

Q2 2020 Earnings Call

Company Participants

- Derek Bulas, Associate Vice President of Legal
- Jennifer Allen, Vice President and Chief Financial Officer
- V. Prem Watsa, Founder, Chairman and Chief Executive Officer

Other Participants

- Chris Pearson, Analyst
- Jaeme Gloyn, Analyst
- Jeff Fenwick, Analyst
- Mark Dwelle, Analyst
- Tom MacKinnon, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, and welcome to Fairfax 2020 Second Quarter Results Conference Call. Your lines have been placed in a listen-only mode. After the presentation, we will conduct a question-and-answer session. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time.

Your host for today's call is Prem Watsa, with opening remarks from Mr. Derek Bulas. Mr. Derek Bulas, please begin.

Derek Bulas

Good morning, and welcome to our call to discuss Fairfax's 2020 second quarter results. This call may include forward-looking statements. Actual results may differ perhaps materially from those contained in such forward-looking statements as a result of a variety of uncertainties and risk factors. The most foreseeable of which are set out under risk factors in our Base Shelf Prospectus, which has been filed with Canadian Securities Regulators and is available on SEDAR, and which now include the risk of adverse consequences to Fairfax's business, investments and personnel, resulting from or related to the COVID-19 pandemic. Fairfax disclaims any intention or obligation to update or revise any forward-looking statements except as required by applicable securities law.

I'll now turn the call over to our Chair and CEO, Prem Watsa.

V. Prem Watsa {BIO 1433188 <GO>}

Thank you, Derek.

Good morning, ladies and gentlemen. Welcome to Fairfax's second quarter 2020 conference call. I plan to give you some of the highlights and then pass the call to Jen Allen, our Chief Financial Officer, for additional financial and accounting details.

Like I said on our first quarter conference call, these are unprecedented times, and I want to, again, thank the people on the front lines, doctors, nurses in our hospitals, our grocery stores, our policemen, our utilities and many other essential services in our lives that we take for granted and they have put themselves in harm's way and have gotten us through what we hope is the worst of this pandemic.

I also wanted to thank our employees all over the world who put a good part of the last four months have almost 100% work from home, not missing a beat in our business of providing outstanding service to our customers. I'm very grateful to all of them. We expect this pandemic to come to an end, and we expect to return to normalcy soon.

Coming now to our results in the second quarter, Fairfax's net earnings in the second quarter were \$435 million compared to net earnings of \$494 million in the second quarter of 2019, which equates to net earnings per diluted share of \$15.26 versus 2017, 2018 and 2019. For the first six months of 2020, our net loss was \$824 million versus net earnings of \$1.3 billion for the first six months of 2019, primarily reflecting net unrealized losses on our investments in the first quarter of 2020.

Fairfax's book value per share decreased by 8.3% to \$435 in the first six months of 2020 adjusted for the \$10 per share common dividend paid in the first quarter of 2020. Our insurance and reinsurance companies produced a consolidated combined ratio of 100.4% in the second quarter, which included \$308 million or 9.2 combined ratio points of COVID-19 losses. Excluding these losses, the consolidated combined ratio was in the low 90s. We had continued growth in premiums on the back of a strong pricing environment.

All of our major insurance companies, with the exception of Brit, generated combined ratios of less than 100%, with Northbridge at 94.3%, Zenith at 94.6%, Allied World at 98%, Crum & Forster at 98.9% and Odyssey at 99.8. Brit had a combined ratio of 114.9%, almost 115%, in the quarter driven by COVID-19 losses primarily related to its event cancellation business. Excluding these losses, Brit had a combined ratio of 90.4%.

At the end of the second quarter, we have booked COVID losses of approximately \$400 million on a net basis across all our companies. Of this, a little less than half comes from business interruption exposures primarily outside of the United States and about a third comes from event cancellation coverages. The balance comes from areas such as casualty, surety and travel lines.

On a net basis, approximately 70% of our provisions are in IBNR, paid losses about 10% and case reserves make up the remaining 20%. As you can see, there is still considerable

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uncertainty as to the ultimate cost of the virus. The IBNR estimates may prove excessive in some of our companies, and they may not be enough in others.

In addition, as we all are well aware, the pandemic is ongoing. As long as it persists and disrupts the economy, new losses may emerge. The size of the ultimate loss will also depend, to some extent, on various court outcomes as litigation has been filed in many jurisdictions and countries.

All in all, we are quite comfortable with the provisions we've made to date in the context of the current market environment and confident of earning an underwriting profit in 2020, absent other extraordinary events.

Our underwriting income, excluding COVID losses, continues to increase with a lower consolidated combined ratio and strong organic growth continuing at our companies. Our insurance and reinsurance businesses net written premium increased year-over-year by approximately 5%, primarily due to growth at Northbridge, Odyssey, Brit and Allied World. Zenith is our only company not seeing premium increases as workers' compensation rates in the United States continue to decrease.

Throughout other lines of business in most parts of the world, we are seeing price increases anywhere from 10% to 30% and terms are tightening. For the year-to-date, the change in net premium written was 8%. We expect this growth to increase once we get past COVID-19 and the economy opens up fully. We think we are in a hard market and well positioned to expand significantly. In May, Brit announced its plans in collaboration with Google Cloud to launch Ki, a standalone business and the first fully digital and AI driven Lloyd's Syndicate.

Ki will aim to significantly reduce the amount of time and effort taken by brokers to place their follow on capacity, creating greater efficiency, responsiveness and competitiveness. This is a very exciting new venture in the insured tech space with Matthew Wilson, Mark Allan and their team have done an outstanding job getting this initiative up and running.

Speaking of setups, I mentioned in the past our Digit Insurance company led by Kamesh Goyal, Digit was formed in late 2016 in India. It is a fully digital company focusing on keeping insurance simple. Today, Digit is writing approximately \$350 million in gross written premiums, has almost 1,700 employees and a market share in India of 1.6% in the growing Indian non-life insurance market. We hold 45% of Digit, and I'm very excited for the future.

For the quarter, operating income was \$121 million, and we continue to look to grow by increasing underwriting profits and increasing interest and dividend income. Net gains on investments were \$644 million, primarily resulting from a tightening of corporate credit spreads and a recovery in equity markets, subsequent to the global economic disruption in March 2020 caused by the COVID-19 pandemic.

We've mentioned this many times at our Annual Meeting and on our annual reports and quarterly calls with IFRS accounting where stocks and bonds are recorded at market and

subject to mark-to-market gains or losses quarterly and annual income will fluctuate and investment results will only make sense over the long term.

In the first quarter of 2020, we had a negative 3.6% return on our investment portfolio, while in the second quarter, we had a positive return of 2.1%. This is for the whole portfolio, offsetting approximately 60% of our investment losses in the first quarter. As I have highlighted in the first quarter conference call, if you look at Page 188 of our 2019 annual report last column shows that total -- annual total return on our investment portfolio for the last 34 years. There were four years when we had a negative return on the total portfolio. In each case, we've rebounded significantly the next year. Just to highlight for you from that table, in 1990, we had a negative 4.4%, 1991, a positive 14.6%, in 1999, a negative 2.7%, in 2000, a positive 12.2%, in 2013, a negative 4.3%, 2014, the next year, 8.6%, 2016, most recently, a negative 2.2% and the following year, 2017, positive 6.8%.

Only four years out of the 34 years we had a negative return. Each time investors worried about our investments and each time, as I've said previously, they were proven wrong. As I've said before, almost 60% of our first quarter investment losses were made up in the second quarter. Our history has shown that our returns are very lumpy. And this has worked for us over the last 34 years. We have never focused on steady quarterly earnings.

To give you an example from the past, we purchased 74% of Ridley. Some of you will remember, in 2008, for approximately CAD80 million or \$8.44 per share. After receiving \$5.50 per share in dividends over the next seven years, we eventually sold our position at \$40.75 per share or CAD384 million in 2015 for an annual compounded return of approximately 31%. You can see that it was only on sale that we made our return. As mentioned in previous calls, we continue to be focused on monetizing many of our noninsurance investments.

We continue to look to put more of our cash to work in our insurance operations, our portfolios without reaching for yield or taking duration risk. There is significant opening up an investment-grade spreads. As we mentioned in our previous call, that's allowed us to sell some of our treasuries and short-dated bonds and buy \$3.9 billion in primarily investment-grade corporate bonds with an average yield of 4.1%, average term of four years. We continue to focus on redeploying cash and increasing investment income.

In the second quarter, we announced our first mortgage real estate platform with Kennedy Wilson to target first mortgage loans secured by high quality commercial real estate in the western part of the United States, in Ireland and in the UK. We have had a very successful history of investing with Kennedy Wilson, dating back to 2010 and we are very excited about this initiative.

On July 22, it was announced that BlackBerry would redeem its 3.75% convertible debentures and issue a new convertible debenture at 1.75% convertible at \$6 per share with a maturity of November 2023, three years. We will redeem our current \$500 million holdings and the 3.75% convertible and subscribe for the same amount of the new issue.

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On July 10, 2020, just recently, Fairfax Africa entered into a merger agreement with Helios Holdings Limited, pursuant to which Helios will acquire a 45.9% voting and equity interest in Fairfax Africa, and be appointed sole investment adviser to Fairfax Africa. Closing of this transaction is expected to be in the third quarter of 2020, subject to various conditions and regulatory and shareholder approvals. Upon closing, Fairfax Africa will be renamed Helios Fairfax Partners and continue to be listed on the Toronto Stock Exchange. Helios has been investing in Africa for over 15 years. We are very excited about this transaction and we welcome Tope and Baba, the co-founders of Helios and the rest of the Helios team to the Fairfax family.

In May, we closed our Horizon -- our acquisition of Horizon North. We acquired 49% of Horizon North through the sale of Dexterra for shares of Horizon North. The combined operations create a leading Canadian services company. We provided approximately \$630 million in cash and marketable securities in capital to support our insurance and reinsurance operations. To enable our companies to continue to grow in this very strong pricing environment as well as to support fluctuations in our investments from the effects of COVID-19 at the end of the first quarter.

Like I said earlier, we expect these market fluctuations to reverse over time. After these contributions, we continue to have approximately \$1.9 billion predominantly in cash and short-term securities in the holding company. Please note our cash in the holding company is to meet any and every contingency that Fairfax might face in this uncertain period. We are not making any long-term investments with this cash. All of our large investments like Fairfax India, Fairfax Africa, Recipe, Thomas Cook are all well-financed and do not need any cash from Fairfax. They either have significant cash themselves or have large lines to comfortably take them through this period of uncertainty.

Again, I'll remember -- I remind you, we continue to hold CPI-linked deflation floor contracts, nominal amount of \$78 billion and an average remaining term to maturity of three years. We carry these contracts at only \$14 million, and they continue to provide us with downside protection in the event of a catastrophic turn of world events.

At June 30, 2020, the company's insurance and reinsurance companies held approximately \$13.6 billion in cash and short-dated securities, representing approximately 35% of the portfolio investments, comprised of \$9.7 billion in subsidiary cash and short-term investments and \$3.9 billion of short-dated US treasuries. Our investment portfolios will be largely unimpacted by rising interest rates as we have not read for yield. In fact, we will benefit from rising investment income.

With a run rate of approximately \$19 billion in gross premium, a huge focus on underwriting discipline, a portfolio of approximately \$39 billion and HWIC operating in a stock pickers market, all grounded on our fair and friendly culture built over 34 years, we expect to generate a good return, which we define as 15% for our shareholders over time. We feel the best is yet to come.

Finally, I wanted to highlight a very important initiative I have joined called the Canadian Council of Business Leaders Against Anti-Black Systemic Racism, it's called the BlackNorth

initiative. The initiative is the call to action to rally the Canadian business community to eliminate anti-black systemic racism and create opportunities within the workplace for black people.

Within Fairfax, I have recently spent time with 16 black individuals across our companies in Canada, United States and the UK to get their views on these issues and what we can do better as a company. I'm pleased to say all of them are very happy at Fairfax, but we have now formed a black initiatives action committee at the Fairfax level made up of individuals across our insurance and reinsurance companies to discuss these issues openly and to create more opportunities for people from the black community and all minorities within our company. Needless to say, racism will not be tolerated in our company.

I will now pass the call over to Jen Allen, our Chief Financial Officer. Jen?

Jennifer Allen {BIO 20542595 <GO>}

Thank you, Prem.

Similar to the introductory commentary I provided during the first quarter conference call, I would like to begin by highlighting some of the developments in our operations and provide additional perspective around the procedures performed to ensure we address the continued global economic uncertainty created by the COVID-19 pandemic.

Fairfax's head office teams continue to work from home and have been operating very effectively over the last four months. Our quarterly reporting processes remain robust. And similar to the first quarter, we performed additional procedures to ensure we understood the impact that the developing economic environment had on our subsidiaries.

The COVID-19 pandemic has significantly impacted the global financial markets and those could be seen in Fairfax's first quarter results. As the economies begin to reopen, we saw some of those positive developments reflected in the financial markets and are in aspects of Fairfax's second quarter results.

And now looking at Fairfax's second quarter results. In the second quarter of 2020, Fairfax reported net earnings of \$435 million or \$15.26 on a per share on a fully diluted basis. That compared to the second quarter of 2019 when we reported net earnings of \$494 million or \$17.18 per share on a fully diluted basis. For the first six months of 2020, Fairfax reported a net loss of \$824 million or \$31.76 per share on a fully diluted basis. That compared to the six months of 2019 when we reported net earnings of \$1.3 billion or \$44.17 per share on a fully diluted basis.

Underwriting loss at our insurance and reinsurance operations in the second quarter of 2020 was \$13 million with a combined ratio of 100.4% and that compared to an underwriting profit of \$100 million and a combined ratio of 96.8% in the second quarter of 2019. Underwriting profit in the first six months of 2020 decreased to \$90 million with a

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combined ratio of 98.6% compared to an underwriting profit of \$189 million with a combined ratio of 96.9% in the first six months of 2019.

The increase in the combined ratios in the second quarter and first six months of 2020 compared to the same periods in 2019 principally reflected COVID-19 losses at \$308 million and \$392 million or 9.2 and 6.0 combined ratio points, respectively. And higher current period catastrophe losses that was partially offset by higher net favorable prior-year reserve development and decreases in the commission and underwriting expense ratios. In the first six months of 2020, the COVID-19 losses were primarily comprised of business interruption exposures that represented 46% and were principally from our international businesses. And event cancellation coverage accounted for approximately 36%.

The losses were principally comprised of incurred, but not reported losses that represented on a net basis 70% of the COVID-19 losses reported. Current period catastrophe losses were \$96 million and \$201 million or 2.9 and 3.1 combined ratio points in the second quarter and six months of 2020. That compared to [ph]\$21 million and \$88 million or 1.3 and 1.5 combined ratio points in the second quarter and six months of 2019.

Our combined ratios benefited from net favorable prior-year reserve development in the second quarter and six months of 2020 of \$105 million and \$201 million, which translated into 3.1 combined ratio points in each of those respective periods. That compared to net favorable prior-year reserve development \$41 million and \$91 million, which represented 1.3 and 1.5 combined ratio points in both those respective periods in 2019.

Looking at our operating company results and starting with Northbridge. Northbridge's underwriting profit was \$90 million and \$30 million with combined ratios at 94.3% and 95.4% in the second quarter and first six months of 2020. And that compared to underwriting profits of \$3 million in the second quarter and the first six months of 2019 with combined ratios of 99.1% and 99.4%. Current period catastrophe losses of \$22 million and \$24 million or 6.5 and 3.6 combined ratio points principally related to Fort McMurray floods and Calgary hailstorms in the second quarter and six months of 2020.

The impact of COVID-19 added \$23 million and \$26 million or 7.1 and 3.9 combined ratio points of losses to Northbridge's underwriting results in the second and first six months of 2020. In Canadian dollar terms, net premiums written by Northbridge in the second quarter and six months of 2020 increased by 9% and 14% in each of those respective periods, reflecting strong retention of renewal business, growth in new business and price increases noted across the group.

Moving to Odyssey Group. Odyssey Group reported underwriting profits of \$1 million and \$14 million with combined ratios of 99.8% and 99.2% in the second quarter and six months of 2020. That compared to underwriting profits of \$27 million and \$68 million and combined ratios of 96.6% and 95.9% in second quarter and six months of 2019. Current period catastrophe losses of \$40 million and \$93 million represented 4.6 and 5.4 combined ratio points in the second quarter and six months 2020. Those were higher

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than the current period catastrophe losses of \$32 million and \$68 million that represented 4.1 and 4.5 combined ratio points in the second quarter and six months of 2019.

The impact of COVID-19 added \$50 million and \$100 million or 5.7 and 5.9 combined ratio points of losses to Odyssey Group's underwriting results in the second quarter and six months of 2020. Odyssey Group's combined ratios in the second quarter and first six months of 2020 benefited from net favorable prior-year reserve development at \$17 million and \$59 million, that's 1.9 and 3.5 combined ratio points, respectively. That compared to net favorable prior-year reserve development of \$4 million and \$40 million, which equated to 0.5 and 2.7 combined ratio points in the second quarter and first six months of 2019.

Net favorable prior-year reserve development in the second quarter and first six months of 2020 primarily reflected better-than-expected emergence related to US Insurance, Europe, Asia and Latin America, partially offset by net adverse prior-year reserve development in North America.

Odyssey Group wrote \$935 million and \$1.8 billion of net premiums in the second quarter and six months of 2020, which represented increases of 9% in both those respective periods. The increase has principally reflected growth in the US insurance with increases noted in US crop, financial products and professional liability lines. Growth in North America from US property in US casualty reinsurance and in the growth in the London market.

Moving on to Crum & Forster. Crum & Forster reported underwriting profits of \$6 million and \$22 million with combined ratios of 98.9% and 98.1% in the second quarter and six months of 2020. That compared to underwriting profit of \$13 million and \$24 million and combined ratios of 97.5% and 97.6% in the second quarter and six months of 2019.

Attritional current period catastrophe losses were \$9 million and \$21 million in the second quarter and six months of 2020 that represented about 2 combined ratio points in each of those respective periods, which was higher when compared to \$4 million and \$9 million or above 1 combined ratio point of the current period catastrophe losses in the second quarter and six months of 2019.

The impact of COVID-19 added \$17 million and \$20 million or 3 and 1.7 combined ratio points of losses to Crum & Forster's underwriting results in the second quarter and six months of 2020. Crum & Forster's net premiums written decreased by 3% in the second quarter, principally reflecting reduced exposure, stemming from decreased economic activity associated with COVID-19. That was partially offset by strong price increases across the group. Net premiums written increased by 8% in the first six months of 2020, primarily reflecting growth in surety, credit and programs and accident and health, partially offset by reduced exposure resulting from decreased economic activity associated with the 2019.

Looking at Zenith National. Zenith National reported underwriting profits in the second quarter and six months of 2020 (inaudible) and \$27 million and combined ratios of 94.6%

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and 91%, which compared to underwriting profits of \$28 million and \$68 million with combined ratios of 84.5% and 81.4% in each of those respective periods in 2019. The underwriting profits in the second quarter and six months of 2020 included \$20 million and \$48 million or 14.5 and 15.8 combined ratio points of net favorable prior-year reserve development, which compared to \$22 million and \$59 million or 12 and 16.2 combined ratio points in the second quarter and six months of 2019.

The net favorable prior-year reserve development in the second quarter and six months of 2020 principally reflected net favorable emergence related to accident years 2014 through 2019. Zenith National wrote a and \$160 million and \$370 million of net premiums in the second quarter and first six months of 2020, which was lower than \$154 million and \$427 million of net premiums in those respective periods for 2019. The decreases in net premiums written in 2020 primarily reflected lower payroll exposure due to the impact of COVID-19 and price decreases in the workers' compensation business.

Looking at Brit. Brit in the second quarter and the first six months of 2020 reported underwriting losses of \$63 million and \$60 million with combined ratios of 114.9% and 107.3%. That compared to underwriting profits of \$17 million and \$29 million with combined ratios of 96% and 96.4% in each of those same periods in 2019. Current period catastrophe losses of \$20 million and \$32 million represented 4.8 and 3.9 combined ratio points in the second quarter and six months of 2020, which were higher than the current period catastrophe losses of \$2 million and \$3 million that represented less than 1 combined ratio point in the second quarter and six months of 2019.

The impact of COVID-19 added \$103 million and \$128 million or 24.5 and 15.6 combined ratio points of losses to Brit's underwriting results in the second quarter and six months of 2020. Excluding the impact of those COVID-19 losses, Brit's combined ratios in the second quarter and six months of 2020 was 90.3% and 91.7%. Net favorable prior-year reserve development was higher in the second quarter and six months of 2020 at \$20 million and \$34 million or 4.7 and 4.2 combined ratio points, principally reflecting better-than-expected claims experienced in 2017 to 2019 catastrophe events. Prior-year reserve development was nominal in the second quarter and six months of 2019.

Brit's net premiums written increased by 7% and 5% in the second quarter and six months of 2020, reflecting growth in core lines of business generated by increased contribution from underwriting initiatives that were launched in recent years primarily related to Brit's US operations. And price increases were noted across most lines of business and that was partially offset by reductions in noncore lines of business through active portfolio management.

Turning to Allied World. Allied World reported profits of \$14 million and \$48 million in the second quarter and six months of 2020, with combined ratios of 98% and 96.3% in each respective period. That compared to underwriting profit of \$13 million and nil in the combined ratios of 97.9% and 100% in the same periods in 2019.

Current period catastrophe losses of \$4 million and \$30 million in the second quarter and six months of 2020 represented 0.6 and 2.4 combined ratio points, principally related to

the Australian bushfires and Nashville tornadoes, which compared to no catastrophe losses noted in the comparative periods of 2019.

The impact of COVID-19 added \$83 million or 12.2 and 6.4 combined ratio points of losses to Allied World's underwriting results in the second quarter and six months of 2020. Allied World's underwriting profit in the second quarter and six months of 2020 benefited from \$25 million or 3.7 and 2.0 combined ratio points of net favorable prior-year reserve development, reflecting better-than-expected emergence across all major business segments. This contrast to the second quarter and the first six months of 2019's net adverse prior-year reserve development of \$25 million or 3.9 combined ratio points, and \$80 million, primarily reflecting deterioration in the insurance segment.

Allied World contributed \$791 million and \$1.6 billion to net premiums written in the second quarter and six months of 2020, representing year-over-year increases of 20% and 15% primarily due to improved pricing and growth across both the insurance segment and the reinsurance segment.

Moving on to Fairfax Asia. Fairfax Asia reported nominal underwriting profit and an underwriting loss of \$1 million, combined ratios of 99.4% and 101% in the second quarter and six months of 2020. This was slightly down from an underwriting profit of \$1 million and \$2 million and combined ratios of 97.9% and 98.4% in those same periods in 2019.

The combined ratios in the second quarter and six months of 2020 included \$5 million and \$9 million or 8.1 and 8.3 combined ratio points of net favorable prior-year reserve development. That compared to \$8 million and \$13 million or 17.5 and 14.3 combined ratio points of net favorable prior-year reserve development in the second quarter and six months of 2019. The net favorable prior-year reserve development of both year's principally related to automobile, property, workers' compensation and marine loss reserves.

Our insurance and reinsurance - other segment produced underwriting profits of \$2 million and \$10 million and combined ratios of 99.3% and 98.3% in the second quarter and six months of 2020, which compared to an underwriting loss of \$1 million and \$4 million, with combined ratios of 100.3% and 100.8% in those same periods in 2019.

Net favorable prior-year reserve development of \$16 million and \$25 million in the second quarter and six months of 2020 reflected emergence across all segments. That compared to net favorable prior-year reserve development of \$19 million and \$21 million in the second quarter and six months of 2019 principally at Group Re, Bryte Insurance, Fairfax Latam and Colonnade. The impact of COVID-19 at a \$22 million and \$26 million or 8.5 and 4.8 combined ratio points of losses in the insurance and reinsurance - other segment underwriting results in the second quarter and six months and were primarily noted at Bryte Insurance.

Our US Run-off segment subsequent to the contribution of European Run-off to RiverStone Barbados on March 31, 2020, starting from April 1, 2020, the operating results presented in our MD&A will include US Run-off only. Run-off reported operating losses of

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\$16 million in the second quarter of 2020 compared to operating losses of \$13 million in the same period in 2019. Excluding the first quarter of 2020 Part VII transfer and a reinsurance transaction in the first quarter of 2019, Run-off reported operating losses of \$48 million in the first six months of 2020 and that compared to operating losses of \$36 million in the same period of 2019. The operating results in the second quarter and six months of 2020 were impacted by the deconsolidation of European Run-off as noted on March 31, 2020.

And finally, a few comments on our noninsurance companies reporting segment. As presented in our MD&A, restaurants and retail reported a pretax loss before interest and expense and other in the second quarter and first six months of 2020 of \$44 million and \$131 million, which included noncash impairment charges on right-of-use assets and finance lease receivables principally related to Recipe's previously announced restaurant portfolio restructuring, additional COVID-19 related impairments and lower business volumes, resulting from the impact of the COVID-19 pandemic.

The restaurants and retail reporting segment did not require any support from Fairfax during the first six months of 2020 and necessary credit facility amendments were put in place by those companies to ensure liquidity and covenant compliance would be noted for the foreseeable future. The majority of their businesses are reopen as the lockdown restrictions and industries that they operate begin to be lifted.

Now looking at the consolidated results for Fairfax, our consolidated interest and dividend income decreased year-over-year from \$222 million and \$458 million in the second quarter and six months of 2019 to \$205 million and \$423 million in the second and six months of 2020, reflecting lower dividend income earned on common stocks and lower interest income earned due to sales and maturities of our US treasury bonds. In the second half of 2019, that was partially offset by the reinvestment of the US treasury bond proceeds, principally into higher yielding high quality corporate bonds and short-term investments.

Consolidated share of loss of associates of \$23 million and \$228 million in the second quarter and six months of 2020 compared to share of profit of associates of \$143 million and \$266 million in the second quarter and six months of 2019. With the second quarter and first six months of 2020 reflecting cash impairment charges of \$19 million and \$211 million, primarily on the company's investments in Quess, Resolute and Astarta that we recorded in the first quarter of 2020 and reflected share of losses on noninsurance associates from the economic effects of COVID-19. That was partially offset by share profit at RiverStone Barbados and to note the share of profit of associates in 2019 reflected a spin off distribution gain at IIFL of \$173 million.

Our consolidated net gains on investments of \$644 million in the second quarter and net losses on investments of \$895 million in the first six months of 2020 compared to consolidated net gains on investments of \$449 million and \$1.2 billion in the second quarter and first six months of 2019. The increase in net gains in the second quarter of 2020 reflected higher net gains on bonds, reflecting the tightening of the corporate credit spreads, partially offset by lower net gains on net equity exposures.

Our net losses in the first six months of 2020 compared to net gains in the first six months of 2019 and reflected net losses primarily on our net equity exposure and they were partially offset by higher net gains on our bonds. Fairfax recorded a provision for income taxes of \$123 million on pretax earnings at about 22.3% effective tax rate in the second quarter of 2020 and a recovery of income taxes of \$110 million on a pretax loss of 10.2 and an effective tax rate in the first six months of 2020.

Finishing off with our financial position. Our total debt to total capital ratio, excluding the consolidated noninsurance companies, increased to 31.8% at June 30 from 24.5% at December 31, 2019, primarily reflecting increased total debt that related principally to our short-term borrowings on our credit facility at the end of June that was \$970 million drawn and the April debt issuance of \$650 million and decreased common shareholders' equity principally related to the six-month net loss.

During the second quarter, the company repaid \$800 million on the credit facility, an additional \$270 million was repaid in July, leaving outstanding balance of \$700 million drawn on the facility. At June 30, our book value per share was \$435.11 compared to \$486.10 at December 31, 2019. That represented a decrease of 8.3% adjusted for a \$10 per common share dividend that was paid in the first quarter of 2020, but an increase since the first quarter of 2020 of 3.1%.

And now, I'll pass it back over to you, Prem.

V. Prem Watsa {BIO 1433188 <GO>}

Thank you very much, Jen.

We now look forward to answering your questions. Please give us your name, your company name and try to limit your questions to only one, so fair to everyone on the call. Okay, Ella, we are ready for the questions.

Questions And Answers

Operator

Thank you, speakers. We'll now begin the question-and-answer session. (Operator Instructions) Our first question is coming from the line of Jeff Fenwick from Cormark Securities. Sir, your line is open.

Q - Jeff Fenwick {BIO 15350794 <GO>}

Hi, good morning, everyone.

A - V. Prem Watsa {BIO 1433188 <GO>}

Hey. Good morning, Jeff.

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Q - Jeff Fenwick {BIO 15350794 <GO>}

So just firstly, I wanted to circle back to the (inaudible) discussion, and I know it's a bit of a fluid environment here, but it seems like, I want to speak to some of the other industry observers that the commentary, but a lot of this is politically driven right now, less so. And then specific policy structures today. I'm just wondering what's your take on the exposure? And we think about it in terms of is the risk about having contract law change, which seems to be maybe to have a challenge to get the courts to do that? Is it because Fairfax's focused on specific area of insurance like event cancellation and maybe that we're just not specific pandemic exclusions in the wordings of those policies? Or is it more because a lot of this is international? And maybe the legal regimes there aren't quite as robust as they are in the US. So just any color you could offer there.

A - V. Prem Watsa {BIO 1433188 <GO>}

Yeah, I think, Jeff, you're exactly right. In the US, contract law is very specific. We feel there's very little chance that business interruption will be provided, but unless you have property damage. You need to have property damage, hurricane, earthquake, fire loss and then you get business interruption, but not business interruption by itself with pandemic coverage. So we think it's highly unlikely. There was many governors were trying to -- seven, eight governors were trying to do this, but I think the industry is very strong on this that it's not covered. Hence no premium and so unfortunately, those losses, and we feel for all of these smaller businesses perhaps gone bankrupt.

But it's not covered, and we never got any premium for it. So we feel very comfortable that will prevail. But internationally, as you point out, the contracts are not as -- contract law is not that straightforward and so we just have to wait and see. But at the end of the day, we provided 70% of our reserves are for COVID IBNR, that's incurred, but not reported. So they're not specific to any cases. So we feel -- we are well provided for it. And as I said before, at the end of the day, as we look at 2020, we think we'll make an underwriting profit that means a combined ratio below 100%.

Q - Jeff Fenwick {BIO 15350794 <GO>}

And is there an issue of just duration of the shut-ins and more businesses or more events being disrupted that can factor in here? I mean, if this extended longer, do you have more potential exposure that might require you to take incremental provisioning against this?

A - V. Prem Watsa {BIO 1433188 <GO>}

Yeah. If you have cancellations, for example, if you go into 2021, then events that could be canceled because of the -- if you provided cancellation insurance, then you'll be exposed, but there are -- a lot of our exposures by the end of the first quarter 2021 will be run off, so that it doesn't continue right, Jeff, because of renewals. So by the end of 2021, cancellation insurance exposures will run-off.

So this is unlike other catastrophes like hurricanes and earthquakes where you it comes, you know the damage, this is sort of what they call a live cat, so it's continuing. And we provided our best estimate. We think it's a good estimate. But we recognized as uncertainties in the next six months, a year.

FINAL

Q - Jeff Fenwick {BIO 15350794 <GO>}

Okay. And when I strip away those charges in the quarter, 91% combined ratios quite a bit lower than where Fairfax has been running and trying to get a sense of how much of this is from the more favorable pricing environment we've been seeing taking hold in a hard market versus perhaps a period of time here -- just with shutdown, shut-ins, maybe just lower claims frequency overall helping you out, maybe it's a bit of a one-time benefit to take the combined ratio lower. So what's the balance do you think between just robust (inaudible) price adequacy?

A - V. Prem Watsa {BIO 1433188 <GO>}

Yeah, that's a very good question, Jeff. And broadly speaking for across our businesses, we haven't taken that into account, we haven't dropped loss ratios, broadly speaking, which means like we are not reflecting the lower claims that you might see because of the shutdown. But we are seeing significant price increases, Jeff, like 10% to 30%, that's rate on rate. We've had rate increases. Then we are having a great increases again. We think these rates in excess of loss cost trends and it reminds me of 2001, the September 11 when 2000, you had price increases in 2000 September 11 came into being, and then prices really took off in 2002 and 2003 and 2004. And in that time period, you might remember, we increased our premiums by 100%, for the whole company, and we are thinking that this was a hard market. Our companies are well reserved. We're well capitalized, we've got a really good management team who've been with us for a long time. We have every plan -- every expectation that will take advantage of that as we have in the past.

Q - Jeff Fenwick {BIO 15350794 <GO>}

All right, thank you for that color. I'll pass the line.

A - V. Prem Watsa {BIO 1433188 <GO>}

Thank you, Jeff. Next question?

Operator

Sure. Our next question is coming from the line of Tom MacKinnon from BMO Capital. Sir, your line is open.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah, thanks very much. Good morning, Prem. Good morning, Jen.

A - V. Prem Watsa {BIO 1433188 <GO>}

Hey. Good morning, Tom.

Q - Tom MacKinnon {BIO 2430137 <GO>}

A question about the movement of some money down into the subs, the insurance and the reinsurance subsidiaries. I wonder if you can elaborate a little bit more as to which

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ones you've been putting the money into? Has it been insurance or reinsurance and or Run-off? Has it been in the US or Canada or Europe or any other jurisdiction? And just perhaps a little bit more color as to why, I understand markets are firming and capital needed to write business. But you also mentioned something about, just to manage with respect to fluctuations in their investment portfolios. So maybe if you can help us understand the need to put money into subsidiaries in that regard as well. Thanks.

FINAL

A - V. Prem Watsa {BIO 1433188 <GO>}

Yeah. Thank you, Tom. So in our Run-off, it's very marginal increase in capital to run off operations, but -- and you'll remember, RiverStone UK, it's separate, we've got 60% of that 40% is with OMERS, it's separately capitalized. But in our insurance and reinsurance business, you've got -- you're having significant growth like we are seeing rate increases, we're seeing, as I said before, and we're seeing significant growth, and then of course, you've got the volatility of stock prices going up and down and so we want each of our companies to be really well capitalized to take advantage of these opportunities and so that's what we've done.

And the cash in our holding company term, that's for it. It's not meant for any investments. It's meant for supporting our companies through this hard market. The hard market is not going to last for long as you know, the last time taking September 11 three or four years, and so our companies -- we want them to be really well capitalized to take advantage of the opportunity.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay, thanks for that.

A - V. Prem Watsa {BIO 1433188 <GO>}

Thank you, Tom. Next question, please.

Operator

Thank you. Our next question is coming from the line of Mark Dwelle from RBC Capital Markets. Your line is open.

Q - Mark Dwelle {BIO 4211726 <GO>}

Hey, good morning.

A - V. Prem Watsa {BIO 1433188 <GO>}

Hey. Good morning, Mark.

Q - Mark Dwelle {BIO 4211726 <GO>}

Good morning. Tom actually stole my first question. So I'll proceed with my second one, it's kind of runs together. I noticed you made some partial repayment of the line of credit draws. But there is still a fairly substantial amount of that held at the holding company. Can

you just talk about your thinking there? Why you decided to keep the money? I mean, certainly the volatility in the markets has died down quite a bit. You did raise the money in April. So I would have thought most of that would have been repaid.

A - V. Prem Watsa {BIO 1433188 <GO>}

Yeah. We do, I think \$1.8 billion something and we've taken it down to \$700 million. And so we just wanted to keep a large amount of cash in the holding company, and I think we've got \$1.9 billion at the end of June. And so, \$700 million of that is through our lines. It's four year lines. That's why we have these lines, Tom. So it's very much where we want to keep it over time, we want to pay it off totally, reduce it to zero, but right now we thought we're paying it up slowly, as you said, we've -- in the third quarter, in July, we paid \$270 million. And so it's about \$700 million net. But over time, we'll reduce it even more and take it down to zero.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Thank you for that and then a question maybe for Jennifer. I mean, I appreciate all the really good disclosures in note 6 related to the investments in associates and impairment assessments. Can you just talk about that in a little bit more detail? Several of these holdings, Eurobank is one that comes to mind. But there are others. The fair value is pretty significantly below the carrying value. And I'm just trying to understand the process, primarily as a way of understanding what might actually trigger the need for potentially a sizable impairment.

A - V. Prem Watsa {BIO 1433188 <GO>}

So let me just a first crack, at the Eurobank, for example, we've had term Eurobank is a equity-accounted investment now, and we have some of our investments are consolidated, for example, Fairfax India and Africa and Recipe and Thomas Cook, I think all so you have these companies that are consolidated. And so that's just how the accounting works. And like that we are going to hold for a long time.

Share prices fluctuate. Eurobank was at about, I think, closed the year at \$0.92 and it dropped to \$0.40 in the first quarter, maybe even lower and nothing to do with the market pressure refracting COVID-19, nothing to do with the bank. It's the finest bank in Greece, and we expect that to come back in space. We began equity accounting that position because we are the third at the end of the year. So it's -- at this thing last fall two or three years, then you look at impairments, but we feel pretty comfortable that we don't take -- we are very conservative in taking marking up our investments, and we are similarly conservative in -- similarly, we don't react to things on a quarter-by-quarter basis. So we think, over time, investments have been marked appropriately.

Jen, you want to add to that?

A - Jennifer Allen {BIO 20542595 <GO>}

Sure. Thank you, Prem.

FINAL

So Mark, as you noted in note 6, we go through the accounting standard requires you (inaudible) publicly listed or private company to provide a fair value and assess that for impairment anytime you're carrying value, as Prem indicated, on an equity accounted basis is higher than that fair value. Not like your mark-to-market investments, we hold significant influence, so the guidance allows you to look for what's called a value in use.

And I just want to highlight that similar to our equity position in the six months ended, we haven't yet seen a rebound yet in a lot of these primary holdings that we have. So as an example, our Eurobank, as you noted, the market hasn't come back yet and fully rebounded to where it should be. So what we do is we look at the underlying cash flows of each of these companies for the next five years.

Look at Seaspac or Atlas Mara -- sorry, Atlas Corp as an example, very strong company underneath. It's just unfortunate that that stock price hasn't rebounded. So we take a five-year view of those cash flows, and apply a discount rate, we compare that to peers and its industry to make sure we're reasonable range and it's a longer term view on that. So there is no impairment taken in the second quarter as we can substantiate that carrying value.

I mean just to know, with this as Prem noted, a more conservative view, it's almost like a mini consolidation that you do on one line because we have significant influence. So although we're looking at ones that are under water, stuff like a Bangalore Airport, we only carry it at \$650 million but fair value of 1.4. We're not taking that fair value increment through our book value per share either.

So it is a very conservative view and a longer term view on the holdings of these positions.

Q - Mark Dwelle {BIO 4211726 <GO>}

Thank you, Jen.

A - V. Prem Watsa {BIO 1433188 <GO>}

Any other question there, Mark?

Q - Mark Dwelle {BIO 4211726 <GO>}

No. No, that was very helpful. Thank you for the additional color on those.

A - V. Prem Watsa {BIO 1433188 <GO>}

Thank you, Mark. We presented for a little more time. So we will continue with the questions. Please go ahead and ask the next question.

Operator

Sure. Thank you so much. Our next question is coming from the line of Jaeme Gloy from National Bank Financial. Your line is open.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Thank you, good morning.

A - V. Prem Watsa {BIO 1433188 <GO>}

Hey, good morning, Jaeme.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

I just wanted to drill down on the leverage, which ticked up a point or two across various metrics. Can you refresh my memory on which metric you are specifically focused on as it relates to credit rating agencies and what they're focused on in terms of maintaining or upgrading ratings. And then the follow-up to that is, if you're significantly on side on the leverage, granted you do want to keep some capital for growing premiums in the subsidiaries, but why not be a little bit more aggressive here on the share buybacks?

A - V. Prem Watsa {BIO 1433188 <GO>}

Yeah. So we are cautious on the share buyback right now, particularly with the opportunity and the insurance business and particularly given the fact that the (inaudible) last that long. But Jaeme, in terms of -- there are so many definitions, all of the AM Best has a different definition than S&P and we look at both, we look at gross debt capital, but we also look at net. So we keep a lot of cash. Unlike a lot of companies we -- this is cash in the holding company as opposed to cash in the insurance company, we've lots of cash in the insurance companies.

But in the holding company, we keep a lot of cash. And if you take it on a net basis, which I always look at, with our leverages not extensive and it's all bond, other than the money that we use with the bank line, all of it is long-term debt. And so we -- our financial position, we think it's very, very sound. And with the definitions, Jaeme, vary and sometime if you talk to Peter Clarke, he might be able to give you a sense for them.

Q - Jaeme Gloyn {BIO 19737597 <GO>}

Thank you.

A - V. Prem Watsa {BIO 1433188 <GO>}

Okay, Jaeme. Next question, please.

Operator

Thank you. Our next question is coming from the line of Christopher (inaudible) investor. Sir, your line is open.

Q - Unidentified Participant

Thank you. Good morning. My question relates to the rate of dividend and share buybacks. But first I want to recognize that shares large investment purchase (inaudible) level of stock earlier this year, I appreciate the vote of confidence in the greater alignment

of economic to voting interest. I'm coming back to the sort of 2017 AGM meeting, when the suggestion was made over time that we buy back the shares issued number of shares issued for the Allied World acquisition.

Suffice it to say, I think that's been slower, that's slower than anticipate we're 3.5 years into it. And although what I'd ask the answer was possible, and that was what we're going to use the money to buy back minority interest in the fund operations, well, fast forward a little bit and I just looked this up yesterday based on first quarter book value Berkshire and current market price, Berkshire was selling at 1.3 times book, Markel was selling 1.4 times book and Fairfax is at 0.7 times book, but one half which is a tremendous buy on one side, but also not a good verdict by the market on the other.

And I was wondering if the firm we consider using, they have subsidiaries to fund their own expansion since a good market. But just said that they're adequately financed debt is cheap and they are offset by financial assets on the other side and that would free up cash to go into more aggressive share buyback program, currently, it appears to me anyway, the investors are voting with their feet and walking away from Fairfax.

I just went back and checked on relative performance and I can appreciate it a bad couple of years or more than that, but it looks to me that I haven't been here 10 years have been about 7 and Fairfax investors have had a lost decade the share price in February 2009 is similar to the share price today.

Suffice it to say that I'm sure the Berkshire and Markel have done considerably better, and I'm wondering what consideration you and the management would give to an aggressive buyback program because I didn't really see it hear that mentioned in the presentation. And I don't see any other way out of this discount promo. Thanks.

A - V. Prem Watsa {BIO 1433188 <GO>}

Christopher, so I understand what's your question. Let me just say that I have said that our share price has been ridiculously cheap. I said that at the annual meeting. I said that in the first quarter. Saying it again. And of course and I disclose that I've taken advantage of it and bought as many shares as I could and to let everyone know it's cheap. In 35 years, we never know when the stock price is going up or down. We just know it's cheap, they're going to go up in the next six months so as I bought it, so that in the next five years, I think it'll be a terrific return.

And Fairfax as a company, when we retire stock, we're going to retire ton of stock of its available, but we have to be careful when we retire it in relationship to the potential we have in the insurance business in terms of our financial position, in terms of the uncertainty in the marketplace. So we have to take all of that into account. Our stock prices cheap. I can tell you and I don't know if it will be six months or a year or when it will go up, but it's going to go up very significantly. And that's been my experience over 35 years and to our shareholders, I'd say take advantage of it if you got the opportunity to. But otherwise, we just have to focus on the long term.

So next question, Ella.

Operator

Thank you. Our next question is coming from the line of Chris Pearson from Davenport Asset Management. Sir, your line is open.

Q - Chris Pearson {BIO 18978341 <GO>}

Hey, good morning, everyone. Thanks for taking the question. Not to be too redundant or beat a dead horse, but I too had a question on capital allocation and don't need you to review the answer you just gave, Prem, but maybe to expand upon that and just help us as shareholders with the math around writing insurance versus buying back stock, given the 30 % disconnect to book value. How is writing insurance right now? I understand it's a hard market. It's a great opportunity and these opportunities don't last very long. But how is that allocation of capital more accretive to shareholder value than buying back stock at these levels? Thank you.

A - V. Prem Watsa {BIO 1433188 <GO>}

So a good question, Chris. First of all, we bought in the past significant amount of our stock. We've continued to buy some shares in the last year or two, we have bought quite a bit. Within our capability to buy the shares in the past three, but I remember we bought 20% plus of our stock. So we understand buying shares. We understand the ability to take advantage of them.

Let me just tell you what happened in Odyssey Re in terms of a hard market. Odyssey went from, in 2001, it wrote about \$800 million. It went to \$2.5 billion and it's that's premium, so it expanded significantly and its investment portfolios went from something like \$2 billion to eventually about \$8 billion, \$7 billion or \$8 billion, without any new money going in. And so, if you're taking a long-term view, you're really building significant economic value when you expand at the right time and that was the right time in 2001. We think it's the right time right now.

But your point's well taken about buying back stock, this is not something we're not thinking of all the time. Believe me, but we don't want to. As I said it before, at the expense of our financial position. And so we are always looking long term and -- but yeah, we are looking at taking full advantage of our share price as and when we can.

Next question, Ella, and we'll make it give them the time, we'll make it the last question.

Operator

Okay. The next question is coming from the line of (inaudible) private investor. Sir, your line is open.

Q - Unidentified Participant

Good morning, everyone. Two questions. So the first question is the BlackBerry convertible that you guys are going to be at 1.75%. Isn't that too low? Or is that because you guys are getting out the convertible at \$6?

A - V. Prem Watsa {BIO 1433188 <GO>}

Yeah, sorry, just on that question, it's because it's the conversion price has dropped to \$6 a share and compared to the alternatives that the company had, this is a very good alternative.

Q - Unidentified Participant

Okay. And the second question is the stocks that you guys bought in March like (inaudible) Google, have you guys sold any of those positions or do we have to wait till the next quarterly filings to see those?

A - V. Prem Watsa {BIO 1433188 <GO>}

Yeah, some of them, we were holding. Some of them have gone up significantly, and we're selling. So yeah, we don't discuss the names because we might be buying or selling them. And so -- but some of them have gone up quite significantly and up 40%, 50%, and we've sold them.

Q - Unidentified Participant

Okay, thanks a lot.

A - V. Prem Watsa {BIO 1433188 <GO>}

Thank you very much. Ella, I think that brings us to the end of our conference call. Thank you all for joining us on this call. We look forward to presenting to you after the third quarter. And thank you very much, Ella.

Operator

You're welcome. And that concludes today's conference. Thank you so much, everyone, for your participation. You may now disconnect. Have a great day.

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