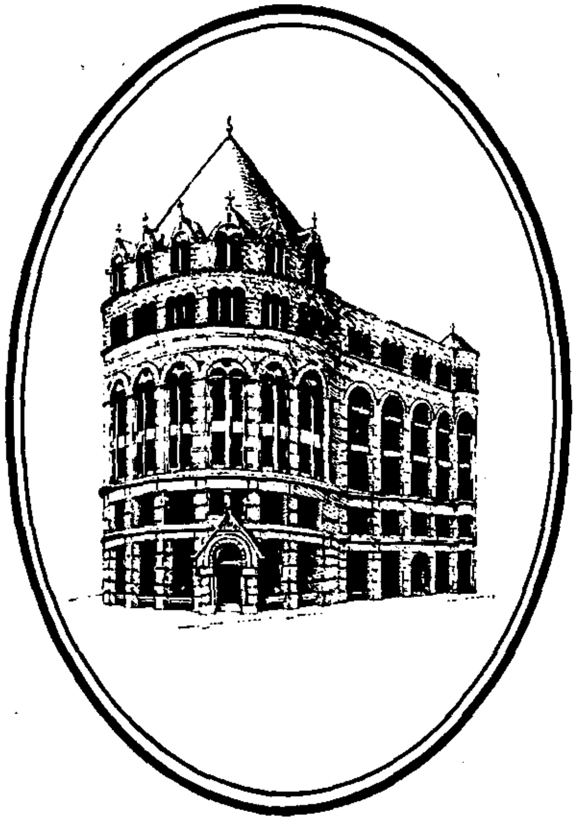
The Plymouth Rock Company



1985 Annual Report

The Plymouth Rock Company

INCORPORATED
177 Milk Street
Boston, Massachusetts 02109

Chairman's Letter

March 31, 1986

To Our Shareholders:

Our projections for Plymouth Rock Assurance Corporation in 1985 had set out a tough objective: profitability in our second year. It is satisfying to be able to report that we recorded, in fact, a modest net income for the year. Welcome as these results may be, I hope they will not be misunderstood. Our performance must be measured over decades, rather than months or years. Insurance is more a marathon than a sprint, and Plymouth Rock is but a few inches from the starting line.

Growth is the commanding feature of our 1985 numbers. Net Premiums Earned, the top line of the income statement, rose from $2.2 million to $4.1 million. A better measure of the expansion might be Gross Premiums Written, a figure not customarily displayed in the financials. This is the volume our agents entrusted to us, the amount our policyholders were billed, and the index of our staff's workload. Our Gross Premiums Written rose from $3.7 million in 1984 to $11.7 million in 1985. We had roughly 7,500 policyholders in 1984; by the end of 1985 we had close to 25,000.

Our management budget envisioned a $10.1 million year for Gross Premiums Written. As things turned out, we passed our marks in homeowners and in servicing carrier automobile volume. In both lines I believe the extra volume was induced by Plymouth Rock's growing reputation for good service. If I am right, the same conditions bode well for next year's business growth.

Our Loss Ratio in 1985 was 69%, almost identical to our 1984 Loss Ratio. This is better than industry averages and looks better still if we are compared to other newly formed companies. Rigorous risk selection and rapid growth are compatible for a new company only in the presence of careful pre-screening by agents and intensive computer support for underwriters. Traditionally equipped underwriters in affordable numbers would never have time enough to consider each new risk to the point of sophisticated judgment. One strategy available to new companies is to grow for a time with highly tolerant underwriting, accepting a high initial loss ratio. Then later they can begin to refine and season the book of business as full staffing becomes more affordable. We have committed ourselves instead to concentrate on underwriting from inception. This requires a considerable expenditure for mathematical and statistical talent as well as state-of-the-art data management capability in our computers.

The piper must be paid for all of this support. The costs show up in the Expense Ratio. We think we can save more than a dollar in losses for every expense dollar committed to underwriting rigor. Even if it were an even trade, though, we would take it. An excessive Expense Ratio can be trimmed more easily than a wayward Loss Ratio can be set back on the straight and narrow. We feel more secure confronting the harder of the two tasks first.

It will get tougher to keep the Loss Ratio in line before it gets easier. Even the most carefully selected book of business changes in character over time. Families with children become families with additional drivers. Cars and homes get older and eventually deteriorate. People undergo changes in their habits, sometimes for the worse. We have selected each new risk with great care. Now, beginning in 1986, we will look at our book afresh each year, removing dangerous automobile risks to the state reinsurance pool and pulling improved risks back out of the pool. There are no illusions that our present Loss Ratio will maintain itself automatically.

Our Loss Ratio for 1985 would have been even better had it not been for Hurricane Gloria, which hit us on September 27. The press had portrayed the nascent storm as an apocalypse, so we prepared for the worst. When it was over, the press described it as a dud. They must not have seen the insurance statistics. Gloria did more insured damage in Massachusetts than all previous hurricanes of the last three decades put together. Eloise and Belle, the big storms of the mid-seventies, did about $2 million apiece in the kind of damage that shows up in the Massachusetts claim statistics. Gloria will have been responsible for at least $40 million in damages. Storm claims cost us about $200,000 before reinsurance and just over $105,000 net of reinsurance. We wish Gloria hadn't visited, of course, but we also realize that the unpredictability of events like Gloria is precisely what makes people need us.

The silver lining in Gloria's cloud was a letter we received soon afterwards from one of our agents. While other carriers were calling and writing agents before the storm to tell them to restrict new coverages, we had written to say that we would be open all weekend to help with immediate claims needs. One agent responded with a note calling our planning "superb...right out of the book *In Search of Excellence.*" We couldn't buy that kind of advertising.

Our expenses for the year were almost precisely on budget. Since our premiums were a bit higher than projected, our Expense Ratio was a shade better than the forecast. That means that it ended the year at 46% rather than 48%. This compares with 56% last year, and it keeps us on our five year course to a ratio no greater than 30%. We are struggling hard to provide exceptional service for our agents and customers, a constructive and pleasant working environment for our staff, and the most sophisticated tools for our underwriting... all within a strict budget. One of our most serious tests in the future will be to maintain these high standards and still be competitive with respect to expenses. We haven't yet proved we can do that.

Our portfolio remains conservative. Liquidity risk and equity performance risk were kept low by confining 1985 investments to heavily traded fixed-income issues. Credit risk was kept just as low, with more than 85% of our portfolio in securities issued or guaranteed by the Federal government. The rest is in high-grade corporate or municipal bonds. Interest rate exposure is also quite low by industry standards. Our portfolio contains no fixed-maturity instruments more than six years out, and our variable-maturity GNMA holdings have an average expected life not much longer than that. Someday we may purchase less liquid bonds, bonds with longer maturities, preferred stock, common equities, or real estate. But it remains our preference at this stage to rivet all possible attention on the task of building a profitable insurance base and to keep the portfolio simple. Our average current return was about ten percent in 1985. We ended the year with an unrealized capital gain of over half a million dollars.

The coming year will be a time for growth, for reducing our Expense Ratio and for further sharpening our underwriting skills. The real challenge for 1986, though, has no simple reflection in the numbers. Two years ago, Keith Rodney and I could put our fingers on any piece of paper in the office. We could overhear the handling of almost every telephone inquiry. The level of customer service was ours to command. With tens of thousands of policyholders, this will be less and less the case. Effective control of service quality has gravitated toward department managers and supervisors. Keith's task and mine are becoming more abstract.

We must be able to communicate the company's goals and standards to a greater number of people than we can personally train. We will have to inculcate our emphasis on friendly and personal treatment of those who do business with us into the lasting culture of our emerging organization. We must somehow cause the high service notion to become instinctive throughout the company and make sure it is reinforced on all possible occasions. At the same time, we will have to find ways to keep up the flow of thoughts and suggestions from our employees so that we continue to learn about service too. The company will be fifty people by year end, and these tasks are getting harder. They do not lend themselves to rigorous formal solutions like our computerized underwriting, nor has anyone pointed us to a good hornbook. But the importance of these challenges can scarcely be overstated.

Growth in our environment depends absolutely on the market's opinion of us. And for that, in turn, we depend just as absolutely on the quality of our service. Customer satisfaction is the most important thing we have to offer.

James M. Stone

James M. Stone

Coopers
&Lybrand

certified public accountants

To the Board of Directors of
The Plymouth Rock Company:

We have examined the consolidated balance sheets of The Plymouth Rock Company as of December 31, 1985 and 1984, and the related consolidated statements of income, and sources and uses of cash for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of The Plymouth Rock Company at December 31, 1985 and 1984, and the consolidated results of its operations and sources and uses of cash for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

Boston, Massachusetts
January 31, 1986

THE PLYMOUTH ROCK COMPANY

CONSOLIDATED BALANCE SHEETS

December 31, 1985 and 1984

ASSETS	1985	1984
Marketable securities	$ 8,629,602	$ 4,519,568
Premiums receivable	1,155,435	5,142,597
Cash and short-term investments	1,348,862	195,660
Fixed assets	518,900	395,822
Accrued investment income	158,674	71,135
Deferred acquisition costs	297,060	212,938
Total assets	$12,108,533	$10,537,720
LIABILITIES		
Losses and loss adjustment expenses	$ 1,684,985	$ 597,125
Unearned premiums	1,303,406	1,064,688
Advance premiums	2,663,022	5,354,031
Commissions	403,745	157,941
Amounts payable to reinsurers	2,434,095	141,774
Other liabilities	370,269	206,587
Total liabilities	8,859,522	7,522,146
STOCKHOLDERS' EQUITY		
Preferred stock	3,500,000	3,500,000
Common stock	3,000	3,000
Additional paid-in capital	27,000	27,000
Retained deficit	(280,989)	(514,426)
Total stockholders' equity	3,249,011	3,015,574
Total liabilities and stockholders' equity	$12,108,533	$10,537,720

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, 1985 and 1984

	1985	1984
Premiums earned	$4,115,153	$2,240,898
Losses and loss expenses incurred	2,832,211	1,546,682
Underwriting, general and administrative expenses	1,875,739	1,247,569
Underwriting loss	(592,797)	(553,353)
Net investment income	762,520	388,679
Interest expense	-0-	99,379
Gain (loss) from insurance operations	169,723	(264,053)
Capital gains	63,713	4,085
Income before federal income taxes	233,436	(259,968)
Federal income taxes	55,000	-0-
Income (loss) before extraordinary item	178,436	(259,968)
Extraordinary item - tax benefit of loss carryforward	55,000	-0-
Net income (loss)	$ 233,436	$ (259,968)

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

THE PLYMOUTH ROCK COMPANY

CONSOLIDATED STATEMENTS OF SOURCES AND USES OF CASH

for the years ended December 31, 1985 and 1984

	1985	1984
Sources of cash:		
Net income (loss) before extraordinary item	$ 178,436	$ (259,968)
Change in noncash items:		
Depreciation and amortization	164,177	86,271
Insurance reserves	1,326,578	1,661,813
Deferred acquisition costs	(84,122)	(212,938)
Accrued investment income	(87,539)	(39,764)
Premium balances receivable, net of advance premiums	1,296,153	(101,457)
Payable to reinsurer	2,292,321	141,774
Commissions payable	245,804	157,941
Other	163,681	66,496
Extraordinary item	55,000	-0-
Cash provided by operations	5,550,489	1,500,168
Carrying value of investments sold	3,550,501	92,450
Investment repayments	253,941	26,662
Issuance of capital stock	-0-	2,000,000
Total cash provided	$9,354,931	$3,619,280
Uses of cash:		
Investments in fixed maturities	$7,937,043	$1,360,951
Fixed assets	264,686	125,661
Conversion and repayment of borrowings	-0-	2,075,000
Total cash used	8,201,729	3,561,612
Net change in cash and short-term investments	$1,153,202	$ 57,668

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

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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1. Summary of Significant Accounting Policies

A. Principles of Consolidation

The consolidated financial statements include the accounts of The Plymouth Rock Company and its subsidiary, Plymouth Rock Assurance Corporation. All significant intercompany accounts and transactions have been eliminated.

Certain of the 1984 balances have been reclassified to conform to the 1985 presentation.

B. Marketable Securities

Marketable securities are comprised entirely of fixed-income investments carried at amortized cost.

C. Fixed Assets

The Company provides for depreciation and amortization principally on the straight-line method. Charges to expense are sufficient to write off the cost of the assets over their estimated useful lives and leasehold improvements over the term of the lease. Maintenance and repairs are charged to expense as incurred.

D. Income Taxes

The Company provides for taxes on income as reported in the consolidated statements of income. Taxes are adjusted for timing differences between book and taxable income relating to acquisition costs and for tax credits. The investment tax credit is accounted for using the flow-through method. At December 31, 1985 and 1984, net operating loss carryovers of approximately $218,000 and $452,000 were available to reduce future years' federal taxable income. As of the same dates, investment credit carryovers of approximately $51,000 and $34,000 were available to reduce tax liability. The net operating loss carryovers and investment tax credit carryovers expire in the years 2000 and 1999, respectively.

Continued

1. Summary of Significant Accounting Policies, continued

E. Premiums

The company reports premium revenues as earned on a pro rata basis over the terms of the policies. Unearned premiums represent amounts which are applicable to the unexpired terms of policies in force. Unearned premiums are presented net of reinsurance. The company has classified as advance premiums as of the balance sheet date amounts which are applicable to policies with effective dates in January of the following year.

F. Losses and Loss Adjustment Expenses

The liability for losses and loss adjustment expenses includes estimated provisions for claims incurred and related expenses determined on the basis of claim adjusters' evaluations. Such estimates are continually reviewed and updated. Any adjustments resulting from these reviews are reflected in income currently. The liability for losses and loss adjustment expenses is presented net of reinsurance.

G. Deferred Acquisition Costs

Commissions and premium taxes are deferred and amortized pro rata over the contract periods in which the related premiums are earned. The amount charged to operations during 1985 and 1984 were $1,616,000 and $448,000, respectively. All other acquisition costs are charged to operations as incurred. Deferred acquisition costs are presented net of reinsurance.

Continued

2. Net Investment Income

The components of net investment income before federal income taxes during 1985 and 1984 were as follows:

	1985	1984
Interest income from securities	$759,822	$416,353
Interest income from accounts receivable	93,703	27,040
Gross interest income	853,525	443,393
Investment expenses	91,005	54,714
Net investment income	762,520	388,679
Realized capital gains	63,713	4,085
Net investment income and capital gains	$826,233	$392,764

At December 31, 1985 and 1984 unrealized capital gains (losses) were as follows:

	1985	1984
Market value of securities at December 31	$9,165,782	$4,482,197
Carrying value of securities at December 31	8,629,602	4,519,568
Excess market value over book value	$ 536,180	$ (37,371)

Continued

3. Fixed Assets

At December 31, 1985 and 1984, the components were as follows:

	1985	1984
Furniture and fixtures	$178,544	$ 83,001
Office equipment	13,207	9,317
Computers	413,307	325,916
Leasehold improvements	154,843	76,981
	759,901	495,215
Less accumulated depreciation and amortization	241,001	99,393
	$518,900	$395,822

4. Stockholders' Equity

Stockholders' equity is comprised of the following:

	1985	1984
Preferred stock, no par value:		
Series A, 4% voting, cumulative convertible; authorized, issued and outstanding - 10,000 shares	$ 250,000	$ 250,000
Series B, 4% nonvoting, cumulative convertible; authorized, issued and outstanding - 50,000 shares	1,250,000	1,250,000
Series C, 4-7% nonvoting, cumulative convertible; authorized, issued and outstanding - 28,572 shares	2,000,000	2,000,000
Common stock:		
Class A, $.10 par value - voting; authorized 128,572 shares, issued and outstanding - 30,000 shares	3,000	3,000
Additional paid-in capital	27,000	27,000
Retained deficit	(280,989)	(514,426)
Total stockholders' equity	$3,249,011	$3,015,574

Continued

4. Stockholders' Equity, continued

At December 31, 1985 and 1984, there were 88,572 shares of Common-Class B nonvoting stock with a $.10 par value, none of which are issued or outstanding.

The Preferred Series A, B, and C stock may be converted into an equal number of shares of Common-Class A or B stock at the option of the owner at any time. It may also be converted by the Company, contingent upon the occurrence of certain events or conditions specified in the corporate articles of organization. Also, owners of any Common-Class B stock outstanding may at any time exchange any such shares for an equal number of shares of Common-Class A stock.

In the event of involuntary liquidation, Preferred Series A and B shareholders are entitled to $25 per share and Preferred Series C shareholders are entitled to $70 per share in preference to common stock. Preferred shareholders are also entitled when declared, or in event of involuntary liquidation, to dividends amounting to $300,000 and $160,000 at December 31, 1985 and 1984, respectively.

5. Stock Options

The Company has an incentive stock option plan for certain key employees. The plan authorizes the issuance of options for up to 10,000 shares of Common-Class A voting stock. The exercise price and expiration date are determined by the Board of Directors. At December 31, 1985 and 1984, options were issued and outstanding for 5,000 shares exercisable at $25 per share and 5,000 shares exercisable at $40 per share which expire in 1988.

Continued

6. Commitments

Rental expenses for 1985 and 1984 (net of sublease rental income of $45,000 and $67,000) aggregated $116,000 and $98,000. The Company leases office facilities for which the minimum lease commitments are as follows:

Year	Gross Rental Expense	Sublease Income
1986	$218,000	$72,000
1987	291,000	-0-
1988	145,000	-0-
	$654,000	$72,000

All lease commitments expire on June 30, 1988. Under existing leases, there are no material contingent rentals or restrictions imposed on the Company.

7. Reinsurance

Treaty reinsurance ceded is utilized to reduce exposure to large losses. The company ceded earned premiums under such treaties of $2,652,000 and $250,000 in 1985 and 1984, respectively. The liability for loss and loss adjustment expenses is reflected net of treaty reinsurance recoverable of $670,000 and $77,000 for 1985 and 1984, respectively. The Company remains primarily liable as the direct insurer on all risks.

Directors and Officers of The Plymouth Rock Company

Directors

James M. Stone, *Chairman*

James N. Bailey

Wilmot H. Kidd, III

Keith R. Rodney

C. Carter Walker, Jr.

Officers

James M. Stone,
President and Chief Executive Officer

Keith R. Rodney,
Senior Vice President and Secretary

James N. Bailey,
Treasurer

Directors and Officers of Plymouth Rock Assurance Corporation

Directors

James M. Stone, *Chairman*

James N. Bailey

Alexander Ellis, Jr.

Wilmot H. Kidd, III

Keith R. Rodney

Maurice H. Saval

C. Carter Walker, Jr.

Officers

James M. Stone,
President and Chief Executive Officer

Keith R. Rodney,
Senior Vice President and Secretary

James N. Bailey,
Treasurer

William M. Kelley,
Vice President - Claims

COUNSEL:
Ropes & Gray, Boston

AUDITORS:
Coopers & Lybrand, Boston