1998

TO OUR BUSINESS PARTNERS

We are pleased to report another busy and successful year. In 1998 we extended our record of success in earning consistent underwriting profits and superior investment returns. While we will review our company's annual progress in this report, we will also discuss some important long term industry trends which we expect to affect us. Also, without making too many predictions, we will try to look toward the future, and give you some idea of what we expect.

Overall our 1998 results were extremely good. While premium growth was small, given the competitive insurance marketplace, bottom line profits were very solid. Underwriting profit exceeded $5 million and our combined ratio was 98%. Investment returns were excellent as we earned a total tax equivalent return on our portfolio of 8.9%. Earnings per share amounted to $10.17, comprehensive income was $12.07 per share, and book value per share grew 18% to $77.02.

Underwriting

The property and casualty insurance market remains extremely competitive but we continue to maintain our underwriting discipline. The net effect is that our premium growth has been very modest over the past few years and 1998 was no exception. In 1998, gross written premiums increased just 3% to $437 million and net earned premium was flat at $333 million. These small changes in total volume do not accurately reflect the vital efforts of our associates in eliminating unprofitable business, fighting "tooth and nail" to keep existing business in the face of fierce competition, and developing and expanding new business opportunities.

We continue our focus on maintaining adequate price levels and disciplined risk selection so that we can earn underwriting profits. In 1998 we reported a combined ratio of 98%, a result slightly better than last year.

Loss Reserves

Our practice is to establish current year reserves on a conservative basis because loss data emerging during the first underwriting year is somewhat limited. Over time, underwriting results for each specific year become more apparent and reserve levels can more easily be set. As in prior years, we have enjoyed the benefit of finding our actual loss experience to be better than originally estimated. We believe that our total loss reserves are as strong today as ever.

In reviewing our loss experience over the past few years, we found that some lines of business were significantly more profitable than

we originally thought. On the other hand, we continue to learn bad news about the ultimate costs associated with asbestos and environmental claims. Because of these events, we have reallocated reserves among different business units. While these shifts occurred, we believe our overall level of loss reserves remains sufficient to cover our exposures.

There can be no doubt that our strong commitment to underwriting profitability, coupled with a conservative approach to setting loss reserves, underpinned the Company's success over a number of years. The underwriting results in 1998 represent the seventh year in a row we have reported an underwriting profit and the twelfth year out of thirteen since our initial public offering in 1986.

Investments

At year end our investment portfolio was $1.5 billion, an increase over the prior year of 5%. During the year, investment markets were quite exciting. The bond market enjoyed the continuation of the broad trend of lower interest rates causing bond prices to be generally higher. The change throughout the year, however, was certainly not smooth. In addition, many events, including problems in Russia and Brazil, the failure of prominent hedge funds, and the Asian meltdown produced very different results among various segments of the fixed income market. Quality and liquidity proved to be extremely valuable. Despite the turbulence we are quite pleased with our fixed income performance.

The stock market was no less interesting, as in spite of a brief September correction, equity prices continued to rise. It is incredible that the S & P 500 index has increased by more than 20% for the fourth year in a row. We have trouble believing that the underlying intrinsic value of the companies represented increased at the same rate. Consequently, as business people making business judgements, our portfolio is not weighted toward the securities in the index. Our 13.3% return on equities, although solid, was short of the index return. We currently own no high technology or internet stocks (the valuations of which we also don't understand). We continue our long-standing practice of careful selection and extremely low portfolio turnover as it serves our purpose of owning good companies for the long term, and maximizing the total after tax return to our shareholders.

Book Value Growth

Our primary financial goal is to increase book value over the long term on a per share basis. In 1998 book value grew from $357 million to $425 million. On a per share basis book value increased 18%, to $77.02 from $65.18. Our goal is to compound book value at a 20% annual rate. In 1998 we just missed the

mark, however, we do expect some volatility in this measure on an annual basis. In the past five years, a more meaningful period and the one we use to calculate incentive compensation, book value grew at a 23% compound annual rate on a per share basis.

Several years ago we discussed our "model for profit." This model helps one understand how we believe we can compound book value at a 20% rate. Simplistically, if we do not lose anything in the underwriting operation, and maintain $4 in investments for every $1 in equity, earning a 5% after tax total return, then we will grow book value at a 20% rate. At year end our investments totaled $1.5 billion and shareholders' equity was $425 million. This represents only $3.50 in investments for every $1 in equity. This is the obvious result of growing book value at a rate faster than the investment portfolio. As discussed later, the acquisition of Gryphon Holdings, Inc. provides additional investment leverage and positions us to work toward compounding book value at 20% in the future.

Gryphon Acquisition

One of the most important events of the year for us was the decision to purchase Gryphon. This transaction consumed a great deal of energy throughout the year, and concluded with an agreement to purchase the company for approximately $150.7 million and the assumption of $55.0 million in debt. Gryphon is an insurance holding company that owns three insurance companies: Associated International Insurance Company based in Woodland Hills, California; Calvert Insurance Company with offices in Hoboken, New Jersey; and The First Reinsurance Company of Hartford which operates out of Chicago. Together these companies control approximately $200 million in annual premium volume.

Gryphon has excellent franchises in property subject to earthquake risk, professional liability insurance for architects and engineers, as well as directors and officers liability insurance and other miscellaneous professional coverages. The company was also active in many other programs with very inconsistent results. In today's environment, it is very difficult for a small company to operate successfully in multiple products across many states. As with other companies in similar circumstances, Gryphon was burdened with too much overhead and too much bureaucracy. While the company tried to grow its way out of its problems, this strategy proved to be difficult in the current competitive environment.

The process of integrating Gryphon into the Markel organization has just begun. We expect that each line of business that we continue to write will be managed by an existing Markel operating company. For example, the property division writing California earthquake coverage

will become a business within the Essex Insurance Company where we currently write similar coverages. The architects and engineers coverage, as well as the Chicago operations specializing in directors and officers coverage, will become part of the Shand/ Evanston team where we have a great deal of expertise and believe we can add value and grow these businesses.

Gryphon did not enjoy underwriting success. In fact, the company incurred significant underwriting losses in each of the past four years. These results stemmed from high operating costs, a lack of management focus, inadequate loss reserves, and attempts to develop new business in areas where the company lacked sufficient expertise. We believe that as part of Markel this will quickly change. As the unprofitable businesses are run off and underwriting standards are reviewed, we expect Gryphon's premium volume to decline, probably by as much as 50%; however, more importantly, we expect the remaining businesses to ultimately produce underwriting profits.

As part of our review of Gryphon we determined that the company's loss reserves were set somewhat optimistically. As a result, Gryphon took an additional charge in the fourth quarter to set its reserves on a more realistic basis. At year end we think the company's reserves are adequate (although not yet with the margin of safety we would prefer).

In looking at the investment side of the operation we also see significant opportunity. Gryphon has an investment portfolio of approximately $400 million, invested in high quality fixed income securities with fairly short durations. Markel will also be able to add significant value in the management of the investment portfolio and overall investment leverage will improve. On a pro forma basis at December 31, 1998 we now have investments of $1.8 billion and equity of $425 million which represents slightly more than our targeted level of investment leverage of $4 in portfolio for each $1 in equity.

When we achieve underwriting profitability, we can take full advantage of the additional investment leverage, and the acquisition will help us to compound book value at a 20% rate. The additional premium will better utilize our growing capital base and the additional portfolio provides the balance sheet leverage we seek to maintain.

We believe we start 1999 in an excellent position to continue to build shareholder value. As always, for the actual results, we must wait and be patient.

Industry in Transition

The property and casualty insurance industry remains very competitive. Industry premium growth has been slow, returns on equity from operations are at unacceptably low levels and the industry has too much capital.

There are more than 3,000 insurance companies competing for business. Price levels continue to decline and it's hard to remember when the industry last earned an annual underwriting profit. Many observers also believe that loss reserves are now inadequate. Compensating for weak operations, the industry has been bailed out by rising investment portfolio values from the decline in interest rates and rising stock prices. In addition, many companies are manufacturing earnings per share though creative reinsurance arrangements. This environment will not necessarily change quickly, however, it will change.

Over the past several years there has been a continued change among the companies which lead the industry. Many of the industry's former leaders have been acquired or substantially reorganized. Merger and acquisition activity has picked up among both large and small companies as the industry consolidates. We expect this trend to continue.

In 1986 when we completed our initial public offering, we trumpeted our small size, our spontaneity and flexibility, our ability to make decisions quickly, and our customer focus. These attributes undoubtedly contributed to our success. Today we are by most measures at least ten times larger than when we went public. Can we maintain these strengths and values as we continue to grow? The acquisition of Gryphon will add $100 million in premium, $300 million in incremental investment portfolio and initially more than 100 new associates. How long will it take this group to embrace the Markel Style? As we grow and meet the new challenges of our changing industry, we recognize the importance of sticking with and communicating to our new associates the important, common sense principles which guided us in the past.

The industry is facing many challenges and we expect as many or more changes in the next decade as we saw in the last. Neither inadequate pricing, nor inadequate loss reserves can last forever. These problems must be addressed and resolved and opportunities exist for Markel to be part of the solution. Interest rates are currently as low as they have been in many years. At current levels, many insurance companies will see a significant decline in investment income and returns on equity could drop to even lower levels. In this environment, we expect to see a continuation of industry consolidation.

All of these developments spell opportunity for Markel. While growth is not one of our strategic objectives, we expect to grow in the future. We want to provide excellent customer service, quality products, underwriting profits, and superior investment returns. All of this to build shareholder value.

The Markel Style

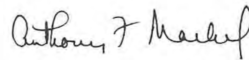
As an organization, one of our core strengths has been our strong values; values we articulate in The Markel Style. Often organizations have trouble balancing the different demands from clients, associates and shareholders. Some would believe that every decision is a trade off among these different interests. We disagree. Our goal is to make decisions which support all constituencies. For example, associates become owners through payroll stock purchase programs and loan plans, as opposed to dilutive stock options. Additionally, our incentive compensation systems are designed to reward individual achievement. Our performance culture builds financial strength which our clients can count on. Creating an atmosphere in which people can reach their personal potential is much easier when the business is growing and successful. Success breeds success and we have designed Markel to be successful. We also know that just as soon as we become complacent, just as soon as we start to think we're pretty good, then we're headed for trouble. We pledge not to become satisfied with what we've done in the past. We set long term goals and we work toward them every day. We've come a long way and we are excited about the road ahead.

In closing, we would like to express our deep appreciation to Prem Watsa , who resigned from our Board of Directors in November, for his loyal service and keen advice over the years. Your Company is much stronger today because of Prem's contributions.

Additionally, we welcome Tom Gayner to the Board. Tom joined Markel in 1990 and has contributed both in the management of our equity portfolio and his common sense business advice.

Thank you for your support.

Alan I. Kirshner
Chairman of the Board and Chief Executive Officer



Anthony F. Markel
President and Chief Operating Officer

Steven A. Markel
Vice Chairman

Darrell D. Martin
Executive Vice President and Chief Financial Officer

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