

TO OUR BUSINESS PARTNERS:

Nineteen eighty-nine was another profitable and eventful year for your Corporation and we are pleased to share the following highlights with you, our business partners. While some of our business units did not meet expectations, overall Corporate goals were exceeded.

For 1989, total operating revenues increased 28% to \$89.8 million. Net income increased 24% to \$13.8 million and net income per share was up 12% to \$2.60. These results represent a return on average shareholders' equity of 24%.

Our long-term goals remain unchanged: To achieve a 20% annual growth in revenues and a 20% annual return on shareholders' equity. For the past five years our revenue growth has averaged 39% and return on equity has averaged 30%. Since December 31, 1985, shareholders' equity has increased from \$6.7 million to \$64.7 million at December 31, 1989, or \$1.34 per share to \$11.98 per share.

BROKERAGE OPERATIONS

In October 1989, we completed the acquisition of certain assets of the Rhulen Agency which has added several new market niches and will strengthen our position in certain agricultural markets. A major portion of Rhulen's business is seasonal, with most revenues being earned in the second and third quarters. As a result, the Rhulen Division recorded a loss in the fourth quarter and reduced our earnings by approximately \$0.14 per share. We do, however, expect this acquisition to contribute to future earnings and cash flow.

Also during 1989, our leadership position in specialty municipal liability coverages continued to expand, augmented by the acquisition of a book of business from Special Risks, Inc. the previous year.

CLAIMS ADMINISTRATION

Lindsey & Newsom continued its expansion program during 1989. At year-end, we were operating from 152 offices serving 36 states, making us one of the largest independent claims organizations in the country. In addition to expansion, our energy is also being focused on staff training and development with the goal of providing our clients with the highest quality service available in the business. This philosophy, and mission, is clearly expressed in Lindsey & Newsom's creed, "First, we'll be the Best, then we'll be First."

Despite business generated from the catastrophes of 1989, our profit margins and return on investment continue to be lower

than our long-term objectives. This will continue to be true in 1990, as we are consciously investing to position Lindsey & Newsom for further growth and profitability.

UNDERWRITING

Essex Insurance Company and Market American Insurance Company are leaders in maintaining disciplined underwriting standards, providing unequalled customer service, and achieving exceptional results. In 1989, the Companies collectively reported a combined ratio, an indicator of underwriting profitability, of 79% on a statutory basis. More importantly, this ratio has averaged 86% for the past five years. As a comparison, the industry's average combined ratio for 1989 was in excess of 110%, and has averaged 109% for the past five years.

The insurance market continues to be in a very competitive cycle. While many experts expect pricing to stabilize in 1990 and 1991, most are suggesting the improvement will be gradual. By focusing on unique product niches and sound underwriting standards, we expect to continue our success regardless of the market cycles.

STRATEGIC PARTNERSHIPS

Our investments in the Shand/Evanston Group and Fairfax Financial contributed significantly to our results for 1989, largely due to exceptional investment performance. The investment portfolios of these Companies, as well as the equity portfolio of Essex Insurance Company, are managed with a disciplined value orientation by Hamblin Watsa Investment Counsel, based in Toronto.

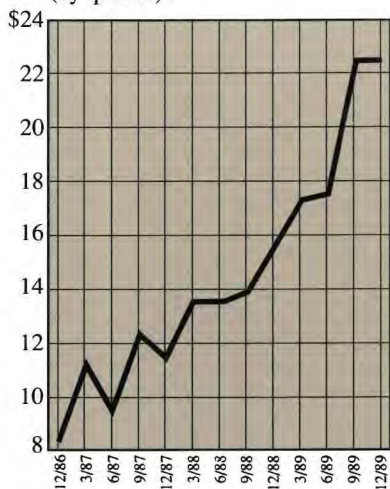
Each of our business units operates autonomously. Though synergy among the Companies is not a priority, we are quite pleased that in 1990, the Shand/Evanston Companies and Essex Insurance Company will be participating in the underwriting of certain business generated by the Rhulen acquisition.

FINANCIAL STRENGTH

While our primary financial goal is to earn a 20% return on shareholders' equity, we are also dedicated to maintaining a strong financial position. During 1989, the total assets of the company increased from \$147.3 million to \$195.7 million.

Our investment portfolio increased 31% to \$66.5 million, with the majority of the funds invested in high quality fixed income investments. However, to achieve a balance in investment opportunities and because we believe better

STOCK PRICES
(by quarter)



Adjusted for 20% Stock Dividend 9/15/89.

long-term returns can be realized in the equity markets, \$13.8 million is invested in equity securities.

Our investment in unconsolidated subsidiaries has increased to \$38.9 million. Of this amount, \$16.7 million represents our investment in Fairfax Financial. Fairfax is publicly traded on the Toronto Stock Exchange and the market value of our shares at year end amounted to \$27.4 million. This amounts to \$1.97 per share more than our carrying value.

As a result of acquiring the Rhulen Agency, we have increased our investment in policy renewal rights from \$3.8 million to \$19.1 million. Policy renewal rights represent the value attributable to expiration and renewal rights for lines of business acquired. This asset will be amortized over the next seven to ten years. While this expense will penalize our near-term earnings, we will achieve tax savings and additional cash flow.

To finance the Rhulen acquisition, we have restructured our long-term debt and increased it to \$44.5 million as of year-end 1989. The restructuring involved replacing our previous \$20 million revolving credit facility with a commercial paper program backed by a \$70 million stand-by revolving credit facility. The facility will remain available until December 1992. At that time, the participating banks may elect to extend the revolving facility for an additional three years or convert the balance outstanding to a seven-year term loan. While we have significant credit available, we will be cautious in using it.

For any insurance company, one of the most important balance sheet items is the adequacy of the reserve for unpaid losses and loss adjustment expenses. At December 1989, our reserves amounted to \$31.5 million. There is always a degree of uncertainty in establishing loss reserves and estimating the future cost of claims, many of which may not have yet been reported. We establish our reserves very conservatively and are proud that in each of the past five years, the reserves we have established have, in fact, proven to be more than adequate. While we cannot eliminate all risk from these estimates, we have a high degree of confidence that the reserve level at year-end will prove to be sufficient.

SHAREHOLDERS' EQUITY

At year-end, shareholders' equity (including redeemable common stock) was \$64.7 million or \$11.98 per share. This compares to \$49.8 million, or \$9.54 per share for the previous year and to \$21.6 million or \$5.00 per share at December 31, 1987.

LOOKING FORWARD WITH ENTHUSIASM

While our results over the past several years have been extremely good, of more importance is the future. We continue to be very optimistic about the company, our markets and our ability to achieve favorable results. Though it is difficult to predict the future, we will share some of our thoughts and expectations.

Our brokerage business should double in size as a result of the Rhulen acquisition. Clearly, our 1990 revenues will increase as a result, although the impact on net income is less clear. As previously mentioned, a large portion of the purchase price has been allocated to policy renewal rights and will be amortized over the next several years. While this represents a non-cash item, it will reduce reported earnings. As with any similar transaction, risk and uncertainty do exist. We expect the acquisition to contribute to our earnings in 1990. However, due to the seasonality of the business, quarterly comparisons with prior years will be distorted.

Growth in our claims operation will continue in 1990, as a result of previous branch expansion and openings planned for 1990. Looking even further into the future, we seek to develop a financially strong, high-quality, full-service claims operation.

We expect the current business environment to exist throughout 1990, and, therefore, forecast only modest growth for our underwriting activities. While growth may be limited, we expect our profitability to remain strong. Longer term, we expect the market to harden, and we expect to be in a position to capitalize upon it.

Our strategy is to diversify into different segments of the insurance industry and to specialize in unique product niches. This strategy provides us with the balance of different businesses throughout the insurance cycle as well as the opportunity to become market leaders. It's proven successful in the past and we look forward to the future with enthusiasm.

Alan I. Kirshner
President and Chairman of the Board

Anthony F. Markel
Executive Vice President

Steven A. Markel
Executive Vice President



Markel Corporation executive officers (clockwise from top): Alan I. Kirshner, Anthony F. Markel, and Steven A. Markel.