



**William Smead**  
Chief Executive Officer  
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## Where's Warren?

July 7, 2015

Dear Fellow Investors,

The conspicuously dressed children's book character, Waldo, who dons a striped shirt and hat, is hard to miss, unless he's in strange places or bizarre geographic settings. Similarly, Warren Buffett is often hard to miss. Yet every now and then, some bizarre market event happens, and we must ask, where's Warren?

Ace Limited recently announced the acquisition of one of our portfolio holdings, Chubb Corporation (CB), for \$62.93 in cash and 0.6 shares of Ace common stock. Chubb is one of the most admired property and casualty insurance companies in the U.S. They have been a very quiet company, making very little attempt to woo the investment community or be a major advertiser of their business. In other words, they were a public company which behaved very much like a privately-owned business—a favored attribute of Berkshire Hathaway. As owners of both companies, we think it's fair to ask: where's Warren?

Shareholders of Ace will own 70% of the combined company and Chubb shareholders will own 30%. As we write this on July 6th of 2015, Chubb is trading at around \$121 per share, up 27% from the pre-acquisition price. With Berkshire Hathaway sitting on a growing pool of cash (somewhere around \$60 billion) and as a major player in Chubb's insurance world, we think Buffett could attempt to earn significantly more on Chubb's investment portfolio. Moreover, we think Berkshire could easily accept their regulatory capital needs within Berkshire's existing capital base. So again, where's Warren? Why is this not the \$20-40 billion acquisition that Warren Buffett has been looking for?

The *Wall Street Journal*, one of the few publications to significantly cover the deal, raised the idea that Berkshire Hathaway is avoiding the reinsurance industry because of lousy pricing, pointing towards a difficult reinsurance environment:

Reinsurers assume other insurance companies' risk, and Berkshire BRK.A, has long generated fat profits in the sector to help fuel its growth. But over the past few years, a host of new competitors — mostly pension funds seeking higher-yielding alternatives to conventional bond holdings — have piled in, pushing down some reinsurance prices and prompting some companies to pursue deals to bolster their defenses.

The article gave Ajit Jain, one of the leading candidates to succeed Buffett as the CEO of Berkshire, a chance to give the lay of the land:

“What was a very lucrative business is no longer a very lucrative business going forward,” Ajit Jain, a longtime top lieutenant to Buffett and a potential candidate to succeed him as chief executive, said in an interview...Berkshire will pursue reinsurance deals when they make sense, he said. “But since the reinsurance business isn't going to offer as many opportunities for the foreseeable future, we feel like we should go down the food chain.”

Since reinsurance is a small part of Chubb's revenue and Warren has a very talented insurance guy to oversee and integrate Chubb, it raises the question: where's Warren on Chubb?

We suspect a couple of issues were at play. 1) Warren and Charlie Munger have stated that they prefer not to use shares of Berkshire Hathaway in a major acquisition because they consider it undervalued on an “intrinsic value” basis. 2) We believe Chubb did not want an all-cash offer. 3) It appears that the top management of Chubb, including its CEO, are looking to retire; Buffett prefers to buy companies like Chubb when the existing management wants to carry on.

We think Chubb is a classic get rich slowly company which never excited public investors. It is being taken over at a market P/E multiple by another relatively low P/E multi-line insurer. Our job is to decide whether we would like to be a shareholder of Ace Limited on an on-going basis.

We prefer to own our companies for a long time and wonder if Mr. Buffett was given a chance to bid on Chubb. If you are really looking for the next “whale” acquisition of \$20-40 billion, as Buffett says he is, this \$28 billion takeover looked right up his alley.

For us and our investors, it is too bad that Warren isn’t willing to swap shares of Berkshire Hathaway in exchange for owning Chubb. Remember, Waldo wasn’t always easy to find and sometimes Warren isn’t either.

Warm Regards,

A handwritten signature in black ink, appearing to read "W. Smead". The signature is fluid and cursive, with a large initial "W" and a long, sweeping tail.

William Smead

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