FAIRFAX

FINANCIAL HOLDINGS LIMITED

1997 Annual Report

Contents

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Five Year Financial Highlights

(in $ millions except share and per share data)

	1997	1996	1995	1994	1993
Revenue	2,088.3	1,475.8	1,145.5	634.9	344.0
Net earnings	232.5	150.8	87.5	38.1	33.3
Total assets *	10,207.3	5,778.4	2,873.5	2,173.4	1,200.3
Shareholders= equity	1,395.7	911.1	472.6	391.9	279.5
Shares outstanding					
B year-end *(mil.)*	11.1	10.5	8.9	9.0	8.0
Return on average equity	20.4%	21.4%	20.1%	12.1%	20.3%
Per share					
Net earnings	21.59	15.36	9.79	4.66	5.42
Shareholders= equity	125.38	87.05	53.28	43.77	35.13
Market prices per share					
High	403.00	310.00	100.00	76.00	61.25
Low	285.00	98.00	66.25	52.00	24.00
Close	320.00	290.00	98.00	67.00	61.25

** commencing in 1995, reflects a change in accounting policy for reinsurance recoverables*

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.

Insurance subsidiaries

Commonwealth Insurance, based in Vancouver, offers commercial property and oil and gas insurance in Canada, the United States and internationally, and commercial casualty insurance in Canada. In 1997 Commonwealth’s net premiums written totalled $83.5 million. Commonwealth has been in business since 1947 and at year-end the company had capital and surplus of $151.0 million and there were 129 employees.

Falcon Insurance, based in Hong Kong, writes property and casualty insurance to niche markets in Hong Kong. The company will have capital and surplus of HK$240 million (approximately HK$5.4 = C$1) and there are 42 employees. The company was purchased in January 1998.

Federated Insurance is based in Winnipeg. Its two companies market a broad range of insurance products in Canada primarily for commercial customers. In 1997 Federated’s net premiums written totalled $63.6 million, consisting of $52.3 million of property and casualty business and $11.3 million of life and group health and disability products. Federated has been in business since 1920 and at the end of 1997 had capital and surplus of $53.3 million and 250 employees.

Lombard Insurance, based in Toronto, writes a complete range of commercial and personal insurance products in Canada. The company has been in business since 1904. In 1997 Lombard’s net premiums written were $363.3 million. At year-end the company had capital and surplus of $217.7 million and there were 690 employees.

Markel Insurance, based in Toronto, 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. In 1997 net premiums written were $55.4 million, and at year-end the company had capital and surplus of $60.2 million and 102 employees.

Ranger Insurance, based in Houston, Texas, specializes in writing property and casualty insurance to niche markets in the United States such as propane distributors, petroleum and gas marketers and agri-products. The company has been in business since 1923. In 1997 Ranger’s net premiums written were US$145.6 million. At year-end the company had capital and surplus of US$131.4 and there were 287 employees.

Reinsurance subsidiaries

CRC (Bermuda) Reinsurance, based in Bermuda, continues to be a major reinsurer of Lombard Insurance. The company received its insurance certificate early in 1995 and had net premiums written in 1997 of $97.1 million. At year-end the company had capital and surplus of $110.5 million.

Compagnie Transcontinentale de Réassurance (CTR) is based in Paris, France and writes primarily property, casualty and some life reinsurance internationally. The company was established in 1951 and in 1997 CTR's net premiums written were FF945.2 million (approximately FF4.2 = C$1). At year-end the company had capital and surplus of FF1,020.3 million and 151 employees.

Odyssey Reinsurance is based in New York, New York and writes property and casualty reinsurance in the United States and Canada. The company was established in 1918 and in 1997 Odyssey Re=s net premiums written were US$197.4 million. At year-end the company had capital and surplus of US$424.5 million and 148 employees.

Sphere Drake is based in London, England and Bermuda and writes traditional and alternative reinsurance and specialized insurance. The company, which was established in 1948, was purchased by Fairfax effective December 3, 1997 and in 1997 Sphere Drake's net premiums written were US$266.1. At year-end the company had capital and surplus of US$325.9 and 244 employees.

Wentworth Insurance was incorporated in 1990 and is domiciled in Barbados. In 1997 Wentworth=s net premiums written were $5.2 million. At year-end the company had capital and surplus of $237.9 million and there were 7 employees.

Claims adjusting subsidiary

Lindsey Morden Group is engaged in providing claims adjusting, appraisal and loss management services to a wide variety of insurance companies and self-insured organizations across Canada and the United States. In 1997 revenue totalled $166.3 million. The company was established in 1923, and at year-end the group had 1,528 employees located in 304 offices.

Investment management subsidiary

Hamblin Watsa Investment Counsel provides discretionary investment management, primarily to pension funds and insurance companies, including the insurance and reinsurance company subsidiaries of Fairfax. Hamblin Watsa was founded in 1984 and at year-end managed approximately $6.4 billion.

Note: All companies are wholly owned except Lindsey Morden Group, a public company of which Fairfax owns 65% of the equity and 92% of the votes.

To Our Shareholders

With the help of strong financial markets, we earned 20.4% on average shareholders= equity in 1997 (versus approximately 10% for the TSE 300). Net income after tax increased by 54% to $232.5 million. In spite of a 6% increase in shares outstanding, earnings per share increased by 41% to $21.59 per share. Book value per share increased by 44% to $125 but our share price increased by only 10% to $320 per share. The stock market was unimpressed! Those of you who take your cue from stock prices may think we had a poor year B particularly as the TSE 300 and S&P 500 rose by 13% and 31% respectively in local currency.

During the year, we strengthened our global reinsurance business with the purchase of Sphere Drake and again ended the year in a stronger financial position than when we began. We issued a 40 year debenture (I expect to be there at maturity) and ended the year with a cash position of $207 million in the holding company and unused, unsecured, committed, long term bank lines in excess of $1 billion. With the purchase of Sphere Drake, we increased our Arainy day@ cushion (more on that later) to $221 million from $193 million (including CTR) in 1996, and also on closing increased our reserve and reinsurance recoverable indemnifications that are not shown on our balance sheet by $109 million. Not bad for a slow year!

Our purchase of Sphere Drake fit into our long term strategic plan discussed with you in last year's Annual Report B we responded to a telephone call! Late in 1996, Michael Watson, President and Chief Executive Officer of Sphere Drake, walked into our offices and impressed us with a very balanced review of the possibilities of Sphere Drake.

On June 23, 1997 we announced the purchase of Sphere Drake, a London, England-based reinsurance company listed on the NYSE, for a payment of US$7.50 per share in cash or Fairfax shares and a 10 year, 8% contingent note (subject to reduction from adverse reserve development and reinsurance recoverable bad debt) of US$4.50 per share. No interest or principal is due on the contingent note (officially named a contingent value right) until maturity. The total purchase price was US$217 million.

At December 31, 1996, Sphere Drake had a book value of over US$250 million (US$13.80 per share) and an investment portfolio of approximately US$900 million. Net premiums written in 1996 were US$289 million. Sphere Drake is the first public company that Fairfax has purchased.

So why did we buy Sphere Drake? The major reasons were:

1) Sphere Drake fills out the global network of Odyssey Re Group (Fairfax's reinsurance group) with operations in London and Bermuda. Sphere Drake has

been in the London market since 1948 and in Bermuda since 1990. Michael Watson, who runs the company, joined Sphere Drake in March 1995. His two significant achievements since he joined the company, from our point of view, were to increase the reserves by US$90 million in December 1995 and to reduce the lines of business from 17 to the profitable core of 6 in 1996 (net premiums written dropped by 50% in 1996). In common with all the Fairfax insurance companies, Michael and his management team are focused on underwriting profitability. Like Jean-Philippe Casanova at CTR, Michael reports to Andy Barnard.

2) The addition of Sphere Drake=s business and capital results in Odyssey Re Group being among the top reinsurance groups in the world with in excess of US$1 billion in capital and approximately US$750 million in net premiums written.

3) Like Odyssey Re and CTR, Sphere Drake provides Fairfax with further business and investment diversification.

4) The US$4.50 per share contingent note, together with the discount to book value, provides very meaningful downside protection for Fairfax. The contingent note itself provides an initial indemnification of US$171 million after tax in ten years from adverse reserve development and reinsurance recoverable bad debt.

5) Given Sphere Drake's combined ratio in the 105% area and its investment portfolio of US$900 million, as well as attractive purchase financing, Fairfax should achieve its 20% return objective on the purchase price.

6) We were able to finance the purchase of Sphere Drake at fair terms and Fairfax continues to maintain its very strong financial position.

As with the purchase of Odyssey Re and CTR, there are risks in any purchase and the main ones are discussed below:

1) The major risk is the run-off of old books of business in the London market that are exposed to asbestos and environmental long tail liabilities. We feel the contingent note provides sufficient protection but only time will tell.

2) Sphere Drake has reinsurance recoverables of US$560 million on a reserve base of US$1,246 million. The company is exposed to potential bad debts on its reinsurance recoverables. We feel comfortable with the bad debt reserve of

US$33 million already in place and the contingent note indemnification we have, but again, only time will tell.

3) Sphere Drake=s historical results have been mediocre (mainly due to adverse loss development). With the protection from adverse loss development in place and the reduction in net premiums to its profitable core, we think Sphere Drake has the ability to achieve underwriting profitability over time.

With the addition of Sphere Drake, the Odyssey Re Group will have combined capital in excess of US$1 billion, net premiums written of approximately US$750 million and major offices in New York, Paris, London, Bermuda, Toronto, Singapore and Tokyo. While this makes us one of the top 20 reinsurance groups in the world, our focus continues to be underwriting profit and *not* market share. We are excited about the acquisition of Sphere Drake and welcome Michael Watson and the employees of Sphere Drake to the Fairfax group.

We financed the purchase of Sphere Drake by issuing 650,000 shares at $395 per share to raise $246 million net, and US$125 million of unsecured debentures with a coupon of 7 : % and a 40 year term to maturity (a spread of 122 basis points above U.S. Treasuries). The additional money raised was used to pay back a US$100 million bank financing that Sphere Drake had as well as increase Fairfax=s cash position in the holding company. As in the past, our equity issue was led by Dick Falconer from CIBC Wood Gundy and ably supported by Nesbitt Burns, ScotiaMcLeod, RBC Dominion Securities, TD Securities, Deutsche Morgan Grenfell, First Marathon, Midland Walwyn and Newcrest Capital. Also as in the past, our U.S. debt financing was led by J.P. Morgan and strongly supported by CS First Boston and Deutsche Morgan Grenfell. We thank our Canadian and U.S. investment dealers for doing an excellent job for us again and welcome our new shareholders and bondholders to the company. As emphasized in the past, our company is run for the long term benefit of our shareholders which implies maintaining a very strong financial position which will benefit our bondholders. The emphasis though is long term.

After the purchase and financing of Sphere Drake, Fairfax=s investment portfolios have increased
to approximately $5.8 billion or $521 per share B up 34% from $390 per share as at December 31, 1996 (including CTR). Investment income per share (interest and dividends only) from these portfolios, which ultimately drives earnings per share and book value per share, should increase to approximately $30 per share in 1998.

This is perhaps a good time to discuss stock price fluctuations B particularly for the benefit of some of our newer shareholders! Stock prices *have always* fluctuated B and *will always* fluctuate. This applies to stocks in general but to Fairfax in particular. Our consistent policies to attract long term investors, combined with a lack of promotion, should result in less fluctuation than stocks in general over the long term B but in the short term we will experience our share of Aair pockets@. We experienced this in 1997, when our share price began the year at \$290, went to a high of \$403 and then dropped to a low of \$285 and closed at \$320. From the issue price of \$395, our stock price dropped by 19% to the close of \$320.

A few points in relation to these fluctuations:

1) These fluctuations are magnified in terms of absolute dollar changes but are not abnormal based on percentage changes. In fact, if our stock was split 100:1 (don=t worry, it won=t happen), many of you would not have noticed the fluctuation from \$3.95 to \$3.20 even though the percentage drop would be the same.

2) In the past we have experienced similar and sometimes even larger share price fluctuations . The largest share price drop that Fairfax has experienced in the past, under present management, was in 1990 when our share price dropped from \$21 e to \$8 f or a decline of 60%. We could experience similar declines in the future but *if* we continue to achieve our 20% objective, these fluctuations will be as irrelevant in five years time as the 1990 fluctuations are from today=s perspective. Please note the big A*if*@ and remember there is no guarantee we will achieve our 20% objective in the future.

3) Some of our more recent shareholders have reacted to these fluctuations with persistent telephone calls to our head office asking about the effects of El Niño, the Mexican earthquake, the Asian crisis, etc., etc. We have to re-emphasize that our company is run for the long term; short term stock price fluctuations are meaningless and as we have only thirteen people in our head office, we do not have the time to answer these telephone calls. So as a matter of policy, we will not be responding to investor calls about stock price fluctuations or other questions about Fairfax on an individual basis but would be delighted to answer your questions at our annual meeting. Our Annual Reports provide you with full and complete disclosure supplemented by our more brief (thankfully!) quarterly reports. If we have significant additional information to disclose to you, rest assured we will do it through an immediate press release. So please, no telephone calls! If you cannot handle the short term fluctuations, then perhaps we are not the stock for you.

The objective of our Annual Report is to provide you with enough information so that you can get some idea about (a) what Fairfax is worth; (b) our ability to meet our obligations (in other words, our financial soundness); and (c) how we have done given the hand we have been dealt.

Most of this report deals with (b) and (c) but I would like briefly to discuss (a). What is Fairfax worth? In the 1995 Annual Report, I mentioned the concept of intrinsic value or what a company is worth. Intrinsic values do not fluctuate as much as stock prices and are based on the earnings or future cash flows from a company B the earnings or future cash flows that can be distributed to shareholders after the reinvestment requirements of the business for capital expenditures and working capital requirements. Broadly speaking, for our insurance and reinsurance business, capital expenditures and working capital requirements are minimal and so our earnings are free to be distributed to shareholders. So, the future earnings for Fairfax will determine the company=s intrinsic value.

On the other hand, the book value of a company shows the net amount of moneys that have been invested in the company over time. Return on shareholders= equity, i.e. return on book value, is the link between book value and intrinsic value as future earnings will be determined by the return on shareholders' equity. When a company like Fairfax earns more than 20% on shareholders= equity then, given that long term interest rates are below this figure, the intrinsic value of the company will exceed its book value and its stock price will reflect its intrinsic value over time. So while stock prices fluctuate in the short term B reflecting the twin emotions of fear and greed B in the long term they always reflect underlying intrinsic value. This is how we view the link between book values, intrinsic values and stock prices. We have given you a framework to value Fairfax but you will have to come up with your own number for intrinsic value.

When we have made acquisitions and financed them through stock issues, we have made sure that stock prices are fair to the seller (us) and to the buyer, i.e. as close to intrinsic value as possible. However, this means that we have issued shares at premiums to book value. Some of you may think (mistakenly!) that all we are trying to do is increase book value per share by issuing shares at premiums to book value. Many companies actually do this and justify their acquisitions by saying that earnings will be accretive. The key we think is the return on shareholders= equity on the additional capital raised to make the acquisition. Earnings may be accretive even if the return on the additional capital is only 10%! Our objective has always been and continues to be a 20%+ return on the additional capital raised. Our after-tax return on the purchase price for our recent acquisitions is shown below.

	1997	1996	1995
	%	%	%
Lombard	54	38	27
Odyssey Re	32	24	B
CTR	14	B	B

These returns are based on the full purchase price and have not taken favourable debt financing into account. CTR has had a lower return because of lower investment returns but this should improve soon. While the financial markets have accentuated our returns because of realized capital gains, it is fair to say that we are focused on achieving a 20% return on our purchase price for every acquisition or we will not make the acquisition. We believe the structure of the Sphere Drake acquisition (together with Sphere Drake's becoming part of Odyssey Re) will ensure that that acquisition achieves our objectives. Since we began in 1985, the only insurance acquisition that has not met our return objectives is Ranger (we have made a positive return though!).

We should bring your attention to the best article that I have come across on why every company in the private sector should have a focus on increasing long term shareholder value. The article is by the late Roberto Goizueta, then Chairman of Coca-Cola, entitled AWhy Share Owner Value?@, and is included in Coke=s 1996 annual report. The gist of Roberto=s article is that increasing shareholder value in the *long* term benefits not only shareholders but customers, employees and also the community. Trying to increase shareholder value in the *short* term ultimately benefits no-one. Our own experience, comparing the company we began with in 1985 ($1.8 million market value and revenue, assets and shareholders= equity of $17 million, $42 million and $10 million, respectively) with our company in 1997 ($3.5 billion market value and revenue, assets and shareholders= equity of $2.1 billion, $10.2 billion and $1.4 billion, respectively), shows that currently we are in a much better position to fulfil our obligations to our customers, employees and shareholders than we were in 1985. In fact, based on our policy of donating at least 1% of pre-tax earnings to charitable organizations, we donated $3.8 million in 1997 B well in excess of the market value of the whole company in 1985. It is well worth reading Roberto=s article!

For the benefit of our new shareholders who have not read our old Annual Reports, I want to re-emphasize that you continue to have one major short term disadvantage by my controlling all the multiple voting shares. I will not sell my shares even at a 100% premium to the market price and thus my multiple voting shares prevent you from getting an attractive one time bonanza. However, for this short term pain, this share structure has served Fairfax very well (easy for me to say!!) and, we hope, will provide you with attractive long term returns. In case you were unaware of the power of compounding, 20% over 13 years results in a zero being added to whatever you began with!!

The table below shows the sources of our net earnings.

	($ millions)	
	1997	**1996**
Insurance and underwriting	(56.2)	(50.6)
Interest and dividends	242.3	144.1
Total	186.1	93.5
Claims adjusting (Fairfax portion)	1.8	2.3
Interest expense	(43.2)	(35.0)
Goodwill and other amortization	(4.8)	(4.8)
Corporate overhead and other	(15.0)	(6.6)
Realized gains	206.8	131.3
Pre-tax income	331.7	180.7
Less: taxes	99.2	29.9
Net earnings	232.5	150.8

The table shows you the results from our insurance (underwriting and investments) and non-insurance operations. *In this report insurance operations include reinsurance operations.* Claims adjusting shows you our share of Lindsey Morden=s after-tax income. Goodwill and other amortization includes Hamblin Watsa goodwill ($1.4 million) and amortization from Ranger ($3.4 million). The corporate overhead expense is net of Hamblin Watsa=s pre-tax income and includes one time expenses associated with our acquisitions and our issues of securities (don't worry B overhead at Fairfax has not increased much). Shown separately are realized gains so that you can better understand our earnings from our operating companies. Also please note the unaudited financial statements of our combined insurance operations and of Fairfax with Lindsey Morden equity accounted, as well as Lindsey Morden=s financial statements shown on pages 72 to 77.

Insurance operations

We have included a table below that shows clearly the combined ratios of each of our companies for 1996 and 1997. As you can see, our Canadian companies had another excellent year with a combined ratio of 100%. Odyssey Re performed as expected, CTR was close and Ranger had a much improved year. In total, our insurance operations had a combined ratio of 104%, a little better than 1996. Given our conservative reserving at all our companies, and the transition period before recent acquisitions achieve our objectives, we were pleased with these results even though we have not taken the total combined ratio for all our companies below 100% yet. The industry, across the world, continues to be fiercely competitive B and to think I thought the cycle would turn in 1991!!!

	1997	1996
	%	%
Commonwealth	88.8	87.0
Federated	97.4	100.2
Lombard	102.8	100.8
Markel	103.0	102.9
Total Canadian insurance	*100.0*	*99.0*
Ranger	112.1	123.5
Total U.S. insurance	*112.1*	*123.5*
Odyssey Re	106.0	110.0
CTR	109.2	B
Wentworth and other *	81.8	98.0
Total reinsurance	*104.7*	*109.7*
Total	*103.8*	*104.9*

** includes Sphere Drake for one month in 1997*

Commonwealth, under John Watson's leadership, continued to produce exceptional results, with a combined ratio of 88.8% versus 87.0% in 1996. John and his management team have had combined ratios of less than 100% in six of the last seven years.

In 1997 Commonwealth's gross premiums written dropped by 10% to $235 million due to the soft market, while net premiums written dropped by 4% to $83 million. Exceptional underwriting results combined with excellent investment income produced net income after taxes of $28.2 million B another record! Commonwealth seems to go from one high to another.

Federated, led by John Paisley, had another exceptional year in 1997 with a combined ratio of 95.9% (versus 98.6% in 1996) for the property and casualty company (97.4% including the life operations). John and his management team have had combined ratios of less than 100% in seven of the last eight years in the property and casualty company.

In spite of a soft market, gross premiums written for Federated increased 2% to $71.2 million, while net premiums written increased by 5% to $63.6 million. In 1997 Federated successfully entered the Building Contractor market and also was among the first companies to introduce "Critical Illness Insurance" to its clients. The company continued to reduce its expense ratio from 34.8 % in 1996 to 33.3% in 1997. Net income after taxes increased by 40% to $7.7 million from $5.5 million in 1996.

Byron Messier and his management team at Lombard had an excellent year in 1997 B even though they just missed the 100% objective! Everything included, Lombard had a combined ratio of 102.8% in 1997 B the "everything" includes all start-up expenses for Zenith Insurance in Ontario (which were written off in 1997) and the high marketing costs for the Privilege 50 program (discussed in last year's Annual Report). Excluding these start-up expenses and marketing costs, Lombard had a combined ratio of 100.6% B commercial lines at 102.3% and personal lines at 97.6%.

Zenith Insurance, as discussed last year, was launched in June in Ontario to provide home and car insurance to people over 50 years old. Total premiums written for Privilege 50 in 1997 (Ontario, Alberta and the Maritimes) were $14.3 million. The loss ratio on this business was in the 70% area but heavy marketing costs resulted in a combined ratio of approximately 130% for the program. In time we expect this to be an excellent program for Lombard and its customers.

Lombard's gross premiums written (including CRC (Bermuda)) decreased by 1% in 1997 to $500.9 million, while net premiums written increased 1% to $460.4 million. Net income after taxes increased to a record $82 million due to significant realized gains. In the three years since we purchased Lombard it has earned $183 million B in excess of our purchase price of $155 million.

Markel, under Mark Ram's leadership, had another excellent year as the company continued to deliver more unique, value-added products and services to its insureds, building on its almost five decades of continuous service to the Canadian trucking industry. In spite of being faced with irrational competition, Markel produced a combined ratio of 103%. The introduction of Markel Advantage Software (software developed in-house to assist in the management of various trucking operations of Markel's insureds), its second truck driver training school and its in-house dedicated toll-free service (24 hours a day, seven days a week) continue to make Markel the premier trucking insurance company in Canada.

The company's expertise has been recognized by its customers as over 90% of them renewed with Markel in 1997 despite the intense competition. Also in recognition of the company's expertise, Markel was the only insurer invited to participate fully in *Target '97*, a major road safety program organized by the Ontario government.

In 1997 Markel's gross premiums written and net premiums written dropped by 25% and 12% respectively to $73.3 million and $55.4 million, mainly due to Markel's cancellation of unprofitable programs. Net income after taxes increased by 61% to $7.4 million because of higher realized gains.

Ranger had a much improved (!) year in 1997 with a combined ratio of 112.1% versus 123.5% in 1996. Excluding the run-off lines, Ranger's combined ratio for continuing lines was 100.5% B close to our 100% objective. With Bob Rich at the helm, we feel comfortable that Ranger's combined ratio in 1998 will be in the 100% area.

In 1997 Ranger's gross premiums written were about flat at US$223 million, while net premiums written were down 6% from 1996 to US$146.0 million. Pre-tax income went from a loss of US$2.2 million in 1996 to a profit of US$15.8 million in 1997, while net income after taxes increased 12% to US$10 million. Year-end GAAP capital of US$131.4 million was the highest in Ranger's history.

Wentworth, benefiting from favourable development from the past of $7.8 million, showed an underwriting profit of $7.9 million on net premiums earned of $5.2 million. Excluding the favourable development, Wentworth had a combined ratio of 98% in 1997. Net income after taxes was a record $30 million in 1997 because of the significant underwriting profits and realized gains.

Odyssey Re, New York, had an excellent year in 1997 with a combined ratio of 106.0% as expected after US$15.5 million in indemnification from Skandia, Sweden. During the year, the company was able to enlarge its pool of management talent and establish a stronger, more diversified portfolio. Furthermore, significant strides were taken in developing alternative distribution channels, such as its subsidiary Hudson Insurance Company.

Net premiums written at Odyssey Re were US$197.4 million in 1997 B about 2% less than in 1996. Net income after taxes was US$70.8 million, up 10% from US$63.5 million in 1996. At the Odyssey Re level, we decided to write off lease costs in excess of market of US$11.9 million after tax (US$18.3 million pre-tax) which, because of negative goodwill at Fairfax, has no impact on Fairfax's net income but does reduce Odyssey Re's net income to US$58.9 million. The write-off of excess lease costs will result in rent savings of over US$2 million annually for the remaining lease term. Andy Barnard expects Odyssey Re's combined ratio in 1998 to be in the 103% area.

1997 was the first year for CTR under Fairfax ownership. Under Jean-Philippe Casanova's leadership, CTR had a combined ratio of 109.2% in 1997, higher than expected for its first year. Gross premiums written and net premiums written declined significantly due to extremely soft market conditions to FF1,331 million and FF945 million respectively. Net income after tax was FF82 million B a14% return on our investment. With higher investment income and improved underwriting results, our returns are expected to increase to our target 20% level. CTR is expected to bring combined ratios to the 100% area in the next two years. During 1997 CTR added to its senior management depth in its Singapore based operations and its facultative operations. A.M Best and S&P have upgraded CTR to the AB level B the highest rating the company has ever had.

Late in 1997 we formed the Odyssey Re Group, a holding company that owns Odyssey Re (New York), CTR and Sphere Drake. Jim Dowd is Chairman of this Group, while Andy Barnard is President and CEO. Jean-Philippe Casanova and Michael Watson report to Andy while running their own decentralized operations. Over time, Andy, Jean-Philippe and Michael will be co-ordinating the operations and bringing them together to operate as one worldwide reinsurer. As shareholders, this offers great opportunity for us and we are extremly fortunate to have these men leading our reinsurance group.

S&P has raised its rating of each company and the Group to the AB level.

Our insurance companies are all well capitalized as shown on page 66. We continue to have significant unused capacity and it will continue to be unused as long as current conditions prevail.

As you know, it is our policy to have our reserves set at a level that results in redundancies in future years. How did we do in 1997? We provide extensive disclosure on our claims reserves beginning on page 51 the MD&A. In Canada our insurance companies had redundancies of $12.0 million in 1997, while in the U.S. we had a deficiency of US$0.8 million. As explained on page 55 in the MD&A, the U.S. deficiency in 1997 was net of redundancies at Odyssey Re and Wentworth, but reflected a rather significant deficiency at Ranger of US$8.7 million resulting from the run-off of certain reinsurance assumed lines. While core lines at Ranger, as well as discontinued insurance lines, are well reserved, we were disappointed with the deficiency noted above. In total then, we had a net reserve redundancy of $10.8 million in 1997. Our reserves continue to be certified by independent actuaries at the individual insurance company level and on a consolidated basis.

In January 1998 we purchased Euro-America Insurance Limited, a small insurance company based in Hong Kong, for its net book value of HK$22.5 million. The company=s name has been changed to Falcon Insurance Company Limited and its capital will be increased to HK$240 million. In case you think we must have been suffering a sudden attack of the Asian 'flu, we bought this company because Kenneth Kwok agreed to come in as its CEO. Kenneth has had a long and successful track record running a Continental subsidiary in Hong Kong and was well known to Byron Messier and his team at Lombard. We welcome Kenneth and the employees of Falcon Insurance to the Fairfax group and look forward to participating in the long term growth of the company.

Claims adjusting

Under Ken Polley=s leadership, Lindsey Morden had another excellent year in 1997 B on the basis of free cash flow B even though earnings per share were down 34% from 1996. In 1997, after capital expenditures and working capital requirements, Lindsey Morden generated free cash flow of $6.3 million ($1.04 per share). The company used this free cash mainly to pay dividends of $2.8 million (504 per share) and reduce short and long term debt. As Ken, Don Smith and Ferd Roibas feel that this level of cash flow is sustainable, the board of Lindsey Morden decided to increase the dividend to 604 per share in 1998 and authorized the use of additional funds to buy back shares if appropriate.

It is quite remarkable that in the two years 1996 and 1997, Lindsey Morden generated $14 million in free cash flow compared to only $4 million in the previous five years. While many of you may not know this, Francis Chou has spent much time with Ken and his team, and along with Rick Salsberg, has been instrumental in developing a simple bonus formula based on free cash flow. The turnaround has been amazing!

Investment management

While 1997 was an excellent year on an absolute basis, relative to exploding U.S. and Canadian stock markets, our equity results did not keep pace. Our bond results in 1997 were excellent on both a relative and absolute basis.

The key, of course, is long term and as shown in the table below, HWIC has produced excellent results in all of the areas in which it provides investment management B Canadian equities, Canadian bonds, U.S. bonds and balanced funds.

Annualized rates of return (%)

Cumulative periods ended December 31, 1997

	5 years	10 years	15 years
Canadian Equities	24.1	14.2	15.6
TSE 300	17.5	11.0	11.9
U.S. Equities	30.3	24.9	22.3
S&P 500	23.1	19.2	18.7
Canadian Bonds	16.3	12.9	B
SM Index	10.9	11.6	B
U.S. Bonds	9.7	11.1 *	B
ML Index	6.4	8.3 *	B
Balanced Fund	20.4	14.7	B

* 9 years

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

Total fees in 1997 were $9.8 million, down from a record $10.1 million in 1996, mainly because of no incentive fees being earned in 1997. Fairfax earned a 35% pre-tax cash return in 1997 on its $14 million investment in HWIC.

Financial position

As in previous reports, we feel our unaudited balance sheet with Lindsey Morden equity accounted (shown on page 74) is the best way to understand our financial position. Here is what our year-end financial position looks like compared to the end of 1996.

	($ millions) 1997	1996
Cash and short term investments	207.1	101.1
Long term debentures	718.4	470.5
Net debt	511.3	369.4
Common shareholders= equity	1,395.7	911.1
Net debt /equity	37%	41%
Net debt/total capital	27%	29%

As shown, common shareholders= equity, our capital, increased by $484.6 million B $246.4 million net from the stock issue, $7.3 million for shares issued in the Sphere Drake acquisition and $232.5 million from net income, less $1.6 million used to purchase 5,100 shares at about $309 per share. Our US$125 million debenture issue in July 1997 and our effective FF200 million borrowing in connection with our purchase of CTR resulted in the increase in long term debentures. Earnings plus the additional funds raised in excess of the funds required for the Sphere Drake acquisition resulted in our cash position doubling to $207 million from $101 million in 1996. Our net debt to equity and net debt to capital ratios dropped in 1997 to 37% and 27% respectively from 41% and 29% respectively in 1996 in spite of the Sphere Drake acquisition. Over the past two years we have purchased three reinsurance companies for a total of approximately $770 million and still ended 1997 with a significantly lower net debt to equity and net debt to capital ratio than at the end of 1995. Please note, we have not included the Sphere Drake contingent note ($46.0 million) in our debt to equity and debt to capital ratios as no principal or interest is payable for ten years, and adverse reserve development as well as reinsurance recoverable bad debt goes against the note.

A very significant item of financial conservatism on our balance sheet is the negative goodwill (or, as the accountants call it, excess of net assets acquired over purchase price) that is shown on our balance sheet. This item ($184 million), together with additional provisions arising from our recent acquisitions ($37 million), results in our "rainy day" cushion of $221 million. These cushions, together with the remaining $334 million of reserve/reinsurance unrecoverable protection that is not on our balance sheet, significantly protect our shareholders= equity from asset or liability deficiencies that may occur in the future.

One unintended aspect of our recent success in acquiring companies at a discount to book value is the imposition of an accounting rule that requires that the excess of net assets acquired over their purchase price be categorized as such on our balance sheet and be amortized into income over 30 years. We are not happy about increasing our annual income by the amount of this amortization, which was $7.7 million in 1997, and you can be confident that we have been and will be zealous in applying conservative accounting in other areas so as to mitigate the effect of this increase.

Our financial position continues to be very strong for the same reasons that we discussed in our 1996 Annual Report. Briefly they are:

1) We have no bank debt. Our debt consists of four public debentures with a long term to maturity (6 years, 18 years, 29 years and 40 years) and low interest rates (7 : %, 8 3 %, 8 3 % and 7 : %) and two small 6 year and 9 year debentures issued to vendors with a 7 : % and 2 2 % coupon respectively. All of this debt (except the 2 2 % debenture, which has comparable terms to the other debt) was issued under a single trust indenture containing no restrictive covenants, thus providing us with great flexibility. We have swapped the fixed interest rates on all the public debentures (with the exception of the one maturing in 6 years) into floating rates, saving approximately 125 basis points on average currently.

2) We have unused, unsecured, committed, long term bank lines in excess of $1 billion with excellent covenants. These bank lines are with five Canadian, three U.S. and two European banks. In addition, we have LOC facilities in excess of $70 million.

3) Our net long term debt is less than three times our earnings base. Also, our earnings base is well diversified among many insurance and reinsurance companies, Lindsey Morden and HWIC, and among Canadian, U.S. and, through CTR and Sphere Drake, non-North American streams of income.

4) Available cash flow at the Fairfax (holding company) level from dividends, management fees and interest covers our expenses (administrative and interest) by about two times. This is based on normal dividend payouts from our insurance companies (and effectively none from our reinsurance companies), which is much less than our maximum dividend-paying capacity. Note Fairfax=s parent company-only income statement on page 79.

5) With $207 million in cash in the holding company, we can pay our administrative and interest expenses at Fairfax, with *no* dividends from any of our insurance or reinsurance companies, for five to six years B our management holding company survival ratio!

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

7) Our foreign exchange exposure from Ranger and Odyssey Re has been fully hedged by the U.S. debenture issues and the purchase of foreign exchange contracts. We have also hedged our expected U.S. dollar income for the next five years with the purchase of additional foreign exchange contracts, as disclosed in note 10. We have done the same for CTR (in French Francs) and Sphere Drake (in U.S. dollars).

Investments

1997 was an exceptional year in the Canadian and U.S. financial markets and the best year ever for Fairfax as far as realized gains are concerned. The unrealized gains as of year-end are shown below.

	($ millions)	
	1997	**1996**
Bonds	116.6	26.9
Preferred stocks	25.5	19.0
Common stocks	(19.4)	81.2
	122.7	127.1

In spite of our concern expressed in last year=s Annual Report about the level of stock prices in Canada and the U.S., we realized a record $207 million in gains B about 58% more than the $131 million realized in 1996 (which was almost twice the record $72 million realized in 1995). Since 1985 we have realized cumulative gains of $500 million. While we do not expect to realize the gains that we have recently had from Canadian and U.S. stock markets in the future, we do expect to continue to realize gains from our investment portfolios. While realized gains are not predictable as far as timing is concerned and many people de-emphasize them, we consider them as good as interest income and continue to search out opportunities for making these gains in the future. The $207 million in realized gains in 1997 was virtually all from common stock (see note 2).

The table on page 62 shows the returns on our investment portfolio. Investment income (interest and dividends) increased again in 1997 due to CTR and will do so again in 1998 due to Sphere Drake. Pre-tax investment income per share has increased from $15.42 per share in 1996 to $23.64 per share in 1997 and should increase in 1998 to approximately $30.00 per share because of Sphere Drake.

Gross realized gains totalled $223 million. After realized losses of $5 million and increased provisions of $11 million, net realized gains were $207 million. The major contributors to realized gains were Stelco ($25.7 million), Torstar ($23.6 million), Emco ($14.4 million), Edper Group ($14.1 million), Trizec ($10.8 million), E-L Financial ($7.5 million), CHUM Ltd. ($5.9 million), Dofasco ($5.7 million), Rothmans ($5.4 million), Gentra ($4.5 million), Jannock ($2.2 million), St. Lawrence Cement ($2.0 million), Morrison Petroleum ($1.9 million), Firebird Fund (a Russian mutual fund B $19.5 million), RLI Corp. ($7.8 million), Twentieth Century ($5.9 million), Outboard Marine ($4.8 million), Loews ($3.7 million), Salomon ($3.3 million), Partners Re ($2.1 million), American Express ($2.1 million) and Fifth Third Bancorp ($1.1 million).

Last year we made the point that Awith many warning lights flashing, we were being more cautious than usual in making any new stock investments@. Since making this profound statement, the TSE 300 and S&P 500 have increased 13% and 31% respectively in 1997. However, we have (perhaps stubbornly!) not changed our mind. In fact, we feel compelled to change the Awarning flashing lights@ to Ared alert@. Given the levels of the market, the possibility of deflation (or certainly no inflation) caused by massive Asian stock market and currency devaluations, mindless Along term@ investing in mutual funds by individuals and a lack of investment Avalues@ in the North American stock markets, we have reduced our U.S. and Canadian common stock investments significantly.

Perhaps an example will illustrate the amount of speculation in the U.S. market. According to a recent Doom, Boom and Gloom report by Marc Faber, GE's current market capitalization of $241 billion exceeds the combined value of the stock markets of Malaysia, Indonesia, Thailand, the Philippines and South Korea. Readers with a sense of history will remember that the market capitalization of Nippon Telephone, the Bell Canada of Japan, in 1987/88 exceeded the total value of the Canadian stock market. The Japanese market dropped 60% from 1989 to 1991 and Nippon Telephone, ten years later, is still 62% below its 1987 high. According to the November 21, 1997 issue of *Grant=s Interest Rate Observer*, GE is currently selling at 2.5 times revenue (the previous peak being 1.4 times in 1972) and 27.5 times earnings (the previous peak being 28 times in 1972). In case you have forgotten, between 1972 and 1974, the S&P 500 dropped by approximately 50%!

There are two major risks that we see in the U.S. and Canadian financial markets. The first risk is mutual funds. Eleven years ago, Citibank, one of the largest U.S. banks, had US$196 billion in assets while Fidelity, the largest mutual fund organization in the U.S., had US$70 billion in assets. Today, Citibank has US$311 billion in assets, while Fidelity has US$550 billion. Since the depression, the U.S. and other major countries have developed mechanisms, including central banks like the Federal Reserve and the Bank of Canada, to prevent runs on banks. Today, the money is no longer in the banks but in mutual funds which are one phone call away from having a run on them with no preventative measures in place. A run on equity mutual funds could cause a Avirulent decline@, as Mr. Greenspan would say, in stock prices which could have a negative impact on the economy causing further damage.

The second major risk we see is what *Friedberg=s Commodities and Currency Comments* considers to be the Arepricing of risk@. Falling interest rates and a benign economy have resulted in yield spreads declining significantly and bond investors reaching for yield. We are particularly cautious about bonds collateralized with consumer debt (credit card receivables, second mortgages, auto dealer receivables, etc.). We think future default experience will be significantly worse than the past and these type of bonds will experience Aa repricing for risk@. We do not own any of these bonds and own only very good quality bonds. I hope we haven=t made you too uneasy!

So where have we invested the Fairfax portfolios? In common equities, while we are very concerned about North American markets, we see many excellent opportunities in

Japan and the Far East. These markets have come down 50%+, and many currencies are down at least as much. We plan on adding to our positions in Japan and other Asian countries while maintaining our Latin American investments and reducing further our U.S. and Canadian investments. As of December 31, 1997 our common stock holdings in total were only 10% of our $5.8 billion investment portfolio B the lowest level since we began at Fairfax.

In the bond area, we have built very significant holdings of Aput@ bonds over the past three years. These are high quality bonds that have dual maturity dates B the first maturity date being from 3 to 10 years and the second from 15 to 40 years. The issuer pays a slightly lower interest rate for providing this feature. From the buyers= perspective, if interest rates go up, these bonds trade like short term bonds, but if rates drop, these bonds trade like long term bonds. The risk/return characteristics of these bonds are excellent and Brian Bradstreet has accumulated approximately $2.2 billion of these bonds. If long term interest rates continue to decline, these bonds have significant upside potential.

The stress testing of violent market fluctuations on regulatory capital that we do monthly at Fairfax (which we now call our "doomsday test") continues to show that all our companies meet this test. As previous comments indicate, we are concerned that our "doomsday" scenario may be tested some time soon.

Miscellaneous

You may have missed that dividend cheque again that we paid you in 1997. By purchasing 5,100 shares at about $309 per share for a total cost of $1.6 million, we indirectly gave you a dividend of 144 per share. While we have had very minimal stock buybacks in the past few years, we should remind our newer shareholders that we have bought back significant amounts of our shares in the past (i.e. 1.6 million shares or 25% in 1990). By the way, you may not know, but the Michael Jordan of stock buybacks was Henry Singleton at Teledyne. Henry began Teledyne in 1961 with approximately seven million shares outstanding and grew the company through acquisitions while shares outstanding peaked in 1972 at 88 million. From 1972 to 1987, long before stock buybacks became popular, Henry reduced the shares outstanding by 87% to 12 million. Book value per share and stock prices compounded in excess of 22% per year during Henry=s 27 year watch at Teledyne B one of the best track records in the business. We will always consider investing in our stock first (i.e. stock buyback) before making any acquisitions.

Please review page 78 which is an unaudited, unconsolidated balance sheet showing you where your money is invested. As you can see, we have $1,240.8 million invested in our reinsurance companies, $699.0 million in our insurance companies, $30.4 million in Lindsey Morden, $6.8 million in Hamblin Watsa and $207.1 million in cash. Our insurance companies and Lindsey Morden are carried at their underlying book value, i.e. very conservatively stated. You can see how conservatively stated when you note that General Accident paid $738 million or in excess of two times book value for Canadian General B a company not much larger than Lombard. While all our insurance companies are conservatively valued on our balance sheet, please do not look for a quick bonanza as *none* of them is for sale B at any price! As long term shareholders of Fairfax, you benefit greatly from the fact that all our presidents run their companies as their own with a loyalty and commitment that is unmatched in the industry. Any short term sale for a one time gain would destabilize this loyalty and commitment, ultimately resulting in lower long term returns for Fairfax.

Since we began in 1985, twelve years ago, our book value per share has compounded at 41% annually, while our stock price has compounded at 47% (both not repeatable in the future). During this time period, Fairfax has averaged a return on average equity of 20.4%, in excess of our objective and in excess of all but three companies on the TSE 300. So you can see, earning 20% on equity over time is very difficult B particularly with a much larger equity base. Having said that, this continues to be our goal over the next five years.

So what strengths does Fairfax have that will help it to achieve a 20% return on equity in the future? Let me list them for you.

1) Five main established insurance companies (Commonwealth, Federated, Lombard, Markel and Ranger) and three main established reinsurance companies (under the Odyssey Re Group) with strong management teams focused on underwriting profit. Together this adds up to a widely diversified base of $1.8 billion in premiums and about $10 billion in assets.

2) An investment team with a proven track record over the long term with the ability to invest directly or indirectly in any market in the world, managing an investment portfolio of $5.8 billion which should produce investment income (interest and dividends only) of $330 million annually or approximately $30 per share.

3) A lean head office team which is experienced in monitoring operations and in reacting quickly to make an acquisition when opportunities develop, in all cases with a continuing focus on financial conservatism and protecting the company from worst case events.

4) A track record of creating wealth for shareholders for the past twelve years while maintaining financial soundness. This results in our ability to access the stock and bond markets for long term capital and the banks for short term capital.

5) A twelve year record of treating people fairly. A company that *has not* and *will not* compromise its integrity.

6) A commitment to build our company over the long term B and not to flip it in the next few years. The whole focus of Fairfax is the *long term*.

Before you accuse your Chairman of excessive optimism (not uncommon), I should immediately direct your attention to the section on Issues and Risks on page 69 that lists the risks that Fairfax faces. Sorry, no free lunch!

We had another excellent annual meeting last year at the Metro Toronto Convention Centre B excellent because many of you came and your questions benefitted all shareholders. This year, our annual meeting will be held at 4:30 p.m. on Tuesday, April 14, 1998 in Room 106 at the Metro Toronto Convention Centre. As always, all our presidents, as well as the officers of Fairfax and the investment professionals at Hamblin Watsa, will be there. Given the fluctuations in the price of Fairfax stock, I may come incognito. We look forward to seeing you there.

Again, on your behalf, I would like to thank the board and the management and employees of all our companies for an outstanding year.

February 27, 1998

V. Prem Watsa
Chairman and Chief Executive Officer

Consolidated Financial Statements

for the years ended December 31, 1997 and 1996

Consolidated Balance Sheets

as at December 31, 1997 and 1996

	1997 *($000)*	**1996** *($000)*
Assets		
Cash and short term investments	207,104	101,067
Accounts receivable	1,669,839	626,245
Recoverable from reinsurers...............................	2,164,466	1,258,899
Claims in process	14,872	15,029
Income taxes refundable......................................	31,448	16,288
Prepaid expenses...	21,825	15,273
	4,109,554	2,032,801
Portfolio investments (note 2)		
Subsidiary cash and short term investments		
(market value B $823,762; 1996 B $513,205) ...	823,762	513,205
Bonds		
(market value B $3,970,151; 1996 B $2,151,569)	3,853,505	2,124,620
Preferred stocks		
(market value B $297,101; 1996 B $201,239) ...	271,642	182,229
Common stocks		
(market value B $565,627; 1996 B $588,128) ...	585,063	506,939
Real estate		
(market value B $54,627; 1996 B $26,461)	54,627	26,461
Total (market value B $5,711,268; 1996 B $3,480,602)	5,588,599	3,353,454
Deferred premium acquisition costs.....................	220,113	145,496
Deferred income taxes	169,445	134,824
Capital assets	54,434	40,915
Goodwill..	41,320	43,758
Other assets	23,804	27,141
	10,207,269	5,778,389

Signed on behalf of the Board

"V. P. Watsa"

Director

"R. Hartog"

Director

	1997 ($000)	1996 ($000)
Liabilities		
Bank indebtedness	594	2,394
Accounts payable and accrued liabilities	282,516	220,009
Premium deposits	105,708	43,674
	388,818	266,077
Provision for claims (note 3)	6,322,737	3,293,449
Unearned premiums	1,113,842	688,009
Contingent value rights (note 4)	45,988	B
Long term debt (note 5)	735,563	487,038
	8,218,130	4,468,496
Non-controlling interest	20,509	21,000
Excess of net assets acquired over purchase price	184,097	111,724

	1997 ($000)	1996 ($000)
Shareholders= Equity		
Capital stock (note 6)	766,739	513,420
Retained earnings	628,976	397,672
	1,395,715	911,092
	10,207,269	5,778,389

Consolidated Statements of Earnings

for the years ended December 31, 1997 and 1996

	1997 ($000)	1996 ($000)
Revenue		
Gross premiums written	1,883,560	1,411,636
Net premiums written	1,392,627	1,043,079
Net premiums earned	1,460,641	1,030,888
Claims fees	166,331	162,266
Interest and dividends (note 2)	254,562	151,387
Realized gains on investments (note 2)	206,773	131,274
	2,088,307	1,475,815
Expenses		
Losses on claims	1,034,665	753,777
Operating expenses	408,187	336,880
Interest expense	44,703	36,554
Commissions, net	264,790	161,291
	1,752,345	1,288,502
Earnings before income taxes	335,962	187,313
Provision for income taxes (note 8)	102,261	34,360
Earnings from operations	233,701	152,953
Non-controlling interest	(1,203)	(2,133)
Net earnings	232,498	150,820
Net earnings per share (note 12)	$21.59	$15.36

Consolidated Statements of Retained Earnings

for the years ended December 31, 1997 and 1996

	1997 ($000)	1996 ($000)
Retained earnings B beginning of year	397,672	247,259
Net earnings for the year	232,498	150,820
Excess over stated value of shares purchased for cancellation (note 6)	(1,194)	(407)
Retained earnings B end of year	628,976	397,672

Consolidated Statements of Changes in Cash Resources
for the years ended December 31, 1997 and 1996

	1997 *($000)*	**1996** *($000)*
Operating activities		
Earnings from operations	233,701	152,953
Amortization	6,578	13,565
Deferred income taxes	24,704	5,224
Gains on investments	(206,773)	(131,274)
	58,210	40,468
Increase in provision for claims	143,792	56,635
Increase in unearned premiums	22,006	19,926
Changes in non-cash working capital		
Accounts receivable	(129,215)	35,681
Recoverable from reinsurers	(66,141)	33,149
Claims in process	157	361
Income tax refundable	(5,791)	9,262
Prepaid expenses	29,326	(2,698)
Accounts payable and accrued liabilities	28,923	30,602
Premium deposits	62,034	(10)
Other	91,238	(93,141)
Cash resources provided by operating activities	234,539	78,873
Investing activities		
Investments B purchases	(2,046,201)	(2,278,410)
B sales	2,029,078	2,308,306
Purchase of capital assets	(25,326)	(18,317)
Purchase of subsidiaries, net of cash acquired	(215,199)	(262,452)
	(257,648)	(250,873)
Financing activities		
Capital stock transactions (note 6)	244,783	287,718
Increase in long term debt (note 5)	198,414	176,802
Change in non-controlling interest	(1,694)	(52)
	441,503	464,468
Increase in cash resources	418,394	292,468
Cash resources B beginning of year	611,878	319,410
Cash resources B end of year	1,030,272	611,878

Cash resources consist of cash and short term investments including subsidiary cash and short term investments less bank indebtedness.

February 4, 1998, except as to Note 17, which is as of February 20, 1998

Auditors' Report to the Shareholders

We have audited the consolidated balance sheets of Fairfax Financial Holdings Limited as at December 31, 1997 and 1996 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, 1997 and 1996 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 4, 1998

Valuation Actuary's Report

Coopers & Lybrand has valued the policy liabilities of the subsidiary insurance and reinsurance companies of Fairfax Financial Holdings Limited in its consolidated balance sheet at December 31, 1997 and their change as reflected in its consolidated statement of earnings for the year then ended in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods, except as described in the following paragraph.

Under accepted actuarial practice, the valuation of policy liabilities reflects the time value of money. Management has chosen not to reflect the time value of money in the valuation of its policy liabilities. Our valuation complies with that policy.

In our opinion the valuation is appropriate, except as noted in the previous paragraph, and the consolidated financial statements fairly present its results.

Coopers & Lybrand
Richard Gauthier, FCIA, FCAS
Toronto, Ontario

1. Summary of Significant Accounting Policies

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements. Estimates also affect the reported amounts of income and expenses for the reporting period of the statement of earnings. Actual results could differ from those estimates.

Business operations

The company is a financial services holding company which, through its subsidiaries, is engaged in property, casualty and life insurance and reinsurance, investment management and insurance claims management.

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, Wentworth Insurance Company Ltd., Ranger Insurance Company, Lombard General Insurance Company of Canada, CRC (Bermuda) Reinsurance Limited, Odyssey Re Group Ltd. (Odyssey Reinsurance Corporation, Compagnie Transcontinentale de Réassurance, Sphere Drake Insurance plc and Sphere Drake Insurance (Bermuda) Limited) and Hamblin Watsa Investment Counsel Ltd., all 100% owned; and Lindsey Morden Group Inc., 65% equity and 92% 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 and reinsurance 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 adjustment fees arising therefrom are accounted for on an estimated percentage-of-completion basis.

Deferred premium acquisition costs

Acquisition costs consist of brokers= commissions and premium taxes. 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. Bonds are classified at the earliest of the available maturity dates. Preferred and common stocks are carried at cost. Real estate is carried at book value. 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. Such writedowns are reflected in realized gains (losses) on investments. At December 31, 1997 the aggregate provision for losses on investments was $27.8 million (1996 B $16.5 million).

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. For reinsurance, the provision for claims is based on reports and individual case estimates received from ceding companies. The estimates are regularly reviewed and updated as additional information on the estimated claims becomes known and any resulting adjustments are included in income. A provision is also made for management=s calculation of factors affecting the future development of claims including claims incurred but not reported (IBNR) 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.

The operations of the company=s subsidiaries in the United States, France and the U.K. are self-sustaining. As a result, the assets and liabilities of these subsidiaries are translated at the year-end rates of exchange. Revenue and expenses are translated at the average rate of exchange for the years. The unrealized gains and losses, if material, which result from translation are deferred and included in shareholders= equity under a caption Acurrency translation adjustment@.

The company enters into foreign currency contracts from time to time to hedge the foreign currency exposure related to its net investments in self-sustaining foreign operations. Such contracts are translated at the year-end rates of exchange and a corresponding adjustment, if material, will be included in the currency translation adjustment account in shareholders= equity.

Goodwill

The excess of purchase cost over the fair value of the net assets of acquired businesses is amortized on a straight line basis over their estimated useful life which ranges from 10 years for Hamblin Watsa Investment Counsel Ltd. and Ranger Insurance Company to 40 years for Lindsey Morden Group Inc. The company assesses the continuing value of goodwill based on the underlying cash flows and operating results of the subsidiaries.

The excess of net assets acquired over purchase price paid for acquired businesses of $184.1 million (1996 B $111.7 million) is amortized to income on a straight line basis over 30 years.

Reinsurance

The company reflects third party reinsurance balances on the balance sheet on a gross basis to indicate the extent of credit risk related to third party reinsurance and its obligations to policyholders and on a net basis in the statement of earnings to indicate the results of its retention of premiums written.

2. Investment Information

		1997		1996	
		Book value *($000)*	**Estimated Fair Value** *($000)*	**Book Value** *($000)*	**Estimated Fair Value** *($000)*
Subsidiary cash and short term investments		823,762	823,762	513,205	513,205
Bonds					
Canadian	B government	612,618	640,957	498,843	499,707
	B corporate	117,350	125,959	154,559	166,631
U.S.	B government	613,747	614,564	450,639	447,902
	B corporate	2,177,903	2,262,197	1,020,579	1,037,329
Other	B government	230,687	234,860	B	B
	B corporate	101,200	91,614	B	B
Preferred stocks					
Canadian		271,642	297,101	177,437	195,943
Foreign		B	B	4,792	5,296
Common stocks					
Canadian		167,404	167,190	376,711	431,224
U.S.		113,342	126,037	130,228	156,904
Other		304,317	272,400	B	B
Real estate		54,627	54,627	26,461	26,461
		5,588,599	5,711,268	3,353,454	3,480,602

The estimated fair values of preferred and common stocks and debt securities are based on quoted market values. The book value of real estate approximates fair value.

Management has reviewed currently available information regarding those investments whose estimated fair value is less than book value, amounting to an aggregate unrealized loss of $167 million, and ascertained that the book values are expected to be recovered. Debt securities whose book value exceeds market value can be held until maturity. Preferred and common stock investments have been reviewed to ensure that corporate performance expectations have not changed significantly to adversely affect the market value of these securities other than on a temporary basis.

Liquidity and interest rate risk

Maturity profile as at December 31, 1997

	Within 1 Year *($000)*	**1 to 5 Years** *($000)*	**6 to 10 Years** *($000)*	**Over 10 Years** *($000)*	**Total** *($000)*
Bonds (book value)	338,259	907,396	2,296,022	311,828	3,853,505
Effective interest rate					6.7%

The above maturity profile classifies all dual maturity bonds to their shorter put date.

Investment Income

	1997 ($000)	1996 ($000)
Interest and dividends:		
Cash and short term investments	31,651	13,887
Bonds	195,448	111,311
Preferred stocks	14,751	11,401
Common stocks	14,191	28,253
	256,041	164,852
Expenses	(1,479)	(13,465)
	254,562	151,387
Gain on sale of investments:		
Bonds	6,085	43,101
Preferred stocks	320	110
Common stocks	214,055	68,936
Other	(2,459)	26,737
Provision for loss	(11,228)	(7,610)
	206,773	131,274
Net investment income	461,335	282,661

3. Provision for Claims

The provisions for unpaid claims and adjustment expenses and for the third party reinsurers= share thereof are estimates subject to variability, and the variability could be material in the near term. The variability arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Variability can be caused by receipt of additional claim information, changes in judicial interpretation of contracts or liability or significant changes in severity or frequency of claims from historical trends. The estimates are principally based on the company=s historical experience. Methods of estimation have been used which the company believes produce reasonable results given current information.

Changes in claim liabilities recorded on the balance sheet for the years ended December 31, 1997 and 1996 and their impact on unpaid claims and adjustment expenses for these two years are as shown in the following table:

	1997 ($000)	1996 ($000)
Unpaid claim liabilities B beginning of year B net	2,192,627	965,372
Increase (decrease) in estimated losses and expenses for losses occurring in prior years	(10,823)	16,018
Provision for losses and expenses on claims	1,045,488	641,519
Paid on claims occurring during:		
the current year	(479,611)	(253,507)
prior years	(410,226)	(315,640)
Unpaid claim liabilities of Odyssey Re	B	1,138,865
Unpaid claim liabilities of CTR	600,955	B
Unpaid claim liabilities of Sphere Drake	1,211,976	B
Unpaid claim liabilities before reserve indemnification B end of year B net	4,150,386	2,192,627
Reserve indemnification	(48,606)	(46,600)
Unpaid claim liabilities B end of year B net	4,101,780	2,146,027
Reinsurance gross-up	2,220,957	1,147,422
	6,322,737	3,293,449

The basic assumptions made in establishing actuarial liabilities are best estimates of possible outcomes. To recognize the uncertainty in establishing these best estimates, to allow for possible deterioration in experiences, and to provide greater comfort that the actuarial liabilities are adequate to pay future benefits, actuaries are required to include margins (referred to as provisions for adverse development) in some assumptions. A range of allowable margins is prescribed by the Canadian Institute of Actuaries relating to claim development, reinsurance recoveries and investment income variables. The company presents its claims on an undiscounted basis.

4. Contingent Value Rights

As part of the consideration for the purchase of Sphere Drake, the company issued contingent value rights ("CVRs") bearing effectively 8% interest per annum and payable in 2007, subject to earlier redemption at the option of the company. The amount payable at maturity is subject to adjustments for the development of Sphere Drake's provision for claims as of December 31, 1996, the development of Sphere Drake's reserves for unrecoverable receivables from reinsurers and indemnifiers as of December 31, 1996, the result of commutations and certain actuarial expenses. At December 31, 1997 the principal amount, together with currently accrued interest, of the CVRs had been reduced by $64 million to $46 million.

5. Long Term Debt

The long term debt at December 31 consists of the following balances:

	1997 *($000)*	**1996** *($000)*
Fairfax unsecured senior notes of US$100 million at 7.75% due December 15, 2003	142,960	137,060
Fairfax unsecured senior notes of US$100 million at 8.25% due October 1, 2015 *	142,960	137,060
Fairfax unsecured senior notes of US$125 million at 8.30% due April 15, 2026*	178,700	171,325
Fairfax unsecured senior notes of US$125 million at 7.75% due July 15, 2037 *	178,700	B
Fairfax unsecured senior note at 7.75% due December 15, 2003	25,000	25,000
Fairfax FF300 million debt at 2 2 % due February 27, 2007 (effectively a FF200 million debt at 8%) B see note 13	50,111	B
Long term debt of Lindsey Morden Group Inc.	17,132	16,593
	735,563	487,038

* *In 1996 and 1997 the company entered into various interest rate swap agreements on the asterisked debt with an aggregate balance of $500,360 whereby it now pays interest on that debt at a rate linked to LIBOR, saving approximately 125 basis points on average during 1997.*

Interest expense on long term debt amounted to $44,116 (1996 B $35,971).

Principal repayments on these loans are due as follows:

	($000)
1998	B
1999	1,507
2000	2,146
2001	2,146
Thereafter	729,764
	735,563
Less: current portion	B
	735,563

6. 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

	1997		1996	
	number	*($000)*	*number*	*($000)*
Subordinate voting shares	10,383,530	780,761	9,717,158	527,442
Multiple voting shares	1,548,000	5,000	1,548,000	5,000
	11,931,530	785,761	11,265,158	532,442
Interest in shares held through ownership interest in shareholder	(799,230)	(19,022)	(799,230)	(19,022)
Net effectively outstanding	11,132,300	766,739	10,465,928	513,420

On July 14, 1997 the company issued 650,000 subordinate voting shares at $395 per share for net proceeds of $246,358, and on December 3, 1997 issued 21,472 subordinate voting shares at $341.94 per share for an aggregate of $7,342 as part of the consideration for the Sphere Drake acquisition. In 1997, under the terms of a normal course issuer bid approved by The Toronto Stock Exchange, the company purchased and cancelled 5,100 subordinate voting shares for an aggregate cost of $1,575, of which $1,194 was charged to retained earnings.

On March 26, 1996 the company issued 1,100,000 subordinate voting shares at $155 per share for net proceeds of $163,596, and on October 3, 1996 issued 500,000 subordinate voting shares at $260 per share for net proceeds of $124,682. In 1996, under the terms of a normal course issuer bid approved by The Toronto Stock Exchange, the company purchased and cancelled 3,500 subordinate voting shares for an aggregate cost of $560, of which $407 was charged to retained earnings.

7. Reinsurance

The company follows the policy of underwriting and reinsuring contracts of insurance and reinsurance which, depending on the type of contract, limits the liability of the individual insurance and reinsurance companies to a maximum amount on any one loss of $0.3 to $4.0 million, varying by line of business. Reinsurance is generally placed on an excess of loss basis in several layers. The company=s reinsurance does not, however, relieve the company of its primary obligation to the policyholders.

The company has guidelines and a review process in place to ascertain the creditworthiness of the companies to which it cedes. No information has come to the company=s attention indicating weakness or failure of any of its current reinsurers.

During the year, the company ceded premiums earned of $453,445 (1996 B $402,967) and $304,636 (1996 B $267,568) of claims incurred.

8. 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 in the following table:

	1997 *($000)*	**1996** *($000)*
Provision for taxes at statutory marginal	149,772	72,057
Non-taxable investment income	(18,346)	(15,018)
Income earned outside Canada	(28,406)	(977)
Utilization of prior years= losses and other	(759)	(21,702)
Provision for income taxes	102,261	34,360

Deferred tax assets of the company under Canadian and US GAAP are as follows:

	1997 *($000)*	**1996** *($000)*
Operating and capital losses	42,690	B
Claims discount	115,093	112,494
Unearned premium reserve	39,282	40,605
Deferred premium acquisition cost	(39,391)	(42,185)
Investments	(6,057)	7,230
Allowance for doubtful accounts	16,115	14,385
Other	1,713	2,295
Deferred tax assets, Canadian GAAP	169,445	134,824
Unrealized gains on investments	(46,615)	(48,316)
Deferred tax assets, US GAAP	122,830	86,508

9. Statutory Requirements B Insurance Subsidiaries

The company=s insurance subsidiaries are subject to certain requirements and restrictions under their respective insurance company Acts including minimum asset requirements and dividend restrictions.

10. 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 may under certain circumstances be obligated to purchase loans to officers and directors of the company and its subsidiaries from a Canadian chartered bank totalling $14,636 (1996 B $11,145) for which 390,280 (1996 B 393,570) subordinate voting shares of the company with a year-end market value of $124,890 (1996 B $114,135) have been pledged as security.

At December 31, 1997 the company had net foreign currency contracts outstanding to sell US$820,000, primarily to hedge its net investment in and future earnings from U.S. and U.K. subsidiaries and U.S. portfolio investments of Canadian subsidiaries, as well as FF1,100 million to hedge its net investment in and future earnings from Compagnie Transcontinentale de Réassurance. At December 31, 1997 the unrealized gain associated with these foreign currency contracts was $10 million.

11. Operating Leases

Aggregate future commitments at December 31, 1997 under operating leases relating to premises, automobiles and equipment for various terms up to ten years are as follows:

	($000)
1998	37,300
1999	32,900
2000	25,500
2001	18,100
2002	15,700
Thereafter (in aggregate)	34,000
	163,500

12. Earnings per Share

Fully diluted and basic earnings per share are the same in 1997 and 1996. The weighted average number of shares for 1997 was 10,769,865 (1996 Β 9,817,482).

13. Acquisitions

On December 3, 1997 the company purchased Sphere Drake Holdings Limited of Bermuda for US$217 million ($310 million) of which US$139 million was paid in cash and Fairfax shares (note 6) and US$78 million in contingent value rights (note 4). In addition, the company injected US$100 million of capital into Sphere Drake to permit the repayment of Sphere Drake's US$100 million of debt. At December 3, 1997 (after repayment of its US$100 million of debt) Sphere Drake had US$1,952 million in total assets and US$1,641 million in total liabilities at fair value.

On February 27, 1997 the company purchased Compagnie Transcontinentale de Réassurance (CTR) of Paris, France for FF700 million (approximately $175 million), of which FF300 million was financed by a 10 year 2 2 % borrowing (effectively FF200 million at an 8% rate). At February 27, 1997 CTR had FF4.2 billion ($1.1 billion) in total assets and total liabilities of FF3.3 billion ($875 million) at fair value, resulting in an excess of the fair value of net assets acquired over the effective purchase price of FF300 million. The vendor provided a secured indemnification to a maximum of FF250 million for any inadequacy in CTR's provision for claims as at December 31, 1995 and for any of CTR's reinsurance receivable relating to the period up to December 31, 1995 which subsequently becomes unrecoverable.

Effective May 31, 1996 the company purchased Odyssey Reinsurance Corporation (then named Skandia America Reinsurance Corporation) of New York, New York. The purchase price was US$228 million cash. On May 31, 1996 Odyssey Re had US$1,836 million in total assets and US$1,522 million in total liabilities at fair value, resulting in a US$86 million excess of the fair value of net assets acquired over the purchase price. The vendor provided a secured indemnification to a maximum of US$175 million for any inadequacy in Odyssey Re=s provision for claims as at December 31, 1995 and for any of Odyssey Re=s reinsurance receivable relating to the period up to December 31, 1995 which subsequently becomes unrecoverable.

14. Segmented Information

The company is a financial services holding company which through its subsidiaries is engaged in the insurance of commercial and personal property, oil and gas, casualty and life risks, property, casualty and life reinsurance and the provision of claims adjusting, appraisal and loss management services, as well as in investment management.

	Canada		United States		Europe and Far East		Total	
	1997 ($000)	1996 ($000)	1997 ($000)	1996 ($000)	1997 ($000)	1996 ($000)	1997 ($000)	1996 ($000)
Revenue								
Insurance	651,507	605,645	301,105	295,951	0	0	952,612	901,596
Reinsurance	142,835	125,011	450,870	272,840	342,401	0	936,106	397,851
Claims adjusting	56,931	58,004	106,465	101,817	2,935	2,445	166,331	162,266
Corporate and other	33,258	14,102	0	0	0	0	33,258	14,102
	884,531	802,762	858,440	670,608	345,336	2,445	2,088,307	1,475,815
	42.4%	54.4%	41.1%	45.4%	16.5%	0.2%	100.0%	100.0%
Earnings before income taxes								
Insurance	111,679	94,121	37,930	6,397	0	0	149,609	100,518
Reinsurance	48,304	28,810	147,015	97,199	24,838	0	220,157	126,009
Claims adjusting	1,117	2,513	5,156	6,394	(229)	(9)	6,044	8,898
Corporate and other	(39,848)	(48,112)	0	0	0	0	(39,848)	(48,112)
	121,252	77,332	190,101	109,990	24,609	(9)	335,962	187,313
	36.1%	41.3%	56.6%	58.7%	7.3%	0.0%	100.0%	100.0%
Identifiable assets								
Insurance	1,532,279	1,591,594	1,155,915	983,330	0	0	2,688,194	2,574,924
Reinsurance	461,456	373,910	4,284,651	2,521,191	2,542,641	0	7,288,748	2,895,101
Claims adjusting	33,129	33,487	58,636	56,002	2,781	3,598	94,546	93,087
Corporate and other	135,781	215,277	0	0	0	0	135,781	215,277
	2,162,645	2,214,268	5,499,202	3,560,523	2,545,422	3,598	10,207,269	5,778,389
	21.2%	38.3%	53.9%	61.6%	24.9%	0.1%	100.0%	100.0%
Amortization	3,583	8,472	2,995	5,093	0	0	6,578	13,565
Interest expense	44,053	35,904	650	650	0	0	44,703	36,554

Geographic revenue is determined based on the domicile of the various subsidiaries and where they primarily derive their revenue.

CRC (Bermuda) Reinsurance is included in the Canadian segment and Wentworth Insurance is included in the United States segment.

15. Fair Value

Information on the fair values of financial instruments of the company where those values differ from their carrying values in the financial statements at December 31, 1997 include:

	Note Reference	Book Value	Estimated Fair Value
		($000)	*($000)*
Investments	2	5,588,599	5,711,268
Long term debt	5	735,563	781,961
Foreign exchange contracts	10	0	10,000

The amounts do not include the fair value of underlying lines of business. While fair value amounts are designed to represent estimates of the amounts at which instruments could be exchanged in current transactions between willing parties, certain of the company=s financial instruments lack an available trading market. Therefore, these instruments have been valued on a going concern basis. Fair value information on the provision for claims is not determinable.

These fair values have not been reflected on the financial statements.

16. US GAAP Reconciliation

The consolidated financial statements of the company have been prepared in accordance with generally accepted accounting principles (AGAAP@) as applied in Canada which are different in some respects from those applicable in the United States, as described below.

Consolidated Statements of Earnings

There is no material difference between the consolidated net earnings as reported under Canadian GAAP for the years ended December 31, 1997 and 1996 and the consolidated net earnings which would be reported by applying US GAAP.

Net earnings per share

There is no material difference between the net earnings per share as reported under Canadian GAAP for the years ended December 31, 1997 and 1996 and the net earnings per share which would be reported by applying US GAAP.

Consolidated Balance Sheets

The following shows the balance sheet amounts in accordance with US GAAP where different from the amounts reported under Canadian GAAP:

	1997 ($000)	1996 ($000)
Assets		
Portfolio investments		
Bonds	3,970,151	2,151,569
Preferred stocks	297,101	201,239
Common stocks	565,627	588,128
Total portfolio investments	4,832,879	2,940,396
Deferred income taxes	122,830	86,508
Other assets (reinsurance assets)	5,327,614	2,829,777
Total assets	10,283,323	5,857,221
Liabilities		
Total liabilities	8,811,554	4,867,297
Shareholders= Equity		
Total shareholders= equity	1,471,769	989,924

The difference in consolidated shareholders= equity is as follows:

	1997 ($000)	1996 ($000)
Shareholders= equity based on Canadian GAAP	1,395,715	911,092
Investments available for sale B unrealized gains	122,669	127,148
Less: related deferred income taxes (note 8)	(46,615)	(48,316)
Shareholders= equity based on US GAAP	1,471,769	989,924

Disclosure of interest and taxes paid

The aggregate amount of interest paid for the years ended December 31, 1997 and 1996 was $53,111 and $33,781 respectively. The aggregate amount of taxes paid for the years ended December 31, 1997 and 1996 was $43,736 and $17,505 respectively.

17. Subsequent Events

On January 16, 1998 the company announced that it had completed the purchase of Falcon Insurance Company Limited for HK$22.5 million cash which was equivalent to Falcon's net assets. Falcon will be further capitalized to HK$240 million by April 1998 and will write property and casualty insurance in Hong Kong and surrounding territories.

On February 20, 1998 the company announced that it had agreed to purchase Skandia International Insurance Corporation of Sweden (SIIC) and Skandia U.K. Insurance plc (SUKI) of England for US$75 million. It is estimated that at December 31, 1997 SIIC and SUKI had total assets of US$745 million and combined shareholders' equity of US$105 million. At December 31, 1997, the business of SIIC and SUKI consisted of reinsurance run-off operations.

Management=s Discussion and Analysis of Financial Condition and Results of Operations

Sources of Revenue

Revenue reflected in the consolidated financial statements includes premiums earned and investment income of the insurance companies, claims adjusting fees of Lindsey Morden and other miscellaneous income. The following table summarizes the total revenue derived from these categories from the date of acquisition of each company for the past five years.

Revenue by Line of Business

	1997 ($000)	1996 ($000)	1995 ($000)	1994 ($000)	1993 ($000)
Insurance	1,888,718	1,299,447	985,916	476,445	201,402
Claims adjusting	166,331	162,266	154,914	156,093	142,105
Other income	33,258	14,102	4,690	2,359	515
	2,088,307	1,475,815	1,145,520	634,897	344,022

The increase in insurance revenue in 1997 over 1996 was mainly the result of the inclusion of Odyssey Re for all of 1997 as opposed to seven months after its acquisition in 1996 and the February 27, 1997 acquisition of CTR, which resulted in higher insurance premiums and investment income.

On a geographic basis, Canadian operations accounted for approximately 42% of Fairfax=s revenue and 36% of operating profits in 1997, compared with approximately 54% of revenue and 41% of operating profits in 1996.

Canadian insurance operations accounted for approximately 44% of Fairfax=s premiums in 1997 (1996 B 56%).

Net Earnings

Sources of net earnings with Lindsey Morden equity accounted were as follows for the past five years:

	1997	1996	1995	1994	1993
	($000)	*($000)*	*($000)*	*($000)*	*($000)*
Underwriting	(56,157)	(50,563)	(40,883)	(16,880)	2,065
Interest and dividends	242,300	144,101	86,274	53,742	23,006
Insurance earnings before realized gains	186,143	93,538	45,391	36,862	25,071
Claims adjusting (Fairfax portion)	1,824	2,298	2,098	532	395
Interest expense	(43,182)	(34,997)	(19,086)	(10,426)	(4,228)
Goodwill and other amortization	(4,817)	(4,765)	(4,765)	(1,392)	(1,392)
Corporate overhead and other	(14,991)	(6,656)	(5,618)	(2,147)	(2,862)
Realized gains	206,773	131,274	71,912	20,026	27,822
Pre-tax income	331,750	180,692	89,932	43,455	44,806
Less: taxes	99,252	29,872	2,435	5,350	11,466
Net earnings	232,498	150,820	87,497	38,105	33,340

Net earnings in 1997 were $232.5 million, an increase of $81.7 million or 54% from 1996 net earnings of $150.8 million.

The major changes which affected net earnings were:

B Insurance earnings before realized gains increased by $92.6 million over 1996 due to increased interest and dividend income, partially offset by slightly higher underwriting losses

B Net realized gains increased in 1997 to $206.8 million from $131.3 million in 1996

B Interest expense increased in 1997 due to interest expenses from the debt issued in 1997 related to the purchase of Sphere Drake and CTR and to interest expenses from the debt issued in 1996 related to the purchase of Odyssey Re being expensed throughout 1997

B Corporate overhead and other increased mainly because of one time expenses associated with acquisitions and securities issues

S The provision for income taxes was higher in 1997 due to the higher pre-tax income as a result of increased investment income.

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 the past thirteen years:

	NET PREMIUMS		RATIOS		
	Written *($000)*	**Earned** *($000)*	**Loss** *(%)*	**Expense** *(%)*	**Combined** *(%)*
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
1992	128,664	118,854	79	35	114
1993	163,508	150,844	73	26	99
1994	411,570	400,559	74	30	104
1995	864,589	829,340	74	31	105
1996	1,043,079	1,030,888	73	32	105
1997	1,392,627	1,460,641	71	33	104

In 1997 the combined ratio was above 100% because of ratios above 100% for the recently acquired reinsurance companies and Ranger (our Canadian companies achieved a ratio of 100%). Since current management took over in September 1985 Fairfax has had combined ratios of less than 100% in five of the twelve full years and greater than 100% in the remaining seven years.

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

		1997 ($000)	1996 ($000)	1995 ($000)	1994 ($000)	1993 ($000)
Commonwealth	Written	83.462	87.297	87.875	90.403	71.181
	Earned	86,484	87,770	86,962	86,520	61,855
Federated	Written	63.588	60.405	57.549	50.396	41.629
	Earned	62,343	59,472	54,297	47,376	40,436
Lombard	Written	363.283	357.550	351.592	30.727	B
	Earned	351,480	349,566	352,082	26,869	B
Markel	Written	55.350	62.576	79.683	55.937	44.896
	Earned	65,370	60,148	56,976	52,149	43,749
Ranger	Written	201.939	212.815	180.253	175.410	B
	Earned	205,744	209,409	173,937	179,345	B
CRC (Bermuda)	Written	97.086	99.044	92.270	B	B
	Earned	95,798	97,805	89,252	B	B
CTR	Written	224.299	B	B	B	B
	Earned	268,222	B	B	B	B
Odyssey Re	Written	273.453	155.044	B	B	B
	Earned	290,924	158,547	B	B	B
Sphere Drake	Written	22.072	B	B	B	B
	Earned	26,056	B	B	B	B
Wentworth and other	Written	8.095	8.348	15.367	8.697	5.802
	Earned	8,220	8,171	15,834	8,300	4,804
Totals	Written	1.392.627	1.043.079	864.589	411.570	163.508
	Earned	1,460,641	1,030,888	829,340	400,559	150,844

Increased competition resulted in a decrease in net premiums written in 1997 at Commonwealth, Markel and Ranger. Federated and Lombard had a slight increase in premiums due to increased market penetration at Federated and the Privilege 50 program at Lombard. Wentworth had flat premiums written in 1997 while Odyssey Re results have been included for twelve months in 1997 versus only seven months in 1996. CTR results were included for ten months in 1997 and Sphere Drake results for only one month in 1997.

Because of the competitive market, net premiums written decreased in 1996 at Markel and remained flat at Commonwealth and Lombard. Federated and Ranger had higher net premiums written in 1996 due to increased market penetration in their respective segments. Ranger and Lombard were included in Fairfax=s income statements for the first time in 1994 B for a year and for one month respectively. CRC (Bermuda)=s premiums originate mainly from a quota share treaty with Lombard.

The total underwriting profit (loss) for the individual insurance companies for the past five years is shown in the following table:

	1997 ($000)	1996 ($000)	1995 ($000)	1994 ($000)	1993 ($000)
Commonwealth	9,686	11,435	9,104	1,867	5,126
Federated	1,606	(132)	(1,120)	257	(1,320)
Lombard	(19,863)	(17,475)	(30,915)	(143)	B
Markel	(1,942)	(1,717)	(1,088)	(7,965)	(5,088)
Ranger	(24,971)	(49,131)	(31,524)	(15,061)	B
CRC (Bermuda)	7,447	2,813	6,635	B	B
CTR	(24,565)	B	B	B	B
Odyssey Re	(17,477)	(4,881)	B	B	B
Wentworth and other	13,922	8,525	8,025	4,165	3,347
Totals	(56,157	(50,563)	(40,883)	(16,880)	2,065

As shown, in 1997 the largest underwriting losses were incurred at Ranger, CTR and Odyssey Re. These losses are expected to decrease in 1998. Lombard's underwriting loss should be considered together with CRC (Bermuda)'s underwriting profit. Wentworth and other's underwriting profit includes Sphere Drake for one month in 1997.

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 (IBNR) based on the volume of business currently in force and the historical experience on claims.

As time passes, more information about the claims becomes known and provision estimates are appropriately adjusted upward or downward. Because of the estimation elements encompassed in this process, and the time it takes to settle many of the more substantial claims, several years are required before a meaningful comparison of actual losses to the original provisions can be developed.

The development of the provision for claims is shown by the difference between estimates of reserves as of the initial year-end and the re-estimated liability at each subsequent year-end. This is based on actual payments in full or partial settlement of claims, plus re-estimates of the reserves required for claims still open or claims still unreported. Unfavourable development means that the original reserve estimates were lower than subsequently indicated.

The following table presents a reconciliation of the provision for claims and loss adjustment expense (LAE) by company for the past five years. As shown in the table, the sum of the provision for claims for each of Fairfax=s insurance subsidiaries is $6,322.7 million as at December 31, 1997 B the amount shown as Provision for claims on Fairfax=s balance sheet on page 28. The Aother@ shown in the table below is the $14 million Fairfax indemnification of Ranger reserves.

Reconciliation of Provision for Claims and LAE as at December 31

	1997 *($000)*	**1996** *($000)*	**1995** *($000)*	**1994** *($000)*	**1993** *($000)*
Commonwealth, Federated and Markel	261,078	244,972	219,406	211,313	185,010
Lombard	308,075	307,877	312,331	311,546	B
CRC (Bermuda)	194,900	193,270	163,592	150,930	B
Total Canadian subsidiaries	764,053	746,119	695,329	637,789	185,010
Wentworth	8,639	13,363	12,095	7,659	1,486
Ranger B net of indemnification	214,445	210,585	169,017	217,251	235,525
Odyssey Re	1,206,491	1,138,865	B	B	B
CTR	600,955	B	B	B	B
Sphere Drake and other	1,268,571	B	B	B	B
Total non-Canadian subsidiaries	3,299,101	1,362,813	181,112	224,910	237,011
Federated Life	24,626	23,095	22,214	22,975	22,825
Other	14,000	14,000	14,000	B	B
Total provision for claims and LAE	4,101,780	2,146,027	912,655	921,674	444,846
Reinsurance gross-up	2,220,957	1,147,422	414,482		
Total including gross-up	6,322,737	3,293,449	1,327,137		

The four tables that follow show the reconciliation and the reserve development of the insurance companies= provision for claims. In order to avoid the distortions caused by foreign exchange fluctuations, separate tables are provided for the Canadian and non-Canadian subsidiaries of Fairfax. CRC (Bermuda) is included with the Canadian subsidiaries while Wentworth is included with the non-Canadian subsidiaries.

The following table shows for Fairfax=s Canadian subsidiaries the provision for claims liability for unpaid losses and LAE as originally and as ultimately estimated for the years 1993 through 1997. The favourable or unfavourable development from prior years is credited or charged to each year=s earnings.

Reconciliation of Provision for Claims
Canadian Subsidiaries

	1997 *($000)*	**1996** *($000)*	**1995** *($000)*	**1994** *($000)*	**1993** *($000)*
Provision for claims and LAE at January 1 for Commonwealth, Federated, Markel and, for 1997, 1996 and 1995, Lombard and CRC (Bermuda)	746,119	695,328	673,789	185,010	179,588
Incurred losses on claims and LAE					
Provision for current accident year=s claims	553,902	482,970	456,967	139,671	102,582
Increase (decrease) in provision for prior accident years= claims	(11,974)	(16,692)	4,149	2,809	360
Total incurred losses on claims and LAE	541,928	466,278	461,116	142,480	102,942
Payments for losses on claims and LAE					
Payments on current accident year=s claims	(285,066)	(195,604)	(205,766)	(53,222)	(40,696)
Payments on prior accident years= claims	(238,928)	(219,883)	(233,811)	(62,955)	(56,824)
Total payments for losses on claims and	(523,994)	(415,487)	(439,577)	(116,177)	(97,520)
Provision for claims and LAE at December 31	B	B	B	211,313	185,010
Provision for claims and LAE for Lombard and CRC (Bermuda) at December 31	B	B	B	462,476	
Provision for claims and LAE at December 31 including Lombard and CRC (Bermuda)	764,053	746,119	695,328	673,789	

The company strives to establish adequate provisions at the original valuation date. It is the company=s objective to have favourable development from the past. The Canadian subsidiaries had favourable development in 1997 of $12.0 million. The reserves will always be subject to upward or downward development in the future.

The following table shows for Fairfax=s Canadian subsidiaries the original provision for claims reserves including LAE at each calendar year-end commencing in 1987 with the subsequent cumulative payments made from these years and the subsequent re-estimated amount of these reserves. The following insurance subsidiaries= reserves are included from the respective years in which they were originally acquired:

Subsidiary	Year Acquired
Markel Insurance Company of Canada	1985
Federated Insurance Company of Canada	1990
Commonwealth Insurance Company	1990
Lombard General Insurance Company of Canada	1994
CRC (Bermuda) Reinsurance Limited	1994

Provision for Canadian Subsidiaries - Claims Reserve Development

(including Commonwealth, CRC (Bermuda), Federated, Lombard and Markel)

As at December 31	**1987 and prior**	**1988**	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**
	($000)	*($000)*	*($000)*	*($000)*	*($000)*	*($000)*	*($000)*	*($000)*	*($000)*	*($000)*	*($000)*
Provision for claims including LAE	59,400	71,964	79,357	192,372	168,394	179,588	185,010	673,789	695,328	746,119	764,053
Cumulative payments as of:											
One year later	18,752	21,015	25,194	44,055	48,050	56,824	62,955	233,811	219,883	238,928	
Two years later	27,154	33,196	35,440	76,947	75,402	87,878	105,537	351,600	355,035		
Three years later	32,919	42,043	44,169	98,149	94,834	110,565	127,418	457,680			
Four years later	37,784	47,901	50,119	115,417	110,838	126,123	147,296				
Five years later	41,128	52,103	55,310	127,003	120,435	137,732					
Six years later	43,991	55,675	58,687	135,020	128,060						
Seven years later	45,654	57,855	60,422	142,082							
Eight years later	46,352	59,152	61,625								
Nine years later	47,052	60,150									
Ten years later	47,303										
Reserves re-estimated as of:											
One year later	56,920	71,673	80,602	175,138	168,001	179,948	187,819	677,938	678,636	734,145	
Two years later	54,920	69,930	73,904	173,992	157,848	174,820	191,825	676,826	692,888		
Three years later	53,004	67,676	71,810	165,752	157,671	171,833	197,833	685,675			
Four years later	52,295	64,478	67,165	166,797	156,291	177,451	198,650				
Five years later	50,235	64,394	65,414	165,625	158,366	177,370					
Six years later	50,822	62,939	65,181	167,289	161,088						
Seven years later	49,198	63,103	64,087	169,803							
Eight years later	49,815	62,250	64,196								
Nine years later	48,636	62,218									
Ten years later	48,669										
Favourable (unfavourable) development	10,731	9,746	15,161	22,569	7,306	2,218	(13,640)	(11,886)	2,440	11,974	

The Canadian subsidiaries had a net redundancy of $12.0 million during 1997, with all of the Canadian insurance companies contributing to this reserve redundancy.

While management is pleased with the generally favourable development over the years, future development could be significantly different from the past due to many unknown factors.

The following table shows for Fairfax's non-Canadian subsidiaries the provision for claims liability for unpaid losses and LAE as originally and as ultimately estimated for the years 1994 through 1997. The favourable or unfavourable development from prior years is credited or charged to each year's earnings.

Reconciliation of Provision for Claims

Non-Canadian Subsidiaries

	1997	**1996**	**1995**	**1994**
	(US$000)	*(US$000)*	*(US$000)*	*(US$000)*
Provision for claims and LAE at January 1 for Ranger, Wentworth and, for 1997, Odyssey Re	1,046,113	166,603	160,331	179,001
Incurred losses on claims and LAE				
Provision for current accident year's claims	255,601	116,238	93,235	97,899
Increase in provision for prior accident	805	23,981	38,117	8,202
Total incurred losses on claims and LAE	256,406	140,219	131,352	106,101
Payments for losses on claims and LAE				
Payments on current accident year's claims	(71,964)	(37,832)	(34,394)	(39,277)
Payments on prior accident years' claims	(196,571)	(71,596)	(90,686)	(85,494)
Total payments for losses on claims and LAE	(268,535)	(109,428)	(125,080)	(124,771)
Provision for claims and LAE at December 31	1,033,984	197,394	166,603	160,331
Provision for claims and LAE for Odyssey Re at	B	848,719	B	B
Provision for claims and LAE for CTR at December	420,365	B	B	B
Provision for claims and LAE for Sphere Drake at	887,360	B	B	B
Provision for claims and LAE at December 31 for Ranger, Wentworth, Odyssey Re, CTR and Sphere Drake before indemnification	2,341,709	1,046,113	166,603	160,331
Reserve indemnification	(34,000)	(34,000)	(34,000)	B
Provision for claims and LAE at December 31 for Ranger, Wentworth, Odyssey Re, CTR and Sphere Drake after indemnification	2,307,709	1,012,113	132,603	160,331
Exchange rate	*1.4296*	*1.3706*	*1.3652*	*1.4028*
Converted to Canadian dollars	C$ 3,299,101	C$ 1,387,202	C$ 181,030	C$ 224,910

The unfavourable reserve development of US$0.8 million in the U.S. operations for the 1997 year was due to additional development of reserves at Ranger (US$8.7 million) balanced by redundancies at Odyssey Re (US$2.9 million) and Wentworth (US$5.0 million). The unfavourable reserve development at Ranger was due mainly to the run-off of certain reinsurance assumed lines. Core lines at Ranger, as well as the discontinued insurance lines, are well reserved, recognizing that reserves will always be subject to upward or downward development in the future.

The following table shows for Fairfax's U.S. subsidiaries the original provision for claims reserves including LAE at each calendar year-end with the subsequent cumulative payments made from these years and the subsequent re-estimated amount of these reserves. The following insurance subsidiaries' reserves are included from the respective years in which they were originally acquired (Wentworth from 1993 as its operations were minor prior to that):

Subsidiary	
Wentworth Insurance Company Ltd.	Commenced business 1990
Ranger Insurance Company	Acquired 1993
Odyssey Reinsurance Corporation	Acquired 1996

Provision for U.S. Subsidiaries' Claims Reserve Development
(including Ranger, Wentworth and Odyssey Re)

As at December 31	**1993** *(US$000)*	**1994** *(US$000)*	**1995** *(US$000)*	**1996** *(US$000)*	**1997** *(US$000)*
Provision for claims including LAE	179,001	160,331	166,603	1,046,113	1,034,834
Cumulative payments as of:					
One year later	85,494	90,686	71,596	196,571	
Two years later	142,398	133,272	121,389		
Three years later	170,085	160,953			
Four years later	182,093				
Reserves re-estimated as of:					
One year later	187,203	198,448	190,584	1,046,918	
Two years later	213,295	216,610	200,800		
Three years later	225,886	225,902			
Four years later	237,714				
Favourable (unfavourable) development before indemnification	(58,713)	(65,571)	(34,197)	(805)	
Reserve indemnification	20,000	34,000	B	B	
Favourable (unfavourable) development after indemnification	(38,713)	(31,571)	(34,197)	(805)	

The additional reserve development in 1997 at Ranger, discussed on page 55, resulted in increasing the reserve deficiencies for 1995 and prior periods at Ranger as shown in the table above.

Asbestos, Pollution and Other Hazards

All of Fairfax's reinsurance subsidiaries in the Odyssey Re Group wrote reinsurance policies prior to their acquisition by Fairfax which involve asbestos related and environmental pollution (APH) coverage, primarily in the United States. In addition, Ranger has approximately US$8.0 million in APH reserves at year-end 1997. Following is an analysis of Fairfax's gross and net reserves from APH exposures at year-end.

At December 31, 1997

	Gross			**Net**		
	Outstanding	**IBNR**	**Total**	**Outstanding**	**IBNR**	**Total**
	(US$000)	*(US$000)*	*(US$000)*	*(US$000)*	*(US$000)*	*(US$000)*
Asbestos	151,958	125,346	277,304	84,657	66,714	151,371
Pollution	71,433	49,669	121,102	59,886	40,547	100,433
Other hazards	4,184	321	4,505	3,433	321	3,754
Total	227,575	175,336	402,911	147,976	107,582	255,558

The gross amount of US$402.9 is included in the C$6,322.7 million of Provision for claims on Fairfax's balance sheet on page 28.

Many insurance coverage issues and circumstantial uncertainties make the estimation of these reserves very difficult. Inconsistencies among the states with regard to coverage, occurrence definitions and Superfund reform can all affect the outcome of APH claims.

These APH reserves are continuously monitored by management and are reviewed extensively by independent consulting actuaries.

Fairfax is protected against adverse development of these reserves at Odyssey Re, CTR and Sphere Drake from their levels at the time of acquisition of those companies to the extent of the available indemnifications obtained in connection with those acquisitions, as discussed under Indemnifications on page 59.

Reinsurance Recoverables

Fairfax's subsidiaries purchase certain reinsurance so as to reduce their liability on the insurance and reinsurance risks which they write. Fairfax strives to minimize the credit risk of purchasing reinsurance through adherence to its internal reinsurance guidelines. To be a reinsurer of Fairfax, a company must have high A.M. Best and/or Standard & Poor's ratings and maintain capital and surplus exceeding $100 million. The following table shows Fairfax's top fifteen active reinsurers at December 31, 1997. These fifteen reinsurers represent 53% of Fairfax's $2,164 million in reinsurance recoverable (which total is net of bad debt reserves aggregating $91 million).

Reinsurers	A.M. Best Rating	Reinsurance Recoverable ($000)
Equitas	B	291,290
Skandia Insurance Company Ltd.	A+	217,453
Frankona	A	75,717
TIG Reinsurance	A	70,298
Employers Reinsurance	A++	65,458
Centre Reinsurance	A	53,180
GAN	AB	51,058
Lloyds of London Underwriters	A	50,356
Hannover Reinsurance	A+	44,091
Kemper Reinsurance	A	41,520
Everest Reinsurance	A	39,900
General Reinsurance	A++	38,978
CIGNA	B+	36,369
Swiss Reinsurance	A	34,302
Munich Reinsurance	A++	32,507
Other reinsurers	B	1,112,989
		2,255,466
Provision for uncollectible reinsurance		91,000
Total reinsurance recoverable on paid and unpaid losses		2,164,466

To support these reinsurance recoverable balances, Fairfax has the benefit of letters of credit, trust funds or offsetting balances payable totalling $1,367 million. Equitas and Lloyds are also required to maintain funds in Canada and the United States which are monitored by the applicable regulatory authorities.

Reinsurance treaties typically contain provisions concerning ceding commissions, required reports to the reinsurers, responsibility for taxes and arbitration in the event of a dispute, and provisions allowing the company to demand that a reinsurer post letters of credit or assets as security if a reinsurer becomes an "unauthorized" or "unapproved" reinsurer under applicable laws and regulations.

Fairfax is protected against adverse development of the reserves for unrecoverable reinsurance at Lombard, Odyssey Re, CTR and Sphere Drake from their levels at the time of acquisition of those companies to the extent of the available indemnifications obtained in connection with those acquisitions, as discussed under Indemnifications on page 59.

Indemnifications

Shown below are the indemnifications originally received by Fairfax on previous acquisitions. These indemnifications protect Fairfax from adverse development in the respective companies' claims reserves and unrecoverable reinsurance as at the end of the respective original years shown. The indemnifications will be settled as of the end of the respective settlement years shown.

Year	**Company**	**Amount** *(millions)*	**Amount** *(C$ millions)*	**Settlement Year**
1993	Ranger	US$ 20	28	1998
1993	Lombard	C$ 40	40	1998
1995	Odyssey Re	US$ 175	245	2005
1995	CTR	FF 250	60	2005
1996	Sphere Drake	US$ 78	109	2006
			482	

At December 31, 1997 the company estimates that the Ranger indemnification has been exhausted and that the other indemnifications have been used to the following extent: Lombard B 0, Odyssey Re B US$31 million (C$44 million), CTR B FF50 million (C$12 million) and Sphere Drake B US$45 million (C$64 million), leaving remaining indemnifications totalling C$334 million.

Year 2000

The company commenced work on the "Year 2000" issue in 1995 and is planning to complete the last parts of the project by November 1, 1998 since insurance and reinsurance policies issued in November 1998 expire in the year 2000.

The senior management and Audit Committee at Fairfax have been reviewing the progress of each subsidiary's Year 2000 plans for the past year and a half.

A year ago the company completed surveys of all the services it purchases or provides where the Year 2000 Issue could have an impact on its business and believes all major issues have been addressed.

It is estimated that about 80% of the system modifications (on which $5.5 million was spent in 1997) are now complete and that the cost of the remaining changes will be approximately $6 million in 1998. Testing began in 1997 and 95% of the testing is expected to be complete by September 1998.

Until the testing is complete, it is not possible to be certain that all aspects of the Year 2000 issue have been addressed. However, since Fairfax has a number of insurance and reinsurance subsidiaries, it is anticipated that if the system failed at one subsidiary, it would be possible to process that subsidiary's business on another subsidiary's system in the short term.

Insurance Environment

The property and casualty insurance market continued to be very competitive in 1997 with combined ratios in Canada and the U.S. expected to be approximately 103% and 102% respectively, versus 103% and 106% respectively in 1996. An absence of major catastrophes in North America continued to have a favourable influence on the industry. However, many insurance companies continue to write insurance at inadequate prices. Significant restructuring and consolidation continues to take place in the industry. We continue to believe that over time price increases must take place to compensate for the underwriting losses combined with interest rates which are insufficient to adequately offset these losses. Currently, however, the industry continues to be highly competitive.

CTR and Sphere Drake Acquisitions

Effective February 27, 1997 the company acquired Compagnie Transcontinentale de Réassurance. The consolidated balance sheet of CTR upon acquisition was as follows:

	(FF millions)
Investments, including cash	3,200
Deferred premium acquisition costs	80
Accounts receivable	640
Other assets	230
	4,150
Provision for claims	2,220
Unearned premiums	500
Other liabilities	500
Deferred income taxes	50
Shareholders= equity	900
	4,150

The purchase price of FF700 million (approximately $175 million) was paid in cash (FF400 million) and a FF300 million 10 year 2 2 % borrowing (effectively FF200 million at an 8% rate).

CTR writes primarily property, casualty and some life reinsurance internationally. CTR=s net premiums written for 1997 were FF945 million.

Effective December 3, 1997 the company acquired Sphere Drake Holdings Limited. The consolidated balance sheet of Sphere Drake upon acquisition (after repayment of Sphere Drake's US$100 million of debt) was as follows:

	(US$000)
Investments, including cash	746,560
Deferred premium acquisition costs	39,129
Accounts receivable	549,590
Recoverable from reinsurers	560,317
Deferred income taxes	35,113
Other assets	21,308
	1,952,017
Provision for claims	1,245,977
Unearned premiums	130,097
Other liabilities	264,681
Shareholders= equity	311,262
	1,952,017

The acquisition price was US$217 million ($310 million) of which US$139 million was paid in cash and Fairfax shares and US$32 million in contingent value rights (note 4). In addition, the company injected US$100 million of capital into Sphere Drake to permit the repayment of Sphere Drake's US$100 million of debt.

Sphere Drake writes traditional and alternative reinsurance and specialized insurance products. Its net premiums written for 1997 were US$266 million.

Interest and Dividend Income

The majority of interest and dividend income is earned by the insurance companies. The Commonwealth and Federated acquisitions added $130 million and $101 million respectively to the investment portfolio at the end of 1990, and interest and dividend income for Commonwealth was included for only two months in 1990. Ranger's $400 million investment portfolio acquired effective December 31, 1993, Lombard's $684 million portfolio acquired effective November 30, 1994, Odyssey Re=s $1,490 million portfolio acquired effective May 31, 1996, CTR's $764 million portfolio acquired effective February 27, 1997 and Sphere Drake's $1,068 million portfolio acquired effective December 3, 1997 are included in the following tables only as indicated.

	Average Investments at Book Value	Interest and Dividend Income					
		Pre-Tax			After Tax		
		Amount	Yield	Per Share	Amount	Yield	Per Share
	($000)	*($000)*	*(%)*	*($)*	*($000)*	*(%)*	*($)*
1985	29,060	2,455	8.45	0.87	1,271	4.37	0.45
1986	64,181	4,678	7.29	0.96	2,522	3.93	0.52
1987	109,825	8,042	7.32	1.10	5,499	5.01	0.77
1988	130,782	8,922	6.82	1.22	6,618	5.06	0.90
1989	135,703	11,628	8.57	1.51	8,537	6.29	1.11
1990	237,868	20,704	8.70	2.75	14,017	5.89	1.86
1991	338,461	26,051	7.70	4.44	17,731	5.24	3.02
1992	366,481	23,988	6.55	4.17	17,749	4.84	3.09
1993(1)	418,207	23,251	5.56	3.78	17,994	4.30	2.92
1994(2)	852,010	58,219	6.83	7.12	39,608	4.65	4.85
1995	1,608,054	89,354	5.56	10.00	73,664	4.58	8.25
1996(3)	2,548,076	151,387	5.94	15.42	111,458	4.37	11.35
1997(4)	4,584,569	254,562	5.55	23.64	174,408	3.80	16.19

(1) *Ranger is not included in this line.*
(2) *Lombard is not included in this line.*
(3) *Odyssey Re is included in this line for seven months.*
(4) *CTR is included in this line for ten months and Sphere Drake for one month.*

Interest and dividend income increased in 1997 due to the inclusion of Odyssey Re=s portfolio for a full year versus seven months in 1996, as well as the acquisitions of CTR and Sphere Drake in 1997. As shown, the pre-tax income yield decreased in 1997 to 5.55% due to declining interest rates in 1997. The after-tax income yield dropped in 1997 because of lower pre-tax yields. Pre-tax interest and dividend income per share has compounded at 32% per year since 1985.

Investments for the past thirteen years are shown in the following table, the first five columns of which show them at the average of their carrying values at the beginning and end of each year, and the final two columns of which show them at year-end.

	Cash and Short Term Investments ($000)	Bonds ($000)	Preferreds ($000)	Common ($000)	Total Investments Average ($000)	Total Investments Year-end ($000)	Per Share ($)
1985	10,526	15,388	732	2,414	29,060	32,728	6.55
1986	16,605	24,523	7,979	15,074	64,181	95,633	13.65
1987	28,025	26,242	16,516	39,042	109,825	124,016	16.90
1988	29,843	23,575	25,191	52,173	130,782	137,548	18.79
1989	20,623	28,528	32,212	54,340	135,703	133,858	18.30
1990	33,596	99,220	45,652	59,400	237,868	335,740	61.30
1991	60,099	140,177	75,685	62,500	338,461	341,180	62.54
1992	77,929	108,818	99,821	79,913	366,481	396,240	65.44
1993(1)	102,968	90,682	118,604	105,953	418,207	848,774	106.70
1994(2)	226,205	303,859	132,138	189,808	852,010	1,551,343	173.25
1995	297,989	796,310	157,017	356,738	1,608,054	1,668,656	188.14
1996(3)	470,651	1,462,064	168,438	446,923	2,548,076	3,454,521	330.07
1997(4)	822,569	2,989,063	226,936	546,001	4,584,569	5,795,703	520.62

(1) *Ranger is not included in the first five columns in this line.*
(2) *Lombard is not included in the first five columns in this line.*
(3) *Odyssey Re is included in this line.*
(4) *CTR and Sphere Drake are included in this line.*

Total investments per share at year-end 1997 increased significantly due to the CTR and Sphere Drake acquisitions. Since 1985 investments per share have compounded at 44% per year.

Return on Investment Portfolio

The following table shows the performance of the investment portfolio for the past thirteen 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 Value ($000)	Interest and Dividends Earned ($000)	Realized Gains (Losses) after Provisions ($000)	Change in Unrealized Gains (Losses) ($000)	Total Return on Average Investments ($000)	(%)
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
1992	366,481	23,988	3,400	(11,197)	16,191	4
1993[1]	418,207	23,251	27,822	28,792	79,865	19
1994[2]	852,010	58,219	20,026	(42,407)	35,838	4
1995	1,608,054	89,354	71,912	45,438	206,704	13
1996[3]	2,548,076	151,387	131,274	112,676	395,337	16
1997[4]	4,584,569	254,562	206,773	(4,479)	456,856	10

(1) *Ranger is not included in this line.*
(2) *Lombard is not included in this line.*
(3) *Odyssey Re is included in this line.*
(4) *CTR and Sphere Drake are included in this line.*

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 has no predictive value and variations in amount from period to period have no practical analytic value. At December 31, 1997 the aggregate provision for losses on investments was $27.8 million (1996 B $16.5 million). At December 31, 1997 the Fairfax investment portfolio had an unrealized gain of $122.7 million compared to an unrealized gain at December 31, 1996 of $127.1 million.

The company has a long term value-oriented investment philosophy. It continues to expect fluctuations in the stock market.

Capital Resources

At December 31, 1997 total capital, comprising shareholders= equity and non-controlling (minority) interest, was $1,416.2 million, compared to $932.1 million at December 31, 1996.

The following table shows the level of capital as at December 31 for the past five years:

	1997	1996	1995	1994	1993
			($ millions)		
Non-controlling interest	20.5	21.0	18.9	17.3	17.4
Shareholders= equity	1,395.7	911.1	472.6	391.9	279.5
	1,416.2	932.1	491.5	409.2	296.9

Fairfax's consolidated balance sheet as at December 31, 1997 continues to reflect significant financial strength. Fairfax's shareholders' equity has increased from $911.1 million at December 31, 1996 to $1,395.7 million at December 31, 1997.

On July 14, 1997 the company issued 650,000 subordinate voting shares at $395 per share for net proceeds of $246.4 million, and on December 3, 1997 issued 21,472 subordinate voting shares at $341.94 per share, for an amount of $7.3 million, as part of the Sphere Drake acquisition. In 1997, under the terms of a normal course issuer bid approved by The Toronto Stock Exchange, the company purchased and cancelled 5,100 subordinate voting shares for an aggregate cost of $1,575,000 of which $1,194,000 was charged to retained earnings.

On March 26, 1996 the company issued 1,100,000 subordinate voting shares at $155 per share for net proceeds of $163.6 million, and on October 3, 1996 issued 500,000 subordinate voting shares at $260 per share for net proceeds of $124.7 million. In 1996, under the terms of a normal course issuer bid approved by The Toronto Stock Exchange, the company purchased and cancelled 3,500 subordinate voting shares for an aggregate cost of $560,000, of which $407,000 was charged to retained earnings.

In 1995 the company purchased and cancelled 85,100 subordinate voting shares for an aggregate cost of $6,892,000, of which $4,384,000 was charged to retained earnings.

On October 12, 1994 the company issued 1,000,000 subordinate voting shares at $76 per share for net proceeds of $74.4 million. On November 26, 1993 the company issued 2,000,000 subordinate voting shares at $55 per share for net proceeds of $104.8 million.

Fairfax's indirect ownership of its own shares through The Sixty Two Investment Company Limited results in an effective reduction of shares outstanding by 799,230, and this reduction has been reflected in the earnings per share and book value per share figures.

A common measure of capital adequacy in the property and casualty industry is the premiums to surplus (or common shareholders' equity) ratio. This is shown for the insurance subsidiaries of Fairfax for the past five years in the following table:

	Net Premiums Written to Surplus (Common Shareholders= Equity)				
	1997	**1996**	**1995**	**1994**	**1993**
Markel	0.9:1	1.2:1	1.6:1	1.3:1	1.1:1
Federated	1.2:1	1.2:1	1.2:1	0.9:1	1.1:1
Commonwealth	0.6:1	0.6:1	0.7:1	0.8:1	0.7:1
Ranger	1.1:1	1.1:1	1.2:1	1.5:1	1.6:1
Lombard	1.4:1	1.7:1	2.0:1	2.3:1	B
Odyssey Re	0.5:1	0.6:1	B	B	B
Canadian insurance industry	1.2:1	1.3:1	1.3:1	1.4:1	1.4:1
U.S. insurance industry	0.9:1	1.0:1	1.1:1	1.3:1	1.3:1

In Canada, property and casualty companies are regulated by the Office of the Superintendent of Financial Institutions on the basis of their Section 516 surplus. At December 31, 1997 Fairfax=s Canadian property and casualty insurance subsidiaries had a combined Section 516 surplus of approximately $442 million (1996 B $406 million), significantly in excess of minimum requirements.

In the U.S. the National Association of Insurance Commissioners (NAIC) has developed a model law and risk-based capital (RBC) formula designed to help regulators identify property-casualty insurers that may be inadequately capitalized. Under the NAIC=s requirements an insurer must maintain total capital and surplus above a calculated threshold or face varying levels of regulatory action. The threshold is based on a formula that attempts to quantify the risk of a company=s insurance, investment and other business activities. Fairfax does not anticipate any adverse effects of such requirements because of the strong capitalization of Ranger and Odyssey Re. At the end of 1997 Ranger and Odyssey Re each had capital and surplus in excess of three times the authorized control level.

Fairfax and its insurance subsidiaries are rated as follows by the respective rating agencies:

	A.M.	Standard & Poor=s	Duff & Phelps	DBRS	Moody=s
Fairfax	B	BBB+	BBB+	BBB(hig	Baa3
Commonwealth	A	AB	A+	B	B
Federated	A	AB	B	B	B
Lombard	AB	AB	B	B	B
Markel	AB	AB	B	B	B
Ranger	AB	B	A	B	B
CRC (Bermuda)	AB	B	B	B	B
CTR	AB	AB	B	B	B
Odyssey Re	AB	AB	B	B	B
Sphere Drake	B++	AB	B	B	B
Wentworth	A	B	B	B	B

In 1997 Standard & Poor's upgraded Odyssey Re, CTR and Sphere Drake to an AB and provided an initial group rating for the insurance companies of AB (thereby as a consequence downgrading Commonwealth to AB from A). A.M. Best upgraded CTR to an AB and is expected to upgrade Sphere Drake to an AB. All other ratings were maintained during the year.

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=s parent company-only income statement is disclosed on page 79. As shown, Fairfax had revenue of $152.9 million in 1997, consisting of dividends from its insurance subsidiaries ($125.8 million), management fees ($12.4 million), interest income ($14.0 million) and realized gains ($0.7 million). After interest expense ($42.6 million), operating expenses ($9.0 million) and non-recurring expenses ($9.0 million), the parent company (or holding company) had income of $92.3 million before taxes. As inter-company dividends are tax free the parent company paid no income taxes, so that net income after taxes amounted to $92.3 million. This income statement shows that in 1997 Fairfax comfortably met all its obligations from internal sources.

In 1998 Fairfax has access to a much larger amount of dividends and management fees and should again comfortably meet all its obligations from internal sources.

Fairfax has a large cash holding of $207 million available to meet unexpected requirements. The cash in the holding company would permit Fairfax to meet its net interest and other expenses for five to six years without access to any dividends from its insurance subsidiaries.

Also, Fairfax has in excess of $1 billion of unused, unsecured, committed, five year bank lines. The principal covenant attached to these lines is a covenant to maintain a net debt to equity ratio not exceeding 1:1.

During 1997 Fairfax raised US$125 million in unsecured debentures due 2037 through a public issue in the United States. These funds were used to complete the acquisition of Sphere Drake.

During 1996 Fairfax raised US$125 million in unsecured debentures due 2026 through a public issue in the United States. These funds were used to complete the acquisition of Odyssey Re.

During 1995 Fairfax raised US$100 million in unsecured debentures due 2015 through a public issue in the United States. These funds were used in part to pay off the long term bank debt of $60 million described in the next paragraph.

During 1994 Fairfax raised $74.4 million through the share issue referred to above under ACapital Resources@. A further $60 million in five year unsecured bank loans provided the balance of the cash component of the purchase price of Lombard. Payment of the purchase price was completed by the issue to the vendor of an unsecured $25 million debenture due 2003 containing the same terms as the publicly issued debentures.

The company manages its debt levels based on the following financial measurements and ratios:

	1997	**1996**	**1995**
Net debt *($ millions)*	511.3	369.4	227.7
Net debt to equity	37%	41%	48%
Net debt to capital	27%	29%	33%
Net debt to earnings	2.2x	2.4x	2.6x
Interest coverage	8.7x	6.2x	5.7x

The company=s financial position is very strong and all of its ratios improved in 1997.

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

Issues and Risks

The following issues and risks, among others, should also be considered in evaluating the outlook of the company.

Claims Reserves

The major risk that all property and casualty insurance and reinsurance companies face is that the provision for claims is an estimate and may be found to be deficient in the future for a variety of reasons including unpredictable jury verdicts, expansion of insurance coverage to include exposures not contemplated at the time of policy issue (e.g. asbestos, pollution, breast implants), or poor weather. The provision for claims amounted to $6,322.7 million on Fairfax=s balance sheet as at December 31, 1997.

Reinsurance Recoverables

Most insurance and reinsurance companies reduce their liability for any individual claim by reinsuring amounts in excess of the maximum they want to retain. This third party reinsurance does not relieve the company of its primary obligation to the insured. Reinsurance recoverables can become an issue mainly due to solvency credit concerns but also due to policy disputes. Fairfax had $2,164.5 million recoverable from reinsurers as at December 31, 1997.

Catastrophe Exposure

Insurance and reinsurance companies are subject to losses from catastrophes like earthquakes, windstorms or hailstorms, which are unpredictable and can be very significant.

Prices

Prices in the insurance and reinsurance industry are cyclical and can fluctuate quite dramatically. With under-reserving, competitors can price below underlying costs for many years and still survive.

Foreign Exchange

The company has assets, liabilities, revenue and costs that are subject to currency fluctuations, particularly in the U.S. dollar but also other foreign currencies. These currency fluctuations have been and can be very significant.

Cost of Revenue

Unlike most businesses, the insurance and reinsurance business can have enormous costs that bear no relation to revenue. Similar to short selling in the stock market (selling shares not owned), there is no limit to the losses that can arise from most insurance policies.

Regulation

Insurance companies are regulated businesses which means that Fairfax does not have access to each insurance company's net income and shareholders' capital without the approval of the insurance regulatory authorities.

Common Stock Holdings

The company has a significant amount of common stocks in its portfolio. As common stocks fluctuate, the company's equity (or surplus) is exposed to fluctuations in the stock market.

Goodwill

Most of the goodwill on the balance sheet comes from Lindsey Morden. Continued profitability is essential for there to be no deterioration in the carrying value of the goodwill.

Ratings

The company has excellent claims paying and debt ratings by the major rating agencies in North America. As financial stability is very important to its customers, the company is vulnerable to downgrades by the rating agencies.

Holding Company

Being a small company, Fairfax is very dependent on strong operating management, which makes it vulnerable to management turnover.

Quarterly Data (unaudited)

(*in $ millions except per share data)*

Years ended December 31	**First quarter**	**Second quarter**	**Third quarter**	**Fourth quarter**	**Full year**
1997					
Revenue	484.9	545.2	547.4	510.8	2,088.3
Net income	31.9	62.9	71.0	66.7	232.5
Earnings per share	$3.05	$6.01	$6.51	$6.02	$21.59
1996					
Revenue	276.4	316.1	420.0	463.3	1,475.8
Net income	15.6	20.1	40.3	74.8	150.8
Earnings per share	$1.75	$2.03	$4.11	$7.47	$15.36

Stock Prices

Below are The Toronto Stock Exchange high, low and closing prices of subordinate voting shares of Fairfax for each quarter of 1997 and 1996.

	First quarter *($)*	**Second quarter** *($)*	**Third quarter** *($)*	**Fourth quarter** *($)*
1997				
High	307.00	403.00	400.00	386.00
Low	285.00	293.00	375.00	295.00
Close	299.00	400.00	383.00	320.00
1996				
High	190.00	190.00	266.00	310.00
Low	98.00	160.00	172.00	250.00
Close	167.00	173.00	256.00	290.00

Fairfax Insurance and Reinsurance Companies
Combined Balance Sheets
as at December 31, 1997 and 1996
(unaudited)

	1997 ($000)	1996 ($000)
Assets		
Accounts receivable	1,617,407	635,465
Recoverable from reinsurers	2,164,466	1,258,899
Income taxes refundable	24,766	14,652
Prepaid expenses	9,229	5,797
	3,815,868	1,914,813
Portfolio investments (at book value)		
Cash and short term investments	819,010	509,554
Bonds	3,849,084	2,124,620
Preferred stocks	273,642	184,229
Common stocks	591,750	504,925
Real estate	54,324	26,461
	5,587,810	3,349,789
Deferred premium acquisition costs	220,113	145,496
Deferred income taxes	172,799	138,860
Capital assets	41,630	26,906
Other assets	18,373	21,400
	9,856,593	5,597,264
Liabilities		
Accounts payable and accrued liabilities	364,429	340,500
Premium deposits	105,708	43,674
	470,137	384,174
Provision for claims	6,322,737	3,293,449
Unearned premiums	1,113,842	688,009
	7,436,579	3,981,458
Shareholders= Equity		
Capital stock	1,327,912	758,862
Contributed surplus	21,445	21,182
Retained earnings	600,520	451,588
	1,949,877	1,231,632
	9,856,593	5,597,264

Fairfax Insurance and Reinsurance Companies
Combined Statements of Earnings
for the years ended December 31, 1997 and 1996
(unaudited)

	1997 *($000)*	**1996** *($000)*
Revenue		
Gross premiums written	1,883,560	1,411,636
Net premiums written	1,392,627	1,043,079
Net premiums earned	1,460,641	1,030,888
Expenses		
Losses on claims	1,034,665	753,777
Operating expenses	217,343	166,383
Commissions, net	264,790	161,291
	1,516,798	1,081,451
Underwriting loss	(56,157)	(50,563)
Investment and other income (expense)		
Interest and dividends	242,300	144,100
Realized gains on investments	207,539	124,459
	449,839	268,559
Other	(19,104)	(15,573)
	430,735	252,986
Earnings before income taxes	374,578	202,423
Provision for income taxes	99,488	30,028
Net earnings	275,090	172,395

Fairfax Insurance and Reinsurance Companies

Fairfax=s insurance and reinsurance business is conducted by ten subsidiaries. These subsidiaries underwrite a wide range of commercial and personal property, oil and gas, casualty and life insurance and property, casualty and life reinsurance in Canada, the United States and internationally.

Fairfax with Equity Accounting of Lindsey Morden
Consolidated Balance Sheets
as at December 31, 1997 and 1996
(unaudited)

	1997 ($000)	1996 ($000)
Assets		
Cash and short term investments	207,104	101,067
Accounts receivable	1,638,914	597,170
Recoverable from reinsurers	2,164,466	1,258,899
Income taxes refundable	33,683	17,611
Prepaid expenses	16,406	11,280
	4,060,573	1,986,027
Portfolio investments		
Subsidiary cash and short term investments (market value B $823,473; 1996 B $512,867)	823,473	512,867
Bonds (market value B $3,970,151; 1996 B $2,151,569)	3,853,505	2,124,620
Preferred stocks (market value B $297,101; 1996 B $201,239)	271,642	182,229
Common stocks (market value B $565,562; 1996 B $588,128)	585,063	506,939
Real estate (market value $54,627; 1996 B $26,461)	54,627	26,461
Total (market value B $5,710,980; 1996 B $3,480,264)	5,588,310	3,353,116
Investment in Lindsey Morden	31,043	30,330
Deferred premium acquisition costs	220,113	145,496
Deferred income taxes	173,029	138,860
Capital assets	43,584	29,006
	10,784	12,656
Other assets	22,149	25,497
	10,149,585	5,720,988
Liabilities		
Accounts payable and accrued liabilities	263,067	202,595
Premium deposits	105,708	43,674
	368,775	246,269
Provision for claims	6,322,737	3,293,449
Unearned premiums	1,113,842	688,009
Contingent value rights	45,988	B
Long term debt	718,431	470,445
	8,200,998	4,451,903
Excess of net assets acquired over purchase price	184,097	111,724
Shareholders' Equity		
Capital stock	766,739	513,420
Retained earnings	628,976	397,672
	1,395,715	911,092
	10,149,585	5,720,988

Fairfax with Equity Accounting of Lindsey Morden
Consolidated Statements of Earnings
for the years ended December 31, 1997 and 1996
(unaudited)

	1997 ($000)	1996 ($000)
Revenue		
Gross premiums written	1,883,560	1,411,636
Net premiums written	1,392,627	1,043,079
Net premiums earned	1,460,641	1,030,888
Interest and dividends	254,562	152,177
Realized gains on investments	206,773	131,274
Equity earnings of Lindsey Morden, net of dividends	1,832	2,278
	1,923,808	1,316,617
Expenses		
Losses on claims	1,034,665	753,777
Operating expenses	249,421	185,860
Interest expense	43,182	34,997
Commissions, net	264,790	161,291
	1,592,058	1,135,925
Earnings before income taxes	331,750	180,692
Provision for income taxes	99,252	29,872
Net earnings	232,498	150,820
Net earnings per share	$21.59	$15.36

Lindsey Morden Group Inc.
Consolidated Balance Sheets
as at December 31,1997 and 1996

	1997 ($000)	1996 ($000)
Assets		
Cash	290	336
Accounts receivable	30,925	28,064
Claims in process	14,872	15,029
Prepaid expenses	1,344	919
	47,431	44,348
Capital assets	10,851	11,909
Other assets	36,264	36,830
	94,546	93,087
Liabilities		
Bank indebtedness	594	2,394
Accounts payable and accrued liabilities	19,578	16,136
Income taxes payable	2,235	1,323
Long term debt B current portion	B	1,275
Deferred income taxes	3,584	4,036
	25,991	25,164
Long term debt	10,805	10,335
Future retirement payments	6,327	6,258
	17,132	16,593
Subordinated convertible debenture	B	7,900
Shareholders= Equity		
Capital stock	30,715	22,986
Retained earnings	20,708	20,444
	51,423	43,430
	94,546	93,087

Lindsey Morden Group Inc.
Consolidated Statements of Earnings
for the years ended December 31, 1997 and 1996

	1997 ($000)	1996 ($000)
Revenue	166,331	162,266
Cost and expenses		
Cost of service	132,230	127,102
Selling, general and administration	26,535	23,919
Interest	1,522	2,347
	160,287	153,368
Earnings before income taxes	6,044	8,898
Income taxes	3,009	4,487
Net earnings	3,035	4,411

Consolidated Statements of Retained Earnings
for the years ended December 31, 1997 and 1996

	1997 ($000)	1996 ($000)
Retained earnings B beginning of year	20,444	16,508
Net earnings for the year	3,035	4,411
Dividends	(2,771)	(475)
Retained earnings B end of year	20,708	20,444

These condensed financial statements have been prepared from the Lindsey Morden Group Inc. audited consolidated financial statements as at and for the years ended December 31, 1997 and 1996, copies of which are available on request.

Fairfax Financial Holdings Limited
Unconsolidated Balance Sheets
as at December 31, 1997 and 1996
(unaudited)

	1997 *($000)*	**1996** *($000)*
Assets		
Subsidiary companies		
Reinsurance companies	1,240,818	578,998
Insurance companies	698,976	653,032
Lindsey Morden	30,423	30,330
Hamblin Watsa	6,767	8,167
Noro	2,031	2,326
	1,979,015	1,272,853
Cash and short term investments	207,104	101,067
Investment portfolio	979	8,496
Other assets	43,441	12,086
	2,230,539	1,394,502
Liabilities		
Accounts payable and other liabilities	70,405	12,965
Contingent value rights	45,988	B
Long term debt	718,431	470,445
	834,824	483,410
Shareholders= Equity		
Capital stock	766,739	513,420
Retained earnings	628,976	397,672
	1,395,715	911,092
	2,230,539	1,394,502

The investments in subsidiaries are carried on the equity basis whereby they are included at their original purchase price plus Fairfax's share of the earnings less dividends.

Fairfax Financial Holdings Limited
Unconsolidated Statements of Earnings
(parent company-only income statement)
for the years ended December 31, 1997 and 1996
(unaudited)

	1997 *($000)*	**1996** *($000)*
Revenue		
Dividend income	125,829	34,452
Interest income	13,970	8,212
Management fees	12,406	8,736
Realized gains	696	6,840
	152,901	58,240
Expenses		
Interest expense	42,559	34,997
Operating expenses	8,991	7,574
Non-recurring expenses	9,033	3,044
	60,583	45,615
Net earnings	92,318	12,625

Consolidated Financial Summary *(in $ millions except share and per share data)*

	Return on average share-holders= equity	Per Share: Share-holders= equity	Per Share: Net earnings B fully diluted	Revenue	Earnings before income taxes	Net earnings	Total assets[(1)]	Invest-ments	Net debt[(2)]	Share-holders= equity	Shares outstand-ing at year-end *(000)*	Closing stock price
For the years ended December 31:												
1985	B	2.08	(1.89)	17.0	(0.9)	(0.9)	41.5	32.7	B	10.4	5,000	3.25[(3)]
1986	25.4%	5.89	1.35	53.7	9.1	6.5	129.8	95.6	2.8	41.3	7,007	12.75
1987	31.3%	8.32	2.23	113.0	18.2	16.0	185.4	124.0	2.8	61.0	7,337	12.37
1988	21.2%	10.13	1.94	133.6	21.3	14.4	246.8	137.5	28.2	74.2	7,322	15.00
1989	20.3%	12.41	2.25	125.8	19.2	16.7	248.1	133.9	22.0	90.8	7,316	18.75
1990	23.0%	17.29	2.92	195.4	23.2	21.3	536.0	335.7	65.9	94.7	5,477	11.00
1991	21.3%	21.41	3.94	250.0	32.5	22.5	516.6	341.2	51.3	116.8	5,455	21.25
1992	7.7%	23.76	1.76	286.8	7.0	10.0	590.5	396.2	68.2	143.8	6,055	25.00
1993	20.3%	35.13	5.42	344.0	46.7	33.3	1,200.3	848.8	132.4	279.5	7,955	61.25
1994	12.1%	43.77	4.66	634.9	46.0	38.1	2,173.4	1,551.3	218.0	391.9	8,955	67.00
1995	20.1%	53.28	9.79	1,145.5	95.9	87.5	2,873.5	1,668.1	227.7	472.6	8,869	98.00
1996	21.4%	87.05	15.36	1,475.8	187.3	150.8	5,778.4	3,454.5	369.4	911.1	10,466	290.00
1997	20.4%	125.38	21.59	2,088.3	336.0	232.5	10,207.3	5,795.7	511.3	1,395.7	11,132	320.00

(1) Commencing in 1995, reflects a change in accounting policy for reinsurance recoverables

(2) Total debt (beginning in 1994, net of cash in the holding company) with Lindsey Morden equity accounted

(3) When current management took over in September 1985

Readers of the Management=s Discussion and Analysis should review the entire Annual Report for additional commentary and information.

Corporate Information

Directors of the Company

Winslow W. Bennett
President, Winwood Holdings Ltd.

* Robbert Hartog
President, Robhar Investments Ltd.

* Steven A. Markel
Vice Chairman
Markel Corporation

Kenneth R. Polley
President and Chief Executive Officer
Lindsey Morden Group Inc.

John C. Puddington
President
Trilwood Investments Limited

* V. Prem Watsa
Chairman and Chief Executive Officer

* *Audit Committee Member*

Operating Management

John B. O. Watson, President
Commonwealth Insurance Company

Jean-Philippe Casanova, President
Compagnie Transcontinentale de Réassurance

Kenneth Kwok, President
Falcon Insurance Company Limited

John M. Paisley, President
Federated Insurance Company of Canada and
Federated Life Insurance Company of Canada

Anthony F. Hamblin, President
Hamblin Watsa Investment Counsel Ltd.

Kenneth R. Polley, President
Lindsey Morden Group Inc.

Byron G. Messier, President
Lombard General Insurance Company
of Canada

Mark J. Ram, President
Markel Insurance Company of Canada

James F. Dowd, Chairman
Andrew A. Barnard, President
Odyssey Reinsurance Corporation

Robert H. Rich, President

Ranger Insurance Company

Michael C. Watson, Chairman
Sphere Drake Insurance

Officers of the Company
Brenda Adams
Vice President and 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

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Auditors
Coopers & Lybrand

General Counsel
Tory Tory DesLauriers & Binnington

Transfer Agent and Registrar
CIBC Mellon Trust Company

Share Listing
The Toronto Stock Exchange
Stock Symbol FFH

Annual Meeting
The annual meeting of shareholders of Fairfax Financial Holdings Limited will be held on Tuesday, April 14, 1998 at 4:30 p.m. in Room 106 at the Metro Toronto Convention Centre, 255 Front Street West, Toronto.