S&P Capital IQ

CONTENTS

Fairfax Financial Holdings Limited TSX:FFH

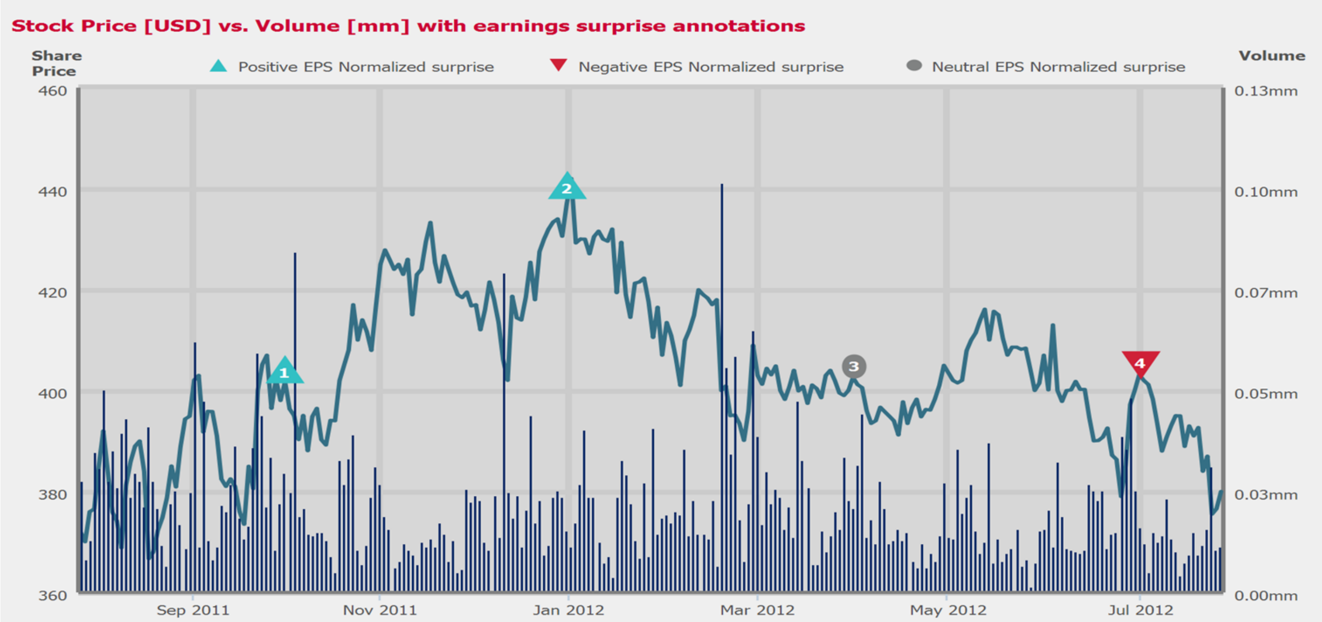
FQ3 2012 Earnings Call Transcripts

Friday, October 26, 2012 12:30 PM GMT

S&P Capital IQ Estimates

	-FQ3 2012-			-FQ4 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	5.92	0.90	(84.80 %)	9.95	15.49	18.60
Revenue (mm)	1915.25	1854.70	(3.16 %)	1666.00	7234.05	7719.67

Currency: USD
Consensus as of Oct-26-2012 11:10 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2011	26.35	53.29	102.24 %
FQ4 2011	2.43	21.40	780.66 %
FQ1 2012	4.35	(0.69)	NM
FQ2 2012	6.74	3.85	(42.88 %)

Call Participants

EXECUTIVES

David J. Bonham
Chief Financial Officer and Vice President

Paul C. Rivett
President

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

ANALYSTS

Chris Lafayette

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Paul David Holden
CIBC World Markets Inc., Research Division

Tom MacKinnon
BMO Capital Markets Equity Research

William Kontes

SHAREHOLDERS

Unknown Shareholder

Presentation

Operator

Good morning, and welcome to Fairfax's 2012 Third Quarter Results Conference Call. [Operator Instructions] 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 Paul Rivett.

Mr. Rivett, please begin.

Paul C. Rivett
President

Good morning, Audra. Welcome to the conference call to discuss Fairfax's third quarter results. The comments we make during this conference call may contain 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 listed in Fairfax's annual report, which is available on our website and set out under risk factors in our base shelf prospectus filed with Canadian securities regulators.

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

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Good morning, ladies and gentlemen. Welcome to Fairfax's third quarter conference call. I'd like to give you some of the highlights and then pass it on to Dave Bonham, our CFO, for additional financial details. In the third quarter of 2010 -- 2012, book value per share was up slightly, 1.7% from year-end, adjusted for the $10 per share common dividends paid out of the first quarter of this year. We had continued improved underwriting results on increased premiums and we've produced a small investment loss due to unrealized investment losses related to our defensive hedging strategy. And we finished the quarter with cash and marketable securities at the holding company of $967 million. The consolidated combined ratio for Fairfax in the third quarter and the year-to-date, was 95.4% and 97.1%, respectively. Reserve redundancies were $38 million or 2.4 percentage points on the combined ratio in the quarter. We continue to reserve conservatively. As I have said in recent calls, we continue to grow our premiums. The large catastrophe losses in 2011, very low interest rates, and the reduced reserve redundancies means that there's no place to hide for the industry. Combined ratios have to drop well below 100% for the industry to make a single-digit return on equity with these low interest rates. In the third quarter, net premiums written by our insurance and reinsurance operations increased by 5.6% to $1.51 billion from $1.43 billion in 2011. At the subsidiary level, net premiums in the third quarter of 2012 were as follows: for Zenith, up 27.3%; Crum & Forster, up 19.7%; OdysseyRe, up 6.1%; Fairfax Asia, up 8.2%; and Northbridge, in Canadian dollars, down 5.5% after the eliminating the non renewal of Northbridge's US property line which was transferred to OdysseyRe. Net investment losses of $23.6 million in the third quarter of 2012 consisted of the following. Please note the table on Page 2 of our press release -

In the third quarter, the net realized gains on bonds and equities of $340 million, as you can see from the table, was offset by net unrealized losses of $364 million, primarily from our equity hedges. In the 9 months, net realized gains from equities and bonds in the main of approximately $730 million were offset by net unrealized losses of $723 billion, primarily from our equity hedges and CPI-linked derivatives and other losses. We continue to be approximately 100% hedged in relation to our equity and equity-related securities, which includes convertible bonds and convertible preferred stock. We have said for some time that we are concerned about the economies of North America and Western Europe, accentuated by the breaking of the real estate bubble in China in late 2011. And we continue to believe that we are not adequately paid to take risks with bond and stock markets at current levels.

As of September 30, 2012, we have almost $8.1 billion in cash and short-term investments, about 33% of the investment portfolio, to take advantage of opportunities that may come our way. In the short term, our investment income will be reduced. On October 12, 2012, the company completed the purchase of the runoff business of Brit Group with a cash payment by the company's runoff operations of $332 million at a discount to book value. Brit Insurance had an investment portfolio of approximately $1.4 billion. On October 1, 2012, the company announced the sale of Cunningham Lindsey for about $260 million and we expect it to close in the fourth quarter. In the fourth quarter, we also completed the debt offering of CAD 200 million and announced the note repayment of $200 million for GFIC. During the quarter, the company completed the purchase of Thomas Cook (India) for about $173 million. We are very positive about the long-term prospects of this company in India. The class action litigation against Fairfax was dismissed with prejudice, which means that no further possibility of appeal. Fairfax did not make any payment in connection with this dismissal. The New Jersey litigation against hedge funds and other defendants was dismissed without prejudice on legal grounds. We believe the decision was incorrect, and we plan to appeal. Now, I would like to turn it over to Dave, so he can give you some information on the underlying financials. Dave?

David J. Bonham
Chief Financial Officer and Vice President

Thank you, Prem. First, I'll focus on Fairfax's consolidated financial results for the first quarter then move onto the key highlights of the operating company's results and finally, we'll discuss our financial position. So first, the consolidated financial results. For the third quarter of 2012, Fairfax had net earnings of $35 million, and fully diluted earnings per share of $0.90. That compares to net earnings of $974 million and fully diluted earnings per share of approximately $47 per share in the third quarter of 2011. The biggest drivers of the change in our quarterly performance year-over-year were decreased net gains on investments in 2012, offset by the significant improvement in the underwriting performance of our operating companies. For the third quarter of 2012, Fairfax' insurance and reinsurance operations reported a combined ratio of 95.4%, and an underwriting profit of $74 million. That compares to a combined ratio of 100 -- 107.5%, and an underwriting loss of $105 million in the third quarter of 2011.

The combined ratio in the most recently completed quarter benefited from lower catastrophe losses of $61 million, or about 3.8 combined ratio points. Compared to the third quarter of 2011, which included catastrophe losses of $172 million, or about 12.3 combined ratio points. Catastrophe losses in the third quarter of 2012 were comprised of a number of smaller, or attritional losses as we sometimes call them, with the largest relating to Hurricane Isaac. In terms of prior period reserved development, Fairfax's insurance and reinsurance operations recorded $38 million of net favorable development to prior year's reserves or about 2.4 combined ratio points in the third quarter of 2012. And that compared to $7.5 million of net unfavorable reserve development or about 0.5 combined ratio point in the third quarter one year ago. So that works out to an accident year combined ratio of 97.8% in the third quarter of 2012 and that compares to last year of 107%. The difference between the 2 accident year combined ratios, about 9.2 combined ratio points, principally reflects the absence of any significant catastrophe events during the third quarter of 2012, the likes of which occurred in 2011. The company recorded a net loss in investments of $24 million in the third quarter of 2012, compared to a net gain on investments of approximately $1.6 billion in the third quarter of 2012 -- third quarter of 2011. Last year's net gains included about $1.3 billion of gains on bonds, principally government bonds. In the third quarter of 2012, our equity hedges -- or our equity holdings did not appreciate to the same extent as the indexes underlying the majority of our hedges. This caused us to record a net loss of $162 million on our net equity related holdings. Partially offsetting this loss, were net gains on bonds primarily U.S. state and municipal bonds. Consolidated interest and dividend income decreased by 41%, from $170 million in the third quarter of 2011 to $100 million in the third quarter of 2012. Primarily as a result of sales during 2011 and 2012 of higher yielding bonds, the proceeds of which were reinvested into lower yielding cash and short-term investments. And the decrease also reflected a lower total return swap expense as a result of the timing of dividends payable by Fairfax on its short total return swaps, and that was partially offset by the impact of additional short positions affected through total return swaps in late 2011.

The average portfolio size at fair value, including holding company cash and investments, was comparable on a year-over-year basis at $24.8 billion at September 30, 2012, versus $24.9 billion at September 30, 2011. We ended the quarter with an investment portfolio at fair value of $25 billion.

Turning to our operating company results, starting with OdysseyRe. OdysseyRe had a strong third quarter. Producing a combined ratio of 86.3%, and an underwriting profit of $95 million. In the third quarter of 2011, OdysseyRe had produced a combined ratio of 103.4%, and an underwriting loss of $19 million. On an accident year basis, the combined ratio at OdysseyRe in the third quarter of 2012 was 88.7%, compared to 103.6% in the same quarter last year. Cat losses for OdysseyRe were $44 million, or 6.3 combined ratio points in third quarter of 2012, compared to cat losses in the third quarter of 2011 of $109 million, or 19.7 combined ratio points. Cat losses in 2012 were comprised of primarily attritional losses, Hurricane Isaac being the largest among them at about $10 million. Whereas in the third quarter of 2011, you'll recall the cat losses at OdysseyRe were comprised principally of reserve increases on the Japan earthquake and tsunami, hurricane Irene and other attritional losses. OdysseyRe's net premiums written increased 6.1% in the third quarter of 2012 to $682 million, from $643 million in the same quarter last year. Primarily reflecting increases in property, quota share, and property catastrophe reinsurance.

Moving onto Crum & Forster. Crum & Forster had an improved combined ratio of 101.4% in the third quarter of 2012 and a lower underwriting loss of $4.2 million, compared to a combined ratio of 102% in the third quarter of 2011, and an underwriting loss of $5 million in that period. On an accident year basis, the combined ratio in the third quarter of 2012 of 101.4% was comparable to the accident year ratio of 101.7% in the third quarter of 2011. Net premiums written by Crum & Forster increased by 19.7%, to $318 million in the third quarter of 2012, from $266 million in the third quarter of 2011. This increase primarily reflected growth in Crum & Forster's specialty lines of business, specifically in excess and surplus casualty, property, specialty, and accident and health lines of business.

Zenith National. Zenith reported a combined ratio of 114.7% in the third quarter of 2012, and an underwriting loss of $23 million, compared to a combined ratio in the third quarter 2011 of 124% and an underwriting loss of $31 million. Zenith did not have any net development to prior years reserves in its most recently completed quarter, so its accident year combined ratio mirrors its calendar year combined ratio of 114%. Whereas in the third quarter of 2011, Zenith reported a net adverse development of $9 million or 6.8 combined ratio points, and produced an accident year combined ratio of 117.5%. Much of the improvement in Zenith's combined ratio reflected a 5.6 combined ratio point decrease in its expense ratio excluding commissions on a year-over-year basis. And that was principally the result of increased net premiums earned. Net premiums written by Zenith were $128 million in the third quarter of 2012, compared to $101 million in the third quarter of 2011, an increase of 27% reflecting Zenith's ability to write new business and retain existing customers at higher prices.

Moving to Northbridge. Northbridge's third quarter 2012 combined ratio of about 100% was stronger compared to its combined ratio of 101.4% in the third quarter of 2011. Which included 9.5 and 4.6 combined ratio points of net favorable development in those periods, respectively. On an accident year basis, Northbridge's combined ratio was 109.7% in the third quarter of 2012, which compared to an accident year combined ratio of 106% in the third quarter of 2011. When comparing the change in Northbridge's net premiums written year-over-year, keep in mind that on May 1, 2012, Northbridge transferred the renewal rights of its US property book of business to an affiliate of OdysseyRe, were it would be a better strategic fit. In our interim report, on Page 46, we have provided the details of Northbridge's premiums in Canadian dollars to avoid the distortion caused by the effects of foreign exchange, and also excluding the premiums of Northbridge's US property business in 2012 and 2011. Making reference to that table, in Canadian dollars, Northbridge's written premium was CAD 217 million for the third quarter of 2012 compared to CAD 230 million in the third quarter of 2011, a decrease of 5.5% year-over-year, reflecting decreases in new business and lower retentions of existing business, partially mitigated by modest improvements in pricing.

Fairfax Asia. For the third quarter of 2012, Fairfax Asia reported a combined ratio of 83.2%, and an underwriting profit of $10 million, compared to a combined ratio of 73% and underwriting profit of $15 million in the third quarter 2011. The third quarter 2012 accident year combined ratio was 84.3%, compared to 75.6% in 2011.

Net premiums written by Fairfax Asia were $54 million in the third quarter of 2012, compared to $50 million in the prior year quarter, with the increase of 8.2%, primarily the result of increased writings of commercial automobile, marine hull and property lines of business at Pacific Insurance.

Moving on to Insurance and Insurance Other segment -- Insurance and Reinsurance - Other segment, that division in the third quarter of 2012 produced a combined ratio of 102.1%, and an underwriting loss of $3 million, compared to a combined ratio of 147% and an underwriting loss of $61 million during the same period last year.

Cat losses, once again primarily attritional cat losses, added 3.7 combined ratio points to the third quarter of 2012 combined ratio and were significantly lower in comparison to the third quarter of 2011, when the combined ratio included 42 combined ratio points of cat losses. The calendar year combined ratio of Insurance and Reinsurance - Other, included 2.9 combined ratio points of net unfavorable development to prior year's reserves compared to 9.9 combined ratio points of net unfavorable development in 2011.

Net premiums written decreased to $113 million from $125 million, a decrease of about 10.1%, primarily as a result of the combination of the non renewal of certain classes of business where terms and conditions were considered inadequate at Advent and also lower reinstatement premiums at Advent year-over-year, partially offset by decreased reinsurance purchased by Fairfax Brazil as well as Advent.

And finally, to runoff. Runoff had another positive quarter even though realized gains were reduced. It produced pre-tax income before interest expense of $13 million in the third quarter of 2012, compared to a pre-tax income before interest expense of $181 million in 2011.

So now turning to our financial position starting with book value per share. Book value per share at September 30, 2012, was $360, an increase of slightly less than 1% from book value per share of $357, at June 30, 2012. And an increase of about 1.7% from our December 31, 2011 book value per share of $365, adjusted for the $10 per share common dividend that was paid in the first quarter of this year. Common shareholders' equity increased during the quarter by $65 million to $7.328 million (sic) [billion] from $7.264 million (sic) [billion] at June 30, 2012. The principal components of the increase included the net earnings that were attributable to shareholders of Fairfax of $35 million, the effect of increased accumulated other comprehensive income of $44 million which principally comprised unrealized currency translation gains. And these were partially offset by the payment of dividends on preferred shares of $16 million. In terms of financial leverage, our quarter end total debt to total capital ratio decreased to 26.2%, compared to 26.4% at December 31, 2011. And this was primarily as a result of the repayment of $86 million of Fairfax debt which came due in April, partially offset by the consolidation of the subsidiary debt of Thomas Cook (India).

In October 2012, the company issued $200 million of 10-year bonds with an annual coupon of 5.84% and followed that up by announcing the settlement of the note we incurred when we have purchased General Fidelity Insurance in August 2010. Now that note will be settled for a cash payment of $200 million. The acquisition of Thomas Cook (India) Limited for $173 million, added $135 million of goodwill and $41 million of subsidiary debt to our third quarter consolidated balance sheet. At the end of the quarter, Fairfax had cash and securities of almost $1 billion at the holding company. And that concludes my section, Prem.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer
Thank you, Dave. 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's fair to all on the call. Audra, we are ready for your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Tom MacKinnon with BMO Capital.

Tom MacKinnon
BMO Capital Markets Equity Research

Prem, what we're seeing here, we're starting to see underwriting results improve, both for you guys and for the industry, and but your -- to some extent, your investment portfolio was a conservative and cautious stance, doesn't really allow you to participate fully in any kind of earnings run-up associated with what could be potentially firming markets. I'm wondering what's your message to investors relative this? Is this just to continue to be patient? And what would it take to change your mind, vis-à-vis the equity hedges and the significant cash position?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

That's a very good question. That's a key question, Tom. The underwriting operations for our company -- all our companies is improving as you pointed out, improving quite significantly. But the investment side, we're very conservative. We've got 33%, $8 billion in cash, common stock positions are fully hedged. We have very little corporate bonds. Our muni bonds are predominantly guaranteed by Berkshire Hathaway, so it's a very conservative portfolio. And the reason for our conservative portfolio is very simply, the -- it seems to us that the disconnect between the fundamentals, in terms of companies and economies, and markets. So stock price -- stock and bond markets are high and the fundamentals we think, are quite different, meaning on the low side. And so you'll either have the fundamentals go up over time to catch up with stock prices, catch up with very low spreads, or you'll have the markets come down. And we've said for some time, this time period, we think of it as a 1 in 50, 1 in 100-year event. It's not a normal time period. And so we just think you have to be very, very careful. The fact that we've got cash in our portfolios, making no money today is a big advantage as and when opportunities come. Because of course, the only people who can take advantage of it is the people who have cash. In 2008, Tom -- 2008, 2009, you had a very significant -- 2 things happened, right? You had the stock market dropped almost 30% and the spreads widened significantly. And in that time period, we had 75% of our portfolios in cash and government bonds. So we could take advantage of the opportunities that presented themselves to us. And 2010, 2011, we've started hedging and in by 2011, we've hedged significant parts of our portfolio. But the other hand, we have realized very significant gains. So in the first 9 months, I think we have realized $730 million, but it's masked in a way, by the unrealized losses on the hedges. And we expect that to reduce, Tom, over time, and perhaps even become profits as it had in '08, '09.

So, and to summarize, Tom, we just said we've always been always long-term -- our long-term results are excellent. In any single year, in any single quarter, we can't tell you what we'll make. Our investment results have been lumpy. They're not smooth. We're not looking at providing 5%, 10%, 15% growth every quarter. We don't know how to do it -- we'd love to do it if we could but what we have focused our company from inception, 27 years ago, is on the long term. And that continues to be the case.

Operator

Mark Dwelle with RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

A couple of questions. Kind of relate to the acquisitions recently and divestitures. Let me start with the Cunningham Lindsey sale, is -- if I'm following the one chart correctly, a $260 million-proceed, that should put results in plus or minus of around $150 million of realized gain in the fourth quarter?

V. Prem Watsa

Founder, Chairman and Chief Executive Officer

Yes, I think that's right -- that's exactly right, Mark.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay. And then, I guess, following on with that. The $35 million that you'll reinvest related to that, that will just, I guess, remain as an investment and affiliate, kind of just out with the old and in with the new, but it's the same thing?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

It's a small investment. Dave, would you put it in affiliates? Or where would you characterize that?

David J. Bonham
Chief Financial Officer and Vice President

It will just go into our common stock portfolio. And it will be carried on a fair value basis.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay, very good. The second question I had. If you just, I guess, the acquisition -- the Brit acquisition. I guess, that's closed now. If I'm mathing that out right, about 75% of book value is -- was the purchase price?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

No, no. It was more like, I think we said in the past press release, we said it was closer to 95% of book value, Tom. And we had 2 things, Tom. We had the discount to book value, closer to 95%. But we had the ability to -- when we did our due diligence, any liabilities we didn't like, we were able to put it in a reinsurance transaction back to the company, back to Brit. And so -- and over 18 months, 2 years, we're going to review those liabilities and if we feel comfortable, we'll commute that reinsurance transaction. So from my standpoint, it was, we -- the advantage of runoff, we've got a separate runoff company, they review every single claim, claim by claim by claim. And so we feel very comfortable with what we've taken on at approximately a little discount to book value. But what you have here is $1.4 billion in investment portfolios, that will pay off over time. And we can invest it and make a return. The GFIC transaction that we did about a year, a year and a half ago, has been a very positive for us. In the annual report, will give you more of the details but it's worked out very well. And this one, we think, will work. This is perhaps the biggest one we've done and we expect it to work out very well also.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

What's the nature of the underlying liabilities? Is it auto or commercial liabilities?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

It's from the U.K. It's got a varied book of liabilities. Dave, anything you would add to that? I don't know if we've disclosed some of that in our...

David J. Bonham
Chief Financial Officer and Vice President

Yes. No, I think you're right there, Prem. It's an assortment of U.K. and domestic international insurance and reinsurance businesses, so across the spectrum.

V. Prem Watsa

Founder, Chairman and Chief Executive Officer

The duration term will be like in 5 years, say half the liabilities will be paid and the remaining will be mostly paid by, say, 10 years. That's the sort of runoff that we get involved in. But the advantage, Tom, is that we've got a separate marker -- I'm sorry -- the advantage we've got is a separate runoff group that handles these liabilities and there's -- maybe there's 2 or 3 of these groups in North America that can do it.

Operator

William Kontes with Boenning.

William Kontes

My question regards to the OdysseyRe political donation. And I was wondering if you could help us understand a little bit more about why that was done and how you see this being important to the success of the firm?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. Thank you for that question. Yes, the contribution was made by OdysseyRe and the decision to make the contribution was made entirely by OdysseyRe. Fairfax did not participate in the contribution or the decision to make the contribution. OdysseyRe chose to make that contribution because it is one of the only remaining reinsurers in the United States and its paying US taxes. The fact that competitors have moved offshore, and pay lower taxes is a competitive disadvantage to OdysseyRe. And OdysseyRe believes Governor Romney is the best choice to rectify this inequality. So that's why they made the -- a donation. But thank you for asking that question.

Operator

Chris Lafayette with the Clark Estate.

Chris Lafayette

I was wondering if you guys could talk a little bit about how you manage risks to any single catastrophic event. And then, given various operating structures and reinsurance agreements, how much of your book value would be at risk to any single event?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

In -- with the catastrophe, right?

Chris Lafayette

Correct. Yes.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Now. So that's a very good question, it's one that we -- in the property/casualty business, catastrophe risk is the biggest risk that you face and we've -- 27 years, we've focused on it single-mindedly. Each of our companies look at it at their level. And it comes right off to Fairfax, it comes through our Chief Risk Officer, comes to our offices and I'm involved in it myself because this is the type of thing that can impact our company. And what we do, broadly speaking, is OdysseyRe is our main source of exposures and they have said that they would expose their common equity -- OdysseyRe's common equity, to about 15% of shareholders equity and we linked that 15% to the rate return we expect to make, over time. So if you think of 15% return that we make, and 15% exposure, it's sort of a 1-year payback that we will expose our company, not to capital, but to 1 year's worth of income. And last year's a good test because we had almost a billion dollars of catastrophe losses, and we still made $40 million or $50 million after tax. But that's what we -- and we look at it very carefully, we look at it at different scenarios, $100 billion events, events that haven't taken place. You have got to look at events that haven't taken place. So you have got to look at the possibility. We never had a $100 billion event or a $200 billion event. Well we simulate that in our companies. And -- but our exposure is mainly from OdysseyRe. And to a large extent, Odyssey has limits so that we know what the exposures can be. But that's a good question. It's one we're focused on all the time.

Chris Lafayette

That was very helpful. And then just one more if I could. You guys recently renewed the buyback authorization. I was just wondering how you think about that, with the stock trading around book value. The company's been more aggressive historically. What do you look for as far as indicators...

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Well, yes. We're always looking at the alternative of buying back our stock, but we won't do it at the expense of our holding company cash and marketable securities, that we'd like to keep $1 billion. And in this uncertain environment, were just very, very careful. But rest assured, in any deal that we make, that were always comparing it and buying our stock and retiring it. You have pointed out in the past we've bought, maybe this goes back a little time, but we might have bought 18%, 20% of our company back at one point in time. And over time, we expect to retire our shares. But in these times, we'll be careful doing it. And it will never be done at the expense of our holding company cash and marketable securities of $1 billion. We'll always keep that $1 billion there for the unexpected developments.

Operator

Paul Holden with CIBC.

Paul David Holden
CIBC World Markets Inc., Research Division

Two questions. First relates to improvements in the underwriting margin. So one of the way to look at the combined ratio is on an accident year basis less cat losses. And year-to-date, I come up with a number of 96.1% and that's versus 96.3% last year, so really not much of an improvement year-over-year. But I would have thought that we would have seen a bigger improvement given some of the forces you highlighted in terms of low investment yields, necessitating higher pricing. So maybe you can talk about why we haven't seen a big improvement, and what might change over the next 12 months to lower that -- the combined ratio on that sort of that basis?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

So, Paul, whenever your -- our premium dropped by, I think, for the first 9 months, approximately at 11%. So whenever you -- and you look at each of the company -- then you look at the -- and Dave has gone through it, but whenever you have premiums going up, your expense ratios come down. And so our expense ratios in the past have gone up. Because we've had soft markets and we've reduced our premiums. Now, expense ratios are coming down because of the fact that premiums are going up. So if you look at Zenith for example, Zenith was up 27% in terms of its premium and so the expense ratios come down significantly. The loss ratios we've maintained, Zenith has been historically maintaining it's very -- 60%, 65% areas but the expense ratios have come down. And so the markets have bottomed out. The rates are going up but it's not like the hard markets of 2002, 2003, 2004. But the pricing has improved, and simple, pretty well across the board it's very good and anything that's exposed to catastrophe given the losses of last year as the rates have still firmed up significantly and remaining there. But -- so we see our combined ratios coming down. With these low interest rates, even if you have a combined ratio of 95% or less, you're going to have a single-digit return on equity. And so combined ratios have to come down. And what you're seeing, for companies that haven't reduced their premium in the last few years, you're seeing reserve development crop up, you're seeing reserves go up. And so you're seeing companies being put into runoff or lose their rating, and that's begun now. And that's usually a sign of change taking place. We are very careful about our reserving, we like our reserves to be strong. You've seen our 10-year results. Our reserve redundancies run at 6% to 8% over time. And so we're comfortable with where we are right now, and the business is improving. But like I said, it's not a hard market. We're writing approximately net premiums written -- that's not gross, it's net -- we're writing about $6 billion. And in a really good market, I've said that in our annual meeting and I've said it elsewhere, that we could double that premium. And we very -- we have different units and different -- really good management teams, all focused at the right time, not on a forecast but actually seeing prices to increase that premium. So we feel very good where we are in terms of our underwriting and I must say in our investment positions, even though we're not making money for our shareholders. The company is poised to reap the benefits of being conservative. So we like where we are.

Paul David Holden
CIBC World Markets Inc., Research Division

Okay. So I'm going to try to summarize, if I may. So the key to leverage maybe on the next 12 months would be: one, firms changing or the industry probably speaking changing the position on reserves, i.e. they've been releasing a lot of reserves over the last few years, that's probably come to an end. And then also, a decline in the expense ratio as you ramp up your underwriting activity?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, I think that's fair. That's fair.

Paul David Holden
CIBC World Markets Inc., Research Division

Okay. And then my second question would be related to the additional investment you made in the CPI-linked derivative this quarter, maybe just the thought process behind that.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. So -- all that Paul, it's averaging down. We've done that before and we added about $20 million and in this case, we've structured it so that we have an 8 years remaining, it's a 10-year contract when we bought it, it's 8 years remaining. The CPI has gone up a little since that time so we put $2 million and increased the strike price, right? So we increased the strike price to be closer to where the CPI is today.

That's all we did. We just freshened up -- freshened it a little for $20 million but we will always look at averaging them. As we've had a significant unrealized loss by the way, more than 2/3 of our investment is now in an unrealized loss position that's, I think, we've got it around $140 million, something like that. We might have paid more than $400 million to it but it's all unrealized. It goes to our income statement like it's a loss but as I said in my prepared comments, it's -- we haven't lost any money. It's mark-to-market and that's what the accounting is these days. So it goes through -- it flows through our statements as losses but we haven't sold anything yet.

Operator

Our next question is Shezad Okhai [ph] with Fairfax.

Unknown Shareholder

I think there's an error there, I'm actually not with Fairfax. I'm a small investor in Fairfax. And while a small investor, it's a significant portion of my very modest net worth, since I've been invested with you since 2010. And I think my question, Prem, is really maybe a follow-on to the gentleman from BMO Capital Markets where -- I guess, I'm looking for some guidance and counsel from you. It feels like you're going through potentially another 7 lean years as you did in the earlier part of the 2000's where, at least since I have been invested, book value hasn't moved very much. Given all of the various forces you've talked about at length and the various quarterly calls and the annual shareholder meetings, but it feels increasingly that -- as you've said, either the markets are will come down to meet the fundamentals or vice versa. And it just -- I just wonder how you feel about things given every time the market seems to move down towards the fundamentals, the central banks are constantly coming in and priming the pump. And I just wonder if you feel -- if you ever feel you're fighting a losing battle against the Fed and ECB?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, that was -- Shezad, that's a good question. And so the first thing, just to say you is we've always focused on the long-term and when we went through our 7 lean years, Shezad, we were turning around our company. We were turning around Crum & Forster and the -- take reinsurance and all of that, and that took some time to turn it around. Today, our companies are in excellent position, they're underwriting-focused, they are well reserved, they've cut back in the soft markets and they are well- positioned to expand significantly at the right time. And then as we are expanding today, you're seeing that in Zenith, and you're seeing it in Crum & Forster, you're seeing it on Odyssey. And the Canadian market's always lag -- have lagged in the past and you'll see it in time in Canada. So underwriting operations are very well-positioned, and our investment philosophy and position -- they're always long term. So when we had credit default swaps in the past, it took a few years for it to work out and as you know, we made a lot of money. And so right now, it's very important not to reach for yield because if you do reach for yield, if you put money into the stock market at these prices, you could suffer permanent losses. We'll take temporary losses but we don't like taking permanent losses. So I don't think we'll be at a position where our results will be poor for a long period of time but you're right for the last year and a half, it hasn't been good. But our results for year ending 2011, for the 5 years, is among the best in the business and of course, for the 26 years ending 2011, it's better than anyone else in our industry. So we're focused on the long-term and we continue, we've always been focused on the long-term, and continue to be focused on doing well for our shareholders always.

Operator

Thank you, at this time, there are no further questions.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Well, Audra, 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.

Operator
Thank you for participating. Today's call has concluded. Please disconnect your phone line at this time.