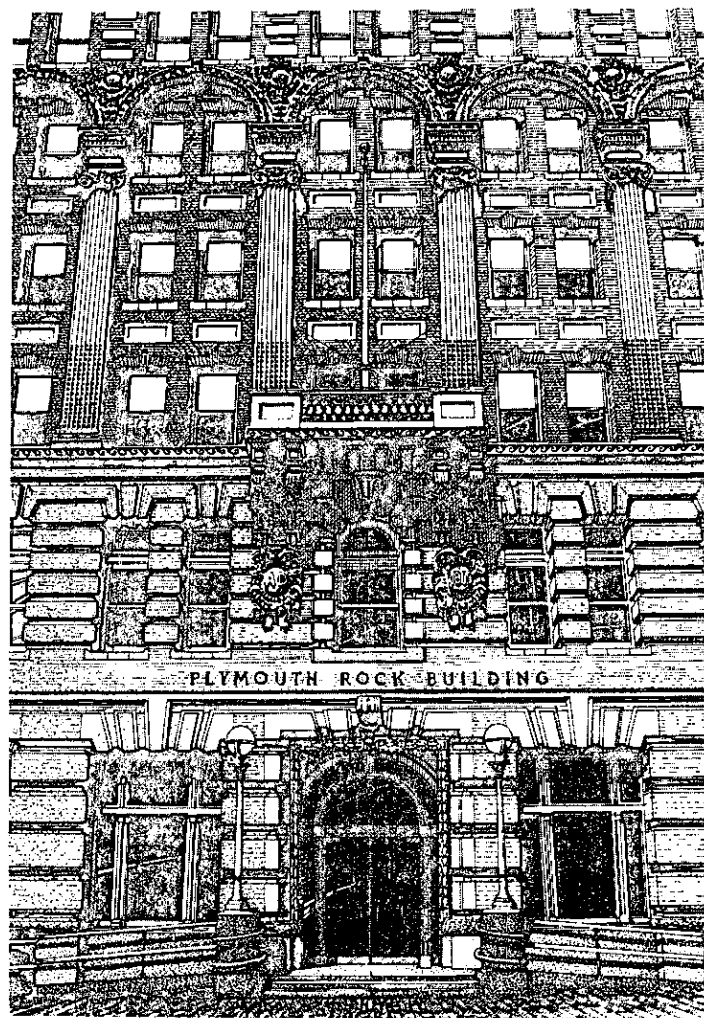


# The Plymouth Rock Company



## 2002 Annual Report

**The Plymouth Rock Company**  
**695 Atlantic Avenue**  
**Boston, Massachusetts 02111**

**Chairman's Letter**

February 21, 2003

To Our Shareholders:

This was, as anticipated, a reasonably good year at Plymouth Rock. Net income for the group in the year ended December 31, 2002 was just under \$11.8 million, up 14.5% from last year's equivalent. Growth in premiums, excluding the New Jersey premiums not written in a Plymouth Rock owned company, was about 11%, almost all of this from additional units rather than rate increases. The omission of managed New Jersey business from these numbers, though, is especially significant this past year because the lion's share of our growth effort in 2002 was concentrated there. The highlight of that story, which I prefer to tell separately because of Palisades' reciprocal structure, is that premiums rose by 36%, with an even greater growth rate in 2003 already assured.

Shareholders' equity on a GAAP basis rose by \$11.5 million over the equivalent number for year-end 2001. On a per share basis, the increase in book value was from \$551 to \$603. As you well know by now, this book value represents only a part, perhaps about half, of your Company's economic net worth before applying any valuation multiple. The value of the contract Plymouth Rock holds to manage the Palisades reciprocal in New Jersey is not recognized for balance sheet purposes by generally accepted accounting principles, though it has an obvious commercial value. Substantial gains in Palisades' capital this year, for the same reason, are not reflected in the GAAP book value increase described above. Also outside GAAP purview are the unrealized gains on our real estate portfolio and, in the cases of Homesite Group and Response Insurance, where Plymouth Rock is a substantial common shareholder, any value in excess of our cost less a proportional share of operating losses. I am confident that economic book value of the Plymouth Rock enterprise is now over \$1000 per share.

Another metric not apparent in GAAP financial reports, and which this letter always tries to supply, is an estimate of the scale of our business enterprise. To perform the required calculation, we add the net premiums earned, from the top line of Plymouth Rock's income statement, which were \$141 million in 2002, to the change in premiums which the Company has written but not yet earned. Then we add in the business that is ours but which we ceded as reinsurance to Commonwealth Automobile Reinsurers (CAR) and General Re. Next we add in the business which is not ours but which we manage for others, including the New Jersey personal lines premiums now at Palisades and the automobile insurance premiums handled at Pilgrim Insurance. From this is netted a few items that would otherwise be double counted and business that is not ours but is assumed as a part of our statutory obligation to CAR, which serves as the Massachusetts residual market mechanism. The grand total is \$329 million, an

increase of about 20% since last year and more than two and a quarter times the top line of the financials. I find this number more instructive as to our workload, employment needs, and profit potential than the netted GAAP equivalent on the income statement. For a reality check, try adding the Gross Premiums Collected on the Consolidated Statements of Cash Flows to the managed premium amounts and subtract the CAR assumed premium; this will yield a number similar to mine. It looks as though enterprise scale may approach \$400 million in 2003 and Hal Belodoff is boldly predicting half a billion by 2005. Cumulative book value return on capitalization from inception now stands at 17.6%.

Hal has an expanding leadership role throughout all of the Plymouth Rock operating companies, but he has an extra measure of hands-on responsibility for Plymouth Rock Assurance, still our largest company, and he is executing that responsibility very well indeed. This was the first year in quite a while that the combined ratio was held below 100%. Of course, given Massachusetts's unique degree of regulation over this business, success here requires satisfactory external conditions as well as excellent management skills. The Massachusetts automobile insurance environment today is neither the best nor the worst we have seen. Following many years of approximate adequacy, state-set premium rates are probably falling a bit behind cost trends. On the other hand, nobody seems to be asserting that the gap is a forbidding one. The Commissioner announced a rate increase at year-end that was billed as 2.7%. She was immediately criticized by consumer groups for giving the industry too much. In fact, she gave very little. This is the first time in my memory that a Commissioner has made an increase look larger, and therefore more controversial, than it actually was. Most of the 2.7%, it turns out, represents a statutorily mandated assessment to pay for the insolvency of Trust Insurance a few years ago and a formulaic reconciliation of the industry's Safe Driver Incentive Program. These are just repayments of moneys we and all other insurers pay out by law, and their mandatory recoupments could easily have been described separately from the true rate increase. The actual increase with which the companies can pay for claims and other cost inflation in 2003 looks to be close to zero. That may be an opportunity lost for the industry, since the year in which a new Governor is *about* to take office is a particularly good one for a Commissioner to grant necessary catch-ups in costs without undue political consequences.

One stated goal of the Commissioner is to make Massachusetts more attractive as a venue for national companies. Consistent with this, the Insurance Department is seeking a rationalization of the residual market mechanism, so that it does not disproportionately favor one company over another as much as it seems to today. There is merit to that objective, which the Commissioner shares with the Massachusetts Attorney General and a number of companies, but there is a risk as well. Plymouth Rock will support changes in CAR to this end -- but only if the changes maintain two elements of the current system that are working well for the public. One is a flattening by degree of the relative premium differentials across territories which is then compensated for in the marketplace by the residual market credit mechanism. This helps remove a large and unfair burden placed on city dwellers by urban crime and commuting patterns. The other is the high level of individual responsibility that companies have under the present formulas for settling their claims efficiently, rather than pooling the results and thus lessening the incentives for careful investigation. This discipline helps keep overall rate levels for everyone lower. Our state has kept peace between its insurance consumers and the companies for years now by maintaining these two principles of sound public policy. Plymouth Rock will oppose

any attempt to raise inner city premium relativities to unaffordable levels or to pool and share risks such that individual companies hold the industry's claims pen without accountability for how the money is spent.

Among the most interesting events of this past year was a dance that Plymouth Rock had previously decided to sit out -- and which we, therefore, just watched in 2002. Our competitor, Safety Insurance, announced and postponed a public offering of its shares, announced and postponed again, and finally went forward with a successful offering. In the fall of 2001, Safety Insurance was sold by its founder to a private equity investor group. For us to have acquired Safety at the time would have been inconsistent with our goal of becoming a more diversified enterprise, and we did not want to take on the debt that probably would have been required to consummate the purchase. We saw the price paid by the new owner, however, as a genuine bargain. The new owner has now proven that proposition this year by taking Safety public at a price a good bit higher -- though still below that company's book value.

If you are asking whether Safety's pricing in the public market suggests that Plymouth Rock, too, is worth less than book value, let me offer a bit of comfort. Three differences in valuation are evident right away. The first is in the diversification by state that we have worked so hard to accomplish. Safety is, without question, more dependent on the exigencies of auto insurance in Massachusetts, and its related politics, than is Plymouth Rock. The second is that, at least according to an independent study commissioned by the Massachusetts Attorney General, Plymouth Rock has a five-year Return on Earned Premiums (defined in the A.G.'s report as earned premiums plus investment income minus losses and expenses, all as a percentage of earned premiums) of 9.5% versus Safety's 1.7% over the same period. We have not verified these numbers ourselves, but I am not surprised there is some difference in this favorable direction. Finally, Plymouth Rock has diversified its distribution arrangements and has a number of stabilizing multi-year arrangements with its agents, while Safety is more traditional in its approach to agency contracts. Taking all of these factors into account and comparing your Company not just to Safety, but to all of its Massachusetts peers, Plymouth Rock looks pretty strong. But, then again, I am biased.

The greater rate adequacy problem in recent years has not been state-set rates but company discounts. It looks as though this coming year the discounts will remain approximately stable, having been gradually but significantly reduced over the last four years. This is good news for us, given the disappointing rate announcement. Our loss ratio is good and there is every reason to believe it will remain so. The Plymouth Rock Assurance net pure loss ratio improved to about 60% in 2002, after full provision for all residual market assessments. The expense ratio, which has traditionally been a greater challenge for our service-oriented culture, also improved. As we like to measure it, on a gross basis and including investment expenses and loss adjustment expenses, it came to 38.8% in 2002, even after provision for considerable IT systems improvements -- including a much upgraded new data imaging system.

Don Southwick continues to manage BCS Holdings for us, where Plymouth Rock owns outright several agencies where the proprietors found a sale to us to be the most attractive perpetuation plan. Don also helps us manage relationships with other agencies with which we have special relationships, and he is regularly meeting with new acquisition candidates in Massachusetts, New

Hampshire and Connecticut. The agencies under Don earned about \$600,000 for our group last year in profits, but, of course, their value in steering good business to the Company is many times that amount.

Last year I reported Eric Neely's prediction that he could generate \$5 million in premium for us in our maiden year in Connecticut. That year now over, I must now acknowledge that Eric and I were a little overly optimistic about timing. Actual volume for our first year in Connecticut was closer to \$3 million, but Eric has signed up enough agents now that he is predicting a return to the original fast track with a bit more than \$10 million year in 2003. Sometimes, when a company enters a new state, it must accept a few years of poor loss ratio to gain its foothold. That does not seem to be the case for Plymouth Rock in Connecticut. The first year pure loss ratio appears to be comfortably in the 60's, because the bulk of the business so far has been seasoned agency business transferred from other carriers. As we improve our visibility and reputation for service in Connecticut, we should get more such transfers. Connecticut agents seem to be feeling a bit abandoned by their traditional agency carriers, so the situation for a high-service entrant, like us, is extremely attractive.

Eric splits his time these days between Connecticut and New Hampshire, stopping off in between at our headquarters in Boston. He is now the president of Mt. Washington Assurance, where he has had product management responsibility for over a year. Mt. Washington has not been a financial winner for us so far. Despite some noble efforts by some fine leaders in the past, it has always suffered from insufficient scale to achieve a decent expense ratio. That company's volume has now grown to \$15 million, and it projects premium revenues of \$20 million in 2003. Mt. Washington finished the year 2002 with a nice improvement over the preceding year. Eric says he can get the combined ratio below 100% for the first time in that company's history during 2003. He is not yet able to predict when Mt. Washington will meet the first two of the three goals I set years ago for all Plymouth Rock start-ups: that each earn for the group at least a 15% return on capital, that its profits exceed a million dollars, and that it be an enterprise we are proud to be associated with. We'll just have to take one step at a time but, at this pace, realization of the numerical goals should not be far away. We are already proud of Mt. Washington for its high quality of staff, its excellent agency force, and its solid service.

Bunker Hill Insurance, the homeowners specialty carrier in our group, has a new president of exceptional credentials. John Tierney was the head of the Property and Casualty Actuarial Practice at Tillinghast-Towers Perrin for some years before a relatively short stint as an executive at another company, from which he came to us. There is a pleasant touch of irony to his joining us as president of Bunker Hill. Already familiar with his fine technical reputation twenty years ago, I sought him out as a consulting actuary to help me with our very first homeowners rates and forms filing in 1984. He adds a dimension of expertise to our whole group as well as providing leadership at Bunker Hill. Shortly after John's arrival here, Hal and John and I agreed upon a set of new objectives for John and Bunker Hill. We all felt that, due to risk adjustment, the appropriate return on capital target for a homeowners writer should be closer to 20% than the 15% we aim for in auto insurance. And reinsurance should be sufficient to withstand the worst Atlantic storm likely to occur within a 250 year period.

John quickly and correctly determined that Bunker Hill's current economics did not meet this standard. To get there, he commenced a program to cut that company's expenses in every category, and to raise its premium rates and reduce exposure to risks that were particularly expensive to reinsure (especially in coastal areas) -- but not to *abandon* any geographical area of the state. He has also begun to buy that company's reinsurance more strategically. Results in 2002 remained sub-par, with net income just under \$500,000 on \$29 million in premiums. Just as important, Bunker Hill's protection against catastrophes currently falls short of the one year in 250 standard. Putting in place the proper catastrophe protection is a task John feels he can accomplish during 2003. At the same time, and despite the greater reinsurance cost this strategy implies, John predicts that he can more than double the net income in 2003. We won't quite reach the 20% return on capital target even then, but Bunker Hill will be well on its way.

This was an extremely important year for Palisades. The reciprocal's capital and premiums are not recorded on our financials, since the policyholders own the reciprocal, but the more business there is at Palisades the greater is the fee income we can earn for managing it well. This past year, the New Jersey group thrived on its existing book and then supplemented those results with three replacement deals, in which Palisades accepted a capital contribution in each case from an exiting carrier in exchange for absorbing that carrier's policyholders in a non-disruptive fashion. Assuring that there is no market disruption when a company exits is a requirement placed on the industry by New Jersey law. In 2002, the Harleysville Group, the Great American Financial Group and the Hartford (other than for its AARP business) exited New Jersey auto, and in each case left business and capital behind with Palisades. The total capital added to the reciprocal amounted to \$32 million, which more than doubles the capitalization of that enterprise, and the business Palisades promised to absorb in 2002 and 2003 amounted to \$60 million, close to 90% growth over the volume a year ago. This is why I can say that the 2002 premium growth of \$24 million, only half of which reflects replacement business, will certainly be exceeded next year, when the vast bulk of the acquired volume goes on the books, along with any new business the existing and new agents generate. Premium in New Jersey for 2003 will predictably approach \$150 million, making Palisades the second largest independent agency automobile carrier in that state. Watch out Plymouth Rock Assurance. Gerry Wilson is determined to make Palisades the largest company in the extended family.

The profit picture is also promising, although the new business -- which we were effectively paid to take -- will not carry as favorable a loss ratio as the existing book for some years. The expense ratio is now approaching the point where I will no longer be able to chide Gerry for being less efficient than Plymouth Rock Assurance. Gerry inherited a fine team at Palisades, and has augmented it with other strong leaders. The newest Palisades officer is Marc Buro, who has been immensely helpful at every stage of each replacement transaction. Gerry and his staff planned the 2002 victories in mid-2001 and executed them without a serious glitch at any point. It is no small chore to double a company, as Gerry will have done in a two-year period, and uphold a standard of excellence in operations and service at the same time, but the New Jersey team is doing exactly that. It helps that the business comes in gradually over the year, that Palisades is having less trouble than it anticipated in filling new staff positions, and that 98% of the transferred business can come to Palisades in an automated fashion with no manual intervention.

There are always risks in a political and pervasively regulated environment like New Jersey. The state's battle with State Farm is still unresolved, leaving hundreds of millions of dollars in premium overhanging the market. There is an active coalition of industry giants, lobbying to deregulate the New Jersey auto insurance market in ways that often appear to us unrealistic. The coalition has run ads implying that more and more carriers will leave if deregulation is not implemented. The powerful trial lawyers association, meanwhile, is hankering to repeal or weaken the no-fault laws. The New Jersey Insurance Department has, so far, been level headed and moderate in its approach to all of this turmoil but it is under constant pressure to make concessions to keep companies from bolting. At some point, enough of these concessions can create a bumpy and uneven playing field that is very hard to correct. We are open to reform of the system, and particularly the rate change approval mechanism, but our worries for New Jersey spring from the same sources as our concern about proposed Massachusetts reforms. No matter what is done, traffic density and ingrained habits will always cause New Jersey to be an expensive state in terms of average premium level. The disparity between rich suburbs and poorer cities in the Garden State is particularly pronounced, and a purely free market solution in this compulsory product market would be unfair to urban residents as well as unworkable. In New Jersey, the political powers have never created an effective credit system which would allow reasonable rate flattening without making the cities unattractive to the carriers. Unless they do so, we fear that any significant movement toward deregulation will make the urban availability problem thornier and give rise to ad-hoc solutions that are inconsistent and potentially unfair. Palisades is now, however, a major domestic writer. The one thing you can be sure of is that it will remain in New Jersey, and therefore it will always seek to be a constructive force in helping the regulators create a level playing field for a meaningfully competitive industry that serves the New Jersey public well. The growth in the works for Palisades transforms that company from a start-up to a mid-sized institution. What more could we have asked for ten short years ago when Hal and I started to design a New Jersey company for the Plymouth Rock family? Happy Tenth Birthday, Palisades.

The most disappointing event of 2002 was the discovery at Pilgrim Insurance, our insurance services company, of an accounting error that had caused the profits for the past four years to be overstated. There were several parts to the error, but the most significant was that certain accruals related to our CAR business were never tried up as the actual numbers became known. The odd thing is that our auditors, internal as well as independent, our management, and our Board were all aware that Pilgrim had some imprecision in these numbers, but no one believed that the magnitude of the necessary adjustment was as great as it turned out to be. The problem is behind us now, but Pilgrim, which should have earned \$1.5 million for our group in 2002, instead earned a negligible profit after the write-downs.

In a sense, the errors are a cost of our decentralized management. The Plymouth Rock Assurance accounting department, now led by Peter Phelps, had far more sophisticated controls for such entries in use right in the same building. Keeping "each tub on its own bottom", in the words Harvard uses to describe the university's organizational structure, brings both benefits and drawbacks. In the future, the Internal Audit staff, which operates across company lines in our group, will take more responsibility for seeing that best practices are universally applied. The silver lining here is two-fold. One is that the scrubbing done by Pilgrim's new, and excellent, accounting chief was thorough and the other small companies in the group will benefit by

application of a similar scrub. The other is that the results at Pilgrim on a current basis were actually fine. Hal and I would be very surprised if that company earns less than \$1.5 million next year, representing a 25% return on the capital Plymouth Rock deploys for Pilgrim's business. Near the end of the year, Vin Nieroda, who has run Pilgrim for many years now and built most of its present business, told us that he plans to retire from that job later this year. Vin is planning a model exit, with the business in good shape and, if possible, a successor trained. We will miss Vin, and it won't be easy to find a comparable replacement.

The Plymouth Rock positions in Response Insurance and in Homesite Group are much on my mind at this time. Our 2002 goals for Response, a national direct response auto carrier from New York to California, included taming the loss ratio, tightening expenses, and further strengthening the top management team. The prior year, 2001, had been a year of rapid growth. This was a year of improved metrics, at the explicit sacrifice of growth. It will be nice when Response can accomplish both in one year, but that was too great a risk to attempt in 2002. I am pleased to report that Mory Katz and his team achieved all of Response's 2002 goals to a satisfactory degree, with good groundwork laid for more progress in 2003.

Response began the year as roughly a \$75 million company, which was well behind its original business plan scale target. We attribute the shortfall over the six years since Response's founding to two major causes. One was a decision by the industry's giant, State Farm, to reduce rates for huge numbers of drivers even to the point of costing that company billions of dollars. Getting the right people to switch was very difficult when they were enjoying unprecedented decreases in premiums. The other was a liability claims cost crisis in New York, which by our own decision was Response's most important state. This cost everyone writing in New York dearly; for Response, which was virtually a New York-only company at first, it was particularly painful. The published loss ratio for 2001 was 88% and the general expense ratio was around 40%. The numbers Response will be publishing for calendar 2002 show the loss ratio of about 70%, finally reaching the range that can sustain a successful direct writer. A portion of the improvement came from the 2001 acquisitions, a portion came from a recapture of some 2001 over reserving, and a third contributor was substantially enhanced product sophistication and targeted pricing increases. The last was made possible, in part, by the fulfillment of Response's managerial objective. John Javaruski, an actuary by background who oversaw the successful turnaround a few years ago of the Kemper Direct loss ratio, joined Response as Mory's number two. His impact is plainly visible.

On the expense ratio side, there was also good progress, but it takes some explaining to find it in the published numbers. Response left its expensive Westchester headquarters behind and consolidated its operations at the Connecticut offices of its subsidiary, Connecticut Life and Casualty. There was an accompanying reduction in staffing. While the general expense ratio for 2002 will look even worse than the prior year's number, that comparison blurs the distinction between on-going costs and restructuring costs. At least five million dollars have been removed from the company's run rate expenses. This is a step in the right direction, but another step of much greater significance was taken just after year-end. Response announced in January that it will be purchasing the direct response auto insurance subsidiaries of Great American Financial Group. This acquisition, when approved, will assure that 2003 can be a rapid growth year once again. On a pro forma basis, we can think of Response as a \$125 million company now, among



the 100 largest auto insurers in the country and one of the fifteen largest direct response carriers. Its leaner expense base and the increased scale, taken together, allow Mory to predict a much improved expense ratio for 2003. It appears that Response will finally reach renewal breakeven.

I have long thought in terms of three milestones a direct response auto writer must pass. The first is renewal breakeven, where revenues from the renewed book of business exactly cover losses and expenses on that book. The second is passed when the renewal profit is sufficient to fund a reasonable growth rate for new business. This requires a more profitable renewal book than the first marker, because the new business written inevitably runs at a substantial first-year loss. The third milestone, and a breakthrough for investor valuation, occurs when there is a moderate profit even at a handsome growth rate or a handsome profit at a moderate growth rate. To fund first-year losses on rapid growth, and still have something left over for the owners, requires a generous margin on a large block of renewed business. Only the first milestone is now in sight for Response, but this is no small event. Once that is passed, it takes time, hard work and competence to reach the other milestones, but the capital of the business should be secure. More scale and a proven engine for generating internal growth at solid metrics are the next challenges for Response. While getting there more slowly than Peter Wood and I had hoped when we founded Response means that the rate of return on our 1995 Response investment may disappoint, I will consider getting there at all to be a success. The signs at least are now pointing the right way.

Homesite Group's story may look similar on the financial statements, but it is actually quite a different situation. While that company, a national homeowners writer, is behind its original growth plan too, the reasons have little in common. Where Response needs a large call center infrastructure and marketing budget to generate its new business, Homesite gets its volume from partners who already have access to the customers. The call center cost requirements are much smaller and the branding expense is virtually nil. Whereas Response has to season new business to achieve a decent loss ratio, Homesite's business has been running a pure loss ratio near 50% from the start. Whereas Response has yet to build a reliable internal growth engine, Homesite's partnership relationships already in place should provide at least 60% growth next year. Fabian Fondriest could use a COO, but, all in all, he and his management team are as strong as I have ever seen in a five-year-old company.

The Homesite partners, supplying the business to supplement their own auto insurance products, include General Motors, General Electric, Metropolitan, Prudential, and Nationwide – with more well known names to come. Reinsurance is not proving a problem. In fact, in the aftermath of September 11, the familiar lines of domestic property catastrophe coverage, especially in the personal lines, are welcomed by new and old reinsurers alike at reasonable rates. Homesite's only serious issue is that it hasn't yet the scale to pay for its general expenses, but it is getting close, and all of the other key metrics for the business are good enough already. I am very happy with Plymouth Rock's investment in Homesite. While the financials display none of this, the investment has probably increased in value this year, not just because of the company's progress, but because the founders, among whom Plymouth Rock is the largest holder, have acquired from certain of the original investors call options that became ours when those investors decided not to participate in a long-scheduled round of financing. These calls, if exercised, could increase the founders' stake from close to 20% to more than twice that by letting us buy out some of the

original investors at or near their cost bases. We have three years to decide whether to exercise the calls, and paying out a strike price of over \$50 million will make sense, of course, only if Homesite is taking off, but my instinct says that those calls are going to enhance your investment in a successful business.

This was another poor year for most equity investors, with the major common stock indices having fallen by about 20% of their value. We have a portfolio for the Plymouth Rock Companies which is close to one-third invested in equity instruments of various kinds, so we could not escape the impact entirely. Nonetheless, we had a better year in investments than a great many of our peers. The overall portfolio return was about 3% on a total return basis. Bonds are still our largest portfolio component, and they had a decent year, returning us 4.7% pre-tax in interest and another 2.6% in realized and unrealized gains. Our marketable common stocks were down about 10.5%, which combined with a point and a half of dividends, meant a 9% loss in total return. This was a great deal better than the markets as a whole, and allowed our from-inception IRR on marketable common stock investments to remain above 22%. Equity alternatives and equivalents, mostly funds that own specialized portfolios of equity type securities, earned us 3% this past year. Our owner-occupied real estate, mostly in downtown Boston, had its first poor year according to the appraisers. Based on the appraisals, we consider our holdings in that category to be down about 13% for the year. This is a good estimate, no doubt, of the trend in Boston real estate generally. I can't resist pointing out, however, that I may be more bullish than the experts about our 695 Atlantic Avenue headquarters building, located exactly at the transportation hub of the city, and right where the Big Dig construction work is being completed first. The avenue in front, after having been torn up for years, looks beautiful already, and the building is acceptably full. We are selling the small property we have owned in Concord, New Hampshire at a decent profit, but we are not likely to be sellers on Atlantic Avenue.

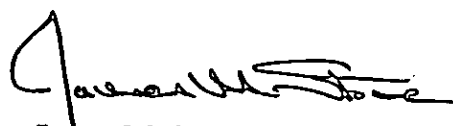
Stock prices look a bit better to us, as investors of new money, than they did before. Plainly, there are bargains available now that were not there just a few years ago, and we have done some cautious and selective buying. Jim, Rick and I would all feel better, though, if there were not such uncertainty surrounding the U.S. fiscal picture. Tax cuts and wars aren't necessarily a compatible couple. Similarly, the market seems to have forgotten about the danger of additional terrorist events, which makes its prices subject to a downward shock if a serious attack occurs. It has taken a host of favorable factors, moreover, to keep inflation such a non-issue for so long a period. Whether that combination will remain in place is far from certain right now. Having been a financial sector regulator for eight years, I am also of the view that the corporate governance scandals of 2002 tend to undermine market confidence. It takes good regulation and good behavior to make a free market work well. We would, therefore, consider a strengthened SEC, and stronger disclosure rules, bullish forces for the markets.

I mentioned last year our Company's participation, and my own, in the new Lindsay Goldberg & Bessemer Fund. I am pleased to report that the new fund has raised its planned \$2.0 billion in limited partnership interests. Not many investors other than Bob Lindsay and Alan Goldberg could have accomplished that in 2002. We now look forward to making some money through investing with LGB.

More important for our capital position, though, than anything we will do in the investment markets is that we had in 2002 a special opportunity to repurchase some of our own shares. At the start of the year, Progressive Casualty Insurance owned 26% of Plymouth Rock. Glenn Renwick, the CEO of Progressive, served on the PRC Board. Over the year, Glenn expressed increasing concern that Plymouth Rock's emphasis on New Hampshire and Connecticut was a harbinger that the two companies would become more and more competitive. Uncomfortable owning so much of a competitor, or potential competitor, Progressive offered to sell back to the Company enough shares to bring Progressive's holdings in Plymouth Rock below 10% of the shares outstanding. This is an important threshold because it is used by some insurance departments to test whether there exists a presumptive control relationship.

Progressive offered to sell 40,701 shares over the next five years with a scheduled sales price beginning at \$625 for the 2003 tranche and rising thereafter. There was also a provision that, if we completed the entire transaction before mid-year 2003, there would be a favorable discount from the multi-year price schedule. Given that the base year offer price was roughly at GAAP book value and considerably below appraisal value, the Board accepted the offer. Progressive will, on completion of the repurchase, become a 9% shareholder and the number of shares outstanding will ultimately be reduced by nearly a fifth. Glenn has also resigned from the Board, where he will be missed. I hope to remain corporate friends with Progressive, within the limits defined by a conservative reading of the anti-trust laws. Theirs is the most impressive story in my business lifetime in the personal insurance lines, and their business has been conducted with integrity as well as acumen.

This is the only annual report letter you have ever received, or are likely to receive, written from Paris. Sometime in the 1980's, when Plymouth Rock was very small, I asked the investors for the right to take a six-month sabbatical every five years. I asked for and received a parallel privilege from the Response and Homesite investors. The first five years at Plymouth Rock went by, and I waived my opportunity. The same happened after the second five years. This year, as we approach a twentieth anniversary celebration at Plymouth Rock, I just had to take the sabbatical. For many years now, I have had in mind to write a book, and I am hard at work trying to do so. If I am right about the benefits of sabbaticals, I should return to the Company in July with a clearer head, renewed energy, and a broader perspective. If not, I will at least return happy and extremely well fed.



James M. Stone

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, 2002 and 2001, 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.

*PricewaterhouseCoopers LLP*

Boston, Massachusetts  
February 6, 2003, except as to Note 12  
for which the date is March 5, 2003

**THE PLYMOUTH ROCK COMPANY**  
**CONSOLIDATED BALANCE SHEETS**

**December 31, 2002 and 2001**

<b>Assets</b>	<u>2002</u>	<u>2001</u>
Cash and cash equivalents	\$ 18,369,952	\$ 19,808,169
Investment securities	216,860,669	197,589,976
Premiums receivable	29,365,987	25,638,442
Accrued investment income	1,792,494	1,936,905
Receivable from reinsurers	34,112,487	34,281,433
Real estate	23,360,296	22,125,291
Deferred acquisition costs	8,595,038	8,336,942
Fixed assets	10,836,402	7,869,437
Deferred income taxes	5,062,617	5,095,008
Goodwill and intangible assets	3,450,287	4,577,845
Amounts due from service clients	4,243,842	3,400,267
Other assets	<u>5,548,051</u>	<u>4,022,109</u>
Total assets	<u>\$361,598,122</u>	<u>\$334,681,824</u>
<b>Liabilities</b>		
Claim and claim adjustment expense reserve	\$105,597,045	\$105,367,683
Unearned premium reserve	54,787,182	46,316,440
Payable to reinsurers	18,886,910	15,886,911
Advance premiums	8,591,575	7,052,832
Note payable	5,810,040	6,778,380
Commissions payable and accrued liabilities	25,819,006	20,958,370
Unearned service fees	1,687,869	2,699,023
Amounts due to service clients	7,900,454	6,420,971
Other liabilities	<u>326,577</u>	<u>2,540,602</u>
Total liabilities	<u>229,406,658</u>	<u>214,021,212</u>
<b>Stockholders' Equity</b>		
Common stock and paid-in capital	21,454,625	21,454,625
Retained earnings	103,621,137	92,894,559
Net unrealized gain on investments	<u>7,115,702</u>	<u>6,311,428</u>
Total stockholders' equity	<u>132,191,464</u>	<u>120,660,612</u>
Total liabilities and stockholders' equity	<u>\$361,598,122</u>	<u>\$334,681,824</u>

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, 2002 and 2001**

<b>Revenues</b>	<u>2002</u>	<u>2001</u>
Premiums earned in underwriting activities	\$141,285,688	\$127,955,823
Fees earned from service activities	32,093,162	28,329,835
Investment income and capital gains	<u>14,729,533</u>	<u>16,917,953</u>
Total revenues	<u>188,108,383</u>	<u>173,203,611</u>
 <b>Expenses</b>		
Claims and claim adjustment expenses	97,580,869	91,517,913
Policy acquisition, underwriting and general expenses	44,753,662	42,865,622
Service activity expenses	<u>28,840,860</u>	<u>23,727,568</u>
Total expenses	<u>171,175,391</u>	<u>158,111,103</u>
 Income before federal income taxes	16,932,992	15,092,508
Federal income taxes	<u>5,178,830</u>	<u>4,824,818</u>
Net income	<u>\$ 11,754,162</u>	<u>\$ 10,267,690</u>

<b>Per share data</b>		
Weighted average common shares outstanding	219,101	219,014
Net income per share	\$53.65	\$46.88
Common shares outstanding at end of year	219,101	219,101
Common stockholders' equity per share	\$603.34	\$550.71

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, 2002 and 2001**

<b>Cash flows from operating activities</b>	<u>2002</u>	<u>2001</u>
Gross premiums collected	\$213,581,771	\$189,975,654
Reinsurance premiums paid	(61,836,742)	(60,596,200)
Finance charges collected	4,546,488	3,490,184
Fees and commissions collected	29,904,647	21,748,030
Investment income and capital gains received	11,814,154	14,467,636
Gross claims and claim expenses paid	(145,346,574)	(134,220,836)
Reinsured claims and claim expenses collected	47,865,819	45,025,553
Policy acquisition, underwriting and general expenses paid	(42,684,515)	(40,047,141)
Federal income taxes paid	(6,598,745)	(5,875,000)
Service activity expenses paid	(24,902,523)	(17,524,954)
Net cash provided by operating activities	<u>26,343,780</u>	<u>16,442,926</u>
<b>Cash flows from financing activities</b>		
Payment on note payable	(968,340)	(968,340)
Issuance of common stock	-0-	99,960
Dividends to stockholders	(1,027,584)	(1,392,726)
Net cash used in financing activities	<u>(1,995,924)</u>	<u>(2,261,106)</u>
Net cash provided	<u>\$ 24,347,856</u>	<u>\$ 14,181,820</u>
<b>Investment of net cash provided</b>		
Change in cash and cash equivalents	\$ (1,438,217)	\$ (51,187,298)
Net investment activity	17,960,502	57,996,260
Purchase and disposal of goodwill and intangible assets	(760,670)	884,959
Purchases of real estate	1,971,248	2,320,931
Purchases of fixed assets	6,614,993	4,166,968
Net cash invested	<u>\$ 24,347,856</u>	<u>\$ 14,181,820</u>

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, 2002 and 2001**

	Common Stock and Paid-in Capital	Retained Earnings	Net Unrealized Gain/(Loss) on Investments	Total Stockholders' Equity
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	<u>-0-</u>	<u>(1,392,726)</u>	<u>-0-</u>	<u>(1,392,726)</u>
December 31, 2001	\$21,454,625	\$ 92,894,559	\$6,311,428	\$120,660,612
Comprehensive income	-0-	11,754,162	804,274	12,558,436
Dividends to stockholders	<u>-0-</u>	<u>(1,027,584)</u>	<u>-0-</u>	<u>(1,027,584)</u>
December 31, 2002	<u>\$21,454,625</u>	<u>\$103,621,137</u>	<u>\$7,115,702</u>	<u>\$132,191,464</u>

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

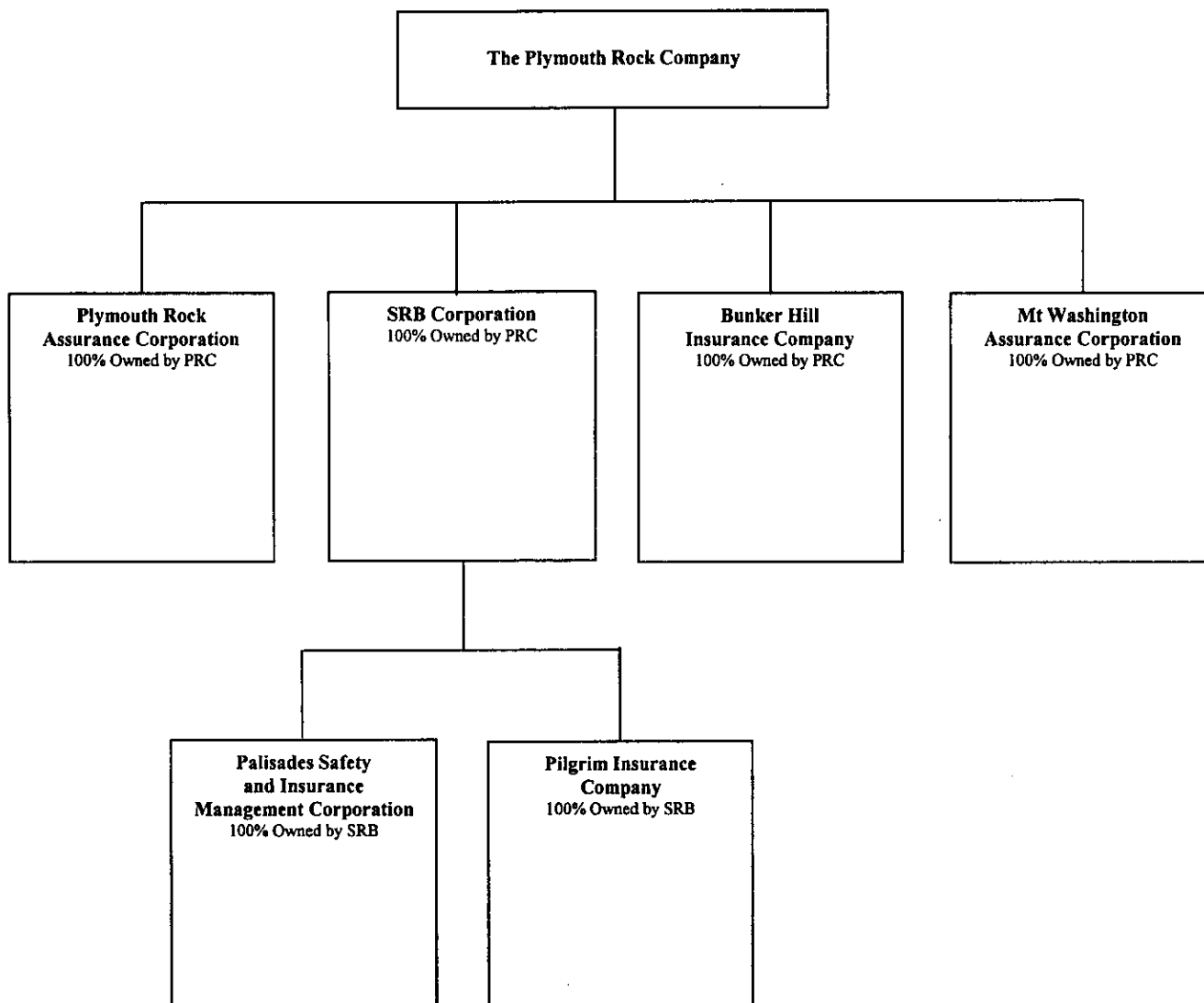


# THE PLYMOUTH ROCK COMPANY

## NOTES TO CONSOLIDATED 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 99 Bedford Corporation and 695 Atlantic Avenue Company, LLC, which own real estate, and BCS Holding Company, LLC, a wholly owned subsidiary of Plymouth Rock Assurance Corporation and owner of an independent insurance agency, Neighborhood Insurance, LLC. Direct Response Corporation and Homesite Group Incorporated are not among the Plymouth Rock Companies, but The Plymouth Rock Company owns a common and a 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.

**B. Investments and Real Estate**

Cash and cash equivalents include short-term money market instruments 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. Where declines in the value of marketable securities are deemed other than temporary, the securities are carried at market value and the loss is reported as a component of net realized gains or losses on the sale of securities. 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. 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.

**D. 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 for 2002 and 2001 consist of:

	<u>2002</u>	<u>2001</u>
Current year federal income taxes	\$5,725,169	\$5,176,908
Change in deferred taxes	(546,339)	(352,090)
Total	<u>\$5,178,830</u>	<u>\$4,824,818</u>

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. Summary of Significant Accounting Policies, continued**

**D. Income Taxes, continued**

Deferred income taxes in the balance sheets as of December 31, 2002 and 2001 consist of the net effect of these temporary differences:

	<u>2002</u>	<u>2001</u>
Discounting of claim reserves	\$2,926,146	\$2,742,660
Deferred income	5,465,067	4,237,427
Net unrealized gain on investments	(3,830,072)	(3,251,342)
Other	<u>501,476</u>	<u>1,366,263</u>
Total	<u>\$5,062,617</u>	<u>\$5,095,008</u>

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 difference arises principally because the Company receives significant nontaxable interest from state and municipal bonds.

**E. 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 \$1,164,095 and \$1,130,013 at December 31, 2002 and 2001, respectively, and are presented net of unbilled amounts of \$24,055,487 and \$21,538,714, 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 items, amounts due from (to) service clients, are balances with insurers who contract for services from Pilgrim Insurance Company and Palisades Safety and Insurance Management Corporation. The latter company has a management arrangement with Palisades Safety and Insurance Association, a reciprocal insurance exchange that writes personal lines business in New Jersey.

**F. 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.

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. Summary of Significant Accounting Policies, continued**

**F. Reinsurance, continued**

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:

	2002		2001	
	Premiums Written	Losses Incurred	Premiums Written	Losses Incurred
Gross	\$217,109,985	\$145,565,936	\$184,619,404	\$133,492,457
Ceded	(65,828,318)	(47,985,067)	(52,149,737)	(41,974,544)
Net	<u>\$151,281,667</u>	<u>\$ 97,580,869</u>	<u>\$132,469,667</u>	<u>\$ 91,517,913</u>

Ceded premiums earned for 2002 and 2001 were \$60,262,620 and \$48,481,860, 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 \$42 million and \$37 million for 2002 and 2001, respectively.

The Company has treaties for catastrophe reinsurance. During the years ended December 31, 2002 and 2001, the Company incurred catastrophe premiums of approximately \$1,731,000 and \$1,466,000, respectively. During 2002, the Company received approximately \$3,005,000 related to its experience under a terminated catastrophe reinsurance treaty for the two and one-half years ended June 30, 2002.

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 motor vehicle insurance programs. The Company's income statement and reinsurance activity exclude premiums earned related to this third-party business of \$43,931,971 and \$38,158,764 and claims and claim adjustment expenses of \$54,536,676 and \$46,712,621 in 2002 and 2001, respectively. In connection with these arrangements, claim reserves exclude \$43,856,143 and \$34,802,380 at December 31, 2002 and 2001, respectively.

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. Summary of Significant Accounting Policies, continued**

**G. Claims and Claim Adjustment Expense Reserves**

Claims 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. Claims 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 reserves for claims and claim adjustment expenses:

	<u>2002</u>	<u>2001</u>
Balance at beginning of year	\$105,367,683	\$105,788,472
Claims and claim adjustment expenses incurred:		
Current year	110,447,000	104,943,000
Prior years	(8,014,202)	(9,949,490)
	<u>102,432,798</u>	<u>94,993,510</u>
Claims and claim adjustment expenses paid:		
Current year	63,424,000	58,560,000
Prior years	38,694,851	38,586,760
	<u>102,118,851</u>	<u>97,146,760</u>
Change in reinsurance recoverable on unpaid claims	<u>(84,585)</u>	<u>1,732,461</u>
Balance at end of year	<u>\$105,597,045</u>	<u>\$105,367,683</u>

Loss development in involuntary business accounts for approximately \$2.7 million and \$4.7 million of the prior years reserve changes in 2002 and 2001, respectively.

Claims and claim adjustment expenses incurred, shown above, include expenses for service activity clients of \$4,851,929 and \$3,475,597 reported in service activity expenses in the Company's consolidated statements of income for 2002 and 2001, respectively.

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**3. Consolidated Revenues**

Revenues, net of reinsurance, for the separate companies for 2002 and 2001 were:

	2002	2001
The Plymouth Rock Company	\$ 8,038,643	\$ 6,938,046
Plymouth Rock Assurance Corporation	147,663,909	136,090,470
Mt Washington Assurance Corporation	429,676	408,193
Bunker Hill Insurance Company	19,029,879	18,200,982
SRB Corporation	7,448,448	5,943,346
Pilgrim Insurance Company	18,930,193	18,375,534
Palisades Safety and Insurance Management Corporation	10,872,036	7,549,268
	<u>212,412,784</u>	<u>193,505,839</u>
Intercompany eliminations	(24,304,401)	(20,302,228)
Total revenues	<u>\$188,108,383</u>	<u>\$173,203,611</u>

**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:

	2002	2001
Net income	\$11,754,162	\$10,267,690
Depreciation and amortization	5,950,465	4,887,572
Change in operating assets and liabilities:		
Premiums receivable	(3,727,545)	2,508,806
Accrued investment income	144,411	(471,240)
Receivable from reinsurers	168,946	(310,133)
Deferred acquisition costs	(258,096)	277,571
Deferred income taxes	(546,339)	(352,090)
Claim and claim adjustment expense reserve	229,362	(420,789)
Unearned premium reserve	8,470,742	3,270,718
Payable to reinsurers	2,999,999	(9,121,406)
Advance premiums	1,538,743	879,473
Commissions payable and accrued liabilities	4,933,427	5,510,902
Unearned service fees	(1,011,154)	(2,695,764)
Amounts due to and from service clients	635,908	5,604,892
Other assets and other liabilities	(4,939,251)	(3,393,276)
Net cash provided by operating activities	<u>\$26,343,780</u>	<u>\$16,442,926</u>

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**5. Commitments and Guarantees**

The Company's rental expenses for 2002 and 2001 aggregated approximately \$1,177,000 and \$1,155,000, respectively. For the years 2003 through 2009, the minimum lease obligations of the Company range from approximately \$66,000 to \$2,410,000 annually. Total obligations of the Company under leases are approximately \$12,250,000 through 2009.

As of December 31, 2002, 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 2002 and are not expected to result in any net liability to the Company.

**6. 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 aged 21 years or older. The Company accrued \$1,776,097 and \$1,556,759 as of December 31, 2002 and 2001, 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 \$4,985,151 and \$4,160,238 as of December 31, 2002 and 2001, respectively, for liabilities relating to these plans. At December 31, 2002, the Company is contingently liable under these plans to pay an additional \$577,780 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, 2002 and 2001 was 11,033 and 9,389, respectively. The Company has recorded compensation expense of \$355,500 and \$311,080 in 2002 and 2001, 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.

**7. Fixed Assets**

Purchases of fixed assets were approximately \$6,615,000 and \$4,167,000 in 2002 and 2001, respectively. The table below summarizes fixed assets at December 31, 2002 and 2001.

	Useful Lives	2002	2001
Furniture and fixtures	5-10 years	\$ 4,143,576	\$ 3,636,797
Computers and software development	3-5 years	18,046,741	13,424,994
Leasehold improvements	2-6 years	3,075,347	2,583,352
Vehicles	3 years	2,028,717	1,425,090
Total cost		27,294,381	21,070,233
Less: accumulated depreciation and amortization		16,457,979	13,200,796
Net book value		<u>\$10,836,402</u>	<u>\$ 7,869,437</u>

# THE PLYMOUTH ROCK COMPANY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 8. Real Estate

The Company had ownership interests in three real estate properties as of December 31, 2002. One of these interests is a two-thirds ownership interest through a limited liability company. This investment is accounted for under the equity method. Building improvements of approximately \$333,571 and \$797,916 were incurred in 2002 and 2001, respectively. The table below summarizes real estate at December 31, 2002 and 2001.

	2002	2001
Land	\$ 4,697,778	\$ 4,697,778
Buildings, improvements and other	22,645,429	20,674,181
Total cost	27,343,207	25,371,959
Less: accumulated depreciation	3,982,911	3,246,668
Net book value	<u>\$23,360,296</u>	<u>\$22,125,291</u>

Rental income other than from Plymouth Rock companies aggregated approximately \$4,457,000 and \$4,226,000 in 2002 and 2001, respectively. For each of the years 2003 through 2007, minimum annual rent receivable by the Company is approximately \$2,072,000. Total obligations of lessees through 2007 are approximately \$10,360,000. 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 2002 using the income and sales comparison approaches, was \$31.4 million. Because of uncertainties inherent in the appraisal process, as well as changing market conditions, the amounts that could be realized if the properties were actually offered for sale may differ from these appraised values.

Subsequent to December 31, 2002, the Company sold one of its real estate interests. This real estate interest was sold for approximately \$1,350,000 and had a cost basis at the time of the sale of approximately \$900,000.

### 9. 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 \$398,000 and \$459,000 during 2002 and 2001, respectively. The Company has the right to prepay this note at any time.



# THE PLYMOUTH ROCK COMPANY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 10. Investment Securities and Investment Income

#### A. Marketable Securities

At December 31, 2002 and 2001, amortized cost, unrealized gains and losses before federal income taxes, and fair value of fixed income and equity securities were as follows:

At December 31, 2002:	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government securities	\$ 48,106,284	\$ 1,332,466	\$ -0-	\$ 49,438,750
State and municipal securities	44,749,400	2,164,523	51	46,913,872
Corporate debt securities	27,270,023	1,244,035	43,665	28,470,393
Mortgage-backed securities	15,733,493	380,434	5,534	16,108,393
Common stocks	31,212,180	6,876,314	1,387,686	36,700,808
Total	<u>\$167,071,380</u>	<u>\$11,997,772</u>	<u>\$ 1,436,936</u>	<u>\$177,632,216</u>

At December 31, 2001:	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government securities	\$ 23,327,598	\$ 555,719	\$ 88,840	\$ 23,794,477
State and municipal securities	43,368,446	795,054	110,230	44,053,270
Corporate debt securities	42,897,529	983,942	107,948	43,773,523
Mortgage-backed securities	19,862,335	461,266	21,573	20,302,028
Common stocks	18,713,896	7,129,992	419,528	25,424,360
Total	<u>\$148,169,804</u>	<u>\$ 9,925,973</u>	<u>\$ 748,119</u>	<u>\$157,347,658</u>

At December 31, 2002, maturities of marketable securities were as follows:

	Amortized Cost	Fair Value
Due in 90 days or less	\$ 75,103	\$ 75,182
Due after 90 days and in one year or less	4,694,893	4,764,406
Due after one year and in five years or less	102,567,819	106,238,788
Due after five years and in ten years or less	17,124,962	18,071,878
Due after ten years	11,396,423	11,781,154
Common stocks	31,212,180	36,700,808
Total	<u>\$167,071,380</u>	<u>\$177,632,216</u>

The Company classifies these marketable securities as available for sale.

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**10. Investment Securities and Investment Income, continued**

**B. Alternative Equity Investments**

Alternative equity investments include entities that focus predominantly on publicly announced mergers and acquisitions arbitrage. Substantially all of the investments made by these entities are in publicly traded securities, and the Company has the contractual right to withdraw its funds from these entities each year. At December 31, 2002 and 2001, the Company's recorded equity in these alternative equity investments, which includes realized and unrealized gains, was \$26,306,353 and \$27,525,281, respectively. The costs of these investments were \$19,000,000 in each of 2002 and 2001.

Other alternative equity investments include privately held common stocks, preferred stocks, surplus notes and single-purpose entities investing in companies that are not publicly traded. The Company's recorded equity amounted to \$12,922,100 and \$12,717,037 at December 31, 2002 and 2001, respectively. The Company recorded unrealized gains of \$384,938 and \$384,916 associated with one of these investments as of December 31, 2002 and 2001, respectively. The costs of these investments were \$16,951,465 and \$16,504,332, respectively. These amounts include investments in Direct Response Corporation and Homesite Group Incorporated totaling approximately \$9.8 million at December 31, 2002 and 2001. These companies derive underwriting revenue from personal lines property and casualty insurance activity throughout the United States, except in certain New England states.

The Company has committed to invest \$10 million in a private equity fund, Lindsay Goldberg & Bessemer L.P. (the "Fund"). The Company is a limited partner of the Fund. The chairman of the Company is a member of the general partner of the Fund.

**C. Investment Activity**

The components of investment activity during 2002 and 2001 were as follows:

	2002	2001
Balance at beginning of year	\$197,589,976	\$143,328,787
Change in marketable securities:		
Sales	(127,780,084)	(68,684,987)
Purchases	146,754,429	117,865,400
Net change in marketable securities	18,974,345	49,180,413
Net change in investments in alternative equities	(1,013,843)	8,815,847
Net investment activity	17,960,502	57,996,260
Net change in purchases in process	(72,813)	(1,543,683)
Net change in unrealized gain on marketable securities and alternative equities	1,383,004	(2,191,388)
Balance at end of year	<u>\$216,860,669</u>	<u>\$197,589,976</u>

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**10. Investment Securities and Investment Income, continued**

**C. Investment Activity, continued**

Comprehensive income is defined as net income plus the change in net unrealized gain on investments. Accordingly, the net unrealized gain on investments is reduced by realized gains previously included as unrealized in comprehensive income of \$1,061,968 and \$139,720 in 2002 and 2001, respectively.

**D. Analysis of Investment Income and Capital Gains**

The components of investment income and capital gains before federal income taxes during 2002 and 2001 were as follows:

	2002	2001
Interest income and dividends from securities	\$ 7,605,816	\$ 8,319,456
Earnings from alternative equity investments	274,506	2,078,435
Rental income	4,456,891	4,225,978
Finance charges from premiums receivable	4,546,488	3,490,184
Gross investment income	16,883,701	18,114,053
Rental expenses	(2,271,335)	(2,229,842)
Investment expenses	(613,591)	(562,463)
Investment income	13,998,775	15,321,748
Net realized capital gains	730,758	1,596,205
Investment income and capital gains	<u>\$14,729,533</u>	<u>\$16,917,953</u>

**11. Goodwill and Intangible Assets**

Goodwill of \$2,282,226, representing the excess of the purchase price over the estimated fair value of net assets acquired, results from the purchase of insurance agencies. Effective January 1, 2002, the Company ceased amortizing goodwill in accordance with new accounting rules. The Company now reviews goodwill annually for impairment. No impairment of goodwill was recorded for 2002. Had the Company not amortized goodwill of \$198,202 during 2001, net income and earnings per share would have been approximately \$10,396,521 and \$47.47, respectively. Intangible assets of \$1,168,061, representing expirations and non-competition agreements, also exist as a result of the purchase of insurance agencies and are being amortized over periods ranging from three to seven years. Amortization associated with these intangible assets for 2002 and 2001 was \$366,892 and \$252,769, respectively.

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**12. Stockholders' Equity**

**A. Common Stock**

Common stock at December 31, 2002 and 2001 is composed of Class A common shares and Class B common shares, both classes having a par value of \$0.10 per share. There are 300,000 Class A shares authorized, of which 152,732 and 152,596 were issued and outstanding on December 31, 2002 and 2001, respectively.

There are 90,000 Class B shares authorized, of which 66,369 and 66,505 were issued and outstanding on December 31, 2002 and 2001, respectively. The Class A common shares are fully transferable and have the right to elect twenty percent of the Board of Directors. The Class B common shares are not transferable, but may be converted to Class A common shares on a one-for-one basis at any time at the option of the holder, or automatically upon the occurrence of certain events. The Class B common shares elect eighty percent of the Board of Directors.

In December of 2002, the Company entered into an agreement with one of its shareholders to repurchase 40,701 shares of Class A common shares. On January 31, 2003 and March 5, 2003, the Company repurchased and retired 9,600 and 31,101 shares of Class A common shares for payments of \$6,000,000 and \$18,660,600, respectively.

**B. Statutory Surplus and Dividend Availability**

The Company's insurance subsidiaries are required to file financial statements with state insurance departments. The accounting principles prescribed or permitted for these financial statements differ in certain respects from generally accepted accounting principles. On a statutory accounting basis, capital and surplus of the Company's insurance subsidiaries aggregated approximately \$82,864,016 and \$79,686,645 at December 31, 2002 and 2001, respectively. Regulatory limits restrict the amount of dividends that can be remitted to the Company from its insurance subsidiaries without permission of state insurance regulators.

Subsequent to year-end, a consolidated insurance subsidiary made a loan of \$8 million to the Company and a loan of \$8.5 million to one of its consolidated subsidiaries on February 21, 2003 and January 31, 2003, respectively. Additionally, an extraordinary dividend of \$6.7 million was approved from the same consolidated insurance subsidiary by the Massachusetts Division of Insurance and was paid to the Company on February 20, 2003.

Revised statutory accounting principles became effective on January 1, 2001. The changes in statutory accounting rules relating to the treatment of taxes increased the Company's statutory surplus by \$5.6 million.

**C. Earnings per Share**

Earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding. Basic and diluted earnings per share are equal.

## **Directors and Officers of The Plymouth Rock Company**

### **Directors**

James M. Stone, *Chairman*  
Peter J. Wood, *Vice Chairman*  
James N. Bailey  
Hal Belodoff  
Michael J. Johnston  
Wilmot H. Kidd, III  
Norman L. Rosenthal

### **Officers**

James M. Stone  
*President*  
James N. Bailey  
*Treasurer and Clerk*  
Hal Belodoff  
*Vice President*  
Paula W. Gold  
*Vice President*

## **Directors and Officers of the Plymouth Rock Group of Companies**

### **Non-Management Directors**

Alexander Ellis, III  
Michael J. Johnston  
William M. Kelley  
Wilmot H. Kidd, III  
Eugene J. Meyung  
Norman L. Rosenthal  
Peter J. Wood

### **Management Officers and Directors**

Francis P. Arment  
Geoffrey H. Arnold  
James N. Bailey  
Hal Belodoff  
Marc V. Buro  
Frederick C. Childs  
John W. Delano  
William E. Emmons  
Paula W. Gold  
Stewart W. Kemp  
Michael A. Luciani  
Paul D. Luongo  
Loren J. Mattingly  
Mary Beth McNerney  
Karen A. Murdock  
Eric W. Neely  
Vincent V. Nieroda  
Peter A. Phelps  
Donald J. Southwick  
James M. Stone  
Mark A. Sweeney  
Barry O. Tagen  
John P. Tierney  
Gerald I. Wilson

**Independent Accountants:**  
PricewaterhouseCoopers LLP

**Counsel:**  
Ropes & Gray