

The Plymouth Rock Company



2006 Annual Report

The Plymouth Rock Company
695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 20, 2007

To Our Shareholders:

The year 2006 brought record profits again. Net income was up by 16% over the prior year, to a new total of \$53.9 million. That we passed the \$50 million milestone in net income is certainly gratifying, but, as usual, the results require more than a few numbers to tell their story. Last year, I expressed more concern about the top line trends than about the profits. Indeed, the trend in our total premiums underwritten and managed underperformed the bottom line substantially. Total group volume fell from \$1.06 billion to \$1.05 billion, about 1%. While this is not so bad in a year of flat or falling premiums for the auto insurance industry, it is quite far from our long term target. A note of caution about net income is appropriate as well. Like many companies in 2006, Plymouth Rock experienced reserve releases from prior years that added to its reported gains. In our case, this was particularly so. Almost \$10 million of the Company's reported income for the year arises from a net reduction of prior period indemnity reserves in Massachusetts auto insurance, including reserves for residual market assessments, a gain not likely to be repeated soon. There is good news that may not meet the eye right away as well. The whole Plymouth Rock group is still in the midst of the most ambitious and expensive systems transformation in the Company's history, so the 2006 results inevitably record substantial costs of that work without yet reflecting its expected efficiency rewards. Perhaps most important, our enterprise prospects for 2007 are looking quite good as the new year begins. Overall, Hal and I would recommend a smile.

Shareholders' equity for our group now stands at \$249 million, reflecting a 26% increase since December 31, 2005. The per-share book value is \$1,358. Cumulative book value return on capitalization from Plymouth Rock's 1983 inception, a number I provide to you each year, now stands at 18.8%, up a full half point from last year's reading. Remember that the book measure applies no valuation multiple, or a multiple of unity, to the shareholders' equity, and thus it surely understates in our case the internal rate of return for an original investor. Our New England underwriting companies and their subsidiaries, taken as a group, had \$336 million in gross premiums written in 2006, and their contribution to net income came in at 8.1% of their gross writings. The three insurance management companies and their subs oversaw \$716 million in writings, and they brought 3% of this total to the bottom line. My shorthand targets are for our underwriting companies to return 7.5% on gross premiums and for the reciprocal managers to earn about half that. With the help of reserve releases, the underwriters exceeded this target in 2006. The reciprocal managers fell just a little short. The group as a whole, configured as we are today, should earn 5% on gross premiums. The reported number was a hair better than that. Our investments had a fine year, beating both the fixed-income and equity

benchmarks and our own long-term performance statistics handsomely. The increment to overall net income from investing in a portfolio broader than just investment grade bonds in 2006 was \$18 million pre-tax, an exceptional contribution to the overall good results given our investment constraints and conservative inclinations.

The greatest source of concern as 2006 began was declining volume in our New Jersey companies. Written premium at High Point and at Palisades had fallen by nearly 10% in 2005, so all eyes were on those companies in 2006. The recent year's news at Palisades was reassuring. The number of vehicles insured by Palisades was 132,000 at the year's start and rose to 138,000 at its close. Although the turnaround is owed in part to the purchase of a small book of business from Parkway Insurance, endogenous growth was also running at a positive annualized rate of over 7% by year-end. The return to growth, moreover, seems not to be an anomaly. Persistency, the percentage share of our policyholders who renew with us, rose steadily in the second half of the year, returning by December to territory past the 85% marker that I consider the healthy company borderline. The fourth quarter was also the best quarter for new business. These improvements appear to be continuing into the current year, with another acquisition adding to the stream as well. Palisades' loss ratio was good, perhaps even too good. According to A.M. Best statistics, in fact, Palisades had the lowest average loss ratio for the 2001 to 2005 period of the top 50 auto insurance writers. The 2006 accident year pure loss ratio was in the low 50's. I'm proud that our agents and underwriters are so skillful, but I'd welcome a drop from best-in-show to merely best-quartile with respect to loss ratio if it came with a fast enough rate of growth. Even better would be to cut the expense ratio that Palisades now shows, so that loss ratio would need to rise only a few points in order to reduce our prices and encourage rapid growth. Now that the Matrix redesign of our IT systems has been largely (and very professionally) implemented at Palisades, Ed Fernandez and his truly first-rate executives are working on exactly that.

High Point, where Gerry Wilson and Jim Tignanelli are the chairman-president team, has a tougher challenge than Palisades. The turnaround is not nearly so complete at High Point, but I am heartened by trends there as well. Historically, direct response companies have drawn more from the market shares of carriers with proprietary sales forces than from independent agency carriers. If that is what happened in New Jersey as the estimable gecko proliferated and threatened the Garden State's various native species, one would expect High Point to have been relatively hard hit. High Point's count of insured vehicles fell by approximately 9% in 2005. In 2006, the count fell again, this time by 7%. The news is actually better, though, than a slight reduction in the rate of decline. High Point has just renewed its contract with the Prudential marketing force for five years following the two remaining in the current contract. This will give both the Pru agents and High Point extra motivation to search for mutually rewarding innovations in sales. High Point, moreover, has recently purchased from Lancers Insurance, effective at the start of 2007, its subsidiary specializing in New Jersey teachers. This is a book of almost 30,000 insured vehicles. Marc Buro will lead an effort to boost our share of that attractive specialty market. Gerry reminds us regularly that every week without growth is a week without sunshine for him. Hal and I have always liked that trait in Gerry.

One contributor to my confidence is that GEICO seems to have exhausted early most of the potential direct response market in New Jersey. Auto insurance has long been a segmented market, where some customers prefer to buy from agents with whom they

have a personal relationship and others directly from a carrier. Before its direct response competitors could even get started, GEICO had the smarts to sweep into New Jersey and soak up as much as it could of the readily available direct response share. I can't imagine that its growth will continue at anywhere near the initial clip. Another source of confidence is that our New Jersey service remains spectacular. With other companies just starting to boast of good service in their ads, we have the real thing. Palisades once again had zero valid complaints filed with the N.J. Department of Insurance, making it the best in the state by that test whether one looks at a one-year, three-year or five-year period. High Point also does extremely well by the complaints measure, with only three valid complaints last year, but it still has to catch Palisades to be the state's best. It is also worth noting that, as I predicted in last year's letter, New Jersey is coming back to its senses on the public policy of the automobile insurance market. The free-for-all deregulation that wooed some national players back into the state swept some valid and important urban rate protections away along with more burdensome and less necessary restrictions. The Corzine administration took admirably little time to realize that availability and affordability are unavoidable government responsibilities with respect to an expensive, compulsory product like auto insurance. There is every indication that New Jersey will once again act in 2007 to protect its urban population from unsustainably high relative rates. We will be fully supportive of these efforts, even if much of the industry opposes them. Sound public policy will help level the playing field among carriers and eventually benefit widely accessible carriers like ours as well as the driving public.

Pilgrim Insurance had a big year, though you won't see the impact in the profit numbers for at least another year. Its managed premiums grew by over 40%, including work it does for other companies in our own extended family, and it opened two new lines of auto insurance servicing business, one here in Massachusetts and the other in New Jersey as a joint venture with High Point and Palisades. Pilgrim contributed \$2.7 million to the group bottom line, less than last year's number, but this will surely increase as the new business comes fully on line and Ellen Wilcox continues to add to the client base. Return on equity continues high, at 24%, in part because so much of the capital of this business is in its people. Ellen recruited two new officers this year, expanding that strength and setting a good example for our other company leaders.

Plymouth Rock Assurance, by far the largest of the three underwriting companies, had a year that seems too good to be true. While the results are in fact true, they *are* too good to be repeated. The Massachusetts and Connecticut auto insurer produced a profit of \$25.1 million after taxes, about half again its budgeted result for the year. The principal reason for the cornucopia of earnings was that, with increasingly timely and accurate estimates of residual market deficits available from Commonwealth Automobile Reinsurers, Plymouth Rock Assurance has accelerated the timing of CAR reserve releases. We had always been very slow on that score over the years, in the interests of conservatism. Our former timing would now be unreasonably slow. Speeding up reserve adjustments after a period when results have been extraordinarily good necessarily has a profoundly positive impact on the bottom line. Had there not been the reserve speedup, the year's results would have underperformed the budget, but would still have been respectable. The loss ratio at that company, even excluding reserve releases, remains absolutely solid, and the growth rate was once again at the top of our peer group. The challenge remains the expense ratio. Put bluntly, we still have not figured out how to be

a low-cost producer without sacrificing our unusually high service level. Executives here who contribute to that accomplishment can expect all the kudos and thanks I can give them. Results in Connecticut and New Hampshire remain quite disappointing, with premiums written down for the year in both states. The two states are still small components of our book, but I hesitate to start up fresh in, say, New York or Pennsylvania until we can show that we can build our books in the two states in which we are already writing. Thom Cranley, the man in charge, has a good product manager to the north and several candidates for the same role south of Massachusetts, and there has been a major product redesign for both states, but results are still in the future. Watch this spot next year.

One of the most significant of 2006 events in Massachusetts was an event that did not occur. Once again, the coalition of insurers seeking an overhaul of Massachusetts regulation failed to get their deregulation program implemented. The overhaul coalition of companies had two partial victories, however. One was a smooth implementation of the redistribution of Exclusive Representative Producers (brokers having no voluntary appointments with insurers and assigned to companies involuntarily) among the carriers writing auto insurance business in the state, a step Plymouth Rock joined with the coalition in supporting as a fair method of equalizing the ERP burden. The other was a victory in the Supreme Judicial Court, affirming the authority of the Insurance Commissioner to scrap the current reinsurance pooling mechanism in the residual market in favor of an assigned risk plan similar to those used in most other states. The Court's decision was swiftly followed by the promulgation of implementing rules by the Commissioner, but she did not remain in office long enough for them to take effect. A new administration took office in January and suspended action. The incoming governor, Deval Patrick, appointed his own Insurance Commissioner, a highly respected judge, and established a study group of insurance experts and distinguished citizens to examine the wisdom of proceeding with the proposed changes. We were not a party to the litigation challenging the Commissioner's authority, and we are not opposed in principle to an assigned risk system. We are decidedly not, however, a member of the overhaul coalition of companies, and we would not be saddened to see a return to the drawing boards before such fundamental changes are made to the system of regulation here.

When the government decided to require insurance as a condition of driving a car, which was in 1927 here in Massachusetts, it took on a responsibility to safeguard the availability and affordability of the insurance product. Some members of the overhaul coalition want to blow up the appropriate protections Massachusetts has built up over the years. One such protection is provided by rate tempering, sometimes called flattening, which reduces territorial and other demographic differentials (but not driving record differentials) between the highest and lowest premium rates in the system. Another is a prohibition on companies in our state charging a driver an increased premium based on subjective or unstated criteria by placing that driver in a surcharged residual market pool. A third protection is that Massachusetts, where the Commissioner sets maximum rates and lets each company offer its own discounts below the established rate levels, does not employ rating differentials based on credit scores, occupation or other socio-economic variables other than principal place of garaging. A powerful system of credits, invisible to the consumers, allows the market to work with all of these restrictions and restores company incentives to write in all territories and for most drivers. The residual market in 2006 contained fewer than 5% of the state's drivers. For thirty years, consumers have been

relatively content (or as content as they can be in a state with a high overall rate demography), and it is undisputed that companies are doing quite well here. Massachusetts ranks among the two or three best states for percentage of drivers insured, and forty-nine states have had more rapid rate increases over the past four years.

Having said all of this, we at Plymouth Rock believe that the residual market system, even after ERP redistribution, could be fairer in its allocation of costs among companies, and that an assigned risk system, where each company pays 100% of the claims it settles, has better behavioral incentives than a pooling system, where each company has custody of an industry checkbook. For this reason, while most Massachusetts writers are polarized at one extreme of the debate or another, we did not join either the overhaul coalition or the anti-overhaul coalition. We would prefer to work toward the best of both worlds. As long as there are legislative protections for the consumer, reflecting an acceptance that our public's protections do not have to be abandoned just because some other states have accepted a lower standard of fairness, Plymouth Rock is open to any improvement in the residual market. In the end, it is government's job, and not industry's, to set levels of regulatory protections. The new Governor has shown all the right instincts on issues of fairness. Hal, Paula Gold and I will offer to be as helpful as we can to his appointees as they search for the appropriate public policy answers and helpful again in implementing the decisions they make.

Our New England homeowners business at Bunker Hill Insurance grew in both premiums and earnings contribution. Net income exceeded \$2 million, up 41% from 2005. All of this was accomplished by John Tierney and his team against a backdrop of systems changes and skyrocketing reinsurance costs. The systems upgrade was part of our enterprise-wide Matrix project and is now essentially complete at Bunker Hill. The reinsurance costs were courtesy of Katrina and Wilma, as well as changes in the various models that attempt to predict damage potential from storms. I worry that all of these models, though well-intentioned, are biased upward in the states where events are fewest and actual data therefore most sparse. The reinsurers who buy the products of the modeling companies would presumably prefer to spread price increases over a broad area than to seek them only where regulators and customers are already in shock. Rating agencies and the modelers themselves have more to lose by underestimating the risk in seldom hit locations than overestimating it. While I cannot prove that these unintended asymmetries actually cause the Northeast storm hazard to be overstated by the modelers, raters, and reinsurers, I am increasingly committed to forming our own considered judgments. A conclusion that there is an overstatement of risk in reinsurance prices could lead us to a cautious increase in retentions within our own family of working layer storm coverage at Bunker Hill.

The Plymouth Rock portfolio at year-end 2006 was invested 41% in investments other than bonds and cash, up from 34% at the end of last year. This seems a healthy change in an era where investment grade bonds seem to be held mainly by institutions externally induced to hold them. A diversified portfolio of publicly traded common stocks seems to have replaced bonds as the conservative vehicle of choice, and alternative equity vehicles have replaced stocks as the standard domain in which to seek higher returns at higher risk. A younger writer might say "Stocks are the new bonds", or something to that effect. The total return on investments during 2006 for the Plymouth Rock portfolio was 13.4%, which is 532 basis points above our from-inception average return and looks even better

when compared to the prior year taken alone. The bonds returned 3.75%, beating their modest benchmark by a small margin. We have never had much of an appetite for credit or interest rate risk in order to boost that return. The common stock portfolio, in our case markedly undiversified, produced an immodest return of 24% in 2006, with Morgan Stanley, Merck, ExxonMobil, and Target all star performers. The 2006 result helped secure a record of which we are particularly proud: since Jim Bailey, Rick Childs and I began investing in common stocks back in 1993, our all-time compounded IRR has exceeded 20%. The diversified equity arbitrage funds we call equity equivalents were also big winners in 2006; so, too, was owner-occupied real estate. With the Big Dig about finished on Atlantic Avenue, we are situated in what has to be about the most desirable business neighborhood in the world.

Last year I waxed a bit about private equity investing. I can usually tell when this letter has either been unclear or wrong from the number of comments I receive from its readers; the valuable exercise is then to figure out which sin I've committed. I said last year that no one knew how to quantify the aggregate opportunity for private equity today, but it could be at least as great as implied by the prodigious amounts being raised for that kind of investing today. A number of readers suggested that I have simply gotten caught up in the latest bubble mentality. Let me take another crack at the same discussion. It is incontrovertible that record amounts are being raised these days by private equity buyout fund managers, as well as numerous other alternative equity fund managers whom this discussion is specifically not addressing, and it is similarly evident that published returns for the best known of the private equity fund managers have exceeded returns typically available in the public equity markets. The economist in me wants to know why these events are occurring and whether they will continue. The easy part is that the latter condition, atypically high returns, drives the former, the ready flow of funds. I suspect that the flow of funds is also aided by increasing concentrations of assets in the hands of professional managers. Widely dispersed savings don't seek, and can't find, private equity deals. The vast sources of liquidity from which specialized investments are made today are a product of financial concentration. This is an era in which little heed is paid to the worries of Jefferson and both Presidents Roosevelt about inherent dangers to democracy and economic stability from gargantuan scale in business and financial institutions. Assets today move quickly and in huge quantities according to the decisions of a relatively few professional overseers. They will make their money available to private equity funds, just as they will for hedge funds, as long as these investments suggest high returns. The harder question here is why there appear to be such alluring returns available.

Without question, a goodly fraction of the apparent excess return is simply illusion. Minimally regulated investment pools tell us largely what they choose, and it is human nature anyway that press and public attention tends to be drawn mainly to the best, or spectacularly bad, performers. More careful observers assure me that there is a complete spectrum of results in private equity, from winners to losers and everything in between, and it is next to impossible to compute fully reliable performance averages. In this field, where one knows relatively little about the losers, it is easy to believe the average performance is better than it really is. Reporting, moreover, allows fees, which are highly material, to be obscured and dogs to be held with the true late bloomers for many years in portfolios at cost while successes are realized or revalued early. Both of these reporting imperfections plainly tend to bias published IRR's upward. Still, I remain doubtful that

all of the unexplained returns are illusion. It seems unconvincing, as some have asserted, that the high returns are mathematically equal to the S&P common equity returns, adjusted upward for risk. Even with corrections for risk and illusion, the returns for the major private equity firms seem to have been above those for diversified public equity investment funds. If this is the case, I'd look to two principal explanations: leverage and discipline. Private equity investors may be correcting for unnecessarily conservative tendencies in business operators (such as myself) with respect to debt, or they may be overcorrecting. If the higher leverage is effectively compensating for management over-conservatism, the incremental return will be greater than just the payment for risk. If leverage is stretched beyond optimal, private equity managers having been tempted by readily available and cheap debt, on the other hand, the returns achieved could actually be less than the risk should require. We can't really learn which situation applies, case by case or in the aggregate, as long as interest rates remain so low. Today's interest rates are low enough to make both correction and overcorrection look like gloriously brilliant strategies.

The return increment from increased discipline is not dependent in the same manner on economic conditions. Here private equity investors may be compensating for another conservative tendency in business operators (such as myself once again) -- not to rock boats quite as often as they need rocking. CEO's, especially those of us who pride themselves in taking account of the human dimensions to our businesses, tend not to remove veteran executives, reexamine assumptions, shake up our organizational structures, revisit assumptions of corporate culture, or seize new expansion opportunities as often as might be ideal for the pure maximization of profit. Some of us (*not* such as myself, of course) tend to stay on the payroll longer than we should. Private equity managers are an unusually smart and driven subset of the population, and they can be dispassionate, even in some cases to the point of ruthlessness, in dealing with such matters. There is no gain that will survive the market learning curve, of course, when the actions of the new owners are mainly designed to take early dividends and dress up the company for resale, at the expense of its future prospects. Conversely, there can be true economic gain when the added discipline leads to expansion, whether by organic building or intelligent acquisitions. This last point, by the way, may be an argument for avoiding funds too bulked-up, or ill-prepared, to permit active attention to fostering growth. While I sometimes hesitate to admit it, I am inclined to believe that, all in all, the impact of unemotional growth-focused discipline on a typical company's rate of return is likely to be in the positive direction. Note please that I have not mentioned selection of companies in which to invest as the top reason for above-market returns. This was once a powerful contributor, but I doubt it still has the impact it had before the funding boom. With all the private equity funding now in use, virtually every company that wants a private equity owner can find one, and prices paid are, at a minimum, more efficient. Though the advantages, including with respect to investment selection, that the most competent private equity investors have over the less so are durable, the industry-wide edge that existed in smart investment selection, at least in the U.S. domestic corporate sphere, is either diminished or gone.

All market anomalies must end someday. That private equity returns will at some point reflect only the appropriate premiums for risk and liquidity we can be pretty sure, but the timing of all such corrections is tougher to divine than the direction. It is a reasonable bet that those who measure such things are already witnessing an expanding gap among

performance quartiles of private equity firms, and seeing a simultaneous diminution of the mean result. Although these trends should continue until the process is complete, market corrections are not constrained to occur in an orderly manner or a predictable pace. At a minimum, reported returns will be boosted as long as real interest rates remain historically low. And when rates rise, the discipline advantage, at least for the builders rather than the superficial arbitrageurs of acquired businesses, can continue as long as there are enough potentially improvable companies to be bought. It must of necessity terminate when there is too much private equity money chasing too few opportunities. The private equity phenomenon is more than a bubble, but less than a miracle, a paradigm shift, or a change in the rules of sensible investing.

Much has happened at Response and Homesite, in my view largely to the good. Both of these companies, in which Plymouth Rock and I hold sizable investment positions, experienced changes of ownership in 2006. At Response, a direct-to-the-consumer automobile insurance carrier, an eleven-year-old shareholders' agreement expired. Mory Katz, Response's veteran CEO, continues in that capacity as president, but I am no longer serving as that company's chairman. Having held the title of chairman of Response since 1995, it was not without some emotion that I relinquished it to Jeff Keil, an experienced leader in financial services who has consulted for Response during much of the last two years. I gave up the chair in November for two reasons. Most simply, my contractual tour of duty was up in 2005, and it had been long understood that I would not extend it indefinitely. More important, I had concluded that the job of building that company required more than I was able to give it in my part-time role. Response has done a credible job of launching itself as a national (other than Massachusetts) player in direct response auto insurance, and building a reputation for fine service and competent administration at its current scale of \$140 million in written premiums, but it has not developed a growth engine that permits organic expansion at a rapid rate.

With my strong support, the private equity partnerships managed by Metalmark, which have held a dominant position in Response but shared Board control with us and others during the term of the 1995 agreement, are negotiating to sell more than half of their position to JC Flowers & Co. Chris Flowers is an investor with a reputation as a winner and a person of the highest ability and integrity. He has recently raised a multibillion dollar private equity fund to specialize in financial services, so he would be a perfect partner for Response. I am hopeful that adding Chris and Jeff to the team may allow Response to accomplish what the current leadership has not yet brought it: marketing capabilities and creativity powerful enough to assure rapid growth at profitable metrics and staying power sufficient to attract the best available talent. I have offered to assist the company as a consultant and to return to the Board as a director should the negotiations conclude successfully; Metalmark and a number of its distinguished co-investors would also plan to stay active.

Homesite Group underwrites homeowners insurance throughout most of the country and gets its business largely through referrals from well-known corporate mega-partners. AIG Direct and GMAC Insurance are now the largest of these partners, and this year Progressive, which has the potential to match anyone out there as a homeowners source, is starting up with Homesite as well. Homesite has recently passed the \$200 million mark in written premiums, and, under Fabian Fondriest's fine leadership, it continues to

grow rapidly. To finance its growth, Homesite raised \$120 million in new capital at year-end 2006, all from one new investor. Our new 33% shareholder is Alleghany Corporation, headed by Weston Hicks, whom Hal, Fabian and I, as well as several of our Board members, have known and respected for some years. We are all enthusiastic about working with Weston. Alleghany will, from now on, be a full partner in Homesite's long-term development.

Homesite's metrics are a delight. The pure direct loss ratio for 2006 was 51%, making this the fifth consecutive year in which this essential index of underwriting quality has remained 59% or better at Homesite. Homesite's current scale, though rapidly being left behind, is sufficient to permit Homesite at long last to achieve a competitive expense ratio as well. The combined ratio for 2006 was 94.9% and that was with nearly 40% earned premium growth. The combined ratio on renewal business is even lower, comfortably in the eighties. Homesite earned its first underwriting profit in 2006 and produced \$18 million in pre-tax net income. Fabian and his close-knit team have every reason to be proud. The year just starting looks promising for both the top and bottom line and, thanks to Alleghany, Homesite has enough capital on its books to grow at prudent capitalization to at least half a billion dollars in annual premium volume.

On my list of objectives every year is upgrading our talent. We were second to none in Massachusetts for analytics when we started writing business in 1984, but now we need to be the best in the country. That's a more formidable goal, especially with Progressive out there teaching the industry new standards of analytic excellence all the time, but we took a major step this year in that direction. Hal and I had long been convinced that some of the best analytical brains are either inefficiently used for, or not ideally suited to, management tasks. So, we established a group of Plymouth Rock Fellows, at the status of officers but largely exempted from the normal chain of command. Our first three Fellows are proving themselves admirably at pricing and product design and, while the model is new and untested, we expect this arrangement to be a source of great strength for our group over the years. We would welcome a few more university-quality thinkers in that elite group. As always, we could use more traditional officers and managers of the highest caliber as well. That search is constant, so join us in searching. We'll always be willing to create a new job if we find a person with long-term prospects for excellence and don't have the right slot at the moment.

In closing, I'd like to congratulate Hal Belodoff, my partner in every aspect of the enterprise, for taking on the title of President of The Plymouth Rock Company. I've had that title myself since the Company's inception, along with the chairmanship, but Hal has fully earned it now. We have strengthened our Board as well with the addition of Sandra Urie, the first new Plymouth Rock Company director in some years. Sandy is the CEO of Cambridge Associates and a first-class executive in her own right. We will benefit from her wisdom and welcome her warmly as we contemplate what Hal calls our next billion.



James M. Stone

REPORT OF INDEPENDENT AUDITORS

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, 2006 and 2005, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.



Boston, Massachusetts
March 1, 2007

THE PLYMOUTH ROCK COMPANY
CONSOLIDATED BALANCE SHEETS

December 31, 2006 and 2005

Assets	<u>2006</u>	<u>2005</u>
Cash and cash equivalents	\$ 41,497,830	\$102,038,299
Investment securities	378,822,101	273,814,528
Accrued investment income	3,279,971	2,163,997
Premiums receivable	100,822,806	88,570,183
Deferred acquisition costs	11,715,935	12,028,613
Receivable from reinsurers	32,230,909	17,918,482
Amounts due from service clients	14,539,408	11,009,391
Prepaid expenses, agent loans, and deposits	7,354,490	6,749,229
Real estate	24,395,073	23,525,566
Fixed assets	55,219,967	58,399,614
Goodwill and intangible assets	3,946,370	4,873,425
Other assets	<u>2,680,914</u>	<u>2,121,993</u>
Total assets	<u>\$676,505,774</u>	<u>\$603,213,320</u>
Liabilities		
Claim and claim adjustment expense reserves	\$143,587,929	\$142,017,734
Unearned premium reserve	123,062,244	130,345,838
Advance premiums	7,060,606	9,265,253
Commissions payable and accrued liabilities	72,196,981	54,312,357
Payable to reinsurers	37,476,980	24,163,620
Unearned service fees	32,612,027	29,582,337
Amounts due to service clients	5,594,963	10,443,266
Deferred income taxes	2,614,715	1,438,441
Note payable	1,936,680	2,905,020
Income tax payable	1,501,471	1,256,705
Other liabilities	<u>337,633</u>	<u>529,624</u>
Total liabilities	<u>427,982,229</u>	<u>406,260,195</u>
Stockholders' Equity		
Common stock and paid-in capital	25,224,933	24,766,913
Retained earnings	211,460,113	168,487,576
Net unrealized gain on investments	<u>11,838,499</u>	<u>3,698,636</u>
Total stockholders' equity	<u>248,523,545</u>	<u>196,953,125</u>
Total liabilities and stockholders' equity	<u>\$676,505,774</u>	<u>\$603,213,320</u>

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

THE PLYMOUTH ROCK COMPANY
CONSOLIDATED STATEMENTS OF INCOME
For the years ended December 31, 2006 and 2005

Revenues	<u>2006</u>	<u>2005</u>
Premiums earned in underwriting activities	\$262,624,050	\$226,598,085
Fees earned from service activities	190,027,204	181,725,750
Investment income and capital gains	<u>33,239,227</u>	<u>25,917,113</u>
Total revenues	<u>485,890,481</u>	<u>434,240,948</u>
 Expenses		
Claims and claim adjustment expenses	170,631,588	161,387,044
Policy acquisition, underwriting, and general expenses	78,247,534	59,132,424
Service activity expenses	<u>153,195,082</u>	<u>140,498,391</u>
Total expenses	<u>402,074,204</u>	<u>361,017,859</u>
 Income before income taxes	83,816,277	73,223,089
Income taxes	<u>29,907,491</u>	<u>26,767,894</u>
Net income	<u>\$ 53,908,786</u>	<u>\$ 46,455,195</u>

Per share data		
Weighted average common shares outstanding:		
Basic	179,797	179,726
Fully diluted	182,310	182,316
Net income per share:		
Basic	\$ 299.83	\$ 258.48
Fully diluted	\$ 295.70	\$ 254.81
Common shares outstanding at end of year	182,988	182,911
Common stockholders' equity per share	\$1,358.14	\$1,076.77

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, 2006 and 2005

Cash flows from operating activities	<u>2006</u>	<u>2005</u>
Gross premiums collected	\$321,520,199	\$329,074,029
Reinsurance premiums paid	(67,416,134)	(111,495,770)
Finance charges collected	6,498,228	6,148,085
Fees and commissions collected	189,619,358	178,659,992
Investment income and capital gains received	28,193,337	15,074,739
Gross claims and claim expenses paid	(210,836,155)	(211,764,664)
Reinsured claims and claim expenses collected	36,254,737	74,686,101
Policy acquisition, underwriting, and general expenses paid	(67,566,708)	(54,206,740)
Income taxes paid	(33,174,165)	(12,797,512)
Service activity expenses paid	(136,869,280)	(129,996,823)
Net cash provided by operating activities	<u>66,223,417</u>	<u>83,381,437</u>
Cash flows from financing activities		
Payment on note payable	(968,340)	(968,340)
Issuance of common stock	174,020	82,076
Dividends to stockholders	(10,936,249)	(7,990,108)
Change in liabilities for outstanding checks	<u>106,295</u>	<u>2,036,143</u>
Net cash used in financing activities	<u>(11,624,274)</u>	<u>(6,840,229)</u>
Net cash provided	<u>\$ 54,599,143</u>	<u>\$ 76,541,208</u>
Investment of net cash provided		
Change in cash and cash equivalents	\$ (60,540,469)	\$ 71,371,897
Net investment activity	92,188,383	(30,732,746)
Purchase of goodwill and intangible assets	46,863	763,684
Net real estate activity	1,842,860	1,676,360
Purchases of fixed assets	<u>21,061,506</u>	<u>33,462,013</u>
Net cash invested	<u>\$ 54,599,143</u>	<u>\$ 76,541,208</u>

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

THE PLYMOUTH ROCK COMPANY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the years ended December 31, 2006 and 2005

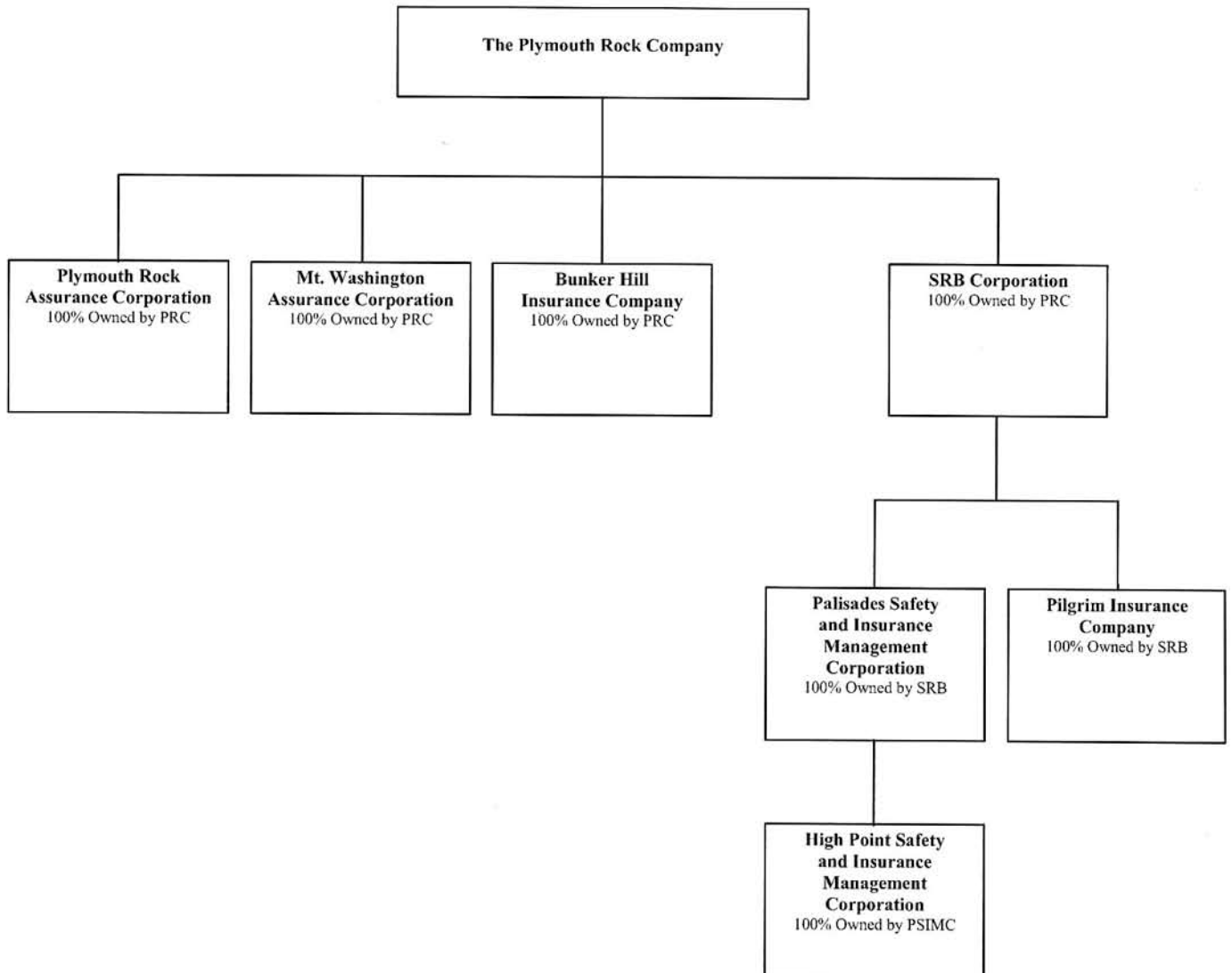
	Common Stock and Paid-in Capital	Retained Earnings	Net Unrealized Gain on Investments	Total Stockholders' Equity
December 31, 2004	\$24,335,943	\$130,022,489	\$ 7,688,986	\$162,047,418
Comprehensive income	-0-	46,455,195	(3,990,350)	42,464,845
Issuance of common stock	430,970	-0-	-0-	430,970
Dividends to stockholders	<u>-0-</u>	<u>(7,990,108)</u>	<u>-0-</u>	<u>(7,990,108)</u>
December 31, 2005	24,766,913	168,487,576	3,698,636	196,953,125
Comprehensive income	-0-	53,908,786	8,139,863	62,048,649
Issuance of common stock	458,020	-0-	-0-	458,020
Dividends to stockholders	<u>-0-</u>	<u>(10,936,249)</u>	<u>-0-</u>	<u>(10,936,249)</u>
December 31, 2006	<u>\$25,224,933</u>	<u>\$211,460,113</u>	<u>\$11,838,499</u>	<u>\$248,523,545</u>

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

THE PLYMOUTH ROCK COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization of the Plymouth Rock Companies

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



Other affiliates include 99 Bedford Corporation and 695 Atlantic Avenue Company, L.L.C., which own real estate, and Shared Technology Services Group Inc. and BCS Holding Company, LLC, which are wholly owned subsidiaries of SRB Corporation. Direct Response Corporation and Homesite Group Incorporated are not among the Plymouth Rock Companies, but The Plymouth Rock Company owns a common stock interest in each.

THE PLYMOUTH ROCK COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies

A. Principles of Consolidation

The consolidated financial statements include the accounts of The Plymouth Rock Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

B. Cash, Investments, and Real Estate

Cash and cash equivalents include money market funds and short-term money market instruments with maturity dates no longer than 90 days at the date of acquisition. Liabilities for outstanding checks of \$4.5 million and \$4.4 million are included in accrued liabilities at December 31, 2006 and 2005, respectively. Marketable fixed income and equity securities are carried at their fair values. The fair values of securities are based on quoted market prices. The calculation of gain or loss on the sale of marketable securities is based on specific identification at the time of sale. Where declines in the value of marketable securities are deemed other than temporary, the securities are carried at market value and the loss is reported as a component of net realized capital gains on the sale of securities. Net unrealized gains or losses on securities available for sale, net of applicable deferred income taxes, are credited or charged directly to stockholders' equity. Alternative equity investments are recorded at market value.

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

C. Deferred Acquisition Costs

Commissions and premium taxes are deferred and amortized pro rata over the contract periods in which the related premiums are earned. All amounts deferred at December 31 are charged to operations in the following year as the related premiums are earned. Deferred acquisition costs are presented net of deferred commission income on ceded reinsurance. Net amortization associated with these deferred costs for 2006 and 2005 was \$27.8 million and \$25.8 million, respectively.

D. Stock-Based Compensation

The Company records compensation costs for stock-based employee compensation plans at fair value.

E. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts of assets, liabilities, revenues, and expenses reported in the financial statements and the disclosure of contingent assets and liabilities in the footnotes. Actual results could differ from those estimates.

THE PLYMOUTH ROCK COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies, continued

F. Income Taxes

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

Income taxes in the statements of income for 2006 and 2005 consist of:

	<u>2006</u>	<u>2005</u>
Current year federal income taxes	\$29,254,611	\$19,905,828
Current year state income taxes	4,164,326	3,089,164
Change in deferred federal taxes	(2,945,193)	4,133,089
Change in deferred state taxes	<u>(566,253)</u>	<u>(360,187)</u>
Total	<u>\$29,907,491</u>	<u>\$26,767,894</u>

Deferred income taxes in the balance sheets as of December 31, 2006 and 2005 consist of the net effect of these temporary differences:

	<u>2006</u>	<u>2005</u>
Discounting of claim reserves	\$ 3,617,806	\$ 3,649,878
Deferred income	9,108,603	9,772,850
Net unrealized gain on investments	(6,679,289)	(1,991,575)
Depreciation	(12,097,453)	(16,100,869)
Other	<u>3,435,618</u>	<u>3,231,275</u>
Total	<u>\$ (2,614,715)</u>	<u>\$ (1,438,441)</u>

The net unrealized gain on investments is presented in stockholders' equity, net of an estimate of applicable deferred income taxes. The Company's reported provision for income taxes is less than that computed by applying the income tax rate for these years to income before income taxes. This difference arises principally because the Company incurs state tax expense and receives significant nontaxable interest from state and municipal bonds.

G. Reinsurance

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

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies, continued

G. Reinsurance, continued

Receivables from reinsurers represent amounts recoverable for reinsured claims. Premium and losses net of reinsurance activity are as follows:

	2006		2005	
	Premiums Written	Losses Incurred	Premiums Written	Losses Incurred
Gross	\$336,114,882	\$212,606,350	\$334,632,073	\$224,668,613
Ceded	(80,774,426)	(41,974,762)	(85,838,999)	(63,281,569)
Net	<u>\$255,340,456</u>	<u>\$170,631,588</u>	<u>\$248,793,074</u>	<u>\$161,387,044</u>

Ceded premiums earned for 2006 and 2005 were \$76,462,399 and \$101,920,406, respectively.

The Company has treaties for quota share reinsurance with cession rates of 30 to 35 percent for homeowners property insurance premiums and certain Massachusetts automobile liability and physical damage premiums. The commission amount which the Company receives under the homeowners treaties are determined on a sliding scale based upon loss ratios. Revenues and expenses are reflected net of quota share reinsurance totaling \$66 million and \$57 million for 2006, respectively. For 2005, revenues and expenses were reflected net of quota share totaling \$88 million and \$85 million, respectively.

The Company also has treaties for catastrophe reinsurance. During the years ended December 31, 2006 and 2005, the Company incurred costs for catastrophe premiums of \$4.3 million and \$3.7 million, respectively.

A Massachusetts subsidiary of the Company, Plymouth Rock Assurance Corporation, is required to be a member of Commonwealth Automobile Reinsurers (CAR). Plymouth Rock Assurance Corporation accounts for its transactions with this entity as reinsurance. The Company records its estimated share of this activity on the basis of information provided by CAR. During 2006, CAR produced actuarial reports which were supported by an independent analysis and opinion, and the Company conducted a thorough review of its reserves for this business. This review resulted in the Company lowering its claim and claim adjustment expense reserves by \$20 million.

Through its subsidiary, Pilgrim Insurance Company, the Company acts as an intermediary for certain insurance companies in administering motor vehicle insurance programs. The Company's income statement and reinsurance activity exclude \$60,610,615 and \$54,412,003 of premiums earned related to this third-party business and \$53,344,623 and \$44,789,792 of claims and claim adjustment expenses in 2006 and 2005, respectively. In connection with these arrangements, claim reserves exclude \$55,634,334 and \$52,647,311 at December 31, 2006 and 2005, respectively.

THE PLYMOUTH ROCK COMPANY

2. Summary of Significant Accounting Policies, continued

H. Claim and Claim Adjustment Expense Reserves

Claim reserves represent the estimated liabilities for claims reported to the Company plus reserves for claims incurred but not yet reported. Claim adjustment expense reserves represent the estimated expenses relating to settling of 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. The table below provides a reconciliation of the beginning and ending reserves for claims and claim adjustment expenses:

	2006	2005
Balance at beginning of year	\$142,017,734	\$129,113,785
Claims and claim adjustment expenses incurred:		
Current year	185,535,000	162,680,000
Prior years	(8,991,530)	4,310,320
	<u>176,543,470</u>	<u>166,990,320</u>
Claims and claim adjustment expenses paid:		
Current year	119,073,000	89,316,000
Prior years	63,993,769	58,233,611
	<u>183,066,769</u>	<u>147,549,611</u>
Change in reinsurance recoverable on unpaid claims	8,093,494	(6,536,760)
Balance at end of year	<u>\$143,587,929</u>	<u>\$142,017,734</u>

During the years ended December 31, 2006 and 2005, estimated claim and claim adjustment expenses occurring in prior years developed favorably by \$9.0 million and unfavorably by \$4.3 million, respectively. The favorable development in 2006 occurred primarily on losses assumed from CAR. The unfavorable development in 2005 was due primarily to losses on voluntary automobile business.

Claims and claim adjustment expenses incurred, shown above, include expenses for service activity clients of \$5,911,882 and \$5,603,276 reported in service activity expenses in the Company's consolidated statements of income for 2006 and 2005, respectively.

THE PLYMOUTH ROCK COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Summary of Significant Accounting Policies, continued

I. Revenues Earned in Underwriting and Service Activities

Premium revenues are earned on a daily basis over the terms of the policies. Unearned premiums represent amounts that are applicable to the unexpired terms of policies in force and are presented net of reinsurance. Premiums receivable are net of reserves for doubtful collections of \$1,915,359 and \$1,673,788 at December 31, 2006 and 2005, respectively. Premiums receivable, unearned premium reserve and payable to reinsurers at December 31, 2005 have been revised and increased by \$48,291,531, \$36,019,698 and \$12,271,833, respectively, for unbilled but written premiums to conform to 2006 accounting practices.

Underwriting revenue is derived from personal lines property and casualty insurance activity, predominantly in Massachusetts. The Company also derives fee income by providing insurance, investment management, policy processing, billing, and claim management services in several Northeast states. Fee income is earned over the related policy periods. The balance sheet items, amounts due from (to) service clients, are balances with insurers for which Pilgrim Insurance Company, Palisades Safety and Insurance Management Corporation (PSIMC), and High Point Safety and Insurance Management Corporation (HPSIMC) provide services. PSIMC serves as attorney-in-fact for Palisades Safety and Insurance Association, a New Jersey reciprocal insurance exchange. HPSIMC provides services to High Point Preferred Insurance Company, High Point Safety and Insurance Company, and High Point Property and Casualty Insurance Company (High Point Insurance Companies), insurers domiciled in New Jersey.

J. Acquisition

In January, 2005, the Company purchased an insurance agency for \$1.0 million. The Company used the purchase accounting method to account for this transaction. The Company's net income includes the results of operations of this agency in 2006 and 2005.

3. Commitments and Guarantees

The Company's rental expenses for 2006 and 2005 aggregated \$7.3 million and \$5.9 million, respectively. For the years 2007 through 2011, the minimum lease obligations of the Company to unrelated third parties range from \$6.2 million to \$7.0 million annually. Total obligations of the Company under leases are \$69.9 million through 2020.

As of December 31, 2006, a subsidiary of the Company had guarantees outstanding on loans to certain of its independent insurance agents with balances totaling \$310,000. These loans were fully performing in 2006 and are not expected to result in any net liability to the Company.

THE PLYMOUTH ROCK COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. Commitments and Guarantees, continued

Effective October 31, 2003, two subsidiaries of the Company, Palisades Safety and Insurance Management Corporation and High Point Safety and Insurance Management Corporation, entered into a Transition Services Agreement with Prudential Insurance Company of America. The purpose of this agreement is to provide transitional processing support for the High Point Insurance Companies, formerly Prudential's New Jersey personal lines insurance companies, which were acquired on October 31, 2003 by Palisades Safety and Insurance Association, a New Jersey reciprocal insurance exchange managed by Palisades Safety and Insurance Management Corporation. Under the terms of the original agreement, Prudential agreed to supply certain levels of systems and administrative support for a variable period of 18 to 36 months. This agreement has been extended through April, 2007 with estimated remaining costs of approximately \$6.0 million.

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:

	<u>2006</u>	<u>2005</u>
Net income	\$ 53,908,786	\$ 46,455,195
Depreciation and amortization	28,166,378	12,828,873
Deferred income taxes	(3,511,446)	3,772,902
Gain realized on exchange of stock	-0-	(6,617,676)
Change in operating assets and liabilities:		
Accrued investment income	(1,115,974)	(262,709)
Premiums receivable	(12,252,623)	(6,197,585)
Deferred acquisition costs	312,678	(245,692)
Receivable from reinsurers	(14,312,427)	16,692,551
Claim and claim adjustment expense reserves	1,570,195	12,903,949
Unearned premium reserve	(7,283,594)	22,194,989
Advance premiums	(2,204,647)	47,068
Commissions payable and accrued liabilities	17,786,716	(1,463,594)
Payable to reinsurers	13,313,360	(25,716,255)
Unearned service fees	3,029,690	(2,463,762)
Amounts due from and to service clients	(8,378,320)	1,244,756
Prepaid expenses, agent loans, and deposits	(605,261)	1,527,929
Income tax recoverable and payable	244,766	10,197,480
Other assets and other liabilities	(2,444,860)	(1,516,982)
Net cash provided by operating activities	<u>\$ 66,223,417</u>	<u>\$ 83,381,437</u>

THE PLYMOUTH ROCK COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Consolidated Revenues

Revenues, net of reinsurance, for the separate companies for 2006 and 2005 were:

	2006	2005
Underwriting company revenues:		
Plymouth Rock Assurance Corporation	\$266,561,376	\$231,417,011
Mt. Washington Assurance Corporation	175,658	169,979
Bunker Hill Insurance Company	21,963,990	21,960,613
	288,701,024	253,547,603
Management company revenues:		
The Plymouth Rock Company	37,517,638	20,583,890
SRB Corporation	79,144,761	62,308,422
BCS Holding Company, LLC	5,290,445	5,615,460
Pilgrim Insurance Company	30,012,067	25,582,318
Palisades Safety and Insurance Management Corporation	41,836,088	40,102,318
High Point Safety and Insurance Management Corporation	116,268,519	112,149,415
	310,069,518	266,341,823
Eliminations:		
Technology costs	(43,648,226)	(39,609,235)
Dividends	(52,445,850)	(27,745,630)
Other	(16,785,985)	(18,293,613)
Total revenues	<u>\$485,890,481</u>	<u>\$434,240,948</u>

6. Fixed Assets

The table below summarizes fixed assets at December 31, 2006 and 2005.

	Useful Lives	2006	2005
Furniture and fixtures	5-10 years	\$ 9,638,472	\$ 8,924,891
Computers and software development	3-7 years	85,931,767	67,764,715
Leasehold improvements	2-6 years	11,405,246	9,925,176
Vehicles	3 years	3,356,501	2,862,207
Total cost		110,331,986	89,476,989
Less: accumulated depreciation and amortization		<u>55,112,019</u>	<u>31,077,375</u>
Net book value		<u>\$55,219,967</u>	<u>\$58,399,614</u>

Depreciation expense incurred was \$24.2 million and \$9.9 million during 2006 and 2005, respectively. During 2006, the Company changed its method of depreciating software. This change reduced pre-tax income by \$1.9 million.

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. 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. The Company incurred expense related to this plan of \$5,270,964 and \$5,484,904 during 2006 and 2005, respectively.

The Company has established deferred compensation plans for officers, managers, and directors other than its founding shareholders. These plans generally provide for a rate of return on deferrals based on the financial performance of the Company. The Company incurred expense related to these plans of \$3,346,283 and \$2,105,870 during 2006 and 2005, respectively.

In 1997, the Company implemented a Stock Incentive Award plan to reward key employees. The value of each Stock Incentive Award is based on the compounded increase in excess of 10 percent per year of the appraised value of the Company's common stock for the five-year vesting period following the date of the award. The cumulative numbers of outstanding awards as of December 31, 2006, 2005, and 2004 were 3,546, 5,263, and 6,806, respectively. No awards were issued during 2006. During 2006 and 2005, respectively, 1,684 and 1,543 awards became eligible for exercise, of which 77 and 71 were exercised for common stock and 1,607 and 1,472 were exercised for cash. Under the terms of this plan, the cash awards will be held by the Company over a two-year maturation period. At the end of this two-year period, the initial amounts of the cash awards together with investment returns accrued on them will be distributed to the participants. During 2006 and 2005, respectively, 33 and 0 awards were forfeited. Total expense recorded for the Stock Incentive Award plan was \$1,533,455 and \$1,995,449 in 2006 and 2005, respectively.

Separate stock incentive awards totaling 6,044 shares were granted to individual officers of the Company in 1998 and 2000. During 2005, 1,111 of these shares vested after certain performance and service requirements were met. These awards were exercised for cash. The Company recorded no expense in 2006 and \$333,300 in 2005 related to these awards.

Effective February 2, 2004, the Company provided a long-term compensation package to a key officer. This package includes a grant of 3,150 shares of restricted stock with an appraised value of \$990 per share and an option to purchase 200 shares of restricted stock at an exercise price of \$150 per share. The option was exercised on March 26, 2004. All of these restricted shares will vest in their entirety in 2010 and 2011 provided that certain performance and service requirements are met. The Company recorded expense of \$284,000 in both 2006 and 2005 related to this package.

On May 1, 2006 and May 1, 2005, the Company granted stock incentive awards totaling 222 and 1,110 shares, respectively, to a key officer. These awards will vest at different times during a period starting in 2006 and ending in 2011 provided that certain performance and service requirements are met. During 2006, 222 awards, of the 2005 grant, vested and were exercised for cash. The Company recorded expense of \$96,170 in 2006 related to these awards.

THE PLYMOUTH ROCK COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. Real Estate

The Company had ownership interests in two real estate properties as of December 31, 2006. One of these interests is a two-thirds ownership interest through a limited liability company. This investment is accounted for under the equity method. Costs for building improvements on these properties of \$1.6 million and \$1.1 million were incurred in 2006 and 2005, respectively. The table below summarizes the real estate costs and carrying values at December 31, 2006 and 2005:

	2006	2005
Land	\$ 4,523,650	\$ 4,523,650
Buildings, improvements, and other	<u>26,585,949</u>	<u>24,743,089</u>
Total cost	31,109,599	29,266,739
Less: accumulated depreciation	<u>6,714,526</u>	<u>5,741,173</u>
Net book value	<u>\$24,395,073</u>	<u>\$23,525,566</u>

Rental income from lessees other than Plymouth Rock Companies aggregated \$2.7 million and \$2.3 million in 2006 and 2005, respectively. For each of the years 2007 through 2011, minimum annual rent receivable by the Company is \$1.8 million. Total obligations of lessees to the Company through 2011 are \$9.2 million. Buildings and improvements are depreciated over their useful lives, which range from two to thirty-nine years.

The total appraised value of the Company's real estate interests, as determined by an independent appraiser during 2006 using the income and sales comparison approaches, was \$37.8 million. Because of uncertainties inherent in the appraisal process, as well as changing market conditions, the amounts that could be realized if the properties were actually offered for sale may differ from their appraised values.

9. Goodwill and Intangible Assets

Goodwill of \$3,366,790 and \$3,748,504 at December 31, 2006 and 2005, respectively, representing the excess of the purchase price over the estimated fair value of net assets acquired, has resulted from the Company's purchase of insurance agencies. The Company reviews goodwill annually for impairment. No impairment of goodwill was recorded for 2006 or 2005. Intangible assets of \$579,580 and \$1,124,921 at December 31, 2006 and 2005, respectively, representing expirations, non-competition agreements, brand name, and website expenditures, also exist as a result of the purchase of insurance agencies and are being amortized over periods ranging from three to seven years. During 2006, the Company sold a portion of its agency business. This sale resulted in a reduction to goodwill and intangible assets of \$381,714 and \$222,275, respectively. Amortization associated with these intangible assets for 2006 and 2005 was \$369,929 and \$406,484, respectively.

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. Investment Securities and Investment Income

A. Marketable Securities

At December 31, 2006 and 2005, 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, 2006:	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government securities	\$ 30,697,543	\$ 9,821	\$ 729,269	\$ 29,978,095
State and municipal securities	140,369,413	134,436	549,367	139,954,482
Corporate debt securities	52,571,672	12,737	814,899	51,769,510
Mortgage-backed securities	14,007,334	2,713	181,976	13,828,071
Common stocks	47,829,913	20,648,027	14,435	68,463,505
Total	<u>\$285,475,875</u>	<u>\$20,807,734</u>	<u>\$2,289,946</u>	<u>\$303,993,663</u>

At December 31, 2005:	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government securities	\$ 38,073,371	\$ 12,778	\$ 805,999	\$ 37,280,150
State and municipal securities	46,582,601	165,689	240,860	46,507,430
Corporate debt securities	68,738,077	37,954	1,291,986	67,484,045
Mortgage-backed securities	22,621,403	4,093	337,162	22,288,334
Common stocks	41,805,627	8,516,678	376,774	49,945,531
Total	<u>\$217,821,079</u>	<u>\$ 8,737,192</u>	<u>\$3,052,781</u>	<u>\$223,505,490</u>

At December 31, 2006, maturities of marketable securities were as follows:

	Amortized Cost	Fair Value
Due in 90 days or less	\$ 11,456,203	\$ 11,433,497
Due after 90 days and in one year or less	23,986,659	23,772,284
Due after one year and in five years or less	156,355,680	154,977,643
Due after five years and in ten years or less	14,102,516	13,749,437
Due after ten years	31,744,903	31,597,296
Common stocks	47,829,914	68,463,506
Total	<u>\$285,475,875</u>	<u>\$303,993,663</u>

THE PLYMOUTH ROCK COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. Investment Securities and Investment Income, continued

A. Marketable Securities, continued

The Company classifies these marketable securities as available for sale. At December 31, 2006 and 2005, the Company carried securities that had been in an unrealized loss position for longer than twelve months with a total fair value of \$101.4 million and \$87.5 million, respectively. Unrealized losses related to these securities were \$1.9 million and \$1.7 million at December 31, 2006 and 2005, respectively. The Company views these losses as resulting from market conditions and believes them to be temporary. At December 31, 2006, the Company recorded a loss of \$17,640 on one security, for which it believes the value it previously recorded to be "other than temporarily impaired." No such losses were recorded in 2005.

B. Alternative Equity Investments

Alternative equity investments include positions in entities that focus predominantly on publicly announced mergers and acquisitions arbitrage. Substantially all of the investments made by these entities are in publicly traded securities, and the Company has the contractual right to withdraw its funds from these entities each year. At December 31, 2006 and 2005, the Company's recorded equity in these alternative equity investments, which includes realized and unrealized gains, was \$38,806,303 and \$25,566,945, respectively. The cost of these investments was \$26,000,000 and \$16,000,000 in 2006 and 2005, respectively.

Other alternative equity investments include privately held common stocks, preferred stocks, surplus notes, and partnership entities investing in companies that are not publicly traded. The Company's recorded equity in such investments amounted to \$36,022,135 and \$24,742,093 at December 31, 2006 and 2005, respectively. The Company recorded unrealized gains of \$0 and \$5,800 associated with these investments as of December 31, 2006 and 2005, respectively. The costs of all such investments as of December 31, 2006 and 2005 were \$36,022,135 and \$24,736,293, respectively. These amounts include investments in Direct Response Corporation and Homesite Group Incorporated totaling \$11.3 million at December 31, 2006 and 2005. These companies derive underwriting revenue from personal lines property and casualty insurance activity throughout the United States, except in certain New England states.

The Company has remaining commitments to invest \$1.7 million and \$19 million in two private equity funds, Lindsay Goldberg & Bessemer L.P. I (Fund I) and Lindsay Goldberg & Bessemer L.P. II (Fund II), respectively. The Company is a limited partner of both Fund I and Fund II. The Chairman of the Company is a member of the general partner of Fund I. At December 31, 2006, the Company had invested \$8.3 million and \$1.0 million in Fund I and Fund II, respectively.

THE PLYMOUTH ROCK COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. Investment Securities and Investment Income, continued

C. Analysis of Investment Income and Capital Gains

The components of investment income and capital gains before federal income taxes during 2006 and 2005 were as follows:

	2006	2005
Interest income and dividends from securities	\$11,718,198	\$10,758,059
Earnings from alternative equity investments	14,116,938	3,805,713
Rental income	2,522,074	2,293,000
Finance charges from premiums receivable	6,498,228	6,148,085
Gross investment income	34,855,438	23,004,857
Rental expenses	(1,684,480)	(1,518,493)
Investment expenses	(1,117,448)	(871,321)
Investment income	32,053,510	20,615,043
Net realized capital gains	1,185,717	5,302,070
Investment income and capital gains	<u>\$33,239,227</u>	<u>\$25,917,113</u>

D. Investment Activity

Activity in investment securities during 2006 and 2005 was as follows:

	2006	2005
Balance at beginning of year	\$273,814,528	\$304,063,548
Change in marketable securities:		
Proceeds from maturities	(31,628,000)	(7,877,000)
Proceeds from sales	(39,115,246)	(214,773,275)
Purchases	138,406,429	185,363,397
Net change in marketable securities	67,663,183	(37,286,878)
Net change in investments in alternative equities	24,525,200	6,554,132
Net investment activity	92,188,383	(30,732,746)
Gain realized on exchange of stock	-0-	6,617,676
Net change in purchases in process	(8,387)	5,051
Net change in unrealized gain on marketable securities and alternative equities	12,827,577	(6,139,001)
Balance at end of year	<u>\$378,822,101</u>	<u>\$273,814,528</u>

Comprehensive income is defined as net income plus the change in net unrealized gain on investments. Accordingly, the net unrealized gain on investments is reduced by realized gains previously included as unrealized in comprehensive income of \$340,000 and \$3.7 million in 2006 and 2005, respectively.

THE PLYMOUTH ROCK COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Note Payable

The Company issued a note payable in the amount of \$9,683,400 at an interest rate of 6.32% in 1998 in conjunction with the purchase of outstanding shares of its common stock. Payments of principal are scheduled to be made in ten equal annual installments of \$968,340. Interest payments on this note totaled \$153,000 and \$214,000 during 2006 and 2005, respectively. The Company has the right to prepay this note at any time.

12. Stockholders' Equity

A. Common Stock

Common stock at December 31, 2006 and 2005 is composed of Class A common shares and Class B common shares, both classes having a par value of \$0.10 per share. There are 300,000 Class A shares authorized, of which 117,237 and 116,939 were issued and outstanding on December 31, 2006 and 2005, respectively.

There are 90,000 Class B shares authorized, of which 65,751 and 65,972 were issued and outstanding on December 31, 2006 and 2005, respectively. 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, and are converted automatically upon the occurrence of certain events. The Class B common shares have the right to elect 80 percent of the Board of Directors, a right which has never been exercised in full. Presently, two Directors are elected by the Class B shareholders and all others are elected by the Class A shareholders.

B. Statutory Surplus and Dividend Availability

The Company's insurance subsidiaries are required to file financial statements with state insurance departments. The accounting principles prescribed or permitted for these financial statements differ in certain respects from accounting principles generally accepted in the United States of America. On a statutory accounting basis, capital and surplus of the Company's insurance subsidiaries aggregated \$154.7 million and \$118.8 million at December 31, 2006 and 2005, respectively. Regulatory limits restrict the amount of dividends that can be remitted to the Company from its insurance subsidiaries without permission of state insurance regulators.

C. Earnings Per Share

Basic earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding throughout the year plus dilutive potential common shares that were outstanding at year-end.

Directors and Officers of The Plymouth Rock Company

Directors

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

Officers

James M. Stone
Chief Executive Officer
James N. Bailey
Treasurer and Clerk
Hal Belodoff
President and Chief Operating Officer
Paula W. Gold
Vice President
Colleen M. Granahan
Vice President

Directors and Officers of the Plymouth Rock Group of Companies

Non-Management Directors

Alexander Ellis, III
Kerry A. Emanuel
Fabian J. Fondriest
Samuel F. Fortunato
Michael J. Johnston
William M. Kelley
Wilmot H. Kidd, III
Eugene J. Meyung
Norman L. Rosenthal
Sandra A. Urie
Peter J. Wood

Paula W. Gold
Colleen M. Granahan
Carroll M. Foley
Eric L. Kramer
Lisa K. Lasky
Michael A. Luciani
Paul D. Luongo
Richard J. Mariani
Mary Beth McInerney
Karen A. Murdock
Michael T. Murdock
Thomas G. Myers
Louis C. Palomeque
Carl A. Peterson
Anne M. Petruff
Linda D. Schwabenbauer
Joseph Scaturro
Donald J. Southwick
Mary A. Sprong
Karen L. Stickel
James M. Stone
Mark A. Sweeney
Barry O. Tagen
John P. Tierney
James A. Tignanelli
Ellen S. Wilcox
Gerald I. Wilson

Management Directors and Officers

Richard F. Adam
Francis P. Arment
James N. Bailey
Hal Belodoff
Mary L. Biernbaum
Marc V. Buro
Frederick C. Childs
Nancy L. Conlin
Thomas A. Cranley
William E. Emmons
Edward J. Fernandez

Counsel:
Ropes & Gray LLP

Independent Auditors:
PricewaterhouseCoopers LLP