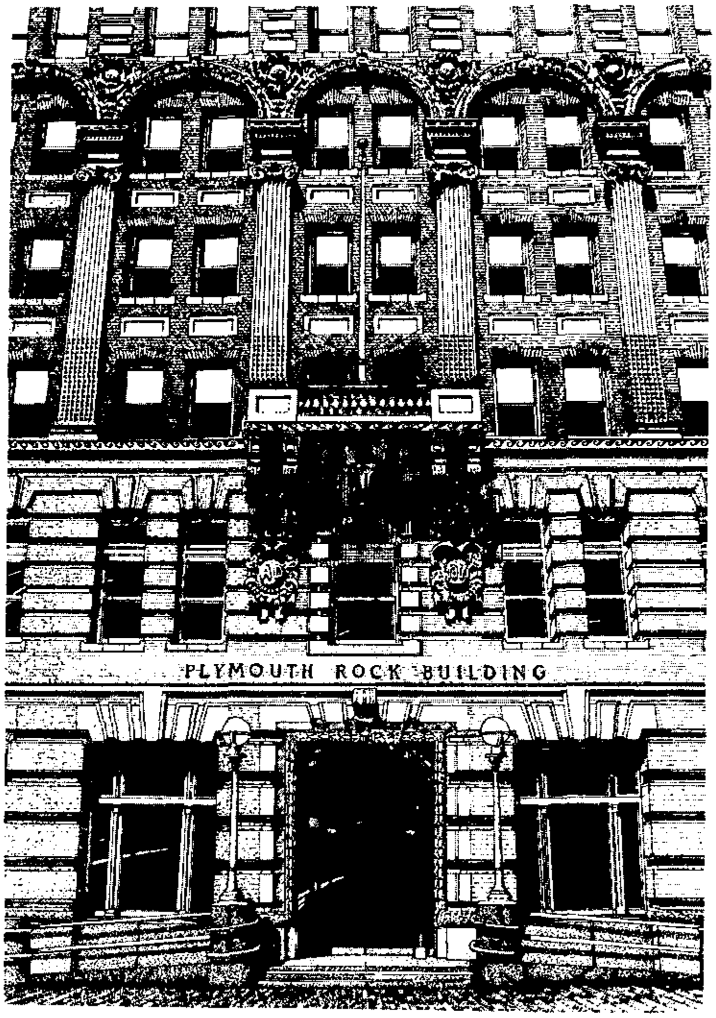
The Plymouth Rock Company



1997 Annual Report

The Plymouth Rock Company

695 Atlantic Avenue
Boston, Massachusetts 02111

Chairman's Letter

February 23, 1998

To Our Shareholders:

An iceberg floats with only a small fraction of its mass visible above the waves. Plymouth Rock in 1997 moved further toward that profile. While the financial statements that follow are accurate and complete, they describe less than in past years about the true state of your investment. Of the seven property and casualty insurance businesses in which we have either positions of influence or outright control, three are related to our group by contract or investment. The Company's positions in these three businesses are of a kind or quality which does not permit consolidation of their financials with Plymouth Rock's. About a quarter of the total volume for the seven carriers lies outside the financial statements and, more important, about three-quarters of the committed capital. In addition, we have an investment portfolio containing many positions that are marked to market -- such as publicly traded equities and bonds -- but also quite a few that are not regularly revalued -- such as private equities and real estate. Looking beyond the income statement and balance sheet should be increasingly important under these circumstances to anyone who would estimate the value of Plymouth Rock shares.

The 1994 letter to shareholders warned that the economics of Massachusetts automobile insurance were too good to keep and that we were past the peak of a cycle. Ever since then, my primary business goal has been to reduce dependence on that line, which at one time represented over 80% of Plymouth Rock's capital allocation and premium volume. Measured by volume, the underwriting of this state's personal auto insurance now produces less than half of the total revenue implicated in either management or ownership relationships with the Plymouth Rock group. More important, of the shareholder capital committed or pledged to our various relationships, a total of over $500 million, only 10% is in our initial line and state. As a consequence, Plymouth Rock is less dependent, by a wide margin, on Massachusetts automobile coverage than our peers who grew up in the same era. As you read the news from that line of business, I expect you will be convinced that this is fortunate.

A moment to describe the Plymouth Rock group is of value here. While any number of ways to sort and classify our activities may be equally valid, I now think of three subsets of business relationships when I describe my own job to others. First, there are five insurance companies in our family offering property and casualty insurance coverage through independent agents. With respect to strategic direction, these companies, together writing $203 million in annual gross premiums, are overseen by a committee of their four chairmen: Keith Rodney, Paula Gold, Hal Belodoff, and myself. Leadership at the operating executive level in the agency companies is provided by some of the same individuals, plus Bill Kelley, president of Mt Washington Assurance Corporation, and Vin Nieroda, president of both Pilgrim Insurance and Bunker Hill Insurance. Next, there are two major start-ups in which Plymouth Rock, Peter Wood and I have significant shareholder positions, and Peter and I have contractual duties of board direction. Direct Response Corporation and Homeowners Direct Corporation were financed in 1996 and in 1997, respectively, in each case with over $200 million in preferred stock commitments from blue chip investor groups led by Morgan Stanley Capital Partners. These companies are not controlled by any one of the participants, and are therefore outside the Plymouth Rock group, but their success can bring great benefit to Plymouth Rock. Finally, there is our investment business, which has no outside clients but manages the capital and policyholder funds for all of the companies with whom we have operating relationships. This group is run by Jim Bailey, with more than a little help from Rick Childs and his staff.

The major companies whose results are consolidated in the financial statements are Plymouth Rock Assurance Corporation, the Massachusetts auto carrier; Bunker Hill Insurance Company, the homeowners carrier; Pilgrim Insurance, our fee-based servicing insurer; Mt Washington, writing personal lines in New Hampshire; and our Palisades management company, which oversees the New Jersey reciprocal writer, Palisades Safety and Insurance Association. The 1997 results for the Plymouth Rock Companies, which represent about an 11% return on common equity including both net income and net unrealized investment gains, are shown on the financials. Profitability is better than last year's but far short of the 20% return on equity we set as our long-term target. The main culprit is the ugly and continuing price war in Massachusetts auto insurance. While I can report that return on capital since inception in 1983 still exceeds 20% on a cumulative basis, that can not keep up much longer with sub-par current returns.

Plymouth Rock Assurance is in the hot seat these days, and through no particular fault of its own. For years, that company's goal was to provide the best service to customers and agents, while running the lowest loss ratio in its industry arena. The theory was that, whatever might be the level of industry profitability, Plymouth Rock would be at or near the top, while excellence in service would assure loyalty among customers and agents and attract new growth. The company has succeeded over the years at this task, so everything should be fine -- and it is not. The problem is that Plymouth Rock's larger competitors, entranced by the glitter of easy profits a few years back, began a destructive scramble for top line growth. They discounted prices below the Commissioner's state-set rates, sometimes as much as 20%, and found themselves in a tar pit of poor results that is painfully tough to climb out of. The Commissioner, answerable to the public, would seem compelled by politics to reduce her rates each year that the regulatees voluntarily give so much of the money back. While the state-made rates have been by and large responsible under the circumstances, it is not surprising that she has just ordered another 4% overall reduction. If her rates were about right last year for an adequate return on industry capital, the reduced and discounted rates for 1998 will produce seriously negative industry returns.

Meanwhile, the less price-aggressive companies, such as Plymouth Rock Assurance, must come up with innovative discounts of their own to keep from losing valued customer relationships. The largest carriers have recently responded to the competition they induced with still more cuts. Although it had looked briefly as though the price war was moderating, a recent round of discounts has renewed its intensity. The good years, it seems, were simply too good. Reserve redundancies from those years continue to roll into results, including our own, and temporarily mask the rate inadequacy. The price leaders, who have captured some benefit on the top line, enjoy a temporary expense efficiency that further masks the truth. Strong financial markets provide even more cover. I can't tell if our peers realize how far from statistical accuracy their premiums are today, but I am sure the picture at Plymouth Rock Assurance will worsen as the latest round of cuts works its way through the premium cycle. There is every reason to expect, moreover, that it will worsen again in 1999, when reserves from the good years have finally worked their way out of the results. If there is a silver lining for the industry to be found here, perhaps it will be an evolution to a better blend of competition and regulation in Massachusetts.

Plymouth Rock Assurance, now principally under Keith Rodney's able leadership, will respond by seeking to discount only groups whose customer quality will enhance the long term loss ratio and whose mechanics offer promise of expense ratio reductions. For a while Plymouth Rock may lose money on these groups, but we intend to be a stronger company at the close of the price war than when it began -- with a still more select book of business, a better combined ratio than our peers, and a more widely recognizable service differential than we already have. Of this result I can feel reasonably confident. Of the timing and the interim cost, alas, I can not.

Plymouth Rock Assurance Corporation is no longer in the homeowners business at all. That line is served by a separate and distinct company in our group, Bunker Hill Insurance Company. Bunker Hill had a good year in 1997. It wrote about $25 million in premiums, representing something like three percent of the homes in Massachusetts, and it earned $1.9 million in profits. The management team would undoubtedly agree that some of this prosperity is due to their skill, especially in underwriting, and some to old-fashioned good luck. The nightmares for any homeowners executive are price wars, irrational regulation and natural disasters. Bunker Hill saw none of these in 1997.

Vin Nieroda wears two hats, and his Pilgrim's hat fit him as handsomely this year as his Bunker Hill outfit. Long ago Vin established the goals that Pilgrim should return at least $1 million in annual profits on the tiny capital base that suits its service-only format, and do so in a way that makes all associated feel proud. Once again, Pilgrim has met these objectives. Managed volume this year was $21 million, and profits were $1.4 million. Pilgrim's worry is always that, with a small number of large clients, neither business retention nor profit margin is as predictable as when the clients are many and none have special bargaining power. Every year the company has faced situations that result from these threats, and every year Pilgrim has overcome them and grown stronger. This is in large measure because Pilgrim has the same lofty aims in terms of service quality as Plymouth Rock Assurance. Pilgrim's new chairman is Paula Gold, who has proven herself especially qualified to help with the large client relationships Pilgrim must maintain.

The big news at Pilgrim this year was *un*-diversification. When we began to worry about Massachusetts automobile insurance some years ago, we selected workers compensation as a business that could relieve some of our dependence on personal auto coverage. Workers compensation was a line of business with enough volume, and enough troubles, to be a worthy focus, and we admired the proactive loss reduction and self-insurance approaches that some alternative market companies had developed. The right combination is a benefit to both provider and client. That reasoning led us to create Boston Risk Management Corporation as our vehicle for entering the workers compensation service business. This year Pilgrim, which was BRMC's corporate parent, sold that company's assets and its name to the state's leading health maintenance organization rather than continue in the building of BRMC's business. Two considerations motivated the sale. First, we had not made enough progress to see a large business ahead of us anytime soon. The concept still seems right; we just may not have been the right people to do it at this time. Second, and more important, we found in Direct Response and Homeowners Direct a preferable mode of reducing dependence on Massachusetts auto insurance, allowing geographical diversification without requiring us to learn the intricacies of another line of business. We can now redouble our efforts to build, with no intellectual dilution, the most expert and best informed writers of autos and homes anywhere in the country.

Mt Washington Assurance is our smallest agency carrier. It remains too small to return substantial profits but well enough managed to keep making progress. Bill Kelley stands by his promise that he will get Mt Washington to between twenty and twenty-five million dollars in volume before he retires. If this can be done, and that company can earn $1.5 to $2 million in profits each year in northern New England, it will be a little gem for us.

This year the volume was more like $8 million and the bottom line was around break-even again, so Mt Washington is only a semi-precious stone at this point. Frankly, I have been surprised at how difficult growing in the New Hampshire market has been. Good service and good prices have seen only moderate recognition. Perhaps the volume goal is somewhat ambitious for a small state with no unusual market disruptions. If so, Bill may seek to experiment a bit with new marketing methods to achieve his target. Hal Belodoff became Mt Washington's new chairman this year, and he should be just the right partner for Bill in any such endeavor.

Our New Jersey companies are all members of the growing Palisades family. There is a management company owned by the Plymouth Rock group and two licensed insurance carriers: Palisades Safety and Insurance Association and its newly chartered subsidiary, Palisades Insurance Company. Palisades, with two licensees, is now able to offer an appropriately priced product to a wide cross section of the New Jersey marketplace. The two insurers, taken together, have more than $52 million in annual written premiums. That amount, remember, is one of the items not consolidated with the Plymouth Rock group results. The Palisades companies are profitable for the second consecutive year, with a pure loss ratio of about 60% and a direct expense ratio a bit better than that of their Massachusetts cousins. It has always been my view that Palisades will someday be larger than Plymouth Rock Assurance. The New Jersey companies need to double their volume for that prediction to come true, but Hal Belodoff took the reins in Hoboken when Palisades had no volume at all, so the task may be less daunting to him than it would be to a less entrepreneurial executive. While catch-up may take some time, the New Jersey price environment is preferable to that in Massachusetts today, and the Palisades reciprocal is considering its first profit-sharing dividend to the Association members. That is an announcement we have all looked forward to since the day the New Jersey companies were created.

"If you think it's impossible to get a fair rate on auto insurance, you should meet some Response Insurance customers. You can't spot them in a crowd -- they come in all shapes, sizes, ages and colors. You *can* spot them on the road because they're all responsible drivers. At Response Insurance, we specialize in insuring as many of these drivers as possible -- wherever we can find them. This way, we can keep your rates as low as possible while giving you the great service you deserve." That is a quote from the media-supported direct mail campaign of Response Insurance Company. Last year I reported on the founding of Direct Response Corporation and its $215 million financing commitment through Morgan Stanley Capital Partners. DRC, as we call it, has two insurance subsidiaries, Response Insurance and Response Indemnity, which have now started writing in the Westchester County area of suburban New York. The quote and the theme, "Response Insurance for Responsible People", convey the flavor of the appeal. Under a license agreement with Direct Line Insurance, the DRC companies will fortify their brand recognition with the use of the red telephone logo that worked so brilliantly for Direct Line in the U.K. over the years.

DRC is now engaged in its first marketing campaign. It has a team of excellent vice presidents, and a mainframe systems capability unusually powerful for a start-up company. Among its goals for the coming year are to find a chief executive officer who can allow Peter and me to step back into the role of strategic guidance, to begin a marketing campaign and writings in the California market, and to launch at least one marketing effort based on a select affinity relationship. Time after time, industry executives remind us that creating a direct writer on a significant national scale is not a modest undertaking. They are right, of course. GEICO and USAA took about seventy years each to get to their current positions of strength. There is a huge amount to be done, but it would be hard to imagine a better mix of ingredients for a full-fledged try. I have kiddingly boasted that DRC passed the first milestone for any ambitious insurer in that it now has more policyholders than employees. A more serious milestone will be reached when DRC proves it can add new customers at a sustainable cost per dollar of acquired premium volume.

In November of 1997, the same common shareholders who founded DRC -- Plymouth Rock, Peter and I -- received a commitment to fund another personal lines direct response carrier, Homeowners Direct Corporation. The investor group, again led by Morgan Stanley Capital Partners and including many (but not all) of the DRC participants, subscribed to $205 million in preferred stock. Plymouth Rock is once again to be a $5 million preferred stock investor as well as a common stockholder. A company separate from DRC was created because the founders came to the conclusion that there is a fundamental incompatibility between an ideal automobile insurance book of business and an ideal homeowners book. The lessons of Twentieth Century's pain from the Northridge earthquake, Allstate's memorable loss from Hurricane Andrew, and GEICO's carefully considered exit from the homeowners line all served to educate us to this reality. In the auto line, a company can minimize its costs of acquisition and maximize its profits by writing in highly concentrated clusters. High market share in a compact area can be extremely valuable. In homeowners, this is a recipe for disaster. While it should be theoretically possible to build two separate books of business under the same corporate roof, one concentrated and one widely spread, separation seems the more prudent course.

Homeowners Direct will be headquartered here in Boston, despite the fact that, like DRC, it will not be writing in Massachusetts or northern New England. It will write virtually everywhere else, keeping an ultra-cautious eye on its spread of risk. The company expects to compete by virtue of three simultaneous advantages: low acquisition costs, a planned spread of risk that should lower catastrophe reinsurance expenses, and a sophisticated approach to conventional loss underwriting that has eluded those carriers who see homeowners as an adjunct product for their automobile insurance customers.

Like DRC, Homeowners Direct has begun a search for a chief executive officer who can release Peter and me to more strategic roles. Meanwhile, we have begun the systems planning for that company; initiated our catastrophe modeling with a licensing agreement for software and data from RMS, the industry's leading supplier of hurricane and earthquake analysis; and started down the path to licensing in some key target states.

The investment side of our business, centered in SRB Corporation, has an increasing load to carry. Not only are invested assets augmented by the addition of the two new direct response writers, the traditional vehicles for putting these funds to work are all looking ever less appealing in today's market environment. We consider neither the public equities market, with the Dow Jones Average hovering near 8000, nor the bond market, with rates at some maturities near twenty-five years lows, easy places to find the bargains around which good investing must be centered. Low bond yields, moreover, often provide capital gains at the expense of reinvestment opportunities. Price to book ratios, price-earnings ratios, and price to GNP ratios are all a bit frightening. Some say that a "new paradigm" can explain all of this, but, in old-fashioned terminology, the present U.S. market levels seem to presume a continuing vibrant economic growth with a less than customary risk of inflation. I suspect this combination in turn depends on a three-legged foundation: a peaceful new world order replacing the cold war, the accelerating expansion of free trade, and continued growth in foreign markets for U.S. goods. If so, there is vulnerability just as there has been in the past. When the whole market is bullish, even the relative bargains may be too expensive for us.

This situation is more than a little painful, since SRB has espoused -- and performed well with -- a balanced debt and marketable equity strategy that would work in any normal environment. As a consequence of today's abnormal environment, Jim and Rick would either have to move toward cash or search out alternative equity vehicles. Current thinking leans toward the latter. The managed investment portfolio, including funds of the new direct companies, is just under $400 million and rising. With market performance strong, the balances already invested enjoyed a good year. Plymouth Rock group's stocks rose by 29% in value, a bit less than the S&P index. Five-year average returns, however, remain a full sixteen points better than the S&P's 20% average annual increase. Bonds did fine as well, with unrealized capital gains bringing total pre-tax return on the bond portfolio to 7.6% for the year. Jim and Rick are now adding to the mix investments in other asset classes.

We purchased our headquarters building this year, bringing Plymouth Rock group owner-occupied real estate holdings -- our favorite kind -- to $20 million. We are loath to be a real estate lender but reasonably comfortable as an owner. There is every reason to believe we have done quite well on real estate bought to date, though no gains are reflected in our financials. The same is true for our private equity investment in CAT Limited, perhaps the best respected of the Bermuda reinsurers spawned by Hurricane

Andrew. While we may have done better in private investments overall than on the marketable stock and bond portfolio, it will nonetheless be a great relief when someday we can return with comfort to investing principally in the U.S. public securities markets.

The year ahead promises to be busy, and probably downright difficult. With both new and continuing challenges, there are too many goals to list them all here. Among my hopes, though, are that the next annual report records no more unpleasant surprises in New England (or, better yet, that Massachusetts auto insurance has begun to recover its balance), that Palisades has continued both top line growth and bottom line acceleration, and that each of the direct ventures has found the outstanding CEO it deserves. Putting this last wish another way, Plymouth Rock's value will be much enhanced when Direct Response Corporation and Homeowners Direct have found chief executives as inspiring and well suited for their assignments as the current roster of officers now in place at the Plymouth Rock Companies.

James M. Stone

REPORT OF INDEPENDENT ACCOUNTANTS

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

We have audited the accompanying consolidated balance sheets of The Plymouth Rock Company and subsidiaries as of December 31, 1997 and 1996, and the related consolidated statements of income, cash flows and changes in stockholders' equity for the years then ended. 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 in accordance with generally accepted auditing standards. 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Plymouth Rock Company and subsidiaries as of December 31, 1997 and 1996, and the consolidated results of their operations, and their cash flows for the years then ended, in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P.

Boston, Massachusetts
February 6, 1998

THE PLYMOUTH ROCK COMPANY

CONSOLIDATED BALANCE SHEETS

December 31, 1997 and 1996

Assets	1997	1996
Cash and cash equivalents	$ 14,697,261	$ 18,807,078
Investment securities	188,444,223	189,115,572
Premiums receivable	17,418,942	12,862,881
Accrued investment income	2,212,030	2,561,592
Receivable from reinsurers	34,728,738	33,066,634
Real estate	20,276,470	8,224,710
Deferred acquisition costs	8,040,084	8,093,603
Fixed assets	5,338,139	4,913,014
Deferred income taxes	1,234,234	2,815,271
Other assets	4,858,043	3,546,240
Total assets	$297,248,164	$284,006,595
Liabilities		
Claim and claim adjustment expense reserve	$116,859,224	$115,609,451
Unearned premium reserve	29,518,238	26,014,708
Premiums payable to reinsurers	18,152,271	17,708,340
Advance premium	8,912,985	7,402,907
Commissions payable and accrued liabilities	14,670,846	17,335,290
Unearned service fees	4,108,386	4,293,749
Other liabilities	2,038,261	2,020,649
Total liabilities	194,260,211	190,385,094
Stockholders' Equity		
Common stock and paid-in capital	19,563,891	19,563,891
Retained earnings	71,663,197	66,197,907
Net unrealized gain on investments	8,025,642	4,200,365
Common stockholders' equity	99,252,730	89,962,163
Minority interests in subsidiaries	3,735,223	3,659,338
Total stockholders' equity, including minority interests	102,987,953	93,621,501
Total liabilities and stockholders' equity	$297,248,164	$284,006,595

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, 1997 and 1996

Revenues	1997	1996
Premiums earned in underwriting activities	$101,123,515	$ 96,503,448
Fees earned from service activities	14,269,284	12,264,434
Investment income and capital gains	14,121,121	13,724,776
Total revenues	129,513,920	122,492,658
Expenses		
Claim and claim adjustment expenses	74,822,461	69,410,785
Policy acquisition, underwriting and general expenses	34,727,908	38,698,027
Service activity expenses	12,315,472	10,314,157
Total expenses	121,865,841	118,422,969
Income before federal income taxes	7,648,079	4,069,689
Federal income taxes	1,506,524	(158,681)
Net income	$ 6,141,555	$ 4,228,370

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, 1997 and 1996

Cash flows from operating activities	1997	1996
Gross premiums collected	$138,404,117	$134,210,680
Reinsurance premiums paid	(35,451,764)	(42,901,823)
Finance charges collected	2,552,010	2,730,978
Fees and commissions collected	13,156,560	10,746,129
Investment income received	13,000,048	12,076,426
Gross claims and claim expenses paid	(108,512,051)	(104,804,381)
Reinsured claims and claim expenses collected	33,324,446	37,130,849
Policy acquisition, underwriting, and general expenses paid	(31,534,691)	(38,967,056)
Federal income taxes paid	(3,147,162)	(100,000)
Service activity expenses paid	(11,760,904)	(7,799,647)
Net cash provided by operating activities	10,030,609	2,322,155
Cash flows from financing activities		
Dividends to stockholders	(443,515)	(1,212,799)
Dividends to preferred stockholder of subsidiary	(245,000)	(140,000)
Net cash provided by financing activities	(688,515)	(1,352,799)
Net cash provided	$ 9,342,094	$ 969,356
Investment of net cash provided		
Change in cash and cash equivalents	$ (4,109,817)	$ (2,858,244)
Net investment activity	(2,523,841)	(429,770)
Purchases of real estate	12,504,065	1,636,113
Purchases of fixed assets	3,471,687	2,621,257
Net cash invested	$ 9,342,094	$ 969,356

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, 1997 and 1996

	Common Stock and Paid-in Capital	Retained Earnings	Net Unrealized Gain on Investments	Minority Interests	Total Stockholders' Equity
December 31, 1995	$19,563,891	$63,315,336	$4,070,856	$3,570,859	$ 90,520,942
Net income	-0-	4,228,370	-0-	95,479	4,323,849
Dividends to stockholders	-0-	(1,212,799)	-0-	-0-	(1,212,799)
Dividends to preferred stockholder of subsidiary	-0-	(133,000)	-0-	(7,000)	(140,000)
Net unrealized gain during 1996	-0-	-0-	129,509	-0-	129,509
December 31, 1996	19,563,891	66,197,907	4,200,365	3,659,338	93,621,501
Net income	-0-	6,141,555	-0-	88,135	6,229,690
Dividends to stockholders	-0-	(443,515)	-0-	-0-	(443,515)
Dividends to preferred stockholder of subsidiary	-0-	(232,750)	-0-	(12,250)	(245,000)
Net unrealized gain during 1997	-0-	-0-	3,825,277	-0-	3,825,277
December 31, 1997	$19,563,891	$71,663,197	$8,025,642	$3,735,223	$102,987,953

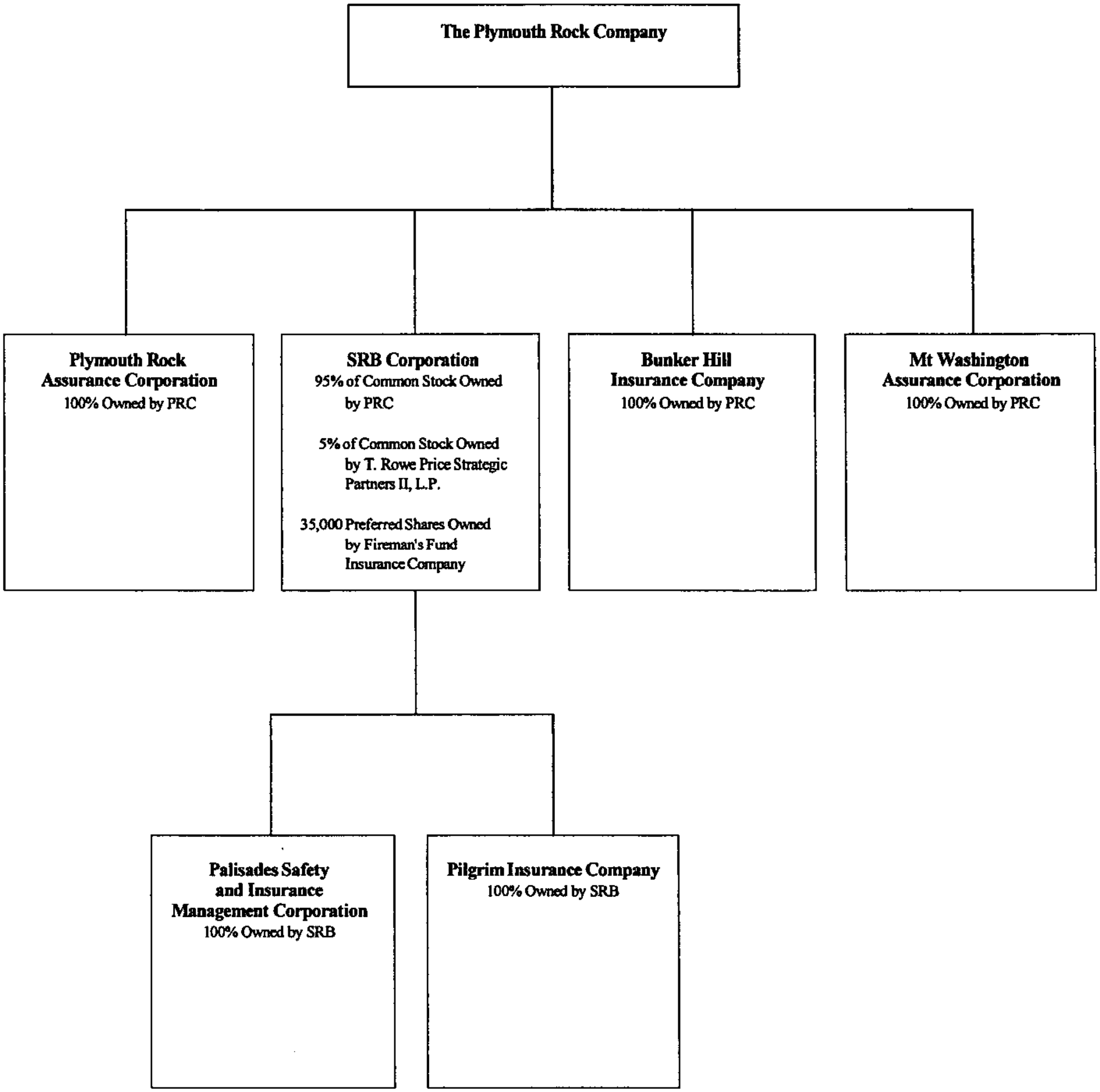
The accompanying notes are an integral part of the financial statements.

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization of the Plymouth Rock Companies

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



Direct Response Corporation and Homeowners Direct Corporation are not among the Plymouth Rock Companies, but The Plymouth Rock Company owns a common and preferred stock interest in each.

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. Certain prior year amounts have been reclassified to conform to 1997 reporting practices.

B. Investments and Real Estate

Cash and cash equivalents consist of short term money market instruments and commercial paper with maturity dates no longer than 90 days at the date of acquisition. Marketable fixed income and equity securities are carried at their market values. The market 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. Net unrealized gains or losses on securities available for sale, net of applicable deferred taxes, are credited or charged directly to stockholders' equity. Alternative equity investments are carried at cost plus the Company's share of realized gains and losses, which are also included in investment income.

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

C. Income Taxes

The Company files its federal income tax return on a consolidated basis. The Company's federal income tax return reflects current income taxes, which are not the same as the provision for income taxes shown in the Consolidated Statements of Income. This is because the rules of the Internal Revenue Code and those of generally accepted accounting principles can differ with respect to the time periods in which income and expenses are recognized.

Federal income taxes consist of:

	1997	1996
Current	$1,896,084	$(989,691)
Deferred	(389,560)	831,010
Total	$1,506,524	$(158,681)

Deferred income taxes in the balance sheet as of December 31, 1997 and 1996 consist of the net effect of these temporary differences:

	1997	1996
Discounting of claim reserves	$3,577,841	$3,646,032
Deferred income	2,627,479	2,549,536
Net unrealized gain on investments	(4,134,421)	(2,163,824)
Other	(836,665)	(1,216,473)
Total	$1,234,234	$2,815,271

2. Summary of Significant Accounting Policies, continued

C. Income Taxes, continued

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 federal income taxes is less than that computed by applying the federal income tax rate for these years to income from operations before federal income taxes. This is principally because the Company receives significant non-taxable interest from state and municipal bonds.

D. 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 which 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 $535,749 and $463,398 at December 31, 1997 and 1996, respectively, and are presented net of unbilled amounts of $15,289,474 and $15,228,970, 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, brokerage, policy processing, billing and claims management services in two Northeast states. Fee income is earned over the related contract periods.

E. Reinsurance

Treaty reinsurance is used to reduce exposure to large claims. The Company regularly evaluates the financial condition of its reinsurer 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.

Amounts recoverable for claim reserves and paid claims are reflected as receivable from reinsurers. The income statement is reflected net of reinsurance activity as follows:

	1997		1996	
	Premiums Written	Losses Incurred	Premiums Written	Losses Incurred
Gross	$135,187,586	$109,643,048	$139,041,024	$106,645,758
Ceded	(32,810,144)	(34,820,587)	(46,940,193)	(37,234,973)
Net	$102,377,442	$ 74,822,461	$ 92,100,831	$ 69,410,785

Ceded premiums earned for 1997 and 1996 were $36,741,749 and $41,596,990, respectively.

2. Summary of Significant Accounting Policies, continued

E. Reinsurance, continued

The Company has treaties for quota share reinsurance ranging from 40 to 50 percent, which reinsure certain coverages for losses in excess of approximately 88 percent of premiums earned during specified accounting periods. Revenues and expenses are reflected net of quota reinsurance totaling approximately $28 million and $25 million for 1997 and 1996, respectively.

The Company has a catastrophe reinsurance treaty. At December 31, 1997 and 1996, the Company had paid approximately $1,350,000 and $3,980,000, respectively, (net of cumulative losses and commissions) to the reinsurer to cover future catastrophes. This contract has an experience rating feature whereby a substantial portion of the amount paid could be returned to the Company if the experience continues to be favorable. During 1997, the Company received approximately $4,270,000 of income relating to this feature.

The Company is a member of Commonwealth Automobile Reinsurers and accounts for ceded policies as reinsurance. The Company's estimated share of the Commonwealth Automobile Reinsurers deficit is recorded in claim and claim adjustment expenses.

The Company acts as an intermediary for certain other insurance companies in administering commercial automobile insurance programs. The Company's income statement and reinsurance activity exclude premiums earned of $20,504,357 and $21,898,725 and claim and claim adjustment expenses of $15,235,560 and $15,759,501 in 1997 and 1996, respectively. In connection with these arrangements, receivables and claim reserves exclude $8,439,660 and $7,323,910 at December 31, 1997 and 1996, respectively.

F. 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.

G. Claim and Claim Adjustment Expenses

Claim reserves represent the estimated liability for claims reported to the Company plus reserves for claims incurred but not yet reported. Claim adjustment expense reserves represent the estimated expenses related to settling 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. Claims incurred in 1997 and 1996 include payments for events reported in prior years. Payments for prior reported events amounted to approximately $43.8 million and $37.7 million in 1997 and 1996, respectively. Reserves carried for these claims at prior year end were $53.6 million and $49.1 million, respectively. Claim and claim adjustment expense reserves at December 31, 1995 were approximately $113.8 million.

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. Consolidated Revenues

Revenues, net of reinsurance, for the separate companies for 1997 and 1996 are:

	1997	1996
The Plymouth Rock Company	$ 3,929,202	$ 11,765,791
Plymouth Rock Assurance Corporation	101,394,619	102,939,444
Mt Washington Assurance Corporation	4,103,354	3,877,604
Bunker Hill Insurance Company	11,148,421	2,771,146
SRB Corporation	3,823,664	6,850,222
Pilgrim Insurance Company	10,756,263	10,066,171
Palisades Safety & Insurance Management Corporation	6,125,712	4,946,203
	141,281,235	143,216,581
Intercompany eliminations	(11,767,315)	(20,723,923)
Total revenues	$129,513,920	$122,492,658

4. Reconciliation of Net Income to Net Cash Provided by Operating Activities

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

	1997	1996
Net income	$ 6,141,555	$4,228,370
Depreciation and amortization	3,170,343	3,290,610
Minority interests	88,135	95,479
Change in premiums receivable	(4,556,061)	(644,171)
Change in accrued investment income	349,562	(28,910)
Change in receivable from reinsurers	(1,662,104)	(1,401,567)
Change in deferred acquisition costs	53,519	1,836,926
Change in deferred income taxes	(389,560)	831,010
Change in claim and claim adjustment expense reserve	1,249,773	1,841,377
Change in unearned premium reserve	3,503,530	(4,354,199)
Change in premiums payable to reinsurers	443,931	(1,099,582)
Change in advance premium	1,510,078	(293,940)
Change in commissions payable and accrued liabilities	1,278,937	1,914,936
Change in unearned service fees	(185,363)	(321,004)
Change in other assets and other liabilities	(445,701)	(3,237,804)
Income on sale of investment securities	(511,954)	(318,758)
Income on disposal of fixed assets	(8,011)	(16,618)
Net cash provided by operating activities	$10,030,609	$2,322,155

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Real Estate

During 1997, the Company acquired a two-thirds interest in real estate for $11.5 million. Building improvements of approximately $486,000 and $1,636,000 were incurred in 1997 and 1996, respectively. The table below summarizes real estate at December 31, 1997 and 1996.

	1997	1996
Land	$ 4,697,778	$1,719,628
Buildings, improvements and other	16,299,456	6,773,541
Total cost	20,997,234	8,493,169
Less: accumulated depreciation	720,764	268,459
Net book value	$20,276,470	$8,224,710

Rental income other than from Plymouth Rock companies aggregated approximately $2,551,000 and $1,141,000 in 1997 and 1996, respectively. For each of the years 1998 through 2004, minimum annual rent receivable by the Company is approximately $1,085,000. Total obligations of lessees through 2004 are approximately $7,595,000. Buildings and improvements are depreciated over their useful lives, which range from two to thirty-nine years.

6. Fixed Assets

Purchases of fixed assets were approximately $3,472,000 and $2,621,000 in 1997 and 1996, respectively. The table below summarizes fixed assets at December 31, 1997 and 1996.

	Useful Lives	1997	1996
Furniture and fixtures	5-10 years	$ 2,159,207	$ 3,323,782
Computers	3-5 years	5,895,711	6,819,926
Leasehold improvements	2-6 years	1,412,641	2,978,762
Vehicles	3 years	1,193,352	1,045,147
Total cost		10,660,911	14,167,617
Less: accumulated depreciation and amortization		5,322,772	9,254,603
Net book value		$ 5,338,139	$ 4,913,014

7. Lease Commitments

Rental expenses for 1997 and 1996 aggregated approximately $258,000 and $1,826,000, respectively. For each of the years 1998 through 2002, the minimum lease obligations of the Company range from approximately $100,000 to $470,000 annually. Total obligations for leases through 2002 are approximately $1,600,000.

THE PLYMOUTH ROCK COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8. Investment Securities and Investment Income

A. Available for Sale Securities

At December 31, 1997 and 1996, amortized cost, unrealized gains and losses before federal income taxes and market value of fixed income and equity securities were as follows:

At December 31, 1997:	Amortized Cost	Unrealized Gains	Unrealized Losses	Market Value
U.S. government securities	$ 13,256,127	$ 210,625	$ 64	$ 13,466,688
State and municipal securities	51,237,665	1,055,062	1,709	52,291,018
Corporate debt securities	47,388,443	667,589	199,966	47,856,066
Mortgage-backed securities	20,533,849	197,074	47,043	20,683,880
Common stocks	10,138,024	10,278,495	-0-	20,416,519
Total	$142,554,108	$12,408,845	$248,782	$154,714,171

At December 31, 1996:	Amortized Cost	Unrealized Gains	Unrealized Losses	Market Value
U.S. government securities	$ 7,700,621	$ 52,251	$ 92,105	$ 7,660,767
State and municipal securities	62,795,882	654,728	43,682	63,406,928
Corporate debt securities	67,182,760	533,521	224,615	67,491,666
Mortgage-backed securities	35,266,084	120,475	444,093	34,942,466
Common stocks	4,989,143	5,807,709	-0-	10,796,852
Total	$177,934,490	$7,168,684	$804,495	$184,298,679

At December 31, 1997, maturities of available for sale securities are as follows:

	Amortized Cost	Market Value
Due in 90 days or less	$ 1,077,779	$ 1,077,263
Due after 90 days and in one year or less	1,375,519	1,378,724
Due after one year and in five years or less	74,533,258	75,445,167
Due after five years and in ten years or less	32,602,666	33,245,102
Due after ten years	22,826,862	23,151,396
Common stocks	10,138,024	20,416,519
Total	$142,554,108	$154,714,171

8. Investment Securities and Investment Income, continued

B. Alternative Equity Investments

Alternative equity investments include 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 each year. At December 31, 1997, the Company's recorded equity in these alternative equity investments was $24,224,800. The costs of these investments were $24,000,000.

Other alternative equity investments include privately held common stocks, preferred stocks, surplus notes and single-purpose entities investing in companies that are not publicly traded. The Company's recorded equity amounted to $9,505,252 and $4,816,893 at December 31, 1997 and 1996, respectively. The costs of these investments were $9,355,640 and $5,002,612, respectively. These amounts include investments in Direct Response Corporation and Homeowners Direct Corporation totaling approximately $3.7 million and $900,000 at December 31, 1997 and 1996, respectively. These companies will derive underwriting revenue from personal lines property and casualty insurance activity, writing throughout the United States, except in certain New England states.

C. Investment Activity

The components of investment activity during 1997 and 1996 were as follows:

	1997	1996
Balance at beginning of year	$189,115,572	$188,852,957
Change in available for sale securities:		
Sales	(142,865,788)	(138,189,095)
Purchases	111,428,788	136,040,510
Net change in available for sale securities	(31,437,000)	(2,148,585)
Investments in alternative equities	28,913,159	1,718,815
Net investment activity	(2,523,841)	(429,770)
Net change in purchases in process	(3,943,382)	496,156
Net change in unrealized gain on available for sale securities	5,795,874	196,229
Balance at end of year	$188,444,223	$189,115,572

8. Investment Securities and Investment Income, continued

D. Analysis of Investment Income and Capital Gains

The components of investment income and capital gains before federal taxes during 1997 and 1996 are as follows:

	1997	1996
Interest income and dividends from securities	$10,747,566	$10,893,874
Rental income	2,551,179	1,140,958
Finance charges from premiums receivable	2,552,010	2,730,978
Gross investment income	15,850,755	14,765,810
Rental expenses	(1,723,502)	(908,532)
Investment expenses	(518,086)	(451,260)
Investment income	13,609,167	13,406,018
Realized capital gains	511,954	318,758
Investment income and capital gains	$14,121,121	$13,724,776

9. 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 21 years or older with at least one year of service. The Company accrued $1,009,951 and $863,510 as of December 31, 1997 and 1996, respectively, for liabilities relating to this Plan.

The Company has a Deferred Compensation Plan for officers, managers and directors other than its founding shareholders. This Plan provides for a rate of return on deferrals based on the financial performance of the Company. The Company accrued $2,165,706 and $2,293,509 as of December 31, 1997 and 1996, respectively, for liabilities relating to this Plan.

During 1997, the Company introduced a stock incentive plan through which it intends to make annual awards to key employees. The Company has recorded no expense in 1997 with respect to awards under this Plan.

10. Stockholders' Equity

A. Common Stock

Common stock at December 31, 1997 and 1996 is composed of Class A common 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 148,464 and 147,786 were issued and outstanding on December 31, 1997 and 1996, respectively. There are 90,000 Class B shares authorized, of which 83,838 and 84,516 were issued and outstanding on December 31, 1997 and 1996, respectively.

10. Stockholders' Equity, continued

A. Common Stock, continued

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, or automatically upon the occurrence of certain events. The Class B common shares elect 80 percent of the Board of Directors.

B. Preferred Stockholder's Interest in Subsidiary

A subsidiary of the Company has issued 35,000 shares of cumulative preferred stock with no par value, all of which were outstanding at December 31, 1997 and 1996. The preferred stockholder is entitled to receive cumulative cash dividends of 7 percent per year when declared by the subsidiary's Board of Directors out of funds legally available. The preferred stockholder is also entitled to receive, if and when declared by the Board of Directors, special cumulative dividends of 20 percent of the difference between the subsidiary's net income and the amount of regular preferred dividends for that year. Such special dividends are limited to $1,000,000 on a cumulative basis and, if declared, would approximate this amount. Under certain conditions the preferred shares may be redeemed by the subsidiary at $120 per share with adjustment for dividends. In addition, under certain circumstances the holder may redeem the preferred stock at $100 per share plus any accrued but unpaid dividends. In the event of corporate liquidation, the preferred stockholder of the subsidiary is entitled to receive out of available subsidiary funds $120 per share ($4,200,000 in the aggregate), with adjustment for certain dividends paid, plus any accrued but unpaid dividends. The preferred stock is convertible under certain default circumstances, with appropriate regulatory approval, into specified amounts of the subsidiary's common stock.

C. 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 generally accepted accounting principles. On a statutory accounting basis, capital and surplus of the Company's insurance subsidiaries aggregated approximately $65,997,000 and $60,026,000 at December 31, 1997 and 1996, respectively. Regulatory limits restrict the amount of dividends which can be remitted to the Company from its insurance subsidiaries without approval of state insurance regulators.

Directors and Officers of The Plymouth Rock Company

Directors

James M. Stone, *Chairman*

Peter J. Wood, *Vice Chairman*

James N. Bailey

Charles B. Chokel

Michael J. Johnston

Wilmot H. Kidd, III

Keith R. Rodney

Officers

James M. Stone
President

Keith R. Rodney
Executive Vice President and Clerk

James N. Bailey
Treasurer

William M. Kelley
Vice President

Raymond D. Moore
Vice President

Directors and Officers of the Plymouth Rock Group of Companies

Non-Management Directors

Charles B. Chokel
Normand A. Dion
Alexander Ellis, III
Michael J. Johnston
Wilmot H. Kidd, III
Eugene J. Meyung
David L. Warnock
Peter J. Wood

Management Officers and Directors

Francis P. Arment
Geoffrey H. Arnold
James N. Bailey
Hal Belodoff
John W. Delano
Paula W. Gold
William M. Kelley
Stewart W. Kemp
Raymond D. Moore
Karen A. Murdock
Vincent V. Nieroda
Keith R. Rodney
James M. Stone
Maria C. Walsh

Independent Accountants:
Coopers & Lybrand L.L.P.

Counsel:
Ropes & Gray