The Plymouth Rock Company

695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 8, 2016

To Our Shareholders:

Most every business experiences good years and not-so-good years. The headline news from 695 Atlantic is that 2015 provided a double-barreled encounter of the second kind. Our underwriting results were socked by extreme weather (yes, again) over the winter, and the year's investment performance rolled in a dark cloud of its own. The silver lining is that even a poor year for Plymouth Rock is not nearly as distressing as it can be for a great many other businesses. Your shareholder-owned corporation, The Plymouth Rock Company, earned barely half the net income called for by our five-year plan, and less still if unrealized investment losses are taken into account. On the other hand, despite the disappointments, our book value per share (including those unrealized losses) continued to accrete, even if more modestly than usual. I hope this provides you the same considerable comfort it gives Hal and me.

These days, you can employ an easy shortcut to understanding our financial results at the most basic level. Our Company is *omnis divisa*, like Caesar's Gaul, in three parts. The first is an investment business centered in The Plymouth Rock Company itself and its investment subsidiaries. Another is our automobile and homeowners underwriting business, with writings in three New England states. And third but not least, there is our fee-based business, mainly represented by Pilgrim Insurance Company and the much larger New Jersey auto and homeowners reciprocal management business. Among the reasons this division is convenient as an intellectual aid is that each of the three segments should contribute profits of roughly similar magnitudes to the bottom line. In a period during which equity returns run at the 10% annual rate typical of their performance over the entire twentieth century, the sum of realized and unrealized gains in the holding company equity portfolio alone should exceed $20 million. Historically, our equities have done better than the market's 10% by a nice margin. The New England underwriting business was budgeted to return nearly $22 million in 2015, with normal provision for weather catastrophes. The fee-based businesses were expected to provide us $25 million in profits, excluding intracompany fees. Economic return on equity, had all this occurred as hoped, would have been in the high teens. In a year with pleasant surprises in a couple of these segments, The Plymouth Rock Company's return on shareholders' equity can exceed 20%.

The past twelve months, alas, looked nothing like that lyrical year of pleasant surprises. The overall equity markets were worse than lackluster, with the Dow Jones and the

Standard & Poor's indices each closing the year below their starting levels. As weak as the market averages were, our own equity portfolio underperformed them as the result of one regrettable investment decision. The winter's weather had axe-murdered the dream of strong New England underwriting results by mid-February. Only the two fee-based businesses met their contribution expectations. It has long been comforting for me to consider our business as generally occupying a rate of return corridor bordered on the bountiful side by 20% and on the infelicitous side by 10%. This past year we busted through the wall in the uglier direction. Our gain in book value per share, plus dividends paid out, represented only a 3.1% return. That number looks more like 4.9% if the $6.6 million in tax-adjusted gains on our real estate holdings determined by appraisal (but unreflected in standard financial statements until realized) are added to income. And, while one might insist that the $5 million premium over book value we paid out in another repurchase of our own shares isn't really lost and could also be tacked on to calculate true economic return, I won't argue for that extra point. The increment wouldn't take us in any event near the double-digit advance to which we are accustomed.

The financial statements display $29.3 million in net income for the shareholder group, which compares with $29.2 million last year. Plymouth Rock's book value now stands at $3,139 per share. While these results chop another two-tenths of a point from the cumulative annual book value rate of return since 1983, that number still exceeds 18%. Fully consolidated net income for the whole group, including the net income of the New Jersey reciprocal, was $53.1 million. While this, too, appears to be in excess of last year's number, don't be fooled. Comprehensive income, which correctly reflects our 2015 unrealized securities portfolio losses, is a fraction of the prior period's number.

Premiums written rose in both of our major markets. The New Jersey uptick of close to 3% came entirely from rate increases and the skillful purchase of a small competitor's renewals, while the New England companies enjoyed 8% growth, mainly from rate increases. The group's underwritten and managed premium volume now rounds to $1.2 billion. We continued our stock buyback initiative in 2015. Although the timing may not have been ideal in the short run, we continue to think these repurchases constitute sound long-term decisions and, just as important, our initial investor welcomed a little increase in liquidity after a patient 32-year holding period. We purchased close to 5% of the Company's aggregate outstanding shares from Central Securities in 2015, reducing Central's stake in Plymouth Rock to 23%, about three-fifths of what it was a few years back. To that end, we ratcheted our recent collateralized bank loan back up to the $35 million level. My aversion to borrowing is as strong as ever, but it is not so absolute that valid purpose and absurdly low interest rates can't overcome it a while longer.

The New England experience provided the most drama this past year, not much of it pleasurable. New England president Chris Olie's characteristic optimism was dashed earlier than usual in 2015. Whereas it was a polar vortex in the preceding year that had brought Massachusetts its coldest winter in decades, the foe this time was snow. And more snow. The winter had started gently, with an uncharacteristically mild December and early January. Then the skies opened on January 26, and the snow just wouldn't stop. By March, nine feet of snow had fallen on Boston, garnering national news attention and setting a record for the whole 143 prior years of reliable Boston weather data. My family will remember this as the year that our dog Duke could go outside every

morning from the second floor of our house, which delighted him no end. For Plymouth Rock, the ever-rising white drifts presaged ice dams on insured roofs as the snow cycled through melts and freezes, and, sure enough, those claims arrived in droves. Direct costs to our Bunker Hill homeowners business consequent to the omnipresent ice, slush, and snow exceeded $30 million. While we recovered a good bit of that in reinsurance and taxes, it still handed Bunker Hill one of its worst years ever. The 2015 combined ratio at Bunker Hill was over 115%, dragging that company well into the red for the year. It is scant consolation that several of our Massachusetts peers were hit even harder.

Ordinarily, we might figure that homeowners losses of this magnitude and origin would be partially recompensed by reduced automobile claims as sensible commuters left their cars in their garages and traveled to work by public transportation. That simply wasn't an option in February of 2015. The arctic conditions savaged and crippled the entire rapid transit system, and even sensible commuters found themselves reluctantly driving to work on obstructed, crowded, and slippery roads. Our automobile loss ratio, instead of easing matters, added to winter's sting. Hal, Chris, and I can recount without hesitation our pride in the way the New England claims departments cheerfully and effectively handled their auto and homeowners loads, and I am well aware that customers buy our product largely because these kinds of events can occur, but it certainly would have been nicer if 2015 had compensated for a too-wintry 2014 rather than piling on.

When the ice and snow finally melted, the remainder of the seasons transpired without any new shocks, although auto property claim indicators appear to be heating up just enough to raise concerns. By yearend, we were recording a New England automobile combined ratio of 103%, only slightly better than we showed the prior year. On the good news side of the ledger, our joint marketing program with AARP continues to grow in scale, and our recently implemented new automobile product offering -- referred to around here as Prime -- is boosting new business volume even more than anticipated. With auto cost trends rising, though, we have to watch that the hot business flow doesn't signal that our attractive rate revisions overshot their mark. It helps that independent agency relationships are healthier than ever, with agents particularly happy that we are teaching them (or maybe, more accurately, learning together with them) about rapidly evolving modern marketing tools.

Pilgrim Insurance Company, which services other insurers for a fee, continues to face headwinds from the shrinkage of the private passenger residual market upon which its original business was built, but it progressed despite the challenging environment. Its revenues were $14 million in 2015, up 20% from the prior year, and it provided over $2 million of the Company's net income. The new year promises to be even better. Plymouth Rock's New Hampshire operation suffered from the same winter conditions that clobbered Massachusetts, though the snow was not as bad there and people in the Granite State are a bit more prepared to handle it. The net income impact of that state's $20 million book of business was a bit short of breakeven. Connecticut is a more interesting story. We have never done well there, but a sophisticated product management team has narrowed our losses considerably and assures us we are headed for profits there by 2017. Premium volume in Connecticut was $30 million in 2015, up just a bit from the year before that, but whereas the net income impact of Connecticut was negative by $2.8 million in 2014, the drag was less than half that this past year.

Our New Jersey business was born proudly as Palisades, an independent agency carrier. The independent agency channel, now branded as Plymouth Rock, is as important to us today as ever. It represents about $250 million in premium volume, a number that grew by 5% this past year. The threat from direct response companies, which now write a higher share of the total business in New Jersey than in any other state, continues unabated. In a state where personal lines insurance was once dominated by agents, only Travelers, Progressive, and our company can still be considered large and successful independent agency players. Our exclusive agency business in the Garden State is written through the Prudential agent network, via a long-standing contract extended just this year through 2020. We have never found a way to grow this book, though its overall profitability is strong and consistent. The exposure count of automobiles insured through Pru shrank during 2015 by 3.5%, which is doubly painful because seasoned business has been much more favorable than our new writings in this channel. And our arrangement with Pru doesn't give us access to their new homeowners business there. The count of insured homes under the Pru contract, a particularly valuable contributor to our results, has inexorably declined over time. This past year it fell by 9%, a rate of diminution that Gerry Wilson and his team would dearly like to slow.

If we assume that the New Jersey exclusive agency channel will continue to contract gradually until we find new magic, and that independent agents will have trouble reversing the direct response conquests, Gerry's best growth opportunity may be in his direct channel. With determined leadership in place, that business continues to expand and improve. Its premium in force has just passed $100 million, and its combined ratio improves over time as scale benefits the expense ratio, more of the book matures to become seasoned renewal business, and our skills are enhanced by learning. The improvement in 2015 was a modest point and a half, bringing the combined ratio below 108% and within modern-weapon shooting distance of profitability. Note for perspective that the improvement over the last two years is about 13 points, and the net loss suffered by that channel has been more than halved. As scale and skills continue to grow, there are good prospects for taking this channel into the black. The direct team foresees the red ink nearly gone by the end of the current year. Not that there should be any doubt of this, but let me be clear that Gerry, Hal, and I remain fully committed to service excellence and profitability in all three of our New Jersey channels. We like the multi-channel platform for that state. And entering a new state in that region is always a possibility.

Net income in New Jersey, taking the reciprocal and the management company together, was $48 million in 2015, including some well-aged capital gains harvested at yearend. The loss ratio has deteriorated a bit, while the expense ratio has improved by nearly the same amount. Neither year's bottom-line number matches what I'd ideally like to see for New Jersey profits, but we'd beat both outcomes easily if the automobile line could be made to earn a fit return. The 2015 result, though, is satisfactory -- a statement I only wish I could make about investments or the New England underwriting experience.

Last year's report talked about two important new initiatives that call for an update at this time. One was a campaign to lower Plymouth Rock's overall expense ratio by a full two points over two years. In both New Jersey and New England, the first year's task has been successfully accomplished, for which congratulations to Gerry, Chris, IT chief Paul

Luongo, and all the vice presidents are in order. The second year's point will be harder to capture. The other, and longer-term, initiative described last year was the creation of a national insurance brokerage firm. In addition to potentially making a healthy profit for our group, we see that effort as likely to sharpen our whole group's marketing savvy -- and particularly so with respect to Internet selling. I may sound like a broken record on this score, but I'll say again that the Internet is an inevitable destination for virtually all retail marketing. My prediction is that insurance sales for many customers will require an element of personal contact and counseling as well, but even this relationship piece can be built around an Internet platform and the devices people use to stay connected. Our brokerage firm, InsuraMatch, handled about $32 million in premium volume for a variety of carriers in 2015, including local premium we had already secured at our traditional in-house agency. Its countrywide expansion plans from here are ambitious.

This brings me to the investment story. Two equity investment decisions, only one of them propitious, had disproportionate impacts on our year's portfolio tally. No one should be surprised to read that our highly conservative holdings of high-grade, short-maturity bonds returned us little once again. In keeping with long-held preference, we decreased our allocation to corporate and municipal bonds in 2015. Even anticipated boosts in yield, driven by an emerging shift in Federal Reserve policy, won't make them worth their risks. We searched for an alternative destination for the bond sale proceeds where they could be safely retained as our capital base enlarges and our capacity for common stock holdings increases. In step with numerous sophisticated investors, we satisfied ourselves that Master Limited Partnerships, financing oil and gas pipelines, were a safe and stable substitute for stocks and bonds. We had recently experienced success with one MLP investment. So, we bought $62 million worth of similar MLP interests for our group of companies in 2014 and 2015.

As promised, the three selected MLP's came with generous dividend yields and an advantaged tax status to boot. The theory of the investment was that their values would be secure as long as no less oil and gas made its way through pipelines. Thus, it seemed, lower oil prices wouldn't hurt them -- and might even increase the demand for fuels. But oil prices fell precipitously and it hurt them plenty. Two flaws in the logic have become obvious in retrospect. One was that some MLP's expanded into operation of upstream facilities that did in fact depend for their profits on oil prices. At least as important, all of the MLP interests bore market prices inflated by predictions of the future growth in pipeline transmissions that would accompany a domestic production boom. Lower oil prices took the wind out of those future expectations, and our MLP positions lost $17 million in after-tax value for the group during 2015 as a consequence. Much of the loss appears on our comprehensive financials as diminution of unrealized gains, and not yet on the income statement. Those are the losses I referred to earlier when I said that our net income failed to tell the whole story. Jim Bailey and I, who must accept primary responsibility for the investment decision, believe that today's low prices represent an overreaction to fundamental forces, so we are not immediately inclined to sell our MLP positions. Hold or sell, though, the money is lost, at least for now. The MLP's were actually not a suitable investment for us -- because we didn't sufficiently understand their businesses or obtuse financial reports at the start in the manner our investment philosophy requires. A lesson here is not to rely so readily on outside experts when our investment

successes have all come from doing the work ourselves. We should never buy a security, even as a temporary holding, because we think someone else understands it.

The losses were partly made up for by a good call a bit earlier. In 2014, we started buying shares in Partner Re, a large and solid reinsurer selling well below book value -- when we thought it was worth more than that. Others eventually agreed, and there was a well-publicized takeover battle for control of Partner Re. The victor in the proxy battle was a company controlled by the Agnelli family, originally of Fiat fame, which paid a healthy premium for the stock. We earned nearly $12 million after taxes from our position. Given that our group's total investment portfolio is $1.9 billion, the MLP losses and the Partner Re gains taken together moved the needle by only about a half of a point of total return. The misstep deserves attention here not because it is financially stressful, but because it was embarrassing and the only loss of any scale in our whole investment history. The lack of upward movement in common stocks marketwide did us much more harm than the MLP's. Even with dividends taken into account, the Standard & Poor's 500 basket returned less than a point and a half. The common stock component of our portfolio did no better. We can hardly celebrate, but we can still note that our twenty-two year internal rate of return on common stocks remains over 15%, beating the market averages over this period by a wide margin.

Prices for Boston real estate continued their rapid upward trajectory. The combined appraisal value for our two downtown buildings, though not reflected on our financials, rose by about 12%, to a total valuation in excess of $90 million. The year was not equally kind, though, to hedge funds and private equity partnerships. Their return contribution to our portfolio slipped marginally over the line into negative territory for the first time. The data seems increasingly to suggest that the hedge fund sector as a whole has never really matched, leverage-adjusted, the mean returns of direct investments in common stocks. Private equity results are harder to measure, given more extensive use of leverage and reporting that allows wins to be announced early and losses held for long periods at unverified valuations. My guess is that private equity probably has done better than the market as a whole, benefiting hugely from this long era of low interest rates, but at some point there must be too much money and talent chasing too few deals as fiduciaries keep pouring money in that direction. Sector returns have to fall under these conditions. Only the truly talented fund managers will continue to outperform the indices. Jim, Rick Childs, and I still like our careful selection of hedge funds and private equity partnerships, but we chose them because we admire their talent and their integrity, not because we consider hedge funds or private equity mystically blessed asset classes.

You will be spared a public policy discourse this year. For this one year only, I have a better offer. Please order my pending book on that subject, *Five Easy Theses* (Houghton Mifflin Harcourt, 2016). The book deals, in five chapters, with five pressing domestic public policy issues. The first chapter is on fiscal balance, calling out some of the worst tax loopholes and sources of waste, as well as identifying the reforms needed to fortify Social Security. The second chapter is on wealth inequality, how to prevent the disappearance of the middle class, and how to halt the sequestration of wealth at the pinnacle of the economic pyramid. The third chapter, on healthcare, explains why America has the most expensive healthcare system in the world but lacks the favorable outcomes that should follow the cost. Chapter four takes on education. Grade school

education should be America's strength but instead is increasingly a weakness for this country. The book lays out a reform plan, as well as a post-secondary program, to make education work for both the college-bound and work-bound young. The final chapter is on the financial sector, offering a path to curbing out-of-control banking, derivatives, and hedge fund activity, and making finance once again the servant of America's real commercial sector. My standing offer is to sign the book for anyone who likes it and to refund the purchase price for any reader who regrets having spent time on the book and returns it to me. *Five Easy Theses* will be released the first week in May but can be pre-ordered even now from Amazon and better bookstores everywhere.

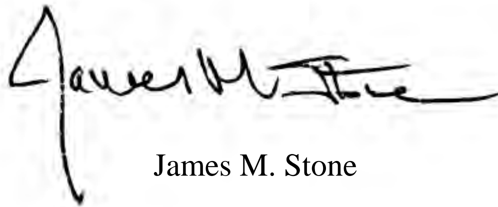
There are two elephants in our living room. Each has been described in previous editions of this letter, but neither has gone away or even eyed the door. One is the specter of driverless cars, which can someday shrivel the auto insurance industry, and the other is the threat of climate change, which some see as causing a quantum jump in the severity of nature's assaults. If we paid attention only to the first elephant, one plausible response might be to phase out our auto insurance business in a planned and orderly manner in favor of property insurance -- before external vectors force that outcome. Plymouth Rock might then look more like its admirably successful offspring, Homesite. If we focused instead on the second elephant, though, we might go the opposite way, following GEICO's lead and concentrating all the more on automobile coverages. Insuring property against climate-driven catastrophes, after all, could force a company to bet the family farm every year on the outcome of a process no one fully understands -- and a game in which one uncool hand can be terminal.

No mathematically tight solution can be found to the problems these elephants pose for us. With guidance from some of you who sit on the Board, though, we are fixing our attention on a strategy that fits our position, predictions, and predilections. We have little doubt about the long-term future of automobile insurance. Even without fully driverless cars, the trend to shared and professionally driven cars and the welcome progression toward ever-safer cars should exert downward pressure on premiums -- even as increased road congestion and more expensive repairs pull in the other direction. We have no interest, though, in abandoning auto insurance as a consequence. First, the downshift will be slower than some expect. It will take several decades for premiums to decline enough to hurt our franchise. A 2015 public presentation by Progressive's management, well worth a look, laid out the lags realistically. The increasing benefits of safer cars, moreover, will presumably be reflected in lower claim costs before they work their way into rate changes, so they should actually boost profits for some years. Meanwhile, advances in telematics and driver usage feedback should allow us to ratchet up the encouragement of safe habits and rewards for responsible drivers. Finally, if our competitors fret more than we do about the future of auto insurance, gloom may abate their competitive zeal, which would delight us no end. A slow enough shrinkage of premiums and a profitable passage along the way can provide an environment quite acceptable to Plymouth Rock. We will stay the course.

As for climate change, yes, the data suggests there has been some. Although I realize that individual observations constitute scant proof, I have seen for myself some memorable ghosts of retreating glaciers. How the future course of change will be shaped by natural cycles and human behavior and what effect it will have on insured weather events remain

open questions. For unrelated reasons, the prediction that homeowners premiums will continue to rise is even safer than that auto premiums will decline. Homes are getting larger, more exposed to wind and water, and more expensive to repair. Worsening weather events can be absorbed by insurers if their pace is no faster than rate trends, and future catastrophes remain close to the familiar in scale. We have determined that we should take some risk on these prophesies -- but not blindly so. We will expand our property profile carefully, bolstered by the best mathematics that can be brought to bear, well protected by reinsurance, and isolating as well as possible the rest of our business from catastrophe consequences. We haven't decided yet whether to start another company with external partners or build the line within our own shop. But growth in the homeowners book is now on the agenda. To that end, we have initiated a search for a senior executive to lead a safe and analytical expansion of those writings. Were we sufficiently spooked by both pachyderms, I suppose we could migrate toward becoming mainly an investment company -- something we have been pretty good at despite this year's misstep. As of now, though, we are not unduly alarmed by either beast. We see both of them at this point as bearing us as many opportunities as challenges.

Looking at this tough year in perspective, you might consider this parting thought. When flooded with problems, in life or in business, one should always stop to ask whether the incoming waves are one-off surges or harbingers of more dangerous tides to follow. The latter should rightly cost sleep and alter behavior, the former not so much. The trials of 2015, which layered sorry investment performance on top of unforgettable Massachusetts snowstorms, seem relatively uninformative with respect to the future. While there is no certainty in the prediction of complex phenomena, there seems statistically little risk of a doubly bad draw of this magnitude in any given year. I see no reason to imagine, in fact, that either blizzards or down markets represent the normal state of the future. We think here in terms of decades; and, with that time scale in mind, we will continue to insure against the weather, and we will continue to invest in stocks. The last two years are already in the rear-view mirror.



James M. Stone