FAIRFAX

FINANCIAL HOLDINGS LIMITED

1989 Annual Report

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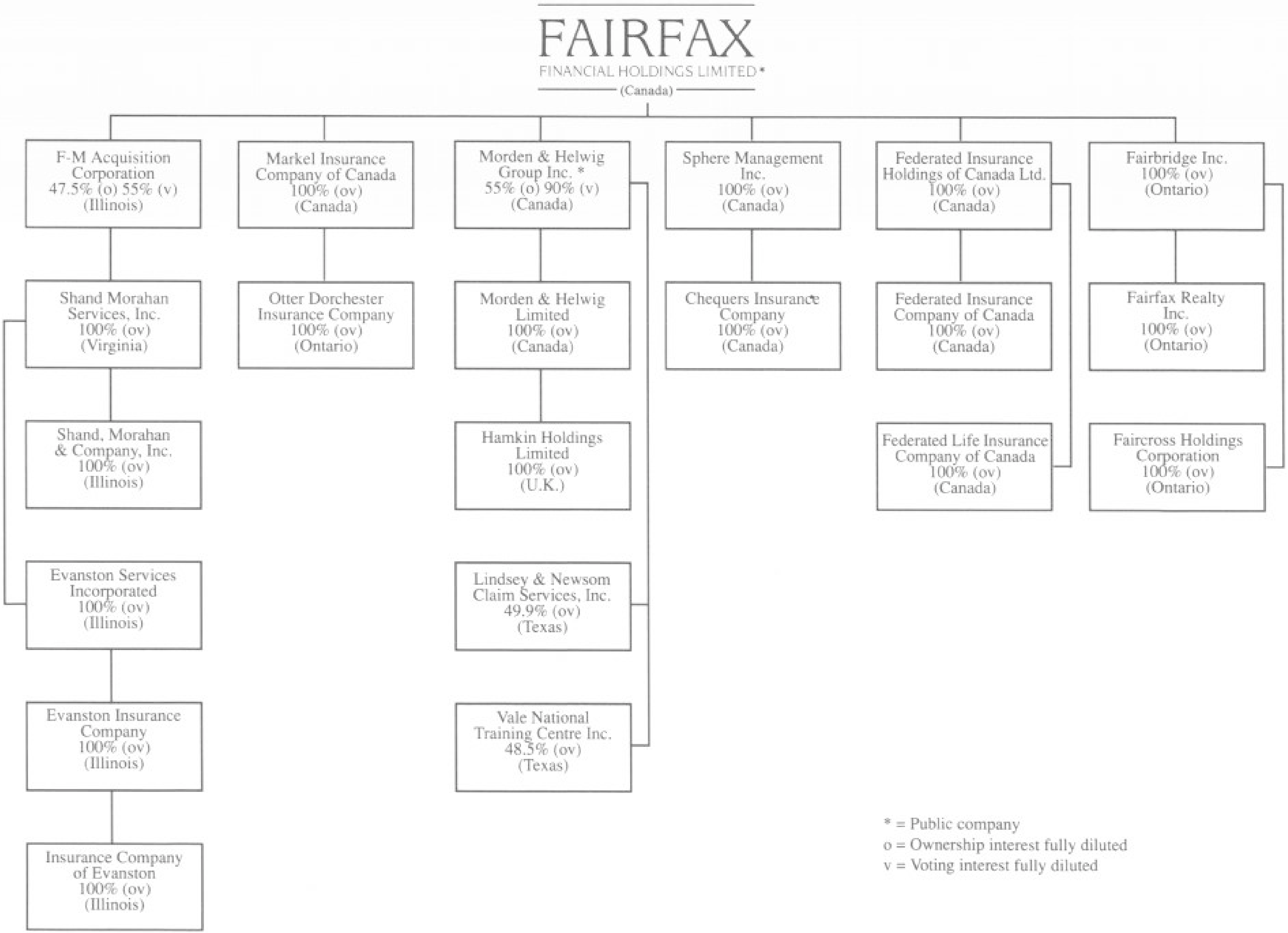
FINANCIAL HIGHLIGHTS
(in thousands except for per share data)

	1989	1988	1987	1986	1985
Total revenues	125,754	133,649	112,971	53,733	17,015
Operating earnings after tax	16,741	14,357	10,795	4,837	(910)
Net earnings	16,741	14,357	16,019	6,548	(910)
Total assets	248,065	246,786	185,413	129,845	41,477
Shareholders' equity	90,830	74,176	61,048	41,275	10,379
Return on average equity	20.3%	21.2%	31.3%	25.4%	—
Per share - fully diluted					
Operating earnings	2.25	1.94	1.50	1.01	(1.89)
Net earnings	2.25	1.94	2.23	1.35	(1.89)
Shareholders' equity	12.41	10.13	8.32	5.89	2.08
Market prices per share					
High	19.00	15.13	17.50	14.13	6.00
Low	14.00	11.75	10.50	6.00	3.00
Close	18.75	15.00	12.37	12.75	6.00

CORPORATE CHART

March 1, 1990

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



FAIRFAX
FINANCIAL HOLDINGS LIMITED

CORPORATE PROFILE

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

Chequers Insurance Company (formerly Sphere Reinsurance Company of Canada) sold its book of reinsurance business effective January 1, 1989. Chequers then received approval to be a primary insurer of property and casualty risks and ceased writing reinsurance business. In 1989 gross premiums written relating to the direct business were $1.1 million, compared to reinsurance premiums written in 1988 of $16.3 million. At year-end Chequers had nine employees.

F-M Acquisition Corporation acquired Shand, Morahan & Company, Inc. and Evanston Services, Inc., both of Evanston, Illinois, in December 1987. The companies provide specialty insurance coverages, primarily in the professional and product liability markets. In 1989 gross premiums written on a combined basis totalled $110.8 million and the group had 287 full-time employees at year-end.

Fairbridge Inc. was incorporated in March 1989 and functions as our investment bank. Fairbridge has participated in three projects, the major one being a significant interest in Walwyn Inc., a national stockbroker. It has net investments of $16 million and has four employees.

Federated Insurance Holdings of Canada Ltd. was acquired as of January 1, 1990, and is based in Winnipeg. Its subsidiaries market a broad range of insurance products primarily for commercial customers. In 1989 Federated's gross premiums written totalled $50 million, consisting of $43 million of property and casualty business and $7 million of life, group health and disability products. There were 245 employees and six branches at the end of 1989.

Markel Insurance Company of Canada is one of the largest trucking insurance companies in Canada and has provided the Canadian trucking industry with a continuous market for this class of insurance since 1951. For 1989 gross premiums written were $45.2 million and the group had 111 employees.

Morden & Helwig Group Inc., acquired in 1986, 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 the U.K. For the year gross consolidated revenues totalled $49.1 million, and revenues of their 49.9% owned company, Lindsey & Newsom Claim Services, Inc., totalled US $40.9 million. The group had 1,558 employees located in 305 branches.

To Our Shareholders

We were optimistic. We thought 1989 was going to be a difficult year; it was much worse as you will soon find out. While we earned $16.7 million and did earn 20.3% on common equity (vs 11% for the TSE 300), it was mainly due to very significant realized gains in 1989. In 1989 E.P.S. increased 16% to $2.25 while book value per share increased 22% to $12.41 per share.

The table below shows the sources of our net earnings:

	($ millions) 1989	1988	% Change
Operating earnings before realized gains	8.9	15.7	-43%
Realized gains on investments	15.5	7.8	+99%
Operating earnings	24.4	23.5	+4%
Interest expense	5.2	2.2	+136%
Earnings before income taxes	19.2	21.3	-10%
Income taxes	1.2	5.3	-77%
Net earnings before minority interest	18.0	16.0	+12%
Less: minority interest	1.3	1.7	-24%
Net earnings	16.7	14.3	+16%

As you can see in the table, operating earnings before realized gains dropped by 43%. This was largely due to a huge underwriting loss in Markel Insurance Company. More on this later. Realized gains almost doubled during 1989, resulting in earnings before income taxes dropping by 10%. Realized gains amounted to about 12% of the portfolio. Interest expense increased 136% or $3 million. Our tax provision dropped very significantly because certain sources of income are exempt from tax or are taxed at lower rates. As a result net earnings increased by 16% during 1989.

Since we began in 1985, we have said that our insurance companies would be run to achieve an underwriting profit. We emphasized that our companies would rather write significantly reduced business than write it at unprofitable rates. In 1986 and 1987 we were able to achieve this objective because the insurance cycle was on the upswing. As the insurance cycle began its downswing in 1988, we seemed to be holding to our objective. The true test of our approach was in 1989. While we continued to practise what we preached in Shand, Morahan and Otter Dorchester, we failed miserably in Markel.

Markel had an unbelievable combined ratio of 133.6% in 1989 - a far cry from our target of 100%. We had an underwriting loss of $14 million as compared to our expectation of a loss of $1 million. Why did this happen? As Rick Salsberg explains in his section on Markel's operations, the losses were mainly due to unprofitable diversification (taxis and surety) - the grass is greener on the other side - and accepting trucking risks at unprofitable prices - something we said we would not do!

What is particularly worrisome is that the underwriting loss in 1989 was mainly due to 1989 business as opposed to reserve development on past business. Things can change very quickly in the insurance business.

We have emphasized in the past that our companies are run independently by our presidents. While the advantages of this approach are many, the downside is that things can happen in any of our companies of which we may not be aware. This happened to us in Markel in 1989. Again, as Rick discusses in his section, we found out that Markel's surety operations were being run in a very loose manner. Performance bonds were being issued in excess of reinsurance limits. Financial guarantee bonds, for which we have no reinsurance, were being issued and claims were not fully disclosed. We have made proper provisions for surety operations which resulted in a combined ratio of 343% in 1989.

You can be sure that if additional information indicates that more reserves are required, we will provide for them immediately. Rick Salsberg has spent virtually all of the first quarter of 1990 identifying and fixing this problem for us.

Why did this happen at Markel? Could Fairfax have reacted sooner? Do we need to be more centralized, more hands-on in our operations? All good questions. On reflection, I think the major reason for the problem was that while our individual companies were run in a decentralized manner, they were still all reporting to me. We recognized this early in 1989 and reorganized Fairfax so that David Rooney and Rick Salsberg became responsible for Shand, Markel and Morden & Helwig at the Fairfax level. We continue to believe strongly in decentralized operations with Fairfax responsible for performance measurement, succession planning, acquisitions and financing. For performance measurement, each of our companies submits annual business plans which are reviewed and signed off by the person responsible for the individual company. This method of operation we feel will make it unlikely that our experience at Markel will be repeated and if it were necessary, we would be able to react much sooner. We continue however to run on a decentralized basis and let the presidents manage their companies.

Otter Dorchester, while profitable, continued to suffer from weather-related losses. We are in the process of determining an acceptable business strategy for Otter.

Early in 1989 we made the decision to sell Sphere's book of reinsurance business to Skandia Re for $5.75 million. This was an extremely difficult decision for us. We decided to sell the company because we did not have any niche in this business and because the industry is dominated by very large participants. In this sale we ensured that our partners, Rui and Bill, were well looked after and all the employees of Sphere were treated fairly. Led by Rick Salsberg and John Varnell, we ensured that the interests of Sphere Re's customers, employees and shareholders were looked after in this transaction. We initially estimated our realized proceeds on this sale to be $23 million. This comprised Sphere Re's book value of $14 million, the value of its loss reserves of $3.25 million, and the $5.75 million consideration by Skandia.

Since then, mainly due to significant realized gains in 1989, we estimate the proceeds to be well in excess of our original expectations. We are amortizing the gain on the transaction ($2.3 million) over the life of the reserve run-off to protect against unexpected reserve development. As discussed in Note 8, Sphere Re's contingent note of $1.12 million has been completely eroded due to reserve development, and we have written this off in 1989.

After the sale of Sphere's reinsurance business, we changed the name of the company to Chequers and obtained a new insurance licence. Chequers will specialize in unique niches. Bill Andrus is President of this company and will be working with David, Rick and John to identify and develop new insurance products or distribution methods. The first project, only begun in October 1989, will be selling personal lines insurance through the Laurentian Financial Services network in Eaton stores across Canada. It is still too early to tell how this project will work out but we will know by year-end 1990.

Joe Prochaska and Bob Libby continued to produce good results at the Shand, Morahan group. As explained by Joe in his section, Shand's combined ratio increased to 118.6% from 104.6% in 1988 due to higher expense ratios associated with running off business written in the past. Higher investment income resulted in the Shand group earning a 13% return on equity in 1989 (27.4% for F-M Acquisition). Since we acquired the Shand group in 1987 for US $30 million plus a five year contingent note for US $47 million, the company has earned a total of US $26.4 million, and the contingent note and accrued interest has decreased to US $23.5 million due to reserve development. Though Shand's business is primarily long tail in nature, we feel we have conservatively provided for the reserves.

Morden & Helwig, our claims operation, under Ken Polley's leadership, has come a long way since we acquired it in 1986. In three years, revenues in Canada have increased from $30.9 million to $46.7 million, the number of branches from 135 to 147 and net income from $2.2 million to $2.8 million. In the same period, shareholders' equity has increased from $6.2 million to $27.3 million, mainly due to a share issue of $15 million in 1987. Through the acquisition of a 50% interest in Lindsey & Newsom Claim Services, Inc. in 1987 and the merger with National Claims and Gordon Boyd in 1989, Morden & Helwig has revenues of $49.1 (US $40.9) million in the U.S. through 151 branches. Also in 1988 Morden & Helwig acquired Hamkin Holdings Limited which has seven branches in the U.K. Total revenues in 1989 were $2.4 (£1.2) million. Over a three year period this is very dramatic growth! Also, this was accomplished while maintaining a sound balance sheet with little debt. Profitability though has suffered. While the Canadian operations have been very profitable and have earned close to 20% on equity capital invested in Canada, the U.S. and the U.K. operations have been barely profitable. Bob Irwin and Terry Grant have had their hands full consolidating the National Claims and Gordon Boyd operations under the Lindsey & Newsom name. This has required a tremendous amount of time and effort. While 1989 was a disappointment, we fully expect improved returns from our U.S. and U.K. operations in the years to come. Shareholders should read Morden & Helwig's annual report to get more details about our claims operations.

As discussed in last year's annual report, we are proceeding with the creation of an international claims company.

1989 was the first year for Walwyn Inc. under Tony Arrell's leadership. When we purchased a major position in late 1988, we expected to lose money in our first year. We were not disappointed! This was mainly because the individual investors had not returned to the stock market even though investment returns were excellent last year. What is not obvious is the significant improvement in Walwyn's underlying operations under Tony's leadership. Walwyn has attracted many capable investment professionals recently and its research product has improved significantly. While the risks mentioned in last year's annual report continue to be significant, we believe that over the long term Walwyn will be an excellent investment for Fairfax. In 1989 Walwyn's loss was $5.3 million, and Fairfax reflected a $1 million loss as its equity pick up in its financial statements. This was less than our proportionate share of the loss because of the provision of $1.1 million set up as of December 31, 1988. Interest costs to finance the Faircross purchase of the Walwyn shares amounted to $0.9 million in 1989 (see Note 4). For further details on Walwyn's operations, please read Walwyn's annual report.

In last year's annual report, we said we were concerned about the debt on our balance sheet and were working to reduce it. In 1989 we replaced our short term debt with long term debt, and reduced our total debt by $7.6 million to $14.4 million. This consists of a five year committed loan facility as described in Note 8. We have already received $6.2 million in dividends from Chequers and expect to receive an additional $4 million in early 1990. With additional dividends from Markel, we expect to have further reduced the debt we had as of December 31, 1989. With almost $100 million in equity capital (including $7.5 million in convertible debentures) and little debt, we are in a strong financial position and we feel that our insurance companies are well reserved. At the end of the year, we had unrealized losses of $1.1 million in our Canadian insurance companies and US $0.5 million in our U.S. insurance companies. You know my feelings on unrealized gains or losses!

In 1988's annual report, we suggested that our investment banking department was likely to become a separate company. We have done that in 1989 and called the company Fairbridge Inc. It is run by Paul Fink. A major plus for Fairbridge and Fairfax was that Tony Griffiths joined Fairbridge as Chairman in early 1989. Tony brings his great business experience, contacts and most importantly, his sense of humour to our company. We have already benefitted greatly from his association. As discussed last year, Fairbridge had done three deals only (including Walwyn). Carbovan Inc., in partnership with Agra Industries Limited, completed the building of the vanadium extraction plant and it should be in production early in 1990. We continue to expect this project to earn good returns even though it was over budget in construction costs. Develcon Electronics Ltd. continues to plod along in spite of much effort by Paul and Tony. Our exposure is quite minimal.

Fairfax Realty Inc., the real estate subsidiary of Fairbridge, is run by Rob Mills who made our first real estate investment - a small shopping mall in Calgary. We have invested $1.5 million in this project, net of a non-recourse mortgage on the mall of $2.9 million. All of these investments are discussed in greater detail in Note 4. Currently, Paul is not planning any significant additional investments in Fairbridge until the present ones mature.

Fairfax continues to attract good people. Ronald Schokking and Sam Chan joined us during 1989 to help John Varnell and Bill Andrus in the finance and actuarial functions respectively. As we grow, it is key that we are able to attract hardworking, talented people like Ronald and Sam.

Our investment results in 1989 again were excellent though they did not match the respective indices in

Canada and the U.S. Since we began in 1985, Fairfax's Canadian equity portfolios (at Markel Insurance) have compounded at 20.7% (vs 11.7% for the TSE 300) and 24.6% for the U.S. portfolio (vs 17.7% for the S&P 500). The other insurance company portfolios have done as well since they have been acquired. This record, albeit only four years long, was accomplished in the 1980's, a decade of great pessimism. Fears of recession, government and trade deficits, international debt crises, etc., etc. dominated the news every year of the decade. Surprisingly though, we have had stable economic growth with low rates of inflation since the decade began after the recession of 1981/82. This experience of *low* expectations vs *excellent* results was also experienced in the 1950's. And like the 1950's, the stock market was a great place to be in the 1980's. The S&P 500 compounded at 17.6% per year during the 1980's second only, out of the last six decades, to the 19.4% in the 1950's. As an aside, the Wall Street Journal recently noted that Mr. Kandel's book "How to Cash in on the Coming Stock Market Boom", published in 1982, sold 15,000 copies, while Mr. Batra's "The Great Depression of 1990" sold some 500,000 copies! The time to worry is when books like Mr. Kandel's become best sellers. We continue to be optimistic about long term prospects for stocks in Canada and the U.S.

We have expressed some skepticism about the Japanese market for a few years now. This unfortunately did not stop it from increasing 20% in 1989. However, after 40% in 1988, the momentum definitely seems to be slowing down!! Nippon Telephone, the Bell Telephone of Japan, presently sells at 81 times earnings, but at its high in 1987 and 1988 it had a market value in excess of the whole stock market in Canada. While speculation in Japan appears to be rampant it is nothing like in Taiwan. According to Grant's, a publication that monitors financial excesses, there are more brokerage firms (250) in Taiwan than listed companies (172).

In 1989 we benefitted strongly from the financial services, mining and manufacturing sectors in North America. The major contributors to realized gains in 1989 were Royal Bank ($2.7 million), Princeton Mining ($2.1 million), The Progressive Corporation ($1.7 million), Bank of Commerce ($1.6 million), Loews Corp ($1.5 million), Deere & Co. ($0.6 million), Gordon Jewelry ($0.6 million), Northern Telecom ($0.4 million), Shaw Industries ($0.4 million), and Hudson's Bay ($0.3 million). Total realized losses in 1989 amounted to $0.8 million. Since 1985 realized gains have amounted to $33.4 million in our Canadian operations or $4.33 per share before tax. We fully expect to earn realized gains in the next four years comparable to the last four even though the timing on an annual basis is not predictable.

At the end of 1989 we had $21.1 million invested in banks and insurance company stocks, $13.4 million in industrial products and $6.3 million in mining stocks.

Late in 1989 we made two significant purchases which we should discuss with you. The first was the acquisition of Federated Insurance Holdings of Canada Ltd. for which we signed a letter of intent in November 1989 and are now in the process of closing. Federated provides life and property-casualty insurance to commercial accounts across Canada. It is a direct insurer (as opposed to agents) and has done business in Canada for 65 years. In 1989 it had $50 million in gross premiums written.

As discussed in Note 18, we are buying Federated for approximately $28 million of which $20 million is in two 10% contingent notes maturing in five and ten years respectively, and the rest is cash. Federated's book value is approximately $26 million with acquisition adjustments that take it significantly higher. We are really excited about this acquisition and would like to welcome all the Federated employees to the Fairfax Group. We look forward to a long and mutually profitable association. David Rooney has done a tremendous job in working to close this transaction and he has ongoing responsibility for Federated.

The second purchase we made at the end of the year was a major position in FCA International Ltd., one of the two largest collection companies in North America. We have followed FCA for many years and have been very impressed by its successful track record since the mid-60's. FCA has earned returns on equity in excess of 20% with the exception of the last few years. When Mark Lubotta phoned and said his family could be sellers, we purchased the block. We look forward to a long association with Mark Lubotta and Steve Levy, Chairman and President respectively of FCA. The purchase is described more fully in Note 15. We consider FCA to be a long term passive investment, and are currently working towards bringing in a financial partner with us, not unlike our investment in Walwyn.

In last year's annual report we discussed the power of compounding. Recently we analyzed another great example in Canada. Laidlaw, run by its founder Michael Degroote, has had a track record few companies can match. In 1969, when it went public, Laidlaw had sales of $5.7 million, net income of $0.3 million and common equity of $1.4 million. Twenty years later in 1989, Laidlaw's sales were $1.7 billion, net income $285 million and common equity $1.8 billion. Earnings and common equity compounded at rates in excess of 40% while sales compounded at 33%. Not surprisingly, Laidlaw's stock price compounded at 40% also! The issue price of $3 per share in 1969 is equivalent to $2,606 today - adjusting for stock splits. A purchase of 1,000 shares of Laidlaw at a cost of $3,000 would today be worth $2.6 million. The long term is where it's at and that's our focus too !

As we enter 1990 and the last decade of the twentieth century, your company faces many challenges. The immediate ones are the continuing downswing in the insurance cycle and its impact on our insurance companies, the problems we have encountered at Markel, continued growing pains at Lindsey & Newsom, potential losses in Walwyn and an uncertain stock market environment. As I look back to 1989, with the exception of Markel, these were the same fears we faced as we began the year. While we managed to earn 20% last year, it is quite possible that we will not achieve it in 1990. Remember our objective is to achieve 20%+ returns over the long term but not particularly every year. The short term outlook is ever so uncertain but, as in the past, with good people on board at Fairfax we believe the long term future will be excellent. Since we began in September 1985, Fairfax has earned an average return on common equity of 24.6% vs 11.4% for the TSE 300, book value has grown from $1.84 per share to $12.41 per share and share prices have risen from $3 per share to $18.75 per share. We hope that we can continue to maintain these growth rates in the future.

George Christoff will be retiring this year as a director of Fairfax but will continue to serve our company as a director of Markel Insurance Company. We thank George for his support and contribution over the many years he has served Fairfax, particularly during the company's difficult times.

On your behalf, I would like to thank the Board, the management and employees of all our companies for making 1989 another excellent year.

March 30, 1990

V. P. Watsa

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

PRESIDENT'S OPERATING REVIEW

As we have discussed in past annual reports the insurance industry has been operating in a "soft" cycle with increased competition and price levels under pressure. These market conditions continued in 1989 and we can expect a similar environment in 1990. While it appears price levels in several lines of business are levelling, it is difficult to predict how long the cycle will last.

Most insurance products have become "commodities" with price being the most important factor in a client's purchasing decision. With excess capital (or capacity) in the insurance industry, prices have been forced down to unreasonable levels. Complicating matters for insurance companies is the fact that claims costs, especially for individual policies, are unknown when pricing decisions are made. Additionally, because policies are normally written for annual terms, the impact of pricing decisions is often not apparent for some time.

While these industry problems make it a difficult business, it is certainly possible to compete profitably. By specializing in unique market niches and developing expertise in specific areas, companies can add value for their clients. With disciplined underwriting standards and sound actuarial information, companies *can* estimate their costs. By properly managing the business, we can assure that we maintain adequate price levels.

Unfortunately, in 1989 we failed miserably at Markel Insurance in managing our business. The result was a $14 million underwriting loss as compared to $1 million in 1988.

At F-M Acquisition Corporation, while underwriting losses continued, they were not the result of any lack in maintaining disciplined underwriting standards or adequate price levels, but rather operating costs which are difficult to reduce with declining premium volume.

While these insurance operating results certainly do not inspire much confidence, we continue to believe that the business can be managed to earn underwriting profits and we will be working diligently to achieve this goal.

Government regulation appears to be gaining better definition. In Ontario the proposed no-fault plan shows considerable promise to deliver stability to the insurance marketplace. The final rules and 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 - by an open and competitive marketplace.

While insurance operations must struggle with the underwriting cycle, companies do have the benefit of developing significant investment portfolios to support policyholder reserves for losses and unearned premiums as well as shareholders' equity.

1989 was an extremely good year with respect to our investment returns. The investment portfolios are managed by Hamblin Watsa Investment Counsel and their results were impressive. The portfolio (excluding F-M Acquisition) amounted to $120.6 million at December 1989 as compared to $109.5 million last year. The return on these investments is summarized in the following chart.

Fairfax Portfolio Return ($000)

	1989	1988	1987
Interest and dividends	11.6	8.9	8.0
Realized gains	15.5	7.8	9.2
Income reported during year	27.1	16.7	17.2
Unrealized gains (losses)	(1.1)	5.2	(6.9)
Total return	26.0	21.9	10.3

Additionally, Hamblin Watsa Investment Counsel manages the US $337 million portfolio of F-M Acquisition and achieved the following returns.

F-M Acquisition Portfolio Return (US $000)

	1989	1988	1987
Interest and dividends	22.8	21.1	19.2
Realized gains	12.6	3.7	0.8
Income reported during year	35.4	24.8	20.0
Unrealized gains (losses)	(1.2)	0.5	(10.0)
Total return	34.2	25.3	10.0

We expect 1990 will prove to be a challenging year. We will certainly not be able to achieve our goal of earning underwriting profits, however, we do expect to change the recent trends and make strides toward this goal.

March 30, 1990

SA Markel

Steven A. Markel
President and Vice Chairman

CHEQUERS INSURANCE COMPANY
(Formerly Sphere Reinsurance Company of Canada)
OPERATING REVIEW

FINANCIAL SUMMARY ($000)	For the years ended December 31				
	1989	1988	1987	1986	1985
Gross premiums written	1,061	16,278	18,871	17,506	15,352
Net premiums earned	244	17,031	17,655	16,359	12,162
Net incurred losses	233	11,984	13,745	12,693	10,000
Net commission and operating expenses	(205)	6,244	5,905	5,308	4,101
COMBINED RATIO	n/a	107.0%	111.3%	110.0%	115.9%
Underwriting loss (income)	(216)	1,197	1,995	1,642	1,939
Investment income	7,351	4,402	3,954	2,855	2,164
Earnings after tax	6,018	2,498	1,885	807	262
Total assets	37,774	43,815	38,823	31,352	24,636
Shareholders' equity	13,688	13,870	11,372	7,487	6,680
RETURN ON EQUITY	43.7%	19.8%	20.0%	11.4%	4.0%

Sphere Reinsurance Company of Canada underwent a major change in its basic business in 1989. The Sphere Reinsurance book of business was sold to Skandia effective January 1, 1989, and the company is running off the pre-1989 reinsurance treaties and claims provisions. The net operating profit of the re-insurance run off was a favorable $0.5 million for 1989. Investment income for the year was $7.3 million compared with $4.4 million in 1988. Realized gains increased to $4.8 million from $1.5 million in 1988. As a result, net earnings after tax showed an impressive increase to $6 million from $2.5 million in 1988.

In September 1989 the company was licenced across Canada as a primary property and casualty insurer and began writing business in October 1989. For this purpose the company changed its name from Sphere Reinsurance Company of Canada to Chequers Insurance Company. The company markets personal lines insurance products through a dedicated sales network across Canada.

In the first three months of operation as a primary insurer we wrote gross premiums of $1 million. We continue to seek out new opportunities for this company and look forward to its future growth.

March 30, 1990

W R Andrus

William R. Andrus
President and Chief Executive Officer

F-M ACQUISITION
OPERATING REVIEW

SELECTED FINANCIAL INFORMATION (US $000)

	For the years ended December 31				
	1989	1988	1987	1986	1985
Combined Shand, Morahan Services, Inc.					
Gross premiums written	110,807	110,780	124,745	157,899	151,961
Net premiums earned	71,101	65,310	105,391	120,110	44,262
Net commissions and fees	1,310	748	5,302	10,695	14,152
Net incurred losses	55,384	51,470	88,327	104,529	53,284
Underwriting loss	14,386	7,866	9,107	13,209	15,747
COMBINED RATIO	118.6%	104.6%	108.6%	111.0%	135.6%
Investment income	33,598	24,807	18,124	21,681	15,608
Earnings after tax	11,600	13,475	3,094	7,782	4,180
Total assets	527,921	525,356	542,694	472,069	362,225
Shareholders' equity	86,986	91,653	81,021	68,174	60,495
RETURN ON EQUITY	13.0%	16.4%	4.2%	11.7%	6.8%
F-M Acquisition Corporation					
Underwriting loss	6,907	1,542	—	—	—
Net income	13,338	13,025	—	—	—

We held our own in 1989 with a net income just slightly higher than the prior year's. The make-up of the income comes from better than expected investment returns that more than offset an underwriting loss. F-M Acquisition is a composite of specialty underwriting and servicing operations doing business almost exclusively in the United States. Operationally, we are underwriting managers primarily of professional liability insurance under the banner of Shand, Morahan & Company, Inc. The companies we manage are Evanston Insurance Company and Insurance Company of Evanston. The United States continues to have soft (price competitive) market conditions. We believe that there are many lines on an industry basis where pricing is inadequate to give shareholders proper returns. We have responded to these conditions, and will continue to do so, with disciplined underwriting approaches that offer reasonable terms to our clients while providing adequate coverage for anticipated claims. We have been successful in retaining a fair share of our renewals and adding modest numbers of new insureds. In essence, repeating from my last report to you, we are not sacrificing proper pricing for market share.

In 1989 Shand, Morahan Services, Inc.'s return on equity was 13% compared to 27.4% for F-M Acquisition.

Having made these statements let me hasten to explain the underwriting loss that exceeds that of a year ago in both dollars of loss and percent of loss. Claim costs are manageable and are in line with projections. Our underwriting loss comes primarily from above average expenses. Part of this is attributable to extra resources and costs needed to run off business written in the early 1980's and to some redundancies in staffing in the face of reducing premium volumes. Both areas are being addressed vigorously. However, we expect that above average expenses will be ongoing for the next two to three years, and will then occur periodically during cyclical downturns.

The nature of our core business is to protect insured professionals for their errors and omissions which may not be known for months or even years. As a result, claim investigation and handling typically require a long and costly defence. It is this process that characterizes the business as "long tail" with inherent difficulties in establishing reserves that will be adequate until the claim is resolved. We have taken steps during the past few years to blend other business with our professional liability business in order to lend balance while retaining our identity and reputation as specialty or niche underwriters. Five years ago we entered into several small agency contracts to provide coverage for non-preferred low limits property and general liability coverage and preferred truck physical damage insurance. Claims on this business are "short tail" in nature and the $20 million in writings to date have been profitable. A year ago we entered into another contract for non-standard, low limits passenger car business. We have limited our premium writings to $5 million annually. Claims from that business are generally quick to resolve, and our experience has been break even.

Our biggest venture is an acquisition costing several million dollars, made last fall of a managing general agency producing $15 million of motorcycle, boat and mobile home business. This is short tail business, and the agency has a good underwriting record. We will continue to add similar specialty business to our portfolio where we believe the business is well-managed and complements our long tail book. Another approach we have been pursuing to reduce the volatility of our business is to sell non-risk bearing services. This is being done primarily through a Shand, Morahan division known as ALTIS. ALTIS has the capability of managing any or all aspects of an insurance operation, or assisting in the development and management of alternate risk bearing facilities. In 1989 ALTIS was successful in contracting to manage all aspects of a national risk retention group. On other accounts ALTIS may provide combinations of underwriting, claims or administration services. We are very pleased with the performance of our subsidiary insurance companies.

In 1989 A.M. Best improved their rating of Evanston Insurance Company to "B+" which has been favorably received in the marketplace. Additionally, the financial results for the 1989 year show continued improvements in underwriting results, net income, contribution to surplus and various ratios viewed critically by A.M. Best and other rating agencies.

We are also in the process of chartering another licensed insurance company that will give us added marketing capabilities as we grow and diversify our specialties.

The numbers above clearly reflect the importance of investment income. Much of the success is attributable to Hamblin Watsa Investment Counsel Ltd. which directly manages the equity portion of our portfolios and lends guidance to overall investment strategies. Hamblin Watsa's investment philosophy is sound and we expect continuing rewards from this end of the business.

Overall, our core business responded as expected during the year. Premium writings were somewhat disappointing, down 10% from projections, but ultimate loss projections on the business written look good. Product lines not achieving production goals were lawyers', architects', and engineers' liability and mutual funds. Each line was impacted to varying degrees by intensified competition and new competitors pursuing professional lines. The mutual funds business was impacted by the formation of a competitive captive insurance company chartered by the mutual funds national trade association. We expect this captive to cause ongoing marketing problems for us. On the positive side, we have been pleased with production in our insurance company, products and Special "K" Facility product lines.

The challenges from so many facets of the business are before us, especially during this down cycle. Nevertheless, there have been and will be rewards for the shareholders and for the staff who cause the results to happen. They happen through the support and contributions of all our business associates, shareholders and staff to whom we offer our sincere thanks and appreciation.

March 30, 1990

Joseph J. Prochaska, Jr.
President and Chief Executive Officer

MARKEL INSURANCE COMPANY OF CANADA
OPERATING REVIEW

GROUP FINANCIAL SUMMARY ($000)	For the years ended December 31				
	1989	1988	1987	1986	1985
Gross premiums written	45,208	49,443	52,507	51,615	23,415
Net premiums earned	41,595	42,006	42,723	34,633	14,049
Net incurred losses	40,524	31,095	30,515	24,614	13,533
Net commissions and operating expenses	15,048	11,758	10,809	7,363	4,147
COMBINED RATIO	133.6%	102.0%	96.7%	92.4%	125.8%
Underwriting income (loss)	(13,977)	(847)	1,399	2,656	(3,631)
Investment income	15,433	9,869	11,977	4,297	2,850
Earnings (loss) after tax	3,844	5,756	10,070	5,612	(781)
Total assets	117,689	102,119	97,163	71,525	38,472
Shareholders' equity	29,749	30,909	28,153	18,083	7,471
RETURN ON EQUITY	13.0%	19.7%	43.6%	43.9%	—

Markel Insurance Company of Canada provides property and casualty insurance and related services to the transportation industry. It specializes in insuring small to medium sized long haul trucking fleets across Canada against public liability and property damage. In addition the company writes small portfolios of cargo insurance, umbrella excess liability insurance and surety.

The above results incorporate the operations of both Markel and its wholly owned subsidiary Otter Dorchester Insurance Company. Otter accounted for $7.7 million of the gross premiums written and $1 million of the underwriting loss (compared to $12.7 million and $2 million respectively in 1988). The discontinuance of automobile coverages in late 1988 and stricter underwriting accounted for the reduction in Otter's gross premiums written in 1989.

With the resignation of Markel's former president on February 2 of this year, I have become closely involved in the day to day affairs of Markel. I am encouraged that its extremely poor results in 1989 have served as a dramatic impetus within that company towards a focus on responsible operation and revitalization of effective management.

What were the key problem elements in 1989? The soft, competitive markets which prevailed throughout the year were unforgiving to a company that professed a goal of underwriting breakeven but did not apply the stringent monitoring and discipline and the toughness of mind necessary to achieve that objective. The result was a combined ratio of 116% on Markel's core trucking business, and significantly worse ratios, particularly in taxis, in those recently entered specialty areas where the company was less experienced.

Further, we recently discovered a serious departure from appropriate underwriting and operating procedures on the part of a former employee of the surety department. This past conduct will result in Markel's liability for claims on prior business substantially beyond the acceptable losses we would have anticipated. As a result of Markel's providing in its reserves for the surety bond losses which we now expect, the combined ratio for the 1989 surety business was 343%. Investigation of the various bond situations is continuing in order to ensure that adequate reserves are maintained.

In all the circumstances, the 1989 underwriting loss includes not only strengthened reserves which were felt appropriate after our usual reviews, but a substantial reduction in deferred premium acquisition costs and the establishment of a premium deficiency reserve, so that the losses we expect in connection with the unearned premiums at the end of 1989 have been fully reflected in the 1989 results.

Why are we confident of dramatic improvements commencing in 1990? Some easy and evident actions were quickly implemented: all taxi policies have been cancelled, all truck policies are being re-underwritten and daily car rental policies are being re-examined. Responsibility for achieving underwriting breakeven is being expressly and widely accepted by the employees. Emphasis is being placed on Markel's core truck insurance business, while a distinct service orientation is being developed. Sound management techniques are being energetically applied as all aspects of operations, procedures, administration and costs are reviewed.

We expect the soft market to continue in 1990; competition will remain intense and Markel's premium volume will be reduced. 1990 will be a difficult year but with teamwork and co-operation from the employees, the provision of good service to the company's brokers and policyholders, and the positive steps described above being implemented, Markel will build on its strong financial position and progress towards profitable operations and an enhanced reputation in its chosen markets.

March 30, 1990

Eric P. Salsberg
Vice President, Corporate Affairs
Fairfax Financial Holdings Limited

MORDEN & HELWIG GROUP INC.
OPERATING REVIEW

FINANCIAL SUMMARY ($000)	For the years ended December 31				
	1989	**1988**	**1987**	**1986**	**1985**
REVENUES	49,092	43,348	33,528	30,939	27,398
Earnings before extraordinary items	2,814	2,984	2,389	1,423	1,304
Earnings after tax	2,814	2,984	2,389	2,155	1,764
Total assets	40,944	38,404	34,117	14,501	14,121
Shareholders' equity	27,325	25,618	23,510	6,219	4,429
RETURN ON EQUITY	10.6%	12.2%	16.1%	40.5%	49.6%

1989 was a year of mixed results for Morden & Helwig Group Inc. Although our core company, Morden & Helwig Limited, reached its expectations, our investments in the U.S. and the U.K. did not. Consolidated revenues increased to $49.1 million from $43.3 million in 1988 which provided an operating profit of $5.1 million compared with $4.8 million last year. Unfortunately, our earnings from equity investments were substantially reduced resulting in a decline in net earnings from $2.98 million in 1988 to $2.8 million, as well as a decline in our earnings per share from 67¢ to 64¢.

Our adjusting operations in the U.K. were profitable, although our travel claims company was affected by the decline in European travel.

We stated last year that our strategic plan was to have a strong U.S. presence and ultimately to have an international claims adjusting company. This has now materialized; however, the consolidation of the three entities in the U.S., Lindsey & Newsom, Gordon Boyd & Co., and National Claims Service, combined with thirty other U.S. mergers, resulted in disappointing earnings. The blending of the different cultures, accounting methods, computerization and training, as well as higher interest rates, increased our costs substantially.

Our strategic plan for 1989 emphasized the following key strategies:

- significant improvement in top-line revenue throughout the Group;
- head office computerized program and in-house computerized branch system throughout most of the U.S. and U.K.;
- profitability of all regions in Canada, our core region in the U.S. and the U.K.;
- expansion of new business areas

In an effort to define our basic business for those inside and outside our company, we have prepared a mission statement which we believe establishes a firm foundation for our guidance. It states who we are, what we do, and why we do it, as follows:

We are an international independent claims company providing our clients with experience, service and innovation, career opportunities for our employees and a fair return for our stockholders.

In Ontario, the Ontario Motorist Protection Plan is scheduled to come into effect in mid-1990, and modifications are still being made to the legislation. It is expected this change will affect the way we do business and will increase the demand for our rehabilitation services. Investigations will still be necessary as in the past and we anticipate this, together with a shortage of qualified personnel, could cause an increased demand for our services.

Although we have been negotiating changes to the Goods and Services Tax legislation as it relates to our business, we are at the present time considered taxable. The effects of the tax on our business are not presently known.

The increased needs of our clients have prompted us to develop some exciting new programs, including Rehabilitation Resource Management, a temporary claims personnel service, aviation, and a Canada-wide fidelity and surety bond operation. Our marketing group has been challenged to secure new and different business and this is already showing results.

We continue to consolidate our operations in Canada, improve profitability and as well, we are concentrating on our worldwide strategic plan. We anticipate an improvement in our operating results for the U.K. and the U.S. in 1990.

Change continues to dominate the world insurance scene. Several insurers are pulling out of the market altogether and others are withdrawing from certain portions of the business. This causes many corporations to consider self-insurance, an area of the marketplace we recognized in the early 80's.

At Morden & Helwig Group Inc. we have every reason to be extremely optimistic about our future. We have a diversified international business base, combined with dedicated and experienced individuals, to meet tomorrow's challenges. Our primary focus is the insurance community, an area we know best. Our reputation for professionalism and quality has been strengthened by improved financial and technical resources. Our extensive experience in complex claims handling, as well as our ability to manage risk on a continuing basis and to minimize litigation, continues to enhance our business opportunities. Our computerized claims monitoring technology, with on line capability, keeps us ahead of our competition.

On behalf of the Board of Directors of Morden & Helwig Group Inc., we express our gratitude for the support of our stockholders, our clients and our employees during the past year, and we are looking forward to a prosperous future as we progress through the 90's and into the next century.

March 30, 1990

Kenneth R. Polley
President and Chief Executive Officer

FAIRFAX
FINANCIAL HOLDINGS LIMITED

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 1989 AND 1988

CONSOLIDATED BALANCE SHEETS AS AT DECEMBER 31, 1989 AND 1988

	1989 ($000)	1988 ($000)
ASSETS		
Cash and short term investments *(note 2)*	13,221	28,027
Accounts receivable	25,189	26,884
Claims in process	8,493	7,266
Income taxes refundable	1,263	—
Prepaid expenses	1,030	545
	49,196	62,722
Portfolio investments		
Bonds - at amortized cost (market value - $30,948; 1988 - $24,417)	32,497	24,558
Preferred stocks - at cost (market value - $29,819; 1988 - $32,875)	32,415	32,008
Common stocks - at cost (market value - $58,793; 1988 - $57,424)	55,725	52,955
Total (market value - $119,560; 1988 - $114,716)	120,637	109,521
Investments in associated companies *(note 3)*	31,966	24,787
Other investments *(note 4)*	27,719	27,721
Deferred premium acquisition costs	876	4,991
Fixed assets *(note 5)*	5,348	5,016
Goodwill	4,922	5,641
Other assets *(note 6)*	7,401	6,387
	248,065	246,786

Signed on behalf of the Board

V. P. Watsa

Director

S.A. Markel

Director

	1989 ($000)	1988 ($000)
LIABILITIES		
Bank overdraft *(note 7)*	4,051	4,013
Short term borrowings *(note 7)*	—	20,000
Accounts payable and accrued liabilities	15,561	21,409
Premium deposits	11,293	8,361
Income taxes payable	—	3,230
	30,905	57,013
Provision for claims	81,118	71,964
Unearned premiums	12,137	22,757
Long term debt *(note 8)*	14,431	2,061
Subordinated convertible debenture *(note 9)*	7,500	7,500
Deferred income taxes	442	1,079
Minority interest	10,702	10,236
	126,330	115,597
SHAREHOLDERS' EQUITY		
Capital stock *(note 10)*	43,501	43,543
Retained earnings *(note 14)*	47,329	30,633
	90,830	74,176
	248,065	246,786

CONSOLIDATED STATEMENTS OF EARNINGS FOR THE YEARS ENDED DECEMBER 31, 1989 AND 1988

	1989 ($000)	1988 ($000)
Revenue		
Premiums earned	40,444	66,265
Claims fees	49,092	43,349
Interest and dividends	11,628	8,922
Realized gains on investments	15,458	7,802
Equity in earnings of associated companies	6,367	6,729
Other income	2,765	582
	125,754	133,649
Expenses		
Losses on claims	40,174	47,627
Operating expenses	57,120	51,542
Interest expense	5,154	2,230
Commissions	4,102	10,926
	106,550	112,325
Earnings before income taxes	19,204	21,324
Provision for income taxes *(note 13)*	1,192	5,297
Earnings from operations	18,012	16,027
Minority interest	(1,271)	(1,670)
Net earnings	16,741	14,357
Net earnings per share - fully diluted *(note 17)*	$2.25	$1.94

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS FOR THE YEARS ENDED DECEMBER 31, 1989 AND 1988

	1989 ($000)	1988 ($000)
Retained earnings - beginning of year	30,633	17,392
Net earnings for the year	16,741	14,357
Dividends on preferred shares	—	(1,044)
Excess over stated value of shares purchased for cancellation	(45)	(72)
Retained earnings - end of year	47,329	30,633

CONSOLIDATED STATEMENTS OF CHANGES IN CASH RESOURCES
FOR THE YEARS ENDED DECEMBER 31, 1989 AND 1988

	1989 ($000)	1988 ($000)
Operating activities		
Earnings from operations	18,012	16,027
Depreciation	1,428	896
Amortization of goodwill	719	453
Deferred income taxes	(637)	452
Realized gains on investments	(15,458)	(7,802)
Equity in earnings of associated companies	(6,367)	(6,729)
	(2,303)	3,297
Increase in provision for claims	9,154	12,526
Increase (decrease) in unearned premiums	(10,620)	1,958
Decrease (increase) in cash funds resulting from changes in other operating working capital items	(3,311)	2,017
Cash resources provided by (used in) operating activities	(7,080)	19,798
Investing activities		
Portfolio investments - net purchases	3,071	(8,522)
Purchase of fixed assets	(1,760)	(1,640)
Acquisition of subsidiary companies	—	(2,504)
Other investments	(1,824)	(36,768)
	(513)	(49,434)
Financing activities		
Repurchase of capital stock	(87)	(185)
Dividends on preferred shares	—	(1,044)
Issuance of subordinated convertible debenture	—	7,500
Increase (decrease) in long term debt	12,370	(1,006)
Minority interest	466	185
	12,749	5,450
Increase (decrease) in cash resources	5,156	(24,186)
Cash resources - beginning of year	4,014	28,200
Cash resources - end of year	9,170	4,014

Cash resources consist of cash and short term investments less bank overdraft and short term borrowings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 1989 AND 1988

(in $000s except per share amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business operations

The company is a financial services holding company which through its subsidiaries and affiliates is engaged in the insurance 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 using 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 temporary, the investment is written down to its estimated 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 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 statements 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. CASH AND SHORT TERM INVESTMENTS

Cash and short term investments include $5,049 (1988 - $1,956) representing deposits held in trust, the liability for which is included in accounts payable.

3. INVESTMENTS IN ASSOCIATED COMPANIES

Associated companies, at equity:	1989 ($000)	1988 ($000)
F-M Acquisition Corporation	22,362	15,211
Lindsey & Newsom Claim Services, Inc.	8,057	8,134
Vale National Training Centers, Inc.	1,547	1,442
	31,966	24,787

F-M Acquisition Corporation:

In 1988 the company acquired an additional 12.5% common share interest, increasing its interest to 47.5%, and also purchased 62.5% of the non-voting 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 sheets and statements of earnings in U.S. dollars is as follows:

BALANCE SHEET	December 31,1989 ($000)	December 31,1988 ($000)
Cash and investments	337,248	308,800
Reinsurance and premium receivables	138,020	150,675
Property and equipment	23,736	22,946
Other assets	21,138	26,097
Total assets	520,142	508,518
Reinsurance and other payables	124,407	132,804
Provision for claims	242,224	227,203
Unearned premiums and fees	43,063	37,174
Capitalized lease obligations	22,039	22,217
Notes payable	38,119	49,171
Total liabilities	469,852	468,569

Notes to Consolidated Financial Statements

	December 31, 1989 ($000)	December 31,1988 ($000)
Shareholders' equity		
Preferred	12,960	14,580
Common	14,000	14,000
Retained earnings	23,330	11,369
Total shareholders' equity	50,290	39,949
Total liabilities and shareholders' equity	520,142	508,518

STATEMENT OF EARNINGS	Year Ended December 31, 1989 ($000)	Year Ended December 31,1988 ($000)
Operating revenue	70,688	62,249
Investment income	34,193	25,305
	104,881	87,554
Operating costs	78,760	65,208
Interest expense	7,033	6,510
	19,088	15,836
Income tax	5,750	2,811
Net earnings	13,338	13,025

Included in notes payable are contingent amounts due in 1992, totalling US$12,679 (1988 - $23,836) which are subject to reduction based on development of unpaid claims and reinsurance collections. Included in other payables is accrued interest on contingent notes payable of $10,850 (1988 - $5,000).

Lindsey & Newsom Claim Services, Inc. and Vale National Training Centers, Inc.:

The company's 55% (1988 - 53%) owned subsidiary, Morden & Helwig Group Inc., owns a 50% interest in Lindsey & Newsom Claim Services, 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 31 states. Vale National provides claims adjusting training courses in three states.

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

BALANCE SHEET	December 31, 1989 ($000)	December 31,1988 ($000)
Current assets	9,939	6,227
Fixed assets	6,883	5,499
Goodwill	11,598	11,903
Other	8,403	9,168
Total assets	36,823	32,797

	December 31, 1989 ($000)	December 31,1988 ($000)
Accounts payable	2,225	2,012
Long term debt	8,719	6,893
Other	9,185	8,835
	20,129	17,740
Shareholders' equity	16,694	15,057
Total liabilities and shareholders' equity	36,823	32,797

STATEMENT OF EARNINGS	Year Ended December 31, 1989 ($000)	Year Ended December 31,1988 ($000)
Operating revenue	40,908	20,209
Operating costs	39,612	18,779
	1,296	1,430
Income tax	585	647
Net earnings	711	783

4. OTHER INVESTMENTS

	1989 ($000)	1988 ($000)
Other investments, at cost:		
F-M Acquisition Corporation- 10% cumulative redeemable preferred shares	10,274	11,492
Walwyn Inc. - 12.5% subordinated debentures, due 1993, convertible into common shares at $4 per share	8,350	11,250
Carbovan project - 15% loan and common shares	4,475	1,516
Fairfax Realty Inc. - real estate investment (net)	1,504	—
Others	11	92
Other investments, at equity:		
Walwyn Inc. - common shares	3,105	3,371
	27,719	27,721

Notes to Consolidated Financial Statements

F-M Acquisition Corporation:

During each of 1989 and 1988 F-M Acquisition redeemed 10% of the issued 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 and matures December 1993. 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, 1989 the fully diluted book value and market value of Walwyn Inc. was $2.65 (1988 - $2.91) and $3.05 (1988 - $3.65) respectively. Faircross has accounted for its investment in Walwyn recognizing its 37.7% fully diluted share of net losses. Faircross has used an effective acquisition date of December 31, 1988. During 1989 the company acquired 217,362 common shares of Walwyn Inc. for $742.

Carbovan Inc. Project:

In 1988 the company started to make loans towards a project that involves the conversion of fly ash from the tar sands to vanadium products and carbon. During 1989 the plant was in a construction phase. Production has started in February 1990. The project is undertaken with two partners, Agra Industries Limited and Renzy Mines Ltd. Fairfax owns 25% of the project, with a possible increase to 50% under certain circumstances. The loans accrue interest at a rate of 15% per annum. Interest will not be recorded as income until the project commences production. Fairfax has entered into a joint and several agreement with Agra to guarantee a $6 million loan made to Carbovan by the Alberta Opportunity Company.

Fairfax Realty Inc.:

During the year Fairfax incorporated a realty company, Fairfax Realty Inc. This company acquired a 75% interest in a shopping mall in Calgary, Alberta. The investment is shown net of a 12.375% mortgage of $2.9 million, due June 1994, which is non-recourse to Fairfax Financial Holdings Limited and is secured by the shopping mall.

5. FIXED ASSETS

	1989 ($000)	1988 ($000)
Land and buildings	1,542	2,203
Furniture and equipment	9,797	7,813
Leasehold improvements	935	609
	12,274	10,625
Less accumulated depreciation	6,926	5,609
	5,348	5,016

6. 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 $7,348 (1988 - $5,818). The loans are secured by 512,000 shares (1988 - 410,000 shares) with a year-end market value of $9,600 (1988 - $6,150).

7. BANK OVERDRAFT

The bank overdraft represents temporary operating loans, of which $2,316 (1988 - $2,703) is secured by a general assignment of book debts of a subsidiary company. In 1988 short term borrowings represent 13% demand notes payable which were paid off in 1989. Interest expense on the bank overdraft and short term borrowings amounted to $520 (1988 - $1,553).

8. LONG TERM DEBT

The long term debt balance of 1989 represents U.S. dollar loans on a $30 million (Canadian) revolving credit facility at a current average annual rate of 9.85%, maturing in 1994. The loans are secured by the shares of a subsidiary company. Interest expense on the long term debt amounted to $2,561 (1988 - $250). In 1989 $1,120 was included in income relating to an elimination of contingent notes payable with respect to Sphere Reinsurance Company of Canada. In 1988 this amount of note payable was included in long term debt.

9. SUBORDINATED CONVERTIBLE DEBENTURE

During 1988 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 $639 (1988-$427).

10. 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 ten votes per share and an unlimited number of subordinate voting shares carrying one vote per share.

Issued capital	1989		1988	
	Number	($000)	Number	($000)
Subordinate voting shares	4,968,200	35,917	4,974,200	35,959
Multiple voting shares	2,348,000	7,584	2,348,000	7,584
	7,316,200	43,501	7,322,200	43,543

In 1988 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 6,000 (1988-14,200) subordinate voting shares for an aggregate cost of $87 (1988 - $185), of which $45 (1988-$72) was charged to retained earnings. A subsequent second bid was approved which allows the company to purchase and cancel up to 10% of the public float of its subordinate voting shares up to October 1990.

Notes to Consolidated Financial Statements

1. REINSURANCE

The company follows the policy of underwriting and reinsuring contracts of insurance which generally limits 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, 1989 provision for claims reflects recoveries from reinsurers of $16,256 (1988 - $17,546). During the year the company ceded $9,274 (1988 - $10,764) of premium income and $5,426 (1988 - $3,707) of claims incurred.

2. 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 $801 in 1989 (1988 -$753).

The company holds an investment of 20,780 (1988 - 94,400) common shares of Markel Corporation at a cost of $165 (1988 - $1,310) and a market value of $541 (1988 - $2,083).

The company reinsures a portion of risks with an associated company. Net premiums ceded in 1989 amounted to $181 (1988 - $425) and net losses recovered $79 (1988 - $274). Included in deposits is an amount due from the related company of $670 (1988 - $320).

3. INCOME TAX POSITION

The provision for income taxes in the consolidated statements of earnings includes a recovery of deferred income taxes of $637 (1988 - provision of $452).

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.

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

	1989	1988
	%	%
Provision for taxes at Canadian statutory marginal income tax rate	44.3	48.0
Non-taxable capital gains	(11.9)	(5.9)
Non-taxable investment income	(11.8)	(7.2)
Equity earnings of associated companies	(14.7)	(15.2)
Other - net	0.3	5.3
Provision for income taxes at effective rate	6.2	25.0

14. STATUTORY REQUIREMENTS - INSURANCE SUBSIDIARIES

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

15. 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 acquired forward contracts at an average rate of $1.26 for the U.S. dollar equivalent of $68,650 (1988 - $67,850) which expire over the next four years.

On December 15, 1989, 870675 Ontario Limited purchased 1,960,500 common shares of FCA International Ltd. for approximately $21.5 million. The purchase was financed by a bank loan at prime +1% secured by an assignment and pledge of these shares. Fairfax is negotiating with a financial partner to purchase these shares at an option price of $11 per share. The market value of these shares on December 31, 1989 is $10.375 per share.

The company has various letters of credit outstanding totalling $3,000 (1988 - $2,500). The company has further guaranteed repayment of borrowed funds of Carbovan - see Note 4 - and of Develcon Electronics Ltd. for $1,000 (1988 - nil). These guarantees are secured by certain assets of each of the investee companies.

16. OPERATING LEASES

Aggregate future commitments at December 31, 1989 under operating leases relating to premises, automobiles and equipment for various terms up to ten years are as follows:

1990	$ 4,000
1991	3,400
1992	2,800
1993	2,100
1994	1,900
Thereafter	3,800
	$18,000

17. EARNINGS PER SHARE

Earnings per share on the consolidated statements of earnings have been presented on a fully diluted basis. Basic earnings per share are $2.29 for 1989 and $1.96 for 1988.

18. SUBSEQUENT EVENT

The company has reached an agreement with Federated Mutual Insurance Company of Owatonna, Minnesota to acquire its wholly-owned subsidiary Federated Insurance Holdings of Canada Ltd. The purchase price of approximately $28 million is payable in two 10% contingent notes of $10 million each, maturing in five and ten years respectively, with the remaining balance payable in cash. The notes are subject to reduction, based on development of unpaid claims. Federated Insurance Holdings of Canada Ltd. has approximately $116 million in total assets and $90 million in total liabilities as at December 31, 1989.

Notes to Consolidated Financial Statements

19. SEGMENTED INFORMATION

The company is a financial services holding company which through its subsidiaries and affiliates is engaged in the insurance 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	1989 ($000)	1988 ($000)
Revenue		
Insurance and reinsurance	74,975	88,512
Claims adjusting, appraisal and loss management	49,414	44,157
Corporate and consolidation adjustments	1,365	980
Consolidated	125,754	133,649
Equity earnings		
Insurance and reinsurance	7,240	6,250
Claims adjusting, appraisal and loss management	44	479
Corporate and consolidation adjustments	(917)	—
Consolidated	6,367	6,729
Earnings before income taxes		
Insurance and reinsurance	18,076	18,380
Claims adjusting, appraisal and loss management	4,845	5,612
Corporate and consolidation adjustments	(3,717)	(2,668)
Consolidated	19,204	21,324
Identifiable assets		
Insurance and reinsurance	154,677	157,384
Claims adjusting, appraisal and loss management	40,945	38,413
Corporate and consolidation adjustments	52,443	50,989
Consolidated	248,065	246,786
Depreciation and amortization	346	299
Insurance and reinsurance	1,148	710
Claims adjusting, appraisal and loss management	555	340
Corporate and consolidation adjustments	2,049	1,349
Consolidated		
Interest expense		
Insurance and reinsurance	309	496
Claims adjusting, appraisal and loss management	363	438
Corporate and consolidation adjustments	4,482	1,296
Consolidated	5,154	2,230

(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 in Canada (Walwyn Inc. - see Note 4) and in the United States (F-M Acquisition Corporation, Lindsey & Newsom Claim Services, Inc. and Vale National Training Centers, Inc.). Condensed financial statements of these U.S. companies are disclosed separately in Note 3.

February 9, 1990

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, 1989 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 & Robertson, Inc. In our opinion:

(i) the amount of claims liabilities in the consolidated balance sheet makes proper provision for future payments under the subsidiary companies' policies for the net retention on claims incurred prior to January 1, 1990; 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 9, 1990

AUDITORS' REPORT TO THE SHAREHOLDERS

We have examined the consolidated balance sheets of Fairfax Financial Holdings Limited as at December 31, 1989 and 1988 and the consolidated statements of earnings, retained earnings and changes in cash resources for the years then ended. Our examinations were 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, 1989 and 1988 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand
Chartered Accountants
Toronto, Canada

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Results of Operations 1989/1988

Total revenue of $125.8 million was $7.8 million or 6% lower than 1988 revenue of $133.6 million. Net earnings were $16.7 million or $2.25 per share compared with 1988 net earnings of $14.4 million, an increase of $2.3 million or 16% and 31¢ per share. The property and casualty insurance environment in general experienced another year of intense competition and poor underwriting results. Insurance markets worldwide remain very price competitive. Despite this adverse operating environment, the company achieved a satisfactory net income and a return on average equity of 20.3% compared with 21.2% last year.

Individually, the subsidiaries performed satisfactorily with the exception of Markel Insurance which had an unacceptable underwriting loss of $14 million in 1989, compared to a $1 million loss in 1988. Changes are being implemented and an improved 1990 performance is expected.

Realized gains on the disposal of portfolio securities in 1989 totalled $15.5 million, a $7.7 million or 99% increase over the $7.8 million of gains in 1988. At December 31, 1989 the Fairfax investment portfolio had an unrealized loss of $1.1 million compared with an unrealized gain of $5.2 million at December 31, 1988.

Interest expense increased to $5.2 million from $2.2 million in 1988 as a result of financing the Walwyn purchase and the other investment banking projects. The effective tax rate of 6.2% in 1989 is significantly lower than in 1988 as disclosed in Note 13 of the notes to the consolidated financial statements.

Results of Operations 1988/1987

Total revenue of $133.6 million increased $20.6 million or 19% over 1987 revenue of $113 million. Net earnings were $14.4 million or $1.94 per share, $1.6 million or 29¢ per share lower than 1987 net earnings of $16 million or $2.23 per share. In 1987 net earnings included a non-recurring item of $3.5 million related to a gain on reduction of an interest in Morden & Helwig Group Inc. Operating earnings were $14.4 million in 1988 versus $10.8 million in 1987, an increase of $3.6 million or 33%.

Realized gains on the disposal of portfolio securities in 1988 totalled $7.8 million, a $1.4 million or 15% decrease from the $9.2 million of gains in 1987. At December 31, 1988 the Fairfax investment portfolio had an unrealized gain of $5.2 million compared to an unrealized loss of $6.9 million at December 31, 1987.

Investment banking

Fairbridge Inc. has participated in three investment banking projects, being Walwyn Inc., a stock brokerage firm; the Carbovan Inc. project, a vanadium product manufacturer; and Fairfax Realty Inc.'s real estate investment.

Walwyn lost $5.3 million in 1989 and the short term outlook for that industry continues to be poor. The other two projects were in a construction phase in 1989 and will be completed in early 1990. These investments are described in Note 4 of the notes to the consolidated financial statements.

Liquidity

The normal cash requirements of the company continue to be covered by internally generated funds. A major source of funds is the payment of dividends by the company's insurance subsidiaries which are governed by insurance statutes and regulations. The consolidated statement of changes in cash resources (cash and short term investments less bank overdraft and short term borrowings) lists the cash resources provided by or used in operating, investment and financing activities. Cash resources increased by $5.1 million to $9.2 million in 1989. Reduction of bank loans continues to be emphasized by the company. In 1989 we replaced our short term debt with long term debt and reduced our total debt by $7.6 million to $18.5 million. At December 31, 1989 the revolving line of credit available was $10 million. The balance of the credit facility has been allocated to letters of credit outstanding of $3 million. (See Note 8 of the notes to the consolidated financial statements). The long term debt at year-end was $14.4 million. The debt equity ratio improved to .2:1 compared to .35:1 in 1988. Our goal is to be debt free but it will be a function of the opportunities that arise.

Capital Resources
The company is in a strong financial position that will allow it to take advantage of opportunities as they occur. Individual investments by the company have been disclosed in detail in Note 4 of the notes to the financial statements. Capital expenditures with respect to fixed assets were $1.6 million in 1989.

Divestiture
During 1989 the company agreed to sell the book of business of our reinsurance subsidiary, Sphere Reinsurance Company of Canada (now renamed Chequers Insurance Company), for $5.75 million, effective January 1, 1989.

Acquisition
An agreement was reached in December 1989 to purchase Federated Insurance Holdings of Canada Ltd. of Winnipeg, disclosed in Note 18 of the notes to the consolidated financial statements.

Risks
The two major risks or unknowns facing the company are the volatility of the insurance cycle and the stock market. In the short term at least the company does not expect an improvement in the insurance marketplace or the stock market.

A reader of this Management Discussion and Analysis should refer to the entire annual report for additional commentary.

CONSOLIDATED FINANCIAL SUMMARY
($000 except per share amounts)

	For the years ended December 31									
	1989	1988	1987	1986	1985	1984	1983	1982	1981	1980
REVENUES										
Insurance premiums earned	40,444	66,265	62,012	40,885	14,049	16,616	19,621	14,443	10,676	7,633
Service revenues	49,092	43,349	33,529	6,850	—	—	—	—	—	—
Interest and dividend income	11,628	8,922	8,042	4,678	2,455	2,337	2,009	2,198	2,421	1,757
Equity earnings	6,367	6,729	18	—	—	—	—	—	—	—
TOTAL REVENUES	107,531	125,847	103,812	52,781	16,623	18,953	21,630	16,641	13,097	9,390
EARNINGS										
Earnings before realized investment gains and taxes	3,746	13,522	9,044	8,133	(1,339)	(4,879)	93	542	(538)	(2,425)
Realized investment gains	15,458	7,802	9,159	952	459	25	215	(66)	(276)	424
Total pre-tax earnings	19,204	21,324	18,203	9,085	(880)	(4,854)	308	476	(814)	(2,001)
Extraordinary items	—	—	1,700	1,711	—	—	—	—	—	—
NET EARNINGS AFTER TAX	16,741	14,357	16,019	6,548	(910)	(4,775)	280	218	(326)	(785)
TOTAL ASSETS	248,065	246,786	185,413	129,845	41,477	31,401	32,325	28,739	29,351	27,714
CASH AND INVESTMENTS	133,858	137,548	124,016	95,633	32,728	25,391	24,218	20,337	22,265	21,853
DEBT	14,431	22,061	3,067	3,000	—	1,000	300	800	—	—
SHAREHOLDERS' EQUITY	90,830	74,176	61,048	41,275	10,379	2,287	7,062	6,782	6,565	6,891
NUMBER OF SHARES -FULLY DILUTED	7,712	7,718	7,336	7,007	5,000	616	616	616	616	616
RETURN ON SHAREHOLDERS' EQUITY	20.3%	21.2%	31.3%	25.4%	—	—	4.1%	3.3%	—	—
PER COMMON SHARE -FULLY DILUTED										
Net earnings	2.25	1.94	2.23	1.35	(1.89)	(7.75)	0.45	0.35	(0.53)	(1.27)
Dividends	—	—	—	—	—	—	—	—	—	0.0625
Shareholders' equity	12.41	10.13	8.32	5.89	2.08	3.71	11.46	11.01	10.66	11.19

Directors of the Company

† H. Anthony Arrell
Chairman and Chief Executive Officer,
Walwyn Inc.

Winslow W. Bennett
President, Winwood Holdings Ltd.

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

+* Robbert Hartog
President, Robhar Investments Ltd.

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

William R. Andrus
President and Chief Executive Officer
CHEQUERS INSURANCE COMPANY

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

J. Paul T. Fink
President
FAIRBRIDGE INC.

Sanjeev Rastogi
Acting President
MARKEL INSURANCE COMPANY OF CANADA

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

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

Eric P. Salsberg
Vice President, Corporate Affairs

Ronald Schokking
Controller

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Transfer Agent and Registrar
The Royal Trust Company

Share Listing
Toronto Stock Exchange
Exchange Symbol FFH

General Counsel
Tory, Tory, DesLauriers & Binnington

Auditors
Coopers & Lybrand