

Q4 2016 Earnings Call

Company Participants

- David James Bonham, Chief Financial Officer & Vice President
- Eric P. Salsberg, Vice President-Corporate Affairs and Corporate Secretary
- Vivian Prem Watsa, Chairman & Chief Executive Officer

Other Participants

- Jeffrey Fenwick, Analyst
- Mark Dwelle, Analyst
- Mikel Abasolo, Owner
- Paul Holden, Analyst
- Tom MacKinnon, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, and welcome to the Fairfax 2016 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. 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 Eric Salsberg. Mr. Salsberg, please begin.

Eric P. Salsberg {BIO 1552007 <GO>}

Yeah. Thank you. Good morning. Welcome to our call to discuss Fairfax's year-end 2016 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.

Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you, Rick. Good morning, ladies and gentlemen. Welcome to Fairfax's conference call on our 2016 results. I plan to give you some of the highlights and then, pass it on to

Dave Bonham, our CFO, for additional financial details.

In 2016, book value per share decreased 6.4% adjusted for the \$10 per share common dividend paid in the first quarter of 2016. Our insurance companies had an excellent year with a combined ratio of 92.5% with excellent reserving and significant underwriting profits of \$576 million.

For the full year, all our operating segments had combined ratios below 100% with an overall combined ratio of 92.5%. Zenith had a very good combined ratio of 79.7%, Fairfax Asia 86.4% and OdysseyRe 88.7%, all below a 90% combined ratio.

The insurance and reinsurance operations produced strong operating income, excluding net gains or losses on investments of \$1 billion. In 2016, we realized gains on our investment portfolio of \$564 million before the equity hedges.

Excluding all hedging losses and before mark-to-market fluctuations in our investment portfolio, we earned approximately \$1.2 billion in pre-tax income for the year. Including all hedging losses and mark-to-market fluctuations in our investment portfolio, we've reported an after-tax loss of \$513 million for 2016. It was a painful quarter and year for Fairfax. Our insurance and reinsurance businesses premium volume was up for the full-year of 2016 by 3.8%.

At the subsidiary level, the change in net premiums written for the year and the combined ratios were as follows. OdysseyRe, premiums were flat, combined ratio of 88.7% as I said before; Crum & Forster up 9%, combined ratio of 98.2%; and Northbridge in Canadian dollars up 10% with a combined ratio of 94.9%; Zenith up 4% with a combined ratio of 79.7%; Fairfax Asia up 10% with a combined ratio of 86.4%; and Brit with a combined ratio of 97.9%, Brit was in 2015 for about five months, and now was in 2016 was there for the full year.

As we've said before, very low interest rates and reduced reserved redundancies means that there is no place to hide for our industry. Combined ratios have to remain well below 100% for the industry to make a single-digit return on equity with these lower interest rates. While the short-term is always tough to predict, fundamentals will eventually play out and we believe pressure will continue to be on the industry to make an underwriting profit.

Net investment losses of \$1.2 billion for the year consisted of the following. Please refer to page 2 of our press release. Net losses on equity and equity related investments was \$1.3 billion, resulting from net losses of \$105 million on our equity investments, and a \$1.2 billion net loss on our equity hedge mainly because of a 19.5% increase in the rest of 200 index during the year. We've realized losses of \$184 million in our equity portfolio on our equities primarily related to SandRidge Energy and realized \$2.6 billion of losses due to the removal of our hedges. More on the removal of our hedges later.

Our CPI-linked derivatives with a notional value of approximately \$110 billion produced unrealized losses of \$196 million during the year. The majority of these contracts as you

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know are based on the underlying U.S. CPI index about 54% or the European Union CPI index of about 40%. Further information is available on page 4 of our press release, where we have included a table of the inflation swaps.

On average, they have 5.6 years to run. We continue to hold them as insurance for the unexpected, events like a collapse in World Trade, a problem with China or the disintegration of the European Union. So we will continue to hold our deflation swaps. When you review our statements, please remember that when we own more than 20% of our company via equity account and when we own above 30%, we consolidate. So that mark-to-market gains in these companies are not reflected in our results.

The fair values of our investment in an associates is \$3.3 billion, versus the carrying value of \$2.6 billion and unrealized gain of \$700 million, that's not on our balance sheet. Investment gains have been an important component of our returns over time, since we began 31 years ago, we've had a cumulative \$10.2 billion in realized and unrealized gains.

As we mentioned in our annual meetings, annual reports and quarterly calls with IFRS accounting with stocks and bonds are recorded at market and subject mark-to-market gains and losses, quarterly and the annual income will fluctuate widely and investment results will only make sense over the long term.

In December 2016, Fairfax entered into an agreement to acquire Allied World, a market-leading global property casualty and specialty insurer and reinsurer. Under the terms of this agreement, Allied World shareholders would receive a combination of Fairfax subordinate voting shares and cash equal to \$54 per Allied World share for a total equity value of approximately \$4.9 billion.

In January 2017, the company entered into an agreement, pursuant to which OMERS will invest \$1 billion in order to indirectly acquire approximately 21% of the issued and outstanding shares of Allied World, simultaneously with the acquisition of Allied World.

We are in the final rounds of negotiations with a number of parties that are interested in following almost leaders, co-investors, and we are confident that we will be able to raise an additional \$500 million and potentially up to \$1.5 billion. We continue to work with partners to utilize the remainder of the option. The transaction remains subject to a number of regulatory approvals and certain Allied World shareholder approvals. Closing of the transaction is expected to occur in the second quarter of 2017.

Over 31 years, our decentralized approach and our fair and friendly culture have attracted many companies that join us and property and casualty insurance and elsewhere. We are the first choice for many good companies and management teams, both from an acquisition point of view as well as the financing.

Let me explain how it works from a management standpoint. AMAG in Indonesia, which we acquired in 2016, is run by Linda Delhaye, who has run it for more than 10 years, and is part of Fairfax Asia, run by Mr. Athappan. Bryte Insurance, formerly Zurich South Africa, is

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run by Edwyn O'Neill and came to us through Mark Cloutier at Bryte Insurance, who will continue to monitor it while reporting to Andy Barnard.

The Latin American companies and portfolios in Eastern Europe, we acquired from AIG, have individual branch managers in all of the countries reporting to Peter Csakvari for Eastern Europe and Company Presidents reporting to Fabricio Campos for Latin America; both of whom report to Bijan Khosrowshahi.

Peter Csakvari has been with us for two years following 17 years with AIG; and Fabricio just joined us and was with AIG for more than 15 years. Bijan has been with us for eight years and before that, he was with AIG for 23 years. Bijan, of course, will work closely with Andy Barnard.

Allied World built by Scott Carmilani and his team, have an outstanding track record, and will continue to be run by Scott working with Andy. We discussed this in our December 19, 2016's conference call, and you said this would be a transformative acquisition for Fairfax. For all of you shareholders who haven't had a transcript, or a look at the presentation, I'd recommend going and reviewing that.

Over the past six months, Nigel Fitzgerald has led the charge to buy Tower in New Zealand, a company that has operated there for over 145 years. While we were all impressed by Richard Harding and the team who run the company, Nigel who runs Advent in London, will work with Richard as well as continue to be responsible for Advent, all reporting into Andy. The transaction remains subject to shareholder and regulatory approvals.

Recently, we've created a company called Fairfax Africa and it is listed on the Toronto Stock Exchange today, having raised \$500 million. The reason behind this is similar to Fairfax India. Four years ago, we met Mike Wilkerson and Neil Holzapfel and we took AFGRI private together on the Johannesburg Exchange. AFGRI has been a great investment. And with Neil and Mike having specialized in Africa for the past decade, and with Neil and two partners permanently located in South Africa, we decided to create Fairfax Africa to take advantage of the significant opportunities there.

These are all examples of how our decentralized approach and fair and friendly culture work together to provide outstanding opportunities for you, our shareholders.

At year-end, Fairfax India had invested \$1.1 billion that it had raised about two years ago. So early in 2017, Fairfax India completed a \$500 million share offering at a price of \$11.75 per share. Subsequently, Fairfax India purchased additional shares in IIFL for a total consideration of \$75 million and now holds approximately 27% of the company.

Also, in 2017, Fairfax India acquired 51% of Saurashtra, the largest container freight station at Mundra Port for \$30 million. We continue to be very excited about the potential in India, especially under Prime Minister Modi's leadership.

Please note that Fairfax India and Fairfax Africa are great investments for us. But, over time, will also be a significant source of earnings, through an additional income stream of fees that come to Fairfax Financial.

As we said in our third quarter call, with the uncertainties of the U.S. elections and a possible new U.S. administration, we decided to sell 90% of our U.S. long treasuries. In the fourth quarter, we continued to reduce the duration of our bond portfolio to approximately one year through the sale of additional treasury bonds and U.S. muni bonds and repurchased treasury locks for the bonds that have yet to be sold.

The effective sale of our bond portfolios had a cumulative realized gain of \$2.3 billion from our original cost - \$1 billion from treasuries and \$1.3 billion from U.S. muni bonds. The risk in our bond portfolio through an increase in interest rates has been eliminated. Also, after the election, we eliminated our Russell and other index hedges and reduced our individual company shorts. The volatility of the past in our earnings from our holdings of long bonds and equity hedges is over.

Why did we make these dramatic changes? We believe the new U.S. administration's proposed policies of reducing corporate taxes to 15% to 20%, rolling back regulation and business like Obamacare, Dodd-Frank and a myriad other regulations and significant infrastructure spending has the potential of boosting economic growth significantly in the United States.

Already sentiment among small business has improved dramatically and animal spirits in the U.S. have been revived. When the U.S. economy, which is approximately \$20 trillion does well, much of the world does well, too. To us this means, our concerns of China or Europe precipitating a worldwide recession depression, have been significantly reduced but not eliminated.

Also, the trade policies of the U.S., could precipitate a collapse in world trade. So these risks will be very much monitored by us, but we think the new administration's policies may make this a stock pickers' market and one in which we have thrived over the past 31 years.

In the past few years, we have played defense. We are expecting to play offense, but always with a 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. Our recent investments of \$150 million in Chorus, and CAD 150 million in Mosaic in a bond and warrant structure are examples of an emphasizing downside protection with potential upside with great management teams with excellent track records. The stock markets are not cheap, but selectively we expect to invest our \$10 billion in cash over time, always keeping a watchful eye on the risks outlined earlier.

Over the last few months, there have been media and analyst reports with respect to a rumored \$1 billion sale of our portion of our 35% stake in ICICI Lombard and to a rumored application by us with an Indian partner for a new insurance license in India. These reports

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have noted that if a new license were issued, we would be required to own no more than 10% of ICICI Lombard. We cannot comment specifically on these rumors.

However, what we could say as that we have in the past is reminded our shareholders that we have created significant value in our investments in numerous companies that are not valued at market value in our financial statements. And for the right price, these holdings may be sold opportunistically.

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

David James Bonham {BIO 15243784 <GO>}

Thank you, Prem. First of all, we wanted to let you know that in addition to the press release that we issued yesterday, all of the details of our fourth quarter and year-to-date financial results will be made available in our Annual Report, which we posted for our website on March 10, 2017. So now, we can move into Fairfax's consolidated results for the full year of 2016, some details of the operating company results and then onto our consolidated financial position. So for the full year of 2016, Fairfax reported a net loss of \$513 million or \$24 for fully diluted share and that would compare to net earnings of \$568 million, \$23 for fully diluted share in the full year of 2015. The net loss in 2016 principally reflected net investment losses that were offset by strong operating income.

Our insurance and reinsurance operations produced an underwriting profit of \$576 million and a combined ratio of 92.5% in 2016 that compared writing profit of \$705 million and a combined ratio of 89.9% last year. The decrease in underwriting profit year-over-year was about a \$129 million principally reflected increased current period catastrophe losses, partially offset by higher net favorable prior year reserve development.

Net premiums written by our insurance and reinsurance operations increased by 11% in 2016 principally reflecting the consolidation of Brit's net premiums written of about \$1.5 million in the full year of 2016 compared to about \$946 million for the period that we owned Brit in 2015.

So turning to our operating company results, we can start with OdysseyRe. In 2016, OdysseyRe reported an underwriting profit of \$235 million and a combined ratio of 89% that compared to underwriting profit of \$337 million and a combined ratio of 85% in 2015. Slightly lower underwriting profit in 2016 principally reflected higher current period catastrophe losses, the impact of lower net premiums earned, lower writings of higher margin property catastrophe business and continued rate pressure, and that's partially offset by increased net favorable prior year reserve development and lower current period extraordinary losses. OdysseyRe wrote about \$2.1 billion in net premiums in 2016 and that was fairly consistent with the net premiums they wrote in 2015.

Moving onto Crum & Forster, Crum & Forster's underwriting profit of \$32 million and a 98% combined ratio in 2016 was slightly lower than the underwriting profit of \$35 million at a 98% combined ratio in 2015. The decrease in underwriting profit was principally due

to increased current period catastrophe losses at a deterioration in accident and health loss experience in the current action here, and that's principally related to a single program and increased commission expense. And those factors were partially offset by net favorable prior year reserve development, and an improvement in non-cat loss experience in the current accident year. There is no net favorable prior year reserve development last year.

Crum & Forster's net premiums written increased by 9% in 2016, primarily reflecting growth in the accident and health and commercial transportation lines of business, as well as incremental contributions from the acquisitions Crum completed in 2015, that was partially offset by decreases in their construction contracting line of business.

Zenith National reported increased underwriting profit in 2016 of \$164 million and a combined ratio of 80% that compared to an underwriting profit of \$134 million and a combined ratio of 83% in 2015. The improvement in 2016 principally reflected increased net favorable prior reserve development and a lower estimated accident year loss ratio.

Net premiums written by Zenith of \$890 million in 2016 increased by 4% year-over-year principally reflecting an increase in exposure and that's partially offset by modest price decreases. Northbridge reported underwriting profit of \$46 million and a combined ratio of 95% in 2016 compared to an underwriting profit of \$71 million and a combined ratio of 92% in 2015. Northbridge's underwriting results in 2016 reflected the impact of increased current period catastrophe losses, namely the Fort McMurray wildfires and a deterioration in non-cat loss experience related to the current year, that's principally the result of increased frequency of large losses and that was all partially offset by increased net to favorable prior reserve development. In Canadian dollar terms, net premiums written by Northbridge in 2016 increased by 10%, reflecting increased new business writings at Northbridge Insurance and modest price increases across the group.

Turning to Brit. In 2016, Brit produced an underwriting profit of \$29 million and the combined ratio of 98%. In 2015, Brit produced an underwriting profit of \$45 million and a combined ratio of 95%. And as a reminder, Brit was acquired in June 2015, so comparative figures for 2015 are only for the period in which we owned it. The underwriting profit in 2016 included \$76 million of current period catastrophe losses and that was principally comprised the impacts of Hurricane Matthew and the Fort McMurray wildfires.

Fairfax Asia reported increased underwriting profit of \$41 million and the combined ratio of 86% in 2016, at compared underwriting profit of \$35 million and a combined ratio of 88% in 2015.

Net premiums written by Fairfax Asia increased by 10% in 2016, that principally reflected the acquisitions of the Fairfirst Insurance in Sri Lanka and AMAG in Indonesia. Also reflected increased ratings at Pacific Insurance and the impact of increased premium retention and that was primarily at First Capital.

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The insurance and reinsurance other segment produced an underwriting profits of \$28 million and combined ratio of 94% in 2016, somewhat lower than the underwriting profit of \$46 million and combined ratio of 90% in 2015. The decrease in underwriting profit in 2016 principally reflected increased current period catastrophe losses and lower net payroll prior year reserve development partially offset by improvements in the non-cat loss experience related to the current action year.

Net premiums written by the insurance and reinsurance, other segment decreased by 6% in 2016 and that decrease reflected the non-recurring impact of the QBE loss portfolio transfer in 2015 at Polish Re and decreased as a Group Re primarily related to the non-renewal in 2016 of an intercompany property quote share agreement with Brit. Those were partially offset by increases at Fairfax Brazil and Advent.

Runoff reported an operating loss of \$149 million in 2016 compared to an operating loss of \$74 million in 2015, the increase in the operating losses in 2016 principally reflected higher net adverse development and lower interest and dividend income, partially offset by lower operating expenses.

Turning to some of our consolidated figures. Consolidated interest and dividend income increased from \$512 million in 2015 to \$555 million in 2016 reflected higher interest income earned that was principally on increased holdings of higher yield in government and corporate bonds, partially offset by the impact of sales of U.S. state municipal bonds. We had lower total return swap expense in 2016, lower interest on funds withheld expense and was partially offset by lower dividend income in 2016.

Fairfax recorded an income tax recovery of \$160 million in 2016 and that was relative to a pre-tax loss of \$554 million producing an effective tax rate of 29%. We ended 2016 with an investment portfolio including holding company cash of \$28.4 billion compared to \$29 billion at the end of 2015. The lower investment portfolio reflected net unrealized depreciation of common stocks and net losses on derivatives partially offset by net unrealized depreciation of bonds. Our total debt to total capital ratio increased to 28.7% at the end of 2016 from 21.8% at the end of 2015 and that was primarily as a result of debt issued during 2016 by Fairfax India and Cara, and that was to finance various purchases and it was also reflective of the company's lower shareholders equity at the end of 2016.

The proceeds from Fairfax's fourth quarter 2016 debt issuance a real mark to retire debt that is already outstanding. So now Prem, I'll pass it back to you.

Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you very much, Dave. Now, we're happy to answer your questions. Please give us your name, your company name and try to limit your questions to only one all on the call. So, Jen, we are ready for your questions.

Q&A

Operator

Thank you. We will now begin the question-and-answer session And our first question is from the line of Junior Roth (27:40) a Private Investor. Your line is now open.

Hi Prem, how is it going? Quick question, what do the CPI index need to go back to get the price we paid for the equity?

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

Sorry, give me that question again.

Q - Operator

So the CPI index right now is at a loss right, to get it back into a gain state. What does the CPI index need to go to in the U.S. and Europe?

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

Yeah. Dave, why don't you answer that?

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

Yeah. So we don't have those figures in front of us. But in our financial reporting, we do give you all the index values on the CPI indices as to where the average was when we stuck those contracts. So you can compare the two to where the index is at the current point in time and get the answer to that question.

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

And in terms of the indiceOs, it's very close to where they are. But we might be in for a period of inflation, as you saw the last numbers come out in the United States and so we'll be watching it carefully. But as I said before, it's tremendous protection, it's got five or six years to go, and we will be able to keep them.

Q - Operator

Okay. Thanks.

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

Thank you very much. Next question please.

Operator

And our next question is from the line of Jeff Fenwick from Cormark Securities. Your line is now open.

Q - Jeffrey Fenwick

Hi. Good morning, Prem.

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

Good morning.

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

Hi, Jeff.

Q - Jeffrey Fenwick

Just with the movement on the balance sheet this quarter, your debt-to-capital levels capital levels moved up fairly meaningfully, I guess quarter-over-quarter here. I just wanted to get your sense of level of comfort with where you're sitting there from a capital position today, and is there any concern around that or any plans in terms of offering incremental capital?

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

Yeah, Jeff. We're focused right now to bring that back, back to where it was. We have many, many possibilities of doing that. But of course, as Dave mentioned, it excludes debt from our Fairfax India, Jeff. It includes debt from our subsidiaries, which is really not our debt it's consolidated into our companies.

Fairfax India, for example has every expectation to pay-off its debt by the end of March. But we would get that much lower. If there is any truth to those rumors that I highlighted for you, our debt equity comes back significantly.

Q - Jeffrey Fenwick

And then maybe just a question or two here on your investment positioning as you're entering 2017. I mean, obviously significant change and you articulated that for us. Just wondering around your concerns about market volatility. I mean it's certainly been a lot of initial euphoria post the U.S. election. But we know that change takes time and those changes as they emerge may be different than what people originally thought. And how do you manage those risks in the near-term with respect to the pace of deploying that capital out in the market?

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

So you know Jeff, when you think about it, there's always going to be volatility. I think of going back few years now. 1965, the Dow Jones hit 1,000; 1982 it was still at 1,000, 17 years later. So there are long periods where the index might not go up significantly, but individual companies and stocks do very well. So that's what we mean by saying it's a stock pickers' market.

The last number of years that the stock markets have gone up. We're not expecting the markets in general to do very well, but we think individual companies might do well, but always subject to the value investing principles of margin of safety provide downside protection, great management teams, we gave you Mosaic and Chorus in a quasi-

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convertible structure. So when we invest these monies, we'll be investing it in that way. Are we going to have 20%, 30% fluctuations? Very much possible.

Then, never forget that the stocks that we have haven't done very well recently, especially in 2016. And over time, we expect them to do well. We've got some investments in Greece. I've talked about it in our annual report last year; I'll give you an update again. In this year's annual report, we've got our investment in BlackBerry, which is stable now. So we've got these investments that we expect to do well. We don't expect them to go down a lot from here. And so that's another reason for us to take our hedges off, because the components of our stock positions have come down significantly already.

Q - Jeffrey Fenwick

Okay. And maybe just one last one, if I may, on Fairfax India, which is not having its own call. Is there any update you can provide on the status of the Bangalore Airport investment? I know that's been in the works for a long time and waiting for approval from various agencies. Any update you can provide there?

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

Yeah. So very much, Jeff. The security clearance that we were waiting for, we have obtained. And so now it's just a question of closing the transaction, which we do expect to close in the next week or two. And it's working with the seller and his banks to make sure that it works well for everyone concerned. But there is no hurdles now any longer after we got the clearance, the security clearance. So it should close relatively soon. And we'll have the 33% from the controlling shareholder. We'll have 5% from Zurich as we mentioned. So we'll have 38% and I just came back from there. It's a wonderful airport. It's got tremendous possibilities. It's running at about 20-plus million passengers today. Has all the ability to go to 60 million. Bangalore as you know, is the Silicon Valley of India. And so yeah, so we're very excited, it will happen hopefully in the next few weeks.

Q - Jeffrey Fenwick

Great. Thanks a lot, Prem.

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

Okay.

Operator

Thank you.

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

Thanks, Jeff. Yes, Jen, next question, please.

Operator

And our next question is from the line of Paul Holden from CIBC. Your line is now open.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you. Good morning.

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

Good morning, Paul.

Q - Paul Holden {BIO 6328596 <GO>}

Good morning. Two questions if I may. First is a quick one. Would you happen to have what the duration of your bond portfolio was say mid-2017 just to give us a sense of how much you've reduced it in 2016?

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

Yes, Paul. We had very long bond portfolios. Our treasury bonds were mainly 30-year treasury bonds. And we had California bonds, which were very long-term, and we had some muni bonds, which had call features in it. So I don't have the duration, but they were long. And once we decided we sold the 90% just recognizing the risk of the administration change unexpectedly, which happened. And so, now, we basically have sold the bonds, in the case of treasuries, all California's or we have locked them up with the treasury lock, and so our duration is plus-minus a year, and the risk, as I said, in terms of interest rates going up are eliminated.

I just want to highlight the reason we changed so dramatically. We just think we've always thought what will make us change, and of course the good situation was if the markets come down and we cover our hedges at a profit that would have been terrific. But we also thought of the other side and the other side was if what happened happens. So in our mind, the facts changed, and here are the facts. The new administration comes with economic policies that are focused on reducing corporate taxes to 15% to 20%, as you know; roll back regulation significantly; and regulation in business have been very heavy over the last 8 years; and at a very significant infrastructure spending, which is exactly what the United States needs. And so these are very powerful combination of policies.

I mentioned that it's already got animal spirits up in the United States. And so the economic growth could take place there. And so in that set up, we thought if we had known this earlier, you would say I'm rightly so, and when I say you, I mean generally, to our shareholders, we perhaps if we had known that this type of thing could happen, we should not have hedged even a few years ago. But of course, that was not possible. At least for us, it wasn't possible to think through that potential. But as we saw it, we reacted and we've taken it out, and now we are back to what we've done for 31 years and (37:24) on our value-oriented basis. And as I said in our script, that we've made \$10 billion over that time period, cumulative gains. We expect in the next three years, four years, five years to do as well in the position that we have. But that's what would be - our bond portfolios are plus-minus one year.

So Paul, what's the next question you had, maybe I answered it?

Q - Paul Holden {BIO 6328596 <GO>}

Yeah. So next question is in terms of that deployment of the \$10 billion of cash you have today, obviously, you have to do that in the context of risk-weighted assets in terms of solvency ratios and your credit rating, insurance rating, et cetera, so maybe you can just sort of help us think about the feasibility set in terms of asset class in terms of how you can deploy that?

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

Yeah. So the \$10 billion will be capital as I said. But we liked the idea of buying bonds, getting us 5%, 6%, 7% as we did with Mosaic and Chorus. Backing very strong teams, in the case of Mosaic and Chorus. In Canada, we're well known. These companies are giving us 20% or 50% of the shares outstanding. And you don't do that lightly if you are in management. But they know we are friendly. We demonstrated over 31 years of always being friendly, of always being supportive, and that's a big plus that we have.

Our culture is a huge plus. It's a differentiating factor between us and the other companies that we compete with, in any industry I mean, So, you have in Canada, people come all over the place for financing from us. They come to Paul Rivett, they come to others. And insurance companies, I gave you a whole list, they've come to us to be part of Fairfax because it's decentralized. They can run the company like they see fit. And we will see similar things happening, Paul, in the United States. The U.S. is a big country, there is all sorts of opportunity taking place, all sorts of entrepreneurs and for an entrepreneur with a great track record and wants to expand in the U.S., we have the right partner for them. And they will be amenable, they'll be sensitive and will work with us in structures that work, like we did with Chorus and with Mosaic and I'll speak a lot more about this in our Annual Report, yeah.

Q - Paul Holden {BIO 6328596 <GO>}

Great. Thank you.

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

Thank you, Paul and next question, Jen.

Operator

Thank you. And our next question is from the line of Tom MacKinnon from BMO Capital. Your line is now open.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah, thanks very much. Good morning, everyone.

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

Good morning, Tom.

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Q - Tom MacKinnon {BIO 2430137 <GO>}

Prem, I'm just following up on Paul's question. If I look at equity, your common equity and preferred equity plus your investment in associates, those are, I don't know, low-20s, 23% say of your total portfolio. How high would you take that? Like traditionally, we don't see insurance companies with much higher than 25% or 30% of their total portfolio invested in equity and investments and associates?

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

No, that's right Tom and so somewhere around that 25% plus, minus is sort of the maximum. But first of all our equities, we could - as they do well, we can sell them and replace them with other investments that's happening as we speak, in terms of the stock markets. But also the structure like a Chorus, where we have a convertible, but we split them into a bond, which really as insurance companies have a lot of bonds, and a warrant, which is five years or seven years, which perhaps has no value today, but has the upside if the company does as well as we think it might. So that structure is very conducive to us. It works really well. And so those are the type of things we're looking at doing that makes sense for Fairfax.

Q - Tom MacKinnon {BIO 2430137 <GO>}

That's great. And just as a quick follow up. What do you hold ICICI Lombard on your balance sheet at? I know you did increase your stake and the cost of that is disclosed, but what do you hold to that?

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

I think about \$350 million plus or minus, we showed it there in our statements, and it's about, we increased our stake, it was about \$100 million Tom, and then we bought 9% to 10% at about \$250 million, \$240 million, something like that.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah.

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

And so our total investment I think is \$350 million, and so that's what I was alluding to in terms of those rumors.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah. And I think in terms of Allied World, there's really around \$2.7 billion more needed. There is just talk about OMERS with a \$1 billion you....

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

Yeah. So, so.

Q - Tom MacKinnon {BIO 2430137 <GO>}

...so that \$1.7 billion more. How comfortable are you in terms of raising that from potentially like party?

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

So, Tom, we've got \$1 billion from OMERS and we've said in my prepared comments, I said we're very confident of another \$500 million, so that's \$1.5 billion. That \$1.5 billion term, if we forgive Allied World shareholders in cash, that'll be like Brit, 70% Fairfax, 30% partners. As we get another \$1 billion, then it will be like 50% - 51% Fairfax, 49% partners, so that's the split. We feel confident as I said for \$1.5 billion, which is a 70-30 split. And if we get the additional \$1 billion, then we would be more like 50-50, 51% for us, 49% - we'll always control the company. And we expect to retire this over time, just like we did. We have the ability to buyback these shares, over time, five years, seven years basically.

And so if we do a 70-30, and we've issued the 30%, the 30% 70-30, and then we've issued some shares, the shares that we would issue on a 70-30 split term would be approximately 23.5%. So that means, if we go over the \$1.5 billion if you bear with me, we're issuing \$14 per share of Allied World in common shares and we're issuing the 30% comes in cash, and the 70% would be in shares, a part of it will be in shares. And so, net-net Fairfax's shares outstanding will go up by 23.5%, if we only do \$1.5 billion in financing for that \$30 a share. So everything in the company with Allied, as I've mentioned before, goes up with third, the premiums go up by a third, the investment portfolio goes up by a third, but the shares outstanding will only go up by 23.5%. If we get \$2.4 billion, which gives us 51%, then the shares outstanding go up by about only they go up by only 15%.

So if we have more cash come in, and that's not guaranteed as you know, but if we're working with many partners as I've said, but if that does come in then the shares that we would issue would be much less. In our minds, if that doesn't come in we'll just think of using cash flows from Allied World to buy back our stock, that we would have issued in excess of what we wanted to issue. So that's how we're thinking about it, but at the moment it looks like our shares outstanding will be up by about 23.5%. But on March 3, is when we have to announce how much cash, how much shares and we will do that on that date.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. And how come you can't use any of this or why won't you be able to use substantial amount of this \$10 billion in cash? Is that just because it sits in operating insurance subsidiaries that's hard to pull out?

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

Yes, it sits with our insurance companies at the time it sits in Allied insurance companies mainly in the United States, but all over the world and we'll invest that, because a lot of that was invested in and most of that was invested in our bond portfolios. And so the interest rates are going up some, so cash is not a bad thing to have, five-year treasuries are at 2% in that area, so we will - we get some interest income but over time we will be investing that as I said earlier.

Q - Tom MacKinnon {BIO 2430137 <GO>}

And sorry what was the significance of the March 3 date, sorry, what's that?

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

March 3rd is the date when we have to let Allied World shareholders know that \$30 in cash or shares, how much is going to be in cash, how much is going to be in shares.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thanks.

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

So the way to look at Allied World is to think of it as fully funded. It's either cash or shares and the only the point we have make on March 3 is that whether it's going to be in the - whether we're going to put \$1.5 billion in cash or \$2 billion in cash or \$2.5 billion in cash that we have to announce then and then subject to regulatory approval sometime in the second quarter, maybe late in the second quarter is when the approvals are that we expect to come.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Thanks for that Prem.

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

Okay. That's perfect. Jen, next question please.

Operator

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

Q - Mark Dwelle {BIO 4211726 <GO>}

Yeah. Good morning. We've already covered a lot of the investing and financing type of questions. I just wanted to ask a couple of others. There were a little bit more operational, could you provide the amount in total of cat losses and favorable developments in the quarter? Just in dollar terms your points whatever is easiest?

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

I can do that for you. So, in the fourth quarter we had 12.9 points of favorable developments in our combined ratio and that would and then for the year-to-date that would be 8.5 points. And in terms of dollars, \$257 million in the quarter, \$655 million in the year of favorable development. And if you're looking at cat losses 5 points, 4 points of cat losses in the fourth quarter, 4.6 points of cat losses year-to-date.

Q - Mark Dwelle {BIO 4211726 <GO>}

Thank you. That's very helpful. And then the second question I had was, the net written premium volume at Brit fell off fairly substantially in the fourth quarter on a year-over-year basis. And I was wondering if there was any change there. I know the pricing has been under pressure for Brit, but that was a much steeper decline than we suggested by just pricing alone?

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

Yeah. Pricing is under pressure. Yeah, but not huge, 0% to 5% in all our companies across the world. Some closer to flat, some closer to 2% or 3%, and some are little more. In the case of Brit, in that direct insurance businesses, it might have been down 2.9% Mark and the reinsurance business like 4.5%, 5% in terms of pricing. So they are charged to all insurance companies, is not to focus on the top line. And if they had to reduce it, they'll reduce it. We don't even think twice about that.

And so, we're not focused on premium at all. We're focused on combined ratios. And good reserving and I can tell you at the end of the year, our reserves are very good and in very good shape and our management teams all over the world are very much focused on underpinning and on an underwriting basis, we've had an outstanding year. Another very good year, and our reserves are in good shape, and so we are writing \$10 billion in gross premium all over the world and with all these different management groups that have been with us for a long time, I must say that's a very stable operation and Scott Carmilani and Allied World, they've run it for 15 years that's going to be such a good fit.

It's going to no integration problems, no synergies that we expect from them, in terms of cost synergies, but of course in terms of revenue synergies over time. We expect that will take place, but no-cost synergies. You'll never hear us talk about \$100 million, \$200 million of synergies and we think that's a huge plus. And I'll remind you, Allied World had a return on equity of 12% over the last 15 years.

And if you look at their 10-year returns on their investment portfolios, it was approximately 3.9%, I think it is Peter, and our 10-year returns even in spite of not good returns in the last 5 years, 10-year returns are approximately 7%. And you put our 7% on the combined ratios and you get a 20% return on equity. That 12% becomes 20%. That's basically how Fairfax was built. And it will continue to be the case over time.

And so as I said that it was a painful quarter, painful year. But I want to reassure our shareholders, we are very focused on doing well for you. We've done really well for you over a long period of time. But I'm the first to recognize that we haven't done well for you in the last 5 years and we'll make that up for you over time. Mark, any other questions you had?

Q - Mark Dwelle {BIO 4211726 <GO>}

Just one other last quick one. The Fairfax Africa investment, I assume that's going to appear on the results in the reported balance sheet and so forth in a pretty similar manner to the Fairfax India Holding?

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

Yes, yes. It will come - it will have its own statements of course, and like Fairfax India now, which will have a second annual meeting, and by the way I'm going to welcome all of you for our annual meeting not only Fairfax Financial, but Fairfax India's annual meeting, which is in the afternoon, and you will see and meet a lot of the management team who run our Indian companies and they're very, very impressive. We all had a chance to do that, our management team and our board of directors about a few weeks ago. But we'll bring them in and we'll have a presentation, you'll have a chance.

We're really quite excited in terms of our investments in India, and it's difficult to see. Mark you've done a really good job in understanding the Fairfax India, but the potential in that country is huge. And we have the better part in Fairfax India; the better part of \$2 billion invested there; and then our other investments like ICICI Lombard and other - Thomas Cook and all of those, they add up to about \$3 billion. So we have about \$5 billion, not on a cost basis because we've done very well on it, but in terms of market, approximately \$5 billion invested in India. And we think the returns over time is going to be significant.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Thank you for that. We'll see you soon. Take care.

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

Thank you, Mark. Jen, next question?

Operator

Thank you. Our next question is from the line of Mikel Abasolo from Solo Capital Management. Your line is now open.

Q - Mikel Abasolo {BIO 3756596 <GO>}

Thank you. Good morning. Thank you for taking my questions again. And my first question does have to do with the removal of your Russell 2000 hedges. And my question to you is, I mean, in my mind, even if the new U.S. administration orchestrated a miracle or even if they were as good as Cardoso in Brazil or Modi in India, don't you think that our wages of evaluation of the U.S. stock market and particularly, Russell 2000 with two-thirds of the company is making a loss will definitely overwhelm the potential or the marginal improvement in the prospect of U.S. companies coming from better policies if they manage to actually orchestrate better policies. So my question and I fully understand...

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

Yeah. No, Mikel, I understand (56:07).

Q - Mikel Abasolo {BIO 3756596 <GO>}

...your Greek investments.

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

Yeah. It's a good question and the markets are not cheap. I grant you that. I said that in our prepared comments. So you're exactly right. And some of you might wonder and might actually think that we're doing it at exactly the wrong time. And this is of course what makes investing such a great business because there's all sorts of opinions and all sorts of views. Our view was just that these are very significant policy changes. If they come to place and they might not come into place, cutting in corporate tax, dropping corporate taxes to the 15%-20% area is huge. If it's instituted and your point might well be that, and many of you have said, that it might not take place.

The rollback in regulation, Obamacare, Dodd-Frank, all of these regulations you take them back, America is always based on business. And when you open it up for business again and these animals spirits come back, and then you throw in the infrastructure spending and some of you might have a chance to review the 50 infrastructure projects that are already explained.

And you read just a few of them, and they are very, very significant. And so I mean, you put all of that, the profit margins are high, but tax rates coming down is going have a significant impact on profits. Economic growth will have a significant impact. They're talking 3% or 4% economic growth. The confidence factor, the animal spirits is another factor. So when I look at it, Mikel, I'm saying the markets might not go up significantly in the next five years or 10 years, who knows right.

But there might be individual names, that go up and individual companies that do well. And there will be fluctuations, 20%-30% fluctuations all the time. And so we want to identify the companies that do well and the risks are very clearly, the world trade collapse because of the some of the policies that's being talked about. The rest are about Europe and the Brexit going right through plans and Holland and other countries, and of course, China is always a potential risk.

So you have that risk. That's one of the reasons we've got the deflation swaps. We're keeping \$110 billion, which is in our books I think less than \$100 million. So it's not a big item there, but if any of these risks come to play, our deflation swaps will be worth a lot. And on the other side, we think because (58:58) \$20 trillion economy is factoring well.

Yeah, so, \$20 trillion economy does well. A lot of these risk, perhaps, not eliminated, but reduced. So, that's where what we think, Mikel, but only time will tell, okay, but we appreciate your question, it's a good question.

Jen, next question, please?

Operator

And your next question is from the line of Luis Fernandez from Prosper Partners (59:25). Your line is now open.

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

Yes, Luis (59:31).

Q - Operator

Yes, hello, good morning. Thanks for taking my questions. Well, I just wanted to ask you, I mean, you already mentioned but I wanted to ask you again. Given your long-term plan of growing book value per share of 15%, how do you think, we can compensate for the last six years of kind of like zero growth, and are we still in plan? And basically what's your view on the future of Fairfax kind of like the same question?

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

Yeah, I mean, that's a very good point. We haven't done well, as we said last five years or six years, and the question is, your question can we compensate for that? Only time will tell if we can or not. We used to think that we could compensate with the treasury bonds and our government bond portfolio, which as I've told you we made \$2.3 billion of gains. We could have made perhaps a little more. We thought we could compensate on the hedges. But remember we've got a whole bunch of equity positions that are not showing any profits today.

For example, Eurobank; for example, Blackberry. They're all valued at market and I can make I think some scenarios where that would be very different from where it is today. If you were to take those equity portfolios, common stocks were three but quiet. And you could make a scenario where there'll be valued a lot higher than they valued today. Today this is where they are. This is the vitality of it, but they're not selling it. And so, we've taken the heads on the hedges. We've made a lot of money on the bond portfolios, but not made more than perhaps we could have. And now, our focus is trying to do well and only time will tell if we can compensate for the lack of progress as you said in the last five years plus.

Let me tell you this, Louis. If you think of intrinsic values, if you think of what we have built over that time period, if you think of the individual companies that I'm making an underwriting profit year after year after year, you are going to think that the intrinsic value of Fairfax's are a lot higher than what it is today, and I have no question about that.

On the investment side, we've demonstrated a scale for a long period of time, you are exactly right, we haven't done that in the last five years to six years, well you're going to see that change in the future. We've got the same team. There's no difference in our team, but the intrinsic value and book value tend to go together over time while I would suggest to you that right now that our intrinsic value of our companies is significantly higher than what the book value indicates. Some of the reasons which you have alluded to.

So thank you for that question, Louis and I'll move on, Jen, to the next question.

Operator

Thank you. Our next question is once again from Mikel Abasolo from Solo Capital Management. Your line is now open.

Q - Mikel Abasolo {BIO 3756596 <GO>}

Yes. Thank you. So sorry for taking some time from you and I hate to do this question, but it's kind of significant to me. I know that part of your success in the past and most likely in the future comes from your reputation as a fair and loyal partner. And my question is an uncomfortable one, because I wanted to ask you about the deliberate support that Fairfax did to a corporate action by your Greek Holding Mytilneos over its affiliate METKA.

I think that transaction is an outright abuse of minority shareholders of METKA and I wanted to ask you how come Fairfax actively supported that? And full disclosure, you know we're a shareholders of Fairfax India and also of Mytilneos and of METKA. So, we're an interested third-party, but we were very disappointed to see that you were involved in that. Thank you.

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

No, thank you for that question and if you will send me an e-mail, I'll make sure that we have our guys who specialize in it, in Mytilneos and they have reviewed it. They think it's fair, we want to give you our perspective as a shareholder. So that you would understand it. You might not agree with it, but you'll understand it. And we'd be happy to share that with you, if you send us your e-mail, okay?

Q - Mikel Abasolo {BIO 3756596 <GO>}

Thank you so much. Thank you very much.

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

Thank you very much for that question.

And Jen, anymore questions?

Operator

At this time, we do not have any questions on queue sir.

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

Well, Jen, if there are no more questions, thank you all for joining us on this call. We look forward to presenting to you again in the next quarter. Thank you, Jen.

Operator

Thank you, and that concludes today's conference call. Thank you all for joining, and you may now all disconnect.

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