S&P Capital IQ

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Fairfax Financial Holdings Limited TSX:FFH

FY 2011 Earnings Call Transcripts

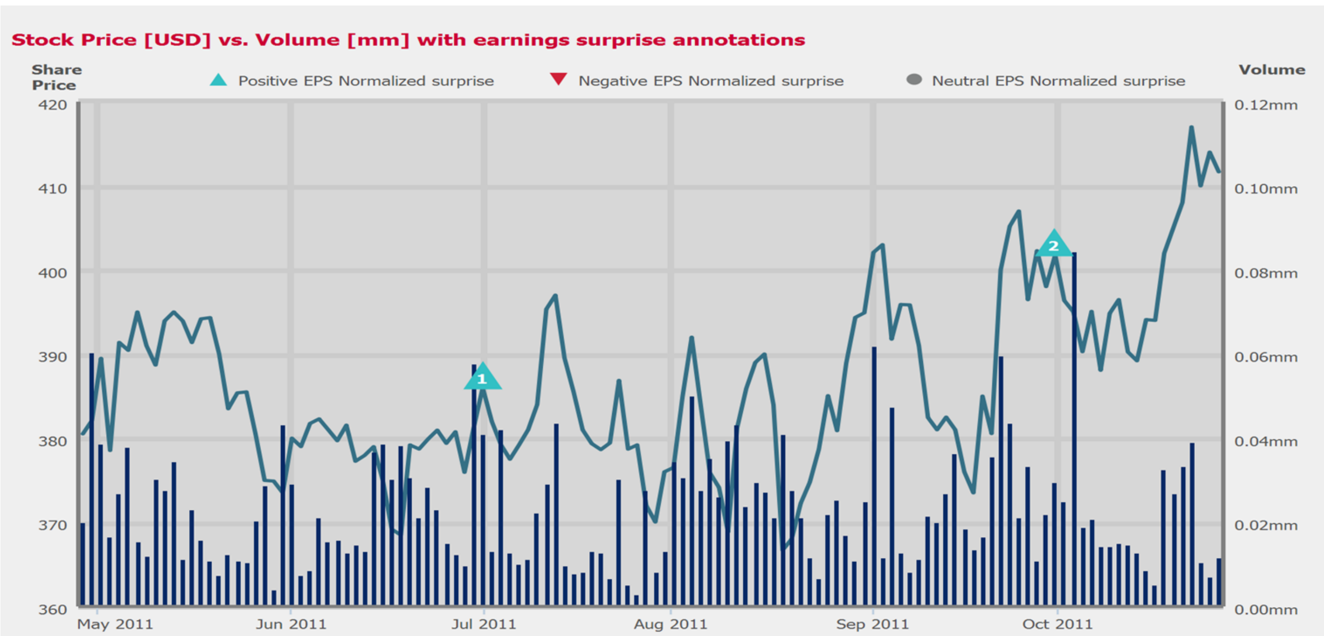
Friday, February 17, 2012 1:30 PM GMT

S&P Capital IQ Estimates

	-FQ4 2011-			-FQ1 2012-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	SURPRISE	CONSENSUS
EPS Normalized	2.43	21.40	▲780.66	2.51	-	41.97
Revenue (mm)	1477.13	823.60	▼(44.24 %)	1887.55	▲0.13	7638.07

Currency: USD

Consensus as of Feb-17-2012 10:55 AM GMT



Call Participants

EXECUTIVES

Bradley Paul L. Martin
Vice President of Strategic Investments

John Charles Varnell
Vice President of Corporate Development

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

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Paul David Holden
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Sean Barry

Tom MacKinnon
BMO Capital Markets Equity Research

Presentation

Operator

Good morning, and welcome to Fairfax's 2011 Year End 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 Brad Martin. Mr. Martin, please begin.

Bradley Paul L. Martin
Vice President of Strategic Investments

Good morning, welcome to the conference call to discuss Fairfax's 2011 year end results. The comments we'll make making 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 large variety of uncertainties and risk factors the most foreseeable of which are listed on Fairfax's annual report, which is available on our website at fairfax.ca or are set out under risk factors in Fairfax's base shelf prospectus filed with the securities regulatory authorities in Canada, which is available on SEDAR. I will now turn the call over to our Chairman and CEO, Prem Watsa.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Thank you, Brad. Good morning, ladies and gentlemen. Welcome to Fairfax's year end conference call. I plan to give you the highlights and then pass it on to John Varnell, our CFO, for additional financial results. Our book value per share decreased by about 0.4% in 2011 to $364.55 per share from about $376 a share at the end of December 2010. After we adjust for the $10 dividend per share that we paid in the first quarter of 2011.

Our results have always been lumpy as I've said during the third quarter call and they were regained in the fourth quarter. We had realized and unrealized gains of $1.6 billion in the third quarter of which $0.9 billion was reversed in the fourth quarter. The best way to look at our results is for the full year 2011. Firstly, 2011 was the second worst year on record of major catastrophes for the industry. The Japanese earthquake cost the industry $35 billion; the Thai floods, $13 billion to $20 billion; U.S. tornadoes, $14 billion; New Zealand earthquake, $12 billion; Hurricane Irene, $5 billion and some other catastrophes ended up costing our industry in 2011 approximately $105 billion.

The worst year for catastrophes was 2005 with the Katrina, Rita and Wilma hurricanes costing the industry $125 billion. These catastrophes in 2011 cost us approximately $1 billion, the worst catastrophe loss in our history. Despite of these losses, our investment results of $700 million of investment income, interest in dividend status and $691 million of realized and unrealized gains, resulted in Fairfax basically breaking even in 2011 with our book value being essentially unchanged after adjusting for that $10 per share dividend that was paid out in the first quarter of 2011.

As you know, our results are lumpy and as I've said to you many, many times and particularly lumpy in the short term. Here is what happened to our book value per share on a quarterly basis in 2011. We ended the year 2010 at a book value of $376 per share. At the end of the first quarter, our book value went down to $355 a share; end of second quarter, $359 a share; at the end of the quarter 3, $403 a share; and at the end of quarter 4, back to $365. So with fluctuating markets and mark-to-market accounting, we don't see how results can be anything but lumpy.

While 2011 and 2010 were nothing to write home about, our last 5-year compound annual growth rate in book value per share was 19.5% and over our history of 26 years, the compound growth rate in book value was 23.5%, among the best in the business that we're in. We achieved these results by taking short-term pain for long-term gain. We have always been focused on the long term. In our industry, catastrophes happen. They're unpredictable, they often destroy companies. We have always focused, since we began in this industry, we've always focused on our total exposures. We work hard towards limiting our losses to 1 year's worth of income and no loss of shareholders' capital.

At both the OdysseyRe level and Fairfax we again achieved this objective. By the way, the best way to look at results in the property-casualty business is over long periods of time. For example, for all of OdysseyRe's property business, over the 12 underwriting years, 2000 to 2011, encompassed September 11, 4 hurricanes of 2004 and Katrina, Rita and Wilma in 2005 and Hurricane Ike in 2008 and the Chilean earthquake in 2010, OdysseyRe growth at cumulative $6.4 billion of net premiums at an average combined ratio of 94.5%.

For you, our shareholders, the most important point to recognize in our 2011 results is our business is expanding again after being in a downturn for the past 4 years. In 2011, including the acquisitions we made, net premiums written at Fairfax grew by 23%. Excluding acquisitions, Fairfax grew by 11%. At the subsidiary level, net premiums written in 2011 grew as follows: Zenith, plus 18%; Crum & Forster, plus 14%; OdysseyRe, plus 13%; Fairfax Asia, plus 14%; Northbridge, plus 2%. We are growing again. Huge catastrophe losses in 2011, very low interest rates and a lack of reserve redundancies means there is no place to hide for the industry.

Combined ratios had to drop well below 100% for the industry to make a single-digit return on equity with these low interest rates. In the investment area, net investment gains of $691 million for the year 2011 consisted of the following. If you will please note Page 2 of our press release, the table there is what I'm highlighting now. Net losses on equity and equity-related investments of $793 million are predominantly unrealized and were reduced by net unrealized gains of $414 million on our equity hedges.

So our equity hedges were a positive in 2011. Net bond gains of $1.3 billion and net losses in CPI-linked derivatives of $234 million. Other net gains of $25 million resulted in a net investment gain of $691 million in 2011 for Fairfax. In total, we realized almost $1.1 billion in gains in 2011, which were offset by $397 million in unrealized losses for a net gain of $691 million. We sold about 1/2 of our long treasury position, and about 3% on the long treasuries for a gain of $271 million.

Much of the unrealized losses are only fluctuations and if history is any guide, should result in profits over time. As of December 31, 2011, the company held an approximately $1 billion of cash short-term investments and marketable securities at the holding company level. Our company continues to be soundly financed with little near term debt maturities as we extended the term of our debt at lower interest rates in 2011.

Finally, we continue to be approximately fully hedged in relation to our equity and equity-related securities, which includes convertible bonds and convertible preferred stock with some variation in the percentage hedged due to fluctuating markets. We continue to be very concerned about the prospects for the financial markets and the economies of North America and Western Europe accentuated by the breaking of the real estate bubble in China in late 2011. Now I would like to turn it over to John, so he can give you some more information on the underlying financials. John?

John Charles Varnell
Vice President of Corporate Development

Thank you, Prem. I will start with the Fairfax consolidated results for the fourth quarter and for 2011. I'll talk about the operating company results and I'll finish up with a bit on financial position. For the full year 2011, we had net earnings of $45.1 million, that compares to prior year earnings of $335.8 million. 2011 loss fully diluted per share was $0.31 per share and that deducts the preferred dividends versus our 2010 results of $14.82 per share.

We had a net loss for the fourth quarter of $771 million or fully diluted $38.47 per share. That compares to the fourth quarter of 2010 where we had a $494 million net loss and that diluted is $24.77 per share. For the full year 2011, Fairfax had a combined ratio of 114.2%, that compares to 103.5% combined ratio in 2010. We had an underwriting loss in 2011 of $754 million, that compares to an underwriting loss of $160 million in 2010. As Prem said, the catastrophe losses for the year 2011 were just over $1 billion, made up of the Japanese earthquake, Thailand floods and a lesser extent, U.S. tornadoes, New Zealand and Hurricane Irene, which had an impact of 19.3 combined ratio points.

For comparison purposes the cat losses in 2010 were $331 million, which included Chile, New Zealand and the Xynthia storm, as well as some other catastrophes for a 7.3 combined ratio point impact. In terms of prior period reserve development, we had good results in 2011. We did record a benefit from favorable reserve development for the year, $89.4 million or about 1.7 combined ratio points and that was about the same impact as we had in 2010. That works out to an accident year combined ratio in 2011 of 115.9% and that compares to a 2010 combined ratio of 105.2%

Now I'll talk about the operating companies starting with OdysseyRe. In the fourth quarter and fiscal year, they had underwriting losses due to Thailand and Japan. In the fourth quarter their combined ratio was 122.7% and they generated an underwriting loss of $122 million. In 2010, they had an 85.8% combined ratio and an underwriting profit of $68 million. For the full year 2011, Odyssey had a 116% combined ratio and an underwriting loss of $336 million. The full year 2010 Odyssey had a 95% combined ratio and an underwriting profit of $95 million.

On an accident year basis, the combined ratio at Odyssey was 119.3% for 2011 compared to 98.6% in 2010. Cat losses in 2011 accounted for $734 million or 36.7 combined ratio points from the catastrophes we mentioned previously. Cat losses in 2010 accounted for 11.7 combined ratio points for Odyssey. On an accident year basis, excluding the cat losses, Odyssey performed at 82.5% in 2011 that compares to about 87% in 2010. And on a net premium written basis, Odyssey wrote $2.1 billion this year up from $1.85 billion last year as Prem mentioned.

Odyssey's net premiums written increased 9.7% in the fourth quarter of 2011 to $477 million compared to the fourth quarter of 2010, they wrote net premium of $435 million, which reflected increased ratings across many of OdysseyRe's lines of business, which included property, marine business, travel business and commercial automobile lines of business.

Crum & Forster in the fourth quarter had a combined ratio of 120% and an underwriting loss of $57 million. For the full fiscal year, the combined ratio was 107.9% and an underwriting loss of $79 million. On an accident year basis, the combined ratio was 104.2% Net premiums written at Crum & Forster were just under $1.1 billion compared to $773 million in 2010 and that reflects the acquisition of First Mercury, as well as internal growth. Crum & Forster continues to focus on growing its specialty business and that resulted in year-over-year increases of 25% net premiums written in the fourth quarter of 2011. The growth in Crum & Forster specialty lines of business are primarily at Seneca and AMC Fairmont divisions, including the accident and health lines of business and the increased gross premiums written by $44 million or 29% in the fourth quarter compared to the previous quarter.

Zenith had a combined ratio for the year of 127% and an accident year ratio of 122%. Net premiums written by Zenith were $524 million in 2011 compared to $186 million for the 2010 year and the 2010 year was just a partial year that they are owned by Fairfax. Net premiums earned by Zenith during the fourth quarter and year ended December 31, 2011 increased year-over-year by 19% and 15.8%, respectively, reflecting Zenith's ability to write new business, to retain existing customers at higher prices as there were changes in the economic and competitive environment for workers' compensation business.

Northbridge's fourth quarter combined was 101.9%, full year combined ratio for Northbridge was 102.8%. On an accident year basis, the combined ratio of Northbridge was 106% as Northbridge benefited from favorable development of 3.7 points. Net premiums written by Northbridge were $1.1 billion for the year compared to $985 million in 2010 measured in U.S. dollars and that was an increase of 11%. Northbridge's net premiums written increased by 3.7% or 4.9% in Canadian dollar terms in the fourth quarter of 2011 compared to the fourth quarter of 2010, reflecting some price improvements and increased levels of new business retentions of existing business.

Fairfax Asia. The fourth quarter combined for Fairfax Asia was 89.2% for the whole year. The combined ratio at Fairfax Asia was 83.2% compared to 89.3% in 2010 and they generated an underwriting income of $34 million compared to $17 million in 2010. Net premiums written by Fairfax Asia were $213 million compared to $157 million in 2010. Their net premiums written increased by 13% as a result of increased writings of professional indemnity commercial automobile property business, the favorable effect of foreign currency translation at first capital.

Reinsurers in the insurance other in the fourth quarter had a combined ratio of 155% and for the full fiscal year had a combined ratio of 140.9% due to our participation in cat loss programs, that was favorable development at 7.9% or 7.9 combined ratio points in 2011. The net premium written declined by about $50 million in 2011. And finally, our runoff group had another good year and earned $361 million pretax in 2011 compared to $136 million earned in 2010. Our companies continue to be well capitalized by premium to surplus ratio test.

Northbridge on a premium written to statutory surplus is writing at 0.7 to 1; Crum & Forster at 0.9 to 1; Zenith at 0.8 to 1; OdysseyRe at 0.6 to 1; and Asia at 0.5 to 1; and overall Fairfax's writing at a 0.7 to 1 premium to surplus ratio.

Interest in dividend income decreased slightly year-over-year for Fairfax. It was down 1% to $705 million from $711 million in 2010. 12-month interest and dividend yield was flat at 3.26% in 2011 compared to 3.36% in 2010 before hedging expense. Our average portfolio size over the last 12 months and this includes holding company cash and investments increased in 2011. The average portfolio size was $24.1 billion and we ended the year with an investment portfolio, which included holding company cash and investments of $24.5 billion.

In terms of financial leverage our year end debt to capital ratio was 26.4% compared to 23.9% in 2010. And before I pass it over to Prem, I'd like to remind everyone that our annual general meeting will be held on Thursday, April 26 at 9:30 a.m. at Roy Thomson Hall. The details will be in the annual report on the last page, which will be published on March 9, in the evening. Back to you, Prem.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer
Terrific, John. Thank you very much. And now we are happy to answer your questions. [Operator Instructions] Okay, Caroline, we are ready for the questions.

Question and Answer

Operator

[Operator Instructions] Our first question or comment comes from Paul Holden from CIBC.

Paul David Holden
CIBC World Markets Inc., Research Division

I'm wondering if you can talk a little bit more about your reinsurance operations from, I guess, sort of 3 perspective, your experience with the January rate renewals, your capacity to underwrite more business and reinsurance and then shall we still expect cat losses of, say, 4% to 5% of premiums written long term?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

The last component again, Paul?

Paul David Holden
CIBC World Markets Inc., Research Division

Cat losses of, say, 4% to 5% of premiums written, is that a good long-term average?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. So just on the $1.1 billion, as I mentioned to you cat losses in 2011 were very, very high. And so the industry and many participant in the industry have had losses for the year, including investment income and so capital has depreciated significantly. In the property cat area prices have gone up quite significantly. In Japan, for example, price increases in the 50% area. In Thailand, it's early days but 100% price increases. So the cat exposure pricing is up significantly and maintaining pressure all over North America also. So that's an area where we find the pricing is attractive and we are taking advantage of it. So whenever you have cats, catastrophes, you have losses the other side of it is the opportunity side and we are facing that as we speak. On cat loss over time 4 to 5 percentage points is reasonable for Fairfax but in any one year, it's one of those situations where you have years where there's no catastrophe and some years where you have catastrophes. But 4 to 5 percentage points over the long term is not a bad cost to take into account.

Operator

Our next question comes from Jeff Fenwick from Cormark Securities.

Jeffrey Michael Fenwick
Cormark Securities Inc., Research Division

So I just wanted to follow up on the reinsurance question first and then maybe we can talk a bit about U.S. P&C. So on the reinsurance side there, I guess, the exposure to the Thai floods there was a bit larger than I would've thought and maybe just a bit of color on how it was that large. And secondly on Japan we continue to see some emergence of claims there as well, so how should we be thinking about that sort of ongoing process in Japan and how it's going to impact future quarters here.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, so in terms of Thailand. That's a very good question. It was a little higher than what we expected also and the reason for that was Thailand wasn't really a catastrophe exposed area, it was not considered a catastrophe exposed area. And so the Thailand floods were a surprise. The exposures were very significant, Japanese industry had built a huge amount of manufacturing in Thailand outside Bangkok and so those losses were a surprise. We, I think, we feel comfortable that we reserved for it and also, look and analyze so that we can be more effective in the future. As far as the Japanese outbreaks, tsunami losses, there was 1 account the same current account, which basically we've reserved it at limit so it can't move. So we feel comfortable there too, Jeff, that these losses are behind us. And as I've said the pricing -- so you get -- when you get these big losses, many companies withdraw from writing in the industry. They recognize the risk, see the risk, we haven't had a Japanese earthquake for a long time. Thailand hasn't had a flood in 50 years. So then the exposures were very obvious to everyone and so the prices go up and when the prices go up then you're getting paid to take the risk and so we'll make sure that we maintain our exposures and sometimes increase our exposures, always within our limits.

Jeffrey Michael Fenwick
Cormark Securities Inc., Research Division

Fair enough. Maybe we just speak a little about the U.S. insurance business, I mean, obviously some encouraging signs from some of the specialty lines in terms of growth but the adverse development there in the quarter out of Crum and Zenith was maybe a little more also than I would've expected. And any color on what was at play there and what we should think in terms of emergence patterns there going forward?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. So just maybe on the adverse development, we are very conscious of reserves and we always want to be properly reserved at any time and so Zenith saw some reserve development. They hit it hard in 2010 they hit it hard in 2011. You'll see for 4 years now, we've been reducing business. I'm talking about Fairfax in total. We've been reducing our business, all of the companies that have increased their business will see the emergence of these losses and we'll have to face up to them in time. We'd like to think we are ahead of the game by reserving properly as when we see these developments, so Zenith is well reserved. And in terms of pricing, we're seeing significant price increases in the workers' compensation area for Zenith. For example, you saw it, I told you in terms of the price, in terms of the premium increases, this is for Zenith for the year. John mentioned to you that we've owned it in the middle of 2010. But if you look at Zenith's results, Zenith 2011 compared to Zenith 2010 for the full year, they're up 18% and the trends as of 1/1 2012 are very good also. So they carry over and what happens if you write business in the submarkets, the reserve development comes to haunt you. And we've had this over 26 years, we've experienced this and the key thing is -- the key strategy tactic is to drop your premiums at that time which we've done in Crum, in Zenith. Zenith of course is a classic, they did it even before. Stanley Zax did it even before we bought it. They were writing $1.1 billion they dropped it to $450 million, they're running at, to $500 million and it's bottomed out now and the expense ratio for Zenith -- when John talks about the combined ratio at 125%, it's not the loss ratio. The loss ratio is very, very steady in the 60%, 65% area but the expense ratio increases because of the drop in premiums while that expense ratio is going to drop now. And Zenith is well-positioned to expand significantly in the years to come. So the specialty areas, property related areas and the exposure to catastrophe had price increases. Casualty pricing has bottomed out, and of course, we'll have to see how the momentum continues. From an industry-wide basis, Jeff, it's just that interest rates have come down to such low levels. There's really a lack of investment income, I'm thinking interest income, particularly for the industry, 4, 5 -- 5 years ago, our treasury rates were in the 5% area. They're now less than 1%, now 0.75%. So that's very significant decreases in interest rates, if you take shorter rates, like 2 or 3 year rates, they're basically nonexistent. So the underwriting profit has to be significant just to make a single digit 6%, 7%, 8% return on equity. You have to get very significant underwriting profit. And so we see think those trends are coming to bear but you have to monitor it of course and only time will tell. But we like what happened to us in 2011, fourth quarter of 2011 also and our business is now growing again as I said. From our shareholders' standpoint, that is the single most important thing to focus on, from a long-term standpoint because when our business grows, our investment portfolios grow, our investment income over time will grow. And I've talked about this before, it's vicious cycle and it works. So early days still, let me remind you, early days, but we like what we see.

Operator

Our next question comes from Mark Dwelle from RBC Capital Markets.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

A few questions. Can you provide a breakdown in terms of the actual catastrophe losses in the quarter and what portion of that was kind of in quarter losses and what portion were additions related to catastrophes that occurred in prior quarters?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. I think we do that in our statements, don't we, Dave? We break it down to the statements. I think one is where Thailand in 2011 fourth quarter, Thailand was the big one and the one that we had an increase on was the Japanese earthquake. So in the fourth quarter, let me see, so the Thailand floods was about -- a little more than $200 million and the Japanese earthquake, Mark, was about $105 million, that's an increase, right. And that's basically to a limit. And then we had odds and sorts of $8 million for New Zealand. This is on Page 80, by the way, in the interim report. It is 108 pages, I think, Mark so it's a little tough to go through it. It's all this IFRS reporting. But $8 million in New Zealand earthquake; so the U.S. tornadoes $5 million; and odd and sorts, total comes to about $360 million. And that was about 25.8 percentage points, John mentioned -- that's for the quarter, John mentioned 19.3% for the year and our combined ratio was 114%.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay. My second question, post the end of the quarter, you guys acquired Thai Re and I was just wondering if you could provide a little bit of an overview in terms of what the size of that business is and when it may close, just kind of a little bit of background just to help us model how that might go going forward?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Sure. Whenever you have these catastrophes, Mark, and know this, you follow the industry for some time. The opportunity side, Thai Re is a company, has been in business for a long time in Thailand. It is the dominant, local reinsurer, it's run by a gentleman by the name of Surachai, and his track record over 22 years is -- the combined ratio in the middle 80s, 85% area over 22 long years. A very, very smart businessman and we've been looking -- we've known him for 10 years and we've been looking for an opportunity to have a deeper relationship with him, well you have Thai floods and the company's equity I think was basically eliminated. And so they're doing the rights issue and we're putting in approximately $70 million for approximately 25% of the company fully diluted. And we think a very good price with an accomplished insurance executive, Surachai, and we're going to be partners with him. This will close, Mark, in the middle of -- before the end of the first quarter. And I think the rights issue comes in about a few weeks time and then we close up after that. We get 2 members of the board and we also will help them on the investment side. So it's very -- we're really excited about that company in terms of, it's not huge for us but we're developing our Asian business. You saw our Asian business. What is quite remarkable for me, and I talk about it on our annual report, is Mr. Athappan runs the Fairfax Asia and runs First Capital particularly, and most of these catastrophes took place in Asia, well, he still have a very good combined ratio, excellent combined ratio, in the high 70s percent, below, I think below 80% last year. So our Asian business is growing. Our Asian business is run very well, this Thailand investment for us, 25%, is another way to build it and we think we got it at a good price.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

Okay, that's helpful. One last question, if I may. Has there been any material change in your equity hedge position since the end of December? Where obviously you're 105% hedged or so at the end of the quarter. Has there been any big change in that since that time?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

No, there hasn't been. And that 105% by the way is we aim for 100% sometimes we sell some stock position or some common stock positions go up. And so the hedges is plus or minus 100% really it doesn't mean that we are a lot more negative on the stock market or anything like that, just plus or minus 100% but no change. Yes, no change. We think -- I mentioned in my opening comments and we'll say more in the annual report, but we've had periods like this in 2010 and 2011 where markets get excited. We think the problems in Europe are well known. We think the United States is having a tepid recovery, the 2.8% growth in the fourth quarter if you take out inventories, it's more like 0.8%. And I know some of the numbers are coming in a little more positive. We just think there's a long period of deleveraging that's going to take place with these ups and downs in the marketplaces, perhaps more optimism comes at one time, pessimism at the other. And you have to protect yourself during periods like this. But there will be a time when, if you take a long-term view, that common stocks will be very attractive. So we like the common stock portfolio that we have, the stocks that we own, but we just worry about the downside.

Operator

Our next question comes from Tom MacKinnon from BMO Capital.

Tom MacKinnon
BMO Capital Markets Equity Research

A question, Prem, you said in your remarks that you think the industry combined ratio is in need to drop below 90%. And I imagine you're referring to the industry combined ratios as it relates to reinsurers and commercial line writers, now...

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

I'm talking, broadly speaking not below 90% I'm talking in the 90% area, Tom. So that if you did the math and you take some average interest rate to get any type of return on equity with these low interest rates and remember, the 5-year rates are rolling off every month, you've got interest income coming down as these old interest rates roll off, right. So if you've got 2-year maturities and 3-year maturities they're rolling off and investment income's coming down, there's not too many places, obvious places, of getting investment income. And so to compensate for that, underwriting profits have to be significantly higher and/or, you're going to make a no return on your capital.

Tom MacKinnon
BMO Capital Markets Equity Research

I don't know how much you think your combined ratios could decline, but even if they fell 4 or 5 points and you actually got a significant increase in your earned premiums, say, 40% or 50%. Is equity -- how do you respond to the...

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

To that? Yes, so Tom, the way we look at it...

Tom MacKinnon
BMO Capital Markets Equity Research

As equity markets went up and bond rates went up, it would be a wash. So I think you're somewhat positioned for a firming market but an improving macro environment might offset some of that. I mean you are more leveraged on the investment side, if you will, than on the underwriting side. I mean it depends on whatever the scenario based on certain scenarios, if you will.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, so let me tell you on the underwriting side, when we've been shrinking our business, 2 things happen, right. The first one is our expense ratios have gone up. We kept talking about that, our expense ratios have gone up. Well, with our business going up, the expense ratios will come down and better pricing will just get your loss ratios, will get you better loss ratios, particularly in some of our specialty lines and in our property lines, and over time in the casualty area. So the loss ratios will come down but the expense ratios come down and then in the investment side, we have $6 billion in cash in our insurance companies, $6 billion of cash, we've got muni bonds. Our treasury bond that you might have thought with economic growth, we've sold half of them. So we've got the other half, we've sold it at not too different interest rates, long rates from where they are today, so that's about 3%. And those will be sold some time. And some time we'll take the hedge out and we've got a lot of flexibility. That's what we built into our company, lots of flexibility to take advantage of opportunity as and when it arises over time. And so I mentioned at the end of 2011, our 5-year compounded growth in book value of 19.5%, I don't think you'll find too many companies with that. That means we don't worry about a quarter and quite often a year. So 2011 wasn't a significant year for us, and 2010 wasn't a significant year for us. But the last 5 years, if you take them together and it's 19.5% compounded growth in book value. So that's how we've always built our company over 26 years, our growth in our book value is 23.5% per year for 26 years, very, very few companies in any industry have achieved that. And we do that, as I said, by taking short term pain like the fourth quarter for long-term gain. And it's very difficult to do for most companies but we've always -- we've got a culture of focusing in the underwriting side and in the investment side on the long term. And you know we attract certain shareholder base that likes that, if you're looking for quarterly results and perhaps annual results, Fairfax really is not the company for those investors because we really don't know how to do well for our shareholders on a quarter-by-quarter basis. We have done well for our shareholders over the long term and that continues to be our focus.

Tom MacKinnon
BMO Capital Markets Equity Research

Okay. Thanks, Prem. Thanks for highlighting the flexibility. I think that's an important thing to note.

Operator

Our next question comes from Daniel Baldini from Oberon Asset Management.

Daniel Baldini

When I look at the results of a couple of these insurance companies that folks consider best in class like Arch or Markel or White Mountains or W.R. Berkley, their combined ratios over the past couple of years have been lower than Fairfax's. And in Arch's and Markel's recent press releases they also talked about these extraordinary cat losses. And so I'm sort of interested to understand a little better how your underwriting strategy might be different from theirs. I mean are you pricing lower than them in expectation or hopes of acquiring more float, which you can very cleverly invest, are you maybe intentionally taking more risk with the expectation that when things go well the payoff will be higher? And that would be really interesting.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Daniel, that's a good question. But no, we definitely don't do that. We're not pricing lower to get more business so that we can have a higher float, so that we have money to invest. We definitely don't do that. But when you look at some of these companies you quoted like Arch, Markel, remember OdysseyRe is almost 50% of our business. So we've got a company that's in the reinsurance business worldwide and it's about 50% of our business. So you have a catastrophe, you compare our results to Everest Re, you compare our results to Transatlantic and we give you results for OdysseyRe. So you can compare Odyssey to any of those companies or PartnerRe or Platinum or any of these other reinsurance companies that are Bermuda based, you'll see Odyssey does very well and then if you look at each of these companies, they are good companies, the ones that you mentioned. But you look at them on a 5-year basis and a 10-year basis and you look at them on a 15-, 20-year basis, our returns compare very well. In fact, we tend to exceed them, almost any long-term period. But those are good companies, they follow the same approach we do in terms of focusing on underwriting profit and reserving well, and that's what we've done for 26 years. And we continue to do that and when the market's done as they seem to be doing today, we'll see our expense ratios come down and our loss ratios improve and have a good underwriting profit again. So in the last 4 years, Daniel, we dropped our business. If you look at each of our companies Crum & Forster, Zenith, I mentioned Odyssey, premiums have come down, Northbridge. Our premiums have come down not gone up. So we're definitely not interested in getting float for the sake of getting float. We look at the 2 sides separately. Our presidents are all focused on underwriting profit, no bonuses, compensation for the top line and no bonuses, compensation for generating float. It's all about underwriting profitability with good reserving.

Operator

[Operator Instructions] Our next question or comment comes from Howard Flinker from Flinker & Company.

Howard Flinker

I'm not sure if I heard you clearly but if I didn't, maybe you could spew a few numbers. What were the expense and loss ratios for the 2 fourth quarters, this year and last year and for the full year last year? And separately, what was the growth in premiums written in this year's fourth quarter adjusted for acquisitions.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. So Howard on Page 79 of our...

Howard Flinker

I didn't look at the whole thing. On Page 79 okay, I'll look at it.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

If you look at Page 79 it will give you the fourth quarter loss ratio underwriting expense, combined ratios for the accident year and for the calendar year.

Howard Flinker

For the whole company or for separate divisions?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

That will give it to you in total and if you look at it in the sections on each company, you'll find the combined ratios and the premium for each of them and by quarter. I apologize it's a long report. But when you look at that long report you'll find all the information there.

Howard Flinker

And the adjusted growth in premiums written in the fourth quarter, or is it real growth or if you want to call it that?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, it's all there, Howard, for you to read.

Howard Flinker

Finally I'll add that the 90% combined ratio for the industry, it will probably earn about 8% on equity.

V. Prem Watsa

Founder, Chairman and Chief Executive Officer

There you are. What interest rate did you use?

Howard Flinker

Current. 3% in the long bonds and make it 2% on the 10 year.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. So there you are.

Howard Flinker

It's nothing to write home about.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

I'm sorry?

Howard Flinker

8% is still nothing to write home about.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Well, that's right. That's exactly our view, Howard.

Operator

Our next question comes from Sean Barry from RBC Dominion Securities.

Sean Barry

Can you speak a little to your investment in Gulf Insurance and things that are going on there and any concerns there?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Gulf Insurance is our partnership with KIPCO. They're in the Middle East, Sean. And they've had another excellent year, combined ratio is in the 80% area and it's a fine company. We're very happy with our partners, looking forward to expanding in that area over time. We're in 7 countries there. We have more recently been helping them to manage the investment portfolios because as Howard's previous question has said, the property-casualty business, Sean, without an investment component is not a very profitable business and you can look at it and when I say that I'm talking 10, 15, 20 years. If you look at the property cash of the industry, increase in book value or the return on equity is nothing like other industries. And the only reason we've been able to do as well as we have is we manage the investment portfolios perhaps a little better than the others. And so that investment expertise we're bringing in, more recently we brought it into Gulf Insurance Co. in the Middle East, and as I said earlier, we are bringing it into Thailand. In our partnership in India, we already manage those portfolios. We, of course, in 100%-owned companies, we manage all the investment portfolios. But we think the property-casualty business without an investment perspective, always taking a long-term perspective, is not very attractive. So at the Gulf Company, Gulf Insurance Co. is doing very well.

Sean Barry

Were they able to increase their premiums because I thought last year their combined ratio about 94% then with other concerns with respect to the Arab spring and everything going on in Syria et cetera. So their combined ratio is in the low 80s now?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, we've increased the business, I think, in the 10% area, we'll give you a little more information, Sean, in the annual report for each of our companies. And so the business has grown at 10% plus I think, and the combined ratio as I said have continued to be excellent.

Operator

And I'm currently showing no further questions or comments at this time.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

So Caroline, if there's no more questions, thank you, all, for joining us on this call. We look forward to presenting to you again in the next quarter and prior to that, as John Varnell said, we look forward to seeing you at our annual general meeting on April 26. Thank you very much.

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