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| Gwin: | 00:03 | Hello, and welcome to the Price-to-Value Podcast with Southeastern Asset Management, where our global investment team discusses the topics that are most top of mind for our clients from a Business, People, Price point of view.   |
| Gwin: | 00:17 | We at Southeastern are long-term, concentrated engaged, value, investors, and we seek to own high quality businesses, run by capable people, at a discounted price-to-intrinsic value or P/V.  |
| Gwin: | 00:28 | I'm Gwin Myerberg, Global Head of Client Relations and Communications. Today's podcast will be a different format than usual. We'll be sharing a recorded phone call between Vice-Chairman Staley Cates and Prem Watsa, the Chairman and CEO of Fairfax Financial Holdings, which we own in our Global, US, and Non-U.S. portfolios. |
| Gwin: | 00:46 | We hope that you'll enjoy the discussion and that you'll learn as much as we did.  |

Staley: 00:51 On our first podcast with an external guest, it's extremely fitting to us that the first guest is Prem Watsa of Fairfax. As they say, Prem definitely needs no introduction, but we are going to do a very brief one anyway. If you look, you can find all kind of information about Prem online, and most of the investors on this podcast would know him well.

Staley: 01:11 But the highlights, to me, are several from the official bio. One is he founded Fairfax in 1985 in Toronto. The second major point is, as many of you know, is he modeled it after Berkshire Hathaway. Not surprisingly over the years, he has been called the "Warren Buffett of Canada" so many times, we have lost track related to that model.

Staley: 01:33 I'm here doing a podcast, but I'm about to use a broadcast word officially, and that word is "mic drop". Because the mic drop, as we discuss Prem's record, and you can see this in his last Annual Report which covered 2017, and came out early in 2018, is the compounded book value growth over that period of 19.5% and a stock price compounded gain over that whole period of 18.1%.

Staley: 02:01 Then to the more "unofficial" bio, which is more personalized, Prem is one of the best partners we have ever had. He has been not just a great investor and peer, but just a great friend for a long time.

Staley: 02:15 Prem was incredibly close to Sir John Templeton. Sir John was a great mentor and friend of Prem's and of Fairfax's, and we share that as well. Sir John was fantastic to Mason personally as a mentor in the early days and then to Southeastern as the firm evolved. And no one carries that torch better than Prem.

Staley: 02:37 With that, we will start with the questions. Prem, I thought we would start in 2003, 2004. I don't have many things on my office wall, but one of them is a funny plaque representing the tombstone of when Southeastern invested in Fairfax, as did Markel. That was in the midst of quite the short attack. So, it might be interesting if you just tell that story.

Prem: 03:08 Well, Staley, first of all, thank you for having this interview. You guys have been great partners. I've known you for a long, long time and, of course, over that time, we've become very good friends.

- Prem: 03:20 Of course, you were there when we had that huge short attack. We'll never forget that. It was right in the middle of our 33 years. It happened on a Martin Luther King, Jr. weekend, so it just happened a few days before that. We had a Forbes article talking about how we could run into some difficult times.
- Prem: 03:46 There was a guy, Staley, I remember, Peter Ebert, who had a newsletter. He came out the next day with something negative on us. Then finally we had on Friday, before the Martin Luther King, Jr. Monday weekend, Morgan Keegan came out with a tech report saying we were \$5 billion under-reserved. Five *billion*. We got that report late on Friday and we thought, you know, this guy must be kidding. Never heard of him before, never heard of Morgan Keegan before.
- Prem: 04:24 On Monday, when the United States markets were closed and Canada was open and not a lot of trading, the short attack began, and they drew our stock way down. The transaction team called us and said, "You know, you have to make a comment." So we made a comment and said something to the effect that there was no truth in these articles. That began a short attack.
- Prem: 04:54 For the longest time, we didn't take it too seriously, we just thought, you're allowed to short the stock, you're allowed to buy it, and results will out eventually.
- Prem: 05:06 Then our President today [Paul Rivett], in those days a young lawyer, came and told us and a few years after 2003, he said, "Hey, this seems like a short attack. These guys are saying the same thing as these other fellows and another newspaper are saying the same thing to our shareholders, the analysts, our auditors, the rating agencies."
- Prem: 05:37 So that's when we realized we were in the midst of a short attack. We got a lot of information put together, we hired a New York law firm. The attack took place, and in 2006 we sued the shorts.
- Prem: 05:57 I'll tell you, they really hadn't done too much work. They didn't really understand our company and we survived that attack quite well. But the bottom line was, we became much stronger because of it. Our company came together like never before.

Prem: 06:16 To every problem, there's an opportunity. Mr. Templeton always said that, and from our standpoint that was a big plus with hindsight, in terms of how we all came together. We never lost anyone. None of our presidents left, none of our officers left, and we became much closer because we all went through the same experience.

Staley: 06:38 One thing we learned, or took away from that watching it, was: it's one thing if the shorts attack a company with a certain kind of product. But in the world of insurance, where it's really about confidence and the rating agencies are so important, that a lot of that stuff, if it ends of scaring the ratings agencies, it can actually, tangibly end up scaring the customer. Which is not always the case in some other categories.

Prem: 07:06 No question. They wrote articles in newspapers, in the Toronto newspapers saying that Fairfax is going bankrupt. It was a pretty concerted attack.

Prem: 07:23 But what they missed, Staley, if they had spent five minutes on our Annual Report, is that we were a very decentralized company. So we've got each of our companies, separately financed, separately run. So at any one time, we could take a company public, we could sell it if we had to. We never did have to sell any companies. But we could take it public.

Prem: 07:44 We took Odyssey Re public, if you remember. We took our Canadian company, Northbridge public. We were able to borrow, refinance our bonds at common price still.

Prem: 08:04 We had many, many alternative options, that if you had read our Annual Report, which to the best of my knowledge, these guys hadn't done that, you'd have recognized that we had a lot of options in front of us.

Staley: 08:23 Well, moving along chronologically, as we hit the GFC in 2008, the just beyond historic investment thing that happened is your investment portfolio being up 16.4% in a year, when the S&P was down 40%. Which was just hard to believe and a lot of that was driven by the CDS winning outcome.

Staley: 08:52 Now there are movies like "The Big Short", and credit default swaps are pretty widely traded. But at the time,

that was a newer vehicle, and we certainly learned about it through your holdings of them. Can you talk about how you found them and how you did the work?

- Prem: 09:07 Yeah, so first of all we looked at housing in the United States and for the first time in that time period, 2004, 2005, 2006, housing all over the US was going up. Housing was recognized as an asset that could appreciate and of course, extrapolate it to the extreme.
- Prem: 09:26 We sold these mortgage bank bonds. So you had these mortgage bank bonds and other asset backed bonds being rated, AA, AAA. There were thousands of these structures that were rated AAA and AA, and we found it quite amazing that there were five or six companies that were AAA. But there were thousands of these structures, and these structures didn't have a CFO. If you ever ran into a problem, they had no organization behind it.
- Prem: 10:00 So that prompted us to look at it a little more and then we came across these ... Bryan Bradstreet, who I've worked with who's a fixed income guy, partner and worked with us, as you know, Staley, for 40+years. Bryan came up with the idea of CDS and we liked the optionality of it.
- Prem: 10:23 At the end of the day, we bought about 340 million. We began in 2004, 2005, 2006. And believe it or not, in our 2006 Annual Report, I said, our CDSs, and they're all five-year, seven-year CDSs. But at the time and mark to market, of course, in 2006 they had gone down 75%. We took a deep breath, and we bought some more.
- Prem: 10:52 In 2007, things turned. You'll remember some of the real estate fund stock redemptions - Bear Stearns had one in the middle of June that was a first early warning sign. Then of course, Bear Stearns went bankrupt in 2008.
- Prem: 11:16 The CDS structure, those derivatives, just went through the roof in 2007 and 2008. We were able to sell them for \$2.4 billion of gains, which was just amazing, transformative for us in Fairfax. In 2004, 2005, and 2006, we were trading water. We hadn't made much money. But in 2008, we were very worried about the stock market. We were worried about the CDSs and the leverage that the investment banks had.
- Prem: 12:05 I remember looking at the leverage of Bear Stearns and Lehman Brothers and AIG at the time. AIG wrote a lot of

these CDS contracts. So we were very fortunate when it happened and our company became very strong in 2008; 2007 and 2008 were very significant years for us.

- Staley: 12:26 Well, they certainly were. So taking the logic of that huge winning bet and then reading your stuff and talking to you in subsequent years, there were a lot of times we would talk about individual stocks. But then in the wake of that success, it felt like or seemed like, that you guys would do more macro-based things. Again, that one had been hugely successful, so that would be completely logical. But is that accurate and fair?
- Prem: 13:01 No, I think that's not unfair at all because that experience was very positive for us. But we worried about the fact that interest rates were 0%. There was very little financial flexibility, we thought, with the big deficits in the United States.
- Prem: 13:25 So we were worried about "What happens if you go into another recession?" We worried about China. But at all times, whenever we invested money, it was always based on the value approach. Looking back though -and I say it in our annual report, when interest rates dropped to a long rate, 30-year rates, 2.5 and 3% - in 2011, in our Annual Report, we talked about the fact, Staley, we said, "Interest rates have come down so much there's no use buying long bonds. Maybe for a few years, but really 2.5-3%, in a long-term sense, that's what you can get. If you look at stocks with a long-term viewpoint, we're worried about the next few years, but over time, stocks should perform well."
- Prem: 13:49
- Prem: 14:24 We didn't take our own advice and we kept hedging our common stock portfolios. We kept our long bonds. Over time, we did quite well, but with hindsight, we should've sold them at that, as I said, 2.5-3% in 2011, 2012. And just focused on what we have been very good at - like you guys at Southeastern - focusing on value investing, good companies at good prices.
- Prem: 15:01 Which is what we got back to in 2016 with the new administration, the Trump administration, getting in and their policies of 21% tax rates. Taking back regulation, rolling back regulation, and of course, potentially infrastructure spending.

Prem: 15:25 So we sold our long bonds at that time, and we've got lots of cash. Lots of 2 and 3- year bonds. Basically, the risk assets are in our common stock portfolio, which is about 20 to 25%. All on a value basis, which we've done for four years.

Staley: 15:47 Can you elaborate on that a little bit? There are, as you know and you probably get the questions as often as we do, but there's quite the raging debate on "Does value investing even work?"

Staley: 16:00 It's been a tough time for a lot of value managers of all forms. Whether it's company structures or long only buy satellite guys or hedge funds. So this feels existential these days, but can you talk about where we are in value investing?

Prem: 16:18 Yeah, you're exactly right. In the last 10 years since that 2008, 2009 crash, call it the great financial crash. Since that time, value investing basically I think one, maybe two years we've had that value-oriented stocks have done well compared to momentum. You've had technology, as you know. The FANG stocks and high technology stocks have done well. They don't have to make any money, it seems, and they continue to finance at higher valuations.

Prem: 16:54 But the long history of the stock market shows that value investing pays off. You have to be patient. You have to take a long-term viewpoint. Some of these newer models make it come up in some time, and you never know when.

Prem: 17:15 We had the dot com era for some time, as you'll remember in the 2000 time period. It seemed like these companies would go through the roof. Of course, they suddenly hit the wall and came down 75, 80%. And some of them disappeared.

Prem: 17:34 So we just think value investing, where you're buying something, a dollar for 50 cents is the expression. Good companies run by good, honest, hardworking presidents, CEOs. And you're buying them at fair prices. We think over time, that should work. Yeah, we're still continuing to be believers like you and Mason at Southeastern.

Staley: 18:05 One other follow-up on that. You are a global investor the way your mentor, Sir John pioneered, and we have assets all over the globe as well.

Staley: 18:14 So one question that we get that I'm asking you as well would be, do you differentiate on applying value investing to US and Non-U.S.? Is there a difference in how you apply it? Is there a difference in probability of success, US versus Non-U.S.?

Prem: 18:29 Yeah, the United States of course, Staley, the accounting is terrific. You've got the FCC, you've got tremendous disclosure. So the risk is much less.

Prem: 18:44 As you go into places like Europe and Greece and where we've been. And you go into India and you go into parts of Asia, you have to be very, very careful. But the opportunity in those countries can be very significant.

Prem: 19:01 The one that I'm particularly excited about is India because it's a country that's become business friendly now. Taking out 67 years of socialism, it's growing among the larger economies in the world, it's growing at the fastest rate, about 7, 7.5%. It's going from a very low base, so that the opportunity for companies to grow 30, 40% for long periods of time is very much prevalent.

Prem: 19:35 As you know, that's why we started a company called Fairfax India, which we control at Fairfax.

Staley: 19:42 Well, the other existential investment question these days is active versus passive. We consider John Vogel an incredible figure and another patron saint of investing. Held him in huge high regard on a lot of things about indexing and passive.

Staley: 20:02 But that seems to have gone pretty far these days, that pendulum. But can you talk about active versus passive?

Prem: 20:09 Yeah, no, that's right. The passive idea indexing, I think Mr. Buffet's support of it has taken it perhaps to the extreme levels. Especially when you look at the indices and you see all these high technology stocks at a very high weighting in the S&P 500. It tends to perpetuate itself.

Prem: 20:37 Active investing, investing where you're picking stocks one by one, I think is long-term the only way to go. But it takes a lot of time, a lot of devotion to the task, like you guys do, Staley. So it's not for everyone. If you don't have that time, then you should buy an index fund.



Prem: 21:05 But for people like yourself, who focus on value investing for 40 years. And us for 40 years. We think that's the way to go and we think over time, our shareholders will benefit greatly from that approach

Staley: 21:22 One other thing about the investment side before we move to the underwriting side of the house. But that would be it's been interesting that Berkshire and Fairfax and Markel, with similar models and histories, seems like have all pivoted towards private company transactions. Not just pieces of companies in the form of public equities.

Staley: 21:44 Can you talk about that? Is that a meaningful pivot? Is it still intact? How do you contrast these days the private side versus the public side?

Prem: 21:56 It's just opportunistic, wherever we see the opportunity, we go there. Public versus private companies, American companies versus companies all over the world. We're looking for the best investments on a value-oriented basis that we can make.

Prem: 22:14 We bought a private company in Canada called Toys R Us. Toys R Us, the American company, went bankrupt. The Canadian company had no debt, one billion in revenue, 100 million of EBITDA, and been in business for like 30 years. We had the brand name.

Prem: 22:41 We were able to buy it for approximately \$280 million. The real estate values, they owned about half their stores, I think. The real estate values were equal to what we paid.

Staley: 22:58 That will work.

Prem: 22:59 We paid ... that works, right? We had a lady who's been in the company for 25 years and been running the company for the last five or six. It was focused on Canada. So that is one we had the ability to buy.

Prem: 23:20 You get these opportunities. Another one, a company called Carillion in the UK went bankrupt suddenly. So the Canadian subsidiary didn't know that this was going to happen. All their cash was being swept and put into the UK. So they had to declare bankruptcy. It's called CCAA in Canada.

Prem: 23:48 So we were able to buy that, which is a service business, servicing airports and servicing hospitals and universities

and cafeterias and other similar institutions, for \$500 million in revenue. We were able to buy that for five times free cash flow.

- Prem: 24:09 So those are examples when you get opportunity like that with good management that we take advantage of it. And we like good management in place. In both companies, they were in place.
- Prem: 24:29 But public companies, we bought stock in a company called Seaspan, which is a container-ship company run by a fellow by the name of David Sokol. David is from MidAmerican fame. Built MidAmerican for Berkshire for 20 years. Compounded book value, earnings per share, revenues, 20% plus. Just understands risks versus reward. Very, very clearly understands that.
- Prem: 25:03 So we were very happy to have put money with David. With one of the Washington family, Dennis Washington, has the biggest ownership, and we're next to that. We're fully supportive of David and Dennis. Staley, over five, 10 years this could be a phenomenal investment for us.
- Prem: 25:27 So public, private, United States, Canada, the world, wherever. Like you, like Southeastern, wherever the opportunities pull us or drag us to, we go there.
- Staley: 25:40 Well, one other follow-up on that. With all the private equity money out there. I mean both that they already have and that they're continuing to raise, has that pushed up multiples and made it tougher since you began doing this in earnest on the private side?
- Prem: 26:06 The difference for us is we're not private equity. So private equity is very focused, they need to get in and they need to get out, and they need a certain time at three years, four years, five years. Quite often, they fire the people who are running the company and replace them with people they think will do well.
- Prem: 26:23 We go into companies where we like the management. So we wouldn't go in if we didn't like the management. It's always friendly. It's always long-term and it's always supportive of the management. We're not watching every single move that they make. We give them the ability to run the company as they have in the past. So this culture ... we do that of course with our insurance companies as you know, Staley.

Prem: 26:50 So this culture with 33 years, you attract people, you attract companies. You attract them in the States. You attract them in Canada. In Canada, if anyone's selling their company, we'd be the first stop. If they want to sell it for the highest price, we wouldn't be the place they'd go to.

Prem: 27:07 But if they want to run it and they want to, for safe purposes, they want to sell 30, 40, 50% and still keep 20%, they'd come to us because they've built a company, they're really fond of it. It's like family for them and they want to continue to run it. We'd be the first choice for businesses like that.

Prem: 27:28 We are in many parts of the world, and we've got our companies in India that we really like. I mentioned Seaspan to you, which is basically in the United States and operates in the world and of course, in Canada.

Prem: 27:49 In Greece, we have some investments that these people, the people who run it, will run it for a long, long time. They're very loyal to us because that's how we've treated them. Of course, you know, Staley, in business as in life, as you treat people, thus they will treat you.

Prem: 28:11 One of the principals of our culture is the idea of the golden rule, treat people like you want to be treated yourself.

Staley: 28:18 I was going to ask you about that culture and you've hit a lot of these points. Because it's incredibly important to Fairfax and a great example for a lot of other companies.

Staley: 28:27 But amplifying on that, can you talk about what you have to do differently to maintain those parts of the culture as you're this size? Compared to when the company was a lot smaller?

Prem: 28:38 So, Staley, the important thing is to recognize that business is a good thing. When you look at companies, countries, and the United States. The United States was built by business, so was Canada. All over the place. In terms of entrepreneurs beginning companies and having huge success. I'm thinking of long-term success.

Prem: 29:08 So here, our culture's based on providing outstanding service to our customers, looking after the employees that provide that service, and making return for our shareholders. You have to do that. For us it's 15% plus

over time. Then we put 1-2 % back into the communities we do business.

Prem: 29:28 So as you know, when we began, the whole company was worth like \$2 million. We refinanced it for \$10 million. Now, 33 years later, the last five years we've been reinvesting in our communities at the rate of \$25 million dollars per year.

Prem: 29:48 I use that just to say that when business is successful, everybody benefits. Our culture's based on that. We have a set of guiding principles as you know. So what I do is I go to all our companies and I remind them that we have these guiding principles. That our culture is what will differentiate us in the future long after I'm gone.

Prem: 30:13 As you know, we're building our company for the next 50, 100 years. Long after I'm gone. These principles of providing outstanding service, looking after our employees, making a return for our shareholders, and of course putting money back into communities, that has to survive.

Prem: 30:33 But you have to have a team-oriented culture. Like what your president Ronald Reagan said, "Anything in the world is possible if you don't care who gets the credit." That's what we've done at Fairfax. We try to do whatever makes sense.

Prem: 30:55 Because we've been operating for 33 years, we have our Canadian company is run by Silvy Wright, 25 years with us. Kari Van Gundy has run Zenith, as you know. She's been in the company for more than 25 years, she runs Zenith in California.

Prem: 31:14 Then Andy Barnard, who supervises all our insurance and reinsurance companies, has been with us for 21, 22 years. And Brian Young at Odyssey is 22 years. Marc Adee, 20+years. You have this continuity, which is a huge plus in a company. That helps build up our culture. Even though we're very decentralized, that continues to build our culture.

Prem: 31:43 I remind them that insurance is quite, we try to differentiate it, but the products are very similar. But what differentiates us is our culture. Is the fact that we're very team oriented and we provide outstanding service and look after our employees.

Staley: 32:05 The model has two engines and we've talked about the investment engine. But moving over to the underwriting engine, it's been a really interesting evolution on your underwriting side. You've been a great investor pretty much right out of the chute.

Staley: 32:23 Then on the underwriting side, that's probably been more of an evolution and sometimes a struggle. Some acquisitions, some organic. But can you just talk about that whole evolution of the underwriting side?

Prem: 32:34 Yeah. Staley, you know our company, you at Southeastern know our company better than most because you've been involved. You saw how our Odyssey Re was struggling 15 years ago. And combined ratios were above 100%.

Prem: 32:53 Now Odyssey Re, we have owned it from 1996, so 22 years. Odyssey Re in the last two years, in 2017, you had the record catastrophes, the hurricanes in the United States. A tough year for hurricanes in 2018. Odyssey had a 93, 94% combined for both years. 10 years now in a row it's had a 93.5% I think combined ratio.

Prem: 33:27 So our insurance companies, almost without exception for the big insurance companies that we have, have been outstanding in terms of two things which we measure carefully: combined ratios below 100% and reserving. You'll remember when we had reserve problems when we bought TIG and we bought Crum and Forster.

Prem: 33:54 Now with all of these companies, Odyssey, Crum and Forster, Northbridge, for the last 10 years have had redundancies, which means the reserves develop positively. That means if you set it up for \$100 as your reserve, then over the years, it goes down and not up. If it goes down, then it's a positive redundant. If it goes up, then you're deficient.

Prem: 34:20 We just focus on that and just a long focus has helped us make sure that all our companies ... and it's tough to do. So a learning experience for us, Staley, with Crum and with TIG was never again to buy companies which are turnarounds. Because it takes a long time to turn around the culture of a company which is not disciplined in underwriting.

Prem: 34:52 Because we sell a product which is a very difficult to price. How do you price a trucking insurance? How do you price

a Directors and Officers insurance? You need that to be present.

Prem: 35:06 So Zenith, which does workers compensation and is a wonderful, wonderful company, has had a track record of underwriting success for almost 40 years now. So we bought that in 2010 from Stanley Zax, who was the guy who founded it.

Prem: 35:23 So we focus now on underwriting profit-oriented companies. Allied, a worldwide US company that we bought two years ago, run by Scott Carmilani. A 15-year track record of 92, 93% combined. Reserve redundancies every year.

Prem: 35:46 Scott and Allied really wanted to be part of Fairfax because they'd be decentralized. Scott could continue to run the company, and he felt very comfortable with that. Two years later, they're all happy with that decision to join Fairfax.

Staley: 36:07 In the wake of that Allied acquisition, do you find yourself at a place where you now cover so many industries and geographies that you don't think you'll need more acquisitions? Or is it possible that there could still be a geographic need or a type of insurance need to do more acquisitions?

Prem: 36:27 No, I think now with Allied, we cover large companies, the Fortune 500, the Fortune 1000. That expertise we can take to Japan for example, we're working on with our partners Mitsui. We can take it to many parts of the world and into Europe also.

Prem: 36:48 We have a very diversified, at \$16 billion, diversified all over the world. We have tuck in acquisitions in Asia, maybe a small one here, small one there that comes up. Or in Latin America.

Prem: 37:04 But we've basically got a very nice network and now we're focused on organic growth. Meaning taking if you are very good in transportation in one country, then can we not do that in other countries?

Prem: 37:21 We've got a digital operation that we started from scratch as you know in India, called Go Digit. It's run by a fellow by the name of Kamesh Goyal. Fantastic guy. They're running at about \$175 million in about a little more than a

year, year and a half. Everything is digital, no paper. That operation, once it continues in the next few years, we'll move it to other countries under Kamesh's guidance.

- Prem: 37:53 So we don't expect to buy anything significant in the insurance business, in terms of size. Importantly, we don't expect to issue any more shares. Our shares have gone up when we began from five million shares to about 28 million. We've bought about a million recently in our press release, we said we bought about a million. So we're back to about 27 million.
- Prem: 38:22 Over the next 10 years I'd like to continue to buy our stock back. That's the best thing we can do for our shareholders. Of course, at good prices.
- Prem: 38:32 You'll remember, and I've quoted Henry Singleton, who created a company called Teledyne in the 60s and went from 10 million shares to 100 million in 1971, 72. And 15 years later, in 1986, 87, it went back to about 12 million. A phenomenal track record during that time period.
- Prem: 39:01 We think we have the ability to replicate some of that success, Staley.
- Staley: 39:11 That brings up an interesting question about share repurchase. Which is for you guys and for us, share repurchase has always been an important part of the capital allocation arsenal, but it's meant to be like M&A [Mergers and Acquisitions]. It's meant to be done at great prices, not just kind of mindlessly.
- Staley: 39:28 But there are a lot of companies, a lot of companies do it in large size for the wrong reason. Then this even has gotten political recently with some politicians seeing them as evil and wanting to outlaw them literally compared to other forms of investment by corporations. Can you talk about that whole debate?
- Prem: 39:48 Yeah. I think someone, I forget who it was, who said that, "When you buy shares, it's not like that money disappeared. It goes to the shareholders." They can invest it, they can spend money, they can do whatever, they can consume it. So it's not that the money disappears.
- Prem: 40:06 But I do agree with what you said, which is mindlessly buying your stock doesn't make any sense for your

shareholders. You have to buy it at stock prices that are reasonable, and I think that's very important.

- Prem: 40:27 Long ago, we bought in 1990 I think, close to 20% of our shares. I'm hoping we get that opportunity over time. Because our company, you know the difference between intrinsic value and book value. So our book value we think today, because of all of this market to market accounting, is not a very good representation of the intrinsic value of our business.
- Prem: 40:54 In this year's Annual Report, I'm trying to show you that in terms of per share, as shareholder of Fairfax what you own. We just think the intrinsic value of our company is much, much higher. So, if you go back to your question on acquisitions, if we make 13% on shareholders capital, we're making approximately \$2 billion: \$300 million goes for dividend, 10 bucks a share. So we've got \$1.7 billion available to us.
- Prem: 41:31 So we might have some tuck-in acquisitions or we might have some non-insurance acquisitions. But the rest of the money goes to buy back our stock at attractive prices. If we're selling \$310 book, of course we're not going to buy it back.
- Prem: 41:46 But otherwise, as you said, we need to look at our shares first before we do anything else.
- Staley: 41:56 One thing, jumping back to the underwriting subs, one thing I'm curious about is when you're wearing your Odyssey Re goggles, can you just talk about reinsurance from the standpoint of all the alternative capital going in?
- Staley: 42:08 There are questions on "are some of the great reinsurance franchises different? Is it a tougher business because capital can flow in from hedge funds, not just insurance companies?" Just what that looks like.
- Prem: 42:23 Yeah. You've got all sorts of capital coming in from hedge funds, maybe from pension funds, who want to diversify. Who think that you can buy bonds exposed to catastrophe [cat] or things like that, that will help them diversify.
- Prem: 42:40 They forget that this is a risk business, Staley. It's a huge risk business, which was seen in 2017. I thought they would disappear seeing the losses that prevailed in 2017. Well, in 2018, quite a few came back to renew their capital



commitments for 2018. In 2018, you had a few hurricanes, you had losses in Japan. Then you had these California wildfires. It was big, big losses. Reminded us again that it's a risk business.

Prem: 43:19 I think the effect of those two years will be felt. It's being felt in many of these specialized companies on cat insurance. So they're not able to, they might not be able to renew their funding. We'll have to see in the next six months as we get to the cat season in the United States, which is where the biggest cat market is.

Prem: 43:46 If that happens, then prices could go up significantly. A lot of our competitors have got hit in 2018 particularly with the California wildfires, with the bridge in Japan that got hit by a typhoon. So sometimes the market changes, prices go up. You need some type of catastrophe before that happens or something in the investment side.

Prem: 44:23 The only people who can benefit are if you've got the capital and you've got the ability, the fortitude, to write business at the right prices. In our management team, we have that. So we're looking at these. We can't predict of course, so it's not based on any prediction, we have to actually see the price go up. Then we can expand our business significantly.

Prem: 44:53 Odyssey Re has just been the other side of that. Odyssey also buys reinsurance. So if you buy reinsurance properly, Staley, you protect yourself. If it's very cheap, if your retro insurance is very cheap, then you buy it. If it's not, then you keep it for your own account. Odyssey has been excellent in 2017 and 2018 doing exactly that.

Staley: 45:22 Well, Prem, thank you so much for all this. As we close this, is there anything else you'd like to cover?

Prem: 45:29 No. Staley, I just want to, first of all, I wanted to thank you. I really enjoyed having this interview with you. But I wanted to thank you and Mason and your company because you've been fully supportive of Fairfax over that long time period. This is what you bring. Southeastern brings this to the companies they invest in. They're a stamp of approval, and it's long-term. They come up with great ideas.

Prem: 45:56 When we needed money in the short attack, Mason and Staley came in and with Markel. And I said in our Annual

Report, I didn't like the price that we were selling our shares at, but I loved the partners.

- Prem: 46:20 So I must say that - this is for Southeastern's investors and shareholders - you've got a great group of partners there who look after your money. They've got a terrific track record, and their style of value investing, like ours, will come to the fore in the years ahead.
- Staley: 46:42 Well, Prem, we're all so grateful to you for that, for the years of history, and thanks so much for doing the podcast.
- Prem: 46:48 Hey, thanks again, Staley.
- Staley: 46:49 Talk to you soon.
- Prem: 46:49 Thanks a lot.
- Staley: 46:49 Bye.
- Gwin: 46:51 Many thanks to Prem Watsa for joining us today and for the time that you spent on the discussion with Staley. Thank you also to all of our listeners for tuning into the Price-to-Value podcast with Southeastern Asset Management.
- Gwin: 47:02 If you have any questions or would like to share topics that you'd like to see us cover in future episodes, please feel free to send us an email [podcast@SEasset.com](mailto:podcast@SEasset.com).