

Company Name: Fairfax Financial HD
 Company Ticker: FFH CN
 Date: 2014-08-01
 Event Description: Q2 2014 Earnings Call

Market Cap: 11,377.10
 Current PX: 500.44
 YTD Change(\$): +76.33
 YTD Change(%): +17.998

Bloomberg Estimates - EPS
 Current Quarter: 1.970
 Current Year: 38.720
 Bloomberg Estimates - Sales
 Current Quarter: 2069.500
 Current Year: 9419.500

Q2 2014 Earnings Call

Company Participants

- V. Prem Watsa
- David Bonham

Other Participants

- Paul Holden
- Mark A. Dwelle
- Tom MacKinnon
- Chris Lafayette

MANAGEMENT DISCUSSION SECTION

V. Prem Watsa

Business Highlights

Book Value per Share and Combined Ratio

- In H1 2014, book value per share increased by 17.1%, adjusted for the \$10 per share common dividend paid in Q1 2014
- Our insurance companies had an excellent H1 with a combined ratio of 92.8% with excellent reserving and significant underwriting profits of \$209mm
- In Q2, OdysseyRe, again, had an excellent combined ratio of 88.6%, while Zenith had a combined ratio of 89.8%

Investment Portfolio

- As shown on page 33 of our quarterly report, we realized gains on our investment portfolio of \$329mm during Q2
- Excluding all hedging losses, and before mark-to-market fluctuations in our investment portfolio, we earned \$443mm in pre-tax income
- If you include all hedging losses and mark-to-market fluctuations in our investment portfolio, we reported pre-tax income of \$523mm and after-tax income of \$364mm in Q2 2014
- Our second quarter has continued the trends of Q1
- You will note our investment portfolios went up by \$544mm in Q2 2014 in spite of being about 85% hedged, 28% in cash, and little exposure to corporate bonds
 - How did this happen? Long U.S. government bond rates continue to drop and our common stocks did much better than the Russell index

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Hedging

- We have yet to financially benefit from our hedges and are approximately \$100B 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 and second quarters of 2014 were a case in point
- Our common stock portfolios continued to be hedged at 85%
- We did not add to our hedges, but our common stocks outperformed the index

Cash and Marketable Securities

- We continue to be soundly financed with the year-end cash and marketable securities in the holding company of \$1.1B
- A few more points, our insurance and reinsurance premium volume increased by 4.4% in the quarter, adjusting for the crop insurance at OdysseyRe
- The combined ratio for our insurance and reinsurance operations was 92.7% in the quarter

Net Premiums Written and Combined Ratios

- At the subsidiary level, the increase in net premiums written after adjusting for the one-time impact, described on page 32 of our interim report, and combined ratios for Q2 were as follows
- This is all in for Q2
 - OdysseyRe, up 5.8%, with a combined ratio of 88.6%
 - Crum & Forster, up 16.7%, with a combined ratio of 98.8%
 - Northbridge, up 2.7% in Canadian dollars, with a combined ratio of 95.3%
 - Zenith, up 5%, with a combined ratio of 89.8%
 - And Fairfax Asia, up 14.8%, with a combined ratio of 93.4%

Interest Rates

- As we have said before, very low interest rates and reduced reserve redundancies means there will be no place to hide for the 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 the significant excess capital in our industry today and many new entrants, insurance rates will likely go down first before they eventually go up

Investment

- On the investment side, net investment gains of \$409mm in Q2 consisted of the following
- Please refer to page 2 of our press release

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- Net gains on equity and equity-related investments after equity hedges of \$160mm, resulting from net gains of \$348mm and \$188mm net loss in our equity hedge, reflects the outperformance of our stock portfolio vs. the Russell index
- We've realized gains of \$320mm on our equity and equity-related holdings in Q2 2014 and \$713mm in H1
- Also, in Q2, we had unrealized gains of \$381mm, primarily on our municipal and Treasury bond portfolio because of the impact of dropping interest rates

Mark-to-Market Gains and Losses

- 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 wildly and investment results will only make sense over the long-term
- Core inflation continues to be at or above 1% in the United States and Europe, levels not seen since the 1950s, in spite of QE1, QE2 and QE3
- Long-term government bond rates in Europe are making record lows, quite often the lowest in 200 years

CPI-Linked Derivatives

- Our CPI-linked derivatives with a notional value of approximately \$104B are down 80% from our cost and are carried on our balance sheet at \$122mm, even though they have 7.6 years to run
- As I have said to you before, our CDS experience comes to mind
- Also, please remember that it took five years in Japan before deflation set in for the next 18 years
- When you review our statements, also please note 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

Cash and Short-Term Investments

- As you can see on page 11 of our quarterly report, the fair values of our investment in associates is \$2.3B, which is a carrying value of \$1.8B and unrealized gain of \$440mm not on our balance sheet
- We continue to be very concerned about the prospects for the financial markets and the economies of North America and Western Europe, accentuated, as we have said many times before, by potential weakness in China and emerging markets
- As we have said now for some time, we believe there continues to be a disconnect between the financial markets and the underlying economic fundamentals
- As of June 30, 2014, we have \$7.5B in cash and short-term investments in our portfolio, which is 28% 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

Regulatory Investigation

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- Finally, I want to bring to your attention, on page 18 of our second quarter report, we have added a paragraph under contingencies regarding a regulatory investigation in Québec
- We are fully cooperating with the Québec authorities, who required strict confidentiality during the investigation
 - While we are not permitted to give you any further details at this time, I can say there is no personal trading involved and we are confident that we did nothing wrong

David Bonham

Financial Highlights

Net EPS and Loss

- First, I'll focus on Fairfax's consolidated results for Q2 2014 then move on to the operating company results and finish with the consolidated financial position
- For Q2 2014, Fairfax has reported net earnings of \$364mm, or \$16.15 per share on a fully diluted basis
 - That compared to Q2 2013 when we reported a net loss of \$158mm, or \$8.55 per fully diluted share
- YTD, Fairfax has reported net earnings of just over \$1.1B, or \$51.84 per share on a fully diluted basis, was significantly higher than YTD net earnings of \$4mm at this time last year

Underwriting Profits

- Our insurance and reinsurance operations reported higher underwriting profits of \$110mm and \$209mm and combined ratios of 92.7% and 92.8% in Q2 and first six months of 2014
 - Last year, during those same periods, our underwriting profit was \$84mm and \$170mm and the combined ratios were 94.2% and 94.1%
 - So that's an increase of \$39mm in our underwriting profit on a YTD basis

Combined Ratios and Catastrophe Losses

- Our combined ratios benefited from net favorable prior year reserve development of \$76mm and \$131mm, translating into 5 and 4.5 combined ratio points in Q2 and first six months of 2014
 - And that was somewhat lower than net favorable development of \$106mm and \$142mm, representing 7.4 and 4.9 combined ratio points in Q2 and first six months of 2013
- Current period catastrophe losses were lower y-over-y and totaled \$56mm or 3.7 combined ratio points in Q2 2014 and \$86mm or 3 combined ratio points in the first six months of 2014
- By way of comparison, in Q2 and first six months of 2013, we incurred cat losses of \$112mm and \$144mm, representing 7.7 and 5 combined ratio points, respectively

Premiums

- Please note that during Q2 2014, OdysseyRe changed the manner in which it recognized premiums from its U.S. crop business

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- Enhanced underwriting systems and the accumulation of sufficient internal historical data allowed OdysseyRe to recognize the majority of the premium from its U.S. crop insurance business in Q2 to more closely correspond with the planting season
 - Whereas in 2013, these premiums were recognized in Q3
 - The full effect of this change on our financial reporting is described on page 43 of our interim report for the six months ended June 30, 2014
 - This change increased our net premiums written by \$143mm in Q2 for six months
- So after adjusting net premiums written in 2014 by this amount, net premiums written by our insurance and reinsurance operations increased by 4.4% and 2.3% in Q2 and first six months

OdysseyRe

Underwriting Profits and Combined Ratios

- Now, turning to our operating company results, we'll start with OdysseyRe
- In Q2 and first six months of 2014, Odyssey reported underwriting profits of \$70mm and \$146mm and combined ratios of 88.6% and 87.3%
 - That compared to underwriting profits of \$75mm or rather, \$79mm, and \$174mm and combined ratios of 85.9% and 84.4% in Q2 and first six months of 2013
- Catastrophe losses totaled \$49mm and \$71mm, and that translated into 7.8 and 6.2 combined ratio points in Q2 and first six months of 2014, with the largest single loss totaling \$25mm in connection with Windstorm Ela in Q2
- OdysseyRe's combined ratios included the benefit of \$25mm and \$47mm, or about 4 combined ratio points of net favorable prior year reserve development in each of Q2 and first six months of 2014, with the net favorable reserve development in the first six months of 2014 more heavily weighted towards favorable emergence on prior year's non-catastrophe loss reserves across all of OdysseyRe's divisions

Net Premiums Written

- Excluding in 2014, the net premiums written related to its U.S. crop insurance business, as we mentioned earlier, OdysseyRe wrote \$531mm and a little over \$1.1B of net premiums in Q2 or first six months, reflecting an increase of 5.8% in Q2 and a nominal decrease in the first six months of 2014, principally due to growth across most lines of businesses in the U.S. insurance division, offset by declines in writings of reinsurance business, primarily proportional and excess of loss property lines of business and that was due to competitive market conditions

Crum & Forster

Underwriting Profits and Losses

- Moving on to Crum & Forster, Crum & Forster's underwriting results improved in Q2 and the first six months of 2014, with underwriting profits of \$4mm and \$5mm and combined ratios of 98.8% and 99.3%
- Crum & Forster reported underwriting losses of \$6mm in each of Q2 and first six months of 2013, and those corresponding combined ratios were 102% and just a little below 101%

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Reserve Development, Catastrophe Losses and Net Premiums

- There is no prior year reserve development in 2014 and 2013
- And current period catastrophe losses were \$5mm and \$12mm in Q2 and the first six months of 2014, adding 1.1 and 1.9 points to the combined ratios during those respective periods
- Net premiums written by Crum & Forster increased by 16.7% and 16.4% in Q2 and first six months of 2014, primarily reflecting incremental gross premiums written related to the renewal of the American Safety business and growth in the Fairmont accident and health business combined with higher net risk retention in certain lines of business

Zenith

Underwriting Profits, Combined Ratios and Net Premiums Written

- Turning to Zenith
- Zenith reported underwriting profits of \$18mm and \$34mm and corresponding combined ratios of 89.8% and 90.2% in Q2 and first six months of 2014
 - And that's a significant improvement over the combined ratios of 95.6% and 102.6% reported in Q2 and first six months of 2013
- The improvement reflected the following
 - First, a y-over-y decrease of 2.3 and 4.7 percentage points in the estimated accident year loss ratios in Q2 and first six months of 2014 due to favorable loss development trends for accident year 2013
 - Second, increased net favorable development of prior year's reserves, representing 9.4 and 9.8 points on the combined ratios, compared to net favorable development of 6 and 3.2 combined ratio points during those same periods of last year
 - And finally, the underwriting expense ratios benefited from a 6% and an 8% increase in net premiums earned in Q2 and the first six months of 2014
- Net premiums written by Zenith of \$151mm and \$441mm in Q2 and the first six months of 2014 increased by 5% and 2.4% on a y-over-y basis, reflecting premium rate increases

Northbridge

- Northbridge reported underwriting profits of \$11mm and \$12mm and combined ratios of 95.3% and 97.5% in Q2 and first six months of 2014, an improvement relative to the combined ratios of 100.4% reported in each of those same periods in 2013
- Northbridge's underwriting results included the benefit of net favorable prior year reserve development across most accident years and lines of business of \$27mm and \$42mm, representing 11.6 and 9.2 combined ratio points in Q2 and first six months of 2014
 - And that was somewhat lower than the net favorable development of \$54mm and \$62mm, representing 22 and 12.8 combined ratio points in Q2 and first six months of 2013
- There were no catastrophe events in the first six months of 2014, whereas the Alberta floods in Q2 2013 were principally responsible for adding 13.9 and 6.9 points to the combined ratios in Q2 and first six months of 2013

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Canadian Dollar Terms

Net Premiums Written

- In Canadian dollar terms, net premiums written by Northbridge increased by 2.7% and 2.1% in Q2 and first six months of 2014, reflecting higher net risk retention and increased gross premiums written at Federated Insurance and in the Western region at Northbridge Insurance, partially offset by the strategic non-renewal of an unprofitable portfolio business
- That's after adjusting for the one-time impact of the inter-company unearned premium portfolio transfer on January 1, 2013, between Northbridge and Group Re that we describe on page 37 of our interim report

Fairfax Asia

Combined Ratios and Unfavorable Emergence

- Fairfax Asia, Fairfax Asia's combined ratios increased from 90.7% and 90.9% in Q2 and first six months of 2013 to 93.4% and 93.6% in 2014, primarily as a result of net adverse prior period reserve development of 3 and 3.8 combined ratio points in Q2 and first six months of 2014, whereas Fairfax Asia reported net favorable prior period reserve development in those corresponding periods last year
- Unfavorable emergence in 2014 was principally related to losses assumed by Pacific Insurance from the Malaysia motor vehicle insurance pool, where participation is compulsory

Net Premiums Written

- On a y-over-y basis, net premiums written by Fairfax Asia in Q2 and first six months of 2014 increased by 15% and 26%, principally reflecting increased writings of marine hull, commercial automobile and property business
- The combined ratios of the insurance and reinsurance other division of 97.8% and 97.7% in Q2 and first six months of 2014 improved compared to the combined ratios of 100.2% and 99.3% reported in the same periods in 2013
- Net premiums written decreased by 16% and 17% in Q2 and first six months of 2014, reflecting the non-renewal of certain classes of business where terms and conditions were considered inadequate at Advent, Polish Re and Fairfax Brasil, and excluding the one-time impact of the inter-company unearned premium portfolio transfer on January 1, 2013 between Northbridge and Group Re that we described earlier, which suppressed net premiums written by Group Re in 2013 by \$39mm

Runoff

- Turning to runoff
- Runoff reported operating losses of \$29mm and \$50mm in Q2 and first six months of 2014 compared to operating losses of \$5mm and \$6mm in the same periods in 2013
- The y-over-y decrease in operating profitability primarily reflected net adverse development at U.S. runoff in 2014 and a gain on a significant commutation that was recorded in 2013
- But after factoring in net gains on investments, runoff reported pre-tax earnings of \$65mm and \$233mm in Q2 and first six months of 2014

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Consolidated Results

Interest and Dividend Income

- Turning to some of our consolidated results
- Our consolidated interest and dividend income increased from \$112mm in Q2 2013 to \$120mm in Q2 2014, reflecting lower total return swap expense and a modest increase in investment income earned
- In the half year, consolidated interest and dividend income decreased slightly from \$212mm to \$211mm, reflecting lower investment income earned, partially offset by a decrease in total return swap expense

Income Tax Provisions and Tax Rate

- The company recorded income tax provisions of \$157mm and \$491mm in Q2 and first six months of 2014 at an effective tax rate of approximately 30%
- The effective tax rate was higher than our Canadian statutory income tax rate of 26.5%, primarily as a result of significant income earned in the U.S., which is taxed at the higher U.S. statutory income tax rate of 35%

Debt to Total Capital Ratio

- Moving on to our financial position, our total debt to total capital ratio decreased to 24.7% at June 30, 2014 from 26.1% at December 31, 2013
- And that was primarily as a result of the increase in our common shareholders' equity, reflecting the net earnings in the first six months of the year

QUESTION AND ANSWER SECTION

<Q - Paul Holden>: I have – really, it's two questions, but they're interconnected, so sort of one question, I guess. It's regarding OdysseyRe and the premium growth you saw there. So just wondering how much of OdysseyRe is comprised of the U.S. specialty lines vs. the reinsurance?

And then the second part to that is with respect to U.S. commercial lines, still seeing an oversupply situation in sort of the more plain-vanilla type insurance lines. I'm wondering if any of that excess supply is starting to flow over to the specialty lines and causing any pricing pressure there?

<A - V. Prem Watsa>: Yeah, good question, Paul. OdysseyRe, of course, is a mix of specialty lines through Hudson, and Hudson Insurance and our reinsurance business through OdysseyRe. OdysseyRe has a worldwide platform, as you know, the reinsurance platform, so there's many dials that they can move up and many dials that they can move down.

The one big change that's happening in the business right now, which you know of, is property cat prices are coming down and so our exposures are coming down and our premium levels are coming down in that area. But the other areas and the specialty lines, I think, I don't know, Dave, if you want to add, some of the prices – if I was to look at Crum, and prices are still going up 3.5%, 3% to 4%. Zenith, of course, is still having single-digit price increases and our Canadian companies are having 3% to 4% price increases.

The U.S. insurance for OdysseyRe, I think we figure approximately a third of our business, right?

<A - David Bonham>: Yes.

<A - V. Prem Watsa>: One-third of the business. Dave, do you want to add to that?

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<A - **David Bonham**>: Yeah. U.S. insurance about \$370mm out of the \$776mm in gross premiums written in the quarter and about \$550mm out of the \$1.4B of gross premiums written YTD.

<A - **V. Prem Watsa**>: Terrific. Thank you, Paul. If you have any more – if you need a little more clarification, please phone Dave or John Varnell. Rebecca, next question?

<Q - **Mark A. Dwelle**>: On the change in the accounting related to the crop business, can you give me an idea – I mean is that most of their crop book, or is that picking up about one additional month or a couple different – maybe just generally the overall size of the crop book?

<A - **V. Prem Watsa**>: Dave, you want to answer that?

<A - **David Bonham**>: Sure. Yeah. The figures that we disclosed in the interim would basically be their entire – virtually all of their spring planting crop premiums. So think of it as just bringing all of the – or the majority of the crop premiums that would have been there next quarter bringing it into Q2.

<A - **V. Prem Watsa**>: So instead of – Mark, instead of reporting that in Q3, they have enough systems now and enough confidence to put it in Q2. In the past we were putting it into Q3, now we're putting it in Q2. So we've explained that in the MD&A, but that's what it is. And it's pretty well all of the business, right, Dave?

<A - **David Bonham**>: Yeah, that's right.

<A - **V. Prem Watsa**>: Yeah.

<A - **David Bonham**>: Yeah.

<Q - **Mark A. Dwelle**>: Yeah. It was pretty well disclosed. I just – I wasn't sure whether that was kind of all of the book, most of the book, or just a fraction of the book. So that was what I was mainly after. The second question I had was related to the reserves. I mean we definitely have seen an improvement in reserve releases over the last several quarters, which is excellent news. I was curious what accident years most of these are coming from. Are they relatively older accident years or more recent ones, and if there's any particular lines of business that are accounting for most of the releases?

<A - **V. Prem Watsa**>: So, Mark, you know our policy is to have our current accident years always conservative, and so that the redundancies come in the future, of course. We don't want to ever be in that position where you go the opposite way. But when we look at it here, a lot of the redundancies are coming across property lines and the more recent property lines and generally across all our companies is what our Chief Actuary, our Peter Clarke says.

<Q - **Tom MacKinnon**>: Question with respect just to the cash, it looks like it's coming down a little bit over the last couple of quarters and I don't know if there's any read-through here or are you trying to put a little bit more cash to work. How should we be thinking about that? And then I have a follow-up.

<A - **V. Prem Watsa**>: So, Tom, I think of that cash as a resultant. So if we see something – publicly we've talked about Eurobank and we put money into this bank in Greece, which we liked. So we used cash for that. So if there's anything we like, we go on and buy it. So it's not like we want to keep 30% cash at all times. We are using the cash wherever the opportunities are and Eurobank is a classic example. But we don't find enough opportunities with significant downside protection to take advantage of the cash that we have.

So, our thinking is, it remains as cash. It's still very significant, I think, 25% to 30% and – but it then gives us the ability to react when we see something like that Eurobank to put it in. So we're continuing to look at opportunities all over the world, but only if it meets our long-term value-oriented criteria.

<Q - **Tom MacKinnon**>: How low do you think you'd want to take it? I assume you'd still want to keep at least \$1B in cash at the Holdco. But with \$7.5B in there, do you think you've got the opportunity to redeploy \$3B to \$4B to \$5B of that \$7.5B in cash?

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<A - V. Prem Watsa>: Yeah. No, I think that's right. That's right, Tom. We'll always keep \$1B, of course, in the holding company as we've said before. But in the insurance companies, we have lots of flexibility to add to opportunities.

Many people feel that because of our – and I highlighted that in my prepared comments that because of the fact that we've got cash, stocks are 85% hedged and we have few corporate bonds that we can't make any money. Well, that's just not right.

Under certain circumstances, we can make a ton of money. We've done it in the past. We can't tell you when we'll do it. When we can – we can't predict the quarter or the year that it'll happen, but the first two quarters are a great example of that. Under certain circumstances, we can make a lot of money for our shareholders.

And I remarked in my prepared comments that these interest rates in Europe are 200-year lows. That means the German 30-year, they call it bonds, long government bonds, are selling below 2%. You have to go back 200 years. So that's just telling you that these markets – that something is happening in the marketplace when you have 200-year lows, with no inflation to speak of. And the last number in Europe was 0.4% and in the U.S., it's running around 1%.

So with all of these QE1, QE2, QE3, inflation's very muted, very low. And the economy, by the way – and you saw the 4% in Q2, 1.7% of that was inventory buildup, so it's more like 2.3%. But if you look at the half, nominal GNP for the United States, nominal for H1, was 2.5%. Real GDP for H1 was 0.9%. So still very tepid in spite of all of these monetary easing.

And we have – we are of the opinion that you have to protect yourself from that. We never want to look for money and be in a position where we get blindsided. And we continue to be that way inclined. And I know in the last few years that it was not necessary. And perhaps, we'll muddle through and perhaps that won't be necessary. But we worry about this.

Perhaps one other point that I could make is in China, there's a few numbers suggesting there's a little bit of a pickup. I just thought – I've talked about it in our annual report, but Bill Gates made an interesting point. He's written a little article where he said China used more cement in the last three years than the U.S., United States, used in the entire 20th century, that's 100 years. China used more cement in the last three years than the United States used in the entire 20th century.

And then you'll be interested, anyone who looked at Japan in the 1990s will be interested in these two comments that an executive from one of China's largest real estate companies made in London. The first comment he said was the total land value in Beijing, that's only Beijing, is 62% of U.S. GDP. Total land value in Beijing is 62%. And the second comment he made was China's house production per 1,000 head of population reached 35. It reached 35 in 2011 and that figure is below 12 in most developed economies. Even when the housing market is hot, no country has had a figure of greater than 14. This is their house production per 1,000 head of population.

So this is staring us in the face, we think, and we just want to be careful and conservative. We're trying to build our company over 25, 30 years. We have to go through periods like this where you're not going to be – where you have to be careful. But in spite of that, we do have many things in our portfolio, including more recent purchases of common stock that can do well for our shareholders.

<Q - Tom MacKinnon>: Okay. And one quick follow-up, if I may.

<A - V. Prem Watsa>: Yeah. Sure, Tom.

<Q - Tom MacKinnon>: In your prepared remarks, you did talk about some pressure on investment income in the short-term. And I assume that's from the cost of the total return swaps, as well as the higher cash component. I did notice, though, q-over-q the total return swaps cost had declined substantially. Just thinking about how we should be looking at that going forward, or any reason why it may have fallen q-over-q? Is it kind of a lumpy cost, or what is that?

<A - V. Prem Watsa>: So, Tom, on the hedges, the total return swaps, I'm thinking of the stock hedges, right, Tom?

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 YTD Change(\$): +76.33
 YTD Change(%): +17.998

Bloomberg Estimates - EPS
 Current Quarter: 1.970
 Current Year: 38.720
 Bloomberg Estimates - Sales
 Current Quarter: 2069.500
 Current Year: 9419.500

<Q - Tom MacKinnon>: Yes.

<A - V. Prem Watsa>: Yeah. So, that's predominantly Russell 2000 and we haven't increased them. We've kept them flat. The nominal amounts are flat. Of course, they go up or down with the stock prices, but the nominal amounts are flat. And when we outperformed those indexes, then the hedge ratio drops. And of course, if we underperform, the hedge ratio will increase. And if we add or sell, then it'll affect the ratio, too, add or sell common shares. If we buy Eurobank, then that ratio will drop. And if we sell something, then that ratio will increase.

But, Dave, you want to add to that, Dave?

<A - David Bonham>: Yeah. That's right. So, the expense is going to be a function of the notional amount of the hedge that we have on. And just as an example, you recall we closed the S&P 500 hedge last year. By not having that hedge in this quarter on the quarter expense, that saved us about \$8mm in total return swap expense. So that accounts for a significant portion of the decrease in total return swap expense in the quarter, just that one.

<Q - Tom MacKinnon>: Yeah. Just looking quarter over quarter, though, the notional amount hadn't change, but the cost is running about half of what it was in Q1. Are these just – maybe you can follow up later on that, but that's...

<A - V. Prem Watsa>: Well, why don't we follow up on that with you, Tom.

<Q - Tom MacKinnon>: Yeah. Okay. Thank you.

<Q - Chris Lafayette>: Just two questions regarding the equity hedge. And I think that you alluded to the first question that I have with your comment on China and the cement demand there. How do you expect a slowdown in China in a likely scenario to sort of flow through and impact North America?

And second question is regarding your assumptions. It seems that a lot of them are macro-related. Is there a valuation component to the equity hedges as well? And if so, what are you looking at from valuation standpoint?

<A - V. Prem Watsa>: Yeah. That's a good question, Chris. On China, China is the second largest economy, right? So, you're talking \$8 trillion, \$9 trillion. The United States, \$16 trillion, \$17 trillion, Europe, about the same, and then you've got China. And so, any problem there will impact the world. You must remember – you know this, of course, that China consumes 40%, 50% of almost every commodity you can think of, copper, steel, iron ore. And so, a slowdown in China will impact the rest of the world quite significantly.

And in terms of valuation, your second question, the Russell 2000, any type of price earnings ratios that you would look at would suggest that they're very high levels. If you look at market cap to GDP ratios going back 100 years, you'll see them at high levels.

The Shiller ratios that we showed at our annual meeting are – and price earnings ratios, Shiller bases on a 10-year average, you'll see that that's on the high side. So many valuation parameters. But also, Chris, of course, earnings, earnings have been going up some. And in a tougher economic environment, earnings are likely to come down. The S&P is making a lot of money. There's lots of stock buybacks, so the EPS have been going up.

And so, there's not only the macro, but the valuation parameters. And then finally, we look for things on a bottoms-up basis and we're not finding too many things that – we think, that gives us downside protection and allows us make a return over time. So you put all of those reasons together, and we like competition.

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Company Ticker: FFH CN
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