To Our Shareholders

We just made it. With the help of strong financial markets, we barely cleared our 20% return on equity hurdle. We earned 20.1% on average shareholders' equity in 1995 (versus 12.4% for the TSE 300). Reflecting our larger equity base, we made record earnings on an absolute and on a per share basis. Net income after tax in 1995 increased by 130% to $87.5 million. In spite of the 9% increase in the average number of shares outstanding, earnings per share increased by 110% to $9.79. Book value per share increased by 22% to $53.28 while the share price closed at $98.00, up 46% in 1995. While our shares did trade at $100, we were hoping they would close the year at $100 so that your future analysis of our compound growth would be much easier. Don't throw out that calculator yet!

1995 marks the end of Fairfax's first decade. Since we began in September 1985, our results have been much better than we expected and are quite humbling when we consider all the mistakes that we have made over this time period. And for sure, our results will not be repeated. In its first decade, Fairfax has earned an average annual return on shareholders' equity of 20.3% (versus 7.5% for the TSE 300), pretty well right on our 20% objective. However, book value per share has increased by more than 25 times while the stock price has increased by 30 times. We began with one insurance company, Markel Insurance, with annual premiums in 1985 of $17 million. Today we have seven insurance companies, an investment counselling operation and a claims adjusting company, with revenue in excess of $1 billion (insurance premiums of $829 million). In 1985 the company had never earned $1 million in its past. In 1995 we earned $87.5 million. Investable assets increased from $33 million in 1985 to $1.7 billion in 1995. This record was achieved while always maintaining a strong financial position, and we ended the decade in the strongest financial position we have ever had.

While we are very gratified by these results, we are even more grateful for the fact that they were achieved by treating our customers, employees and shareholders – and others that we deal with – in a fair and friendly way. This approach to business may penalize our results in the short term, but it is the only one we feel comfortable with and the way you can expect us to behave in the future.

How does Fairfax's record rank among Canadian businesses? As disclosed annually, the Report on Business Magazine (July 1995 issue) ranks Fairfax's five year average ROE at 59 (or 51 on the basis of our calculations) out of the top 1000 companies listed on the Canadian stock exchanges, i.e. in the top 5-6% of all companies in Canada. Our own analysis suggests that for the nine years ending December 31, 1994 (those are the latest figures that are available), Fairfax's average ROE of 20.3% was the ninth best of all the TSE 300 companies. In terms of share price growth and book value growth for the same period, Fairfax was fourth best among the TSE 300 companies (rest assured we won't tell you who was ranked higher!!). So you can see that 20% is an extremely challenging objective for us and one that we will continue to strive for in the next five years. Our past record of 40% annual compound growth in stock price and book value, as we have repeated *ad nauseam*, is not repeatable in the future. Besides earning 20.1% on shareholders' equity in 1995, our most significant accomplishment was our strong year-end financial position. We did our second U.S. debt financing, led again by J.P. Morgan and First Boston. We issued US$100 million of unsecured debentures with an 8¼% coupon and a 20 year term to maturity. While we were happy with the absolute rate, the spread of 170 basis points over comparable treasuries was a little higher than we expected. The rating agencies (Standard & Poor's, Duff & Phelps and Dominion Bond Rating Service) all upgraded us to a BBB+ before the issue. Unfortunately, late in the year Moody's rained on our parade with a Baa3 rating on our debentures. We welcome our debenture investors and want to reassure them that we run our company at standards that merit an A, and we hope to convince the rating agencies of that soon. Proceeds from the debenture issue repaid our long term bank debt and also left us with about $70 million cash in the parent company. By year-end, we had raised our unused, unsecured, committed, long term bank lines to $215 million from $105 million. Our debenture issue and increased bank lines resulted in Fairfax being in the strongest financial position it has ever been in during its ten year history. Our small head office at Fairfax, led by Rick Salsberg and John Varnell and ably supported by Brenda Adams, Sam Chan and Ronald Schokking, took all of this in stride.

We commented in our 1994 Annual Report that although our share issue in 1994 at $76 was $12 above the previous day's trade, it was a fair price for our shares over the long term. We said we were "concerned with making our investors look good in the long term". While a year is certainly not the long term – and if our shares had not gone up in 1995 we would not be making this comment – our shares have gone up by 29% from the issue price, significantly higher than the 8% for the TSE 300. Our focus continues to be the long term.

With our shares now trading at three digits, we are often asked about stock splits for greater liquidity, higher stock prices, etc., etc. We have always replied in the negative. Our view is that stock splits do not make shares more or less valuable; they just increase the number of slices that you take from a cake but do not increase the size of the cake. Our focus is to increase the long term intrinsic value of our company (the cake) and not change the number of slices.

Together with our dividend policy (no dividends), investor relations department (none) and lack of emphasis on short term (quarterly) earnings, we have instituted policies that cater to the long term investor, i.e. investors who buy and hold our shares for the long term. Have we been successful in attracting this type of investor? During 1995 1.5 million shares of Fairfax were traded on the TSE, or approximately 20% of the public float. When compared to the companies in the TSE 300, Fairfax's turnover (shares traded as a percentage of the float) in 1995 was ranked eighth from the bottom – exactly where we want to be!! The highest turnover on the TSE was 1250%, the lowest 13% and the average 60%. Sell your shares if we ever make the TSE options list.

While we are discussing the long term, we should remind you (as we did in our 1986 Annual Report) that you have one significant short term disadvantage by my controlling all the multiple voting shares. I will not sell my shares even at a 100% premium to current prices (i.e. $200 per share) and thus my multiple voting shares prevent you from getting an attractive one time bonanza. However, for this short term pain, we hope to provide you with good long term gains. In case you forgot the power of compounding, a 20% ROE over 13 years (with no dividends) results in a tenfold increase in book value (and may I dare say, stock prices?!). While we have more than achieved this in the past, the future is definitely not guaranteed.

As we are discussing my shares, you should know that I have arranged my affairs so that my death (not expected soon!) will not trigger the sale of any of my multiple voting shares. No short term bonanza even at my passing away!

With Fairfax at $100 per share, many of you are probably wondering if this is as good as it gets. Is the stock overvalued and can it drop significantly? This is a good question and you will have to come to your own conclusion based on the facts that we have disclosed in this Annual Report. However, you should recognize the following:

1) Stock prices will always fluctuate – including Fairfax's. They can easily go down 50% from current levels but as long as you don't have to sell, you will not lose money.

2) At $100, the shares are selling at approximately twice book value, close to the top of their historical range. In relation to earnings, the shares are trading at approximately ten times – significantly less than the 13.8 times and 17.8 times for the TSE 300 and S&P 500 respectively.

3) In the past decade, stock price growth has followed growth in book value irregularly and over time.

4) Our book values are very conservatively stated but they are a first proxy for intrinsic value or what the company is worth. While you should make your own estimate of intrinsic value, it is fair to say that in 1995 the intrinsic value of Fairfax increased by at least the same percentage as the increase in book value.

So I really don't know what stock prices will do in the short term – never have – but I suggest taking the long view.

While we are talking about the long view, you will be happy to hear that at Fairfax, we eat our own cooking. All of the key officers of Fairfax (including yours truly), the partners of Hamblin Watsa and the presidents of our subsidiaries have a very significant portion of their net worth in Fairfax shares. At least three out of our six directors also have a meaningful investment in Fairfax. In total, over 21% of all Fairfax shares are owned by the directors, officers and employees of Fairfax. At $100 per share, this works out to approximately $189 million. So if you ever get indigestion when you look at our stock price in the financial pages, it may help to know we are suffering too!

The table below shows the sources of our net earnings:

	1995	**1994**
	($ millions)	
Insurance underwriting	(40.9)	(16.9)
Interest and dividends	86.3	53.8
Total	45.4	36.9
Claims adjusting (Fairfax portion)	2.1	0.5
Interest expense	(19.1)	(10.4)
Goodwill amortization	(1.4)	(1.4)
Corporate overhead and other	(9.0)	(2.1)
Realized gains	71.9	20.0
Pre-tax income	89.9	43.5
Less: taxes	2.4	5.4
Net earnings	87.5	38.1

The table shows you the results from our insurance (underwriting and investments) and non-insurance operations. Claims adjusting shows you our share of Lindsey Morden's after-tax income. The corporate overhead expense is net of Hamblin Watsa's pre-tax income. 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 operations and of Fairfax with Lindsey Morden equity accounted, as well as Lindsey Morden's financial statements, shown on pages 46 to 51.

The significant increase in the underwriting loss in 1995 was largely due to Ranger, and secondly, Lombard. Interest and dividend income as well as interest expense increased because of the Lombard acquisition in 1994. Lindsey Morden made a significantly higher contribution to our earnings in 1995. Corporate overhead and other increased mainly because of one time expenses associated with the debt issue, the start-up of our reinsurance division in New York, reduced income from Hamblin Watsa and other expenses. As the table shows clearly, realized gains were the main reason for the large net earnings increase in 1995. Taxes continued at lower levels because of the utilization of available losses and loss carry forwards, a greater amount of tax-free Canadian dividend income, and higher income from lower taxed non-North American operations.

Insurance operations

1995 worked out to be an excellent year for our Canadian insurance companies but not so for Ranger. Overall, we had a combined ratio of 104.9% for 1995 versus 104.2% in 1994. Excluding Ranger, our insurance companies had a combined ratio of 101% while Ranger had a combined ratio of 118.1% (after indemnifications). Since 1985 we have achieved our target combined ratio of 100% or less in only five of the last ten years a .500 record which in baseball would be terrific but is nothing to write home about in the insurance industry.

Commonwealth, led by John Watson, continued to produce excellent results. Commonwealth had a superb 1995 with a combined ratio of 89.5% versus a Northridge-plagued 97.8% in 1994. Underwriting profit in 1995 was about $9.1 million. Since we purchased it in 1990, this company has had a combined ratio of less than 100% in every year except 1992 (Hurricane Andrew), i.e. four out of five great years. Recently, Standard & Poor's upgraded Commonwealth to an A from A– and Duff & Phelps to an A+ from an A, while A.M. Best continues to rate Commonwealth at an A (excellent).

Gross premiums at Commonwealth increased to a record $291 million from $263 million in 1994, while net premiums earned remained flat at $87 million. Net income after taxes was a record $20.2 million versus $17.5 million in 1994. While premiums increased in every division in 1995, there are growing signs that pricing in the oil and gas and petroleum sector has peaked. Canadian property, casualty and U.S. property divisions have all firmed but are still very competitive.

Commonwealth continues to very carefully monitor its exposure to catastrophes through the Insurance Risk Assessment System program. As mentioned in earlier Annual Reports, we remain exposed to the unlikely possibility of a major catastrophe impacting the income statement of Commonwealth but not, we feel, its balance sheet.

1995 was the first full year for Lombard (which used to be known as Continental) under Fairfax's ownership. Led by Byron Messier and his management team, Lombard had an excellent first year with a normalized combined ratio of 103% (after indemnification). During the year, Byron split the company into two divisions – the commercial lines division led by Rick Patina and the personal lines division led by Henry Rodrigues. This should result in a greater focus in the company on each of the different lines of business. In July 1995 Lombard and Henry Rodrigues were selected by Canadian Information Productivity Awards, out of 20,000 entries, as the Information Innovator of the Year. Independently audited, the judges felt that Henry and Lombard had "revolutionized the personal lines business with a productivity edge of up to 10:1 versus the competition". As a low cost operator in the personal lines business, this could result in significantly more business at combined ratios of less than 100%. Byron and Henry are proceeding with care!

In 1995 Lombard had gross premiums written of $510 million, up 4% from 1994. After reinsurance, Lombard had net premiums written of $444 million. The company maintains a quota share treaty with a related Bermuda company (CRC (Bermuda)). Approximately $92 million of net premiums written flows to CRC (Bermuda) and the remaining $352 million remains with Lombard. Net income after taxes (including CRC (Bermuda)) amounted to $42 million in 1995. Late in the year, as per our agreement with Continental U.S., Byron changed Continental's name to Lombard. Because of dropping interest rates, we recouped the $14 million by which Lombard's investments were written down in November 1994 because of mark-to-market purchase accounting. The prospects for Lombard look very good for a combined ratio of less than 100% in 1996.

Federated, under John Paisley's leadership, had another very good year at the property and casualty company with a combined ratio of 100.1% (102.1% including the life operations). Gross premiums increased by 18% to $55 million while net premiums written increased 19% to $47.2 million. Federated's customer retention rate in 1995 was 95% and with its specialty focus, it continues to be the leader in the farm equipment, tire dealers, plumbing and heating contractors and independent petroleum distributors markets. In 1995 Federated earned $6.9 million after taxes, about 23% less than the $9.0 million earned in 1994 because of lower investment income.

Under Mark Ram's leadership, Markel had a spectacular turnaround in 1995. After three years of combined ratios of 115%, Mark, in just a year and a half, has turned Markel around with a combined ratio of 101.9%. This, with more conservative reserving! Shows you why management skills get magnified in the insurance business both ways!! More importantly, Mark and his team are building Markel, brick-by-brick, for sustained long term success. I think it is fair to say, Markel has not been in better shape since its founding in 1951, certainly since we purchased it in 1985.

Markel's net premiums written in 1995 were $80 million versus $56 million in 1994. Net income after taxes in 1995 was $9.7 million.

Ranger had a very poor year in 1995. Prior to indemnification, Ranger had an unbelievable combined ratio of 138.0% – mainly because of a very significant strengthening of case reserves. During the year, we found out that case reserving at Ranger was not adequate. After the remaining indemnification of US$11.5 million (total US$20 million indemnification secured by real estate obtained at purchase) and an additional US$14 million indemnification provided by Fairfax (backed mainly by the $14 million recouped from Lombard as mentioned earlier), Ranger reported a combined ratio of 118.1%. This was very disappointing to us and you have every right to question our judgment – again!! However, before you sell your stock you may want to consider the following points on Ranger:

1) We think we have licked the reserving problem and perhaps gone too far. We'll know by this time next year.
2) In spite of this reserving hit, Ranger earned $18 million after tax in 1995 after the indemnifications discussed above because of capital gains (mainly stocks) of $34 million and interest and dividend income of $17 million.
3) Pete Wallner took over as President in May 1995. We feel comfortable that Pete will return Ranger to its traditional strengths in its core lines and that 1995 will not be repeated.
4) Pete has discontinued the poor performing lines, reduced overhead and focused on underwriting profitability by increasing retentions in our core lines like propane and petroleum distributors.
5) In spite of its reserving hit, Ranger ended the year with the highest statutory capital position it has ever had and A.M. Best continues to rate it an A (excellent).

All in all, Pete and the management team at Ranger have come through a gruelling year, but with continued strong support from Fairfax we expect 1996 to be a much improved year and on the way to sustained underwriting profitability.

Wentworth, our Barbados company, had an excellent year in 1995. Because of the absence of catastrophes, Wentworth had a combined ratio of 62% on net premiums earned of $16 million. Wentworth earned $8.0 million in 1995 versus $0.5 million in 1994.

Early in 1995 Kris Datt joined us to begin an international property reinsurance division in New York. Kris has had an excellent long term track record of underwriting profitability and we look forward to his group's contribution to Fairfax.

Our insurance companies (with the exception of Lombard) continue to have low operating leverage (net premiums written to common shareholders' equity) as shown on page 42.

Lombard's leverage has dropped considerably in 1995. We have the capacity to increase our premiums significantly but there are no signs that we will want to do it soon. The insurance downcycle began in 1988 and continues unabated even though there are many constructive changes taking place in the industry.

You have no doubt read about Lloyd's and the problems that that institution is going through. You will be happy to know that our exposure to Lloyd's is very minimal. We are mindful of our reinsurance recoverables and deal only with the most financially sound reinsurers.

Our reserves continue to be certified at the individual insurance company level by Joe Cheng for Commonwealth, Ron Miller for Federated, Lombard and Markel, and Coopers & Lybrand for Ranger. They are then reviewed on a consolidated basis and certified by Coopers & Lybrand. All of this is in addition to the extensive monitoring and analysis done by our actuary at Fairfax, Sam Chan. Sam's and our goal at Fairfax is to ensure that the reserve ''past'' does not hurt us in the future but helps us, i.e. it is a very important policy of ours to ensure that we have redundancies each year in each of our insurance companies. In spite of this focus, we have had Ranger! So you can see it is not easy but we are persevering.

We provide extensive disclosure on our total claims reserves beginning on page 33 which will help you appraise our past reserving accuracy. As discussed in the MD&A, our Canadian insurance companies, excluding Lombard, had redundancies; including Lombard, after its $7.0 million indemnification they had a redundancy of $2.9 million. As discussed earlier, Ranger had a very poor year, resulting in a net US$4.1 million deficiency (or US$38.1 million before indemnifications). While we are not pleased with our reserving surprise at Ranger, rest assured we will not tolerate lax reserving practices. All in all, over the past ten years, our reserving has been good – no room for complacency though!

Claims adjusting

Ken Polley and Lindsey Morden came through for us in 1995. After many years of grinding it out in the pits, Ken and his management team achieved record earnings in 1995. In spite of flat revenue of $155 million (versus $156 million in 1994), Lindsey Morden earned a record $8.1 million before taxes and $4.1 million after taxes – an 11% return on average shareholders' equity. We continue to feel that Ken, with the support of Don Cain, Don Smith and Duncan Smith, will achieve our 20% return on equity target and make this a very attractive investment for its shareholders (including us).

You will note that during 1995 Morden & Helwig changed its name to Lindsey Morden to better reflect its extensive operations in the U.S.

Lindsey Morden's balance sheet improved in 1995 due to the record earnings. Its debt to equity ratio improved to 0.45:1 from 0:55:1 in 1994. We are breathing a little easier on the goodwill shown on the company's balance sheet!!

During the year Lindsey Morden's subordinated convertible debenture was refinanced for an additional five years at fair terms for the company. The coupon on the debenture was reduced to 8% from 10% and the conversion price to $7.50 per share from $11.00. Lindsey Morden could not have refinanced its convertible debenture at more favourable terms in the marketplace. Fairfax, as the holder of this debenture, plans to convert it into subordinate voting shares before the maturity date (assuming this is justified by the share price).

For further information on Lindsey Morden, please read its annual report – available by phoning Duncan Smith at (416) 362-6762.

Investment management

1995 was an excellent year on an absolute and relative basis for U.S. equities and bonds. This was not the case for Canadian equities. However, as shown on the next page, on a long term basis the partners of HWIC have produced excellent results in each of the areas in which they provide investment management – Canadian equities, U.S. equities, Canadian bonds and balanced funds.

Annualized rates of return (%)

Cumulative periods ended December 31, 1995

	5 years	10 years	15 years
Canadian Equities	16.9	11.2	13.5
TSE 300	10.8	8.3	8.7
U.S. Equities	34.2	19.6	19.5
S&P 500	20.4	14.6	15.8
Canadian Bonds	16.9	12.1	–
SM Index	12.8	11.3	–
Balanced Fund	18.4	13.4	–

Source: Representative balanced fund managed by HWIC for eleven years. Equity results for an additional four years are from the organization for which the principals previously worked.

Because of the poor relative returns in 1995, HWIC did not earn any incentive fees and, in fact, had to provide each client with a 10% discount on their fees. Total fees in 1995 were $5.3 million, down 43% from $9.3 million in 1994 because there were no incentive fees in 1995. In spite of the drop in revenue, Fairfax earned a 17% pre-tax cash return in 1995 on its $14 million investment in HWIC. We should repeat again that while returns after goodwill amortization (of $1.4 million annually) will be less than those mentioned above, we think the returns we have shown are the best measure of HWIC's performance.

Financial position

As in previous reports, we feel our unaudited balance sheet with Lindsey Morden equity accounted (shown on page 48) is the best way to understand our financial position. We have changed the table below because our recent long term debenture issue (US$100 million at 8¼% for 20 years) resulted in a significant amount of cash in our holding company.

Here's what our year-end financial position looks like compared to the end of 1994:

	1995	**1994**
	($ millions)	
Cash and short term investments	$ 70.4	$ 7.2
Short term bank debt	–	–
Long term bank debt	–	60.0
Long term debentures	298.0	165.3
Total debt	298.0	225.3
Net debt	227.6	218.1
Common shareholders' equity	472.6	392.0
Net debt/equity	48%	56%
Net debt/total capital	30%	35%

As shown, common shareholders' equity increased by $80.6 million – $87.5 million from net income less $6.9 million used to purchase 85,100 shares at $81 per share. The long term debentures increased because of the US$100 million debenture issue in October 1995. Proceeds of C$133 million were used to fully repay the long term bank debt of $60 million, leaving $70 million in cash in the holding company after $3 million of net disbursements. Given our current cash position in the holding company and our plans always to have a significant cash position, we have changed our definition of debt to net debt which means total debt less cash. We think net debt to equity is a better ratio for us than the gross debt to equity ratio. Obviously, this puts our financial position in a better light – and so you may properly be sceptical. When management cannot meet its targets, it usually resorts to changing the targets to meet its actual results. Having said that, we do feel this change applies to us. Our net debt to equity ratio and net debt to total capital ratio dropped significantly from 56% and 35% respectively at year-end 1994 to 48% and 30% at year-end 1995.

Also, by year-end 1995 we had increased our unused, unsecured, committed, long term bank lines to $215 million (from $105 million) from six major banks – three Canadian, two U.S. and one European. As emphasized in the past, these are unused bank lines and provide us with flexibility on an emergency basis – we will not use them to make an acquisition. By the way, we pay 0.25% per annum (i.e. approximately $540,000 annually) for the privilege of having these lines. A little insurance you may say!

We also have letter of credit (LOC) facilities in excess of $70 million for use in the ordinary course of our insurance businesses. As mentioned earlier in the report, Fairfax ended 1995 in the strongest financial position it has ever been in during its ten year history.

Why do we feel this way? Because of the following:

1) We have no bank debt. Our debt consists of two public debenture issues with a long term to maturity (8 years and 20 years respectively) and low interest rates (7¾% and 8¼% respectively), and a small eight year 7¾% debenture issued to a vendor. All of this debt was issued under a single trust indenture containing a covenant package that provides us with great flexibility.

2) We have unused, unsecured, committed, long term bank lines of $215 million with excellent covenants with three Canadian, two U.S. and one European bank. In addition, we have LOC facilities in excess of $70 million.

3) Our net long term debt is less than three times our expected earnings base. Also, our earnings base is well diversified between many insurance companies, Lindsey Morden and HWIC, and Canadian and U.S. streams of income.

4) Cash flow at the Fairfax (holding company) level from dividends, management fees and interest covers our expenses (administrative and interest) by about two times. Note Fairfax's parent company-only income statement on page 53.

5) For the first time in Fairfax's history, we have about $70 million of cash at the holding company which means we can pay our interest expenses for about three years with no dividends being taken from our regulated insurance companies.

6) As discussed in the MD&A, our insurance companies are all over-capitalized with large solvency margins in excess of mandated regulatory levels. This includes Lombard, which was not as strong last year.

7) Our foreign exchange exposure with respect to the balance sheet and future U.S. dollar income (mainly Ranger) was fully hedged at year-end 1994 by our first US$100 million debenture issue and foreign exchange contracts. With our second US$100 million debenture issue in 1995, we felt the balance had shifted the other way and our U.S. liabilities exceeded our assets. So we unwound our US$25 million foreign exchange contract at C$1.50 to US$1.00 (at a profit of $2.2 million) and are looking at partially unwinding the US$50 million foreign exchange contract at C$1.37 to US$1.00 during 1996. The additional foreign exchange contracts mentioned in note 9 to the financial statements hedge U.S. portfolio investments in Canadian insurance subsidiaries.

Long term shareholders should note that the reasons discussed above put Fairfax in its strongest position ever even though in the early years we had little or no debt.

Investments

1995 was an excellent year for stock and bond markets – particularly for the U.S. stock market and bonds. While our results relative to the indices were not very good in 1995, it was a record year for realized gains. The change in unrealized gains or losses is shown below:

	1995	**1994**
	($ millions)	
Bonds	21.7	(17.5)
Preferred stocks	5.7	(1.4)
Common stocks	(12.9)	(12.1)
	14.5	(31.0)

Declining interest rates and rising stock markets resulted in a $31.0 million unrealized loss being transformed into a $14.5 million unrealized gain. This was after a record $72 million in realized gains in 1995. To put the realized gains in perspective, it took us nine years to achieve cumulative realized gains of $83 million – we achieved 87% of that in the tenth year alone!! The $72 million in gains consisted of $62 million realized from stock gains and $10 million from bonds. The $62 million realized from stocks is about a 17% return on an average common stock portfolio of approximately $357 million – about 7% above the 10% interest income we could have obtained if it was all invested in bonds.

After a year like 1995, some of you probably think that we have scraped the bottom of the barrel as far as realized gains are concerned and perhaps used it all to achieve our 20% objective in 1995. While we always look at the long term, we remain sceptical of managements who forever are promising good things in the distant future but don't deliver in the present. After all, many of our long term decisions in the past should blossom in the present – if they were good decisions! So while we balance the present with the long term, rest assured that we expect to make significant realized gains on the approximately $390 million that we had invested in U.S. and Canadian stocks at the end of 1995 though the timing of these returns is entirely unpredictable.

Our aggregate provisions for losses on investments as at December 31, 1995 of $9 million increased by $2 million from December 31, 1994. We feel these provisions are adequate to provide against unexpected events taking place in the future.

The table on page 39 shows the returns on our investment portfolios. Investment income (interest and dividends) has increased dramatically because of the Lombard investment portfolio. After tax investment income per share has increased to $8.25 from $4.85 in 1994. Since the 45¢ per share generated in 1985, after tax investment income per share has compounded at 34% annually.

Gross realized gains totalled $80.2 million. After realized losses of $6.3 million and increased provisions of $2.0 million, net realized gains were $71.9 million. The major contributors to realized gains were Magma Copper ($9.7 million), Loews ($5.8 million), Repap ($5.3 million), Bristol Myers ($3.3 million), AIG ($3.0 million), Berkley ($2.2 million), Rainy River ($1.7 million), Brascan ($1.7 million), Security Capital ($1.6 million), Noranda ($1.6 million), Stelco ($1.5 million), Canadian Tire ($1.2 million), Toronto-Dominion Bank ($1.0 million) and Alcan ($1.0 million).

At the end of 1995 we had approximately $390 million or $44 per share invested in common shares. Canadian common shares amounted to approximately $270 million while U.S. common shares were approximately $120 million. Of this amount, $154 million was invested in financial services companies, $62 million in industrial products companies and $39 million in natural resource companies. With the Dow Jones making record highs, we are reminded again of Ben Graham's statement from "The Intelligent Investor" that we quoted to you in our 1987 Annual Report after the crash in October. Ben said,

> "The investor with a portfolio of sound stocks should expect their prices to fluctuate and should neither be concerned by sizeable declines nor become excited by sizeable advances. He should always remember that market quotations are there for his convenience, either to be taken advantage of or to be ignored. He should never buy a stock because it has gone up or sell because it has gone down. He would not be far wrong if this motto read more simply: 'Never buy a stock immediately after a substantial rise or sell one immediately after a substantial drop.' "

While we are finding it difficult to identify good long term values in the U.S., in Canada we continue to find them quite abundantly. The Canadian market has lagged the U.S. market very significantly in the last ten years but we expect it to catch up in the future. We hope this means the Canadian market will go up to bridge the difference as opposed to the opposite!!

Our "nuclear bomb" testing on insurance regulatory capital of a simultaneous decline of 50% in our common stock holdings, 30% in our preferred stock holdings and 20% in our bond holdings resulted in the purchase of a "put" at Lombard. We purchased a two year put on the TSE 300 in February 1995, off 20% from the prevailing level, to hedge the $70 million in Canadian stocks that we owned in Lombard. We paid $1 million for this insurance which resulted in a very significant reduction in the additional capital which would be required for Lombard if the "nuclear bomb" exploded. While we don't expect the "nuclear bomb" scenario to materialize, all our insurance companies are well protected if it does.

Chandran Ratnaswami joined us late in 1995. Paul Fink and Chandran are reviewing international insurance and common stock investments for us. This may be our acorn for a future oak tree!!

While we have almost eliminated our very small past investments in real estate, in 1995 we purchased a 45% interest in two office buildings in downtown Toronto. Why the change of heart on real estate? Basically, John, Rick and I could not resist the allure of first class office buildings in prime downtown locations in our home town being offered on very reasonable terms. We think we bought them at good prices, certainly well down from what they were selling at in 1988/89 – but only time will tell if the returns work out well!

Miscellaneous

In 1995 Fairfax and its subsidiaries donated approximately $953,000 (1% of pre-tax income) to a variety of charities across North America.

We remind you to review page 52 which is an unaudited, unconsolidated balance sheet on an equity accounted basis showing you where your money is invested. As you can see, we have $653.7 million invested in our insurance companies, $28.1 million in Lindsey Morden, $11 million in HWIC and over $70 million in cash. Our insurance companies and Lindsey Morden are shown at their underlying book values. Our insurance companies continue to be very conservatively valued.

You know about our dividend policy. Last year, though, we indirectly gave you a $0.77 per share dividend by retiring 85,100 shares at $81 per share for a total cost of $6.9 million. If we had distributed the $6.9 million to you, you would have received approximately $0.77 per share on the 8.9 million shares outstanding. We think this continues to be the most tax effective way of distributing excess capital. In our 1992 Annual Report, we said that we would consider buying back our shares at close to book value as long as it was within our financial capability.

As demonstrated by our purchases in 1995, we are a little less sensitive about the price we pay for our shares as long as our long term prospects for a 20% return remain intact.

We decided to list the risks that we face in the section on Issues and Risks on page 44. You should read them carefully because they can be significant in the short term. However, in the long term, with the good people we have at Fairfax and our subsidiaries and our way of doing business, our flexible corporate structure, significant sustainable investment income and our share of good fortune, we expect to continue to earn a return on shareholders' equity in excess of 20% by running Fairfax for the benefit of customers, employees and shareholders.

In late 1994 and in 1995, two of the founders of Markel Financial, our predecessor company, passed away. We record with much sadness the deaths of Stanley and Milton Markel, the fathers of Steven and Tony Markel respectively. On a happier note, one of our directors, Winslow Bennett, celebrated his 70th birthday in 1995. Winslow was one of the founding shareholders of Sixty Two and continues to support us wholeheartedly.

We had an excellent annual meeting last year at the old Toronto Stock Exchange building on Bay Street – excellent because many of you came and asked questions that benefitted all shareholders. This year our annual meeting will be held at the same place again (the Design Exchange, 234 Bay Street, Toronto) at 4:30 p.m on April 17, 1996. We hope to see as many of you there as possible.

Again, on your behalf, I would like to thank the Board and the management and employees of all our companies for another great year.

March 1, 1996

V. P. Watsa

V. Prem Watsa
Chairman and
Chief Executive Officer