# 2018

## To Our Business Partners

Greetings. Here is our annual report to you for the year 2018.

At Markel, we aspire to build one of the world's great companies. Our core values remain integrity, adaptability, continuous learning, and humility, among others. We wrote the Markel Style over 30 years ago to describe our values and culture. We believe this statement of our values ties our varied businesses together. Today, it does so for more people and in more places than ever before. As to tomorrow and beyond, while we've grown tremendously over decades, we feel like we're just getting started.

Each year we write you this letter to update you on the condition and performance of your company. This year's letter will be longer than usual (not necessarily due to popular demand). We'd like to take some extra time and space to describe our strategic initiative in the Insurance Linked Securities (ILS) market, and to answer some specific questions many of you have raised in recent months about that initiative. As usual, we also have a lot to tell you about our existing insurance, ventures, and investment activities.

### Short Version

If you'd like the summary version of 2018, here it is. 2018 was a good, but not great, year. We grew the business both organically and by acquisition. We increased the capabilities of the Markel Corporation in every aspect of our business. As a marker of this growth we set a new record in revenues. While we are reporting lower bottom line profitability due to downdrafts in investment markets and ongoing high levels of insured catastrophes, we believe that the economic value of Markel stands at a new record level as well. Finally, we ended the year with fewer shares of Markel than at the beginning, so each share of Markel that you own represents a bigger piece of the company than what it did a year ago.

### Extended Play Version

As we noted last year, we define a great company as one with a win/win/win structure. Our customers win as we serve them with products and services that make their lives better. Our associates win because we

**Financial Highlights**

| *(in millions, except per share data)* | **2018** | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|---|---|---|---|
| Total operating revenues | **$ 6,841** | 6,062 | 5,612 | 5,370 | 5,134 | 4,323 | 3,000 | 2,630 | 2,225 |
| Gross written premiums | **$ 7,864** | 5,507 | 4,797 | 4,633 | 4,806 | 3,920 | 2,514 | 2,291 | 1,982 |
| Combined ratio | **98%** | 105% | 92% | 89% | 95% | 97% | 97% | 102% | 97% |
| Investment portfolio | **$ 19,238** | 20,570 | 19,059 | 18,181 | 18,638 | 17,612 | 9,333 | 8,728 | 8,224 |
| Portfolio per share | **$1,385.24** | 1,479.45 | 1,365.72 | 1,302.48 | 1,334.89 | 1,259.26 | 969.23 | 907.20 | 846.24 |
| Net income (loss) to shareholders | **$ (128)** | 395 | 456 | 583 | 321 | 281 | 253 | 142 | 267 |
| Comprehensive income (loss) to shareholders | **$ (376)** | 1,175 | 667 | 233 | 936 | 459 | 504 | 252 | 431 |
| Shareholders' equity | **$ 9,081** | 9,504 | 8,461 | 7,834 | 7,595 | 6,674 | 3,889 | 3,388 | 3,172 |
| Book value per share | **$ 653.85** | 683.55 | 606.30 | 561.23 | 543.96 | 477.16 | 403.85 | 352.10 | 326.36 |
| 5-Year CAGR in book value per share [1] | **7%** | 11% | 11% | 11% | 14% | 17% | 9% | 9% | 13% |
| Closing stock price | **$1,038.05** | 1,139.13 | 904.50 | 883.35 | 682.84 | 580.35 | 433.42 | 414.67 | 378.13 |

[1] CAGR — compound annual growth rate

enjoy our jobs, and through them provide the means to serve our families, our colleagues, our customers, our communities, and ourselves. Our shareholders win because by doing these things in positive and sustainable ways, we create financial value which shows up in the increasing value of Markel over time.

In order to build one of the world's great companies we need to have what someone once called, "The Right Owners, the Right Associates, and the Right Strategy." Over the course of this letter we'll try to address each of those issues.

## Right Owners

The first idea is that of the "Right Owners." As your management team, we want and need a partnership with our owners. We need that partnership to be long term, and not subject to short term whims of market disruptions, or false objectives derived from too short term an orientation. We need our partners to *want* the same things as we do, namely, the long term creation of one of the world's great companies. That notion embeds ideas about sustainability, diversity, resilience, durability, and adaptability that have served as the hallmarks of Markel since our inception.

Having the right owners with a suitable long term time horizon provides us with an immense competitive advantage. In today's world, short term and artificial time pressures permeate too many decisions. Our dual time horizon of, *Forever and Right Now*, allows us to make necessary, *Right Now*, decisions on a day by day basis. But, we always get to make those decisions with the *Forever* mindset guiding us while we do so. That is an incredibly rare advantage in today's world. It would not happen without you as long term committed owners. For that we are greatly appreciative.
Thank you.

In order to earn the trust and respect of the right owners, we treat you as full partners. We think about what we would want to receive from management if our roles were reversed. If we were distant shareholders, and away from any contact for a year, we would want to know how is the firm doing. We might wonder what is going well and what is not going well. Is the firm going in new directions or maintaining the direction that you told us about last year? Did we add to the businesses we already owned? Did we buy any new businesses? Were there any major management changes, and what else took place that mattered at Markel last year?

These are the sorts of questions we'll attempt to answer in this letter, and the spirit in which we'll describe our current circumstances as well as our ongoing hopes and dreams for the future.

| 2009 | 2008 | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | 2001 | 2000 | 1999 | 1998 | **20-Year CAGR[1]** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| $ 2,069 | 1,977 | 2,551 | 2,576 | 2,200 | 2,262 | 2,092 | 1,770 | 1,397 | 1,094 | 524 | 426 | **15%** |
| $ 1,906 | 2,213 | 2,359 | 2,536 | 2,401 | 2,518 | 2,572 | 2,218 | 1,774 | 1,132 | 595 | 437 | **16%** |
| 95% | 99% | 88% | 87% | 101% | 96% | 99% | 103% | 124% | 114% | 101% | 98% | |
| $ 7,849 | 6,893 | 7,775 | 7,524 | 6,588 | 6,317 | 5,350 | 4,314 | 3,591 | 3,136 | 1,625 | 1,483 | **14%** |
| $799.34 | 702.34 | 780.84 | 752.80 | 672.34 | 641.49 | 543.31 | 438.79 | 365.70 | 427.79 | 290.69 | 268.49 | **9%** |
| $ 202 | (59) | 406 | 393 | 148 | 165 | 123 | 75 | (126) | (28) | 41 | 57 | |
| | | | | | | | | | | | | |
| $ 591 | (403) | 337 | 551 | 64 | 273 | 222 | 73 | (77) | 82 | (40) | 68 | |
| $ 2,774 | 2,181 | 2,641 | 2,296 | 1,705 | 1,657 | 1,382 | 1,159 | 1,085 | 752 | 383 | 425 | **17%** |
| $282.55 | 222.20 | 265.26 | 229.78 | 174.04 | 168.22 | 140.38 | 117.89 | 110.50 | 102.63 | 68.59 | 77.02 | **11%** |
| | | | | | | | | | | | | |
| 11% | 10% | 18% | 16% | 11% | 20% | 13% | 13% | 18% | 21% | 22% | 23% | |
| $340.00 | 299.00 | 491.10 | 480.10 | 317.05 | 364.00 | 253.51 | 205.50 | 179.65 | 181.00 | 155.00 | 181.00 | **9%** |

## Right People

The second idea is that of the "Right People." We believe we have a great formula to help us attract and retain the right people. It is called the Markel Style. The Style explicitly describes attributes such as hard work, pursuing excellence, integrity, having a sense of humor, and adapting to change, among others. It also talks about having fun while doing so.

The Markel Style serves as a written monument to who we are as the people of Markel. It talks about why we work hard, and how our ultimate goal of winning stems from doing things for others. We believe that the ultimate value of a firm derives from the value that the firm delivers to its customers… *others.* The Markel Style applies to every single person of this organization whether they are in the insurance, ventures, or investment operations.

Five years ago 7,200 associates called Markel their professional home. Today, that number stands at over 17,000. Today there are over 17,000 unique stories of people helping others. They are doing so in their work by providing products and solutions that meet the needs of a customer. They are doing so by having the means to take care of their families and their communities. They are doing so by setting examples, teaching, mentoring, coaching, listening, learning, giving, and helping, in countless ways, in countless situations.

We continue to attract the right people who yearn for the values embedded in the Markel Style. We thank them for what they do. We're committed to running Markel in such a way as to continue to create this opportunity for more and more people over time. Thank you for this opportunity.

## Right Strategy

The third idea is that of the "Right Strategy." In our initial annual report in 1986 we described our overall strategy as one of *"Diversification and Specialization."* That continues to be the case. Diversification means that we pursue more than one business or idea at a time. This creates a tough, flexible, and resilient organization, capable of withstanding setbacks in any one area. Diversity, and being good at it, allows us to continue to move forward no matter what. And we have observed over the years that "no matter what" seems to happen on a recurring basis.

We also believe diversity applies to more than just the list of businesses we're in. It means diversity in the people of our organization. We need people with different skills, backgrounds, and points of view, to bring robust talent to the tasks at hand.

Diversity also means doing business in more than one place. Over the years we've grown from a small local business in Richmond, Virginia to a global operation. The sun is always shining on some Markel facility somewhere in the world.

Specialization means being good at something specific. Markel bursts at the seams with world class experts in the disciplines of insurance, reinsurance, investments, safety, risks, industrial equipment, securitizations, medical services, horticulture, consumer goods, transportation equipment, affordable housing, and so on and so on. We bring specialized expertise to bear on challenging problems. As we solve those problems for our customers, we serve them, and make them better off than they would be without us.

Each customer problem we solve today gives us the opportunity to solve another one tomorrow. That is the ultimate formula for the sustainability of Markel over time.

The tactics of how we accomplish those worthy goals change over time. It is our job as the associates of Markel to figure that out. It's a fun and challenging task to do so. And that challenge helps to motivate us and drive the excellence you find in this company.

We believe we're pursuing the "Right Strategy" of being "Diversified and Specialized." We view the long term record of excellent financial performance as a validation of that statement, and we expect to continue to refine and adapt our tactics to build on that record going forward.

## 2018 Financial Results

Usually, when people have a headline like, "2018 Financial Results" they mean just for the year 2018. We mean that and more.

For the year 2018, at the top line, we reported total revenues of $6.8 billion compared to $6.1 billion in 2017. At the bottom line, we reported a comprehensive loss of ($376 million) compared to comprehensive income of $1.2 billion in 2017. We'll break out the steps and items between the top and bottom line over the course of this report but those are the annual, twelve month results. Additionally, Markel shares closed the year at a price of $1,038 compared to $1,139 a year ago.

We measure ourselves over longer and more important time frames as well. Longer term results matter more, and provide better and more robust data as to how we are doing in achieving our ultimate goals. As a tool to help reinforce this message, we use *five* year calculations as the basis for the vast majority of our management incentive compensation programs as opposed to year by year measurements. We think this helps to demonstrate and reinforce the fact that we put our money where our mouth is when it comes to the importance of a long term time horizon.

With a five year view, here are the same numbers. At the top line we reported revenues of $29.0 billion from 2014 to 2018 compared to $14.2 billion from 2009 to 2013. At the bottom line we earned comprehensive income of $2.6 billion in the 5 years from 2014 to 2018 compared to $2.2 billion in the years from 2009 to 2013. Additionally, Markel shares closed 2018 at a price of $1,038 compared to $580 at the end of 2013.

It's unusual for companies to describe their progress in this sort of multi-year fashion. We do so because we think it highlights the long term focus with which we operate. We also think that it washes away some portion of short term market volatility distortions. We think looking at the fundamental economic measures over long time horizons helps us to make better long term decisions. We back up that belief by tying the bulk of our incentive compensation to the accomplishment of long term goals.

We provide even more data which describes and supports our long term focus in the chart at the bottom of this letter. We show 21 years of key financial items and we do so every year in this letter.

We report in this way by design. It helps us keep our focus on doing the right thing every day to accomplish long term and enduring excellence. We wish to minimize short term distractions and costly stop gap behaviors which might puff up short term results at the possible expense of long term performance.

## Captain's Log 2018

In 2018, we made excellent progress in continuing to build the long term economic value of Markel but it was a challenging year. We made some mistakes in certain areas. We experienced short term mark to market declines in our investment portfolio, and we look back wishing that we had done some things differently a year ago.

The good news from this report though is that we learned immense lessons during 2018. We continued to relentlessly and continuously learn, and to increase our capabilities to serve our customers, associates, and shareholders as we move forward.

Specifically, the challenges in 2018 included the second successive year of higher than average property catastrophe losses as manifested in record hurricane, typhoon, and wildfire losses. Not surprisingly, those losses affected our insurance, reinsurance, and Insurance Linked Securities operations. We also experienced headwinds in our publicly traded investment portfolio from rising interest rates and negative overall equity market returns. We also experienced highs and lows in our diverse Markel Ventures business operations.

We are incredibly optimistic that we learned immense lessons from each of those experiences and we will go on to use that knowledge and wisdom to build the future value of Markel. We're also pleased and relieved to report to you that over the years we've built a resilient and durable business. We can and did absorb some painful lessons in 2018, yet we still earned reasonably good financial results while doing so. That statement becomes even truer when viewed over longer time frames such as the five rather than one year time period.

We also have some excellent news from 2018. Namely, we acquired Nephila, the market leader in Insurance Linked Securities, and we added Brahmin Leather to our Markel Ventures operations. We also worked to improve our skills and capabilities within all of the existing insurance, investment, and ventures operations.

In our existing operations we pursued the non-glamorous daily tasks of day to day execution and daily work. As always, we tended to our businesses one day, one customer, one decision, at a time. We helped our long standing associates with training, and experience, to become better at their daily work, and to learn new skills and capabilities. We also added talented individuals with specific skills and capabilities all across the organization to help us all continuously adapt and grow.

Today, newer skills might be called digital, or cyber, or analytics, or other terms. Those words speak to the increasing complexity of today's world. We need to constantly develop new capabilities in whatever skills the marketplace needs. This concept is nothing new, and we've been doing it at Markel for decades. Expect us to continue. Stopping means death and we have no interest in that.

## Five year view

One of the benefits of looking at the five year comparison of numbers is that you can start to see things with a clearer perspective than year by year.

When you look at the last five years at Markel you see the transformation of your company in stark terms.

Here are some of the ways we've transformed Markel.

In the U.S. we combined our insurance operations from their separate silos of wholesale and retail. Our simple goal is to seamlessly provide all customers of Markel with any insurance capability found within our organization. We want to be able to provide insurance coverage to our customers in whatever way they want to buy it.

Some coverages will be available on-line and direct to consumer. For example, our coverages for motorcycles, boats, horses, liability for directors of non-profit entities, and many other lines can be researched and purchased on-line directly from Markel.

Other forms of insurance require the expertise of retail insurance agency networks. We have direct access and availability of appropriate insurance to retail insurance agents as they explain coverages, and provide and share servicing responsibility, for those customers.

Finally, complex and large scale insurance products require the specialized knowledge and distribution capabilities of wholesale insurance brokers, and large international insurance agency operations. Through the offerings of our Markel Assurance division, we can meet the needs of those customers and that distribution system as well.

Five years ago, each of those efforts operated in semi-autonomous silos with minimal overlap. Today, we are approaching the ability to match the capabilities that exist within Markel to any customer, anywhere.

Five years ago, the gross written premium revenues of the preceding divisions that now make up the combined Markel Assurance grouping were $1.6 billion. In 2018, those gross written premiums were $2.1 billion. The growth reflects our increased ability to provide whatever our customer wants and needs in whatever method they wish to purchase it. We're just trying to get out of our own way here in order to give the customer what they want, how and where they want it.

We also operate internationally with our London based Markel International operations. With a combination of licenses owned by Markel International, as well as those markets where we can operate through our licenses with Lloyd's of London, we can serve customers all around the globe.

Our international operations offer local market coverages to local customers in the UK, Canada, Continental Europe, and Asia, with local offices and local presence. We also offer global coverages to global customers through the combined capabilities of Markel Assurance and Markel International along with our Lloyd's, and Markel Global Reinsurance capabilities.

Also, while Brexit looms large as a current issue for the UK, we prepared years in advance to be ready for such a development. Namely, we established a local German presence several years ago. We've worked to continuously develop our capabilities within Europe on a separate and standalone basis from the UK. As such, we believe we're prepared to adapt to whatever Brexit outcome ultimately takes place.

Five years ago the gross written premiums of our International Insurance operations were $826 million, in 2018 they were $1.1 billion.

Through our Global Reinsurance capabilities headquartered in Bermuda and with US, UK, and other locations, we offer global reinsurance coverages. Five years ago the gross written premiums of our reinsurance operations were $566 million, in 2018 they were $1.1 billion.

Reinsurance by its nature tends to be volatile from year to year. While we've suffered the blows of back to back years of record high catastrophe losses, we are confident in the leadership of our reinsurance business and we expect meaningful and positive returns on capital from our ongoing reinsurance activities.

The change in the scope and scale of our Insurance Linked Securities (ILS) operations over the last five years is the most dramatic of all. Five years ago the revenues of our ILS business were $0. In 2018 they were $92 million. We'll pick up the discussion of ILS shortly.

In our Markel Ventures operations, five years ago we reported total revenues of $686 million and EBITDA of $84 million. In 2018 we reported total revenues of $1.9 billion and EBITDA of $170 million. We use the imperfect tool of EBITDA to give you a least-worst proxy of the earning power of the Markel Ventures companies. We think EBITDA gives you a better view of the underlying economic earnings power of the Markel Ventures companies since purchase accounting tends to distort the GAAP measure of net income. The distortion is especially true in the early years following acquisitions. Over time, as the base of Markel Ventures grows and amortization of purchase accounting items diminish, the net income measurement should converge towards the same rate of change as the EBITDA measure.

The seeds of Markel Ventures, planted decades ago, now show up as meaningful crops. Expect this to continue.

**Insurance Linked Securities (ILS) Strategy Discussion - "Everything You've always wanted to know about Insurance Linked Securities but were afraid to ask."**

Over the last several years, we've been on a multi-year and multi-acquisition process to build our capabilities in the insurance linked securities market. Through the acquisitions of ILS managers CATCo, and Nephila, as well as State National, with its necessary regulatory servicing and licensing capabilities, we've assembled the largest single entity that participates in the Insurance Linked Securities market. We are incredibly optimistic about the future of this business and what it means for Markel as a whole.

That said, we encountered unexpected challenges in our CATCo ILS management operations in 2018. As we announced in December, we received inquiries from U.S. and Bermuda authorities into loss reserves recorded in late 2017 and early 2018 at CATCo and its subsidiaries. We are fully cooperating. We continue to investigate the issue, and we retained first rate outside advisors to conduct a fulsome inquiry into the matter. As of this writing, the investigation remains ongoing. We will report on the outcomes of the investigation when it concludes.

We are confident that our efforts in Insurance Linked Securities will prove to be a valuable and important strategic pillar of our operations at Markel. We will learn, and we will adapt as necessary, to make our ILS operations a key contributor to our results over time.

In response to many of your questions, we thought it would be a good idea to describe the nature of the Insurance Linked Securities business. What is it? What are Insurance Linked Securities? How does this market work? What do buyers want? What do sellers want? What is Markel's role in the business and what are our potential risks and rewards?

As a first step to answer these questions, take the point of view of the buyer of an ILS product. In one incredibly oversimplified example, that buyer could be a major insurance company that sells a broad variety of coverages in a given market. If a company sold homeowners coverages, auto coverages, business interruption coverages, and other lines in markets like Florida or California, they might be concerned that a single event in one location could cause losses across all of the products they sell. As we've seen in recent years, hurricanes in Florida and wildfires in California caused massive losses to whatever stood in harm's way. All and every coverage was hit, and often well beyond what industry participants expected to be the case.

In order to protect themselves, major insurance companies might buy a type of an insurance linked security known as an "Industry Loss Warranty" (ILW) cover. These covers provide buyers with reimbursement if total industry losses from an event exceed a certain amount. This is in essence a reinsurance purchase, but it is not tied to specific coverages or policies. It just is meant to provide some reimbursement to the buyer if the total industry losses go over a certain amount.

An ILS manager finds buyers who are looking for this type of coverage.

As the ILS manager finds buyers who seek this sort of coverage, it needs to find sellers (capital providers), who will provide the capital to fund losses if they occur.

The sellers of the coverage (the investors) put up cash to pay for losses if they occur.

In exchange, if there are no or limited losses, the investors receive their cash back, plus the cash that the buyers paid to put the coverage into place.

The ILS manager puts the transaction together and matches up the buyers and sellers with specific terms, rates and coverages. It facilitates the custody of the cash during the time of coverage, and settles out the cash in, and cash out, for all parties. The manager typically provides only a small, if any, amount of the underlying capital behind these transactions. The bulk of the capital comes from the investors, and the ILS manager earns management fees, as well as performance fees based on outcomes.

To continue with the math of how this might work in very simple terms consider the following example. Assume a buyer paid a premium of 25% of the total coverage for an ILW policy. That means they are paying $25 million for $100 million in coverage. The sellers/investors put up $75 million of cash. That cash gets added to the $25 million of the premium from the ILW buyer and the $100 million total amount is held in escrow in the form of cash.

If you assume the over-simplified example of no fees or expenses, the 25% rate for that coverage implies that the event being covered would happen once in four years.

Here's what happens for the investors if there are no losses (what the actuaries assumed would happen in three out of four years for this type of coverage). The buyer would be out $25 million but have been protected against a catastrophic outcome.

The investors would receive their $75 million back and the $25 million cash paid by the buyer. That would produce a return of 33% ($25 million divided by $75 million). That's why sellers/investors provide capital for these transactions.

That would be the result in any one year, for one policy, when there weren't any losses. These products are for large losses, and big catastrophes, so that is not an unrealistic outcome in any one year.

Obviously, if those conditions prevailed continuously, the market would stop because that outcome is too favorable to the sellers, and the buyers are paying too much for the risk they're seeking to reduce.

With the same math over four years, the numbers should balance out perfectly. If the losses truly do occur once every four years, then collectively the buyers and the sellers each put in $100 million and they each took out $100 million over time.

The real world is obviously more complicated than that over-simplified example. Many things in life are more complicated to *do* than they are to *say*. That is certainly the case for Insurance Linked Securities. Here are some of the complexities, and how they start to affect real world outcomes.

The first complexity is to acknowledge that the real world will not play out in a precise one in four way. For instance, assume that the big catastrophic event took place once every three years rather than once every four years. What happens then?

In that case, over the three years, buyers would have paid a cumulative premium for the coverage of $75 million (3 years x $25 million), and they would have collected a loss payment of $100 million when the catastrophe occurred. They'd be up a net $25 million on the trade and the sellers/investors would be net $25 million behind ($75 million collected over 3 years minus the $100 million of loss payments).

Following the same math and logic, if the event took place once every five years, the buyers would be behind a net amount of $25 million and the sellers would be up by an equal and opposite amount.

As such, the first part of the equation for an ILS manager is to attempt to underwrite the risk of the product as to the frequency (how often it might happen) and the severity (the cost when it does). Our ILS managers and their actuaries use various tools to attempt to calculate appropriate pricing that will roughly balance out the equation for buyers and sellers over time. That is the first and most challenging complexity when we go from the oversimplified example to the real world.

Also, fees and expenses are not zero. Buyers will pay a price that is ultimately higher than the actuarial technical rate because they get something more than just a reimbursement for when a loss happens. They get to structure their balance sheet in a way that helps to prevent a "risk of ruin." That is a valuable assurance, and they will pay something to provide themselves with assurance that they will be financially solvent after major catastrophes to be able to continue to operate.

ILS products provide real and valuable benefits to their customers to protect them in the event of major catastrophes. Even if the catastrophe doesn't happen, the ability to operate with confidence, and in a financially sound and protected manner, is of the foremost importance. This is a win-win circumstance for the ILS manager and its buyers.

For the investors, the returns from their investments should not be correlated to overall financial markets, general economic conditions, or other circumstances. Investments in Insurance Linked Securities provide diverse and independent cash flows for their portfolios. This ability to earn returns that are separate and distinct from stock markets, interest rate moves, or other factors is of value to investors seeking to manage investment portfolios. As such, an ILS manager provides a product that helps investors meet their objectives. We can earn a fair and appropriate fee as compensation for doing so. Again, this is a win-win relationship between ILS managers and the investors.

Additionally, the fees and expenses associated with these transactions, as well as the returns on capital supporting these deals, tend to be lower than those associated with traditional forms of reinsurance coverage. That is one of the reasons the Insurance Linked Security market developed. The world continues to demand better, faster, and cheaper solutions to all problems, and the ILS market addresses that dynamic for insurance products.

In the short run, compared to hundreds of years of traditional insurance coverages, this is a relatively new market. In 2018 a series of record-setting catastrophes in multiple markets caused the investors in ILS markets to experience losses. This was the second year in a row of such events, and those losses have triggered much discussion about the results and long term viability of the ILS market. We believe in the future of the ILS market and that the results will balance back out towards a more sustainable equilibrium.

In hindsight, CATCo's initial estimates for the catastrophe losses of 2017 and 2018 proved to be too low. The losses to investors on CATCo products have exceeded initial estimates.

Among other matters, the reserve setting process at CATCo involves a unique challenge in that products such as Industry Loss Warranty covers end up with a completely binary outcome. To continue our extreme and oversimplified example, if the industry loss number in a given contract is set at $5 billion, and industry losses turn out to be $4,999,999,999, the loss for the sellers/investors in the ILS security is zero. If the overall industry loss deteriorates by $2, that means the ILS contract would go to a total loss that might be hundreds of millions.

Determining a point estimate for what that loss might be, and doing so for a wildfire that is burning while you are in the room and trying to come up with that number, is a tough task. Frankly, it is impossible to get it exactly right.

Going forward, we are revisiting and reexamining the processes and elements that go into the setting of reserves, pricing decisions, and actuarial matters at CATCo. We remain committed to operating with complete integrity and to the very best of our ability.

We understand the trust you have placed in us and there is nothing more important to us than deserving it.

We are optimistic that we will end up with an improved ILS investment management operation over time. Insurance Linked Securities provide fundamentally sound and valuable services for both buyers and sellers of the product.

We hope that this discussion helps to provide clarity on the nature of the Insurance Linked Security business and why we believe it to be an important element of our long term platform at Markel.

## Nephila and State National

In 2018 we purchased Nephila. Nephila literally started the ILS market 20 years ago and they are the number one player in the ILS industry.

Nephila operates in a different portion of the ILS market than CATCo. For Nephila, losses tend to be more frequent but less severe. As such, the risks and rewards for both buyers and sellers tend to be more tightly dispersed than would be the case at CATCo.

Frank Majors and Greg Hagood started Nephila in 1997 and built a wonderful organization over decades. As they reviewed their options for sustaining their company and building its future, they believed that Markel offered the best fit culturally and professionally for the Nephila team. We agree.

We are delighted with the early months of Nephila joining Markel and we believe that the combined platform of Nephila, along with State National, along with CATCo, along with our existing reinsurance operations, gives us the number one market position to meet the needs of buyers and sellers in this arena.

We occupy a unique position in the insurance/risk transfer industry to provide a full and complete solution to buyers and sellers in this realm.

State National's fronting capabilities provide many of the licensing and regulatory processes and mechanisms necessary to operate in the ILS and alternative capital world.

With our current array of capabilities, we offer the broadest based, most comprehensive marketplace, to address risks through Insurance Linked Securities. We believe that over time, the ILS market addresses more risk areas than just property catastrophe coverages. We are already providing risk transfer products that deal with areas such as weather and energy, and we expect to continue to increase the percentage of risk transfers that might be suitably addressed by the ILS mechanism.

As the number one player in this market, we have the advantage of more flow, and more conversations, about how we can meet the needs of buyers and sellers in this marketplace than anyone else. The ultimate size and scale of this idea could be one of the most important strategic moves we've ever made.

Stay tuned. We're learning and figuring it out.

Today, we know more about how to price and describe risk in this marketplace than we did yesterday. We're more sensitive to hidden or previously unthought-of correlations that can cause events to cluster in ways that they did not in the past. We're more sensitive to the implications of climate change, and how that might increase both loss frequency and severity along with more correlation of previously uncorrelated events. Our predictive models, both within Markel, and those available from industry sources, are more robust now that they've been tested and modified based on the experiences of 2017 and 2018.

And, the prices for transferring these risks are higher in 2019 than what they've been in the two previous years. Higher prices help while learning.

## The Strategic Platforms of Markel

There are five strategic platforms embedded in Markel at this point. In alphabetical order they are as follows

1 - Insurance & Reinsurance
2 - Insurance Linked Securities
3 - Investments
4 - Markel Ventures
5 - Our Mindset

### 1 - Insurance & Reinsurance

This is our legacy at Markel and the foundation of our company. It's how we started, and the basis for what we've been able to do in building up the rest of Markel over time.

In our insurance operations we produced Gross Written Premiums of $5.8 billion in 2018 compared to $5.3 billion in 2017. We operated profitably with a combined ratio of 98% despite six points of catastrophe losses during the year and we continued to adapt and refine our insurance operations on a continuous basis.

While insurance marketplace conditions remain tough and hyper competitive, we are pleased to report underwriting profitability for the year. You can observe that we've earned underwriting profits in 14 of the 21 years in the chart included in the letter. We remain committed to earning underwriting profits on a consistent year by year basis. We've learned from each episode of higher industry catastrophes and we would expect to improve this ratio in the years to come.

We're especially pleased that we were able to report an underwriting profit in 2018 with a combined ratio of 98% compared to the underwriting loss in 2017 and the combined ratio of 105%. Catastrophe losses remained elevated in 2018. For us to be able to move from an underwriting loss to an underwriting profit while still facing historically high catastrophe losses is a marker of the improvement in our capabilities and decisions all around the insurance organization.

### 2 - ILS

We expect 2019 to be a year of improving and expanding our product offerings for the benefit of buyers and investors as we continue to build a robust and important platform for the future (see previous discussion).

### 3 - Investments

In our investment operations we earned a total return of (1.0%) in 2018 compared to 10.2% in 2017. In our equity operations we reported a loss of (3.5%) compared to a gain of 25.5% in 2017. As always, equities remain volatile in any given year and the year to year comparison demonstrates both types of volatility (up and down).

Over the longer term we've earned excellent returns on our equity investments. In keeping with the five year theme of this letter, we earned 9.7% on our equities over the last five years compared to 3% on our fixed income portfolio. This is an excellent outcome, and provides evidence for why we continue to commit a higher percentage of our investment portfolio to equities than most insurance based organizations.

We continue to follow our longstanding four part equity investment discipline of seeking investments in 1-profitable businesses with good returns on capital and not too much leverage with 2-management teams with equal measures of talent and integrity, 3-with reinvestment opportunities and capital discipline at 4-reasonable prices.

Long term readers of this letter will recognize that catechism of how we describe our equity investing approach. It has not changed in decades and we think the thought process remains durable and effective in making productive investment decisions.

While we produced a return of negative (3.5%) in 2018 on our equities, and we do hate negative returns, we do take some comfort in the fact that this performance exceeded the loss of (4.4%) experienced in the S&P 500. We've outperformed the S&P 500 index by more than 100 basis points for over 30 years. We are proud of this record. We think it remains one of the best in the entire investment industry. We hope you take comfort that our approach remains sound in both theory and in execution.

In our publicly traded fixed income portfolio we earned a total return of 1.3% in 2018 compared to 3.4% in 2017. Just as is the case with equity investments, we have a stated discipline to manage fixed income securities. We allocate enough funds to more than provide for our estimate of the ultimate claim payments of our insurance operations. We match those funds in duration and currencies to our expected liabilities, and we invest them exclusively in the highest credit quality investment options that we can find. We seek to minimize credit risk and we don't try to predict or forecast moves in interest rates.

In a rising interest rate environment, the market value of those securities declines. That is what happened in 2018. We normally hold our positions until they mature. As such, those short term fluctuations do not affect our ability to meet the liabilities of our insurance claims and we continue to protect our balance sheet. Mark to market accounting requires us to report the market volatility of the bonds that we hold for multiple years. Mark to market accounting does not allow us to adjust the net present value of our estimates of future claims payments as interest rates change. In any given year, this causes an accounting presentation mismatch to economic reality. We're following U.S. GAAP accounting and adjusting the market value of the bonds on the asset side of the balance sheet. We are also following U.S. GAAP accounting and not adjusting for the change in the economic net present value of the claims payments on the liability side of the balance sheet.

This process repeats itself every year and the swings of any given year resolve back towards the other direction in subsequent years. Nothing new to report.

More importantly, the recurring dividend and interest income from our portfolio totaled $434 million in 2018 compared to $406 million in 2017. Over the five year time frame we've been talking about total recurring dividend and interest income was $1.9 billion in the 2014-2018 period compared to $1.4 billion in the 2009-2013 period. The recurring income is only a portion of the total investment returns, but we think the increase in that number over time demonstrates the soundness and productiveness of our investment approach.

### 4 - Markel Ventures

In 2018 we reported revenues of $1.9 billion compared to $1.3 billion in 2017. EBITDA totaled $170 million compared to $188 million. As we've stated for several years, purchase accounting tends to create year by year distortions from our view of economic reality. That effect is the largest in the early years following an acquisition and bigger deals can often produce bigger purchase accounting effects. That was very much the case in 2018 with the swings from our largest deal ever, Costa Farms. In 2017, the effects of Hurricane Irma, associated insurance recoveries from that event, inventory replacements, earn out calculations and other items increased EBITDA in 2017 and decreased it in 2018. As such the year by year comparison doesn't do a good job of directionally describing the business.

When you examine longer periods of time, those distortions fade away and the economic reality of the underlying business comes through. Keeping with our theme of looking at results over five year periods, the results from Markel Ventures shine through. Over the last five year period, revenues totaled $6.4 billion compared to $1.7 billion and EBITDA totaled $709 million compared to $206 million.

The ongoing growth and maturity of Markel Ventures represents a valuable pillar of the long term growth and soundness of the Markel Corporation. The cash flows from our Markel Ventures operations are somewhat independent of insurance cycles, interest rate movements, and public equity volatility. As such, the recurring cash flows from the Markel Ventures operations create optionality for Markel to have cash coming in the door from multiple sources on a relatively consistent and recurring basis.

In order to take advantage of opportunities in times of crisis or financial market disruptions, you need two things, Courage and Cash. Markel Ventures helps on both fronts as the growing record of cash consistently coming in provides us with the tangible and the intangible materials to make good capital allocation decisions.

During the year we also welcomed Brahmin Leather to the Markel organization. We're thrilled to do so. Bill and Joan Martin, along with their son Scott, built a marvelous organization over 30 years at Brahmin. Susan Thacker joined as CEO a few years ago. Susan and Scott will continue to lead the company and we're delighted to welcome them to Markel. Please check out their products on Brahmin.com and enjoy the quality and style of Brahmin products.

In our existing Markel Ventures operations we enjoyed a year of overall growth and solid profitability. We encountered challenges connected to running businesses, and we continued to support our managers with capital and the message of consistent long term focus. We want to operate every segment of Markel Ventures with the mindset of doing the right thing, and doing things *for* our customers rather than *to* them.

The results of this mindset continue to bear fruit and we expect more growth from Markel Ventures over time. As we have said during the last several years, market prices for acquisitions tend to be quite high. Consequently, we've exercised discipline and not chased after deals. Fortunately, our demonstrated performance, and our values based culture, continues to cause our phone to ring with incoming opportunities.

People know about Markel and the values by which we run this company. That doesn't appeal to everyone, but it appeals to some. In the highly competitive arena to purchase wonderful businesses, this is a profound strategic advantage. Some people value our long term, sustainable approach and we continue to answer the phone when they're looking for a new home. We will behave in such a way to keep that going.

## 5 - Mindset

If you describe something as being in 3D you're talking about the measurable, tangible elements of height, width, and depth. A common practice is to call *time* the fourth dimension. Throughout this letter, we've written extensively and repeatedly about the concept of time and our approach to thinking in long term ways. At the same time, we understand and appreciate the need to make decisions and take actions constantly, and we've written in previous years about our dual time horizon of *forever and right now* in order to provide the right focus to the right time periods for any given decision or process.

We'd like to suggest that the Mindset with which we operate Markel is something like a fifth dimension. There is such a thing, at least conceptually. The fifth dimension is an abstract mathematical concept that suggests that movement, and change, through time and space, alter the easily measured items of the first three dimensions.

At the risk of getting too weird, what we mean by this reference is that our culture, the values we attempt to describe and teach through the written word of the Markel Style, our beliefs, the way we interact with our customers and our colleagues, are all examples of this fifth dimension of a mindset that pervades Markel.

We recruit for people who seem to intuitively understand this concept. We promote and celebrate people within the organization who seem to behave in ways that make this intangible idea real, and we look for acquisitions and new ideas which fit this construct.

*We believe that our purposeful embrace of this intangible idea is the "secret sauce" of Markel.* Our mindset is a fifth dimension. It guides us as leaders, and provides explicit and implicit forces that help us make better decisions that show up in our quantifiable measures of the first through fourth dimension i.e. annual financial results over many years.

### Not Yet

While traveling this year we met a CEO who described his company as a "Not Yet" company. He started a business from scratch and has built a global multi-billion firm from nothing. As he said, he doesn't say no to new ideas or new opportunities because he is only in the fill in the blank ______ business. He says that his company has "Not Yet" considered a new potential idea, but perhaps it could and should. He spoke profoundly about the need to embrace change by reminding us that, "resisting change is like holding your breath. If you get good at it you'll die."

Embracing change, and following the doctrine of "Not Yet", in many ways describes the history of Markel.

When Sam Markel started this business, there was "Not Yet" an insurance product that covered losses and injuries caused by the growing presence of automobiles compared to horses. Markel figured out a way to provide that coverage and improve the safety and outcomes for our customers, the drivers and passengers of that day and place.

When the interstate highway system came into being, there was "Not Yet" an insurance product that covered the new risk of what happens when heavy trucks hit lighter cars. Markel figured out a way to provide those coverages and help make driving safer for all.

When new technology creates new products, new services, and new risks, there is "Not Yet" a way to actuarially understand the risks involved and to create an insurance bridge between the capabilities of entrepreneurs and the demand of customers for new products or services. The people of Markel figure out ways to create that bridge, and allow for progress that new products and technology bring to society.

When people built businesses in diverse fields such as bakery equipment, car hauling trailers, medical services, truck flooring, houseplants, affordable housing, and other products and services, there was "Not Yet" an obvious home at Markel for those firms to continue to serve and prosper as their ownership structure changed and generations passed. The people of Markel figured out a way to sustain the values of service and durability through our Markel Ventures entity.

Our mindset of "Not Yet" powers our drive to continue to build Markel into one of the world's great companies. So far, so good.

We can't wait to get to work every day and learn how to be better. It's an exhilarating way to live and a great formula for building a business.

Thank you for your support and partnership.

Respectfully submitted,

Thomas S. Gayner, *Co-Chief Executive Officer*

Richard R. Whitt, III, *Co-Chief Executive Officer*