Fairfax Financial Holdings Ltd.: Is This a Classic Buy-the-Dip Scenario?

Description

When I first learned about Warren Buffett, I read everything I could about him. He's the Oracle of Omaha — the greatest investor in the world. What I learned is that he likely would not have been nearly as rich if he didn't have his insurance business, because he would not have had the resources required to pick up assets like he did.

Insurance is a very complex business that is easy to explain. Insurance companies offer you a policy. In exchange for a monthly or yearly premium you pay them, they'll insure you. If the companies have more people paying a premium than what is being paid out in claims, they have a float. That float can be used by the insurance company to make investments.

Well, while true that investing in Warren Buffett is a great play, there's another… Invest in Canada's Warren Buffett. His name is Prem Watsa, and he is the CEO of **Fairfax Financial Holdings Ltd.** (TSX:FFH). As you can imagine, Fairfax holds a multitude of different insurance companies that all provide float for Watsa and his team to invest.

In Q1 2017, Fairfax's net premiums earned were US$1.981 billion, with OdysseyRe brand and Crum & Forster each nearly generating half a billion dollars. But its combined ratio, which takes incurred losses plus expenses and divides by the earned premium, was, on a consolidated basis, 94.6%. None of its insurance companies paid out more than they received in premiums. Because of this, Fairfax's underwriting profit alone was US$107.2 million.

Fairfax recently completed the acquisition of Allied World, another insurance company, which will add additional float to the business. Over the past 15 years, Allied World has delivered an average combined ratio of 90.7%, so Watsa is getting a big boost to work with.

It's perfect timing because there might be an opportunity to pick up shares of other companies for cheap if the market experiences a pullback. Watsa's war chest for this is huge. At the end of the first quarter, Fairfax had US$27.5 billion in assets, with 39% in cash and short-term investments. If something happens, you can bet Watsa will be ready.

Nevertheless, from a strictly investment perspective, 2016 wasn't the strongest for Fairfax. It had a

US$1.2 billion net loss in its investments, which pulled the entire business into the red. This is only fourth time in 31 years that Fairfax has reported a loss. Between 1985, when Watsa took over, and today, the stock has grown by 18.6% on a CAGR basis.

Here's the general thesis:

In the past year, Fairfax has given up over 15% of its value because of the rough couple of years. However, I believe, thanks to the Allied World acquisition and the billions of dollars it's sitting on, that Watsa and team could be in a great position to boost investment earnings for the foreseeable future.

And, along the way, you can expect to receive a 2.22% yield. Buffett may be far better known than Watsa, but they both come from the Benjamin Graham school of thought for value investing, so you're in good hands. And hey, at least Watsa pays a dividend. What's your excuse, Buffett?

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jaycodon