Dear Business Partners

We are proud to report another very good year. In 1993 net income was $24 million, or $4.23 per share, which amounted to an 18% return on average stockholders' equity. At year end, stockholders' equity totalled $151 million, or $27.83 per share, representing a 38% increase from $109 million, or $20.24 per share in 1992. Some of this increase was the result of a change in accounting for the unrealized gains on fixed maturity investments, which is discussed later in more detail.

1993 Underwriting Results

Gross premium volume was $313 million in 1993, compared to $304 million in 1992. On the surface, that's a 3% increase. However, 1992 production included approximately $18 million in premiums from sold or discontinued brokerage operations. Our core business, or "same store sales", actually increased by a much larger percentage, around 9%.

We continue to underwrite and retain a growing portion of our gross premium volume. As a result, earned premiums, which represent most of our revenue, increased 26% to $193 million from $153 million in 1992.

While we are pleased to see sustained growth in our business, we are especially pleased to report that we have again earned underwriting profits. For both 1993 and 1992, our combined loss and expense ratio was 97%, representing a 3% profit margin.

1993 Investment Results

Our 1993 investment results were also strong, as evidenced by a total investment return of 11%. Net investment income (dividends and interest less expenses) totalled $24 million and comprised approximately 5% of the total return, while realized gains of $16 million and unrealized gains of $16 million each accounted for approximately 3% of the total investment return.

At December 1993, the investment portfolio was $597 million, or $110 per share.

During the year, we increased our tax-exempt investments and by year-end held $164 million in state and municipal bonds. We also have continued to increase our investment in equity securities. At December 1993, we had $108 million in equity investments including $22 million in unrealized gains related to these investments. While we realize market gains when we believe it is appropriate to do so, we also recognize the tremendous power of compounding growth when we are fortunate enough to find stocks that can appreciate over many years. We believe we can benefit by sticking with good investments and deferring the tax bill.

In accordance with new accounting guidelines, at December 1993 we recorded our fixed maturity securities at fair value. In prior years, fixed maturity securities were recorded at amortized cost. The change resulted in an increase in carrying value of $12 million, and after adjustments for taxes, an increase in stockholders' equity of $8 million. While the new accounting treatment will more accurately reflect the value of our assets, it will also introduce additional short-term volatility to stockholders' equity.

Loss Reserves

Loss reserves represent our estimate of the future cost to settle claims. We strive to estimate reserves at levels which are more likely to be redundant than deficient. In the past we have been successful in achieving this goal and believe that our reserving methods are sound.

In recent years, we have made aggressive efforts to settle older claims, particularly those professional and products liability claims which pre-date our acquisition of Shand/Evanston. The effect of those efforts was a $46 million decrease in our gross loss reserves. In 1993, claim payments totalled $261 million, of which $233 million related to claims from prior years.

In 1993 we offered a number of our reinsurers the opportunity to commute, or pre-pay their liabilities in return for a release from further exposure to changes in reserve estimates. As a result, we collected $66 million in cash from reinsurers who accepted our offer and increased our net loss reserves by the same amount. We will benefit from additional investment income on the cash generated by the commutations, as well as from reduced collection and administrative costs. A potential disadvantage is that we will have less reinsurance protection if our losses develop adversely. We think we have adequately priced for this risk.

Due to the commutations and our success in closing older claims, amounts recoverable from reinsurers were reduced by $119 million in 1993.

Long-Term Debt

In October 1993 we achieved another milestone. We completed a shelf registration of $100 million in public debt securities, and after receiving ratings from the major independent credit rating agencies, we issued $75 million of 10 year bonds in the public markets.

The bond issue allowed us to repay all of our bank debt and help to reduce our total long-term debt to $78 million at December 1993. At year-end, the ratio of long-term debt to total capital was 34%.

Because interest rates remained very attractive, early in 1994 we sold the balance of the debt under the shelf registration. In total, the debt was issued at an effective fixed cost of 7.5%.

Shareholder Relations

Although the history of our company dates back to 1930, we are a relatively young public company. Our initial public offering was in December 1986, only seven years ago. As a public company, we have endeavored to treat our fellow shareholders as equal partners.

We are committed to sound business practices and we try to provide complete disclosure so that our partners can fully understand the value of the company. The objective of our shareholder relations program is to attract *and retain* investors who share our long-term goals.

If we are successful in meeting our objective, we would expect our stock to trade at its intrinsic value and be less sensitive to issues unrelated to the value of the company. While we cannot be the most unbiased in determining our own intrinsic value, we believe a significantly undervalued or overvalued stock does not serve our best interests. In 1993, the stock price appreciated 26%, while book value was up 38%.

Dividends and Splits

We are earning very strong returns on our capital and have confidence in our ability to do so in the future. As a result, we have no plans to institute cash dividends.

The intrinsic value of our company will be the same whether we maintain 5.4 million shares outstanding or split them to increase that number. Splitting the number of outstanding shares will not result in the stock trading at a price more closely related to its intrinsic value. In fact, the opposite may well be true. Of course, we will continue to work to increase the intrinsic value of the company, and we will be happy to see our efforts reflected in the market value of our stock.

Reported Earnings versus "Real Cash Money"

In managing our business, we try to value sound economic judgment over accounting conventions which often do not represent meaningful economic reality. This philosophy will sometimes result in decisions which reduce accounting earnings, yet increase our "real cash money."

We can find two prime examples of this in our business. First, our investment objective is to maximize total returns. In doing so, we invest in common stocks where we sacrifice current income for the opportunity to enjoy capital appreciation. The value of this policy can be seen in our total returns, which have averaged 11% over the past five years.

A second example relates to the amortization of intangible assets. As a result of prior acquisitions, we have significant amounts of intangible assets. A large portion of these assets are tax deductible and are being expensed on an accelerated basis. While accounting convention requires amortization to be included in operating expenses, the charge bears little relationship to our current cost of operations. Further, due to the accelerated amortization of certain assets, amortization expenses will decrease in the near future. After-tax amortization charges will decline to $.88 per share in 1994 and $.37 per share in 1995.

The following chart emphasizes earnings per share from underwriting and investing activities, which we believe is a more meaningful representation of our operating performance:

	1993	1992	1991
Core operations	$3.31	$3.03	$2.61
Realized gains	1.83	.89	.94
Underwriting and Investing	5.14	3.92	3.55
Gain on sale	—	2.50	.28
Relocation expenses	—	(.60)	—
Amortization expenses	(.91)	(1.18)	(1.15)
Net income	$4.23	$4.64	$2.68

Income from underwriting and investing represents the real economic results of our ongoing business operations. Core operations include underwriting and ordinary investment activities. In 1993 and 1992, earnings per share from core operations increased 9% and 16%, respectively.

Realized gains from investments, while inherently volatile and difficult to predict, have also provided significant returns over the past three years. As a percent of our average investment portfolio, returns from realized gains averaged 3% in 1993, compared to 2% in 1992 and 2% in 1991.

Admittedly, we have enjoyed very good financial markets and predicting 1994 and 1995 results would be a dangerous game. Nevertheless, we strongly believe that over the long term, our investment strategy will maximize our returns.

The Future

We fully expect the insurance industry to be just as competitive in 1994 as it was in 1993. Although we would benefit from an improved market, we aren't counting on it. We believe that we can continue to meet the challenges of a competitive market through our focus on specialty products and niche markets and our commitment to superior quality and excellent customer service. Given our past success, we think we've found a formula that works.

Alan I. Kirshner
Chairman and C.E.O.

Anthony F. Markel
President and C.O.O.

Steven A. Markel
Vice Chairman

Darrell D. Martin
Executive Vice President and C.F.O.

Clockwise from left: Anthony F. Markel, Darrell D. Martin, Steven A. Markel, Alan I. Kirshner