The Plymouth Rock Company

695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 8, 2024

To Our Shareholders:

Imagine a hypothetical insurer. This fictional company has a $3 billion investment portfolio. Its mix of stocks and bonds can be expected to return something approaching 6%, so it should have pre-tax investment revenue of about $175 million in that year. Its gross premiums written are $2 billion, and net premiums earned are $1.7 billion. If that same company has a combined ratio of 110% and a fraction, spending a little more than $1.10 on claims and expenses for every premium dollar it collects, it will lose something like $175 million on underwriting. So the company needs to have a better combined ratio than that to make its first dollar of profit, and much better to be doing tolerably well. Our very real company's roughly $3 billion portfolio and $2 billion in gross premiums (with $1.7 billion of net premium) happen to look rather like those of the imaginary insurer. But this past year Plymouth Rock enjoyed an investment return more than twice the hypothetical 6%, and we made almost $400 million pre-tax on our investments. Our combined ratio in 2023 was 106%, so our loss on the underwriting side, which some might describe as a cost of the investment funds, was around $100 million. This simple exercise suggests that our bottom-line income before taxes should round to $300 million. And, in fact, although the financial statements present the results in a different order, our pre-tax income on a comprehensive basis was very close to that.

The market giveth and the market taketh away. In shining contrast to the dismal year prior, 2023 was a bountiful year for both stocks and bonds. The investment gains were especially welcome at present given that we are still shouldering burdens on the underwriting side of our business. Not only was underwriting performance in 2023 saddled with an externally adverse environment that hampered the entire insurance industry, but our operating results were simultaneously weighed down by two handicaps of our own making. Our shareholder-owned company lost about $30 million pre-tax on underwriting. After taxes, that loss combined with our investment gains to leave the stockholders almost $200 million in comprehensive income. Consolidated comprehensive income of $253 million, uniting these results with those of the reciprocal entities we manage, was among the best results in our history. While the total return is nothing to complain about, Andy and I would have strongly preferred to see underwriting earn a profit, setting our cost of investment funds below zero. Underwriting losses are common in our industry, but losses at this year's level are neither necessary nor acceptable to us. Our ideal would be dependable black ink on the underwriting side in about the same magnitude as we showed in losses this past year. Having said that, we cannot deny that we take comfort to be with a company where a $253 million profit marks a disappointing year.

The industrywide headwinds referred to above originate mainly from inflation. The inflationary vectors most relevant to us are in costs of car and home repairs. For a variety of reasons, the rate of inflation in those two cost elements remained high even as overall national inflation cooled a bit. Inflation always hits insurers hard because regulated rate increases tend to lag rising claims costs. We fully understand why governors and insurance commissioners are loath to worsen the financial burdens of worried voters, but it would be nice if the pain of inflationary periods didn't fall so disproportionately on us. The silver lining is that insurance prices cannot be suppressed indefinitely and will eventually catch up. There can even be a temporary lift if they catch up after the inflation subsides. I hope that doesn't prove to be just wishful thinking in this cycle.

The self-inflicted handicap we face consists of two separate holes we dug for ourselves and now need to climb out of. The deeper hole was created when we entered new states to build our home insurance business rapidly, setting prices that were too low and employing underwriting standards that were too lax. As a result, we are stuck now with a greater need for rate increases than other companies as well as a number of properties we don't want to cover. It is easier to attract unprofitable homes in our states, unfortunately, than to shed them. New York statutes, for example, limit non-renewal of homes to 4% of a company's policies in any one year, and, even within that constraint, policies can only be non-renewed on one of every three anniversaries of the initial policy inception. Some of the other states aren't much easier. On top of inflation's costs, pricing and non-renewal restrictions have turned our error into a nagging and persistent source of losses.

The other hole impedes our Direct Group's progress. I deserve a share of the responsibility for the thought error involved. I had argued for several years that business we took from aggregators and volume referred to us by other carriers could render us a profit that would help finance the growth of our direct-to-the-consumer book. That proved to be a Pollyannish prediction. The policies from these sources, which we call Partner business, have produced losses year after year. Andy and I are well aware that it will take climbing out of both the Home insurance hole and the Direct Group's Partner hole, as well as rate increases that catch up with inflation, to give us the healthy underwriting profits we aspire to see. At least we all know what needs to be done. We are counting on making healthy progress on all fronts in this coming year, but we must content ourselves right now with half a loaf.

Our consolidated comprehensive income was spread unevenly within our enterprise once again this past year. Both of the trenches to climb out of are more serious obstacles for our managed reciprocal, where Direct Auto and Home Insurance play dominant roles, than for our stock company, which writes mainly Independent Agent auto insurance. Consequently, equity for our shareholders rose by 22% while the reciprocal's equity gain was only 9%. Enterprise book value is now a healthy $1.6 billion. The 39-year compounded annual rate of return on shareholder book value, adjusted for dividends, is 18%. The scale of the entire Plymouth Rock enterprise, as measured by direct underwritten and managed premiums, grew nearly 15% in 2023, and just last month it passed $2 billion.

Mary Boyd's Independent Agency Group is our largest and most stable business segment. It anchors our enterprise. Her team took volume up 23% and topped the $1 billion mark this past year, a milestone we celebrated accordingly. While the group's combined ratio of 102% failed to bring us underwriting profits, the headwinds of inflation and regulatory reluctance hurt many of our peers a good deal worse. While Andy and I would ideally like to see a combined ratio for Mary's group in the mid-90's, that probably won't be in the cards for us until inflation is tamed. If the Independent Agency Group breaks 100% in the year just beginning, we will consider it a fine accomplishment. The growth rate in Mary's segment is the highest of our three groups and the combined ratio is the lowest. The Independent Agency Group is able to achieve this in part because it has assembled a truly talented and cohesive team of officers and directors that applies meticulous scrutiny to every detail of our business. It is a constant pleasure to observe how well they work together.

Looking at the independent agent business by state, we should look first to Massachusetts, our original state and still our largest. We have over $475 million worth of independent agent auto premium there, producing a combined ratio this last year of 101%. Inflation represents the sole impediment in the Bay State to the results we want. Neighboring New Hampshire, our smallest state by volume, is a stand-out, with a point of underwriting gain. Although New Jersey, our second largest state, has been more reluctant than other states to grant homeowners rate increases, we have done reasonably well in private passenger auto. We write $290 million worth of independent agent automobile volume in the Garden State, with a 2023 combined ratio of 100%. Connecticut, where we have just over $45 million in volume, produced a 104% combined ratio. Our most concerning jurisdictions by far are our newly entered states, New York and Pennsylvania. In the Keystone State, where we have only recently built effective communication with regulators, Mary's annual volume of $30 million there produced a combined ratio of 114%. New York, with more than three times that volume and an unsightly combined ratio of 119%, has provided us a worse case of heartburn. Fortunately, it appears that rate increases are finally in the pipeline. Repairing New York's numbers is Mary's top priority as the new year begins. The mending is especially important because we still see New York as the jurisdiction with the greatest growth potential for our company. Commercial automobile insurance enjoyed an especially strong year, as did Pilgrim, our reliable third-party administrator for residual market business.

You are quite familiar by now with the pricing and risk selection woes of our Home Group, so let me concentrate here on the path Bill Martin and his team are taking to climb out of the crevice. The depth of the hole is obvious from the group's 2023 combined ratio, which was a fraction over 116%. We don't come close to earning back that loss from investments. While it is true that two points of that ratio arose from an unwanted Christmas gift, when a December windstorm hit the northeast for the second year in succession, this is hardly a consolation. Storms are an intrinsic part of our business, and we take no comfort in knowing that we might otherwise have seen a 113% combined ratio. Ideally, home insurance, characterized by greater uncertainty and catastrophe risk than the auto insurance business, should have the better combined ratio of the two. Needless to say, we are far from the target.

To deal with the situation, Bill's cadre has divided our book of business into three buckets. First, there are those policies that simply don't meet our current risk appetite. The Home Group expects to shed as many of these policies over time as regulation permits. Then, there are policies that meet our standards, but are simply underpriced. We will endeavor to keep these policies, but we will seek to raise their rates as dictated by indicated needs. Finally there are the policies on which we are currently making money. These policyholders have to be protected from price increases they don't deserve to suffer. While state restrictions on non-renewal slow down the culling process and rate increase approvals in some states come more slowly than we might like, the most stubborn obstacle to success arises not from regulation but from natural market forces. The policyholders we might wish to cull are, as a rule, unwelcome at other companies and certainly not at our underpriced premium levels, so many policyholders understandably choose to stay with us. Their profitable counterparts at the other end of the spectrum, conversely, find ready embrace elsewhere and, if they shop, some will find even more favorable rates than ours. Left alone, these conditions would cause the results to worsen over time rather than improve, and the 2023 combined ratio of 116% is accordingly higher than in the prior year. It will require a steep and intense uphill climb to adjust that book.

Lest it sound as though all is lost, I should offer a reminder that these are fixable problems. The Home Group has initiated an ambitious program to shed policies in the riskier bucket, all within regulatory confines, by exercising our right to cancel or non-renew policyholders who fail to observe the law or where the property has undergone a material deterioration in condition. The Home team is also separating out by tier or legal entity, wherever possible, our best policyholders from the others and protecting them from increases. This allows the Home Group to raise rates for the middle-bucket policyholders more quickly than before the buckets were identified and separated. And we have built a constructive relationship with the insurance regulators, particularly in Pennsylvania where our initial mistakes were most costly. Similar priority is now being given to New York. Bill believes he can reduce his group's combined ratio by eight points in this new year. Although the climb would still remain arduous, that would represent real progress. The situation today is the result of an unfortunately perfect storm. The original pricing errors could have been corrected far more quickly absent reinsurance cost increases and the inflation that stressed or exhausted regulatory willingness to permit rate increases. When inflation abates, the future will look much brighter. We must not forget, moreover, that the Home Group's volume has grown from $75 million to more than $360 million in the last eight years, so the promise of rewards is substantial when we get out of the ditch. No one at 695 Atlantic doubts that we will build a large and profitable homeowners business.

The climb out of the hole that encumbers the Direct Group's performance is more straightforward to address. Jeff Briglia's domain has three parts. As a result of our Prudential purchase in 2003, Jeff maintains a well-seasoned Legacy book of about 71,000 New Jersey policies. Their number is never enhanced by new sales, so the policy and premium counts shrink every year by attrition. Eventually this business will all be gone as the ranks of the policyholders are thinned by age and relocation, but policyholder loyalty to us has remained strong and, as a result, Jeff's group still has $140 million in profitable Legacy volume. Jeff also has a growing direct-to-the-consumer business, which we refer to as our Core Direct book. An enterprise-wide team effort, skillfully executed, resulted in the purchase of the renewals from General Electric's in-house insurer, Electric Insurance. The increment will help boost the Core Direct segment of our business as it passes the $100 million mark in premiums. We have never underestimated the challenge involved in creating a profitable Core Direct business, but we think the ordeal worthwhile. A Core Direct business can be sustainably in the black only when the profits from renewed business are substantial enough to pay for marketing to new customers. We aren't there yet, but the metrics now point to eventual success. The troublesome element of Jeff's business is the business derived from aggregator and company intermediaries. We call that our Partner business.

The Legacy book requires little by way of strategic thinking. All we can do is keep the customers as happy as possible and hope that they all have long healthy lives. The Core Direct business is the opposite with respect to strategy. That business can be best understood by focusing on three controlling parameters: the average cost of acquiring a new customer, the loss ratio and general expense ratio, and the number of years that a customer remains with us. To oversimplify just a little, a customer who costs a quarter to acquire and produces a dime of profit every year will be a substantial blessing only if he or she remains with us for four years or more. If that customer costs us fifty cents to acquire, earning a profit over the life of the policy is probably unrealistic. If the customer produces only a couple of pennies of profit annually (or worse, produces a loss), it is impossible to make money from the sale. The Direct Group team has lowered the cost of acquisition impressively in recent years. Doing even better in this regard now depends on scale economies in advertising and branding. Incoming business quality has improved markedly, and it is looking more attractive through a combined ratio lens as well. We are increasingly looking to telematics, in-car and telephonic devices that monitor driver behavior, to keep the loss ratios working for us. Basing rates on individual driver responsibility should not only help the quality of the business, it should be popular with regulators. No other classification system can match it in fairness. New business policy life expectancy, the measure of duration, is up almost 50% in the last two years. If all three indices just continue on their current paths of improvement, we can expect Core Direct volume to become a signature contributor to Plymouth Rock's enterprise value.

The third of Jeff's domains, our Partner business, is not showing similar promise as we now handle it. Both aggregator referrals and insurer referrals have performed more like purchased Internet leads than like the pre-qualified customers we had hoped to acquire. We have lost serious money in this channel. Jeff reduced the volume of aggregator business severely in the last year and he has now turned his focus to the business we are taking by referral from other insurance companies. This volume too will have to be scrutinized with enhanced discipline. Since Legacy volume is always shrinking by attrition and Partner business was intentionally cut back during 2023, we experienced only 5.4% overall growth in the Direct Group as a whole. The Core Direct business will grow in 2024, but perhaps insufficiently to overcome the drag in growth of volume from the other two channels. Our hope is that, as recompense for any potential diminution of expansion, Jeff's overall combined ratio, which was 106% this past year, will close much of the gap we need to traverse for underwriting breakeven.

Investment results this past year were sensational. Plymouth Rock's equity portfolio rose in value by 20%. In 2022, the stock and bond market's nasty slides cost us about $345 million. We made all of that back and then a bit in 2023. Given that 2021 was an even richer year in percentage terms than 2023, if we look at the last three years taken together, we can observe with reasonable satisfaction that our equities were up by 34% over the period. It was a bumpy ride, but not a bad one. The temporarily disfavored stocks we hunt for are, by their nature, long-term picks, so we don't get overly concerned by lags in any single year's performance. This year's market, though, was so bullish that this was not even an issue. Most of our stocks appreciated nicely. Intel and General Electric nearly doubled in value, while Microsoft again provided our largest dollar gain. Ericsson recovered fully from a precipitous midyear dip. Our only serious loser this year was CVS, which declined by 13% but which we are still persuaded to hold. Our performance this year lagged the Standard & Poor's 500 Index by a couple of points, but that is hardly a cause for worry. We have continued, over our investment history, to outperform the index. Plymouth Rock's from-inception annual return is 13%; the S&P 500 equivalent number is 10%.

The investment headline event of the past year was an adjustment in Plymouth Rock's equity portfolio strategy. In the past, we have always limited our common stock holdings, other than strategic insurance investments, to about nine stocks. This contrasts with the multitudes of stocks most large insurance companies hold. Last year made us reassess that limit just a tad. Mindful of our underwriting losses in the Home Group and Direct Group, we decided to hew more closely to the market as a whole by doubling the number of individual stocks and thus trimming the risks inherent in purposeful non-diversification. It is still very much our goal to beat the market with a carefully selected and concentrated portfolio, but we are more conscious now of how unexpected down periods can impact our ratings. So we decided to reduce the likelihood of suffering a double-trouble year in which the market tanks and our own stock picks do even worse. Our revised portfolio is designed to maintain opportunities to outperform the market but with a closer sectoral match to the economy and the market as a whole. Put another way, our future outperformance will rely more on spotting individual winners and less on predicting the best sectors to overweight. You can expect to see our ongoing common stock performance track the S&P more closely than before.

We will remain on the lookout for stocks that the market is erroneously undervaluing. We are most inclined to buy when we can identify a source of potential in a stock that the market fails to appreciate, and we are disinclined to liquidate a position unless analysis calls for abandonment of our original investment hypothesis. Carrying out our strategy now has been made easier by the formal addition of Dan Rasmussen to our investment team. Dan, a hedge fund manager whose market newsletter we have long admired for its philosophical depth and who has advised us informally in the past, has recently been elected chair of our investment committee. Jim Bailey, Rick Childs and I are glad to have him as a part-time member of our circle.

We increased the fixed income share of our portfolio modestly this year in response to rising yields. With our weighting toward stocks still at 58% of the total, we are confident that our investments will still convey an advantage over industry peers with portfolios weighted toward bonds, but the gap won't be as great now as it was when interest rates were minimal. I can deemphasize this year my usual complaint about having to hold bonds at all. While stocks should always be superior in the long run, it makes a huge difference that our bonds now yield more than 5% annually rather than the 1% they offered just two years ago. Our $1.2 billion mix of BB-rated and BBB-rated bonds should pay us about $40 million more in 2024 than it would have just a few years ago. Relaxation of the Federal Reserve's suppression of interest rates in favor of market pricing was sensible monetary policy, and it is good for Plymouth Rock as well. Our longstanding practice of buying only short-duration bonds, meanwhile, has paid off nicely. We were able to turn over our portfolio more rapidly than competitors who have concentrated on longer-term bonds, and thus we are already enjoying the enhanced yields. Thanks in part to those short durations, Plymouth Rock's bond return in 2023 was a handsome 6.3%.

We were neither buyers nor sellers of real estate this past year, and the dependable cash flow from our three largely owner-occupied buildings isolated us from the consequences faced by some debt-laden, cash-strapped owners when forced to sell into a depressed market. I am fairly confident that the commercial real estate downturn in prosperous cities will prove to be temporary. Our carefully chosen locations, moreover, place our properties squarely within the market segment that will first recover tenant demand. In any case, our three buildings don't have a dollar of bank debt and we never intend to sell. At today's prices, I might even be a buyer … if we needed more space for our people. Our private equity investments in Lindsay Goldberg Funds IV and V are looking better each year. Other private equity firms, those who depend too much on auction purchases, excessive leverage, and quick turnover of their investments, may well see diminished returns as the decade continues, but Lindsay Goldberg is better positioned than most. Building on the strength of the returns from Funds IV and V, Lindsay Goldberg's incipient Fund VI has just had a first closing. We will participate once again.

When close friends greet me with the standard "How are you?" these days, I tend to give them a fuller answer than they perhaps sought. I'll say something like this: "Within the personal bubble - family, health, and business, I'm feeling fine about things… outside the bubble, not fine at all." In truth, I have never lived through a less encouraging period in U.S. politics or world affairs. This is not to imply that it's never been worse. Well before my time, when my father finished law school in 1932, the situation was far grimmer. Adolf Hitler led his Nazi Party to first place that year in the German election. Imperial Japan offered a preview of its full-scale war in China with the bombing of Shanghai in January, and its military effectively ended civilian rule in May with the assassination of Prime Minister Tsuyoshi. Mussolini, already entrenched in Rome, published "The Doctrine of Fascism" in 1932. And even the word "depression" may fail to convey the depths of the economic distress here in the United States. The stock market that summer was down 89% from its peak. Unemployment in the country climbed that year to 23%. Many Americans believed that our once-prosperous democracy had lost its way forever, and attraction to both the extreme right and the extreme left was on the rise. Pessimists envisioned a future gloomier still, and the night indeed grew even darker than the naysayers were imagining. Our democracy survived, but only after the world endured a devastating global war and witnessed the unforgettable nightmare of the Holocaust.

Although today's circumstances aren't nearly that bad, we experienced on January 6 of 2021 an unprecedented threat to our historically remarkable experiment in representative democracy. In the carefully chosen words of Senate Republican Leader Mitch McConnell: "This failed insurrection only underscores how crucial the task before us is to our republic." If my prognostications for 2024 hold true, a period of gridlock may be among the less worrisome outcomes we could face then in Washington. As I write these words, two brutal wars are raging beyond our borders. Though I pray I am wrong and that progress has been made before you read these words, I fear both will grow more brutal before calm can prevail. And heaven help us if the parties involved allow conflict over the Western Pacific to turn into a third confrontation. For our nation's part, we must accept that we no longer occupy the solitary global throne we inherited as the least devastated country after World War II. China now has an economy arguably equal to, or larger than, our own, and other countries cannot be denied a role in international affairs now either. In none of the three tense or warring zones can I envision a decisive win for the ally we are now supporting or any productive road to peace without an openness to concessions discomforting to some actors. Repeating last year's letter, all of this notwithstanding, there is shelter for Plymouth Rock at the firm level. The impressive strength of the U.S. economy is rather ironically protected from the morasses I fear, and our own business is insulated from both national politics and world affairs. I will continue to worry every day about the endangered state of U.S. political comity and about potentially existential threats to the world, but not for Plymouth Rock's sake. For now at least, our company is within the bubble.

Plymouth Rock, as a private company, has always aimed its sights on the future, and over a longer horizon than most public companies. Our investment decisions, based on ten-year forward estimates of fundamental value, are only one example. Our hiring is another. We hire carefully and expect our folks to stay longer than most insurers seem to count on. We have just constructed for our team a large, and already popular, state-of-the-art gym at 695 Atlantic to help secure long tenures. We are actively hiring for more long-term keepers, and our pool of potential hires has recently expanded due to layoffs at struggling InsurTechs and a number of our competitors. We lead most other carriers in technology, and we are working hard to expand that lead. We are ever-mindful of the durable benefits of our excellent service reputation. And, although this year's letter focused principally on underwriting challenges, we also tend to our expenses. In the long run, a favorable expense ratio is an indispensable element of the underwriting results we seek. This past year, all three of our operating groups achieved reductions in expense ratios. The Plymouth Rock enterprise as a whole is about three points more efficient than it was just two years ago. Expense ratio management is difficult, but it can convey a particularly durable advantage. If we can only now climb out of our two underwriting holes…

James M. Stone