The Plymouth Rock Company

695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 29, 2008

To Our Shareholders:

Plymouth Rock did not have an easy 2007. Net income for the group was $36.3 million, down almost a third from last year's profit level. The return on shareholders' equity was nearly 15%, a number that would make many corporations happy -- but not ours. This past year provided you around half the rate of return on equity the Company has been accustomed to delivering since 2004. It would be possible to excuse the disappointing results by noting that last year's report described $10 million of 2006 profits as a residual market reserve release not likely to be repeated any time soon -- or by observing that profits are down for other automobile insurers in our key states and around the country because of a general upward inflection in claim frequency. While these explanations are completely accurate, they blur the most important part of the story…and they let Hal Belodoff and me off the hook more quickly than we deserve. The most salient fact to convey to you in this letter is that performance at Plymouth Rock Assurance, our New England automobile insurance writer and our flagship company, was worse than it needed to be. Profit performance in New Jersey was substantially better than here in New England, although High Point Insurance, the largest New Jersey business we manage, joined Plymouth Rock Assurance in top line decline. As a consequence our entire group ended the year 3.6% smaller than it began 2007.

Neither the diminution in writings nor the reduced profits prevented shareholders' equity for our group from rising by 11.5% to $277 million, even after payment of a $13 million common stock dividend. The book value is now $1,514 per share, and the cumulative book value return since 1983 is 18.7%, a tenth of a point below last year's number but still a result we can look upon with satisfaction.

The major story in 2007 was here in Massachusetts. The New England underwriting companies taken together wrote $315 million in gross premiums during 2007, about $20 million less than they wrote in 2006, and their return on gross premiums written was 4% against a 7.5% target for that measure. The top line results actually reflect a year quite close to flat with respect to Plymouth Rock Assurance's market share and the number of cars it insures, since state-set premiums for Massachusetts automobile insurance, by far our largest line of business in New England, were reduced by 11.7% when new rates took effect in the spring. A flat market share is far from disaster, though flat is a pretty accurate description of how it feels. The bottom line is where the serious issues lie. The absolute profit numbers are unsatisfactory, and a worse rub is that we are underperforming our peers in profitability. In fact, the more deeply Hal and I looked into the subject of relative performance, the more we both became convinced that Plymouth Rock Assurance has underperformed for some time. You have all heard me say over the years that Plymouth Rock is less than exemplary in its expense management. It now appears that we were not fully making up the gap, as I had thought and too often reported to you, on the loss ratio side of the house.

I should provide some numbers to elucidate the situation as we now see it. Comparing results among insurers for any single year, though, can be misleading. One always wonders whether contrasting companies were in the same reserve situation at the start and end of the period, and whether expenses were accelerated or slowed during the year in question. I have come to depend mainly on five-year results and current trends. A look at Plymouth Rock Assurance versus its two largest primarily domestic competitors over the last five years shows our company a full five points higher in combined ratio than the average of the other two. Our direct loss ratio was only about average among the three for the period, certainly not good enough to make up for a more expensive cost structure. The picture is darker when trends are considered. At the start of the five-year period, Plymouth Rock Assurance had a better loss ratio than the two peers. But our loss ratio gradually worsened relative to the others, and by 2006 it was the highest of the three. Recent claims experience is thus adding to the expense gap it used to cancel. Hal and I are chagrined by these results, as well as our failure to see them coming. To repair them we have launched “Operation Flagship”, a highly focused project to cut operating expenses at Plymouth Rock Assurance, to make sure that we are paying exactly what each claimant deserves and never more or less, and to reemerge as a superior performer in our peer group. We will be aided in this endeavor by some talented recruits to our vice presidential ranks. Andrew Rippert has joined us as Chief Underwriting Officer, taking responsibility for our Plymouth Rock Fellows, and for all New England underwriting, product and pricing decisions. Bill Hartranft is the new Chief Financial Officer, succeeding Eric Kramer who is now working full time in Hal’s office of the president. Bill Tsingos is the new General Counsel. Mike Cesinger will head up the claims department when Frank Arment, whom we were fortunate enough to have hired out of a first retirement fifteen years ago, retires once again in 2008. You have every right not just to ask but to demand that Operation Flagship succeed.

Plymouth Rock Assurance will be in the forefront of our thinking in 2008 for another reason as well. In April, Massachusetts auto insurance will make the transition to a competitive rating environment. As a business matter, we are comfortable with competitive rates and the assigned risk approach to the residual market favored by the Commissioner. On the public policy questions involved, our enthusiasm is in check. We fear for those drivers at the lower end of the income spectrum and in our cities if the state’s unique affordability and availability protections are allowed to erode. We are also concerned about a potentially large residual market pool and the emergence of a substantial uninsured driver population. The Commonwealth says it is mindful of these issues, but we have not seen enough detail from the regulators to be confident that Massachusetts' high standard of fairness can be maintained under the new system. Having said this, we all recognize that public policy decisions are not ours to make. They are the domain of elected officials or their appointees, and in this case some particularly competent ones. Their process has been deliberate, and many of the decisions that affect our areas of concern are yet to be made. We will do our best to make the new system work, and we have filed and gained approval for our first set of competitive rates in Massachusetts.

Results in Connecticut have been poor for some time, but 2007 reaffirmed that things can always get worse. In the insurance business, that can mean getting worse retroactively. Midyear in 2007 our overseer of Plymouth Rock operations in Connecticut, Thom Cranley, told us that the claims there had been underestimated in past years and reserves would have to be strengthened. The direct consequence of this reserve strengthening was a bigger loss for the 2007 accounting period than actually belonged to that period. In fact, the loss ratio for accidents actually occurring in 2007 was the best in our Connecticut history, and Thom is actively appointing new agents. New Hampshire's operation is roughly the same size as Connecticut's and also under Thom's purview. For the last few years taken together, New Hampshire has operated at about breakeven for us. With a more sophisticated product now in place and an ambitious program of agent appointments planned for 2008, Thom expects to see volume grow and both loss ratio and expense ratio improve. We may all be wearing rose-colored glasses, and you may accuse me of being too patient in our small-volume states, but we are not saying Uncle. These states are, at a minimum, good laboratories for Plymouth Rock.

Bunker Hill Insurance, our New England homeowners writer, grew modestly and made money for us, but the results lagged both 2006 results and budgeted 2007 amounts. While premiums rose at Bunker Hill by 3.3%, the net income of just over a million dollars was only half of the previous year's number. Among the culprits was an expense ratio that has never been properly tamed. Reinsurance purchasing was an area of progress at Bunker Hill in 2007. John Tierney, who has just recently left our group of companies, restructured the retention program to accept a little more risk and save a more than commensurate portion of the cost. Bunker Hill is also improving its product refinement. The benefits of these two initiatives should appear in the 2008 numbers. We are exploring approaches to expanding somewhat our homeowners risk retention in the future.

Our three insurance management companies oversaw $699 million in writings, of which $648 million arose from our New Jersey reciprocal operations. The three taken together produced $18.4 million in profits for the group. My overall earnings target for our management companies comes to about 3.5% on gross writings, so their 2.6% return on their writings represents less than a full success. Their profits, though, were better than their top line results. The writings of the Palisades reciprocal in New Jersey grew from $157 million to $166 million, a 6% growth that looks even better when one considers that that company's average premium fell, along with other New

Jersey insurers' prices, by roughly 6%. The writings overseen by the other two management companies, High Point and Pilgrim Insurance, however, fell by $14 million and $11 million, respectively. The fastest growing company in our entire group in 2007, Palisades deserves first place in the discussion order.

When fully competitive rates were introduced in New Jersey a few years ago and the direct writers jumped in with their massive advertising budgets, I'm sure many a local insurance executive wondered whether the independent agency companies could survive the onslaught. Some of our New Jersey staff and agents probably worried about Palisades' future. Indeed, the independent agents in New Jersey have lost some market share since the direct response giants entered the state…but Palisades has actually gained market share since then. Palisades, in fact, is now the second largest independent agency carrier in New Jersey; only Travelers is larger in that market segment. Considerable credit is due to Ed Fernandez and his outstanding management team. Palisades has first-rate agent relationships, excellent product and service capabilities, and a long record of minimal consumer complaints. There is every reason to expect its success to continue.

The High Point group remains our largest family member, with $480 million in New Jersey automobile and homeowners insurance premiums written. We acquired this business, as well as High Point's dominant distribution source, from Prudential in 2003, and we knew at the time that it would be tough to keep the Pru sales engine running at full steam while Pru itself was de-emphasizing property and casualty lines. The agents remain on a Pru payroll, not ours, and retirements in their ranks exceed new appointments. The issue was never whether we could keep 100% of the business on Pru's books at the time of the acquisition, but how long it would take us to build new distribution strength with the Pru agents and through alternative channels, so that the annual growth would more than make up for inevitable attrition. The growth challenge is not so much a consequence of the competitive product environment as it is an expected attribute of the original transaction. High Point's volume has indeed fallen since the acquisition but there is no fear of its hemorrhaging. This past year the voluntary auto book of business fell in dollar volume by 2.3%. This means that the number of voluntary automobile exposures written and the voluntary market share actually grew, since the average premium in that segment of the book decreased by close to 5%. The Pru force, we are pleased to say, includes many talented, energetic, and highly successful professionals. They come with good training, a strong tradition, large rolodexes, and a brand name known everywhere. Paired with our staff at High Point, they provide a level of customer service few companies outside of our family can match. Gerry Wilson and Jim Tignanelli have spent a great deal of time and energy on how to best motivate the Pru force to sell more of our product, and they are making progress. In March, with wide support from the agents, Pru renewed its distribution contract with us for another seven years.

At the top of Gerry Wilson's list for 2008 are two tasks that have implications for our entire family of companies: strengthening our decision support analytics to take our companies to the cutting edge in product sophistication and competitive agility; and the development of our web marketing skills. We consider that excellence in the use of the Internet is still a story in the making for the insurance industry. There is no reason not to try to set the standard in a medium where creativity and analysis are as important as large budgets.

Our New Jersey companies have always been particularly good at acquisitions. This past year, Gerry and Marc Buro negotiated High Point's purchase of GMAC's automobile insurance book. That book, which is moving to High Point month by month as policies renew, brings new and interesting group marketing opportunities to High Point for expansion in the near future. In the here and now, it is nice to know that the GMAC book should provide enough volume to assure year over year growth for High Point in 2008. Gerry is sleeping better now.

Pilgrim Insurance, too, fell somewhat short of its goals for 2007. Our Massachusetts-based insurance management company suffered from the uncertainties of a pending reform that left potential customers waiting on the sidelines for more definition. At the same time, there was continuing depopulation of the state's residual market, good and healthy for the system but bad for Pilgrim's business. Managed premiums were down $11 million, and net income dropped accordingly to less than $1 million. Ellen Wilcox, Pilgrim's president, views this year as transitional. Pilgrim is ready for the new managed competition environment as we enter 2008, and it appears from recent marketing discussions that its Massachusetts customers are ready now as well. In 2007, Ellen launched Pilgrim's Connecticut commercial auto insurance program, and this coming year she plans to help Palisades with its commercial auto offering in New Jersey.

This past year was no fun for many investors, but quite kind to our investments at Plymouth Rock. In part, this is because Plymouth Rock has changed its portfolio asset allocation considerably in the past few years; we do better in equities than in fixed income securities. A portfolio that was invested 66% in bonds and cash in 2005 is now held 56% in bonds and cash, and I expect it will continue in that direction. If you ask whether this is wise in such an uncertain stock market environment, I would respond that it is wise prospectively in almost any market environment. Yes, it is true that stocks can be volatile and risky, but as we see it the interest rate and credit dangers inherent in owning bonds make their risks just about as great, and with less generous compensation for the hazard involved. And, yes, it is true that the equity market and the economy right now have uncertain prospects, but we are long-term holders and it is in markets like these that bargains are found.

The total return on investments during 2007 for the Plymouth Rock portfolio was 12.0%, 365 basis points higher than our from-inception average return. Our bonds returned 5.4% and underperformed their benchmark by a bit, but our stocks returned 15% in a year when the relevant common stock indices were sideways at best. As they like to say on Wall Street, that's not so shabby. Plymouth Rock has always held an intentionally undiversified portfolio of common stocks, usually half a dozen stocks or fewer. Merck and Intel common shares were our star performers in 2007, both up by more than 30%. And yet again I can report, with appropriate thanks to Jim Bailey and Rick Childs, that our all-time common stock IRR since 1993 exceeds 20%. The alternative equity category, our non-marketable equity holdings led by our position in Lindsay Goldberg, also performed beautifully in 2007, returning 24%. Our real estate purchases in downtown Boston continue to be a winning doubleheader, exceeding original goals in both appreciation and cash-on-cash return.

Most years, I try to spend a part of this letter looking in depth at a selected element of our investment philosophy or economic events that may affect our portfolio. For the last two years, I have focused on the private equity business. To do so again would be repetitious, but I do want, very briefly, to summarize and reiterate last year's points. While we at Plymouth Rock believe that fruitful private equity opportunities will continue to exist indefinitely for reasons of economic structure and human nature, we believe just as strongly that a shakeout is coming that will separate the best and most constructive private equity investors from the rest. We continue just as firmly to disbelieve that returns on historical private equity investments have been as high as the readily accessible published numbers show; to disbelieve that present returns, whatever they may be, can be sustained in an environment with tightening credit and too much money chasing the same deals; and to disbelieve that all private equity fund managements are created equal, or anywhere near so, in competence.

This year, I would like to comment a bit on an issue and a half in the penumbra of the current subprime mortgage market debacle. The first issue concerns the behavior of the lending industry and current state of financial regulation. In the 1980's both the savings and loan industry and the commercial banking industry went through periods of severe crisis, and there were ample lessons to go around when the dust settled. Mortgage originators, whether banks or not, could see that underwriting default risk on loans is much more difficult than origination and requires different skill sets. By the same token the ultimate lenders should have learned that when originators don't have a stake in outcomes, their motivation to be prudent about who qualifies for loans, and to assure that the applications are honest, diminishes. The simplest available observation was that you can't simultaneously borrow massively in short-term markets, lend those funds out for long durations, and enjoy any but a fool's peace of mind. The public policy community should have learned that banks so large, or so integral to our economic fabric, that they cannot be allowed to fail can easily tend to translate that feeling of security into too much willingness to take on risk. And I might add, though few seem to agree with me here, that we all should have learned the dangers of mixing oversized institutions with overly complex instruments. By "oversized" I mean any business so large that top management, however brilliant and well-staffed, cannot comprehend the true risk posture of the institution. By "overly complex" I mean instruments whose true riskiness is close to indecipherable because, for example, the outcomes are subject to hidden correlations in their vulnerabilities, exposed to low probability-high severity events that defy historical study, or dependent on game theory sequences written into their underlying legal terms.

For a while, after the 1980's crises, it seemed as though many of the private industry lessons had been well learned. Banks in particular seemed to be concentrating on originating mortgages, then securitizing and selling off most of the debt tranches; and at many financial institutions there was an enhancement of enterprise risk management techniques that helped keep borrowing and lending sources better matched. Unfortunately, the learning seems to have faded over time. No one wanted to be left behind when the underwriting risk began knocking, with seductive profitability at first, at the back doors of the originators, but with less discipline than in the past because the mortgage application and screening process had occurred far outside the securitized vehicles. The whole psychology was reminiscent of what happens in our own industry when there hasn't been an earthquake or a hurricane in a particular region in a long time: memories fade, and myopia dominates analysis. In the most telling and repeated quote so far about this period's pervasive decline in loan underwriting rigor, one respected banking leader said: "As long as the music is playing, you've got to get up and dance." The statement has elicited many reactions. Mine is that, if this is so, it supports the case for better regulation.

The public policy lessons from the situation a few decades ago, unfortunately, were even less well absorbed than the private industry lessons. Regulation of finance has been on the defensive for the last three decades. There used to be, since the 1930's, a nearly universal consensus that the financial sector needed oversight at least with respect to its marketing practices, its use of leverage, and its disclosure standards. This is a consensus that ought to be restored, but I am not optimistic that it will be. The overall anti-government political tide of recent times has been one contributor to deregulatory fervor. Another has been the recent surge in the influence of campaign money on politics, an ill that seems to strengthen and ebb in cycles through American history and is currently in a waxing phase. A third force has been globalization, a generally welcome trend but a side effect of which has been a competitive race to the bottom in the supervision of financial activities everywhere. I cannot say for sure that there have not been benefits from freer financial markets. Perhaps, though I am not entirely convinced, cost of capital for real investment has actually been reduced by the explosion of less regulated trading. But, in my judgment, systemic protection and consumer protection have been too greatly diminished. There should have been better point-of-sale oversight in the subprime mortgage market. There should have been less opportunity for financial institutions to take on risky liability positions and fail to reflect the underlying realities on their balance sheets. And there should have been better regulatory scrutiny of the leverage and correlated event exposure inherent in many of the securitized instruments. We are all placed unnecessarily at risk by the lack of regulation. These are times I feel fortunate to be in an industry whose cycles are endogenous and not particularly correlated with broader economic events.

I referred above to an issue and a half because I have only a few sentences, with no conclusion, to offer on the second topic: the consequences of rising investment in the United States financial sector by sovereign wealth funds. I have long believed the United States wise not to let our own government, under ordinary circumstances, hold equity interests in our businesses. Governments are not persons, even to the dubious extent that corporations are (the remarkable 1886 *Santa Clara County* decision of the U.S. Supreme Court notwithstanding); governments are hard to discipline and they are not traditionally subject to the same ethical standards as natural persons. Their behavior is further from pure profit-maximization than that of individuals; they inevitably have other -- and often more pressing -- economic and political motives for their actions. Although sovereign wealth funds are neither new nor intrinsically evil, and I would certainly not expect them to invest their reserves without regard for available public equity markets, I expect their new visibility to create some tough nuts for policymakers. Jim Bailey is more optimistic than I that relatively painless regulatory solutions can crack those nuts; perhaps I see the range of likely behaviors and motives of investing governments in the future as wider than he does. To me, the combination of impacts from huge and continuing U.S. payment outflows and the reinvestment by foreign governments of those dollars here in key financial businesses seems ever more certain to influence the lives of the next American generation.

The space allocated in this letter to Homesite and Response, where Plymouth Rock and I continue to hold investment positions, will be less than it has been in the past. This is not because their stories are any less interesting, but because I am no longer chairman of either company and Plymouth Rock no longer plays an important role in any part of their management other than investments. Both companies have strong CEO's, long-horizoned and deep-pocketed investors, and capable Boards of Directors. Response, which grew by 4% on a net loss of about $5 million, had a better 2007 than many of its peers in the direct response automobile insurance business. It still needs, however, to find its creative marketing stride and, with that stride, enough volume to earn a reliable profit on its accumulated renewal book. Homesite Group is doing just fine. Underwriting homeowners insurance via referrals from well-known corporate mega-partners, it is now closing in on quarter-billion dollar per year scale and shows no sign of slowing down. It earned a substantial profit in 2007 and there are no known clouds on its horizon for 2008. I look forward to the day when both Homesite and Response reach the billion dollar mark that Plymouth Rock passed in 2003 (and which I surely hope we won't have to pass again). Little could make me prouder in my business career than to have been a principal founder of three different billion dollar companies, all highly respected for their business practices, their acumen, and their good citizenship.

James M. Stone