Company Name: Fairfax Financial HD
Company Ticker: FFH CN
Date: 2014-10-31
Event Description: Q3 2014 Earnings Call

Market Cap: 11,554.43
Current PX: 508.24
YTD Change($): +84.13
YTD Change(%): +19.837

Bloomberg Estimates - EPS
Current Quarter: 6.760
Current Year: 12.470
Bloomberg Estimates - Sales
Current Quarter: 2065.500
Current Year: 9499.500

Q3 2014 Earnings Call

Company Participants

- Prem Watsa
- David Bonham

Other Participants

- Tom MacKinnon
- Jeff M. Fenwick
- Paul Holden
- Mark A. Dwelle
- Mikel Abasolo

MANAGEMENT DISCUSSION SECTION

Prem Watsa

Q3 Highlights

Performance

- 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 nine months of 2014, book value per share increased by 22.1%, adjusted for the $10 per share common dividend paid in Q1 2014
  - We ended the quarter with common shareholders' equity of $8.6B or $404 approximately per share
- Our insurance and reinsurance companies had an excellent third quarter with a combined ratio of 91.2% with very good reserving and significant underwriting profit of $136mm
- In Q3, OdysseyRe, again, had an excellent combined ratio of 88.3%, while Zenith had a combined ratio of 83.8%

Hedging Gains

- As shown on page two of our quarterly release, we have realized gains on our investment portfolio of $16mm during Q3
- Excluding all hedging gains and before mark-to-market fluctuations in our investment portfolio, we earned $138mm in pre-tax income
- Including all hedging losses and gains and mark-to-market fluctuations in our investment portfolio, we reported pre-tax income of $616mm and after-tax income of $475mm in Q3 2014

Investment Portfolio

- Our third quarter has continued the trends of H1 2014
- You will note investment portfolios went up to $26.9B, almost $27B in Q3, in spite of being 79% hedged, 23% in cash and short-term investments and little exposure to corporate bonds
- How did this happen? Long U.S. government bond rates continued to drop and our common stocks did much better than the Russell index, which dropped 7.7%

Cash Levels

- We have yet to significantly benefit from our hedges and are approximately $108B in deflation swaps
- And of course, our cash position gives us great optionality
- At our annual meeting, we made the point that while we are protecting our capital on the downside, our investment portfolios could also do very well
- The first nine months of 2014 are a case in point

Common Stock Portfolio

- Our common stock portfolios continue to be hedged at approximately, as I said, 79%
- We selectively bought more stocks, but we did not add to our hedges
- Our common stocks outperformed the index
  - We continue to be soundly financed with year-end cash and marketable securities in the holding company of $1.4B
- A few more points, our total insurance and reinsurance premium volume remained unchanged in the quarter, adjusting for the crop insurance at OdysseyRe
- At the subsidiary level, the change in net premiums written described on page 32 of our interim report and combined ratios for Q3 were as follows
- OdysseyRe, net premiums were down 3% with an 88.3% combined ratio; Crum & Forster, premiums were down 1% with a 99.7% combined ratio; Northbridge, in Canadian dollars 7.2% increase in premiums and with a 94.3% combined ratio; Zenith, approximately 6% increase in net premiums with an 83.8% combined ratio; and Fairfax Asia, which had a 3% decrease in premiums with a 74% combined ratio

Interest Rates

- As we have said before , very low interest rates and reduced reserve redundancies means there will be no place to hide for our industry
- Combined ratios will have to drop well below 100% for the industry to make a single-digit return on equity with these low interest rates
  - However, with a significant excess capital in our industry today and many new entrants, insurance rates will likely go down first before they eventually go up

Net Investment Gains and Equity Investments

- On the investment side, net investment gains of $494mm in Q3 consisted of the following

- Please refer to page two of our press release
- Net gains on equity and equity-related investments after equity hedges of $316mm, resulted from the net losses of $52mm in our equity investments, offset by $367mm net gain in our equity hedge, reflecting the decline in the Russell Index
  - We have realized gains of $6.6mm in our equity and equity-related holdings in Q3 and $720mm in the first nine months
- Also, in Q3, we had unrealized gains of $478mm, primarily on our equity hedges
- As we've 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 widely and investment results will only make sense over the long term

Core Inflation

- Core inflation continues to be at or below 1% in the United States and Europe, levels that we have not seen since the 1950s
- In spite of QE1, QE2 and QE3, long-term bond rates in Europe are making record lows, quite often the lowest in 200 years
- In Germany, almost half of the German government bond market is yielding negative interest rates
- Also, six to seven countries in Europe are already experiencing deflation

European Union CPI Index

- Our CPI-linked derivatives with a nominal value of approximately $108B are down over 80% from our cost and are carried on our balance sheet at $110mm, even though they have 7.5 years to run
- The majority of these contracts are based on the underlying U.S. CPI Index or the European Union CPI Index
  - Further information is available on page 13 of our quarterly report
- As I've said to you before, our deflation swap experience reminds us of what happened in the CDS years ago
- Also, please remember that it took five years in Japan before deflation set in for the next 18 years
- When you review our statements, please note that when we own more than 20% of a company, we equity account
  - And about 30% we consolidate, so that mark-to-market gains in these companies are not reflected in our results

Thomas Cook and Ridley

- As you can see on page 11 of our quarterly report, the fair value of our investment in associates is $2.17B, with a carrying value of $1.81B and unrealized gain of $356mm not on our balance sheet
- Also Thomas Cook and Ridley, which are consolidated in our financial statements, are doing very well compared to our original purchase price
- We continue to be concerned about the prospects for the financial markets and the economies in North America and Western Europe accentuated, as we have said many times before, by the potential weakness in China and the emerging markets

Financial Markets

- We have said and now we have said it for after some time, we believe there continues to be a disconnect between the financial markets and the underlying economic fundamentals
- As of September 30, 2014, we have $5.9B in cash and short-term investments, which is approximately 23% of our total investment portfolio to take advantage of opportunities that come our way
- As a result, in the short term, our investment income will likely be reduced
- On October 30, 2014, this year, shareholders of Pethealth Inc. overwhelmingly voted to support our takeover bid, which should close before year-end

Pethealth

- Pethealth, operating in the United States, Canada and the United Kingdom, is North America's second-largest provider of medical insurance for dogs and cats
- Closing of this acquisition is anticipated to occur during Q4
- We're very excited about the prospects of Pethealth in the long term
- In August 2014, we issued $300mm 10-year bond offering, with a coupon of 4.875%
- First time, we were able to do a 10-year bond issue below 5%
  - We plan to substantially use the proceeds to retire debt

David Bonham

Financial Highlights

Net Earnings

- First, I'll focus on Fairfax's consolidated results for Q3 2014, then move on to the operating company results and finish with the consolidated financial position
- For Q3 2014, Fairfax reported net earnings of $461mm or $20.68 per share on a fully diluted basis
  - That's compared to Q3 2013, when we reported a net loss of $572mm, a net loss of $29.02 per fully diluted share
- YTD, Fairfax reported net earnings of just over $1.6B, or $72.53 per share on a fully diluted basis, and that reflects a significant improvement over 2013, when we incurred a YTD net loss of $568mm

Insurance and Reinsurance Operations

- Underwriting profits at our insurance and reinsurance operations in Q3 and first nine months of 2014 increased to $136mm and $345mm with combined ratios of 91.2% and 92.3%, compared to underwriting profits of $105mm and $275mm and combined ratios of 93.4% and 93.9% in Q3 and first nine months of 2013
  - That represents increases of $32mm and $70mm on a quarter-to-date and YTD basis in our underwriting profit

Net Favorable Development

- Our combined ratios benefited from net favorable prior-year reserve development in Q3 and first nine months of 2014 of $96mm and $227mm, translating into 6.2 combined ratio points and 5.1 combined ratio points
- And that was somewhat higher in net favorable development of $86mm, representing 5.4 combined ratio points in Q3 2013, and about the same as the $228mm and 5.1 combined ratio points of net favorable development in the first nine months of 2013
- Current-period catastrophe losses were lower in 2014 and totaled $65mm or 4.2 combined ratio points in Q3 and $151mm or 3.4 combined ratio points in the first nine months
- By way of comparison, in Q3 and first nine months of 2013, we incurred cat losses of $74mm and $218mm, representing 4.7 combined ratio points and 4.9 combined ratio points, respectively

U.S. Multi Peril Crop Insurance Business

- Please note that during Q2 2014, OdysseyRe changed the manner in which it recognizes premiums from its U.S. Multi Peril Crop Insurance business
- Following enhancements to its underwriting systems and the accumulation of sufficient internal historical data, OdysseyRe began to recognize the majority of the premium from its U.S. crop insurance business in Q2 to more closely correspond with the spring planting season; whereas in 2013, these premiums were recognized in Q3

U.S. Crop Net Premium written

- The full effect of this change on our financial reporting is described on page 44 of our third quarter interim report
- After excluding U.S. crop net premiums written of $126mm from Q3 2013, such that both of Q3s of 2014 and 2013 exclude that U.S. crop premium, net premiums written by our insurance and reinsurance operations was relatively unchanged in Q3 2014 and increased by 1.8% in the first nine months of 2014

Q3 Operating Results

OdysseyRe

- Now, turning to our operating company results, starting with the OdysseyRe
- In Q3 and first nine months of 2014, Odyssey reported underwriting profits of $73mm and $219mm and combined ratios of 88.3% and 87.6%, compared to underwriting profits of $84mm and $258mm and combined ratios of 87.6% and 85.6% in Q3 and first nine months of 2013

Catastrophe Losses

- Catastrophe losses in Q3 and first nine months totaled $41mm and $112mm, which translated into 6.6 combined ratio points and 6.4 combined ratio points, with Windstorm Ela, the largest individual catastrophe loss in 2014, accounting for losses of $36mm in the first nine months of 2014
- OdysseyRe's combined ratios in Q3 and first nine months also included the benefit of $35mm and $81mm or 5.5 combined ratio points and 4.6 combined ratio points of net favorable prior-year reserve development, and that was split relatively equally between catastrophe and non-catastrophe loss reserves

Net Premiums and Reinsurance Business

- OdysseyRe wrote $568mm and a little over $1.8B of net premiums in Q3 and first nine months, reflecting a decrease of 3% in Q3 2014 and a nominal decrease in the first nine months of 2014
- And this was principally due to declines in writings of reinsurance business, primarily proportional and excess of loss property lines of business, due to competitive market conditions, offset by growth across most lines of business in the U.S. insurance division and excluding the Multi Peril Crop Insurance net premiums written in Q3 2013 as we described earlier

Crum & Forster

- Moving on to Crum & Forster, Crum & Forster reported underwriting profits of $1mm and $5mm and combined ratios of 99.7% and 99.4% in Q3 and first nine months of 2014, compared to underwriting profits of $2mm and an underwriting loss of $3mm and combined ratios of 99.3% and 100.4% in Q3 and first nine months of 2013
  - There was no net prior-year reserve development in 2014 and 2013, and current-period catastrophe losses were also not significant in 2013 or in Q3 2014
- But in the first nine months of 2014, catastrophe losses were $13mm, representing 1.3 combined ratio points

Net Premiums Written

- Net premiums written by Crum & Forster decreased by 1% in Q3 2014, principally reflecting increased ceded premiums at CoverXSpecialty
- And increased by 10.2% in the first nine months, primarily reflecting incremental gross premiums written related to the renewal of the American Safety business
  - Which was acquired last year, and the growth in the Fairmont accident and health business, combined with higher net risk retention in certain other lines of business

Zenith

- Looking to Zenith, Zenith reported underwriting profits in Q3 and first nine months of 2014 of $30mm and $64mm and corresponding combined ratios of 83.8% and 87.9%, that was a significant improvement over combined ratios of 96.8% and 100.5% reported in Q3 and first nine months of 2013
- The improvement reflected a y-over-y decrease in the estimated current accident year loss ratios of 6.9 percentage points and 5.4 percentage points in Q3 and first nine months of 2014 and that was due to favorable loss development trends for the accident year 2013, combined with price increases equal to estimated loss trends for the accident year 2014

Net Premiums Written

- And the second reason was increased net favorable development of prior year's reserves in Q3 and the first nine months of 2014, representing 11.4 combined ratio points and 10.4 combined ratio points and that compared to net favorable development of 4.6 combined ratio points and 3.7 combined ratio points during those same periods last year
- Net premiums written by Zenith of $153mm and $593mm in Q3 and first nine months of 2014 increased by 5.9% and 3.3% on a y-over-y basis, principally reflecting premium rate increases

Northbridge

- Northbridge
- Northbridge reported underwriting profits of $14mm and $26mm and combined ratios of 94.3% and 96.4% in Q3 and first nine months of 2014
- And that's an improvement relative to the underwriting losses of $4mm and $6mm and combined ratios of 101.5% and 100.8% reported in those same periods in 2013

Underwriting Results

- Northbridge's underwriting results in Q3 and first nine months included the benefit of net favorable prior-year reserve development across most accident years and lines of business of $14mm and $57mm, and this was lower than the net favorable development of $45mm and $108mm in Q3 and first nine months of 2013
- Current-period catastrophe losses were also lower in Q3 and first nine months of 2014, accounting for 3.1 combined ratio points and 1.1 combined ratio points in those respective periods
  - Whereas the Alberta and Toronto floods in 2013 were principally responsible for adding 8.9 points and 7.6 points to the combined ratios in Q3 and first nine months of 2013

Canadian Dollar Terms

- In Canadian dollar terms, net premiums written by Northbridge in Q3 and first nine months increased by 7.2% and 3.6%, reflecting higher net risk retention and increased gross premiums written at Federated Insurance and at Northbridge Insurance in its Western and Ontario regions, partially offset by the strategic non-renewal of an unprofitable portfolio business in 2014 and excluding the one-time impact of the intercompany unearned premium portfolio transfer on January 1, 2013, between Northbridge and Group Re that we describe on page 38 of our third quarter interim report

Fairfax Asia

- Looking at Fairfax Asia, Fairfax Asia's combined ratio improved from 80.9% in Q3 2013 to 74.2% in Q3 2014, primarily as a result of increased profit commission on reinsurance ceded by First Capital, while it's combined ratio of 87.6% in the first nine months of 2014 was comparable with the first nine months of 2013 when it was 87.3%
- On a y-over-y basis, in 2014, net premiums written by Fairfax Asia decreased by 3% in Q3 and increased by 18% in the first nine months
- YTD increase principally reflected increased writings of commercial property – commercial automobile and property insurance and in the marine hull lines of business

Insurance and Reinsurance-Other Segment

- The insurance and reinsurance-other segment, the combined ratios of insurance and reinsurance-other division were 99% and 98.2% in Q3 and the first nine months of 2014, compared to 96.4% and 98.3% in those same periods in 2013
- The decrease in underwriting profit in Q3 2014 principally reflected increased current-period catastrophe losses, partially offset by an improvement in the non-catastrophe underwriting margins related to the current accident year and increased net favorable prior-year reserve development

Net Premiums Written

- Net premiums written by the insurance and reinsurance-other reporting segment decreased by 11.1% in the first nine months of 2014, primarily reflecting a non-renewal by Advent and Polish Re of certain classes of business where terms and conditions were considered inadequate
  - And excluding the one-time impact of the intercompany unearned premium portfolio transfer on January 1, 2013 between Northbridge and Group Re that we described earlier and that suppressed net premiums written by Group Re in the first nine months of 2013 by $39mm

Runoff

- Turning now to Runoff, Runoff completed two significant transactions in the quarter
- First, it provided reinsurance protection to a third-party runoff portfolio of construction defect policies, resulting in a recognition of $85mm of non-recurring premiums and a corresponding $85mm of incurred losses
- And second, Runoff commuted a significant reinsurance recoverable with a carrying value of $313mm and received cash and investments of $310mm

Operating Losses

- Runoff reported operating losses of $17mm and $67mm in Q3 and the first nine months of 2014 compared to operating losses of $8mm and $14mm in the same periods in 2013
- The decrease in operating profitability principally reflected incremental operating expenses associated with the construction defect reinsurance transaction in the quarter and the American Safety acquisition, which occurred last year
- The decrease in operating profitability on a YTD basis also reflected net adverse development at U.S. Runoff in 2014 and a gain on a significant commutation in 2013
- After factoring in net gains on investments, Runoff reported pre-tax earnings of $75mm and $308mm in Q3 and first nine months of 2014

Interest and Dividend Income

- Our consolidated interest and dividend income increased from $61mm in Q3 2013 to $74mm in Q3 2014, reflecting lower total return swap expense and a modest increase in investment income earned
- In the first nine months, consolidated interest and dividend income increased from $273mm to $284mm in 2014, reflecting slightly higher investment income earned, combined with a decrease in total return swap expense

Tax Rate

- The company recorded income tax provisions of $141mm at an effective rate of 23% in Q3 2014 and $632mm at an effective rate of 28% in the first nine months of 2014
- The effective tax rate in Q3 2014 was lower than our Canadian statutory income tax rate of 26.5%, primarily as a result of non-taxable investment income earned in the U.S. and the release of provisions following the completion of certain prior-year's income tax audits
  - And that was partially offset by income earned in the U.S. which is taxed at the higher U.S. statutory income tax rate of 35%

Common Shareholders' Equity and Net Earnings

- Moving on to our financial position, our total debt-to-total capital ratio decreased to 25.1% at September 30, 2014 from 26.1% at December 31, 2013, primarily as a result of the increase in our common shareholders' equity, reflecting the net earnings in the first nine months of year, partially offset by the issuance in August of $300mm principal amount of our senior notes due 2024 for a net proceeds of $294mm
- We intend to use the proceeds from this offering to fund the repayment upon maturity of Fairfax and OdysseyRe unsecured senior notes coming due in 2015, and to redeem in Q4 2014, $50mm principal amount of OdysseyRe unsecured notes and $21.5mm principal amount of American Safety trust preferred securities

QUESTION AND ANSWER SECTION

<Q - Tom MacKinnon>: My question has to do really with a little bit on the equity hedges. If I look, you made money on the equity hedges in the quarter, largely as a result of the Russell Index going down. But looks like you actually had to payout money on the equity hedges in the quarter. It looks like about $167mm from page 10 and page 12 of the interim report. So, maybe you can just help me understand why you actually had to payout that money on these hedges when – aren't they settled each quarter or is there just some other timing issue and accounting issue that I'm not quite sure of?

<A - Prem Watsa>: Yeah. Thank you, Tom. That's a good question. I'll pass it on to Dave.

<A - David Bonham>: Sure. Sure. Yeah. Thanks, Tom. Yeah. You're right on the cash, the actual cash that, that was dispersed in the quarter. But you should also note that we do have some receivables setup for the mark-to-market that we'll receive in Q4. So, about $151.3mm and $126.3mm on the equity index and equity positions respectively, so we'll be getting that cash in Q4.

<Q - Tom MacKinnon>: Okay.

<A - Prem Watsa>: And Dave, we – it's mark-to-market every month or – yeah.

<A - David Bonham>: It's mark-to-market, some of them are quarterly, some of them are monthly.

<A - Prem Watsa>: Yeah.

<A - David Bonham>: But that's when we pay the cash.

<Q - Tom MacKinnon>: Okay. So, that will be – essentially be getting $380mm coming in pretty soon here and that should – so net in the quarter, that should help out then, I guess. All right. Then the next question is just with respect to the growth that we're seeing in terms of net premiums written in Northbridge. I think it was up 9% maybe on a constant-currency basis and there was a mention of an impact of a fronting arrangement as well. I'm wondering what impact that had on the y-over-y growth in Northbridge.

<A - Prem Watsa>: Do you have any comments to that. Dave?

<A - David Bonham>: I don't have the figure for the top line gross premiums written, but we look pretty closely at our net premiums written and what we actually retain, and that fronting arrangement wouldn't have any impact on the...

<Q - Tom MacKinnon>: Okay. So, on the net premium things, it wouldn't had any impact on the – okay.

<A - Prem Watsa>: On the net premiums written.

<Q - Jeff M. Fenwick>: Prem, just wanted to follow up on, you've been pretty consistent in your commentary about the macro risks that you're seeing there and the potential impact on investments. But when I look at the way that you're deploying some of your funds here, it looks like the amount of cash and marketable securities, the balance there has been kind of gradually trending lower over the last few quarters. I think it was about 30% of the portfolio start of the year, down below 25% now. And just wondering how are you balancing that view of the risk and does this imply you're seeing some areas where you are seeing value and where you feel the risk reward is attractive to you?

<A - Prem Watsa>: Yeah. So, Jeff, it's – our cash positions, whether it's 30% or 25%, is not a top-down view. It's looking for opportunities and when we don't see them, it's parked in cash. What we've seen selectively, Jeff, is opportunities that work for us. And so, the cash has come down. It's come down some from 30% to, as you said, a little below 25%. But we're still very concerned. We still look at this whole time period as a one-in-hundred-year event.

So, if you remember, in the liability side, catastrophes were very low this year in 2014. So, there were no windstorms to speak about in Florida, but that doesn't mean that we don't protect ourselves from a category five coming into Miami, right? It hasn't come ever. But we want to survive that.

So, in a similar sense, we look at the left-hand side of the balance sheet, the investment portfolios, and we always have to protect ourselves from the markets coming down, we use that 30%, 40%, 50% drop in the markets. Interest rates going up, all sorts of permutations and combinations. But broadly speaking, we're looking at protecting ourself from worst-case events on the left-hand side of the balance sheet. And at the moment, it doesn't seem to worry too many people. But that doesn't mean we don't protect ourselves.

But the fact that our cash position has gone from 30% to 25% small, we've seen some positions. We've taken a position in Eurobank, for example, that's public, that's a new one that we've disclosed. But otherwise, our position hasn't changed in any significant way.

<Q - Jeff M. Fenwick>: Okay. And I guess that feeds into my follow-on question there around the CPI contracts. And you continue to add here to the notional value and is there some target in terms of just how big you'd like that exposure to be or is it just a question of these contracts, you can acquire them at attractive pricing today and it's just giving you more cover and you're happy to sit on them?

<A - David Bonham>: Jeff, that's a good question. We've accumulated – and when I say, it's got some similarity to our credit default position, I meant like, when we bought it, you'll remember in the credit default position, it dropped quite significantly and we averaged down. And that's what we've basically been doing with our deflation swaps. They're long-term contracts and we're averaging down. And we've got a very good position now, where I've said in the last few quarters that, plus/minus, we're where we want to be. We might use a little money just to refresh the CPI indices, get them back to where they are today.

But we see, in sort of worst-case events – and right now, as I said in my prepared comments, deflation in six or seven countries in Europe, I mean, actual deflation. China, there's a – China's economy is weak, no one knows how weak. But you do know that commodity prices have – the price of oil has gone recently from $100 to $80. The price of iron ore has collapsed from $190 to less than $80 a ton. And price of copper have trended down. So, you're seeing commodity prices come down significantly.

China's real estate prices are coming down. We've talked about that before. And so, if anything happens in China, Jeff, you've got a very significant deflationary factor. And in that environment, if that happens, some may say when that happens, these contracts are – even though, they've got seven years or eight years to go, they are marketable contracts, they react to sentiment about inflation or deflation. So, if you think inflation, these contracts will be worthless. But if you – and that means we'd lose $110mm over some time period. So, there is very little downside in our book value for that $110mm.

But if the sentiment changes towards deflation, these contracts will respond pretty significantly. And we keep that, because in a deflationary environment, and Japan is a great case, it's very difficult to make any money, because everything is going down; stock prices are going down and interest rates are going down, credit spreads widen significantly. So, it's very difficult to make any money. And perhaps, one of the few places you'll make money is on the deflation swap.

So, we've got that in the back of our mind and we're very happy with the position that we've acquired, and it's been acquired over a few years, as you know. But mark-to-market is down like 80%, more than 80%.

<Q - Paul Holden>: Wanted to ask you about the position you have in U.S. treasuries and other fixed-income products outside the munis, which we know you're going to hold to maturity. In the past, when rates have dropped to extremely low levels such as this, we've seen you sell some of U.S. treasuries. Not sure you did the same this quarter. Maybe your updated thoughts on your holding of fixed income.

<A - Prem Watsa>: Yeah. So U.S. treasuries is a good – another case as to what happens in the marketplace. We've had QE3, I don't know, about a year ago or so or a little longer, and most people expected interest rates to go up and treasuries did go up. When they started tapering, which most people would have expected interest rates to go up, long treasuries to go up further, they started tapering, meaning they're no longer buying treasuries. Treasuries rates have come down. Long treasuries ended the year 2013 at close to 4% and they've been trending down every quarter. They ended the September quarter at 3.20% and now they're at 3.05% or something, to the surprise of many.

So, that's another possibility of deflation being in the air, because if you have a deflation in the United States, or very lower rates of inflation, then of course you'd gravitate towards the most-secure bonds, which is U.S. treasuries, and we continue to have some. We've sold in the past at the 2.50% area, I think, Paul, and we keep our options open as to where we'd sell them. But a long treasury we've sold at approximately 2.5%. But I must say that Van Hoisington, who I've quoted before, came out with an excellent third quarter for our shareholders.

I want you to make sure you read that, because it's an excellent third quarter report. He's the only guy that we know of in many – among money managers, who's got it right in the last 10 years. And he's been very positive on long treasuries. And he's made the point that the velocity of money, which impacts how an economy does, in United States, it's been trending down significantly, but it's been trending down in Europe even more; and in Japan, even more in absolute rates. And it's what looking at those figures, because it does make some very good points.

So, we continue to like the treasury position. It's not cute, but it can be significant in terms of making some money for us. But Jeff (sic) [Paul] (40:32), it's interesting to me when I watch the fact that QE3 came in and interest rates, QE3, what it did was buy bonds and other things, which you'd expect the interest rates to come down, they did the opposite. When they stopped, the Fed stopped, interest rates came down.

So, Paul, thank you for that. And what's your – anything else that you had, Paul?

<Q - Paul Holden>: Just one other question that's unrelated is, on the cat losses, obviously, this has been a year of low cat losses. If cat losses will return to more normal levels, what kind of impact you think that would have on the combined ratio?

<A - Prem Watsa>: Yes. Cat losses fluctuate and our cat exposures are coming down some. But Dave, would you have an answer to that?

<A - David Bonham>: Yeah. So, I'm looking at our cat losses about 4 points – in 3 points, 4 points on Q3 and first nine months, and maybe a more normal number would be 5 point or a little higher than 5 points. So, it would be a little more significant, but I don't think it would be within our expectations of how we price the business. So, there'll be no surprises there.

<A - Prem Watsa>: We take a certain amount of cat margin or we expect certain cat, this [ph] hasn't (42:03) been a very god year, as you know, Paul. But yeah, so I think the industry has benefited from the fact that there hasn't been cat. But we take that into account. We've had 2011, which was a huge cat year across the world and it was well within our tolerances.

<Q - Mark A. Dwelle>: Question for Dave, you commented on the Zenith and the improvement in their combined ratio. I just wanted to clarify, were you saying that they had an end-of-the-period reduction in the loss [ph] PIK (42:55) for the year such that there was a kind of catch-up – favorable catch-up adjustment in this quarter's result, or were you just saying that the actual [ph] PIK (43:02) has been lower each sequential quarter this year relative to last year?

<A - David Bonham>: Yeah. The [ph] PIK (43:09) has been lower and I don't think there was any particular catch-up in Q3. They've been looking at the loss ratio [ph] PIK (43:18) for this accident year and started to see these trends emerging earlier on in the year. So, that [ph] PIK (43:26) for the 2014 loss ratio has been fairly consistent throughout the year.

<Q - Mark A. Dwelle>: Okay, that's kind of what I thought. I just – the way it was said, it kind of threw me for a loop. So, thanks for that. The second question – the second topic I wanted to talk about was just the Runoff purchase of the Everest Re contractors business. I mean, that's a business line that's been notoriously difficult across the industry. I was just curious kind of some background or any other details you could provide about that deal.

<A - Prem Watsa>: Mark, we have a very specialized Runoff operation. There is only two or three of them who can compete with us. We look at every claim. We look at all the claims in detail. Our guys are – that's all they do. They know the exposures and our record, Mark, is excellent, like we've made some terrific purchases in the last five years or six years. And so, it's like anything else. When you buy these reserves, you have to have a margin of safety, and we have a margin of safety when we buy reserves from Everest Re or from other deals that we've done in the past. And if we don't get the margin of safety, this is not a growth business for us. Very simply, we won't do it.

So, if we don't get the price that we're looking for, we don't do it. And all of us are involved. It comes from the Runoff, Andy looks at it. Chief Risk Officer, Peter Clarke looks at it and I look at it. And it has to be priced properly before we make the purchase. And we're very comfortable with what our CEO, Nick Bentley, who leads Runoff operation, has done on this purchase.

<Q - Mikel Abasolo>: My question is on Eurobank. I think that [ph] yours is a bet (45:53) on the Greek economy restoring balance, avoiding a [ph] structure of deflation (45:58) and ultimately remaining in the Euro. My question is why did you trust Greece's macro economy to be as resilient as Ireland's, allowing you to score similar success with Eurobank, perhaps, as you had with Bank of Ireland? And if I may, on your other Greek investments, particularly Mytilineos, what is your stance now that the stock prices have collapsed again in Greece? Thank you very much

<A - Prem Watsa>: Thank you, Mikelo (sic) [Mikel] (46:27). In Greece, first of all, we've always been long-term investors. We like the leadership of the country. We think it's pro-business. We think Greece has suffered greatly in terms of its economic position and it's bottoming out and, in fact, increasing – economically increasing. We think Eurobank – the banking industry in Europe, in Greece, there were about 20, 25 banks five years, six years, seven years ago, while there is only four now and Eurobank is one of the four. They're approximately the same size and Eurobank is very well run. So, we like that.

We like the management team of Eurobank. And we feel very confident that over the long term, Eurobank will do well, as well as the Bank of Ireland has done for us in Ireland. If you just take Ireland for two years, in 2011, it's difficult to think how Ireland – the prospects for Ireland was two years ago or three years ago in 2011. And today, it's so different. So, it's very difficult to tell how Greece's positioned will be a few years from now. We think it will be good.

As far as the prices coming down, Mikelo (sic) [Mikel] (48:00), these are the fluctuations. They go up, they go down. We don't pay too much attention to them. We look at the long term. And in the long term, we think Greek investments will do very well. So, thank you for your question Mikelo (sic) [Mikel] (48:16). I'll pass it on to Shirley for any other questions. Shirley?

<Q>: And my question relates to the intrinsic value of Fairfax. Is there a rule of thumb, so to speak, such as 1.5 times stated book to arrive at an approximate intrinsic value of Fairfax? I have never heard management refer to their approximate estimation of intrinsic value. Are you comfortable in issuing your appraisal of intrinsic? If you would, please, comment on this, I'd appreciate it. Thank you.

<A - Prem Watsa>: Well, thank you for that question, [ph] Marvin (49:00). We really are not – we manage the company. We're all long-term shareholders, have got, I don't know, 80% to 85% my net worth in Fairfax. But what the intrinsic value of the company is that we leave to you and all the shareholders who've been with us for a long time. But our track record is very good. Over the long term, our track record is excellent. And you have to take that into account and see what you think the price – the appropriate price is. But we don't estimate and we don't give you a sense for what we think the intrinsic value is, because really that would be promoting the company and the stock price and we've never done that.

We believe that we need to disclose all the information. We believe we have to perform. We want to increase book value long term 15%. Our track record since inception is closer to 22%. But of course, there's no guarantee that we'll get you 15% over the long term. But the value of the company we leave to our share holders and yourself, [ph] Marvin (50:22).