

Q2 2017 Earnings Call

Company Participants

- David James Bonham, Chief Financial Officer & Vice President
- Peter S. Clarke, Chief Risk Officer & Vice President
- Vivian Prem Watsa, Chairman & Chief Executive Officer

Other Participants

- Andrew Hollingworth, Partner
- Mark Dwelle, Analyst
- Paul Holden, Analyst
- Tom MacKinnon, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to Fairfax 2017 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. 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. Peter Clarke.

Mr. Clarke, please begin.

Peter S. Clarke {BIO 15243793 <GO>}

Good morning and welcome to our call to discuss Fairfax's 2017 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 the Canadian Securities regulators and is available on SEDAR.

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

Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you, Peter. Good morning, ladies and gentlemen. Welcome to Fairfax's second quarter conference call. I plan to give you some of the highlights and then pass it on to Dave Bonham, our CFO, for additional financial details.

In the first half of 2017, book value per share increased by 5.7% adjusted for the \$10 per share common dividend paid in the first quarter of 2017. Our insurance companies had an excellent first half, with a combined ratio of 94.7% with excellent reserving and underwriting profit of \$216 million.

In the second quarter, all our major insurance companies had combined ratios of less than 100%, with Fairfax Asia at 85.9%, Zenith at 89.5%, OdysseyRe at 90.5%. Second quarter operating income was very strong at \$184 million and net investment gains in the quarter of \$205 million, which arose primarily as a result of net gains on equities of \$237 million, offset by some losses on bonds, including treasury locks and CPI-linked derivatives.

As shown on page 35 of our quarterly report, we realized losses on our investment portfolio of \$83 million in the quarter, more than offset by unrealized gains of \$288 million. All in all, we had net earnings of \$312 million.

Our insurance and reinsurance businesses, net premium written was up in the second quarter by 6.6%, primarily due to modest growth of our insurance and reinsurance operations and the acquisition of Bryte Insurance, AMAG and Fairfirst Insurance, while the combined ratio for insurance and reinsurance operations was 94.9%. Excluding the acquisitions, our net premium written was up 4.8%.

At the subsidiary level, the change in net premiums written and the combined ratios in the second quarter were as follows: OdysseyRe, premiums up 4.7% with combined ratio 90.5%; Crum & Forster, premiums up 5.7%, Crum & Forster's combined ratio was 99.2%; Northbridge, premiums up 9.5%, and this is in Canadian dollars, our combined ratio was 99.7%; Zenith, premiums up 4.1% with the combined ratio 89.5%; Fairfax Asia, premiums flat with combined ratio 85.9%; and Brit, premiums up 6.3% with a combined ratio of 97%.

Net investment gains of \$205 million in the second quarter of 2017 consisted of the following. Please refer to page 2 of our press release. Net gains on net equity exposures of \$237 million resulted from net gains of \$323 million on long equities and an \$87 million net loss on individual short positions.

We realized losses of \$14.3 million on equities, principally from realized losses on EXCO Resources due to an increase in ownership that resulted in the equity method of accounting and the sale of IBM, partially offset by realized gains on (4:50) and the Bank of Ireland.

We also had gains of \$65 million on our bond portfolio, primarily due to the effect of decreasing in interest rates on our government bonds, offset by losses on our CPI-linked derivatives of \$13 million. The loss in the other category consisted of losses on our treasury locks that offset the gains on our government bonds.

As we have mentioned in our annual meetings, 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.

As I said in our AGM, we continue to hold our CPI-linked derivatives with a notional value of \$114 billion, which produced unrealized losses of \$13 million in the second quarter. If some of the unexpected risk come to pass, these CPI-linked derivatives could become very valuable. We will hold them for some time.

When you review our statements, please remember that when we own more than 20% of a company, we equity account. And when we own about 50%, we consolidate so that mark-to-market gains in these companies are not reflected in our results.

As you will see on page 12 of our quarterly report, the fair values of our investments and associates is \$5.1 billion versus a carrying value of \$3.6 billion and unrealized gain of approximately \$1.5 billion, which is not on our balance sheet.

During the second quarter of 2017, the company completed the acquisition of the business and renewal rights acquired from AIG in Hungary, Czech Republic, Slovakia, Poland and Bulgaria. The acquisition of AIG's insurance operations in Chile and Colombia just closed, while Argentina and Uruguay are expected to be completed in the second half of 2017, and Venezuela is expected to be completed in the first quarter of 2018.

In July 2017, the company decreased its ownership interest in ICICI Lombard to 22% by selling a 12.2% equity interest to certain private equity investors for net proceeds of \$380 million and realized a net gain on investments of \$232 million after tax.

This transaction values ICICI Lombard at \$3.1 billion, which implies Fairfax's remaining 22% equity interest has a fair value of approximately \$688 million. On July 14, 2017, ICICI Lombard announced an initial public offering whereby Fairfax will reduce its equity interest in ICICI Lombard to 10% which will permit us to establish a general insurance company in India, Go Digit General Insurance Limited, under the leadership of Kamesh Goyal.

Early in July, Fairfax together with certain co-investors completed the acquisition of 94.6% of the outstanding shares of Allied World. At the closing of the acquisition of Allied World, Ontario Municipal Employees Retirement System, the pension fund manager for government employees in the province of Ontario, Alberta Investment Management Corporation, an investment manager for pensions, endowments and government funds in the province of Alberta, and certain other third parties invested \$1.6 billion for Allied World.

The remaining 5.4% of the outstanding shares of Allied World are expected to be acquired in the third quarter of 2017 for purchase consideration of approximately \$229 million, consisting of approximately \$109 million in cash and \$120 million by the issuance of approximately 275,000 subordinate voting shares for a total share issuance for Allied World of approximately 5 million shares. Fairfax will ultimately own approximately 67% of Allied World and our partners 33%. A big welcome to the Allied World employees again.

In June, Fairfax Africa agreed to invest a minimum of \$130 million in Atlas Mara Limited, comprising of a participation in an offering of new ordinary shares at a price of \$2.25 per share, expected to raise \$100 million. Fairfax Africa will purchase not less than 30% of the equity offering and have the ability to purchase any shares not taken up by existing

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shareholders. And also, a \$100 million convertible bond that will convert into new ordinary shares at a price of \$2.25 per share upon closing of the equity offering. The convertible bond investment closed on July 17, and the equity offering is expected to close in the third quarter of 2017. Atlas Mara is a financial services institution listed on the London Stock Exchange that operates in seven sub-Saharan African countries.

Also, on July 13, 2017, Fairfax India increased its equity interest in Bangalore International Airport to 48% through the acquisition of an additional 10% equity interest from a wholly-owned subsidiary of GVK Power and Infrastructure for a purchase consideration of approximately \$200 million. Bangalore International Airport owns and operates the International Airport in Bangalore, India through a public-private partnership.

As far as our investments are concerned, as you know, in the past few years, we had played defense, we are expecting to play offense, but always with a long-term value-oriented philosophy. We will continue to pick good companies, which provide significant downside protection and potential appreciation over the long term. We have agreed to invest about \$550 million in bonds or preferred shares with warrants recently in about five companies, which include Altius, Chorus, Mosaic Capital, Westaim and more recently AGT Food. We get 5% to 6% plus upside through the warrant.

As of June 30, 2017, we have \$12.3 billion in cash and short-term investments in our portfolio, which is about 43% of our total investment portfolios to take advantage of opportunities that come our way. As a result in the short-term, our investment income will be reduced.

Now, I'd like to turn it over to David Bonham, our CFO, so he can give you some more information on the underlying financials. Dave?

David James Bonham {BIO 15243784 <GO>}

Thank you, Prem. So, in the second quarter of 2017, Fairfax reported net earnings of \$312 million or \$12.67 per share on a fully diluted basis. That compares to the second quarter of 2016 when we reported net earnings of \$239 million or \$9.58 per share on a fully diluted basis. So, year-to-date, in 2017, Fairfax has produced net earnings of \$394 million, \$15.70 per diluted share. And that's an improvement over 2016 when we had net earnings of \$188 million or \$7.07 per diluted share.

Underwriting profits at our insurance and reinsurance operations in the second quarter and first six months was \$108 million and \$216 million, respectively, and with combined ratios in those periods of 95%. The underwriting profits somewhat higher than the underwriting profits of \$82 million and \$204 million and relatively consistent combined ratios compared to 2016, second quarter 2016, 96%, and six months was 95%.

Quarter-to-date and year-to-date underwriting profit increased \$26 million and \$12 million. And that was primarily due to lower current period catastrophe losses, partially offset by lower net favorable prior year reserve development. Current period catastrophe losses in

the second quarter of 2017 totaled \$45 million or two combined ratio points, and was \$84 million or two combined ratio points in the first half of 2017.

By way of comparison, cat losses in the second quarter and first six months of 2016 were \$158 million and \$189 million, that's 8 and 5 combined ratio points. Those losses primarily related to the Fort McMurray wildfires.

Our combined ratios benefited from net favorable prior year reserve development in the second quarter and first six months of 2017 of \$108 million and \$211 million, translating into about 5 combined ratio points in each of those respective periods. That compared to net favorable prior year reserve development of \$175 million and \$260 million in the second quarter and first six months of 2016, about 9 and 7 combined ratio points in each of those respective periods.

Net premiums written by our insurance and reinsurance operations increased by 7% in the second quarter and 9% in the first six months, reflecting growth in almost all of our operating segments. The increase in the second quarter and the first six months of 2017 also reflected the impact of the consolidation of the net premiums written by Bryte Insurance of \$22 million in the quarter and \$108 million year-to-date. Bryte was an acquisition that we made near the end of 2016.

So turning to our operating company results, starting with OdysseyRe. Odyssey reported underwriting profits of \$56 million and \$104 million with combined ratios of 91% and 90% in the second quarter and the first six months of 2017, compared to underwriting profits of \$30 million and \$74 million, and combined ratios of 94% and 93% in the same periods last year. So, that reflects lower current period catastrophe losses, lower extraordinary losses, partially offset by lower net favorable prior year reserve development.

Catastrophe losses at OdysseyRe in the second quarter and first six months totaled \$25 million and \$54 million and translating into 4 and 5 combined ratio points in those respective periods, a significant decrease from the cat losses of \$75 million and \$102 million in the second quarter and first six months of 2016.

OdysseyRe's combined ratios in 2017 included the benefit of \$31 million and \$67 million of net favorable prior year reserve development, that's in the quarter and first half, that principally related to property catastrophe loss reserves. In comparison, there were \$68 million and \$103 million of net favorable prior year reserve development in the second quarter and the first six months of 2016.

OdysseyRe wrote \$661 million and just over \$1.2 billion of net premiums in the second quarter and the first six months of 2017. Net premiums written increased by 5% in the quarter, 9% in the half year, reflecting increases in almost all of the divisions except for Latin America.

Moving on to Crum & Forster. Crum & Forster produced underwriting profits of \$4 million and \$6 million in the second quarter and first six months of 2017. Combined ratios of about 99% in both of those periods compared to underwriting profit of \$6 million and \$16

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million with combined ratios of 99% and 98% in the second quarter and first six months of 2016. Net prior year reserve development was either nil or very nominal in the second quarters and the first six months of both 2017 and 2016.

Current period catastrophe losses were \$7 million and \$10 million in the second quarter and first half of 2017 compared to cat losses last year of \$14 million and \$16 million in those respective periods. Crum & Forster's net premiums written increased by 6% and 4% in the second quarter and first six months of 2017, reflecting growth in their accident and health and commercial transportation lines of business, partially offset by decreases in excess and surplus in marine lines of business.

To Zenith National, Zenith National reported underwriting profits in the second quarter and first six months of \$21 million and \$58 million, translating in the combined ratios of 90% and 85% compared to underwriting profits of \$32 million and \$63 million with combined ratios of 84% in each of those respective periods in 2016. The combined ratios included 6 and 12 combined ratio points of net favorable prior reserve development in the second quarter and first six months of 2017 compared to 10 and 12 combined ratio points in the same periods last year.

Zenith wrote \$170 million and \$502 million of net premiums in the second quarter and first half of 2017, increases over \$163 million and \$491 million in those respective periods last year. Those increases and about 4% and 2% in the quarter and half year principally reflected growth in exposure, partially offset by modest price decreases.

Moving to Brit, in the second quarter and first six months of 2017, Brit produced underwriting profits of \$12 million and \$23 million, combined ratios of 97% in each of those periods. Compared to underwriting profit of \$400,000 and \$14 million and combined ratios of just under 100% and 98% in those same periods in 2016. There were no current period catastrophe losses in the second quarter and first six months of 2017 in Brit, compared to \$32 million and \$35 million of current period catastrophe losses last year in those periods and again principally related to the Fort McMurray wildfires.

Brit experienced net favorable prior year reserve development in the second quarter and first six months of 2017 of \$8 million compared to \$22 million in those same periods in 2016. Brit's net premium written increased 6% and about 2% in the second quarter and the first six months of 2017, which reflected the impact of new business initiatives and measured growth in its core lines of business offset by the impact of additional reinsurance purchased.

Moving on to Northbridge, Northbridge's underwriting profit was \$1 million in the second quarter, \$3 million in the first six month of 2017, translating the combined ratios of 99.7%, 99.3% in each of those respective periods. That compared to underwriting profits of nil and \$3 million and combined ratios of 100% and 99% in those same periods of 2016.

Underwriting profits in the second quarter and first six months included \$4 million and \$5 million of current period catastrophe losses. Catastrophe losses in the same period last

year were \$21 million in both the quarter and half year, and again, the Fort McMurray wildfires being the major contributor.

Northbridge's underwriting results in the second quarter and first six months included the benefit of net favorable prior year reserve development of \$24 million and \$30 million. That represented 10 and 7 combined ratio points, respectively, in comparison to the favorable development that we had last year, \$38 million and \$37 million, representing 17 and 9 combined ratio points in the second quarter and first six months of 2016.

In Canadian dollar terms, net premiums written by Northbridge in the second quarter and first half of 2017 increased by 9% and 11%. And that was reflective of increased renewal and new business writings combined with modest price increases right across the organization.

Fairfax Asia's underwriting profit of \$12 million and \$17 million and combined ratios of 86% and 90% in each of the second quarter and first half of 2017 had decreased slightly when compared to the underwriting profits of \$13 million and \$25 million in those comparable periods in 2016. The combined ratios in the second quarter and first six months included \$19 million and \$25 million of net favorable prior year reserve development compared to \$16 million and \$30 million of net favorable prior year reserve development in those periods last year.

Insurance and reinsurance other, that segment produced an underwriting profit of \$4 million in the quarter, \$5 million year to date, combined ratios of 98% and 99% in those respective periods, compared to underwriting profit of \$1 million and \$9 million in the same periods in 2016. The improvement in the second quarter in underwriting profit reflected increased profitability, primarily at Group Re and at Advent.

Runoff reported operating losses of \$40 million and \$80 million in the second quarter of 2017 and the first six months and that compared to operating losses of \$1 million and \$16 million in those same periods in 2016. The increase in the operating loss of Runoff reflected higher net adverse prior year reserve development and lower interest and dividends that occurred in 2017.

Looking at our consolidated interest and dividend income, that decreased quarter-over-quarter from \$161 million to \$107 million in 2017 and from \$314 million in the first six months of 2016 to \$236 million in the first six months of 2017. The decrease reflecting lower interest income earned as a result of sales of U.S. treasury bonds and municipal bonds in 2016 and early in 2017.

Fairfax recorded income tax provisions of \$44 million and \$69 million in the second quarter and first six months of 2017, representing effective rates of about 12% in the quarter, 15% year-to-date. The lower effective tax rate relative to the Canadian statutory tax rate reflected the benefit of non-taxable investment income and income that has been taxed at lower rates in other jurisdictions. So, particularly in the UK in respect to Brit where the UK tax rate is lower than the Canadian statutory rate, and then partially offset by income that's taxed at higher rates, particularly in the U.S. where the U.S. tax rate is higher.

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We ended the second quarter with an investment portfolio inclusive of holding company cash of \$28.7 billion compared to \$28.4 billion at the end of 2016. And our total debt to total capital ratio decreased to 27.4% at June 30, 2017 from 28.7% at December 31, 2016, reflecting an increase in consolidated shareholders equity and our non-controlling interest.

So, with that, I'll pass it back over to you, Prem.

Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you, Dave. Now, we are happy to answer your questions. Please give us your name, your company name and try to limit your questions to only one so that it's fair to all on the call. Okay. Natalie, we are ready for the questions.

Q&A

Operator

Thank you. We have our first question and it's from Paul Holden of CIBC. Your line is open.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you. Good morning.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Hey. Good morning, Paul.

Q - Paul Holden {BIO 6328596 <GO>}

Good morning. Two questions. The first one is just a quickie. When I look at your table of net gains losses on investments, it includes a foreign currency loss of \$33.5 million on underwriting activities. So, just trying to figure out exactly what that is and why it's in the investment gains and losses.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Dave, you want to answer that? Dave?

A - David James Bonham {BIO 15243784 <GO>}

I can do that. So, it's in investment gains and losses because that's where we record all of our foreign exchange gains and losses on all aspects of our operations. So, we bring that all into net gains and losses. And the quantum of the amount is just having to do with the mix of our insurance assets and liabilities and the jurisdictions where we hold them and the rates that apply there. So, I hope that's helpful.

Q - Paul Holden {BIO 6328596 <GO>}

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Okay. So, it's more of a mark-to-market sort of net book value of your insurance operations. Is that correct?

A - David James Bonham {BIO 15243784 <GO>}

Yeah, actually, so nothing to do with investments at all. It's really the technical reserve. So, it's the biggies that drive the valuation. There will be the revaluation of foreign currency denominated claims, liabilities, reinsurance, recoverable, those type of assets and liabilities.

Q - Paul Holden {BIO 6328596 <GO>}

Understand. Okay. Thank you. That's helpful. And then second question, so I am getting lots of questions from shareholders and interested investors asking about capital ratios and how I think about capital ratio. So I might answer, but curious to think about how you're thinking about in the context of your high cash position, your low underwriting leverage, but somewhat offset by relatively higher financial leverage. I guess, really, the point of the question is how do you think about excess capital, if there is any, and your ability to deploy that excess capital?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yeah. So, Paul, your question on capital is a good one. We're in a transition phase right now because we just acquired Allied and we have sold, as you know, in early July, a 12% of ICICI Lombard. There's an IPO and we plan to sell about the same, 12%. And then, we'll have a 10% in the marketable ICICI Lombard common shares. And all of that is through \$1 billion when you look at it. So, our focus is on, by the end of the year, to have more than \$1 billion in cash and marketable securities. And our leverage likely will come down by that time. But this is a transition time and the middle of the year as we've just done Allied and we're going through the sale of ICICI Lombard.

Q - Paul Holden {BIO 6328596 <GO>}

Great. Thank you.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Thanks, Paul. Next question, Natalie.

Operator

Our next question comes from Tom MacKinnon of BMO Capital. Your line is open.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah. Thanks very much. Good morning, everyone.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Hey. Good morning, Tom.

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Q - Tom MacKinnon {BIO 2430137 <GO>}

Question with respect to your comments about we're going to play some offense right now, 43% in cash and I think that's up a little bit from the quarter prior to that. But if I look at your common equity plus your investment in associates, plus your preferreds and then your share of Fairfax India and Africa, we're up into the \$8 billion or \$9 billion, which would be about - so, let's call that equity and that would be about 30% of your total invested assets. So, it sounds like playing offense - well, you tell me. It is playing offense mean getting more equity and how comfortable are you with your equity concentration being about 30% of your total invested assets? Do you have room really to take that any higher or is playing offense just continuing along this convertible bond...

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yeah. That's exactly right, Tom. We're looking at - we just did the AGT. You saw that. I think it's 7% at 5.375 percentage coupon, pretty secured. So, we have a good bond for seven years that give us a little more than 5%. And then we've got a warrant, which has the ability to do well over that time period. And we like AGT, the company, we like the founder who is running it.

And so in these markets, you have to be careful. We've said many a time. But long-term value-oriented approach that we have followed for a long time, it's a stock pickers market to choose your spots. These are all Canadian companies who are looking in the United States, but rarely will we buy common shares. We'd rather buy a convertible and in the form of a bond plus one, sometimes just a straight convertible.

And the interesting thing, Tom, is that we're having the opportunity. People want us to have a significant shareholding in that company, quite often 20%, 25% because over 32 years, we've demonstrated that we are not hostile, we are friendly, we back good management, we back it for the long term. And that's coming to be a big advantage for us as we look for these opportunities. But our cash is not going to burn a hole in our pockets. We're going to be careful and invest it as and when we see the opportunity like we did with AGT.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Are you comfortable in having convertible bonds be 20% to 30% of your total investment portfolio? And what does this mean in terms of capital as well? Would these things hold a higher capital charge in backing your insurance subsidiaries than, say, treasuries or corporates?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yeah. So, the bonds that we have, there's a capital charge, but it's not as significant as equities. And our equity positions are, as you have said, 25% to maybe a little higher than that. And we're comfortable with that at the moment looking at the composition of what we own. But in terms of investing it, as I said, if we can look at - opportunistically, if we come across companies which we like and we have the ability to get a convertible type structure, that's where we'll be looking at.

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But, of course, we have many investments that can change. And for example, Eurobank has done very well in the quarter. It's back to \$1. Greece in the last 10 days have issued a five-year bond. First time in three years that they've come into the capital markets at 4.4%, a five-year bond, \$3 billion worth. And as I said to you, any country that does not have access to the bond market is in deep trouble that it cannot survive. And Greece has now accessed the bond market for the first time, plans to access it again. And today, they relaxed the capital control some, getting close to the time period when capital controls will no longer be there. The yields are still about 5%, 5.5%, 5.25%. And in the case of Cyprus, which had capital controls for two years and took them off. And Cyprus got access to the bond market. That 10-year bonds are in the 2.5% area.

So, you are seeing changes like that and we will react to them both on the plus side, meaning, adding to it, and then the - and the ability to sell our positions as and when we think it's appropriate. And so, the markets keep changing and we take advantage of it. We like where we are. We like our position. We like the strength of Fairfax today with the cash in the holding company. But the fact that we've just completed a - for us, a transformative acquisition, I can't put it in any simpler language. I mean, Allied World, a public company, listed in the New York Stock Exchange. We think acquired at a good price and with a great leader in Scott Carmilani, all of that is a plus for us, but, of course, always in the long-term.

Q - Tom MacKinnon {BIO 2430137 <GO>}

And if I could just squeeze a quick one in with respect to - for Dave. On the tax rate, what should we be looking at for the tax rate going forward? I mean, this quarter was helped by a - a little bit by some prior period recoveries - prior year recoveries. And there's always that advantage of these tax-advantaged debt securities. But how should we be thinking about it going forward? The 12% seems low, but what should we be thinking about for tax rate?

A - David James Bonham {BIO 15243784 <GO>}

Yeah. Good question. So, the tax rate is going to be, in any given quarter, a little bit difficult to predict because it's going to be dependent on where we earn money or lose money in different jurisdictions and the tax rates that apply to that. So, we've got a little bit of change in our mix this quarter, which has resulted in probably a little bit of an unusual - usually low-tax rate. I saw your note there this morning and I think the rate there that you have in mind maybe between in the low 20s is probably a little more reasonable on an ongoing basis.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. And with bringing in Allied World, would you expect your tax rate to modestly increase?

A - David James Bonham {BIO 15243784 <GO>}

With Allied World, I don't think we're going to see much of an increase there. So, no, I would say no.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. So, low 20s. Thanks very much.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you. Thank you, Tom.

Operator

Our next question comes from Mark Dwelle of RBC Capital Markets. Your line is now open.

Q - Mark Dwelle {BIO 4211726 <GO>}

Yeah. Good morning. Just a couple of questions. First related to the Allied acquisition, will there be any meaningful, I'll call it, acquisition-related charges that you'd be recognizing in the course of the - probably the third quarter? Just from getting that put together and - I know there's not a lot like integration charges, but inevitably there's lawyers and other aspects that just result in a meaningful number.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yeah, Mark. Dave, you can add to this, but we don't think there's going to be any significant cost expenses charges. But, Dave, you want to expand on that?

A - David James Bonham {BIO 15243784 <GO>}

Yeah. It won't be material, tens of millions of dollars

on the low end, but nothing significant.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. And then, related to - you mentioned there is obviously a laundry list of AIG units that were acquired or then were acquired in July or so forth. I mean, could you give an idea of amongst the ones that have been completed? What the kind of annualized amount of premium associated with the ones that are already closed? I know the total of all the units was meant to be around \$700 million to \$800 million gross written premium. Just trying to get a sense of kind of what proportion in premium terms has actually now been done.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Dave or Peter, you've got to take a crack at that. We've told you the ones that we have closed, Mark, and the ones that still have a month or two to go. But Dave or Peter, you want to add to that?

A - David James Bonham {BIO 15243784 <GO>}

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Yes. Sure. So if you're looking in the six months, the contribution so far is not very much. So, of the ones that have closed, the AIG branched contributed about \$6 million. So it's - we're kind of a standing start right now, but that will ramp up over time toward the estimates that you mentioned in your question.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Maybe I can ask it the other way around. Of the couple that are still outstanding, I think it was like Venezuela and Uruguay and maybe there was one other I can't recall, are those ones pretty tiny compared to this entire - in terms of the entire total? I'm just trying to get an idea, as we look forward, what portion is kind of done and what portion is kind of still in process?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

So, perhaps, Dave or Peter, if you've got that total that we expected from Eastern Europe as well as Latin America, the AIG acquisitions, in total, they were running at - Dave?

A - Peter S. Clarke {BIO 15243793 <GO>}

Yeah. This is Peter here. Essentially, by the end of the year, the majority of the premium will be on our books, but you have to remember that it will be on a written basis because we're basically starting from zero. So, that premium will take up to 12 months to come through the numbers on an earned basis. But by the end of the year, essentially, everything will be closed out. Venezuela is very, very small. And so - yeah, so by the end of 2017, we'll be writing all the premium on our own books.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. So, it sounds like at least the expected earnings impact to these ones will be pretty de minimis over the course of the balance of this year. It will really be more into next year that we start to see a meaningful pick-up in earned through premiums and then obviously we'll have whatever combined ratio associated with that.

A - David James Bonham {BIO 15243784 <GO>}

That's right.

A - Peter S. Clarke {BIO 15243793 <GO>}

I think that's right.

A - David James Bonham {BIO 15243784 <GO>}

That's right, Mark.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Those are my questions. Thank you.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yes, Natalie. Next question.

Operator

Yes. Our next question comes from Andrew Hollingworth of Holland Advisors. Your line is open.

Q - Andrew Hollingworth {BIO 1896571 <GO>}

Thank you and good afternoon. I'm calling from London. We're shareholders of yours. I wonder if I could just ask, Prem, a couple of direct questions. And these sort of go back sort of six months or so to when references were made to sort of Henry Singleton and cancellations of shares and so on. We'd be very interested to understand sort of what led to that sort of change your sentiment? And whether that is a function of the attitude towards valuation of the company today? Whether it's a function of the scale of the underwriting facilities that's now been built? And therefore, it's not a sort of lasting change that we expect to have been in place for many, many years and decades to come, or is it more tactical to do with a sort of undervaluation of the corporation you observe today? So, that'd be great if you answer that one. And then, I've got one very small follow-up.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yeah. We talked about this, Andrew, at our annual meeting and it's a good question. Our share buybacks are basically - I made the point that first we have to be financially very sound and then our focus will be on share buybacks. And so, right now, we've just completed Allied World. We want to make sure that the ICICI Lombard transactions, which I mentioned earlier, go through, make sure that our cash positions are through \$1 billion at year end.

And as the excess cash comes in, we just think our shares today are not expensive and now we think it's appropriate for us to buy them, buy as much as we can. And so, that's how we look at it. We'll never buy stock at the expense of our financial position. And it's only after our financial position is very strong that we'd look at buying back stock.

Q - Andrew Hollingworth {BIO 1896571 <GO>}

Can I follow up from that? I just observed that, obviously, the group - I mean, in terms of the logic of being a value investors buying your own shares back at a good price is obviously very compelling. But, obviously, there's a big difference between the stocks that Fairfax has issued in the last 10 years or so in order to buy other businesses. And then, obviously, that's the very opposite extreme to the large cancellation of stock that Singleton did that you referred to. So, just help us understand, from an operational perspective, is there a - we have now built a global collection of assets. That means that we don't need to build more and add more shares or to buy further assets and further businesses, or is it not like that? That's not how this has come about?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

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No. I think we have the ability to buy some very fine companies like we bought Brit, and then we bought Allied, and we did them with the idea that we'd be financially sound. So, we issued some shares. We also got some third-party financing, as you know, like OMERS and AIMCo. So that would be minimized, the dilution in terms of share issuance. But we do think, Andrew, when you look back in the next few years and you look back at what we've acquired that you as an investor and all our shareholders, we think, will be very pleased with it. Right now, as those shares are being issued and it gets digested, it takes some time. But I think, long term, we'd like to think that the companies we've acquired are very significant in terms of the opportunity going forward.

But, as I said in our annual meeting, we're not really looking - we think we are well structured. We've got plus minus \$14 billion premium worldwide. We've got \$37 billion, \$38 billion with Allied, \$40 billion investment portfolio. We got lots of cash. So, we think we are well structured. And for whatever the market brings, the stock market or the economy, and we think our company is structured to do well. But we're not oriented towards issuing any more shares for buying companies. We want to digest the companies we've acquired and we wanted to look at how we can organically expand our business because there's a lot of revenue possibilities for us, no expense synergies. We don't believe in that. But revenue possibilities among our companies is very significant, so we're focused on that. And at the right time, right opportunity, all things being equal, we'd look at buying back stock.

Q - Andrew Hollingworth {BIO 1896571 <GO>}

That's really, really helpful. Thank you. Can I have just one quick follow-up on that?

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yes.

Q - Andrew Hollingworth {BIO 1896571 <GO>}

And that's, you (46:35) earlier on described sort of the appetite for the convertibles and answered the other gentleman's question. Is it just tactical on your view that there's a sort of change of opportunities that's available there? Or is there a little bit of reflection inside Fairfax? So it sort of looks that from the investment side of things that hasn't gone quite according to plan as you might like in the last four or five years. And maybe in some way that overshadowed the brilliance that's been achieved in the combined ratios. And therefore, there's an attitude that says, let's have a slightly more vanilla investment function that means it ensures its operations get to shine through or is it not like that? It's still exactly the same investment operations that existed before.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yeah. So, as someone questioned earlier, our stock positions are pretty significant. We have the stock positions. We balance that with a big cash position. But when we see good companies - and this is the plus factor of Fairfax, all over the world, I may add. People want to join us, businesses want to join us. Allied World, being a great example. This AGT company which is a fabulous agriculture company, terrific track record, built by a guy by the name of Murad from scratch in the last 15 to 20 years. And they were comfortable

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issuing fully diluted approximately 20% of their stock, prior to the issuance, maybe 25% of the common shares, through a one structure. And we think we'll be able to help them. And we think over time, that company is going to do well.

So, we have opportunities like that. But it also reflects, as you pointed out, a cautious view on the marketplace, as stock prices are high. Earnings are coming up. Some of the positives of the new administration is coming through in terms of less regulation. We'll have to wait and see in terms of tax, whether they'll be able to put that through. The risk, of course, always is about trade, whether trade will come down significantly because of some of their actions. But barring all of that, we think the way we are structured and the way we are trying to go forward make sense to us.

Q - Andrew Hollingworth {BIO 1896571 <GO>}

Thank you very much for your time.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Yeah. Thank you, Andrew. Next question, Natalie.

Operator

Our next question comes from Junior Rah (49:13) of private investors. Your line is now open.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Good morning, Junior (49:23). No? Natalie, next question, please?

Operator

There are no questions in queue. One moment, please.

A - Vivian Prem Watsa {BIO 16700363 <GO>}

Natalie, if there are no more questions, we thank you all for joining us on this call and we look forward to presenting to you again after the next quarter. So, Natalie, thank you very much.

Operator

Thank you. And that concludes today's conference. Thank you all for your participation. You may now disconnect.

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