Q4 2017 Earnings Call

Company Participants

- David Bonham, Vice President and Chief Financial Officer
- Derek Bulas, General Counsel
- Prem Watsa, Founder, Chairman and Chief Executive Officer

Other Participants

- Chris Lafayette, Analyst
- Junior Ross, Analyst
- Mark Dwelle, Analyst
- Mikel Abasolo, Analyst
- Paul Holden, Analyst
- Tom MacKinnon, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, and welcome to Fairfax's 2017 Year-end Results Conference Call. Your lines have been placed in a listen-only mode. After the presentation, we will conduct a question-and-answer session. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time.

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

Derek Bulas

Good morning and welcome to our call to discuss Fairfax's year-end 2017 results. This call may include forward-looking statements. Actual results may differ perhaps materially from those contained in such forward-looking statements as a result of a variety of uncertainties and risk factors. The most foreseeable of which are set out under Risk Factors in our Base Shelf Prospectus, which has been filed with Canadian Securities Regulators and is available on SEDAR.

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

Prem Watsa {BIO 1433188 <GO>}

Thank you, Derek. Good morning, ladies and gentlemen. Welcome to Fairfax's conference call on 2017 results. I'd plan to give you some of the highlights and then pass it on to Dave Bonham, our Chief Financial Officer for additional financial details.

Our results in 2017 were the best in our 32-year history. We had record net earnings of over 1.7 billion, resulting in a 24.7% increase in book value per share adjusted for the $10 per common share dividend. We also ended the year with 2.4 billion in cash and marketable securities at the holding company.

2017, however reminded us yet again that our industry is a risk business. In 2017, the insurance industry experienced some of the largest catastrophe losses in its history, as a result of hurricanes Harvey, Irma, Maria and the fires in California. Losses for the property and casualty insurance industry from catastrophes are estimated to be about $130 billion. Our company's share of the losses amounted to approximately 1.3 billion, well within our expectation that in a year of extreme catastrophe losses, we expect to breakeven and will not suffer any significant loss of capital.

Fortunately, the reduction of our shareholding in ICICI Lombard to about 10% resulted in cash and shares of ICICI Lombard of 1.4 billion and a net after tax gain of 930 million. And through our strategic alliance with Mitsui Sumitomo, it is resulted in a net after-tax gain of 1 billion on the sale of First Capital.

Fairfax had an excellent year in 2017 in spite of the catastrophe losses as I said with cash and marketable securities had record levels at the holding company. Our insurance companies had a combined ratio of 106.6%, which included 11.2 points of catastrophe losses from the hurricanes and California fires. Excluding these losses, our insurance companies had a combined ratio of 95.4% for the full year 2017.

OdysseyRe had an outstanding year with a combined ratio of 97.4%, not withstanding all of these historic catastrophe losses. For the year, Fairfax had an operating loss of 216 million resulting primarily from these hurricane losses. But it was more than offset by the $1 billion gain on the sale of First Capital and investment gains of 1.5 billion which arose primarily from the reduction of our holding in ICICI Lombard.

All in all, we had net earnings of 1.7 billion for the year ended December 31st, 2017. Our insurance and reinsurance businesses' net premium written was up 26% in 2017, primarily due to a modest growth of our insurance and reinsurance operations and the acquisitions of Allied World, Bryte Insurance, AIG operations in three Latin American countries and the branches in Central and Eastern Europe, and our insurance operations in Indonesia AMAG. Excluding these acquisitions, our net premiums written were up 8.3%.

Net investment gains of 1.5 billion for 2017 consisted of the following. And I would ask you to refer to page two of our press release. As I mentioned earlier, the table shows we realized gains of 930 million from the reduction of our shareholding in ICICI Lombard, net gains on other equity exposures of 649 million resulted from net gains of 1.1 billion on long equities and 418 million net loss on individual short positions.

We had realized gains of 201 million, that's actually sold on equities. We have mentioned in our annual meetings, annual reports and quarterly calls with IFRS accounting, the 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. Our individual short positions have been reduced to minimal levels at year-end and early in 2018.

As I said at our AGM, we continue to hold our CPI-linked derivatives with the notional value of 117 billion, with the remaining life of 4.6 years, which produced unrealized losses of 71 million in the year. If some of the unexpected risk come to pass, the CPI-linked derivatives could become very valuable. We will hold them for some time. They are on our books for only $40 million.

Now when you review our statements, please remember, and I mentioned this before, that we -- when we own more than 20% of a company, we equity account, and when we own above [ph] 50%, we consolidate. So that mark-to-market gains in these companies are not reflected in our results. The fair value of our investments in associates and certain consolidated non-insurance subsidiaries exceeds the carrying value by approximately 1.2 billion, an unrealized gain of about $44 per share, that's not on our balance sheet.

Now, as we've said in the past, we believe the new US administration's policies of reducing corporate income tax to 21%, rolling back regulation on business and significant possible infrastructure spending has the potential of boosting economic growth significantly in the United States. Already sentiment among small businesses has improved dramatically and animal spirits in the US are alive and well. When the US economy, which is approximately 20 trillion does well, much of the world does well too. To us this means our concerns on China or Europe precipitating a world-wide recession or potentially depression have been significantly reduced, but not eliminated. The fundamentals of the -- for the United States may well be excellent for the next few years.

Of course, the trade policies in the -- of the United States could precipitate a collapse in world trade. So these risks will continue to be very much monitored by us, but we continue to think the new administration's policies may make this a stock picker's market and one in which we have thrived over the past 32 years.

In the past few years, as you know, we have played defense. We are now playing offense, but always with the long-term value oriented investment philosophy. We will continue to pick good companies, which provides significant downside protection and potential appreciation over the long-term.

Recently, we invested 250 million in debt and warrants of Seaspan. We are very excited to be partners in Seaspan under David Sokol's leadership and Dennis Washington's sponsorship. David has one of the most outstanding records I've come across, as he built MidAmerican Energy from revenues of 116 million in 1991 to revenues of 11 billion in 2010, while net income increased from 27 million to 1.2 billion.

Dennis, of course, is one of North America's most successful entrepreneurs and his family a Seaspan's largest shareholder. This investment will add approximately 14 million in investment income annually, plus potential capital gain in the future. We continue to build our annual investment income with significant downside protection. It is now three years since we began Fairfax India, and it has done extremely well under Chandran Ratnaswami's leadership.Since inception, the company's book value per share is compounded at 15.5% per year, 13.5% after performance fees versus the Bombay Sensex Index of 5.9% over the same period. Fairfax Financial earned an incentive fee of $114 million or 7.7 million shares of Fairfax India. We hope Fairfax Africa, which began -- we just began in 2017, does as well.

Speaking of exceptional performance, Quest [ph], a subsidiary of our Thomas Cook has done really well since Thomas Cook acquired a 78% interest in Quest for 47 million in 2013. In 2017, Thomas Cook sold a 5.4% interest for cash proceeds of 97 million. The remaining 50% in Quest that Thomas Cook owns is now worth more than $1 billion.

In October, Colonnade acquired the business and renewal rights of the insurance operations of AIG in Romania. This is the last deal that closed as part of the AIG Eastern European acquisition. On December 21, 2017, the company increased its unsecured revolving credit facility with a syndicate of lenders to $2 billion from 1 billion and extended the expiry to December 21st, 2021 from May 11, '19. There were no amounts drawn on the company's credit facility as at December 31st, 2017.

On December 4th, we completed a public bond offering of CAD650 million principal amount of 4.25% unsecured senior notes due December 6th, 2027, a 10-year note. Proceeds from this offering were used to repay 125 million principal amount of purchase consideration payable upon maturity, the old Xerox note, and we redeemed our CAD388 million of our 2019 bonds, paying 7.5%. We are refinancing our maturities in the next few years at much lower rates.

The company's total debt to total capital decreased from 28.7% at the end of '16 to 25.8% at the end of '17. Our fixed charge coverage improved to six times in 2017 and our average coverage ratio for the five years ending 2017, excluding the effects of the company's hedge, it was about 5.4 times.

Cash and marketable securities in the holding company amounted to 2.4 billion. The company is extremely strong financially and reflecting these improvements DBRS upgraded us to BBB high. Subsequent to year-end, Fairfax entered into an agreement to sell its 51% ownership interest in Keg Restaurants to Cara for consideration of 76 million, comprised of cash of 8 million and 3.4 million shares of Cara subordinate voting shares.

David Aisenstat, our partner and the inspiring leader of Keg Restaurants, has also agreed to sell his ownership interest to Cara and we hope will work as magic on Cara's high-end restaurants. Fairfax also entered into an agreement with Carillion Canada to acquire the very profitable services business carried on by the company in Canada, relating to facility management of airports, commercial and retail properties, defense facilities, select healthcare facilities and on behalf of oil and gas and mining clients. It is expected the transaction will close in the first quarter of 2018. We are very pleased to have the fantastic operators of Carillion Canada of these service businesses and over 4,500 employees in Carillon Canada join our group.

The US enacted tax reform legislation late in 2017, the reduction in the corporate income tax from 35% to 21% resulted in a 326 million loss in 2017 from a big decrease in the company's net deferred tax asset. The repeal of this additional minimum tax regime and the mandatory redeemed repatriation of post 1986 undistributed foreign earnings and profits of a specified foreign corporation did not have a significant impact on the company. I'm sure Dave will have more information for you on that. The company does not expect any significant exposure to the minimum base erosion and anti-abuse tax on certain payments to foreign affiliates. Fairfax will benefit from the lower rates in the United States going forward.

As of December, 2017, we have 19 billion in cash and short-term investments in our portfolio, which is 49% of our total investment portfolio, that's including the holding company cash to take advantage of opportunities that come our way. Rising short-term rates will increase our investment income. During the fourth quarter, we bought back about 184,000 shares for 96 million and at approximately $522 per share. With the run rate of 15 billion in gross premium, a huge focus on underwriting discipline, a portfolio of approximately 40 billion and HWIC playing offense all grounded on a fair and friendly culture built over 32 years. We expect will generate a 15% return for our shareholders, for 2018, this means around 2 billion net income or $70 per share.

Now, I would like to turn it over to David Bonham, our Chief Financial Officer. So he can give you some more information on the underlying financials. Dave?

David Bonham {BIO 15243784 <GO>}

Thank you, Prem. So in the fourth quarter of 2017, Fairfax reported net earnings of $870 million or $30 per share on a fully diluted basis and that compared to the fourth quarter of 2016, when we reported a net loss of $702 million or $30.77 per share on a fully diluted basis. For the full year in 2017, Fairfax produced net earnings of 1.7 billion or almost $65 per diluted share and that was an improvement over 2016, when we reported our net loss of $513 million or $24.18 per diluted share.

Underwriting losses at our insurance and reinsurance operations in the fourth quarter and full year of 2017 were 24 million and 642 million and that would translate in the combined ratios of 101% and 107% and that compared with the underwriting profits of 197 million and 576 million, combined ratios of 90% and 93% in each of those respective periods in 2016. The decrease in underwriting profitability principally reflected the pre-tax impact of the third quarter hurricanes, Harvey, Irma and Maria, which totaled 906 million and the California wildfires, which totaled 185 million occurring in the fourth quarter.

CAT losses in the fourth quarter and full year of 2016 were 107 million and 353 million, respectively, about 5 combined ratio points in each of those periods and the full year effect was inclusive of the Fort McMurray wildfires and Hurricane Matthew.

Our combined ratios benefited from net favorable prior year reserve development in the fourth quarter and full year of 2017 of 193 million and 492 million and that translated into 7 and 5 combined ratio points in each of those respective periods. So, that was somewhat lower than the net favorable development that we had in the prior year of 257 million in the quarter, 655 million year-to-date, which represented 13 combined ratio points in the quarter, 9 in the year-to-date of 2016.

Turning to the net premiums written and adjusting for the recent acquisitions that Prem had mentioned. Net premiums written by our insurance and reinsurance operations increased by 14% in the fourth quarter, 8% in the full year, and that primarily reflected a growth at OdysseyRe, Northbridge, Brit and Crum & Forster.

Turning to our operating company results, starting with Northbridge. North Bridge's underwriting profit was $4 million in the fourth quarter, $9 million in the full year of 2017 that resulted in the combined ratio of about 99% in each of those respective periods. That compared to underwriting profit of 19 million and 46 million and combined ratios of 92% and 95% in those same periods in 2016.

The underwriting results in 2017 included $9 million of current period catastrophe losses, while current period catastrophe losses in 2016 were 29 million mostly related to the Fort McMurray wildfires. Northbridge's underwriting results in the fourth quarter and full year of 2017 included the benefit of net favorable prior year reserve development of $28 million and $94 million, representing 11 and 9 combined ratio points for those periods.

When we look in Canadian dollar terms, net premiums written by Northbridge in the fourth quarter and full year of 2017 increased by 12% and 11%, respectively. And that reflected increased renewal and new business writings combined with price increases across the Group. OdysseyRe reported underwriting profits of 124 million and 60 million and combined ratios of 80% and 97% in the fourth quarter and full year of 2017. And that was despite the current period catastrophe losses mostly related to Harvey, Irma, Maria, the California wildfires. Those total current period catastrophe losses at OdysseyRe amounted to 76 million in the quarter, 392 million year-to-date and translated into 17 -- 13 combined ratio points in the quarter, 17 on a year-to-date basis.

Odyssey's combined ratios in the fourth quarter and full year benefited from 178 million and 288 million of net favorable prior year reserve development, that's 29 combined ratio points and 12 combined ratio points, respectively, and that principally related to catastrophe and casualty loss reserves.

Odyssey wrote 618 million and 2.5 billion of net premiums in the fourth quarter and full year of 2017. Net premiums written increased 27% in the quarter, 19% in the full year and that was reflective of increases across most basically all of their divisions.

Crum & Forster produced underwriting profits of 15 million and 3 million in the fourth quarter and full year of 2017 with combined ratios of 97% and 99.8%, respectively, compared to underwriting profit of 9 million and 32 million and combined ratio points of

98% in each of those respective periods in 2016. Net prior year reserve development was not significant in the fourth quarters or full years of 2017 or 2016 at Crum & Forster.

Current period catastrophe losses of 42 million or 2.3 combined ratio points in 2017 mostly reflected the impact of the Hurricane Irma in the third quarter and that compared to current period catastrophe losses of 26 million or 1.5 combined ratio points in 2016. Crum & Forster's net premiums written increased by 5% and 3% in the fourth quarter and full year of 2017, respectively, primarily reflecting growth in their accident and health commercial transportation lines of business, partially offset by decreases in Excess & Surplus and marine lines of business.

Zenith National reported underwriting profits in the fourth quarter and full year of 25 million and 117 million, that translated into combined ratios of 88% and 86% and that's relative to underwriting profits in the same period last year of 50 million and 164 million. Those combined ratios in 2017, included seven combined ratio points in the quarter, nine combined ratio points year-to-date of net favorable reserve development that was slightly lower than the 12 and 13 combined ratio points that we had in the fourth quarter and full year 2016.

Zenith wrote a 161 million and 837 million of net premiums in the fourth quarter and full year of 2017, just slightly higher than the 148 million and 819 million that they wrote in the same respective periods last year. The increases in net premiums written in 2017 primarily reflected increases in exposure, partially offset by modest price decreases.

Turning to Brit. In the fourth quarter and full year of 2017, Brit produced an underwriting loss of 3 million and 202 million and represented combined ratios of 101% and 113%, that was comparable to underwriting profits last year of 3 million and 29 million and combined ratios of 99% and 98%. Current period catastrophe losses in the fourth quarter and full year of 2017 were 14 million and 259 million, respectively, that's 3 and 17 combined ratio points primarily comprised of Hurricanes Harvey, Irma, Maria, the California wildfires.

Net favorable prior year reserve development was $10 million in the full year of 2017 relative to $54 million in the full year 2016. Brit's net premium written increased 19% in the quarter, 3% for the full-year. The increase in the full year of 2017 primarily reflected increased contribution from certain initiatives that they've launched in prior years, it represented measure growth in their core lines of business, partially offset by reductions in other lines of business through active portfolio management, modest price decreases and the unfavorable impact of foreign currency translation, and also on the net premium written side, the impact of additional reinsurance purchased in 2017.

Allied World. We acquired Allied World on July 6th, 2017 and they contributed $992 million to net premiums written since its date of acquisition. Allied World's underwriting loss of 587 million and its combined ratio of 157 since July 6, 2017 were significantly impacted by $542 million current period catastrophe losses, about 53 points since the time we've owned them, principally related to Hurricanes Harvey, Irma, Maria and the wildfires in California.

Fairfax Asia's underwriting profits of 6 million 38 million, combined ratios of 92% and 88% in the fourth quarter and full year of 2017 were comparable to the same periods in 2016. And looking at the insurance and reinsurance segment, it produced underwriting losses of 25 million and 81 million, combined ratios of about 110% in both the fourth quarter and full year of 2017. And that compared to underwriting profits last year of 10 million in the quarter, 28 million year-to-date last year, combined ratios of 91% and 94%. The full year of 2017 underwriting results again were negatively impacted by current period catastrophe losses of 79 million or 10 combined ratio points.

Turning to run-off. Run-off reported operating losses of 90 million and 185 million in the fourth quarter and the full year of 2017 compared to operating losses of 121 million and 149 million in the same periods in 2016. The increase in the year-to-date operating loss reflected higher net adverse prior year reserve development that was primarily related to asbestos exposures, partially offset by net favorable development on workers' compensation loss reserves that they have, and finally, there is net favorable development in the European run-off segment upon settlement in the Lloyd's aviation market in connection with the World Trade Center losses.

On the consolidated interest and dividend income, it increased quarter-over-quarter from 136 million in the fourth quarter of 2016 to 172 million in the fourth quarter of 2017. Those increases primarily reflected the acquisition of Allied World and its contribution also reflected lower total returns swap expenses year-over-year and those benefits were essentially offset by lower interest income earned as a result of extensive sales of US Treasury and municipal bonds in late 2016 and in the first quarter of 2017.

Fairfax recorded an income tax expense of 366 million at a 30% effective tax rate in the fourth quarter of 2017 and then in the full year, it recorded an income tax provision of $408 million at a 20% effective tax rate. So if we look at the effective tax rate for the full year 2017 of 20%, it was lower than the Canadian statutory income tax rate of 26.5% for a couple of principal reasons. The $930 million gain on the sale of ICICI Lombard and the just over $1 billion gain on the sale of First Capital were not taxable in the jurisdictions in which we held them and those proceeds were able to be repatriated back to Canada, back to the holding company without incurring any additional taxes in Canada.

So partially offsetting those great benefits was the impact of the US enacted tax reform which added $326 million to our provision for income taxes, that's mainly the result of the reduction in the US corporate income tax rate from 35% to 21% and that caused us to revalue our deferred tax asset to the lower rate.

We ended the year with an investment portfolio inclusive of holding company cash, 39 billion compared to 28 million at the end of 2016. As at December 31, Allied World had added approximately 8 billion to the year-over-year increase. Our total debt to total capital ratio decreased to 25.8% at December 31, 2017 from 28.7% at December 31, 2016 that was reflective of an increase in our shareholders' equity and non-controlling interest, partially offset by higher long-term debt, mainly the long-term debt of Allied World that we consolidated.

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

Prem Watsa {BIO 1433188 <GO>}

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

Questions And Answers

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Mr. Tom MacKinnon from BMO Capital. You may now proceed.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah. Thanks very much. Good morning, everyone.

A - Prem Watsa {BIO 1433188 <GO>}

Hey, good morning , Tom.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Prem, I was wondering about, if I look at the cash position that's increased then the just over cash position has increased by $1 billion just quarter-over-quarter, and the total cash position is up to the 48% range. W hat's driving some of that? And again, maybe what are some of the plans with respect to that, especially given that you have issued 5 million in shares for the acquisition of Allied World?

A - Prem Watsa {BIO 1433188 <GO>}

Yeah. Tom as Dave said, the ICICI Lombard gain and the First Capital gain, the proceeds of ICICI Lombard were 1.4 billion, about 550 million something like that in ICICI Lombard stock, which is the 10%, and the First Capital was about 1.6 billion, 1.7 billion. So we had very little tax as Dave said. And so those were the two primary flows into the holding company, Tom. And we've just wanted to be very, very strong financially, always have. And so this provides a net 2.4 billion after we acquired -- after we digested the largest acquisition in our history, Allied World, and so this gives us tremendous flexibility.

Our focus is -- when you look at Fairfax today, Tom, and you've followed it for some time, we've got a run rate, as I said, about 15 billion in premium, $40 billion of investments, and our focus very simply is to make a return for our shareholders, which we said was 15%, and I've always said 15%. We are playing old friends now in the investment portfolios of 40 billion. So we're not looking for acquisitions and any additional money is very much focused on buying back our stock. We think our stock is attractive. We just told you we bought stock at $522 per share US. So we would look at buying back our stock.

We think that's the best thing we can do for our shareholders. Now that we've got a very a significant operation. You remember we come from 10 million in 1985, we've got $15 billion of premium worldwide very well diversified. And so that just allows us a lot of flexibility to make a return for our shareholders and we really don't need to buy another company.

Q - Tom MacKinnon {BIO 2430137 <GO>}

So when you talk about being on the offense in your investment portfolio and then very much focused on buying back stock, would it be safe to say that the excess cash position would be more than likely deployed in terms of buying back stock as opposed to beefing up your concentration in equities, because, I think you might be running around 25% or so?

A - Prem Watsa {BIO 1433188 <GO>}

Yeah, that's right. We've got about 25%. So we like this idea, like we mentioned about Seaspan and where we have a bond of 5.5% coupon and 250 million, it's 5 years, sometimes 7 years, and then we have a warrant which gives us the warrant -- the stock price was at 650 at the time. That's already above that.

And -- but it's a 7 year warrant. And companies Tom, in Canada, across the piece and in the United States want us as their partner and very selectively, particularly through Paul Rivett, our President, he has come to us, I mean you just examined what we did with Seaspan, with Chorus in Canada, with AGT in Canada, and so, Altius, smaller company in Canada. This examine those and you will see what we're doing is building a lot of investment income with capital gain possibilities that we get on the side, but the investment income of our company is going forward.

Now, interest rates we think will go up, Tom, and when those interest rate -- short-term rates have gone up significantly, another 100 basis points for the 2-year bond in the United States. So our investment income starts going up, because of that. But more importantly, we haven't reached for yield, you're going to find out a lot of insurance companies have reached for yield -- high-yield, junk bond debt, reached for yield in terms of all sorts of credit structures, and we think in a higher interest rate environment, some of those may be costly. We don't have that.

But we have the ability to deploy our capital to continue to raise investment income with the capital gain on the side. And we're very -- have -- Greece, we've put money into Greece, and we haven't made much money. We think Greece, this is the year for Greece. That is a good chance that Greece will do very well, that's coming out of its access to bond market, you've probably seen, they've done a $3 billion bond issue, 7 year bond issue, they'll do more. The key for them was to access the bond market, they've done that.

So we've got Eurobank, which we think is very well poised to do well in Greece. We've had it for three or four years. We've had BlackBerry, we think is doing extremely well. So when you put all of that investment income , plus our equity exposures is how we expect to make $2 billion or 15% after-tax return on our capital, which is, as you know, $12.5 billion, Tom.

So we're very much focused on using what we have all of our companies. I told you we've got disciplined underwriting operations, very, very disciplined and using them plus our investments to make that 15% return and let there be no doubt, we are on the offense, we're playing offense to buy -- to increase our investment income and to have capital gains on the side.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. And if I can squeeze in one more. How should we think about the impact of tax reform in terms of going forward. You might have a lower tax rate on some of your domestic US business, but then you've got all kinds of different, kind of structures associated with the tax. So I'm wondering is it going to be a material impact going forward?

A - David Bonham {BIO 15243784 <GO>}

Yeah, that's a great question, Tom. Obviously it's going to be a great benefit for Fairfax to be paying tax at the lower rate. So I think you can kind of look at when our annual report will come out, and so you can look at the historical, because that won't change too much. And you'll see where we are in our income in the tax note and you'll be able to, I think, come up with kind of a blended rate of what you should expect going forward. But it will be a good benefit.

Some of the other impacts Prem alluded to was the base erosion and anti-abuse tax that's something that is punitive to companies that are moving, making payments to offshore affiliates. So I think that's causing a lot of companies and the industry to kind of re-evaluate, some of the reinsurance structures, including us. So, as we mentioned in our press release, we don't think the impact of that is going to be overly significant after we take the few actions to do a little bit of a restructuring in the way that we managed our reinsurance structures.

A - Prem Watsa {BIO 1433188 <GO>}

Tom, we are worldwide, of course, but the United States is more than 60% of our operations. And so going from 35% to 21% has to be very significant, as Dave said. And yeah, so -- and we think it's, as I said earlier, we think it will be significant for the US economy. So that 21% by the way, Tom, you have to go back to the 30s. The United States has never had a 21% corporate income tax in the modern day. And after the second world war, they've never had it. You have to go back into the 30s before you get 21% tax. So it's a very significant move that has happened in the United States.

Q - Tom MacKinnon {BIO 2430137 <GO>}

So -- If I'm hearing correctly with 60% of the operations in the US you will benefit and the issue in terms of erosion in this benefit as a result of offshore affiliates et cetera is not material with respect to you guys.

A - Prem Watsa {BIO 1433188 <GO>}

Yeah. It's not significant as we said, yeah. We'll continue to examine. It just came out at year-end as you know. But our feeling is this is not significant.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay, thanks.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you, Tom. Next question, Aubrey.

Operator

Thank you. The next question comes from Mr. Paul Holden from CIBC. You may now proceed.

Q - Paul Holden {BIO 6328596 <GO>}

Hi, thank you. Good morning.

A - Prem Watsa {BIO 1433188 <GO>}

Good morning, Paul.

Q - Paul Holden {BIO 6328596 <GO>}

Just one question for you. So it was a very tough year for the industry, because of Cat losses. I know, rates are going up. Maybe you can talk a little bit about your rate renewal experience both on the reinsurance side and the US commercial side to start 2018.

A - Prem Watsa {BIO 1433188 <GO>}

Yeah. So, $130 billion of losses. The rates have gone up, but it's not -- hasn't gone up huge, Paul. So rates have gone up. And if you -- they're no longer going down, that's the important thing. It's no longer -- rates are not going down. If it's casualty premiums that's going up like 0% to 5% in that area, but if it's loss affected property business that's loss affected 20%, 25%, and maybe higher depending on where the business is, and if it's property business, that's not have had any losses to the Hurricanes, or California fires, about 10% in that area, but the prices are going up, they haven't gone up as they did after September 11th or after -- in 2005, Katrina, Rita, Wilma, they haven't gone up significantly, 25%, 30%, 40% all across the board, that hasn't happened, but they're not going down and they are going up.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. That's helpful. Thank you.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you, Paul.

Operator

Thank you. The next question comes from Mark Dwelle of RBC Capital Markets. You may go ahead.

Q - Mark Dwelle {BIO 4211726 <GO>}

Yes, good morning.

A - Prem Watsa {BIO 1433188 <GO>}

Good morning, Mark.

Q - Mark Dwelle {BIO 4211726 <GO>}

Prem, I want to start by asking for a little bit of clarification on something you've said a couple of times. You've mentioned $2 billion of earnings at a 15% ROE rate. I want to make sure you're not trying to give us guidance there. You're just doing a little bit of math for us --

A - Prem Watsa {BIO 1433188 <GO>}

No, never give you guidance, never give you guidance, Mark. No guidance at all. I'm just saying that if we have to make 15%, that's the amount of net income that we have to make. And I'm making the point that our company is focused on our existing business, worldwide business of $15 billion worldwide, each and every company is focused on making that 15%, sometimes more depending on where they're located.

And if you add all of that up, it will come to $2 billion, if we make that 15%. No guarantees at all that we make 15%. And we've never provided guidance, we never will. But I'm just telling you that if you add up all of that, Mark, then you will get 2 billion, like.

So we are very focused on building our investment income with $40 billion that investment income compounds very nicely. And so when you -- I gave you the Seaspan, I gave you Chorus, just look at those things, they have a very significant investment income, very little downside financially sound companies, with the kicker if I may add of a warrant or a stock position, that perhaps can increase significantly.

So that's our structure. And the most important thing, Mark, you followed us for some time, is that we are being -- people are coming to us, if they want capital for expansion, if they want a partner they are coming to us, both from the United States and Canada and also in Fairfax India and Fairfax Africa, we've got many opportunities that come our way. So we're feeling very good. And the key for us is to always have a very strong financial position.

Q - Mark Dwelle {BIO 4211726 <GO>}

That's entirely what I thought. I just wanted to make double sure of it and for anybody who hasn't listened to the call for 15 years to make sure they knew it too.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you for clarifying that.

Q - Mark Dwelle {BIO 4211726 <GO>}

A couple of quick questions for Dave. I noticed in the favorable or adverse development tables that Allied World had about $50 million reserve addition. Could you talk about that a little bit? Is that just sort of harmonizing reserving practices or was there something more detailed underlying that?

A - David Bonham {BIO 15243784 <GO>}

Yeah, that was just related to one specific claim at Allied World that developed unfavorably in the quarter. Other than that, there was nothing, there is no actions that we've had to take to harmonize Allied World's reserving, their practices were relatively consistent with ours.

Q - Mark Dwelle {BIO 4211726 <GO>}

Could you share what the kind of business that was in?

A - Prem Watsa {BIO 1433188 <GO>}

That was in across a couple of lines of business casualty.

Q - Mark Dwelle {BIO 4211726 <GO>}

Casualty.

A - Prem Watsa {BIO 1433188 <GO>}

So, Mark, you know that they have said they have reserve redundancies before we took them over. At the end of the year, we continue to think they are very well reserved. And this came up and they just decided to book it and we said, fine. Their cat losses were little higher than we'd expected. And as part of our company, they've -- their cat losses in the future would be significantly reduced. We just, we are very careful about Cat losses across our company. And so -- but we've got -- we are very happy with Scott Carmilani, we've got to know, Scott and the management team and we are very excited to have them as -- joined our Fairfax family.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. And one other quick numbers question, if I may. The incentive fee income that you earned related to Fairfax India and hopefully someday, Fairfax Africa. What line on the P&L does that show up in?

A - David Bonham {BIO 15243784 <GO>}

That amount actually eliminates fund consolidation, because it's -- we consolidate Fairfax India, so it comes out of Fairfax India, it goes into Fairfax, so there's no real increase or decrease in the resources of the consolidated entity, but it becomes the value that gets transferred from Fairfax India to the holding company.

A - Prem Watsa {BIO 1433188 <GO>}

Our equity interest in Fairfax India increases from 30% to approximately (Multiple Speakers) 33% [ph]. So as long as we continue to do well, we have the, -- if the Fairfax India stock price market selling above two times book value, then we can take cash. But our agreement is very simply that if it's below two times book, two times net asset value, we have to take shares, which we're very happy to take, and so that 114 million was in shares of Fairfax India. And it's a good thing for the shareholders as I mentioned to you after incentive fees 13.5% rate of return in the last three years compounded versus 5.96 for the Bombay Index.

So we did well for our shareholders. And Mark you followed this company, I must tell you that when you read Chandran's Annual Report of Fairfax India, Annual Report, you will find that there is a lot of intrinsic value that's been built in that company already. So it's only three years old. We are very excited about the possibilities of Fairfax India going forward.

Q - Mark Dwelle {BIO 4211726 <GO>}

Look forward to that. And thanks very much for the answers.

A - Prem Watsa {BIO 1433188 <GO>}

Yeah. Thank you, Mark. Next question, Aubrey.

Operator

Thank you. The next question comes from Mikel Abasolo of Solo Capital Management. Please proceed.

A - Prem Watsa {BIO 1433188 <GO>}

Good morning, Michael.

Q - Mikel Abasolo {BIO 3756596 <GO>}

Yes, good morning. Thank you for taking my call. This is a very quick one, because the other one I got has been thoroughly answered. And this is on your real estate investments, in particular on Kennedy Wilson and Grivalia, in Greece, I know that they're quite different and they live in different positions in their respective cycles, but if you could elaborate or comment on those two that will be very helpful? Thank you very much.

A - Prem Watsa {BIO 1433188 <GO>}

Yeah, when the real estate in Greece, particularly, Grivalia, you're talking about, there's a terrific CEO there, George Chryssikos and we were very happy to have gone above 50%

in that company. You have an exceptional manager, an exceptional person running it. To survive in the last five or six years in Greece was very tough. He survived. It was basically un-levered net cash and now he is reinvesting it very well, has been in the last few years.

And we're just very excited to participate with George in Grivalia. And if Greece improves, the Greece has come down from the top, something like 25% plus of the economy, and it's been -- it's come -- done that and stayed down for like eight, nine years. So it's been a depression that Greece has gone through. Unemployment's gone from 30% as you perhaps know down to -- it's improved, it's down to 20%.

And -- but when the economy moves up, it can move up significantly. We saw it in Ireland and then that will be good for the banks, good for Grivalia, good for Greece as an economy. And so we're very positive. Greece lost its access to the bond market. It's just got it -- got it little in last year, got it more recently this year. And once it gets regular access to the bond market, then we think that Greece will benefit significantly. It'll be out of the ECB program.

Long rates -- tenure rates in Greece went up above 20% few years ago and now they've gone through 10%, gone through 5%, and now they're just up 4%, they went down to 3.6% a few weeks ago. And that's still high compared to German rates, the spreads are still high. And because now there -- I think the risk of leaving that EU has been eliminated now. And so we're very positive on Grivalia and RealEstate.

Kennedy Wilson is another company that we have stock position and we've made a lot of investments in Dublin with them, really well, another gentleman by the name of Bill McMorrow has an outstanding track record, 30-year track record, by the way he will be speaking at the IV Business School, Ben Graham seminar, the day before our annual meeting, and I recommend you all come and hear him. But that's another company that we participate in the real estate area. Those are the main real estate investments we have.

Q - Mikel Abasolo {BIO 3756596 <GO>}

Thank you very much.

A - Prem Watsa {BIO 1433188 <GO>}

Yeah, thank you Mikel and, Aubrey, can we have the next question?

Operator

Sure our next question comes from private investor by the name of Junior Ross. Please proceed.

Q - Junior Ross

Hi, Prem. How is it going?

A - Prem Watsa {BIO 1433188 <GO>}

Hi, Junior, how are you doing?

Q - Junior Ross

Pretty good. Thanks. Quick question for you. Two questions. So what would contribute to a dividend increase on Fairfax Financial? And the second question is if you could touch on Bangalore Airport and how the expansion and stuff is going?

A - Prem Watsa {BIO 1433188 <GO>}

Okay. Good question, Junior. Dividends, we paid a $10 dividend. We've got -- our focus will be very much on our stock -- retirement of our stock, first. Our focus will also be on -- we've got investors with -- in Eurolife and in Brit, and in Allied, our partners there, over time we can take them, we can take it private 100% and that will be very much our focus. And it's only then that we look at dividend. It's highly unlikely that our dividend would increase. So this to let you know that we think $10 dividend works and that's where we would keep it. So just that I'm not misleading you.

And your question on Bangalore International Airport, there is a phenomenal investment. We own 48% of it now. And so basically, we have a controlling interest. We have a guy who runs it in -- just about 50 years old Hari Marar and just he has been there for 10, 11 years. He is running the airport. And we are very impressed with Hari. And it was designed for about 20 million passengers. Chandran was telling me recently, it's got 25 million They're on their expansion path to 65 million and then perhaps ultimately do 100 million. The 65 in the next three or four years, they've got a second terminal second runway and we've got about the better part of 500 acres that we can develop. So you'll see in Chandran's message in his annual report that comes out on Fairfax India, it's going to be a phenomenal investment for us and it's great for Bangalore as the third-largest city in that country. And so it will be -- it's a win-win for everyone. But we are very excited about the possibilities with Hari leading the charge.

Q - Junior Ross

Thanks.

A - Prem Watsa {BIO 1433188 <GO>}

So, thank you very much, Junior. Next question , Aubrey.

Operator

Sure. Next question comes from Chris Lafayette from The Clark Estates. Please proceed.

Q - Chris Lafayette

Hi, thanks for taking my call.

A - Prem Watsa {BIO 1433188 <GO>}

Hey, good morning Chris.

Q - Chris Lafayette

Good morning. In relation to your CPI-linked derivatives position. Could you talk about the prospect for inflation versus deflation particularly in relation to the US tax cuts being deficit financed?

A - Prem Watsa {BIO 1433188 <GO>}

Yeah, I know, Chris, I think inflation is very likely now as the economy we think the economy could grow significantly in the next few years. Interest rates could go up, because of inflation coming up, supply demand of money, Federal Reserve backing up from its Q3 program and so interest rates could go up significantly and the spreads could widen. The spreads as you know, high yield spreads are very -- at very minimum levels today, they could expand.

And we think it's expected that inflation will start going up as the United States as full employment. So its already at 4%. There is the prospect of a higher participation rate in the United States. As you know, it's 62%, perhaps likely go up from here as better jobs and more high paying jobs come along. But I think you're right, likely inflation will pickup.

The deflation bonds, there are risks, right, there are risks in terms of China something happening there, there is risk in terms of world trade, we think all well contained. But if the unexpected happens and we go into a recession, then of course those you might get deflation and you've got very little market value in it, there's $40 million in our books, so -- and it was 4.5 half years ago. So we'll continue to hold it insurance for the worst case.

Q - Chris Lafayette

Okay. And as one quick follow-up to that, it seems like those tax cuts were at least partially responsible for you changing to more offensive position in your investment portfolio. How do you think about the durability of those tax cuts, given that you could have a regime change, we have US mid-term elections coming up next year and then eventually a change?

A - Prem Watsa {BIO 1433188 <GO>}

Yeah. So you've got it for four years. I don't think that you could change it another three years rather, and it's not going to change before that. And then, of course if you have a new administration, it could change, but remember it doesn't take much of an increase in economic growth. The deficit is forecasted to be 1.5 billion 1.4 billion or trillion over 10 years, a 0.25% maybe 0.00375% [ph] or 0.5% or increase in economic growth and that deficit gets wiped out and you have a surplus. So you have all these assumptions that go forward. No one is expecting the economic growth in the United States to be, say, 3% for example. I don't know what it will be, but if it is 3%, you're not going to get the deficit I think it's pretty well gone. And so you know you've got these balancing factors and in three years, you'll know, I know -- and when Reagan put those tax decreases in place, the economy in the four years after he did that, I think went up at 4% a year and the tax revenues increased significantly. So not a long period of time that we have, but the incentives are very significant and when you drop the tax rate as you have and we'll just have to wait and see.

Q - Chris Lafayette

Great, thank you.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you, Chris. Last question Aubrey.

Operator

The next question comes from a private investor by the name of Sridip [ph] Banerjee. You may now proceed.

Q - Unidentified Participant

Good morning, Prem.

A - Prem Watsa {BIO 1433188 <GO>}

Hey, good morning, Sridip.

Q - Unidentified Participant

So, can you share any updates regarding NCML and Sanmar. I mean, I'm specifically asking about these two, because as a Fairfax India shareholder, very few information come out in press regarding these two privately held holdings, right. And second part of this we all know that WTI crude price is going up. Does that have any negative impact on Sanmar?

A - Prem Watsa {BIO 1433188 <GO>}

Yeah. So the two questions. This Fairfax India has got about six investments and two smaller ones, and two in the main public IIFL and Fairchem. (inaudible) . The others are private as you said. So Sanmar is doing very well, as you know. And Chandran is going to discuss it further, but their Egyptian expansion gets completed in June 2018 and it's going on time, on budget. And so that's going to be a very positive development. It's a very good company run by very good people. And NCML is doing extremely well, another private company in the green management business and we like it a lot.

And so those are two investments, Sridip, you mentioned in Fairfax India and they are all doing well. We've got another few more there that Chandran will discuss in more detail, but suffice to say that they're doing well. Fairfax India is building a lot of intrinsic value. IIFL just came out with this results anything you look at is growing at 30% a year. This is the big plus of India, there is -- with the business friendly government, the economy is moving very significantly. The price of all going to $60 that we don't think will affect it in any significant way this Sanmar you are talking about will not impact it significantly.

So we thank you for your question. And Aubrey, now I think the time is over. And we want to thank all of you for joining the call. We look forward to seeing you at our Annual Meeting on Thursday, April 26, where you will get a chance to meet our outstanding CEOs and partners in our group. So Aubrey, we thank you very much for arranging this call.

Operator

You're welcome. That concludes today's conference. Thank you all for joining. You may now disconnect.