The Plymouth Rock Company

695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 8, 2010

To Our Shareholders:

This past year will be remembered in Plymouth Rock's corner of the world as neither the best nor the worst of times. For the United States economy, 2009 was a disappointing year, with overall employment left behind as some of the Wall Street leaders recovered. While the pain continues for all too many, the automobile insurance industry is somewhat sheltered by the compulsory nature of its product. Two of Plymouth Rock's three principal operating companies in fact did quite well in 2009, as did our securities portfolio, which we can hope will prove a leading indicator of real economic gains. Although Plymouth Rock Assurance Corporation, our New England underwriter, did not match New Jersey's High Point or Palisades in results for the year, the group's bottom line performance on the whole was pleasing. Net income was $51.5 million, which can be compared to a profit of $35.9 million in the previous year and represents an 18% return on equity at the start of the year. Total shareholders' equity rose by nearly 17.7% after payment of both our customary dividend to shareholders in March and an additional dividend of the same $7.8 million magnitude later in the year. Without these two dividends, equity would have risen by 23%. Book value is now $1,816 per common share. The cumulative book value return over the full twenty-six years of the Company's operations is now 18.5%, having risen a tenth of a point above last year's cumulative number.

Growth on the top line, while no match for the bottom-line gain, was our best in some years. Plymouth Rock group's total insurance premiums underwritten (those shown net of reinsurance on the income statement) and premiums managed (which are described in the footnotes) increased by 5% to $1.11 billion. The reported numbers, as always, reflect some outcomes we wish could repeat year after year and some we are glad will not be repeated. The 2009 results were enhanced by the sale at a solid profit of the Response Insurance founders' shares we have owned since 1995. Without that transaction the 2009 net income figure would have been $8.8 million less. On the other hand, Plymouth Rock reserved an amount that reduced net income by several million dollars for an anticipated industry-wide retroactive adjustment to the manner in which Massachusetts motorcycle insurance premiums have been calculated for most of the decade. In projecting the year's results forward, you may want to discount for both of these items.

As I reflect on the past year, it is not the financial performance I rank first in import. The most consequential changes in 2009 were almost certainly organizational. I

believe our group has now been strengthened considerably, both in structure and in terms of top-level talent. Even before the start of the year, Hal Belodoff and I had concluded that he was pulled in too many different directions with heavy responsibilities at all of the operating companies, as the direct supervisor of our IT subsidiary's senior management, and as president of Plymouth Rock Assurance Corporation with about ten direct reports. So together we designed a structure we both feel better about, where Hal, as the Chief Operating Officer for the group, continues his oversight role in the IT area as before and now holds the chairmanship of each of the three major companies. The relief for Hal is that he no longer runs Plymouth Rock Assurance day to day. That job now belongs to Chris Olie, a new hire but an experienced hand at our kind of work. Chris has joined Hal, Gerry Wilson, Ed Fernandez, and me as a member of the informal management committee that meets for a couple of hours every Monday afternoon. It's a nice feeling, even when it is humbling, to sit in those meetings with such a strong group of operating insurance executives. Recognizing this strength, Hal and I restructured reporting lines at our smaller operating companies as well. All of their leaders will now report to, or at least interact regularly with, a company president on the management committee.

Chris Olie's shop, Plymouth Rock Assurance, needed internal strengthening as well. The team of five direct reports (note the reduction from Hal's ten reports) that Chris oversees includes a high percentage of new blood. Though the restructuring and hiring effort was a serious time consumer for Hal, Chris and me, it already has the feel of a sound investment. Like the Monday meeting, the Plymouth Rock Assurance officer ranks have never been longer on talent. This talent is a source of comfort and confidence not to be underestimated in an environment of rapidly evolving external challenges.

Progress in this past year wasn't confined to organizational change, however. Two enterprise-wide projects for which I noted special affection a year ago in this letter moved impressively forward. In both cases, as Hal and I tackled organizational chores, it was Gerry Wilson who led these efforts. The first of these projects is a Decision Support System. For twenty-six years now, I have insisted that what differentiates us from the competition must include a superior ability to analyze and employ hard data about our business. In the early days of the Company, we seemed to have that desired analytical edge, but over time I have watched that advantage erode. Gerry correctly diagnosed that a part of the problem was that our experience and policy data were accessible only to computer experts. So throughout 2009 he led a team of staffers in building us an analytical tool that every executive and aspiring rocket scientist can use to query, to explore, and to blaze new trails in the management of risk. As I write this letter, just over a year later, I am beginning my own training in how to use the new wizardry. The second such project has a much shorter provenance, but no less consequence. In recent years, it has become apparent that use of the Internet will soon be a determinant of competitive success of the same order as analytics. Gerry seized the lead there as well, and he organized and oversaw a second successful project team in this arena. None of our companies had the ability to sell and bind a policy over the Internet at the end of 2008. Thanks to the energy and competence of the Consumer Interface team, High Point is now doing so. We can see the results in their volume figures already. Plymouth Rock and Palisades,

borrowing High Point's technology and modifying it to work with an independent agency model, will follow in 2010.

Since High Point is our largest company, I will keep the focus there for the moment to report on that company's operating progress. As you know well, when we bought High Point's business from Prudential half a dozen years ago, we wondered whether we had purchased a gradually wasting asset. High Point would still have been a decent enough acquisition, but real success depended on turning the declining volume around. We were all aware from the start that the Prudential life and financial products agency force, as competent and welcome as it is, would need to be supplemented as a source of long-term automobile insurance growth. The search began immediately for both acquisitions and new marketing tools to turn the annual changes in scale from negative to positive. While an acquisition was the highlight of 2008, internal growth was the story in 2009. By year-end, about 60% of High Point's new business applications were arriving from sources other than Pru agents. Automobile insurance premiums, policies in force, and vehicles covered all grew modestly for the year as a whole. This is no wasting asset. I am quite hopeful that the 2009 results mark the beginning of a new life, with a much improved franchise value, for High Point.

High Point's operational results were good, but not ideal, in 2009. The net pure loss ratio was 64%, only a point or so over the budgeted number but nowhere near the shining 2008 loss ratio result. The all-inclusive expense ratio for the insurer and its management company taken together, encompassing claim adjustment expenses as well as operating, acquisition and investment expenses, was right on budget at 35%. That latter statistic at High Point was better than the prior year's equivalent and handily at the best run rate in our entire group of companies. Due to the elevated claim costs, though, the High Point companies' ratio of net income to gross written premiums fell to 4.8%, matching neither last year's result nor my target of 7.5%. I attribute much of the loss ratio deterioration to rising claims costs for auto insurance results everywhere, but some of it is doubtlessly a cost of the growth, especially the cost of the growth in channels relatively new to our team. The long fall in national claim frequency appears now to be over, and the trends of both loss ratio and price are pretty universally upward. When this fact is combined with High Point's plan to continue its growth from the Internet and other innovative sources, loss ratio will be that company's top concern as it enters 2010. Customer service at High Point is as strong as ever. Among large New Jersey companies, High Point is confident it is (yes, yet again) among the companies at the favorable tail of the Department of Banking and Insurance's compilation of complaint records.

Ed Fernandez at Palisades, also in New Jersey, had a particularly impressive operating year. Aggregate market share for the New Jersey independent agency channel has fallen every year since the national direct response writers entered the state with banners flying. In 2003, independent agency companies wrote roughly a quarter of all New Jersey policies. By 2009, their share of the market had fallen to 18%. One might, therefore, have expected the volume at Palisades to have diminished as well. A rational person would have bet on it, but energy and talent can sometimes defy rational expectations. Palisades grew year over year in each of the

last four years. In 2008, it became New Jersey's largest independent agency company, and Palisades maintained the lead in 2009. A portion of this past year's growth came from the business Ed acquired when he bought Proformance Insurance, but internal growth was strong as well. The pure loss ratio for the reciprocal insurer was 62%, about two points over budget, in keeping with the industry trend. The all-inclusive expense ratio benefited from a one-time takedown of a reserve for integration of the Proformance operations and systems, a reserve that turned out to be more conservative than Palisades' unusually effective team actually needed for the task. Removing that reserve adjustment to approximate an expense run rate, the all-inclusive expenses were 38% of premiums. The ratio of the company's net income to gross written premium was 5.9%. Like High Point, Palisades did all this at no sacrifice of customer service quality and finished again among the best New Jersey performers in consumer complaint rankings. The Palisades team deserves applause for progress on a new agency interface initiative, on the amazingly smooth integration of the Proformance acquisition, as well as for just plain good work on its existing operations.

Seasons of trial are sure to come for Palisades, as Ed has constantly reminded us. Two related future challenges to which Ed is giving particular attention are the maintenance of its growth in a shrinking agency channel and the incorporation of the Internet into the independent agency mode of marketing. Even with its complement of talent and energy, Palisades will find it tough to go against the trend indefinitely if the independent agency market share keeps contracting. There is some comfort to be taken from the hypothesis that the recent rapid shift in market shares represented a one-time adjustment for a state that had previously seen no active direct response presence. While national figures reveal a persistent trend toward direct response writers, that trend is nothing like New Jersey's rate of channel switching, so a plateau in market shares with a more gradual slope toward the direct response mode seems a realistic expectation. In the end, as long as the direct response writers have their current cost advantage and, at the same time, lead the business in the use of modern Internet technology, they will have an appeal everywhere…and a special appeal in the state with the nation's highest premiums. To overcome that force over a long time frame, Palisades will constantly need to hone its mode of operation to maintain a differentiably superior level of customer service, achieve the maximum possible cost efficiency, and pioneer in the effective sharing with its agents of today's rapidly developing Internet tools. Easy? No, but who ever said it should be easy? Talent and energy have their greatest comparative advantages when the tasks are rigorous. Palisades is well positioned to succeed.

The under-performing company in our group remains our flagship Massachusetts company, Plymouth Rock Assurance Corporation. I'd like to believe that this is not related to my offices being located on its premises. Plymouth Rock Assurance posted a combined ratio of 104% for the year, and its insured exposure volume rose by 1%. The combined ratio is good enough to remain in the black, since investment income is greater than the four points by which the sum of the claim and expense outflows exceeds premium receipts, but it makes no one happy. Perhaps more important, as of the last numbers published by our peers, our company is making too little progress at narrowing the loss ratio gap that has existed for most of this new century. This may,

or may not, prove to be the century of China, as some pundits say, but I will be miserable for my allotted time within it if it proves to be the century of our Massachusetts competitors. To be fair, Plymouth Rock Assurance seems to have completely closed an expense ratio gap that accompanied the loss ratio overage for some years. Both Hal and Chris, moreover, think the New England companies may now be conservatively reserved on the loss ratio side of the house. Chris's budget for 2010 projects a combined ratio back in double digits. That result would make me feel far, far better.

Meanwhile, the ground is moving under Plymouth Rock Assurance. The phase out of its home state's socially conscious relative price regulation continues, with effects for the competitive landscape and company strategies as well as public policy. As this letter is written, a new state Insurance Commissioner is just taking office, Commissioner Burnes having recently moved on to a university teaching position, but deregulation remains the order of the day, at least for the interim. One of the former Commissioner's stated goals was to attract well-respected national direct writers into the state, and GEICO and Progressive both entered with a fanfare from the press and the Department. Neither company, however, has gone full tilt for market share as yet, perhaps reflecting an uncertainty about whether the regulatory freedoms they were granted suffice for their preferred ways of doing business or whether the changes have a likelihood of permanence on this politically volatile turf. The experience so far is nothing like New Jersey's, where GEICO won a 10% market share within eighteen months of entry. We have to assume that the direct response campaigns will intensify to some extent in 2010.

For Plymouth Rock Assurance, the deregulated environment contains an element of blessing. One of the explanations for that company having underperformed some of its Massachusetts independent agency peers recently is that it has been less restrictive than others in the acceptance of new customers with less than perfect driving records. Under the old environment, this strategy was sound for growth and agency relationships but carried a loss ratio penalty. With rating discretion now significantly expanded, Plymouth Rock Assurance will continue to take a broad spectrum of drivers but will be able going forward to fine tune their premiums more accurately to produce profitability in every subset of the business. The newly strengthened underwriting team is right on it.

I would be less than true to my history if I failed to comment on the public policy impacts of the state's anti-regulatory thrust. Whether it turns out to be a benefit or a drag on our own business, rate deregulation is already becoming punitive for that segment of the Massachusetts public who can least afford the economic pain. I have always favored competitive rates, but I believe competition is compatible with the tempering of extreme relative cost disparities. For thirty-three years (yes, since Michael Dukakis was Governor for the first time and I was Commissioner), this state has provided an incentive in the form of credits against their residual market charges for companies to lower the greatest territorial and age price differences between drivers with comparable records. Those credits, in turn, made insurance more affordable, especially to clean drivers in the cities, and aided our state in becoming about the best in the country at curbing the uninsured driver population. There were

few if any complaints about the urban relief, meanwhile, from voters outside the cities. Only national insurance carriers protested the tempering of the relative premium differentials. As the competitive rate regime was introduced, both the Attorney General and the Insurance Department pledged to protect urban drivers. The Department recently called for credits larger than the industry had recommended, and the Attorney General published a less than glowing report on the impacts of deregulation to date, but it still remains very far from clear that effective tempering will be maintained. An unexpected ruling last fall would permit companies in 2010 to raise urban rates on renewal by 25%, and many are likely to do so. Three years of increases at 25% per year are sufficient to nearly double a driver's premiums. It is not too late for a strong enough state-mandated credit plan to counter the lack of territory caps. There is no cause, after all these years, to let insurance rate competition harm those most vulnerable.

There are several smaller New England companies in the Plymouth Rock group. Under our new structure, Chris and his direct reports play a major role in all of them. Both Pilgrim Insurance, the insurance services company, and Encharter, the holding company for independent agencies in which we have stakes, have come closer to Plymouth Rock Assurance for governance purposes. Though Mt. Washington, the New Hampshire writer, maintains a separate board of directors, it coordinates closely with Plymouth Rock Assurance, which reinsures its business. Bunker Hill, the New England homeowners writer, is more independent but will benefit from coordination as well. The company most changed is Pilgrim Insurance. After much soul searching in 2009, Hal and Ellen Wilcox came to the conclusion that Pilgrim could no longer thrive as a wholly independent entity, now that recent regulatory changes in Massachusetts have diminished its original value proposition. Ellen has retired from our group, with our enduring respect and affection; and Pilgrim is now smaller than before and perhaps not as well positioned for expansion, but a bit more profitable. We are saddened when a company shrinks in size or horizon, but we would eventually be all the sadder still if we ignored business realities. Encharter and its affiliated agencies will now be overseen by Chris's new vice president for marketing as well as its own president. To date, Encharter has been consistently sound and useful to its parent company, but it has not yet met the goal of showing the world how an independent agent can approach direct writer economics in an Internet era. That remains a goal in New England, as it is Ed's goal for Palisades in New Jersey, for 2010 and beyond.

Mt. Washington Assurance had a more rewarding year than in 2008. Its written premiums increased by 8.3%, and the combined ratio was under 99%. Perhaps more important, new business sales increased by 20% and the number of account customers, for whom we insure both the auto and the home, rose by 35%. Connecticut results were not as good. Written premiums there fell by 5%, and the combined ratio was well over 100%. The trend has improved, though, and the level of sophistication applied to Connecticut pricing and product management has increased markedly. The business in Connecticut is not a big money-loser in dollar terms for our group, but it continues to be a drag on the combined ratio for our New England companies. We are actively exploring ways to innovate there as an alternative to ramping down. I'd feel a bit of a patsy staying with a business model

that has had so many consecutive years of losses, however small a factor in the group's results.

Bunker Hill generally performs, and performed in 2009 as well, better than the other small companies, though we all worry that its return is not commensurate with the risk of weather-related catastrophe inherent to homeowners insurance. That company returned just over $2 million in operating profits, which represents about a 10% return on equity. This is only half the return garnered by the best of the country's homeowners writers in years without extreme catastrophe losses. Bunker Hill's goals this past year included raising the percentage of its insured homes matched with a Plymouth Rock automobile insurance policy and re-underwriting a greater number of renewal policies to look for changes in circumstance. One sign of hard economic times is that roughly 20% of the homes inspected in Bunker Hill's new foreclosure monitoring program were vacant or suffering from serious lack of maintenance.

Investment results improved for just about everyone after the first quarter of 2009, as the panic, like all things, ran its course. There is accordingly less to say about investments this year than last, and that is fine. Our bond holdings, which constituted more than half of the overall investment portfolio during the year, returned about 3%. The marketable equities portfolio, still distributed among just half a dozen stocks, returned 29% including the impact of dividends, nearly making up for its 2008 deterioration in value. The Standard and Poor's 500 Index, in the same period, returned 26% including dividends. The 2009 gains move our all-time internal rate of return on marketable common stock investments back over the 17% mark. This is a number for which I have great affection, even though it's not quite the 20% I would gladly have us marry. Our hedge funds had an excellent performance year and the private equity positions had a good one, though quantifying the latter's value at any point in time is an inexact science. Only home office and investment real estate holdings, as measured by annual independent appraisals, had a down year. The appraisals marked down our two Boston buildings by 35%, a number of more theoretical than immediate practical interest. We are the most unlikely of sellers, although if properties are actually available at low prices we might become buyers again.

The income statement shows $34.9 million of 2009 investment income and capital gains, not including the $5.6 million we earned from premium finance and loans to our agents. The former number can be compared to $10.3 million on the same line on the 2008 statements. There were no OTTI (Other Than Temporarily Impaired) charges at year-end 2009 for stocks that fall more than briefly to well below their original purchase costs. Some changes in the investment portfolio's value flow directly to the balance sheet without affecting income. For example, unrealized gains on our equity positions, which grew by more than $16 million in 2009, are reflected in the balance sheet valuation of investments but not on the income statement at all. Under GAAP rules, changes in the market values of our real estate holdings are reflected on neither the income statement nor the balance sheet, causing the statements this year to look better than the underlying economic facts as we would measure them.

A stock purchase agreement was signed in 2008 by which Response Insurance Group, the direct response auto insurer we helped create in 1995, was sold to a competitor, Unitrin. The closing occurred in February of 2009. I will forever be disappointed that we ran out of time to build Response to its full potential, but I understand and accept that investors can not be as patient as entrepreneurs. Plymouth Rock and I earned something for our sweat equity and options in Response. Our financials also reflect a gain from the purchase of Response's long-held share in our 695 Atlantic Avenue headquarters building, a minority ownership interest that Unitrin understandably asked us to swap out of Response's portfolio.

Homesite Group had a year of impressive growth and disappointing profits. Its national homeowners writings grew by 25%, with no end in sight as the ramp up of the business referred by the giant national direct writers continues, supplementing the well-seasoned volume that has come over the years from its other partners. Total premium volume at Homesite Group has reached nearly $340 million on an annualized basis. Profits, only about $2.4 million for a year in which its management had predicted a considerable multiple of that number, were depressed by adverse weather in the Midwest states. It may have been an aberrational result or it may be that Homesite, and the rest of the industry as well, has underestimated the risk associated with locations subject to tornadoes and hailstorms. There may have been a moral hazard contribution to its claims as well. This was a year, unfortunately, in which some people may have been tempted to collect on insurance rather than sell a house they could no longer afford. It would be satisfying to see a few of the mortgage brokers who sold properties to folks who plainly couldn't afford them share jail cells with the arsonists, although realism says that most culprits of both varieties will remain free. Fabian Fondriest continues to be an exceptional chief executive officer at Homesite. I will simply restate the two goals I set for that company at its start: to reach a billion dollars in profitable annual volume, and to become known throughout the industry as the intellectual leader of the homeowners insurance business.

A year ago in this space, I offered some recommendations for changes in financial sector regulation in the light of the 2008 crisis. Twelve months have since gone by, and just about nothing has been done yet to curb the excesses that invited the crisis. Neither the Obama Administration nor the hardworking House Committee on Financial Services can be accused of ignoring the issue or failing to put in time on it, but there is scant reward for an incomplete effort in our politics. Voters have shown their anger, an anger that seems still waxing, at the perception that taxpayers were taken dangerously into hock to help restore Wall Street's lofty compensation without reducing an unemployment rate that remains near its post-Depression high. The true kernel of the issue that has people so upset is not to be found in ethics lectures or compensation formulas. It would be to the good now if politics forced our leaders to soberly inquire whether Wall Street's gains are simply too high for the economic value its activities provide and the systemic risks they introduce. This question is not identical to asking what caused the 2008 crisis, but it is closely related.

Sophisticated writers have pointed out that the leading Wall Street firms no longer think of themselves primarily as investment banks and commercial lenders,

channeling money to growing companies and spurring free enterprise. Perhaps they learned too well from observing hedge fund expansion. The big profits have been in trading (defined broadly to include the securitization of debt and nearly simultaneous repurchasing of similar debt securitized by others), and one question ripe for this moment is whether the present level of trading activity, in addition to exacerbating America's already infelicitous relative income disparities, should be permitted to persist. The profits that economists tend to respect come from value added (a consequence of successful manufacturing and technology), or from wisely allocating capital to companies that then prosper (the source of gain for venture capitalists and fundamental investors). The trading profits that fuel Wall Street's bonuses are of many types, but provide relatively little value added or enhancement of capital allocation. Much of the trading is zero-sum, where there is an explicit loser for every winner. Given the scale of the gains on the banking side, don't the ultimate losers have to be non-financial businesses and more traditional investors? Much of the trading involves the sale of proprietary hedging instruments, which can serve to reduce risk for a commercial business but serve the client and the economy well on balance only if: (a) they are sold at fair and reasonable prices; (b) they are sold by entities that can actually meet the obligations - without taxpayer subsidies - when things go wrong; and (c) they don't create by an over-concentration of correlated instruments more systemic risk for the economy than they remove for the buyers. These tests are unmet in all too many trades.

Paul Volcker deserves support when he urges that commercial banks be prohibited from employing the large balance sheets provided by insured deposits to engage in proprietary trading. If only one change were to be made, though, I would still suggest that financial institutions of all types be forbidden to operate with the sky-high leverage that turned an inevitable cyclical turn in 2008 into an international disaster. Trading at a scale beyond comprehension and excessive leverage together constitute systemic nitroglycerine. If experts reach the conclusion that today's massive trading activity is in fact a drag on the economy rather than a spur, as I suspect may be the case, a transaction tax might also be considered, perhaps with rates that varied inversely by holding period. Finally, if all derivatives were required to be traded on exchanges, or at least cleared through clearing houses, with all the benefits of posted prices and default guarantees, excessive bonuses would begin to take care of themselves. It is the missing transparency in the various derivative markets, perhaps more than any other factor, that generates the mysterious profits on which the bonuses that threaten the current political landscape are based.

As we look to the future within our own group of companies, Hal's attention and mine are directed increasingly toward technology. Even if we could tell the fire and wind where to stop, or limit their impact on us by sound underwriting and prudent reinsurance, we would have no ability at all to slow the pace of technological change or temper its effects. I am convinced that the Internet represents a commercial revolution the likes of which has not been seen since the invention of the telephone. There is no way we or any other insurer will be able to avoid its playing a central role in the sale and servicing of our products. Along with the Internet will come an increased role in the personal lines of insurance for handheld devices such as smart phones and tablets. Some carriers already permit customers to file accident claims

and pay their bills with their phones. And side by side with the expanded role of the Internet, there will arise frontiers of data mining for risk analysis beyond current imagination. I worry sometimes about the maintenance of privacy in the next generation, but worries will not stop what is being wrought. The Plymouth Rock information technology team, which we call our Shared Technology Services Group, has taken us on time and on budget, with minimal disruption of our service to agents or customers, through a transition from systems that differed company to company and depended dangerously on outside vendors to a proprietary, enterprise-wide, twenty-first century processing system. Now it must take us to a new level of excellence, where we can organize and analyze every bit of data that is useful to our strategists, change directions in pricing and underwriting approaches on a dime (or at least on a quarter), and lead our agents and customers to enjoy all the available benefits of the coming era in communications. The other choice is to be left behind.