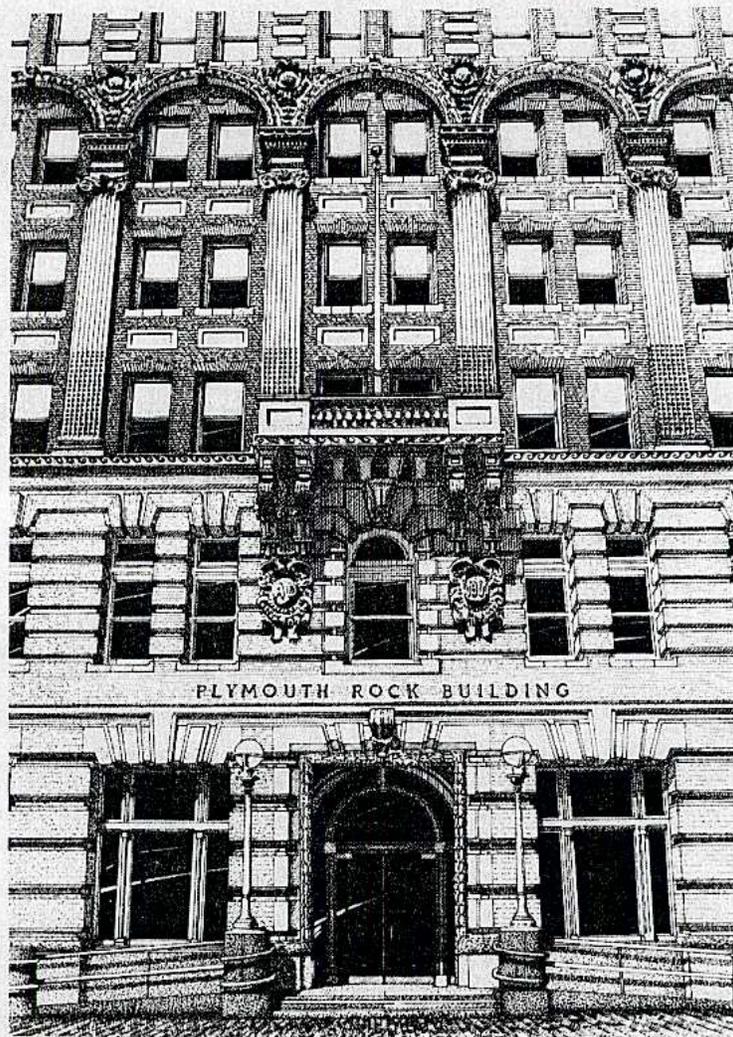


# The Plymouth Rock Company



## 2005 Annual Report

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

**Chairman's Letter**

February 9, 2006

To Our Shareholders:

Were the bottom line the only test of a fine year, 2005 would be as fine as could be. Net income for the Plymouth Rock family of companies was up almost 27% to \$46.5 million. This is a record result by a wide margin. There are two reasons, though, for tempering our exuberance just a bit. One is that overall volume for the group went down for the first time in many years, and not because we were trimming away customers we didn't want or turning away risks at insufficient prices. The other is that 2005 was among the most profitable years in the history of our industry, both nationally and in our principal states. Industry-wide results that border on excessively good always contain the seeds of their own undoing. So Hal and I urge that we all celebrate a good 2005, but not without thinking how much nicer it would have been if we had earned these profits in a year when we were growing and the rest of the property casualty insurance business was struggling.

The accompanying audited financials, prepared in accordance with generally accepted accounting principles, show the year's results in detail. Common shareholders' equity at year-end stood at \$197 million, reflecting a 21% increase since December 31, 2004. On a per-share basis, fully diluted net income was \$255 and the book value increased from \$886 to \$1077. This sizable gain in equity helped once again to boost the cumulative book value return on capitalization from Plymouth Rock's 1983 inception. That number, an internal rate of return index of how an original investor would have done without applying any multiple to book value, has moved up another third of a point to 18.3%. Though not quite my long-standing target of 20%, this would not be a bad rate at which to have compounded your investment over 22 years. The true IRR on the investment, however, has been higher to the extent that our market multiple to book exceeds unity. An outside appraiser estimates the market value, and thus the market multiple, every year. The appraiser last year estimated that the company was worth about 2.3 times its book value, after a 20% discount for lack of marketability. This sounds reasonable enough, but a private company has no direct way of proving the accuracy of a market worth estimate. Enjoying as we do the blessed freedom from distractions and governance conflicts that our private company status affords us, we are not likely to find out soon how a public market would value Plymouth Rock.

Just as our true economic value as an enterprise is not immediately apparent from the financials, the picture of our scale that the GAAP income statement offers is similarly contracted. As is the custom in this annual letter, I can try to give you a better estimate of scale. Where we manage a reciprocal insurer group, the GAAP income statement recognizes only the service fees to the management companies we own, not the premiums of the much larger insurers. The New Jersey insurers we manage together wrote \$672 million in premiums during 2005. The same concept applies to Pilgrim's servicing business on behalf of clients. Pilgrim's fees, including pass-through expenses, are reflected on the income statement

as about \$25 million, while the premiums it managed were close to \$57 million. Even the underwriting companies are bigger than they might appear on the income statement, since the top line on the income statement each year is reduced by net reinsurance ceded and unearned premium reserve increases. The three underwriting companies had a gross premium volume of \$335 million in 2005, versus the \$227 million in net premiums earned that are displayed on the income statement. My calculation of our group's 2005 scale puts us at \$1.06 billion in gross premiums written, more than twice our income statement revenues.

Looking at the year's profits in broad perspective, it is useful to separate the underwriting results from the management results and both of these from investment results. This past year, the three New England underwriting companies earned a net income of \$20.4 million, just over 6% on their gross premiums. While I'd like to see the ratio a little higher, 7.5% of direct premiums to be specific, this is a good showing. The three insurance management companies, which are only expected to earn about half as much per unit of premium volume, earned a net income of \$23.2 million, or 3.2% of managed premiums and very close to the appropriate target. The holding companies added \$2.9 million to the gains. The total return on investments in the 2005 calendar year ranked below the average for the last ten years' results, but comfortably beat the benchmark return for the year. Total return on the Plymouth Rock Companies' portfolio was 4.7%, which you can compare to 5.0% in the year prior and an average of about 7.7% from inception. To add a bit of perspective to these numbers, one should also consider that the contribution to economic profit above and beyond the fixed-income benchmark return in 2005 was 356 basis points, which exceeds our long-term mean result by about a hundred basis points and last year's equivalent number by about 35 points. The relatively low absolute return was principally a reflection of a low interest rate environment. Reported profits were helped by the partial liquidation of a strategic investment in Ping An Insurance Company (of China). We made a profit of \$1.0 million pre-tax on an investment of \$10,000 in that company, a percentage result we may never repeat. We took an income statement gain of \$6.6 million before taxes on Gillette shares as well, following that company's acquisition by Proctor & Gamble. The after-tax contribution of these two gains to 2005 net income was close to \$5 million.

The disappointments this year were predominantly in New Jersey, our largest state. That state, which has been a heavily regulated jurisdiction for as long as I remember, has moved decisively toward a more typical free-market insurance environment. In itself, this should have been neutral news for us -- though it may prove to disappoint New Jersey's urban consumers. For a company like ours less regulation means more competitors, but it also brings more flexibility for creative underwriting and marketing strategies. The change has not been neutral so far. Not only did we lose more business than we should have to effective companies that entered the state as the rules changed, but the strongest of these, GEICO, had also been our largest agency in the state. GEICO had for some years referred to Palisades, through a GEICO-owned agency, their policyholders moving to New Jersey from other jurisdictions. Palisades has lost over three quarters of that business in the past two years, much of it having flowed back to GEICO when the cute little lizard re-entered the state. Overall, Palisades' written premium fell by nearly 10% in 2005. That is a reduction of \$16 million. The loss of the GEICO agency relationship probably accounted for half of this total, including both business lost and new business not gained during the year. Another \$4 million was the result of reductions in rates, rather than lost exposure units. That means less than half of the reduction came from loss of customers, or failure to attract new customers, at our independent agencies. The independent agency book held up relatively well. Still, we lost business in 2005. These were good customers, written at profitable rates, and there is nothing propitious about losing them. Unplanned shrinkage in volume makes me uncomfortable whenever it occurs. In this case, we all saw it coming. Hal and Gerry Wilson and I are all culpable in not having devoted more time, and earlier, to defense and alternative growth strategies.

It is true, at the same time, that Palisades had a splendid combined ratio for the year, in the Elysian Fields of the eighties. But I don't want to find us in the situation of the farmer whose farm of a hundred acres was reduced in size ten acres last year by a bank foreclosure and another ten looks likely to go the same way this year and the next. It's not a problem, the farmer smiles. The farm was too large to work efficiently at a hundred acres, and he got more crop out of the ninety this year than he had previously gotten from the hundred. When it's eighty, says he, it will be even more efficient and the crop will be larger still. You can see where this is headed. Our companies need to grow to thrive. At year-end, the Palisades exposure count indeed appeared to have stabilized. Gerry Wilson and his Palisades team deserve considerable credit for this. Perhaps next year we can count Palisades among the companies that benefited from the regulatory changes in New Jersey. I still caution our people, though, that the state's regulatory environment is not stable. In a good enough period for auto insurers -- and this one has been spectacular -- a state can curtail relative rate regulation and still see premiums fall in the suburbs while burying the potential crisis in the cities. As the cycle corrects, however, rates may spin out of control in the urban areas. Compulsory automobile insurance is too imbued with public policy, and too naturally income-regressive a product, to be left to a pure free market. The New Jersey regulatory story isn't over yet.

Premiums managed at High Point, like those at Palisades, fell in 2005. Gross premiums written by the High Point insurers declined from \$568 million in 2004 to \$521 million in 2005. This is a drop of 8.2%. The decline in premiums in force was more like 11%. Rate level reductions in automobile insurance accounted for about a fifth of this drop. The rest represented the departure of auto insurance customers, virtually none of them shed at our own initiative. Ironically, while homeowners business was strategically curtailed during the year, increases in average premium more than made up for the declining unit count in that line's 2005 results. The decrease was all in automobile insurance. The problem at High Point is more serious than that at Palisades because the reduction was in no measure due to a one-time reclamation of another company's agency business. All of the customers lost were from High Point's principal distribution channel. The business lost, like the business retained, was quite good. The combined ratio at High Point in 2005 was about 96%, up only a point or so from last year's pleasing results.

One thing we can surely say about the loss of business is that it was not from poor service. We believe that High Point will be in a tie for the second lowest count of valid auto insurance consumer complaints when the New Jersey Department of Insurance tally is published. To put Jim Tignanelli's achievement in context, a number of large and prominent auto insurers traditionally have complaint rates on the New Jersey list dozens of times the rate we expect High Point to show. We understand that High Point, however, will fall short of being number one on the honor roll in the Insurance Department listing, and it has some rough competition to challenge for that honor in the future. You guessed it. We have been informed that, just like last year, the best record among the listed insurers, when both size and complaint count are considered, will belong to Palisades.

If it wasn't service, wasn't a one-time recapture of agency business, and wasn't lack of enthusiasm on High Point's part, what was responsible for the volume decline? One element could have been rates. High Point might have lowered or segmented its rates a bit more, and accepted a higher combined ratio at least on some parts of the book, to prepare for competition with the new entrants. Another contributor could have been lack of branding. This was the second full year of operating without the benefit of the Prudential name. We have not sought to make High Point Insurance a household phrase. Possibly, too, there was something amiss in the customer-agency-company communications chain. I wish I could give you a more rigorous answer. What seems certain is that we have something to fix. Competition in newly deregulated New Jersey is still heating up, with Progressive having just recently made its entry. Even if the turn of the cycle and a few years of experience with deregulation will lead to a counter-

reaction among urban insureds in New Jersey, the next few years promise to be highly competitive. High Point will have to define and communicate its value proposition more effectively. That is a top priority for 2006, and the Boards of both High Point and The Plymouth Rock Company can count on briefings at every meeting along the way. I am optimistic. As Gerry Wilson likes to say: "New Jersey is a no complacency zone" for us. He and Jim Tignanelli are an exceptionally strong team.

Pilgrim Insurance is the eldest, and smallest, sister of our three insurance management companies. That doesn't make it unappreciated, however. In 2005, it contributed \$3 million to the overall bottom line, with relatively little risk and a 30% return on equity. Ellen Wilcox would say that the high ROE is available because Pilgrim's real equity as a manager is sweat equity, work rather than balance sheet commitments -- and she would, of course, be right. In any event, Pilgrim is a much valued winner in our family of carriers. Its premiums under management rose about 3% over the prior year, despite rate decreases in the Massachusetts book it oversees. Profits rose by nearly 11%, indicating continued good management of the company's expenses. Ellen is ready to take on more of the world, and Hal and I both encourage her to do just that. Her first step will be to service assigned risk business in New Jersey. Twin Lights, the company that will take on that task, is open for business already.

The three underwriting companies account for one third of the Plymouth Rock family's premiums and about 44% of its profits. These are the companies where we must commit substantial capital in proportion to the premium we write, and where we directly and immediately bear underwriting risk. The total amount of capital committed to Plymouth Rock Assurance Corporation, Bunker Hill, and Mt. Washington Assurance is about \$125 million, so the return on equity from underwriting was almost 19% in 2005. Plymouth Rock Assurance's performance had been good in 2004. In 2005, it was better. The combined ratio improved from 99% to 95%, with both the net loss ratio and the net expense ratio lower than the year prior. The all-inclusive expense ratio, covering claim adjustment and investment costs as well as all underwriting expenses, stood at 35.7%, still too high by a few points but lower than it has been for many years. Plymouth Rock Assurance, for the second consecutive year, was the fastest growing top-ten writer in Massachusetts. The bad news is that, while premiums written in Connecticut rose about \$1 million, premiums written in New Hampshire fell by \$3.1 million. Expanding Plymouth Rock Assurance's New England footprint continues to be one of the less successful efforts in our Company's history. The loss ratio quality of the business we have in New Hampshire and Connecticut is entirely satisfactory. The lack of volume must be owed to a combination of our unsophisticated product offerings, which provide attractive rates to an overly select subset of drivers, and an insufficient marketing focus in New Hampshire. Both of these issues should be addressed in 2006.

The much debated regulatory changes in store for Massachusetts were not a factor in 2005 results. As you will remember, the Commissioner was stayed by the courts from scrapping the residual market reinsurance pool in favor of an assigned risk plan. Attention then turned to the Legislature, and the Governor filed a bill which would not only grant the necessary authority for establishing an assigned risk plan to the Commissioner, but would also change profoundly the ways rates are made and regulated. The Governor's office says it does not want to abandon the partial flattening of rates across cities and more rural areas that has characterized Massachusetts since the 1970's, but the Governor's bill makes no provision for maintaining that tempering. Similarly, the Governor's office says it wants to reward good drivers, but the proposed legislation would appear to allow premium rates to be set with more emphasis on socio-economic factors such as credit history and occupation, and less on driving record than is currently the case. The Legislature has not acted as yet. The mayors of Boston and several other cities, the state's leading consumer groups, the Attorney General, and the leading newspaper have said that they do not support the Governor's bill as written, but it is far from dead. Legislative spending by the industry is the highest, and the campaign the most intense, I have ever seen in this state's insurance wars.

Meanwhile, the Commissioner has acted, well within her current authority, to cure the greatest of the unfairnesses in the present residual market system. By assigning risks to companies by agent, and thus in “lumps” that may include many risks at a time, the system inevitably renders some companies lucky and some unlucky. Those who are skillful at handling claims or clever in manipulating the subtleties of the assignment process can enhance the effects of initial assignment luck. The problem for the Department was that, while luck and trickiness are not deserving of rewards, claims skill must be rewarded fully if claim fraud is to be held in check. Companies can invest profitably over time in learning the ruses of the occasional rogue agency and its confederates in crime. We try to do that actively here at Plymouth Rock. The Commissioner was thus faced with a hard problem: how to redistribute the assignment burden more equally without undermining the incentive to handle the claims professionally. She chose a one-time redistribution of the assignments, taking the best and worst assigned agencies from companies whose results were different from the mean and reallocating them to make every company’s assignment load an equal burden. This is not an ideal solution, because it ignores the differential fraud-prevention efforts that contributed to the unequal results, but Plymouth Rock supported it as better than leaving the currently excessive disparities in place. We did so in the hope, however, that any such redistribution will be quite infrequent. Redistribution of assignments was an extreme remedy, not in itself a positive step. It disrupts customers and honorable agencies as well as the less numerous cheaters, and it undermines any incentive for companies to invest in long-term fraud prevention. We will be disappointed on public policy grounds if it happens again soon.

Our results will be hurt a little, but not intolerably, by the redistribution of 2006. That’s the cost of the cure. We do not feel threatened financially by the looming legislative debate, but we hope the Legislature is not blinded into abandoning the aspects of the unique Massachusetts system that have worked well. Our percentage of uninsured drivers is among the lowest anywhere in the country; our rates have risen less rapidly in the past decade than those of 48 states and at only half the national average rate of increase; our customers are not condemned to assigned risk status on grounds unrelated to driving records; and our urban-rural premium relativities are moderated to prevent untenable disparities. We could support legislation if it locked in these features of today’s system that work so effectively in the consumers’ interests, and ultimately in the industry’s. We would hope that any legislation dealt a blow to the self-interested decision making so inexorably linked to a powerful and company-dominated residual market board with wide-ranging powers. That would be the single best signal Massachusetts could send that our state’s system is fair and welcoming to all companies willing to accept our consumer protections.

Bunker Hill Insurance Company, the New England homeowners writer, had a reasonably good year. Its premiums rose about 1% to \$37 million, and its net income rose by 25% to \$1.5 million. John Tierney can also be credited with strengthening the reinsurance protection at reasonable cost, a prerequisite for more growth in the future. This is no small accomplishment given that the storm modelers keep increasing their estimates of maximum damage potential from East Coast hurricanes. Bunker Hill’s return on equity, at 12%, however, is still below par. Homeowners insurance, with concentration primarily in one state and a full acquisition load, is a tough business.

If Plymouth Rock evaluates its investment results for 2005 by comparison of the portfolio’s performance to its agreed-upon benchmarks, our year can be described as nothing short of excellent. Had we cared only about absolute levels of return, I would have described the results differently. The overall total return was 4.7%, which is lower in absolute magnitude than we have averaged in the past. Rick Childs, Jim Bailey, and I continue to take responsibility for the portfolios. As is always the case for Plymouth Rock, the results were dominated by the fixed-income returns, and this holds much of the explanation for the numbers. All bonds taken together produced a return of only 1.9% in 2005, which is

quite low by historical tests. The benchmark performance, though, for bonds of the intermediate duration and conservative grade we like was only 1.2% in 2005. To have beaten the index by more than half again, without adding credit risk and actually decreasing duration risk, is a rare accomplishment of which Rick and Standish Mellon, our outside fixed-income advisor, can be proud. An environment of low yields and falling prices is never a rich one for fixed-income investors.

The stock market was better to us. Our six-stock marketable equity portfolio, which still contains the closely watched Merck as a component, rose by 11.9% for the year, handily beating the S&P gain of less than 5%. That result approaches our ambitious target level, although it falls short of the 20% IRR that still characterizes our stock market performance from its inception. One concern we have discussed internally about the marketable equity portfolio is its unaccustomed current concentration in jumbo capitalization stocks. Plymouth Rock has done reasonably well with shares of some of the very largest companies in the world, but an inconsistency with our theory of markets nags me. To perform as well against the market as we have in the past, theory suggests we should buy stocks in companies whose future prospects we understand better than the market does. That can't be an easy task with respect to the most heavily studied companies in the world. We will consider some new equity holdings to supplement the super-giants.

How do we feel about 4.7% overall returns? Insurance company investment officers all over the country, I suspect, are asking themselves a similar question. It is hard not to compare insurance results with the higher returns of more glamorous portfolios, such as the top university endowments, that have gotten so much press attention recently. Much of the difference in outcomes lies simply in the relative freedom of these other portfolios from the regulatory, accounting, liquidity, and rating agency constraints that impel insurers toward fixed-income holdings. Part of the difference may arise from the top performers' greater scale, which gets them access to opportunities not generally available to many insurers of our size class and allows payment of star compensation to large teams of nationally known professionals. Jim and Rick and I run a lean shop. These are differences we can not do anything about, at least anytime soon. Another distinction may be in preferences with respect to asset allocation. Even constrained insurers could shift their allocations a little by cutting back on fixed-income holdings, common equities and real estate holdings to make room for more equity alternative vehicles such as hedge funds, venture funds, and buyout firms. Plymouth Rock already holds a smaller share of its portfolio in bonds than the typical member of our peer group in Massachusetts, and the conversation here is ongoing about our optimal mix. Let me share some individual thoughts on some of the choices.

The appellation "hedge fund" strikes me as not in itself informative. Hedge funds are not so much an investment class, but a collective name for a wide range of strategies, some relatively conservative and some quite risky, whose common element is that they are subject to less disclosure and less regulatory supervision than traditional investment vehicles. To the extent that any individual fund is more leveraged than we would think wise, or its strategies are not reasonably transparent to us, these investments will run contrary to much we have said about portfolio philosophy here. Some hedge funds, on the other hand, have met our standards, and we are pleased to be involved with them. The venture capital business has an appeal based on its location in a segment of the equity market where competitive efficiency is necessarily low. One concern, however, is that, after a few slow years, the best venture firms are increasingly well funded again, and average returns should be falling. We are attracted only by exceptional talent and track records in venture management. It is plausible, I admit, that the whole venture field may prosper beyond market expectations and my own, continuing to have generally outsized returns. This could occur if the world of business is entering an era of accelerating change, in which the giant companies of today will be replaced ever faster by unfamiliar challengers, who will then in turn yield their dominance to even newer players. In that world, branding in technology-driven products would be less and less durable and innovation rewarded above all. Even if we foresaw a future

like that, Plymouth Rock would have to accept somewhat reduced venture returns because the speedy decision making and technological prognostication required for direct venture investing have not been our preferred skills, and instead we would gradually increase our participation in carefully selected funds.

Private equity buyout firms are a particularly interesting vehicle class, both for investment purposes and as an economics study. The top performing buyout firms (though apparently not the entire class of firms) have experienced greatly outsized returns for decades now, and their well of new capital seems not to be running dry. In fact, the well is gushing as we enter 2006. The question of the moment is whether the inflow of capital is yet enough to correct the market inefficiencies that permitted the above-market returns. These returns in my view come largely from altering inertial conditions in the corporate world. To the extent that private companies and entrenched public companies are loyal to familiar management teams, constrain boldness, or shy away from leveraged capital structures, there can be opportunities for private equity firms to earn high returns by forcing upon them these market-favored rigors. Social benefit is not necessarily automatic, but it seems clear enough that this strategy can be profitable for investors in a low interest rate environment when applied with exceptional competence. No one really knows how to quantify the aggregate opportunity of this sort in the United States, or in the free enterprise world, but it could be greater than even the jumbo funds of today can take advantage of. Enough capital will fill any such gap over sufficient time, of course, but for now we may be inclined to add to our allocation for the ablest and most honorable firms in the private equity category. You all know that I am involved with the general partnership at Lindsay, Goldberg & Bessemer, so Jim and Rick make the recommendations without me when that firm is under consideration.

The Plymouth Rock portfolio at year-end 2005 was invested 66% in bonds and cash, 13% in marketable equities, 7% in illiquid or strategic equities, 7% in real estate and 7% in equity equivalents. While we think this is an appropriate allocation for a conservative financial institution, we will continue our conversation about the mix. Don't expect radical changes. None of us would feel good about substantially increasing our risk profile or about chasing yesterday's returns into tomorrow's world.

Mory Katz runs Response Insurance, in which Plymouth Rock and I own strategic investment interests. Response has, since 1997, offered direct-to-the-consumer auto insurance policies at highly competitive rates in a number of states -- other than Massachusetts. As chairman, I work with Mory on financial planning, hiring, and key strategy decisions. My originally contemplated term of ten years as the chairman of Response ended this past September. I offered to stay on a while longer or leave the Response Board of Directors, at the choice of the majority shareholders. After lengthy discussions, it was agreed that I should stay as chairman of Response until November 30 of 2006, and then presumably turn over the reins to the other investors. Response has now had three years in the black. It has not, however, performed to investor -- or, for that matter, my own -- expectations. It's an extremely sound company, and moving every year in the right direction. It has the loss ratio and spending discipline, the IT systems, the regulatory relationships, the footprint, the service mentality and the officer talent to become a major carrier in its field. Still, over the ten-year haul, its progress has been slower than anticipated. I had hoped that by now Response would be at least a \$200 million company, a scale at which the expense ratio would fall within normal industry ranges, and that it would have demonstrated its ability to grow profitably and rapidly at reasonable marketing cost metrics. Instead, Response is a \$135 million enterprise, still short of the scale point, and the growth engine remains unproven.

To achieve the full success I have always sought for Response, with an attrition rate of about 15% on existing policies, that company must generate good new business volume equal to 35% of its current book of business. Just as important, it must do so spending less than 35 cents on the dollar to generate that business. When it can do this, maintaining a favorable loss ratio at all times, Response will be the

“20-20 company” it ought to be: an exciting and highly valued enterprise that can earn a 20% return on capital with a 20% growth rate. Despite continued progress toward the right metrics, Response was not able to grow with those metrics in 2005, and it is unlikely it can close the full gap even in a good 2006. It is, however, on the right track to succeed without the need for adopting the riskier strategies of some of its competitors. Mory and I are both confident, in fact, that time on the current course alone can get Response to the metrics we seek, and that progress should be faster from here than it was in the early years. The other owners, however, may not be as patient as we are. I continue to urge that the company be given a chance to succeed and to realize the inherent ownership value that comes with a soundly built direct response auto insurance company of the appropriate metrics. The investors would be wise not to let impatience rule the day.

Our other significant strategic investment, Homesite Group, has no problem generating volume growth. Homesite, which underwrites homeowners insurance risks throughout most of the country and gets its business largely by referrals from large corporate partners, grew from \$100 million in direct premiums in force at the end of 2004 to \$170 million in December of 2005. It counts as its partners such giants as AIG Direct, GMAC Insurance, Prudential, and Wells Fargo, with others already contracted to come on line in 2006. Just as important, Homesite has by now accumulated an expertise, and a reputation for expertise, second to none in the \$50 billion a year business of homeowners insurance coverage. Fabian Fondriest, the company’s CEO, and Doug Batting, the COO, run a tight ship and imbue it with impressive analytical discipline. Homesite is now the partner of *first* resort for blue chip partners who don’t want to carry as much homeowners insurance risk as they can generate. This is an enviable market position as long as Homesite doesn’t overexpose itself to homeowners catastrophe risk. Careful risk underwriting (and letting partners know Homesite will not accept every risk or relieve them principally of their catastrophe-prone exposures), geographic balance from the large scale down to the most granular level, and prudent reinsurance purchasing are the tools that should allow the company to manage its catastrophe exposure. Critically important to its success is that Homesite does not write auto insurance business, where the temptation for concentration of risk is just about overwhelming for most carriers. Knowledge is important, too. To that end, Homesite has recently added MIT Professor Kerry Emanuel to its Board of Directors. Kerry is one of the top experts in the world on storms, weather, and climate change.

Homesite’s loss ratio remains, as it has been from inception, excellent. Even in the year of Hurricane Katrina (and, yes, we insured a few homes in New Orleans and along the Mississippi), the pure loss ratio stayed under 60% -- not as low as prior years but an enviable result for 2005. This year, Homesite’s scale will allow the general expense ratio to reach its targets, and acquisition expense has never been a problem. I said above that a “20-20 company” was exciting, so Homesite should be more than exciting since it is preparing to grow considerably faster than 20% at an ROE of that magnitude. While there is lots of slip between cup and lip, I fully expect Homesite to be the second company I chair to reach the billion-dollar scale mark. So does Jim Bailey. This confidence is demonstrated unambiguously by the fact that The Plymouth Rock Company bought \$5 million more of Homesite’s stock in 2005 at the same arm’s length price paid by a knowledgeable outside investor; Jim Bailey bought the same amount for his personal account; and High Point bought three times that much. This year, Homesite will have to raise quite a bit more money than it raised in 2005 if it is to accept anywhere near all of the sound business being offered to it by its partners. The future is hard to read, but my guess at this moment is that, while Homesite will be able to raise the next tranche of capital privately, it may eventually need the public market to supply it with appropriate capital for its business expansion.

I’ll close this year’s letter with discussion of two topics that affect the whole Plymouth Rock company group: systems and executive talent. You are all familiar with what we call our Matrix project, which will bring all of our principal systems capabilities in-house for the first time, establish a common IT

platform among our companies, and, we hope, greatly increase our operating efficiency. You are also aware that Matrix represents the largest investment our companies have ever made, over \$50 million. This past year, our in-house data centers were completed in both Massachusetts and New Jersey. Palisades joined Plymouth Rock Assurance and our smaller companies on the Matrix claims system, and High Point's conversion to Matrix claims is under way as I write. High Point now issues homeowners, fire and umbrella policies on the Matrix system. In the spring of 2006, Palisades and High Point will begin issuing all of their policies on Matrix. Plymouth Rock Assurance and the other New England companies will follow in the summer and fall. By year-end, the implementation of Matrix should be largely complete, and we will all breathe a sigh of relief. Homesite and Response, of course, have their own effective IT systems and are not part of the Matrix effort. Hal and Paul Luongo (Matrix's leader and our IT chief) have taken primary responsibility for keeping Matrix on track and on budget. I have no reason to doubt their increasingly confident predictions that Matrix will be a double success, double because it will not only help free us from dependence on and costs of outside vendors, but also allow us to substantially enhance agency and company functionality while realizing the full expense ratio benefits of our last few years' increases in scale.

The other general topic is talent, a subject I have talked about in virtually every annual report, but on which there is now more to say than usual. This past year, 2005, was the year we finally established a formal objective-setting and performance-review process for our officers. The days when Hal and I could evaluate the work of the entire officer corps by subjective reaction and first-hand observation are over. The new process is better anyway, in that -- even for those of us in the top jobs -- it adds a measure of introspective reflection to the setting of goals and an equal measure of reality checking when the results come in. We also informed our officers, at an off-site conference on future corporate ambitions in 2005, of a new responsibility for which all will be held accountable: the hiring and nurturing of potential successors. Just as we are too large now for ad hoc, free-form performance appraisals, we are finally large enough to look internally rather than to search firms for a hefty share of officer promotions. It is time to grow our own next generation of leaders, people we already know share Plymouth Rock's high standards of service, of analytics, of good citizenship, and of results. In December, Thom Cranley joined us from Accenture Consulting as Plymouth Rock Assurance's COO, and 2006 should be a big year for hiring. One area where we are particularly eager to add strong people is in product management, which encompasses pricing, product design and loss ratio responsibilities. In its early days, Plymouth Rock was known as a leader in product analytics. We have slipped a bit relative to the competition. Hal, Gerry, and I have promised each other that we will regain that edge, even if it costs somewhat more than we would like to get there. It is only after Matrix is completed and the talent pool is expanded that Plymouth Rock will be comfortable entering the next states on our radar screens. We may have to wait just a bit for that New York moment, but it should be a sweet one when we do it right.



James M. Stone

**REPORT OF INDEPENDENT AUDITORS**

To the Board of Directors and Stockholders of  
The Plymouth Rock Company:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, cash flows and changes in stockholders' equity present fairly, in all material respects, the financial position of The Plymouth Rock Company and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.



Boston, Massachusetts  
March 13, 2006

**THE PLYMOUTH ROCK COMPANY**  
**CONSOLIDATED BALANCE SHEETS**

**December 31, 2005 and 2004**

<b>Assets</b>	2005	2004
Cash and cash equivalents	\$ 97,644,198	\$ 28,308,444
Investment securities	273,814,528	304,063,548
Accrued investment income	2,163,997	1,901,288
Premiums receivable	40,278,652	38,206,115
Deferred acquisition costs	12,028,613	11,782,921
Receivable from reinsurers	17,918,482	34,611,033
Amounts due from service clients	11,009,391	11,059,351
Prepaid expenses, agent loans, and deposits	6,749,229	8,277,158
Real estate	23,525,566	22,575,769
Fixed assets	58,399,614	34,901,150
Goodwill and intangible assets	4,873,425	4,516,225
Deferred income taxes	-0-	185,810
Income tax recoverable	-0-	8,940,775
Other assets	2,121,993	2,774,645
	<u>\$550,527,688</u>	<u>\$512,104,232</u>
 <b>Liabilities</b>		
Claim and claim adjustment expense reserves	\$142,017,734	\$129,113,785
Unearned premium reserve	94,326,140	79,535,686
Advance premiums	9,265,253	9,218,185
Commissions payable and accrued liabilities	49,918,256	51,376,800
Payable to reinsurers	11,891,787	34,328,555
Unearned service fees	29,582,337	32,046,099
Amounts due to service clients	10,443,266	9,248,470
Note payable	2,905,020	3,873,360
Deferred income taxes	1,438,441	-0-
Income tax payable	1,256,705	-0-
Other liabilities	529,624	1,315,874
	<u>353,574,563</u>	<u>350,056,814</u>
 <b>Stockholders' Equity</b>		
Common stock and paid-in capital	24,766,913	24,335,943
Retained earnings	168,487,576	130,022,489
Net unrealized gain on investments	3,698,636	7,688,986
	<u>196,953,125</u>	<u>162,047,418</u>
Total stockholders' equity	<u>196,953,125</u>	<u>162,047,418</u>
Total liabilities and stockholders' equity	<u>\$550,527,688</u>	<u>\$512,104,232</u>

The accompanying notes are an integral part of the financial statements.

**THE PLYMOUTH ROCK COMPANY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**For the years ended December 31, 2005 and 2004**

<b>Revenues</b>	2005	2004
Premiums earned in underwriting activities	\$226,598,085	\$194,045,502
Fees earned from service activities	181,725,750	178,684,585
Investment income and capital gains	25,917,113	19,243,627
Total revenues	434,240,948	391,973,714
<b>Expenses</b>		
Claims and claim adjustment expenses	161,387,044	143,031,969
Policy acquisition, underwriting, and general expenses	59,132,424	54,075,250
Service activity expenses	140,498,391	135,668,460
Total expenses	361,017,859	332,775,679
Income before income taxes	73,223,089	59,198,035
Income taxes	26,767,894	22,566,324
Net income	\$ 46,455,195	\$ 36,631,711

<b>Per share data</b>		
Weighted average common shares outstanding:		
Basic	179,726	179,555
Fully diluted	182,316	182,300
Net income per share:		
Basic	\$ 258.48	\$ 204.01
Fully diluted	\$ 254.81	\$ 200.94
Common shares outstanding at end of year	182,911	182,840
Common stockholders' equity per share	\$1,076.77	\$ 886.28

The accompanying notes are an integral  
part of the financial statements.

**THE PLYMOUTH ROCK COMPANY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the years ended December 31, 2005 and 2004**

<b>Cash flows from operating activities</b>	2005	2004
Gross premiums collected	\$329,074,029	\$322,871,998
Reinsurance premiums paid	(111,495,770)	(116,279,102)
Finance charges collected	6,148,085	5,638,084
Fees and commissions collected	178,659,992	201,502,970
Investment income and capital gains received	15,074,739	15,081,174
Gross claims and claim expenses paid	(211,764,664)	(187,823,442)
Reinsured claims and claim expenses collected	74,686,101	68,230,709
Policy acquisition, underwriting, and general expenses paid	(54,206,740)	(43,201,476)
Income taxes paid	(12,797,512)	(27,983,381)
Service activity expenses paid	(129,996,823)	(124,696,181)
	<u>83,381,437</u>	<u>113,341,353</u>
<b>Cash flows from financing activities</b>		
Payment on note payable	(968,340)	(968,340)
Issuance of common stock	82,076	113,498
Dividends to stockholders	(7,990,108)	(2,779,277)
	<u>(8,876,372)</u>	<u>(3,634,119)</u>
Net cash provided	<u>\$ 74,505,065</u>	<u>\$109,707,234</u>
<b>Investment of net cash provided</b>		
Change in cash and cash equivalents	\$ 69,335,754	\$ 2,111,545
Net investment activity	(30,732,746)	81,655,779
Purchase of goodwill and intangible assets	763,684	1,249,678
Net real estate activity	1,676,360	(364,456)
Purchases of fixed assets	33,462,013	25,054,688
	<u>\$ 74,505,065</u>	<u>\$109,707,234</u>

The accompanying notes are an integral part of the financial statements.

**THE PLYMOUTH ROCK COMPANY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**For the years ended December 31, 2005 and 2004**

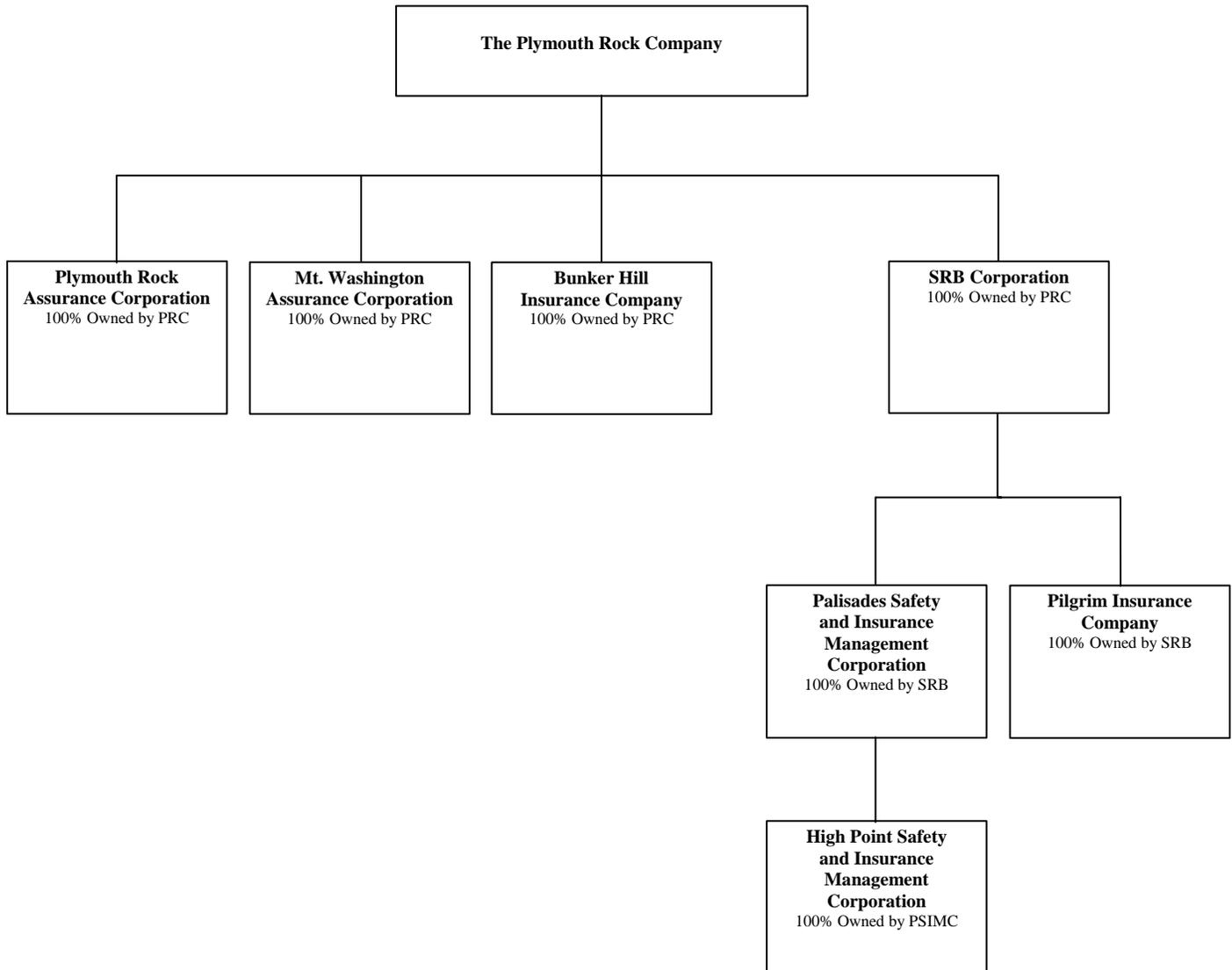
	Common Stock and Paid-in Capital	Retained Earnings	Net Unrealized Gain on Investments	Total Stockholders' Equity
December 31, 2003	\$23,583,760	\$ 96,170,055	\$10,350,292	\$130,104,107
Comprehensive income	-0-	36,631,711	(2,661,306)	33,970,405
Issuance of common stock	752,183	-0-	-0-	752,183
Dividends to stockholders	-0-	(2,779,277)	-0-	(2,779,277)
December 31, 2004	24,335,943	130,022,489	7,688,986	162,047,418
Comprehensive income	-0-	46,455,195	(3,990,350)	42,464,845
Issuance of common stock	430,970	-0-	-0-	430,970
Dividends to stockholders	-0-	(7,990,108)	-0-	(7,990,108)
December 31, 2005	<u>\$24,766,913</u>	<u>\$168,487,576</u>	<u>\$ 3,698,636</u>	<u>\$196,953,125</u>

The accompanying notes are an integral  
part of the financial statements.

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Organization of the Plymouth Rock Companies**

The corporate and ownership structure of the principal Plymouth Rock Companies is shown in the following chart:



Other affiliates include 99 Bedford Corporation and 695 Atlantic Avenue Company, LLC, which own real estate, and Shared Technology Services Group Inc. and BCS Holding Company, LLC, which are wholly owned subsidiaries of SRB Corporation. Direct Response Corporation and Homesite Group Incorporated are not among the Plymouth Rock Companies, but The Plymouth Rock Company owns a common stock interest in each.

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. Summary of Significant Accounting Policies**

**A. Principles of Consolidation**

The consolidated financial statements include the accounts of The Plymouth Rock Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

**B. Cash, Investments, and Real Estate**

Cash and cash equivalents include money market funds and short-term money market instruments with maturity dates no longer than 90 days at the date of acquisition. Marketable fixed income and equity securities are carried at their fair values. The fair values of securities are based on quoted market prices. The calculation of gain or loss on the sale of marketable securities is based on specific identification at the time of sale. Where declines in the value of marketable securities are deemed other than temporary, the securities are carried at market value and the loss is reported as a component of net realized capital gains on the sale of securities. Net unrealized gains or losses on securities available for sale, net of applicable deferred income taxes, are credited or charged directly to stockholders' equity. Alternative equity investments are recorded using the equity method of accounting.

Real estate and fixed assets are carried at cost less accumulated depreciation and amortization. The Company provides for depreciation and amortization principally on the straight-line method over the estimated useful lives or the applicable lease terms.

**C. Deferred Acquisition Costs**

Commissions and premium taxes are deferred and amortized pro rata over the contract periods in which the related premiums are earned. All amounts deferred at December 31 are charged to operations in the following year as the related premiums are earned. Deferred acquisition costs are presented net of deferred commission income on ceded reinsurance.

**D. Income Taxes**

The Company files its federal income tax return on a consolidated basis. The provision for income taxes is based on income reported in the financial statements. Deferred income taxes arise when there are differences between reported income and taxable income.

Income taxes in the statements of income for 2005 and 2004 consist of:

	<u>2005</u>	<u>2004</u>
Current year federal income taxes	\$19,905,828	\$14,388,460
Current year state income taxes	3,089,164	2,684,342
Change in deferred taxes	<u>3,772,902</u>	<u>5,493,522</u>
Total	<u>\$26,767,894</u>	<u>\$22,566,324</u>

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. Summary of Significant Accounting Policies, continued**

**D. Income Taxes, continued**

Deferred income taxes in the balance sheets as of December 31, 2005 and 2004 consist of the net effect of these temporary differences:

	<u>2005</u>	<u>2004</u>
Discounting of claim reserves	\$ 3,649,878	\$ 3,034,247
Deferred income	9,772,850	8,215,836
Net unrealized gain on investments	(1,991,575)	(4,140,226)
Depreciation	(16,100,869)	(8,864,992)
Other	<u>3,231,275</u>	<u>1,940,945</u>
Total	<u>\$ (1,438,441)</u>	<u>\$ 185,810</u>

The net unrealized gain on investments is presented in stockholders' equity, net of an estimate of applicable deferred income taxes. The Company's reported provision for income taxes is less than that computed by applying the income tax rate for these years to income before income taxes. This difference arises principally because the Company receives significant nontaxable interest from state and municipal bonds.

**E. Claim and Claim Adjustment Expense Reserves**

Claim reserves represent the estimated liabilities for claims reported to the Company plus reserves for claims incurred but not yet reported. Claim adjustment expense reserves represent the estimated expenses relating to settling of these claims. Claim and claim adjustment expense reserves are presented before estimated recoveries for reinsurance. The methods of making such estimates and establishing the resulting reserves are reviewed regularly, and any adjustments are reflected in income currently. The table below provides a reconciliation of the beginning and ending reserves for claims and claim adjustment expenses:

	<u>2005</u>	<u>2004</u>
Balance at beginning of year	\$129,113,785	\$108,734,842
Claims and claim adjustment expenses incurred:		
Current year	162,680,000	143,512,000
Prior years	4,310,320	5,180,505
	<u>166,990,320</u>	<u>148,692,505</u>
Claims and claim adjustment expenses paid:		
Current year	89,316,000	75,378,000
Prior years	58,233,611	52,917,610
	<u>147,549,611</u>	<u>128,295,610</u>
Change in reinsurance recoverable on unpaid claims	<u>(6,536,760)</u>	<u>(17,952)</u>
Balance at end of year	<u>\$142,017,734</u>	<u>\$129,113,785</u>

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. Summary of Significant Accounting Policies, continued**

**E. Claim and Claim Adjustment Expense Reserves, continued**

Prior year reserves on voluntary automobile business increased by approximately \$5.6 million and \$5.5 million in 2005 and 2004, respectively.

Claims and claim adjustment expenses incurred, shown above, include expenses for service activity clients of \$5,603,276 and \$5,660,536 reported in service activity expenses in the Company's consolidated statements of income for 2005 and 2004, respectively.

**F. Reinsurance**

Treaty reinsurance is used to reduce exposure to large claims. The Company regularly evaluates the financial condition of its reinsurers and monitors the concentration of credit risk to minimize significant exposure. The Company maintains catastrophe, quota share, and excess of loss contracts that are prospective in nature and remains primarily liable as the direct insurer on all voluntary risks.

Receivables from reinsurers represent amounts recoverable for reinsured claims. Premium and losses net of reinsurance activity are as follows:

	2005		2004	
	Premiums Written	Losses Incurred	Premiums Written	Losses Incurred
Gross	\$334,632,073	\$224,668,613	\$321,414,035	\$208,002,393
Ceded	(85,838,999)	(63,281,569)	(108,712,502)	(64,970,424)
Net	\$248,793,074	\$161,387,044	\$212,701,533	\$143,031,969

Ceded premiums earned for 2005 and 2004 were \$101,920,406 and \$99,119,241, respectively.

The Company has treaties for quota share reinsurance with cession rates of approximately 35 percent for homeowners property insurance premiums and 30 percent with respect to certain Massachusetts automobile liability and physical damage premiums. The commission amount which the Company receives under the homeowners treaties are determined on a sliding scale based upon loss ratios. Revenues and expenses are each reflected net of quota share reinsurance totaling approximately \$88 million and \$82 million for 2005 and 2004, respectively.

The Company also has treaties for catastrophe reinsurance. During the years ended December 31, 2005 and 2004, the Company incurred costs for catastrophe premiums of approximately \$3.7 million and \$3.9 million, respectively.

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. Summary of Significant Accounting Policies, continued**

**F. Reinsurance, continued**

A Massachusetts subsidiary of the Company, Plymouth Rock Assurance Corporation, is required to be a member of Commonwealth Automobile Reinsurers. It accounts for its transactions with this entity as reinsurance. The Company records its estimated share of this activity on the basis of information provided by Commonwealth Automobile Reinsurers. The Company evaluates this information and, if necessary, makes adjustments within the reserves to reflect management's estimate of the results of this activity.

The Company acts, through its Pilgrim Insurance Company subsidiary, as an intermediary for certain insurance companies in administering motor vehicle insurance programs. The Company's income statement and reinsurance activity exclude \$54,412,003 and \$51,230,143 of premiums earned related to this third-party business and \$44,789,792 and \$39,007,348 of claims and claim adjustment expenses in 2005 and 2004, respectively. In connection with these arrangements, claim reserves exclude \$52,647,311 and \$56,826,271 at December 31, 2005 and 2004, respectively.

**G. Stock-Based Compensation**

The Company records compensation costs for stock-based employee compensation plans at fair value.

**H. Revenues Earned in Underwriting and Service Activities**

Premium revenues are earned on a daily basis over the terms of the policies. Unearned premiums represent billed amounts that are applicable to the unexpired terms of policies in force and are presented net of reinsurance. Premiums receivable are net of reserves for doubtful collections of \$1,673,788 and \$1,814,278 at December 31, 2005 and 2004, respectively, and are presented net of unbilled amounts of \$48,291,531 and \$44,166,483, respectively.

Underwriting revenue is derived from personal lines property and casualty insurance activity, predominantly in Massachusetts. The Company also derives fee income by providing insurance, investment management, policy processing, billing, and claim management services in three Northeast states. Fee income is earned over the related policy periods. The balance sheet items, amounts due from (to) service clients, are balances with insurers for which Pilgrim Insurance Company, Palisades Safety and Insurance Management Corporation (PSIMC), and High Point Safety and Insurance Management Corporation (HPSIMC) provide services. PSIMC serves as attorney-in-fact for Palisades Safety and Insurance Association, a New Jersey reciprocal insurance exchange. HPSIMC provides services to High Point Preferred Insurance Company, High Point Safety and Insurance Company, and High Point Property and Casualty Insurance Company (High Point Insurance Companies), insurers domiciled in New Jersey.

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**2. Summary of Significant Accounting Policies, continued**

**I. Acquisition**

In January of 2005 and October of 2004, the Company purchased two insurance agencies for approximately \$1.0 million and \$1.3 million, respectively. The Company used the purchase accounting method to account for these transactions. The Company's net income includes the results of operations of these agencies from the dates of purchase through December 31, 2005.

**3. Reconciliation of Net Income to Net Cash Provided by Operating Activities**

The following items account for the differences between net income and net cash provided by operating activities:

	2005	2004
Net income	\$ 46,455,195	\$ 36,631,711
Depreciation and amortization	12,828,873	8,224,205
Deferred income taxes	3,772,902	5,493,522
Gain realized on exchange of stock	(6,617,676)	-0-
Change in operating assets and liabilities:		
Accrued investment income	(262,709)	(206,763)
Premiums receivable	(2,072,537)	9,731,515
Deferred acquisition costs	(245,692)	(1,085,168)
Receivable from reinsurers	16,692,551	2,948,877
Claim and claim adjustment expense reserves	12,903,949	20,378,943
Unearned premium reserve	14,790,454	12,022,777
Advance premiums	47,068	310,118
Commissions payable and accrued liabilities	(1,463,594)	20,564,332
Payable to reinsurers	(22,436,768)	(10,307,823)
Unearned service fees	(2,463,762)	1,813,746
Amounts due from and to service clients	1,244,756	20,992,384
Prepaid expenses, agent loans, and deposits	1,527,929	(881,699)
Income tax recoverable and payable	10,197,480	(10,910,579)
Other assets and other liabilities	(1,516,982)	(2,378,745)
Net cash provided by operating activities	\$ 83,381,437	\$113,341,353

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**4. Consolidated Revenues**

Revenues, net of reinsurance, for the separate companies for 2005 and 2004 were:

	<u>2005</u>	<u>2004</u>
Underwriting company revenues:		
Plymouth Rock Assurance Corporation	\$231,417,011	\$193,828,054
Mt. Washington Assurance Corporation	169,979	178,678
Bunker Hill Insurance Company	<u>21,960,613</u>	<u>19,876,918</u>
	253,547,603	213,883,650
Management company revenues:		
The Plymouth Rock Company	20,583,890	26,397,016
SRB Corporation	62,308,422	45,940,612
BCS Holding Company, LLC	5,615,460	4,151,570
Pilgrim Insurance Company	25,582,318	24,211,810
Palisades Safety and Insurance Management Corporation	36,638,958	35,302,881
High Point Safety and Insurance Management Corporation	<u>112,149,415</u>	<u>113,442,687</u>
	262,878,463	249,446,576
Eliminations:		
Technology costs	(39,609,235)	(22,817,889)
Dividends	(27,745,630)	(35,745,450)
Other	<u>(14,830,253)</u>	<u>(12,793,173)</u>
Total revenues	<u>\$434,240,948</u>	<u>\$391,973,714</u>

**5. Fixed Assets**

Purchases of fixed assets were approximately \$33.5 million and \$25.1 million in 2005 and 2004, respectively. The table below summarizes fixed assets at December 31, 2005 and 2004.

	<u>Useful Lives</u>	<u>2005</u>	<u>2004</u>
Furniture and fixtures	5-10 years	\$ 8,924,891	\$ 8,245,233
Computers and software development	3-7 years	67,764,715	41,619,434
Leasehold improvements	2-6 years	9,925,176	6,999,435
Vehicles	3 years	<u>2,862,207</u>	<u>2,482,704</u>
Total cost		89,476,989	59,346,806
Less: accumulated depreciation and amortization		<u>31,077,375</u>	<u>24,445,656</u>
Net book value		<u>\$58,399,614</u>	<u>\$34,901,150</u>

Depreciation expense incurred was approximately \$9.9 million and \$5.0 million during 2005 and 2004, respectively.

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**6. Compensation Plans**

The Company has a Savings and Investment Plan under Section 401(k) of the Internal Revenue Code. This defined contribution plan covers all employees aged 21 years or older. The Company accrued \$6,190,974 and \$5,441,109 as of December 31, 2005 and 2004, respectively, for its share of liabilities relating to this plan.

The Company has established deferred compensation plans for officers, managers, and directors other than its founding shareholders. These plans generally provide for a rate of return on deferrals based on the financial performance of the Company. The Company accrued \$10,177,367 and \$7,710,974 as of December 31, 2005 and 2004, respectively, for liabilities relating to these plans.

In 1997, the Company implemented a Stock Incentive Award plan to reward key employees. The value of each Stock Incentive Award is based on the compounded increase in excess of 10 percent per year of the appraised value of the Company's common stock for the five-year vesting period following the date of the award. The cumulative numbers of outstanding awards as of December 31, 2005, 2004, and 2003 were 5,263, 6,806, and 8,315, respectively. No awards were issued during 2005. During 2005 and 2004, respectively, 1,543 and 1,351 awards became eligible for exercise, of which 71 and 360 were exercised for common stock and 1,472 and 991 were exercised for cash. Under the terms of this plan the cash awards will be held by the Company over a two-year maturation period. At the end of this two-year period, the initial amounts of the cash awards together with investment returns accrued on them will be distributed to the participants. During 2005 and 2004, respectively, 0 and 158 awards were forfeited. Total expense recorded for the Stock Incentive Award plan was \$1,995,449 and \$3,256,425 in 2005 and 2004, respectively.

Separate stock incentive awards totaling 6,044 shares were granted to individual officers of the Company in 1998 and 2000. During 2005, 1,111 shares vested after certain performance and service requirements were met. These awards were exercised for cash. The Company recorded expense of \$333,300 in 2005 and \$866,580 in 2004 related to these incentive awards.

Effective February 2, 2004, the Company provided a long-term compensation package to a key officer. This package includes a grant of 3,150 shares of restricted stock with an appraised value of \$990 per share and an option to purchase 200 shares of restricted stock at an exercise price of \$150 per share. The option was exercised on March 26, 2004. All of these restricted shares will vest in their entirety in 2010 and 2011 provided that certain performance and service requirements are met. To determine the fair value of the option on the 200 shares of restricted stock, the Company used the minimum value method with an interest rate of one percent and an expected option life of one year. The Company recorded expense of \$284,000 and \$452,000 in 2005 and 2004, respectively, related to this package. Under the terms of this package, stock options on 4,933 shares previously granted to this officer were canceled, and a deferred compensation liability to this officer was settled for its fair value.

## THE PLYMOUTH ROCK COMPANY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 6. Compensation Plans, continued

Effective May 1, 2005, the Company granted additional stock incentive awards totaling 1,110 shares to a key officer. These awards will vest at different times during a period starting in 2006 and ending in 2010 provided that certain performance and service requirements are met.

#### 7. Real Estate

The Company had ownership interests in two real estate properties as of December 31, 2005. One of these interests is a two-thirds ownership interest through a limited liability company. This investment is accounted for under the equity method. Costs for building improvements on these properties of approximately \$1,106,851 and \$2,440,381 were incurred in 2005 and 2004, respectively. The table below summarizes the real estate costs and carrying values at December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Land	\$ 4,523,650	\$ 4,523,650
Buildings, improvements, and other	<u>24,743,089</u>	<u>23,066,729</u>
Total cost	29,266,739	27,590,379
Less: accumulated depreciation	<u>5,741,173</u>	<u>5,014,610</u>
Net book value	<u><u>\$23,525,566</u></u>	<u><u>\$22,575,769</u></u>

Rental income from lessees other than Plymouth Rock companies aggregated approximately \$2.3 million and \$3.5 million in 2005 and 2004, respectively. For each of the years 2006 through 2010, minimum annual rent receivable by the Company is approximately \$1.7 million. Total obligations of lessees to the Company through 2010 are approximately \$8.7 million. Buildings and improvements are depreciated over their useful lives, which range from two to thirty-nine years.

The total appraised value of the Company's real estate interests, as determined by independent appraisers during 2005 using the income and sales comparison approaches, was \$26.0 million. Because of uncertainties inherent in the appraisal process, as well as changing market conditions, the amounts that could be realized if the properties were actually offered for sale may differ from these appraised values.

## THE PLYMOUTH ROCK COMPANY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 8. Investment Securities and Investment Income

##### A. Marketable Securities

At December 31, 2005 and 2004, amortized cost, unrealized gains and losses before federal income taxes, and fair value of fixed income and equity securities were as follows:

At December 31, 2005:	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government securities	\$ 38,073,371	\$ 12,778	\$ 805,999	\$ 37,280,150
State and municipal securities	46,582,601	165,689	240,860	46,507,430
Corporate debt securities	68,738,077	37,954	1,291,986	67,484,045
Mortgage-backed securities	22,621,403	4,093	337,162	22,288,334
Common stocks	41,805,627	8,516,678	376,774	49,945,531
<b>Total</b>	<b><u>\$217,821,079</u></b>	<b><u>\$ 8,737,192</u></b>	<b><u>\$3,052,781</u></b>	<b><u>\$223,505,490</u></b>

At December 31, 2004:	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government securities	\$ 81,651,917	\$ 70,415	\$ 510,630	\$ 81,211,702
State and municipal securities	35,488,967	711,199	134,989	36,065,177
Corporate debt securities	66,512,696	143,351	448,496	66,207,551
Mortgage-backed securities	40,204,658	88,300	266,523	40,026,435
Common stocks	24,626,992	10,961,390	33,918	35,554,464
<b>Total</b>	<b><u>\$248,485,230</u></b>	<b><u>\$11,974,655</u></b>	<b><u>\$1,394,556</u></b>	<b><u>\$259,065,329</u></b>

At December 31, 2005, maturities of marketable securities were as follows:

	Amortized Cost	Fair Value
Due in 90 days or less	\$ 5,569,182	\$ 5,559,352
Due after 90 days and in one year or less	30,484,009	30,298,370
Due after one year and in five years or less	120,983,549	119,090,203
Due after five years and in ten years or less	11,681,874	11,387,094
Due after ten years	7,296,838	7,224,941
Common stocks	41,805,627	49,945,530
<b>Total</b>	<b><u>\$217,821,079</u></b>	<b><u>\$223,505,490</u></b>

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**8. Investment Securities and Investment Income, continued**

**A. Marketable Securities, continued**

The Company classifies these marketable securities as available for sale. At December 31, 2005 and 2004, the Company carried securities that had been in an unrealized loss position for longer than twelve months with a total fair value of approximately \$87.5 million and \$17.8 million, respectively. Unrealized losses related to these securities were approximately \$1.7 million and \$0.5 million at December 31, 2005 and 2004, respectively. The Company views these losses as resulting from market conditions and believes them to be temporary. At December 31, 2004, the Company recorded a loss of \$1,020,435 on one security, for which it believes the value that it previously recorded to be "other than temporarily impaired" as defined by generally accepted accounting principles. No such losses were recorded in 2005.

**B. Alternative Equity Investments**

Alternative equity investments include positions in entities that focus predominantly on publicly announced mergers and acquisitions arbitrage. Substantially all of the investments made by these entities are in publicly traded securities, and the Company has the contractual right to withdraw its funds from these entities each year. At December 31, 2005 and 2004, the Company's recorded equity in these alternative equity investments, which includes realized and unrealized gains, was \$23,994,577 and \$27,007,350, respectively. The cost of these investments was \$14,500,000 and \$19,000,000 in 2005 and 2004, respectively.

Other alternative equity investments include privately held common stocks, preferred stocks, surplus notes, and partnership entities investing in companies that are not publicly traded. The Company's recorded equity in such investments amounted to \$26,314,461 and \$17,990,869 at December 31, 2005 and 2004, respectively. The Company recorded unrealized gains of \$5,800 and \$1,249,113 associated with these investments as of December 31, 2005 and 2004, respectively. The costs of all such investments as of December 31, 2005 and 2004 were \$26,308,661 and \$16,741,756, respectively. These amounts include investments in Direct Response Corporation and Homesite Group Incorporated totaling approximately \$11.3 million and \$6.7 million at December 31, 2005 and 2004, respectively. These companies derive underwriting revenue from personal lines property and casualty insurance activity throughout the United States, except in certain New England states.

The Company has committed to invest \$10 million in a private equity fund, Lindsay Goldberg & Bessemer L.P. (the Fund). The Company is a limited partner of the Fund. The chairman of the Company is a member of the general partner of the Fund. At December 31, 2005, the Company had invested approximately \$5.9 million in the Fund.

## THE PLYMOUTH ROCK COMPANY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 8. Investment Securities and Investment Income, continued

##### C. Analysis of Investment Income and Capital Gains

The components of investment income and capital gains before federal income taxes during 2005 and 2004 were as follows:

	2005	2004
Interest income and dividends from securities	\$10,758,059	\$ 7,772,896
Earnings from alternative equity investments	3,805,713	3,817,562
Rental income	2,293,000	3,505,871
Finance charges from premiums receivable	6,148,085	5,638,084
Gross investment income	23,004,857	20,734,413
Rental expenses	(1,518,493)	(1,799,891)
Investment expenses	(871,321)	(662,382)
Investment income	20,615,043	18,272,140
Net realized capital gains	5,302,070	971,487
Investment income and capital gains	\$25,917,113	\$19,243,627

##### D. Investment Activity

The table below provides a reconciliation of the beginning and ending balances for investment securities:

	2005	2004
Balance at beginning of year	\$304,063,548	\$226,497,287
Change in marketable securities:		
Sales	(222,650,275)	(60,212,769)
Purchases	185,363,397	138,417,604
Net change in marketable securities	(37,286,878)	78,204,835
Net change in investments in alternative equities	6,554,132	3,450,944
Net investment activity	(30,732,746)	81,655,779
Gain realized on exchange of stock	6,617,676	-0-
Net change in purchases in process	5,051	3,337
Net change in unrealized gain on marketable securities and alternative equities	(6,139,001)	(4,092,855)
Balance at end of year	\$273,814,528	\$304,063,548

Comprehensive income is defined as net income plus the change in net unrealized gain on investments. Accordingly, the net unrealized gain on investments is reduced by realized gains previously included as unrealized in comprehensive income of approximately \$2.9 million and \$2.1 million in 2005 and 2004, respectively.

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**9. Commitments and Guarantees**

The Company's rental expenses for 2005 and 2004 aggregated approximately \$5.9 million and \$4.9 million, respectively. For the years 2006 through 2010, the minimum lease obligations of the Company to unrelated third parties range from approximately \$3.1 million to \$5.6 million annually. Total obligations of the Company under leases are approximately \$44.7 million through 2014.

As of December 31, 2005, a subsidiary of the Company had guarantees outstanding on loans to certain of its independent insurance agents with balances totaling approximately \$437 thousand. These loans were fully performing in 2005 and are not expected to result in any net liability to the Company.

Effective October 31, 2003, two subsidiaries of the Company, Palisades Safety and Insurance Management Corporation and High Point Safety and Insurance Management Corporation, entered into a Transition Services Agreement with Prudential Insurance Company of America. The purpose of this agreement is to provide transitional processing support for the High Point Insurance Companies, formerly Prudential's New Jersey personal lines insurance companies, which were acquired on October 31, 2003 by Palisades Safety and Insurance Association, a New Jersey reciprocal insurance exchange managed by Palisades Safety and Insurance Management Corporation. Under the terms of the original agreement, Prudential agreed to supply certain levels of systems and administrative support for a variable period of 18 to 36 months. This agreement has been extended through April of 2007 with estimated remaining costs of approximately \$15.1 million.

**10. Goodwill and Intangible Assets**

Goodwill of \$3,748,504 and \$3,322,104 at December 31, 2005 and 2004, respectively, representing the excess of the purchase price over the estimated fair value of net assets acquired, has resulted from the Company's purchase of insurance agencies. The Company reviews goodwill annually for impairment. No impairment of goodwill was recorded for 2005 or 2004. Intangible assets of \$1,124,921 and \$1,194,121 at December 31, 2005 and 2004, respectively, representing expirations and non-competition agreements, also exist as a result of the purchase of insurance agencies and are being amortized over periods ranging from three to seven years. Amortization associated with these intangible assets for 2005 and 2004 was \$406,484 and \$302,017, respectively.

**11. Note Payable**

The Company issued a note payable in the amount of \$9,683,400 at an interest rate of 6.32% in 1998 in conjunction with the purchase of outstanding shares of its common stock. Payments of principal are scheduled to be made in ten equal annual installments of \$968,340. Interest payments on this note totaled approximately \$214,000 and \$275,000 during 2005 and 2004, respectively. The Company has the right to prepay this note at any time.

**THE PLYMOUTH ROCK COMPANY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**12. Stockholders' Equity**

**A. Common Stock**

Common stock at December 31, 2005 and 2004 is composed of Class A common shares and Class B common shares, both classes having a par value of \$0.10 per share. There are 300,000 Class A shares authorized, of which 116,939 and 116,723 were issued and outstanding on December 31, 2005 and 2004, respectively.

There are 90,000 Class B shares authorized, of which 65,972 and 66,117 were issued and outstanding on December 31, 2005 and 2004, respectively. The Class A common shares are fully transferable and have the right to elect 20 percent of the Board of Directors. The Class B common shares are not transferable, but may be converted to Class A common shares on a one-for-one basis at any time at the option of the holder, and are converted automatically upon the occurrence of certain events. The Class B common shares have the right to elect 80 percent of the Board of Directors, a right which has never been exercised in full. Presently, two Directors are elected by the Class B shareholders and all others are elected by the Class A shareholders.

**B. Statutory Surplus and Dividend Availability**

The Company's insurance subsidiaries are required to file financial statements with state insurance departments. The accounting principles prescribed or permitted for these financial statements differ in certain respects from accounting principles generally accepted in the United States of America. On a statutory accounting basis, capital and surplus of the Company's insurance subsidiaries aggregated approximately \$118.8 million and \$104.3 million at December 31, 2005 and 2004, respectively. Regulatory limits restrict the amount of dividends that can be remitted to the Company from its insurance subsidiaries without permission of state insurance regulators.

**C. Earnings Per Share**

Basic earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding. Diluted earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding throughout the year plus dilutive potential common shares that were outstanding at year-end.

## Directors and Officers of The Plymouth Rock Company

### Directors

James M. Stone, *Chairman*

James N. Bailey

Hal Belodoff

Michael J. Johnston

Wilmot H. Kidd, III

Norman L. Rosenthal

Peter J. Wood

### Officers

James M. Stone  
*Chief Executive Officer*

James N. Bailey  
*Treasurer and Clerk*

Hal Belodoff  
*President and Chief Operating Officer*

Paula W. Gold  
*Vice President*

Colleen M. Granahan  
*Vice President*

## Directors and Officers of the Plymouth Rock Group of Companies

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Fabian J. Fondriest  
Samuel F. Fortunato  
Michael J. Johnston  
William M. Kelley  
Wilmot H. Kidd, III  
Eugene J. Meyung  
Norman L. Rosenthal  
Peter J. Wood

Colleen M. Granahan  
Stewart W. Kemp  
Eric L. Kramer  
Lisa K. Lasky  
Michael A. Luciani  
Paul D. Luongo  
Richard J. Mariani  
Loren J. Mattingly  
Mary Beth McInerney  
Karen A. Murdock  
Thomas G. Myers  
Carl A. Peterson  
Anne M. Petruff  
Linda D. Schwabenbauer  
Michael S. Sher  
Donald J. Southwick  
Karen L. Stickel  
James M. Stone  
Mark A. Sweeney  
Barry O. Tagen  
John P. Tierney  
James A. Tignanelli  
Ellen S. Wilcox  
Gerald I. Wilson  
Scott A. Wilson

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Hal Belodoff  
Mary L. Biernbaum  
Marc V. Buro  
Frederick C. Childs  
Nancy L. Conlin  
Thomas A. Cranley  
William E. Emmons  
Paula W. Gold

Counsel:  
Ropes & Gray LLP

Independent Auditors:  
PricewaterhouseCoopers LLP