To Our Business Partners:

In each year since our initial public offering in 1986, significant events have occurred which have shaped Markel's growth and development. When 1990 began we were focused on our corporate strategy of diversification in several segments of the insurance industry and specialization in certain niche markets.

This past year we were presented with a unique opportunity and took advantage of it. The result is that we acquired the remaining shares of the Shand/Evanston Group and sold our ownership in Fairfax and Lindsey & Newsom. The impact of these transactions is that our operation is now completely focused on marketing and underwriting specialty insurance. We have had a close business relationship with these companies and wish them every success in the future. Prem Watsa, Chairman of Fairfax, will remain on Markel's Board of Directors and we look forward to his continued contribution.

Shand/Evanston is one of the premier specialty insurance underwriting organizations in the country. Its largest business includes various niches within the professional liability insurance market. We originally invested in this group in December, 1987 in partnership with Fairfax and certain of Shand/Evanston's management.

Over the past three years Shand/Evanston has contributed significantly to our earnings. Additionally, during the past year, Shand/Evanston has begun underwriting many of the programs which have been developed and marketed by Markel/Rhulen Underwriters.

This "strategic evolution" has the additional benefit of simplifying our operations and organizational structure encouraging synergy between our business units and simplifying our future financial reporting.

1990 RESULTS

In order to better understand our financial results, it is useful to understand the various accounting and reporting issues associated with the Shand/Evanston acquisition and Lindsey & Newsom and Fairfax disposition. For financial statement purposes the transactions have been recorded as occurring on December 31, 1990. As a result, the assets and liabilities of Shand/Evanston have been consolidated with the Company as of December 31, 1990 for balance sheet purposes, while Lindsey & Newsom and Fairfax have been eliminated as of that date. For purposes of income statement presentation, Shand/Evanston's earnings continue to be accounted for as earnings from an unconsolidated subsidiary. However, since both Lindsey & Newsom and Fairfax have been divested, revenues, expenses and earnings associated with these operations have been reclassified as discontinued operations in the Company's consolidated income statements.

In 1990 brokerage operations showed significant growth primarily as a result of the Rhulen Agency, Inc. acquisition in October 1989. The contribution, while not as high as we would like, continues to be good and generates significant cash flow.

Our underwriting units continue to grow and produce very favorable results. The combined ratios for the underwriting companies were 80% in 1990 compared to 79% in 1989.

The overall decline in the stock market during the year affected the Company in three significant ways. The level of realized investment gains from our investment portfolios was much less in 1990 than in 1989. This was equally true for the portfolios at Shand/Evanston. For example, in 1989 income from continuing operations was $1.97 per share, of which $.84 was from investment gains. Of the $1.46 from continuing operations in 1990, only $.12 was attributable to investment gains. Results were further impacted by the valuation of the Fairfax shares surrendered in connection with the acquisition. In establishing the value for the shares we used the quoted market price discounted for size and certain share restrictions. The decline in market price occurring in late 1990 resulted in a $5.4 million loss. While we have recorded this loss for accounting purposes, the economic value of the transaction, which was negotiated in

August 1990, was not affected by the subsequent decline in the value of Fairfax shares. Finally, the stock market decline impacted the Company in the area of unrealized losses associated with marketable equity securities. At December 31, 1990, unrealized losses associated with our consolidated equity portfolios were approximately $10.2 million and are recognized as a direct reduction of shareholders' equity.

While these financial results are short of our long-term goals, we feel 1990 has seen Markel Corporation truly position itself for the future and are proud of what has been accomplished this year.

BALANCE SHEET

The consolidation of Shand/Evanston has resulted in several changes to our balance sheet. The most significant of these are in the areas of our Investment Portfolio, Intangible Assets, Loss Reserves, and Debt.

Investment Portfolio At year end our investments totaled almost $360 million as compared to $66 million one year earlier. This portfolio and the return we expect from it represents a significant opportunity to us. In managing these assets we will seek to provide the security necessary to protect the interests of our policyholders as well as the return to provide growth for our stockholders. At year end, we had $69 million of this portfolio invested in equity securities. While we continue to believe that equities will provide the greatest long term rates of return, we also believe that the Company's financial leverage currently requires that we reduce our investment exposures to equities.

Intangible Assets At year end the following intangible assets were recorded on our books:

Policy renewal rights	$16.4 million
Noncompete and nonpiracy agreements	19.3 million
Goodwill	35.8 million
	$71.5 million

We recognize this represents a substantial investment in the future business prospects of the Markel/Rhulen products acquired in 1989 and the additional interest in Shand/Evanston acquired in December 1990.

The policy renewal rights are being amortized over the next nine years. However, almost 50% will be written off over the next three years. The noncompete and nonpiracy agreements will be amortized over the next four years. The result is that in 1991 we expect to expense $9 million for the amortization of these amounts. These non-cash charges will have an adverse impact on earnings. However, to the extent they are also tax deductible, they will generate significant cash savings from the associated tax benefit.

Loss Reserves The Company's reserve for unpaid losses and loss adjustment expenses amounted to $302 million at year end compared to $31 million at December 31, 1989. These amounts represent our best estimates of the amounts necessary to meet our obligations to our policyholders. As we have discussed in prior years, in establishing these estimates, we attempt to take into consideration all of the relevant information and actuarial methods available to us. While it will always be difficult to accurately determine such future liabilities, we have established a standard for ourselves whereby we seek to set our reserves at a level which we believe is more likely to prove to be redundant than deficient.

Debt The Company's long term debt amounted to $127 million at December 31, 1990 and is much higher than we desire for the long term. The debt increased in 1990 as a result of additional borrowings to complete the acquisition of Shand/Evanston as well as the consolidation of their debt.

We are fortunate to enjoy excellent relationships with our bankers and it is important that we continue to maintain their confidence. Most important however, is that the Company's cash flow is adequate to meet our repayment requirements.

Our goal is to significantly reduce the amount of debt and operate in the future with less leverage.

PRO FORMA RESULTS

The nature and size of the Company will be significantly different in the future. While not necessarily indicative of future results, the pro forma income statements in Note 18 to the consolidated financial statements provides an indication of how the consolidated operations might have appeared had the

acquisition of Shand/Evanston and disposition of Lindsey & Newsom and Fairfax occurred on January 1, 1989.

Total operating revenues would have approximated $220 million in 1990 compared to $161 million in 1989. At $145 million for 1990, earned premiums become the dominant revenue source, highlighting the underwriting focus of the Company. This focus will likely be continued in the future as our underwriting units participate to a larger extent in the business handled by our brokerage operations. With investment portfolios of $360 million, investment income will continue to be a major contributor to operating income.

As previously discussed, the non-cash expense related to the amortization of intangible assets adversely impacts income but, to the extent tax deductible, saves tax dollars. In 1990, amortization expense would have been $9.2 million. We expect these charges to continue to be significant through 1994. Interest expense in the 1990 pro forma is $16.9 million on total debt of $127 million. Interest cost on this debt is expected to be significantly less in the future due to the contractual adjustment of the accrual terms on the contingent notes at Shand/Evanston.

We are optimistic about the future given the financial opportunities presented us by our specialty underwriting focus.

FINANCIAL GOALS

In each of our previous reports, we have discussed our financial goals of achieving a 20% growth in revenues and a 20% return on average shareholders' equity. In our underwriting business we have always placed a higher priority on underwriting profit as it is often difficult and imprudent to grow in a period of significant price competition. While we expect to continue to grow, a much larger part of our revenues will be generated from our underwriting activity. As a result, we will not seek to maintain a 20%

Alan I. Kirshner

Steven A. Markel Anthony F. Markel

growth rate as a financial goal.

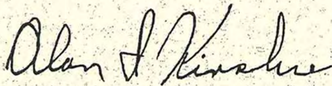
As a result of various financial accounting issues, the Company's return on equity calculation is becoming distorted. For example, the amortization of intangibles is an expense. However, it is a non-cash expense which reflects our accounting treatment of acquisitions, not the intrinsic value of our business. Another example is our investment in equities. Accounting rules require that we recognize in our statement of income realized gains and losses while we only recognize unrealized gains and losses in our balance sheet. The result can create higher returns on equity with a decline in the value of our investments. Finally, with the additional financial leverage of our borrowings, we should earn a high return on equity.

We are developing better criteria for measuring "real return on investment" which will take these issues into consideration.

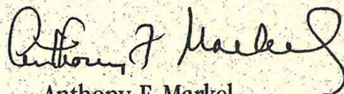
THE FUTURE

We ended 1990 with the completion of a series of complex transactions intended to simplify our Company. Today we no longer have a complicated organization. Our business and financial structure is really quite simple. We are focused on marketing and underwriting specialty insurance. In each market we serve, we seek to provide quality products and excellent service and, as a result, to earn a position of market leadership.

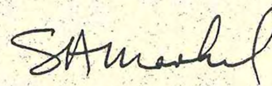
We expect the strength of our marketing and sales organizations to complement our sound underwriting operations. While the insurance marketplace is likely to remain very competitive throughout the year, we believe we can continue to operate on a profitable basis in our areas of specialization with good underwriting results and good investment returns. As we focus on areas that have proven our most profitable in the past, we look forward to 1991 and beyond with enthusiasm and confidence. ■



Alan I. Kirshner
President
Chairman of the Board



Anthony F. Markel
Executive Vice President



Steven A. Markel
Executive Vice President