

What does White Mountain (also known by its major divisions name, One Beacon) do? Mr. Ray Barrette, Managing Director and CEO, had this to say about OneBeacon, "... Together, we will focus on what we do best - underwriting personal and small-medium commercial accounts through independent agents committed to being our true partners." OneBeacon sells exclusively through its current network of independent agents, is headquartered in Boston, MA, and is focused on selling property/casualty insurance. It produced \$4.4 billion in revenue in 2000 and is rated A (excellent) by the A.M. Best Company.

I have attempted to bring together from many sources the background information an investor would need in order to consider becoming a part owner of this corporation. The biggest piece of information needed to evaluate the company that is lacking is historical performance information on the CGU purchase. I tried to attain this information but was advised the information is "tainted" due to the old CGU parent company not writing profitable business and not reserving adequately. I will leave it up to the readers to determine their own intrinsic value calculations for White Mountain.

A company's business psychology and its culture are two important factors to consider when an investor is determining whether to make an investment in any company. It is also one of the first factors I try to determine when making the initial examination of a company. To this end I have transcribed White Mountains Operating policies here:<sup>1</sup>

### **What We Care Most About**

#### *Underwriting Comes First.*

An insurance enterprise must respect the fundamentals of insurance. There must be a realistic expectation of underwriting profit on all business written, and demonstrated fulfillment of that expectation over time, with focused attention to the loss ratio and to all the professional insurance disciplines of pricing, underwriting, and claims management.

#### *Maintain a Disciplined Balance Sheet.*

The first concern here is that insurance liabilities must always be fully recognized. Loss Reserves and expense reserves must always be fully recognized. Loss reserves and expense reserves must be solid before any other aspects of the business can be solid. Pricing, marketing, and underwriting all depend on informed judgement of ultimate loss costs and that can be managed effectively only with a disciplined balance sheet.

#### *Invest for Total Return.*

Historical insurance accounting has tended to hide unrealized gains and losses in the investment portfolio and over reward reported investment income (interest and dividends). Regardless of the accounting, the group must invest for the best growth in value over time. In addition to investing our bond portfolios for total after tax return that will mean prudent investment in equities consistent with leverage and insurance risk considerations.

#### *Think Like Owners.*

Thinking like owners has a value all its own. There are other stakeholders in a business enterprise and doing good work requires more than this quarter's profit. But thinking like an owner embraces all that without losing the touchstone of a capitalist enterprise.

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<sup>1</sup> White Mountains Insurance Group, Ltd. 2000 Management Report, page 21.

## **What We Do Not Care Much About**

*Reported Operating Earnings According To Generally Accepted Accounting Principles.*

Trying to produce a regular stream of quarterly operating earnings often produces disaster. Trying to manage your company according to generally accepted accounting principles can often be silly. As our friend says, we would rather produce a lumpy 103 than a regular 99 (note: this quote is from Warren E. Buffett). We prefer to measure ourselves as we would hope owners measure us by growth in intrinsic business value per share

Growth in Revenue

We applaud owners who reward executives on premium growth. This often provides fine opportunities for us later.

Market Share

Often introduced by business consultants. In our personal experience chasing market share has produced the biggest disasters in our business. Often we have profited later from that excitement.

Strategic Purchase

We have never made a strategic purchase ... maybe we will someday. We often sell to strategic buyers. Our problem is we really don't *have* much of a strategy other than to increase intrinsic value per share.

## **Putting Our Capital To Work**

Intellectually we really don't care much about leaving our capital lying fallow for years at a time. Better to leave it fallow and to wait for the occasional high return opportunity. Frankly, sometimes shareholders would be better off if we just all went to play golf.

Overall, we should be students of capital and business. Adam Smith had it right, "Capital will flow according to its own nature: the invisible hand." If we do not earn and deserve our owner's capital, we will not long have it.

We also admire Benjamin Graham who said, "In the short run the market is a voting machine, in the long run it is a weighing machine."

## White Mountain Subsidiaries<sup>2</sup>

### **The Peninsula Insurance Company (100% Owned)**

Peninsula Insurance Company ("PIC") was established in 1960, is a Maryland-domiciled property and casualty insurer which writes both personal and commercial lines, primarily private passenger auto, homeowners, commercial auto and commercial multiple peril. Most of PIC's insurance products are sold in Maryland, Delaware and Virginia. PIC is rated "A" (Excellent) by A.M. Best Company.

In the United States, property and casualty insurance can be obtained through national and regional companies that use an agency distribution system, direct writers, brokers or through self-insurance including the use by corporations of subsidiary captive insurers. PIC markets insurance products principally through independent agents. PIC's primary business focus is to establish strong long-term relationships with its agents and insured customers by focusing on providing quality insurance products to families and small private businesses. PIC pays their independent agents commissions representing negotiated percentages of the premium they write. These commissions, which currently range from 5.0% to 20.0% of premium, depending on the line of business, constitute a significant portion of total acquisition costs and are included in underwriting expenses.

The long-term relationships cultivated by PIC with its agents and insured customers have produced a relatively high level of renewal persistency, particularly in PIC's standard private passenger auto and commercial auto books of business. Renewal persistency can be a significant indicator of an insurance company's long-term prospects for successful underwriting. An insurance company typically incurs more marketing and underwriting costs to write new business (e.g., policies written for new customers) than it does to write "seasoned" business (e.g., policy renewals). Additionally, losses and loss adjustment expenses are typically higher and less predictable for new business than for seasoned business.

The principal competitive factors that affect PIC are: (i) pricing; (ii) underwriting; (iii) quality of claims and policyholder services; (iv) appointing and retaining high quality independent agents; (v) operating efficiencies; (vi) product differentiation and availability; and (vii) increased competition from national direct writers. No single company or group of affiliated companies dominates the insurance industry. The highly competitive environment in the property and casualty insurance market during the past several years has intensified due to increased capacity resulting from growing capital supporting the industry and robust investment returns achieved in recent years. PIC maintains a disciplined approach to pricing and underwriting of insurance risks. Application of this disciplined approach in a highly competitive environment results in a lower volume of insurance premiums than would result from a less disciplined approach, but should produce better overall financial returns from the business over long periods of time.

#### Selected financial information for PIC:

Year Ended December 31,

Statutory Basis (a) in Millions	2000	1999	1998
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Net written premiums, by line of business:			
Private passenger auto	\$16.2	\$16.9	\$ 20.2
Commercial auto	3.5	2.7	2.2
Commercial multiple peril	1.0	.9	1.0
Homeowners	.9	1.0	1.0
Other	1.1	1.0	1.3
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Total net written premiums	\$22.7	\$22.5	\$ 25.7
	=====		
Ending total admitted assets	\$48.1	\$56.4	\$ 57.3
Ending policyholders' surplus	\$20.0	\$27.5	\$ 24.2

<sup>2</sup> White Mountains, March 2001 10K

## Folksamerica Reinsurance Company (100% Owned)

Folksamerica, through its wholly owned subsidiary, Folksamerica Reinsurance Company (a New York-domiciled reinsurance company), is a multi-line broker-market reinsurer which provides reinsurance to insurers of property and casualty and accident and health risks in the United States, Canada, Latin America and the Caribbean. Folksamerica is rated "A" (Excellent) by A.M. Best Company. During 2000, 1999 and 1998, Folksamerica had net written premiums of \$332.6 million, \$201.7 million and \$212.6 million, respectively. At December 31, 2000 and 1999, Folksamerica had total assets of \$2.8 billion and \$1.3 billion, respectively, and shareholder's equity of \$339.7 million and \$249.4 million, respectively.

Folksamerica's net written premiums by line of business:<sup>3</sup>

Millions	Year Ended December 31,				
	2000	1999	1998	1997	1996
Liability	\$208.4	\$122.6	\$122.0	\$123.6	\$ 79.6
Property	91.6	68.9	87.2	104.9	85.9
Accident and Health	26.4	-	-	-	-
Other	6.2	10.2	3.4	3.9	6.4
Total	\$332.6	\$201.7	\$212.6	\$232.4	\$171.9

Folksamerica's net written premiums by geographic location:

Millions	Year Ended December 31,				
	2000	1999	1998	1997	1996
United States	\$296.7	\$172.2	\$190.9	\$208.6	\$155.2
Canada	21.6	21.0	13.9	10.1	4.2
Latin America and the Caribbean	14.3	8.5	7.8	13.7	12.5
Total	\$332.6	\$201.7	\$212.6	\$232.4	\$171.9

On October 10, 2000, Folksamerica acquired an 80% interest in Esurance Inc. ("Esurance") for \$9.0 million in cash. Esurance is an internet-based insurance provider, which sells personal auto insurance in 26 states.

### Reinsurance Overview

Reinsurance is an arrangement in which a reinsurance company (the "reinsurer") agrees to indemnify an insurance company (the "ceding company") for all or a portion of the insurance risks underwritten by the ceding company under one or more insurance policies. Reinsurance can benefit a ceding company in a number of ways, including reducing net liability exposure on individual risks, providing catastrophe protections from large or multiple losses, stabilizing financial results and assisting in maintaining acceptable operating leverage ratios. Reinsurance also provides a ceding company with additional underwriting capacity by permitting it to accept larger risks and underwrite a greater number of risks without a corresponding increase in its capital or surplus. Reinsurers may also purchase reinsurance, known as retrocessional reinsurance, to cover their own risks assumed from primary ceding companies. Reinsurance companies enter into retrocessional agreements for many of the same reasons that ceding companies enter into reinsurance agreements.

Folksamerica writes both treaty and facultative reinsurance. Treaty reinsurance is an agreement whereby the ceding company is obligated to cede, and the reinsurer is obligated to assume, a specified portion or category of risk under all qualifying policies issued by the ceding company during the term of a treaty. In the underwriting of treaty reinsurance, the reinsurer does not evaluate each individual risk assumed and generally accepts the original underwriting decisions made by the ceding insurer. Facultative reinsurance is

<sup>3</sup> White Mountain's March 2001 10K

underwritten on a risk-by-risk basis whereby Folksamerica applies its own pricing to an individual exposure. Facultative reinsurance is normally purchased by insurance companies for individual risks not covered under reinsurance treaties or for amounts in excess of limits on risks covered under reinsurance treaties. The majority of Folksamerica's premiums are derived from treaty reinsurance contracts both on an excess of loss and quota share basis, which in 2000 amounted to 23.2% and 67.1% of its total earned premiums, respectively. Folksamerica derives its business from a spectrum of ceding insurers including national, regional, specialty and excess and surplus lines writers. Folksamerica selects transactions based solely on anticipated underwriting results of the transaction which are evaluated on a variety of factors including the quality of the reinsured, the attractiveness of the reinsured's insurance rates, policy conditions and the adequacy of the proposed reinsurance terms.

A significant period of time normally elapses between the receipt of reinsurance premiums and the disbursement of reinsurance claims ("float"). The claims process generally begins upon the occurrence of an event causing an insured loss followed by: (i) the reporting of the loss to the ceding company; (ii) the reporting of the loss by the ceding company to Folksamerica; (iii) the ceding company's adjustment and payment of the loss; and (iv) the payment to the ceding company by Folksamerica. During this time, Folksamerica earns investment income on the float. Therefore, Folksamerica's combined ratio can generally be higher than that of White Mountains' consolidated property and casualty insurance operations and yet may still earn an equivalent or superior return on equity.

Folksamerica generally obtains all its reinsurance business through brokers and reinsurance intermediaries, which represent the ceding company in negotiations for the purchase of reinsurance. The process of effecting a brokered reinsurance placement typically begins when a ceding company enlists the aid of a reinsurance broker in structuring a reinsurance program. Often the ceding company and the broker will consult with one or more lead reinsurers as to the pricing and contract terms for the reinsurance protection being sought. Once the ceding company has approved the terms quoted by the lead reinsurer, the broker will offer participations to qualified reinsurers until the program is fully subscribed by reinsurers at terms agreed to by all parties.

Folksamerica pays its reinsurance brokers' commissions based on negotiated percentages of the premium it writes. These commissions, which generally average 5% of premium, constitute a significant portion of Folksamerica's total acquisition costs and are included in its underwriting expenses. During the year ended December 31, 2000, Folksamerica received approximately 56.4% of its gross reinsurance premiums written from three major reinsurance brokers as follows: (i) E.W. Blanch - 21.6%; (ii) Guy Carpenter and affiliates - 17.6%; and (iii) AON Re, Inc. - 17.2%. During the year ended December 31, 2000, Folksamerica received no more than 10% of its gross reinsurance premiums from any individual ceding company.

Esurance Inc ([www.esurance.com](http://www.esurance.com)) is a subsidiary of Folksamerica that was founded in 1998. This company incorporates the Internet into their business model by offering expert advice, quote comparisons, instant coverage, as well as convenient, always available, policy management and claims handling. Using the Internet as a distribution model reduces overhead since it eliminates paper-based processes. This savings are then passes to the customer.

#### **Main Street America Holdings, Inc. (50% Owned)**

MSA is a subsidiary of National Grange Mutual Insurance Company ("NGM"), a New Hampshire-domiciled property and casualty insurance company, which insures risks located primarily in New York, Massachusetts, Connecticut, Pennsylvania, New Hampshire, Virginia and Florida. NGM's principal lines of business and approximate percentage of total direct written premiums are personal automobile (41.5%), commercial multi-peril (18.0%), homeowners (14.4%) and commercial automobile (13.9%). MSA, through its subsidiaries, participates in NGM's property and casualty business through a reinsurance agreement. MSA's net written premiums totaled \$265.4 million, \$242.7 million and \$258.5 million in 2000, 1999 and 1998, respectively, and its net income was \$3.8 million, \$25.8 million and \$13.4 million, respectively. MSA's total assets as of December 31, 2000 and 1999 were \$608.7 million and \$582.3 million, respectively, and its shareholders' equity was \$253.8 million and \$233.4 million, respectively. From 1994 to 1997 White Mountains owned 33.1% of the common stock of MSA ("MSA Common Stock"). During

that period MSA participated in 40% NGM's property and casualty business through a reinsurance agreement. In 1998 White Mountains acquired an additional 131,487 shares of MSA Common Stock for \$74.4 million (which includes a purchase price adjustment of \$4.1 million paid to MSA during 2000) which raised White Mountains ownership of MSA to 50.0%. As a result of White Mountains' additional investment in MSA, MSA's reinsurance pooling agreement was increased from 40.0% to 60.0% and NGM contributed certain of its insurance, reinsurance and financial services subsidiaries to MSA. White Mountains' investment in MSA Common Stock is accounted for using the equity method.

**OneBeacon Insurance (100% Owned)**

The following is an overview of who OneBeacon is today:

Over \$4 billion in written premium and ranks as the 17th largest p & c insurer in the U.S. Strength and stability of a national company with the focus, presence and responsiveness of a regional company. It is represented exclusively by select independent agents and is licensed in all 50 states, with 13 regions and branch offices throughout the country.

OneBeacon offers personal, commercial and specialty products and services through 6,200 property/casualty independent agents in the United States in addition to a nationwide claims service. OneBeacon's Personal Lines insurance provides customers with protection for their homes, automobiles and personal possessions along with personal liability coverage. You can use this link to find an agent closest to your location:

<http://www.onebeacon.com/Locator/default.cfm?PID=1689009&EID=0>

From the "mom and pop" business to the large manufacturer, OneBeacon has a commercial insurance product or package tailored to meet the demands of today's evolving business marketplace. Each product segment is supported by highly skilled underwriters who understand industry needs, OneBeacon products and appropriate pricing disciplines. The OneBeacon quality is further enhanced by our professional field teams' cycle time standards designed to achieve and maintain the competitive advantage of a service leader. From building, business personal property and liability to boiler and machinery, fleet auto and workers compensation, OneBeacon offers a broad spectrum of quality products, people and services for our business clientele.

The latest OneBeacon price releases can be found at:

<http://www.onebeacon.com/PressCenter/PressRelease.cfm?PID=1689009&EID=0>

*OneBeacon Historical Revenues and Profits:*

	1998	1999
Revenues (Life)	\$400 million	\$389 million
Revenues (General)	<u>\$3.979 billion</u>	<u>\$4.194 billion</u>
Total Revenues:	\$4.379 billion	\$4.5 billion
Operating Profit (Life)	\$25.6 million	\$32 million
Operating Profit (Health)	<u>\$221 million</u>	<u>\$285 million</u>
Total Operating Profit:	\$246 million	\$317 million

1999 Division Results:

*Life and Savings*

Single premium sales were 6% lower as a result of reduced demand for immediate annuities. The life product sales were ahead of 1998 sales by about 24% over the previous year. The CGU Annual Report

stated, "The US life business continues to strengthen its relationships with banks and to gain more of its sales through banking channels."

### *General Insurance*

Here are some interesting comments from the 1999 CGU Annual Report:

"Of all the companies in the US distributing through independent agents, the group is the 8<sup>th</sup> largest and has strong market positions in a number of regions, particularly the North East. It also has leading positions in specialist sectors such as the agricultural and marine markets."

"The general insurance profit of 178 million pounds reflected a 44 million pound improvement in the underwriting result from most classes of business."

"In the year that Hurricane Floyd causes extensive damage along parts of the Eastern Seaboard, CGU's claims service received a 95% satisfaction rating from its customers."

### Current Performance of OneBeacon Operations

The following two paragraphs are from a press release available on OneBeacon's website.

White Mountains anticipates that OneBeacon's statutory combined ratio for the month of June will be 126%, on earned premiums of \$330 million. June results are expected to include approximately 10 points attributable to catastrophes – primarily storms in the mid-west and certain gulf-coast regions (CAT's 44 and 45).

Ray Barrette, Managing Director and CEO of OneBeacon, stated "The June combined ratio of 126% represents a run rate of approximately 115% plus 7-8% points of higher than average catastrophe activity, augmented by 3-4% points of additional conservatism. Our balance sheet is in good shape and the reported combined ratio is not impacted by prior years' claim developments. The underlying results are worse than expected and are completely unacceptable. The management team and staff at all levels are very focused on improving the underwriting results as quickly as possible. Prices are up, poor and marginal accounts and agents are being eliminated and claims handling is being strengthened. We are committed to taking any and all actions necessary to produce acceptable underwriting results within 18 months."

History of OneBeacon (CGU Corporation) with Transaction Details<sup>4</sup>

Effective June 2, 1998, Commercial Union plc and General Accident plc, both UK corporations, were merged in a pooling of interests to form CGU plc. The U.S. operations of both companies were formally merged on December 31, 1998 when General Accident Corporation of America (GACA) was merged into Commercial Union Corporation (CUC) and the name was changed to CGU Corporation (the "Company"), which is a wholly-owned subsidiary of CGNU plc, its ultimate parent. CGNU plc is a United Kingdom Company listed on the London Stock Exchange, and was formed on May 30, 2000, when CGU plc merged with Norwich Union plc to form CGNU plc. The Company, through certain of its subsidiaries, is primarily engaged in underwriting and risk placement of property and casualty insurance business. The Company is also engaged, through certain other subsidiaries, in underwriting of life insurance and annuities.

The Company's primary subsidiaries are CGU Insurance Company and subsidiaries (Pennsylvania domiciled), Commercial Union Insurance Company and subsidiaries (Massachusetts domiciled), General Accident Insurance Company and subsidiaries (Pennsylvania domiciled), CGU Life Insurance Company of America and subsidiary (Delaware domiciled), National Farmers Union Property and Casualty Company and subsidiary (Colorado domiciled), Houston General Insurance Company and subsidiaries (Texas domiciled), and Pilot Insurance Company (a Canadian Subsidiary).

In CGNU PLC's 2000 annual report the company stated this rationale when considering sale of its CGU Corporation: "Following an extensive review, we have concluded that, despite the scale and strength of our US general insurance business and its attractive portfolio of personal and small commercial lines

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<sup>4</sup> White Mountains Insurance Group, Ltd., June 1, 2001, 8-K

business, it will not be possible to reach a leading position without a substantial level of investment, particularly in view of the likely consolidation in a fragmented market. We have therefore decided to dispose of our US general insurance business and have appointed Goldman Sachs and Co, in this respect."

They also said this concerning the same topic in their annual report, "Given that the US business ranked only 15<sup>th</sup> in a fragmented market and carried historic long-tail liabilities, CGNU took the decision to sell."

On September 25, 2000, CGNU plc announced it had entered into a definitive agreement to sell its U.S. property and casualty operations to White Mountains Insurance Group, Ltd (White Mountains). The agreed-upon purchase price is approximately \$2,170,000, subject to purchase price adjustments and certain pre-closing reinsurance transactions, payable in cash and a Sellers Note amounting to \$260,000. Concurrent with the sale:

The Company will enter into certain retroactive reinsurance arrangements, which will include the cession of all asbestos, environmental and certain other latent exposures, as well as an excess of loss reinsurance agreement covering adverse development.

The Company will sell its life insurance and Canadian property and casualty operations to CGNU plc for \$503,800, subject to purchase price adjustments and certain reinsurance transactions.

Long-term debt owed to CGNU plc amounting to \$1,100,000 at December 31, 2000 and included in the accompanying balance sheet will be paid with proceeds from the anticipated sale of the Company's discontinued operations and with proceeds from sales of investment securities.

#### Berkshire Hathaway Stake Information<sup>5</sup>

On June 1, 2001, Berkshire Hathaway, Inc. ("Berkshire") purchased from the Company, for \$75.0 million in cash, warrants (the "Warrants") to acquire 1,714,285 common shares at an exercise price of \$175.00 per share. Of the total Warrants purchased by Berkshire, Warrants to purchase 1,170,000 common shares (the "Series A Warrants") were immediately exercisable and Warrants to purchase approximately 544,285 common shares (the "Series B Warrants") will become exercisable upon approval by shareholders. Shareholder approval will be sought at the same time as approval of the conversion of Convertible Preference Shares is sought. If shareholder approval has not been obtained by March 31, 2003, Berkshire will thereafter have the right to require the Company to repurchase the Series B Warrants at a price per Series B Warrant equal to the then-current market price per common share less \$175.00. The Warrants have a term of seven years from the date of issuance although the Company has the right to call the Warrants for \$60.0 million in cash commencing on the fourth anniversary of their issuance. Since the Series B Warrants do not yet represent common equity to the Company, they constitute a contingent put liability (similar in nature to a stock appreciation right) which will be carried at fair value through a periodic charge or credit to the income statement. The Series B Warrants will become permanent common equity upon shareholder approval, if and when such approval is obtained.

On June 1, 2001, Berkshire also purchased for \$225.0 million, \$300.0 million in face value of cumulative non-voting preferred stock (the "Berkshire Preferred Stock") of a subsidiary of the Company. The Berkshire Preferred Stock is entitled to a 2.35475% dividend per quarter and is mandatorily redeemable after seven years. The Berkshire Preferred Stock represents subsidiary preferred stock, which is considered to be minority interest in the Company's consolidated financial statements.

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<sup>5</sup> ibid

### OneBeacon's Reinsurance Contract

Immediately prior to the Acquisition, CGU entered into reinsurance agreements with National Indemnity Company (the "NICO Cover") and General Re Corporation (the "GRC Cover"), which provide CGU with significant reinsurance protections against unanticipated increases in recorded reserves for insurance losses and loss adjustment expenses. The NICO Cover provides up to \$2.5 billion of protection against CGU's *asbestos, environmental and certain other latent exposures*. The treaty covers all exposures on business written before 1987, asbestos claims for business written before 1993, and all lead liability losses for business written before 1996 (This information was gathered from a Standard & Poors, June 1, 2001 news release). The GRC Cover provides for up to \$400.0 million in excess of loss reinsurance protection against adverse development on accident year 2000 and prior losses.

I was going to include the historical combined ratios for this division but I was not able to find that historical information listed. I also learned that the combined ratio figures wouldn't be a very accurate indicator of performance anyway because CGU hadn't been accurately maintaining their reserves. This was a big reason behind the reinsurance contract they signed with National Indemnity and General Re.

### Investment Operations<sup>6</sup>

White Mountains' philosophy is to invest all assets to maximize their after tax total return over extended periods of time. Under this approach, each dollar of after tax investment income, realized gains and unrealized gains is valued equally. Management further believes that the investment assets of its reinsurance and insurance operations should be invested in a "balanced portfolio" consisting of a mixture of fixed income investments, equity securities and occasionally other investments in order to maximize returns over extended periods of time. The Company's Investment Committee, headed by John D. Gillespie and comprised of certain other members of the Company's Board of Directors (the "Board"), key management and investment professionals, oversee the Company's investment activities, which are more extensive than in the recent past. The Investment Committee regularly monitors the overall investment results of White Mountains, reviews the results of each of White Mountains' various investment managers, reviews compliance with established investment guidelines, approves all purchases and sales of investment securities and ultimately reports the overall investment results to the Board.

As previously stated, the investment portfolios of White Mountains' reinsurance and insurance operations consist, in part, of common equity securities and other investments. At December 31, 2000, the investment portfolios of White Mountains' reinsurance and insurance operations contained \$181.5 million of common equity securities and other investments, which represented approximately 14% of their total portfolio, excluding short-term investments. Management believes that modest investments of common equity securities within its investment portfolio will enhance after tax returns without significantly increasing the risk profile of the portfolio when considered over long periods of time.

Richard Howard, formerly employed at T. Rowe Price for 19 years as head of the 1.3 billion Capital Appreciation Fund since 1989, will be helping manage the investment portfolio of White Mountains.<sup>7</sup> While Mr. Howard was the manager, the Capital Appreciation fund racked up a 10-year annualized return of 13 percent, landing it in the top 5 percent of Morningstar's hybrid fund category over that span.

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<sup>6</sup> White Mountains March 2001 10K

<sup>7</sup> Reuters, T. Rowe Capital Appreciation gets New Manager, August 03, 2001

***Five Largest Portfolio Holdings (As of 5/14/01)***<sup>8</sup>

Company Name	Number of Shares	May 14, 2001 MV	July 20, 2001 MV
Berkshire Hathaway, CL A	485	\$31,743,250	\$32,980,000
Berkshire Hathaway, CL B	10,342	\$22,504,192	\$23,476,340
Aon Corp.	172,960	\$6,140,080	\$5,993,064
Citigroup	106,666	\$4,797,837	\$5,394,099
General Electric	114,000	\$4,772,040	\$5,301,000
Amgen	75,000	\$4,514,063	\$4,590,750

**Key Player Information**<sup>9</sup>

Mr. Jack Byrne was re-appointed Chief Executive Officer of the Company in January 2000 after a brief retirement and is currently its Chairman. He has served as Chairman of the Board of the Company since 1985 and formerly served as President and Chief Executive Officer from 1990 to 1997, and as Chief Executive Officer from 1985 to 1990. Mr. Byrne is at Folksamerica and recently was a director at Markel Corporation. He also played an indispensable role as the CEO of Geico Corporation by bringing the company back from the brink of bankruptcy.

Jack Byrne owned approximately 1.2 million shares, (or about 20%) of the company as of March 26, 2001.

Mr. Raymond Barrette has served as Managing Director and Chief Executive Officer of OneBeacon since June 2001 and has been a director of the Company since 2000. Mr. Barrette formerly served as President of the Company from 2000 to June 2001 and served as Executive Vice President and Chief Financial Officer of the Company from 1997 to 2000. He was formerly a consultant with Tillinghast-Towers Perrin from 1994 to 1996 and was with Fireman's Fund from 1973 to 1993. Mr. Barrette is also Chairman of Folksamerica.

Mr. Patrick Byrne has been a director of the Company since 1997. Mr. Byrne serves as President and CEO of Overstock.com, an internet shopping service. Mr. Byrne formerly served as President and CEO of Fecheimer Bros. Co. (a wholly-owned subsidiary of Berkshire Hathaway Inc.), a manufacturer of uniforms and accessories, from 1997 to 1999 and President and CEO of Centricut, LLC, a manufacturer of industrial torch consumable parts, from 1994 to 1999. In addition, since 1991, Mr. Byrne has been the managing general partner of a number of limited partnerships investing in real estate, gaming, insurance and international trade. Mr. Byrne is the son of Mr. Jack Byrne.

Mr. George Gillespie has been a director of the Company since 1986. Mr. Gillespie has been a Partner in the law firm of Cravath, Swaine & Moore ("Cravath") since 1963. He is also a director of The Washington Post Company. Mr. Gillespie's son, Mr. John Gillespie, is also a director of the Company.

Mr. John Gillespie was appointed to the board in August 1999. He is the founder and Managing Partner of his own investment firm, Prospector Partners, LLC, in Hartford, Connecticut. Prior to forming Prospector Partners, Mr. Gillespie was President of the T. Rowe Price Growth Stock Fund and the New Age Media Fund, Inc. White Mountains owns limited partnership investment interests which were managed by Mr.

<sup>8</sup> White Mountains 13F dated May 14, 2001

<sup>9</sup> Most of this information is from White Mountains DEF 14A files with the SEC on July 6, 2001

Gillespie during 2000. See "Item 13. Certain Relationships and Related Transactions". Mr. Gillespie's father, Mr. George Gillespie, is also a director of the Company.

#### Retirement and Postretirement Plans<sup>10</sup>

Prior to the Redomestication, White Mountains terminated two non-qualified compensation plans and paid participants a total of \$88.6 million in full satisfaction of White Mountains' long-term obligations. This payment resulted in an incremental pretax cost to the Company of \$15.2 million, however, this action provided the Company with increased tax deductible expenses during 1999 and served to reduce future compensation and benefit expenses.

During 1999 the Board mandated deferrals of compensation earned by certain of its executive officers that was payable in connection with the Redomestication. Deferred balances are invested in phantom shares, which are valued based on the market value of Shares. As of December 31, 2000 and 1999, these balances totaled \$7.7 million and \$2.9 million, respectively.

White Mountains has various defined contribution employee savings plans for the benefit of substantially all its employees. The costs of these plans are not material to White Mountains' financial statements.

Folksamerica has a defined benefit pension plan for the benefit of its employees and for former employees of the Company's discontinued mortgage banking operations. Benefits under this plan are based on years of service and each employee's highest average eligible compensation over the last five consecutive years of employment. The fair value of the assets in Folksamerica's defined benefit plan exceed its current and future employee obligations under the plan, therefore, the cost of this plan is not material to White Mountains' financial statements.

White Mountains' does not have any significant ongoing postretirement benefit plan obligations.

#### Employee Share-Based Compensation Plans<sup>11</sup>

White Mountains' Incentive Plan provides for granting to participants of the Company (and certain of its subsidiaries) various types of share-based incentive awards including performance shares and options to acquire Shares. At December 31, 2000, 206,400 Shares remained available for grant under the Incentive Plan.

Performance shares are conditional grants of a specified maximum number of Shares or an equivalent amount of cash. The grants are generally payable (subject to the attainment of a specified after tax return on equity) at the end of a three year period or as otherwise determined by the Compensation Committee of the Board. The financial goal for full payment of the performance shares is the achievement of a 13% annual after tax return on equity (as specifically defined by the Compensation Committee) as measured over the applicable performance periods. Performance share payments can double if returns significantly exceed 13%. The Compensation Committee consists solely of disinterested, non-management Directors.

For the three year performance periods beginning 2000, 1999 and 1998 the Company granted a total of 34,000, 31,300 and 47,800 performance shares, respectively, to its employees. No performance shares were paid in 2000. During 1999 and 1998 the Company paid a total of 141,650 and 47,129 performance shares, respectively, to its participants in cash and Shares. Performance shares paid during 1999 included 58,100 performance shares relating to the period from 1996 to 1998, 40,300 performance shares paid early relating to the period from 1997 to 1999 and 43,250 performance shares paid early relating to the period from 1998 to 2000.

White Mountains expenses performance shares ratably over the performance period assuming full vesting at the current market values of the shares. During 2000, 1999 and 1998, White Mountains recorded \$25.8

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<sup>10</sup> ibid

<sup>11</sup> ibid

million, \$6.1 million and \$7.2 million, of pretax performance share expense, respectively. The Company's performance share expense for 2000 was significantly higher than that of prior years as a result of: (i) a significant increase in the market value of Shares during the year; and (ii) the recording of \$12.0 million of additional performance share expense undertaken to provide for potential future vesting of performance shares at an amount greater than 100% in light of the achievement of above plan results for 2000.

#### Equity Partners

White Mountains fully diluted shares outstanding will increase to 10 million shares. Jack Byrne said, "Since September we have increased the equity and reduced the debt components of the transaction. CGU's loss reserves were significantly strengthened at year-end and we purchased significant adverse development reinsurance covers at closing. All these actions resulted in a reduced tangible book value but a much stronger balance sheet. As a result of the transaction, we estimate that our post-closing tangible book value has increased to approximately \$290 per share, prior to the impact of purchase accounting adjustments."

Participating in the deal are principal equity partners Berkshire Hathaway, Franklin Mutual Advisors, Leucadia National Corporation, Banc One Capital Corp., Fairfax Financial Holdings Limited, Gotham Partners, Markel Corporation, Prospector Partners, CSFB Private Equity, through DLJ Merchant Banking Partners III, CAI Managers & Co., L.P., Fairholme Capital Management, Northaven Management, Inc., and Wyper Capital. The debt facility was arranged by Lehman Brothers Inc. Jack Byrne said, "We are fortunate to have assembled a world class group of equity and debt partners. We appreciate their commitment and support."

#### Conclusion

Given the high quality and experience of the management team at White Mountains it is certainly worth the time to examine the company and keep a close watch on it in the future. I own shares in this corporation and so I will not trade in those securities for 30 days from the date this article is published on FocusInvestor.com. As always, any suggestions or comments are appreciated. I can be contacted via email at [focusinvestor@yahoo.com](mailto:focusinvestor@yahoo.com).