S&P Capital IQ

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Fairfax Financial Holdings Limited TSX:FFH

FQ3 2014 Earnings Call Transcripts

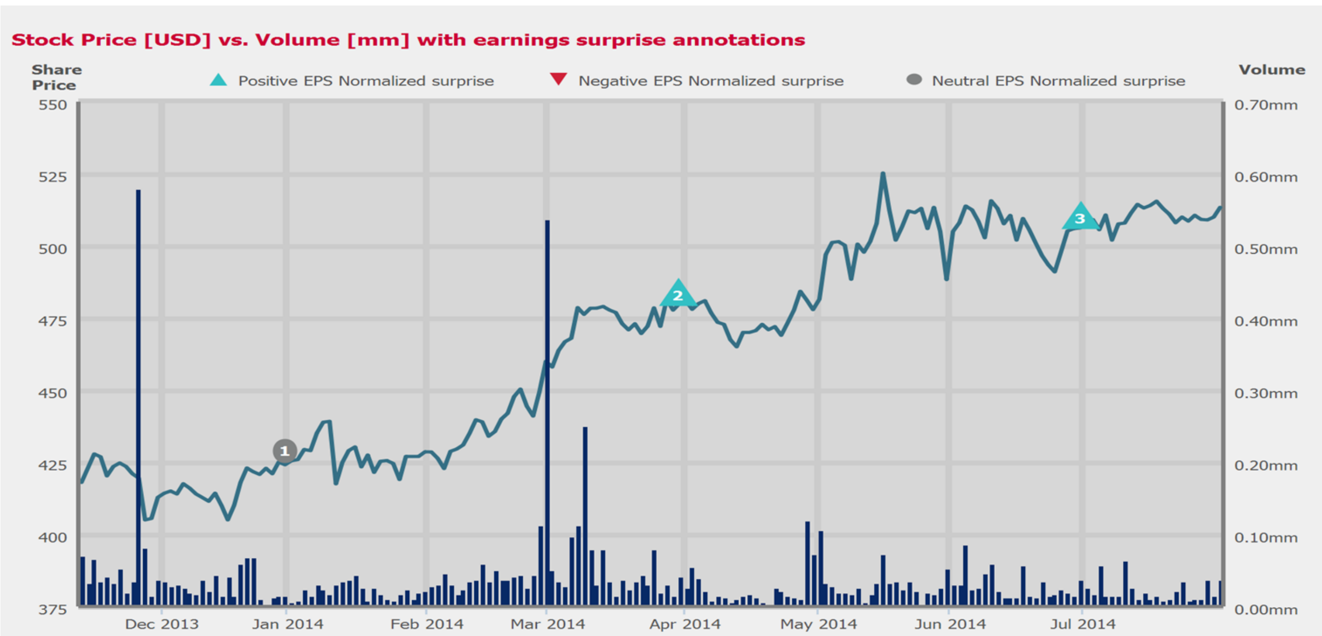
Friday, October 31, 2014 12:30 PM GMT

S&P Capital IQ Estimates

	-FQ3 2014-			-FQ4 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	2.74	3.80	▲38.69	5.01	14.47	15.50
Revenue (mm)	2144.30	2654.20	▲23.78	2065.30	9499.65	8331.35

Currency: USD

Consensus as of Oct-31-2014 4:37 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2013	-	(29.02)	NM
FQ4 2013	4.82	(0.98)	NM
FQ1 2014	3.06	3.73	▲21.90 %
FQ2 2014	10.79	16.15	▲49.68 %

Call Participants

EXECUTIVES

David J. Bonham
Chief Financial Officer and Vice President

Eric P. Salsberg
Vice President of Corporate Affairs and Corporate Secretary

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

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Presentation

Operator

Good morning, and welcome to Fairfax's 2014 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 Rick Salsberg. Mr. Salsberg, you may begin.

Eric P. Salsberg
Vice President of Corporate Affairs and Corporate Secretary

Good morning, and welcome to our call to discuss Fairfax's 2014 third quarter results. This call may include forward-looking statements. Actual results may differ perhaps materially from those contained in such forward-looking statements as a result of variety of uncertainties and Risk Factors, the most of 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.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Good morning, ladies and gentlemen. Thank you, Eric. Welcome to Fairfax's Third Quarter Conference Call. I plan to give you some of the highlights and then pass it on to Dave Bonham, our CFO for additional financial details. In the first 9 months of 2014, book value per share increased by 22.1% adjusted for the $10 per share common dividend paid in the first quarter of 2014. We ended the quarter with common shareholders equity of $8.6 billion of $404 approximately per share. Our insurance and reinsurance companies had an excellent third quarter with a combined ratio of 91.2% with very good reserving and significant underwriting profit of $136 million. In the third quarter, OdysseyRe again had an excellent combined ratio of 88.3%, while Zenith had a combined ratio of 83.8%. As shown on Page 2 of over quarterly release, we have realized gains on our investment portfolio of $16 million during the third quarter, excluding all hedging gains and before mark-to-market fluctuations in our investment portfolio, we earned $138 million in pretax income, including all hedgings, losses and gains and mark-to-market fluctuations in our investment portfolio. We reported pretax income of $616 million and after-tax income of $475 million in the third quarter of 2014. Our third quarter has continued the trends of the first half of 2014, you will note investment portfolios went up to $26.9 million, almost $27 billion in the third quarter in spite of being 79% hedged, 23% in cash and short-term investments and little exposure to corporate bonds. How did this happen? Long U.S. government bond rates continued to drop and our common stocks did much better than the Russell Index, which dropped 7.7%. We have yet to significantly benefit from our hedges and our approximately $108 billion in deflation swaps. And, of course, our cash position gives us great optionality. At our Annual Meeting, we made the point that while we're protecting our capital under the downside, our investment portfolios could also do very well. The first 9 months of 2014, our occasion points. Our common stock portfolios continue to be hedged at approximately as I said 79%. We selectively bought more stocks, but we did not add to our hedges. Our common stocks outperformed the index. We continue to be soundly financed with the year-end cash and marketable securities in the holding company of $1.4 billion. A few more points, our total insurance and reinsurance premium volume remained unchanged in the quarter, adjusting for the crop insurance at OdysseyRe. At the subsidiary level, the change in net premiums written described on Page 32 of our interim report and combined ratios for the third quarter was follows: OdysseyRe, net premiums were down 3% with an 88.3% combined ratio; common foster premiums were down 1% for the 99.7% combined ratio; Northbridge in Canadian dollars, 7.2% increase in premiums and with a 94.3% combined ratio; Zenith approximately 6% increase in net premiums with an 83.8% combined ratio; and Fairfax Asia, which had a 3% decrease in premiums with the 74% combined ratio. As we have said before, very low interest rates and reduced reserve redundancies means there will be no place to hide for our industry. Combined ratios will have to drop well below 100% for the industry to make a single-digit return on equity with these low interest rates. However, with the significant excess capital in our industry today and many new entrants, insurance rates will likely go down first before they eventually go up. On the investment side, net investment gains of $494 million in the third quarter consisted of the following. Please refer to Page 2 of our press release. Net gains on equity and equity related investments after equity hedges of $316 million, resulted from the net losses of $52 million in our equity investments, offset by a $367 million net gain in our equity hedge reflecting the decline in the Russell Index. We have realized gains of $6.6 million in our equity and equity related holdings of the third quarter and $720 million in the first 9 months. Also, in the third quarter, we had unrealized gains of $478 million, primarily on our equity hedges. As we've mentioned in our annual meetings, annual reports and quarterly calls with IFRS accounting with stocks and bonds are recorded at market and subject to mark-to-market gains or losses, quarterly and annual income will fluctuate widely and investment results will only make sense over the long term.

Core inflation continues to be at or below 1% in the United States and Europe levels that we have not seen since the 1950s. In spite of QE1, QE2 and QE3, long-term bond rates in Europe are making record lows, quite often the lowest in 200 years. In Germany, almost half of the German government bond market is yielding negative interest rates. Also, 6 to 7 countries in Europe are already experiencing deflation. Our CPI-linked derivatives with a nominal value of approximately $108 billion are down over 80% from our cost and are carried on our balance sheet at $110 million even though they have 7.5 years to run. The majority of these contracts are based on the underlying U.S. CPI index or the European Union CPI index. Further information is available on Page 13 of our quarterly report. As I've said to you before, our deflation swap experienced reminds us of what happened in the CDS years ago. Also, please remember that it took 5 years in Japan before deflation set in for the next 18 years. When you review our statements, please note that when we own more than 20% of a company, the equity account and above 50% we consolidate. So that mark-to-market gains in these companies are not reflected in our results. As you can see on Page 11 of our quarterly report, the fair value of our Investment and Associates, it's $2.17 billion, with a carrying value of $1.81 billion and unrealized gain of $356 million not on our balance sheet. Also, Thomas Cook and Ridley, which are consolidated in our financial statements, are doing very well compared to our original purchase price. We continue to be concerned about the prospects of the financial markets and the economies in North America and Western Europe accentuated as we have said many times before by the potential weakness in China and the emerging markets. We have said and now we've said it for some time, we believe that continues to be a disconnect between the financial markets and the underlying economic fundamentals. As of September 30, 2014, we have $5.9 billion in cash and short-term investments, which is approximately 23% of our total investment portfolio to take advantage of our opportunities that come our way. As a result, in the short term, our investment income will likely be reduced. On October 30, 2014, this year, shareholders of Pethealth Inc, overwhelmingly voted to support our takeover bid, which should close before year end. Pethealth operating in the United States, Canada and the United Kingdom is North America's second-largest provider of medical insurance for dogs and cats. Closing of this acquisition is anticipated to occur during the fourth quarter. We're very excited about the prospects of Pethealth in the long term. In August 2014, we issued a $300 million 10-year bond offering with a coupon of 4 7/8%. First time, we were able to do a 10-year bond issue below 5%. We plan to substantially use the proceeds to retire debt. Now, I would like to turn it over to Dave Bonham, our CFO, so he can give you some more information on the underlying financials. Dave?

David J. Bonham
Chief Financial Officer and Vice President

Thank you, Prem. First, I'll focus on Fairfax's consolidated results for the third quarter of 2014, then move on to the operating company results and finish with the consolidated financial position. For the third quarter of 2014, Fairfax reported net earnings of $461 million or $20.68 per share on a fully diluted basis. That's compared to the third quarter of 2013 when we reported a net loss of $572 million or net loss of $29.2 per fully diluted share. Year-to-date, Fairfax reported net earnings of just over $1.6 billion or $72.53 per share on a fully diluted basis and that reflects a significant improvement over 2013 when we incurred a year-to-date net loss of $568 million. Underwriting profits at our insurance and reinsurance operations in the third quarter and first 9 months of 2014 increased to $136 million and $345 million with combined ratios of 91.2% and 92.3%, compared to underwriting profits of $105 million and $275 million and combined ratios of 93.4% and 93.9% in the third quarter and first 9 months of 2013. That represents increases of $32 million and $70 million on a quarter-to-date and year-to-date basis in our underwriting profit. Our combined ratios benefited from net favorable prior year reserve development in the third quarter and first 9 months of 2014 of $96 million and $227 million, translating into 6.2 and 5.1 combined ratio points. And that was somewhat higher, the net favorable development of $86 million, representing 5.4 combined ratio points in the third quarter of 2013 and about the same as the $228 million and 5.1 combined ratio points of net favorable development in the first 9 months of 2013. Current period catastrophe losses were lower in 2014 and totaled $65 million or 4.2 combined ratio points in the third quarter and $151 million or 3.4 combined ratio points in the first 9 months. By way of comparison in the third quarter and first 9 months of 2013, we incurred cat losses of $74 million and $218 million, representing 4.7 and 4.9 combined ratio points respectively. Please note that during the second quarter of 2014, OdysseyRe changed the manner in which it recognizes premiums from its U.S. multipayroll crop insurance business. Following enhancements to its underwriting systems and the accumulation of sufficient internal historical data, OdysseyRe began to recognize the majority of the premium from U.S. crop insurance business in the second quarter to more closely correspond with the spring planting season. Whereas in 2013, these premiums were recognized in the third quarter. The full effect of this change in our financial reporting is described on Page 44 of our third quarter interim report. After excluding U.S. crop, net premiums written of $126 million from the third quarter of 2013 such that both of the third quarters of 2014 and 2013 exclude that U.S. crop premium, net premiums written by our insurance and reinsurance operations was relatively unchanged in the third quarter of 2014, an increase by 1.8% in the first 9 months of 2014.

Now turning to our operating company results. Starting with OdysseyRe. In the third quarter and first 9 months of 2014, Odyssey reported underwriting profits of $73 million and $219 million and combined ratios of 88.3% and 87.6%. Compared to underwriting profits of $84 million and $258 million and combined ratios of 87.6% and 85.6% in the third quarter and first 9 months of 2013. Catastrophe losses in the third quarter and first 9 months totaled $41 million and $112 million, which translated into 6.6 and 6.4 combined ratio points with Windstorm Ela, the largest individual catastrophic loss in 2014, accounting for losses of $36 million in the first 9 months of 2014. OdysseyRe's combined ratios in the third quarter and first 9 months also included the benefit of $35 million and $81 million or 5.5 and 4.6 combined ratio points of net favorable prior year reserve development and that was split relatively equally between catastrophe and non- catastrophe loss reserves. OdysseyRe wrote $568 million and a little over $1.8 billion of net premiums in the third quarter and first 9 months reflecting a decrease of 3% in the third quarter of 2014 and a nominal decrease in the first 9 months of 2014. And this was principally due to declines in writings of reinsurance business, primarily proportional and excessive loss property lines of business due to competitive market conditions, offset by growth across most lines of business in the U.S. insurance division and excluding the multipayroll crop insurance net premiums written in the third quarter of 2013 as we described earlier. Moving on to Crum & Forster. Crum & Forster reported underwriting profits of $1 million and $5 million and combined ratios of 99.7% and 99.4% in the third quarter and first 9 months of 2014, compared to underwriting profits of $2 million and an underwriting loss of $3 million and combined ratios of 99.3% and 100.4% in the third quarter and first 9 months of 2013. There was no net prior year reserve development in 2014 and 2013. And current period catastrophe losses were also not significant in 2013 or in the third quarter of 2014. But in the first 9 months of 2014, catastrophe losses were $13 million, representing 1.3 combined ratio points. Net premiums written by Crum & Forster decreased by 1% in the third quarter of 2014, principally reflecting increased ceded premiums at Coverexe [ph] Specialty and increased by 10.2% in the first 9 months, primarily reflecting incremental gross premiums written related to the renewal of the American Safety business, which was acquired last year and the growth in the Fairmont Accident and Health business, combined with higher net risk intention and certain other lines of business. Looking to Zenith. Zenith reported underwriting profits in the third quarter and first 9 months of 2014 of $30 million and $64 million, and corresponding combined ratios of 83.8% and 87.9%, that was a significant improvement over combined ratios of 96.8% and 105.5% reported in the third quarter and first 9 months of 2013. The improvement reflected a year-over-year decrease in the estimated current accident year loss ratios of 6.9 and 5.4 percentage points in the third quarter and first 9 months of 2014. And that was due to favorable loss development trends for the accident year 2013, combined with price increases equal to estimated loss trends for the accident year 2014. Increased -- -- and the second reason was increased net favorable development to prior year's reserves in the third quarter and first 9 months of 2014, representing 11.4 and 10.4 combined ratio points and that compared to net favorable development of 4.6 and 3.7 combined ratio points during those same periods last year. Net premiums written by Zenith of $153 million and $593 million in the third quarter and first 9 months of 2014, increased by 5.9% and 3.3% on a year-over-year basis, principally reflecting premium rate increases. Northbridge. Northbridge reported underwriting profits of $14 million and $26 million and combined ratios of 94.3% and 96.4% in the third quarter and first 9 months of 2014. And that's an improvement relative to the underwriting losses of $4 million and $6 million and combined ratios of 101.5% and 108% reported in those same periods in 2013. Northbridge is underwriting results in the third quarter and first 9 months included the benefit of net favorable prior year reserve development across most accident years and lines of business of $14 million and $57 million and this was lower than the net favorable development of $45 million and $108 million in the third quarter and first 9 months of 2013. Current period catastrophe losses were also lower in the third quarter and first 9 months of 2014, accounting for 3.1 and 1.1 combined ratio points in those respective periods. Whereas the Alberta and Toronto floods in 2013 were principally responsible for adding 8.9 and 7.6 points to the combined ratios in the third quarter and first 9 months of 2013. In Canadian dollar terms, net premiums written by Northbridge in the third quarter and first 9 months increased by 7.2% and 3.6%, reflecting higher net risk retention and increased gross premiums written at Federated Insurance and at Northbridge insurance and its Western and Ontario regions, partially offset by the strategic nonrenewal of an unprofitable portfolio of business in 2014 and excluding the onetime impact of the intercompany unearned premium portfolio transfer on January 1, 2013, between Northbridge and Group Re that we described on Page 38 of our third quarter interim report. Looking at Fairfax Asia. Fairfax Asia's combined ratio improved from 80.9% in the third quarter of 2013 to 74.2% in the third quarter of 2014, primarily as a result of increased profit commission on reinsurance ceded by First Capital, while it's combined ratio of 87.6% in the first 9 months of 2014 was comparable with the first 9 months of 2013, [indiscernible] 87.3%. On a year-over-year basis, in 2014, net premiums written by Fairfax Asia decreased by 3% in the third quarter and increased by 18% in the first 9 months. Year-to-date increase principally reflected increased writings of commercial property -- commercial auto mobile and property insurance and in the marine hull lines of business. The insurance and reinsurance other segment. The combined ratios of Insurance and Reinsurance - Other division were 99% and 98.2% in the third quarter and first 9 months of 2014 compared to 96.4% and 98.3% in those same periods in 2013. The decrease in underwriting profit in the third quarter of 2014 principally reflected increased current period catastrophe losses, partially offset by an improvement in the non-catastrophe underwriting margins related to the current accident year and increased net favorable prior year reserve development. Net premiums written by the insurance and reinsurance other reporting segment decreased by 11.1% in the first 9 months of 2014, primarily reflecting the nonrenewal by Advent and Polish Re of certain classes of business or terms and conditions were considered inadequate and excluding the onetime impact of the intercompany under premium portfolio transfer on January 1, 2013, between Northbridge and Group Re that we described earlier, and that's suppressed net premiums written by Group Re in the first 9 months of 2013 by $39 million. Turning now to runoff. Runoff completed 2 significant transactions in the quarter. First, it provided reinsurance protection to a third-party runoff portfolio of construction defect policies, resulting in the recognition of $85 million of nonrecurring premiums and a corresponding $85 million of incurred losses. And second, runoff commuted a significant reinsurance recoverable with a carrying value of $313 million and received cash investments of $310 million. Runoff reported operating losses of $17 million and $67 million in the third quarter and first 9 months of 2014, compared to operating losses of $8 million and $14 million in the same periods in 2013. The decrease in operating profitability principally reflected incremental operating expenses associated with a construction defect reinsurance transaction in the quarter and the American Safety acquisition, which occurred last year. The decrease in operating profitability on a year-to-date basis also reflected net adverse development at U.S. runoff in 2014, and a gain on a significant commutation in 2013. After factoring in net gains on investments, runoff reported pretax earnings of $75 million and $308 million in the third quarter and first 9 months of 2014. Our consolidated interest and dividend income increased from $61 million in the third quarter of 2013 to $74 million in the third quarter of 2014, reflecting lower total return swap expense and a modest increase in investment income earned. In the first 9 months, consolidated interest and dividend income increased from $273 million to $284 million in 2014, reflecting slightly higher investment income earned combined with a decrease in total return swap expense. The company recorded income tax provisions of $141 million at an effective rate of 23% in the third quarter of 2014 and $632 million at an effective rate of 28% in the first 9 months of 2014. The effective tax rate in the third quarter of 2014 was lower than our Canadian Statutory income tax rate of 26.5%, primarily as a result of nontaxable investment income earned in the U.S., and the release of provisions following the completion of certain prior years income tax audits. And that was partially offset by income earned in the U.S., which is taxed at the higher U.S. statutory income tax rate of 35%. Moving on to our financial position. Our total debt to total capital ratio decreased to 25.1% at September 30, 2014, from 26.1% at December 31, 2013, primarily as a result of the increase in our common shareholders equity, reflecting the net earnings in the first 9 months of the year, partially offset by the issuance in August of 300 principal amount of our senior notes to 2,024 for net proceeds of $294 million. We intend to use the proceeds from this offering to fund the repayment upon maturity of Fairfax and OdysseyRe unsecured senior notes coming due in 2015 and to redeem in the fourth quarter of 2014, 50 principal amount of OdysseyRe unsecured notes and $21.5 million principal amount of American Safety Trust preferred securities. And now Prem, I'll pass it back to you.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer
Thank you, Dave. Now, we're happy to answer your questions. Please give us your name, your company name and try to limit your questions to only one, so that it's fair to all on the call. So, Shirley [ph], we are ready for the questions.

Question and Answer

Operator

[Operator Instructions] And our first question comes from Thomas MacKinnon from BMO Capital Markets.

Tom MacKinnon
BMO Capital Markets Equity Research

My question has to do really with little bit on equity hedges. If I look, you made money on the equity hedges in the quarter, largely as a result of the Russell Index going down, but looks like you actually had to payout money on the equity hedges in the quarter. It looks like about $167 million from Page 10 and Page 12 of the interim report. So maybe can you just help me understand why actually head to pay out that money on these hedges, aren't they settled each quarter or is it just some other timing issue and accounting issues that I'm not quite sure of?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Tom, that's a good question. I'll pass it on to Dave.

David J. Bonham
Chief Financial Officer and Vice President

Sure, sure. Yes, thanks, Tom. You're right on the cash, the actual cash that was dispersed in the quarter. But you should also note that we do have some receivables set up for the mark-to-market that we'll receive in the fourth quarter. So about $151.3 million and $126.3 million on the equity index and equity positions respectively. So we'll be getting that cash in Q4.

Tom MacKinnon
BMO Capital Markets Equity Research

It's mark-to-market every month or...

David J. Bonham
Chief Financial Officer and Vice President

It's mark-to-market, some of them are quarterly, some of them are monthly. But that's when we pay the cash.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. So that will be essentially beginning 380 coming in pretty soon here and that should net in the quarter that should help out then I guess. All right. Then, the next question is just with respect to the growth that we're seeing in terms of net premiums written in Northbridge. I think, it was up 9% on -- maybe on a constant currency basis. And there was mentioned of an impact of a fronting arrangement as well. I'm wondering what that had -- impact that had on the year-over-year growth in Northbridge?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Do you have any comments to that, Dave.

David J. Bonham
Chief Financial Officer and Vice President

I don't have the figure for the top line gross premiums written, but we look pretty closely on our net premiums written, what we actually retain and that fronting arrangement wouldn't have any impact on the...

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. So on the net premiums things, it wouldn't have any impact on the net premiums written.

Operator

The next question comes from Jeff Fenwick with Cormark Securities.

Jeffrey Michael Fenwick
Cormark Securities Inc., Research Division

Prem, just wanted to follow up on, you have been pretty consistent in your commentary about the macro risks that you're seeing there and the potential impact on investments. But when I look at the way that you're deploying some of your funds here, it looks like the amount of cash and marketable securities, the balance there has been kind of gradually trending lower over the last 3 quarters, I think it was about 30% of the portfolio at the start of the year, down below 25% now. I just was wondering, how you're balancing that view of the risk and does this imply you're seeing some areas where you're seeing value and feel the risk reward is attractive to you?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, Jeff. It's -- our cash position whether it's 30% or 25%, is not a top-down view. It's looking for opportunities and when we don't see them, it's parked in cash. What we've seen selectively, Jeff, is opportunities that brought for us and so the cash has come down. It's come down some from 30% to, as you said, little below 25%. But we're still very concerned. We look at this whole time period as a 1 and 100-year event. So if you remember in the liability side, catastrophes were very low this year in 2014. So there were no windstorms to speak about in Florida. But that doesn't mean that we don't protect ourselves from a category 5 coming into Miami, right. It hasn't come ever. But we want to survive that. So in a similar sense, we look at the left-hand side of the balance sheet, the investment portfolios, and we always have to protect ourselves from the markets coming down, we use a 30%, 40%, 50% drop in the markets, interest rates going up, all sorts of permutations and combinations. But broadly speaking, we're looking at protecting ourselves from worse case events on the left-hand side of the balance sheet. And at the moment, it doesn't seem to worry too many people, but that doesn't mean, we don't protect ourselves. But the fact that our cash position has got some 30% to 25% small, we have some positions. We've taken a position in Eurobank. For example, that's public, that's a new one that we've disclosed. But otherwise, our position hasn't changed in any significant way.

Jeffrey Michael Fenwick
Cormark Securities Inc., Research Division

Okay. And I guess that feeds in to my follow on question there on the CPI contracts and you continue to add here to the notional value, is there some target in terms of just how big, you would like that exposure to be or is it just a question of these contracts can acquire them at attractive pricing today and just giving you more cover and you are happy to sit on them.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Jeff, that's a good question. We have accumulated and when I say it's got some similarity to our credit default position. I meant like when we bought it, you'll remember in the credit default position, it dropped quite significantly and we averaged down and that's what we basically been doing with our deflation swaps. The long-term contracts and we're averaging down and we've got a very good position. Now, I've said in the last few quarters that plus, minus, where we want to be, we might use a little money just to refresh the CPI indices, get them back to where they are today. But we see in sort of worse case events, right now, as I said in my prepared comments, deflation in 6 to 7 countries in Europe. I mean, actual deflation. China, there's -- China's economy is weak, no one knows how weak. But you do know that commodity prices have -- the price of oil he gone recently from $100 to $80. The price of iron ore has collapsed from $190 to less than $80 a ton. And price of copper trended down. So you're seeing commodity prices come down significantly. China's real estate prices are coming down. We've talked about that before and so if anything happens in China, Jeff, you've got a very significant deflationary factor. And in that environment, if that happens, some may say when that happens, these contracts are even though they've got 7 or 8 years to go, they're marketable contracts. They react to sentiment about inflation or deflation. So if you think inflation, these contracts will be worthless. But if you -- and that means we'd lose $110 million over some time period. So there is very little downside in our book value for that $110 million. But if these -- if the sentiment changes towards deflation, these contracts will respond pretty significantly and we keep that because in the deflationary environment and Japan is a great case, it's very difficult to make any money, because everything is going down, stock prices are going down and interest rates are going down, credit spreads widened significantly. So it's very difficult to make any money and perhaps, one of the few places you'll make money is on the deflation swap. So we've got that in the back of our mind and we're very happy with the position that we've acquired and it's been acquired over a few years as you know. But mark-to-market is down like 80%, more than 80%.

Operator

The next question comes from Paul Holden with CIBC.

Paul David Holden
CIBC World Markets Inc., Research Division

I wanted to ask you about the position you have in U.S. treasuries and other fixed income product outside the [indiscernible] which we know you can hold to maturity. In the past, when rates have dropped to extremely low levels such as this, we've seen, you sell some U.S. treasuries. Not sure, you did the same this quarter, maybe your updated thoughts on your holding a fixed income.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. So U.S. treasuries is a good -- another case as to what happens in the marketplace. We have had QE3, I don't know, about a year ago or so, or a little longer, and most people expected interest rates to go up and treasuries did go up. When they started tapering, which most people would have expected interest rates to go up, long treasuries to go up further, it started tapering, meaning they are no longer buying treasuries. Treasuries rates have come down. Long treasuries ended the year 2013 and close to 4% and they've been trending down every quarter. They ended this September quarter at 320 and now they are at 305 or something to the surprise of many. So that's another possibility of deflation being in the air because if you have deflation in the United States, very low rates of inflation, then, of course, you would gravitate towards the more secure bonds, which is U.S. Treasuries. And we continue to have some. We've sold in the past at the 250 area, I think, Paul, and we keep our options open as to where we'd sell them, but a long treasuries, we've sold at approximately 2.5, but I must say that Ben Hoisington who have quoted before came out with an excellent third quarter for our shareholders. I want you to make sure you read that because it's an excellent third quarter report. He is the only guy that we know of among money managers who has got it right in the last 10 years. And he has been very positive on long treasuries. And he has made that point the velocity of money, which impacts how an economy does. In United States, it's been trending down significantly, but it's been trending down in Europe even more and in Japan, even more in absolute rates. And it's worth looking at those figures, because it does make some very good points. But so we continue to like the treasury position. It's not huge, but it's -- it can be significant in terms of making some money for us. But, Jeff, it's interesting to me when I watch the fact that QE3 came in and interest rates of QE3 what it did, was buy bonds and other things, which you would expect the interest rates to come down. They did the opposite. When they stopped, the Fed stopped, interest rates came down. So, Paul, thank you for that. And what's your -- anything else that you had, Paul?

Paul David Holden
CIBC World Markets Inc., Research Division

Just one other question, it's unrelated, is on the cat losses. Obviously, this has been a year of low cat losses. If cat losses will return to more normal levels, what kind of impact you think that would have on the combined ratio?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. Cat losses fluctuate and our cat exposures are coming down some. But, Dave, would you have an answer to that?

David J. Bonham
Chief Financial Officer and Vice President

Yes. So I am looking at our cat losses about 4 points and 3 points, 4 points on the third quarter and first 9 months and maybe a more normal number would be 5 or little higher than 5 points. So it would be a little more significant, but I don't think it would be within our expectations of how we price the business. So there would be no surprises there.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

We take a certain amount of cat margin, we expect certain cat. This has been a very good year, as you know, Paul. But, yes, so I think the industry has benefited from the fact that there has not been cat. But we take that into account. You know we've had 2011, which is the huge cat year across the world and it was well within our tolerances.

Operator

The next question comes from Mark Dwelle with RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Question for Dave. You commented on the Zenith and the improvement in their combined ratio. I just wanted to clarify, are you saying that they had an interperiod reduction in the loss pick for the year, such that there was kind of catch-up adjusted -- favorable catch-up adjustment in this quarter's results or are you just saying that the actual pick has been lower each sequential quarter this year relative to last year?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, the pick has been lower. And I don't think there was any particular catch-up in the third quarter. They've been looking at the loss ratio pick for this accident year. And started to see these trends emerging earlier on the year. So that pick for the 2014 loss ratio has been fairly consistent throughout the year.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay. That's kind of what I thought, just the way it was said it kind of -- we went through a loop [ph]. So thanks for that. Second question -- second topic I wanted to talk about was just the runoff purchase of the Everest Re contractors' business. That's a business line that's been notoriously difficult across the industry and I just curious kind of some background or any other details you could provide about that deal?

David J. Bonham
Chief Financial Officer and Vice President

Mark, we have a very specialized runoff operation. There's only 2 or 3 of them who can compete with us. We look at every claim, we look at all claims in detail. Our guys -- that's all they do. They know the exposures and our record mark is excellent. Like we've made some terrific purchases in the last 5 or 6 years and so it's like anything else. When you buy these reserves, you have to have a margin of safety. And we have a margin of safety when we buy reserves from Everest Re or from other deals that we've done in the past and if we don't get the margin of safety, this is not a growth business for us. Very simply, we won't do it. So if we don't get the price that we're looking for, we don't do it. And all of us are involved that comes from the runoff and Andy looks at it, our Chief Risk Officer Peter Clarke looks it and I look at it and it has to be priced properly before we make the purchase and we are very comfortable with what our CEO, Nick Bentley, who leads our runoff operation, has done on this purchase.

Operator

Next question comes from Mikel Abasolo with Solo Capital Management.

Mikel Abasolo

My question is on Eurobank. I think, that yours is a bet on the Greek economy restoring balance, avoiding a structure of deflation and ultimately remaining the euro. My question is why do you trust Greece's macro economy to be as resilient as Ireland's allowing you to score a similar success with Eurobank perhaps as you had with Bank of Ireland. And, if I may, on your other Greek investments, particularly [indiscernible], what is your stance now that the stock prices have collapsed again in Greece.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

We -- in Greece, first of all, we've always been long-term investors. We like the leadership of the country. We think it's pro business. We think Greece has suffered greatly in terms of its economic position and it's bottoming out and in fact increasing -- economically increasing. We think Eurobank, the banking industry in Europe, in Greece, they were about 20, 25 banks, 5, 6, 7 years ago, while there is only 4 now and Euro bank is one of the 4. They are approximately the same size and Eurobank is very well run. So we like that, we like the management team of Eurobank, and we feel very confident that over the long term, Eurobank will do well as well as the Bank of Ireland has done for us in Ireland. If you just take Ireland for 2 years in 2011, it's difficult to think how Ireland, the prospects for Ireland was 2 years ago, or 3 years ago in 2011. And today, it's so different. So it's very difficult to tell how Greece is positioned well be few years from now. We think it will be good. As far as these prices coming down, Mikel, these are the fluctuations that go up, they go down, we don't pay too much attention to them. We look at the long-term. And in the long term, we think Greek investments will do very well. So thank you for your question, Mikel. I'll pass it on to Shirley for any other questions, Shirley.

Operator

And our final question comes from Marvin Dice with Royal Securities.

Marvin Dice

And my question relates to the intrinsic value of Fairfax. Is there a rule of thumb for such as 1.5x stated book to alive at an approximate intrinsic value of Fairfax. I've never heard management refer to their approximate estimation of intrinsic value. Are you comfortable in issuing your appraisal of intrinsic? If you would, please comment on this. I'd appreciate it.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Thank you for that question, Marvin. We really are not -- we managed the company. We are all long-term shareholders, I've got, I don't know 80%, 85% my net worth in Fairfax. But what the intrinsic value of the company is that we leave to you and all the other shareholders who've been with us for a long time. But our track record is very good. Over the long term, we our track record is excellent. And you have to put that -- take that into account and see what you think the price -- the appropriate price is. And but we don't estimate and we don't give you a sense for what we think the intrinsic value is because really that would be promoting the company and the stock price and we've never done that. We believe that we need to disclose all the information. We believe we have to perform. We want to increase book value long-term, 15%. Our track record since inception is closer to 22%. But, of course, there's no guarantees that we will get you 15% over the long-term. But the value of the company we leave to our shareholders and yourself, Marvin.

Operator

At this time, I'm showing no further questions.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

So Shirley, if there are no more questions, I thank you, everyone, for joining us on this call. And we look forward to presenting to you again after the next quarter. Thank you very much.

Operator
Thank you. This does conclude today's conference. Thank you for your participation. At this time, you may disconnect your lines.