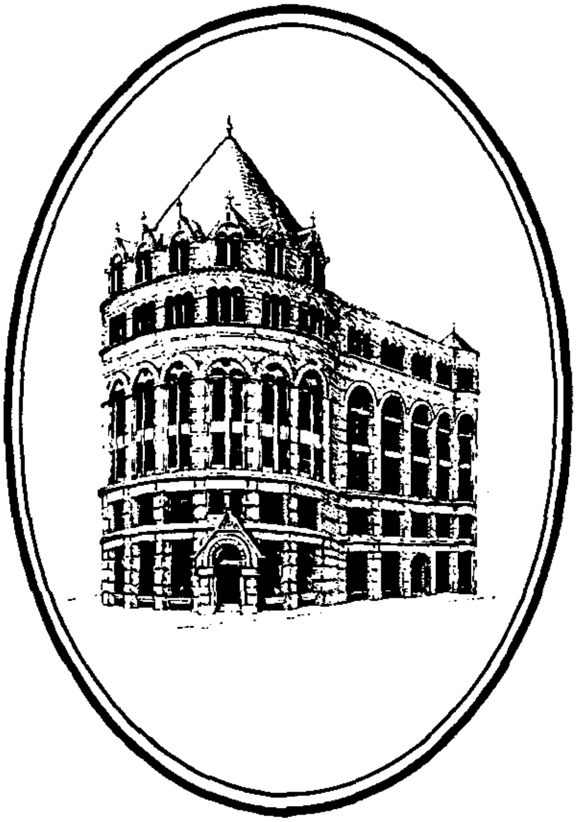
The Plymouth Rock Company



1986 Annual Report

The Plymouth Rock Company
INCORPORATED
177 Milk Street
Boston, Massachusetts 02109

Chairman's Letter

March 31, 1987

To Our Shareholders:

The year 1986 was characterized at Plymouth Rock by rapid growth and a pleasing enhancement of retained earnings. Gross Premiums Written expanded from $11.7 million to $21.3 million, an increase of about 80%. This is the best measure of how big a company we are and how much we've grown. Although financial statements focus, and rightly so, on the much smaller number that measures Net Premiums Earned, the gross written figure determines our scale and our staffing. We closed 1986 a twenty million dollar enterprise. We will soon have to begin thinking of Plymouth Rock as a middle-sized company rather than a start-up. We expect another year of rapid expansion in 1987, which is sure to reinforce this feeling.

Our net income, just over $1.3 million, was boosted by two non-recurring items (a tax loss carry-forward benefit of $100,000 and net capital gains of $436,000) as well as substantial operating progress. The tax carry-forward from 1983 and 1984 is now entirely used up; and the investment profits — as nice as they are — largely reflect our benefits, as fixed income investors, from the falling interest rate environment of the last two years. We will have no tax loss advantage in 1987, and it is virtually inconceivable that capital gains will have a similar impact on our 1987 results. Consequently, I would call attention to the item labelled "Income from Insurance Operations", about half way down our income statement, as a more meaningful index of our business progress than the larger bottom line amount.

The 1986 Income from Insurance Operations of $1,087,284 compares with a 1985 profit on a similar basis of $169,723. This year's number is 6.0% of gross premiums earned versus last year's 1.9% of gross premiums earned. A six percent profit on gross premiums is something we did not expect to see so early in Plymouth Rock's corporate life.

Our management budget for 1986 had underestimated volume for the year by about two and a half million dollars. This is the second year in a row that volume has been above expectations. As we ask ourselves why, our attention is drawn to a pair of marketplace phenomena that literally dominate our Massachusetts personal lines environment. One factor is the chronic and continuing deterioration of competition for Massachusetts automobile insurance business. The other, related only in part, is the low and worsening quality of service the industry offers to its agents and customers in personal lines.

Massachusetts automobile insurance has been described for years by the insurance industry as a disaster area. During most of the decade of the 1970's, the numbers told a different story. Regulation was always weighty but Massachusetts profitability compared favorably to countrywide statistics. In the 1980's, however, profits have increasingly fallen below the predictions inherent in the Insurance Commissioner's annual rate decisions. In both 1985 and 1986 premiums were reduced from existing levels, yet neither frequency of claims nor average claim cost for these years appears to have fallen. For 1987, the industry requested an increase of nearly 40%. A full quarter into the new year, the decision had not been issued. The automobile rate setting process has become so contentious and tedious that a highly capable Commissioner with an excellent staff has not, as of this date, been able to produce a rate decision due in the fall of 1986.

The perception of rates so inadequate as to defy any near-term correction, combined with the fact of an encumbered rate-making process, has had its undeniable impact on the marketplace. National companies, never comfortable with Massachusetts, are being moved to actions once considered unthinkable. A few have gotten out. Numerous others are threatening to do so. And all too few, sadly, have made the commitment to hunker down and work toward a constructive, long-term solution which suits the needs of the public as well as the industry. In the meanwhile, volume is amply available to any company that seeks it.

The service problem is partially a corollary to this condition and partially the consequence of unrelated trends. Those companies who view themselves as remaining in Massachusetts only at great financial sacrifice have tended to cut back both staffing and service levels in an effort to trim the expense component of their net losses and, simultaneously, to discourage new customers. This aggravates a pre-existing tendency toward lower service that has been visible for years now. The national competition between agency companies and direct writers has put great pressure on company expense ratios. In states like Massachusetts, with a high agency market share and some unique processing costs, this has led to unrealistically tight operating budgets at some carriers, and, in some cases, a loss of regard for the all-important customer. The worsening service drives business quickly in the direction of those few companies that have managed to keep service levels high. It is easy to draw new business when your competitors don't want it and can't service it properly. We expect our growth to continue in 1987.

Our highly favorable 1986 loss ratio (62% as opposed to 69% in 1985) reflects the continued success of our sophisticated underwriting models, and it was both directly and indirectly aided by the market environment. With so few of our competitors seeking new business, Plymouth Rock was able to maintain its selectivity with no adverse volume consequences. At the same time, our loss results were aided by a lower deficit payment to the residual market mechanism, Commonwealth Automobile Reinsurers (or C.A.R.). Since 1984, C.A.R. has responded to the tight market situation by operating a system of rewards and penalties for market performance. Movement in participation shares is tightly capped. Companies that grow are thus rewarded with participation shares in the C.A.R. deficit that can lag substantially behind current voluntary market shares. A company withdrawing coverage is required to accept a share of the deficit that exceeds current market share. Since C.A.R.'s deficit for fiscal 1986 was a staggering $550 million, the effects of differential participation shares can be as important a determinant of a carrier's overall loss ratio as cautious underwriting.

The legality of using the residual market mechanism as a source of incentives for the provision of coverage has been challenged by a number of insurers. The Commissioner of Insurance recently issued a long and scholarly decision upholding C.A.R.'s approach, and the matter will now go to the courts. Pending any court action, the rules stand. To achieve a low loss ratio against this backdrop of tight rates and powerful market share incentives, a company must choose its voluntary risks skillfully and simultaneously grow its way into a reduced residual market participation. Both pieces are essential, and Plymouth Rock has paid attention to both. The peril, however, is obvious. At some point, we will use up all the available growth opportunities that meet our underwriting standards. We may lose even sooner the rewards from C.A.R. Under a new rule proposal before the Commissioner of Insurance, C.A.R. would phase out most of the growth rewards beginning in 1989. This would be adverse to Plymouth Rock and other rapidly growing companies but, frankly, I think the proposal is fair. Rate adequacy is, in the end, an irresistable force and there can be no immovable objects.

Plymouth Rock's expense ratio for 1986 was within a point of our budget goal. Although I would always prefer to hit the budgetary target dead on, the 1986 result is consistent with the pressures of rapid growth. Our greatest stresses were on occupancy costs, policy processing, personnel administration and accounting. Both the rent and policy processing overages reflect decisions made in 1986 to prepare for another volume surge in 1987. We could perhaps have argued to defer some of these costs, but we don't like to do so when the money is gone and the contingency for which it was spent remains too uncertain.

The additional cost in accounting was due not only to the heavy premium volume but also to an upgrading of systems and procedures that worked well for a ten million dollar business but won't serve a company twice or three times that size. We also decided, a year earlier than planned, to set up a full-time personnel office. This was one of the most fortunate decisions we made all year. I don't see how our managers would have gotten through 1986 without the help this gave them in their recruiting and supervisory tasks.

Our budget focuses on the ratio of gross expenses, including claim department expenses and investment expenses, to gross premiums earned. By this measure, we moved from a 54% cost in 1985 to a 44% cost in 1986. Our financial statements focus on net expenses, which exclude claim and investment costs and deduct out reinsurance commissions and reimbursements. The ratio to premiums on that basis was 37% in

1986, down from 46% last year and 56% in 1984. Our goal is to bring the expense ratio down to 37% on the budgetary scale and below 30% on the accounting scale. The battle to achieve this while keeping service standards high continues unabated.

Our investment portfolio at year end included about $16 million of cash and marketable securities. We remain loathe to accept unnecessary investment risk. There is risk enough on the insurance side of our business. Plymouth Rock's securities portfolio is now held entirely in fixed-income government securities. We sold all of our convertible corporates during the year and purchased municipal bonds to replace them. The share of our portfolio devoted to municipals has grown as we have begun paying taxes. We think the spreads between taxable and tax-exempt securities remain favorable for the latter.

Our portfolio duration, always shorter than is typical for an insurance company, is now even shorter than it was in previous years. We want very little exposure to interest rate risk at this juncture. At the end of 1985, we had an unrealized capital gain of $536,000. This grew in 1986, and we harvested most of it into capital. The market value of our portfolio as of the end of 1986 exceeded the carrying value by $284,000.

Looking ahead is always difficult, and the turmoil in Massachusetts automobile insurance makes it all the more difficult today. We will doubtlessly be buffeted by forces beyond our control. Our best consolation is that we are a relatively agile company. Because we are smaller than the giants, and because all of our talent can be mustered to analyze and react to change in Massachusetts, Plymouth Rock will look for opportunities where others find dangers and channels where others find rocks. Our company enters its next year with a solid underwriting track record, a hard-earned reputation for service, a healthy respect for budgeting, and a group of agents and employees that should give any insurance company a warm feeling. These assets don't make us feel smug, or even secure, but they do keep us ready for the next challenge and fundamentally optimistic.

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, 1986 and 1985, 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, 1986 and 1985, 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
March 27, 1987

THE PLYMOUTH ROCK COMPANY

CONSOLIDATED BALANCE SHEETS

December 31, 1986 and 1985

ASSETS	1986	1985
Marketable securities	$14,605,627	$ 8,629,602
Cash	1,342,210	1,348,862
Premiums receivable	3,208,254	1,155,435
Accrued investment income	230,102	158,674
Deferred acquisition costs	530,257	297,060
Fixed assets	904,608	518,900
Total assets	$20,821,058	$12,108,533
LIABILITIES		
Losses and loss adjustment expenses	$ 3,348,552	$ 1,684,985
Unearned premiums	2,213,298	1,303,406
Advance premiums	4,060,783	2,663,022
Commissions	699,233	403,745
Amounts payable to reinsurers	4,988,678	2,434,095
Other liabilities	951,068	370,269
Total liabilities	16,261,612	8,859,522
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 earnings (deficit)	1,029,446	(280,989)
Total stockholders' equity	4,559,446	3,249,011
Total liabilities and stockholders' equity	$20,821,058	$12,108,533

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, 1986 and 1985

	1986	1985
Premiums earned	$7,390,736	$4,115,153
Losses and loss expenses incurred	4,566,126	2,832,211
Underwriting, general and administrative expenses	2,738,572	1,875,739
Underwriting income (loss)	86,038	(592,797)
Net investment income	1,001,246	762,520
Income from insurance operations	1,087,284	169,723
Holding company expenses	48,669	0
Income from operations before federal income taxes	1,038,615	169,723
Federal income taxes	265,000	37,000
Income from operations	773,615	132,723
Capital gains (net of taxes of $201,000 in 1986 and $18,000 in 1985)	436,820	45,713
Income before extraordinary item	1,210,435	178,436
Extraordinary item - tax benefit of loss carryforward	100,000	55,000
Net income	$1,310,435	$ 233,436

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, 1986 and 1985

	1986	1985
Sources of cash:		
From operations:		
Income before extraordinary item	$ 1,210,435	$ 178,436
Change in noncash items:		
Depreciation and amortization	258,646	164,177
Insurance reserves	2,573,459	1,326,578
Deferred acquisition costs	(233,197)	(84,122)
Accrued investment income	(71,428)	(87,539)
Premium balances receivable, net of advance premiums	(655,058)	1,296,153
Payable to reinsurers	2,554,583	2,292,321
Commissions payable	295,488	245,804
Other	580,799	163,681
Cash provided by operations	6,513,727	5,495,489
Extraordinary item	100,000	55,000
Cost of investments sold or matured	13,738,745	3,804,442
Total cash provided	$20,352,472	$9,354,931
Uses of cash:		
Investments purchased	$19,754,387	$7,937,043
Fixed assets	604,737	264,686
Net change in cash	(6,652)	1,153,202
Total cash used	$20,352,472	$9,354,931

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

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.

B. Marketable Securities

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

C. Fixed Assets

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.

D. Income Taxes

The Company files its federal income tax return on a consolidated basis. Deferred taxes are provided to reflect the income tax effect of timing differences between book and taxable income. The investment tax credit arising prior to January 1, 1986 is accounted for using the flow-through method. In 1986, a net operating loss carryover of approximately $218,000 and an investment tax credit carryover of approximately $51,000 were used to reduce 1986 federal income taxes.

E. Premiums

Premium revenues are earned on a daily 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.

Advance premiums represent amounts which are applicable to policies with effective dates in January of the following year.

Continued

1. Summary of Significant Accounting Policies, continued

F. Losses and Loss Adjustment Expenses

Loss reserves represent the estimated liability on claims reported to the Company, plus reserves for losses incurred but not yet reported. Loss adjustment expense reserves represent the estimated expenses related to these claims and losses. Such estimates are presented net of amounts recoverable from reinsurance. The methods of making such estimates and establishing the resulting reserves are reviewed regularly and resulting adjustments are reflected in income currently.

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 amounts charged to operations during 1986 and 1985 were $3,641,000 and $1,616,000, respectively. Deferred acquisition costs are presented net of commissions income on ceded reinsurance.

2. Treaty Reinsurance

Treaty reinsurance ceded is used to reduce exposure to large losses. The Company ceded earned premiums under such treaties of $4,415,000 and $2,652,000 in 1986 and 1985, respectively. The liability for losses and loss adjustment expenses is reflected net of treaty reinsurance recoverable of $997,000 and $670,000 for 1986 and 1985, respectively. The Company remains primarily liable as the direct insurer on all voluntary risks.

Continued

3. Net Investment Income

The components of net investment income before federal income taxes during 1986 and 1985 are as follows:

	1986	1985
Interest income from securities	$ 873,027	$759,822
Interest income from accounts receivable	250,904	93,703
Gross interest income	1,123,931	853,525
Investment expenses	122,685	91,005
Net investment income	1,001,246	762,520
Realized capital gains	637,820	63,713
Net investment income and capital gains	$1,639,066	$826,233

At December 31, 1986 and 1985, unrealized capital gains are as follows:

Market value of securities	$14,889,735	$9,165,782
Carrying value of securities	14,605,627	8,629,602
Excess of market value over book value	$ 284,108	$ 536,180

Continued

4. Stockholders' Equity

Stockholders' equity is comprised of the following:

	1986	1985
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 on common stock	27,000	27,000
Retained earnings (deficit)	1,029,446	(280,989)
Total stockholders' equity	$4,559,446	$3,249,011

The changes in retained earnings are as follows:

	1986	1985
Retained earnings (deficit) beginning of year	$ (280,989)	$(514,425)
Net income	1,310,435	233,436
Retained earnings (deficit) end of year	$1,029,446	$(280,989)

Continued

4. Stockholders' Equity, continued

At December 31, 1986 and 1985, 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 ($1,500,000 in the aggregate) and Preferred Series C shareholders are entitled to $70 per share ($2,000,000 in the aggregate) in preference to common stock. Shareholders are also entitled when declared, or in the event of involuntary liquidation, to dividends amounting to $440,000 and $300,000 at December 31, 1986 and 1985, respectively.

5. Stock Options

The Company has an incentive stock option plan for certain key employees which authorizes the issuance of options for up to 10,000 shares of Common-Class A voting stock. Options have been granted to purchase 5,000 shares at $25 per share and 5,000 shares at $40 per share. These options are exercisable through December 31, 1988. No options were exercised as of December 31, 1986.

6. Savings and Investment Plan

Effective January 1, 1986, the Company adopted a Savings and Investment Plan covering all employees 21 years or older with at least one year of service. In 1986, the Company made discretionary contributions of $53,000.

7. Lease Commitments

Rental expenses for 1986 and 1985 (net of sublease rental income of $82,000 and $45,000) aggregated $224,000 and $116,000, respectively. The Company leases office facilities for which the net minimum lease commitments are approximately $346,000 in 1987 and $173,000 in 1988.

Continued

8. Income Taxes

The 1986 provision for federal income taxes on income from operations is composed of:

Currently payable	$ 51,000
Payable in future years	214,000
Total	$265,000

The difference between the provision for federal income taxes and the tax provision at the statutory rate (46%) is due to the deduction of tax-exempt interest, investment tax credit carryover and other special deductions.

9. Fixed Assets

At December 31, 1986 and 1985, fixed assets are:

	1986	1985
Furniture and fixtures	$ 329,580	$178,544
Office equipment	60,513	13,207
Computers	720,931	413,307
Leasehold improvements	241,357	154,843
Automobiles	12,257	0
	1,364,638	759,901
Less accumulated depreciation and amortization	460,030	241,001
	$ 904,608	$518,900

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

William J. Whitebone,
Vice President - Underwriting

COUNSEL:
Ropes & Gray, Boston

AUDITORS:
Coopers & Lybrand, Boston