To Our Shareholders

It happened again. For the third time in 14 years and the first time in the last five years, we did not earn a return on equity in excess of 20%. We earned 4.3% on shareholders' equity in 1999 (versus 6.2% for the TSE 300) – the lowest return on equity since we began in 1985 and the first time we have not earned as much as the TSE 300. And it gets worse! Net income after taxes dropped by 68% to $124.2 million, while earnings per share dropped by 72% to $9.20 per share because of a 12% increase in shares outstanding. Book value per share, however, increased by 26% to $231.98 while our share price dropped by 55% to $245.50 per share from $540 at year-end 1998. From a net income and return point of view, there is no question that 1999 was the worst year we have had in our 14 year history.

While 1999 was very disappointing, Fairfax has had an enviable track record since we began in 1985. Book value per share has compounded at 40% annually while our stock price, even after the decline in 1999, has compounded at 36% annually. In fact, there are only two companies in Canada and eight in the U.S. whose stock price has compounded at a rate faster than ours over the last 14 years. While the low return on equity in 1999 resulted in our long term average return on equity slipping slightly below our objective of 20% (to 19.2%) since inception, there were only two companies in Canada and 75 companies in the U.S. that have had a higher return on equity than ours over the period. In fact, in the U.S. property and casualty industry, there is only one company that has had a higher ROE than Fairfax in the last 14 years and *none* have compounded book value or stock price as fast. So you can see why we are so grateful for this long term record – which has been achieved during the longest and toughest *down-cycle* in the history of the property and casualty insurance business.

Having given you the bad (quantitative) news about 1999, let me highlight for you the good (qualitative) news that will impact Fairfax in the years to come. Fairfax enters 2000 with the strongest management team at both the subsidiary and holding company level that it has ever had. While we have always emphasized underwriting profit, today, at Fairfax, there is a renewed focus on achieving a 100% combined ratio by each President. Anything less is *unacceptable*. Also, we ended the year 1999 in the strongest financial position in our history with cash and marketable securities at the holding company in excess of $700 million and long term undrawn, unsecured bank lines in excess of $1.3 billion. In our letter to you on November 3, 1999 (reprinted in Appendix I), which was prompted by the significant decline in our stock price, we discussed these factors further and also commented on stock price fluctuations and intrinsic value. As we know this is a subject near and dear to your heart, we felt we should review this again for the benefit of those who may not have read this letter.

The table below shows Fairfax's annual stock price fluctuations compared to intrinsic value as represented by return on shareholders' equity (ROE) and annual book value changes.

Intrinsic Value vs Stock Price Fluctuations

	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
1985-1999	**19.2%**	**+ 40%**	**+ 36%**

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

In our 1997 Annual Report, we discussed the relationship between intrinsic values and book values and the fact that return on shareholders' equity is the link between them as future earnings will be determined by the return on equity. We have stated many times that for Fairfax, the percentage change in book value is a good first approximation of the percentage change in intrinsic value in any single year.

From the table the following observations can be made.

1) Book value has never decreased and has in fact compounded at 40% annually over the 14 year stretch. Even after a significant decline in stock prices in 1999, over the long term, stock prices and book values (and thus intrinsic values) have compounded at roughly comparable rates. In the past, depending on the year-end, stock prices have compounded at slightly higher or slightly lower rates than book value – but always roughly comparable. Some of you book value skeptics may want to note page 71 which shows that investments per share have compounded at 46% annually over the past 14 years. Growth of investments per share and investment income per share of course ultimately drives the growth of earnings per share and book value per share.

2) On a yearly basis, stock price changes have no correlation with book value or intrinsic value changes. In 1986, Fairfax's stock price increased by 292% even though the book value only increased 183%. In 1990, our stock price *dropped* 41% even though our book

value *increased* 39% and Fairfax earned a 23% ROE. A careful examination of the table will show you that stock price fluctuations on an annual basis are quite random but reflect economic reality (or intrinsic value) only in the long term. In 1999, our stock price dropped 55% even though book value has increased 26% and investments per share have increased 30% to $1,299 per share. As in 1990, the stock market is not reflecting the build-up of long term intrinsic value at Fairfax but the short term volatility in its earnings.

3) So do annual stock price fluctuations connote high risk? Was the price decline in 1990 or in 1999 because Fairfax was a very risky company? Not at all! As I have said previously, Fairfax has the best management team it has ever had and is in the strongest financial position since it began in 1985. Stock price fluctuations reflect short term earnings and are based on emotions of the day and do not reflect the long term fundamentals of the company.

So how do we feel about the stock price decline in 1999? First of all, much poorer!! Remember, directors, officers and employees of the company own 16% of the shares outstanding and have not sold any shares of consequence. All the key officers of Fairfax, including myself, most of our directors, the principals at Hamblin Watsa and most of our subsidiaries' Presidents have a very significant portion (more than 90% in my case) of their net worth in Fairfax shares. So we certainly believe in eating our own cooking! Having said that, we have consistently advised you that Fairfax is run for the long term, that quarterly earnings surprises will come and will not bother us (no profit warnings from Fairfax), and that you should be prepared for stock price fluctuations of 50-60% as they have happened before for Fairfax – and almost every other company listed on the TSE or NYSE at one time or another.

We have also said (as recently as in our 1997 Annual Report) that we would not respond to stock price fluctuations (i.e. answer telephone calls from worried investors) and our press policy would be maintained (i.e. no comment!). We take very seriously our responsibility to disclose the pluses and particularly the minuses to you each year and feel very comfortable that we have done exactly that over the past 14 years. Any further comment is unnecessary and distracting. Our belief is that results will prevail in the long term and short term promotion of Fairfax is neither necessary nor desirable.

So we feel satisfied that we have adequately warned you about the possibility of fluctuations and have always emphasized the long term. In fact, when we sold shares at $500 for the TIG acquisition, we told our investors that we expected them to make a good return in the long term – as no one knows what will happen in the short term. There is no change in our expectations. As we said in our 1994 Annual Report, ''we are concerned about making our investors look good in the long term – not in the short term''. So while we feel good about warning you about short term fluctuations, we hope to make you feel even better in five years time when, based on our performance, these fluctuations will be as irrelevant as the ones in 1990 were. I should add that my multiple voting shares allowed me to sleep a little better in 1999. Sorry, no takeovers at Fairfax!

There is a silver lining in every cloud. Because of the very significant decline in our stock price, we were able to buy back 706,103 shares of Fairfax at an average price of $293 per share –

approximately 5% of the shares outstanding. So far in 2000, we have repurchased an additional 244,044 shares at an average price of $190 per share. In 1990, under similar conditions, we repurchased 1.8 million shares or 25% of the shares outstanding at approximately $9 per share – one of the better investments we have made!

As far as buybacks are concerned, please note:

1) We have always considered investing in our stock first (i.e. stock buybacks) before making any acquisitions. We do not plan to issue our stock at prices less than $500 per share to buy another company – however attractive it may be.

2) We issued 1 million shares for the purchase of Crum & Forster (C&F). By repurchasing almost 1 million shares while maintaining our very strong financial position, we feel our shareholders will have been able to effectively buy C&F at no cost or dilution to them. We are now working on TIG!!

3) Similar to our acquisition policy, we will not buy back our shares at the expense of our financial position.

While buying back shares at attractive prices does not increase the total intrinsic value of the company, it significantly increases *the intrinsic value per share* of the company. Also, by shrinking the denominator, it will help us achieve our 20% return on equity objective over time.

In March of 1999, we issued US$275 million in seven year bonds with a coupon of 7 3/8% to finance the purchase of TIG. In the fourth quarter, we issued two tranches of Fairfax preferred securities for $400 million: $200 million of perpetual preferred shares with a five year reset provision (please see note 7) and $200 million (US$136 million) of RHINOS (through Fairfax Inc., our U.S. holding company), which are quasi-preferreds with a three year maturity (please see note 6). Both preferreds were issued to raise cash in the holding company and provide us with additional resources to repurchase our shares.

As you know, we have encouraged our Presidents and key executives in our subsidiaries and in the holding company to own shares of Fairfax through interest-free loans. While this worked well in Canada, it was less effective on a global basis for tax and other reasons. So late in 1999, we implemented a restricted stock plan for our key management with vesting periods of up to ten years. As in the loan plan, these shares are purchased in the open market, financing costs are expensed as incurred and principal is amortized over the term of the plan. We expect this to be a significant plus for our key executives. The total cost for all these share plans is $74.9 million (520,734 shares at an average cost of $144 per share). Annual after-tax principal and interest costs (at 7% interest) are about $7 million or $0.53 per share.

Also, in late 1999, for the first time we implemented a plan that similarly awards restricted stock every year, equal to 5% of salary, to each and every employee of our insurance and reinsurance subsidiaries if their company achieves its combined ratio objective for the year. This is in addition to the employee share purchase plan described in past Annual Reports.

It has been more than ten years since we developed our guiding principles for Fairfax based on the three objectives that we have had from our inception in September 1985. We have made the point that everything can be changed in our company except these guiding principles that have served us so well for so long. These guiding principles are now so entrenched in our company that we have decided to share them publicly in Appendix II (we waited to make sure our guiding principles ‘‘guide’’ before sharing them with you). The key section in our guiding principles is the section on values. We have clearly stated that we do not want to succeed at the expense of our values.

In its first year of operation, The Hub Group, under John Varnell and Rick Gulliver, completed a significant number of acquisitions of insurance brokers in Canada and entered the U.S. through the purchase of Mack & Parker. Marty Hughes, President and CEO of Mack & Parker, joins Rick Gulliver as the management team responsible for The Hub Group’s North American operations. In one year, The Hub Group has become the buyer of choice and the third largest insurance broker in Canada. The opportunities for growth in the U.S. are significant. We continue to be very excited about the possibilities of The Hub Group in the long term. For more information, please read The Hub Group’s first annual report, which you can get by phoning Pat Hios at 416-979-5866.

An extremely important strategic acquisition for us in 1999 was the purchase of TRG Holdings, the company that manages the runoff of International Insurance Company and other discontinued lines of business written by the former Talegen group of insurance companies. We purchased TRG because of its excellent management team led by Michael Coutu and Dennis Gibbs who run among the best runoff operations in the U.S., including the resolution of complex litigation, the collection of reinsurance assets and the settlement of environmental and other latent claim litigation. We purchased all the Class 1 common shares of TRG for US$97 million which is below the Class 1 shareholders’ US$140 million share of TRG’s underlying net assets. The outstanding Class 2 non-voting, participating preferred shares continue to be held by Xerox Financial Services, Inc. TRG owns International Insurance Company and has an investment portfolio of US$1.1 billion and total Class 1 and 2 shareholders’ equity of US$0.5 billion.

With this acquisition, TRG management, through RiverStone, will be responsible for the management of all runoff operations, the settlement of environmental and other latent claims, the collection of impaired reinsurance recoverables and the resolution of complex litigation for all Fairfax companies. We welcome Michael Coutu, Dennis Gibbs and all the employees of TRG and RiverStone to the Fairfax Group and look forward to their very significant contributions to our group.

In June 1999, we had the opportunity to purchase approximately 6.6 million shares of Zenith National Insurance Corp. (about 38.4% of the shares outstanding) at US$28 per share – a little higher than the underlying book value of approximately US$26 per share at the time. Zenith National, a specialist in workers’ compensation insurance, particularly in California, has been run by Stanley Zax since 1977. Stanley has among the best records in the business with a combined ratio of 102.9% over the past 21 years, and under his watch, book value per share has compounded at approximately 19% per year. You can understand why we paid a premium for Zenith!!

In last year's Annual Report, we mentioned the fact that Sphere Drake (formerly Odyssey Re London) had entered into various reinsurance contracts principally covering personal accident and workers' compensation risks which were in dispute. Later, in March 1999, we commenced litigation over these contracts, the first time we have ever commenced legal proceedings. Since that time, the workers' compensation fiasco, particularly Unicover, has hit front page news. Essentially what happened was U.S. primary workers' compensation insurers were buying very cheap reinsurance by retaining most of the premium and passing most of the losses to their reinsurers – who then passed it on to their reinsurers who in turn passed it along to their reinsurers who in turn passed it along to their reinsurers – and the chain continued through many levels and then it appears that these losses were passed back again to the top of the chain, causing what is known in the business as ''a spiral''. The industry discovered this spiral in 1999 and many participants, including Sphere Drake, rescinded the contracts and returned the premiums to the ceding companies. More recently, there have been many settlements up the chain which is good news for Sphere Drake as it means the losses are unlikely to flow down the chain. While it will likely take some time to finally settle this fiasco, we think it is very unlikely to be significant for Fairfax (even if our first defence, the rescission of our contracts, is not successful) because of the following reasons:

1) The primary workers' compensation insurance companies, the major beneficiaries of these contracts, have a huge incentive to settle as they have to pay their customers' claims immediately and then try to collect from their reinsurers, many of whom have rescinded their contracts alleging misrepresentation, fraud, etc. The incentive for the industry to put this behind it is very high.

2) Sphere Drake received cumulative gross premiums from this business of US$27 million. Although the final impact of these contracts will not be known for some time, Sphere Drake's net exposures reported under these contracts through the end of 1999 have not been material.

3) Our US$1 billion Swiss Re cover (more on this later) protects Fairfax from potential losses from these contracts.

Andy Barnard and others at Odyssey Re Group spent much time on this problem during 1999 but were happy to pass this on to TRG for resolution. In the future, these types of problems (hopefully we won't have any!) will not distract our operating management as they will be passed on to TRG immediately.

The purchase of TIG, the lawsuit in Sphere Drake and the relatively low after-tax cost resulted in Fairfax purchasing a US$1 billion adverse loss development reinsurance cover from a AAA rated subsidiary of Swiss Re Group. This cover protects Fairfax from development in claims and uncollectible reinsurance above the reserves set up by our insurance and reinsurance subsidiaries (including TIG but not International Insurance) as of December 31, 1998. As mentioned earlier, this includes the potential workers' compensation claims from Sphere Drake.

At December 31, 1999, Fairfax ceded US$191 million to Swiss Re in respect of TIG's strengthening of 1998 and prior claims. This adverse claims development was fully reflected in the purchase price for TIG, which was at a US$280 million discount to book value (as described on page 68 in the commentary to the TIG balance sheet at the date of acquisition). In addition, we ceded a further US$60 million to Swiss Re in respect of other subsidiaries' 1998 and prior claims, principally relating to Ranger, C&F and Sphere Drake.

The protection provided by this cover is in addition to the vendor indemnifications and other reinsurance protections of $1,804 million received by Fairfax (including a $254 million indemnification now provided by a Fairfax reinsurance subsidiary, as described on page 67) and by Fairfax's accumulated negative goodwill and other purchase provisions of about $550 million. These protections are, in the main, why we stated in our November 3, 1999 letter that Fairfax has a rock solid balance sheet.

In our 1997 Annual Report, I said that a major strength at Fairfax is a lean head office team which is experienced in monitoring operations and reacting quickly to opportunities but always focusing on downside protection from worst case events. In 1999, the Fairfax team excelled at protecting the company from worst case events as the earlier discussion on the US$1 billion reinsurance cover shows. The head office team grew again in 1999 as Jean Cloutier (actuarial) joined us from Lombard and David Ma (systems) joined us from Markel, while Jim Migliorini (reinsurance underwriting), Scott Galiardo (actuarial) and Denise Davies (systems) from Odyssey Re Group joined our small U.S. holding company office. These additions add tremendous depth to Fairfax. Please don't extrapolate this growth!!

In 1999, we had our first retirement at the holding company. Brenda Harvey, our Corporate Secretary, who was responsible for our name (fair, friendly, acquisitions), these Annual Reports and for providing organization and stability amidst the general confusion and chaos created by your Chairman, has retired. Now you know the real reason for the collapse in our stock price! We will miss Brenda and, on behalf of all of you, we want to thank her again and wish her a very happy retirement. We welcome Elizabeth Murphy, formerly Secretary Treasurer of Commonwealth, as our new Corporate Secretary. Promotion from within is alive and well at Fairfax!

Y2K came and went and we had no problems anywhere in the Group because of the hard work and careful planning by all our systems people across our companies. Externally, Y2K is another example of a ''popular'' issue never becoming a problem; it's always the unexpected that can be lethal!

While we are hugely skeptical about internet stocks and their valuations (more later), we do think the internet will affect us and others significantly – and can perhaps help provide entrepreneurial companies, like ours, with a competitive edge. Sam Chan is in charge of implementing this technology at Fairfax, working closely with the Presidents of each of our subsidiaries.

The table below shows the sources of our net earnings:

	1999	1998
	($ millions)	
Insurance underwriting	(617.1)	(311.4)
Interest and dividends	711.5	432.0
Total	94.4	120.6
Realized gains	121.7	440.8
Runoff	(54.2)	–
Claims adjusting (Fairfax portion)	2.8	12.4
Interest expense	(129.3)	(84.4)
Goodwill and other amortization	(5.1)	(5.0)
Swiss Re premium	(35.3)	–
Corporate overhead and other	(20.2)	(15.9)
Pre-tax income (loss)	(25.2)	468.5
Less: (recovery of) taxes	(158.0)	81.0
Less: non-controlling interest	8.6	–
Net earnings	124.2	387.5

The table shows you the results from our insurance (underwriting and investments), runoff and non-insurance operations. *In this report, insurance operations include reinsurance operations.* Runoff operations include TRG, Odyssey Re Stockholm and (from July 1, 1999) Sphere Drake. Claims adjusting shows you our share of Lindsey Morden's after-tax income. Goodwill and other amortization includes Hamblin Watsa goodwill ($1.4 million) and amortization from Ranger ($3.6 million). The corporate overhead expense is net of Hamblin Watsa's pre-tax income and interest income on Fairfax cash balances and includes one time expenses associated with our acquisitions and our issues of securities (don't worry – overhead at Fairfax has not increased much). The first year's premium payable to Swiss Re of $35.3 million is shown separately. 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 equity accounted, as well as Lindsey Morden's financial statements, shown on pages 80 to 85.

The very large underwriting loss in 1999 was mainly due to C&F ($211.1 million), TIG ($64.2 million) and Odyssey Re Group ($247.4 million). Catastrophes significantly impacted us in 1999 as there were more than ten worldwide catastrophes compared to a more normal one or two. Catastrophes in 1999, including earthquakes in Taiwan, Turkey and Colombia, windstorms in Europe and Florida and typhoons in Japan and Korea, cost us $190 million. Almost makes you nervous watching the weather channel!

Interest and dividend income, as well as interest expense, increased because of the C&F acquisition in 1998 and the TIG and TRG acquisitions in 1999. Lindsey Morden's contribution declined significantly while corporate overhead and other increased because of the above-mentioned one time expenses.

Our runoff operations (TRG, Odyssey Re Stockholm and Sphere Drake) cost us $54.2 million, mainly because of losses from Sphere Drake's unearned premium (on transfer to runoff), including losses from the European storms.

Realized gains dropped significantly in 1999 and, combined with the significant underwriting losses, were the main reason for the pre-tax loss in 1999 – the second time we have had a pre-tax loss in our history, the first time being 1990! We had a tax recovery of $158.0 million because our underwriting losses were in high tax jurisdictions while other income was earned in areas with lower tax rates.

Book value increased from $184.54 to $231.98 per share, as a result of increases from our share issue and our earnings and a reduction from our repurchase of shares above book value.

Insurance operations

The table below shows the combined ratios of each of our companies for 1998 and 1999. As you can see, 1999 was a disaster for almost all our underwriting operations. There is no other word for it. I am embarrassed by these results and apologize for them – particularly because I do feel that we have an outstanding group of companies run by an exceptionally talented group of Presidents. None of our companies achieved our 100% combined ratio. In fact, Commonwealth had its worst year ever! Our Canadian insurance operations had a very poor year with a combined ratio of 114.9%. Ranger continued to have an unacceptable combined ratio of 149.4%. C&F had a combined ratio of 120.9%, more than 4 points worse than 1998 and 11 points worse than our expectations. TIG was also worse than we expected at 109.7% before purchase adjustments (105.6% after purchase adjustments). Odyssey Re Group, largely due to catastrophes, had a very poor year in 1999. While the industry was highly competitive again in 1999, our performance was significantly worse. We suffered a year in 1999 in which the risks of the insurance business were crystallized widely and substantially throughout all our companies. Catastrophes and a high frequency of large losses in a very soft (read underpriced) insurance market took their toll on all our insurance operations. Excluding the impact of catastrophes, the total combined ratio for 1999 was 110.1%, compared with 110.9% excluding catastrophes for 1998.

	1999 %	1998 %
Commonwealth	186.7	108.5
Federated	113.8	100.1
Lombard	105.0	102.8
Markel	104.6	106.8
Total Canadian insurance	*114.9*	*105.2*
Ranger	149.4	156.8
C&F	120.9	116.6
TIG	105.6	–
Total U.S. insurance	*111.8*	*123.2*
Odyssey Re Group*	119.4	115.6
Total reinsurance	*119.4*	*115.6*
Total	*114.6*	*113.0*

** includes Sphere Drake for six months in 1999*

Having not sugar-coated the results for 1999, I must tell you that we have the strongest group of Presidents running our decentralized operations that we have ever had. In 2000, we expect all our Canadian companies to get back to the 100% or better combined ratio they have achieved in the past. Ranger has a target of 100%; TIG, 105%; C&F, 110% (a stretch given their starting point); and Odyssey Re Group, 104%. Our consolidated target combined ratio for the Fairfax Group in 2000 is 105% and all our companies are striving for 100% in 2001. We have to prove to you (and ourselves) that we can achieve these results in 2000.

If Commonwealth hit an air pocket in 1998, in 1999 it went into a tail spin! Because of a combined ratio of 186.7%, Commonwealth suffered its first net loss after taxes in its history. John Watson and Ron Schwab and their management team have analyzed the results and, with hindsight, feel there was little they would do differently in 1999. Commonwealth suffered from an unprecedented number of large and medium sized losses arising mainly from its Oil, Gas & Petrochemicals and U.S. Property business written in the 1998 underwriting year, combined with declining premium income, the soft insurance market and the company's willingness to walk away from underpriced accounts. Higher reinsurance costs in its Oil, Gas & Petrochemicals division further exacerbated the results. In 1999, gross premiums written dropped 13% to $170.9 million while net premiums written dropped by 37% to $46.1 million. Commonwealth lost $12 million after taxes.

Federated, under John Paisley's leadership, had an unusually poor year (for them!) with a combined ratio of 116.4% for the P&C company (113.8% including the life operations). This is only the second time in the last ten years that Federated had a combined ratio above 100%. Again, a high frequency of large losses, combined with some reserve strengthening, were the main culprits. John has raised prices, increased deductibles and discontinued the propane line – he is clearly focused on not allowing this to happen again.

Federated's P&C company's gross premiums written increased by 3% to $63.6 million while its net premiums written also increased by 3% to $55.6 million. Federated maintained a competitive expense ratio of 30.0%. It earned $2.3 million after taxes in 1999 versus $8.1 million in 1998.

Lombard's combined ratio increased significantly in 1999 to 105.0%, much to Byron Messier's chagrin. Byron and his management team are focused on reversing the negative trend since they first hit 100% in 1996.

Excluding the continuing high marketing costs for the Privilege 50 program and the final expenses related to the Year 2000 issue, Lombard had a combined ratio of 102.7%.

Net premiums written from the Privilege 50 program increased by 15% to $29.8 million in 1999. While the loss ratio on this business was higher, in the 84% area, lower marketing costs resulted in a combined ratio of 115.0% (144.5% in 1998) for this program. This program is now maturing and, as we expected, the results are beginning to improve. We continue to expect this to be a good program for Lombard and its customers in the future.

Lombard's gross premiums written (including CRC (Bermuda)) remained steady at $511.4 million ($512.4 million in 1998), while net premiums written decreased a little to $466.5 million. Net income after taxes dropped by 43% to $29.7 million due to lower realized gains.

In a very competitive and extremely soft market, Falcon, led by Kenneth Kwok, has been very careful about writing business. Falcon wrote HK$60.5 million (C$12.1 million) in net premiums in 1999 with a combined ratio of 165.1%, as it is still in a start-up phase. We have an extremely talented group of employees at Falcon but are not interested in writing business at unprofitable rates. We are very patient!

Markel had another steady year in 1999 with a combined ratio of 104.6%. Mark Ram and his team have continued to provide consistency during an extremely soft trucking insurance market while their competitors have suffered severe underwriting losses. Markel's combined ratio over the past five years, while not meeting our 100% target, has averaged a steady 103.9%. The company is well on the way to achieving the 100% mark. Markel continues to provide unique value added services and products designed to increase insured and broker loyalty over the long term. Gross premiums written were steady at $77 million while net premiums written decreased by 7% to $54.8 million. Net income after taxes was a little lower at $5.6 million.

Phil Broughton downsized Ranger significantly in 1999, discontinuing approximately half the book of business and reducing expenses commensurately. Phil reduced the agency force from 600+ agents to 100 as he cancelled unprofitable and unproductive agents. While these were very dramatic actions, they were very much needed. There is no substitute for long term profitability in any business. The time had come to take action and Phil took it. While the combined ratio was 149.4% (121.2% after internal stop loss), reflecting higher losses in the discontinued lines and higher ALAE reserves, we can finally, under Phil's strong leadership, see the light for Ranger at the end of a very long tunnel. Gross premiums written declined from US$211.2 million in 1998 to US$137.6 million in 1999 while net premiums written dropped by 32% to US$88.3 million. Ranger's continuing lines book in 2000 is expected to be just over US$80 million. Ranger had a pre-tax loss of US$25.6 million in 1999 (before stop loss) versus US$48.5 million (before stop loss) in 1998. Although Ranger produced an unacceptable combined ratio in 1999, we believe that the enormous changes executed during the year by Phil and his team will yield significant profits in the years to come. I know some of you are saying, ''Show me''!!

The major plus for C&F (and Fairfax) was that Bruce Esselborn joined the company in October 1999 to become Chairman and CEO. Bruce was with AIG for almost 20 years before leaving in 1986 to found United Capitol Insurance Company, an excess and surplus lines insurer. United Capitol was sold to Capsure Holdings, a NYSE-traded insurance holding company of which Bruce became President. After selling Capsure to CNA in 1997, Bruce was a consultant with Marsh & McLennan Capital for 18 months before joining C&F. The average combined ratio for Capsure and United Capitol for the years that Bruce ran these companies was significantly below 100%.

Also in the fourth quarter, Mary Jane Robertson, Bruce's Chief Financial Officer at both United Capitol and Capsure, joined C&F as Executive Vice President and CFO, along with Nick Antonopoulos, an AIG and Marsh & McLennan Capital colleague of Bruce's, as Executive Vice President and COO. With this management team in place, we at Fairfax feel very confident that Crum & Forster will once again become an excellent underwriting company. Fairfax's ability to attract management of the caliber of Bruce Esselborn and his team is a major long term strength of the company.

In 1999, C&F's gross premiums written declined 15% to US$745 million while net premiums written declined 23% to US$599 million. As I mentioned earlier, C&F had a combined ratio of 120.9% in 1999 and, after a US$32 million restructuring charge, it lost US$20 million after taxes.

1999 was a year of significant consolidation for Odyssey Re Group under Andy Barnard's leadership. The most important step forward in 1999 has been the successful merger of Odyssey Reinsurance (New York) and TIG Re. The resulting company, Odyssey America Re, is now a commanding presence in the North American broker reinsurance market, ranking among the largest reinsurance companies in the United States, with annual net premiums written of approximately US$580 million and capital and surplus of US$1.0 billion.

Under the leadership of Andy, Mike Wacek and Roland Jackson, the combination of two separate companies into a new, single company took place briskly and effectively. Within Odyssey America Re, Mike has reorganized our treaty, program and Latin divisions around first rate managers who will lead our underwriting efforts in the future.

Also, at the end of 1999, Andy strengthened the management of our overseas operations by appointing Lucien Pietropoli the new General Manager of our businesses run from Paris and Singapore, while Jean-Philippe Casanova continues as Chairman. Lucien will bring over 20 years of strong underwriting experience in the global reinsurance markets to the task of charting our way forward in the overseas markets in the coming years.

In London, the U.K. operations of Odyssey Re were consolidated into the TIG Re branch and Odyssey Re London ceased active underwriting and is now under the management of TRG. The David Newman Syndicate at Lloyd's will remain part of Odyssey Re whereas we are reviewing our options for Kingsmead (Lloyd's syndicates).

In 1999, Odyssey Re Group had a combined ratio of 119.4% mainly because of worldwide catastrophes which cost US$86 million or 9.9% on the combined ratio. In fact, CTR experienced the worst year in its history. Andy's objective in 2000 is to have the Group achieve a combined ratio of 104% – with no exceptions!! We continue to be confident about the long term prospects for underwriting profits for Odyssey Re Group under Andy's leadership.

TIG Specialty Insurance Solutions (the new name for TIG Insurance Company), led by Courtney Smith, had an excellent first year as part of Fairfax even though they did not meet the 105% combined ratio objective for 1999. Courtney was able to attract Scott Donovan (CFO), Fred Fontein (underwriting) and Jim O'Brien (claims) from his previous employer, joining Steve Brett, Frank Taylor, Lon McClimon and Bill Huff at TIG, to form a very strong management team. Courtney and his team have restructured the organization and focused it on achieving a 100% combined ratio by 2001 (105% in 2000). It will take longer than we expected to achieve underwriting profitability but there was significant work to be done. At Fairfax, we feel comfortable that Courtney and TIG will achieve their objectives in 2000 and 2001.

TIG's gross premiums written in 1999 were US$1,551 million versus US$1,597 million in 1998. Net premiums written increased 7% to US$1,075 million and the combined ratio for 1999 was 109.7% before purchase adjustments. Net loss after taxes, since acquisition, amounted to US$24 million.

Our insurance companies continue to be well capitalized as shown on page 74.

As you know, it is our policy to have our reserves set at a level that results in redundancies in future years. How did we do in 1999? We provide extensive disclosure on our claims reserves beginning on page 54 in the MD&A. In Canada, our insurance companies had redundancies of $8 million in 1999 while in the U.S. Ranger and C&F had an aggregate de ciency of US$30 million. Our reinsurance companies had an aggregate redundancy of US$16 million after the impact of foreign exchange on reserves (an aggregate deficiency of US$11 million before that impact). We continue to work to get our U.S. and reinsurance reserves to the standards of our Canadian reserves.

When we purchased Lombard five years ago, we had a reserve indemnification of $40 million. This was settled during the year for no payment as there was no reserve development since our purchase.

Ranger, however, was a different story. Adverse reserve development far exceeded our indemnification of US$20 million and so we are realizing value from the real estate assets backing this indemnification.

Claims adjusting

1999 was a year of consolidation for Lindsey Morden also. The merger of Ellis & Buckle with the U.K. operations of Cunningham Group was completed, creating Cunningham Ellis & Buckle, the largest loss adjuster in the U.K., while the Canadian operations are being restructured under Ferd Roibas' leadership. In spite of these significant changes and a consolidating marketplace, under Ken Polley's leadership, Lindsey Morden generated record free cash flow, excluding the effect of overfunding pension contributions, of $25.6 million or $2.17 per share.

We have a very strong management team at Lindsey Morden with Ken Polley, Ferd Roibas, Don Smith (U.S. operations), Gerry Loughney and Andrew Lund (U.K.), Pim Polak Schoute (Europe) and Jim Grant (International). Ferd Roibas, Lindsey Morden's Chief Financial Officer, has been promoted to Executive Vice President and Chief Operating Officer, with his first assignment being the Canadian operations. Ken is on the lookout for an outstanding CFO to replace Ferd. The management team is very focused on increasing free cash flow in 2000 and achieving their goal of 20% free cash flow return on equity.

Because of record free cash flow and a strong financial position, the board of Lindsey Morden will continue to review its dividend payout of $1.00 per share during 2000. As one of the very few global adjusters in the world, with 350 branches and almost $450 million in revenue, Lindsey Morden has excellent possibilities ahead. Now it has to capitalize on these opportunities.

As actions speak louder than words, you may be interested in knowing that in 1999 we purchased 768,700 shares of Lindsey Morden, at an average price of $20 per share, to own a total of over 7,000,000 Lindsey Morden multiple and subordinate voting shares.

Investment management

Remarkably, 1999 was another good year for the U.S. and Canadian equity markets. The international equity markets also did very well. While our equity results did not keep pace with the U.S. markets, we did very well in the Canadian and international markets. The U.S. bond market had one of its worst years ever in 1999 and our bond results reflected this.

The key, of course, is long term and as shown in the table below, HWIC has produced excellent results in all of the areas in which it provides investment management – Canadian and U.S. equities and Canadian and U.S. bonds. HWIC now shows 20 year results as the investment team, consisting of five partners, has worked together for over 25 years.

Annualized rates of return (%)

Cumulative periods ended December 31, 1999

	5 years	10 years	15 years	20 years
Canadian Equities	14.2	11.4	14.4	14.6
TSE 300	17.0	10.6	11.8	11.4
U.S. Equities	18.8	20.0	18.5	19.0
S&P 500	29.3	20.8	19.6	19.1
Canadian Bonds	10.6	11.5	11.9	–
SM Index	9.9	10.1	10.9	–
U.S. Bonds	7.3	8.5	–	–
ML Index	7.0	7.1	–	–
Balanced Fund	11.7	12.0	14.1	–

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

Total fees in 1999 were $16.0 million, up from $12.3 million in 1998 mainly because of the addition of C&F, TIG and TRG. Fairfax earned a 24% pre-tax cash return in 1999 on its $14 million investment in HWIC. Cumulatively, on a pre-tax basis, Fairfax has earned 215% since it acquired HWIC in 1992. On our books, HWIC has been depreciated down to $4 million, on which we earned a pre-tax income of $3.4 million in 1999.

Financial position

As mentioned in previous reports, we feel our unaudited balance sheet with Lindsey Morden equity accounted (shown on page 82) is the best way to understand our financial position. Below, we show you our year-end financial position compared to the end of 1998.

	1999	1998
	($ millions)	
Cash and marketable securities	712.7	305.4
Long term debt	1,959.0	1,444.4
Net debt	1,246.3	1,139.0
Common shareholders' equity	3,116.0	2,238.9
Preferred securities (including RHINOS)	578.8	–
Total equity	3,694.8	2,238.9
Net debt/equity	**34%**	**51%**
Net debt/total capital	**25%**	**34%**

As shown, common shareholders' equity, our capital, increased by $877.1 million, with $959.7 million from the common stock issue for TIG and $124.2 million from net income partially offset by $206.8 million used to repurchase 706,103 of our shares at an average cost of $293 per share. Long term debt increased due to our US$275 million debenture issue in connection with the purchase of TIG; TIG's US$100 million note payable, US$25 million in preferred stock due in 2000 and other long term debt of US$28 million; and TRG's bank debt of US$42 million (to be repaid by TRG within the next year); partially offset by a stronger Canadian dollar in 1999. TIG also had issued US$125 million in capital preferred securities (8.597% coupon with a 30 year term) and for the first time ever, we issued Fairfax perpetual preferreds and RHINOS preferred securities for a total of $400 million (please see notes 6 and 7).

These preferred issues increased our cash position to a record high of $712.7 million. Our net debt to equity and net debt to total capital ratios dropped significantly, if you classify all of our preferred securities as equity. Internally, we think we maintained our ratios but increased financial flexibility significantly by increasing our cash position to $712.7 million.

Below we show you our cash position and financial ratios for the past 5 years.

	1999	**1998**	**1997**	**1996**	**1995**
Cash and marketable securities *($ millions)*	712.7	305.4	207.1	101.1	70.4
Net debt/equity	34%	51%	37%	41%	48%
Net debt/total capital	25%	34%	27%	29%	33%

The table shows you that in spite of tremendous growth in the past five years (with revenue increasing from $1 billion to almost $6 billion, and total assets from $3 billion to $32 billion), we have maintained our financial ratios and ended 1999 with record cash and marketable securities plus undrawn long term bank lines in excess of $1.3 billion. This, of course, is after the repurchase of over $200 million of Fairfax stock in 1999. Please note that if we make no acquisitions and do not buy back our shares significantly, our financial position should improve dramatically in the future.

As we have said in past Annual Reports and repeat here, our financial position at year-end 1999 continues to be very strong for the following reasons:

1) We have no bank debt. Our debt consists of seven public debentures with a long term to maturity (4 years to 38 years) and low interest rates (6.875% to 8.30%), three small debentures issued to vendors, and certain debt assumed with the acquisitions of TIG and TRG. 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 all of the public debentures (with the exception of the ones maturing in 2003 and the debentures mentioned in the next sentence) into floating rates, saving approximately 125 basis points on average currently. Also, 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). Including the amortization of the unrealized foreign exchange loss on this swap over the remaining term to maturity, the effective rate for 1999 rises to 5.62% per annum, still below the 7.375% coupon rate of the swapped debentures.

2) We have undrawn, unsecured, committed, long term bank lines in excess of $1.3 billion with excellent covenants. These bank lines are with five Canadian, five U.S. and three European banks. In addition, we have LOC facilities in excess of $100 million.

3) Our net long term debt is less than three times our normalized earnings base. Also, our earnings base is well diversified among many insurance and reinsurance companies, Lindsey Morden and HWIC 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 covers our expenses (administrative and interest) by about two times. This is based on normal dividend payouts from our insurance companies, which are much less than our maximum dividend-paying capacity. Note Fairfax's parent company-only income statement on page 87.

5) With more than $700 million in cash in the holding company, we can pay our administrative and interest expenses at Fairfax, with *no* dividends from any of our insurance or reinsurance companies, for five to six years – our management holding company survival ratio!

6) As discussed in the MD&A, our insurance companies are over-capitalized with significant solvency margins in excess of mandated regulatory levels.

7) Our foreign exchange exposure from our U.S. insurance and reinsurance companies has been fully hedged by the U.S. debenture issues and the purchase of foreign exchange contracts.

Investments

While equity markets worldwide went up in 1999, U.S. bond markets had one of the worst years in the last 50 years as U.S. long treasuries declined 19.5%. The unrealized gains (losses) as of year-end are shown below:

	1999	**1998**
	($ millions)	
Bonds	(1,241.0)	28.0
Preferred stocks	(1.3)	4.4
Common stocks	15.7	(26.9)
	(1,226.6)	5.5

We realized $121.7 million in gains in 1999 – little more than one-quarter of the gains realized in 1998. The unrealized losses at year-end of $1,226.6 million were largely due to higher interest rates. While the pre-tax unrealized losses at year-end amounted to approximately one-third of common shareholders' equity, we emphasized to you in our letter of November 3, 1999 that we are not concerned as:

a) the unrealized bond losses do not impact our U.S. subsidiaries' regulatory capital, and

b) these losses will not be realized as we can and will hold these bonds to maturity or until interest rates drop.

In fact, we said in the letter that if long U.S. Treasury bond yields, which began the year 1999 at about 5% and ended the year at about 6$^1/_2$%, were to go back down to 5%, our unrealized bond losses of $1,241.0 million would become a $500+ million unrealized gain assuming corporate spreads remain the same. Almost a decade ago, in 1990, unrealized investment losses were approximately $34 million on our equity base of $95 million – about one-third of the equity on a pre-tax basis, but at that time, the unrealized losses were mainly due to common stocks. Within 18 months, the unrealized losses had disappeared – a less certain happening than with unrealized bond losses.

We began investing outside North America in 1996. As the Korean market more than doubled in 1999 (in US$), we decided to liquidate our portfolios and realized more than $120 million in 1998 and 1999 from Korea (a 60% + gain on our approximately $200 million investment in 1997). As the Japanese markets did well also, we realized $28 million in Japan (57% on our $49 million investment). A big thank you to Francis Chou, Paul Fink and Chandran Ratnaswami.

Gross realized gains totaled $218 million. After realized losses of $36 million and increased provisions of $60 million (primarily on the S & P Index put contracts in excess of negative goodwill amortization), net realized gains were $122 million. Net gains from fixed income securities were $31 million while net gains from common stocks and other investments were $91 million. The principal contributors to the stock realized gains were Korean stocks ($87 million), Japanese stocks ($28 million) and dilution gains on the issue of Hub shares on broker acquisitions ($12.5 million).

The table on page 70 shows the return on our investment portfolio. Investment income (interest and dividends) increased again in 1999 due to the purchase of C&F, TIG and TRG. Pre-tax investment income has increased from $37.37 per share in 1998 to $56.48 per share in 1999. Our annualized investment income is currently running at $65 per share.

As you know, we have been getting concerned about U.S. equity markets since late in 1996 – and more concerned as the markets have gone higher. Here's what the S&P 500 has done in the past three years.

S & P 500

As of December 31	**Index**	**Earnings**	**Price/ Earnings**	**% Change in Index**
1996	741	39	19x	
1997	970	40	24x	+31%
1998	1229	38	33x	+27%
1999	1469	49	30x	+20%
1996-1999		+26%	+60%	+98%

While earnings have gone up 26% in the last three years, the price to earnings (P/E) ratio has increased 60% to 30x – higher than it's ever been (other than in 1998!). As we said in our 1996 Annual Report, a continued P/E expansion over the long term is not sustainable – even though in the short term anything is possible.

In our last three Annual Reports, we have documented the unbelievable speculation that is taking place in the U.S. equity markets – particularly highlighted by internet stocks. Here's what some of the ''senior'' issues are selling for.

	Price/ Revenue	**Price/ Earnings**	**Price/ Book Value**
AOL	29x	179x	45x
Amazon.com	14x	*	88x
Yahoo!	148x	1,425x	69x

** Loss in 1999*

Yes, Amazon.com has a market value of US$23 billion versus shareholders' equity of US$266 million at December 31, 1999.

Here are some of the ''junior'' issues.

	Market Cap	**Revenue** *(US$ millions)*	**Profit (Loss)**	**Price Change in 1999**
DoubleClick	10,700	258	(56)	+1,037%
Go2Net	2,400	22	(1)	+884%
InfoSpace.com	21,700	37	(10)	+1,023%
Red Hat	10,300	25	(18)	+655%
VerticalNet	8,000	21	(53)	+925%

Are these stocks being purchased by long term investors? DoubleClick turned over its capitalization 21 times in 1999, i.e. an ''investor'' held it for an average of 17.1 days!! An ''investor'' held Red Hat for an average of 45.8 days and the others are very similar! Can you believe this?? If history is any guide, when the music stops, these stocks will be down 90%+, unless they are taken over by another high valued company. Have you noticed the acquisitions made by Northern Telecom and Cisco Systems recently? Northern Telecom paid US$3.25 billion for Qtera Corp., a company that was formed in mid-1998 and had no revenues!!! Not to be outdone, around the same time, Cisco Systems paid US$6.9 billion for Cerent Corp., which had US$10 million in revenues. These valuations have prompted Grant's Interest Rate Observer to say ''possibly never have American investors financed loss-making enterprises as they have today''. It is interesting to observe that in our 1989 Annual Report, we noted that Mr. Batra's book ''The Great Depression of 1990'' sold 500,000 copies while Mr. Kandel's book ''How to Cash in on the Coming Stock Market Boom'' sold 15,000 copies. Messrs. Glassman and Hassett's recent book, ''36,000 on the Dow'', is perhaps timed as well as Mr. Batra's book was in 1989!!! Talking about timing, isn't it interesting that the man who has lost almost US$1 billion is Time Magazine's ''Man of the Year'' (Jeff Bezos from Amazon.com) while the greatest investor of all time who has made nothing but money, Warren Buffett, is yesterday's man.

We have been very wrong over the past three years as the S&P 500 has done very well – but we will not *speculate* and buy things that don't make any economic sense. We do not believe in ''New Eras'' and feel that most participants in today's equity markets in the U.S. will suffer significant *permanent* loss. It is very likely that the high price for the S&P 500 and Dow Jones reached in this cycle (which may have already taken place) will not be seen again in the next ten years – not unlike the Nikkei Dow that peaked in 1989 at 39,000 and is still trading around 20,000 currently, ten years later.

As you know, we have backed our view on the U.S. markets with a purchase of US$700 million (notional value) in S&P 500 Index puts and also US$162 million (notional value) in similar two to three year contracts on a basket of technology stocks (not looking good right now!). At the time of this writing, only US$300 million of the original S&P Index puts have not expired but we have added US$200 million in S&P Index puts and US$100 million in NASDAQ Index puts to continue to have a total of US$600 million with maturities of up to two years.

We continue to have approximately 8% of our investment portfolios in common shares and almost all the rest in cash and good quality marketable bonds (89% of the bonds in the portfolio are rated A or above). By country, our common stock investments at December 31, 1999 were as follows:

	Book Value	Market Value
	($ millions)	
U.S.	298	256
Canada	223	203
Japan	102	92
Latin America	327	508
Other	448	355
	1,398	1,414

As shown, most of our common stock investments continue to be outside North America – in Asia and Latin America – where we think the long term investment values are. Our S&P 500 Index puts and our similar contracts on technology stocks are included in Other. Over time, we expect to realize gains on these investments.

As we have stated in our 1998 Annual Report, we expect a full testing of our ''doomsday'' scenario soon.

Miscellaneous

In 1999, Fairfax and its subsidiaries donated $2.7 million to a variety of charities across North America. On a cumulative basis, since we began our donations program in 1991, we have donated $15.4 million to charitable institutions. One of our U.S. subsidiaries made a one time significant donation to the charity of its choice in its community in 1999. This one time gift will spread each year to the other communities where Fairfax operates across the world.

Please review page 86, which is an unaudited unconsolidated balance sheet showing you where your money is invested.

You will note that as a Canadian company reporting in Canadian dollars, we have always hedged our foreign exchange exposures when we purchased companies in the U.S. or in other countries. At the end of 1999, we have approximately 75% of our business in U.S. dollars and approximately 75% of our employees are in the U.S. For these reasons, we plan to go to U.S. dollar reporting and also list on the NYSE within the next two years. The exact timing will be dictated by the appropriate time to unwind our hedges. While on the subject of hedging, it is interesting to note that since we bought the first of our U.S. companies at the end of 1993, the Canadian dollar has steadily trended down from US75.5¢ to US69¢ currently – we would have been smart not to have hedged any of our exposures!!

In our 1997 Annual Report, we listed the strengths that Fairfax has to achieve its 20% return on equity objective over time, and they have not changed. Neither have the risks – that we have again listed for you on pages 76 and 77. We are in an extremely difficult insurance and investment environment – with many pitfalls facing us daily – but we continue to focus on combined ratios below 100% leading to returns on equity in excess of 20%. With the best management we have ever had, investment portfolios in excess of $17 billion and some good fortune, we look forward to achieving our objectives for you, our shareholders. Also, we do not plan to make any significant acquisitions (other than potential small bolt-on acquisitions by our subsidiaries) until we have achieved a combined ratio of 105% and are clearly on our way to 100%.

Our Annual Meeting this year will continue to be at the Metro Toronto Convention Centre, and will take place on Tuesday, April 11, 2000 in Room 106 at 9:30 a.m. Yes, we have changed the time of our meeting from 4:30 p.m. to 9:30 a.m. to allow more time to answer all your questions – we thought you may have more this year!! While we cannot answer your questions on the telephone, we look forward to answering them all at our Annual Meeting – and our Presidents, Fairfax officers and HWIC principals will also all be there, to shield me from the tomatoes, I hope!!

I want to remind you that our Annual Reports (all 15 of them) are now available on our website at *www.fairfax.ca*. Any press releases are immediately posted to our website. Our quarterly reports for 2000 will be posted to our website on the following days: first quarter – May 4, second quarter – August 8, third quarter – November 7 and fourth quarter – February 9, 2001.

Again, on your behalf, I would like to thank the board and the management and employees of all our companies for their dedication and hard work during a very challenging year.

March 1, 2000

V. P. Watsa

V. Prem Watsa
Chairman and
Chief Executive Officer