



What to Expect When Fairfax Financial Holdings Ltd. Reports This Week

Description

Prem Watsa's company made headlines last year when it announced its important stake in **BlackBerry** ([TSX: BB](#))(NASDAQ: BBRY), but **Fairfax Financial Holdings** ([TSX: FFH](#)) is much more than BlackBerry's top shareholder.

Here are a couple of points I want to hear more about when it reports this week.

Insurance and reinsurance marketplace

Fairfax Financial Holdings is mainly an insurance company operating worldwide in both the reinsurance market and the property and casualty sector. Currently, the insurance market is in what the industry calls a soft phase — this is when insurance contracts are renewed at a lower premium.

Reports of insurance companies hint at premiums in the reinsurance sector being down between 5% to 20% in the last two months. The commercial property and casualty sector is also experiencing a negative shift in the pricing of premiums, albeit not as bad as that in the reinsurance sector.

When I listen to the conference call, I would like to hear what management has to say about the overall market and whether it plans on staying disciplined in its underwriting, sacrificing growth for the time being, or whether it will try to go for increased volume.

A combined ratio — that is, the ratio of expenses divided by the premiums collected — under 94 will be positive news for me.

Investment portfolio performance

Like all insurers, Fairfax Financial makes a good portion of its money through its investment portfolio, and a substantial part of that portfolio is held in fixed-income securities. Looking at the trajectory of interest rates since the beginning of 2014, I am expecting positive earnings from the fixed-income portion of the portfolio with equity being slightly up. Again, here the gains will almost probably be due to mark-to-market on the bond portfolio that should invert in the coming quarters unless management decides to sell a serious portion of it.

I hope to get more colour on the overall vision of management regarding its positioning both on the equity side and the fixed-income one.

On the equity side, any info on its hedging program, whether to the upside or to the downside, would be instructive. On the fixed-income side, exposure to interest rates and any comments on the concluding six months is a plus.

Book value per share

Finally, there is the book value per share, calculated as total common equity divided by common shares outstanding, that I want to hear about.

Insurance companies, like financial institutions, are better valued on a price-to-book value rather than on a price-to-earnings one. Thus far, Fairfax has grown book value at a 4% geometric growth rate for the past five years to \$368 per share last quarter. Considering that on a historical basis Fairfax trades at 1.05 times its book value, justifying a stock price of \$509 means one should be expecting an increase of around 30% for the quarter.

I do not expect such a massive increase, but I will be interested in hearing management talk about its strategy regarding capital allocation, either through a dividend increase or acquisition prospects.

Should you buy?

At the current price of \$509, Fairfax Financial seems expensive to me. The company *does* have a great track record of delivering good shareholder returns, but I do not think the price justifies it for a moment, especially considering that the insurance market is in a soft phase. When I listen to the conference call on Thursday, I will be more focused on the state of the insurance markets than on opening a position in Fairfax Financial in the short term.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BB (BlackBerry)
2. TSX:BB (BlackBerry)
3. TSX:FFH (Fairfax Financial Holdings Limited)

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