direct underwritten and managed premiums, grew in 2022 to exceed $1.7 billion.

Andy joined us about a year ago as our Chief Operating Officer, overseeing all three of our operating insurance groups. Erin Macgowan joined us about the same time as Counsel to the Chairman. Both have exceeded expectations, an impossible-to-overstate contribution to my own peace of mind. Another valued contributor to calm and comfort during the storms of recent years has been Mary Boyd, who captains the largest of our three groups, the Independent Agency Group. That group faced the same inflationary pressures as the rest of the industry but somehow managed to outrun most of the competition. With total written premium volume of nearly $900 million, Mary's group is a major player among agency writers in Massachusetts and New Jersey and a growing player in our other four states. The group's written premium rose by 7% during the year, and, despite the serious hit all auto insurers took from inflation, it kept itself at underwriting breakeven with a combined ratio just under 100%. The Independent Agency auto business would, in fact, have earned a more bountiful underwriting profit had it not been for continuing challenges in New York, where the prices set when we entered that state were plainly too aggressive. The Empire State remains an outlier, with an atrocious combined ratio for 2022 of 119%. But New York regulators are now showing openness to justified rate increases, and correction of the inadequacies is in the works. Don't forget, as we face the obstacles, that New York is likely the most promising arena for the pending growth that will take Mary's group past the billion dollar milepost.

Loss ratios in Massachusetts, our largest state, and in New Hampshire, where our volume is much less, should be acceptably close to targets as soon as inflation-necessitated rate increases are approved. New Jersey had been more reluctant than other states to grant rate changes, but we are becoming confident that the regulators there are now more accepting of the painful exigencies of increased road mileage and inflation. Connecticut, where we have around $30 million in volume, and Pennsylvania, where we also have only a small volume, continue to have unsatisfactory loss ratios, but they are on the mend. Commercial automobile insurance enjoyed a brighter year, producing both growth and profitability. Pilgrim, our third-party administrator of services for other insurance companies, and our in-house insurance agency, Encharter, turned in unexciting but acceptable years. We have not yet replaced InsuraMatch, sold two years ago to Travelers, with another new national broker of our own creation, but it is still our intention to do so when we are confident that we have a gameplan more solid than most of the InsurTechs that Wall Street recently fell in and out of love with. Mary will, of course, rack up more impressive years when external

conditions are more favorable, but, under the adverse circumstances of 2022, this past year has to be considered successful for her whole group – topped off by her having been honored here as the industry-wide Insurance Professional of the Year at a luncheon gala for 500. It was a proud moment for her and the whole Plymouth Rock team.

The Home Insurance Group faced a serious hill to climb in 2022 as a consequence of inflation and a rapidly hardening reinsurance market, and it was forced to start that climb from inside a hole it had dug for itself. Bill Martin and his team introduced an innovative fast-quote-and-bind product in 2020, designed to be especially easy for customers and agents to use. The notion is a good one that Andy and I fully endorse, but the original details incorporated rather too much ease of use and thus invited adverse selection. This error alone would have created a profit impediment but, in addition, the new product's base rates were set substantially too low in just about every state. Adverse selection, inadequate rates, inflation, and rising reinsurance costs came together in 2022 to make the uphill climb for the Home Group every bit as formidable a task as it sounds. The average cost of a homeowners claim, for us and the industry as a whole, rose by double digits during the past year as a tight market for available repairers added to cost inflation's pressure. The outcome was a 2022 combined ratio for Bill's group of 112%, about 15 points worse than the group's budget predicted. We were lucky not to have faced an autumn hurricane catastrophe this past year. Had we been dealt windier fall weather, the numbers would have been even worse. The hole is deep enough and the inflationary mound high enough that none of us expects anything approaching target results in 2023. Inflation remains, and the reinsurance carriers, worried about climate change, are not about to make their markets any more welcoming this year. The budgetary goal is accordingly to achieve only a slender operating profit this year in the Home Group. New Jersey and Connecticut accounted for the majority of the red ink in 2022, so the outcome of pending rate increase requests in those states will largely determine the current year's scorecard.

No one calls this past year satisfactory for the Home Group. As I have said often, however, the full picture for the group during Bill's tenure as its president remains a great deal better than recent results suggest. The Home Group's volume has grown from $75 million to more than $330 million, while providing a net profit for the whole period of about $20 million for our enterprise. That's not too shabby, as they like to say on Wall Street. Scott Kwiker, who formerly headed product and pricing for Mary Boyd, has moved from auto insurance to Bill's team to partner with him in the tasks ahead. And Andy, who spent years as president of a successful monoline homeowners writer, and I have made ourselves fully participating colleagues as well. Rate increases and the reduction of exposure to risks we should never have accepted are the orders of the day — while we watchfully limit overall catastrophe exposure and guard against collateral damage to the stability of our auto insurance book from the inevitable price increases. Don't forget, moreover, that the disappointing 2022 numbers represented a welcome improvement over the more distressing 2021 numbers for the Home Group. Andy, Bill, and I all see the 2021 and 2022 results as temporary bumps in the road for a business segment with superior prospects over the long horizon.

Once again, the most arduous journey forward is that facing Jeff Briglia and his Direct Group. Jeff presides over three segments of business, all written without the help of independent agents. One of these segments, and the least problematic, represents coverage for the personal lines policyholders we inherited when we bought Prudential's New Jersey business in 2003. The scale of this subset shrinks each year by attrition but what remains, nearly $150 million in written premium, is an ultra-seasoned cohort of policies with strong economics. The second segment is what we call Partner Business, $275 million in volume written through our active relationship with Prudential and other insurers, corporate brokers, and aggregators. Handled with care, this portion of the Direct book should by all rights be profitable for us but has not performed well in recent years. We have no reason to accept unsatisfactory results in this segment, so Jeff is cutting back on some elements of Partner volume where near-term profitability looks beyond reach. He has requested changes as part of the renewal of our Prudential contract to more closely tie compensation to performance. The third segment of the Direct Group's business is our direct-to-consumer volume, policies gained without the participation of any kind of intermediary. We write almost $80 million of this kind of business, which we characterize as Core Direct. This business is important to us, because the Core Direct segment, if developed successfully, holds especially excellent potential for future profits and growth.

We have always known that a Core Direct book would be expensive, risky, and difficult to build. Jeff's job would be hard enough had this year's inflation and the return of congested roads not aggravated the tasks at hand. Aware that the construction of a sustainable Core Direct business requires a source of external funding, we had hoped that the necessary funds would come from the other two segments. But the losses in the Partner business exceed the monotonically attriting and inflation-wounded gains in the legacy Prudential book, so the costs of building a Core Direct business show up as red ink for the full group and the whole enterprise. The combined ratio for the Direct Group was an infelicitous 111%. Improvement is needed in all four of the states where we have Direct Group volume, with New York the standout in the adverse direction for both its Partner and Core Direct segments. That state turned in a nightmarish loss ratio, even before adding the requisite expense load, approximating 110%. A hopeful sign is that new business screening is improving everywhere, including New York, and Jeff is working hard on other remedial actions. These include strengthening leadership staffing in the Partner segment, pulling back on incremental volume from stubbornly unprofitable suppliers, and introducing a targeted and hopefully magnetic product for the Core Direct segment.

This was a dreadful year for investment results. We beat the relevant market indices once again, but the absolute numbers have seldom been worse. When portfolio performance is so wanting, it is fair game to question whether decisions on my part and Jim Bailey's contributed to the sorry numbers. A good starting point is to consider strategies of ours that differ from the norms of our peer institutions. Our most glaring deviation from industry practice has to do with asset allocation. The common stock share of the investment portfolio among property casualty insurers averages roughly 20% of total invested assets, with the rest held in fixed income instruments. An industry favored segment of fixed income is blue-chip bonds, over 40% of these with more than five year durations. We, on the other hand, keep 61% of our securities portfolio in common stocks. Whatever bonds we

hold tend to be of relatively short duration. A second departure relates to portfolio diversification. When other insurers do own common stocks, they tend to construct widely diversified portfolios, comprised of a great many issuers' securities. We don't. Excluding our strategic holdings of insurance company securities, our intentionally undiversified portfolio contains no more than nine carefully chosen picks. Finally, we never buy the glamour stocks that so many other investors love, and we don't trade actively the stocks we do own. We look for stocks that are temporarily out of favor but which Jim and I conclude, with advice from Rick Childs and Dan Rasmussen, should recover and prosper over the next ten years. Then we hold onto those stocks patiently unless we later see changes in the fundamentals of their businesses or spot a mistake in our earlier thinking that negates the original investment hypothesis.

With respect to committing so much of our portfolio to common stocks, we are prepared to defend and maintain our preference. We fix our eyes on total return over ten-year periods, with a high tolerance for interim volatility. That orientation, which I consider to yield a meaningful advantage, irresistibly disposes us to common stocks. The equilibrium economics of financial markets requires that stocks should always outperform bonds over long stretches of time. As I pointed out a few years back in this letter, the total return for the S&P 500 Index over the last 100-year period has been about 10%. The same return statistic holds for the 50-year return. The most recent 10-year return is 12.6%. And this is despite the fact that all of these periods terminate at a bearish moment for the market. The average return on bonds of intermediate duration since 1995 has been only 4.4% and recently less. An investment advisor or broker can be fired for a single disastrous year. A portfolio consulting firm can lose a client due to volatility, and likewise a period of losses may be trouble for a manager of a non-profit dependent on a steady endowment income stream. But we can tolerate such jolts, and volatility within reason can be our friend if we are paid to accept it. I'd keep more than 60% of our investment assets in equities if the regulators and rating agencies wouldn't look so askance.

Our preference for picking just a few stocks and limiting those choices to out-of-favor companies requires laborious analysis of fundamentals and a good bit more forbearance than is characterized by most other investors. The reward is an incrementally better return than is available from broad indices. Given the alchemy of compounding, even small return increments over long periods add up to princely rewards. One of the reasons patience is so essential is that we never expect the prices of temporarily disfavored stocks to recover right away. They are, by their nature, long-term picks. Microsoft, for example, which we bought long ago when that company was considered to have been left behind, took a decade more to disprove the skeptics. It is now our largest holding. True to form in this sense, our four most recent purchases – T. Rowe Price, Toyota, General Electric, and Ericsson – lagged the market indices and underperformed our other stocks this past year. We are comforted that, even with this drag, our overall common stock portfolio outperformed the Standard & Poor's 500 Index, as it has most of the last 30 years. Our 30-year average internal rate of return on stocks is 12.3% in contrast to the S&P 500's 9.6%. Another way to accentuate the positive is to look at 2021 and 2022 together. For the two years starting January 1, 2021, our common stock portfolio provided us a net gain. This past year's retreat relinquished only 70% of the prior year's advances. Two steps forward and one step back is something a buy-and-hold investor learns to live with.

Because we feel compelled by rating agency and regulatory constraints to hold a large portfolio of bonds, we do so. Unlike those insurers, though, that feel safest owning long-term blue-chip bonds and locking in coupons for years to come, we worry more about interest rate risk than reinvestment risk. We are, on the other hand, more accepting of a modicum of credit risk than others. Our bond portfolio now consists of 23% BB-rated instruments and 77% higher-rated bonds, none having long durations. Given the Federal Reserve's inflation fighting actions in 2022, this past year was no picnic for bondholders of any stripe, but long maturities were hit particularly hard. We have never owned any of those. Instead, we are able to turn over our short-duration bonds for richer ones as they mature, and the new money invested in bonds will now receive a more suitable reward. The Bloomberg index for bonds with maturities of ten years or more was down 27%. Our bond return was a negative 4.3%.

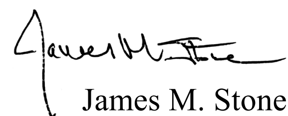
This was a comfortably boring year for our real estate holdings. We didn't buy any buildings, and we didn't sell any. Most probably, we will never be sellers. All is quiet on that front, although I assume commercial real estate values are currently in decline. We have no bank mortgages to pay, and we occupy most of the space in the buildings we own – with some stable intermediate-term tenants on the floors we may someday need for expansion. Although we commission periodic outside appraisals of our properties, market price fluctuations are of only little practical consequence to us. Our private equity investments in Lindsay Goldberg Funds IV and V, meanwhile, yielded banner returns. I have some skepticism these days about those private equity firms who depend too much on auction purchases, excessive leverage, and quick turnovers of their investments, but Lindsay Goldberg is of a better breed.

The contextual story for 2022 is one of unsettling politics both internationally and at home. The world situation is plainly less comforting than it was just a few years ago. Russia's invasion of Ukraine threatens not just a morass for the nations directly at arms and for the neighbors who will suffer shortages, but it has most likely cemented the start of a new Cold War era and launched what may be a long, hot proxy war between Russia and the United States. And this is surely the rosier scenario compared with what can happen should nuclear weapons be employed. The inevitability of Russia's aggression is hard to assess; I suspect this all might have been avoided had leaders judged the long-term consequences of their actions more astutely over the last few decades. Meanwhile, the once promising and largely harmonious relations between the two greatest world players, the United States and China, have fallen off a cliff with an alacrity few had foreseen. There is unfortunately little prospect for recovery of constructive coexistence any time soon, especially while the future of Taiwan hangs fraught in the balance. This is a shamefully lost opportunity. And here at home, it is hard not to describe the domestic political situation as becoming other than a house divided against itself. The evil genies of discord and falsehood, monsters that can trample the fragile flower of our constitutional democracy, have been summoned from their bottle. I wish none of the above was true, but, on the other hand, none of it is yet irreparable should wisdom and decency prevail. My generation wished deeply to leave the world better than we found it. It seems probable that we will leave it in worse shape. For Plymouth Rock at the firm level, at least, there is some narrow comfort. The positioning of our Company isolates us from much of what happens in the broader world. Other than through our common stock holdings and impacts of general cost inflation, we are largely

unaffected in a commercial sense by most anything that happens beyond our six states. We face no currency risks or harm from overseas political turmoil. We import nothing from abroad and sell nothing abroad. Our rates are regulated by the states rather than the federal government. Yes, we should worry greatly about the international picture, but a good deal less for Plymouth Rock's sake.

One silver lining of a rough year is that it can engender greater clarity of thought than normal times. Hoping this to be the case, let me offer a summary view of our company at this juncture. Overall, I urge you to see the current set of challenges as temporary rather than structural. We are strong in talent, product, technology, and service quality, and I am feeling good about the future. Customers and agents are happy with us, and for all the right reasons. We are growing as some of our major competitors in the agency space shrink. Inflation will still be a nemesis in 2023 if commensurate rate approvals fail to materialize, but eventually prices will catch up with trend. Our Home Group has to dig out of its pricing hole as well as to keep up with inflation, but its team is the most impressive it has ever been. Home's most serious cause for concern may be its expanding appetite for reinsurance in a tightening catastrophe coverage market. And while the Direct Group faces even harder tasks in balancing underwriting discipline with its growth ambitions, the potential reward justifies the effort. One competitor likes to describe the successful direct-to-consumer players as protected by a treacherous moat. While the metaphor is apt, the swim still seems irresistible.

I cannot predict the stock and bond markets, of course, but I can assert without qualms that the American economy is basically in quite good health and, therefore, that equity prices will in time recover. It may be useful to add that, since 1945, there have only been two time periods in which an S&P index decline of more than 10% was repeated in immediately subsequent years. While the bond market inflicted pain this year, higher interest rates will be our ally in the years to come. In Virgil's epic poem, Aeneas gathers his battered immigrant band at a particularly disheartening moment and reassures them with these words: "Forsan et haec olim meminisse juvabit." Adapting his message to our own situation with a bit of license, I might say: "Someday perhaps we will look back at this period with pleasure as we recall how we overcame its numerous assaults."



James M. Stone