

**The Plymouth Rock Company**  
**695 Atlantic Avenue**  
**Boston, Massachusetts 02111**

**Chairman's Letter**

February 29, 2000

To Our Shareholders:

Nothing sounds as boring as an annual report that talks about a year of consolidation and building for the future. Though 1999 was just that kind of year, it was never boring for those of us involved in the process. Consolidation was necessitated by interesting and tough issues the prior year, and the future for which we are preparing is exciting. Your Company's performance last year was better than the budget had predicted and considerably better than in the year prior. While the overall return on shareholders' capital, at 7.1%, lagged Plymouth Rock's historical norms, net income per share was up by 28% over 1998. Relatively few of the year's events are candidates to rank among the Company's historical highlights. No new states or lines of business were added in 1999, and no businesses were diminished or sold. There were no changes in top management officers at any of our companies. Much of the year, at this passing of the millenium, was spent on plans for renewed growth to end a cycle of slow expansion. After more turbulence in 1998 than anyone had sought, this kind of year was both welcome and valuable.

Plymouth Rock Assurance Corporation is still our largest company, which means that Massachusetts automobile insurance is still a major factor in our performance. We have come a long way from the days when it was our only business, but "Mass auto", as it is called around here, always commands attention. One of the various measures of progress in diversification over the years is the diminishing share of total corporate value Mass auto represents. Each year, we have an appraisal of our stock performed by an outside investment banker. In May of 1999, the appraisal reported that the Massachusetts automobile business constituted 27% of the Company's overall value. The same appraisal report placed the share of total value attributable to our other three New England agency companies at about 12%, with the management of our New Jersey reciprocal at another 12% of the total value. Investments, primarily by the parent company, in securities, real estate and the two non-controlled direct response carriers account for the other 49% of your Company's value.

Hal Belodoff is now firmly at the helm of the Plymouth Rock agency group. His first order of business was to restore our historically superb relationship with the agents of Plymouth Rock Assurance. Some of those agents had been spooked by our joint marketing efforts with the Savings Bank Life Insurance Agency last year, and wondered whether there was a deeper message there. Hal spent much of 1999 making clear that, if there was a deeper message, it was a positive one for the Plymouth Rock agent. The future of automobile insurance will inevitably involve modern methods of both customer solicitation and customer service...and we think that is good for the agents who have those tools. The agency company of the future will have relationships with other financial institutions, will service agents and their customers with help from the Internet, and will use every available technique for enhancing the value and effectiveness of its agency sales force. The prospect of leading the way there pleases us. While we lost some valued agency relationships in 1998, when

communications with our agents were less than ideal, I am pleased to report that most of the volume has already been restored. Commitments in hand will take the total beyond its prior peak sometime during 2000. Just as important, most of our agents now share our view of the future. They have welcomed our brand new Internet service capability. And more than forty of our agencies are now eligible to write life insurance business through SBLI, an option they never had before. We think that is an ideal combination. Only a Plymouth Rock agent can offer the best service and price combination in both life and auto insurance.

The agency company of the future will own some agencies as well. This is not just to increase stability, but because the arrangement responds to the needs of the agents. While ownership has been frightening to some carriers in the past, we have too long been told by too many agents about perpetuation and liquidity worries not to want to offer an answer. Other agents have decided to concentrate business in a small number of carriers and seek expansion cash in exchange for tighter commitments. The list of motives goes on, but the theme is plain enough. Plymouth Rock should be flexible as a company and entertain any type of relationships our agents want. So, we have committed ourselves to a new receptiveness, and ideas -- including some big ones -- have been coming quickly. We made a major agency purchase in the fall of 1999. Don Southwick, an agent of Plymouth Rock from its earliest days and always one of the very best, decided to seek liquidity and a new professional challenge. As a consequence, Plymouth Rock has purchased the Blair, Cutting and Smith agency, and Don has added some company executive tasks to his continuing agency responsibilities. As an independent agent, Don was our partner, advisor and friend for fifteen years, but this will be even better.

For the last five years now, I have had to devote space in this letter to the price war that has plagued Massachusetts automobile insurance. While the worst now appears to be over, some concern is still warranted. The Commissioner has, once again, set premium rates in the responsible zone, with an increase approaching 1% from last year's base rates. But, as before, the companies followed with downward deviations that take the operative premium rates well below the Commissioner's level. This occurs for two principal reasons. One is that group discounts now apply to perhaps a third of the market, and some of these discounts are set with more wishful thinking than actuarial reality. That behavior is probably inevitable in a competitive environment. The other reason, though, is more artificial. The Insurance Department's Safe Driver Insurance Plan is systematically designed to overprice the best drivers in the state, presumably to minimize the political backlash from bad drivers -- who are handed an undeserved break by the plan. The consequence is that companies seeking to rebalance the prices find themselves able to do only the downward half of the job. Discounts can be offered to drivers with safe records, but, because the Commissioner's rates are the legal limits, the costs cannot be recaptured from those with the accidents and convictions. The result is an average industry-wide rate level stuck perpetually on the short side. The good news is that group discounts, which had fallen a bit in 1998 and 1999, have stayed down in 2000. The unbalanced deviations for safe drivers moderated this year, falling from a market average of 8.0% in 1999 to 6.5% in 2000 for the best drivers. Good fortune with respect to weather, and a continually falling crime rate, made for a reasonable profit picture in 1999. While that is not quite the same as a comfortable environment, it will only take a small increment in pricing rationality to get as much comfort as a business deserves.

Last year's letter took something of a duck on the subject of loss ratio. I noted that the peer group numbers to which we generally compare ourselves looked suspicious in 1998, and the analysis should wait for some seasoning. That instinct proved useful. All published loss ratio numbers combine a measure of hard reality (paid loss data) with a dose of crystal ball gazing (case reserves

and IBNR). Last year's, though, were softer than most. The 1998 claim reserve numbers for Plymouth Rock have now been put to the test and found to have been inadvertently ultra-conservative. The numbers for our peers turned out to be imperfect on average in the other direction. A raw inference from the statutory reports last year would have made us feel that we were losing our edge. It now seems that Plymouth Rock is still strong on loss ratio, with a 1999 loss and loss adjustment expense ratio, including residual market costs, of 74%. We also, alas, remain about where we were on the relative expense ratio comparisons, a few points over the peer group average. Hal is never shy about his commitment to reinforce the loss ratio advantage and vanquish the expense ratio deficit.

At Palisades, the year was satisfactory. This was a relief, given all the fear that accompanied a 1998 New Jersey legislative mandate for an across-the-board 15% rate decrease. The same favorable weather conditions and crime rate improvements as in Massachusetts rendered the premium reductions less problematic than predicted, and we almost had a banner year at Palisades. An error on our part, with no one else to blame, removed that opportunity. The reciprocal insurer, Palisades Safety and Insurance Association, had capitalized a sister company in 1997 to broaden its market reach. That company, which is called Palisades Insurance Company, was intended to insure drivers whose safety records would not gain them immediate access to the favorable rates of the Association. The idea was sound, but, through inexperience in that market segment, we slipped and allowed people without prior insurance to be insured by Palisades Insurance at a rate too close to the preferred rate. That single error, now corrected, had a seven-figure impact on earnings for the whole Palisades group for 1999. The good luck outdistanced the cost of the error, so the combined results were above budget. All of the Palisades businesses, taken together, earned about \$2 million, and the management company contributed about \$500,000 of earnings to Plymouth Rock's consolidated profit.

Profits at the three smaller New England companies were, taken together, short of their budgets by about \$1.2 million and short of 1998 results by about \$0.8 million. The largest shortfall was at Pilgrim Insurance, which services business on a fee basis for half a dozen other insurance carriers and for the Massachusetts residual market. The work for the latter is in the servicing of the state's taxis and limousines, many of which are ceded to the residual market. The more competitive the voluntary commercial insurance market, the fewer taxis are sent to the residual market pool, and the lower Pilgrim's taxi revenues will be. This year a vigorous market absorbed nearly 40% of Pilgrim's anticipated business. Because Pilgrim had just added a large client, the universally respected USAA, Vin Nieroda did not want to contract employment or infrastructure. He is confident that next year he will bring profits back up above their 1998 levels, even if taxis and limousines continue to be pulled out of the pool. At our homeowners writer, Bunker Hill Insurance Company, where Vin is also the officer in charge, results suffered from the 1998 loss of volume. Consequent scale diseconomies combined with an unrelated reserve strengthening on liability claims to produce a disappointing year. Automobile insurance volume has returned to Plymouth Rock Assurance, but Bunker Hill's homeowners business is just catching up now. Vin projects a strong year at Bunker Hill in 2000.

Mt Washington Assurance, serving New Hampshire since 1991, is our smallest business. Its expected profits and losses tend to be in the hundreds of thousands, a decimal point below its sibling companies. That company's net income has fluctuated for a few years around the breakeven point, with 1999 results slightly in the red. Bill Kelley has long told us that the company needs about \$25 million in annual premium volume to post reliable profits. Current volume is just under half that much. Getting there can be half the fun, but, unfortunately, the rest of the journey will be without

Bill Kelley. For entirely personal reasons, Bill has decided to retire. He had long warned me of his plans to spend some of his middle age in retirement; both of us had only hoped that this would come after the volume goals were reached. So Mt Washington will be in need of a new leader next summer. Bill, who contributed in countless ways to Plymouth Rock's successes for most of its first dozen years as its chief of claims and a pillar of its culture, will be missed by all. We are counting on his consulting services as soon as he has time to miss the joys of work he will have given up. Mt Washington's continuity, meanwhile, will be assured by the presence there of Mary Beth McInerney, a veteran manager of great competence who was promoted last year to Vice President.

The year was a roller coaster year for Response Insurance, the older and larger of the two direct response carriers in which Plymouth Rock owns a founder's stake. In May it looked as though that company had hit its stride. Its goal is not modest: Response intends to build a nationally branded billion dollar automobile insurer, operating everywhere except certain New England states, with both loss ratio and expense ratio statistics far better than its traditional competitors. To accomplish that, it needs a scalable technology infrastructure, multiple licenses and approved rates throughout the country, an unusual leadership team, a highly trained customer service staff, an attractive branding motif, and plenty of capital. With no small effort on everyone's part, those elements were largely set in place during 1998 and 1999. The mainframe technology is advanced and scalable to the size we envision, with Internet components being added all the time. Response is licensed in forty-eight states, has rates and forms in twenty-four states and is actually writing in California, New York, Florida, Georgia, Maryland and Illinois (with Texas and Pennsylvania on the near-term horizon). The leadership team was completed with the promotion of Mory Katz to the Chief Executive Officer position and the appointment of Steven Carlsen, who had helped make CAT Limited in Bermuda such a winner, as Chief Operating Officer. They are a fine tag team. The red telephone logo and the Response brand continue to be well received, and the customer service offices in White Plains, New York, and Suisun City, California, are sources of pride to all of us. An internal claims operation to match is currently under construction. Morgan Stanley Dean Witter Capital Partners continues to be fully supportive, and an additional capital commitment in 1999 has now increased its total investment in Response from \$120 million to \$307 million.

All was as it should have been in the spring, and Response set a goal of quadrupling its writings to \$40 million during 1999. As the year went on, though, it became apparent that Response was not in for smooth sailing. The national reduction in crime, including thefts and drunk driving violations, along with a generally safer breed of cars on the road has been good for the public and for insurance industry results, but not so good for a new entrant. Capital is abundant, and recent premium rates have proven excessive. Not surprisingly, this led to rate reductions almost everywhere. When the giants in the industry reduced premiums for all but the worst drivers an unprecedented third year in a row, most of the public stopped shopping for a price break. Direct mail response rates plummeted as the year went on, and those drivers who continued shopping were disproportionately those with records that earned them increases instead of cuts. So, Response ended the year with both its marketing costs and its loss ratio much too high. Many of its direct response competitors, faced with the same conditions, have curtailed expansion -- with the exception of GEICO, which has deep pockets and an exceptionally far-sighted leadership. The whole Response team is thinking hard about an optimal strategy for these conditions. One thing is certain, though. The year 2000 will not look as Mory and Steve had hoped it would just a few months ago. Response will either have to take more risk or accept a slower path to greatness.

Homesite Group, the other direct response investment, is at an earlier stage of development. There, with Charlie Kline, Fabian Fondriest and Russ Fletcher at the helm, a similar building of infrastructure is under way. Fabian was formerly the chief marketing officer of Chubb, and Russ was a senior colleague of Charlie at CAT Ltd. Licenses are coming in quickly, and the building of scalable systems with a focus on the Internet is in process. Test marketing has brought in the first few hundred policies. The strategy, though, is a little different from that of Response. Homesite is not looking to build a stand-alone homeowners insurer by direct mail and advertising, but to become the partner of choice for mono-line automobile insurance writers, mortgage originators and other financial institutions. The opportunity is compelling; while capital was pouring into automobile insurance, it was exiting the homeowners business. Increasingly, even the largest of companies have elected to participate in the homeowners business only indirectly, thus avoiding much of the catastrophe exposure and volatility that inevitably characterizes property coverage. Homesite will be designed, by executives who come with unusual expertise in catastrophe reinsurance, to be the ideal partner. That means having an appreciation of risk assessment and an Internet-driven service capability second to none. It helps, of course, that Homesite is nearly alone in that endeavor. There are few, if any, competitors. The Homesite team is hard at work on building the assets it needs, and negotiating its first major relationship deals. In the best case, next year's letter might not even have to tell you the names of the partners. The better Homesite does in its partnership talks, the more likely you will already know.

Investment results for 1999 were more dramatic in the parts than in the whole. Bond returns were slightly worse than nil while equity prices were up about 20% for Plymouth Rock, just as they were for U.S. stock markets as a whole. The final year of the twentieth century was, according to the index we track, the second worst of the entire hundred years with respect to bond returns, and among the best with respect to equity gains. The combination produced a relatively weak performance, with a total return over the whole marketable securities portfolio of 4.1%. For Plymouth Rock, of course, marketable securities do not tell the whole story. A substantial part of our enterprise value lies in investments that are not marked to market in the manner of publicly traded stocks and bonds. The real estate portion of the portfolio, for example, did better in 1999 than the marketable securities as a whole, and probably a lot better. We had purchased our two Boston buildings, with combined space of more than a quarter million square feet, for a composite price of less than \$90 per square foot. Comparable space in Boston sells today for something around \$250 per square foot. The cash on cash return for the two buildings in 1999 was about 12%, which is four hundred basis points over our investment benchmark. The investments look stellar by either measure. Plymouth Rock's marketable equity returns over the last five years have averaged a remarkable 33% per annum, versus 29% per year for the S&P, but the five-year real estate returns may have exceeded that. We do not, however, conduct an annual appraisal of the properties, and they are carried at depreciated cost on the balance sheet, so an exact calculation of any year's gain is elusive.

The value of our relationship with Palisades is almost entirely unrepresented on the balance sheet. We carry the little New Jersey management company's shares at their book value, but the reciprocal, with its \$55 million in profitable business, is not a part of Plymouth Rock's reporting. Even with an appraisal it is hard to estimate the increment in value in any period, but all of us here are confident that Palisades' value as a business has increased substantially in recent years. The treatment of Response and Homesite in our financials is even more confusing. As non-controlled investments, they are carried according to the "equity method" under Generally Accepted Accounting Principles. This means that our investment basis is reduced by a proportion of their operating losses each year, even if the costs are well spent and the enterprise values of Homesite and Response are growing.

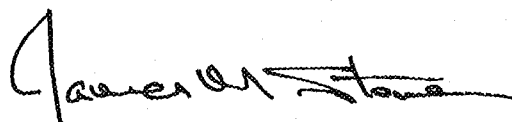
There is no attempt, and none is expected for quite a while, to quantify the true value of Homesite or Response in preparing Plymouth Rock's financials. Since the investments were made, the total write-down of value for the two investments has been over \$2 million. In other words, the two companies are carried this year at \$2 million less than the amounts of our investments in them, and the balance sheet reflects a loss of value on the investments in that amount. As the direct response insurers grow, they will inevitably experience additional operating losses, and thus Plymouth Rock's balance sheet valuation of the two companies will continue to shrink. Only time will tell whether the true value to the investors was rising or falling during the period of growth, but my bet is that both are first-rate investments. If either company realizes its potential, these two investments will do even better than the real estate.

A comment on the state of the equity markets is inescapable here, since Jim Bailey, Rick Childs and I ask ourselves quite regularly these days whether the bull market is due for a massive correction. None of us believes in market timing under ordinary circumstances. We could never convince ourselves that we know how to make money selling dear and buying cheap by the day, week or month. We are not day traders but decade traders, unshakable members of the fundamental value school. The proper focus of fundamental analysis is usually at the level of the individual company. But there are rare times in history when fundamental analysis leads to judgments of the market as a whole. This may be such a time. When people talk of a "new paradigm" or predict a Dow at 36,000 in short order, I shudder. Familiar ratios -- price to book, price to earnings, dividend yield, and both of the latter relative to bond yields -- are far beyond comfort levels. Someone pointed out to me the other day that the *increase* in market worth of publicly traded U.S. stocks over the last four years is greater than the market value of the country's entire housing stock. What does it mean that traditional economic measuring tools could not have predicted the performance of technology stocks over the last decade? Adam Smith, in The Wealth of Nations, described the shift of value from arable land and hoarded gold to the ownership of productive assets. For the next two hundred years, productive assets were generally associated with capital goods and access to skilled labor. As long as most of the national economy was focused on tangible goods, you could evaluate the key factors of production for quantity and quality, and that provided a first approximation of value. To the extent, however, that ideas, entertainment and other services are now replacing tangible product as purchases of choice, businesses become far trickier to value and limits to their potential growth become devilishly tougher to quantify. This makes it that much harder to set a fundamental value on individual stocks or the market as a whole. Where does that leave Jim and Rick and me? First, we acknowledge that more agnosticism is called for now than in the past, and we are less comfortable becoming equity owners when and where this is the case. Second, despite the recognition that an intangibles-driven economy would call for a degree of "new paradigm" thinking, we continue to place trust in the familiar fundamental ratios as useful tools of long term value assessment. So, we have slowed down the buying of additional positions. If the bull market continues, we may either reduce our equity exposure or reconfigure it to emphasize areas where we think value is still in line with price.

A noteworthy change in The Plymouth Rock Company's stock ownership occurred during the year. Progressive Casualty Insurance Company nearly doubled its holdings, which now represent about 24% of the Company. That makes Progressive the third largest shareholder, after Central Securities and me. It does not change the composition of the Board or the nature of our relationship with any of the owners. The history of the transaction goes back to 1987, when Jim Bailey and I set about arranging Plymouth Rock's second (and, to date, last) round of financing. We wanted to limit ourselves to shareholders who could contribute more than money, and our search took us to Peter

Lewis of Progressive, the late Benno Schmidt of J.H. Whitney & Co., and Mike Johnston of the Capital Group. By the standards of non-monetary contribution, all were home runs. Mike Johnston has been an active and valued director ever since. Benno's contributions were praised to the skies in the 1995 Annual Report. And Progressive (now represented on our board by Chuck Chokel) is my candidate for intellectual leader of our industry. The shares owned by J.H. Whitney & Co. and by Benno personally, though some of them went on a brief journey in-between, are the shares that Progressive bought last year. This is a fitting outcome. Our current owners have been the buyers of choice whenever stock has become available. For those who always seek to read more into events than is really there, please offer the reminder that Progressive has now reinforced an existing agreement not to purchase more Plymouth Rock stock without our consent. Their increase in stake is emphatically not a change of control, either actual or contemplated. It is merely an enhancement of a happy and enduring investment relationship.

The 7% return on capital for 1999 cannot help us catch up to the Company's long-maintained standard of 20% annual returns. Last year's letter reported that the sixteen-year cumulative return on capital had fallen to 19.8%. Adding another year at 7% takes the seventeen-year cumulative return down to 19.0%. If that seems insufficient, perhaps some comfort can be taken from the fact that the measurement ignores all of the same items excluded from book value. The calculation for rate of return is simply an internal rate of return measure, using cash in from owners, cash out to owners, and a terminal item for current book value. If real estate were marked to market *or* if the Palisades management company were carried at its true worth *or* if the Homesite and Response investments were reflected at a market value, the rate of return would be comfortably above 20% since inception. With all three adjustments, you would see a margin of safety as well. Having said this, it is still a nice goal to bring the conservatively measured book return back over the 20% mark. A better profitability environment in our key states may be required, but no better than the historical norms for those states. Some improvement in expense ratios will be required, but no more than Hal already predicts growth with attention to efficiency will offer. Within the top management team, growth and efficiency are the most frequent subjects of conversation at this time. These goals have a renewed constituency in the broader ranks of Plymouth Rock employees as well. That is a powerful advantage for any company. I am pleased to observe that, seventeen years from Plymouth Rock's founding, the entrepreneurial spirit still predominates.

  
James M. Stone

