Q3 2011 Earnings Call

Company Participants

- Brad Martin, VP, COO
- John Varnell, VP, CFO
- Prem Watsa, Chairman, CEO

Other Participants

- Jeff Fenwick, Analyst
- Mark Dwelle, Analyst
- Paul Holden, Analyst
- Tom MacKinnon, Analyst

Presentation

Operator

Good morning. Welcome to Fairfax 2011 Third Quarter results conference call. Your lines have been placed in a listen-only mode. After the presentations, we will conduct a question and answer session. (Operator Instructions) 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 Brad Martin. Mr. Martin, please begin.

Brad Martin {BIO 3466650 <GO>}

Good morning. Welcome to the conference call to discuss Fairfax's a Third Quarter 2011 results. The comments we make during this conference call may contain forward-looking statements. Actual results may differ materially perhaps materially from those contained in such forward-looking statements as a result of a large variety of uncertainties and risk factors, the more foreseeable of which are listed in Fairfax's a annual report which is available on our website at www.fairfax.ca or set our on our Risk Factors in Fairfax's Universal Shelf Prospectus filed with the securities regulatory authorities in Canada which is available on SEDAR.

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

Prem Watsa {BIO 1433188 <GO>}

Thank you, Brad.

Good morning, ladies and gentlemen. Welcome to Fairfax's a Third Quarter conference call. I plan to give you some of the highlights and then pass it on to John Varnell, our CFO for additional financial details.

Our results have always been lumpy, and our Third Quarter earnings are a case in point. We earned almost $1 billion in spite of significant catastrophe activity in the quarter because of almost $1.6 billion in net gains on our investment portfolio. Our book value per share increased by 9.7% in the nine months to approximately $403 per share after adjusting for the $10 per share dividend paid in the First Quarter. Excluding acquisitions, our consolidated net premiums written in the quarter grew by 16%, including acquisitions that grew by 21%. The Company continues to be soundly financed with cash and marketable securities at the holding company level in excess of $1 billion.

This is our Third Quarter reporting under International Financial Reporting Standards, IFRS. Our investments are now shown at market value at the end of the quarter and the fluctuations in market values flow through the income statement.

Some highlights during the quarter --The combined ratio of the Company's insurance and reinsurance operations on a consolidated basis was 107.5% in the Third Quarter of 2011 producing an underwriting loss of $105.3 million. Underwriting losses were negatively impacted by $171.7 million of pre-tax catastrophe losses related to Hurricane Irene, the Denmark floods and the development on the Japanese earthquake losses which increased the combined ratio during the quarter by 12.3 points. Catastrophe losses in the first nine months were $661.2 million or 17percentage on our combined ratio.

Net investment gains up $1.6 billion in the Third Quarter and $1.6 billion approximately in the first nine months of 2011 consisted of the following --if you will, please note page two of our press release. You will see there that net losses on equity and equity-related investments of $1.34 billion are predominantly unrealized an were largely neutralized by net unrealized gains of $1.5 billion on our equity hedges. Unrealized bond gains of $1.2 billion and $51 million in unrealized CPI-linked derivatives and other unrealized gains of $118 million resulted in a net gain of $1.6 billion in the quarter, most of it unrealized. The unrealized bond gains were largely due to our long US Treasury bond portfolio which benefited from declining interest rates in the Third Quarter.

As of September 30th, 2011 the Company held $1.22 billion of cash, short-term investments, and marketable securities at the holding company level.

Finally, we continue to be approximately fully hedged in relationship to our equity and equity-related securities, which includes convertible bonds and convertible preferred stock, with some variation in the hedge ratio due to fluctuating markets. We continue to be very concerned about the prospects of the financial market and the economies of North America and Western Europe with the possibility of developing problems in China.

Now I would like to turn it over to John so he can give you some more information on the underlying financials. John.

John Varnell {BIO 5699703 <GO>}

Thank you, Prem.

So starting with our Third Quarter financial results consolidated, the net earnings for Fairfax shareholders were $973.9 million in the 2011 Third Quarter. That compares to earnings of $388 million in the 2010 Third Quarter. The Third Quarter fully diluted EPS was $46.73 dollars compared to fully diluted EPS of $18.44 in the quarter last year. Nine month earnings were $816.6 million this year or $37.78 per diluted share, compared to $830.2 million or $39.56 per diluted share last year.

The Third Quarter earnings were influenced by two main items. The first is the underwriting result. We had a $105.3 million underwriting loss in the quarter compared to a $13.3 million underwriting loss last year. Contributing to this year -- this quarter's underwriting loss were the catastrophe losses, as Prem mentioned, of $171.7 million or 12.3 combined ratio points. Our Third Quarter calendar year combined ratio is 107.5 on a consolidated basis compared to 101.1 last year. Also note that for nine month this year the combined ratio was 111.8 which included 17 points on the combined ratio related to catastrophe losses, and last year the combined ratio was 103.7, which included 8.5 related to catastrophes.

On an accident-year basis, looking at the impact of the results of our reserve development, we had a very small amount, about $7.5 million,

in net adverse development in the Third Quarter, which is about half of combined ratio points. The second large item, as Prem has mentioned, was the large net gains on investments of $1.588 billion. In the Third Quarter of 2011 interest and dividend income decreased to $169.6 million from $189.8 million last year.

Our annualized portfolio yield decreased in the Third Quarter of 2011. The yield on an annualized basis was 2.85% and that compares to the Third Quarter of 2010 yield was 3.45%. The decrease in the yield reflected the increased investment expenses associated with the total return swaps. The average investment portfolio size has increased to $24.9 billion from $23.2 billion last year.

Turning to operating company results starting with Odyssey -- their underwriting result in the Third Quarter was a combined ratio of 103.4 which produced and underwriting loss of $18.9 million. In the Third Quarter of 2010, for comparison, Odyssey had a combined ratio of 89.2% and and underwriting profit of about $51.7 million. Odyssey's cat losses pre-tax net to them for the Third Quarter 2011 were $109 million or about 19.7 combined ratio points. By comparison Odyssey had $41.4 million in cat losses or about 8.6 combined ratio points for the Third Quarter of 2010. Odyssey's Third Quarter 2011 accident year combined was 103.5%.

In terms of premium volumes, Odyssey's net premium written was $642.9 million this quarter compared to $524.1 million last year. This reflected increased writings of crop, commercial auto business in the United States, property business generally offset somewhat by reduced casualty ratings.

At Crum & Forster, the combined ratio was 102 in the Third Quarter. That compares to 106.6 a year ago. Crum had small cat loss of about $3.4 million in the quarter and underlying loss of $5 million. On an accidents year basis Crum's combined ratio is 101.7 this quarter, and that compares to 106.8 in the year ago quarter.

At Crum, we saw an increase of net premiums written to $266 million in the Third Quarter of 2011. That figure includes First Mercury net premiums of 58.1 million --and First Mercury is the acquisition that Crum did most recently. By comparison the net premiums written in the Third Quarter of 2010 were $168.2 million. So if you take out First Mercury, that's an increase in net premiums written of about 11% for Crum & Forster.

At Northbridge, they had a combined ratio of 101.4 in the quarter. That compares to 104.8 in the year ago quarter. They had two combined ratio points of cat impact from Hurricane Irene mostly and that was offset by favorable claim development in the Third Quarter of 2011 of 4.6 combined ratio points. Net premiums written at Northbridge increased to $245 million this quarter from $227 million last year. That includes the impact of a portfolio transfer. Excluding that transfer, their premiums were up a few percentage points.

For Fairfax Asia, their profitable growth continued this quarter. Their combined ratio was 73.1 compared to 76.2 last year. Net premiums written were $49.7 million and that included Pacific Insurance, their most recent acquisition. And that's up from $36.4 million from the prior year. Net premiums written for nine months of 2011 were $163.2 million, up from $124.4 million in nine months of 2010.

In our reinsurance and insurance other segment, we had a $146.7 combined ratio and underwriting loss of $60.7 million due to cat losses of $53.7 million or 41.6 combined ratio points which came from Hurricane Irene and Japanese lost development mainly. Net premiums written in that same decreased by $11 million or 8.73% in the Third Quarter.

At Zenith we reported a 124.3 combined ratio this quarter compared to 125.1. Net premiums written during the Third Quarter increased, about 15% reflecting Zenith's ability to write new business at higher prices.

Just a note on taxes in the quarter. You will see that we had a $514 million provision for income taxes which is a 34.5% tax rate which is higher than usual. That occurred because we had significant earnings in the United States which is a higher tax jurisdiction and we had losses in our low tax jurisdictions.

On financial position, Prem told you that the book value was $402.66per share at September 30. Common shareholders equity ended the quarter at $8.2 billion, preferred end of the quarter at $935 million.

Our total debt to total capital ratio was 24.6%at September 30 and that compares to 23.9% at December 31. Also note that Fairfax had holding company cash and securities of $1.2 billion.

And Prem, that's it for my section and over to you.

Prem Watsa {BIO 1433188 <GO>}

Thank you, John. Now we are happy to answer your questions. Please give us your name, your company name and try to limit your questions to only one so that it is fair to all on the call. Mary Ann, we are ready for the questions.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Jeff Fenwick of Cormark Securities.

Q - Jeff Fenwick {BIO 15350794 <GO>}

Good morning, gentlemen.

A - John Varnell {BIO 5699703 <GO>}

Hi.

A - Prem Watsa {BIO 1433188 <GO>}

Good morning, Jeff.

Q - Jeff Fenwick {BIO 15350794 <GO>}

Prem I just wanted to ask you for perhaps some color around volume growth. I mean quite an impressive number that you highlighted there in the quarter. I know Fairfax has always been conservative in the way that it approaches the market and looking for good price adequacy before you begin to ramp those volumes. So maybe what are you seeing in those markets? Is there -- has there been a material turn in some of these areas where either there's less capital available or players have exited? And are you being opportunistic on a short-term basis or do you think is something where maybe we are starting to see some firming and this is the sustainable trend?

A - Prem Watsa {BIO 1433188 <GO>}

Jeff, the prices are firming up in some markets sort of bottoming out and firming up -- workers' compensation in California for example as John said some of the specialty markets that Crum & Forster is involved in. It's not been out right hot market but there are certain pockets that our companies are taking advantage of. But by any imagination not a hot market yet. Though 1/1 is a very important date. We will a see how that develops.

For the cycle -- as you know, interest rates are low, so every time bonds mature, investment income drops. The cushions of the hot markets of the past are coming down and so sometime -- and in spite of all that the returns on equity are not significant. You've had increases in the Third Quarter in terms of spreads, whatever bond positions you had, unless you had government bond positions of course, you had some unrealized losses or less gains. So the trends we think will change some time. It's very difficult to say when.

Q - Jeff Fenwick {BIO 15350794 <GO>}

And I guess that just sort of feeds into you -- you allow underwriting versus your capital today as you think I highlighted in the past is really a relatively low and there is that opportunity for you to scale. And I guess the key concern is just to be profitable as opposed to actually low combined ratio levels. Let's get the flow growing and try to generate some returns off the flow. Fair enough.

A - Prem Watsa {BIO 1433188 <GO>}

Yes. So this quarter you saw a gain and in the nine months, I highlighted for you the catastrophe losses, significant cat losses. And you know that's our business so these things are not predictable. Beginning right at the top of the -- right at the beginning of the year with the Japanese earthquake and tsunami, and you had Irene and some Danish losses and flood losses. So these things are there. They take place at all times. But we are seeing opportunity on a case by case basis, and if you see the opportunity then we take advantage of it.

Our capital, if you add our equity -- our equity base is about $8.2 billion. We've got $900 million of preferred which are basically perpetual preferred. Then if you had some long-term debt that we have, you've got about $11 billion plus of capital. And you have -- we are writing between $5.5 billion and $6 billion of premium. So we have the ability to write a lot more premium. We won't write it on a forecast. We will write it when we see the prices going up sufficiently that we can make significant underwriting profits with good results.

Q - Jeff Fenwick {BIO 15350794 <GO>}

Okay. Thank you. I'll re-queue.

A - Prem Watsa {BIO 1433188 <GO>}

Thanks. Thank you, Jeff.

Operator

Our next question --

A - Prem Watsa {BIO 1433188 <GO>}

Next question, Mary Ann.

Operator

Our next question is from Mark Dwelle of RBC Capital.

Q - Mark Dwelle {BIO 4211726 <GO>}

Yes. Good morning. A couple of questions.

First, related to I guess Northbridge -- we saw some improvement in the underwriting results there relative to some recent quarters. I know there's been a lot of commentary on the US market as far as rate firming. Are we seeing some of the same trends in the Canadian market? Or is it lagging at all?

A - Prem Watsa {BIO 1433188 <GO>}

It's really too early to tell, Mark, and Canada tends to lag the US. But we are -- we've got very high accident year loss ratios. So all our companies have -- we like to think of it as having high accident year loss ratios they're above 100%. Then we hope our results will be redundant as the years go by. But it's still very competitive in Canada, and so our premiums have gone up some, Mark, but we are very careful.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Thanks for that. Second question. Obviously, a lot of result in the quarter was related to unrealized gains. Is there -- I know in the past sometimes you provided some update in terms of how the portfolio has moved subsequent to the quarter. I guess my guesstimate would be is that some of that gain has eroded in the course of October.

A - Prem Watsa {BIO 1433188 <GO>}

Yes. So Mark, that's right and we had the opportunity it -- these are very liquid treasury bonds, longer-term treasury we can sell at a moment's notice. We decided not to. And it's reflecting the fact that we are still very concerned about the economic outlook. As I said to you, we are concerned about the situation in the United States in terms of -- broadly speaking we're looking at this as a balance sheet recession. So there he is a lot of deleveraging taking place among individuals as well as businesses. And on top of that you've got now the governments in austerity programs in the United States and in Western Europe.

So we think that no fiscal options to speak of in the current environment and no monetary objections because interest rates are basically at zero percent today in both those major areas, Western Europe and the United States. And in that environment we think our study of the past and we think of to look at Japan and the 30s -- those are the two relevant periods we think because they were also balance sheet recessions and there were times when there was a lot of debt in the system, both countries. And so in those time periods government bonds were the ones that benefited an investor.

So as far as your question is concerned in the Third Quarter loan rates might have dropped by approximately 1.5percentage and since the end of the quarter maybe a third of it has been reversed. It's gone up say 50 basis points from the end the quarter. And so these are fluctuations. They continue to go up and down. The markets go up and down.

We're looking through all of that looking at the long-term and there will be a point when we will realize these gains, but we don't think it's today.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. That's very helpful. One last question if I may. You've been fairly reserved in terms of utilizing your share buyback programs. You know, the cash position has remained well north of $1 billion for a long time now. I was wondering if that was something that you're considering more actively during the current environment.

A - Prem Watsa {BIO 1433188 <GO>}

So we always look at that as our number one priority to buy our shares, but in this environment we always want to keep more than $1 billion in cash and marketable securities in the holding company. You pointed out in your previous question that our gains are not realized. They're unrealized. So we take all of that into account and at the appropriate time market prices are appropriate, we'll look at buying our stock back. But it won't be as I said at the expense of our financial position which very simply we define as having cash and marketable securities in excess of $1 billion. So we are keeping ourselves very flexible, Mark. We are financially very sound, we have to act to expand if and when the market is done, the insurance market, and as you can see if we have problems in the economy, problems in the financial markets, we're structured so that we benefit significantly.

Q - Mark Dwelle {BIO 4211726 <GO>}

Okay. Thanks very much for the answers. I appreciate it.

A - Prem Watsa {BIO 1433188 <GO>}

Yes. You're welcome, Mark. Mary Ann, next question.

Operator

Our next question is from Tom MacKinnon of BMO Capital.

A - Prem Watsa {BIO 1433188 <GO>}

Good morning, Tom.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Oh. Good morning, Prem. Thanks very much.

A question with respect to the reserve development in the quarter. You had -- it actually was unfavorable, and it kind of bucked a trend we have seen over last several quarters with some favorable development. You had said you hope reserves are redundant as years go by. If I kind of look at other commercial line players in the States as well as other global reinsurers, they had -- they are still having considerable favorable reserve development. How are we to look at favorable development with respect to Fairfax's book going forward given the fact that it was slightly unfavorable? Should he expect to see really just kind of a neutral or zero impact from reserve development going forward? Or is there much less in the tank here in terms of favorable development going forward?

A - Prem Watsa {BIO 1433188 <GO>}

Yes. I think, Tom, first of all on a quarter by quarter basis it's just very difficult to tell, but your point is exactly right. There's much less left in the tank in terms of favorable development, but we put our accident year combined ratios at -- you know, we think at a level that gives us a chance to have redundant reserving. Quarter by quarter term very difficult to say. This is of course a time period where we're building our company over the long-term. We're very sensitive about reserving to make sure that our reserves are good in all our companies. If we see any area where the reserves should be higher, we put them up because we just want to be very careful in this time of soft market conditions not to keep our reserves low.

When you see other companies report, that's one of the problems in our industry. You really don't know-how good the reserving is for the next three or four years and one commentator called this the cheating phase is what he called it. And our holding company we are very careful about our Chief Risk Officer, Chief Actuary go to each of our companies to make sure that the reserves are appropriate and -- if not we put them up and, John, I don't know if you would add to that.

A - John Varnell {BIO 5699703 <GO>}

Yes. We weren't too bad. Japan was the one item that -- that bumped us up in the quarter. And so that was just because of the uncertainty that's left in the last few claims that are there. But going forward, neutral would be probably where we would expect to go going forward.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thanks. And one other follow-up question with respect to the CPI link derivatives.

A - Prem Watsa {BIO 1433188 <GO>}

Yes.

Q - Tom MacKinnon {BIO 2430137 <GO>}

If you made some money on them in the quarter. If I look at the CPI indices in the US and in Europe and in the UK, they all kind of hit all-time highs at the end of the Third Quarter. How are we to sort of look at how to --

A - Prem Watsa {BIO 1433188 <GO>}

When you.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Put any kind of value on these CPI derivatives.

A - Prem Watsa {BIO 1433188 <GO>}

When you say all-time high you mean the CPIs, right?

Q - Tom MacKinnon {BIO 2430137 <GO>}

That's right. Yes.

A - Prem Watsa {BIO 1433188 <GO>}

So the CPIs if you construct them particularly to the UK and perhaps in Europe they were -- you know they increased the value-added tax and there were many one time items that raised the CPI in those countries and these are ten year contracts. They're long-term contracts and so -- we look at them as protection. It's in our books at the end of September it's a little more than $200 million. We have written them down by a little more than $200 million in the first nine months. We think of it as a ten year deal and any time -- you know, it's a long ways. We point out that in Japan there was 15% cumulative deflation, in the 30s there was comparable deflation.

So it's not a month by month or a quarter by quarter investment strategy, Tom. We are protecting our -- there's going to be unintended consequences. I mean just imagine if you were a Greek bank and you were buying the safest bonds in the country the government debt, you just took a 50% haircut and you probably lost the bank. So there's all sorts of unintended consequences here that you have to be very careful about. And so that's how we take these CPI inflation or deflation derivatives. We take it in the sense that there's being to be things that we are not going so see that we might well get hurt in a deflationary -- we are worried about deflation, not inflation. We think there's a lot of concerns about inflation, but it's really deflation that we are worried about. That's the unexpected possibility, not a certainty, but an unexpected possibility and that's what we worry about.

Q - Tom MacKinnon {BIO 2430137 <GO>}

I guess my question is you're making money in an inflationary market on which you coined as being deflation protection. So how are we to sort of figure out what could be the gain on these things going forward.

A - Prem Watsa {BIO 1433188 <GO>}

On these things -- so, Tom, they fluctuate. So we went up by $51 million in the quarter, I think, but only because we went down very significantly in the first six months. So they fluctuate. I wouldn't put too much attention. It's mark-to-market. They go up and down.

You know, it's like the credit default swaps. We had them from 2003 and 2004 and we didn't make any money for a few years. Then in 2007, 2008 is when it went -- it became unrealized significant gains and then in 2008 is when we realized them at the Fourth Quarter and in 2009. So these things go up and down. They fluctuate. Markets fluctuate. But ultimately it's when you realize it.

The way to look at it very simple. We've got the better part of $50 billion in these derivatives. And so $50 billion, 10% is $5 billion, 1% is $500 million. So for every 1% either real deflation or perceived deflation, if you worry about deflation, then that's what the amounts are. If there's no deflation and if there's inflation and perceived inflation then of course these contracts are worthless. So we would lose today $200 million plus would be written often our book value over the next few years. It's probably got another nine years to go on it, but -- so that's how we look at it. It fluctuates up and down, but we have -- we can't lose more than $200 million and we have an ability if we are right in the view that deflation is what you have to worry about of making some significant returns for our shareholders and perhaps protecting us from some unintended consequences on other parts of our investment portfolio or other parts of our insurance business.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. I just -- maybe I will have to take it offline because even that little example you gave seems to suggest that if we have 1% inflation, you're going to be losing some money on the contract, which we had something higher than that on an annual basis just in the quarter on those indices and you made money on it so.

A - Prem Watsa {BIO 1433188 <GO>}

Tom, these are ten year contacts.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Yes.

A - Prem Watsa {BIO 1433188 <GO>}

So a quarter doesn't make a difference. A year doesn't make a difference. It's cumulative over ten years.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay.

A - Prem Watsa {BIO 1433188 <GO>}

So one year you have a cumulative say 3% or 4% and then the next year if you have deflation of 2%, it's that 2% plus the 4%. Then you have to take the two together and you.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay.

A - Prem Watsa {BIO 1433188 <GO>}

Then you look at the following year and what's the expectation and it's very much based on deflation over ten years. I mean inflation or deflation. The changes in the consumer price index over ten years.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thanks for that.

A - Prem Watsa {BIO 1433188 <GO>}

Yes. Thanks, Tom. Mary Ann, next question, please.

Operator

Our next question is from Paul Holden of CIBC.

Q - Paul Holden {BIO 6328596 <GO>}

Good morning.

A - Prem Watsa {BIO 1433188 <GO>}

Good morning.

Q - Paul Holden {BIO 6328596 <GO>}

Prem, I wanted to ask you sort of how you might approach your net equity exposure here. So if the markets continue to rise as they have, would you consider adding additional short positions on the market? Or are you happy to just sort of net out your long equity exposures? Would you go net short?

A - Prem Watsa {BIO 1433188 <GO>}

Sorry. Yes. It's basically a 100% hedge now. So you know we -- if the markets go up or down, we are hedged. If you look at the Third Quarter the markets went down quite significantly and net-net we had we lost money in our common stock positions, on our convertible preferred stocks our convertible bonds. We made money on the hedge. Net-net it was positive. A little less than $200 million. About $160 million plus so we were positive on $60 million. And over time we basically our stocks have better than the index so over time. And so we've -- we've made some money, not significant amounts of money, and neither have we lost significant amounts of money.

Q - Paul Holden {BIO 6328596 <GO>}

Okay.

A - Prem Watsa {BIO 1433188 <GO>}

We are pretty well hedged the right now. You know, we could in a market that goes down we could reduce it. In 2008, in the last quarter we took out the hedge. We've been gradually in the last 18 months increasing our hedge from 30% to 50% to now 100%. And we could go the other way, of course, if markets decrease. If markets go up, we likely will keep our hedge at 100%.

Q - Paul Holden {BIO 6328596 <GO>}

Right. So you are happy with 100%. You wouldn't necessary go to, let's say, 120% or 130% and thereby be short.

A - Prem Watsa {BIO 1433188 <GO>}

No.

Q - Paul Holden {BIO 6328596 <GO>}

Then just second question if I may on Zenith. You know, underwriting at higher premiums, combined ratio continues to be fairly high -- so when is does that new business start to hit the combined ratio and bring it back down to sort of the long-term average?

A - Prem Watsa {BIO 1433188 <GO>}

Yes. So when you look at Zenith you will see that the expense ratio exceeds the loss ratio so they have a loss ratio of 60%, 62% between 60% and 65% -- but the expense ratio is higher than that. And that just reflects the fact their premium volumes have gone from $1.1 billion in 2005 to about $450 million today. And so as the increase is there by volume, the expense ratio comes down the loss ratio remains the same -- that's just how they underwrite -- and their long-term average as you pointed out is 95%. And we expect that over time that's where they will be. In fact, they will be less than that to make up for these years of 125% combined ratios.

Q - Paul Holden {BIO 6328596 <GO>}

Got it. So it's a matter it of more volume than -- than rate adequacy but I understand the two go hand in hand. Okay. Thank you.

A - Prem Watsa {BIO 1433188 <GO>}

Thank you very much. Mary Ann, next question, please.

Operator

(Operator Instructions)

A - Prem Watsa {BIO 1433188 <GO>}

Any more questions, Mary Ann?

Operator

So far there are no more questions.

A - Prem Watsa {BIO 1433188 <GO>}

Well Mary Ann, thank you very much. If there are no more questions thank you all for joining us on this call and we look forward to presenting to you again in the next quarter. Thank you.

Operator

This does conclude today's conference call. You may disconnect your phones at this time.