FAIRFAX

FINANCIAL HOLDINGS LIMITED

# 1988 Annual Report

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FINANCIAL HOLDINGS LIMITED

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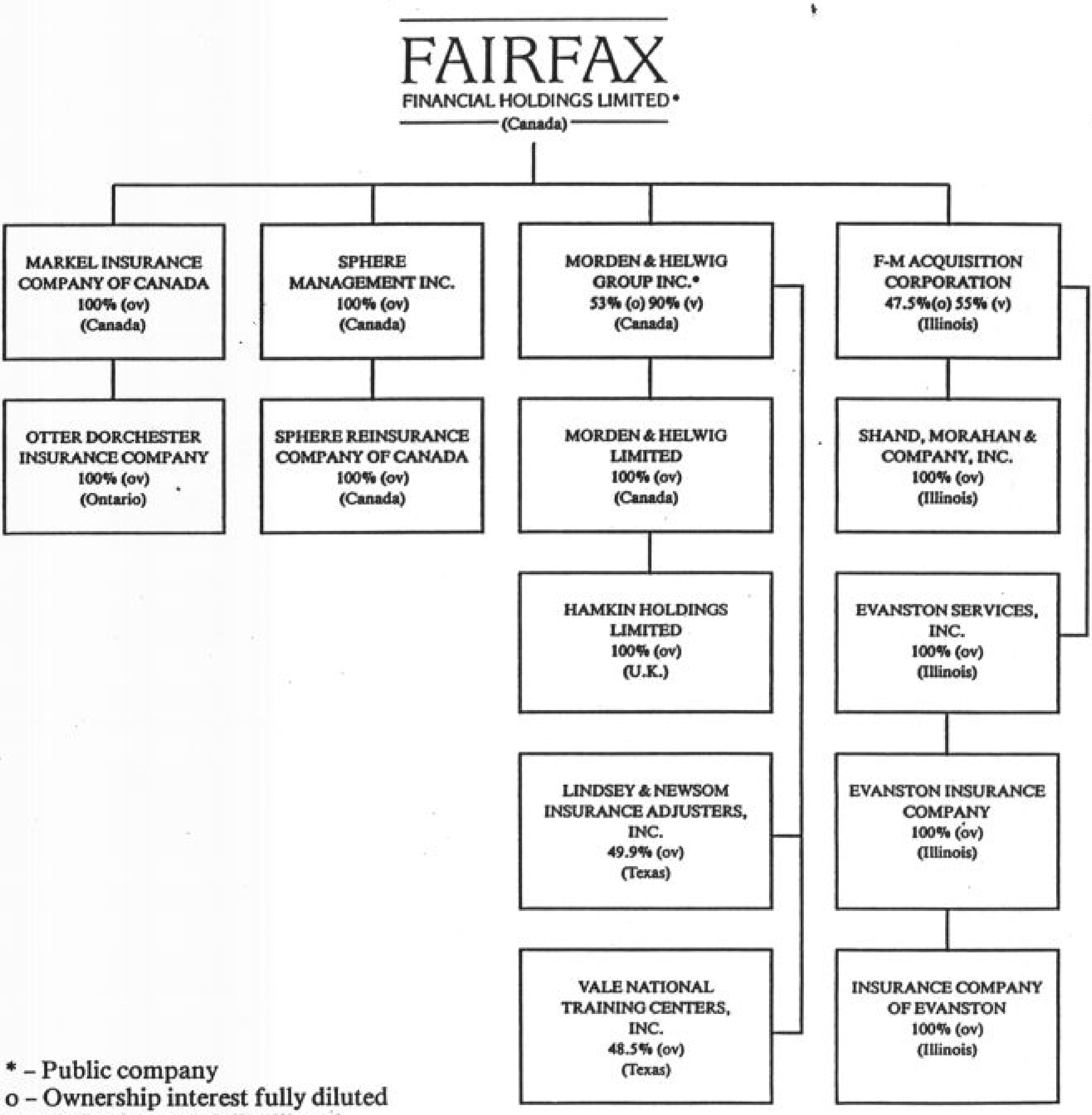
## FINANCIAL HIGHLIGHTS
(in thousands except per share data)

| | 1988 | 1987 | 1986 | 1985 |
|---|---|---|---|---|
| Total revenues | 133,549 | 112,971 | 53,733 | 17,015 |
| Operating earnings after tax | 14,357 | 10,795 | 4,837 | (910) |
| Net earnings | 14,357 | 16,019 | 6,548 | (910) |
| Total assets | 246,786 | 185,413 | 129,845 | 41,477 |
| Shareholders' equity | 74,176 | 61,048 | 41,275 | 10,379 |
| Return on average equity | 21.2% | 31.3% | 25.4% | — |
| Per share – fully diluted | | | | |
| Operating earnings | 1.94 | 1.50 | 1.01 | (1.89) |
| Net earnings | 1.94 | 2.23 | 1.35 | (1.89) |
| Shareholders' equity | 10.13 | 8.32 | 5.89 | 2.08 |
| Market prices per share | | | | |
| High | 15.13 | 17.50 | 14.13 | 6.00 |
| Low | 11.75 | 10.50 | 6.00 | 3.00 |
| Close | 15.00 | 12.37 | 12.75 | 6.00 |

# CORPORATE CHART

The following chart sets out Fairfax and its principal subsidiaries and affiliates:




* – Public company
o – Ownership interest fully diluted
v – Voting interest fully diluted

Investment banking activity is carried on by Fairfax directly

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## CORPORATE PROFILE

**Fairfax Financial Holdings Limited** is a financial services holding company engaged in insurance and related activities through decentralized operating subsidiaries and in investment banking. The corporate objective is to achieve a high rate of return on invested capital and build long term shareholder value.

**F-M Acquisition Corporation,** through subsidiaries based in Evanston, Illinois, provides specialty insurance coverage, primarily in the professional and product liability markets. In 1988 gross premium volume on a combined basis totalled US $103 million, and the group had 318 employees at year-end.

**Markel Insurance Company of Canada** is one of the largest trucking insurance companies in Canada. The Markel group provides the Canadian trucking and agriculture industries with a range of insurance services. In 1988 gross premium volume on a combined basis totalled $62 million, and the group had 115 employees at year-end.

**Morden & Helwig Group Inc.,** through subsidiaries and related companies, is engaged in providing claims adjusting, appraisal and loss management services to a wide variety of insurance companies and self-insured organizations across Canada, in the U.S. and in Britain. In 1988 gross revenues on a combined basis totalled $43 million, and the group had 1,204 employees in 233 branches at year-end.

**Sphere Reinsurance Company of Canada** is one of only two Canadian owned reinsurance companies writing property, auto and casualty risks. In 1988 gross premiums totalled $16 million, and the company had eight employees at year-end.

## To Our Shareholders

No comet flew over us in 1988. We earned $14.3 million on our average equity capital of $67.6 million, a 21.2% return on shareholders' equity. In the last three years, we have earned an average 26.1% on shareholders' equity versus 11% for the TSE 300. Operating earnings per share of $1.94 were up 29% from $1.50 in 1987, while net earnings per share of $1.94 were down 13% from $2.23 in 1987. Book value per share increased 22% to $10.13 per share.

The table below shows the sources of our net earnings:

| | ($ millions) | | |
|---|---|---|---|
| | 1988 | 1987 | % Change |
| Pre-tax earnings before realized gains | 13.5 | 9.0 | +50% |
| Realized gains | 7.8 | 9.2 | −15% |
| Total pre-tax earnings | 21.3 | 18.2 | +17% |
| Income taxes | 5.3 | 5.9 | −10% |
| Earnings from operations | 16.0 | 12.3 | +30% |
| **Less** minority interest | 1.7 | 1.5 | — |
| **Add** gain on sale of Morden & Helwig | — | 3.5 | — |
| **Add** recovery of income taxes | — | 1.7 | — |
| Net earnings | 14.3 | 16.0 | −11% |

As you can see in the table, pre-tax earnings before realized gains increased 50%, mainly due to the inclusion of our share of the Shand, Morahan group's earnings. Surprisingly, in spite of lacklustre markets, realized investment gains in 1988 were about the same as in 1987. As a percentage of our average portfolio, realized gains amounted to 6%. Total earnings from operations increased by 17% pre-tax and 30% after taxes. The effective tax rate in 1988 was 25% compared to 32% last year. Unlike 1987, we did not have any unusual gains in 1988 and so net earnings were down by 11%. While shareholders had a higher total earnings return in 1987 by virtue of unusual gains, the sustainability of our present earnings level is higher currently than a year ago.

There is no question that the insurance cycle is on the downswing. Our insurance companies in 1988 had the wind against them unlike the two prior years when the wind was behind them. We have always said that our insurance companies would not write business unless there was the prospect of an underwriting profit. 1988 tested that resolve. While none of the companies achieved an underwriting profit, all the presidents are firmly committed to this objective. Our insurance companies will continue to face difficult times in 1989 and beyond until the insurance cycle turns. My partner, Steven Markel, discusses this further in his section.

Markel Insurance, led by Keith Ingoe, continued to perform extremely well. The company earned 19.7% on equity in 1988 even though the combined ratio came in at 102%. As discussed in his section, Keith continues to look for better ways to serve his clients. In 1988, under the leadership of Bruce Bedford, Markel Insurance opened a first class driver training school in Guelph, Ontario to fill the need for trained truck drivers. This was a great example of synergy as Bill Andrus from Fairfax worked with

Bruce Bedford and Keith to take an idea from concept to full operation in the space of nine months. Under Bruce's leadership, Markel Training Systems Inc. has plans to expand this service across the country.

Otter Dorchester had an extremely poor year in 1988 as the company suffered from losses on automobile business in Ontario and weather related losses. If you think there is no risk in insurance, read Keith's section on Otter Dorchester. Keith is currently re-evaluating Otter's business strategy.

Sphere Reinsurance, run by Rui Quintal and Bill Grant, had another excellent year in 1988, earning 20% on equity. In 1988, we purchased the minority interest from Rui and Bill, on terms acceptable to them, so as to make Sphere a wholly-owned subsidiary of Fairfax. Rui discusses Sphere's results in greater detail in his section.

The Shand, Morahan group, run by Joe Prochaska and Bob Libby, came through for us in 1988. As Joe indicates in his section, the Shand group earned a 16.4% return on equity resulting in F-M Acquisition earnings of US $13 million – a 35% return on common equity. During the year, we have come to know the people at Shand, Morahan much better and are very impressed at the professionalism we have found in the company. As discussed in our quarterly reports, we raised our interest in F-M Acquisition to 47.5% from 35% by purchasing the shares from Hees International. Our purchase of Shand, Morahan would not have been possible without the support of the management group at Hees.

Also, during the year, we renegotiated portions of F-M Acquisition's purchase contract with Alexander & Alexander at their request which basically is neutral to our position. As of December 31, 1988, we feel that reserve deterioration from the past eroded about $21 million of the note and interest owing to the previous owners.

It was a busy year for Ken Polley and his team at Morden & Helwig as the company continued to expand its operations in Canada and the U.K., and to participate in the U.S. through Lindsey & Newsom. M&H had another excellent year as revenues increased to $43 million and net income increased by 25%.

Lindsey & Newsom operations, run by Bob Irwin, are on a solid foundation. While the returns in 1988 were, for various reasons including the costs of the merger discussed below, less than anticipated, Bob and his management team have worked extremely hard during the year to merge the Gordon Boyd and National Claims Services operations, with 1988 revenues of US $11 million, into Lindsey & Newsom, with 1988 revenues of US $18 million. This merger became formally effective only on January 1, 1989 and thus has not impacted our 1988 financial statements. When you consider the dimensions of this merger (besides the added revenues described above, the number of Lindsey & Newsom offices increased from 62 to 136 and the number of employees from 350 to 775) and the fact that it was all done in the course of nine months, you can appreciate the special efforts of the management group. We now have a very sound base for expansion in the U.S. and the growth potential of our claims adjusting operations over the next few years could be very exciting. **NO** guarantees though! Shareholders should read M&H's annual report to get more details about our claims operations.

As discussed in last year's annual report, the return on equity for Morden & Helwig is still below our target of 20% because of the impact of the new capital raised in 1987 and of the lower than anticipated contribution from Lindsey & Newsom. With Ken's leadership in Canada and Bob's in the U.S., we think it is only a matter of time before we attain the 20% level.

In 1989/90 our plan is to continue with the creation of an international claims company with Morden & Helwig Limited and Lindsey & Newsom Claim Services operating as presently structured.

Late in 1988, just as we were planning our Christmas holidays, Paul Fink came across an opportunity that could be very significant over the years for Fairfax shareholders. After some negotiations, we were able to purchase a controlling (37%) interest in Walwyn Inc. from Financial Trustco for $13.4 million, with Confederation Life and Tony Arrell as partners. To our surprise, this purchase really took the press's fancy and Fairfax made the headlines more than once!!!

Walwyn is predominantly a retail stock brokerage house with 75 offices across Canada. We would not have made this purchase (a) if Tim Miller, the existing CEO, had not consented to Tony Arrell coming in as the new CEO and (b) if the shares could not have been purchased at or below book value (book value at year-end has been written down significantly.) Tony Arrell is a unique individual with an unusual combination of fine operating experience and a value-oriented investment philosophy. Under Tony's leadership, we expect Walwyn to become a first rate investment brokerage house serving the long term interests of its clients.

Concurrent with the purchase of the controlling block, we purchased $9 million of 12.5% subordinated debentures from Walwyn Inc., convertible at $4.00 per share into common shares. Fairfax's total exposure in connection with the Walwyn purchase is approximately $12.5 million.

"How about the downside?" you ask.

The major risks in our Walwyn investment are:

a) the possibility of continuing losses because of individuals not being in the stock market,

b) the possibility of stock trading volumes declining even further, and

c) the major assets of the firm go down in the elevator every day; they may not come back up – for whatever reason!

Our thinking was that most of these negative factors were essentially discounted in the stock price, since we purchased the control block of Walwyn Inc. at about one-third of the price at which the block traded in August 1987. Also, we viewed the investment environment as being quite positive over the longer term. Finally, the stock brokerage business is very people intensive, and while this could be a negative, we believed that Walwyn could truly be a very different company in a short period of time if it could attract capable people, as we felt it could. For more information, shareholders should read the Walwyn Inc. annual report. This investment does not impact our 1988 statements but in 1989 we will be equity accounting our interest in Walwyn.

The major consequence of increasing our ownership in F-M Acquisition and investing in Walwyn is that Fairfax is now in debt. Yes, we took on more debt than we thought we would, though our balance sheet continues to be sound. We financed these major purchases through:

a) a $7.5 million private placement of 8.5% subordinated debentures, convertible into subordinate voting shares at $19 per share; and

b) borrowings of approximately $20 million which we are in the process of refinancing long term.

A few comments with regard to our financial position:

1) We consider the convertible debentures to be quasi-equity and hope they will be converted long before their maturity in 1993.

2) The borrowings finance income producing assets, i.e. 10% preferred shares of F-M Acquisition and 12.5% debentures of Walwyn.

3) Our borrowings of $20 million are modest in relation to our 1988 net income of $14.5 million and shareholders' equity of $74.2 million.

Having said all of that, we are worried! Our top priority is to get Fairfax back to a debt free position (or close to!) as soon as possible. If we have learned one thing about business, it is that too many companies fail because of excessive leverage. Suffice it to say, we are working on reducing this debt as soon as we can.

On December 31, 1988, a very sad event took place for all the original shareholders (including yours truly) who refinanced Fairfax (then Markel) Financial Holdings in its dark days of 1985. Fairfax forced conversion of its $9.3 million of 11.25% convertible preferred shares because the common was trading above $8.50 per share. The fact that Fairfax had prospered so well in three years that it was able to do this at the earliest time permitted was a triumph for all shareholders!

Further on the positive side, our balance sheet continues to be very conservatively stated. Our insurance companies appear to be well reserved. We have recognized only a portion of the amounts by which we expect that our obligations in connection with the Sphere Re and Shand, Morahan acquisitions will be ultimately reduced (in accordance with the purchase agreements). In addition, we ended the year with unrealized gains of approximately $5.2 million in our Canadian insurance companies and US $3.6 million in the U.S. insurance companies owned by F-M Acquisition.

Take the unrealized gains as seriously as we suggested you take the unrealized losses of 1987 – very lightly! In addition to comments made in last year's annual report, because of the debt we consider our balance sheet to be less strong than in 1987, but still very solid.

Fairfax continues to attract very good people – the best sign I know of success in the future. Rick Salsberg, a partner of Tory, Tory, has taken a leave of absence to join us for 1989. You may remember Rick's name in our 1987 and 1986 annual reports in connection with our stock issues. My great fortune was to have Rick's counsel in every major transaction that Fairfax has entered into since we began in 1985. Rick joins David Rooney, Bill Andrus, John Varnell and Brenda Adams at Fairfax. He will also be working with Paul Fink who will no longer be our one-man investment banking department. This is because Rob Mills has joined him as our in-house real estate expert. Rob has years of experience in the real estate business and has consistently applied a value-oriented philosophy to the real estate area.

Our investment banking department is gradually blossoming and we plan to make it a separate company soon. Paul has done three deals only, the largest by far (in terms of financial exposure) being Walwyn. The other two deals are an investment in Carbovan (a vanadium extraction plant) and a position in Develcon Electronics that we obtained for arranging the restructuring and refinancing of that company. While the returns from this area are still insignificant, with Paul and Rob and the others at Fairfax, we think future returns could be very attractive. Please remember that our investment banking department also operates under our overall investment philosophy of downside protection first before looking at potential gain.

Our investment results in 1988 were excellent. Looking back over the past 15 months, we find that the "value" approach has continued to be a reliable guide for us. In 1987's annual report (just after the crash) we cited Ben Graham's words: "Never buy a stock immediately after a substantial rise or sell one immediately after a substantial drop." Our own conclusion as a result of the substantial drop was that the crash had provided more opportunities for long term investment. In hindsight, we were able to take advantage of many of these opportunities.

In 1988, we benefitted significantly from the manufacturing and natural resource sectors in North America. The major contributors to realized investment gains in 1988 were Algoma Steel ($2.0 million), Stewart & Stevenson ($1.0 million), IPSCO ($0.5 million), Laclede Steel ($0.5 million), MRI Resources ($0.5 million), Acme Steel ($0.4 million), Gibraltar ($0.3 million), and Falconbridge ($0.5 million). Total realized losses in 1988 were $1.1 million. Also, we realized $2.0 million in exchange gains as we hedge all our U.S. stock investments against changes in the exchange rate. In fact, in 1988 we have hedged our initial investment and most of our future income for the next five years from Shand, Morahan (U.S.), L&N (U.S.) and Hamkin Holdings (U.K.). Our U.S. and U.K. assets and income are protected from a rising Canadian dollar and will not benefit from a declining dollar. We discuss this further in Note 14 to the financial statements.

In past annual reports we have detailed our long term, value-oriented philosophy. Our insurance company portfolios are skewed toward stocks and convertible securities which we feel will provide good returns over time. How much do we invest in stocks? We have developed guidelines based on excellent work done by David Rooney and John Varnell that limit our exposure to common stocks so that a 50% drop in the stock market and a 20% drop in convertibles and preferreds will not have any impact on our ability to continue to write insurance. Our approach was partially tested during the crash of 1987, but stood the test well. We are not looking forward to a full trial!

We expressed some concern last year about the Japanese stock market. We predicted "a collapse in the highly speculative Japanese stock market" just as it exploded by 40% in 1988. So much for our expertise in Japanese stocks! If this continues, Japan will be the only equity market of consequence. Count me among the skeptics. However, we continue to find long term values in the Canadian and U.S. stock markets.

At the end of 1988 we had $13.3 million invested in banks, $10.5 million in insurance company stocks and $14.5 million in industrial products.

During 1988, Fairfax shares traded in a range of $11.75 to $15.125. At the lower end of the range, we felt our shares were an excellent investment for the company and instituted a buyback of 10% of the float. We managed to purchase only 14,200 shares at an average price of $12.94 per share. We will continue to repurchase our shares if we consider that to be the best investment available for your company.

For your information, over 60% of the shares of Fairfax are owned by The Sixty Two Investment Company Limited, Markel Corporation and the officers and directors of the company. Fairfax's share prices are of interest to us! However, we do not pay much attention to short term fluctuations in share prices – other companies' or our own. Short term fluctuations are driven by the twin emotions of fear and greed while underlying value is always reflected in the long term. At Fairfax, we concentrate on building long term value for all shareholders.

It often amazes us how most people forget the power of compounding. If Fairfax were to achieve an ROE of 20% for the next five years, book value would rise to $25 per share. If this rate continued for the next ten years (which will be extremely challenging to do), book value would increase to $63 per share. Given appropriate premiums to book value, you can see how long term shareholders can do very well if Fairfax achieves a consistent 20% on equity over time. The trick is to achieve the 20% return! Warren Buffett, the Wizard from Omaha, from whom we have learned a lot, has compounded book value of Berkshire Hathaway at 23.5% annually over a 23-year period. Book value increased from $19.46 per share at the end of 1964 to $2,477.47 per share at the end of 1987 while Berkshire's stock price rose from $14 to $2,950 per share over the same period (it is currently $4,825). As we have stated in earlier annual reports, for Buffett and Berkshire Hathaway this record is a fact. For you and us at Fairfax, it is still only a hope!

We face many challenges in 1989 including a downswing in the insurance cycle, an uncertain stock market, growing pains as Morden & Helwig expands through Lindsey & Newsom in the U.S. and possible losses in Walwyn. These factors should make it much more difficult for us to achieve our 20% return on equity objective in 1989. While the short term is uncertain, the long term future of the company continues to be very good due to the excellent people Fairfax has been able to attract.

Before signing off, I want to take time out to particularly thank one of our directors, Robbert Hartog, who is chairman of our Audit Committee and a member of our Executive Committee. Robbert retired from an extremely successful business career by selling the company he founded, Waltec, to Emco Ltd.

He was one of the key founders of Sixty Two who backed me when we made our investment in Fairfax in 1985. Since that time we have made no major decision without Robbert's counsel. Even in retirement, Robbert's schedule would tire a thirty year old, let alone a seventy year old! His unfailing commitment to Fairfax has been, and continues to be, a major reason for our success.

We also thank Fred Kaneb, Robert McDowell and Jim Martin, three directors who have served the company for many years, for their support and contribution, particularly during the company's difficult times. We wish them well as they retire from our Board. We welcome Winslow Bennett, Peter Bloemen and Tony Arrell to our Board and look forward to working with them.

Again, on your behalf, we would like to thank the Board, the management and the employees of our subsidiaries for making 1988 another very good year.

March 31, 1989

V. P. Watsa

V. Prem Watsa
*Chairman of the Board and*
*Chief Executive Officer*

# PRESIDENT'S OPERATING REVIEW

We are quite pleased with our 1988 results. Total revenues have increased 18% to $133.6 million. This increase is primarily due to significant growth in claims fees at Morden & Helwig and the equity in earnings of associated companies. Earnings from operations increased 30% to $16.0 million as compared to $12.3 million in 1987.

Net earnings amounted to $14.3 million or $1.94 per share as compared to $16.0 million or $2.23 per share last year. The 1987 results were favourably impacted by the gain recorded on the sale of shares when Morden & Helwig went public as well as the recovery of deferred income taxes. As you know, our long term goal is to earn a consistent 20% return on shareholders' equity. In 1988 our return was 21%.

The most significant reason for the good results in 1988 is the inclusion of the December 1987 acquisition of the Shand, Morahan group. This investment contributed $6.3 million to our net earnings. In the face of a soft insurance market, Joe Prochaska and his team did a wonderful job and delivered results well in excess of our expectations.

As we discussed in last year's report, the insurance marketplace began a soft cycle in 1987. Competition increased and price levels were under pressure. These market conditions continued in 1988 and we can expect a similar market environment throughout 1989. Unfortunately, we cannot predict either how long or how severe this cycle will be.

The insurance industry is again seeing increasing underwriting losses and reduced cash flows from new tax rates. These factors suggest the cycle could turn. On the other hand, increased interest rates and excess capital committed to the industry suggest the cycle could continue.

Government regulation continues to be a potentially significant issue facing the insurance industry and our operations. The Province of Ontario has established the Ontario Automobile Insurance Board which will review rates and control the allowable increases in automobile insurance premiums. The final regulations are not complete but we believe the major portion of our business will not be adversely affected. While we are certainly prepared to deal with increased government rate regulations, we believe we would all be better served – both the insurance industry and the consumers – with a free market, competitive environment.

In spite of this environment, we remain committed to maintaining sound underwriting standards and price levels necessary to earn underwriting returns. Unfortunately, our insurance companies were not completely successful in achieving this goal in 1988, but we have taken and will continue to take the appropriate action to do so.

Markel Insurance and Otter Dorchester each saw underwriting ratios deteriorate in 1988. Price increases have been put in place to respond to this and more are planned for 1989. We can expect premium volume levels to decline in 1989 in response to this action. Sphere Reinsurance saw a nice improvement in its combined ratios in 1988 since reinsurers' results tend to lag behind the primary insurance industry, and Sphere was fortunate in experiencing no major shock losses nor major storms in 1988. F-M Acquisition also enjoyed an improvement in its combined ratio as it continued to closely manage its underwriting strategy.

Our insurance operations generate most of their earnings from the returns on their investment portfolios. 1988 was an extremely good year. Hamblin Watsa Investment Counsel (HWIC) turned in impressive results.

Fairfax's portfolio (excluding F-M Acquisition) amounted to $137.5 million at December 1988 as compared to $124.0 million last year. The following chart shows HWIC's results for the past two years:

| | 1988 | 1987 |
|---|---|---|
| Interest and dividends | 6.82% | 7.32% |
| Realized gains | 5.97% | 8.34% |
| Income reported during year | 12.79% | 15.66% |
| Unrealized gains (losses) | 9.27% | (7.26)% |
| Total return | 22.06% | 8.40% |

In 1988 HWIC also began managing the US $295.5 million portfolio in F-M Acquisition. This portfolio is heavily weighted toward fixed income securities including tax advantaged securities. In spite of this, the returns were quite good. Interest, dividends and realized gains provided an 8.2% return and unrealized gains in the equity portfolio at year-end amount to $5.2 million.

Our insurance underwriting operations are somewhat balanced with our operations in the claims service business. Morden & Helwig is Canada's leading independent claims organization and its operating results are not significantly impacted by the insurance underwriting cycle.

Morden & Helwig had a good year in 1988 as revenues increased 29% to $43 million and net income increased to $3.0 million. Morden & Helwig has expanded its dominant market position in Canada and through its investment in Lindsey & Newsom Claim Services is now participating in the U.S. market. As Ken Polley explains in his report, Lindsey & Newsom is expanding the base of its operations throughout the U.S. Earnings from our investment in Lindsey & Newsom were somewhat less than we hoped for as the result of certain insurance company failures in Texas as well as costs associated with our planned expansion. We expect growth as we continue to expand our operations in both the United States and England. As we reported last year, we seek to become a leading international claims organization and we believe we are making good progress toward this goal.

As we look to 1989 and beyond we are still optimistic. In the short term it will be very difficult to significantly improve our insurance results, but the claims operations and investment areas show great promise. In the longer term, we can again expect the insurance cycle to become more favourable. Throughout these cycles we remain committed to achieving a 20% return on shareholders' equity.

March 31, 1989

SA Markel

Steven A. Markel
*President and Vice Chairman*

# F-M ACQUISITION CORPORATION OPERATING REVIEW

**SELECTED FINANCIAL INFORMATION (US $000)**
Combined/Consolidated
Shand, Morahan and Evanston Services

| | For the years ended December 31 | | | | |
|---|---|---|---|---|---|
| | 1988 | 1987 | 1986 | 1985 | 1984 |
| Gross premiums written | 102,742 | 124,745 | 157,899 | 151,961 | 107,617 |
| Net premiums earned | 65,310 | 105,391 | 120,110 | 44,262 | 15,782 |
| Net commissions and fees | 748 | 5,302 | 10,695 | 14,152 | 14,142 |
| Net incurred losses | 51,470 | 88,327 | 104,529 | 53,284 | 24,934 |
| Underwriting loss | 7,866 | 9,107 | 13,209 | 15,747 | 11,571 |
| **COMBINED RATIO** | 104.6% | 108.6% | 111.0% | 135.6% | 173.3% |
| Investment income | 24,807 | 18,124 | 21,681 | 15,608 | 12,634 |
| Earnings after tax | 13,475 | 3,094 | 7,782 | 4,180 | 4,860 |
| Total assets | 525,356 | 542,694 | 472,069 | 362,225 | 247,527 |
| Shareholders' equity | 91,653 | 81,021 | 68,174 | 60,495 | 58,165 |
| **RETURN ON EQUITY** | 16.4% | 4.2% | 11.7% | 6.8% | 8.3% |

We had a great year! Our underwriting results improved and investment income moved up significantly. Our first full year under the umbrella of Fairfax Financial and our other shareholders was very successful and we are pleased to report these results to our shareholders.

F-M Acquisition Corporation, through its operating subsidiaries, is a major writer of professional liability and specialty coverages in the United States. Shand, Morahan & Company, Inc. underwrites the coverages, supervises the claims and services the operations of the business. Evanston Insurance Company and Insurance Company of Evanston are the risk-bearing entities in the group.

In the United States, pricing on casualty and liability risks continued to soften throughout the year. But as we discussed in last year's report, we are intent on maintaining sound underwriting practices. We will not sacrifice proper pricing for market share. We will continue to market our products aggressively and seek out niches where we believe proper pricing can be maintained. As we expected, in spite of these marketing efforts, our premium volume did drop due to the softening market. But most importantly, our underwriting loss declined and we will continue to work on reducing it despite the soft market.

With better investment management and an increase in our long term investable assets, we saw significant growth in our investment earnings. The expert guidance provided by Hamblin Watsa Investment Counsel supplied an extra boost to our investment earnings by their astute investment selections. Our investment portfolio has become more heavily concentrated in common stock equities, and although this may add some volatility to our investment earnings, we are confident that this will provide a better return on our portfolio and to our shareholders over the long term.

We are involved almost exclusively in "long-tail" lines of business as Prem discussed last year in his report. It will take many years to settle each policy year's claims and it is always possible that our estimates of the proper level of claim reserves could change. Each quarter we review and evaluate our estimate of the final value of the claims we will pay against any policy year. We are pleased to report that there were no significant changes in our estimates for 1987 and prior during 1988. Our estimates for both the current and prior years are reviewed by our in-house actuaries as well as by two outside actuarial consulting firms – Milliman & Robertson and The Wyatt Company. Management believes our claim reserves properly reflect the ultimate liabilities we will pay on outstanding claims. The various actuaries concur with this evaluation.

During 1988 we implemented a corporate structure change within F-M Acquisition Corporation. We organized an intermediate holding company, Shand Morahan Services, Inc., between F-M Acquisition Corporation and the other companies. Shand Morahan Services, Inc. then owns Shand, Morahan & Company, Inc. and the insurance companies. This change was made to help focus our organization and staff on the necessity of achieving a proper underwriting return and to streamline our internal reporting.

The rating applied to our company by A.M. Best Co. remained at "B" for 1988. Although "B" is a good rating, a higher rating makes our product and pricing more acceptable to buyers. We are optimistic that with another year of improved underwriting results, we will obtain an improved rating. These ratings are viewed critically by many insurance buyers in the United States.

With a "softening" insurance marketplace continued challenges lie ahead. However, we are confident that with the support of our shareholders and staff we will continue to move forward and achieve additional successful years.

For the company and myself, I would like to express our sincere appreciation to our insureds, producers, other business associates and staff who have supported us and contributed to our results.

March 31, 1989

Joseph J. Prochaska, Jr

*President and Chief Executive Officer*

# MARKEL INSURANCE COMPANY OF CANADA
# OPERATING REVIEW

| FINANCIAL SUMMARY ($000) | For the years ended December 31 | | | | |
|---|---|---|---|---|---|
| | 1988 | 1987 | 1986 | 1985 | 1984 |
| Gross premiums written | 49,443 | 52,507 | 51,615 | 23,415 | 21,064 |
| Net premiums earned | 42,006 | 42,723 | 34,633 | 14,049 | 16,616 |
| Net incurred losses | 31,095 | 30,515 | 24,614 | 13,533 | 17,588 |
| Net commissions & operating expenses | 11,758 | 10,809 | 7,363 | 4,147 | 5,646 |
| **COMBINED RATIO** | 102.0% | 96.7% | 92.4% | 125.8% | 139.7% |
| Underwriting income (loss) | (847) | 1,399 | 2,656 | (3,631) | (6,619) |
| Investment income | 9,869 | 11,977 | 4,297 | 2,850 | 2,150 |
| Earnings (loss) after tax | 5,756 | 10,070 | 5,612 | (781) | (4,468) |
| Total assets | 102,119 | 97,163 | 71,525 | 38,472 | 29,875 |
| Shareholders' equity | 30,909 | 28,153 | 18,083 | 7,471 | 3,252 |
| **RETURN ON EQUITY** | 19.7% | 43.6% | 43.9% | — | — |

Markel Insurance Company of Canada provides property and casualty insurance and related services to the transportation industry. We specialize in insuring small to medium sized long haul trucking fleets across Canada against public liability and property damage. In addition the company provides insurance protection to taxis, daily car rentals and charter tour buses, and writes small portfolios of cargo insurance, umbrella excess liability insurance and surety.

In 1988, Markel was faced with intense competition from a number of insurers committed to obtaining market share with unrealistic pricing strategies. Discounts as high as 50% were quoted by other markets and became the rule rather than the exception. Faced with the challenges of this "soft market" Markel remained committed to superior risk selection and pricing integrity which would enable the company to achieve an underwriting profit.

Gross written premiums declined by 6% in 1988 to $49.4 million from $52.5 in 1987. In our efforts to achieve underwriting profit, we lost a number of large fleet accounts from our trucking portfolio to competitors at much lower premiums. This decrease in trucking volume was offset by increased activity in the less competitive classes of taxis, daily car rentals and surety. In 1988, the Ontario Automobile Insurance Board, which had frozen rates in 1987, permitted two rate increases totalling 9% which we applied to our commercial automobile portfolio. In addition, substantial automobile rate increases were introduced in Quebec and New Brunswick in the fourth quarter.

Our Casualty Department also experienced soft market conditions as competing insurers applied substantial discounts to umbrella and excess liability premiums. In 1988 we introduced a mono-line Cargo Department with the responsibility of establishing Markel as an alternative market for this class of business. The buoyant economy in Ontario stimulated construction activity which resulted in a tripling of our surety volume to a level of $2.4 million.

We are pleased with the progress of the two service offices in Halifax and Edmonton which were established in 1987. These offices made significant contributions to our results and have established Markel as a prominent insurance market to the transportation industry in these regions. Through our Montreal office we maintained a strong presence in Quebec.

In 1988, average claims costs continued to increase as did claims frequency. During 1988 we experienced adverse development on some outstanding losses from prior years, however our reserves were more than adequate to provide for these losses. Markel's efficient claims handling, combined with sound risk selection and loss prevention services, allowed us to control losses resulting in an earned loss ratio of 74%. This is still a significant deterioration from 1987 when the loss ratio was 71% and is the result of claims inflation outpacing premium increases. We have continued our conservative reserving practices, and again this year our claims reserves have been certified by our consulting actuaries, The Wyatt Company.

The company incurred an overall underwriting loss in 1988 of $847,000, compared to a profit in 1987 of $1.4 million. The loss was the result of higher claims costs and some unusual expenses associated with the start-up of our new automation system, as well as the move to new premises. One very bright spot was the substantial underwriting profit earned by our surety business. Net investment income continued to be excellent at $9.9 million again because of good capital gains. After-tax earnings were $5.8 million which provided a 19.7% return on equity.

We were successful in negotiating a more favourable reinsurance treaty in 1988 with increased liability limits, and in October an extension was granted to include certain classes of hazardous goods. Since December, Markel has provided a market to insure U.S. subsidiaries of Canadian trucking companies.

In January 1988, to allow room for expansion, we moved to new premises and completed the implementation of a new automation system. The implementation was not without the usual problems for this type of installation, and combined with our relocation resulted in some work backlogs. However, the system is now serving us well and we are experiencing productivity gains on our day to day operations allowing us to provide an improved level of service to our customers.

A good example of the value-added services provided by Markel to the trucking industry is the establishment of the Markel Institute of Professional Transport Training. The Institute provides professional truck driver training services to career-oriented individuals wishing to be employed in the transportation field. Bruce Bedford, formerly Markel's Loss Prevention Manager, heads the Institute and has built a team of experienced instructors to teach the 150-hour course. A property near Guelph, Ontario, was purchased and offices, classrooms and a two acre driving range established. The first students entered the school on September 26, 1988 and by the end of the year 38 students had graduated, many of whom are now employed by Markel policyholders. In order that the Institute shall remain responsive to the transportation industry's needs and concerns, an advisory board, comprising knowledgeable industry members, has been formed. We are proud of this facility and confident that it will provide benefits to the transportation and insurance industries as well as to our shareholders.

At Otter Dorchester Insurance Company, net premiums written for the year were $12.6 million in comparison to $10.7 million in 1987, representing an 18.1% increase due to increased new business and an increase in rates. Severe storms in July and August and losses in the automobile portfolio contributed to an overall underwriting loss of $1.8 million. Because of the additional costs of necessary administrative and computerization changes, and the lack of adequate rate increases, Otter Dorchester discontinued writing automobile coverage effective November 1, 1988 on new policies and on January 1, 1989 discontinued renewal automobile business. In December 1988 Reg Black retired after 18 years' service with the company. He will continue as Vice Chairman and director, and we extend our thanks to Reg for his assistance in the smooth reorganization of the company.

We expect the soft market to continue in 1989; competition will remain intense but Markel will maintain rate integrity by implementing the necessary rate increases. We expect this will reduce our premium volume but ultimately it will enhance our ability to achieve underwriting profit. The Ontario Automobile Insurance Board has established rates for certain classes of automobile insurance. The Board's rulings will have a moderate impact on our portfolio. Commercial automobile fleets, including risks with U.S. exposure, are exempt from these guidelines.

We have looked to the future and have prepared ourselves to deal with these many challenges. In an effort to provide product enhancements and identify niche market opportunities, we anticipate some changes in 1989. The organizational structure of the company will be modified from functional responsibilities to product divisions. This "Product Manager" concept will help us to focus our energies on achieving underwriting profit by line of business and to better meet the challenges of each market. Overall, we are confident that we will be able to better serve the needs of our brokers and policyholders who have continued to support us favourably.

The dedication and teamwork displayed by all employees at Markel position the company well to carry out our plans in 1989 and to once again outperform most of our competitors as we have done in the past three years.

March 31, 1989

Keith E. Ingoe
*President and Chief Executive Officer*

# MORDEN & HELWIG GROUP INC.
# OPERATING REVIEW

**FINANCIAL SUMMARY ($000)**

| | For the years ended December 31 | | | | |
|---|---|---|---|---|---|
| | 1988 | 1987 | 1986 | 1985 | 1984 |
| **REVENUES** | 43,348 | 33,528 | 30,939 | 27,398 | 23,331 |
| Earnings before extraordinary items | 2,984 | 2,389 | 1,423 | 1,304 | 660 |
| Earnings after tax | 2,984 | 2,389 | 2,155 | 1,764 | 740 |
| Total assets | 38,404 | 34,117 | 14,501 | 14,121 | 12,475 |
| Shareholders' equity | 25,618 | 23,510 | 6,219 | 4,429 | 2,684 |
| **RETURN ON EQUITY** | 12.2% | 16.1% | 40.5% | 49.6% | 31.7% |

During 1988 we continued our program of acquisitions and reorganization and as a group we now provide services to the insurance industry in Canada through Morden & Helwig Limited and Centapp Services Inc., in the United States through Lindsey & Newsom Insurance Adjusters, Inc. and Vale National Training Centers, Inc., and in England through Morden & Helwig Limited as well as Hamkin Holdings Limited which was acquired during 1988.

Primarily as a result of the acquisitions of the past two years, revenues increased to record levels and there was continued improvement in the earnings per share. Increases in the company's sales and earnings during 1988 were substantial and gratifying.

Our operations in Canada, the United States and England are all affected by weather, and the mild weather conditions which prevailed throughout 1988 and the absence of any significant storm activity should be considered when reviewing the financial results.

Our 1988 Canadian revenues increased by 29% to $43 million, and the operating earnings for twelve months rose to $4.8 million, an increase of 32% from one year ago.

Additionally, the operating return on revenue increased by 1% to 11% in 1988. Net earnings for the year were $3 million, an increase of $0.6 million or 25% from the year earlier, representing a 5.3¢ earnings per share increase totalling 67¢ for the current year.

A review of these results must consider that the net investment gains and interest income were reduced by $73,000 from a year earlier, and interest expense increased by $0.3 million to $0.4 million compared to last year.Unlike 1987, incoming assignments increased during the first half of 1988 and continued relatively strong throughout the balance of the year. In fact, new assignments received increased 12% from a year ago, and completed assignments increased 14.5% from 1987. Additionally, we have a significant increase in the number of claims on hand at the end of the year.

1988 was a year of consolidation and refinement of our Canadian operations, combined with full development of our computerized branch management system and our corporate computerization program. Additionally, 1988 was the first full year of our 100% ownership of Centapp Services Inc., which has had a substantial improvement in its operations over a year ago. Centapp Services Inc. provides automobile and heavy equipment appraisal services throughout Canada to a number of insurance companies and self-insured organizations, and through a division, Central Printing Service, provides Morden & Helwig with most of its internal printing requirements. In addition, Central Printing provides printing services to outside businesses.

1988 saw the first full year of our branch operation in London, England, which has provided substantial benefits for our operations in both Canada and the United States as a result of a closer working relationship with the significant Lloyd's market in Europe and North America.

In July 1988 we acquired Hamkin Holdings Limited, which owns Hammond Adjusters Limited, operating branch offices in London, England and the surrounding area. Hamkin also operates Travel Claims Services Limited, and combined, provided post-acquisition earnings of Cdn $38,600 on revenues of Cdn $1.4 million.

Lindsey & Newsom Insurance Adjusters, Inc., a regional adjusting company in Texas, was acquired in December 1987 on a 50/50 basis with Markel Corporation. Our strategy in this acquisition was to establish a strong U.S. presence and provide the foundation for further development of our objective to institute a national adjusting company in the United States. During 1988 we continued to expand by the acquisition of independent adjusters who met certain quality standards and added value to our overall operations. There were fourteen branches acquired by such mergers, in addition to five branches opened utilizing our existing staff. By the end of the year, Lindsey & Newsom acquired the operations of National Claims Service and Gordon Boyd & Company, bringing the total number of branches operating in the United States to 128. In December 1988, Lindsey & Newsom also acquired Claims Administration Systems, Inc., a third party administrator with a substantial office in Stanton, California and other subsidiary offices in California. It is expected this company will assist in the development of other offices in the West Coast area.

The Lindsey & Newsom base operation unfortunately had a significant drop in its earnings as a result of the collapse of two major insurance companies. The company suffered a decrease in ongoing assignments as well as a write-off to accounts receivable. Net earnings for the year amounted to US $622,000 representing Cdn $382,561 as our share.

Morden & Helwig Group Inc. is also 48.5% owner of Vale National Training Centers, Inc., a claims management training facility with campuses in Pennsylvania, California and Texas. Their net earnings for the year amounted to US $162,000, which contributed Cdn $96,600 as our share.

The passage of the Free Trade bill will allow the movement of management in both directions across the border and provide increased opportunities for employees in both countries. We believe this will add substantially to our future development.

The difficulties relating to automobile insurance in Ontario continue. We have seen the establishment of the Ontario Automobile Insurance Board which controls the allowable increases in the automobile insurance premiums; however, there does not appear to be a viable, long-range solution to the rising costs of injuries and property damage resulting from motor vehicle accidents in this province. The Board is currently studying the viability of the existing tort system as well as the possible implementation of a no fault system which would allow the public an alternate insurance coverage. As a major portion of our business is derived from the province of Ontario, we are carefully monitoring developments in this connection, and are working with the industry to do what we can to assist in resolving these problems.

Approximately four years ago, we recognized that as a result of the "insurance crisis" the needs of the insurance community were changing, as were those of the captive and self-retention markets. These changes have caused us to focus our marketing effort on these areas, as well as on the international insurance marketplace and the off-shore captive market. Our strategy now is to expand these developing markets and add value to the services being rendered to our clients.

The acquisitions made during 1987 provided us with many new and valuable employees who have continued to attract claims of a much more complicated nature, and in many instances these individuals have assisted with the training of other staff members, adding value to our over-all operations.

It is a challenge to management to provide a working environment conducive to superior individual performance and a remuneration program which is fair, objective and competitive with others in the industry. We are continuing to develop new management internally and be on the lookout for prospects externally, as we believe this is a key ingredient in our continued growth.

The contribution in 1988 by all of our employees in Canada, the United States and in England has allowed us to report another improvement in our earnings as well as gross revenue, and we are optimistic about our prospects in 1989.

In closing, I would like to assure our shareholders that the actions taken by this management in the past few years have provided a solid base for improved growth in the future. The extra efforts of every employee have contributed to these results. I expect a continued improvement in our operations for 1989.

March 31, 1989

Kenneth R. Polley
*President and Chief Executive Officer*

# SPHERE REINSURANCE COMPANY OF CANADA
# OPERATING REVIEW

| FINANCIAL SUMMARY ($000) | For the years ended December 31 | | | | |
|---|---|---|---|---|---|
| | 1988 | 1987 | 1986 | 1985 | 1984 |
| Gross premiums written | 16,278 | 18,871 | 17,506 | 15,352 | 14,229 |
| Net premiums earned | 17,032 | 17,655 | 16,359 | 12,162 | 9,751 |
| Net incurred losses | 11,984 | 13,745 | 12,693 | 10,000 | 7,547 |
| Net commissions and operating expenses | 6,244 | 5,905 | 5,308 | 4,101 | 3,430 |
| **COMBINED RATIO** | 107.0% | 111.3% | 110.0% | 115.9% | 112.6% |
| Underwriting loss | 1,197 | 1,995 | 1,642 | 1,939 | 1,226 |
| Investment income | 4,402 | 3,954 | 2,855 | 2,164 | 2,005 |
| Earnings after tax | 2,498 | 1,885 | 807 | 262 | 779 |
| Total assets | 43,815 | 38,823 | 31,352 | 24,636 | 21,035 |
| Shareholders' equity | 13,870 | 11,372 | 7,487 | 6,680 | 6,419 |
| **RETURN ON EQUITY** | 19.8% | 20.0% | 11.4% | 4.0% | 12.9% |

Sphere Reinsurance continues to be one of only two Canadian owned reinsurance companies. The company is registered under the Canadian and British Insurance Companies Act and is licensed to write all classes of insurance other than life, restricted to the business of reinsurance. Generally, the company writes Canadian business only.

In 1988 net premiums earned were down 3.5% to $17.0 million. This reduction of premium income resulted mainly from a diminished amount of reinsurance business available in the market place. This in turn was caused by much improved operating results experienced by the insurance companies during the last three years, coupled with some mergers which have led to higher retentions – a situation that very much reflects the cyclical nature of our business.

Property risks continue to make up the largest portion of our portfolio, accounting for 70% of our premium income; the remaining 30% comes from auto and casualty risks. Most of our business is still generated from proportional treaties although not to the same extent as in previous years.

Our underwriting results for 1988 produced a loss ratio of 70.4%, which compares quite favourably with the ratio of 78% for 1987. A contributing factor to this improvement was the absence of major shock losses or storms in the year 1988. Net commissions and operating expenses were slightly higher in 1988 due in part to provisions for contingent commissions. The overall combined ratio for the year was 107%, down from 111.3% in 1987; the underwriting loss for the year was $1.2 million, compared with a loss of $2 million for 1987.

Investment income for the year was up at $4.4 million compared with $4 million for 1987. Realized gains for the year were $2.3 million compared with $2.2 million for 1987. Interest and dividends amounted to $2.1 million, slightly higher than the 1987 figure of $1.8 million.

Net earnings for the year were up at $2.5 million compared with $1.9 million for 1987, representing an increase of 32%.

We managed to achieve a rate of return on equity of 19.8% for 1988 which was essentially the same level as the 20% return in 1987.

Total assets at December 31, 1988 stood at $43.8 million of which $38.8 million or 89% were in the form of cash and investments. When compared with the figures at the end of 1987, there was an increase of $5 million in asset growth in 1988. The steady build up of our income-producing assets is a very important aspect of our business, providing the financial stability of the company and generating future earnings.

Total liabilities at December 31, 1988 were $29.9 million, compared with $27.5 million at the end of 1987. Our claims reserves, which have been certified by The Wyatt Company, rose to $20 million at December 31, 1988 from $17.4 million at the end of 1987.

We approach 1989 with a certain amount of trepidation in view of the condition of the market place pressuring premium levels. There continues to be strong competition at the primary level of the market and in addition, there is plenty of reinsurance capacity available, predictably leading to softening of the premium rates and better reinsurance terms for the cedents. Our premium volume for 1989 will be lower than 1988, and we expect to see a deteriorating trend in our underwriting results. However, we are confident that we will be able to generate an operating profit for the year and attain our return on equity targets.

On behalf of the company, we would like to express our sincere appreciation to our staff, brokers and cedents for their support.

March 31, 1989

L. Rui Quintal
*President and Chief Executive Officer*

FAIRFAX
FINANCIAL HOLDINGS LIMITED

# CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 1988

# CONSOLIDATED BALANCE SHEET AS AT DECEMBER 31, 1988

| | 1988 ($000) | 1987 ($000) |
|---|---|---|
| **ASSETS** | | |
| Cash and short term investments | 28,027 | 31,661 |
| Accounts receivable | 26,884 | 21,045 |
| Claims in process | 7,266 | 6,126 |
| Prepaid expenses | 545 | 560 |
| | 62,722 | 59,392 |
| Portfolio investments | | |
| Bonds – at amortized cost (market value – $24,417; 1987 – $22,834) | 24,558 | 22,591 |
| Preferred stocks – at cost (market value – $32,875; 1987 – $15,667) | 32,008 | 18,374 |
| Common stocks – at cost (market value – $57,424; 1987 – $46,918) | 52,955 | 51,390 |
| | 109,521 | 92,355 |
| Investments in associated companies *(note 2)* | 24,787 | 15,740 |
| Other investments *(note 3)* | 27,721 | — |
| Deferred premium acquisition costs | 4,991 | 4,520 |
| Fixed assets *(note 4)* | 5,016 | 3,582 |
| Goodwill *(note 15)* | 5,641 | 3,431 |
| Other assets *(note 5)* | 6,387 | 6,393 |
| | 246,786 | 185,413 |

*Signed on behalf of the Board*

V.P. Watson

Director

SAMarkel

Director

| | 1988 | 1987 |
|---|---|---|
| | ($000) | ($000) |
| **LIABILITIES** | | |
| Bank loans *(note 6)* | 4,013 | 3,461 |
| Short term borrowings *(note 6)* | 20,000 | — |
| Accounts payable and accrued liabilities | 21,409 | 13,696 |
| Premium deposits | 8,361 | 8,711 |
| Income taxes payable | 3,230 | 4,515 |
| | 57,013 | 30,383 |
| Provision for claims | 71,964 | 59,438 |
| Unearned premiums | 22,757 | 20,799 |
| Notes payable *(note 7 & note 15)* | 2,061 | 3,067 |
| Subordinated convertible debenture *(note 8)* | 7,500 | — |
| Deferred income taxes | 1,079 | 627 |
| Minority interest | 10,236 | 10,051 |
| | 115,597 | 93,982 |
| **SHAREHOLDERS' EQUITY** | | |
| Capital stock *(note 9)* | 43,543 | 43,656 |
| Retained earnings | 30,633 | 17,392 |
| | 74,176 | 61,048 |
| | 246,786 | 185,413 |

# CONSOLIDATED STATEMENT OF EARNINGS FOR THE YEAR ENDED DECEMBER 31, 1988

| | 1988 ($000) | 1987 ($000) |
|---|---|---|
| **Revenue** | | |
| Premiums earned | 66,265 | 62,012 |
| Claims fees | 43,349 | 33,529 |
| Interest and dividends | 8,922 | 8,042 |
| Realized gains on investments | 7,802 | 9,159 |
| Equity in earnings of associated companies *(note 2)* | 6,729 | 18 |
| Other income | 582 | 211 |
| | 133,649 | 112,971 |
| **Expenses** | | |
| Losses on claims | 47,627 | 45,275 |
| Operating expenses | 53,772 | 40,702 |
| Commissions | 10,926 | 8,791 |
| | 112,325 | 94,768 |
| **Earnings before income taxes** | 21,324 | 18,203 |
| Provision for income taxes *(note 12)* | 5,297 | 5,878 |
| **Earnings from operations** | 16,027 | 12,325 |
| Gain on reduction of interest in subsidiary, net of tax | — | 3,524 |
| **Earnings before minority interest and extraordinary item** | 16,027 | 15,849 |
| Minority interest | (1,670) | (1,530) |
| Extraordinary item – recovery of deferred income taxes | — | 1,700 |
| **Net earnings** | 14,357 | 16,019 |
| **Earnings per share – fully diluted (note 17)** | | |
| Earnings from operations | $1.94 | $1.50 |
| Earnings before extraordinary item | $1.94 | $1.99 |
| Net earnings | $1.94 | $2.23 |

# CONSOLIDATED STATEMENT OF RETAINED EARNINGS FOR THE YEAR ENDED DECEMBER 31, 1988

| | 1988 ($000) | 1987 ($000) |
|---|---|---|
| **Retained earnings – beginning of year** | 17,392 | 2,417 |
| Earnings for the year | 14,357 | 16,019 |
| Dividends on preferred shares | (1,044) | (1,044) |
| Excess over cost of shares purchased for cancellation *(note 9)* | (72) | — |
| **Retained earnings – end of year** | 30,633 | 17,392 |

# CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION FOR THE YEAR ENDED DECEMBER 31, 1988

| | 1988 ($000) | 1987 ($000) |
|---|---|---|
| **Operating activities** | | |
| Net earnings from operations | 16,027 | 12,325 |
| Depreciation | 896 | 524 |
| Amortization of goodwill | 453 | 491 |
| Deferred income taxes | 452 | 391 |
| Realized gains on investments | (7,802) | (9,159) |
| Equity in earnings of associated companies | (6,729) | (18) |
| | 3,297 | 4,554 |
| Increase in provision for claims | 12,526 | 19,202 |
| Increase in unearned premiums | 1,958 | 3,678 |
| Increase in cash funds resulting from changes in other operating working capital items | 2,017 | 1,285 |
| Cash resources provided by operating activities | 19,798 | 28,719 |
| **Investing activities** | | |
| Portfolio investments – purchases | (50,812) | (62,197) |
| – proceeds of sale | 42,290 | 50,189 |
| Purchase of fixed assets | (1,640) | (954) |
| Acquisition of subsidiary companies *(note 15)* | (2,504) | (7,308) |
| Investment in associated companies | (9,047) | (15,740) |
| Other investments | (27,721) | — |
| | (49,434) | (36,010) |
| **Financing activities** | | |
| Issuance (repurchase) of capital stock | (185) | 4,798 |
| Dividends on preferred shares | (1,044) | (1,044) |
| Reduction of notes payable | (1,006) | — |
| Minority interest | 185 | 9,524 |
| Issuance of subordinated convertible debenture | 7,500 | — |
| | 5,450 | 13,278 |
| **Increase (decrease) in cash resources** | (24,186) | 5,987 |
| **Cash resources – beginning of year** | 28,200 | 22,213 |
| **Cash resources – end of year** | 4,014 | 28,200 |

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED DECEMBER 31, 1988

(in $000s except per share amounts)

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Business operations*

The company is a financial services holding company engaged, through subsidiaries and affiliates, in the insurance and reinsurance of commercial property and casualty risks, the provision of claims adjusting, appraisal and loss management services, and investment banking activities in Canada and the United States.

*Principles of consolidation*

The consolidated financial statements include the accounts of the company and all of its subsidiaries. The company's investments in associated companies and the investment in the common shares of Walwyn Inc. are accounted for under the equity method. Acquisitions are accounted for by the purchase method, whereby the results of acquisitions are included only from the date of acquisition.

*Premiums*

Insurance premiums are taken into income evenly throughout the terms of the related policies. As premium deposits secure the payment of premiums and are refundable, they are not taken into income unless default in payment of premiums occurs.

*Claims in process*

The company records its inventory of claims in process at their estimated value at year-end, based on a determination of the claims in process at year-end through a complete physical count of related files. Claims fees arising therefrom are accounted for on an estimated percentage-of-completion basis.

*Deferred premium acquisition costs*

The costs incurred in acquiring insurance premiums are deferred, to the extent that they are considered recoverable, and amortized over the same period as the related premiums are taken into income.

*Investments*

Bonds are carried at amortized cost providing for the amortization of the discount or premium on a straight line basis to maturity. Preferred and common stocks are carried at cost. When there has been a loss in value of an investment that is other than a temporary decline, the investment is written down to its net realizable value.

*Investment income*

Investment income is recorded as it accrues. Dividends are recorded as income on the record date. Gains and losses realized on the disposal of investments are taken into income on the date of disposal.

*Claims*

Claim provisions are established by the case basis method as claims are reported. The provisions are subsequently adjusted as additional information on the estimated amount of a claim becomes known during the course of its settlement. A provision is also made for management's calculation of factors affecting the future development of claims including claims incurred but not reported based on the volume of business currently in force and the historical experience on such claims.

*Translation of foreign currencies*

Assets and liabilities in foreign currencies are translated into Canadian dollars at year-end exchange rates. Income and expenses are translated at the exchange rates in effect at the date incurred. Realized gains and losses on foreign exchange are recognized in the statement of earnings. Where the company has hedged foreign exchange exposure the effective hedge exchange rate has been used.

*Goodwill*

The difference between purchase cost and the fair value of the net assets of acquired businesses is amortized on a straight line basis over its estimated useful life which ranges from 10 to 40 years.

## 2. INVESTMENTS IN ASSOCIATED COMPANIES

| Associated companies, at equity: | 1988 ($000) | 1987 ($000) |
|---|---|---|
| F-M Acquisition Corporation | 15,211 | 6,385 |
| Lindsey & Newsom Insurance Adjusters, Inc. | 8,134 | 7,970 |
| Vale National Training Centers, Inc. | 1,442 | 1,385 |
| | 24,787 | 15,740 |

F-M Acquisition Corporation:

During the year the company acquired an additional 12.5% common share interest, increasing its interest to 47.5%, and also purchased 62.5% of the preferred shares of F-M Acquisition Corporation for a total cash consideration of $15,544. The preferred shares of F-M Acquisition Corporation are recorded in other investments. The F-M group, based in Evanston, Illinois, provides specialty insurance coverage primarily in the professional and product liability areas.

A summary of F-M's consolidated balance sheet and statement of earnings in U.S. dollars is as follows:

| BALANCE SHEET | December 31,1988 ($000) | December 31, 1987 ($000) |
|---|---|---|
| Cash and investments | 308,800 | 367,446 |
| Reinsurance and premium receivables | 152,671 | 130,589 |
| Property and equipment | 22,946 | 24,204 |
| Other assets | 24,101 | 12,947 |
| Total assets | 508,518 | 535,186 |
| Reinsurance and other payables | 127,804 | 164,370 |
| Provision for claims | 227,203 | 221,110 |
| Unearned premiums and fees | 37,174 | 37,782 |
| Capitalized lease obligations | 22,217 | 22,295 |
| Notes payable | 54,171 | 59,465 |
| Total liabilities | 468,569 | 505,022 |
| Shareholders' equity | | |
| Preferred | 14,580 | 16,200 |
| Common | 14,000 | 14,000 |
| Retained earnings | 11,369 | (36) |
| | 39,949 | 30,164 |
| Total liabilities and shareholders' equity | 508,518 | 535,186 |

**Notes to Consolidated Financial Statements**

| STATEMENT OF EARNINGS | Year Ended December 31, 1988 ($000) | Unaudited (pro forma) Year Ended December 31, 1987 ($000) |
|---|---|---|
| Operating revenue | 62,249 | 119,584 |
| Investment income | 25,305 | 20,099 |
| | 87,554 | 139,683 |
| Operating costs | 71,718 | 127,394 |
| | 15,836 | 12,289 |
| Income tax (recovery) | 2,811 | (669) |
| Net earnings | 13,025 | 12,958 |

Included in notes payable are contingent amounts totalling US$28,836 (1987 – US$34,665) which are subject to reduction based on development of unpaid claims and reinsurance collections.

Lindsey & Newsom Insurance Adjusters, Inc. and Vale National Training Centers, Inc.:

The company's 53% owned subsidiary, Morden & Helwig Group Inc., owns a 50% interest in Lindsey & Newsom Insurance Adjusters, Inc. and a 48.5% interest in Vale National Training Centers, Inc., both of which are accounted for on the equity basis. Lindsey & Newsom provides independent insurance claims adjusting and medical rehabilitation services to insurance companies, insurance agencies and self-insured organizations in 5 states. Vale National provides claims adjusting training courses in 3 states.

A summary of the combined balance sheet and the statement of earnings in U.S. dollars is as follows:

| BALANCE SHEET | December 31, 1988 ($000) | December 31, 1987 ($000) |
|---|---|---|
| Current assets | 6,227 | 5,202 |
| Fixed assets | 5,499 | 4,853 |
| Goodwill | 11,903 | 12,202 |
| Other | 9,168 | 8,824 |
| Total assets | 32,797 | 31,081 |
| Accounts payable | 2,012 | 2,405 |
| Long term debt | 6,893 | 7,130 |
| Other | 8,835 | 7,272 |
| Total liabilities | 17,740 | 16,807 |
| Shareholders' equity | 15,057 | 14,274 |
| Total liabilities & shareholders' equity | 32,797 | 31,081 |

| STATEMENT OF EARNINGS | Year Ended December 31, 1988 ($000) |
|---|---|
| Operating revenue | 20,209 |
| Operating costs | 18,779 |
| | 1,430 |
| Income tax | 647 |
| Net earnings | 783 |

The statement of earnings for 1987 is not shown as both companies were purchased in late 1987 and the comparative numbers are not meaningful.

## 3. OTHER INVESTMENTS

During the year the company made the following other investments:

| Other investments, at cost: | 1988 ($000) | 1987 ($000) |
|---|---|---|
| F-M Acquisition Corporation – 10% cumulative redeemable preferred shares | 11,492 | — |
| Walwyn Inc. – 12.5% subordinated debentures, due 1993, convertible into common shares at $4 per share | 11,250 | — |
| Others | 1,608 | — |
| Other investments, at equity: | | |
| Walwyn Inc. – common shares | 3,371 | — |
| | 27,721 | — |

F-M Acquisition Corporation:

During the year F-M Acquisition redeemed 10% of the outstanding preferred shares at par.

Walwyn Inc. – Common shares:

In December 1988 the company formed Faircross Holdings Corporation, a single purpose company incorporated to acquire 3,671,300 shares of Walwyn Inc. for $13,371 cash. The investment in Walwyn Inc. is shown net of a $10 million 8% debenture which is non-recourse to the company and is secured by the common shares. Under the terms of the debenture any proceeds received from a sale of these shares must be applied first to the outstanding debenture. Faircross has granted options in respect of 1,652,085 common shares exercisable commencing December 2, 1988 at a cost of $3.64 per share. At December 31, 1988 the book value and market value of Walwyn Inc. was $2.61 and $3.65 respectively. The company will account for its effective 20% net investment in Walwyn on an equity basis using an effective acquisition date of December 31, 1988.

**Notes to Consolidated Financial Statements**

## 4. FIXED ASSETS

| | 1988 ($000) | 1987 ($000) |
|---|---|---|
| Land and buildings | 2,203 | 1,451 |
| Furniture and equipment | 7,813 | 6,169 |
| Leasehold improvements | 609 | 410 |
| | 10,625 | 8,030 |
| Less accumulated depreciation | 5,609 | 4,448 |
| | 5,016 | 3,582 |

## 5. OTHER ASSETS

Included in other assets are non-interest bearing loans to officers and directors of the company and its subsidiaries under the company's employee stock purchase plans totalling $5,818 (1987 – $5,981).

## 6. BANK LOANS AND SHORT TERM BORROWINGS

The bank loans represent temporary operating loans, of which $2,703 is secured by a general assignment of book debts. Short term borrowings represent 13% demand notes payable which are unsecured. Interest expense on the bank loans and short term borrowings amounted to $1,553 (1987 – $192).

## 7. NOTES PAYABLE

Included in notes payable is a contingent amount of $1,120 (1987 – $2,800) with respect to Sphere Reinsurance Company of Canada. This amount bears interest at 9.75% per annum, is payable in 1991 and is subject to reduction based on development of Sphere Reinsurance's unpaid claims and claims adjustment expenses. Interest expense on notes payable amounted to $250 (1987 – $300).

## 8. SUBORDINATED CONVERTIBLE DEBENTURE

During the year the company completed the issue of a $7.5 million unsecured subordinated debenture on a private placement basis. The debenture bears interest at a rate of 8.5% per annum, matures five years after issue, is convertible until maturity into subordinate voting shares of Fairfax at $19.00 per share, and is prepayable under certain circumstances. Interest expense on the debenture amounted to $427 (1987 – nil).

## 9. CAPITAL STOCK

*Authorized capital*

The authorized share capital of the company consists of an unlimited number of preferred shares issuable in series, an unlimited number of multiple voting shares carrying 10 votes per share and an unlimited number of subordinate voting shares carrying one vote per share.

*Issued capital*

| | 1988 | | 1987 | |
|---|---|---|---|---|
| | Number | ($000) | Number | ($000) |
| Subordinate voting shares | 4,974,800 | 35,959 | 4,463,000 | 34,373 |
| Multiple voting shares | 2,348,000 | 7,584 | — | — |
| Series I preferred shares | — | — | 2,348,000 | 7,584 |
| Series II preferred shares | — | — | 526,000 | 1,699 |
| | 7,322,800 | 43,543 | 7,337,000 | 43,656 |

During the year the Series I and II preferred shares were converted into multiple voting and subordinate voting shares respectively, on a one-for-one basis, in accordance with their terms.

Under the terms of a normal course issuer bid approved by The Toronto Stock Exchange the company purchased and cancelled 14,200 subordinate voting shares for an aggregate cost of $185, of which $72 was charged to retained earnings. The approval allows the company to purchase and cancel up to 10% of the public float of its subordinate voting shares.

## 10. REINSURANCE

The company follows the policy of underwriting and reinsuring contracts of insurance which limit the liability of the company to a maximum amount on any one loss to $500. Reinsurance is generally placed on an excess of loss basis in several layers. This reinsurance does not relieve the company of its primary obligation to the policyholders. As at December 31, 1988, provision for claims reflects recoveries from reinsurers of $17,546 (1987 – $22,592). During the year, the company ceded $10,764 (1987 –$15,447) of premium income and $3,707 (1987 – $7,099) of claims incurred.

## 11. RELATED PARTY TRANSACTIONS

During the year the company and its subsidiaries purchased investment counsel, data processing and administrative services, in the normal course of business and on normal market terms, from Hamblin Watsa Investment Counsel Ltd. and Markel Corporation, companies in which officers of the company have significant interests. The cost of these services amounted to $753 in 1988 (1987 – $540).

The company holds an investment of 94,400 common shares of Markel Corporation at a cost of $1,310 and a market value of $2,083.

The company reinsures a portion of risks with an associated company. Net premiums ceded in 1988 amounted to $425 (1987 – $419) and net losses recovered $274 (1987 – $5). Included in deposits is an amount due from the related company of $320 (1987 – $109).

## 12. INCOME TAX POSITION

The provision for income taxes in the consolidated statement of earnings includes provision for deferred income taxes of $452 (1987 – $391).

The provision for income taxes differs from the statutory marginal rate as certain sources of income are exempt from tax or are taxed at other than the marginal rate.

## Notes to Consolidated Financial Statements

Reconciliations of the statutory marginal tax rate and the effective tax rate are summarized below:

| | 1988 | 1987 |
|---|---|---|
| | % | % |
| Provision for taxes at Canadian statutory marginal income tax rate | 48.0 | 53.0 |
| Non-taxable capital gains | (5.9) | (12.9) |
| Non-taxable investment income | (7.2) | (8.9) |
| Equity earnings of associated companies | (15.2) | — |
| Other – net | 5.3 | 0.8 |
| Provision for income taxes at effective rate | 25.0 | 32.0 |

### 13. STATUTORY REQUIREMENTS – INSURANCE SUBSIDIARIES

Payments of dividends by the company's insurance and reinsurance subsidiaries and affiliates are governed by insurance statutes and regulations.

### 14. CONTINGENCIES AND COMMITMENTS

A subsidiary of the company is the defendant in several damage suits and has been named as third party in other suits. The uninsured exposure to the company is not considered to be material.

In order to hedge the value and earnings of U.S. dollar investments, the company and its subsidiaries have purchased forward contracts for the U.S. dollar equivalent of $67,850 which expire over the next five years.

The company is contingently liable on several outstanding guaranteed amounts totalling $6,200.

### 15. ACQUISITIONS

*Purchase of minority interest*

On September 30, 1988 the company purchased for $2,060 the 20% minority interest of Sphere Management Company Limited, the parent of Sphere Reinsurance Company of Canada, to increase its interest to 100%. The consideration comprised $1,500 cash and a $560 note payable, due in 1991.

*Acquisitions by subsidiary companies*

During the year the claims adjusting subsidiary of the company completed several acquisitions mainly for cash. The total net assets acquired at fair values assigned as at the effective dates of the acquisitions were as follows:

| | |
|---|---|
| Total assets | $589 |
| Total liabilities | 421 |
| Net assets acquired | 168 |

The total purchase consideration was $2,504.

The excess of the purchase consideration over the fair value of the net assets acquired will be amortized over 40 years.

## 16. OPERATING LEASES

Aggregate future commitments at December 31, 1988 under operating leases relating to premises, automobiles and equipment for various terms up to 10 years are as follows:

| | |
|---|---|
| 1989 | $ 2,900 |
| 1990 | 2,100 |
| 1991 | 1,600 |
| 1992 | 1,400 |
| 1993 | 1,300 |
| Thereafter | 4,100 |
| | $13,400 |

## 17. EARNINGS PER SHARE

Earnings per share on the consolidated statement of earnings have been presented on a fully diluted basis. Basic earnings per share are calculated for 1987 and 1988 assuming conversion of the Series I and Series II preferred shares to multiple voting shares and subordinate voting shares respectively. This conversion was completed in December 1988. Basic earnings per share are as follows:

| | 1988 | 1987 |
|---|---|---|
| Basic earnings per share from operations | $1.96 | $1.50 |
| Basic earnings per share before extraordinary item | $1.96 | $1.99 |
| Basic earnings per share | $1.96 | $2.23 |

## 18. SEGMENTED INFORMATION

The company is a financial services holding company engaged, through subsidiaries and affiliates, in the insurance and reinsurance of commercial property and casualty risks, the provision of claims adjusting, appraisal and loss management services, and investment banking activities in Canada and the United States.

| (a) Industry segments | 1988 ($000) | 1987 ($000) |
|---|---|---|
| Revenue | | |
| Insurance and reinsurance | 88,512 | 73,241 |
| Claims adjusting, appraisal and loss management | 44,157 | 39,316 |
| Other | 980 | 414 |
| | 133,649 | 112,971 |
| Equity earnings | | |
| Insurance and reinsurance | 6,250 | (16) |
| Claims adjusting, appraisal and loss management | 479 | 34 |
| | 6,729 | 18 |

## Notes to Consolidated Financial Statements

| | | |
|---|---|---|
| **Earnings before income taxes** | | |
| Insurance and reinsurance | 18,380 | 15,770 |
| Claims adjusting, appraisal and loss management | 5,612 | 3,826 |
| Other | (2,668) | (1,393) |
| | 21,324 | 18,203 |
| **Identifiable assets** | | |
| Insurance and reinsurance | 157,384 | 143,080 |
| Claims adjusting, appraisal and loss management | 38,413 | 34,117 |
| Corporate | 50,989 | 8,216 |
| | 246,786 | 185,413 |
| **Depreciation and amortization** | | |
| Insurance and reinsurance | 299 | 173 |
| Claims adjusting, appraisal and loss management | 710 | 592 |
| Other | 340 | 250 |
| | 1,349 | 1,015 |
| **Interest expense** | | |
| Insurance and reinsurance | 496 | 371 |
| Claims adjusting, appraisal and loss management | 438 | 121 |
| Other | 1,296 | — |
| | 2,230 | 492 |

(b) Geographic segments

A majority of the company's earnings are derived from operations which are located in Canada, with the exception of equity earnings, which are earned entirely in the United States (F-M Acquisition Corporation, Lindsey & Newsom Insurance Adjusters, Inc. and Vale National Training Centers, Inc.). Condensed financial statements of these companies are disclosed separately in note 2.

February 17, 1989

REPORT OF THE PROPERTY-CASUALTY VALUATION ACTUARY

The Wyatt Company has made the valuation of the net claims liabilities of the subsidiary and affiliated general insurance companies of Fairfax Financial Holdings Limited for Fairfax's consolidated balance sheet at December 31, 1988 and its consolidated income statement for the year then ended, except for the Evanston Insurance Company and the Insurance Company of Evanston for which we have relied upon the valuation made by Milliman and Robertson. In our opinion:

(i) the amount of claims liabilites in the consolidated balance sheet makes proper provision for future payments under the subsidiary and affiliated companies' policies for the net retention on claims incurred prior to January 1, 1989; and

(ii) a proper charge on account of those liabilities has been made in the consolidated income statement.

The Wyatt Company
Actuaries and Consultants

February 17, 1989

## AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheet of Fairfax Financial Holdings Limited as at December 31, 1988 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1988 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Coopers & Lybrand
Chartered Accountants
Toronto, Canada

# CONSOLIDATED FINANCIAL SUMMARY ($000 except per share amounts)

| | For the years ended December 31 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1988 | 1987 | 1986 | 1985 | 1984 | 1983 | 1982 | 1981 | 1980 | 1979 |
| **REVENUES** | | | | | | | | | | |
| Insurance premiums earned | 66,265 | 62,012 | 40,885 | 14,049 | 16,616 | 19,621 | 14,443 | 10,676 | 7,633 | 6,250 |
| Service revenues | 43,349 | 33,529 | 6,850 | — | — | — | — | — | — | — |
| Interest & dividend income | 8,922 | 8,042 | 4,678 | 2,455 | 2,337 | 2,009 | 2,198 | 2,421 | 1,757 | 1,619 |
| Equity earnings | 6,729 | 18 | — | — | — | — | — | — | — | — |
| TOTAL REVENUES OF CONSOLIDATED COMPANIES | 125,847 | 103,812 | 52,781 | 16,623 | 18,953 | 21,630 | 16,641 | 13,097 | 9,390 | 7,869 |
| **EARNINGS** | | | | | | | | | | |
| Earnings before realized investment gains and taxes | 13,522 | 9,044 | 8,133 | (1,339) | (4,879) | 93 | 542 | (538) | (2,425) | 143 |
| Realized investment gains | 7,802 | 9,159 | 952 | 459 | 25 | 215 | (66) | (276) | 424 | 219 |
| Total pre-tax earnings | 21,324 | 18,203 | 9,085 | (880) | (4,854) | 308 | 476 | (814) | (2,001) | 362 |
| Extraordinary items | — | 1,700 | 1,711 | — | — | — | — | — | — | — |
| NET EARNINGS AFTER TAX | 14,357 | 16,019 | 6,548 | (910) | (4,775) | 280 | 218 | (326) | (785) | 524 |
| TOTAL ASSETS | 246,786 | 185,413 | 129,845 | 41,477 | 31,401 | 32,325 | 28,739 | 29,351 | 27,714 | 25,341 |
| CASH & INVESTMENTS | 137,548 | 124,016 | 95,633 | 32,728 | 25,391 | 24,218 | 20,337 | 22,265 | 21,853 | 19,701 |
| TOTAL DEBT | 22,061 | 3,067 | 3,000 | — | 1,000 | 300 | 800 | — | — | — |
| SHAREHOLDERS' EQUITY | 74,176 | 61,048 | 41,275 | 10,379 | 2,287 | 7,062 | 6,782 | 6,565 | 6,891 | 7,715 |
| NUMBER OF SHARES — FULLY DILUTED | 7,718 | 7,336 | 7,007 | 5,000 | 616 | 616 | 616 | 616 | 616 | 616 |
| RETURN ON SHAREHOLDERS' EQUITY | 21.2% | 31.3% | 25.4% | — | — | 4.1% | 3.3% | — | — | 7.0% |
| **PER COMMON SHARE — FULLY DILUTED** | | | | | | | | | | |
| Net earnings | 1.94 | 2.23 | 1.35 | (1.89) | (7.75) | 0.45 | 0.35 | (0.53) | (1.27) | 0.85 |
| Dividends | — | — | — | — | — | — | — | — | 0.0625 | 0.25 |
| Shareholders' equity | 10.13 | 8.32 | 5.89 | 2.08 | 3.71 | 11.46 | 11.01 | 10.66 | 11.19 | 12.52 |

## Directors of the Company

H. Anthony Arrell
President and Chief Executive Officer,
Walwyn Inc.

Winslow W. Bennett
President, Winwood Holdings Ltd.

* Peter J.M. Bloemen
President, Trucena Investments Limited

‡ George Christoff
Account Executive,
Walwyn Stodgell Cochran Murray Limited

* + Robbert Hartog
President, Robhar Investments Limited

Keith E. Ingoe
President and Chief Executive Officer,
Markel Insurance Company of Canada

Anthony F. Markel
Executive Vice President,
Markel Corporation (U.S.)

+ ‡ Steven A. Markel
President and Vice Chairman

Kenneth R. Polley
President and Chief Executive Officer,
Morden & Helwig Group Inc.

* + V. Prem Watsa
Chairman of the Board and
Chief Executive Officer

* Audit Committee Member
+ Executive Committee Member
‡ Investment Committee Member

## Operating Management

Joseph J. Prochaska, Jr
President and Chief Executive Officer
F-M ACQUISITION CORPORATION

Keith E. Ingoe
President and Chief Executive Officer
MARKEL INSURANCE COMPANY OF CANADA

Kenneth R. Polley
President and Chief Executive Officer
MORDEN & HELWIG GROUP INC.

L. Rui Quintal
President and Chief Executive Officer
SPHERE REINSURANCE COMPANY OF CANADA

## Officers of the Company

Brenda Adams
Corporate Secretary

William R. Andrus
Vice President, Corporate Development

J. Paul T. Fink
Vice President, Investment Banking

David E. Rooney
Vice President and
Chief Financial Officer

Eric P. Salsberg
Vice President, Corporate Affairs

John C. Varnell
Vice President and Treasurer

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Chief Financial Officer

Transfer Agent and Registrar
The Royal Trust Company

Share Listing
The Toronto Stock Exchange
Exchange Symbol FFH

General Counsel
Tory, Tory, DesLauriers & Binnington

Auditors
Coopers & Lybrand