S&P Capital IQ

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Fairfax Financial Holdings Limited TSX:FFH

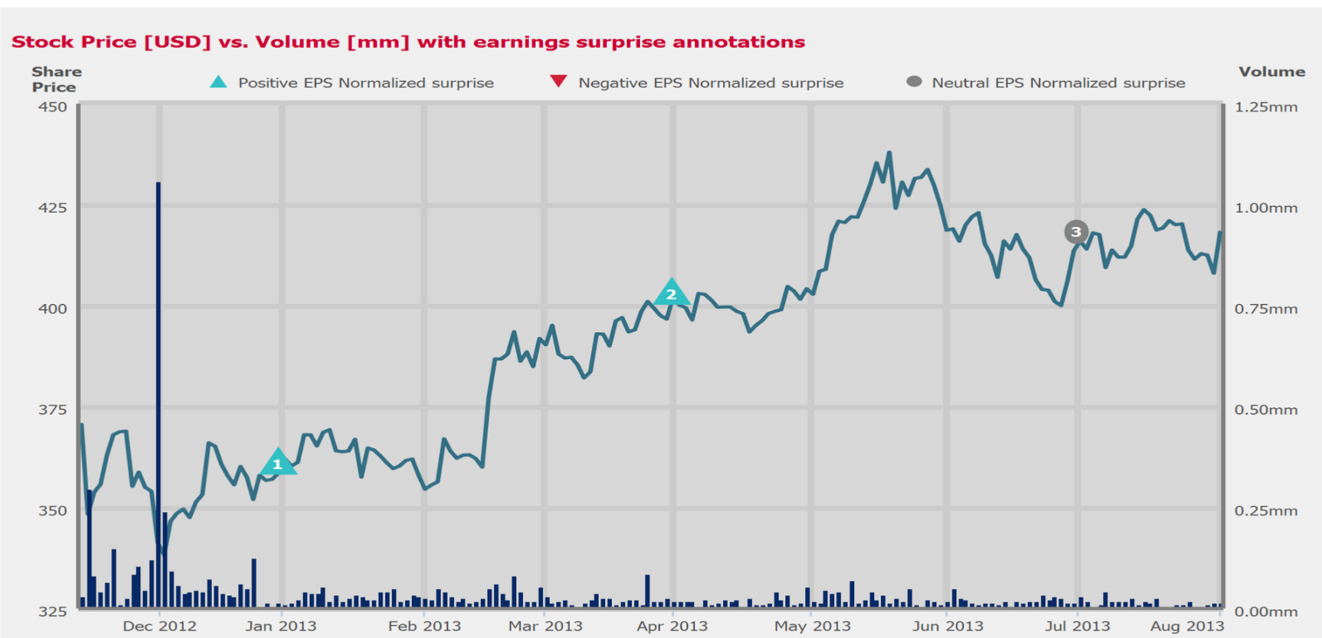
FY 2013 Earnings Call Transcripts

Friday, February 14, 2014 1:30 PM GMT

S&P Capital IQ Estimates

	-FQ4 2013-			-FQ1 2014-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	SURPRISE	CONSENSUS
EPS Normalized	4.82	(0.98)	NM	6.09	▲21.90	12.14
Revenue (mm)	1944.97	1683.70	▼(13.43 %)	1969.05	▲21.95	6299.30

Currency: USD
Consensus as of Jan-28-2014 1:57 PM GMT



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

ANALYSTS

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Jeffrey Michael Fenwick
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Mark Alan Dwelle
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Paul David Holden
CIBC World Markets Inc., Research Division

Tom MacKinnon
BMO Capital Markets Equity Research

Presentation

Operator

Good morning, and welcome to Fairfax's 2013 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 Eric Salsberg. Mr. Salsberg, please begin.

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

Good morning, and welcome to our call to discuss Fairfax's 2013 year-end results. The call may include forward-looking statements. Actual results may differ, perhaps materially, from those contained in such forward-looking statements as a result of a variety of uncertainties and risk factors, the most foreseeable of which are cited under Risk Factors in our base shelf prospectus, which has been filed with the Canadian securities regulators and is available on SEDAR.

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

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Thank you, Eric. Good morning, ladies and gentlemen. Welcome to Fairfax's year-end 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.

Insurance companies had an outstanding year in 2013 with a combined ratio of 92.7% with excellent reserving and record underwriting profits.

OdysseyRe had a record low combined ratio of 84%, while Zenith made an underwriting profit for the first time since we purchased them in 2010.

We have realized gains from our common stock portfolios of $1.3 billion in 2013. Excluding all hedging losses and before mark-to-market fluctuations in our investment portfolio, we earned $1.9 billion in pre-tax income. Including all hedging losses and mark-to-market fluctuations in our investment portfolio, we reported a $0.6 billion after-tax loss for 2013.

We expect the unrealized mark-to-market losses to reverse in the future. In fact, as of February 11, a few days ago, we had an unrealized mark-to-market gain in 2014 of approximately $900 million. After tax, this would have eliminated our loss in 2013.

In the past, we had 2 years, 1990 and 1991, that we had a negative total return. In both cases, we rebounded significantly in the following year. I caution you, we don't pay too much attention to short-term fluctuations in market prices. Our common stock portfolio has continued to be fully hedged, and we continue to be soundly financed with year-end cash and marketable securities in the holding company of $1.3 billion.

Moving onto our insurance and reinsurance businesses. Our insurance and reinsurance businesses premium volume remained flat in 2013 after a number of years of growth. The combined ratio for our insurance and reinsurance operations in 2013 was 89.1% for the fourth quarter and 92.7% for the whole year.

At the subsidiary level, the increase in net premiums written in the year 2013 and combined ratios were as follows: OdysseyRe, increase in premiums in 2013 was flat, combined ratio of 84%; Crum & Forster, increase in premiums flat, 101.9% combined ratio; Northbridge had a 4.6% increase in premium, 98.2% combined ratio; Zenith, 13.1% increase in premium, 97.1% combined ratio for the whole year; and Fairfax Asia had a 7% increase in premiums with an 87.5% combined ratio.

As we have said before, very low interest rates and reduced reserve redundancies means there's no place to hide for the industry. Combined ratios, over time, will have to drop well below 100% for the industry to make a single-digit return on equity with these low interest rates. While the short term is always hard to predict, fundamentals, we think, will eventually play out.

Net investment losses of $1.56 billion in 2013 consisted of the following. Please refer again to Page 2 of our press release.

Net losses on equity and equity-related investments of $537 million resulted from net gains of $1.4 billion from the table and a $2 billion net loss on our equity hedge, principally reflecting the temporary mismatch between the Russell Index and our equity portfolio. This is predominantly because of the Russell 2000 significantly outperforming the S&P 500 in 2013. We realized gains of $1.3 billion on our equity portfolio in the year 2013.

The realized loss of $1.4 billion on our equity hedges was due to the sale of common stocks and, consequently, a permanent reduction in our hedges. Also, we had unrealized losses of $1 billion in our municipal and Treasury bond portfolio because of the impact of rising interest rates. We expect the mark-to-market losses to reverse, as I said earlier, over time, and we have seen some of that already.

As we have mentioned in our annual meetings, annual reports and quarterly calls, with IFRS accounting, where 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 not seen since the 1950s. In spite of QE1, QE2 and QE3, our CPI-linked derivatives, with a nominal value of $83 billion, are down 76% from cost and are carried on our balance sheet at $131.7 million, even though they have 7.5 years to run. As I have said to you before, our CDS experience comes to mind.

When you review our statements, please remember that we own more than 20% -- that when we own more than 20% of a company, we equity account. And when we own above 50%, we consolidate, so that mark-to-market gains in these companies are not reflected in our results. Let me mention some of those gains.

As you can see on Page 14 of our quarterly report, the fair values of our investments in associates is $1.815 billion, which is has carrying value of $1.433 billion, an unrealized gain of $382 million that's not on our balance sheet.

Also, as we own 75% of Thomas Cook and 74% of Ridley, which are consolidated in our statements, unrealized gains on market values as of December 31, 2013 on both these positions is approximately $132 million. Thus, total unrealized gains not reflected on our balance sheet is $534 million.

On top of this, Euro Properties, our investment in an exceptional Greek REIT with outstanding management, where we have increased our investment through the rights issue, has another unrealized appreciation of $109 million not included in our balance sheet, for a grand total of $643 million, all not on our balance sheet.

Of course, all this works out in the long term, so take these mark-to-market fluctuations as just that, fluctuations that have no impact over time.

As I have said before, the company held $1.3 billion of cash, short-term investments and marketable securities at the holding company, and is in a very sound financial position.

We have reduced our equity holdings, because of increasing markets, by approximately 20%, and we continue to be approximately 100% hedged in relationship to our equity and equity-related securities, which include convertible bonds and convertible preferred stock.

We continue to be very concerned about the prospects for the financial markets and the economies of North America and Western Europe, accentuated, as we have said many times before, by potential weakness in China and emerging markets. We continue to feel that there is a big disconnect between the financial markets and the underlying economic fundamentals.

As of December 31, 2013, we have over 32%, or $8 billion, in cash and short-term investments in our portfolios to take advantage of opportunities that come our way. As a result, in the short term, our investment income will continue to be reduced.

Now I'd like to turn over to Dave Bonham, our CFO, 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 results for the fourth quarter of 2013, then I'll move on to the operating company results and finish with the consolidated financial position.

For the fourth quarter of 2013, Fairfax reported a net loss of $6 million, that's a net loss of $0.98 per share on a fully diluted basis, and that compares to the fourth quarter of 2012 when we reported a net profit of $402 million and earnings of $18.82 per share.

On a year-to-date basis, the company reported a net loss of $573 million, translating into a net loss of $31 per diluted share, and that compared to net earnings last year of $527 million or about $23 per diluted share.

Fairfax's underwriting results have shown significant improvement in the fourth quarter and full year of 2013, with our insurance and reinsurance operations reporting combined ratios of 89% and 93%, and underwriting profits of $165 million and $440 million during those respective periods. That's a year-over-year increase in underwriting profit of $280 million in the fourth quarter and $434 million in the full year of 2013.

By way of comparison, in the fourth quarter of 2012, we reported a combined ratio of 107% and an underwriting loss of $115 million, a combined ratio of 99.9% and an underwriting profit of $6 million in the full year of 2012.

So that improvement, representing about 18 combined ratio points quarter-over-quarter and 7 combined ratio points year-over-year, principally reflected higher catastrophe losses in 2012, mainly reflecting the impact of Hurricane Sandy, and the continuation in 2013 of higher net favorable prior year reserve development.

In terms of reserve development, we experienced a $212 million and $440 million of net favorable prior year reserve development in the fourth quarter and full year of 2013, and that benefited our combined ratio by 14 combined ratio points in the fourth quarter, 7 combined ratio points for the full year. That's a little bit more than double the amount of net favorable development we experienced in the fourth quarter and full year of 2012.

Current period catastrophe losses were significantly lower in 2013 relative to 2012, totaling $71 million or about 5 combined ratio points in the fourth quarter, and $289 million or also about 5 combined ratio points in the full year of 2013.

The fourth quarter of 2012 included current period catastrophe losses of $277 million, 18 combined ratio points mostly related to Hurricane Sandy. Current period catastrophe losses amounted to about $410 million or 7 combined ratio points in the full year of 2012.

The year-to-date underwriting results in 2013 reflected the impacts of the Alberta floods, Toronto floods, Germany hailstorms, Central European floods and Typhoon Fitow, with Typhoon Fitow being the most significant catastrophe loss reported during the fourth quarter of 2013.

As Prem mentioned already, net premiums written by our insurance and reinsurance operations increased in the fourth quarter and full year of 2013 by 0.2% and 2.9%, respectively, prior to giving effect to 2 significant unearned premium portfolio transfers at OdysseyRe related to a specific quota share reinsurance contract. And I wanted to note for you that Page 43 of our fourth quarter interim report contains a detailed discussion of these transactions, including their impact on OdysseyRe and Fairfax.

So let's turn to our operating company results, starting with OdysseyRe. In the fourth quarter and full year of 2013, Odyssey reported an underwriting profit of $122 million and $380 million, and combined ratios of 79% and 84%.

Underwriting profit increased year-over-year by $88 million and $114 million in the fourth quarter and full year of 2013, and that reflecting lower current period catastrophe losses and higher net favorable prior year reserve development.

Catastrophe losses in the fourth quarter and full year of 2013 of $65 million and $203 million translated into 11 combined ratio points and 9 combined ratio points in those respective periods, and were principally comprised of Typhoon Fitow and Windstorm Christian in the fourth quarter, and the Alberta floods, Germany hailstorms, Toronto floods and Central European floods during the rest of 2013.

Current period catastrophe losses in 2012 principally reflected the impact of Hurricane Sandy, with total losses of $175 million in the fourth quarter and the full year of 2012.

OdysseyRe's combined ratio in the fourth quarter and full year included the benefit of $134 million or 23 combined ratio points, and $215 million or 9 combined ratio points of net favorable prior year reserve development, principally relating to net favorable emergence on prior year's catastrophe losses.

OdysseyRe wrote 400 -- or rather $541 million of net premiums in the fourth quarter of 2013, and that's a decrease of 6% from the net premiums written of $574 million in the fourth quarter of 2012, the decrease principally reflecting lower writings of property catastrophe and casualty business, which was partially offset by increases in most lines of business in their U.S. insurance division.

In addition to these factors, OdysseyRe's net premiums written in the full year of 2013 also reflected increased writings of U.S. crop insurance and higher year-over-year recurring net premiums related to a significant property quota share reinsurance contract, which had incepted midway through the last year.

Turning to Crum & Forster. Crum & Forster's underwriting results improved in the fourth quarter and full year of 2013, reflecting lower net adverse prior year reserve development and lower current period catastrophe losses.

Crum & Forster reported an underwriting loss of $21 million in the fourth quarter, $24 million in the full year of 2013, and that's a significant improvement over the underwriting losses of $87 million and $113 million in the fourth quarter and full year of 2012.

Net adverse prior year reserve developments was lower year-over-year and totaled $8 million in the fourth quarter and full year of 2013, reflecting net unfavorable emergence on general liability loss reserves at First Mercury, partially offset by net favorable emergence on large liability -- on one single large liability claim at Crum & Forster.

That contrasts the net adverse prior year reserve development of $49 million, or 15 combined ratio points, and $54 million, or 4 combined ratio points, in the fourth quarter and full year of 2012.

Current period catastrophe losses had a nominal impact on Crum & Forster's combined ratios in 2013. Those combined ratios were 107% in the fourth quarter and 102% in the full year of 2012, whereas the combined ratios of 127% and 109% in the fourth quarter and full year of 2012 included 6.5 and 2.4 combined ratio points, respectively, of current period catastrophe losses, mostly related to Hurricane Sandy.

Net premiums written by Crum & Forster increased by 7.8% in the fourth quarter of 2013, and that primarily reflected increases in specialty lines of business, primarily accident and health, partially offset by lower standard lines of business. And that was due to the re-underwriting of the workers compensation business, which is now complete.

Crum & Forster's net premiums written decreased 1.6% in the full year of 2013, reflecting decreased standard lines of business, which was more pronounced through the first 3 quarters of 2013, and changes in the mix of the specialty lines of business.

Net premiums written in the full year of 2013 also included the incremental premiums from the acquisitions of Hartville and American Safety of $14 million and $13 million, respectively.

Zenith reported significant improvements in its combined ratio, which decreased to 88% and 97% in the fourth quarter and full year of 2013 from 114% and 116% in those periods last year.

The improvements reflected the following. Year-over-year increases of 15 and 10 percentage points -- or, sorry, year-over-year decreases of 15 and 10 percentage points in the accident year loss ratios in the fourth quarter and full year of 2013. That's reflecting earned price increases that exceeded estimates of loss trends. Secondly, increased net favorable development of prior year's reserves, representing 10 and 5 percentage points on the fourth quarter and full year of 2013. And finally, decreases in the expense ratio including commissions of 2 and 3 percentage points in the fourth quarter and full year of 2013, and that was as a result of 14% and 13% increases in net premiums earned year-over-year.

Net premiums written by Zenith of $126 million and $700 million in the fourth quarter and full year of 2013 increased by 14% and 13%, reflecting premium rate increases.

Northbridge's combined ratio improved from 114% in the fourth quarter of 2012 to 90% in the fourth quarter of 2013, and from 106% in the full year of 2012 to 98% in the full year of 2013.

In both the fourth quarter and full year, Northbridge's underwriting results reflected increased net favorable development of prior year's reserves, coupled with lower current period catastrophe losses quarter-over-quarter, but higher current period catastrophe losses year-over-year.

Northbridge's combined ratio included the benefit of a net favorable reserve development across most accident years and lines of business of $46 million, or 19 combined ratio points in the fourth quarter, and $154 million, or 16 combined ratio points in the full year of 2013. And that compared to net favorable development of $10 million or 4 combined ratio points in the fourth quarter, $61 million or 6 combined ratio points in the full year of 2012.

Catastrophe losses of $5 million in the fourth quarter of 2013, primarily related to the Toronto ice storms, whereas catastrophe losses of $61 million in the full year 2013, principally related to flooding in Alberta and Toronto. These 2 events together added approximately 5 percentage points to the combined ratio in the full year of 2013.

Combined ratio -- sorry, catastrophe losses in the fourth quarter and the full year of 2012 of $24 million and $39 million added 10 percentage points and 4 percentage points to the combined ratios in those respective periods and primarily reflecting the impact of Hurricane Sandy.

Adjusting for the onetime impact of the intercompany unearned premium portfolio transfer between Northbridge and Group Re, that we describe on Page 51 of our fourth quarter report, net premiums written by Northbridge increased in the fourth quarter and full year by 17.8% and 8.8%, expressed in Canadian dollars, and that reflects increased premium retention following the termination of that intercompany quota share arrangement and the modest growth in writings at Federated Insurance.

Turning to Fairfax Asia. Fairfax Asia's combined ratio increased from 84% and 87% in the fourth quarter and full year of 2012 to 88% in each of the fourth quarter and full year of 2013.

On a year-over-year basis, net premiums written by Fairfax Asia increased by 12% and 7% in the fourth quarter and full year of 2013, principally reflecting increased writings of commercial auto business in the fourth quarter of 2013 and increased engineering and liability business, partially offset by lower writings of marine hull business in the full year of 2013.

At Insurance and Reinsurance -- Other, the combined ratios of this division improved from 110% in the fourth quarter of 2012 to 92% in the fourth quarter of 2013, and improved from 104% in the full year of 2012 to 97% in the full year of 2013.

Net premiums written decreased by 27% and 23% in the fourth quarter and full year of 2013. The unearned premium portfolio transfer that we mentioned in our discussion of Northbridge, suppressed to the net premiums written by Group Re in the full year of 2013 by $39 million.

If we exclude the initial onetime impact of this transfer, net premiums written decreased by 15.9% in the full year of 2013, reflecting the decrease in Group Re's quota share participation on that intercompany reinsurance contract from 10% last year to 0 this year, and also reflected the re-underwriting of certain classes of business at Advent, Polish Re, combined with decreased usage of reinsurance at Advent. And that was partially offset by growth of Fairfax Brazil.

Runoff reported operating income of $91 million and $77 million in the fourth quarter and full year of 2013. That's an increase over the operating income of $13 million and $8 million reported in the same periods last year. The improvement in operating profitability primarily reflected net overall favorable prior year reserve development in 2013 compared to net overall adverse reserve development runoff in 2012, and also reflected a gain on a significant commutation in the full year of 2013.

Moving on to some of our consolidated results. Our consolidated interest and dividend income increased from $73 million in the fourth quarter of 2012 to $104 million in the fourth quarter of 2013, decreased $409 million in the full year of 2012 to $377 million in the full year of 2013.

Both periods reflected lower investment income due to sales of higher-yielding government and corporate bonds in 2012 and 2013, and sales of dividend-paying equities in 2013, the proceeds of which were reinvested into lower-yielding bonds, cash and short-term investments.

The fourth quarter and full year of 2013 also reflected lower total returns of swap expense period-over-period, the decrease even more pronounced in the fourth quarter, reflecting terminations of equity index, total return swaps and certain short positions during 2013.

The company recorded a recovery of income taxes of $24 million and $437 million in the fourth quarter and full year of 2013, representing effective tax rates of 93% and 44%, respectively.

The higher effective tax rate in the fourth quarter and full year of 2013, primarily related to significant pre-tax losses in the U.S., which increases our effective tax rate when we're in a loss position as tax may be recovered at the U.S. tax rate of 35%, and that's substantially higher than the Canadian statutory income tax rate of 26.5%.

Moving to our financial position. We issued $1 million subordinate voting shares on November 15, 2013 for net proceeds after commissions and expenses of $400 million. And we repaid the $183 million principal amount of OdysseyRe unsecured senior notes when they matured on November 1, 2013.

Our total debt to total capital ratio increased to 26.1% from 25.5% at December 31, 2012, due primarily to the decrease in our common shareholders equity during the year 2013.

And now I'll pass it back to you, Prem.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer
Thank you, Dave. Now we are happy to answer your questions. [Operator Instructions] Okay, Caroline, we are ready for the questions.

Question and Answer

Operator

[Operator Instructions] And our first question or comment comes from Jeff Fenwick from Cormark Securities.

Jeffrey Michael Fenwick
Cormark Securities Inc., Research Division

So Prem, a little bit of movement in the investment portfolio through the quarter here, as you mentioned you sold some of your positions and closed out your S&P 500 swap there as well. How are you feeling in terms of the mix today? And where you would like to position the portfolio here going forward in 2014?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, Jeff. We're quite happy with the way we positioned it, Jeff. We are 100% hedged in our common stock portfolios, large cast positions, as you know. And we have muni bonds, predominantly protected by Berkshire Hathaway guarantee. And we have some U.S. government bonds, but very little corporate bonds. So we are basically risked averse, you would say, and concerned about what's happening in the financial markets.

Jeffrey Michael Fenwick
Cormark Securities Inc., Research Division

And just in terms about waiting on the muni bonds, obviously, it's served you well from a yield perspective, but it's obviously a pretty heavy component of your fixed income. Are you still comfortable with that size of the muni position in the portfolio?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, we're very comfortable with our muni positions. We don't think there's any credit risk in the muni bond portfolios. They do have fluctuations, Jeff, in terms of interest rates going up and down. And so when I talked about that $900 million gain from the end of 2013, a third of that was from our bond portfolios going up because long rates have come down. And the rest was basically from the common stock portfolios and markets going up, of course, the hedge benefited. So there is volatility because the markets are volatile and you're into mark-to-market positions on a regular basis. But there's a lot of concern, as you know, in terms of -- which we've talked about in the past, in the U.S. economy, it's still tepid in our minds, and Europe. We've talked about China and of course, emerging markets are causing some problems recently. So there's many unintended consequences, and we continue to be very cautious given that markets have gone up so much and spreads are so narrow.

Jeffrey Michael Fenwick
Cormark Securities Inc., Research Division

And I guess just one follow-up on the exit from S&P 500 total return swap. I've seen that's going to help you out a little bit on the dividend and interest income line there, you had a bit of an expense associated with those swaps. Is that the correct way to think about it?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Dave, you want to add to that, Dave?

David J. Bonham
Chief Financial Officer and Vice President

Yes, that's absolute correct. So we saw a little of that already in the fourth quarter where our dividends that we pay out in respect to those total return swaps is coming in lower, and that's going to continue into next year.

Operator

Next question is from Paul Holden from CIBC.

Paul David Holden
CIBC World Markets Inc., Research Division

I have 2 questions for you. First is related to the insurance operations. I'm hoping you can provide us with a little more color around the favorable reserve development this quarter, mainly at Northbridge and Odyssey since we haven't had a chance to see the reserve tables yet, which I know have been included in the annual report. But I haven't had a chance to look at it yet, so maybe help us out there.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, so I'll pass it on to Dave. But perhaps, just to make the point that we always reserve conservatively on an accident year basis. And then of course, we watch how the reserves develop. And -- so we've been very conservative on an accident year basis for all our companies. But Dave, specifically to OdysseyRe, would you add a few comments?

David J. Bonham
Chief Financial Officer and Vice President

Sure. OdysseyRe reported a favorable development of $114 million in the year and $134 million in the fourth quarter, and that was principally related to prior year's catastrophe loss reserves developing favorably, and also related to casualty reserves developing more favorably this year.

Paul David Holden
CIBC World Markets Inc., Research Division

Okay. And I'm sorry, at Northbridge, was there anything in particular?

David J. Bonham
Chief Financial Officer and Vice President

Nothing specific at Northbridge. Favorable development across all the lines of business and all of the reserves, and that was about $154 million on the year, $46 million on the quarter.

Paul David Holden
CIBC World Markets Inc., Research Division

Okay. And then my second question is related to the investment portfolio. So Prem, you've been warning about the potential for a hard landing in China for some time now, and reiterated that a bit again today. And certainly, we're starting to see some cracks in the financial system there. So my question is, have you contemplated more direct investment vehicles to potentially profit from a hard landing in China?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Well, Paul, that's a very good question. We haven't identified anything specific. What we are more interested in -- China is very large economy, as you know, and anything happening in China will impact the world. China takes almost 50 -- 40% to 50% of every commodity. So of course, China will have an impact on Canada, and will have an impact on many of the commodity-producing countries like Australia and Brazil, other countries in the world. So we are focused on protecting ourselves, first and foremost, and not making as much of a gain. Now we've -- and some of you will say we are hedged and -- 100% hedged on the upside and 100% hedged on the downside. So Paul, how we going to make any money? And what happens, we've realized a lot -- a significant amount of gain, $1.3 million from our -- or $1.3 billion from the common stock portfolios, and we've reinvested it in things that we like, which are significantly down from where they were. And we are protecting our portfolios -- equity portfolios from significant drops, not a 5% and 10% drop, but like 30% plus drops. That's what we're worried about, Paul. And in that environment, the fact that we've sold our common shares that have done very well and bought things that haven't done as well means that we'll be protected on the downside. We don't expect to go down as much as the indices. And that's happened in the past. It happened more recently in 2008, that we came down significantly less and made a lot of money in our hedges, and we think that's yet to happen. But it's fascinating to me that, here we have, a huge monstrous bubble in real estate in China. And here, you're talking -- you're asking me the question that's written about in the press 1 year ago, there was a CBS documentary on it, and it seems to me that almost no one worried about it. It reminds me what happened in the housing prices in 2003, '04, '05, the boom in housing. It reminds me of -- well, it takes me back to the tech boom. The companies -- big companies like Northern Telecom and others, were buying companies -- small little companies for $10 billion and $20 billion with no sales, no revenues and nothing other than a few engineers together. And it takes me back to the 1980s when you had the same type of experience in the oil industry. The problem with these booms, or bubbles, is that they last for some time, and you can never tell when it'll change. And our experience over 35, 40 years is to stay away from them and have the fortitude to continue to stay away, even when you look very wrong. Like last year, for example, if we were really smart, we wouldn't have hedged our common stock portfolio and, perhaps, began to hedge it late in the year or now. Well, we've never done that over 28 years. We've always taken a long-term view. When we recognize problems, we reacted to it and quite often, we've been wrong or too early. And then, as a friend of mine said, "Wrong, wrong, wrong and then right, perhaps better than the other way around." And so, Paul, we continue to be worried about all of these things in spite of the fact that 2013 wasn't the year to have that position.

Operator

Our next question is Tom MacKinnon from BMO Capital.

Tom MacKinnon
BMO Capital Markets Equity Research

Question from about the -- I think part of the reason for the cash, the higher cash position was to provide the flexibility in case you really wanted to -- in case the insurance markets really started to firm. And if we look, net premiums written were up 23% in 2011, 10% in 2012 and now they're flat. So do you think that you've missed this opportunity to take advantage of firming markets -- insurance markets, particularly the reinsurance markets? And maybe you can elaborate a little bit more on some of the thesis for that sizable cash position.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. No, that's a good question, Tom. But in the -- remember there wasn't a wholesale hard market. The hard market and the cat area after 2011. We took full advantage of that. OdysseyRe took full advantage of that. And -- but in the other areas, in the workers comp area, our -- Zenith has gone from $400 million to $450 million in premium, when we bought it, to $700 million last year. So it's done very well. But other than that, you had 5%, 10% increases over these last few years. And so it's not been a full-fledged hard market. And -- but we've taken as much advantage as we can. More recently, the cat prices are down 15% to 20%. There hasn't been a cat event last year. Likely, that drop will continue. And likely, our premiums will drop in that segment, just reflecting the fact that prices are coming down with similar or additional exposures. We've had losses in Calgary, of course, and with the flood losses in Toronto, so that would be a little bit of a plus for our Canadian markets. But the markets happen to have been -- the insurance markets haven't had a full-fledged hard market like we've had after 2001. And the financial markets have been very good, so most people have made good money in the investment portfolios. But you can see a possibility where spreads widen and perhaps, common stock prices come down where the -- where there's a squeeze on capital. Ultimately, that's what happens, you need a squeeze on capital. It happened -- it's happened in the past, can happen again -- or of course, a very significant catastrophe. But yes -- no, we -- the cash positions, though, it would be fair to say, we should have had very low cash positions, Tom, and put it all in -- put a significant amount in the stock market or in bonds and -- corporate bonds, spreads have come down further, and perhaps not hedged our common stock. So our strategy -- our longer-term strategy was definitely wrong in 2013.

Tom MacKinnon
BMO Capital Markets Equity Research

So what would be the things you would look for before you would want to redeploy the cash? And I don't know if investors really want to have a 1/3 of the portfolio earning hardly anything or -- but maybe you could just elaborate, if it's not necessarily firming the insurance market...what are we looking for?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes, we are very long term in orientation. And so our investors, the ones that we've had for a long period of time understand the view that we have. And -- but many investors will not, and they want to be fully invested, and so we wouldn't be the company that they'd invest in. We've just taken a long-term view in all our activities. And the fact that you have cash -- remember, in 2008, 2009, one of the reasons we benefited so significantly was the fact that we had government bonds and cash to take advantage of opportunity. You can't take advantage of opportunity if you don't have cash. We think this is a good time to have a significant amount of cash in your portfolios.

Operator

Our next question is from Art Charpentier from Merritt Research.

Arthur D. Charpentier
Merritt Research Corporation

In your introductory comments, you mentioned the very low rates available for an investment are going to require some more discipline on underwriting so as to earn underwriting profits because you can't rely on investment profits going forward. Obviously, the combined ratios improved dramatically in this last year. But at the same time, to a good degree, it was a much less -- a much lower catastrophic event year. So my question really is, are you implementing -- how much of this improved combined ratio is a result of implementing what you might call a different, maybe more demanding, underwriting approach? And how much of it is a result of essentially being a maybe lighter-than-normal catastrophe year?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Well, Art, that's very good question. And we have benefited from the fact that there's been a few catastrophes last year, no question. But I said last year, at our annual meeting, that our company has benefited very significantly from the fact that a few years ago, we put Andy Bernard, who built OdysseyRe, in charge of all our insurance operations. And the effects of Andy working with our officers, like Peter Clarke and Paul Rivett, has been very significant and will continue to be significant. In fact, Andy mentioned last year at our AGM -- and by the way, you're welcome to attend our AGM. Andy said that he would like Fairfax to be known for its underwriting as much as it is known for its investment record over a long period of time. And I think that's gradually coming into play. And there's been significant improvements in each of our companies, and they'll continue to take place. So we have benefited from the lack of catastrophes, but there's many, many, improvements taking place across all our companies.

Operator

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

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

A couple of questions. First on the reserves. It was probably the best quarter for reserve releases, maybe ever, but certainly and as long as I'm able to remember. You've itemized some of the details on it earlier, but I was wondering -- I mean, I'm sure this was part of the normal year-end detailed review with your outside actuaries, et cetera. I was wondering if there's any particular maybe change in assumption or anything like that, that might have led to the favorable result. I mean, I don't doubt what came up, it's more a matter of whether it's something that we might expect to see more of in the future.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

No. So we're -- first of all, we're very conservative. But a few years ago, Mark, you might have remembered, we tightened up our reserve against Northbridge in terms of paying claims quickly and reserving to ultimate. And this is a few years ago, and perhaps, focused on Lombard. And that's coming through last year and this year. And -- but broadly speaking, we put our accident year loss ratios, combined ratios at a higher level, and we expect the redundancies to come in over time. But Dave, would you want to add to that, Dave?

David J. Bonham
Chief Financial Officer and Vice President

Yes, I would echo your comments, Prem. And no real changes in assumptions driving this. Maybe one extra point, to my Northbridge comment, we're seeing favorable case reserve developments coming through there, which is positive. And as Prem said, reflects the conservatism that we may have had a few years ago. And in general, it's just a reaction to the favorable claims emergence that we're seeing at many of our companies, specifically Northbridge and OdysseyRe.

Mark Alan Dwelle
RBC Capital Markets, LLC, Research Division

That's terrific. Hopefully that keeps up. Second question I had related to -- you guys announced after the end of the year, the acquisition of the Keg Restaurants. I just wanted to check whether that was going to be -- maybe a little bit of background on that, as well as whether that's going to be a consolidated subsidiary or an affiliate-held investment.

David J. Bonham
Chief Financial Officer and Vice President

Yes, that'll be a consolidated subsidiary. So that'll be in our Other reporting segment in the first quarter of 2014.

Operator

Our next question is from Howard Flinker from Flinker & Company.

Howard Flinker

Just a minor question and then a comment. Did you sell a preferred and replaced a preferred? Or was that a new preferred? I was confused by that.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Which preferred were you talking about, Howard?

Howard Flinker

You did the preferred offering. Was it in the fourth quarter, straight preferred?

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

We did that -- sorry, Howard. That was a common stock issue that we did. We did 1 million shares at $431 a share.

Howard Flinker

Oh, it's common. Oh, I misread it, that's my error.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Yes. No, not a problem.

Howard Flinker

Yes, because I still saw the preferred on the books, and I thought, "Well, maybe I had some other misunderstanding." No, it's my mistake. There is another way, which I'll mention to John in a separate call, how you could possibly capitalize on the deflationary pressures. I'm sure you guys have already thought about it, but...

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

We'd love to hear that from you, Howard, when you give John a call.

Operator

I'm currently showing no further questions or comments.

V. Prem Watsa
Founder, Chairman and Chief Executive Officer

Well, if there no more questions, then thank you, all, for joining us on this call. We look forward to seeing you at our AGM in April, and of course presenting to you again after the next quarter. Thank you, Caroline.

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