The Plymouth Rock Company

695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 8, 2018

To Our Shareholders:

You may be wondering why Hal and I initiated so many concurrent changes in our company during 2017. Sometimes we do, too, but it was time for change, and one thing led to another. When I worry that too much may now be in flux, I'm tempted to call these past twelve months The Year of Juggling Dangerously. When things settle down, I plan to rename it The Year We Upped Our Game. Let me refresh you on the changes I am talking about. First, we devoted more time and resources to all four of the Company's on-going major initiatives: building a direct response book of business, turning homeowners into a growth engine, adding to our geographic footprint, and creating a state-of-the-art national insurance agency. The addition of new states to our map triggered a plan to move our New Jersey headquarters to a location more conveniently accessible to and from the new jurisdictions. To jumpstart our brokerage and homeowners projects, as well as state expansion, we turned our attention to several major acquisition transactions. And we thoroughly reorganized our enterprise reporting structure to suit the new reality, shifting around the reporting lines for a great many of our managers and officers. Our task now is to see that all of these upgrades are effected without upsetting the equilibrium of an established and successful business.

Nothing on the list of changes should come as a big surprise. In my 2004 annual letter, I wrote: "There are more states in the Northeast to enter; we are particularly interested in New York and Pennsylvania." It has simply taken this long for Hal and me to develop confidence that our management team, our advanced analytics capability, and our information technology systems were ready for it. All three are better now than they have ever been in the past, so we moved ahead. Companies in the Plymouth Rock family are now licensed and doing business in Pennsylvania. Our application is pending in New York. A good part of last year's annual letter was devoted to the three growth initiatives other than state expansion, and each will be discussed again in this letter. The reorganization was a new thought in 2017, but it follows logically from the other changes. When Plymouth Rock was founded, it made sense for the Company to be structured around our geographies. We were in just a few states, and both Massachusetts and New Jersey had uniquely complex regulatory frameworks that required state-specific expertise. Focusing on individual states has served us well up to this point. We will soon, however, be doing business in six states, too many for a president in each, and their various regulatory environments have converged over the years. We are now open, moreover, to employing all three of our product distribution channels – independent agent, exclusive

agent, and direct response – everywhere but Massachusetts, where our partnership with our independent agents continues to be particularly rewarding. As a result, we believe we will be better served going forward by having a strong president and management team for each distribution channel rather than for each geography. Under the reorganized reporting lines, all Direct and Prudential automobile insurance business in 2018 will be handled by people reporting to Gerry Wilson, while all of our Independent Agent auto business will be led by Chris Olie's team. Bill Martin will have continuing responsibility for all of our newly written homeowners business, and Marc Buro continues to run the brokerage business we call InsuraMatch.

Looking back at the results for the year, we can see a reflection of the strong management cited above and some exceptional luck on top of that. This quite favorable combination eased considerably the stress of all the changes and provided the best bottom line in our history. There was no unforeseen, infelicitous upswing in national claims frequency or cost inflation to contend with in 2017; our part of the country was spared the terrible storms that hit the Gulf region and the wildfires that have been plaguing California; and the stock market registered an unusually strong year. An unexpected boost to earnings came from an event for which we can claim absolutely zero credit. The new tax law could scarcely have been more beneficial to us, as owners of a profitable corporation paying essentially full taxes and holding substantial unrealized capital gains. Net income at your stockholder-owned entity rose from $42.1 million in 2016 to $80.0 million in the year just concluded, a 90% jump. Of this, $19 million comes from reducing the reserve for future taxes payable on our unrealized stock market gains, just straightforward arithmetic that follows from the reduced corporate tax rate. Considering our entire enterprise rather than just the stockholder-owned portion, we enjoyed a rise in fully consolidated net income of 126%, from $58.8 million to $133 million.

A more informative (and more stable) index than net income for the stockholder-owned entity is its gain in book value, which also captures unrealized gains and losses originating in the securities portfolio. This yardstick recorded an advance of 18%. More meaningful still is the true economic gain. This supplements the change in shareholders' equity by the dividends you received in cash during the year and also by the real estate gains that are not taken into book value under generally accepted accounting principles. The past year's dividends and the after-tax real estate gains, based on independent appraisals of our properties, totaled $33.5 million. On a per-share basis, these two adjustments would add $263 per share to the book value in the financial statements. The year-to-year increase in economic book value measured on this basis is 26%. It is this number I look at first to form a perspective on how well the Company has done. As you know, I view Plymouth Rock's return corridor for this statistic as bounded on the weak side by 10% and on the strong side by 20%. The results for 2017 broke through the high-side wall, and handily so. They would be at the desirable end of the comfort zone even without the benefit of the December tax legislation. The thirty-three year compounded internal rate of return on book value for your Company's owners, excluding real estate gains, stands at 18.0%. The Plymouth Rock Group's direct underwritten and managed premium volume has approached $1.3 billion, not including the premium placed with other insurers by our brokerage subsidiary, InsuraMatch.

Whereas in past years these letters have broken down the totals for closer examination by

jurisdiction, our new structure is organized around product and channel, so it makes sense to use the same divisions here in this letter. This is, of course, just another way to slice the same apple. The revised segmentation differs from the model you have become familiar with at the detail level, but the totals of net income and fully consolidated net income are exactly the same numbers as you would have seen under the old regimen.

The Independent Agency Group, led by Chris Olie, includes virtually all of Chris's old domain (New England automobile insurance writings and Pilgrim's servicing business) plus the New Jersey automobile volume written through independent agents and owned by the reciprocal we manage. Chris's group oversaw about $400 million in direct premiums a year ago. His team's written and managed premiums are now over $700 million. Growth in New England personal automobile premium was about 3% for the year, and, although exposures were flat, this apparently beats most of the other agency companies we consider our peers and rivals. The others, in general, have lost more business than we have to the rapidly growing national direct response companies. Volume in the New Jersey independent agent channel, which has faced an especially strong direct response challenge, nevertheless turned in a strong performance. Premiums rose by 8%. We are disappointed by the modesty of this channel's profitability record in New Jersey, but it has at least remained consistently above water. The fully consolidated net income for the entire Independent Agency Group represented, before unrealized investment gains, about 28% of the total for the enterprise as a whole. In years to come, the Independent Agency Group will, we trust, show substantial volume written in our populous new states – both of which have more people and more cars than any state in which we wrote business before this past year.

Massachusetts independent agency auto insurance turned in a combined ratio of just over 98%, which is better than we had expected. The combined ratio for our relatively stable $15 million book of automobile insurance in New Hampshire was around 100%. The automobile insurance combined ratio in Connecticut, where volume grew by 6% to just over $31 million, was more like 115% – an unsustainable result. While the expense contributor to this number can be mitigated simply by scale, the loss ratio remains worrisome. I am assured, though, that despite these 2017 results, Connecticut remains roughly on its glide path to profitability. After a decade of losses, a money-making year in Connecticut will someday provide a fine excuse to open a premium bottle of champagne, but that someday has not yet arrived. The Bay State and Granite State results can always be improved but there is no equivalent need for urgent repair. Connecticut, moreover, is not the only urgent challenge for the Independent Agency Group. Its commercial auto book of business, now accounting for $34 million in annual premium, is losing us money in both New Jersey and Massachusetts. Without Connecticut and commercial automobile writings, we would have produced for you an additional $20 million in net income over the last three years.

Pilgrim Insurance Company, our third-party service provider to other insurers, is also a part of the Independent Agency group. Bill Hartranft, who oversees finance for our whole enterprise, manages this business for Chris. Pilgrim had an impressive growth year, more than doubling its managed premiums and increasing its fee-for-service revenues to almost $26 million. Most of the growth came from Plymouth Rock's resumption of status as a servicing carrier for the Massachusetts residual market in commercial vehicle insurance. This line of business

is fee-based and thus immune from the loss ratio ills of our voluntary commercial book. Even before considering the benefits of the federal tax reductions, the surge in revenue allowed this past year to be Pilgrim's best ever for contribution to enterprise profits.

An important transition for the Independent Agent Group not initiated by Hal and me will occur by the end of 2018. Chris Olie had informed us when he first joined Plymouth Rock that he planned to stay in full-time employment for only five years. We expected him, therefore, to be gone from the presidency of our New England companies by 2014. He has now given notice, effective late in the current year, by which time his tenure will have been closer to nine years. Chris has been a fine colleague, and we would have been happy to see him remain, but we are thankful for the extended tenure he gave us and are exploring a continuing part-time role for him. Recruitment of Chris's successor will encompass both an internal and external search effort. The new chief of the Independent Agent Group will be headquartered in Boston, with about three-quarters of a billion dollars in business to oversee, and a geographic reach that should, before long, lift that channel past the billion dollar mark.

The Direct and Prudential Group, led by Gerry Wilson, is smaller in volume than Gerry's old domain but it contains the fastest growing business segment in the Company and the one that projects the most exciting take-off in the expansion states. The group wrote nearly $500 million in direct premiums in 2017. Its lines include the direct automobile insurance business supervised by Tom Lyons and all the business written through Prudential agents in both automobile and homeowners coverages, and now overseen by Ed Fernandez. The Direct and Prudential Group experienced about 2% growth in the year gone by, with more than all of that increase in volume arising from the direct response segment. Contribution to consolidated net income from Gerry's group was half the total for the Plymouth Rock enterprise as a whole. The Direct product is off to a healthy start already in Pennsylvania, and we hope it will have the same success there, in Connecticut, New Hampshire, and New York as it has had so far in New Jersey.

Most of the business of the Direct and Prudential Group is written through our New Jersey reciprocal insurer and its subsidiaries. This requires me to remind the reader that the profits of this group belong to the reciprocal's policyholders. For management purposes, we regard these results as equal in importance to those of our shareholder-owned entities, but the ownership distinction is real and it is reflected on our financial statements. The 2017 profit performance story for the Direct and Prudential Group looked roughly as it has for some years now. Aided by prior-year development in the right direction, the all-lines combined ratio rounded to 90%, which is more than satisfactory. The bulk of the profit, though, is still in the New Jersey homeowners book we inherited from Prudential in 2003 and which we cannot expand under our current agreement with Pru. The growth, in contrast, was entirely from the direct automobile insurance book, which expanded to an annual premium volume of $119 million, and showed a small profit on the bottom line – which exceeds what we would have required of such an unseasoned book. The largest volume contributor in the group remains the Prudential automobile insurance book, where recently acquired business has for a decade now contributed more bulk than profit. Because legacy business in that channel is still quite profitable, and this year was better than average for auto insurance generally, Pru auto produced an overall combined ratio comfortably in the mid-90's. The premium for

automobiles insured through Prudential agents rose by about 1.1% to $260 million. Improving the new business performance of the Pru automobile book and the persistency and scope of the entire Pru book are top of mind for Ed in his new assignment.

Our homeowners business is undergoing rapid change. Once operated largely as an accommodation to our agents in order to promote automobile insurance volume and boost customer loyalty, our Property Group is now an ambitiously growing profit center of its own. Under Bill Martin's leadership, it writes new business in five states and plans to add New York as soon as the licensing process is concluded. Bunker Hill, the largest and oldest homeowners subsidiary in the group, remains profitable enough to finance much of the expansion, and it should remain able to do so in the future if we manage our reinsurance and risk selection properly. Bill believes that, in this era of publicly available data bases, he can pioneer within our industry with respect to easy, on-line binding of coverage based on pre-fills of data for virtually every home – with minimal need to put our potential customers through the burdensome process of submitting additional information. While the six states we are currently targeting represent a population almost as large as that of England, and may satisfy our appetite for a while, I wouldn't want to rule out a national effort in homeowners at some point. That might require a suitable partner who brings more than money to the table. The volume at the Property Group, meanwhile, is projected to rise by nearly 30% in the year just begun, to something close to $115 million.

Marc Buro has the task of turning our insurance agency subsidiary from a traditional, two-state operation into an Internet-agile, and large, national broker. It is not a simple task, but he's been running at sprinters' pace from the first day. Thanks to a replacement transaction with a giant insurer wishing to cut back its personal lines footprint, volume at InsuraMatch Group has more than doubled – to a total of $88 million in brokered premium. Marc and his recently enhanced team are investing heavily in expansion as well as a new technology platform, so we don't have a profit to show at InsuraMatch yet and may not for a few years. What we have instead is a rapidly expanding brokerage subsidiary exploring marketing techniques that our entire enterprise and our agents will someday need to include in their skill sets. I have no crystal ball to read the future, but one prediction I feel certain enough to bet on is that on-line marketing will someday overtake bricks-and-mortar and the telephone as the dominant sales mode for our industry. InsuraMatch will help us learn and perhaps even lead.

Virtually everyone with long positions in common stocks did well in 2017. The Standard & Poor's Index returned 21.8%, including dividends, a gain that I ascribe in large measure to continuing recovery from the 2008-9 crash and market anticipation of the corporate tax cut. Plymouth Rock's equity performance lagged the index, but a common stock return of 13.5% cannot be cause for too many tears. The relative underperformance of our equities is fairly simple to explain. Our portfolio was overweighted in energy and traditional retail stocks, the former a risk we are comfortable with keeping and the latter less so. The Web-based retailing industry is conquering the world faster than we thought possible just a few years back. A secondary drag relative to the indices was our underweighting in the highest flying high-tech stocks. We just don't feel our comparative advantage in predicting the future profits of individual technology companies is worth a tinker's dam. Finally, our equity portfolio is built mainly around multinational corporations that pay less in taxes than domestics, and thus may

have had less to gain than full tax payers from the rate reductions. Over the two and a half decades since Jim Bailey and I started investing in marketable equities, Plymouth Rock's internal rate of return on common stocks from inception continues to beat the Standard & Poor's handily, so we are not worried about one lagging year. The annual growth and dividend return for our intentionally undiversified common stock portfolio is about 15.1% versus a 12.7% per annum return on the S&P index.

Jim Bailey and I, with help from Rick Childs and a very small team, continue to manage the equity portfolio ourselves. Standish Mellon still oversees our fixed income portfolio, with guidance from us on credit quality (which we keep high) and duration (which we keep short, and this year further attenuated). It should be no surprise, given those tight constraints, that our bonds returned relatively little once again. The total return on our bond portfolio in 2017 was about 3.5%. It is not our own judgment but our rating agency's and our regulators' investment philosophies, right or wrong, that cause us to maintain a billion dollar portfolio of fixed income securities, and we don't expect that to change any time soon. We do not, and will not, try to stretch the fixed income returns by taking long-term interest rate risk. Jim and I continue to believe many of our competitors risk losses from interest rate corrections without a commensurate return to justify that risk. Our alternative equities, the descriptor we use for hedge fund and private equity investments, had a strong year – much better than the prior one – returning overall a little over 15%. Real estate continued to be a strong asset class for us. Operating income on the two office buildings we own here in Boston, when added to the appraisal increases, produced an impressive 2017 return of 21%. The two buildings, bought for a total of $22 million, are now worth almost $120 million.

Once again, there is bad news and (slightly) better news with respect to our investments in Master Limited Partnerships engaged mainly in North American fuel transmission. The bad news is that two of the three entities currently in our portfolio produced negative returns during 2017. The slightly better news is that, having originally made an investment of over $100 million in four of these instruments, we have cumulative losses as of this writing of only a few million dollars, after dividends received. More important is the comfort we can take in knowing that the MLP's taken as a single unit constitute one of only two losing investments we have made in our entire equity investing history, marketable and otherwise – whereas gains have run well into nine digits. The MLP entities have shown a modest recovery trend so far this current year; Jim and I have determined to hold them a while longer.

The element of the broader economic environment most discussed this season by American business leaders is the 2017 tax cut, and rightly so. I thought it unwise policy for Congress to crank up the national debt so massively without a justifying, definable, high-returning investment in the future or an immediate need for temporary stimulus, but the new tax rates are unquestionably good for Plymouth Rock. Not only is The Plymouth Rock Company among those favored corporations previously paying full taxes and thus enjoying the full reduction, but the new law further enriches companies like ours that hold substantially appreciated portfolios of investments in equity securities. Many of those securities have already risen in price to reflect greater after-tax earning power.

Summaries of the new law abound, but it may be worth a few lines here to describe the tax

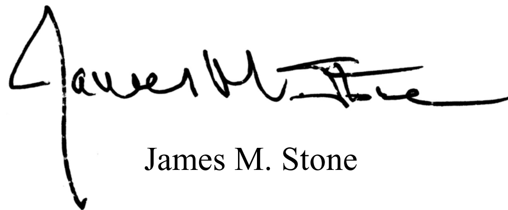
law changes as I view them. While most of the press attention has been focused on the personal tax cuts, most of the impact arises from the corporate provisions. Personal taxes will fall a bit for taxpayers near the bottom of the income and wealth distribution, where the standard deduction and some temporary breaks dominate outcomes. In the middle there is a mix of cases, with upper middle-class taxpayers in high-taxed jurisdictions least well treated. At the top are the big winners, with mega-bucks distributed only at the wealth summit and, importantly, not primarily through the personal tax provisions. More attention ought to have been given to the distributional impact of the corporate tax cut, where the greatest inequality consequences at the personal level arise. The reduced taxes for conventional C-Corporations, including the Plymouth Rock Company, increase individual net worth for shareholders like us. Owners of qualifying pass-through businesses do even better, enjoying a maximum single-layer federal tax of less than 30%. From now on, C-Corporation owners can receive spendable dividend cash in greater amounts than before – even after 21% has been paid in federal corporate taxes, another 25% is taken by federal personal taxes, and state income levies are also met. As Plymouth Rock owners, our cumulative all-level maximum federal tax is 40%, more than ten points better than before but ten points above the maximum federal pass-through rate. I have never been persuaded that pass-throughs, such as S-Corporations and limited liability partnerships (LLP's) or corporations (LLC's), should be favored at all. The case for favoring large pass-throughs is especially weak. It has always seemed reasonable and justifiable that the owners of traditional C-Corporations receive a measure of shelter from lawsuits in exchange for accepting two layers of taxation. The pass-throughs, though, have over the years developed the political clout to wheedle for themselves the quid without the quo. But that is a discussion best kept for another forum. Disapproval of the pass-throughs' special privilege aside, our gain is undeniable.

What commentators seem to have missed is that the wealth distribution impacts of the new corporate tax rates are separate from, and more important than, the implications for Treasury revenues. Most of the gains in net worth at the pinnacle are in the value of unrealized appreciation. The richest Americans have no need to seek liquidity for the bulk of their holdings, so most of their wealth appreciation each year remains untaxed. Their accumulated capital, which measures in the tens of trillions of dollars, has been inflated in many cases by over 20% by the passage of this new law. That's the real gift in the law, and some would say it was among its most powerful motivators, and yet wealth distribution effects were conspicuously absent as a topic in the Congressional or public debate. The most well-heeled in our society will now benefit from a reduced bracket rate on income and from an estate tax that now applies in two taxpayer households only to bequests totaling over $22.4 million. But these transfers are dwarfed by the boosts in net worth enjoyed by the largest holders of common stocks. About 40% of all stock market value is owned by the upper 1% of the population in income, and another 40% by the next 9%. Here, and nearly invisibly, can be found the real winners under the new law.

The argument in favor of the tax bill was that it would boost employment and lower prices to consumers. Perhaps some of this will come to pass, but that doesn't seem a likely scenario any time soon in our own sector. Insurance companies grow in volume and employment mainly when they expand market share, and they tend to grow principally at the expense of competitors so their growth has little overall job market impact. The effects on insurance

prices charged to the consumer are also likely to be minimal. There is little aggregate demand elasticity in personal lines coverages, and the cost of claims is the single most powerful determinant of our premium charges. Time will tell how much of the immediate gain to the owners of insurance companies, if any, is eventually competed out of the equation and returned to consumers. My suspicion is that the mills of this competitive process will grind imperceptibly slowly. Other industries, though, may see events play out differently. Those with more elastic aggregate consumer demand might conceivably expand more rapidly with the lower tax levies. Businesses that face foreign competition or have stashed profits abroad might find improved prospects in the U.S. now, assuming our now-favorable effective tax rates don't generate an international race to the bottom. That said, no such effects are even close to certain, and it still seems a stretch, or a pipe dream, to think GDP growth will suddenly take off as a result of the new regime. I will be happy to be proven wrong on this, and wagers are welcome.

The year just begun promises us a variety of frontier experiences. Even more than at this time a year ago, renewed entrepreneurial spirit characterizes our workplace now. Plymouth Rock will have in 2018 a revised organizational structure, an expanded jurisdictional map, elevated growth ambitions, and some new senior executives to recruit and welcome. We will be simultaneously looking for attractive acquisitions of business in those lines and states where we need to build scale more rapidly than organic growth permits. Hal has talked for some time about the goal of adding the next billion, and I am finally persuaded that this objective is becoming realistic within our planning horizon. It will be hard work to manage all of the change, but I have long been convinced it is healthier for individuals and organizations to be overworked than idle. This year will put that proposition to the test.



James M. Stone