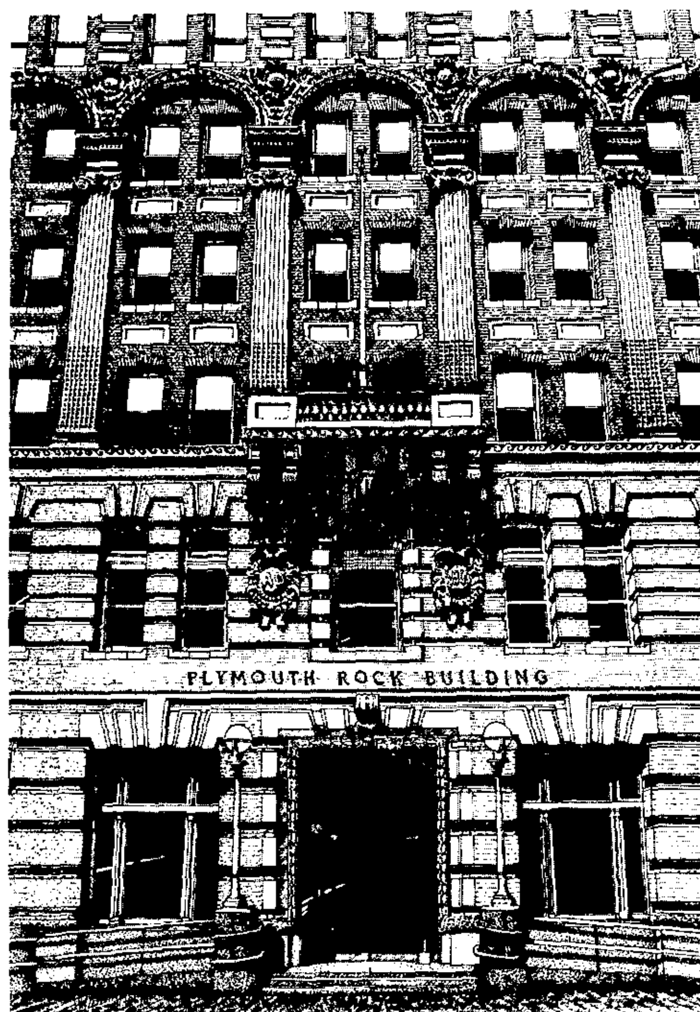
The Plymouth Rock Company



1998 Annual Report

The Plymouth Rock Company

695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 23, 1999

To Our Shareholders:

Some years just rush through memory, their seeming crises arising, resolving and fading by the week. The issues 1998 brought were more substantial, and their resolutions more consequential than that. The financial statements fairly display the negative aspect of the picture, in that common equity on a per-share basis was about flat for the first time since the Company's launch year. But a business's value is seldom fully revealed by its published financials. Balance sheets and income statements make more sense when read in conjunction with other, less accessible numbers, and still more sense when the vital momentum of the business is understood as well. Last year's readers will remember that a rather unusual share of Plymouth Rock's tangible value now lies outside the scope of the audited financials, largely because the Company has a number of important investments that are not marked-to-market under generally accepted accounting principles. The vectors of momentum, of course, require a subjective assessment in every business. The whole picture of our company at this time, not surprisingly, is a great deal more interesting than the financial statements can show. In the end, I hope you will share my conclusion that your company is in good order and its long-term prospects excellent.

To understand this past year's events, it is useful to consider the Massachusetts automobile insurance business at Plymouth Rock Assurance Corporation, still our largest company in terms of volume, before turning to the three smaller New England agency companies and our New Jersey reciprocal management business at Palisades. Our ownership positions in Direct Response Corporation and Homeowners Direct Corporation, while technically within the investment portfolio, represent a category by themselves. Finally, there is our more conventional investment business, including the marketable securities portfolio, various alternative equities and equity equivalents, and three real estate holdings. The hardest issues were those facing Plymouth Rock Assurance. The other agency insurers did fairly well, even though their contribution to the bottom line remains modest. The direct insurers began their long and difficult treks toward prominence. Investment results were mixed, with some of the greatest increases in intrinsic value not visible in the financials.

Plymouth Rock's consolidated net income for the year was $5.2 million. The largest contributor to that number was the sale of our investment position in CAT, Ltd., the Bermuda reinsurer. Common equity per share outstanding on December 31, which had been $427 in the prior year, was $429 at the close of 1998. Why, you may ask, did per-share equity fail to rise as much as the Company's profit? The apparent anomaly arises principally because we repurchased about $11 million worth of common stock at an appraised value of $700 per share, about 1.6 times book value. While the share repurchase is likely to prove positive for the shareholders in the long run, the difference between market and book brings about a reduction in net worth per share in 1998. Even without this transaction, returns would have been low by the Company's historical performance standards. As a result, for the first time since we went into business, the common stock return on book equity from inception has fallen below our cherished target

of 20% per year. The cumulative return since 1993 now stands at 19.8%, to be more precise. There is little I would like better than to see this gap closed sometime soon. Since some of the drags on profits remain with us, though, improvement may take a little longer in coming than any of us would like. To understand this, Plymouth Rock Assurance is the first place to look.

There was never any doubt that 1998 would be a tough year for the Massachusetts automobile writer. Insurers in this state have lived through a price war environment for almost four years now. In December of 1997, the Commissioner announced a fourth consecutive rate decrease in the state-set base rates, this time about 4%. This brought the cumulative base rate decrease to nearly 20% and state-set rates very likely into the inadequate zone. That would be bad enough, but the real problem is company discount programs that take the final premiums still lower. The combined impact of overzealous discounting and state-made rates is a bear trap. Political realities make it difficult for the Commissioner to grant an increase in state-made rates while the companies, by their actions, belie the need for any increases. At the same time, because the base rates systematically overprice certain subsets of the driving population, it is hard for the companies to give up selective discounting. The result is persistent overall rate inadequacy.

The price war took shape in 1995, when one major company offered a 10% discount to any insured who was also a member of the state's largest automobile road service club. It intensified each year thereafter. By the time 1998 began, most carriers were discounting better-than-average drivers by ten to fifteen points from the state-set rates and adding another discount on top of this for those written through their group programs. Groups, which served only a tiny percentage of the driving public just five years ago, had come to account for about a third of industry volume, so the overall decrease in premium per insured since 1994 has been more than 25%. All eyes were on the leading carriers when they filed for the 1998 group and good-driver discounts in January of 1998. One leading Massachusetts insurer filed at first to scale back its good-driver discount, then amended the filing when competitors failed to follow suit. Virtually every company, including ours, filed to keep the discounts high -- and the price war continued to rage. We knew, therefore, in January of 1998 that prices would be below actuarially sound price levels and, further, that the Commissioner would once again have a hard time granting an otherwise justifiable increase. Plymouth Rock Assurance Corporation entered the year expecting to see its average premiums falling.

Plymouth Rock Assurance next found itself facing a relationship crisis with its agents, a situation with which it is (fortunately) inexperienced. A number of the company's oldest, and most valued, agents threatened to leave Plymouth Rock for the embraces of a competitor, and some actually did. The episode was especially distressing to me, because among the agents who left us were several I had signed up myself in 1983. After most of a year's reflection on the events that led up to this defection, I would list three contributing reasons as particularly important. First, our work on Direct Response Corporation and Homeowners Direct Corporation had generated concern among some agents that we might now be considering a direct business strategy in Massachusetts. When we then organized a group discount program for customers of Savings Bank Life Insurance, a friend of the consumer since its founding by Louis Brandeis in 1907, this was inaccurately seized upon by a competitor as the proof that we were walking away from independent agents. Second, Plymouth Rock's communication with its agents on these sensitive matters was insufficient. Our marketing visits to agents were fewer than in the past -- at exactly the time we needed to visit them more. Our message became blurry at exactly the time it needed to be clearest. Finally, the transfer incentive promises for Plymouth Rock books of business were beyond what we thought we should match. We have tended to compensate our agents with more attention to horizontal equity and stability over time than this type of business-buying suggests.

Throughout the summer and fall, the major task for all the Plymouth Rock Assurance officers was to stabilize the situation with the agents, and events since then indicate that a great deal of progress has been made. Plymouth Rock Assurance Corporation has started adding new volume again, and the projected unit count for 1999 shows that new business already identified will make up for a good fraction of the business to be transferred that year. The frequency of agency marketing visits has been raised, and communications have been improved. It has taken some time to sharpen our message to agents, but the theme is now clear to all. Plymouth Rock is committed to its independent agents, and part of that commitment is to keep up with changing times. We want to be known as the company whose agencies can grow the fastest and earn the highest returns, as well as the company that agents find easiest to work with. To accomplish this, we must strive with our agents to build the agency company of the future. The world is changing for agents and their companies; those who pretend time has stopped are courting unpreparedness. Plymouth Rock believes that financial institutions will enter the business of selling insurance; that group and data-mining techniques of selling are here to stay; and that the Internet will play an important role in financial services as it matures. This company and its independent agents look to the future and see opportunity, rather than just threats. New technology is allowing our agents to eliminate redundancy and inefficiency -- while improving service to customers. New marketing tools should give our agents a comparative advantage over their competitors. It is our job to learn every new method that works -- and pass the knowledge on to our agents. We think this makes us the best company for agents to do business with. The proof will be in the long-term success of the Plymouth Rock agents.

At this point in the discussion, I usually write about the loss ratio and the expense ratio. This year the published industry data on that subject is a bit puzzling. While I continue to believe that Plymouth Rock Assurance has a superior loss ratio and a typical expense ratio for its peer group, the preliminary data for 1998 would not support that view. If our underwriting is in danger of reverting to the mean, we must take steps to restore our comparative advantage. If operational costs are higher than absolutely necessary, we must tighten our belts. At this point, though, I am reluctant to reach any firm conclusions of that sort. The price war environment is a strange one, in which perhaps some of our peers are more reluctant than Plymouth Rock to reflect the full negative impact of the inadequate prices. As time hardens the numbers and proves the reserves, we will become much more certain where we stand. Operating management's goal, which I heartily support, is the achievement and maintenance of a combined operating ratio at least five points better than that of our closest competitors. It can't be impossible; we've been there before.

The overall prognosis for 1999 at Plymouth Rock Assurance is better than it might have appeared a few months ago. In December, the Commissioner rather courageously granted a symbolic 0.7% increase in rates, which would seem to be a signal that she thinks the cutting has become excessive. And, just a few weeks ago, the carriers filed their new good-driver discounts. On average, they appear to produce about a two to three point benefit to the carriers on this market segment when compared with last year's levels. Let us hope that the cutthroat prices have finally reached their bottom. Plymouth Rock Assurance expects to make a small profit next year. In such a highly cyclical industry, the best one can hope for is a small profit in bad years and a healthy one in the good years. There is no reason to doubt that this is Plymouth Rock's picture as the clouds lift.

The gross annual writings of Plymouth Rock Assurance, which round to about $100 million, are matched by another roughly equal amount at the other four agency insurance companies we manage or control. Two of those smaller companies are located in Boston and, in fact, have recently moved into 695 Atlantic Avenue. Vin Nieroda is president of both Pilgrim Insurance and Bunker Hill Insurance Company. This was a solid enough year for Pilgrim Insurance, our service company. The only negative news was a decline in the involuntary market premium serviced for clients. Pilgrim won a renewal of its

taxi contract with Commonwealth Automobile Reinsurers (the Massachusetts residual market), and it added business from a new insurance company client. Its managed volume is now at $16 million and rising again. Pilgrim's net income was just over $0.8 million. While this is down from last year, the upward direction should be restored next year as growth resumes. Pilgrim's capital is about $5.5 million, and three-year average profits have exceeded $1.1 million. Since Pilgrim -- as a servicer -- has substantially less underwriting risk than our other insurance companies, its three-year returns in excess of the 20% mark still look quite healthy to us.

Bunker Hill, which writes homeowners insurance in Massachusetts through independent agents, suffered some of the same defections that hurt Plymouth Rock Assurance. Otherwise, its performance remains roughly as expected. Profits on its book of nearly $23 million in homeowners insurance premiums are a little under $1 million. When this is compared to the national homeowners results, Massachusetts and Bunker Hill both look pretty good, but don't forget that in the last decade Massachusetts has fared relatively well with respect to natural disasters. Vin and I would both like to see Bunker Hill do a little better in its good years, so the long run – including years with catastrophes – averages about what we are seeing now. Vin is hard at work on the combination of business replacement, non-catastrophe loss ratio analysis, and expense reductions that will make this possible next year.

Bill Kelley continues to manage our New Hampshire insurer, Mt Washington Assurance. He once told me that his long-time goal was to retire at age 55. While I haven't inquired, rumor has it that he has passed that longevity marker, and he is stuck with a promise he made me when he took over Mt Washington. Bill gave his word that he would stay at his post until Mt Washington's volume was between $20 and $25 million and its net income over $1.5 million. It is fortunate that Bill likes to work, and would probably be bored in retirement, because he may be with us a few more years. That is not to say that Mt Washington is anything other than on track. Although $20 million is not yet in sight, Bill celebrated an important intermediate milestone this past year. Mt Washington's premium volume grew by 28% over the prior year, passing $10 million for the first time, and its bottom line is in the black by about $175,000. The loss ratio is sound, and the expense ratio is improving by the year with better scale. Bill projects a profit of $340,000 for the coming year, on volume of $13 million. He is better than halfway home.

Palisades Safety and Insurance Management Corporation earns service fees for its management of a New Jersey automobile insurer, Palisades Safety and Insurance Association. The insurer is a reciprocal, which means that it is owned by its policyholder-members. The reciprocal format is unique to insurance, and even in our business it is uncommon. The closest familiar analogy might be a mutual fund under the Investment Company Act of 1940, where a fund management company provides the executive and other services the fund needs but the investors own the fund itself. The Palisades management company took in $6.6 million in fees for managing the reciprocal last year. Its net income, which is reflected in Plymouth Rock's earnings, was just over $400,000. Very little capital is required in the management company, but the real potential for a meaningful contribution to Plymouth Rock from New Jersey lies with the growth and health of the reciprocal. If the reciprocal insurer can become larger and more profitable, the profits of its manager will increase more than proportionally. The insurance operations there have only recently reached their economy of scale point. Palisades Safety and Insurance Association (along with its subsidiary, Palisades Insurance Company) now insures more than 50,000 cars. Its written premium volume in 1998 was $55 million. Palisades is the seventeenth largest auto writer in New Jersey, and one of the faster growing. There are dark clouds on the New Jersey horizon as I write this letter, because a recently enacted statute requires all companies to roll back rates -- regardless of their profitability or efficiency -- in 1999. But storms in that state so far have turned out to weaken our competitors more than Palisades, so Palisades' president, Hal Belodoff, is withholding judgment on

what this one might do. New Jersey remains a large and interesting state, where there is an extra measure of opportunity for the company that does a better job than the pack. Palisades is exactly that. New Jersey Insurance Department statistics show it as the best performer in the state with respect to valid complaints per policyholder.

Direct Response Corporation and Homeowners Direct Corporation are neither controlled nor managed by The Plymouth Rock Company, but they both represent important elements of the Plymouth Rock story. They might best be described as strategic, or active, investments to differentiate them from the more traditional passive stock and bond investments that constitute most of our portfolio. In both cases, Plymouth Rock played a founder's role in their creation and received a substantial number of founders' shares. Plymouth Rock provides the new direct companies with services; it has exchanged territorial non-competition agreements between its agency carriers and the new companies; and it has freed up a large portion of my time to serve as chairman of both companies. Plymouth Rock has also agreed to purchase $5 million of preferred stock in each company on the same terms as the outside investors, who have committed over $200 million to the purchase of preferred shares in each company. Direct Response Corporation is intended to become a major writer of automobile insurance on a direct response basis, originating its business principally through direct mail and media advertising, throughout most of the United States (other than Plymouth Rock's agency states). Homeowners Direct Corporation is intended to write homeowners insurance and related products on a direct response basis, originating its business in a similar manner in the same states but with more emphasis on institutional marketing relationships and, perhaps, the Internet. Direct Response Corporation will conduct operations through licensed insurance companies bearing names like Response Insurance and Response Indemnity, while Homeowners Direct Corporation will use the names Homesite Insurance and Homesite Indemnity. Since these companies will be spending very considerable sums on branding their products, I should cooperate in that effort by referring to the two companies as the "Response Insurance Group" (or just "Response Insurance") and the "Homesite Insurance Group" (or just "Homesite") rather than the corporate names associated with our investment positions.

Response Insurance is now almost three years old, having received its first substantial capital infusion in April of 1996. During that time, it has achieved licensing in over forty states, built an impressive infrastructure of systems and customer service capacity, recruited a first rate team of officers and support staff under the leadership of Mory Katz, and begun what appears to date to be a successful marketing program, integrating direct mail and television commercials. Things are looking pretty good there. If you have any doubts, a single visit to Response Insurance's Westchester County, N.Y. offices will probably convince you of this. The journey has just begun, but there have already been tough lessons along the way. Peter Wood and I, who co-founded Response Insurance with Plymouth Rock, had once thought that we could cause that business to grow much more cheaply than we now believe. Infrastructure spending, to be certain that Response Insurance would be prepared for large scale, was higher than anticipated; and acquisition costs in today's highly competitive environment are simply higher than the models we looked at led us to believe they would be. At the same time, Peter and I now see the potential rewards for success in this arena as even greater than we had initially expected. Analysts are talking these days about the total direct response distribution share of the national auto insurance market doubling in ten years, with each point of total market representing $2 billion dollars in volume at the end of that period. The underwriting, marketing, regulatory and systems challenges all constitute barriers to entry for any company wishing to share in this growth. I call these barriers the "moat". But the castle on the other side is all the more worth besieging precisely because of the moat. Since our investors have the vision and resources to share in this view and support the enterprise, we are optimistic that the castle towers will someday add a Response Insurance flag, with a little red telephone on wheels as its crest.

The funding for Homesite came about eighteen months later than Response Insurance's, so you can rewind the video a bit to see where it stands today. Homesite is now licensed in thirteen states, mostly in a strip from Texas to the Dakotas. Its systems are in good shape, and it will share Response Insurance's call center in its early days. The last of the key officer positions are just being filled as I write this letter. Charlie Kline, who served so successfully as president of CAT, Ltd. from its inception to its recent sale, will handle the chief executive's duties, beginning in mid-March. The roster of officers and managers behind him has grown stronger by the month. Everyone at Homesite assures us that the "go-live" date will be this spring, with 1999 volume arising largely from one or more pilot partnerships and targeted direct mail campaigns.

It is worth noting that, for accounting purposes, Plymouth Rock's stakes in Direct Response Corporation and Homeowners Direct Corporation are treated as investments carried according to the equity method. Put simply, this means that Plymouth Rock's carrying value moves with the book value of those companies, not their market values. Thus, as those companies accumulate operating losses to build their valuable franchises, the carrying valuation on the Plymouth Rock balance sheet falls each year and a charge is made each year to Plymouth Rock earnings. This occurs without regard to whether the operating losses are wisely incurred and the true value of the Plymouth Rock investment position is thus rising. Similarly, no upward adjustment was made to the valuation of Plymouth Rock's common stock holdings in these companies due to the commitments of the preferred stock investors, even though the market value of the common stock was doubtlessly enhanced by the nine-figure capitalization of the two companies.

The group's traditional investments, managed by Jim Bailey and Rick Childs at SRB Corporation, had the same roller coaster ride this year as just about everyone else's. Investment managers who lived through 1998 will recall it as the year that the market broke all records in its upward climb, seemed to correct itself to a more historically familiar level, and then went right back through the ceiling. With the year over, and the dramatic fluctuations netted out, it looks like a more ordinary year. SRB manages about $275 million for agency companies and the Plymouth Rock parent, and a total of $470 million counting the assets of the two direct response companies. For the Plymouth Rock companies, holdings in equities and equity equivalents for 1998 were up by about 4%, which lags by a substantial margin the Standard and Poor's 500 Stock Index performance for the year. The lagging performance is the consequence of purposeful non-diversification. Our portfolio is heavily concentrated in a small number of selected equities, which did not have a particularly good 1998. After a careful second look, we still have confidence in the fundamental research underlying the choices, and the same companies remain in our portfolios going into 1999. Marketable equity returns, measured over a five-year period, now average 29% per annum, better by about five points per year than the S&P, which has itself defied gravity (or, at least, history) over this period. By comparison with our benchmark objectives for the various investment classes, which focus on their returns in excess of available short-term debt rates, marketable equity performance looks even better.

Fixed income returns were very close to their benchmarks this past year, with an overall after-tax return of about 5.5%. Owner occupied real estate was the star of our portfolio this year, though much of the return lies outside the purview of the financials. We own three buildings, two in Boston and one in Concord, New Hampshire. Our companies are major tenants in all three of the buildings, so we feel that the risks of vacancy are less for us than they would be for a speculative developer. Taken together, the three buildings had a cash-on-cash (net operating income divided by cost plus improvements) return of almost 11%, more than 250 basis points above our benchmark. The real gain, though, was in the investment value of the two Boston buildings. We bought 99 Bedford Street at $71 per square foot and added another $14 per square foot in capital improvements. We bought 695 Atlantic Avenue at $97 per

square foot and have spent about $6 per square foot on capital improvements. Where pessimists had warned us that, during the so-called Big Dig (Boston's $11 billion traffic flow improvement project) the buildings would be impossible to rent, both are essentially full. The Big Dig has been only a minor inconvenience so far, and its aesthetic benefits promise to make our area one of the nicest urban office locations in the world. Both buildings are less than ten minutes from the airport and an easy walk from South Station, where new high-speed trains to New York will soon be running and commuter rail trains bring Boston's workforce every morning. These look like big winners to me. Since real estate is carried at adjusted cost on the books of the Company, there is no reflection in the balance sheet numbers of the unrealized gains I am quite sure are imbedded in these investments.

A few observations on the general stock market in 1999 may be needed here for context. It is harder than most folks think to predict the direction of markets and harder still to predict the timing as well. If extra returns are to be made, they are more likely to come from fundamental company research than market timing. Having said that, though, I confess to being among those who believe that there is no such thing as a "new paradigm" for fundamental value. Looking at today's stock prices in historical terms, as the old paradigm requires, leads to only one possible conclusion: the market is overpriced. When it will correct, I have no idea. This skepticism does not lead Plymouth Rock to sell its holdings. Jim Bailey and I are sufficiently agnostic to stay with a buy-and-hold approach even in expensive markets. It may affect in-coming asset allocation, however. When the public gets its advice from Pollyanna, there will be few bargains to be found in liquid equity markets. Even real estate has now caught up with the other asset classes, so there are no more bargains as easy to spot as our Boston office buildings. Our concentration in this era should be on strategic investing, positions where we can influence outcomes and not just run with them. We may look for more ways to accomplish this in the years ahead, or at least until the markets have returned to levels we can understand.

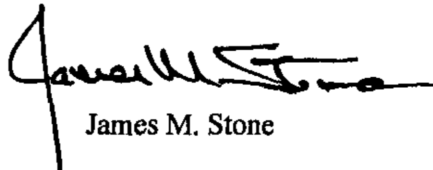
If all of the above does not qualify 1998 as a most unusual year, the changes in executive staff that occurred surely do. In June, Keith Rodney announced his retirement from The Plymouth Rock Company. Keith, one of the Company's three founders, was active in every aspect of our business, so his departure left a sizable hole. His notions of service excellence have loomed large in shaping the culture of Plymouth Rock from the very start, and he spearheaded the introduction of our much-acclaimed Crashbusters® claims service. Everyone here will miss Keith, but I will especially miss him -- after having worked together with Keith in three different jobs over more than 23 years. All of us are waiting with interest to see what his next (doubtlessly successful) endeavor will be. It was Keith's departure that resulted in the repurchase of Plymouth Rock shares. A note representing future payments to be made for Keith's shares is referred to in this year's financials. This represents the first long-term debt in the Company's history, and it should not be taken as a signal of philosophical change with respect to the use of financial leverage.

Hal Belodoff, who helped create Palisades and then led it from its inception, is the new president of Plymouth Rock Assurance Corporation. With the presidency of both Palisades and Plymouth Rock Assurance, and the chairmanship of Mt Washington and Bunker Hill, Hal is definitively the leader of our agency group. There were other officer changes during the year as well. Eric Kramer has replaced Ray Moore as vice president for the Finance and Administration department at Plymouth Rock Assurance. Ray set the right course for the finance area, and Hal and I are confident that Eric, who holds both a Ph.D. in economics and a law degree, will keep up the pace. Rick Childs, who has co-managed the investment portfolio with Jim Bailey for more than five years now, is now a vice president of SRB Corporation. His job changes little or not at all with his new title, but an officership properly reflects his seniority and his value. Loren Mattingly, who heads up the financial area at Palisades, has also been promoted. Like Rick, he had been a manager for more than five years, and has set his own standard of

excellence. Glenn Tippy has joined Palisades as vice president and chief operating officer, with broad responsibilities for both the management company and the Palisades reciprocal. He will fill the gap that Hal leaves as his domain spreads. Bill Walker recently joined Bunker Hill as its vice president for marketing, underwriting and claims. His job is to take Bunker Hill to a new level, restoring what was lost this year, and then some. And, last but certainly not least, Mark Sweeney, whom we had watched with admiration for some years as he led the impressive growth of another Massachusetts auto insurer, has taken charge of marketing at Plymouth Rock Assurance. It is Mark who is working with Hal this year to return that company to a positive growth path and the fully restored confidence of its very special agency force.

Norm Rosenthal joined our Board of Directors this spring. Norm has been a good friend of the Company ever since he started keeping an eye on us for Morgan Stanley more than a dozen years ago. With the industry knowledge he acquired over many years as a top Wall Street insurance analyst, his familiarity with Plymouth Rock, and his immediate immersion into the fast-paced changes 1998 brought to the Plymouth Rock board, he is already a seasoned director.

Given what we already know about price levels, the current year can not possibly be a great one at Plymouth Rock Assurance. It will be good enough, though, if I can report next time around that the worst is over for Massachusetts auto insurers. We expect 1999 to be a reasonably strong year for all of the other agency companies. Traditional debt and equity investments performance is as unpredictable as ever, but this will be a particularly formative, and informative, year at the two direct companies we helped to create. There is every reason to believe that Homesite will write its first homeowners insurance policies during 1999, and Response Insurance has set an ambitious expansion goal, which would catapult it into being the third largest member of our extended family. The momentum in every part of the Company's business is a better source of inspiration than the 1998 numbers.



James M. Stone

PRICEWATERHOUSECOOPERS

REPORT OF INDEPENDENT ACCOUNTANTS

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, cash flows and changes in stockholders' equity present fairly, in all material respects, the financial position of The Plymouth Rock Company and its subsidiaries at December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the years then ended, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

Boston, Massachusetts
February 10, 1999

THE PLYMOUTH ROCK COMPANY

CONSOLIDATED BALANCE SHEETS

December 31, 1998 and 1997

Assets	1998	1997
Cash and cash equivalents	$ 8,607,637	$ 14,697,261
Investment securities	190,764,563	188,444,223
Premiums receivable	14,471,353	17,418,942
Accrued investment income	1,896,179	2,212,030
Receivable from reinsurers	29,732,783	34,728,738
Real estate	20,319,832	20,276,470
Deferred acquisition costs	6,968,030	8,040,084
Fixed assets	6,904,761	5,338,139
Deferred income taxes	1,317,245	1,234,234
Other assets	5,325,016	4,858,043
Total assets	$286,307,399	$297,248,164
Liabilities		
Claim and claim adjustment expense reserve	$113,004,716	$116,859,224
Unearned premium reserve	27,107,560	29,518,238
Premiums payable to reinsurers	20,811,098	18,152,271
Advance premium	5,658,625	8,912,985
Note payable	9,683,400	-0-
Commissions payable and accrued liabilities	10,800,274	14,670,846
Unearned service fees	3,669,139	4,108,386
Other liabilities	2,191,659	2,038,261
Total liabilities	192,926,471	194,260,211
Stockholders' Equity		
Common stock and paid-in capital	20,062,365	19,563,891
Retained earnings	65,508,096	71,663,197
Net unrealized gain on investments	7,514,682	8,025,642
Common stockholders' equity	93,085,143	99,252,730
Minority interests in subsidiaries	295,785	3,735,223
Total stockholders' equity, including minority interests	93,380,928	102,987,953
Total liabilities and stockholders' equity	$286,307,399	$297,248,164

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, 1998 and 1997

Revenues	1998	1997
Premiums earned in underwriting activities	$ 91,661,364	$101,123,515
Fees earned from service activities	13,652,086	14,269,284
Investment income and capital gains	20,121,643	14,121,121
Total revenues	125,435,093	129,513,920
Expenses		
Claim and claim adjustment expenses	71,852,104	74,822,461
Policy acquisition, underwriting and general expenses	35,108,817	34,727,908
Service activity expenses	11,955,275	12,315,472
Total expenses	118,916,196	121,865,841
Income before federal income taxes	6,518,897	7,648,079
Federal income taxes	1,272,064	1,506,524
Net income	$ 5,246,833	$ 6,141,555

Per share data		
Weighted average common shares outstanding	224,901	232,302
Net income less preferred stock dividend per share	$22.85	$25.44
Common shares outstanding at end of year	217,040	232,302
Common stockholders' equity per share	$428.88	$427.26

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, 1998 and 1997

Cash flows from operating activities	1998	1997
Gross premiums collected	$136,165,936	$138,404,117
Reinsurance premiums paid	(46,227,039)	(35,451,764)
Finance charges collected	2,607,377	2,552,010
Fees and commissions collected	14,611,082	13,156,560
Investment income received	19,073,791	13,000,048
Gross claims and claim expenses paid	(115,062,177)	(108,512,051)
Reinsured claims and claim expenses collected	42,595,533	33,324,446
Policy acquisition, underwriting, and general expenses paid	(32,920,651)	(31,534,691)
Federal income taxes paid	(1,490,000)	(3,147,162)
Service activity expenses paid	(12,002,483)	(11,760,904)
Net cash provided by operating activities	7,351,369	10,030,609
Cash flows from financing activities		
Retirement of common stock	(1,000,000)	-0-
Purchase of preferred stock of subsidiary	(3,000,000)	-0-
Dividends to stockholders	(613,275)	(443,515)
Dividends to preferred stockholder of subsidiary	(119,035)	(245,000)
Net cash used in financing activities	(4,732,310)	(688,515)
Net cash provided	$ 2,619,059	$ 9,342,094
Investment of net cash provided		
Change in cash and cash equivalents	$ (6,089,624)	$ (4,109,817)
Net investment activity	3,980,631	(2,523,841)
Purchases of real estate	560,785	12,504,065
Purchases of fixed assets	4,167,267	3,471,687
Net cash invested	$ 2,619,059	$ 9,342,094

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, 1998 and 1997

	Common Stock and Paid-in Capital	Retained Earnings	Net Unrealized Gain on Investments	Minority Interests	Total Stockholders' Equity
December 31, 1996	$19,563,891	$66,197,907	$ 4,200,365	$3,659,338	$ 93,621,501
Comprehensive income	-0-	6,141,555	3,825,277	-0-	9,966,832
Minority interests	-0-	-0-	-0-	88,135	88,135
Dividends to stockholders	-0-	(443,515)	-0-	-0-	(443,515)
Dividends to preferred stockholder of subsidiary	-0-	(232,750)	-0-	(12,250)	(245,000)
December 31, 1997	19,563,891	71,663,197	8,025,642	3,735,223	102,987,953
Comprehensive income	-0-	5,246,833	(510,960)	-0-	4,735,873
Minority interests	-0-	-0-	-0-	72,812	72,812
Dividends to stockholders	-0-	(613,275)	-0-	-0-	(613,275)
Dividends to preferred stockholder of subsidiary	-0-	(106,785)	-0-	(12,250)	(119,035)
Retirement of common stock	(1,526)	(10,681,874)	-0-	-0-	(10,683,400)
Purchase of preferred stock of subsidiary	500,000	-0-	-0-	(3,500,000)	(3,000,000)
December 31, 1998	$20,062,365	$65,508,096	$ 7,514,682	$ 295,785	$ 93,380,928

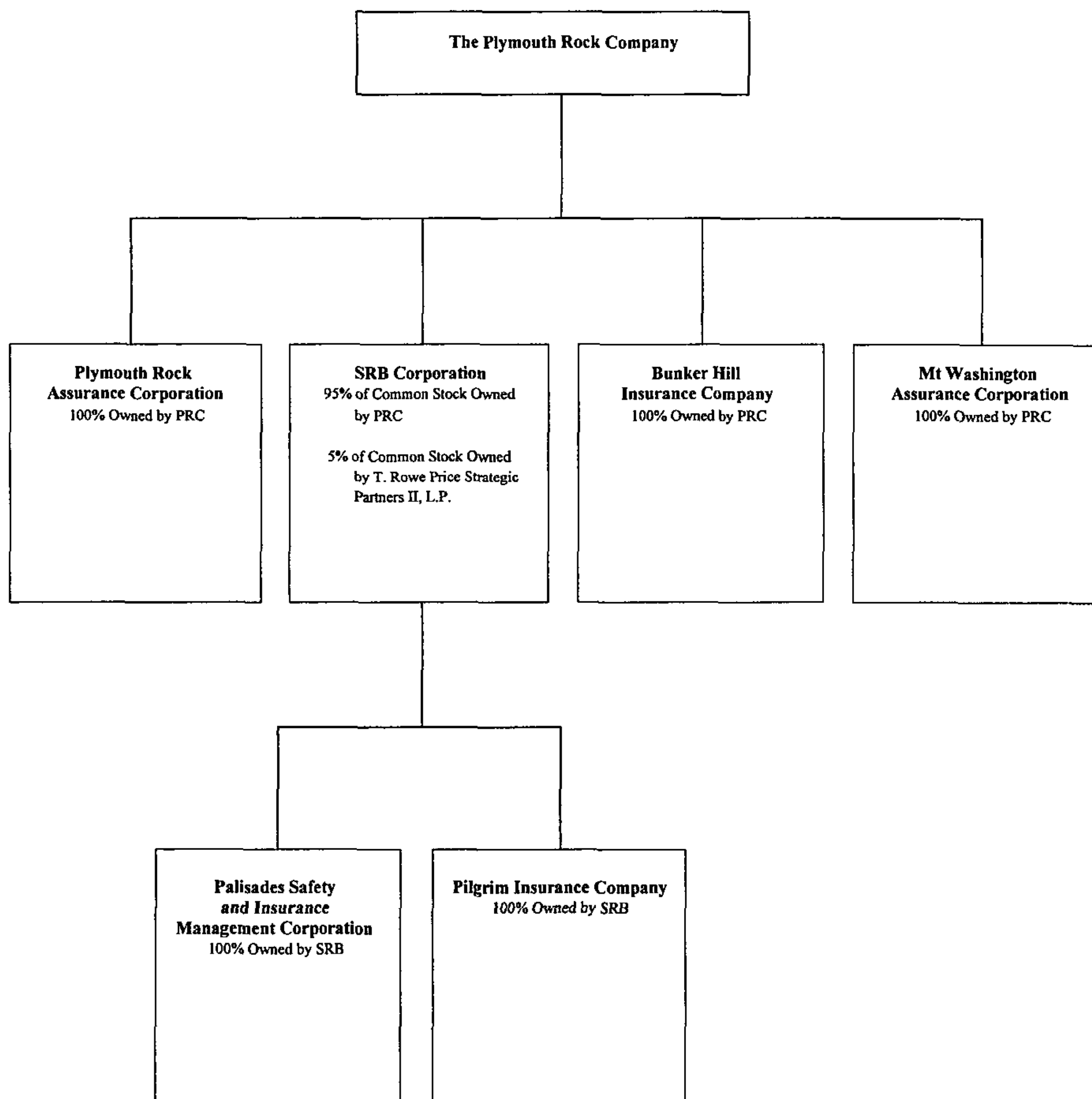
The accompanying notes are an integral part of the financial statements.

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization of the Plymouth Rock Companies

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



Direct Response Corporation and Homeowners Direct Corporation are not among the Plymouth Rock Companies, but The Plymouth Rock Company owns a common and preferred stock interest in each.

2. Summary of Significant Accounting Policies

A. Principles of Consolidation

The consolidated financial statements include the accounts of The Plymouth Rock Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to 1998 reporting practices.

B. Investments and Real Estate

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

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

C. Income Taxes

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

Federal income taxes consist of:

	1998	1997
Current	$1,091,850	$1,896,084
Deferred	180,214	(389,560)
Total	$1,272,064	$1,506,524

Deferred income taxes in the balance sheet as of December 31, 1998 and 1997 consist of the net effect of these temporary differences:

	1998	1997
Discounting of claim reserves	$3,265,274	$3,577,841
Deferred income	2,427,273	2,627,479
Net unrealized gain on investments	(3,871,200)	(4,134,421)
Other	(504,102)	(836,665)
Total	$1,317,245	$1,234,234

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies, continued

C. Income Taxes, continued

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

The Company's reported provision for federal income taxes is less than that computed by applying the federal income tax rate for these years to income from operations before federal income taxes. This is principally because the Company receives significant 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 $615,755 and $535,749 at December 31, 1998 and 1997, respectively, and are presented net of unbilled amounts of $13,022,789 and $15,289,474, 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 and claims management 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:

	1998		1997	
	Premiums Written	Losses Incurred	Premiums Written	Losses Incurred
Gross	$135,855,215	$111,103,325	$135,187,586	$109,643,048
Ceded	(48,160,179)	(39,251,221)	(32,810,144)	(34,820,587)
Net	$ 87,695,036	$ 71,852,104	$102,377,442	$ 74,822,461

Ceded premiums earned for 1998 and 1997 were $47,274,239 and $36,741,749, respectively.

2. Summary of Significant Accounting Policies, continued

E. Reinsurance, continued

The Company has treaties for quota share reinsurance ranging from 40 to 50 percent, which reinsure certain coverages for losses in excess of approximately 88 percent of premiums earned during specified accounting periods. Revenues and expenses are reflected net of quota reinsurance totaling approximately $33 million and $28 million for 1998 and 1997, respectively.

The Company has a catastrophe reinsurance treaty. At December 31, 1998 and 1997, the Company had paid approximately $2,800,000 and $1,350,000, respectively, (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. During 1997, the Company received approximately $4,270,000 of income relating to this feature.

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 $18,291,579 and $20,504,357 and claim and claim adjustment expenses of $16,302,586 and $15,235,560 in 1998 and 1997, respectively. In connection with these arrangements, receivables and claim reserves exclude $11,936,814 and $8,439,660 at December 31, 1998 and 1997, 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 recoveries for reinsurance. The methods of making such estimates and establishing the resulting reserves are reviewed regularly, and any adjustments are reflected in income currently. Claims incurred in 1998 and 1997 include payments for events reported in prior years. Payments for prior reported events amounted to approximately $31.6 million and $43.8 million in 1998 and 1997, respectively. Reserves carried for these claims at prior year end were $42.3 million and $53.6 million, respectively. Claim and claim adjustment expense reserves at December 31, 1996 were approximately $115.6 million.

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. Consolidated Revenues

Revenues, net of reinsurance, for the separate companies for 1998 and 1997 were:

	1998	1997
The Plymouth Rock Company	$ 6,680,174	$ 3,929,202
Plymouth Rock Assurance Corporation	93,570,212	101,394,619
Mt Washington Assurance Corporation	5,350,744	4,103,354
Bunker Hill Insurance Company	14,471,029	11,148,421
SRB Corporation	3,911,355	3,823,664
Pilgrim Insurance Company	9,106,533	10,756,263
Palisades Safety and Insurance Management Corporation	6,581,919	6,125,712
	139,671,966	141,281,235
Intercompany eliminations	(14,236,873)	(11,767,315)
Total revenues	$125,435,093	$129,513,920

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

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

	1998	1997
Net income	$ 5,246,833	$ 6,141,555
Depreciation and amortization	3,664,556	3,170,343
Minority interests	72,812	88,135
Change in operating assets and liabilities:		
Premiums receivable	2,947,589	(4,556,061)
Accrued investment income	315,851	349,562
Receivable from reinsurers	4,995,955	(1,662,104)
Deferred acquisition costs	1,072,054	53,519
Deferred income taxes	180,214	(389,560)
Claim and claim adjustment expense reserve	(3,854,508)	1,249,773
Unearned premium reserve	(2,410,678)	3,503,530
Premiums payable to reinsurers	2,658,827	443,931
Advance premium	(3,254,360)	1,510,078
Commissions payable and accrued liabilities	(2,984,463)	1,278,937
Unearned service fees	(439,247)	(185,363)
Other assets and other liabilities	5,735,428	(445,701)
Net realized capital gains	(6,595,494)	(511,954)
Income on disposal of fixed assets	-0-	(8,011)
Net cash provided by operating activities	$ 7,351,369	$10,030,609

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Real Estate

During 1997, the Company acquired a two-thirds interest in real estate for $11.5 million through a limited liability company. This investment is accounted for under the equity method. Building improvements of approximately $623,000 and $486,000 were incurred in 1998 and 1997, respectively. The table below summarizes real estate at December 31, 1998 and 1997.

	1998	1997
Land	$ 4,697,778	$ 4,697,778
Buildings, improvements and other	16,860,241	16,299,456
Total cost	21,558,019	20,997,234
Less: accumulated depreciation	1,238,187	720,764
Net book value	$20,319,832	$20,276,470

Rental income other than from Plymouth Rock companies aggregated approximately $2,521,000 and $2,551,000 in 1998 and 1997, respectively. For each of the years 1999 through 2005, minimum annual rent receivable by the Company is approximately $1,168,000. Total obligations of lessees through 2005 are approximately $8,178,000. Buildings and improvements are depreciated over their useful lives, which range from two to thirty-nine years.

6. Fixed Assets

Purchases of fixed assets were approximately $4,167,000 and $3,472,000 in 1998 and 1997, respectively. The table below summarizes fixed assets at December 31, 1998 and 1997.

	Useful Lives	1998	1997
Furniture and fixtures	5-10 years	$ 2,329,644	$ 2,159,207
Computers	3-5 years	7,718,234	5,895,711
Leasehold improvements	2-6 years	2,247,687	1,412,641
Vehicles	3 years	1,293,403	1,193,352
Total cost		13,588,968	10,660,911
Less: accumulated depreciation and amortization		6,684,207	5,322,772
Net book value		$ 6,904,761	$ 5,338,139

7. Lease Commitments

Rental expenses for 1998 and 1997 aggregated approximately $443,000 and $258,000, respectively. For each of the years 1999 through 2002, the minimum lease obligations of the Company range from approximately $100,000 to $470,000 annually. Total obligations for leases through 2002 are approximately $1,200,000.

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. Investment Securities and Investment Income

A. Available for Sale Securities

At December 31, 1998 and 1997, amortized cost, unrealized gains and losses before federal income taxes and fair value of fixed income and equity securities were as follows:

At December 31, 1998:	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government securities	$ 25,454,714	$ 593,200	$ 109,092	$ 25,938,822
State and municipal securities	47,780,551	935,149	48,421	48,667,279
Corporate debt securities	39,160,172	710,136	300,977	39,569,331
Mortgage-backed securities	11,893,272	184,514	10,485	12,067,301
Common stocks	20,128,002	11,897,078	2,465,220	29,559,860
Total	$144,416,711	$14,320,077	$2,934,195	$155,802,593

At December 31, 1997:	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government securities	$ 13,256,127	$ 210,625	$ 64	$ 13,466,688
State and municipal securities	51,237,665	1,055,062	1,709	52,291,018
Corporate debt securities	47,388,443	667,589	199,966	47,856,066
Mortgage-backed securities	20,533,849	197,074	47,043	20,683,880
Common stocks	10,138,024	10,278,495	-0-	20,416,519
Total	$142,554,108	$12,408,845	$248,782	$154,714,171

At December 31, 1998, maturities of available for sale securities were as follows:

	Amortized Cost	Fair Value
Due in 90 days or less	$ -0-	$ -0-
Due after 90 days and in one year or less	6,121,332	6,178,254
Due after one year and in five years or less	52,801,873	53,789,135
Due after five years and in ten years or less	51,233,284	51,926,455
Due after ten years	14,132,220	14,348,889
Common stocks	20,128,002	29,559,860
Total	$144,416,711	$155,802,593

8. Investment Securities and Investment Income, continued

B. Alternative Equity Investments

Alternative equity investments include entities that focus predominantly on publicly announced mergers and acquisitions arbitrage. Substantially all of the investments made by these entities are in publicly traded securities, and the Company has the contractual right to withdraw its funds each year. At December 31, 1998 and 1997, the Company's recorded equity in these alternative equity investments, which includes realized and unrealized gains, was $26,096,761 and $24,224,800, respectively. The costs of these investments were $24,000,000.

Other alternative equity investments include privately held common stocks, preferred stocks, surplus notes and single-purpose entities investing in companies that are not publicly traded. The Company's recorded equity amounted to $8,865,209 and $9,505,252 at December 31, 1998 and 1997, respectively. The costs of these investments were $9,929,138 and $9,355,640, respectively. These amounts include investments in Direct Response Corporation and Homeowners Direct Corporation totaling approximately $5.8 million and $3.7 million at December 31, 1998 and 1997, respectively. These companies will derive underwriting revenue from personal lines property and casualty insurance activity, writing throughout the United States, except in certain New England states.

C. Investment Activity

The components of investment activity during 1998 and 1997 were as follows:

	1998	1997
Balance at beginning of year	$188,444,223	$189,115,572
Change in available for sale securities:		
Sales	(101,190,762)	(142,865,788)
Purchases	103,939,475	111,428,788
Net change in available for sale securities	2,748,713	(31,437,000)
Investments in alternative equities	1,231,918	28,913,159
Net investment activity	3,980,631	(2,523,841)
Net change in purchases in process	(886,110)	(3,943,382)
Net change in unrealized gain on available for sale securities	(774,181)	5,795,874
Balance at end of year	$190,764,563	$188,444,223

Comprehensive income is defined as net income plus the change in net unrealized gain on investments. Accordingly, the net unrealized gain on investment is reduced by realized gains previously included as unrealized in comprehensive income of $635,636 and $325,061 in 1998 and 1997, respectively.

8. Investment Securities and Investment Income, continued

D. Analysis of Investment Income and Capital Gains

The components of investment income and capital gains before federal taxes during 1998 and 1997 were as follows:

	1998	1997
Interest income and dividends from securities	$ 9,257,238	$10,373,154
Earnings from alternative equity investments	1,288,913	374,412
Rental income	2,520,634	2,551,179
Finance charges from premiums receivable	2,607,377	2,552,010
Gross investment income	15,674,162	15,850,755
Rental expenses	(1,602,371)	(1,723,502)
Investment expenses	(545,642)	(518,086)
Investment income	13,526,149	13,609,167
Net realized capital gains	6,595,494	511,954
Investment income and capital gains	$20,121,643	$14,121,121

During 1998, net realized gains included gains of approximately $5.5 million from sales of investments carried at cost.

9. Compensation Plans

The Company has a Savings and Investment Plan under Section 401(k) of the Internal Revenue Code. This defined contribution plan covers all employees 21 years or older with at least one year of service. The Company accrued $1,318,334 and $1,009,951 as of December 31, 1998 and 1997, respectively, for liabilities relating to this Plan.

The Company has a Deferred Compensation Plan for officers, managers and directors other than its founding shareholders. This Plan provides for a rate of return on deferrals based on the financial performance of the Company. The Company accrued $2,361,466 and $2,165,706 as of December 31, 1998 and 1997, respectively, for liabilities relating to this Plan.

Since 1997, the Company has made stock incentive awards annually to key employees. The cumulative number of outstanding awards as of December 31, 1998 and 1997 was 5,578 and 2,132, respectively. The Company has recorded no expenses in 1998 and 1997 with respect to outstanding awards. Expense may be recorded in the future with respect to some outstanding awards under the accounting rules applicable to variable awards.

10. Note Payable

The Company executed a note payable in the amount of $9,683,400 at an interest rate of 6.32% in conjunction with the purchase of outstanding shares of its common stock. Payments of principal are scheduled to be made in ten equal annual installments of $968,340 each commencing on June 30, 1999. Interest payments on this note totaled approximately $292,000 during 1998. The Company has the right to prepay this note at any time.