Fairfax Financial Holdings Ltd to Acquire Allied World Assurance Company Holdings Ltd Conference Call

Company Participants

- Andy Barnard, President
- Derek Bulas, Legal Councel
- Paul Rivett, President
- Prem Watsa, Chairman and CEO
- Scott Carmilani, President, CEO and Chairman

Other Participants

- Amit Kumar, Analyst
- Bob Glasspiegel, Analyst
- Jay Gelb, Analyst
- Jeff Fenwick, Analyst
- Mark Dwelle, Analyst
- Paul Holden, Analyst
- Sachin Shah, Analyst
- Tom MacKinnon, Analyst

Presentation

Operator

Welcome and thank you for standing by.

(Operator Instructions)

Today's call is being recorded. If you have any objections, you may disconnect at this time. Mr. Prem Watsa is hosting the call with opening remarks from Mr. Derek Bulas. Thank you, you may begin.

Derek Bulas

Thank you. Good morning. Welcome to our call to discuss our acquisition offer for Allied World.

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 will 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. We welcome all of the Fairfax shareholders and AWAC shareholders to the call.

We have on this call Scott Carmilani, Chairman and CEO of Allied World; Andy Barnard, President of our Fairfax Insurance Group; Paul Rivett, President of Fairfax Financial holdings; and myself.

Let me just begin by saying we are very excited about this transaction. This is transformative for Fairfax and will be the largest and the best company Fairfax has purchased over 31 years. We think it will be very attractive, long term, for our shareholders as well as AWAC shareholders that we hope will become our new shareholders.

Let me be very clear. We are buying AWAC because of Scott Carmilani and his track record with his management team. It is an outstanding track record created by Scott and his team since they began 15 years ago. The average combined ratio since inception is 90%, with reserve redundancies every year for a cumulative $2.2 billion in reserve redundancies. Since going public in 2006, they have distributed to their shareholders, in stock buybacks and dividends, a cumulative $3.3 billion. Their average return on shareholders equity since inception is 12%.

If you combine our average return of 7% in the past 10 years, with their underwriting profit, their return on shareholders equity goes up to approximately 20%. That is simply why we are buying AWAC. AWAC will be run by Scott on a decentralized basis with no cost synergies. I emphasize no cost synergies. No change in operations other than what Scott sees fit to do. AWAC will continue to be built under Scott's vision.

We are offering to purchase the company for $54 per share, a premium of approximately 18% of the current share price. And a price to book value of approximately 1.34 times. Total proceeds for the acquisition will be approximately $4.9 billion. And will be funded through a pre-acquisition dividend by Allied World of $5 per share or approximately $456 million; cash proceeds by Fairfax of $5 per share or $436 million; a stock exchange of Fairfax shares for Allied World shares for $14 per share, or $1.3 billion at a fixed price of $4.61 per Fairfax share; and a stock exchange of Fairfax shares for Allied World shares at a fixed price of US $4.61 per share or, importantly, cash proceeds from Fairfax of $30 per share, $2.7 billion; and our option funded through a Fairfax share issue or a third party equity similar to the partnerships we have done in the past with OMERS, on Brit. And Eurolife. Much more on this from Paul Rivett later on in the presentation.

The entire purchase price is essentially fully funded and funded through additional equity. And will result in lower leverage and higher (inaudible) coverage. Our capital position will remain very strong post acquisition. And we will continue to maintain $1 billion of cash and marketable securities at the holding company.

Now let me tell you why this is such a compelling strategic acquisition for Fairfax. Let's go to the presentation that we gave for you and it's in the website, Fairfax website. And I want to go to Page 2. We'll come back to Page one later on but let's go to Page 2.

So Page two shows you very clearly why this is a compelling strategic acquisition. It's all there for you. I'm just going to highlight some of the big points. The key from us is first point, two great underwriting companies that are brought together with strong franchises. And Andy and Scott will talk a little more about this.

Allied World brings a world class specialty insurance and reinsurance franchise, we'll talk a little bit more about that a little later on. We add an investment portfolio of approximately $9.4 billion under Fairfax's proven investment expertise, I'll highlight that a little, as the balance sheet and capital position of Allied World complements the financial strength of Fairfax. And we think it's an attractive outcome for Fairfax as well as for AWAC shareholders.

Let me just add here that Allied World generates a substantial amount of premium with large US customers. We believe that the recent election of President-elect Trump and the Republican control over both the US House and Senate has a strong potential to make the business climate for growth in the United States great again relative to the rest of the world.

If President-elect Trump can move forward policies to reduce access, reduce burdensome bureaucracy and regulation. And incentivize much needed infrastructure spending, we believe the United States may see significant growth in gross domestic product. And our businesses in the United States including Allied World will benefit from any such positive economic development.

So now particularly for AWAC shareholders a little something on Fairfax. It's right there, won't highlight it. Fairfax has always been run for shareholders providing outstanding service to our customers, looking after our employees, making a return for shareholders which we over the long term like to look at 15%. And then reinvesting in the communities at 1% to 2% of pretax profits.

The highlights for you on Page 3, very significantly all our companies, Andy will emphasize this more, they run on a decentralized basis, focused on underwriting profit and reserve redundancies. The combination of underwriting profit plus a focus on total investment return allows us to make 15% return over time. And I'll talk about that in the next page

So if you go on to Page four now, here is our history of value creation. We started as a very small company. You can see $12 (million) in revenue in 1985. One company in Canada. $17 million of gross premium, this is in 1985, investment portfolio $24 million, portfolio per share $4.78, common shareholders equity $8 million. And book value per share of $1.52. So the book value per share was $1.52.

And you can see the growth over the time period in 1995, 2005, 2015. And 2016. Our compound growth rates have been very significant. They haven't been in a straight line. We look at it long term. But we've compounded book value per share which is our primary focus of 20% a year.

And because we've become much larger now, our objective is to compound book value per share of at about 15%. Not every quarter, not every year. But over time. And we think we have every ability to do that.

Now let me pass it on to Andy to tell you a little more about our Fairfax operations. Andy?

Andy Barnard {BIO 4015704 <GO>}

Thank you, Prem. So to just sort of reset the profile of Fairfax's insurance businesses prior to the Allied acquisition, we show here on slide five our six major largest operating groups. OdysseyRe, predominantly a reinsurer, about 55% of its business currently in the reinsurance segment, 45% in specialty insurance. Crum & Forster is very much a specialty company, very strong presence in the accident and health world, significant portfolios in the E&S segment.

Brit, one of the largest players in the Lloyd's market. Brit is predominantly an insurance company. 75% or so of its volume is in the insurance segment, 25% in the reinsurance segment. Northbridge is a middle market, industry focused commercial writer in Canada, one of the largest players in the Canadian commercial market. TheZenith is our workers compensation specialist based out in California, has a superb track record we believe is second to none in terms of its expertise in the workers compensation space.

Then Fairfax Asia, which consists of a collection of as you can see here nine different companies, several of which are minority positions that we hold in companies. The flagship in Fairfax Asia is First Capital. And it has enjoyed a enormously successful track record over its tenure with Fairfax.

Then we have a collection of smaller companies that we highlight over on the right. The point is in Fairfax all of these companies are run by their CEOs. They all enjoy the autonomy that comes with our decentralized operating philosophy. We have a fantastic group of CEOs running all of these companies. And you can see if we flip to the next slide, the results that come from that system of operating.

So for our major companies here you can see their combined ratios over the last two and three quarters years. You'll note that all of them are operating in a zone of underwriting profitability. We've been delighted with our results, combined ratios running around 90% in the aggregate across all of these companies. You can again get a picture of their size looking at the gross premiums that we show over on the right.

So we have been enjoying substantial underwriting profitability from our existing companies. And of course we're very attracted to Allied World under Scott's leadership because of the underwriting performance that his company has put up over the 15 years of its existence.

So now I'll turn it back to Prem to talk a little bit about the investment portfolio.

Prem Watsa {BIO 1433188 <GO>}

Thank you, Andy. Just to add to what Andy said. And he talked about combined ratios, of course as the annual reports have shown, we've had reserve redundancies on pretty well every company. And it's a policy of ours to have reserve redundancies and we've had that for a long period of time, just like Scott has.

And because of our decentralized operations, we have had many presidents who've retired in the past. But no president has ever left our company for another job in the industry. They retired and that's happened over the years, we've been in business now for 31 years but we've never lost a president.

If I can go on to page 7, our track record of investing. So we've invested now for 40 years, in Fairfax we've invested for the past 31 years. You can see this is a total rate of return on our investment portfolios. That means interest and dividend income. And change in unrealized and realized gains.

The average return over time over that time period was 8.6%. In the last 10 years the rate is around 7% as I said earlier. Allied World's rate of return is in the 3.9% area. So of course the combination of our investment expertise with the demonstrated expertise that Scott and his team have shown in underwriting gives us a terrific rate of return going forward.

If you go on to page 8, you'll see the creation of a leading globally diversified property casualty insurer when you combine Allied with Fairfax. I'll just highlight for you the metrics on the left-hand side, premiums, pretax operating income, cash and invested assets, any one of those has gone by about a third, has gone up by about a third.

In terms of North American insurers you can see we go from about $11 billion market cap to about number seven in terms of size. And in terms of E&S writers, we are among the top five in the United States. So very significant market position for the combination. And to know a little more about Allied, why don't I pass it on to Scott? Scott.

Scott Carmilani {BIO 2076985 <GO>}

Thank you, Prem. Let me also add my own welcome to all of you on this morning's call. This is a tremendous opportunity for all of our shareholders and our company.

Our shareholders are being rewarded for the strong performance of Allied World over the past decade since going public. It does represent an 18% premium to Allied World's closing stock price as of last Friday. This transaction provides significant value to the Allied World shareholders through the ongoing ownership of Fairfax stock.

On page nine of the presentation you can see the Allied World company profile. This acquisition creates a combined platform well positioned for continued success in the future. Allied World's business is highly complementary to the Fairfax franchises. And truly creates a world class specialty insurance and reinsurance franchise, with leading positions in North America and Bermuda. And having a global territorial reach as Andy pointed out and Prem in his remarks earlier.

We'll have enhanced size and capabilities in an industry in which scale increasingly confers significant competitive advantage. Allied World shareholders will benefit from an enhanced business and earnings profile through the access to diversified products and offerings throughout the Fairfax franchises where we complement each other in many areas and many business lines. Combined capacity, reinsurance opportunities. And global possibilities are endless.

If you look at page 9, you'll see how the company's profile has been put together. We operate in three particular segments: North American insurance, global markets insurance. And reinsurance, North American insurance comprising the biggest one.

Flipping to page 10, you can see the breakdown of each of our segments and the product lines that are in each one of them. I'm not going to go through each one but it's there right in front of you. It's very diversified and very well structured. It's almost $2 billion now coming from our North American insurance platform. And about $700 million now in the reinsurance platform year-to-date in 2016.

Page 11 shows the track record that Prem had highlighted and Andy pointed out in his remarks. And the combined ratio since going public in 2006, the consistency of which we've been able to achieve that both of an underwriting and development standpoint, across the bottom of that page you'll see that the cumulative number is just under $2 billion of net reserve redundancy that we've realized since 2006.

This does not count the total redundancy or total giveback to shareholders, as Prem had mentioned. It's much closer to $3 billion than $2 billion for the entire history of our company. I thought it'd be important to show that as we go further. I'm going to turn it back to Andy as he talks about the combined product mix.

Andy Barnard {BIO 4015704 <GO>}

So on slide 12, we're giving you a picture of what the combined entities will look like if we consider the entirety of the Fairfax portfolio. You will see if you look up around the right that there's a slight increase in the casualty, the liability element in the Fairfax portfolio. Then also, a bit more significantly, an increase in our activity in North America in the US in particular.

That speaks to the comments Prem made about the opportunities that we anticipate in the American market as the anticipated growth in the economy takes root. And the opportunities for smart underwriters to benefit from those increasing opportunities. And so this is one of the factors that makes us very excited about adding Scott and his group to the Fairfax family.

On the next slide on page 13, as a matter of interest we've just given you the various outposts that we have in Fairfax presently, represented on the left. And then the offices of Allied World on the right. We note that Allied has an office in Australia, very strong presence in Bermuda, Switzerland. These are all additive to what we already have in the Fairfax group. And are going to further enhance our global footprint and access to business in the foreign markets.

And so I will hand it back to Prem to talk about the next several slides.

Prem Watsa {BIO 1433188 <GO>}

Thank you, Andy. This next slide on page 14 just shows the scope of our operations in terms of when you combine the two, gross premium, net premiums, combined ratios, net income. And book value per share. You can see all of that there, all very significant.

I'll spend a couple minutes on our strong capitalization profile which is page 15. You can see that total debt, common shareholders equity goes up to $13.5 billion, approximately $13.5 billion. You can see that. Then you can see the total capitalization. Total debt to total capitalization is about, when you put the two together, 19.4%. And the premiums to equity. So we've got great opportunity, very underlevered. And I want to remind you that the Fairfax has a policy of keeping $1 billion of cash and marketable securities in the holding company. And in the future we expect to raise that up even more as we become a larger company.

If you move on to the investment portfolio which is page 16, I just wanted to make a few comments for you. And we've done it for Fairfax shareholders in the past. You can see the size of the investment portfolio goes from about $30 billion, which is where we are today, to about almost $40 billion.

In the past few years, we've been worried about the United States economy and other parts of the world. We've talked about it in our Annual Report. But when the biggest economy in the world, plus/minus $20 trillion which is the United States, is on its way up, which we think as I said earlier because of President-elect Trump's policies, very pro-business, corporate tax cut, infrastructure spending, really smart people in charge, we just think the downside is significantly reduced. And we think in a market like that in the United States and perhaps elsewhere, it becomes a value oriented stock pickers market.

This is a market we've excelled in for 40 years. We've got a team that's done really well in that market. And we expect to do very well again in the future. And basically in the last few years we played defense, we're expecting to play offense. But always with a value-oriented approach to our business.

In the bond portfolios we expect to have a short duration, that's where we are today, three years or less. And so we think the bond rates, long bond rates particularly, have bottomed out and are likely to go up as they have since the election. And so we don't expect to have a long bond portfolio, longer, just a two or three year duration. And the ability to invest for the long term and do well as we have in the past.

So we have some deflation swaps, I just wanted to emphasize particularly to our shareholders that they're written down, they've got six years to go. We have no intention of selling them, that's insurance for us and we continue to hold them. So with that, let me pass it on to Paul Rivett, who will talk about the terms of the transaction.

Paul Rivett {BIO 15243791 <GO>}

Thank you, Prem. To reiterate the deal terms, the offer price of US $54 per share or approximately US $4.9 billion in aggregate consists of $5 per share and a pre-closing cash dividend from Allied World; $5 per share in cash; $14 per share in Fairfax shares at a fixed exchange ratio based on the US closing price on Friday of $460.65; and a $30 per share in Fairfax shares at a floating exchange ratio between US $435.65 and $485.65 per Fairfax share.

The key for Fairfax on the last component of the offering price of US $30 per share is that Fairfax has the sole option to pay for the $30 in cash, instead of the floating exchange ratio on Fairfax shares. The option runs for 75 days from today. And we are in active discussions with several parties to provide third party equity funding, much like we've used in Brit and Eurolife that is non-dilutive to Fairfax shareholders.

To reiterate, of the total $4.9 billion purchase price, Fairfax has the sole option to replace $2.7 billion of the stock consideration with cash instead, thereby potentially reducing the dilution to Fairfax shareholders from 27% to 10%. The acquisition is subject to shareholder and regulatory approval. But is expected to close in the first half of 2017.

Now I will turn the call back over to Prem.

Prem Watsa {BIO 1433188 <GO>}

Thank you, Paul. So the last slide, page 17, just summarizes what all of us have been talking about. It's a winning combination. You can see a leading franchise in global specialty insurance with complementary business profiles.

I wanted to emphasize disciplined underwriting combined with successful investing is what this group is all about. We have a longstanding underwriting track record for both companies, plus an investment track record on a total return basis.

And finally we think a very big strength, as Andy has emphasized of our Company, is the decentralized operating structure with very seasoned management. And Scott and his team will join us and Scott's going to run, as I said earlier, Allied World with total freedom to see how he can build a company, of course working with all our other operations.

So with that, Leon, I wanted to open it up for questions and we'll be very happy to answer any and every question you'll have. So Leon?

Questions And Answers

Operator

Thank you.

(Operator Instructions)

Amit Kumar, Macquarie.

Q - Amit Kumar {BIO 15025799 <GO>}

Thanks and good morning. And Scott, congrats on the deal. Obviously you've done a fantastic job with the franchise. Two quick questions, the first one is for Scott and the second one for Prem.

If you look at the price of the deal, the price seems to be comparable to some of the other deals. However, if you look at some of the other specialty deals, the take-out price just seems about okay. My question is: What should give investors the confidence that this is the best price for AWH franchise? And I'm curious, did your ability to continue to be employed, did that play a role in extracting the best price for the shareholders?

A - Scott Carmilani {BIO 2076985 <GO>}

Well Amit, I'll answer that in reverse. No. It did not, for myself. As any CEO should do, the shareholders come first, our employees and the company come second. And the CEO comes third. It just so happens that we were quite lucky and pleased that Fairfax has recognized that strength of the franchise in total. And would like to keep it intact and run it decentralized.

To continue to answer your question, of course we've fully evaluated the available price. It's been long negotiated and hard fought. And that will all be disclosed in the proxy and deal terms as that comes out.

Q - Amit Kumar {BIO 15025799 <GO>}

And when is that coming out?

A - Scott Carmilani {BIO 2076985 <GO>}

Shortly.

A - Derek Bulas

The merger agreement should be out today. The proxy won't be out for some time.

A - Scott Carmilani {BIO 2076985 <GO>}

Probably the end of the day today or tonight on the merger agreement. And the proxy more likely in a few weeks time.

Q - Amit Kumar {BIO 15025799 <GO>}

Got it. The second question. And I'll requeue after this because I assume there's a lot of questions for Prem. Can you talk about the tax discussion and the border adjustment and the Neal Bill? How was all of that factored in, considering that all of those are in play with the Trump Presidency? Thanks.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you, Amit. In terms of the border adjustment and the Bermuda question, we considered all of that.

The big plus with the Trump's administration is the fact that the corporate tax rate, one of the key planks of their administration is to reduce it to 15%. And so once you do that, we think those differences will be insignificant. And then in terms of these border adjustments and that type of thing. But we are monitoring that closely.

It's a level playing field; whatever the rules are will apply to all of us. And so we took that into account and felt that even after that, the transaction was fine. So Amit, thank you very much. Leon, next question.

Operator

Sachin Shah, Albert Fried.

Q - Sachin Shah {BIO 15433972 <GO>}

Good morning, congratulations on the deal. A few questions on your slide, I think it's number one. Basically it says that you have an option to replace the $30 value with floating. What is going to be determined for that to occur?

The second question is: Can you go over the regulatory approvals that are needed? Thank you.

A - Prem Watsa {BIO 1433188 <GO>}

Yes. Thank you, Sachin. Yes. The $30, as Paul had said, we are looking, as he said, discussions with several parties to provide third-party equity funding. As I said to you earlier on the call, it's going to be fully funded with equity. But the $30 does give us the option of providing funding like we did with Brit and like we did with Eurolife. And that's a very significant option. We have people who are very interested in becoming our partners. And I think, Paul, we have about 75 days to make that decision?

A - Paul Rivett {BIO 15243791 <GO>}

That's exactly right. Then I'd add with respect to regulatory approval, obviously we need securities regulatory approval, the insurance regulatory approval. And competition approval. So that's what we are looking for. And we'll dive into all of those right away.

Q - Sachin Shah {BIO 15433972 <GO>}

So just to clarify, do you have a list maybe off chance of what regulatory approvals? And also just wanted to understand the collar is, the Canadian dollar conversion to US dollar, is there a mechanism to understand that more clearly?

A - Prem Watsa {BIO 1433188 <GO>}

Yes, I think that's very simply -- Paul, you want to add to that?

A - Paul Rivett {BIO 15243791 <GO>}

Yes. All of the details will be in the merger agreement. So we'll look to that; as was said, that'll be out shortly. And with respect to the collar, it's again in the merger agreement. But basically subject to a 20-day VWAP prior to the close. And that's exchanging, looking at the exchange rate on those 20 days as well. So that's all going to be in the merger agreement though. So you can get the details there.

Q - Sachin Shah {BIO 15433972 <GO>}

Okay, perfect, congratulations again, guys.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you very much, Sachin. Leon, can we have the next question?

Operator

Jay Gelb, Barclays.

Q - Jay Gelb {BIO 21247396 <GO>}

Thanks very much. Couple questions, first for Scott: I understand it'll be in the proxy. But can you give us some more insight in terms of the process that the Allied World Board went through in terms of the decision to sell the company. And why it chose Fairfax over other potential partners?

A - Scott Carmilani {BIO 2076985 <GO>}

Well Jay, as you may know -- thanks for the question -- we have a very strong, independent, governance-oriented Board who went through a very long and arduous number of meetings, close to 12. We had started these discussions back in September. And we went through many iterations between then and now. And of course, that'll all be articulated and highlighted in the proxy as well, almost too long to go through in a call like this.

Q - Jay Gelb {BIO 21247396 <GO>}

Was the deal shopped for best price after Fairfax, after the Fairfax agreement came to be concluded?

A - Scott Carmilani {BIO 2076985 <GO>}

I would say it was vetted. And there will be a go-shop provision articulated in the merger agreement that'll come out tonight.

Q - Jay Gelb {BIO 21247396 <GO>}

All right. Thanks, we'll make sure and look for that. I think there'll be a lot of attention paid to the mix in terms of cash versus stock. Many other commercial insurance or reinsurance deals have been much more cash than stock. Why hold back on the cash component, given I think it'll move in that direction very quickly?

A - Prem Watsa {BIO 1433188 <GO>}

Yes. When will we --?

A - Paul Rivett {BIO 15243791 <GO>}

I think the key for us is we want to make sure it was fully funded. So doing it from an equity perspective ensures that we meet a rating agency requirement. So we wanted to be sure it was fully funded with equity. But that said, we want to also do the best we can for our Fairfax shareholders. So that is why we will be looking for these third-party equity providers like we did find for Brit and Eurolife to reduce the dilution to our shareholders.

Q - Jay Gelb {BIO 21247396 <GO>}

Final question is: Is there a financing contingency in place, or is there no financing contingency?

A - Prem Watsa {BIO 1433188 <GO>}

No. There's no financing contingency, Jay. And we just think, from our standpoint, any AWAC shareholder getting Fairfax shares as our record demonstrates will have a good return. But as Paul said, there are many third-party shareholders looking to finance that $30 a share, some or all of it. And we are looking at working that through in the next 75 days.

Q - Jay Gelb {BIO 21247396 <GO>}

Thank you, good luck on the deal. And I'll requeue.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you very much. Leon, next question, please.

Operator

Jeff Fenwick, Cormark Securities.

Q - Jeff Fenwick {BIO 15350794 <GO>}

Hello. Good morning, everybody. Just one follow-up again on this $30 component here and the third-party funding: Is there a maximum amount that you'd be willing to let a third party finance this deal? And I believe you did 30% with OMERS. And is there a maximum you go to on this?

A - Paul Rivett {BIO 15243791 <GO>}

Yes. So we will look opportunistically. We are speaking to several parties. We do have the potential to go up to the full $30. But we will only do a transaction that ensures that we, Fairfax, have control. And that's been a tenet of both what we've done for Brit deals and the Eurolife deal. So that will be the gating item for us.

Q - Jeff Fenwick {BIO 15350794 <GO>}

Okay. And just going through the deck here, I don't know Allied World nearly as well as you guys. But I just noticed they do have a very good track record on favorable development, although quite a big step down I guess over the last couple of years. So just maybe can you talk a little bit about the process of reviewing the reserves there and your feeling going forward?

A - Prem Watsa {BIO 1433188 <GO>}

I can just say that publicly in their statements, Allied World has said that their reserves have a redundancy of approximately 3.2%, I think it was. But Scott, do you want to add to that?

A - Scott Carmilani {BIO 2076985 <GO>}

We do both internal and external review of our reserves. We've maintained a consistent level of redundancy from the rating agencies and our external opinions around the 3%, 4% range. The recent reduction in redundancy that you're pointing to were pointing to years of 2012 and 2013 where we had some minor hiccups around a couple lines of business and we put some reserves up to ensure that we would adequately be prepared for those in the future.

Q - Jeff Fenwick {BIO 15350794 <GO>}

Okay. Thank you, I'll requeue.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you, Jeff. Leon, next question, please?

Operator

Bob Glasspiegel, Janney.

Q - Bob Glasspiegel {BIO 1764160 <GO>}

Good morning, Prem and Scott. And congratulations. Quick question on tax structure: Prem, in the press release you mentioned there may be some tax synergies. How much leverage in the tax rate could you theoretically get?

A - Prem Watsa {BIO 1433188 <GO>}

Yes. There's the possibility that, over time, our tax rates could come down. But offsetting that, of course, Bob, as you know is this 15% corporate tax rate in the United States that's being planned. We'll have to wait and see what comes out after President-elect Trump gets into place. So we think that might benefit all companies if that comes through. But we do see some advantages from a tax standpoint.

A - Scott Carmilani {BIO 2076985 <GO>}

And Bob, I would add to that, Allied World's always enjoyed from a structural standpoint a unique tax structure with both a Bermuda operating and holding company, a Swiss operating and holding company, with an efficient tax structure that can always be used depending on how the border adjustments come out.

Q - Bob Glasspiegel {BIO 1764160 <GO>}

Got it. One quick follow-up: Allied World's been creative in their investment strategy, with total return investor like you and they've invested in start-up ventures and given them assets. Is this something that you agree with and would add to, or could you see those assets coming back over time?

A - Prem Watsa {BIO 1433188 <GO>}

So Bob, the investment is one area that's centralized in Fairfax. But having said that, we'll work with Scott and work on arrangements that make sense for both Scott and for Allied and for Fairfax.

Q - Bob Glasspiegel {BIO 1764160 <GO>}

Last question: How long have you locked Scott up for? I know you said you haven't lost anyone.

A - Prem Watsa {BIO 1433188 <GO>}

Sorry, I missed that.

Q - Bob Glasspiegel {BIO 1764160 <GO>}

How long do you plan to lock Scott up for, as far as a contract?

A - Prem Watsa {BIO 1433188 <GO>}

(Laughter) hey, forever. Our Presidents run our companies for the longest time. And Scott's 52. And we are hoping he's there for the next 20 years.

Q - Bob Glasspiegel {BIO 1764160 <GO>}

But no contract?

A - Prem Watsa {BIO 1433188 <GO>}

No, no, no contract, no contract. None of our companies have contracts, Bob. And as I prefaced my comments, we haven't had anyone leave. And one of the reasons is we have 35 people in our head office. And we've got 22,000 people in our companies. And we really do believe in a decentralized operation. And that's been a major plus for our Company over the years.

Q - Bob Glasspiegel {BIO 1764160 <GO>}

I've known you both for a long time. So I could see you getting along well. Thanks.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you very much, Bob. Leon, next question, please.

Operator

Paul Holden, CIBC.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you. Good morning. Couple questions, first one related to the investment portfolio. And Prem, as you highlighted in your opening remarks, a number of changes taking place there in terms of your asset weightings. So two questions there, one is: Is there anything in the current allocation at Allied that's kind of different than Fairfax. But maybe you'd like to keep? Then two, what's the approximate time, post close, to centralize the two portfolios?

A - Prem Watsa {BIO 1433188 <GO>}

Yes, Paul. So we've done these things before with Brit and with Eurolife and with all of the companies that we worked with. And basically it's working with management and, over time, making the changes. And so we'll work with Scott and his investment team. And work something that makes sense for them and makes sense for us.

A - Scott Carmilani {BIO 2076985 <GO>}

Paul, I'd add, Fairfax has an incredible track record over the last 30 years on investing, something we aspire to. So we certainly are looking forward to working with them and centralizing those investments and taking full advantage of that in a complementary way.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. Then next question is related to the underwriting side of the business. So both businesses today running with operating leverage around 0.6 times. So premiums written relative to equity. And Prem, as we know with Fairfax has gotten as high as 1.5 times in the past. So with your changing view on the US economic growth, is there potential for that leverage to go up over time. And what kind of numbers should we be looking to?

A - Prem Watsa {BIO 1433188 <GO>}

Well you know this is what is attractive to us, Paul, because Scott has built the company from scratch. 2001 they started after September 11, they started the company, no premiums. And the track record, by the way, is in the appendix of our presentation. And you can see the record for yourself. And it's an outstanding track record. And we think with what they've built and now a global franchise that they have in Allied World itself, that the expansion possibilities on their own and with us is very significant. But Scott, maybe you want to add?

A - Scott Carmilani {BIO 2076985 <GO>}

Yes, Paul, you're starting to see some of the real synergies and mindset. Andrew has overseen six or seven different franchises maintaining a fairly similar premium leverage in a rather relative tough market over the last decade.

If the administration changed the way they describe themselves to and execute on that. And the pricing environment changes and the risk environment changes, of course we would be looking to reduce that leverage. But a lot of that remains to be seen in the execution of what the next two or three years looks like. But we will certainly be poised to move quickly.

Q - Paul Holden {BIO 6328596 <GO>}

Okay. Great. Then one last question if I may. With respect to financial leverage, Prem, you made a comment that leverage comes down a bit with this transaction. Does that suggest that post close there might be some balance sheet optimization strategies at play, ie, bringing the leverage ratio back up to more what we've seen historically with Fairfax?

A - Prem Watsa {BIO 1433188 <GO>}

No, not at all. We're a very large operation right now. So we're very focused on maintaining a very sound financial position. I told you about the $1 billion of cash; we are looking at raising that over time, because financial strength is what we sell. We've always been financially very strong and we expect to be even stronger as the years go by.

Q - Paul Holden {BIO 6328596 <GO>}

Great, thank you for your time.

A - Prem Watsa {BIO 1433188 <GO>}

Next question, Leon.

Operator

Tom MacKinnon, BMO Capital.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yes. Thanks very much. Good morning, congratulations. Prem, two quick questions here, one is: What percentage, assuming you get a third-party investors in on this $30 share, what percentage of Allied World would you own? I think it looks to be less than 50%. And what would be your plans then for working that percentage up going forward? Then I have one follow-up.

A - Prem Watsa {BIO 1433188 <GO>}

Yes, Tom, in the previous -- these discussions are ongoing, first of all. But if you'll look at what we did at Brit and what we did at Eurolife, these third-party equity providers, we have the ability, if you like, to buy shares from them at predetermined prices over the next three, five years, seven years, over the long term. And we expect to do that.

Q - Tom MacKinnon {BIO 2430137 <GO>}

And do you know what percentage, assuming you had the third-party investors in for $2.7 billion, what percentage of Allied World you would own?

A - Prem Watsa {BIO 1433188 <GO>}

That's difficult to say right now, Tom. We are working out the numbers. And as we get further down in the process we'll let you know.

Q - Tom MacKinnon {BIO 2430137 <GO>}

And you have substantial amount of cash. But I'm wondering why you wouldn't be able to use more cash in the deal. You've got, I think you've got almost $10 billion --?

A - Prem Watsa {BIO 1433188 <GO>}

Yes. We've got about $11 billion of cash. It's all in the insurance companies, other than the $1 billion plus that we keep in the holding company. And the insurance companies, that money gives us the ability to use the investment skills that we have now, because I did tell you that we're going on offense with a value-oriented approach, not just buying our stock sort of going up, that kind of thing but with a value-oriented approach that we've used for more than 30 years.

And so that's what we're going to do, Tom. And we have a policy of not reducing our cash in the holding company to acquire something else. That's just a policy. And in fact, as I said, we're going the other way and raising that to higher levels as time goes by.

Q - Tom MacKinnon {BIO 2430137 <GO>}

The equity component is about 22% of this $39 billion now pro forma with the two Companies combined?

A - Prem Watsa {BIO 1433188 <GO>}

Yes. Approximately. We just took the September numbers and showed it to you. And over time, I think that'll change. But at the moment that's what it is.

Q - Tom MacKinnon {BIO 2430137 <GO>}

How high could you potentially take that equity component?

A - Prem Watsa {BIO 1433188 <GO>}

That's tough to speculate right now, Tom. We'll just have to work our way through. We'll have to look and see a little more of what Allied's portfolios are invested in. And so it'll be a function of further analysis and the closing of the acquisition.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thank you.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you very much, Tom. Can we go on to the next question?

Operator

Mark Dwelle, RBC Capital Markets.

Q - Mark Dwelle {BIO 4211726 <GO>}

Yes. Good morning. A lot of the questions I had have been touched on. But I just want to clarify related to one of the questions Tom just asked. So it wouldn't be your plan to consider dividending any cash out of any of the Fairfax operating subsidiaries to help fund a larger cash component on the deal; did I hear that correct?

A - Prem Watsa {BIO 1433188 <GO>}

No, Mark, we wouldn't be looking at that. As you know, one of our principles is to make sure that each of our companies is soundly financed and have very strong capital positions. I think right now Fairfax will have a AA capital position; we want to maintain that and make it even stronger. And so, yes, there's no intention of dividending money to finance this transaction.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Second couple questions probably are for Scott and Andy. And I'll just ask them together because they can be answered in joint. Are there any particular differences in reserving philosophy between the two Companies? And similarly, is there any particular customer overlap that could be problematic, maybe on the reinsurance side?

A - Prem Watsa {BIO 1433188 <GO>}

Andy, do you want to --?

A - Andy Barnard {BIO 4015704 <GO>}

Oh, yes, I'll take the first crack at that. Mark, no, we don't expect that there will be any problematic overlap. Of course, we're talking about very large companies now. And it stands to reason that on the margins there may be some. But we think the benefits of joining forces with Allied World far outweigh any of those issues on the margins.

And on the insurance side, we really see a rather different profile of business from Allied World than what we currently have in our Fairfax companies. So on that side especially we see it very much as additive to what we have presently.

And on the reserving side, I believe that we have very consistent philosophies. We seek to reserve our more recent accident years very conservatively, hold those reserves. Then after years of seasoning, if all goes well, we find that we have some significant releases that can be made.

A - Scott Carmilani {BIO 2076985 <GO>}

Mark, what the folks on this call may not know is Andy and I are both trained from the same institution more than 30 years ago. So we have very similar philosophies on reserving and reserve handling. We've also, the only difference at all is that we've had the additive outside actuarial also opine on many of our reserves off -- while Fairfax has been more reliant on their own work. But as you can imagine, there's been a fair amount of diligence done on both sides as we look to ensure that we both had that sort of level of reserve in our levels.

Q - Mark Dwelle {BIO 4211726 <GO>}

I appreciate the answers. Congratulations and good luck.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you very much. Leon, can we go on to the next question?

Operator

Jay Gelb, Barclays.

Q - Jay Gelb {BIO 21247396 <GO>}

Thanks, I just had a follow-up. Is shareholder approval required by both Fairfax and Allied World shareholders?

A - Prem Watsa {BIO 1433188 <GO>}

Paul?

A - Paul Rivett {BIO 15243791 <GO>}

Yes. We'll need Allied World shareholders to approve. We don't know yet if we'll be seeking Fairfax shareholder approval; it'll depend on the percentage of equity that we intend to issue. So that'll be determined over the next 75 days.

Q - Jay Gelb {BIO 21247396 <GO>}

I also, it was a little unclear to me in the press release where it talks about whether it's going to be a taxable or non-taxable transaction for Allied World shareholders. What's the factor there?

A - Paul Rivett {BIO 15243791 <GO>}

It depends on, again, the percentage of cash versus equity that's issued. We'll have more on that for you. But that will all again depend on what we do over the next 75 days with respect to that option that we have.

Q - Jay Gelb {BIO 21247396 <GO>}

What's the tipping point there?

A - Paul Rivett {BIO 15243791 <GO>}

I believe it's 40% -- needs to be 40% in stock in order to be a tax-free rollover.

Q - Jay Gelb {BIO 21247396 <GO>}

All right. Thank you.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you very much. Leon, next question?

Operator

At this time, speakers, we show no further questions.

A - Prem Watsa {BIO 1433188 <GO>}

Well thank you very much, Leon. And thank you all for joining our conference call. I look forward to our next conference call after our year-end results. Thank you.

Operator

Thank you. That concludes today's call. Thank you for your participation. You may disconnect at this time.