FAIRFAX

FINANCIAL HOLDINGS LIMITED

# 1991 Annual Report

"L O G O"

# 1991 Annual Report

## Contents

"L O G O"

**Seven-Year Financial Highlights**

*(in thousands except per share data)*

| | 1991 | 1990 | 1989 | 1988 | 1987 | 1986 | 1985 |
|---|---|---|---|---|---|---|---|
| Total revenue | 250,002 | 195,430 | 125,754 | 133,649 | 112,971 | 53,733 | 17,015 |
| Net earnings | 22,515 | 21,306 | 16,741 | 14,357 | 16,019 | 6,548 | (910 ) |
| Total assets | 516,564 | 535,987 | 248,065 | 246,786 | 185,413 | 129,845 | 41,477 |
| Shareholders' equity | 116,775 | 94,676 | 90,830 | 74,176 | 61,048 | 41,275 | 10,379 |
| Shares outstanding year-end | 5,455 | 5,477 | 7,316 | 7,322 | 7,337 | 7,007 | 5,000 |
| Return on average equity | 21.3% | 23.0% | 20.3% | 21.2% | 31.3% | 25.4% | |
| *Per share* | | | | | | | |
| Net earnings fully diluted | 3.94 | 2.92 | 2.25 | 1.94 | 2.23 | 1.35 | (1.89 ) |
| Shareholders' equity | 21.41 | 17.29 | 12.41 | 10.13 | 8.32 | 5.89 | 2.08 |
| *Market prices per share* | | | | | | | |
| High | 22.50 | 21.63 | 19.00 | 15.13 | 17.50 | 14.13 | 6.00 |
| Low | 10.75 | 8.88 | 14.00 | 11.75 | 10.50 | 6.00 | 3.00 |
| Close | 21.25 | 11.00 | 18.75 | 15.00 | 12.37 | 12.75 | 6.00 |

CORPORATE CHART goes on this page

## CORPORATE PROFILE

**Fairfax Financial Holdings Limited** is a financial services holding company whose corporate objective is to achieve a high rate of return on invested capital and build long term shareholder value. The company has been under present management since September 1985.

**Commonwealth Insurance Company,** based in Vancouver, was acquired in November 1990. It offers commercial property and oil and gas insurance in Canada, the United States and internationally, and commercial casualty insurance in Canada. In 1991 Commonwealth's gross premiums written totalled $129 million. Commonwealth has been in business since 1947 and at year-end there were 124 employees and two branches.

**Federated** was acquired in January 1990, and is based in Winnipeg. Its two companies market a broad range of insurance products primarily for commercial customers. In 1991 Federated's gross premiums written totalled $41 million, consisting of $33 million of property and casualty business and $8 million of life and group health and disability products. Federated has been in business since 1920 and at the end of 1991 had 236 employees and six branches.

**Markel Insurance** 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. The company also insures small amounts of agricultural and property and casualty risks and continues to run off its former reinsurance business. In 1991 gross premiums written were $31 million and the group had 95 employees and three branches.

**Wentworth Insurance Company** was incorporated in 1990 as a captive insurance company domiciled in the Barbados.

**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, the U.S. and the U.K. In 1991 revenue totalled $122 million. At year-end the group had some 1,800 employees located in 346 branches.

**To Our Shareholders**

1991 worked out to be a better year than we expected. We earned a record $22.5 million of which $13.6 million was from the 1990 sale of F-M Acquisition. After tax earnings increased 6% while earnings per share increased 35% to $3.94 because of the 25% decrease in the average number of shares outstanding. Return on common equity in 1991 was 21.3% (vs 2.9% for the TSE 300) making it the sixth year we have achieved our objective of earning in excess of 20% after tax on common shareholders' equity. Book value per share increased 24% to $21.41. Our per share figures have benefitted greatly in 1991 (and will also in the future) by the significant decrease in the shares outstanding in 1990. This, of course, means that the intrinsic value per share of our company has increased significantly.

Looking back, the restructuring in 1990 of our partnership interests with Markel Corporation worked out very well for both companies. Both Markel Corporation and Fairfax are selling at historical highs in the stock market and have greater freedom for unhampered growth in the future.

As we enter the seventh year since present management took over the company, we thought it appropriate to reiterate, for the benefit of new shareholders, the objectives that we set out in our 1985 annual report. Surprisingly they have not changed since, although we have expressed them a little differently. Our objectives are as follows:

1) We expect to earn long term returns on shareholders' equity in excess of 20% annually by running Fairfax and its subsidiaries for the long term benefit of customers, employees and shareholders - at the expense of short term profits if necessary.

Our focus is long term growth in book value per share and not quarterly earnings. We plan to grow through internal means as well as through friendly acquisitions.

2) We always want to be soundly financed.

3) We provide complete disclosure annually to our shareholders.

Some observations on our objectives. While we try to achieve a 20%+ return annually and have achieved this in the past six years, this will likely not be the case every year in the future. However, over any longer period (say five years), we would be very disappointed if we had not achieved an average return in excess of 20%. We place no importance on quarterly results. While we report results as they fall, we are conservative in our accounting policies and in our reserving, always providing for the proverbial "rainy day".

You should understand that 20% after tax is an extremely challenging objective and that very few companies achieve this objective over time. In the July 1991 issue of Report on Business magazine, Fairfax's five year return on common equity was ranked 30th out of the top 1,000 companies listed on Canadian stock exchanges. This means that only 3% of the top 1,000 companies in Canada have earned more on equity than we have over the past five years. By retaining all our income (and not paying any dividends) the 20% hurdle becomes more difficult as the years go by. However, over the next five years, we continue to expect to achieve this 20%+ objective.

Over the past six years we have always maintained a strong financial position. Our experience in 1990/91, when our financial position was less strong, has only underlined the importance of this objective. We will always sacrifice return if it endangers our financial health. It is interesting to observe the dramatic collapses of Campeau and First City Financial - both companies with track records extending over 20 years. Campeau's shareholders' equity, built over 19 years to $342 million in 1986, dropped to $94 million in only 12 months due to losses of $254 million in 1987. While this ending may have been a foregone conclusion once Campeau bought Allied Stores and Federated Department Stores, First City's demise was much less predictable although equally dramatic. Shareholders' equity, again built over 21 years to $465 million in 1989, turned negative in only 18 months due to cumulative losses of $549 million.

Both these examples show how lethal financial leverage can be to a company's viability. Decades of growth in retained earnings can disappear in months. While we are very conscious of these failures and others like them that stem from financial excess, please remember that as Warren Buffett commented about Noah, building arks counts, not predicting rain.

Finally, we continue to report to you, once a year, the pluses and minuses about our company. We do this so that you can get a balanced view of our results but also to keep ourselves honest. Managements that fool their shareholders tend to fool themselves. Every year we work on improving your understanding of our company and we will always be receptive to ideas you may have about further disclosure.

The table below shows the sources of our net earnings:

| | ($ millions) | |
|---|---|---|
| | **1991** | **1990** |
| Insurance underwriting | 5.3 | (12.5) |
| Interest and dividends | 25.4 | 19.3 |
| Total insurance | 30.7 | 6.8 |
| Claims adjusting (Fairfax portion) | 0.1 | 1.7 |
| Investment banking (including Midland Walwyn) | (1.1) | (6.4) |
| Interest expense /corporate overhead | (6.5) | (9.1) |
| Realized gains | 2.5 | 5.2 |
| Equity earnings | | 4.5 |
| Income before taxes and provisions | 25.7 | 2.7 |
| Less: provisions for future potential losses | (7.0) | (7.9) |
| Total pre-tax income (loss) | 18.7 | (5.2) |
| Less: taxes | 9.8 | 0.5 |
| Earnings (loss) after taxes | 8.9 | (5.7) |
| Gain on sale of F-M Acquisition | 13.6 | 27.0 |
| Net earnings | 22.5 | 21.3 |

The table shows you our results from our insurance operations (underwriting and investments, excluding realized gains) and our non-insurance operations. Shown separately are provisions for potential losses and taxes, so you can better understand our earnings from our operating companies. Also, please note the unaudited statements of our insurance operations and Morden & Helwig's financial statements shown on pages __ to __. Equity earnings in 1990 were from F-M Acquisition which was sold at the end of 1990.

Insurance earnings rebounded significantly in 1991 because of profits from insurance underwriting and higher dividend and interest income. In spite of a minor contribution from Morden & Helwig, continued losses from investment banking and a high level of interest expenses, pre-tax income before provisions increased significantly from $2.7 million in 1990 to $25.7 million in 1991. To be conservative, we provided $7 million in 1991 for provisions for potential investment losses. After provisions and taxes Fairfax earned $8.9 million versus a loss of $5.7 million in 1990. Because of portfolio appreciation in F-M Acquisition, described in detail in our 1990 annual report, Markel Corporation paid us an additional $13.6 million for F-M which was used to extinguish the contingent note. With this additional gain, our net earnings increased to $22.5 million from $21.3 million last year. In 1990 and 1991 our net gain on F-M totalled $40.6 million and contributed significantly to our performance in those years.

While each of our operations is discussed in more detail below, it is fair to say that the sustainability of our current earnings base is greater today than it has ever been.

**Insurance operations**

In last year's annual report we said that our underwriting results should improve in 1991 because surety would not continue to be a problem. In fact, because of significant recoveries in surety, our underwriting results turned positive in 1991. Our surety problem is now behind us and may perhaps continue to be a minor positive because of further recoveries. We are gratified at having conservatively reserved for surety in 1990 and would prefer to have similar reserving errors in the future. Excluding surety recoveries our insurance operations had a breakeven year in 1991 a terrific achievement in a down cycle. Our insurance company managements deserve to be congratulated on this fine performance.

We completed the amalgamation of Markel, Otter Dorchester and Chequers in 1991 under Bill Grant's leadership. Markel is concentrating again on its expertise of the last 40 years long haul trucking. We plan to be leaders in this industry again.

Federated Insurance, led by John Paisley, continued to make excellent progress in becoming a self-standing, independent operation. In 1991 John and his team achieved a combined ratio of 99% much improved from the 106% of 1990. Federated should have its own information systems in place by 1992 and is poised for achieving consistent underwriting profitability.

Commonwealth, led by John Watson, had an excellent year in 1991. In spite of the competitive environment, John and his team achieved a combined ratio of 99%. In last year's annual report, we said that we expected the earnings from Commonwealth to compensate for the sale of our interest in F-M. In 1991 Commonwealth earned $8.6 million after taxes versus our highest contribution from F-M of $7.2 million in 1989. As some of Commonwealth's insurance lines have recently had significant price increases and because of higher retentions, it is likely that the contribution from Commonwealth will be much higher in 1992.

There are two important points that you should note about our insurance business:

1) We have been operating for four years with the wind against us as the insurance cycle has been on the downswing. There are now faint signs that the cycle is turning. It may still be a year or two before it turns but our expectation is that sooner rather than later we will have the wind behind our back again for perhaps a few years.

2) Our insurance operating leverage is very low. Thus in 1991 we wrote only $21 million of net premiums in Markel against common equity of $35 million an operating leverage of 0.6:1 versus a potential of at least 2:1. At Federated, our operating leverage is 1.1:1 and at Commonwealth only 0.4:1. When the cycle turns we, unlike many insurance companies, have the capacity to write many times the premiums we presently write.

**Claims adjusting**
1991 was a very disappointing year for Morden & Helwig, mainly because of the losses in its U.S. operations (please note statements on pages __). Excluding losses from discontinued operations of US $1.7 million after tax, the continuing U.S. operations lost US $10,000 on revenue of US $54.8 million. This is not acceptable to management and they are focused on turning this around in 1992.

Morden & Helwig's Canadian operations, in spite of difficult industry conditions, continued to perform well, earning $2.2 million after tax in 1991, resulting in a respectable 16% return on equity supporting the Canadian operations.

Since January 1, 1992 the Canadian and U.S. claims operations of Morden & Helwig have been operating under the new name of Lindsey Morden Claim Services. The group has over 340 offices throughout Canada, the United States and the United Kingdom, with over 1,800 employees. We continue to be excited about the potential of the Morden & Helwig group under Ken Polley's overall leadership.

Morden & Helwig strengthened its balance sheet in 1991 as short and long term debt decreased significantly. Shareholders should read Morden & Helwig's annual report to get more details about our claims adjusting operations. You can get a copy by telephoning Don House at (416) 362-6762.

During 1991 Morden & Helwig exchanged Fairfax's US $7 million 9% convertible preferred shares in Lindsey & Newsom for a $7.9 million 10% debenture, convertible into common shares of Morden & Helwig at $11 per share. Fairfax's interest in Morden & Helwig now consists of this convertible debenture plus 2.45 million common shares carried at a cost (including our share of earnings) of $6.88 per share on our unconsolidated balance sheet.

**Investment banking**
As mentioned in last year's annual report, your Chairman's bright ideas have cost your company dearly. Although we do not intend to commit any more capital to investment banking, I should report, in the interest of fair disclosure (some of you may want to skip this section), that cumulative investment banking losses from inception increased by $1.1 million to $9.6 million ($1.65 per share). The increase was mainly due to the closure costs at Carbovan. We hope to dispose of our investment in Carbovan in 1992 (which is already written off); however, as disclosed in Note 13, we are still jointly and severally liable for $11.5 million in guarantees. We continue to have $1 million exposed to Develcon, and we are hoping to resolve this situation in 1992.

Last year we sold our convertible debentures at par in Midland Walwyn and now only have a portfolio investment in common shares. It is interesting to note that if we had not sold our interest to Confederation Life last year but maintained our interest by subscribing pro-rata to the rights issue, our all-in cost for the shares would be approximately $7.20 per share. At current prices of $9 per share for Midland Walwyn, this means we would have had an unrealized gain of approximately $3 million or a 25% return on cost as opposed to the $3.5 million loss taken in 1990. In spite of this opportunity cost, we feel we made the right decision last year as detailed in 1990's annual report.

There were no major changes in our real estate investments and we continue to expect profits on disposition.

Paul Fink, Tony Griffiths and Rob Mills are working hard to liquidate our investments in this area.

**Financial position**
To best understand our financial position, it is appropriate to look at the unaudited statements shown on page _ with Morden & Helwig equity accounted. Here is what our capital position looks like compared to 1990:

| | | *($ millions)* | |
|---|---|---|---|
| | | **1991** | **1990** |
| Short and long term debt | | 30.8 | 31.5 |
| Contingent debt: | | | |
| | Federated | 20.4 | 20.4 |
| | Markel Corporation | 0 | 13.6 |
| | | 20.4 | 34.0 |
| Convertible debentures | | 0 | 7.5 |
| Common equity | | 124.3* | 94.7 |
| Total capital | | 175.5 | 167.7 |

* Includes the convertible debentures which were converted into subordinate voting shares on February 14, 1992.

Our financial position strengthened considerably in 1991. As discussed in last year's annual report, the Markel Corporation contingent debt was extinguished, the convertible debenture was converted into common shares early in 1992 and excess capital of approximately $10 million was released as a result of the Markel Group amalgamation. As an aside, the 1.84 million shares retired in 1990, worth $22 million then, would be worth $46 million today at $25 per share.

Also, you should be aware that we have financed employee stock purchase plans totalling $9.3 million which are included as other assets on our balance sheet (Note 4). These loans are secured by approximately 650,000 shares of Fairfax with a market value at $25 per share of approximately $16 million. If these loans were financed independently at a bank, Fairfax would have an additional $9.3 million for available for debt reduction. We are exploring this possibility.

We continue to feel that we are adequately reserved. Our insurance reserves have been certified by The Wyatt Company by company and in total (note page __). Reserve development in 1991 was minimal.

Thus, while we continue to focus on reducing long and short term debt to levels below $10 million as discussed in last year's annual report, we are very comfortable with our current financial position. In fact, we could be expanding again in 1992 if the right opportunity presents itself.

**Investments**

Since inception in 1985 we have always maintained that unrealized losses are not meaningful in the short term as they do not necessarily indicate permanent impairment. Unrealized losses (like unrealized gains) reflect fluctuations in the market and have no predictive value. What matters over time are the realized gains or losses.

This point is perhaps dramatically illustrated by our investment in Magna as shown below:

| | | *($ millions)* | |
|---|---|---|---|
| | **Cost** | **Unrealized loss as at Dec.31/90** | **Realized gain** |
| Magna shares and convertible debentures | 6.8 | 3.2 | 5.4 |

While we were unhappy about the unrealized loss of $3.2 million as of December 31, 1990, it did not affect our pocket book. What mattered was the *realized* gain of $5.4 million when we ultimately eliminated our position in October 1991. The 79% return on our cost was achieved over approximately two years.

Most fluctuations in stock and bond prices are not as dramatic, but it is fair to say that we continue to expect, in the main, to earn significant realized gains in the long term from our stock and bond investments even though some of them currently show unrealized losses.

The unrealized loss for our portfolios as at year-end is broken down by major categories below:

| | ($ millions) | |
|---|---|---|
| | **1991** | **1990** |
| Bonds | (0.3) | (8.3) |
| Preferred stocks | (0.8) | (8.4) |
| Common stocks | (5.0) | (17.3) |
| | (6.1) | (34.0) |

The total unrealized loss dropped dramatically in 1991 from $34 million at the beginning of the year to $6 million at the close. The unrealized loss in bonds and preferred stock dropped significantly because of declining interest rates while rising stock markets helped reduce the common stock losses. Also, the unrealized loss shown is after a $7 million provision (mainly common stocks) that we took in 1991 just to be conservative. We do not expect this provision to be realized! By the end of February 1992 the unrealized loss was below $1 million.

Gross realized gains in 1991 totalled $9.1 million. After realized losses of $6.6 million and provisions of $7 million, we reported a capital loss in our income statements for the first time since we began of $4.5 million. The major contributors to realized gains were Magna ($5.4 million) and Bank of Montreal ($1.2 million). Realized losses arose in conjunction with the amalgamation of Chequers Insurance Company.

In our 1990 annual report, we disclosed our holdings in Magna, Woodwards and Repap because of the confusion in the press. As already mentioned, we sold Magna. We continue to hold the bulk of our positions in Woodwards and Repap.

Please note the tables on pages __ and __ for additional information on our investments.

A word about our press and/or investor relations department. We have none. We believe in making full disclosure through our annual report, our annual meeting, our interim financial statements and, when appropriate, periodic announcements. Further public comment is rarely necessary or constructive. We believe that Fairfax and each company within the group should be judged by its long term results and not by "good" or "bad" press. This is why we regularly have a "no comment" for the press.

We formalized a charitable donations policy in 1991 that committed us to donate at least 1% of pre-tax income from operations annually. We donated approximately $200,000 last year to a variety of charities across the country.

As you know our companies are decentralized and run by the presidents except for performance evaluation, succession planning, acquisitions and financings which are done at Fairfax. From the very beginning we have emphasized that Fairfax is a holding company and *not* an operating company. In 1991 we re-emphasized this aspect of our organization structure. Our holding company consists of only fourteen people including support staff and we plan to keep it this way. At Fairfax, John Varnell is responsible for all our insurance operations while Rick Salsberg is responsible for our non-insurance operations. Ronald Schokking is our V.P. Finance, Sam Chan our V.P. and Actuary and Brenda Adams our Corporate Secretary. It is because of their exceptional talent and hard work that we can continue to keep Fairfax small.

Since we began in 1985, book value per share has grown tenfold from $2.08 per share to $21.41 a compounded growth rate of 46% that *cannot* be repeated. We are humbled by this experience because it is much greater than we ever expected. Our return on shareholders' equity over the past six years has averaged 23.8% (vs 9.1% for the TSE 300). Total shareholders' capital has increased to $124 million (including the conversion of the 8.5% convertible debentures in February 1992) from $10 million in December 1985.

So much for the past. What about the future?

The future continues to be very uncertain and not predictable. However, our company enters the new year in a far better position than it has had in the past. The insurance down cycle which has negatively impacted us for the last four years is showing signs of changing for the better. Our financial position is very strong and prospects are good for significant capital gains. On the negative side, Morden & Helwig continues to face a challenge in making its U.S. operations profitable. Also, we have not totally divested our investment banking projects. All in all though, it may be a little easier to meet our objectives in 1992.

Our stock price increased by 98% in 1991, going from a 38% discount to book value (of $17.29) at the beginning of the year to book value (of $21.41) at the end of the year. Since September 1985 our stock price has compounded at 37% annually a very high rate but still less than the growth of underlying book value. As mentioned in last year's annual report, fluctuations in premiums or discounts to book value cause shareholder returns to be greater or lower than returns earned by the company in the short term but in the long term these returns should converge.

On your behalf I would like to thank the Board and the management and employees of all our companies for making 1991 another excellent year in spite of the very difficult economic environment.

March 23, 1992

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

"L O G O"

# CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 1991 AND 1990

**Consolidated Balance Sheets**
*as at December 31, 1991 and 1990*

| | 1991 ($000) | 1990 ($000) |
|---|---|---|
| **Assets** | | |
| Cash and short term investments | 72,362 | 47,835 |
| Accounts receivable | 95,983 | 97,259 |
| Claims in process | 12,523 | 12,616 |
| Income taxes refundable | | 5,994 |
| Prepaid expenses | 3,381 | 6,599 |
| | 184,249 | 170,303 |
| *Portfolio investments* | | |
| Bonds (market value $114,086; 1990 $157,649) | 114,412 | 165,942 |
| Preferred stocks (market value $91,644; 1990 $50,477) | 92,482 | 58,888 |
| Common stocks (market value $56,934; 1990 $45,759) | 61,924 | 63,075 |
| Total (market value $262,664; 1990 $253,885) | 268,818 | 287,905 |
| Other investments (note 2) | 4,651 | 12,544 |
| Deferred premium acquisition costs | 6,128 | 5,505 |
| Capital assets (note 3) | 14,587 | 20,375 |
| Goodwill | 23,995 | 24,587 |
| Other assets (note 4) | 14,136 | 14,768 |
| | 516,564 | 535,987 |

Signed on behalf of the Board

Director
[Prem Watsa's signature]

Director
[Robbert Hartog's signature]

| | 1991 ($000) | 1990 ($000) |
|---|---|---|
| **Liabilities** | | |
| Bank indebtedness (note 5) | 4,480 | 8,771 |
| Short term borrowings (note 5) | 5,807 | 12,197 |
| Accounts payable and accrued liabilities | 37,562 | 38,740 |
| Premium deposits | 3,993 | 9,513 |
| Income taxes payable | 2,476 | |
| | 54,318 | 69,221 |
| Provision for claims | 202,120 | 220,602 |
| Unearned premiums | 55,044 | 52,719 |
| Contingent long term debt (note 6) | 20,445 | 34,081 |
| Long term debt (note 7) | 34,522 | 34,107 |
| Deferred income taxes | 8,866 | 6,378 |
| Non-controlling interest | 16,974 | 16,703 |
| | 337,971 | 364,590 |
| Subordinated convertible debenture (note 8) | 7,500 | 7,500 |
| **Shareholders' Equity** | | |
| Capital stock (note 9) | 30,954 | 31,120 |
| Retained earnings | 85,821 | 63,556 |
| | 116,775 | 94,676 |
| | 516,564 | 535,987 |

**Consolidated Statements of Earnings**
*for the Years Ended December 31, 1991 and 1990*

| | 1991 ($000) | 1990 ($000) |
|---|---|---|
| **Revenue** | | |
| Premiums earned | 90,507 | 78,427 |
| Claims fees | 122,982 | 58,281 |
| Interest and dividends | 26,051 | 20,704 |
| Gains (losses) on investments | (4,512) | 2,278 |
| Equity in earnings of associated companies | | 6,657 |
| Other income | 1,338 | 2,087 |
| Gain on sale of associated company (note 16) | 13,636 | 26,996 |
| | 250,002 | 195,430 |
| **Expenses** | | |
| Losses on claims | 54,267 | 65,932 |
| Operating expenses | 154,849 | 92,248 |
| Interest expense | 8,772 | 8,854 |
| Commissions, net | (351) | 5,158 |
| | 217,537 | 172,192 |
| **Earnings before income taxes** | 32,465 | 23,238 |
| Provision for income taxes (note 11) | 9,832 | 545 |
| **Earnings from operations** | 22,633 | 22,693 |
| Non-controlling interest | (118) | (1,387) |
| **Net earnings** | 22,515 | 21,306 |
| Net earnings per share fully diluted (note 15) | $3.94 | $2.92 |

**Consolidated Statements of Retained Earnings**
*for the Years Ended December 31, 1991 and 1990*

| | 1991 ($000) | 1990 ($000) |
|---|---|---|
| **Retained earnings beginning of year** | 63,556 | 47,329 |
| Net earnings for the year | 22,515 | 21,306 |
| Excess over stated value of shares purchased for cancellation (note 9) | (250) | (5,079) |
| **Retained earnings end of year** | 85,821 | 63,556 |

**Consolidated Statements of Changes in Cash Resources**
*for the Years Ended December 31, 1991 and 1990*

| | 1991 ($000) | 1990 ($000) |
|---|---|---|
| **Operating activities** | | |
| Earnings from operations | 22,633 | 22,693 |
| Amortization | 3,784 | 1,414 |
| Deferred income taxes | 2,488 | (967) |
| Losses (gains) on investments | 4,512 | (29,274) |
| Equity in earnings of associated companies | | (6,657) |
| | 33,417 | (12,791) |
| Decrease in provision for claims | (18,482) | (4,635) |
| Increase (decrease) in unearned premiums | 2,325 | (4,706) |
| Decrease (increase) in cash funds resulting from changes in other operating working capital items | 6,359 | (239) |
| Cash resources provided by (used in) operating activities | 23,619 | (22,371) |
| **Investing activities** | | |
| Portfolio investments net purchases | 14,575 | 87,898 |
| Purchase (sale) of capital assets | 3,333 | (4,563) |
| Other investments | 7,165 | 11,938 |
| Purchase of subsidiaries | | (95,700) |
| | 25,073 | (427) |
| **Financing activities** | | |
| Repurchase of capital stock | (416) | (17,460) |
| Increase in long term debt | 415 | 19,676 |
| Increase (decrease) in contingent note payable | (13,636) | 34,081 |
| Non-controlling interests | 153 | 4,198 |
| | (13,484) | 40,495 |
| **Increase in cash resources** | 35,208 | 17,697 |
| **Cash resources beginning of year** | 26,867 | 9,170 |
| **Cash resources end of year** | 62,075 | 26,867 |

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

**Notes To Consolidated Financial Statements**
*For The Years Ended December 31, 1991 and 1990*
*(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, oil and gas, casualty and life risks and the provision of claims adjusting and appraisal and loss management services in Canada and the United States.

*Principles of consolidation*

The consolidated financial statements include the accounts of the company and all of its subsidiaries: Markel Insurance Company of Canada, Federated Insurance Holdings of Canada Ltd., Commonwealth Insurance Company and Wentworth Insurance Company Ltd., all 100% owned; and Morden & Helwig Group Inc., 50% equity and 90% voting interest. Acquisitions are accounted for by the purchase method, whereby the results of acquired companies are included only from the date of acquisition. Divestitures are included up to the date of disposal.

*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 its 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.

The gains (losses) on investments recorded in the income statement are net of provisions for losses on investments of $7 million (1990 $2.9 million). At December 31, 1991 the aggregate provision for losses on investments was $9.9 million (1990 $2.9 million). Management believes that in time the investments will recover in value but from a conservative accounting perspective it was deemed prudent to make these provisions.

*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.

*Provision for 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 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.

*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. The goodwill is primarily related to the company's investment in Morden & Helwig Group Inc.

## 2. Other Investments

| *Other investments, at cost*: | **1991** *($000)* | **1990** *($000)* |
|---|---|---|
| Real estate | 4,651 | 3,127 |
| Midland Walwyn Inc. debentures | | 8,675 |
| Others | | 742 |
| | 4,651 | 12,544 |

The company has invested in several small real estate projects in Alberta, Texas and Ontario, the major one being a 100% (1990 75%) interest in a shopping mall in Calgary, Alberta. This investment of $2.2 million (1990 $2.4 million) is shown net of a 12.04% mortgage of $5 million (1990 $2.8 million), due June 1994, which is non-recourse to Fairfax Financial Holdings Limited and for which the shopping mall has been pledged as security.

## 3. Capital Assets

| | **1991** *($000)* | **1990** *($000)* |
|---|---|---|
| Land and buildings | 4,147 | 4,811 |
| Furniture and equipment | 22,742 | 21,505 |
| Leasehold improvements | 1,378 | 1,331 |
| Automobiles under capital lease | 412 | 3,446 |
| | 28,679 | 31,093 |
| Accumulated amortization | 14,092 | 10,718 |

| | |
|---|---|
| 14,587 | 20,375 |

## 4. 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 $9,260 (1990 $9,631) for which 649,573 shares (1990 664,982 shares) with a year-end market value of $13,803 (1990 $7,315), have been pledged as security.

## 5. Bank Indebtedness and Short Term Borrowings

Bank indebtedness includes $4,315 (1990 $4,380) for which a general assignment of accounts receivable and claims in process of Morden & Helwig Group Inc. have been pledged as security. Short term borrowings include the current portion of long term debt of $5,807 (1990 $4,192) (note 7). Interest expense on bank indebtedness and short term borrowings amounted to $2,012 (1990 $3,507).

## 6. Contingent Long Term Debt

At December 31, 1991, this comprised two 9.625% contingent notes payable to Federated Mutual Insurance Company for $10.2 million due March 21, 1995 and $10.2 million due March 21, 2000, which are subject to reduction based on development of unpaid claims (note 16). The shares of Federated Insurance Company of Canada and Federated Life Insurance Company of Canada, wholly owned subsidiaries of Federated Insurance Holdings of Canada Ltd., have been pledged as security for the notes. Interest expense on the contingent long term debt amounted to $1,968 (1990 $ 1,364). At December 31, 1990, in addition to the 9.625% contingent notes payable described above, there was a contingent note payable to Markel Corporation in connection with the sale of F-M Acquisition Corporation ("F-M") to Markel Corporation. This note was extinguished in 1991.

## 7. Long Term Debt

The long term debt primarily represents a revolving credit facility due in May 1993 and April 27, 1994 and various U.S. dollar bank loans of Morden & Helwig Group Inc. at an average annual rate of 8.68% (1990 9.4%). Shares of two subsidiary insurance companies and shares of Morden & Helwig Group Inc. have been pledged as security for the loans. Interest expense on long term debt amounted to $4,154 (1990 $4,709).

Principal repayments on these loans are due as follows:

| | | |
|---|---|---|
| 1992 | $ 5,807 | |
| 1993 | 10,088 | |
| 1994 | 23,155 | |
| 1995 | 1,228 | |
| 1996 | 21 | |
| Thereafter | 30 | |
| | | $40,329 |
| Less: current portion | 5,807 | |
| | $34,522 | |

## 8. Subordinated Convertible Debenture

The debenture bears interest at a rate of 8.5% per annum, matures on April 30, 1993, is convertible until maturity into subordinate voting shares of Fairfax at $19 per share, and is prepayable under certain circumstances. Interest expense on the debenture amounted to $638 (1990 $638). On February 14, 1992 the debenture was converted into 394,736 subordinate voting shares.

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

*Issued capital*

| | 1991 | | 1990 | |
|---|---|---|---|---|
| | *number* | *($000)* | *number* | *($000)* |
| Subordinate voting shares | 3,907,297 | 25,954 | 3,928,797 | 26,120 |
| Multiple voting shares | 1,548,000 | 5,000 | 1,548,000 | 5,000 |
| | 5,455,297 | 30,954 | 5,476,797 | 31,120 |

Under the terms of a normal course issuer bid approved by The Toronto Stock Exchange the company purchased and cancelled 21,500 (1990 188,898) subordinate voting shares for an aggregate cost of $416 (1990 $2,605), of which $250 (1990 $1,198) was charged to retained earnings.

On December 18, 1990 the company received and cancelled 800,000 multiple voting and 850,505 subordinate voting shares as partial consideration for the sale of F-M to Markel Corporation. The value attributed to these shares was $14,855 based on a $9 share price on the date the transaction was completed of which $3,881 was charged to retained earnings.

## 10. 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 of $1 million. 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, 1991 provision for claims reflects recoveries from reinsurers of $127,140 (1990 $175,453). During the year, the company ceded $54,071 (1990 $19,794) of premium income and $59,694 (1990 $40,740) of claims incurred.

## 11. Income Taxes

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.

A reconciliation of income tax calculated at the statutory marginal tax rate with the income tax provision at the effective tax rate in the financial statements is summarized below:

| | 1991 | 1990 |
|---|---|---|
| | *$* | *$* |
| Provision for taxes at Canadian | | |

| | | |
|---|---|---|
| statutory marginal income tax rate | 14,382 | 10,294 |
| Non-taxable capital gains | (886) | (3,242) |
| Non-taxable investment income | (2,260) | (1,201) |
| Equity earnings of associated companies | | (2,949) |
| Utilization of prior years' losses | (1,404) | (2,357) |
| Provision for income taxes at effective rate | 9,832 | 545 |

## 12. Statutory Requirements Insurance Subsidiaries

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

## 13. Contingencies and Commitments

Subsidiaries of the company are defendants in several damage suits and have been named as third party in other suits. The uninsured exposure to the company is not considered to be material.

The company has a joint and several agreement with Agra Industries Limited to guarantee a $6,000 (1990 $6,000) loan by the Alberta Opportunity Company and a $5,500 (1990 $5,500) bank operating line of credit made to Carbovan Inc. The guarantee is secured by certain assets of the investee company.

## 14. Operating Leases

Aggregate future commitments at December 31, 1991 under operating leases relating to premises, automobiles and equipment for various terms up to 10 years are as follows:

| | |
|---|---|
| 1992 | $9,631 |
| 1993 | 8,041 |
| 1994 | 8,297 |
| 1995 | 4,732 |
| 1996 | 3,268 |
| Thereafter | 2,009 |
| | $35,978 |

## 15. 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 $4.11 for 1991 and $2.99 for 1990. The weighted average number of shares for 1991 was 5,870,638 (1990 7,524,283) on a fully diluted basis.

## 16. Acquisitions and Disposals

On March 21, 1990 the company purchased Federated Insurance Holdings of Canada Ltd. from Federated Mutual Insurance Company of Owatonna, Minnesota. The purchase price of $28.6 million for common equity of $27 million was paid with two contingent notes and $8.2 million cash. Federated Insurance Holdings of Canada Ltd. had $116 million in total assets and $89 million in total liabilities as at March 21, 1990. The excess of the purchase price paid over the fair value of net assets acquired was allocated to provision for claims. Federated is engaged in property and casualty and life insurance business in Canada.

On November 14, 1990 the company purchased Commonwealth Insurance Company of Vancouver, British Columbia from The Home Insurance Company, a subsidiary of AmBase Corporation, for US $49.35 (Cdn $57.5) million. Commonwealth Insurance had $209.7 million in total assets, $141.9 million in total liabilities and $67.8 million in equity as at October 31, 1990. The excess of the fair value of net assets acquired over the purchase price paid was allocated $5 million to investments and $5.3 million to provision for claims. Commonwealth is engaged in commercial property and oil and gas insurance in Canada, the United States and internationally and commercial casualty insurance in Canada.

Effective December 18, 1990 the company's 50% owned subsidiary, Morden & Helwig Group Inc., acquired the remaining 50% common share interest in Lindsey & Newsom Claim Services, Inc. and the remaining 50.5% common share interest in Vale National Training Center, Inc. both of Tyler, Texas from Markel Corporation. The transaction was accounted for by the purchase method. The operating results were equity accounted to the date of acquisition and consolidated thereafter.

On December 18, 1990 the company sold to Markel Corporation its 47.5% common and its preferred share interest in F-M with a carrying value of $34.7 million. In consideration the company received and cancelled 850,505 subordinate voting shares and 800,000 multiple voting shares previously held by Markel Corporation, preferred shares of Lindsey & Newsom Claim Services, Inc. of Tyler, Texas, having a par value of US $7 million, cash of US $33.5 million, and a contingent note receivable of US $11.5 million. This transaction resulted in a gain of $26,996 in 1990 and an additional gain of $13,636 in 1991 when the contingent note was extinguished.

## 17. Related Party Transactions

During the year the company and its subsidiaries purchased investment counselling services, in the normal course of business and on normal market terms, from Hamblin Watsa Investment Counsel Ltd., a company in which an officer of the company has significant interests. The cost of these services amounted to $634 in 1991 (1990 $784).

## 18. Segmented Information

The company is a financial services holding company which through its subsidiaries and affiliates is engaged in the insurance of commercial property, oil and gas, casualty and life risks and the provision of claims adjusting and appraisal and loss management services in Canada and the United States.

*(a) Industry segments*

| | Insurance | | Claims Adjusting, Appraisal and Loss Management | | Corporate and Consolidation Adjustments | | Consolidated | |
|---|---|---|---|---|---|---|---|---|
| | **1991** | **1990** | **1991** | **1990** | **1991** | **1990** | **1991** | **1990** |
| | *($000)* | *($000)* | *($000)* | *($000)* | *($000)* | *($000)* | *($000)* | *($000)* |
| Revenue | 116,038 | 101,639 | 122,982 | 58,449 | 10,982 | 35,342 | 250,002 | 195,430 |
| Equity earnings | | 4,533 | | 255 | | 1,869 | | 6,657 |
| Earnings before income taxes | 28,516 | 12,627 | 2,390 | 5,253 | 1,559 | 5,358 | 32,465 | 23,238 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Identifiable assets | 432,694 | 441,453 | 75,488 | 76,788 | 8,382 | 17,746 | 516,564 | 535,987 |
| Amortization | 1,256 | 7 | 2,148 | 987 | 380 | 420 | 3,784 | 1,414 |
| Interest expense | | 256 | 1,298 | 668 | 7,474 | 7,930 | 8,772 | 8,854 |

*(b) Geographic segments*

| | **Canadian** | | **United States** | | **Total** | |
|---|---|---|---|---|---|---|
| | **1991** *($000)* | **1990** *($000)* | **1991** *($000)* | **1990** *($000)* | **1991** *($000)* | **1990** *($000)* |
| Revenue | 166,029 | 176,873 | 83,973 | 18,557 | 250,002 | 195,430 |
| Equity earnings | | 1,869 | | 4,788 | | 6,657 |
| Earnings before income taxes | 28,168 | 17,040 | 4,297 | 6,198 | 32,465 | 23,238 |
| Identifiable assets | 361,204 | 391,697 | 155,360 | 144,290 | 516,564 | 535,987 |
| Amortization | 2,560 | 1,414 | 1,224 | | 3,784 | 1,414 |
| Interest expense | 8,080 | 8,854 | 692 | | 8,772 | 8,854 |

CORPORATE CHART
March 1, 1992
setting out Fairfax and its principal operating companies

```
                          Fairfax Logo
                               |
  _____________________________|____________________________
  |           |        |    |          |                |
Commonwealth    Federated      |    Markel      Wentworth         |--  Morden & Helwig
 Insurance     Insurance     |   Insurance    Insurance        |     Group Inc.
  Company       Company      |    Company       Company         |
(Canada, U.S.)  of Canada     |    of Canada     (Barbados)       |
                   |                      |
                   |                      |
                   |                      |  Lindsey Morden Claim
        Federated     |                         |--  Services Limited
     Life Insurance__|                             |
         Company                                 |
        of Canada                                |
                                          |  Lindsey Morden Claim
                                          |--    Services, Inc.
                                          |         (U.S.)
                                          |
                                          |
                                          |
                                          |     Vale National
                                          |---Training Center,
                                          |     Inc. (U.S.)
                                          |
                                          |
                                          |
                                          |   Lindsey Morden
                                          |-- Claim Services
                                              (Holdings) Ltd.
                                                  (U.K.)
```

*Note:*

*1) All companies are wholly owned except Morden & Helwig Group Inc., a public company of which Fairfax owns 50% (1990 -48%) of the equity and 90% of the votes.*

*2) All companies carry on business in Canada except as otherwise noted.*

February 14, 1992

**Auditors' Report to the Shareholders**

We have audited the consolidated balance sheets of Fairfax Financial Holdings Limited as at December 31, 1991 and 1990 and the consolidated statements of earnings, retained earnings and changes in cash resources for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1991 and 1990 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.

Coopers & Lybrand
Chartered Accountants
Toronto, Ontario

February 14, 1992

**Report of the Property-Casualty Valuation Actuary**

The Wyatt Company has made the valuation of the net claims liabilities of the subsidiary general insurance companies of Fairfax Financial Holdings Limited for Fairfax's consolidated balance sheet at December 31, 1991 and its consolidated statement of earnings for the year then ended, except for the Commonwealth Insurance Company for which we have relied upon the valuation made by J. S. Cheng & Partners Inc. In our opinion:

(i) the amount of claim 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, 1992; and

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

The Wyatt Company
Actuaries and Consultants

**Management's Discussion and Analysis of Financial Condition and Results of Operations**
*(in $000s except per share amounts)*

## Sources of Revenue

Revenue reflected in the consolidated financial statements includes premiums earned and investment income of the insurance companies, claims adjusting fees of Morden & Helwig and gains on sale of associated companies and other miscellaneous income. The following table summarizes the total revenue derived from these categories from the date of acquisition for the past seven years:

| *Revenue by Lines of Business* | **1991** *($000s)* | **1990** *($000s)* | **1989** *($000s)* | **1988** *($000s)* | **1987** *($000s)* | **1986** *($000s)* | **1985** *($000s)* |
|---|---|---|---|---|---|---|---|
| Insurance | 116,038 | 101,639 | 74,975 | 88,512 | 73,241 | 46,515 | 16,963 |
| Claims adjusting | 122,982 | 58,449 | 49,414 | 44,157 | 39,316 | 6,850 | |
| Other income | 10,982 | 35,342 | 1,365 | 980 | 414 | 368 | |
| | 250,002 | 195,430 | 125,754 | 133,649 | 112,971 | 53,733 | 16,963 |

Total revenue in 1991 was $250 million, an increase of $55 million or 28% over 1990 revenue of $195 million.

Three transactions were primarily responsible for the increase in revenue. Firstly, the 1991 insurance totals reflect twelve months' results of Commonwealth Insurance Company acquired in November 1990, compared to two months' results in 1990.

Secondly, effective December 18, 1990 Morden & Helwig acquired the remaining 50% common share interest in Lindsey & Newsom, and the 1991 claims adjusting revenue reflects twelve months' results for both the Canadian and U.S. operations.

Finally, the equity accounted F-M Acquisition was sold resulting in a gain on sale of $26,996 in 1990 and a further gain of $13,636 in 1991 when the contingent proceeds were settled.

On a geographic basis, Canadian operations accounted for approximately 66% of group revenue and 87% of group operating profits in 1991, compared with 91% of revenue and 73% of operating profits in 1990.

**Net Earnings**

Sources of net earnings on a pre-tax basis with the total tax effect to the company and its consolidated subsidiaries shown as a separate item, were as follows for the past seven years:

| *Sources of Net Earnings by Line of Business* | **1991** *($000s)* | **1990** *($000s)* | **1989** *($000s)* | **1988** *($000s)* | **1987** *($000s)* | **1986** *($000s)* | **1985** *($000s)* |
|---|---|---|---|---|---|---|---|
| Insurance | 30,680 | 6,786 | (3,370) | 6,468 | 8,539 | 9,594 | (1,122) |
| Equity accounted F-M Acquisition | 13,636 | 31,530 | 7,240 | 6,729 | 18 | | |
| Total insurance | 44,316 | 38,316 | 3,870 | 13,197 | 8,557 | 9,594 | (1,122) |
| Claims adjusting (50% equity) | 117 | 1,688 | 1,543 | 1,454 | 5,849 | 539 | |
| Investment banking | (1,058) | (6,370) | (1,439) | | | | |
| Interest and corporate expenses | (6,516) | (9,061) | (1,499) | (2,799) | (1,668) | (353) | (277) |
| Realized investment gains | 2,488 | 5,178 | 15,458 | 7,802 | 9,159 | 952 | 459 |
| Provisions for future potential losses | (7,000) | (7,900) | | | | | |
| Net earnings before taxes | 32,347 | 21,851 | 17,933 | 19,654 | 21,897 | 10,732 | (940) |
| Provision for income taxes | 9,832 | 545 | 1,192 | 5,297 | 5,878 | 4,184 | (30) |
| Net earnings | 22,515 | 21,306 | 16,741 | 14,357 | 16,019 | 6,548 | (910) |

Net earnings in 1991 were $22.5 million, an increase of $1.2 million or 6% over 1990 net earnings of $21.3 million.

The major changes which affected net earnings were:

Insurance underwriting results improved by $17.8 million over 1990

Insurance interest and dividend income increased by $6.1 million over 1990

1990 reflects a gain on the sale of F-M of $26,996 and equity earnings of $4,533 versus a gain in 1991 of $13,636

The equity share of claims adjusting net earnings decreased by $1.6 million from 1990

Investment banking expenses decreased by $5.3 million

The tax provision increased to $9.8 million (effective rate 30.3%) versus the 1990 provision of $545 (effective rate 2.3%) because previous years' loss carry forwards and deductions were used in 1990 and the investment income mix changed.

**Insurance Underwriting**
Fairfax's insurance companies employ disciplined underwriting practices with the objective of rejecting underpriced risks. The combined loss and expense ratio is the traditional measure of underwriting results of property and casualty companies. In any year when the ratio exceeds 100%, it generally indicates that unprofitable business has been underwritten.

A summary follows of the net premiums written and earned, and the loss, expense and combined ratios for each of the past seven years.

| | NET PREMIUMS | | RATIOS | | |
|---|---|---|---|---|---|
| | **Written** | **Earned** | **Losses** | **Expenses** | **Combined** |
| | *($000s)* | *($000s)* | *%* | *%* | *%* |
| 1985 | 23,415 | 14,049 | 96 | 30 | 126 |
| 1986 | 55,992 | 40,885 | 72 | 23 | 95 |
| 1987 | 71,378 | 62,012 | 73 | 25 | 98 |
| 1988 | 68,224 | 66,265 | 73 | 19 | 92 |
| 1989 | 35,477 | 40,444 | 100 | 40 | 140 |
| 1990 | 74,487 | 78,427 | 82 | 31 | 113 |
| 1991 | 93,450 | 90,507 | 60 | 34 | 94 |

In 1991 the loss ratio improved in most lines due to firm underwriting standards to produce a total 94% combined ratio.

Net premiums written and earned by line for the past four years are shown in the following table:

| *Operational area* | | **1991** *($000s)* | **1990** *($000s)* | **1989** *($000s)* | **1988** *($000s)* |
|---|---|---|---|---|---|
| Commercial auto, general liability | Written | 13,190 | 15,654 | 28,795 | 41,677 |
| | Earned | 13,042 | 19,938 | 31,980 | 42,006 |
| Farm and reinsurance run off | Written | 9,969 | 10,393 | 6,682 | 26,547 |
| | Earned | 7,552 | 10,287 | 8,464 | 24,259 |
| Direct commercial lines | Written | 37,249 | 40,012 | | |
| | Earned | 38,838 | 40,858 | | |

| | | | | |
|---|---|---|---|---|
| Commercial property and casualty | Written 33,042<br>Earned 31,075 | 8,428<br>7,344 | | |
| Totals | Written 93,450<br>Earned 90,507 | 74,487<br>78,427 | 35,477<br>40,444 | 68,224<br>66,265 |

Commercial auto and direct commercial premium volume has decreased due to aggressive price competition.

Farm and reinsurance run off premium has declined as the book of business of the reinsurance company was sold in 1989.

Commercial property and casualty premium shows an increase as a result of the timing of the acquisition in 1990. 1991 reflects a full year of operation under Fairfax.

The total underwriting profit (loss) by line for the insurance companies for the past four years is shown in the following table:

| | 1991 | 1990 | 1989 | 1988 |
|---|---|---|---|---|
| | *($000s)($000s)($000s)($000s)* | | | |
| Commercial auto, general liability | 6,121 | (8,708)(12,964) | 1,172 | |
| Farm and reinsurance run off | (1,181)(327) | 1,049 | (822) | |
| Direct commercial lines | 184 | (2,472) | | |
| Commercial property and casualty | 196 | (997) | | |
| | 5,320 | (12,504)(11,915) | 350 | |

The losses in commercial auto and general liability in 1989 and 1990 were the result of surety losses and that book of business was discontinued in 1990. The underwriting profit in 1991 in commercial auto and general liability is primarily a result of recoveries related to surety business. Surety is not expected to affect future results in any significant way.

Direct commercial lines, commercial property and casualty all improved from 1990 due to better quality risk selection.

**Insurance Environment**

The property and casualty insurance market in general experienced another year of poor underwriting results with combined ratios expected in the 110% range for 1991. Insurance companies continue to write insurance at inadequate prices, and until large underwriting losses are incurred the insurance market will remain extremely price competitive.

**Interest and Dividend Income**

The majority of interest and dividend income is earned by the insurance companies. The Commonwealth and Federated acquisitions added $129,751 and $100,837 respectively to the investment portfolio at the end of 1990, and interest and dividend income for Commonwealth was included for two months only in 1990.

| | Average Investments | Interest and Dividend | Income |
|---|---|---|---|

| | at Book Value ($000s) | Income ($000s) | Yield % |
|---|---|---|---|
| 1985 | 29,060 | 2,455 | 8.45 |
| 1986 | 64,181 | 4,678 | 7.29 |
| 1987 | 109,825 | 8,042 | 7.32 |
| 1988 | 130,782 | 8,922 | 6.82 |
| 1989 | 135,703 | 11,628 | 8.57 |
| 1990 | 237,868 | 20,704 | 8.70 |
| 1991 | 338,461 | 26,051 | 7.70 |

The income yield earned declined in 1991 to 7.7% as a result of the decline in interest rates in the latter half of 1991. Investments for the past seven years are shown in the following table, at the average of their carrying values at the beginning and end of each year:

*Investment Portfolio Composition*

| | Cash and Short Term Investments ($000s) | Bonds ($000s) | Preferreds ($000s) | Common ($000s) | Total ($000s) |
|---|---|---|---|---|---|
| 1985 | 10,526 | 15,388 | 732 | 2,414 | 29,060 |
| 1986 | 16,605 | 24,523 | 7,979 | 15,074 | 64,181 |
| 1987 | 28,025 | 26,242 | 16,516 | 39,042 | 109,825 |
| 1988 | 29,843 | 23,575 | 25,191 | 52,173 | 130,782 |
| 1989 | 20,623 | 28,528 | 32,212 | 54,340 | 135,703 |
| 1990 | 33,596 | 99,220 | 45,652 | 59,400 | 237,868 |
| 1991 | 60,099 | 140,177 | 75,685 | 62,500 | 338,461 |

**Return on Investment Portfolio**

The following table shows the performance of the investment portfolio for the past seven years. The total return includes all interest and dividend income, gains (losses) on the disposal of securities and the change in the unrealized gains (losses) during the year.

| | Average Investments at Book | Dividends and Interest Earned | Gains (Losses) | Change in Unrealized Gains (Losses) | Total Return on Average Investment | Percentage Return |
|---|---|---|---|---|---|---|

| | | | | | | |
|---|---|---|---|---|---|---|
| 1985 | 29,060 | 2,455 | 459 | 878 | 3,792 | 13% |
| 1986 | 64,181 | 4,678 | 952 | (352) | 5,278 | 8% |
| 1987 | 109,825 | 8,042 | 9,159 | (7,976) | 9,225 | 8% |
| 1988 | 130,782 | 8,922 | 7,802 | 12,131 | 28,855 | 22% |
| 1989 | 135,703 | 11,628 | 15,458 | (6,272) | 20,814 | 15% |
| 1990 | 237,868 | 20,704 | 2,278 | (32,943) | (9,961) | (4%) |
| 1991 | 338,461 | 26,051 | (4,512) | 27,866 | 49,405 | 15% |

Investment gains (losses) have been an important component of Fairfax's net earnings since 1985. The amount has fluctuated significantly from period to period, but the amount of investment gains (losses) for any period have no predictive value and variations in amount from period to period have no practical analytical value.  The gains (losses) on investments recorded in the statement of earnings for 1991 are net of provisions for losses on investments of $7 million (1990 $2.9 million).  At December 31, 1991 the aggregate provision for losses on investments was $9.9 million (1990 $2.9 million).  At December 31, 1991 the Fairfax investment portfolio had an unrealized loss of $6.1 million compared to an unrealized loss at December 31, 1990 of $34 million.

The company expects continuing fluctuations in the stock market and continues to maintain its long term value oriented investment philosophy.

**Capital Resources**

At December 31, 1991 total capital funds, comprising shareholders' equity, subordinated convertible debenture and non-controlling (minority) interest, were $141.3 million, compared to $118.9 million at December 31, 1990.

The following table shows the level of capital for the last three years:

| | *December 31* *($ millions)* | | |
|---|---|---|---|
| | **1991** | **1990** | **1989** |
| Non-controlling interest | 17.0 | 16.7 | 10.7 |
| Subordinated convertible debenture | 7.5 | 7.5 | 7.5 |
| Shareholders' equity | 116.8 | 94.7 | 90.8 |
| | 141.3 | 118.9 | 109.0 |

Fairfax's consolidated balance sheet as at December 31, 1991 reflects a significant improvement in capital strength from 1990.  Fairfax shareholders' equity has increased from $94.7 million at December 31, 1990 to $116.8 million at December 31, 1991.  In 1991 the company purchased and cancelled 21,500 subordinate voting shares at an average price of $19.35.  Also, on February 14, 1992 the $7.5 million subordinated convertible debenture was converted into 394,736 subordinate voting shares, increasing shareholders' equity to over $124 million.

In November 1991 Fairfax received approval from The Toronto Stock Exchange to purchase up to 320,500 subordinate voting shares of the company under normal course issuer bid regulations.

**Liquidity**
The purpose of liquidity management is to ensure that there is sufficient cash to meet all financial commitments and obligations as they fall due.

Fairfax has the financial flexibility to obtain from internal or external sources the funds needed to fulfil its cash requirements during the current financial year. Cash requirements for Fairfax in 1992 include debt servicing and administration expense, totalling about $6 million. Total dividends available from regulated insurance companies in 1992 are $9 million. The insurance subsidiaries of Fairfax are regulated in their various jurisdictions of operation. As at December 31, 1991 all our insurance companies met the standards set by the applicable regulatory authorities.

Interest expense decreased in 1991 to $8.8 million from $8.9 million due to lower interest rates.

In September 1991 the contingent long term debt declined by $13.6 million when the contingent note related to the 1990 sale of F-M Acquisition was extinguished.

In December 1991 the company paid down bank debt by $10 million as a result of combining three insurance companies into Markel Insurance.

As a result the debt to equity ratio with Morden & Helwig equity accounted decreased to 0.4:1 at December 31, 1991 compared to 0.7:1 at December 31, 1990. The company intends to reduce debt by another $10 to $20 million in 1992, barring any acquisition activity.

The company has not and does not intend to pay dividends as long as it can reinvest the funds and earn a 20% return on equity.

At December 31, 1991 Fairfax had $54 million of revolving lines of credit of which $30 million was utilized.

**Fairfax Insurance Companies**

**Combined Statements of Earnings**
*for the years ended December 31, 1991 and 1990*
*(unaudited)*

| | **1991** *($000)* | **1990** *($000)* |
|---|---|---|
| **Revenue** | | |
| Premiums earned | 90,507 | 78,427 |
| Interest and dividends | 25,361 | 19,290 |
| Realized gains (losses) on investments | (2,165) | 1,308 |
| Equity in earnings of associated companies | | 4,533 |
| Other income | 2,335 | (1,919) |
| | 116,038 | 101,639 |
| **Expenses** | | |
| Losses on claims | 54,267 | 63,986 |
| Operating expenses | 33,606 | 19,868 |
| Commissions, net | (351) | 5,158 |
| | 87,522 | 89,012 |
| Earnings before income taxes | 28,516 | 12,627 |
| Provision for income taxes | 7,676 | (1,660) |
| **Net earnings** | 20,840 | 14,287 |

**Fairfax Insurance Companies**

Fairfax's insurance business is conducted by five subsidiaries. The companies underwrite a wide range of commercial property and oil and gas insurance in Canada, the United States and internationally as well as commercial casualty, commercial truck and smaller amounts of property, casualty, life, health and disability insurance in Canada.

**Fairfax Insurance Companies**
**Combined Balance Sheets**
*as at December 31, 1991 and 1990*
*(unaudited)*

| | 1991 ($000) | 1990 ($000) |
|---|---|---|
| **Assets** | | |
| Cash and short term investments | 72,141 | 55,982 |
| Accounts receivable | 71,802 | 75,310 |
| Income taxes refundable | | 7,228 |
| | 143,943 | 138,520 |
| *Portfolio investments* | | |
| Bonds | 114,506 | 168,942 |
| Preferred stocks | 94,100 | 60,295 |
| Common stocks | 64,409 | 63,593 |
| | 273,015 | 292,830 |
| Deferred premium acquisition costs | 6,128 | 5,505 |
| Capital assets | 5,545 | 3,841 |
| Other assets | 2,650 | 6,894 |
| | 431,281 | 447,590 |
| **Liabilities** | | |
| Accounts payable and accrued liabilities | 24,578 | 24,432 |
| Premium deposits | 3,993 | 9,513 |
| Income taxes payable | 2,441 | |
| | 31,012 | 33,945 |
| Provision for claims | 194,927 | 217,023 |
| Unearned premiums | 55,044 | 52,719 |
| Deferred income taxes | 5,706 | 6,309 |
| | 255,677 | 276,051 |
| **Shareholders' Equity** | | |
| Capital stock | 67,204 | 68,209 |
| Retained earnings | 77,388 | 69,385 |
| | 144,592 | 137,594 |

| | | |
|---|---|---|
| | | |
| | 431,281 | 447,590 |

**Fairfax with Equity Accounting of Morden & Helwig**
**Consolidated Balance Sheets**
*as at December 31, 1991 and 1990*
*(unaudited)*

| | 1991 ($000) | 1990 ($000) |
|---|---|---|
| **Assets** | | |
| Cash and short term investments | 72,038 | 47,659 |
| Accounts receivable | 74,235 | 75,344 |
| Income taxes refundable | | 7,228 |
| Prepaid expenses | 2,132 | 5,037 |
| | 148,405 | 135,268 |
| *Portfolio investments* | | |
| Bonds | 114,412 | 165,942 |
| Preferred stocks | 92,100 | 58,295 |
| Common stocks | 61,924 | 63,075 |
| | 268,436 | 287,312 |
| Investment in Morden & Helwig | 24,874 | 24,304 |
| Other investments | 4,651 | 12,044 |
| Deferred premium acquisition costs | 6,128 | 5,505 |
| Capital assets | 5,635 | 4,031 |
| Other assets | 9,888 | 9,705 |
| | 468,017 | 478,169 |
| **Liabilities** | | |
| Bank indebtedness | 165 | 297 |
| Short term borrowings | | 6,761 |
| Accounts payable and accrued liabilities | 23,174 | 23,100 |
| Premium deposits | 3,993 | 9,513 |
| Income taxes payable | 2,441 | |
| | 29,773 | 39,671 |
| Provision for claims | 202,120 | 220,602 |
| Unearned premiums | 55,044 | 52,719 |
| Contingent long term debt | 20,445 | 34,081 |
| Long term debt | 30,654 | 24,779 |
| Deferred income taxes | 5,706 | 4,141 |
| | 313,969 | 336,322 |
| Subordinated convertible debenture | 7,500 | 7,500 |

**Shareholders' Equity**

| | | |
|---|---|---|
| Capital stock | 30,954 | 31,120 |
| Retained earnings | 85,821 | 63,556 |
| | 116,775 | 94,676 |
| | 468,017 | 478,169 |

**Morden & Helwig Group Inc.**
**Consolidated Balance Sheets**
*as at December 31, 1991 and 1990*

| | **1991** ($000) | **1990** ($000) |
|---|---|---|
| **Assets** | | |
| Cash | 324 | 178 |
| Accounts receivable | 20,640 | 20,780 |
| Claims in process | 12,523 | 12,616 |
| Prepaid expense | 1,249 | 1,572 |
| Net assets of discontinued operations | | 145 |
| | 34,736 | 35,291 |
| Notes receivable | 1,108 | 868 |
| Investments | 381 | 1,093 |
| Fixed assets | 8,952 | 13,339 |
| Other assets | 30,311 | 26,196 |
| | 75,488 | 76,787 |
| **Liabilities** | | |
| Bank indebtedness | 4,315 | 8,422 |
| Accounts payable and accrued liabilities | 10,546 | 9,022 |
| Income taxes payable | 35 | 1,234 |
| Long-debt current portion | 5,807 | 4,192 |
| Deferred income taxes | 3,160 | 3,208 |
| Net liabilities of discontinued operations | 268 | |
| | 24,131 | 26,078 |
| Long-term debt | 3,869 | 8,357 |
| Future retirement payments | 5,758 | 6,060 |
| Minority interest | | 1,804 |
| | 9,627 | 16,221 |
| Subordinated convertible debenture | 7,900 | |

**Shareholders' Equity**

| | | |
|---|---|---|
| Capital stock | 21,831 | 22,231 |
| Retained earnings | 11,999 | 12,257 |
| | 33,830 | 34,488 |
| | 75,488 | 76,787 |

**Morden & Helwig Group Inc.**
**Consolidated Statements of Earnings**
*for the years ended December 31, 1991 and 1990*

| | 1991 ($000) | 1990 ($000) |
|---|---|---|
| **Revenue** | 122,460 | 58,224 |
| Cost of service | 91,711 | 41,219 |
| Selling, general and administration | 25,685 | 11,406 |
| Interest | 1,298 | 668 |
| Gain on disposal of assets | (595) | (97) |
| | 118,099 | 53,196 |
| **Earnings before income taxes** | 4,361 | 5,028 |
| Income taxes | 2,156 | 2,205 |
| Earnings before equity income | 2,205 | 2,823 |
| Equity income | | 329 |
| **Earnings from continuing operations** | 2,205 | 3,152 |
| **Discontinued operations** | (1,971) | (104) |
| **Net earnings** | 234 | 3,048 |

**Consolidated Statements of Retained Earnings**
*for the years ended December 31, 1991 and 1990*
*(unaudited)*

| | 1991 ($000) | 1990 ($000) |
|---|---|---|
| **Retained earnings - beginning of year** | 12,257 | 9,629 |
| Net earnings for the year | 234 | 3,048 |
| Dividends | (492) | (447) |
| Appraisal increase realized | | 27 |
| **Retained earnings - end of year** | 11,999 | 12,257 |

*These condensed financial statements have been prepared from the Morden & Helwig Group Inc. audited consolidated financial statements for the years ended December 31, 1991 and 1990, copies of which are available on request.*

## **Consolidated Financial Summary** *($000 except per share amounts)*

| | *For the years ended December 31* | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **1991** | **1990** | **1989** | **1988** | **1987** | **1986** | **1985** | **1984** | **1983** | **1982** |
| **Revenue** | | | | | | | | | | |
| Premiums earned | 90,507 | 78,427 | 40,444 | 66,265 | 62,012 | 40,885 | 14,049 | 16,616 | 19,621 | 14,443 |
| Claims fees | 122,982 | 58,281 | 49,092 | 43,349 | 33,529 | 6,850 | | | | |
| Interest and dividends | 26,051 | 20,704 | 11,628 | 8,922 | 8,042 | 4,678 | 2,455 | 2,337 | 2,009 | 2,198 |
| Realized gains (losses) on investments | (4,512) | | 2,278 | 15,458 | 7,802 | 9,159 | 952 459 | 25 | 215 | (66) |
| Equity earnings | | 6,657 | 6,367 | 6,729 | 18 | | | | | |
| Other income | 1,338 | 2,087 | 2,765 | 582 | 211 | 368 | | | | |
| Gain on sale of associated company | 13,636 | 26,996 | | | | | | | | |
| *Total Revenue* | 250,002 | 195,430 | 125,754 | 133,649 | 112,971 | 53,733 | 16,963 | 18,978 | 21,845 | 16,575 |
| **Earnings** | | | | | | | | | | |
| Earnings before income taxes | 32,465 | 23,238 | 19,204 | 21,324 | 18,203 | 9,085 | (880) | (4,854) | 308 | 476 |
| Extraordinary items | | | | | 1,700 | 1,711 | | | | |
| *Net Earnings* | 22,515 | 21,306 | 16,741 | 14,357 | 16,019 | 6,548 | (910) | (4,775) | 280 | 218 |
| **Total Assets** | 516,564 | 535,987 | 248,065 | 246,786 | 185,413 | 129,845 | 41,477 | 31,401 | 32,325 | 28,739 |
| *Cash and Investments* | 341,180 | 335,740 | 133,858 | 137,548 | 124,016 | 95,633 | 32,728 | 25,391 | 24,218 | 20,337 |
| *Debt* | 60,774 | 80,385 | 14,431 | 22,061 | 3,067 | 3,000 | 1,000 | 300 800 | | |
| *Shareholders' Equity* | 116,775 | 94,676 | 90,830 | 74,176 | 61,048 | 41,275 | 10,379 | 2,287 | 7,062 | 6,782 |
| *Number of Shares Fully Diluted* | 5,871 | 7,524 | 7,712 | 7,718 | 7,336 | 7,007 | 5,000 | 616 | 616 | 616 |
| *Return on Average Shareholders' Equity* | 21.3% | 23.0% | 20.3% | 21.2% | 31.3% | 25.4% | | 4.1%3.3% | | |
| **Per Common Share** | | | | | | | | | | |
| Net earnings fully diluted | 3.94 | 2.92 | 2.25 | 1.94 | 2.23 | 1.35 | (1.89) | (7.75) | 0.45 | 0.35 |
| Shareholders' equity | 21.41 | 17.29 | 12.41 | 10.13 | 8.32 | 5.89 | 2.08 | 3.71 | 11.46 | 11.01 |

Readers of this Management's Discussion and Analysis should review the entire annual report for additional commentary and information.

## Directors of the Company

H. Anthony Arrell
President, Laucam Holdings Limited

Winslow W. Bennett
President, Winwood Holdings Ltd.

Robbert Hartog
President, Robhar Investments Ltd.

Steven A. Markel
Vice Chairman and Treasurer,
Markel Corporation

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

John Puddington
President, Trucena Investments Limited

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

*Audit Committee Member*
*Investment Committee Member*

## Operating Management

John B. O. Watson
President
Commonwealth Insurance Company

John Paisley
President
Federated Insurance Company of Canada
and
Federated Life Insurance Company of Canada

William S. Grant
President
Markel Insurance Company of Canada

Kenneth R. Polley
President
Morden & Helwig Group Inc.

**Officers of the Company**

Brenda Adams
Corporate Secretary

Sam Chan
Vice President

J. Paul T. Fink
Vice President

Eric P. Salsberg
Vice President, Corporate Affairs

Ronald Schokking
Vice President, Finance

John C. Varnell
Vice President and
Chief Financial Officer

V. Prem Watsa
Chairman and Chief Executive Officer

**Head Office**

95 Wellington Street West
Suite 800
Toronto, Ontario M5J 2N7
Telephone (416) 367-4941

*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

---

*Annual Meeting*
The annual meeting of shareholders of Fairfax Financial Holdings Limited will be held on Wednesday, May 13, 1992 at 4.30 p.m. at The Toronto Stock Exchange