



Fairfax Financial Holdings Ltd. Pulls a Buffett

Description

The big news from **Fairfax Financial Holdings Ltd.** ([TSX:FFH](#)) leading up to Christmas was its US\$4.9 billion insurance acquisition of **Allied World Assurance Co Holdings, AG**. While I [love](#) the fact that Prem Watsa is investing in the U.S. specialty insurance business, it's not the move from Warren Buffett's playbook I'm referring to.

I'm talking about the December 23 announcement by **Mosaic Capital Corp.** ([TSX:M](#)) that Fairfax was investing \$150 million in the Calgary-based value investor that acquires established businesses at attractive prices operating primarily in western Canada and then helps those businesses grow by providing strategic, business, financial, accounting, and legal expertise.

Like Buffett and Watsa, Mosaic buys companies with first-rate management and then leaves them alone to run their businesses. Mosaic looks for businesses that can grow their free cash flow over time, holding the companies for the long term.

Currently, Mosaic owns seven businesses generating between \$5 million and \$15 million of sustainable cash flow. It's operating in niche markets with "wide moat" defensible positions in the marketplace.

Management own 48% of the shares and bring to the table over 100 years of private-equity experience investing in medium-sized businesses in this country. With only \$78 million in market cap, this clearly isn't a make-or-break investment for Fairfax, but it does indicate just how much confidence Watsa has in CEO Mark Gardhouse and the rest of the Mosaic management team.

What's so Buffett-like about the \$150 million investment?

Fairfax is buying \$100 million in 6% senior preferred securities, \$50 million in secured debentures paying a 5% interest rate over a seven-year term, and common share purchase warrants that gives Fairfax the right to buy up to 17 million shares over the next seven years for an exercise price of \$8.81 per share.

Buffett has done many deals like this over the years with **Goldman Sachs, Restaurant Brands International**

, **Dow Chemical**. Those are just three examples of his brilliant deal making. Watsa is doing the same, albeit on a smaller scale.

Prior to the announcement of the deal, Mosaic was trading at \$6.79 per share. To exercise the warrants “in the money,” Mosaic stock would have had to appreciate by 30%; they actually gained 39% on the news.

The deal was a true win/win situation.

Mosaic gets a sugar daddy who can finance future growth at lower interest rates, while Fairfax gets a partner who can execute on some of the opportunities that wind up on its doorstep that are too small for it to act on.

If Watsa were to convert all 17 million shares available under the warrant piece of the deal, Fairfax would own 67% of the company.

Like Buffett’s hiring of Todd Combs in 2011 and Ted Weschler in 2012, Fairfax has used its financial largesse to indirectly hire a team of managers that clearly are good at what they do.

“We are excited to partner with John Mackay, Harold Kunik and Mark Gardhouse and their team through a direct investment in Mosaic,” said Paul Rivett, president of Fairfax. “We look forward to having a partner whose expertise and experience in mid-market private equity acquisitions over the last decade can be combined with our flow of opportunities.”

If you don’t own Fairfax stock, you should. Ditto for Mosaic, despite the big bounce before Christmas.

As Humphrey Bogart said in Casablanca, “I think this is the beginning of a beautiful friendship.”

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