

Fairfax Financial Holdings Ltd.: A Change of Strategy?

Description

It was surprising that **Fairfax Financial Holdings Ltd.** ([TSX:FFH](#)) agreed to sell its stake of 97.7% interest in First Capital, which is the largest commercial property and casualty insurer in Singapore, for US\$1.6 billion to Mitsui Sumitomo Insurance Company, which is based in Tokyo.

Fairfax is getting an extraordinary gain from the sale of First Capital, which was one of its first acquisitions in Asia. In 2002, Fairfax invested US\$35 million in the company. Fairfax will be getting a net gain of US\$900 million after tax on the sale, which translates to an annualized return of ~25%!

Fairfax will also retain a meaningful quota share exposure to First Capital's insurance portfolio. Ramaswamy Athappan will remain as First Capital's CEO, while remaining chairman of Fairfax Asia.

The transaction requires regulatory approval from the Monetary Authority of Singapore and the Financial Services Agency of the Government of Japan and is expected to close in late 2017 or early 2018.



The benefits of the transaction

Fairfax will form a broad market partnership with Mitsui, whose acquisition of First Capital will accelerate the growth of the leading Singapore insurance business and allow it to leverage on Mitsui's strong Asian franchise.

Mitsui has global operations with a strong focus in Asia. It is also the "leading non-life insurance group in Japan with a 33% market share," as stated in Fairfax's late August presentation.

Fairfax will enjoy First Capital's brighter prospects with its meaningful quota share. We shall see how the partnership with Mitsui will play out for Fairfax.

Fairfax can invest the proceeds elsewhere, and it'll be interesting to see what Fairfax will do. Fairfax continues to focus on Asia through its various holdings and operations in Malaysia, Hong Kong, Indonesia, Sri Lanka, India, Vietnam, Thailand, and China.

Long-term value creation

I don't believe Fairfax has strayed from its goal to achieve a high rate of return on invested capital and build long-term value for shareholders.

From 1985 to 2016, under the same management, the company compounded its book value per share by 19.4% annually, which translated to share price per share compounding of 18.6%.

Over the long term, the company aims to compound its book value per share by 15% per year through disciplined underwriting and value investing.

Valuation and dividend

At ~\$633 per share, Fairfax trades at a price-to-book ratio (P/B) of ~1.2, assuming the sale of First Capital is successful, while the stock has traded between a P/B of 1.0 to 1.4 in the last decade. So, the stock is reasonably valued today. At current levels, Fairfax also offers a yield of ~2%, which helps with returns.

Investor takeaway

It's a bit odd that Fairfax is selling one of its strongest insurance businesses. However, the partnership with the buying party may prove to be beneficial to the long-term business. I guess we shall see.

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