Acquisition of Allied World Assurance Company Holdings, AG by Fairfax Financial Holdings Ltd Call

Company Participants

- Andrew Acheson Barnard, President & Chief Operating Officer-Fairfax Insurance Group
- Derek Bulas, AVP-Legal
- Paul C. Rivett, President
- Scott A. Carmilani, Chairman, President & Chief Executive Officer
- Vivian Prem Watsa, Chairman & Chief Executive Officer

Other Participants

- <Q – [05RN78-E Jay Gelb
- Amit Kumar, Analyst
- Jay Gelb, Analyst
- Jeffrey Fenwick, Analyst
- Mark Dwelle, Analyst
- Paul Holden, Analyst
- Robert Glasspiegel, Analyst
- Sachin Shah, Analyst
- Tom MacKinnon, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Welcome, and thank you for standing by. At this time, all participants will be in listen-only mode until the question-and-answer of today's conference. Today's call is being recorded. If you have any objections, you may disconnect at this time. Mr. Prem Watsa is hosting the call, with opening remarks from Mr. Derek Bulas. Thank you. You may begin.

Derek Bulas

Thank you. Good morning, and welcome to our call to discuss our acquisition offer for Allied World. This call may include forward-looking statements. Actual results may differ perhaps materially from those contained in such forward-looking statements as a result of a variety of uncertainties and risk factors, the most foreseeable of which are set out under Risk Factors in our base shelf prospectus which has been filed with Canadian Securities Regulators and is available on SEDAR.

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

Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you, Derek. Good morning, ladies and gentlemen. We welcome all of the Fairfax shareholders and AWAC shareholders to the call. We have on this call Scott Carmilani, Chairman and CEO of Allied World; Andy Barnard, President of our Fairfax Insurance Group; Paul Rivett, President of Fairfax's Financial Holdings; and myself.

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

Let me be very clear, we are buying AWAC because of Scott Carmilani and his track record with his management team. It is an outstanding track record created by Scott and his team since they began 15 years ago. The average combined ratio since inception is 90% with reserve redundancies every year for a cumulative $2.2 billion in reserve redundancies. Since going public in 2006, they have distributed to their shareholders in stock buybacks and dividends a cumulative $3.3 billion. Their average return on shareholders' equity since inception is 12%. If you combine our average return of 7% in the past 10 years with their underwriting profit, the return on shareholders' equity goes up to approximately 20%. That is simply why we are buying AWAC.

AWAC will be run by Scott on a decentralized basis with no cost synergies. I emphasize no cost synergies. No change in operations other than what Scott sees fit to do. AWAC will continue to be built under Scott's vision.

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

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

Now, let me tell you why this is such a compelling strategic acquisition for Fairfax. Let's go to the presentation that we gave for you and it's in the website, Fairfax website, and I want to go to page 2. We'll come back to page 1 later on but let's go to page 2. So, page 2 shows you very clearly why this is a compelling strategic acquisition. It's all there for you.

I'm just going to highlight some of the big points. The key from us is, first point, two great underwriting companies that are brought together with strong franchises and Andy and Scott will talk a little more about this. Allied World brings a world-class specialty insurance and reinsurance franchise. We'll talk a little more about that a little later on. We add an investment portfolio of approximately $9.4 billion under Fairfax's proven investment expertise. I'll highlight that a little as the balance sheet and capital position of Allied World complements the financial strength of Fairfax, and that we think it's an attractive outcome for Fairfax as well as for AWAC shareholders.

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

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

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

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

So, if you go on to page 4 now, here is our history of value creation. We started as a very small company. You can see $12 (sic) [$12 million] (8:00) in revenue in 1985. One company in Canada, $17 million of gross premium, this is in 1985; investment portfolio, $24 million; portfolio per share, $4.78; common shareholders' equity, $8 million; and book value per share of $1.52. So, the book value per share was $1.52. And you can see the growth over the time period in 1995, 2005, 2015 and 2016.

Our compound growth rates have been very significant. They haven't been in a straight line. We look at it long-term, but the compounded book value per share, which is our primary focus of 20% per year. And because we have some – much larger now, our objective is a compound book value per share at about 15%. Not every quarter, not every year, but over time, and we think we have every ability to do that.

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

Andrew Acheson Barnard {BIO 4015704 <GO>}

Thank you, Prem. So, to just sort of reset, the profile of Fairfax is insurance businesses prior to the Allied acquisition. We show here on slide 5 our six major largest operating groups. OdysseyRe, predominantly a reinsurer. About 55% of its business currently in the reinsurance segment, 45% in specialty insurance. Our Crum & Forster is very much a specialty company, very strong presence in the accident and health world, significant portfolios in the E&S segment. Brit, one of the largest players in the Lloyd's market. Brit is predominantly an insurance company. 75% or so of its volume is in the insurance segment, 25% in the reinsurance segment. Northbridge is a middle-market, industry-focused commercial writer in Canada. One of the largest players in the Canadian commercial market. TheZenith is our workers' compensation specialist based out in California, has a superb track record we believe is second to none in terms of its expertise in the workers' compensation space. And then, Fairfax Asia, which consists of a collection of, as you can see here, nine different companies, several of which are minority positions that we hold in companies. The flagship in Fairfax Asia is First Capital and it has enjoyed an enormously successful track record over its tenure with Fairfax. And then, we have a collection of smaller companies that we highlight over on the right.

The point is in Fairfax, all of these companies are run by their CEOs. They all enjoy the autonomy that comes with our decentralized operating philosophy. We have a fantastic group of CEOs running all of these companies.

And you can see if we look to the next slide the results that have come from that system of operating. So, for our major companies here, you can see their combined ratios over the last 2.75 years, you'll note that all of them are operating in a zone of underwriting profitability. We've been delighted with our results. Combined ratio is running around 90% in the aggregate, across all of these companies, you can again get a picture of their size, looking at the gross premiums that we show over on the right.

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

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

Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you, Andy. Just to add to what Andy said, and he talked about combined ratios. Of course, as our annual reports have shown, we've had reserve redundancies on pretty well every company and it's a policy of ours to have reserve redundancies and we've had that for a long period of time, just like Scott has. And because of our decentralized operations, we have had many presidents who've retired in the past, but no president has ever left our company for another job in the industry. They've retired and that has happened over the years. We've been in business now for 31 years, but we've never lost a president.

If I can go on to point - page number 7, our track record of investing. So, we've invested (13:35) in our portfolios in Fairfax, we've invested for the past 31 years, you can see, this is the total rate of return on our investment portfolios. That means interest and dividend income and change in unrealized and realized gains and the average return over time for that time period is 8.6%. In the last 10 years, the rate is around 7%, as I said earlier. Allied World's rate of return is in the 3.9% area. So, of course, the combination of our investment expertise with the demonstrated expertise that Scott and his team have shown in underwriting gives us a terrific rate of return going forward.

If you go on to page 8, you'll see the creation of a leading globally diversified property casualty insurer when you combine Allied with Fairfax. I'll just highlight for you the metrics on the left hand side - premiums, pre-tax operating income, cash and invested assets - any one of those has gone by about a third, has gone up by about a third. In terms of North American insurers, you can see we go from about at $11 billion market cap to about number seven in terms of size. And in terms of E&S writers, we're among the top five in the United States.

So, very significant market position for the combination. And to know a little more about Allied, why don't I pass it on to Scott. Scott?

Scott A. Carmilani {BIO 2076985 <GO>}

Thank you, Prem. Let me also add my own welcome to all of you on this morning's call. This is a tremendous opportunity for all of our shareholders and our company. Our shareholders are being rewarded for the strong performance of Allied World over the past decades since going public. It does represent an 18% premium to Allied World's closing stock price as of last Friday. This transaction provides significant value to the Allied World shareholders through the ongoing ownership of Fairfax stocks.

On page 9 of the presentation, you can see the Allied World company profile. This acquisition creates a combined platform, well-positioned for continued success in the future. Allied World's business is highly complementary to the Fairfax franchises and truly creates a world-class specialty insurance and reinsurance franchise with leading positions in North America and Bermuda and having a global territorial reach, as Andy pointed out and Prem in his remarks earlier. We'll have an enhanced size and capabilities in an industry in which scale increasingly confer a (16:33) significant competitive advantage.

Allied World shareholders will benefit from an enhanced business and earnings profile through the access to diversified products and offerings throughout the Fairfax franchises where we complement each other in many areas and many business lines, combining capacity, reinsurance opportunities and global possibilities arise (16:58).

If you look at page 9, you'll see how the company's profile has been put together. We operate in three particular segments: North American Insurance, Global Markets Insurance; and Reinsurance, North American Insurance comprising the biggest one.

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

Page 11, shows the track record that Prem had highlighted and Andy pointed out in his remarks, and the combined ratio since going public in 2006, the consistency of which we've been able to achieve that both on an underwriting and development standpoint. Across the bottom of that page, you'll see that the cumulative number is just under $2 billion of net reserve redundancy that we realized since 2006. This does not count the total redundancy or total get-backs we've done to shareholders (18:12) as Prem had mentioned. It's much closer to $3 billion than $2 billion for the entire history of our company. I thought it would be important to show that as we go further.

I'm going to turn it back to Andy as he talks about the combined product mix.

Andrew Acheson Barnard {BIO 4015704 <GO>}

So on slide 12, we're giving you a picture of what the combined entities will look like if we consider the entirety of the Fairfax portfolio. And you will see, if you look up around the right, that there's a slight increase in the casualty, the liability element in the Fairfax portfolio. And then also, a bit more significantly, an increase in our activity in North America, in the U.S. in particular. And that speaks to the comments Prem made about the opportunities that we anticipate in the American market as the anticipated growth in the economy takes route and the opportunities for smart underwriters to benefit from those increasing opportunities. And so, this is one of the factors that make us very excited about adding Scott and his group to the Fairfax family.

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

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

Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you, Andy. This next slide on page 14, this shows the scope of our operations in terms of when you combine the two, gross premium, net premiums, combined ratios, net income and book value per share. You could see all of that there. All very significant. I'll spend a couple of minutes on our strong capitalization profile, which is page 15. You can see the total debt, common shareholders' equity goes up to approximately $13.5 billion. You can see that. And then you can see the total capitalization. Total debt to total capitalization is about – when you put the two together – 19.4%, the premiums to equity.

So, we've got great opportunity, very underlevered. And I want to remind you that Fairfax has a policy of keeping $1 billion of cash and marketable securities in the holding company. And in the future, we expect to raise that up even more as we become a larger company.

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

In the past few years, we've been worried about the United States economy and other parts of the world. We've talked about it in our annual report. But when the biggest economy in the world, plus minus $20 trillion, which is where the United States, is on its way up, which we think, as I said earlier, because of President-elect Trump's policies, very pro business, corporate tax cut, infrastructure spending, really smart people in charge, we just think of the downside is significantly reduced. And we think in a market like that in the United States and perhaps elsewhere, it becomes a value-oriented stock pickers market. This is a market we've excelled in for 40 years. We've got a team that has done really well in that market and we expect to do very well again in the future. And basically in the last few years, we've played defense. We're expecting to play offense, but with always with a value-oriented approach to our business.

In the bond portfolios, we expect to have a short duration. That's where we are today, three years or less. And so – and we think the bond rates, are long (23:12) bond rates, particularly are bottomed out and are likely to go up as they have since the election. And so, we don't expect to have a long bond portfolio longer just as a two year or three year duration and the ability to invest for the long-term and do well as we have in the past.

So, we have some deflation swaps I just wanted to emphasize particularly to our shareholders that they're written down. They've got six years to go. We have no intention of selling them. That's insurance for us and we continue to hold them.

So with that, let me pass it on to Paul Rivett who will talk about the terms of the transaction.

Paul C. Rivett {BIO 15243791 <GO>}

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

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

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

Now, I will turn the call back over to Prem.

Vivian Prem Watsa {BIO 16700363 <GO>}

Thank you, Paul. So, the last slide, page 17, just summarizes what all of us have been talking about. We (25:51) as a winning combination. You can see a leading franchise in global specialty insurance with complementary business profiles. I want to emphasize disciplined underwriting combined with successful investing is what this group is all about. We have a longstanding underwriting track record for both companies plus an investment track record on a total return basis. And finally, we think a very big strength, as Andy has emphasized of our company, is the decentralized operating structure with a very seasoned management. And Scott and his team will join us, and Scott is going to run, as I said earlier, Allied World with total freedom to see how he can build the company, of course, looking with all our other operations.

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

Q&A

Operator

Thank you. We will now begin the question-and-answer. The first question is coming from the line of Amit Kumar from Macquarie. Your line is open.

Q - Amit Kumar {BIO 16979665 <GO>}

Thanks. Thanks, and good morning. And Scott, congrats on the deal. Obviously, you've done a fantastic job with the franchise.

Two quick questions. The first one is for Scott, and the second one for Prem. If you look at the price of the deal, the price seems to be comparable to some of the other deals. However, if you look at some of the other specialty deals, the takeout price just seems about okay. My question is, what should give investors the confidence that this is the best price for AWH franchise? And I'm curious, did your ability to continue to be employed, did that play a role in extracting the best price for the shareholders?

A - Scott A. Carmilani {BIO 2076985 <GO>}

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

Continue to answer your question, of course, we've fully evaluated the available price. It has been long negotiated and hard-fought and that will all be disclosed in the proxy and in deals terms as that comes out.

Q - Amit Kumar {BIO 16979665 <GO>}

And when is that coming out?

A - Scott A. Carmilani {BIO 2076985 <GO>}

Shortly.

A - Paul C. Rivett {BIO 15243791 <GO>}

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

A - Scott A. Carmilani {BIO 2076985 <GO>}

Yeah. It's probably at the end of the day today or tonight on the merger agreement. And the proxy, more likely in a few weeks time.

Q - Amit Kumar {BIO 16979665 <GO>}

Got it. The second question, and I'll re-queue after this because there are a lot of questions for Prem. Can you talk about the tax discussion and the border adjustment and nil-bill (29:40). How was all of that factored in considering that all of those are in play with the Trump presidency? Thanks.

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

Thank you, Amit. In terms of the border adjustment and the Bermuda question, we considered all of that. The big plus in Mr. Trump's administration is the fact that the corporate tax rate, one of the key planks of their administration, is reduce it to 15%. And so, once you do that, we think those differences will be insignificant in terms of these border adjustments and that type of thing. But we're monitoring that closely. It's a level playing field, whatever the rules will apply to all of us. And so, we took that into account and felt that even after that, the transaction was fine.

So, Amit, thank you very much. Leon, next question.

Operator

Yes. The next question is coming from the line of Sachin Shah from Albert Fried. Your line is open.

Q - Sachin Shah {BIO 15433972 <GO>}

Good morning. Congratulations on the deal. A few questions on your slide. I think it's number one, basically says that you have the option for – to replace the $30 value with floating. What is going to be determined for that to occur? The second question is can you just maybe go over the regulatory approvals that are needed. Thank you.

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

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

A - Paul C. Rivett {BIO 15243791 <GO>}

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

Q - Sachin Shah {BIO 15433972 <GO>}

So, just to clarify, do you have a list maybe, out of chance (32:32), of what regulatory approvals? And also, just wanted to understand the color, the Canadian dollar conversion to U.S. dollar. Is there a kind of mechanism to understand that more clearly?

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

Yeah. I think that's a very simply – Paul, you want to add to that?

A - Paul C. Rivett {BIO 15243791 <GO>}

Yeah. No. All the details will be in the merger agreement. So, we'll look to that. As we said, that will be out shortly. And with respect to the color, it's again in the merger agreement but basically subject to a 20-day VWAP prior to the close and that's exchanging – looking at the exchange rate on those 20 days as well. So, that's all going to be in the merger agreement. Also, you can get the details there.

Q - Sachin Shah {BIO 15433972 <GO>}

Okay. Perfect. Congratulations again, guys.

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

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

Operator

Yes. The next question comes from the line of Jay Gelb from Barclays. Your line is open.

Q - <Q – [05RN78-E Jay Gelb

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

A - Scott A. Carmilani {BIO 2076985 <GO>}

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

Q - Jay Gelb {BIO 21247396 <GO>}

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

A - Scott A. Carmilani {BIO 2076985 <GO>}

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

Q - Jay Gelb {BIO 21247396 <GO>}

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

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

Yeah. When will we...

A - Paul C. Rivett {BIO 15243791 <GO>}

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

Q - Jay Gelb {BIO 21247396 <GO>}

And my final question is, is there a financing contingency in place or is there no financing contingency?

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

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

Q - Jay Gelb {BIO 21247396 <GO>}

Thank you. Good luck on the deal. I'll now re-queue.

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

Thank you very much. Leon, next question please.

Operator

Yes, the next question is coming from the line of Jeff Fenwick from Cormark Securities. Your line is open.

Q - Jeffrey Fenwick

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

A - Paul C. Rivett {BIO 15243791 <GO>}

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

Q - Jeffrey Fenwick

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

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

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

A - Scott A. Carmilani {BIO 2076985 <GO>}

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

Q - Jeffrey Fenwick

Okay. Thank you. Over to you.

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

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

Operator

Yes. The next question comes from Bob Glasspiegel from Janney. Your line is open.

Q - Robert Glasspiegel {BIO 1764160 <GO>}

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

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

Yeah. No. There is a possibility that, over time, tax rates could come down. But offsetting that of course, Bob, as you know, is this 15% corporate tax rate in the United States that's being planned. We'll have to wait and see what comes out after President-elect Trump gets into place. So, we think that might benefit all companies if that comes through. But we do see some advantages from a tax standpoint.

A - Scott A. Carmilani {BIO 2076985 <GO>}

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

Q - Robert Glasspiegel {BIO 1764160 <GO>}

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

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

So, Bob, the investments is one area that's centralized in Fairfax. But having said that, we'll work with Scott and welcome arrangements that makes sense for both Scott and for

Allied and for Fairfax.

Q - Robert Glasspiegel {BIO 1764160 <GO>}

And last question, how long have you locked the Scott up for? I know you said you haven't lost anyone.

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

Sorry, I missed that.

A - Scott A. Carmilani {BIO 2076985 <GO>}

How long...

Q - Robert Glasspiegel {BIO 1764160 <GO>}

How long have you locked - do you plan to lock Scott up for as far as your contract?

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

Hey, forever. Our presidents run our companies for the longest time. And Scott is 52, and we're hoping he's there for the next 20 years.

Q - Robert Glasspiegel {BIO 1764160 <GO>}

But no contract?

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

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

Q - Robert Glasspiegel {BIO 1764160 <GO>}

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

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

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

Operator

The next question comes from Paul Holden, CIBC. Your line is open.

Q - Paul Holden {BIO 6328596 <GO>}

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

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

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

A - Scott A. Carmilani {BIO 2076985 <GO>}

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

Q - Paul Holden {BIO 6328596 <GO>}

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

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

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

A - Scott A. Carmilani {BIO 2076985 <GO>}

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

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

Q - Paul Holden {BIO 6328596 <GO>}

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

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

No. No, no, not at all (45:31). We're a very large operation right now, so we're very focused on maintaining a very sound financial position. I told you about the $1 billion of cash. We are looking at raising that over time. And because financial strength is what we sell, we've always been financially very strong and we expect to be even stronger as the years go by.

Q - Paul Holden {BIO 6328596 <GO>}

Great. Thank you for your time.

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

Next question, Leon.

Operator

The next question comes from Tom MacKinnon BMO Capital. Your line is open.

Q - Tom MacKinnon {BIO 2430137 <GO>}

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

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

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

Q - Tom MacKinnon {BIO 2430137 <GO>}

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

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

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

Q - Tom MacKinnon {BIO 2430137 <GO>}

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

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

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

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

Q - Tom MacKinnon {BIO 2430137 <GO>}

And the equity component is about 22% of this $39 billion now pro forma with the two companies combined. What...

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

Yeah, approximately. We just took the September numbers and showed it you. And over time, I think that will change. But at the moment that's what it is.

Q - Tom MacKinnon {BIO 2430137 <GO>}

How high could you potentially take that equity component?

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

That's tough to speculate right now, Tom. We'll just have to work our way through. We'll have to look and see a little more what Allied's portfolio have (49:16) invested in. And so, it'll be a function of further analysis and the closing of the acquisition.

Q - Tom MacKinnon {BIO 2430137 <GO>}

Okay. Thank you.

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

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

Operator

Yes. The next question comes from Mark Dwelle, RBC Capital Markets. Your line is open.

Q - Mark Dwelle {BIO 4211726 <GO>}

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

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

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

Q - Mark Dwelle {BIO 4211726 <GO>}

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

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

Andy, you want to take that other....

A - Andrew Acheson Barnard {BIO 4015704 <GO>}

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

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

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

Q - Mark Dwelle {BIO 4211726 <GO>}

Got it.

A - Scott A. Carmilani {BIO 2076985 <GO>}

Yeah, Mark, what the folks in this call may not know is Andy and I are both trained from the same institution more than 30 years ago. So, we have very similar philosophies on reserving and reserve handling. The only difference at all is that we've had the additive outside actuarial also applied on (52:30) on many of our reserves while Fairfax has been more reliant on their own work. But as you can imagine, there has been a fair amount of diligence done both sides as we look to ensure that we both had that sort of level of reserve in IBNR levels.

Q - Mark Dwelle {BIO 4211726 <GO>}

Appreciate the answers. Congratulations, and good luck.

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

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

Operator

Yes. The next question comes from Jay Gelb, Barclays. Your line is open.

Q - Jay Gelb {BIO 21247396 <GO>}

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

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

Paul?

A - Paul C. Rivett {BIO 15243791 <GO>}

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

Q - Jay Gelb {BIO 21247396 <GO>}

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

A - Paul C. Rivett {BIO 15243791 <GO>}

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

Q - Jay Gelb {BIO 21247396 <GO>}

What's the tipping point there?

A - Paul C. Rivett {BIO 15243791 <GO>}

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

Q - Jay Gelb {BIO 21247396 <GO>}

All right. Thank you.

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

Thank you very much. Leon, next question.

Operator

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

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

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

Operator

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