The Plymouth Rock Company

2001 Annual Report

The Plymouth Rock Company

695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 21, 2002

To Our Shareholders:

When I wrote two years ago that Plymouth Rock had been through "a year of consolidation and building for the future", you had every reason to wonder whether that was just wishful thinking or euphemistic phrasing. We had experienced both a drop in revenues and a tightening of operating margins. Now, with 2001 complete, the description looks more convincing. Net income for the group in year 2001 was a respectable $10.3 million, but, just as important, there has been a sharp upturn in growth and an improvement in operating efficiency. The bump in the road during the late '90s is history now; we have made up all the lost volume and more. Top line growth was strong, and it appears to be continuing into 2002. The bottom line was aided by expense ratio progress, even after the costs associated with adding new volume, and that trend too seems to be continuing. You have to spend something to put business on the books, and new business is not as profitable as seasoned books of business. So, the fact that volume grew in our family of companies, without diminution of quality, means that the year's economic gain was greater than the net income. I'd be happy for more years like 2001.

The financials, as always, tell part of the story. The balance sheet shows that shareholders' equity rose by $7.8 million in 2001. This is less than the amount of net income. The difference is explained by a decrease in our unrealized gains on investments and the payment of our customary dividend. On a per share basis, the increase in book value was from $516 to $551. By my estimates, this book value represents roughly half of your true shareholder equity, even before applying a valuation multiple to the base. Among the assets not recognized for balance sheet purposes by generally accepted accounting principles are the contract we hold to manage the Palisades reciprocal in New Jersey, a considerable unrealized gain on our real estate portfolio, and any gain over basis from our minority investments in Homesite Group and Response Insurance. Certain contingent liabilities, less than a million dollars worth, are not carried on the balance sheet but are disclosed in the footnotes. Writing this in a season when the financial news is dominated by the failure of Enron and its off-balance-sheet partnerships, I feel the need to assure you that these off-balance-sheet items are very different indeed. First, we would be more than happy to put all of the non-included items on the balance sheet if we could. The accounting rules simply don't permit it. Second, there are no such items that you are unaware of and none of substance that aren't mentioned in this report. Third, there are no Plymouth Rock guarantees connected with the assets and

the liabilities are strictly limited to the amount disclosed. The only issue we should have to concern ourselves with is how much more than book value these items taken together make our shares worth. Finally, our officers' holdings in Homesite and Response are known to you in detail, and there are no such holdings in the real estate gains or in the Palisades management company. I would support, by the way, a change in generally accepted accounting principles that explicitly required disclosure, at least in footnotes, of most of the things that Enron failed to disclose as well as all the items I have just listed for you. It would not make much difference at Plymouth Rock, but it would make our investment analysts' task quite a bit easier when we looked at other companies.

It is hard to resist a note about derivatives trading, which was at the center of the Enron partnerships' activities. This is a field I had the opportunity to see up close when I was chairing the Commodity Futures Trading Commission. Derivatives markets can be unquestionably useful in hedging risk, but they are to be approached with caution. Foremost among the reasons is that, given their typically high margin leverage, it is very easy for a small imperfection in a supposed hedge to turn it into a hazardous speculation. Anyone who doubts this should read about the fall of Long Term Capital, where even Nobel laureate economists couldn't see the exposure until it was too late. Long Term Capital was a company that at least made a serious attempt to limit the degree of speculative risk. Many ventures into this arena are not that, but pure speculations inaccurately described as hedges simply because among their holdings are positions that gain in value if some relevant market rises and others that fall in response to the same market movement. That makes for a true hedge *only* if the two opposite exposures are precisely balanced and there are no possible world events that can disturb that balance. As soon as there is a deviation from this standard, creating a net exposure in some imaginable future state of the world, there is speculation involved. When there is great leverage as well, that speculation can easily exceed its anticipated level. Remember, too, that derivatives markets are not regulated under the same rules as stock markets. If they are regulated at all, it is largely without restrictions on the use of valuable and private market information or disclosure of large positions. As a consequence, the uninformed speculators as a whole have more than taxes and transactions costs as a handicap in that they must also fund any gains to the holders of the valuable information.

None of this means that Plymouth Rock places derivatives off limits for hedging risk. At present, we make no use of derivatives markets directly, but certain of our portfolio investments do. You should feel very free to ascertain that we have asked ourselves all of the requisite questions. The lack of such questioning and lack of disclosure in the Enron situation with respect to its trading activities was plainly a part of the problem. Business bankruptcies are intrinsic to our system, providing a much needed form of market discipline, and we should not decry them too quickly; but the Enron case left too many innocent victims. In this citizen's view, it would have been far less painful if there had been better pension rules, better derivatives markets regulation, and a better political campaign financing system. No market disciplines need be eroded to improve in all three areas.

The top line in Plymouth Rock's financials shows a net premiums earned number of $128 million. To turn this into the measure I use each year to describe our effective scale, one would add to this about $8 million in premiums written but not yet earned, about $48 million of business that is ours but which we ceded as reinsurance to Commonwealth Automobile Reinsurers and General Re, the $66 million in New Jersey personal lines premiums we manage for Palisades, and $45 million in automobile insurance premiums we manage for others at Pilgrim Insurance. From this is netted $21 million in items that would otherwise be double counted and business which is not ours but is assumed from CAR. The grand total is $274 million, an increase of about 16% since last year. This total reflects a change in how Plymouth Rock Assurance records its residual market load. In the past, the top line on the financials had not reflected business at CAR, where all carriers are forced to share in the losses of high risk drivers. We simply took our share of those losses on the claim and claim adjustment expenses line as though they were a single large claim. Beginning with the 2001 statements, in order to increase consistency with new statutory accounting rules, that company will treat its proportional share of the CAR results as though it had voluntarily assumed reinsurance in that premium amount. It will include a part of CAR premium in its top line and add in its proportional share of the claims and expenses in a corresponding manner. This "grosses up" the company's premiums to a level about $16 million higher than under the old treatment. The 2000 year in the consolidated statement is restated to the new treatment for comparability. None of this, of course, had any impact at all on the bottom line. The $274 million number is, in my view, the best measure of your Company's scale. I expect we will pass $300 million in 2002. It was just ten years ago that we passed the $100 million milestone. Tripling again in the next ten years looks inviting from here.

Once again return on capital in the past year was below our 20% target, and the cumulative return on book value from inception now stands at 18%. On the other hand, this was a much better year than that statement alone implies. The value of the growth is not reflected in those numbers. The year began with a Massachusetts auto insurance rate decrease of more than 8%. And group operating income, before capital gains or losses, is up considerably over last year, even though the net income is not. I continue to think a 20% annual rate of return on equity is a realistic target, as well as a reasonable estimate of the true economic story from inception to date.

Plymouth Rock Assurance, under Hal Belodoff's excellent stewardship, had a solid enough year in its Massachusetts automobile insurance business. Premiums grew as competitors became fewer and less aggressive. Trust Insurance has been liquidated; Berkshire Mutual and Horace Mann stopped writing Massachusetts automobile insurance. Safety Insurance, one of our most direct competitors, changed ownership hands just prior to the death of its founder. Dick Simches was a man of talent and honor, and the whole industry is poorer without him. It remains to be seen whether the new majority owners, a New York private equity firm, will bring about any changes in how Safety operates in the marketplace. Travelers is being spun off from Citigroup, and one might also ask whether changes will occur in its Massachusetts subsidiary, Premier Insurance. Some observers believe that the new public company will have a higher market value if the Massachusetts subsidiary is not part of the package. We are told that other companies, too, are reassessing their

Massachusetts profiles. If so, it will be positive for Plymouth Rock, which goes steadily onward and represents a stable partnership choice for the state's independent agents. Hal, incidentally, has now completed moving his family back to Massachusetts from New Jersey, which will help him in his duties throughout our group of companies as well as in his duties as CEO of Plymouth Rock Assurance.

The rate decision of the Commissioner for 2002 was no Christmas surprise this year. The outcome, very close to no change, was negotiated with the industry in the fall. I continue to believe that this Commissioner has called the rates about right. If there is any shortfall between needs and revenues, it results from voluntary discounting on the part of the carriers. Discounts this coming year have been continued for groups, but most companies, including Plymouth Rock, have stopped offering discounts in excess of those built into the rates for drivers with good records. The Plymouth Rock loss ratio remains attractive, and Hal has recently launched a project to improve it further in 2002. Paula Gold's appointment to a seat on the Governing Committee of CAR, where I served for twelve years in the Company's early years, will help keep us focused on understanding the maze of rules that affect Massachusetts loss ratios. Expense ratio reduction is the more pressing task if we are to meet our return on equity goals. Plymouth Rock's all-inclusive expense ratio was down a point in 2001 to the best level it has seen in five years, just as Hal promised it would be. To move this ratio southward the additional point and a half he has targeted for 2002 requires both discipline and IT systems improvements. The Board has approved a significant upgrade of the Plymouth Rock Assurance IT systems, which Hal assures us will make them cheaper as well as more effective. The first phase of that upgrade, involving imaging of the claims records, is already a success. The next step will be the introduction of a whole new claims processing system, beginning this year.

Perhaps the most important initiative planned for 2002 at Plymouth Rock Assurance is its entry into Connecticut. If your company is to become the true regional carrier we have long envisioned, it must grow its footprint. Connecticut is the next expansion. We are licensed there, and Eric Neely has joined us to lead the effort. Eric was previously a General Manager with Progressive, like Gerry Wilson at Palisades. He is confident he can get us at least $5 million in Connecticut volume during our maiden year. This will represent our first move into a new state in nine years.

Don Southwick, whose BCS Holdings has been a successful partner of ours for several years now, will help Eric get started with Connecticut agents. As in Massachusetts, Don will specialize in providing solutions for the perpetuation puzzles and liquidity needs that so many first-rate agencies encounter. Don can do that better than any of the rest of us at Plymouth Rock because he is among the statesmen of the agency community in New England. Since he took on his role for us, he has successfully managed the purchase of three agencies for BCS, which now has almost $25 million in premiums, $4 million in revenues, and a nice annual profit.

The two companies with the least satisfactory results in our group are the two smallest: Bunker Hill and Mt. Washington. Bunker Hill Insurance, the homeowners carrier in

Massachusetts, had a sub-par year. It earned only $700,000 for the group as opposed to a budgeted net income of twice that. Neither its loss ratio nor its expense ratio was where it ought to be. Since this past year was hurricane-free, the results should have been much better. In the short run, some of the shortfall can be ascribed to unexpected severity in fire claims that may just be random bad luck, but there is a larger issue. The real problem at Bunker Hill is intrinsic to the homeowners business, and well known to us, because it provides the opportunity around which Homesite Group was formed. The homeowners line of business industry-wide is too often priced artificially low in order to attract auto insurance business and too often priced with apparent ignorance of its embedded catastrophe risk. Absent elaborate risk management and highly efficient distribution, homeowners insurance simply can not be a moneymaker for most of its writers, here or nationally. A loser for the industry as booked, the results for this line would be far worse if there were a proper accrual of the true costs of catastrophe risk and catastrophe reinsurance. The prices of reinsurance, moreover, took a jump with 2002 renewals and there is an active debate among industry watchers about which way rates will be headed in the new year. Bunker Hill is useful in supporting the Plymouth Rock reputation for providing full service to agents, but the returns to the business must outweigh its costs. Hal is taking a hard look at internal costs, commissions, and Bunker Hill's rates to be sure that premiums cover the full cost of the risks assumed.

Many installments of this letter have complained that Mt. Washington Assurance Corporation has insufficient scale to achieve a decent expense ratio. In 2001 the loss ratio was equally problematic. Mt. Washington will strengthen its senior management in 2002. I suspect that New Hampshire rates have not been given enough underwriting priority for some time, and the consequences were inevitable. Eric Neely, our new Connecticut team leader, will now take responsibility for New Hampshire product management as well. His experience gives him just the right pedigree. Looking back on the decade we have operated in New Hampshire, there is more red ink than black. There is no way to sugarcoat the fact that you would be at least $6 million wealthier if I had not opened for business there. Having said that, I must add that there is no inclination on Hal's part or mine to give up. I may be accused, perhaps, of being habitually reluctant to give up on good ideas that don't bear fruit on schedule. To that charge, I plead *nolo*. Mt. Washington, in my view, can still succeed for Plymouth Rock, and Eric Neely is off to a good start in proving that. You won't see separate financial results for Mt. Washington, since its numbers are pooled with Plymouth Rock Assurance's, but I promise you will read about it here again next year.

At Palisades, the change in leadership is now complete. Gerry Wilson had the difficult assignment of taking over from Hal, who was at the helm since the day Palisades was licensed. Fortunately, Gerry is among the best insurance executives I have ever had the privilege of working with, and he has taken over smoothly and effectively. After a number of slow growth years in New Jersey, Gerry promptly put his foot on the accelerator. Premiums written in the Palisades insurers rose from $54 million to $66 million, about 22%. The pure loss ratio stayed comfortably in the fifties. The expense ratio is still a bit too high, but Gerry is at work on it. The growth is certain to continue into 2002. I say this not because I have acquired the clairvoyance I have long desired, but because, between the close

of the year and the writing of this letter, Palisades closed on a replacement carrier transaction which will add about $17 million in new volume there. The transaction adds good quality volume while simultaneously increasing the reciprocal's capital. There is likely more to come if companies continue to abandon New Jersey. The Palisades group of carriers there made a profit of about $4 million in 2001, well above budget, and A.M. Best has upgraded the group's rating to a B++. Our New Jersey management company brought about a million dollars to the Company's bottom line. New Jersey is plainly a source of growth in the next few years, and I look forward to its passing the $100 million mark in direct premiums written.

Pilgrim Insurance, which provides service on a fee basis to about a dozen other automobile insurance carriers in Massachusetts, grew again in 2001. Two new clients, AIG and Progressive, now round out an already impressive list. Horace Mann, in connection with its planned exit from Massachusetts auto insurance, hired Pilgrim to be a third-party administrator for some of its claims run-off. This broadens our company's menu of services. Pilgrim's total premiums serviced were up by more than 34% and its revenues by more than that. With a small capital base, no net insurance exposure, and a 20% return on capital yet again, this is a nice business to have in our family. Pilgrim added about $1.4 million to Plymouth Rock's net income. Vin Nieroda, Pilgrim's president, expects an even better year in 2002.

Our investment stakes in Response Insurance and in Homesite Group are significant enough to warrant a discussion of those companies' situations. Our balance sheet reflects the now familiar formula-driven reductions in carrying value of both holdings, but, more important, this may also be a good time to deflate some overly optimistic expectations about the near-term rates of return these ventures appear likely to produce. Response, which is a direct response auto carrier from New York to California, had a decent year on the premium side, and a year of much-needed improvement on the loss ratio side, but its pace of progress continues to disappoint. Let me review some of the facts. Response began the year a $40 to $50 million company with a loss ratio of nearly 100% and ended 2001 with volume of roughly $80 million and a loss ratio close to 80% on a run-rate basis. This is forward movement but the company has nowhere near the size or profitability Peter Wood and I hoped for when we started Response in 1995. We believed then, and believe now, that there is a great prize available for whoever builds the next serious direct response auto insurer in the U.S. Others saw the same opportunity in the mid-'90s as well, and more than half a dozen new entrants joined the field. The new entrants may have spooked the existing captive agency giants, because they soon demonstrated unexpected appetites for competitive combat. State Farm, the nation's largest auto insurer, at a cost to itself literally measured in billions of dollars, took center stage in a reduction in rates for four years in succession, an unprecedented event in the history of the automobile. For a new direct response seller, this was an awful environment.

As I explained last year, a direct response writer's core audience consists of good drivers upset that, despite clean records, they keep receiving premium increases. When those drivers are not, in fact, seeing increases, and enjoying successive rate decreases instead, a

direct response writer can sell only at a greatly increased marketing cost per unit of business acquired and the business that *can* be attracted tends to be of substantially worse risk characteristics. As a consequence, even the largest direct response carriers had three bad years. Most of the other direct response start-ups have dropped out of the game. Response was forced to shift its strategy toward acquisitions rather than direct marketing, and most of the growth in 2001 was from buying other companies. Only this year have there been signs that prices are firming and, as a consequence, Mory Katz and his team at Response are beginning to assess the market again, place by place and audience by audience, to see where and when it can resume its direct marketing.

Response's book of business has suffered also from the choice of New York as Response's first state. When Response looked for a large state in which to begin revenue generation while it expanded its national footprint of infrastructure, New York looked attractive. It had a profitable multi-billion dollar market and a history of reasonable regulation. None of us anticipated that New York would enter a period of rampant personal injury fraud that would make it one of the least profitable states in the country. Though the issues in the New York market are now well documented, Mory is not hopeful that these systemic problems can be resolved in the near future. Response is now diversifying the book geographically. In 2001, it reduced its New York concentration from 80% of its book to less than half. While there were certainly plenty of other good and bad decisions that have influenced that company, the New York choice and the national price pressure have been the salient determinants of the Response story to date.

Does the current situation change my belief that Response can be a success? No. It does, however, change the timetable. To build a self-sustaining and successful engine of growth and profit will probably require at least four years more than originally contemplated. Response has fared better than its class of start-up competitors, and it has survived the first battle of attrition. Absent discouragement, Response should get where it needs to be -- but your rate of return on this investment, and that of the other investors, can not be what we had hoped.

Homesite Group, Inc. is trickier to analyze. That company is still too young to make confident predictions about its future. Charlie Kline left Homesite in 2001, and Fabian Fondriest, an exceptionally able and well-rounded leader, has replaced him as CEO. Homesite's opportunity arises out of the very same homeowners market problems I was discussing above with respect to Bunker Hill. Most writers of homeowners insurance are auto insurance carriers who believe (correctly, I would add) that offering a companion product increases customer retention. Yet most of these carriers would just as soon not offer this particular companion product. Sold as a loss leader, homeowners insurance has not had a good rate of return for many years. It has traditionally high commissions, and terrifying catastrophe exposure, especially if built with the high geographical concentration typical of automobile insurance books. Many carriers, moreover, see its economics as more dismal than usual right now, since reinsurance prices rose across the board after September 11. In this environment, Homesite is finding no shortage of carriers interested in unloading some of their present or future exposures to a partner. Its flagship relationship with GMAC is

proving a benefit to both parties. Homesite can succeed where others fear to tread because it has lower acquisition costs for its business than the average writer, and because it is highly focused on catastrophe management through reinsurance and portfolio underwriting. I am not even convinced that the tight market in reinsurance will continue once the wave of new Bermuda writers floods the market with capacity. But Homesite, like Response, has a national infrastructure to pay for, and it must add partners faster than it has to date in order to pay for that infrastructure. While Homesite does not need as much volume as Response to break even, it probably needs at least twice the $30 million in volume it has today. The jury (and, therefore, the sales force) is still out.

The investments in Response and Homesite are carried on our books according to the equity method of accounting. This means that each is carried at cost less a proportional share of the respective operating losses. The total carrying value of the two investments on Plymouth Rock's books is now about $5.7 million. If we were permitted to carry these investments at current book value, i.e., our minimum percentage of the common stock (after conversion of all preferred shares) times the company's yearend 2001 shareholders' equity, the holdings would be carried at something over $20 million. Should either company do well, of course, the investments can be worth more than this amount. Given that the investments have just under four and six more years, respectively, before they can be sold, I can still hope for exactly that result.

The vast majority of Plymouth Rock's portfolio is held in non-strategic investments. That portfolio did better than one might expect in a year in which the total return on the S&P was a negative 12%. As much as I envy companies with so much capital that they don't have to hold bonds in order to maintain high ratings, this year the fixed income instruments were a blessing. The bottom line was a total return of 7.8% on invested assets. This number is best understood by examining its components. The single largest ingredient of our portfolio is bonds, where falling interest rates lifted values and the pre-tax gain for 2001 was almost 8%. Next in magnitude would come equities, which include both individual company shares and equity equivalents, mostly funds that own equity securities. The combined class came in about a point in the red in 2001, with the equivalents having performed well for the year and the directly held marketable equity positions doing about the same as the market as a whole. To do as the market does is not our goal in the individual marketable equities. You don't need to hire Jim Bailey, Rick Childs and me to accomplish that. But we should draw a bit of security from the long-term performance. Our from-inception marketable equity gain is still around 25% per annum, which beats most, if not all, of the comparables we look at. The third largest element of the portfolio is owner-occupied real estate, which gave us a fine total return of 21%, due to a rise in appraisal values and continuing excellent cash-on-cash returns. It seems that our two downtown Boston buildings have maintained their value and then some despite the softening in the national economy.

Stock prices continue to look inflated to us. Jim, Rick and I are all fundamental value investors and we are frightened when we see price earnings ratios as lofty as they are now. One credible student of the markets says that P/E multiples calculated as of the first quarter of 2002 will be above their levels of early 1929, pre-crash 1987, or boom time in 1999.

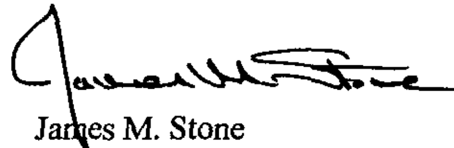
While most market analysts suggest that the current conditions are aberrant, driven by an unusually poor final quarter of 2001 and about to be negated by a swift economic turnaround, we are never confident of equity market predictions. Accordingly, we remain reluctant to add to our marketable equity exposure at these prices. In one stock we own, we are adding to our position because the share prices have returned to our comfort zone, but overall we did more selling than buying during 2001. If we continue to see prospective returns looking pretty skimpy from here, we may repeat that posture in 2002. The dot.com boom may be over, the country may be in a recession, and the market peak may have been passed, but it does not follow that the stock market yet offers many bargains in the kind of stocks we buy. We will switch back happily to being a net buyer if prices fall relative to values, but we make no forecast as to whether this will occur in the next year. One unknowable in that forecast would have to be whether there are further terrorist strikes. The economy, and the markets, are more vulnerable to that kind of blow than most analysts and policy makers have suggested, at least in public pronouncements. Time alone will reveal what is in store on that front.

What can an investor do when prospective returns on publicly traded equities look drab? One can revert to cash or bonds. Or look to real estate and other asset types that may be less than fully correlated with the market indices. One can hunt for well-known marketable equities that other investors have misunderstood and thus remain bargains. Or look at small-cap stocks that are more likely to have been understudied by sophisticated investors. An arena where markets are certain to be inefficient enough to offer particularly good -- and particularly bad -- investment opportunities is the private equity market. We own plenty of bonds and real estate already, and our alternative equity holdings include funds that seek small-cap bargains. This year, we will add a $10 million private equity commitment to the portfolio. This is not something I would have predicted a few years ago at the peak of the high-tech boom, when private equity and venture capital would have been about the last places to look for bargains. Investing in this area, moreover, depends more than elsewhere on personal faith in the managers who are running the funds. Private equity is an easy venue for losing a lot of money quickly. So, the conditions had to be just right. We think they are. The environment is one where private capital is getting scarcer, especially at the larger end of the financing spectrum, which means that bargains are becoming more available. More important, the operators of the particular fund we are investing in are well known to us and enormously respected in the marketplace.

Lindsay Goldberg & Bessemer Fund brings together Bob Lindsay, the CEO of Bessemer Securities, and Alan Goldberg, the former head of Morgan Stanley's private equity division. I am not unbiased about them because, as you know, I will be a member of the new firm's general partnership myself. This, incidentally, means that (a) it would be inappropriate for any of the money invested through LGB to be reserves or capital of our various insurance company subsidiaries; and (b) we have all agreed that no transaction between the Company and LGB should be conducted without an explicit and affirmative recommendation from Jim Bailey. But Rick and Jim independently reached the same conclusion that led me to want an involvement with Bob and Alan: both bring a rare combination of proven investment talent, an inclination and knack for building successful businesses rather than sitting back passively

after the picks are made, and -- *most important* -- *absolutely unimpeachable integrity*. We look forward to investing with Bob and Alan through their fund, and perhaps from time to time as a co-investor in their projects if the opportunity presents itself.

There is one piece of unfinished business that ought to be mentioned. A year ago, I told you that Response was looking for a new COO. That job remains open. Fabian has decided he could use a similar person at Homesite, and Hal is searching for a COO at Plymouth Rock. Finding three executives of the required quality for entrepreneurial entities such as these is no easy assignment. I can guarantee, though, that all three jobs will be interesting day and night, challenging in the extreme, and potentially rewarding. No experience in business is more satisfying than partnering in building a well run and profitable company with your own stamp on it. So, please, search your address books for candidates with the talent, focus and intensity that these jobs call for. I will be glad to print extra copies of this report to use as a sales brochure for the search.



James M. Stone

PRICEWATERHOUSECOOPERS

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of
The Plymouth Rock Company:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, cash flows and changes in stockholders' equity present fairly, in all material respects, the financial position of The Plymouth Rock Company and its subsidiaries at December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

Boston, Massachusetts
February 7, 2002

THE PLYMOUTH ROCK COMPANY

CONSOLIDATED BALANCE SHEETS

December 31, 2001 and 2000

Assets	2001	2000
Cash and cash equivalents	$ 19,808,169	$ 70,995,467
Investment securities	197,589,976	143,328,787
Premiums receivable	25,638,442	28,147,248
Accrued investment income	1,936,905	1,465,665
Receivable from reinsurers	34,281,433	33,971,300
Real estate	22,125,291	20,549,269
Deferred acquisition costs	8,336,942	8,614,513
Fixed assets	7,869,437	6,019,178
Deferred income taxes	5,095,008	3,997,846
Goodwill and intangible assets	4,577,845	4,143,857
Amounts due from service clients	3,400,267	7,207,432
Other assets	4,022,109	3,830,539
Total assets	$334,681,824	$332,271,101
Liabilities		
Claim and claim adjustment expense reserve	$105,367,683	$105,788,472
Unearned premium reserve	46,316,440	43,045,722
Payable to reinsurers	15,886,911	25,008,317
Advance premiums	7,052,832	6,173,359
Note payable	6,778,380	7,746,720
Commissions payable and accrued liabilities	20,958,370	17,183,651
Unearned service fees	2,699,023	5,394,787
Amounts due to service clients	6,420,971	4,623,244
Other liabilities	2,540,602	4,367,325
Total liabilities	214,021,212	219,331,597
Stockholders' Equity		
Common stock and paid-in capital	21,454,625	21,162,165
Retained earnings	92,894,559	84,019,595
Net unrealized gain on investments	6,311,428	7,757,744
Total stockholders' equity	120,660,612	112,939,504
Total liabilities and stockholders' equity	$334,681,824	$332,271,101

The accompanying notes are an integral part of the financial statements.

THE PLYMOUTH ROCK COMPANY

CONSOLIDATED STATEMENTS OF INCOME

For the years ended December 31, 2001 and 2000

Revenues	2001	2000
Premiums earned in underwriting activities	$127,955,823	$111,283,027
Fees earned from service activities	28,329,835	22,504,241
Investment income and capital gains	16,917,953	25,678,368
Total revenues	173,203,611	159,465,636
Expenses		
Claims and claim adjustment expenses	91,517,913	81,148,192
Policy acquisition, underwriting and general expenses	42,865,622	40,061,250
Service activity expenses	23,727,568	17,566,621
Total expenses	158,111,103	138,776,063
Income before federal income taxes	15,092,508	20,689,573
Federal income taxes	4,824,818	6,758,531
Net income	$ 10,267,690	$ 13,931,042

Per share data		
Weighted average common shares outstanding	219,014	218,732
Net income per share	$46.88	$63.69
Common shares outstanding at end of year	219,101	218,732
Common stockholders' equity per share	$550.71	$516.34

The accompanying notes are an integral part of the financial statements.

THE PLYMOUTH ROCK COMPANY

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2001 and 2000

Cash flows from operating activities	2001	2000
Gross premiums collected	$189,975,654	$162,509,500
Reinsurance premiums paid	(60,596,200)	(43,555,317)
Finance charges collected	3,490,184	3,411,742
Fees and commissions collected	21,748,030	19,081,447
Investment income and capital gains received	14,467,636	24,045,700
Gross claims and claim expenses paid	(134,220,836)	(115,476,787)
Reinsured claims and claim expenses collected	45,025,553	37,652,135
Policy acquisition, underwriting and general expenses paid	(40,047,141)	(40,653,000)
Federal income taxes paid	(5,875,000)	(7,585,000)
Service activity expenses paid	(17,524,954)	(17,247,997)
Net cash provided by operating activities	16,442,926	22,182,423
Cash flows from financing activities		
Payment on note payable	(968,340)	(968,340)
Issuance of common stock	99,960	-0-
Dividends to stockholders	(1,392,726)	(638,698)
Net cash used in financing activities	(2,261,106)	(1,607,038)
Net cash provided	$ 14,181,820	$ 20,575,385
Investment of net cash provided		
Change in cash and cash equivalents	$ (51,187,298)	$ 55,437,509
Net investment activity	57,996,260	(40,244,250)
Purchase of goodwill and intangible assets	884,959	2,022,356
Purchases of real estate	2,320,931	646,017
Purchases of fixed assets	4,166,968	2,713,753
Net cash invested	$ 14,181,820	$ 20,575,385

The accompanying notes are an integral part of the financial statements.

THE PLYMOUTH ROCK COMPANY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

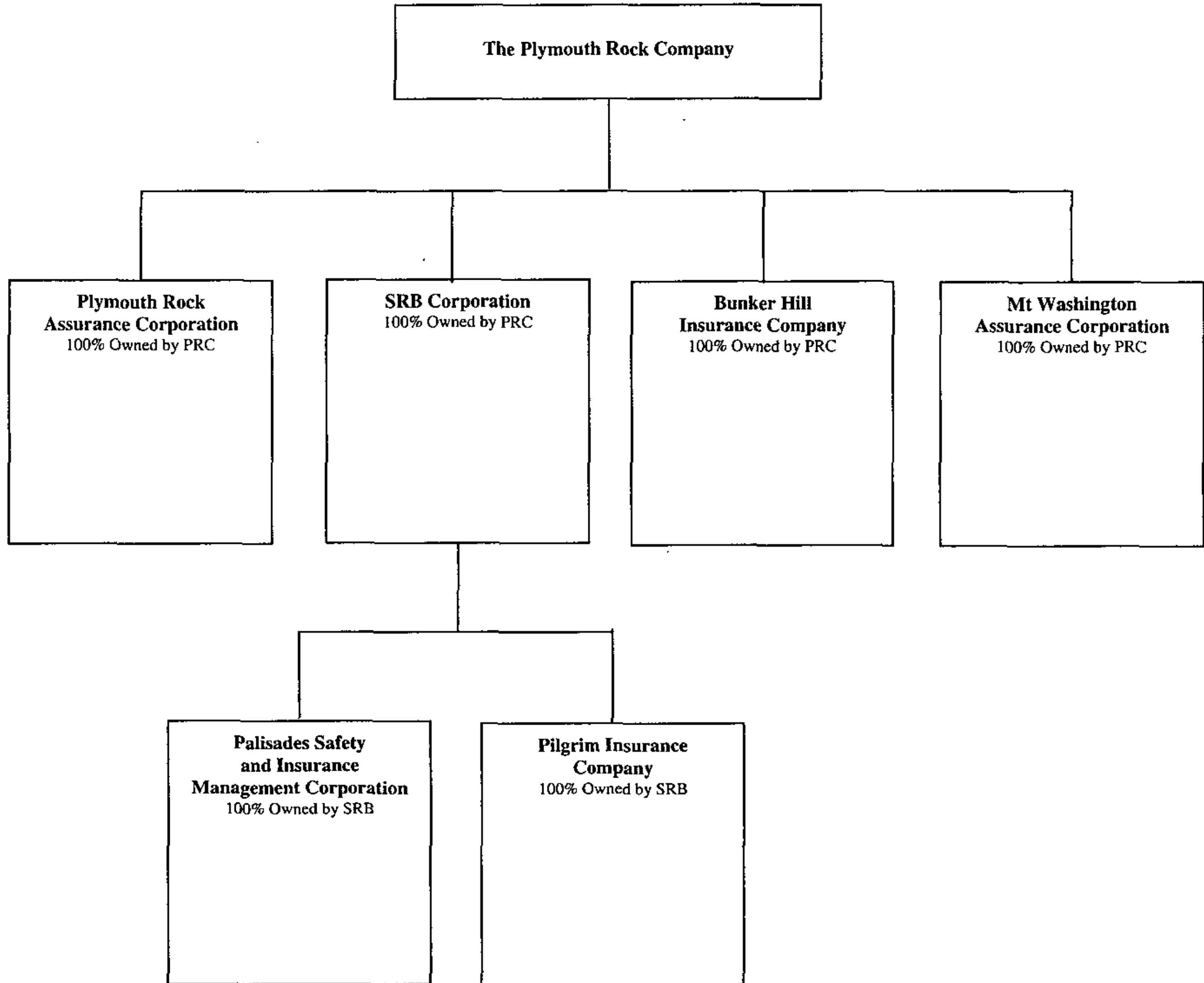
For the years ended December 31, 2001 and 2000

	Common Stock and Paid-in Capital	Retained Earnings	Net Unrealized Gain/(Loss) on Investments	Total Stockholders' Equity
December 31, 1999	$21,162,165	$70,727,251	$8,124,341	$100,013,757
Comprehensive income	-0-	13,931,042	(366,597)	13,564,445
Dividends to stockholders	-0-	(638,698)	-0-	(638,698)
December 31, 2000	21,162,165	84,019,595	7,757,744	112,939,504
Comprehensive income	-0-	10,267,690	(1,446,316)	8,821,374
Issuance of common stock	292,460	-0-	-0-	292,460
Dividends to stockholders	-0-	(1,392,726)	-0-	(1,392,726)
December 31, 2001	$21,454,625	$92,894,559	$6,311,428	$120,660,612

The accompanying notes are an integral part of the financial statements.

1. Organization of the Plymouth Rock Companies

The corporate and ownership structure of the principal Plymouth Rock Companies is shown in the following chart:



Other affiliates include BCS Holding Company, LLC, a wholly owned subsidiary of Plymouth Rock Assurance Corporation, which owns independent insurance agencies. Direct Response Corporation and Homesite Group Incorporated are not among the Plymouth Rock Companies, but The Plymouth Rock Company owns a common and preferred stock interest in each.

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies

A. Principles of Consolidation

The consolidated financial statements include the accounts of The Plymouth Rock Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform with 2001 reinsurance reporting practices.

B. Investments and Real Estate

Cash and cash equivalents consist of short-term money market instruments and commercial paper with maturity dates no longer than 90 days at the date of acquisition. Marketable fixed income and equity securities are carried at their fair values. The fair values of securities are based on quoted market prices. The calculation of gain or loss on the sale of marketable securities is based on specific identification at the time of sale. Net unrealized gains or losses on securities available for sale, net of applicable deferred taxes, are credited or charged directly to stockholders' equity. Alternative equity investments are recorded using the equity method of accounting.

Real estate and fixed assets are carried at cost less accumulated depreciation. The Company provides for depreciation and amortization principally on the straight-line method over the estimated useful lives or the applicable lease terms.

C. Income Taxes

The Company files its federal income tax return on a consolidated basis. The provision for income taxes is based on income reported in the financial statements. Deferred income taxes arise when there are differences between reported income and taxable income.

Federal income taxes on the statements of income consist for 2001 and 2000 of:

	2001	2000
Current year federal income taxes	$5,176,908	$8,560,808
Change in deferred taxes	(352,090)	(1,802,277)
Total	$4,824,818	$6,758,531

Deferred income taxes in the balance sheets as of December 31, 2001and 2000 consist of the net effect of these temporary differences:

	2001	2000
Discounting of claim reserves	$2,742,660	$3,107,173
Deferred income	4,237,427	3,732,394
Net unrealized gain on investments	(3,251,342)	(3,996,414)
Other	1,366,263	1,154,693
Total	$5,095,008	$3,997,846

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies, continued

C. Income Taxes, continued

The net unrealized gain on investments is presented in stockholders' equity, net of an estimate of applicable deferred income taxes. The Company's reported provision for federal income taxes is less than that computed by applying the federal income tax rate for these years to income from operations before federal income taxes. This is principally because the Company receives significant nontaxable interest from state and municipal bonds.

D. Revenues Earned in Underwriting and Service Activities

Premium revenues are earned on a daily basis over the terms of the policies. Unearned premiums represent billed amounts which are applicable to the unexpired terms of policies in force and are presented net of reinsurance. Premiums receivable are net of reserves for doubtful collections of $675,257 and $953,413 at December 31, 2001 and 2000, respectively, and are presented net of unbilled amounts of $21,538,714 and $19,620,643, respectively.

Underwriting revenue is derived from personal lines property and casualty insurance activity, predominantly in Massachusetts. The Company also derives fee income by providing insurance, investment management, policy processing, billing, and claim management services in two Northeast states. Fee income is earned over the related contract periods. The balance sheet item, amounts due from (to) service clients, refers principally to balances resulting from arrangements with insurance companies which contract for services from Pilgrim Insurance Company. Palisades Safety and Insurance Association, a reciprocal automobile insurer writing business in New Jersey, has an insurance management contract with Palisades Safety and Insurance Management Corporation and is also considered a client for this purpose.

E. Reinsurance

Treaty reinsurance is used to reduce exposure to large claims. The Company regularly evaluates the financial condition of its reinsurer and monitors the concentration of credit risk to minimize significant exposure. The Company maintains catastrophe, quota share, and excess of loss contracts that are prospective in nature and remains primarily liable as the direct insurer on all voluntary risks.

Amounts recoverable for claim reserves and paid claims are reflected as receivable from reinsurers. The income statement is reflected net of reinsurance activity as follows:

	2001		2000	
	Premiums Written	Losses Incurred	Premiums Written	Losses Incurred
Gross	$184,619,404	$133,492,457	$167,278,488	$119,442,689
Ceded	(52,149,737)	(41,974,544)	(47,533,882)	(38,294,497)
Net	$132,469,667	$ 91,517,913	$119,744,606	$ 81,148,192

2. Summary of Significant Accounting Policies, continued

E. Reinsurance, continued

Ceded premiums earned for 2001 and 2000 were $48,481,860 and $44,602,691, respectively.

The Company has treaties for quota share reinsurance ranging from 40 to 50 percent which reinsure certain coverages for losses in excess of approximately 88 percent of premiums earned during specified accounting periods. Revenues and expenses are each reflected net of quota share reinsurance totaling approximately $37 million and $34 million for 2001 and 2000, respectively.

The Company has a catastrophe reinsurance treaty. At December 31, 2001 and 2000, the Company had paid cumulative premiums of approximately $5,159,000 and $4,410,000, respectively, to the reinsurer to cover future catastrophes. During 2001 and 2000, the Company accrued approximately $2,404,000 and $854,000, respectively, of income relating to its experience under this contract.

The Company is a member of Commonwealth Automobile Reinsurers and accounts for its transactions with this entity as reinsurance. The Company records its estimated share of this activity from information provided by Commonwealth Automobile Reinsurers. The Company evaluates this information and, if necessary, makes adjustments within the reserves to reflect management's estimate of the results of this activity.

The Company acts as an intermediary for certain other insurance companies in administering commercial automobile insurance programs. The Company's income statement and reinsurance activity exclude premiums earned related to this third party business of $38,158,764 and $29,763,185 and claim and claim adjustment expenses of $44,489,141 and $31,663,765 in 2001 and 2000, respectively. In connection with these arrangements, receivables and claim reserves exclude $32,232,500 and $27,725,969 at December 31, 2001 and 2000, respectively.

F. Deferred Acquisition Costs

Commissions and premium taxes are deferred and amortized pro rata over the contract periods in which the related premiums are earned. All amounts deferred at December 31 are charged to operations in the following year as the related premiums are earned. Deferred acquisition costs are presented net of deferred commission income on ceded reinsurance.

G. Goodwill and Intangible Assets

Goodwill of $3,645,691, representing the excess of the purchase price over the estimated fair value of net assets acquired, results from the purchase of insurance agencies. It is being amortized over a period of fifteen years. In addition, an intangible asset of $932,154, representing expirations, is being amortized over a period of seven years. Amortization expense for 2001 and 2000 was $450,971 and $304,956, respectively.

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies, continued

H. Acquisition

The company purchased one insurance agency for approximately $850,000 and two insurance agencies for approximately $2,200,000 in 2001 and 2000, respectively. These transactions were accounted for under the purchase accounting method. The Company's net income includes results of operations for these agencies from the dates of purchase.

I. Claims and Claim Adjustment Expenses

Claim reserves represent the estimated liability for claims reported to the Company plus reserves for claims incurred but not yet reported. Claim adjustment expense reserves represent the estimated expenses relating to settling these claims. Claim and claim adjustment expense reserves are presented before estimated recoveries for reinsurance. The methods of making such estimates and establishing the resulting reserves are reviewed regularly, and any adjustments are reflected in income currently. The table below provides a reconciliation of the beginning and ending reserve for claims and claim adjustment expenses:

	2001	2000
Balance at beginning of year	$105,788,472	$ 97,733,412
Claims and claim adjustment expense:		
Current year	104,943,000	90,717,163
Prior years	(9,949,490)	(6,406,675)
	94,993,510	84,310,488
Claims and claim adjustment expenses paid:		
Current year	58,560,000	41,811,000
Prior years	38,586,760	37,203,503
	97,146,760	79,014,503
Change in reinsurance recoverable on unpaid claims	1,732,461	2,759,075
Balance at end of year	$105,367,683	$105,788,472

Development in involuntary business accounts for approximately $4.2 million and $2.5 million of the prior years' reserve changes in 2001 and 2000, respectively.

Claims and claim adjustment expenses includes $3,475,597 and $3,162,296 in 2001 and 2000, respectively, of expenses that are reimbursed by insurance companies for which the Company is a service provider. These expenses are included in service activity expenses in the Company's consolidated statements of income.

3. Consolidated Revenues

Revenues, net of reinsurance, for the separate companies for 2001 and 2000 were:

	2001	2000
The Plymouth Rock Company	$ 6,938,046	$ 3,209,388
Plymouth Rock Assurance Corporation	136,090,470	124,887,989
Mt Washington Assurance Corporation	408,193	4,436,362
Bunker Hill Insurance Company	18,200,982	15,775,701
SRB Corporation	5,943,346	4,833,765
Pilgrim Insurance Company	18,375,534	12,736,825
Palisades Safety and Insurance Management Corporation	7,549,268	6,500,317
	193,505,839	172,380,347
Intercompany eliminations	(20,302,228)	(12,914,711)
Total revenues	$173,203,611	$159,465,636

4. Reconciliation of Net Income to Net Cash Provided by Operating Activities

The following items account for the differences between net income and net cash provided by operating activities:

	2001	2000
Net income	$10,267,690	$13,931,042
Depreciation and amortization	4,887,572	4,602,635
Change in operating assets and liabilities:		
Premiums receivable	2,508,806	(9,317,030)
Accrued investment income	(471,240)	306,747
Receivable from reinsurers	(310,133)	(3,202,182)
Deferred acquisition costs	277,571	(921,577)
Deferred income taxes	(352,090)	(2,023,652)
Claim and claim adjustment expense reserve	(420,789)	8,055,060
Unearned premium reserve	3,270,718	3,853,296
Payable to reinsurers	(9,121,406)	9,011,387
Advance premiums	879,473	(345,054)
Commissions payable and accrued liabilities	5,510,902	(98,110)
Unearned service fees	(2,695,764)	(3,219,393)
Amounts due to and from service clients	5,604,892	(1,640,644)
Other assets and other liabilities	(3,393,276)	3,189,898
Net cash provided by operating activities	$16,442,926	$22,182,423

5. Commitments and Guarantees

Rental expenses for 2001 and 2000 aggregated approximately $1,155,000 and $566,000, respectively. For the years 2002 through 2009, the minimum lease obligations of the Company range from approximately $66,000 to $1,149,000 annually. Total obligations for leases through 2009 are approximately $4,500,000.

As of December 31, 2001, a subsidiary of the Company had guarantees outstanding on loans to certain of its independent insurance agents with balances totaling approximately $800,000. These loans were fully performing in 2001 and are not expected to result in any net liability to the Company.

6. Note Payable

During 1998, the Company executed a note payable in the amount of $9,683,400 at an interest rate of 6.32% in conjunction with the purchase of outstanding shares of its common stock. Payments of principal are scheduled to be made in ten equal annual installments of $968,340. Interest payments on this note totaled approximately $459,000 and $522,000 during 2001 and 2000, respectively. The Company has the right to prepay this note at any time.

7. Compensation Plans

The Company has a Savings and Investment Plan under Section 401(k) of the Internal Revenue Code. This defined contribution plan covers all employees 21 years or older. The Company accrued $1,556,759 and $1,517,515 as of December 31, 2001 and 2000, respectively, for liabilities relating to this Plan.

The Company has established Deferred Compensation Plans for officers, managers, and directors other than its founding shareholders. These Plans generally provide for a rate of return on deferrals based on the financial performance of the Company. The Company accrued $4,160,238 and $3,259,616 as of December 31, 2001 and 2000, respectively, for liabilities relating to these Plans. At December 31, 2001, the Company is contingently liable under these plans to pay an additional $708,573 upon the occurrence of certain events.

Since 1997, the Company has made stock incentive awards annually to key employees. The cumulative number of outstanding awards as of December 31, 2001 and 2000 was 9,389 and 12,164, respectively. The Company has recorded compensation expense of $311,080 and $400,000 in 2001 and 2000, respectively, for outstanding awards. Additional expense may be recorded in the future with respect to some outstanding awards under the accounting rules applicable to variable awards.

8. Real Estate

The Company has interests in three real estate properties. One of these interests is a two-thirds ownership through a limited liability company. This investment is accounted for under the equity method. Building improvements of approximately $797,916 and $462,000 were incurred in 2001 and 2000, respectively. The table below summarizes real estate at December 31, 2001 and 2000.

	2001	2000
Land	$ 4,697,778	$ 4,697,778
Buildings, improvements and other	20,674,181	18,353,250
Total cost	25,371,959	23,051,028
Less: accumulated depreciation	3,246,668	2,501,759
Net book value	$22,125,291	$20,549,269

Rental income other than from Plymouth Rock companies aggregated approximately $4,226,000 and $3,609,000 in 2001 and 2000, respectively. For each of the years 2002 through 2006, minimum annual rent receivable by the Company is approximately $2,101,000. Total obligations of lessees through 2006 are approximately $10,505,000. Buildings and improvements are depreciated over their useful lives, which range from two to thirty-nine years.

The total appraised value of the Company's real estate interests, as determined by independent appraisers during 2001 using the income and sales comparison approaches, was $41.9 million. Because of uncertainties inherent in the appraisal process, as well as changing market conditions, the amount that could be realized if the properties were actually offered for sale may differ from these appraised values.

9. Fixed Assets

Purchases of fixed assets were approximately $4,167,000 and $2,714,000 in 2001 and 2000, respectively. The table below summarizes fixed assets at December 31, 2001 and 2000.

	Useful Lives	2001	2000
Furniture and fixtures	5-10 years	$ 3,636,797	$ 3,350,423
Computers and software development	3-5 years	13,424,994	9,374,869
Leasehold improvements	2-6 years	2,583,352	2,905,895
Vehicles	3 years	1,425,090	1,380,068
Total cost		21,070,233	17,011,255
Less: accumulated depreciation and amortization		13,200,796	10,992,077
Net book value		$ 7,869,437	$ 6,019,178