Q1 2018 Earnings Call

Company Participants

- David James Bonham, Chief Financial Officer & Vice President
- Derek Bulas, General Counsel
- Vivian Prem Watsa, Chairman & Chief Executive Officer

Other Participants

- Howard Flinker, Analyst
- Mark A. Dwelle, Analyst
- Mikel Abasolo, Owner
- Paul Holden, Analyst
- Tom MacKinnon, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to the Fairfax's 2018 First Quarter Results Conference Call. Your lines have been placed in a listen-only mode. After the presentation, we will conduct a question-and-answer session. For time's sake, we ask that you limit your questions to one. Today's conference is being recorded. If you have any objections, you may disconnect at this time.

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

Derek Bulas

Good morning and welcome to our call to discuss Fairfax's 2018 first quarter 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, Derek. Good morning, ladies and gentlemen. Welcome to Fairfax's First Quarter Conference Call. I plan to give you some of the highlights as usual and then pass it on to Dave Bonham, our CFO, for additional financial details.

In the first quarter of 2018, book value per share increased by 4.9% adjusted for the $10 per share common dividend paid at the first quarter of 2018. Our insurance companies had an excellent first quarter with a combined ratio of 96% with excellent reserving and producing an underwriting profit of $109 million. All of our major insurance companies had combined ratios of less than 100% with Zenith at 86.1%, Odyssey Group at 91.2%, Allied World at 94.8%.

First quarter operating income was very strong at $238 million and strong net investment gains in the quarter of $934 million, which arose primarily as a result of net gains on equities of $1 billion, offset by losses in bonds and CPI-linked derivatives. The gain on equities was primarily from Thomas Cook changing the accounting for its ownership in Quess Corp. from a subsidiary to an associate company. Under IFRS accounting, Quess Corp. was deconsolidated from Thomas Cook, and Fairfax's ownership in Quess was recorded at fair value. In the next year, Quess will be spun off from Thomas Cook and Fairfax will own approximately 33% of the company.

As shown on page 50 of our quarterly report, we realized gains on our investment portfolio of $727 million in the quarter and had unrealized gains of $207 million. As we have mentioned in our annual meetings, annual reports, quarterly calls, and I mentioned again with IFRS accounting where stocks and bonds are recorded at market and subject to mark-to-market gains or losses, quarterly and annual income will fluctuate and investment results will only make sense over the long-term. All in all, we had net earnings of $684 million for Fairfax shareholders.

Our insurance and reinsurance businesses premium volume was up in the first quarter of 2018 versus 2017 by 42.6% primarily due to increases at Northbridge, Crum & Forster, and Odyssey, and the acquisitions in 2017 of Allied Group, the Latin American operations of AIG in Argentina, Chile and Colombia, and AIG branches in Central and Eastern Europe, offset by the divestiture of First Capital, while the combined ratio for our insurance and reinsurance operations was 96%. Excluding the acquisitions and divestiture, our premium was up 7.1%.

At the subsidiary level, the change in net premiums written and the combined ratios in the first quarter was as follows. Odyssey Group, I just wanted to emphasize Odyssey has changed its name from OdysseyRe to Odyssey Group, which includes OdysseyRe, Hudson Insurance, and Newline Group Insurance in London. So it's three companies together. They thought it appropriate to have a name changed to Odyssey Group. So Odyssey Group had a 91.2% combined ratio and a 24.2% increase in premium, excellent results. Crum & Forster, 99.7% combined ratio, 7.5% growth in premium. Northbridge, 99.2% combined ratio, 6.8% growth. Zenith, 86.1%, premiums down 7.1%. Fairfax Asia, 104.5%, premiums down because of First Capital, 22.1%. Brit, 98.9%, premium is up 3.6%. And Allied World was in, for the first time in Fairfax, 94.8%.

We continue to hold our CPI-linked derivatives with a notional value of $119 billion, which produced unrealized losses of $20 million in the first quarter. If some of the unexpected risks come to pass, these CPI-linked derivatives could become very valuable. We will continue to hold them for some time.

When you review our statements, please remember that when we own more than 20% of a company, we equity count (00:05:56). When we own above 30%, we consolidate, so that mark-to-market gains in these companies are not reflected in our results.

As you can see on page 55 of our quarterly report, the fair values of our investment in non-insurance associates and listed consolidated companies like Cara, Grivalia, Thomas Cook, Fairfax India, Fairfax Africa is $5.5 billion versus a carrying value of $4.7 billion, an unrealized gain of approximately $800 million that's not on our balance sheet.

In January, the company completed the acquisition of the insurance operations of AIG in Uruguay for $5.9 million in cash. In February, Fairfax India entered into an agreement to acquire a 51% equity interest in The Catholic Syrian Bank for approximately $186 million. Transaction is subject to customary closing conditions and is expected to close in the second quarter of 2018. This bank is headquartered in Thrissur, Kerala, and offers banking services across India.

Also in March, Fairfax India entered into an agreement to acquire an additional 6% of the outstanding shares of Bangalore International Airport from Siemens for approximately $67 million. This transaction is subject to customary closing conditions expected to close in the second quarter of 2018 and will increase Fairfax India's equity interest in Bangalore Airport to 54%. Bangalore Airport owns and operates the Kempegowda International Airport in Bangalore, India through a public-private partnership.

In the last four months, we raised $1.84 billion through a CAD 650 million bond issue at 4.25%, a €600 million bond issue at 3.1%, and a $600 million bond issue at 4.58%. Proceeds are being used to retire debt maturities for essentially the next four years. The company expects to save approximately $50 million annually in interest expense. The make whole provision, we will have paid to redeem our debt to-date, is approximately $62 million.

On April 19, 2018, the company entered into an agreement, as you know, to acquire 100% equity interest in Toys "R" Us Canada from its U.S. parent for approximately $237 million, which is CAD 300 million. Closing out the acquisition is expected to occur in the second quarter of 2018. Toys "R" Us Canada is a specialty retailer of toys and baby products with 82 stores across Canada.

During the fourth quarter of 2017 and up to May 2, 2018, the company repurchased for cancellation and repurchased for treasury a total of 543,481, to be exact, shares, subordinate voting shares, at an aggregate cost of approximately $284 million. As we've said in the past, we believe the new U.S. administration's policies of reducing corporate taxes to 21%, rolling back regulation business and possible significant infrastructure spending has the potential of boosting economic growth in the United States for many years to come. Already sentiment among small and large businesses has improved dramatically and animal spirits in the U.S. are alive and well. 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. The fundamentals for the United States may well be excellent for the next few years.

Of course, the trade policies of the United States could precipitate a collapse in world trade, so these risks will continue to be very much monitored by us, and we continue to think the new administration's policies may make this a stock picker's market and one in which we have thrived over the past 32 years. We will continue to pick good companies which provide significant downside protection and potential appreciation over the long-term.

As of March 31, 2018, we have $12.1 billion in cash and short-term investments in our portfolio. We have 32% of our total investment portfolio to take advantage of opportunities that may come our way. We have another approximately $6 billion of one-and-a-half-year treasury bills that are classified as bonds. Interest income is currently running at a run rate of $700 million, up $100 million from year end. With a run rate of $15 billion in gross premium, a huge focus on underwriting discipline, a portfolio of approximately $40 billion, and our investment team operating in a stock picker's market, all grounded on our fair and friendly culture built over 32 years, we expect this will all help us to generate a 15% return for our shareholders.

Now, before I turn it over to Dave Bonham, our CFO, so he can give you some more information on the underlying financials, I wanted to say that in the future, our conference calls will be done by Paul Rivett, our President, with Dave Bonham, our CFO. As Paul is on holiday during the next conference call in August, I will do it. But after that, he will take over the calls.

I will now pass it on to Dave.

David James Bonham {BIO 15243784 <GO>}

Thank you, Prem. So, in the first quarter of 2018, Fairfax has reported net earnings of $684 million or $23.60 per share on a fully diluted basis, and that compared to the first quarter of 2017 when we reported a net earnings of $83 million or about $3 per fully diluted share. Underwriting profit at our insurance and reinsurance operations increased by $2 million year-over-year to $109 million at a 96% combined ratio, relative to an underwriting profit of $107 million last year at a 95% combined ratio.

Our combined ratio in the first quarter of 2018 benefited from net favorable prior reserve development of $86 million and that translated into about three combined ratio points. And that was somewhat lower than net favorable development of $103 million in the first quarter of 2017 when it was 5 combined ratio points. Current period catastrophe losses in the first quarter of 2018, all of which were attritional, totaled $53 million or 2 combined ratio points. And that was higher than the cat losses in the first quarter of 2017, which totaled $39 million or 2 combined ratio points.

So now turning to our operating company results. We can start with Northbridge. Northbridge's underwriting profit of $2 million and a combined ratio of 99% in the first quarter of 2018 was comparable to the underwriting profit of $3 million at a combined ratio of 99% in the same period in 2017. Net favorable prior year reserve development in the first quarter of $13 million or 5 combined ratio points increased from a $10 million or 4 combined ratio points in the first quarter of 2017 and principally reflected better-than-expected emergence on commercial and personal automobile lines of business. In Canadian dollar terms, net premiums written by Northbridge increased 7% in the first quarter of 2018, reflecting price increases across the group and strong retention of renewal business.

Turning to Odyssey Group. In the first quarter of 2018, Odyssey Group reported an underwriting profit of $55 million and a combined ratio of 91%. That compared to an underwriting profit of $48 million and a combined ratio of 90% in the same period last year. Catastrophe losses in the first quarter, all of which were attritional, totaled $38 million translated into 6 combined ratio points and that was somewhat higher than cat losses of $29 million last year translating into 6 combined ratio points.

Net favorable prior year reserve development, principally related to property catastrophe loss reserves, was $41 million or 7 combined ratio points in the first quarter of 2018 and that was similar to the first quarter of 2017 when Odyssey Group reported $36 million or 7 combined ratio points of net favorable prior year reserve development.

Odyssey Group's net premiums written increased by 24% to $690 million in the first quarter of 2018 from $555 million last year, the increase principally reflecting higher net premiums written across all of its divisions with the U.S. insurance division accounting for the majority of the increase mainly in crop and automobile lines of business.

Moving on to Crum & Forster. Crum & Forster's underwriting profit of $1 million at a combined ratio of 99.7% in the first quarter, again, was comparable to underwriting profit of $2 million at a combined ratio of 99.5% in the first quarter last year. There was no net prior year reserve development in the first quarter of 2018 and a nominal amount in the first quarter of 2017. Current period catastrophe losses were also nominal at Crum & Forster in the first quarters of 2018 and 2017. Its net premiums written increased by 7% in the first quarter, principally reflecting growth in excess and surplus lines, accident and health, commercial multi-barrel (00:16:27), general liability, property, and commercial transportation lines of business.

Zenith reported an underwriting profit in the first quarter of $27 million at a combined ratio of 86% compared to an underwriting profit of $37 million at a combined ratio of 80% in the first quarter last year. The year-over-year decrease mainly reflected lower net favorable prior year reserve development, $23 million in the first quarter of 2018 or 12 combined ratio points. And that development reflected net favorable emergence on accident years 2013 through 2016. Net premiums written by Zenith of $308 million in the first quarter of 2018 decreased by 7% year-over-year, and that was principally reflective of price decreases.

Brit reported an underwriting profit of $4 million and a combined ratio of 99% in the first quarter of 2018 compared to an underwriting profit of $11 million and a combined ratio of 97% last year. There is no net prior year reserve development and nominal current period catastrophe losses in both the first quarters of 2018 and 2017. Net premiums written of $409 million in the first quarter increased by 4% year-over-year, reflecting the positive impact of underwriting initiatives they've launched in recent years, price increases, and the favorable impact of foreign exchange.

Allied World reported an underwriting profit of $27 million and a combined ratio of 95% in the first quarter of 2018. Allied World had nominal net favorable prior year reserve development and no current period catastrophe losses in the first quarter of 2018.

Fairfax Asia. Fairfax Asia reported an underwriting loss of $2 million and a higher combined ratio of 105% in the first quarter of 2018 compared to an underwriting profit of $5 million and a combined ratio of 94% in the comparable period in 2017. Net premiums written by Fairfax Asia decreased by 46% in the first quarter, reflecting the impact of the sale of First Capital in the fourth quarter of 2017. Excluding First Capital, net premiums written decreased by 22%, and that was due to lower premium retention at the other companies in the segment.

Insurance and reinsurance other, this segment produced an underwriting loss of $5 million and a combined ratio of 102% in the first quarter 2018. That compared to an underwriting profit of $1 million and a combined ratio of 99.5% in the same period last year. The lower underwriting profit principally reflected the absence of prior year reserve development in the first quarter of 2018, whereas that reporting segment benefited from $13 million or 7 combined ratio points of net favorable prior year reserve development in the comparable period 2017.

Excluding the net premiums written by Fairfax Lat Am and Central and Eastern European AIG branches that were acquired in 2017, net premiums written by this segment were comparable year-over-year. The runoff operating segment reported a loss, operating loss of $33 million in the first quarter of 2018. That was a decrease when compared to the operating loss of $40 million in the same period last year. Losses on claims of $14 million in the first quarter, principally reflected net adverse prior year reserve development related to asbestos loss reserves at U.S. runoff.

Consolidated interest and dividends increased from $128 million in the first quarter of 2017 to $211 million in the first quarter of 2018, reflecting the reinvestment of cash and short-term investments into short-dated U.S. Treasury bonds, the consolidation of Allied World's interest and dividends, total return swap income, and overall higher interest income earned.

Fairfax recorded an income tax provision of $53 million and an effective tax rate of 4.9% in the first quarter of 2018. The low effective tax rate reflected the non-cash gain on the deconsolidation of Quess, which did not attract tax in India and resulted in an income tax rate benefit of $236 million.

Moving to our financial position. Our total debt to total capital ratio increased to 27.2% at March 31 from 25.8% at December 31, 2017, and that increase primarily reflected a temporary increase in our long-term debt prior to deploying those proceeds from the most recent debt offerings to retire outstanding long-term debt. We ended the quarter of 2018 with an investment portfolio, which included holding company cash and investments of $40.2 billion, which increased from $39.3 billion at December 31, 2017.

With that, 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, try to limit your questions to only one, so that it's fair to everyone on the call. Ash, we're ready for the questions.

Q&A

Operator

Thank you. And speakers, our first question comes from Tom MacKinnon from BMO Capital. Your line is now open.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yeah, thanks, good morning.

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

Good morning, Tom.

Q - Tom MacKinnon {BIO 2430137 <GO>}

So I'm just wondering (00:22:18), with the decision to deploy some of the cash, what was driving that and why short-dated U.S. treasuries?

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

Yeah, so short-dated treasuries from 3-month T bills to 1.5-year T bills. You're picking up quite a significant spread as the yield cobbles up, so as the yield cobbles up, moved up. So that – we've put $5 billion, $6 billion. We've done that. Brian Bradstreet's done that. And that basically has resulted in about $100 million plus minus of interest income, Tom, without any capital risk. We think spreads are low. And so we are still keeping – or any bonds we have will be like two, three years, high quality. And we're not taking term risk, neither are we taking any significant credit risk. And we're just waiting for an opportunity to get some more interest income, and at the same time, protecting our down side because spreads are very low in the credit markets.

Q - Tom MacKinnon {BIO 2430137 <GO>}

You've mentioned that deployment of the cash, historically, you've said, it certainly gives us an impression it might be gradual and that's one thing you're looking at with convertibles and warrants as well. Any update on that thinking? And given that you're probably 25% in equities, do you think you'd more into common stock?

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

Yeah, so when you have a 24%, 25% in common stock and we are buying at – they're all on long-term investment values, we think they're very attractive. And you never know when these stock prices go up, so there's some of the things that – for example, in Greece, we think in Greece, this is the year for Greece and investments in Greece, particularly the Eurobank, could do well. Eurobank is selling at about €1, book value of €2.64. Tomorrow, they'll come out with a stress test and see – the rumor is that the stress tests are all fine (00:24:44). And then, suddenly, you have a company that is way below its book value, selling at – we're a shareholder of Eurobank, so I'll take that with a pinch of salt, that's a ridiculous price. So will that go up in the next three months or six months? Who knows, but that thing can go up significantly just like it's come down significantly.

And if you look at each one of our names, now I highlighted that, Tom, in our AGM, I put that all there. And I said, there's a whole bunch of names that we can't forecast, but we expect to do well. Quess, which just came out, was – it's built a huge intrinsic value because of Ajit Isaac and he's built a wonderful company focused on services, and we are spinning it out because Thomas Cook decided to spin it out and we agreed because its market value is bigger than Thomas Cook now. And Madhavan Menon did a wonderful job running Thomas Cook and allowed Quess when we bought it in 2013 to develop. And then now it's got such a high market value and such a terrific track record that it's decided, their board has decided to spin it off. And all shareholders will own the company. We'll own, as I said, 33%. So we've got a lot of things there that we think will develop positively while we've got basically 50% in cash and treasury bills that we can earn more money. But then we get an opportunity like I spoke about, Seaspan. We've put $250 million convertible, a warrant exercisable at 6.5%. And then they had a terrific acquisition that they wanted to make. They came to us. We extended another $250 million at 6.5%. And the stock is about $8 a share, but we get 5.5% of interest income for the next seven years and a warrant that lasts for seven years.

So we've done a lot of that and that I think I've showed that in our annual report, 35%, 37% of that company is what we'd own. People have to trust you a lot before they allow you to have 37% of the company. Well, we've had about six, seven of them already. And we are expecting, and Paul Rivett is very much involved in this. We're expecting that we'll have a lot more, Tom. And we like the protection that we get when we get 5.5%, 6%, 7% in a debenture or a preferred and the warrant in a company that we really like.

So because we built our company over 32 years and we've got this very good culture that we demonstrated, I think, and you saw it at the AGM, it's a huge plus. And that's where these opportunities are coming our way. And so we're very focused, as I said, looking at a totally insurance business and our investments. We don't really have to do a lot. We're focused on making that 15%, which translates to about – with a 95% combined translate to about 7% on our investment portfolios. And I know you'd like it to be quantified as an analyst, as a good analyst, Tom. You want it to be nicely quantified quarter-by-quarter. Well, we've never worked that way.

Fairfax has been built by going on the basis of a lumpy return as opposed to a traditional quarter by quarter by quarter, so that you can forecast it. We're not in that business. We're in the business of building intrinsic value and with a 95% combined, our insurance companies are doing very well, really well reserved, $40 billion of investment portfolio. We don't have to buy anything. We make our 15%. We have a tremendous amount of flexibility in terms of buying things that we want to. But our first objective, as I've said many a time, is to buy back our stock, and we've bought about 0.5 million shares already.

Q - Tom MacKinnon {BIO 2430137 <GO>}

If I can squeeze one more in, your decision not to be on the call going forward, what's on (00:29:17)?

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

Hey, just to – I'm focused on capital allocation and focused on investing. We got $40 billion, Tom. And so I think we just had our AGM, and this quarter is really, from my view (00:29:35), we want to do it because of the quarter. But I think it's the right time. Paul is very involved in all our business, to pass it on to Paul and I'm there. And if there's any question that needs to be answered and all I'll be there. If anything significant is happening, I'll be there. But Paul Rivett is very qualified to take it forward. And next time, Paul, I'm going to be on holidays and Paul will be taking the conference call. So it's a nice transition, Tom. I think it's timely.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Thanks very much.

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

Very welcome, Tom. Next question, Ash.

Operator

Thank you. Our next question comes from Paul Holden from CIBC. Your line is now open.

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

Hey, good morning, Paul.

Q - Paul Holden {BIO 6328596 <GO>}

Hey, good morning. So two-part question. The first part of the question is, when I think about – when I look at the gains Fairfax has realized over the last year and also when I look at the allocation of capital in terms of the equity positions you have, I start thinking more and more about Fairfax as having significant exposure to emerging markets versus the

U.S. economy directly. So my question is, do you agree with that characterization? And if that's true, why have you kind of positioned the portfolio that way?

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

Yeah, no, we're opportunistic, Paul, wherever the values are, so we're in Greece, for example. That's not exactly emerging markets. We're in the United States where the markets are high. Do we own Netflix or do we own any of the high FAA (00:31:24) bank stocks? No. But there's a lot of stuff that is available if you look. And like Seaspan, I gave you an example there and other names that we've talked about. But in the emerging markets, we're really excited about India particularly. We think the opportunity is huge.

We had IIFL, by the way. It's a big investment in Fairfax India. Their quarterly report just came out yesterday. And anything you look at is growing at 35% to 40%. They got three businesses. They're spinning it off and I won't bore you with the details, but just look at that quarterly report, IIFL. And you'll get a sense for the opportunity of good companies, run by founders, who are building businesses over the long-term. Because the economy is growing so significantly and these businesses are coming in from a low base, the opportunity is very significant.

So we are there, and Fairfax Africa, we are seeing a huge number of opportunities with Paul Rivett from our side working with Quinn McLean from our side, and Mike Wilkerson and his team in South Africa. Mike is in New York. We had a very nice meeting at - first annual meeting, Paul, for Fairfax Africa and we're about close to 150 people and investors really, people who are looking at Fairfax Africa as an investment or have invested already. So we are looking - the big plus I think for us is just that people trust us and so these opportunities that we get whether it's Africa or India or in the United States or Canada or in Greece. They think that we will treat them well and they're right. We're going to treat them well, but we expect to make a return.

But it's a long-term return. It's not quarter-by-quarter. So, when you look at your models and you, as an analyst, good analyst, you're looking at your model and trying to quantify, saying, they got 50% in cash, where are they going to get the returns? Very tough to figure out for you, it's tough for us to figure out other than we've got a 32-year record of outstanding investment results. Not good in the last five years. I showed that at our AGM, but next five years are going to be different. So, Paul, follow-up with your next question, if you've got one.

Q - Paul Holden {BIO 6328596 <GO>}

Yeah, so my next question is sort of related to modeling and your, maybe some of your more unique exposures is, how do we think about the minority interest in Allied and Brit and their participation in things like Quess and First Capital, et cetera?

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

Yeah, so the Brit, I said at our AGM, we have the ability and - after three years, that three years comes up in June and there's a couple of months that we work together, but Paul is already working with OMERS, who's our partner, in terms of working out a deal where they get a good return and we're able to buy back that 30%. In Eurolife, we have the same opportunity. In their case, they've done so well that because they had these Greek bonds and Greek bond prices went down significant - I mean, rates went down, prices went up. And so they will have the ability to buy back that 40% that OMERS has. They're not able to buy it in 2019, but we might be able to make a deal to buy it back. And so those two companies might well be 100%-owned.

Allied, we have another two years to go I think before by - in June, we'll have another two years before we can buy back Allied. And we have a wonderful relationship with OMERS. We make sure they do well. And for us, it works out well over the long-term. So it's a good relationship, Paul. And it's a win-win, win for them, win for us.

Q - Paul Holden {BIO 6328596 <GO>}

Thank you.

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

Thank you very much. Ash, next question.

Operator

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

Q - Mark A. Dwelle {BIO 4211726 <GO>}

Yeah, good morning.

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

Good morning, Mark.

Q - Mark A. Dwelle {BIO 4211726 <GO>}

Tom took a couple of my questions. Thank you. So I only have really one other question. I just wondered if you could talk just a second about the debt refinancing. You chose to use some eurobonds as well as Canadian bonds, which is not surprising. Just kind of what the game plan is there, what the timeline is (00:36:26) to get all the redemptions done? I know there are some market aspects to that, but just kind of in general what you're thinking about there.

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

No, that's a good question, Mark. So we raised that, I think, a little more than over a $1.8 billion. This is the advantage of Fairfax, right. We have a very small company at the head office, and it's not focused on the operation, the operation that decentralized. But at that head office, we are focused on acquisitions. We are focused on capital allocation. But also we are focused on financing. So led by Paul, Dave Bonham, and Peter Clarke group, we raised that $1.8 billion with the idea that in the next four years, we have approximately that coming up. And we are - we think interest rates will go up over time because the economy in the United States is doing well, and so if interest rates goes up, it behooves us to refinance. And so we had just refinanced 2018, 2019, 2020 and 2021. We still have some 2021 left, but we just want a clear runway for the next four years. We'll reduce stock costs at the moment about $50 million. We have a make-whole payment that we have to make. When you're calling these bonds, you have to pay the bondholders depending on where interest rates are, the spread is fixed (00:37:59). So we've got some more to go, Mark, on that.

But basically, we want a clear runway for four years. We are extending term for 10 years, so there's going to be no refinancing on that four years for 10 years. We reduced the costs for all 10 years, particularly if interest rates go up, and gives us a huge amount of financial flexibility. So that's basically - we did all of that, as I said, led by Paul, in about three or four months. And for the first time, I took - I was very happy about - to note that for the first time, we did a eurobond issue. And Dave, Fairfax is really not known in the eurobond market. This is the first time, and we had demand, I think, for about €1 billion plus and we did €600 million at 2.75% coupon that we had hedged, so before we went and the hedge took our cost at the 3.1%.

And when I say hedge, what that means is just we're locking up at the underlying. In their case, I guess it's the German bond rate. But In the United States, it's the U.S. Treasury rate, and so that we are not - we are happy with the U.S. Treasury rates so we linked it up (00:39:26). In the case of the U.S., our rate was 4.88%, I think, but it was 4.58% for our 10-year bond because we hedged and the interest rates had gone up. So that's a huge advantage for Fairfax because it's already got access to the eurobond market now and we do - we can raise money in the United States, we can raise money in Canada. So, as you go bigger, $15 million, $14 million, $12.5 million of capital, we need that ability. And our company, I remind you, being built for 50, 100 years from now, long after I'm gone. So we're just cognizant of that and recognizing that.

Q - Mark A. Dwelle {BIO 4211726 <GO>}

I appreciate the update and that's really my only remaining question. Thanks.

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

Thank you, Mark. Ash, next question?

Operator

Thank you. Our next question comes from Howard Flinker from Flinker & Company. Your line is now open.

Q - Howard Flinker

Thank you. Hi, Prem. Hi, John (00:40:33).

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

Hey, good morning, Howard.

Q - Howard Flinker

Hi, a few historically sound property and casualty underwriters have noted lately that rates have begun to creep up. Could you discuss the rating environment please?

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

Yeah, no, we had – Howard, as you know, we had huge catastrophe losses last year, perhaps a record. The numbers are coming in, of course, and with the expectations of $130 billion, $135 billion, so it's a record amount, but the prices didn't go up as much. They've gone up. If they had losses like in the Caribbean, it certainly (00:41:09) went up 10%, 15%, maybe higher for some accounts. But broadly speaking, you didn't have a – you might have thought, you might have speculated after that loss that there'd be hard market. It's not a hard market, but the prices are not going down any longer. The prices have flattened out. And in areas you're getting 5%, maybe higher increases, and so it's not a bad market. But it's not a market like 2001 where you had a broad hardening market where it's allowed you to have greater – we doubled our premium during that market that will fill worldwide hard (00:41:53) market, haven't had that yet, but one of these days something will happen that – because of returns in the insurance...

Q - Howard Flinker

(00:42:02)

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

Yeah, for the insurance, it's not that great.

Q - Howard Flinker

Yeah, miniscule. A bear market in bonds and stocks would greatly shrink capital. That would have hardened the market a great deal.

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

Yeah, no, that's right.

Q - Howard Flinker

Okay. Thanks.

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

Thank you. Thank you, Howard. Next question, Ash.

Operator

Thank you. And our last question in queue comes from Luis Hernandez (00:42:23), and he is a private investor. Your line is now open.

Yes, hello, Prem.

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

Good morning, Luis (00:42:31).

Q - Operator

Good morning. I have basically a question on the share repurchase, just a clarification. You have - you repurchased roughly year-to-date around 340 million shares. And of those, you have 116 million that are for cancellation and the rest are for share compensation, I believe. So the 223 million are essentially not going to be eliminated, they're going to continue on the share count. So basically, my - I mean, is that right?

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

No. (00:43:11) our incentive programs, more recent ones, Luis (00:43:16), however, like 15 years, right. So they're - I don't know if we mentioned that, but they're like longer-term where everything we do are - Canadian share plans are like 5 and 10 years. You get half in 5, and half in 10. But these recent ones are like 15 years. So, for 15 years, they're not going to be issued. They're eliminated. And at the end of 15 years, when our executives get them, then they'll go into the shares outstanding. So that's how it works.

Dave, please confirm that.

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

Yeah, that's absolutely right. So, if we purchase shares for the share plan, that reduces our share count when we purchase the shares. And then as Prem says, they stay in treasury for 5, 10, 15 years, and then when they're reissued, they increase the share count.

Q - Operator

Okay. All right. Good.

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

And you can see that, Luis (00:44:17) in our shares outstanding. If you look in our interim report, you'll see that. That's how it's shown. But that's what we're doing. But as I said before, that we just think every time we get an opportunity where, over time and this is more like in the next 10 years, for every time we get an opportunity, extra cash, we're going to be buying our stock back.

Q - Operator

Right. Well, yeah. Okay. And that's a good clarification. And I just wanted to just pass on the - I mean, so it's 340 million. It's roughly over 1.7%. Do you think that's - I mean we had great prices to buy back in February, March, and I just wanted to feel is that like - could you, guys, be more aggressive or do you think that that's a fine level for repurchase? Just wanted to have your feel on that.

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

Yeah, so you saw we are buying rightly. We bought stuff in the fourth quarter. We bought in the first quarter. We bought in the – right till yesterday. And so we're continuing to buy it. You can see the prices we paid. But we have to always look at Fairfax, and first, financial soundness. We have to always look at it in that sense. We have to look at it, and as I said at the AGM, Luis (00:45:49) that we are looking at buying our minority interest. And when I say minority interest, I'm talking in Brit, talking in Eurolife, which I just explained to you, and Allied. So we have to look at all of that, and then we have to use our cash accordingly in terms of buying our stock. So that's what you should expect in the next 10 years. That's what we're going to do.

But our first alternative always is, can we buy shares back? We've issued shares. I showed that to you in the annual report and in our AGM. We had 5 million outstanding when we began, we issued 22.8 million, and now we got 27.8 million. But that's what we issued to build the company we have. Now we want to – we don't think we need to buy anything. I'm not saying we won't, but not issuing shares to buy it and what we want to do is just go the other way. And every time we have an opportunity in the next 10 years, we are going to be buying back our stock. And we think that's the best thing we can do for our shareholders.

Q - Operator

All right. Sounds great. And one follow-up basically regarding Eurobank. As you mentioned, previously, you have a lot of confidence in the bank and in the recovery of Greece. And given that our cost is way significantly above the current price and like why haven't you guys thought about increasing that position, given that we only own 17% and could own significantly more, is there (00:47:34)?

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

Yeah, yeah, we own quite a bit already, Luis (00:47:38) and cost is much higher, exactly right. But our cost is below book value and book value continues to grow. Just one statistic that you – I don't know if you attended our annual meeting, but Bank of Ireland, since loan loss, since non-performing loans, they peaked in, I think, three or four years ago, they're down almost 75%. These are loans that are non-performing, down 75% as the economy started recovering. The economy in Ireland has recovered very well as you know. But in Greece it's gone down. The better part of 30%, the GDP is down about 28%. It's recovering now. Most people are thinking 12% (00:48:29) as you and I are talking on the telephone, they'll be – because it's down 30%, there will be years where it might grow 6%, 7% growth because it's coming from such a low base.

And the non-performing loans are going to drop and that's huge for a bank like Eurobank. And that's what happened in Ireland with the Bank of Ireland. And Richie Boucher, by the way, is Head of the Risk Committee at Eurobank and is on the board of directors. And so we see tremendous possibilities for Eurobank, but we've got a lot invested already. So we're tempted, Luis (00:49:09), but we haven't bought a lot more.

Q - Operator

All right. Okay. Just asking because it seemed pretty attractive to me and I guess you could add more to it, but I guess you have your - that's a good explanation too.

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

It's a good question that you asked, Luis (00:49:32). Thank you for that. Ash, any more questions?

Q - Operator

All right. Okay. Thank you very much. I didn't go to the annual meeting this year. I had some problems, but I'll make sure I'll meet you guys next year there.

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

Okay. We'd love to see you, Luis (00:49:46). We had a very nice turnout at our AGM, and it was really nice to see all our shareholders. And we really encourage you to come because then you can meet our presidents and you can see some of the other investments we have and all of that. But thank you for your question, Luis (00:50:05). Ash, is there one more, any more questions?

Operator

Yes, we have another question coming from Mikel Abasolo from Solo Capital Management. Your line is now open.

Q - Mikel Abasolo {BIO 3756596 <GO>}

Yes, hello, thank you very much for taking my question again.

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

Good morning, Mikel.

Q - Mikel Abasolo {BIO 3756596 <GO>}

Good morning, yes. Prem, my question is a very short one, very specific one. Warren Buffet in his annual shareholders meeting put the probability of $400 billion catastrophe as immaterial (00:50:41). I think he talked about perhaps a 2% probability. He explicitly mentioned that most property and casualty insurance companies would go under. Have you thought about such a terrible scenario and the probability, how Fairfax (00:51:04)?

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

Yes, Mikel, we think about that. That is the biggest risk an insurance company has and we think of that all the time. We think about it by company and in total Fairfax exposure, and it comes right to me. I'm involved in it myself because that's as you point out and as Warren has pointed out, that's a scenario that can impact the company. So we look at it all the time, have been looking at it for 32 years and making sure that we can - any type of impact like that, that we can survive. And so if that storm, I guess it was Irma that was heading towards Miami, if it had hit Miami, which would have been a huge event, we'd have survived that. And a lot of people would have got badly, badly hit. So we look at all of those worst case scenarios. We've got limits. And most of our exposures, we've got limits, Mikel, that allows us to know what our exposures are. We don't just believe – we don't look at these models. We look at different ways in terms of – different ways of looking at earthquakes and hurricanes and all of that.

And so there's no guarantees in life, but we'd like to think we'd be one of the last to survive. So we have every intention of surviving those events, those worst case events. And like Warren, we look at worst case events. Like, we look at 1,000-year events and, like, way off the scale in – we think of ourselves as, in the head office, as risk officers. All of us look at risk first, like, what can hit our company. And the cat exposure is one. You got stock market fluctuation, interest rates going up. You've got reinsurance recoverables. So we followed this for 32 years, and we have every intention of doing that for the next 50 to 100 years. But a good question, Mikel.

Q - Mikel Abasolo {BIO 3756596 <GO>}

Thank you so much. Thank you very much. Bye.

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

Yeah, thank you, Mikel. Ash, any more questions?

Operator

We show no further questions at this time.

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

Thank you very much, Ash. If there are no more questions, thank you all for joining us on this call. We look forward to presenting to you again after the next quarter. Thank you, Ash.

Operator

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