To Our Shareholders:

2001 was our worst year since we began 16 years ago. It was the first year that we lost money and the third consecutive year we did not achieve our objective of earning a return on equity in excess of 20%. We lost 11.9% on average shareholders' equity in 2001 (compared with a loss of 4.4% for the TSE 300). We had a loss of $346.0 million or $28.04 per share in 2001 compared to a profit of $137.4 million or $9.41 per share in 2000. For the first time ever, book value per share decreased, by 12.2% to $213.06 per share, while our share price dropped by 28% to $164.00 per share from $228.50 per share at year-end 2000. As you can see, on any measure, 2001 was our worst year ever. Our very poor results resulted in our stock continuing to sell below book value during 2001, making it almost two and a half years that Fairfax's stock price has been below book value.

As I write this letter to you, I must say that I am shocked at our atrocious results over the last three years and I sincerely apologize to you, our shareholders. As it is for myself and most of our Board members, Fairfax officers and Hamblin Watsa principals, for many of you your investment in our company constitutes a significant portion of your net worth, which makes these results more painful. As always, we have disclosed the past, studied it and learned from it, and we continue to be focused on performing for you as we have done prior to the past three years.

Our loss in 2001 emanated from the large losses we suffered in the third quarter of 2001 which prompted my letter of November 3, 2001 to you (reproduced in Appendix A) and also prompted us to have our first ever conference call to explain the losses and answer all your questions.

As the letter explains, our third quarter loss was a result of two negative surprises: World Trade Center losses and reserve deficiencies.

The reserve deficiencies at C&F and TIG were particularly embarrassing because we had recognized reserve deficiencies in 2000 and, in fact, had told you in last year's Annual Report that we did not expect this to be repeated in 2001. As our letter indicated, these deficiencies were an industry phenomenon (the U.S. industry reported in excess of US$8 billion in adverse reserve development in 2001) and our management teams had been running their companies for only two years. Against the backdrop of the worst insurance market in 30 years, it has taken longer for us to recognize and fix the problems of the past – much longer than we had expected when we purchased both these companies.

In last year's Annual Report and in our November 3, 2001 letter, we suggested to you that, over time, C&F and TIG would be seen to be good acquisitions. I have nothing more to add other than results will ultimately tell the story.

Last year, we told you that the headwinds that had buffeted the U.S. property and casualty industry for 12 years had changed and we listed the reasons why this up cycle may have some "shelf life". Since then, we have had the World Trade Center loss (the largest loss in the history of the U.S. property and casualty industry, estimated to be in the US$30 to US$50 billion range), 40 year lows in U.S. short term interest rates, declining U.S. and European stock markets (European insurers/reinsurers have common stock holdings in excess of their capital) and asset problems like Enron, KMart, Global Crossing, etc. We think the combination of these factors will result in the industry requiring a minimum combined ratio of 100% to achieve a marginal single digit return on equity – not too dissimilar to the experience of the U.S. property and casualty industry in the 1960s or the Japanese property and casualty industry in the past ten years, both periods during which low interest rates resulted in returns on equity for industry participants of 5% to 9% even with combined ratios below 100%.

As mentioned in my November 3 letter to you, we are now in a hard market again – a market in which our product is not being given away but being priced to cover all costs and provide a fair return (in some cases, to pay back the losses of the past also). Insurance capacity is being severely limited, prices are going up dramatically and policy terms and conditions have tightened significantly. While these conditions have attracted new capital, our guess is that the factors mentioned earlier will result in the industry's favorable conditions continuing for some time.

For the past 16 years, we have carefully expanded through acquisitions, as the opportunity to grow internally was very limited. This has now changed. We expect to grow our insurance/ reinsurance businesses significantly, and increase our retentions significantly, during this hard market (with the exception of TIG Insurance, which because of its MGA platform and our insistence on 100% combined ratios, together with A. M. Best's downgrade of its rating to BBB+, will likely have a decline in its premium base, particularly its MGA produced program business). In the section on insurance, we describe more fully what we have already achieved at our insurance and reinsurance companies.

A very significant positive we had in 2001 was the OdysseyRe IPO completed on June 14, 2001. With the major support of Rob Giammarco and his team at Banc of America, Dick Falconer at CIBC Wood Gundy and many other investment dealers, OdysseyRe was listed on the NYSE through the sale of 17.1 million shares at US$18 per share. After the offering, Fairfax held 48 million (74%) of OdysseyRe's common shares and a US$200 million OdysseyRe three-year term note (US$150 million of which has since been refinanced externally). Based on the IPO price of US$18 per share, the value of the 48 million common shares and the term note of OdysseyRe, together with our cash proceeds from the IPO, amounted to $2 billion (US$1.3 billion). This was very gratifying as it showed that OdysseyRe, which was formed through a merger of our interests in Skandia America Re, CTR and TIG Re, had now arrived. With US$1 billion in net premiums written and US$1 billion in total capital, we anticipate that OdysseyRe, under Andy Barnard's leadership, is poised to grow significantly while achieving our target 100% combined ratio.

Why did we take OdysseyRe public? The reasons, discussed at last year's annual meeting, were as follows:

1. The NYSE listing and SEC registration provided OdysseyRe with a profile and transparency that benefited its worldwide client base.

2. Ratings were expected to improve, and S&P did in fact upgrade OdysseyRe's ratings to A- after the IPO.

3. The IPO provided additional financial flexibility at the Fairfax level. It raised US$434 million in cash and notes for Fairfax (including TIG), and Fairfax's continuing investment in OdysseyRe's now publicly traded shares was worth US$864 million at the IPO price (we have stated clearly that we will not sell control of OdysseyRe).

Our expectations were more than realized by the IPO and while OdysseyRe's stock price is trading below its IPO price currently, Andy is focused on performing for his shareholders over the long term.

Our very positive experience with OdysseyRe has resulted in our decision to take C&F public (assuming markets are willing). The additional financial flexibility at Fairfax will, among other things, assist us in achieving our objective of maintaining at least $800 million in cash and marketable securities in the holding company (about five times our annual interest expense) until our consolidated combined ratio comes down below 105% and our earnings cover our annual interest expense by five times, which should permit our debt ratings, which were dropped below investment grade by S&P and others, to become investment grade again.

The past year has tested our small team at Fairfax, the Presidents who run our companies and our guiding principles like never before. We were battered from all sides and it seemed like nothing we did worked! However, our guiding principles (again included, as Appendix B) survived intact, as did our key management group, in good humor and very focused on getting back to delivering results for our shareholders. During the year, Jonathan Godown (with many years at A.M Best, S&P and Milliman & Robertson) and Jane Williamson (formerly a partner at PwC) joined Fairfax from the outside while Roland Jackson, who was CFO at OdysseyRe, moved over to Fairfax Inc. Charlie Troiano took Roland's position at OdysseyRe. Meanwhile, at Hamblin Watsa, my partner Roger Lace assumed the additional responsibilities of chief investment officer. Our team at Fairfax and Hamblin Watsa and our Presidents continue to be the major strength of our company.

Below we update (painfully!!) the table on intrinsic value and stock prices that we first presented two years ago.

	INTRINSIC VALUE		**STOCK PRICE**
	ROE %	**% Change in Book Value* per Share**	**% Change in Stock Price**
1986	25.4	+ 183	+292
1987	31.3	+ 41	– 3
1988	21.2	+ 22	+ 21
1989	20.3	+ 23	+ 25
1990	23.0	+ 39	– 41
1991	21.3	+ 24	+ 93
1992	7.7	+ 11	+ 18
1993	20.3	+ 48	+ 145
1994	12.1	+ 25	+ 9
1995	20.1	+ 22	+ 46
1996	21.4	+ 63	+ 196
1997	20.4	+ 44	+ 10
1998	20.1	+ 47	+ 69
1999	4.3	+ 26	– 55
2000	4.1	+ 5	– 7
2001	(11.9)	– 12	– 28
1985-2001	**16.3%**	**+ 34%**	**+ 28%**

** First measure of intrinsic value as discussed in our 1997 Annual Report*

2001 was all minuses! In fact, investments per share dropped by 5% after dropping 10% in 2000. While we definitely dropped intrinsic value last year, particularly at TIG, the long term value of the rest of our insurance and reinsurance businesses may well have increased because of the World Trade Center disaster. No substitute for profits though!! By the way, some of you think that our stock price is low because of a lack of liquidity – the table shows you it is because of a lack of performance!

As explained to you in our letter of November 3, 2001, the losses in the third quarter plus the opportunity that we saw in the P&C industry resulted in our issuing 1.25 million shares at $200 per share. This was the first time in our 16 years we sold stock below book value – and oddly enough, this sale was among the toughest to complete. Ten years ago, in 1991, we wrote to you that we would always sacrifice returns in order to maintain a strong financial position. Our stock issue in 2001 was a case in point.

The table below shows the sources of our net earnings with Lindsey Morden equity accounted. (This table, like various others below, sets out an analysis which we have consistently used and which we believe assists you to understand Fairfax, even though it may not follow GAAP: please see note (2) on page 47 in the MD&A. One of the objectives in our guiding principles is to provide complete disclosure annually to our shareholders, and we work hard to do this in a manner which best discloses the substance of our information, both good and bad.)

	2001	2000
	($ millions)	
Underwriting		
Insurance		
Canada	(119.5)	(13.0)
U.S.	(637.9)	(588.4)
Reinsurance	(214.7)	(97.4)
Interest and dividends	491.7	593.5
Operating income (loss)	(480.4)	(105.3)
Realized gains	213.5	378.3
Runoff	(27.4)	43.3
Claims adjusting (Fairfax portion)	(3.9)	(15.4)
Interest expense	(155.2)	(164.7)
Goodwill and other amortization	(7.0)	(5.4)
Negative goodwill	78.6	108.7
Swiss Re premium	(143.6)	(167.2)
Kingsmead losses	(116.7)	(33.0)
Restructuring	(49.1)	(16.4)
Corporate overhead and other	(38.9)	(35.5)
Pre-tax income (loss)	(730.1)	(12.6)
Less (add): taxes	(382.5)	(173.3)
Less (add): non-controlling interests	(1.6)	23.3
Net earnings (loss)	(346.0)	137.4

The table shows you the results from our insurance and reinsurance (underwriting and investments), runoff and non-insurance operations. Runoff operations include TRG, RiverStone Stockholm and Sphere Drake. Claims adjusting shows you our share of Lindsey Morden's after-tax income. Goodwill and other amortization includes amortization of Hamblin Watsa, Lombard, Ranger and Seneca. The corporate overhead expense is net of Hamblin Watsa's pre-tax income and interest income on Fairfax's cash balances. The premium payable to Swiss Re of $143.6 million is shown separately and discussed in the MD&A under Swiss Re premium on page 58. Also shown separately are realized gains so that you can better understand our earnings from our operating companies. Also, please note the unaudited financial statements of our combined insurance and reinsurance operations and of Fairfax with Lindsey Morden and TRG equity accounted, as well as Lindsey Morden's financial statements, shown on pages 94 to 99.

The principal components of the large loss in 2001 were:

(a) World Trade Center losses of $288.3 million (US$186.8 million), described in detail on page 50;

(b) the net cost of 2000 and prior years' reserve strengthening at TIG and C&F of $304 million (US$197 million), described in detail on page 50;

(c) Enron losses at OdysseyRe ($23 million), Kingsmead losses excluding World Trade Center losses ($54.3 million) and restructuring charges ($49.1 million); and

(d) underwriting losses, excluding World Trade Center losses and TIG and C&F's prior years' reserve strengthening, at TIG ($272.7 million) and C&F ($87.6 million) and in Canada ($80.2 million).

With some good fortune in 2002, (a), (b) and (c) should not be repeated and (d) should be significantly reduced. However, in the P&C insurance industry, as our long-suffering shareholders know, there are no guarantees.

Interest and dividends declined by $101.8 million in 2001 to $491.7 million because of increased interest expense on funds withheld payable to reinsurers of $43.9 million (please see Funds withheld payable to reinsurers on page 61) and a $0.8 billion lower average investment portfolio reflecting the payout of claims in the runoff operations and in the U.S. insurance companies, as well as a lower investment yield, as discussed on page 56. The funds withheld payable to reinsurers balance increased in 2001 because of stop loss reinsurance purchased for C&F and TIG for the years 1999 and 2000 and Fairfax's corporate insurance cover with Swiss Re.

In our 1999 Annual Report, we discussed Fairfax's purchase of a US$1 billion adverse loss development reinsurance cover (for 1998 and prior years' claims and unrecoverable reinsurance) from an AAA rated subsidiary of Swiss Re Group. In 2001, we ceded US$203.8 million to the cover for a cumulative total of US$727.4 million. The adverse development (before redundancies) arose mainly from C&F (US$62.4 million), Ranger (US$39.5 million) and our runoff subsidiaries (US$96.1 million). The cost of this cover in 2001 is the Swiss Re premium shown of $143.6 million (more on page 58).

We have a separate section in the MD&A on runoff (page 57), which shows you the components of the $27.4 million lost there. The loss on the Kingsmead syndicates, which we sold to Advent last year, is described further on page 59 in the MD&A.

The large underwriting losses, combined with reduced realized gains, resulted in a pre-tax loss of $730.1 million in 2001 – the third consecutive year we have had pre-tax losses. With the tax recovery of $382.5 million, we had a huge net loss of $346.0 million.

Insurance and Reinsurance Operations

The table below shows you the combined ratios of each of our companies for 2001 and 2000. Also shown is the ''adjusted'' combined ratio for 2001, which excludes the impact of catastrophe losses (World Trade Center, Enron and Tropical Storm Allison) and prior years' reserve strengthening for the U.S. insurance group. In the insurance business, there is always something exceptional taking place in any year – so take ''adjusted'' with a pinch of salt!!

While the group combined ratio at 121% was the second worst combined ratio we have ever had (140% in 1989 was the worst), the underlying operations in all our companies (with the exception of TIG) are all much improved. As mentioned in last year's Annual Report, there is no question that I was too optimistic when we purchased C&F and TIG about industry conditions in 1998 and 1999 and our ability to turn around these operations. Fully developed accident year combined ratios for 1999 for C&F and TIG are now running at 146% and 128% respectively versus our expectations of 110% and 105% at the time of purchase. Please read that sentence again because it is quite astounding how wrong one can be in this industry. Not that this helps but the whole industry, including the very best, had a similar experience!

	Underwriting profit (loss)	Combined ratio		
		Adjusted		
	2001	2001	2001	2000
	($ millions)	*%*	*%*	*%*
Commonwealth	(58.8)	122.6	162.6	105.5
Federated	(2.0)	102.8	102.8	106.5
Lombard	(76.4)	111.5	115.3	100.6
Markel	0.4	99.4	99.4	103.4
Total Canadian insurance[1]	*(119.5)*	*111.0*	*116.4*	*102.0*
C&F	(245.0)	109.0	131.1	124.3
Ranger	(81.7)	120.8	182.9	146.3
TIG	(456.8)	116.0	128.1	123.1
Falcon	(4.0)	125.2	125.2	173.4
Total U.S. insurance[1]	*(637.9)*	*113.7*	*125.3*	*124.3*
OdysseyRe[2]	*(214.7)*	*103.1*	115.4	108.0
Total	*(972.1)*	*110.4*	*120.7*	*116.3*

(1) After recoveries under the Swiss Re cover
(2) Including CTR in 2000

On pages 53 to 56 of the MD&A, we have provided more disclosure on each company's operations so that you can see how each of them individually has done. I will not repeat that disclosure other than to make the following points:

(a) Canadian insurance operations

We have excellent management running our Canadian companies and those managements have been in place for some time. However, excluding Markel, 2001 was a very poor year for them. With the exception of Markel, which continued to have excellent underwriting results, all of our Canadian insurance companies had combined ratios (even adjusted combined ratios!) in excess of 100%. On pages 53 and 54 of the MD&A, we discuss the reasons for their poor underwriting performance in 2001. In this hard market, with price increases in excess of 20% (depending on the line), we expect Ron Schwab (Commonwealth), John Paisley (Federated), Byron Messier (Lombard) and Mark Ram (Markel) all to achieve their target 100% combined ratios (with expanding volume). Each of these companies has increased its retentions significantly.

(b) U.S. insurance operations

Because of the prior years' reserve increase at C&F and TIG, results in our U.S. operations were very painful. However, as discussed in last year's Annual Report, we feel the heavy lifting at C&F and Ranger is over and Bruce Esselborn (C&F) and Phil Broughton (Ranger) can focus on Fairfax's target 100% combined ratio. However, I am not going to predict our results – expect me to forecast 2002 results at the end of the year! Having said that, Doug Libby (Seneca) had another great year with a solid combined ratio of 98%.

TIG, however, continues to be a work in progress. Recently, Courtney Smith resigned and Jim Dowd took over as Interim CEO. We have three separate businesses in TIG. We had approximately US$69 million of net premiums written in 2001 in special risk operations (excess casualty, excess property and healthcare) headquartered in Napa and US$60 million in Hawaii (small commercial and personal lines). We are comfortable with our special risk business run by Steve Brett and our Hawaii business run by Wayne Hikida but, as mentioned earlier, the program business in Dallas (approximately US$895 of net premiums written in 2001) will shrink significantly. In the current environment, we expect our special risk operations to grow significantly.

(c) Reinsurance operations

Through Andy Barnard's excellent leadership, we now have a focused worldwide reinsurance company with one platform and capital base with approximately US$1 billion in net premiums written. OdysseyRe's combined ratio for 2001, excluding catastrophe losses (World Trade Center, Enron and Tropical Storm Allison), was 103%. In 2002, excluding a repeat of 2001's unusual events, OdysseyRe is set to make an underwriting profit and also expand significantly. For more details on OdysseyRe, please review its annual report, which is on its website (*www.odysseyre.com*).

Many of our long term investors look at our P&C operations and have tried to identify the float that we generate and the cost of that float. Warren Buffett and Berkshire Hathaway first provided a table disclosing this in their 1990 annual report. For the first time, here are our numbers.

Year	Underwriting profit (loss) *($ millions)*	Average float* *($ millions)*	Benefit (Cost) of float	Average long term Canada treasury bond yield
1986	3.5	29.8	11.6%	9.6%
1987	1.0	54.8	1.8%	10.0%
1988	0.4	72.1	0.5%	10.2%
1989	(13.3)	80.8	(16.5%)	9.9%
1990	(12.5)	137.1	(9.1%)	10.8%
1991	5.3	180.7	2.9%	9.7%
1992	(16.9)	183.6	(9.2%)	8.8%
1993	2.1	320.4	0.6%	7.8%
1994	(16.9)	683.6	(2.5%)	8.7%
1995	(40.9)	913.2	(4.5%)	8.3%
1996	(50.6)	1,423.1	(3.6%)	7.6%
1997	(56.2)	2,683.5	(2.1%)	6.5%
1998	(311.4)	5,303.3	(5.9%)	5.5%
1999	(617.1)	8,545.7	(7.2%)	5.7%
2000	(698.8)	7,905.5	(8.8%)	5.9%
2001	(972.1)	6,898.8	(14.1%)	5.8%
Weighted average			(7.9%)	6.1%

Fairfax weighted average financing differential: 1.8%

* *Excludes runoff operations*

In the table above, float is the sum of loss reserves, including loss adjustment expense reserves, and unearned premium reserves, less accounts receivable, reinsurance recoverables and deferred premium acquisition costs, for our insurance and reinsurance companies. This float is the amount of money we hold in our insurance and reinsurance operations because we receive premiums much before losses are paid. The cost of this float is the underwriting loss or the excess of losses and expenses over premiums. Of course, if we have an underwriting profit, our float has no cost. Insurance businesses are valuable if they generate increasing float at an acceptable cost. We have compared our cost of float to average long term Canada treasury bond yields (which generally are higher than comparable U.S. treasury bond yields).

From the table, the following observations can be made:

1. We have grown our float very significantly over the past 16 years even though in the past two years it has declined. This growth has been mainly through acquisitions. We expect growth in the next few years to be internally generated.

2. In only five of our 16 years has this float had no cost to us. In another five of those 16 years, the float cost us less than long Government of Canada bonds, i.e. we borrowed at rates less than the Government of Canada. In the remaining six years, our float cost more than long Government of Canada bonds – four of these years being the most recent four. In fact, in 2001, our cost of funds was over eight percentage points higher than long Government of Canada bonds – the highest differential in 16 years. Hopefully an anomaly!!

   On average, over 16 years, our float cost us about 180 basis points above the Government of Canada's borrowing cost in the long term market. Our objective, at a 100% combined ratio, is to have no cost for our float.

3. Finally, of course, the value of the float is not only its cost but also a function of how well it is invested. On that score, we have one of the best investment teams around with an excellent track record. Over time, this is a major positive and, as mentioned before, what attracted me to the business in the first place.

The table below shows you the breakdown of our year-end float for the past four years.

	Canadian Insurance	**U.S. Insurance**	**Reinsurance** *($ millions)*	**Runoff**	**Total**
1998	784.3	4,171.3	3,195.8	–	8,151.4
1999	767.3	4,834.6	3,338.2	2,159.1	11,099.2
2000	814.0	3,417.2	2,639.7	1,443.9	8,314.8
2001	1,124.9	3,173.2	2,628.5	2,378.4	9,305.0

In 1999, the runoff segment was formed with the acquisition of TRG, as discussed under Runoff on page 57. The increase in the reinsurance segment in 1999 reflects the acquisition of TIG Re, offset by the transfer to runoff of Sphere Drake, ORC Re and RiverStone Stockholm, all of which were included in the reinsurance group at year-end 1998. The increase in the U.S. insurance segment in 1999 reflects the acquisition of TIG Insurance. The increase in the runoff segment in 2001 reflects the inclusion of CTR's non-life reinsurance portfolio effective January 1, 2001.

Except for acquisitions, the float generated in our U.S. and reinsurance operations has been flat to declining because we have not increased the amount of insurance/reinsurance business that we have written due to very soft markets. In the next three years, as long as current markets prevail, we expect the float generated in all our businesses, except TIG, to increase.

As you know, each year we emphasize to you the importance of proper reserving at our insurance and reinsurance companies. We have had external actuaries (two sets of external actuaries in some cases) reviewing our reserves since we began in 1985. In spite of this huge focus on reserving conservatively, in 2001 we experienced some very significant unforeseen prior years' adverse development in our U.S. insurance companies – some relating to periods before we acquired the companies and some relating to the transition period of our watch when new management significantly changed underwriting and claims handling practices and controls. As mentioned earlier in this report, our experience and that of others in the industry reflected the very poor pricing environment in the late 1990s. In the current vastly improved pricing environment, we do not expect this experience to be repeated. In Canada in 2001, we had some unexpected development from the past, which we describe on page 65. We continue our strong focus on conservative reserving.

Claims Adjusting

2001 was a turnaround year for Linsdey Morden. As the table below shows, free cash flow (cash flow from operations less net capital expenditures), operating earnings and earnings before tax and goodwill showed vast improvement over last year.

Year ended December 31	**2001**	**2000**
	($ millions)	
Free cash flow	20.6	(7.7)
Operating earnings	12.7	1.6
Earnings before tax and goodwill	(0.8)	(27.1)

It was gratifying that each of the five operating units (Canada, U.S., U.K., Europe and International) contributed to the improved results through significant growth in revenue, cost containment and additional restructuring. Cunningham Linsdey UK had a particularly good year as it generated $25.1 million of free cash flow, more than fully justifying our purchase price of Ellis & Buckle in 1998 and our faith in the leadership of Gerry Loughney. Aggregate free cash flow at the other operating units was $12.7 million (thanks to Bill Hornick at Canadian operations, Farid Nagji at U.S. operations, Pim Polak Schoute and Gerard Böttcher at European operations and Jim Grant at International operations) while corporate and financing costs were $17.2 million.

As Interim CEO, Francis Chou was a tower of strength as he helped guide the turnaround and helped select Karen Murphy as the continuing CEO. Under Karen's disciplined and focused leadership, we expect continued good results in Linsdey Morden.

During the year, Ken Polley and Ferd Roibas retired as Chairman and President respectively and Jim Dowd was named the new Chairman of Lindsey Morden. For more details on Lindsey Morden, please review its annual report, which is on its website (*www.lindseymordengroupinc.com*).

Financial Position

As mentioned in previous Annual Reports, we feel our unaudited balance sheet with Lindsey Morden and TRG equity accounted (shown on page 96) is the best way to understand our financial position. Below, we show you our year-end financial position compared to the end of 2000.

	2001	**2000**
	($ millions)	
Cash and marketable securities	833.4	545.4
Long term debt	2,205.8	1,851.4
Net debt	1,372.4	1,306.0
Common shareholders' equity	3,057.6	3,180.3
Preferred securities	560.8	592.0
OdysseyRe non-controlling interest	361.8	–
Total equity	3,980.2	3,772.3
Net debt/equity	**34%**	**35%**
Net debt/total capital	**26%**	**26%**

Cash and marketable securities in the holding company increased significantly due to our $250 million stock issue plus the external refinancing of most of the OdysseyRe debt to Fairfax. Included also is OdysseyRe's minority interest which supports repayment of OdysseyRe's debt. In spite of the effect of the lower Canadian dollar, our net debt to equity and net debt to capital ratios were maintained during the year.

In the MD&A, we discuss our cash requirements during 2002 (page 86) and provide a line-by-line description of all major assets and liabilities on our balance sheet (beginning on page 60). In spite of the battering inflicted by our results in the last year (and in the two years before that), our balance sheet has retained its strength.

This demonstrates again the importance of a strong balance sheet and financial position. We are focused on maintaining this strength. Our financial position continues to be strong for the following reasons:

1. We have no bank debt. Our debt consists of seven public debentures with a long term to maturity (2 years to 36 years) and low interest rates (6.875% to 8.30%), two small debentures issued to vendors, OdysseyRe's debt created in connection with its IPO and certain debt assumed with the acquisition of TIG. All of the public debentures were issued under a single trust indenture containing no restrictive covenants, thus providing us with great flexibility. We have swapped the fixed interest rates on the five public debentures maturing after 2006 into floating rates (or as noted in the next sentence), saving approximately 153 basis points in 2001. We swapped US$125 million of our 7.375% debentures due April 15, 2018 for Japanese yen denominated debt of the same maturity with a fixed rate of 3.48% per annum (see note 5 to the consolidated financial statements). Including the amortization of the unrealized foreign exchange loss on this swap over the remaining term to maturity, the effective rate for 2001 was 4.375% per annum, still below the 7.375% coupon rate of the swapped debentures.

2. We have unsecured, committed, long term bank lines in excess of $900 million with excellent covenants. These bank lines are with five Canadian, five U.S. and two European banks. Please see the details on page 87 in the MD&A.

3. Our net long term debt is less than three times our normalized earnings base (you have yet to see it!!). Also, our earnings base is well diversified among many insurance and reinsurance companies and Lindsey Morden and geographically from Canadian, U.S. and international sources of income.

4. Available cash flow at the Fairfax (holding company) level from dividends, management fees and interest income should cover our administrative and interest expenses and preferred dividends by one to two times. This is based on normal dividend payouts from our insurance companies, which are less than our maximum dividend-paying capacity. In 2001, we took substantially less than our normal dividend payouts. In 2002, our maximum dividend capacity is $232 million compared with $343 million in 2001 reflecting the poor operating results in 2001, particularly at the U.S. insurance companies. Note Fairfax's combined holding company earnings statement on page 101.

5. With more than $800 million in cash and marketable securities in the holding company at year-end, we could pay our administrative and interest expenses and preferred dividends at Fairfax, with *no* dividends from any of our insurance or reinsurance companies, for three to four years – our management holding company survival ratio!

6. As discussed on page 85 in the MD&A, with the exception of TIG all our insurance and reinsurance companies are well capitalized with solvency margins well in excess of mandated regulatory levels.

7. Our foreign exchange exposure from our U.S. insurance and reinsurance companies has been fully hedged by our U.S. dollar debenture issues and the purchase of foreign exchange contracts. While hedged, the lower Canadian dollar could result in Fairfax using cash to roll over certain of the foreign exchange contracts referred to in notes 1 and 16 of the financial statements.

8. Importantly, the listing of OdysseyRe and (assuming markets are willing) C&F provide meaningful flexibility to Fairfax as cash could be generated by the sale of shares (not the control block).

Investments

Equity markets continued to decline in 2001 with the S&P500 down 13%, the NASDAQ down 21% and the TSE 300 down 14%. Long U.S. treasury yields dropped significantly from 5.46% at December 31, 2000 to 4.88% at October 31, 2001 but closed the year at 5.47%.

The unrealized gains (losses) as of year end are as follows:

	2001	2000
	($ millions)	
Bonds	(321.1)	(463.4)
Preferred stocks	(0.4)	(0.7)
Common stocks	39.9	(25.1)
Real estate	4.4	–
	(277.2)	(489.2)

Our unrealized bond loss of $463.4 million at the end of 2000 became an unrealized gain of approximately $250 million as of October 31, 2001, but because interest rates on long U.S. treasuries increased after that date, we ended the year with an unrealized bond loss of $321.1 million. Assuming corporate spreads remain at their year-end levels, our unrealized bond losses would disappear if interest rates decline by half a percentage point, and would become an unrealized gain in excess of $800 million if interest rates decline by one percentage point.

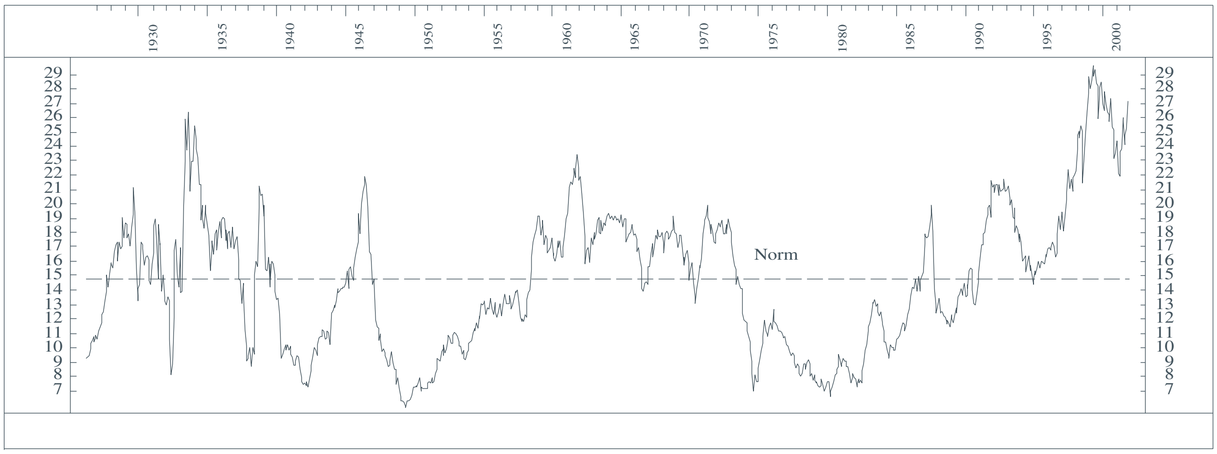
We realized $162.3 in gains in 2001 – about 40% of our gains in 2000. Given the size of the portfolio, we have done much better in the past. Net gains from bonds were $28.4 million. Gross realized gains on common stocks in 2001 totaled $186.7 million (excluding the OdysseyRe IPO gain of $51.2 million). After realized losses of $14.1 million, net realized gains were $172.6 million. The principal contributors to the stock realized gains were put contracts on a basket of technology stocks ($75.1 million), Rothmans ($35.0 million) and S&P500 Index puts ($11.4).

The technology bubble that we discussed in our 1999 and 2000 Annual Reports continued to deflate in 2001. Most of the ''senior'' and ''junior'' issues continued to fall in 2001. The S&P500 also declined but, as the table below shows, continues to sell at very high levels.

As of December 31	**S&P500 Index**	**Earnings**	**Price/ Earnings**	**% Change in Index**
1996	741	39	19x	
1997	970	40	24x	+31%
1998	1,229	38	32x	+27%
1999	1,469	49	30x	+20%
2000	1,320	54	24x	–10%
2001	1,148	26	44x	–13%
1996-2001		**–33%**	**+132%**	**+55%**

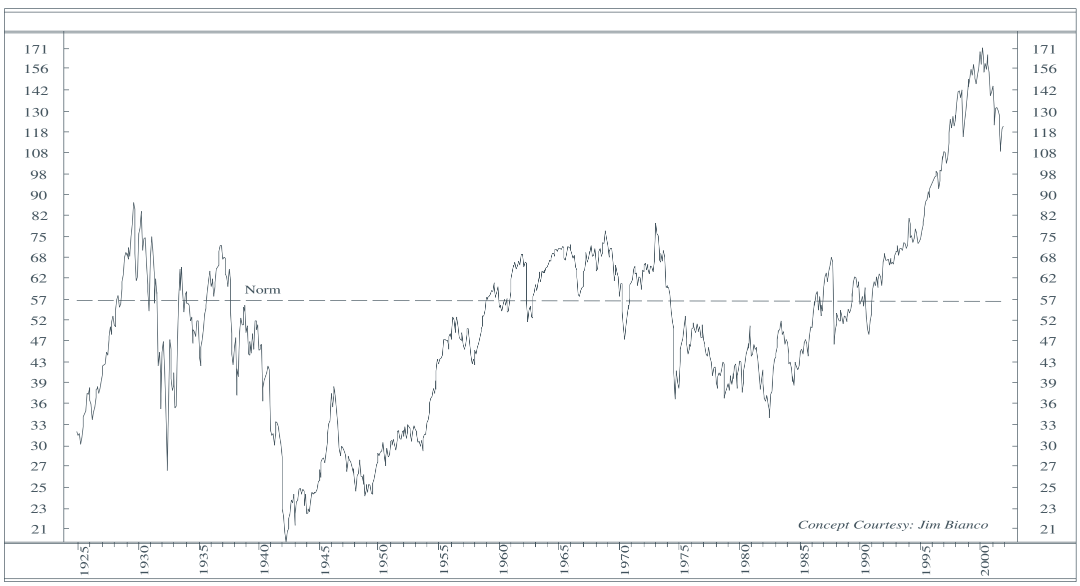
To put the recent five years in perspective, we show you the charts that we discussed at last year's annual meeting.

S&P500 Price/Operating Earnings Ratio (Excludes Write Offs) – 1927 - 2001



Source: Ned Davis Research, Inc.

Stock Market Capitalization as a Percentage of Nominal GDP – 1925 - 2001



Source: Ned Davis Research, Inc.

These charts show you why we have been so concerned about valuation levels in the U.S. market since 1998. On a price to earnings basis for the S&P500 or on a percentage of stock market capitalization to gross domestic product, recent valuation levels have never been seen in the past 100 years in the U.S. Ben Graham, the father of value investing who survived the 1929-32 stock market crash and also the 1972-74 debacle, had this to say about both periods: ‘‘What should a conservative analyst have done in the heady area and era of high growth, high-multiplier companies? I must say mournfully that he would have to do the near impossible – namely, turn his back on them and let them alone.’’ Reflecting on his years on Wall Street, Ben made the point that ‘‘in one important respect, we have made practically no progress at all and that is in human nature . . . people still want to make money very fast.’’ The extremely short term focus in the markets today with undue emphasis on quarterly earnings, promotional quarterly conference calls and huge volatility in stock prices suggests Ben's observation is alive and well.

Both of the above charts show that the pendulum does swing back and forth between greed and fear – and from these levels, declines even to median historical levels would be very painful. It is important to remember that it took 25 years for the Dow Jones to break its 1929 high (of 381) and 16 years to decisively penetrate the 1000 it first reached in 1966. As we did last year, we continue to remind you that we think that most participants in today's equity markets in the U.S. will suffer permanent loss and it is very likely that recent highs in the S&P500 (1,552) and Dow Jones (11,750) will not be seen again in the next decade. When the pendulum does swing – and it seems like it has begun – the two major risks that we have discussed in the past – a potential ''run'' on mutual funds and the ''repricing of risk'' (higher default experience of bonds collateralized with consumer debt) – will be exposed.

This ''off the charts'' valuation level of the S&P500 has resulted in Fairfax continuing to invest in S&P500 Index puts – we currently have US$1.1 billion (notional value) at an average strike price of 1,082. After realizing gains, net of amortization, of US$7.4 million in 2001, the net cost of our S&P500 put program already expensed over the past four years is US$110.3 million. At February 28, 2002 the US$1.1 billion in S&P puts had a carrying value and market value of US$61.6 million.

The US$142 million (notional value) in similar one-year contracts on a basket of technology stocks that we discussed last year resulted in realized gains of US$48.6 million in 2001 (US$32 million in 2000). We currently have US$46 million of these contracts (with unrealized gains of US$8.7 million at February 28, 2002).

As discussed in past Annual Reports, the possibilities for realized gains continue to be:

1. We have approximately $5.5 billion invested in ''put'' bonds (described in our 1997 Annual Report) that have significant upside potential if interest rates decline (limited downside if interest rates increase). As a result of these put bonds, our bond portfolio has an average maturity of 8 years to the put date and 18 years to the long date.

2. We continue to have US$1.1 billion in S&P500 Index puts at an average level of 1,082, which can result in large profits if the U.S. stock market declines significantly.

3. We have $910 million invested in common stock on which we expect to make significant gains over the long term.

Our bond/common stock mix has not changed much in the last few years. We have approximately 6% of our investment portfolio in common shares and almost all the rest in cash and good quality marketable bonds (98.4% of the bonds are rated investment grade, with 83.7% being rated A or above – please see page 82). By country, our common stock investments at December 31, 2001 were as follows:

	Carrying Value	Market Value
	($ millions)	
Canada	175.5	173.7
Japan	146.8	166.5
U.S.	134.8	204.9
Other	452.7	404.6
	909.8	949.7

While we continue to be worried about the absolute levels of the U.S. stock market, as long term value investors, we have maintained our investments in North America because of a few unusual long term value oriented opportunities that came our way last year.

Miscellaneous

Please review page 100 which is an unaudited unconsolidated balance sheet showing you where your money is invested. Please note that our assets are all shown there on an equity basis while a number of the investments included in those assets are publicly traded companies with market values (which fluctuate, of course). Indirectly, through your shares of Fairfax, you own 48 million shares of Odyssey Re (book cost of $21.19 per share), 9,517,012 shares of Lindsey Morden (book cost of $10.30 per share), 11,242,201 fully diluted shares of Hub International (book cost of $11.41 per share) and 7,808,645 shares of Zenith (book cost of $43.93 per share). Also, assuming markets are willing, you will indirectly own marketable shares of Crum & Forster. The market values of these investments, over time, will help you get another reading on the long term value of your Fairfax shares and, we believe, will show you that Fairfax is worth a lot more than its book value.

We made two very small acquisitions (Winterthur (Asia) and Old Lyme) in late 2001 and early 2002. Please see pages 80 and 40 respectively for more details.

We paid a modest $1.00 per share dividend, as discussed in last year's Annual Report.

We continue to want to list on the NYSE but the Canadian dollar refuses to cooperate. We are patient. With the change in accounting for goodwill, our negative goodwill of $51.4 million will be added to common equity as of January 1, 2002 to increase book value per share to $216.64.

For many years now, we have listed for you the risks in our business (this year beginning on page 88). They are many and you should read them carefully. I want to particularly highlight for you the ones on reinsurance recoverables, taxation and ratings. The section on reinsurance recoverables beginning on page 75 of the MD&A discusses this very significant asset on our balance sheet. Dennis Gibbs and his team at RiverStone monitor this asset very carefully for us and while the risks are ever present that some of the reinsurers may default, we think Dennis has this well in control. The settlement of all Fairfax exposures to Equitas in 2001 was an example of what RiverStone can do. The composition of the future income tax asset is discussed on page 60. Part of this asset relates to normal timing differences which arise out of ongoing operations. As for the balance, we are confident that it will be realized from future profitable operations. And finally, the claims paying rating from A.M. Best is critical to our U.S. operations. With Jonathan Godown, we are all focused on improving our ratings.

Your company has gone through a very difficult time in the past three years, particularly last year. However, in spite of these three years, we have among the best long term track records in the property and casualty industry. Since we began in 1985, our book value per share has compounded at 34% annually, while our stock price has compounded at 28%. Your management team has faced many, many problems during these 16 years but with excellent people in a team environment with no egos and a strong will, we have worked through these problems. Let me remind you of the strengths that Fairfax has that I first listed for you in the 1997 Annual Report. They are formidable and they have basically not changed.

1. Eight main established insurance companies (Commonwealth, Crum & Forster, Falcon, Federated, Lombard, Markel, Ranger and TIG) and an established international reinsurance company (OdysseyRe) with strong management teams focused on underwriting profit. These companies, together with TRG, whose expertise and ability complements our insurance and reinsurance operations, as well as the claims operations of Lindsey Morden and our investments in Hub International and Zenith, add up to a widely diversified base of over $6 billion in revenue and over $35 billion in assets.

2. An investment team with a proven track record over the long term with the ability to invest directly or indirectly in any market in the world, managing an investment portfolio of $15 billion which should produce annual investment income (interest and dividends only) of over $50 per share.

3. A lean head office team which is experienced in monitoring operations and in reacting quickly when opportunities develop, in all cases with a continuing focus on financial conservatism and protecting the company from worst case events.

4. A track record of creating wealth for shareholders over the long term while maintaining financial soundness.

5. An unbroken record of treating people fairly. A company that *has not* and *will not* compromise on its integrity.

6. A commitment to build our company over the long term — and not to flip it in the next few years. The whole focus of Fairfax is the *long term*.

In spite of much trying, we were not able to postpone our annual meeting to 2003! So our annual meeting this year will be held on Tuesday, April 16, again at 9:30 a.m. in Room 106 at the Metro Toronto Convention Centre. Our Presidents, Fairfax officers and Hamblin Watsa principals will all be there to answer questions about the future. I hope to attend!

Ken Polley retired last year as a director of Fairfax. Ken has been with us since 1986, almost since the inception of our company. He has been a great supporter of the company and a good friend and we wish him all the very best in the future. We welcome Tony Griffiths to the Board. Tony has had a long association with us and is on many of our insurance company Boards. Given Tony's extensive turnaround experience in Canada, the timing of his election to our Board may not be inappropriate.

I want to again highlight our website for you (*www.fairfax.ca*) and remind you that all our 17 Annual Reports are readily available there, as well as links to the informative websites of our various individual companies. Our press releases are immediately posted to our website. Our quarterly reports for 2002 will be posted to our website on the following days after the market close: first quarter – May 10, second quarter – August 9 and third quarter – November 8. Our Annual Report will be posted on March 7, 2003.

Again, on your behalf, I would like to thank the Board and the management and employees of all our companies for their dedication and commitment during the toughest year we have experienced.

March 8, 2002

V. P. Watsa

V. Prem Watsa
Chairman and
Chief Executive Officer