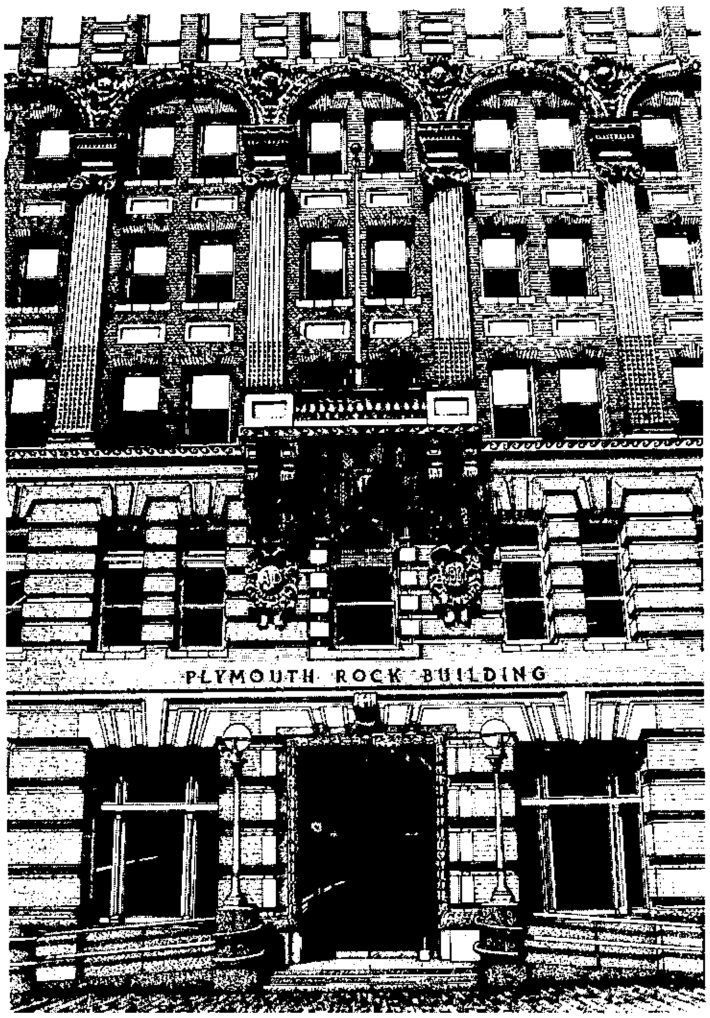
# The Plymouth Rock Company




# 1995 Annual Report

# The Plymouth Rock Company

**695 Atlantic Avenue**
**Boston, Massachusetts 02111**

## Chairman's Letter

February 29, 1996

To Our Shareholders:

Plymouth Rock will recall 1995 as a year in which preparation for change took precedence over all matters immediate. Some of the change was forced upon us, and some was at our own initiative. Fierce competition and the adverse phase of the regulatory cycle came to Massachusetts automobile insurance. And, while our financial results were still dominated by that line of business, much of my own effort in 1995 was devoted to developments elsewhere. Your senior management has, for some time, been anticipating the unfavorable turn in its home state's automobile insurance market. The cyclical nature of that business would be reason enough to seek complementary sources of strength. Just as important, moreover, Keith Rodney and I both feel ourselves drawn, perhaps irresistibly drawn, to the challenge inherent in a broader geographic arena. The transition now being explored would require changes in both scale and structure. We will be consulting with you on these matters as 1996 takes shape.

The results for the year were a little behind those of the prior year. Consolidated net income was $12.3 million, versus $12.8 million for the twelve months of 1994. Even this result, a bit better than budget, reflected an element of good luck in that the winter of 1994-5 was unusually mild and the financial markets allowed us to realize about four million dollars in capital gains. We would have earned something nearer ten million dollars after taxes had the winter and the capital gains been more in line with long term norms. The essential force in the depression of profitability was declining premium rates for Massachusetts automobile insurance coverages. The situation in that line as we look forward is neither alluring nor improving. While what occurred is straightforward enough to explain, explanation falls woefully short of cure.

Automobile insurance rates in Massachusetts have been heavily regulated since 1925. The Insurance Commissioner fixes, after public hearings, a statewide matrix of premium rates, and each company must either use these as promulgated or apply for a downward "deviation", either for all of its business or for some nondiscriminatory subdivision of the book. A company can also apply for approval of any number of group marketing plans, with discounted rates for eligible risks. Neither mechanism allows a carrier to charge more than the Commissioner's rate for any driver in the system. This is a one way ratchet, and thus the privilege to deviate or discount, over most of Massachusetts' regulatory history, has been largely theoretical. Companies have usually just griped and accepted the Commissioner's rates as their own.

This regime is far more restrictive than the rate regulatory environment typical for the fifty states, but over many decades Massachusetts has been neither consistently above nor below the national norms in profitability. For the last several years, Massachusetts rate regulation has tended to encourage price competition, with Massachusetts having been among the top dozen states in profitability every year since 1992. Had anyone suggested in the eighties that Massachusetts auto insurance carriers would soon be using rates below those fixed by the Commissioner, seasoned observers might have laughed derisively. More recently, however, the laughter would seem inappropriate. Competition's first stirrings came in the form of group discounting for payroll deduction plans of selected employer units. Then selectivity went by the board as some companies began to discount open enrollment groups of policyholders, such as automobile clubs, allowing any driver in the state to enjoy the discount simply by joining the sponsoring organization. Next, a number of carriers announced that they would waive the customary finance charges for policyholders who paid their premiums in monthly installments. Finally, at the end of 1995, companies began filing for downward deviations and extending discounts to non-group policyholders across the state.

The impact of these discounts must be regarded as significant by any standard, especially since the Commissioner reduced the base premium rate by about 6.1% for 1995 and another 4.5% for 1996. Premium income for insurers in 1996 will be less by hundreds of millions of dollars than would have been the case had rates simply been flat for the last two years. An individual example may be most illustrative of the cumulative downward pressures. Imagine that typical policyholder Smith paid a $1000 premium in 1994 and has the right characteristics for a 10% downward deviation in 1996. Smith's 1995 premium, assuming an average benefit of the rate decrease that year, would have dropped to $939, reflecting the Commissioner's average statewide decrease. Then in 1996, Smith would have enjoyed both a rate decrease and a deviation, taking the premium down to $807. If Smith joined an open group with an additional 10% discount, the premium would be $726. This is an overall reduction of 27% from the 1994 premium in constant dollars, before any benefit Smith may have received from waiver of finance charges, and an even greater reduction if account of inflation is taken. Profits have indeed been good in recent years, but not that good.

The situation in Massachusetts automobile insurance can, almost certainly, be characterized as an unsustainable price war. Correction is inevitable, but it is hard to say when. Largely because of the prospects for this still dominant segment of our business, the group net income will almost certainly be down in the near future.

Plymouth Rock is not a leader in the price war, but we cannot afford to be a victim either. In our business it is valuable to maintain policyholder relationships over long periods of time. It often costs something extra, whether on the agent's part or the company's, to attract a new customer, and it hurts a company's expense ratio to lose volume after fixed costs have anticipated more. Regular customers, moreover, learn to feel appreciated by Plymouth Rock, and we think most will return that sentiment by engaging in responsible claims behavior. As long as the market imbalance is thought to be short-lived, it does not make sense to passively accept the loss of long term market share, especially among our excellent drivers. We will aim to increase new business selectivity as margins fall, while keeping the defenses around our existing book as formidable as possible.

Accordingly, we have sought and received permission from the Commissioner to offer an 11% downward deviation for good drivers, and we are searching for select group business that properly deserves a discount over all phases of the cycle. Even at this, the lack of a widely available open group plan may cause us to lose a little market share. This is the cost of hewing to selectivity during a competitive feeding frenzy. If we have to accept this outcome, it will be preferable to losing money or discarding the comparative advantage we have gained over the years by offering the best service to the best drivers.

Plymouth Rock Assurance Corporation would be more comfortable in a competitive arena if it could provide its excellent service at an especially low cost. The lowest cost producer always has an edge in competition. That goal, however, remains elusive. With mandated commissions up and premiums down, the gross expense ratio actually rose just over a point in 1995--to 38.8%, including both loss adjustment expenses and investment expenses, a figure which approximates the average expense ratio for our agency company peer group. The pending premium cuts in 1996 will render it fruitless to seek an expense ratio reduction in the coming year. Progress is made in the years when premiums rise and discipline keeps expenses from rising at an equal pace. Over time, years of increasing premiums predominate, so the long struggle is not as hopeless as it may look in this period. The benefit of tough periods is that they redouble the commitment of our department heads to keeping tight reins on staff size and seeking new ways to be efficient.

Last year, I reported to you deep misgivings about homeowners profitability. Given current rate levels in that line, it is by no means clear that any company, at least in our part of the United States, can purchase adequate reinsurance and still have enough left over to earn a worthwhile return on the homeowners business. The profits look great in years without severe winters or tropical storms in the autumn, but the long term record is nothing to brag about and the uninsured catastrophe risk is horrendous. GEICO, one of the most thoughtful carriers in the personal lines business, announced in 1995 that it would leave the homeowners line entirely. Some of our competitors in Massachusetts are cutting back. It should not come as a surprise, therefore, that we talked about beating a similar retreat at Plymouth Rock Assurance Corporation. Instead, we decided to stick with homeowners insurance. A weakening of competitive resolve always creates opportunities, and prices inadequate to pay for the reinsurance are not necessarily inherent to the business. Our choice was to spin our homeowners risks off into a separate corporation, the newly licensed Bunker Hill Insurance Company, where we will specialize in underwriting by precise analysis and mapping of our catastrophe concentration risk. This process will allow the company to write broadly throughout its jurisdiction, while maintaining the spread of risk essential to survival when catastrophe strikes. Assuming Bunker Hill's reinsurers will allow us to pay a rational price for coverage preselected to minimize concentration risk, we are optimistic we can make homeowners a larger rather than smaller business for our family of companies.

The last report prematurely celebrated Mt Washington's first tiny profit. I should probably have described that year's results as breakeven, and the ink went red again in 1995. Mt Washington lost between three and four hundred thousand dollars on gross premiums of $7.1 million. A swing of a few percentage points is normal for personal lines, and the trend reveals little. The challenge for Mt Washington is to add customers until premiums are twice or three times their present level, and thus lower the expense ratio. A company of Mt Washington's small scale cannot be a reliable moneymaker and still pay for a high quality management team. This is the case despite our good luck in having Gene Meyung as that company's chief executive. Gene is a proven industry star who came out of retirement to guide the company for a year or two and insists on being paid less for his time than he could command. Gene, and his eventual successor, will just have to keep plugging to achieve the necessary growth in New Hampshire's highly competitive environment. They will be aided by Ray Moore, the vice president for accounting, data processing and administration at Plymouth Rock Assurance Corporation, who has now added the chairmanship of Mt Washington to his duties. Like its Massachusetts counterpart, Mt Washington has concentrated on building a reputation for unusually good service to both its agents and its customers. I remain confident that, if top service can be combined with efficiency, the strategy is a winner.

Having just confessed to premature celebration with respect to Mt Washington, I should measure my words with respect to Palisades. Hal Belodoff had set as goals for the reciprocal insurer he manages in New Jersey that 1995 premiums written would pass $30 million and that the last quarter of the year would be the company's first quarter of profitability. Both goals were achieved. Palisades now has the scale it needs for reasonable expense ratio control, and it has both the reputation and vigor required to attract new business. Entering its fifth year, Palisades can also begin to answer meaningful questions now about the quality of the business it has secured. New carriers are everywhere assumed to suffer from initial adverse selection, and New Jersey is known as an especially tough state with respect to rate approvals. Palisades' loss ratio, despite both of these handicaps, has averaged very close to sixty points for all years taken together, while Palisades' rate levels are slightly below the statewide average. These two facts together suggest that the book is considerably better than a typical unseasoned book and probably as good as it ever needs to be.

Since complacency ranks as just about the deadliest sin around here, it is worth emphasizing that Palisades' loss ratio is not sustainable without the constant application of effort and skill. It is possible, for starters, that appearances are deceiving and that even now the experience is worse than the books suggest. Some of the liability claims for years past are still outstanding and may develop upward as the cases are finally closed. It may be that good business, which was available for the asking when other carriers were furious at New Jersey's depopulation plan, will dry up as the market tightens. In this case, Palisades may find itself bidding for its future growth, a process not hospitable to loss ratio refinement. Rate needs, moreover, change. It is not enough to have called the cost and market trends skillfully in past rate filings; one has to keep calling them right time and time again. The goal is not to be perfect, a standard incompatible with human enterprises. It is to be better than one's competitors, always and forever. Palisades appears to be doing all the right things to make that possible.

Vin Nieroda, who runs our service company--Pilgrim Insurance, is also a bearer of good news. Pilgrim, under Vin's leadership since inception, has been profitable for seven years in a row. Because Pilgrim's income is fee-based and of lower risk than that generated in our underwriting entities, a dollar of net income there is worth a bit extra in terms of shareholder value. Its 1995 net income was about seven hundred thousand dollars, approaching double the prior year's profit. It appears that Pilgrim's growth will continue into 1996, led by an expansion of its residual market services for taxis and limousines. Vin still has his eyes fixed on a longstanding two-clause challenge for Pilgrim: to earn over a million dollars in an environment where everyone involved is proud to be associated with the company. See this space next year for an update on our Pilgrim's progress.

Boston Risk Management Corporation has a new chief executive, Bob Barrese, whose unambiguous mission is to speed up its growth. While BRMC has a fine reputation for professionalism and a nice little business in the management of self-insured workers compensation programs, its revenues have been a disappointment. With so much to be done in the workers compensation field, this seems ironic. Before I eat too much crow, however, I want to give Bob his chance to improve the record. Bob comes to us with a highly successful track record in marketing and product development at Liberty Mutual. He is probably the most skilled and experienced sales professional ever hired for any of our companies. BRMC continues to appear an attractive adjunct to our personal lines businesses; it is now Bob's work that will shape its role in our corporate family.

This was a good year for investors in stocks and bonds, and SRB Corporation did better than most. Under the executive supervision of Jim Bailey and Rick Childs, SRB's performance was close by its benchmarks on fixed income securities and decisively beat the equities benchmarks. The market value of the group's fixed income portfolio was more than four million dollars below its cost at the close of 1994; a year later market value was nearly two million dollars above cost. Since we keep duration passively short and are loathe to wager anything on interest rate predictions, we must thank general economic conditions for most of the gain in bonds. On the equity side, though, thanks are due Jim and Rick. Our marketable equities portfolio rose in value by nearly seventy percent in a year, about thirty points better than the performance of the Standard and Poor's average--and not because we chose risky or volatile stocks. Our strategy continues to emphasize extensive fundamental analysis of share value, corporate culture and product quality, with the assumption that holding periods will be measured in decades.

The bull market broke records day after day in 1995. The surest conclusion from this fact is that it has gotten progressively tougher to find undervalued stocks. So, late in the year, we turned to real estate, which we think is still quite undervalued in New England and where we have, as a user of space, some degree of downside protection. Many of the newer, large-floorplate properties in this area have recovered somewhat in price since the real estate collapse a few years ago. The prices of older or smaller buildings have not shown equivalent gains. Since we prefer the latter anyway, we purchased an office building in New Hampshire for Mt Washington and an office building in Boston suitable as a future home for Plymouth Rock Assurance or the SRB Companies. We consider that we are now hedged in both places should real estate prices rise in the future. The investment risk from these purchases is tempered by our ability to occupy and our ability to forgo liquidity for long time periods.

At the December board meeting, Ray Moore was added to our short list of holding company officers. Paula Gold, who has played a key role in shaping Plymouth Rock Assurance Corporation's competitive strategy, was promoted at the same time to general counsel of the Massachusetts insurer. After eight years of service on the board, Benno Schmidt will soon retire as a Plymouth Rock Company director. Benno, at 83, remains the wisest person I can call a friend, so I tried in vain to talk him into staying. His best counteroffer, which I have accepted, was to continue our regular lunches and visits. He will be missed and, so far as I can tell, he is irreplaceable.

If the reference to contemplated expansion at the beginning of this letter sounded a bit cryptic, it is because discussions of future projects must be dealt with gingerly. It can be harmful to disclose details of negotiations in progress, deceptive to imply that whatever is cooking is sure to reach the dinner table, and unwise for a business to share its next moves with a large audience. At the same time, this has been a substantial consumer of top management attention. And, given that some of the story has appeared in the press already, it makes little sense to pretend the matter is more secret than it is.

When I predicted last year that Plymouth Rock's next phase of growth would come from outside Massachusetts, I pictured a gradual shift of momentum toward other jurisdictions. We are now contemplating something less gradual. Our newest director, Peter Wood, and I have devoted nearly a week out of every month to discussing the future of personal lines insurance in the United States, and the conversation has never lagged. Peter is the entrepreneur who founded Direct Line Insurance and built it into the largest automobile insurance writer in the United Kingdom. Peter and I, in conjunction with Plymouth Rock, are now thinking of creating a new enterprise in those parts of this country where Plymouth Rock does not write. The business under consideration, which would be modeled upon the best of both Direct Line and Plymouth Rock, will require substantial financing from investors outside the current Plymouth Rock family. The prospects for Plymouth Rock's participation are exciting, and Peter is a world-class talent, but all else is uncertain. To count on launching an ambitious venture would be foolish, and to count on succeeding all the more so, but you can be certain that all involved are giving this their best shot. It is hard to imagine that anyone could assemble a team more ready for the challenge.

James M. Stone

James M. Stone

**THE PLYMOUTH ROCK COMPANY**

**CONSOLIDATED BALANCE SHEETS**

**December 31, 1995 and 1994**

| **Assets** | 1995 | 1994 |
|---|---|---|
| Cash and marketable securities | $210,518,279 | $187,230,410 |
| Premiums receivable | 12,218,710 | 9,300,333 |
| Real estate | 6,812,786 | -0- |
| Accrued investment income | 2,532,682 | 2,283,082 |
| Receivable from reinsurers | 31,665,067 | 29,462,179 |
| Deferred acquisition costs | 9,930,529 | 8,088,075 |
| Fixed assets | 4,580,929 | 4,975,457 |
| Deferred income taxes | 3,713,005 | 6,989,482 |
| Other assets | 1,172,731 | 1,826,369 |
| Total assets | $283,144,718 | $250,155,387 |
| **Liabilities** | | |
| Claim and claim adjustment expense reserve | $108,261,308 | $103,803,373 |
| Unearned premium reserve | 30,368,907 | 27,113,845 |
| Premiums payable to reinsurers | 24,314,688 | 25,146,939 |
| Advance premium | 7,696,847 | 9,857,880 |
| Commissions payable and accrued liabilities | 14,924,199 | 14,751,844 |
| Unearned service fees | 4,614,753 | 3,250,439 |
| Other liabilities | 2,443,074 | 1,952,698 |
| Total liabilities | 192,623,776 | 185,877,018 |
| **Stockholders' Equity** | | |
| Common stock and paid-in capital | 19,563,891 | 10,536,024 |
| Retained earnings | 63,315,336 | 52,398,900 |
| Net unrealized gain on investments | 4,070,856 | (2,218,925) |
| Common stockholders' equity | 86,950,083 | 60,715,999 |
| Minority interests in subsidiaries | 3,570,859 | 3,562,370 |
| Total stockholders' equity, including minority interests | 90,520,942 | 64,278,369 |
| Total liabilities and stockholders' equity | $283,144,718 | $250,155,387 |

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, 1995 and 1994

| **Revenues** | 1995 | 1994 |
|---|---|---|
| Premiums earned in underwriting activities | $ 98,812,414 | $ 98,379,478 |
| Fees earned from service activities | 11,918,892 | 8,490,321 |
| Investment income and capital gains | 17,412,458 | 10,154,394 |
| Total revenues | 128,143,764 | 117,024,193 |
| **Expenses** | | |
| Claim and claim adjustment expenses | 65,789,596 | 62,676,928 |
| Policy acquisition, underwriting and general expenses | 34,256,339 | 29,613,542 |
| Service activity expenses | 11,804,138 | 7,950,566 |
| Total expenses | 111,850,073 | 100,241,036 |
| Income before federal income taxes | 16,293,691 | 16,783,157 |
| Federal income taxes | 3,963,423 | 3,964,262 |
| Net income | $ 12,330,268 | $ 12,818,895 |

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, 1995 and 1994

| **Cash flows from operating activities** | 1995 | 1994 |
|---|---|---|
| Gross premiums collected | $140,473,881 | $143,087,106 |
| Reinsurance premiums paid | (42,594,496) | (44,939,518) |
| Finance charges collected | 3,158,794 | 2,967,753 |
| Fees and commissions collected | 11,151,145 | 7,606,861 |
| Investment income received | 14,801,011 | 8,392,332 |
| Gross claims and claim expenses paid | (92,949,648) | (85,078,426) |
| Reinsured claims and claim expenses collected | 32,725,333 | 33,261,610 |
| Policy acquisition, underwriting, and general expenses paid | (32,983,055) | (30,592,016) |
| Federal income taxes paid | (4,616,074) | (5,306,422) |
| Service activity expenses paid | (9,453,898) | (8,266,043) |
| Net cash provided by operating activities | 19,712,993 | 21,133,237 |
| **Cash flows from financing activities** | | |
| Issuance of common stock | 9,027,867 | -0- |
| Dividends to stockholders | (1,280,832) | (1,193,403) |
| Dividends to preferred stockholder of subsidiary | (140,000) | (140,000) |
| Net cash provided by financing activities | 7,607,035 | (1,333,403) |
| Net cash provided | $ 27,320,028 | $ 19,799,834 |
| ***Investment of net cash provided*** | | |
| Net investment activity | $ 18,983,130 | $ 18,723,661 |
| Purchases of real estate | 6,857,056 | -0- |
| Purchases of fixed assets | 1,479,842 | 1,076,173 |
| Net cash invested | $ 27,320,028 | $ 19,799,834 |

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, 1995 and 1994

| | Common Stock and Paid-in Capital | Retained Earnings | Net Unrealized Gain on Investments | Minority Interests | Total Stockholders' Equity |
|---|---|---|---|---|---|
| December 31, 1993 | $10,536,024 | $40,906,408 | $ - | $3,544,846 | $54,987,278 |
| Net unrealized gain at January 1, 1994 | -0- | -0- | 2,586,086 | -0- | 2,586,086 |
| January 1, 1994 | 10,536,024 | 40,906,408 | 2,586,086 | 3,544,846 | 57,573,364 |
| Net income | -0- | 12,818,895 | -0- | 24,524 | 12,843,419 |
| Dividends to stockholders | -0- | (1,193,403) | -0- | -0- | (1,193,403) |
| Dividends to preferred stockholder of subsidiary | -0- | (133,000) | -0- | (7,000) | (140,000) |
| Net unrealized loss during 1994 | -0- | -0- | (4,805,011) | -0- | (4,805,011) |
| December 31, 1994 | 10,536,024 | 52,398,900 | (2,218,925) | 3,562,370 | 64,278,369 |
| Issuance of common stock | 9,027,867 | -0- | -0- | -0- | 9,027,867 |
| Net income | -0- | 12,330,268 | -0- | 15,489 | 12,345,757 |
| Dividends to stockholders | -0- | (1,280,832) | -0- | -0- | (1,280,832) |
| Dividends to preferred stockholder of subsidiary | -0- | (133,000) | -0- | (7,000) | (140,000) |
| Net unrealized gain during 1995 | -0- | -0- | 6,289,781 | -0- | 6,289,781 |
| December 31, 1995 | $19,563,891 | $63,315,336 | $ 4,070,856 | $3,570,859 | $90,520,942 |

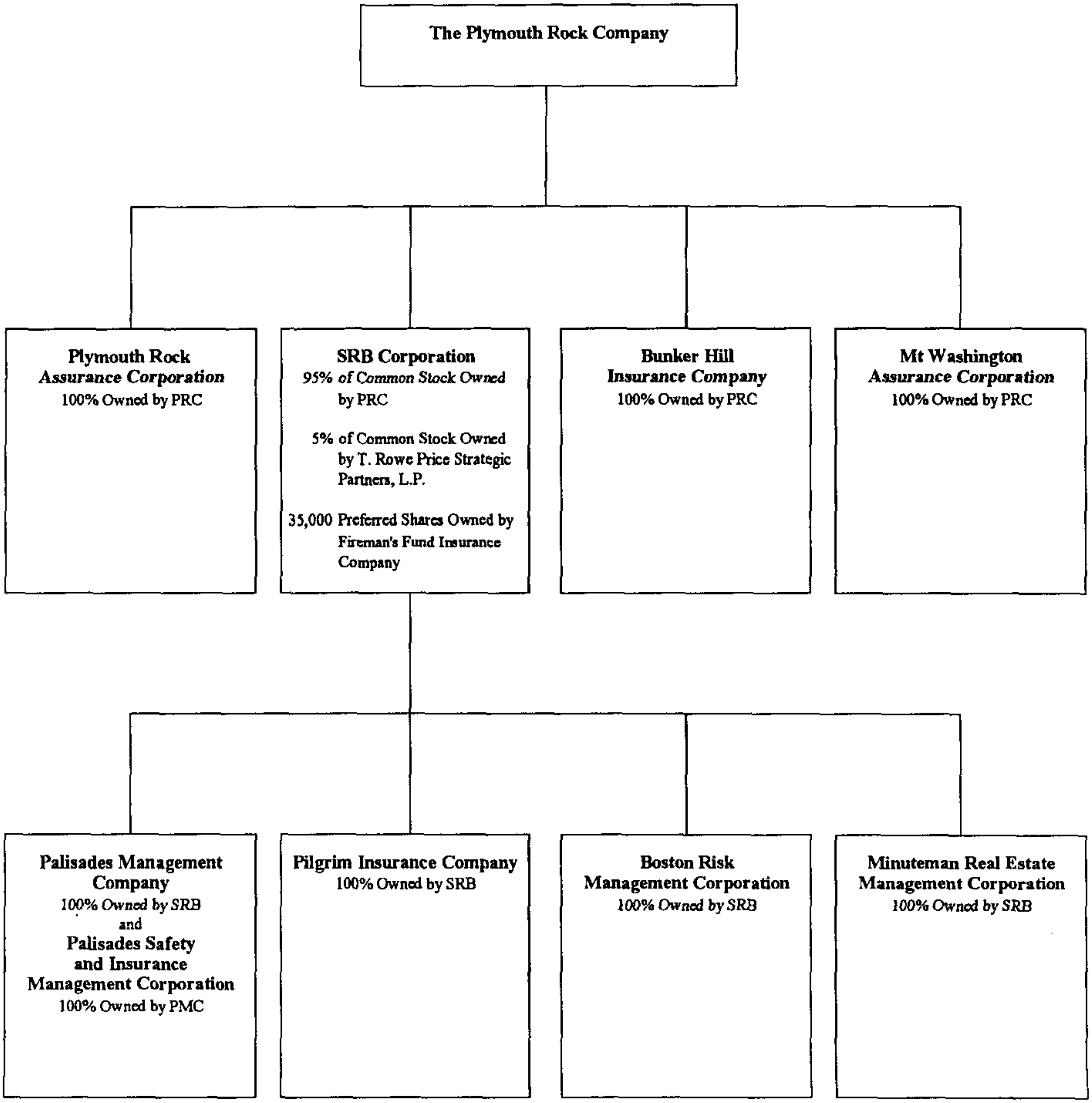
The accompanying notes are an integral part of the financial statements.

# THE PLYMOUTH ROCK COMPANY

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 1. Organization of the Plymouth Rock Companies

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



## 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. Tangible Assets

The cash and marketable securities category is composed primarily of fixed income investments, which are carried at market value. The calculation of gain or loss on the sale of marketable securities is based on specific identification at the time of sale. The market values of investments are based on quoted market prices.

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

### C. Income Taxes

The Company files its federal income tax return on a consolidated basis. The Company's federal income tax return reflects current income taxes, which are not the same as the provision for income taxes shown in the Consolidated Statements of Income. This is because the rules of the Internal Revenue Code and those of generally accepted accounting principles can differ with respect to the time periods in which income and expenses are recognized.

Federal income taxes consist of:

| | 1995 | 1994 |
|---|---|---|
| Current | $3,927,133 | $5,201,078 |
| Deferred | 36,290 | (1,236,816) |
| Total | $3,963,423 | $3,964,262 |

Deferred income taxes in the balance sheet as of December 31, 1995 and 1994 consist of the net effect of these temporary differences:

| | 1995 | 1994 |
|---|---|---|
| Discounting of claim reserves | $3,445,343 | $3,276,058 |
| Deferred income | 2,848,911 | 2,559,000 |
| Net unrealized (gain) loss on investments | (2,097,104) | 1,143,083 |
| Other | (484,145) | 11,341 |
| Total | $3,713,005 | $6,989,482 |

## 2. Summary of Significant Accounting Policies, continued

### C. Income Taxes, continued

The net unrealized gain on investments is presented in stockholders' equity, net of an estimate of applicable deferred income taxes.

The Company's reported provision for federal income taxes is less than that computed by applying the federal income tax rate for these years to income from operations before federal income taxes. This is principally because the Company receives significant non-taxable interest from state and municipal bonds.

### D. Revenues Earned in Underwriting and Service Activities

Premium revenues are earned on a daily basis over the terms of the policies. Unearned premiums represent billed amounts which are applicable to the unexpired terms of policies in force and are presented net of reinsurance. Premiums receivable are net of reserves for doubtful collections of $381,787 and $382,006 at December 31, 1995 and 1994, respectively, and are presented net of unbilled amounts of $15,529,896 and $14,508,952, 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, brokerage, policy processing, billing, claims management and systems development services in two Northeast states. Fee income is earned over the related contract periods.

### E. Reinsurance

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

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

| | 1995 | | 1994 | |
|---|---|---|---|---|
| | Premiums Written | Losses Incurred | Premiums Written | Losses Incurred |
| Gross | $144,981,028 | $97,199,797 | $142,073,842 | $95,592,732 |
| Ceded | (41,880,238) | (31,410,201) | (40,037,561) | (32,915,804) |
| Net | $103,100,790 | $65,789,596 | $102,036,281 | $62,676,928 |

Ceded premiums earned for 1995 and 1994 were $42,128,502 and $41,134,866, respectively.

## 2. Summary of Significant Accounting Policies, continued

### E. Reinsurance, continued

The Company has a 40 percent quota share reinsurance treaty which reinsures certain coverages for losses in excess of approximately 88 percent of premiums earned during specified accounting periods. Revenues and expenses are reflected net of quota reinsurance totaling approximately $25 million and $23 million for 1995 and 1994, respectively.

The Company has a catastrophe reinsurance treaty. At December 31, 1995, the Company had paid approximately $2,800,000 (net of cumulative losses and commissions) to the reinsurer to cover future catastrophes. This contract has an experience rating feature whereby a substantial portion of the amount paid could be returned to the Company if the experience continues to be favorable.

The Company is a member of Commonwealth Automobile Reinsurers and accounts for ceded policies as reinsurance. The Company's estimated share of the Commonwealth Automobile Reinsurers deficit is recorded in claim and claim adjustment expenses.

The Company acts as an intermediary for certain other insurance companies in administering commercial automobile insurance programs. The Company's income statement and reinsurance activity exclude premiums earned of $17,076,060 and $13,402,145 and claim and claim adjustment expenses of $9,340,646 and $5,453,459 in 1995 and 1994, respectively. In connection with these arrangements, receivables and claim reserves exclude $4,255,484 and $3,068,445 at December 31, 1995 and 1994, respectively.

### F. Deferred Acquisition Costs

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

### G. Claim and Claim Adjustment Expenses

Claim reserves represent the estimated liability for claims reported to the Company plus reserves for claims incurred but not yet reported. Claim adjustment expense reserves represent the estimated expenses related to settling these claims. Claim and claim adjustment expense reserves are presented before estimated recovery for reinsurance. The methods of making such estimates and establishing the resulting reserves are reviewed regularly, and any adjustments are reflected in income currently. Losses incurred in 1995 and 1994 include payments for events reported in prior years. Payments for prior reported events amounted to approximately $44.1 million and $35.9 million in 1995 and 1994, respectively. Reserves carried for these claims at prior year end were $45.4 million and $42.1 million, respectively. Claim and claim adjustment expense reserves at December 31, 1993 were approximately $93.3 million.

## THE PLYMOUTH ROCK COMPANY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 3. Consolidated Revenues

Revenues, net of reinsurance, for the separate companies for 1995 and 1994 are:

| | 1995 | 1994 |
|---|---|---|
| The Plymouth Rock Company | $ 3,856,910 | $ 3,260,436 |
| Plymouth Rock Assurance Corporation | 111,102,096 | 104,216,892 |
| Mt Washington Assurance Corporation | 3,653,931 | 3,321,346 |
| SRB Corporation | 5,775,945 | 5,761,724 |
| Pilgrim Insurance Company | 7,794,003 | 5,778,122 |
| Palisades Management Company (Consolidated) | 3,282,660 | 1,910,330 |
| Boston Risk Management Corporation | 291,839 | 346,640 |
| | 135,757,384 | 124,595,490 |
| Intercompany eliminations | (7,613,620) | (7,571,297) |
| Total revenues | $128,143,764 | $117,024,193 |

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

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

| | 1995 | 1994 |
|---|---|---|
| Net income | $12,330,268 | $12,818,895 |
| Depreciation and amortization | 2,328,256 | 2,394,525 |
| Minority interests | 15,489 | 24,524 |
| Change in premiums receivable | (2,918,377) | (1,800,750) |
| Change in accrued investment income | (249,600) | (66,318) |
| Change in receivable from reinsurers | (2,202,888) | 345,806 |
| Change in deferred acquisition costs | (1,842,454) | (1,088,699) |
| Change in deferred income taxes | 36,290 | (1,236,816) |
| Change in claim and claim adjustment expense reserve | 4,457,935 | 10,480,268 |
| Change in premiums payable to reinsurers | (832,251) | (2,953,350) |
| Change in unearned premium reserve | 3,255,062 | 3,971,768 |
| Change in advance premium | (2,161,033) | (659,735) |
| Change in commissions payable and accrued liabilities | 5,397,584 | (205,115) |
| Change in unearned service fees | 1,364,314 | 639,974 |
| Change in other assets and other liabilities | 4,875,602 | (2,198,076) |
| Income on sale of investment securities | (4,217,701) | 673,313 |
| Income on disposal of fixed assets | 76,497 | (6,977) |
| Net cash provided by operating activities | $19,712,993 | $21,133,237 |

## 5. Real Estate

During 1995, the Company purchased two buildings at a total cost of $6,821,924. The table below summarizes real estate at December 31, 1995.

| | Useful Lives | 1995 |
|---|---|---|
| Land | | $1,719,628 |
| Buildings | 39 years | 5,102,296 |
| Building improvements | 2-6 years | 35,132 |
| Total cost | | 6,857,056 |
| Less: accumulated depreciation | | 44,270 |
| Net book value | | $6,812,786 |

Rental income for 1995 aggregated approximately $324,000. Approximately 73,500 square feet of office space and 660 square feet of retail space are leased by the Company. For each of the years 1996 through 2001, minimum annual rent receivable by the Company is approximately $616,000. Total obligations of lessees through 2001 are approximately $3,694,000.

## 6. Fixed Assets

The table below summarizes fixed assets at December 31, 1995 and 1994. Purchases of fixed assets were $1,479,842 and $1,076,173 in 1995 and 1994, respectively.

| | Useful Lives | 1995 | 1994 |
|---|---|---|---|
| Furniture and fixtures | 5-10 years | $ 2,994,093 | $ 2,852,622 |
| Computers | 3-5 years | 5,556,287 | 4,830,664 |
| Leasehold improvements | 2-6 years | 2,413,106 | 2,343,533 |
| Vehicles | 3 years | 946,900 | 650,777 |
| Total cost | | 11,910,386 | 10,677,596 |
| Less: accumulated depreciation and amortization | | 7,329,457 | 5,702,139 |
| Net book value | | $ 4,580,929 | $ 4,975,457 |

## 7. Lease Commitments

Rental expenses for 1995 and 1994 aggregated approximately $1,772,000 and $1,663,000, respectively. There are several leases totaling approximately 88,000 square feet of office space and 22,500 square feet of storage space. Certain leases contain renewal options which may be exercised from three to twelve months prior to expiration. For each of the years 1996 through 2001, the minimum lease obligations of the Company are approximately $875,000 annually. Total obligations for leases through 2001 are approximately $5,250,000.

## 8. Investments and Investment Income

All investment securities are classified as Available for Sale and are carried at market value. Net unrealized capital gains and losses on Available for Sale securities, net of applicable deferred taxes, are credited or charged directly to stockholders' equity.

### A. Composition of Investment Portfolio

At December 31, 1995 and 1994, amortized cost, unrealized gains and losses before federal income taxes and market value of cash and marketable securities are as follows:

| At December 31, 1995: | Amortized Cost | Unrealized Gains | Unrealized Losses | Market Value |
|---|---|---|---|---|
| Cash and cash equivalents | $ 21,665,322 | $ -0- | $ -0- | $ 21,665,322 |
| U.S. government securities | 22,023,187 | 202,321 | -0- | 22,225,508 |
| State and municipal securities | 91,923,929 | 1,307,277 | 75,451 | 93,155,755 |
| Corporate debt securities | 30,717,728 | 617,348 | 64,247 | 31,270,829 |
| Mortgage-backed securities | 29,520,328 | 345,960 | 14,360 | 29,851,928 |
| Common stocks | 8,499,825 | 3,860,673 | 11,561 | 12,348,937 |
| Total | $204,350,319 | $6,333,579 | $ 165,619 | $210,518,279 |

| At December 31, 1994: | Amortized Cost | Unrealized Gains | Unrealized Losses | Market Value |
|---|---|---|---|---|
| Cash and cash equivalents | $ 30,032,476 | $ -0- | $ 2,625 | $ 30,029,851 |
| U.S. government securities | 13,547,694 | 234 | 543,542 | 13,004,386 |
| State and municipal securities | 97,318,958 | 224,102 | 2,538,210 | 95,004,850 |
| Corporate debt securities | 31,831,478 | 56,916 | 985,212 | 30,903,182 |
| Mortgage-backed securities | 9,997,454 | -0- | 275,976 | 9,721,478 |
| Common stocks | 7,864,358 | 733,730 | 31,425 | 8,566,663 |
| Total | $190,592,418 | $1,014,982 | $4,376,990 | $187,230,410 |

At December 31, 1995, maturities of cash and marketable securities are as follows:

| | Amortized Cost | Market Value |
|---|---|---|
| Cash | $ 10,621,075 | $ 10,621,075 |
| Due in 90 days or less | 11,548,782 | 11,549,783 |
| Due after 90 days and in one year or less | 3,765,320 | 3,807,186 |
| Due after one year and in five years or less | 94,139,231 | 95,095,336 |
| Due after five years | 75,776,086 | 77,095,961 |
| Common stocks | 8,499,825 | 12,348,938 |
| Total | $204,350,319 | $210,518,279 |

## 8. Investments and Investment Income, continued

### B. Investment Activity

The components of cash and marketable securities activity during 1995 and 1994 are as follows:

| | 1995 | 1994 |
|---|---|---|
| Balance at beginning of year | $187,230,410 | $163,869,322 |
| Change in marketable securities: | | |
| Sales prior to maturity | (165,842,579) | (70,886,677) |
| Redemptions at maturity | (4,200,474) | (3,150,040) |
| Purchases | 197,393,337 | 76,502,227 |
| Change in marketable securities | 27,350,284 | 2,465,510 |
| Change in cash and cash equivalents | (8,367,154) | 16,258,151 |
| Net investment activity | 18,983,130 | 18,723,661 |
| Net change in purchases in process | (5,225,229) | 7,999,435 |
| Net change in unrealized gain on investments | 9,529,968 | (3,362,008) |
| Balance at end of year | $210,518,279 | $187,230,410 |

### C. Analysis of Investment Income and Capital Gains

The components of investment income and capital gains before federal taxes during 1995 and 1994 are as follows:

| | 1995 | 1994 |
|---|---|---|
| Interest income from securities | $10,828,611 | $ 8,818,706 |
| Rental income | 324,196 | -0- |
| Finance charges from premiums receivable | 2,750,303 | 2,967,753 |
| Gross investment income | 13,903,110 | 11,786,459 |
| Rental expenses | (319,896) | -0- |
| Investment expenses | (388,457) | (958,752) |
| Investment income | 13,194,757 | 10,827,707 |
| Realized capital gains | 4,217,701 | (673,313) |
| Investment income and capital gains | $17,412,458 | $10,154,394 |

## 9. Savings and Investment Plan and Deferred Compensation Plan

The Company has a Savings and Investment Plan under Section 401(k) of the Internal Revenue Code. The Plan, which is a defined contribution plan, covers all employees 21 years or older with at least one year of service. The Company provided $771,510 and $660,229 for discretionary contributions in 1995 and 1994, respectively.

The Company has a Deferred Compensation Plan for officers, managers and directors other than its founding shareholders. The Plan provides for a rate of return on voluntary deferrals based on the financial performance of the Company. The Company accrued $1,464,624 and $743,228 as of December 31, 1995 and 1994, respectively, for liabilities relating to the Plan.

## 10. Stockholders' Equity

### A. Common Stock

Common stock at December 31, 1995 and 1994 is composed of Class A common 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 145,815 and 130,905 were issued and outstanding on December 31, 1995 and 1994, respectively. There are 90,000 Class B shares authorized, of which 86,487 and 87,667 were issued and outstanding on December 31, 1995 and 1994, respectively. The issuance of common stock as described in the Statements of Cash Flows and Changes in Stockholders' Equity includes three transactions, one of which, in the amount of $8.1 million, is subject to a right of rescission prior to October 31, 1996, upon specified conditions.

The Class A common shares are fully transferable and have the right to elect 20 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 80 percent of the Board of Directors.

### B. Preferred Stockholder's Interest in Subsidiary

A subsidiary of the Company has issued 35,000 shares of cumulative preferred stock with no par value, all of which were outstanding at December 31, 1995 and 1994. The preferred stockholder is entitled to receive cumulative cash dividends of 4 percent per year, increasing to 7 percent per year under certain circumstances, when declared by the subsidiary's Board of Directors out of funds legally available. The preferred stockholder is also entitled to special cumulative dividends of 20 percent of the difference between the subsidiary's net income and the amount of regular preferred dividends for that year. Such special dividends are limited to $1,000,000 on a cumulative basis. Under certain conditions the preferred shares may be redeemed by the subsidiary at $120 per share with adjustment for dividends. In addition, under certain circumstances the holder may redeem the preferred stock at $100 per share plus any accrued but unpaid dividends. In the event of corporate liquidation, the preferred stockholder of the subsidiary is entitled to receive out of available subsidiary funds $120 per share ($4,200,000 in the aggregate), with adjustment for certain dividends paid, plus any accrued but unpaid dividends. The preferred stock is convertible under certain default circumstances, with appropriate regulatory approval, into specified amounts of the subsidiary's common stock.

## 10. Stockholders' Equity, continued

### C. 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 \$57,614,000 and \$45,698,000 at December 31, 1995 and 1994, respectively. Regulatory limits restrict the amount of dividends which can be remitted to the Company from its insurance subsidiaries without approval of state insurance regulators.

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# REPORT OF INDEPENDENT ACCOUNTANTS

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

We have audited the accompanying consolidated balance sheets of The Plymouth Rock Company and subsidiaries as of December 31, 1995 and 1994, and the related consolidated statements of income, cash flows and changes in stockholders' equity for the years then ended. 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 in accordance with generally accepted auditing standards. Those standards 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Plymouth Rock Company and subsidiaries as of December 31, 1995 and 1994, and the consolidated results of their operations, and their cash flows for the years then ended, in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P.

Boston, Massachusetts
February 7, 1996

## Directors and Officers of The Plymouth Rock Company

### Directors

James M. Stone, *Chairman*

James N. Bailey

Michael J. Johnston

Wilmot H. Kidd, III

Keith R. Rodney

Benno C. Schmidt

Peter J. Wood

### Officers

James M. Stone
*President*

Keith R. Rodney
*Executive Vice President and Clerk*

James N. Bailey
*Treasurer*

William M. Kelley
*Vice President*

Raymond D. Moore
*Vice President*

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

### Non-Management Directors

Normand A. Dion
Alexander Ellis, III
Michael J. Johnston
Wilmot H. Kidd, III
Benno C. Schmidt
David L. Warnock
Peter J. Wood

### Management Officers and Directors

Francis P. Arment
James N. Bailey
Robert L. Barrese
Hal Belodoff
Elyse D. Cherry
Frederic C. Church, Jr.
Paula W. Gold
Alan M. Hines
J. Robert Keiger
William M. Kelley
Stewart W. Kemp
Eugene J. Meyung
Raymond D. Moore
Vincent V. Nieroda
Keith R. Rodney
James M. Stone

Independent Accountants:
Coopers & Lybrand L.L.P.

Counsel:
Ropes & Gray