

To Our Shareholders,

Fairfax India's book value per share (BVPS), our key performance measure, grew again this year at a healthy rate. After declining by 4.1% in 2018 to \$13.86*, it bounced back, growing by 21.9% in 2019 to \$16.89, a performance significantly superior to the performance of Indian equity indices, and even better than it looks as it was adversely affected by the 2.2% decline in the Indian rupee against the U.S. dollar during 2019.

Here is a snapshot of Fairfax India's performance since it began:

	2019	2018	2017	2016	2015	CAGR ⁽¹⁾
Book value per share	\$ 16.89	\$ 13.86	\$ 14.46	\$ 10.25	\$ 9.50	11.2%
Income	712,689	166,518	609,670	128,604	65,251	
Net earnings	516,338	96,432	452,509	107,825	40,939	
Return on equity	22.0%	4.5%	28.2%	10.3%	4.0%	13.8% ⁽²⁾
Total assets	3,244,937	2,707,057	2,672,221	1,303,497	1,025,451	26.4%
Investments	3,171,332	2,661,347	2,635,726	1,095,569	978,569	27.0%
Common shareholders' equity	2,577,851	2,117,945	2,132,464	1,075,446	1,013,329	20.9%
Shares outstanding (millions)	152.6	152.9	147.4	104.9	106.7	

(1) Since Fairfax India's inception on January 30, 2015, when it raised \$1.03 billion at \$10 per share. From an initial value of \$9.62 (after IPO expenses), BVPS has compounded at 12.1% annually.

(2) Simple average of the return on equity for each of the five years.

After a dismal year in 2018, most Asian emerging markets bounced back in 2019. You will see from the table below (based on the leading US\$ equity index in each country named) that India grew by 11.9%, outperformed only by China's equity index, which grew by 34.4%.

China	34.4%
India	11.9%
Hong Kong	9.7%
Thailand	9.7%
Vietnam	7.7%
Singapore	6.5%
Sri Lanka	2.2%
Malaysia	(5.0)%

And here is a comparison of Fairfax India's change in BVPS in 2019 with the change in major Indian US\$ equity indices:

Fairfax India BVPS	21.9%
S&P BSE Sensex 30	11.9%
S&P BSE 500	5.4%
BSE midcap	(5.1)%
Nifty 50	9.6%

Over the five years since Fairfax India's inception, Fairfax India has significantly outperformed the markets, as demonstrated in the following table showing the annual percentage change over five years:

Fairfax India BVPS ⁽¹⁾	+11.2%
US\$ S&P BSE Sensex 30	+4.3%

(1) Fairfax India's 5-year annualized growth in BVPS is calculated based on its January 30, 2015 IPO price of \$10 per share.

* All dollar amounts in this letter are in U.S. dollars unless specified otherwise. Numbers in the tables in this letter are in U.S. dollars and \$ thousands except as otherwise indicated.

Please note that Fairfax India's book value is based on publicly traded market values only for the six of its twelve investments which are publicly traded (the rest are based on internal valuations), whereas the Sensex is of course based entirely on publicly traded market values.

Fairfax India's net earnings in 2019 were up 435% to \$516 million from \$96 million in 2018, largely as the result of net unrealized gains on investments being \$530 million compared to \$179 million in 2018. Earnings also reflect interest income of \$4.9 million and net foreign exchange losses of \$13.8 million. Fully diluted earnings per share increased 424% to \$3.30 in 2019 from \$0.63 in 2018.

While the change in Fairfax India's BVPS in 2019 resulted primarily from an increase of \$726 million (\$4.76 per share) in the value of its holdings in Bangalore International Airport (BIAL), there were other significant contributors and detractors to the change recorded in 2019:

	<u>(\$ millions)</u>
CSB Bank	55
Fairchem Speciality	31
IIFL Finance	(201)
National Collateral Management Services	(44)

On the investment front during 2019, we completed the acquisition of a 51% equity ownership in Catholic Syrian Bank (now renamed CSB Bank) (CSB) for \$169 million. On November 26, 2019, the day on which it celebrated its 99th birthday, CSB completed its spectacularly successful IPO and was listed on the Indian stock exchanges. The IPO, which was oversubscribed 87 times, was completed at a price of 195 rupees per share (our cost is 140 rupees per share) and consisted largely of existing shareholders selling to new ones (Fairfax India did not sell any shares). The IPO price, based on March 2021 projections, implied a pre-money price to earnings ratio of 19 times and price to BVPS of 1.9 times. The stock started trading on the Indian stock markets on December 4, 2019, closing at 300 rupees per share, and is currently trading at about 185 rupees per share. At the end of 2019, with a closing price of about 216 rupees per share, CSB had posted mark-to-market gains (including foreign currency translation changes) of \$60 million from our cost of acquisition.

We also acquired a 49% equity ownership in Seven Islands Shipping, India's second largest private sector tanker shipping company, for \$84 million.

Also in 2019, we completed a transaction whereby Sanmar Chemicals Group (Sanmar) settled our \$300 million of 13% bonds for \$434 million, of which we invested \$198 million in additional common shares of Sanmar based on an effective equity valuation of approximately \$1.0 billion for the whole company, thereby increasing our equity ownership interest from 30% to 43%. This transaction returned approximately 76% of the capital Fairfax India originally invested while increasing our ownership of Sanmar.

Since we began, Fairfax India has completed investments in ten companies (12 currently, as two of them have combined and one has split into four listed entities), all sourced and reviewed by Fairbridge, Fairfax Financial Holdings' (Fairfax Financial) wholly-owned sub-advisor in India. Fairbridge does outstanding work under the excellent leadership of CEO Sumit Maheshwari, supported by its Director, Anish Thurthi, Vice President, Sheetal Sancheti, and analysts Jinesh Rambhia and Ramin Irani. Fairfax India's Mauritius subsidiary, FIH Mauritius Investments, ably led by its CEO Amy Tan, supported by its senior manager Vishal Mungur and its independent Board of Directors, is an integral part of the investment process. Also, since we began, Deepak Parekh, both as a trusted advisor and a member of the Board of Directors, has provided us with invaluable advice on our transactions.

All of Fairfax India's investments are in outstanding companies with a history of strong financial performance, led by founders and management who are not only excellent but also adhere to the highest ethical standards. The details of these investments in chronological order of the initial investment are as follows:

	Date of Initial Investment	Ownership	Amount Invested (\$ millions)	Fair Value at December 31, 2019 (\$ millions)	Compounded Annualized Return⁽¹⁾
NCML	August 2015	89.5%	188.3	135.0	(8.6)%
IIFL Finance*	December 2015	26.5%	–	166.0	*
IIFL Wealth*	December 2015	13.9%	191.5	191.5	*
IIFL Securities*	December 2015	26.5%	91.3	48.8	*
Spaisa*	December 2015	26.6%	23.5	18.2	*
Fairchem Speciality	February 2016	48.8%	74.4	127.4	17.2%
Sanmar Chemicals Group	April 2016	42.9%	199.0	412.9	23.9%
National Stock Exchange	July 2016	1.0%	26.8	57.2	29.3%
Saurashtra Freight	February 2017	51.0%	30.0	31.2	1.4%
Bangalore International Airport	March 2017	54.0%	653.0	1,429.9	35.7%
CSB Bank	October 2018	49.7%	169.5	229.3	43.4%
Seven Islands Shipping	March 2019	48.5%	83.8	88.8	8.6%
Other Indian Investments			78.5	111.0	29.5%
Total			1,809.6	3,047.2	
* Aggregate: IIFL Finance, IIFL Wealth, IIFL Securities and Spaisa			306.3	424.5	13.8%

(1) Calculated using the internal rate of return.

The increase in the valuation of Fairfax India's investment in BIAL to \$1.4 billion (implying a valuation of \$2.7 billion for 100%) is supported by future cash flow estimates. In addition, Fairfax India, which acquired its interest in BIAL for \$653 million (implying a cost of \$1.2 billion for 100%), and which valued that interest at \$704 million (implying a value of \$1.3 billion for 100%) in December 2018, announced the following in December 2019:

In June 2019, Fairfax India created a 100% owned subsidiary in India named Anchorage Infrastructure Investments Holdings (AIIHL). It is intended that this company will be Fairfax India's flagship investment vehicle for airports and other infrastructure investments in India and that all of the shares it owns in BIAL will eventually be transferred to AIIHL.

Later in 2019, Fairfax India signed definitive agreements with an investor whereby it will transfer 43.6% of BIAL out of the 54% that it owns in BIAL to AIIHL and the investor will pay about \$135 million to acquire from Fairfax India an 11.5% interest on a fully diluted basis in AIIHL. This will result in the investor indirectly owning approximately 5% of BIAL. The transaction values 100% of BIAL at \$2.7 billion.

Fairfax India intends to complete an IPO of AIIHL, targeted to value 100% of BIAL at \$3.0 billion (a targeted valuation of \$1.3 billion for 100% of AIIHL). A "ratchet" mechanism has been agreed with the investor whereby if the IPO is completed at a valuation of AIIHL below \$1.3 billion, the investor will receive incremental shares of AIIHL to compensate for the difference between that actual valuation and \$1.3 billion.

The closing of this transaction is subject to Fairfax India receiving the consent of the other shareholders of BIAL – Siemens (20%), the government of Karnataka (13%) and the government of India (13%) – to the transfer of BIAL shares from itself to AIIHL. We have already received consent from Siemens and are awaiting the consent of the other two shareholders.

BIAL continues to perform extremely well, with annualized passenger traffic of about 34 million and strong financial performance consistent with its plans. A second runway was commissioned in December 2019 and progress towards the opening of a second terminal in 2021 is on plan. When the second terminal (phase one) is completed, BIAL will

have a capacity of about 50 million passengers and plans are in place to expand the capacity to over 90 million passengers by 2038 by adding a phase two expansion to the second terminal and a third terminal. Further, considerable progress has been made in the plans to monetize the 460 acres of land that BIAL can utilize for real estate development. The initial parts of the plan will be implemented within the next 12 months. More detail on BIAL later in this letter.

While the BVPS of Fairfax India is \$16.89, we believe that the underlying intrinsic value is much higher, since all the companies listed above have characteristics giving them the potential for a significant increase in their value. As an example, look at IIFL Finance:

	Unit	
Total market capitalization ⁽¹⁾	\$ mn	1,038
Total assets under management	\$ bn	5.0
<u>5 years to March 2019 average annual⁽²⁾:</u>		
Return on equity		16.0%
BVPS growth		20.5%
Diluted earnings per share growth		28.2%
Closing share price on February 20, 2020	Rs.	188
<u>Estimated March 2021:</u>		
Earnings per share	Rs.	20.5
BVPS	Rs.	138.5
Price ⁽¹⁾ / Earnings		9.2x
Price ⁽¹⁾ / BVPS		1.4x

(1) Based on the rupee closing share price on February 20, 2020.

(2) March is the fiscal year-end.

IIFL Finance is trading at a price to estimated March 2021 earnings of only 9.2 times and price to BVPS of only 1.4 times. With IIFL Finance's strong historical growth and return on equity metrics, we believe there is potential for significant upside on the value of this investment.

Performance Fee

You will recall that under the investment advisory agreement with Fairfax Financial, Fairfax India's sponsor and controlling shareholder, and Fairfax Financial's investment counsel subsidiary Hamblin Watsa, Fairfax Financial is entitled to a performance fee intended to be 20% of any increase in Fairfax India's BVPS (including distributions) above a non-compounded 5% increase each year from the BVPS at inception in 2015. The performance fee is calculated and payable at the end of each three-year period since inception, and the amount payable as at the end of any three-year period would be reduced by the aggregate of the performance fees paid in respect of all prior three-year periods.

The performance fee accrued as of the end of 2019 complies with the above-described intent, even though the language of the investment advisory agreement, failing to fully recognize performance fees already paid, would have provided for the accrual of a higher performance fee. The language of the investment advisory agreement will be amended to make this correction permanent.

Investment and Advisory Fee

Fairfax Financial is also entitled to an investment and advisory fee, calculated and payable quarterly, of 0.5% of the value of Fairfax India's undeployed capital plus 1.5% of its common shareholders' equity less the value of its undeployed capital. During 2019 we discovered that the interpretation that we had applied to the way we calculated this fee was unfavourable to Fairfax India. We have now rectified this interpretation retroactively to inception, resulting in Fairfax India receiving a credit in 2019 of approximately \$6 million.

Indian Investments⁽¹⁾

Bangalore International Airport

Under the strong leadership of Managing Director and CEO Hari Marar and his executive team, BIAL has had another outstanding year. It is the third largest airport in India and the fastest growing airport in the world, and recently was the first airport ever to win Airports Council International's best customer service award for both arrivals and departures.

In May 2018, Fairfax India acquired an incremental 6% of BIAL from Siemens for \$67 million, bringing its ownership to 54%. In 2017, Fairfax India had acquired a total of 48% of BIAL for \$586 million. In total, Fairfax India has invested \$653 million to acquire 54% of BIAL, implying an equity value of approximately \$1.2 billion for the whole company.

The valuation (including foreign currency translation) of Fairfax India's interest in BIAL increased by \$726 million in 2019 to \$1.4 billion, implying an equity value of \$2.7 billion for the whole company. Please refer to the description provided earlier in this letter regarding the change in valuation.

Despite Jet Airways, BIAL's second largest customer, winding up operations during the year, in 2019 passenger traffic grew 4% over the previous year to about 34 million passengers and cargo handled only dropped 1% in the face of an economic slowdown that resulted in a 3% drop in air cargo volume in India. As expected, and for the reasons described below, based on IFRS, BIAL's revenues for 2019 declined by 9% to \$211 million, largely due to a 35% drop in aero revenue, partially offset by a 24% increase in non-aero revenue, and profit after tax declined 44% to \$54 million. However, free cash flow after maintenance capex increased by 87% to \$132 million, mainly because of reduced levels of maintenance capex deployed.

BIAL has three potential sources of revenue:

- **Aero Revenue:** Aero revenue, which has grown at a CAGR of 16% from 2009 to 2019, is the revenue earned for providing services such as landing, parking and other services charged as user development fees (UDF) to airlines and passengers. The aero tariffs for these services are set for five-year periods (called "control periods") and are fixed by the Airport Economic Regulatory Authority (AERA) to provide a 16% return on equity deployed in the Regulatory Asset Base (RAB). AERA treats 30% of non-aero revenue as aero revenue as a subsidy for the purpose of tariff calculations. The tariff order for the second control period (from April 2016 to March 2021) was finalized by AERA in August 2018, well after the control period had begun. Any under or over recovery of tariffs in any control period will be adjusted in the subsequent control period. This is achieved primarily by adjusting downwards or upwards the fee that the airport is allowed to charge passengers and airlines for its aero services. The tariffs that the airport can charge have a very significant impact on the cash flow generated which, in turn, has a major impact on the financing for the planned expansion of the airport.
- **Non-aero Revenue:** All revenue other than aero revenue, such as revenue from cargo handling, ground handling, fuel sales, food and beverage sales and duty-free shops, constitutes non-aero revenue. Non-aero revenue has grown at a CAGR of 17% from 2009 to 2019 and is expected to grow substantially due to an increase in passenger growth rates, the availability of additional space and the increasing propensity of passengers at the airport to make purchases. BIAL has undertaken many innovative projects that engage passengers and enhance their experience at the airport.
- **Real Estate Monetization:** BIAL has approximately 460 acres of land adjoining the airport that can be developed. All this land is undeveloped except for a small piece on which BIAL has built a hotel, currently operated by the Taj hotel brand under a management contract. Bangalore's historical population areas are getting congested, so the city is expanding in the airport's direction. BIAL anticipates significant upside, over time, from monetization of this real estate. We provide below an update on the significant progress made in the actions to monetize the land available for development.

(1) The Indian Investments are presented sequentially beginning with the investment with the highest market value. All of the Indian Investments' figures are based on Indian Accounting Standards (Ind AS) unless otherwise stated.

For the remainder of the second control period, BIAL's aero revenue and total profits will be significantly lower because the tariffs set by AERA have been reduced to compensate for the higher tariff achieved in the first control period and part of the second control period. This situation, which was anticipated in BIAL's financial plans, will persist until March 2021, the end of the second control period. This is the reason for the depressed financial performance described above. Nevertheless, we estimate that BIAL will generate a total ROE of 19.6% for the second control period and an ROE of 19.1% for the combined first and second control periods.

In 2018 BIAL entered a phase of significant investment of about \$1.9 billion to expand its designed capacity of 20 million passengers to about 50 million in 2021 by re-configuration and system improvements in the existing terminal, building a second runway and building phase one of a second terminal and associated supporting infrastructure. The second runway was commissioned as planned in 2019, and significant progress has been made in the construction of phase one of the second terminal, which is expected to be completed in 2021. A financing plan for this expansion, based on a debt to equity ratio of 80:20, has been approved by a syndicate of Indian banks at attractive interest rates.

Plans have also been adopted for the building of phase two of the second terminal and related infrastructure for an incremental investment of about \$1.2 billion to take the capacity to about 70 million passengers by 2028. Most recently, BIAL added a plan for a third terminal and related infrastructure for an incremental investment of approximately \$1 billion, taking the capacity of the airport beyond 90 million passengers by 2038. The total investment of about \$2.2 billion required to complete the above expansions will be funded through internally generated funds and debt.

2019 featured the following significant achievements by BIAL:

- Three important new international routes were established: KLM flights to Amsterdam, Indigo flights to Phuket, and Ethiopian Airlines flights to Addis Ababa.
- Two new international routes were established to become operational in 2020: Lufthansa flights to Munich, and Japan Airlines flights to Tokyo.
- International freight services by SpiceXpress commenced.
- Renewable energy sources were utilized for 64% of the airport's energy needs.
- The concept design of the Forecourt Multi Modal Transport Hub was completed and the contract for construction was awarded.
- Significant progress was made in the plans to monetize BIAL's approximately 460 acres of land that can be developed, as follows:
 - A 100% owned special purpose vehicle (SPV) subsidiary of BIAL was incorporated to carry on the real estate activities of BIAL.
 - The Board approved the terms and conditions under which the land to be developed will be leased by BIAL to the SPV and the financial plans covering the first phase of developing approximately 176 acres.
 - The first development will be a 775 room 3- and 4-star combination business hotel situated on approximately 5 acres of land. The project has been awarded to the Taj Group of hotels and will be owned 100% by the SPV.
 - The second development will be a retail, dining and entertainment village on approximately 23 acres of land. This project will also be 100% owned by the SPV and will be developed in phases.
 - The third development will be business parks over approximately 130 acres of land that will be jointly developed in phases through a combination of land lease, joint development and own development models.
 - In addition, approximately 12 acres of land will be used for the development of an outlet mall and a 5-star hotel.
 - A first of its kind large concert arena in the region, on approximately 6 acres of land, has been awarded to a consortium and is expected to be completed in 2021. Live Nation, a global entertainment company, will act as the consultant to the consortium on the development of the project.

Sanmar Chemicals Group

In 2016, Fairfax India lent Sanmar the rupee equivalent of \$300 million by way of seven-year non-convertible debentures (NCDs). The NCDs provided for 3% payment-in-kind interest and a redemption premium such that the annual yield of the NCDs would be 13%. In addition, for \$1 million Fairfax India received a 30% equity interest in Sanmar's entire chemicals business.

As described earlier in this letter, in 2019 Sanmar completed a transaction whereby it settled our \$300 million of 13% bonds for \$434 million, which also resulted in Fairfax India increasing its equity ownership interest in Sanmar from 30% to 43%.

N. Sankar, the chairman of the Sanmar group, and his son Vijay, the deputy chairman, have grown the group into a large private conglomerate with sales of around \$1 billion and an asset base of around \$2 billion. Founded in the early sixties, its business interests spanned chemicals, engineering technology and shipping, with operations in India, the Middle East and the Americas. Fairfax India's investment is in the chemicals business, which constitutes more than 70% of the group's operations and is housed within three operating companies, two in India – Chemplast Sanmar Limited (CSL) and Chemplast Cuddalore Vinyls Limited (CCVL) – and one in Egypt – TCI Sanmar (TCI). The group is renowned for its high integrity and the highest levels of corporate governance and environmental and social responsibility.

CSL, Sanmar's flagship Indian chemical business, has been in operation for over 50 years, celebrating its golden anniversary in 2017. N. Sankar is considered a pioneer in the polyvinyl chloride (PVC) industry in India. With his visionary leadership, in 2009 CSL commissioned one of the largest greenfield PVC projects in India, with an annual capacity of 300 metric kilotons per annum (ktpa).

Sanmar acquired TCI in 2007, with the intention of setting up a large greenfield PVC plant in Egypt to cater to the high growth markets of North Africa, the Middle East and parts of Europe. TCI until recently had a 200 ktpa capacity PVC plant. Last year, with help from the financing provided by Fairfax India, TCI completed a major expansion plan and added a new 200 ktpa PVC plant, taking total PVC capacity to 400 ktpa, a 130 ktpa calcium chloride plant and a 75 ktpa caustic soda by-product line. These are ramping up to full production, with full capacity expected to be attained in 2020, and will take advantage of Sanmar's significant investment in infrastructure in Egypt.

In 2019 Sanmar reorganized its highly successful CSL business in India into two separate operating companies, each with products that were more compatible to each other in financial and growth characteristics. The commodity suspension PVC business was demerged from CSL into CCVL, with a capacity of 300 ktpa. After the demerger, CSL manufactures paste PVC, chloromethanes, ethylene dichloride (EDC), and vinyl chloride monomer (VCM) at Mettur and Karaikal. Sanmar Speciality Chemicals, which manufactures custom made chemicals for customers in the agro-chemical, pharmaceutical and fine chemical industries, was merged into CSL, making it a division with high potential for growth and high profit margins.

CCVL is now the second largest suspension PVC player in India and CSL is the largest specialty paste PVC player in India. Following the reorganization, since Sanmar's Indian companies had very low levels of debt, they were able to raise debt financing at the operating companies (approximately \$180 million at CSL and \$120 million at CCVL), a significant part of which it used to repay its debt to Fairfax India, thereby significantly reducing its holding company debt.

CSL had another successful year in 2019 with consistent growth and improved margins driven by strong paste PVC demand, lower imports and a drop in ethylene prices. This was partially offset by reduced demand for chloromethanes and lower prices due to the commissioning, by a competitor, of a new plant in India. Chloromethane demand and prices are expected to improve in coming quarters. Caustic soda prices dropped sharply across the world, driven by the economic slowdown, and India was no exception. Sanmar Speciality Chemicals, on the other hand, enjoyed significant increases in volumes and profitability. The following growth plans for CSL are on track:

- a second 45 ktpa chloromethane plant in Karaikal
- expansion in the Speciality Chemicals division
- a 70 ktpa paste PVC plant in Cuddalore.

CCVL enjoyed steady growth in 2019, achieving more than 90% capacity utilization. The Indian PVC growth story remains positive, with steady improvement in consumption that stems from the launch of large infrastructure projects. Increase in Indian import duty on PVC from 7.5% to 10% and the reduction in import duty on raw material (EDC) from 2% to 0% will help further improve future performance. Indian suspension PVC anti-dumping duties were also renewed for another 30 months on imports from the U.S. and China, the two largest PVC surplus countries. The following growth plans for CCVL, both in Cuddalore, are progressing well:

- an increase of suspension PVC capacity from 300 to 600 ktpa – investment of \$86 million; estimated incremental annual EBITDA of \$82 million; timing 2022 – 2023. CCVL has received environmental clearance for this project.
- an increase of suspension PVC capacity from 600 to 900 ktpa – investment of \$100 million; estimated incremental annual EBITDA of \$80 million; timing 2024 – 2025.

While Sanmar's Indian businesses had a very good year, TCI, its Egyptian business, had another difficult year. After the completion of its expansion in September 2018, in 2019 TCI ramped up production in all its facilities. The new PVC plant commissioned with a capacity of 200 ktpa recorded more than 100% capacity utilization on an annualized basis. Its production cost was about \$20 per metric ton lower than the existing plant. However, the spike in EDC prices that began in 2018 did not abate until late in 2019 and this resulted in negative contribution margins for PVC. Calcium chloride granules, a new product launched by TCI, is being accepted well in both domestic and export markets.

The management team has been strengthened with the addition of new people with rich experience in establishing and operating VCM and PVC plants. In order to reduce utility costs, TCI is considering setting up a combined cycle power plant to meet its captive need for both power (132 MW) and steam (236 TPH). TCI is also planning to set up a 50 ktpa chloromethane plant which will enable conversion of captive chlorine into commercial products. It is in the process of obtaining approvals for the above projects.

Based on IFRS, in 2019 Sanmar's revenues grew by 9% to \$719 million, but EBITDA declined from \$100 million in 2018 to a loss of \$9 million in 2019. Net loss in 2019 increased to \$187 million from a loss of \$91 million in 2018.

CSB Bank (formerly The Catholic Syrian Bank)

In 2019 Fairfax India completed its purchase of a 51% interest in CSB for a consideration of \$169 million (140 rupees per share), implying a multiple of 1.1 times the September 30, 2017 BVPS. This was the culmination of an effort that began in December 2016, when the Reserve Bank of India (RBI) gave Fairfax India permission to acquire a 51% stake in CSB. This was the first time in the history of the RBI that anyone was given approval to acquire a majority stake in a bank in India. Our entire investment was infused into CSB as primary capital, thereby increasing its capital adequacy ratio (CAR) to 23% at the end of 2019. The improved CAR will enable the bank to make adequate provisions for loan losses, invest in more branch openings, higher quality people and technology and grow its loan book with well underwritten loans.

Please refer to the description provided earlier in this letter regarding the spectacularly successful IPO of CSB.

CSB is one of the oldest private sector banks in India and has a strong base in Kerala along with a significant presence in the states of Tamil Nadu, Karnataka and Maharashtra. The bank currently operates 416 branches and 290 ATMs across India. With its branches primarily located in south India, it focuses on retail, gold and small and medium enterprise (SME) loans, which together comprise about 75% of total advances. CSB also owns 37 residential and commercial properties and land banks, some purchased several years ago and others acquired by enforcement of security.

Mr. C.V.R. Rajendran, whom we had identified almost four years ago for the CEO role to spearhead the operations of the bank, has been in that position for over three years and is now well in control: he understands the bank and its loan book very well. Prior to Mr. Rajendran's joining, CSB had deviated from its core expertise and built a meaningful corporate lending book, mainly through consortium lending, which resulted in loan losses which have now been fully provided for.

Continuing with the changes he started three years ago, Mr. Rajendran has now completed the implementation of human resource policies and practices that are more performance and productivity oriented. On the management front, he has hired some key executives and is well on his way to rounding out his management team.

Mr. Rajendran has also made a very significant change in the way the bank will be operated in the future. The bank was previously managed on a geographically divided structure, but will now be managed based on business verticals. There will initially be the three following business verticals:

- retail banking (comprised of branch banking; gold loans; two-wheeler loans; micro, small and medium enterprise (MSME) loans; microfinance under financial inclusion (MFI) loans; and agricultural loans);
- SME banking; and
- wholesale banking.

CSB for its internal purposes classifies loan assets of up to five million rupees as MSME and monitors these under the retail banking vertical. Loan assets between five million and 250 million rupees are monitored and serviced separately by the SME banking vertical. Any loan amount higher than 250 million rupees is managed by the wholesale banking vertical.

Mr. Rajendran has hired senior level personnel to develop branch banking which will primarily focus on retail deposits comprising lower cost current and savings accounts (CASA) and cross selling of products to generate non-interest income. CSB plans to open about 100 new branches over the next six months to drive the growth of gold, MSME and two-wheeler loans and to build a stable CASA franchise.

The important effect of this change is that going forward, the branch network will be more focused on raising deposits and generating leads for the business verticals rather than being mini banks that try to do everything.

In 2019, CSB made excellent progress in its key performance measures compared to the previous year, with loan advances growth of 9% (including gold loans growth of 25%) and deposits growth of 3% (including CASA growth of 6%). Net interest income grew 35% and the credit to deposit ratio improved from 67% to 71% while non-interest income was up 48%. In addition, yield on loans improved to 10.7% from 9.9%, CASA improved to 28.6% from 27.6% of total deposits, net interest margin (NIM) improved to 3.4% from 2.6% and the cost of deposits remained stable at 5.9%.

As a result of these improvements, based on IFRS, CSB's revenues for 2019 increased by 23% to \$107 million and net income increased to \$8 million compared to a net loss of \$7 million in 2018. Gross non-performing assets (NPAs) reduced to 3.2% from 7.5%, net NPAs reduced to 2.0% from 3.7% and the CAR was 23%. As you can see, Mr. Rajendran is making very good progress toward his objective of focusing on profitability, productivity, efficiency and asset quality.

We are pleased that Mr. Paresh Sukthankar, former deputy managing director and a member of the Board of Directors of India's leading private sector bank, HDFC Bank, continues to guide us as an advisor.

IIFL Wealth Management Limited (IIFL Wealth)

IIFL Wealth's strong client franchise in the Indian ultra high net worth individual (UHNI) segment, an innovative, diversified product offering, and superior execution make it the leading player in this niche wealth management market. It is the number one wealth manager in India for UHNIs with consolidated total assets under management (AUM) of \$25.1 billion, 29 offices in India and abroad, 900 plus employees and 64 teams consisting of 288 relationship managers serving over 5,600 families.

Since it was founded in 2008 under the IIFL brand umbrella by Karan Bhagat and Yatin Shah, with the leadership of IIFL Holdings founder Nirmal Jain and his partner R. Venkataraman, IIFL Wealth has been an independently managed company in the stable of IIFL Holdings businesses. However, in September 2019 with the demerger of IIFL Holdings, the original company that Fairfax India had invested in, into three separate companies, IIFL Wealth became a separate company listed on the Indian stock exchanges and became the only listed pure play wealth management company in India.

After its listing, because it had other owners at the subsidiary level, its ownership is distributed among the promoters with 24.7%, the U.S. private equity firm General Atlantic with 21.9% and Fairfax Financial and Fairfax India with 19.0%.

You will recall that, as part of the IIFL Holdings group, IIFL Wealth was its fastest growing business, having compounded 5-year growth rates of 32%, 39% and 49% in, respectively, AUM, total revenue and profit after tax.

IIFL Wealth begins its journey as an independently listed company at a time when the wealth management business in India had undergone a very significant change. Effective in October 2018, the Indian capital markets regulator (SEBI) banned the long established practice of mutual funds paying distributors and investment advisors upfront commissions or upfronting trailing commissions that were not disclosed to investors, requiring instead that mutual funds, except in certain very limited situations, pay only trailing commissions that are fully disclosed as part of the funds' management expense ratios.

While this is a very positive and investor-friendly change in regulation that in the long run will benefit the industry, in the short term it has caused the industry to adjust to the new reality by transforming their business models. The change has resulted in the upfront commissions being paid over the life of the investment – reducing upfront revenue but creating a stream of recurring revenue in the future.

IIFL Wealth has two businesses – wealth management (the larger one) and asset management. The wealth management business, which was directly impacted by the above-described change in regulation, had to transform from a distribution and an upfront commission driven business model to a fee-based advisory services and trailing commission-based model. As IIFL Wealth makes this transition, revenue from the former upfront commissions will decline while annual recurring revenues (ARR) will increase. In 2019, the upfront commission and brokerage revenues declined by 106% to \$57 million, while ARR grew by 23% to \$74 million.

However, AUM continued to grow, albeit at a lower rate of 13%, to \$19.8 billion. The wealth management business has embedded in it a non-bank finance company (NBFC) which makes loans to its clients secured by their assets held by IIFL Wealth and has never had a bad loan.

The smaller asset management business is India's leading manager of alternate investment funds (AIF). AUM for this business grew by 46% in 2019 to \$3.8 billion while revenues grew by 78% to \$18 million. This business was strengthened by the addition of a new CIO, Anup Maheshwari, an experienced fund manager with a proven 25-year track record.

To capitalize on the opportunity created by the fee-based model, IIFL Wealth has launched a new platform called "IIFL-ONE". Backed by strong product creation, deep research, specialist teams and innovative technology and using a portfolio management approach, IIFL-ONE is currently in the process of converting IIFL Wealth's existing customers to this platform and already has AUM of \$2.3 billion.

In 2019, as a result of the above changes in the industry, IIFL Wealth's total revenues declined by 17% to \$131 million, profit after tax declined by 23% to \$41 million and ROE declined from 13% to 9%. At listing, the stock traded at a valuation of 31 times March 2020 expected earnings and its market capitalization was 6% of its AUM, reflecting the market's confidence in its growth prospects.

Given the low penetration of wealth management in India and the high rate of wealth creation and growth in dollar millionaires, we believe that IIFL Wealth has a very bright future.

IIFL Finance Limited (IIFL FIN)

Though the predecessor company (IIFL Holdings) had been listed on the Indian stock exchanges since 2005, its demerger into three separate companies has resulted in IIFL FIN getting listed on the Indian stock exchanges in September 2019 as a pure play NBFC. Prior thereto, IIFL Holdings had been a combination of three businesses – an NBFC, a wealth management business and a capital markets business.

For over 50 years, NBFCs in India have been a source of debt financing for individuals and companies. Being relatively less regulated and therefore less bureaucratic than banks, NBFCs are able to meet customer needs on a faster and more flexible, albeit more expensive, basis. Today India has around 9,500 NBFCs of which 81 are permitted to take customer deposits and 278 are considered to be systemically important because they have assets of over \$70 million (five billion rupees). With total loans outstanding of \$330 billion, NBFCs account for approximately 20% of the \$1.6 trillion bank and NBFC loans outstanding in India.

The turmoil that started in September 2018 as a result of the default by a quasi-government lender, Infrastructure Leasing and Financial Services Limited (IL&FS), continues to restrict the operations and performance of most NBFCs including IIFL FIN. Other than a handful, most NBFCs are facing restricted access to longer term funding which they need as they have significantly reduced their dependence on short term commercial paper (CP) financing. As a result, total loan approvals by NBFCs as at June 2019 dropped by 30% from the previous year.

As you can see, IIFL FIN embarked on its journey as a pure play NBFC in a somewhat troubled landscape.

Based on total revenue, IIFL FIN, which is non-deposit taking, is the 22nd largest NBFC in India. In one survey (Banking and Finance Post), it is ranked number two in social engagement and reach (including social media engagement).

Under the able leadership of its CEO, Sumit Bali, IIFL FIN is moving forward aggressively to consolidate its position as one of the major NBFCs in India. It added 504 new branches in 2019, taking its total to over 2,350 branches, with over 18,000 employees and 3 million customers.

It has made further progress in diversifying its lending to a retail-focused loan portfolio which accounts for 87% of its loans. Loan AUM grew 11% to \$5 billion, driven by small home loans, gold loans and microfinance loans which grew by 10%, 41% and 70% respectively. Developer and construction finance loans declined by 6% and now represent 13% of its AUM. IIFL FIN has no exposure now to short term CP financing. Its liquidity profile remained robust, with a surplus across all maturities and undrawn credit lines of over \$400 million. Its total CAR was 21.4%, including a Tier 1 CAR of 17.9%, compared to the statutory requirement of 15% and 10% respectively.

Driven by the divestiture of its commercial vehicle loan portfolio, asset quality improved from this time last year, with net NPAs improving from 1.5% to 1.0%.

In 2019, IIFL FIN's revenues increased 15% to \$363 million and profit after tax excluding extraordinary items increased by 17% to \$103 million, generating an ROE of 15%. Despite these good results, IIFL FIN is trading at a deeply discounted valuation of only 9.2 times price to estimated March 2021 earnings and price to estimated March 2021 BVPS of 1.4 times. We believe there is potential for significant upside on the value of this investment.

National Collateral Management Services (NCML)

NCML was Fairfax India's very first investment, completed in August 2015. NCML has operated for over 15 years in the agriculture value chain by offering end-to-end solutions in grain procurement, testing, storage and collateral management and is now well positioned to further expand and take advantage of the significant market potential in India's underdeveloped agricultural storage industry.

NCML has more than 1.6 million metric tons of storage capacity across 700 warehouses in 16 states in India. It has a network of 28 regional offices, more than 800 touch points at agricultural produce markets and thousands of farmers and traders to facilitate procurement of commodities. With AUM of \$700 million, NCML has a 30% share of the agricultural commodities' collateral management business in India, offering custodial services to about 67 banks and financial institutions for the management of collateralized agricultural commodities, based on which those institutions advance post-harvest loans to farmers or dealers owning commodities. Beyond its major business segments, NCML offers a commodity and weather intelligence service and an online commerce portal (NCML MktYard), both of which continued to make progress in 2019.

In 2015, Fairfax India invested a total of \$149 million to acquire an 88% interest in NCML: \$31 million in primary infusion to fund growth plans and the remaining \$118 million to buy out existing shareholders. In August 2017, Fairfax India acquired an additional 1.4% stake through a rights issue for \$25 million. In September 2019, Fairfax India infused \$14 million as compulsorily convertible debentures to meet equity requirements for construction of silos. Based on discounted cash flows, NCML is now valued at \$135 million compared to our investment cost of \$188 million.

NCML's performance in its various business verticals is primarily linked to the underlying economic activities in two areas: the post-harvest agriculture value chain and the financing of agricultural produce by banks and financial institutions. Most other industries have successfully overcome the disruption caused by demonetization (in November 2016) and Goods and Services Tax (GST) implementation (in July 2017), but the agriculture sector has been the most impacted and activity has yet to recover to previous levels. In addition, the credit crisis in India has had a profound negative impact on the post-harvest agri value chain. The Union Budget of 2020 of the Government of India acknowledged this disruption and the Finance Minister has announced several budgetary measures to support the agriculture sector.

The above factors have had an impact on the business environment for NCML, and 2019 was a particularly difficult year for it. Revenues declined by 29% to \$148 million and net income declined from \$3.6 million in 2018 to a net loss of \$0.8 million in 2019. The decline in revenues was largely due to opportunity loss from unavailability of short term credit to undertake supply chain contracts, management's intention to reduce collateral management business and

locations to mitigate potential risks in a credit constrained environment and losses incurred in the supply chain segment due to an extraordinary decline in the price of castor seeds. These factors, combined with the inability to reduce overheads in line with the decline in revenues resulted in NCML incurring a loss for the year.

We also had a change of guard at NCML – Sanjay Kaul expressed his desire to retire from his executive role. He assumed the role of Chair of the Board and will continue to provide guidance to NCML going forward. We thank Sanjay for his leadership in developing the organization to its strong market position.

We identified Siraj Chaudhry to take over from Sanjay as the CEO of NCML. Siraj spent 24 years at Cargill India, including 12 years as its CEO/Chairman. Siraj not only brings with him a deep understanding of the agriculture sector in India but is also strongly networked within the domestic and international market participants in this sector. Under Siraj's leadership, NCML is taking steps to achieve growth in several of its business verticals while at the same time curtailing certain businesses to reduce the risks presented by a tight credit environment, prioritizing construction of silos and reducing overheads to sustain profitability in a difficult macro environment.

Fairchem Speciality

In March 2017, the merger of Fairchem Speciality and Privi Organics (Privi) was completed, resulting in Fairfax India owning 48.8% of the merged entity. Fairfax India had earlier separately owned controlling interests in both these companies.

Based on IFRS, in 2019 Fairchem Speciality grew consolidated revenues by 38% to \$242 million and net income by 182% to \$27 million. Shareholders' equity grew 34% to \$97 million, generating an ROE of 27%.

While the two businesses have been merged into one corporate entity, they each continue to be managed independently by their founders and existing management teams. We describe below the performance of the two businesses:

The **Fairchem** business, led by Nahoosh Jariwala, is an oleochemicals business. Oleochemicals are, broadly, chemicals that are derived from plant or animal fat, which can be used for making both edible and non-edible products. In recent years the production of oleochemicals has been moving from the U.S. and Europe to Asian countries because of the local availability of key raw materials.

Fairchem occupies a unique niche in this large global playing field. It has developed an in-house technology that uses machinery manufactured by leading European companies to convert waste generated during the production of soya, sunflower, corn and cotton oils into valuable chemicals. These chemicals include acids that go into non-edible products like soaps, detergents, personal care products and paints, and other products that are used in the manufacture of health foods and vitamin E. The company's customers include major multinational companies including BASF, Archer Daniels Midland, Cargill, Arkema and Asian Paints. Fairchem operates out of a single plant in Ahmedabad, the largest city in Gujarat, the home state of Prime Minister Modi: the plant has one of the largest processing capacities for natural soft oil-based fatty acids in India. Over the last ten years Fairchem's sales have grown on average 22% per year, net earnings have grown on average 47% per year, and the average annual ROE was around 21%.

Based on IFRS, in 2019 Fairchem's revenues grew by 10% to \$39 million, net earnings grew by 15% to \$4 million and shareholders' equity grew 17% to \$16 million, generating an ROE of 23%.

In 2019, Fairchem ran into a shortage for its key raw material, which is waste from Indian soft oil refineries. The shortage was caused by demand from China, where customers are able to pay higher prices because their products have better margins, and from a new competitor in India that manufactures the same product as Fairchem. Fairchem has identified three potential substitute raw materials of which one is currently being used in production while the other two are in laboratory testing. Fairchem is hopeful that these alternatives will enable it to mitigate the impact of the reduced availability of its original raw material and to supply the incremental demand for its products.

In 2018 Fairchem completed the implementation of changes in its plants that increased its installed capacity from 45 to 72 ktpa of raw material that can be processed. Fairchem has also initiated two capital expenditure projects – both will be financed by a mix of term borrowings and internal accruals and are expected to enter production in 2020:

- a plant to manufacture sterols and higher concentration tocopherols, and
- a plant to manufacture bio-diesel using three by-products of its manufacturing process: palmitic acid, monomer acid and residue.

The **Privi** business, founded in 1992 and led by Mahesh Babani and D. B. Rao, had a spectacularly successful year in 2019. Based on IFRS, in 2019 Privi's revenues grew 33% to \$203 million, net earnings grew 272% to \$23 million and shareholders' equity grew 37% to \$81 million, generating an ROE of 28%. The increase in revenue and net earnings resulted from higher volumes, higher unit prices, lower raw material costs and a drop in tax rates from about 35% to 25% because of the lower tax rates implemented by the government.

Privi is one of India's leading manufacturers of aroma chemicals. Privi started manufacturing aroma chemicals with only two products, which it gradually expanded to a range of over 50 products today, with a capacity of over 31 ktpa. Its products are used as fragrance additives in perfumes, soaps, shampoos and packaged food. Privi enjoys a dominant position and economies of scale in its product categories. Privi also develops and produces custom-made aroma chemicals to specific requirements of its customers. Privi sources most of its raw materials from pulp and paper companies globally and competes primarily with pure play and niche suppliers such as IFF, DRT and Renessenz.

One of Privi's significant strengths is its established research and development (R&D) capabilities in aroma chemicals, with a staff of 81 people comprised of PhDs in chemistry, chemical engineers and instrumentation engineers. The research specialists continuously strive to develop new products and processes. Importantly, one of the R&D labs is completely focused on developing, through biotechnology, green products and green technologies in technical collaboration with the University Institute of Chemical Technology, Mumbai.

Privi has made significant investments in manufacturing facilities that convert a waste product in pulp and paper manufacturing, crude sulphated turpentine (CST), into aroma chemicals. CST, a more cost-effective raw material than the more traditional plant-based gum turpentine oil (GTO), is procured through annual contracts, while GTO has to be purchased on volatile spot markets.

On April 26, 2018 there was a major fire at Privi's main production facility. In rebuilding the facilities destroyed by the fire, it has created a world class manufacturing plant, with the highest safety standards.

It was an outstanding year for Privi.

Reorganization of the Fairchem Speciality companies: In 2019 Fairchem Speciality announced its intention to divide its two businesses described above, currently functioning independently but under one listed corporate entity, into two separate companies, with each to be listed on the Indian stock exchanges. Fairchem Speciality believes that this is now the best structure for its operations because:

- Each business now has the critical mass to operate independently.
- Each business will be able to create its own business platform and identity and focus on its own business, thereby achieving even greater growth.
- The equity participation offered by each business, listed separately, will better incentivize key people as rewards will be more closely correlated to performance.
- Each business will have greater flexibility to raise and invest capital according to its own needs.

The reorganization is subject to regulatory approvals and is expected to be completed in 2020.

Seven Islands Shipping (SISL)

Founded in 2004 by Captain Thomas Wilfred Pinto, SISL owns and operates tanker shipping vessels that sail primarily along the Indian coast as well as in international waters. SISL is the second largest private tanker shipping company in India.

In March 2019 Fairfax India acquired a 41.4% equity interest in SISL for \$72 million through a direct subscription of \$29 million and a secondary acquisition from existing shareholders of \$43 million. In September and October 2019, Fairfax India acquired an additional 7.1% from existing shareholders for \$12 million, bringing our total ownership interest to 48.5%. At this price, SISL is valued, based on year ended March 31, 2019 numbers, at an EV/EBITDA multiple of 8.9 times, a price to earnings multiple of 32 times and a price to BVPS multiple of 1.7 times.

Captain Pinto is a passionate entrepreneur and operator. We first met Captain Pinto in August 2018 and over the course of the next few months developed a deeper appreciation of the business and his aspirations for the company. He started his career in 1979 as a sailor with India Steamship Company and sailed for about 20 years, with about 10 years as the captain. In 1998, he joined Mercator Lines Limited as a marine superintendent. In 2003, Captain

Pinto acquired his first vessel for about \$650,000 and incorporated SISL as a public limited company in 2004 to avail of various government incentives. Under his leadership, SISL has successfully navigated shipping cycles by opportunistically acquiring vessels at deep discounts during the down-cycles and deploying them immediately on a time charter basis (guaranteed revenue model) to achieve a 4-5 year pay-back. At all times, the company has managed its capital structure prudently and has relied extensively on internal accruals as well as bank debt to expand its fleet.

At the time of our initial transaction, SISL owned 14 vessels with a total deadweight capacity of about 1 million metric tons. Today SISL owns 19 vessels with a capacity of about 1.2 million metric tons. All of SISL's vessels are registered in India and operate as Indian-owned and flagged vessels.

SISL focuses on the pre-owned vessel market. It identifies good quality vessels (generally manufactured in Japan or South Korea and owned by European companies) and acquires them opportunistically at significantly lower valuations during periods of distress in the industry. Typically, the opportunity to acquire vessels at deep discounts arise during downturns or times of significant overcapacity in the industry or due to a case-specific distress sale.

Historically, SISL bought vessels that were 20-21 years old and operated them till they reached about 29-30 years of age. For operations along the Indian coast, the freight rates are based purely on bids and there is no distinction between old and new vessels. SISL benefits from lower upfront capital investment and enjoys the same charter rates as those of the younger ships. The operating and maintenance costs for its fleet are not significantly different from those of the younger ships. The average age of the current fleet is about 19 years and SISL aims to bring this down to about 16 years over the next few years.

SISL enters into two types of arrangements for the deployment of its vessels: time charter contracts that are entered into for a specific duration of time, wherein the charterer uses the vessel for a fixed charter rate expressed in U.S. dollars per day; and voyage charter contracts, wherein the charterer uses the vessel for a specific voyage and the charges are fixed in U.S. dollars.

SISL originally deployed vessels only on a time charter basis, diversifying into voyage charters more recently. Over the past three years, revenues from time charter contracts accounted for about 70% of SISL's total revenues.

SISL typically does not buy vessels until it has visibility of deployment. At any given time, a newly acquired vessel does not stay idle for more than 20 days. This leads to consistently strong cash flow generation for each vessel. Leveraging its strong cash flow profile, SISL has undertaken prudent external borrowing to fund its fleet expansion. SISL's average debt to equity ratio for the past ten years has been about 1.2:1.

Indian Oil Corporation, Hindustan Petroleum Corporation and Bharat Petroleum Corporation, all majority owned by the Government of India, are SISL's top three customers. Strategically, SISL does not deal with corporate groups that are slow payers.

For the oil companies, the overall logistics costs to transport oil are less than 2% of their revenues. However, service quality and service timelines are critical. Hence, these oil companies run transparent bidding competitions to award the logistics contracts and always pay on time, resulting in predictable working capital management for the fleet operators.

SISL has a small and efficient operations team consisting of about 70 core employees at the head office who manage the entire business. Crew scheduling, contracting, repair and maintenance operations are all managed by the company staff. In-house maintenance provides direct visibility to the actual condition of the vessels and helps maintain quality at a lower cost while reducing repair-related downtime. SISL engages, on contract, an approximate 25-member crew for the operation of each vessel.

Under the current Indian regulatory framework, Indian owned and flagged vessels are given preference over foreign vessels for transporting any cargo that originates from India. This is implemented by giving the Indian owned vessels a "right of first refusal" (also known as "cabotage") before a contract can be awarded to a foreign vessel owner. It is our understanding that, because of cabotage protection, foreign vessel owners typically refrain from bidding for contracts for movement of goods along the Indian coast. Hence, the charter rates in domestic shipping are apparently about 30-40% higher than the rates quoted in international shipping markets. SISL bids competitively (because of its lower cost base) and does not rely on cabotage protection to win contracts. Strategically, SISL operates a majority of its vessels in the domestic cargo oil market and has benefitted from the general rate arbitrage in domestic vs. international deployment.

In order to assist Indian shipping companies to compete with their global counterparts, the government has implemented tax provisions that have resulted in SISL enjoying effective tax rates of 2.4% for the past five years, resulting in higher cash flow. SISL has obtained a ruling from the Indian tax authorities that it is entitled to the beneficial tax regime until the year ending March 31, 2026, so the lower tax rate is applicable at least until that time.

In 2019, SISL's revenues grew by 26% to \$82 million, net income grew by 57% to \$12 million and shareholders' equity, including our capital injection, grew 52% to \$112 million, generating an ROE of 11%.

We are very excited about the prospects for SISL.

National Stock Exchange of India (NSE)

In July 2016, Fairfax India acquired a 1% stake in NSE for \$26.8 million. NSE is the largest stock exchange in India with a market share of over 93% in cash equity trading and 100% in equity derivatives trading. With approximately 200,000 terminals in over 2,000 centres, NSE provides trading facilities with national reach. The exchange uses the latest communications technology for automated screen-based trading. In 2019, NSE's revenues grew 13% to \$545 million, net income grew 8% to \$261 million and shareholders' equity grew 11% to \$1.2 billion, generating an ROE of 22%. Our investment is currently valued at \$57.2 million. The planned IPO of NSE has been delayed and is now expected sometime in 2020 or 2021.

IIFL Securities (IIFL SEC)

IIFL SEC is one of the major capital market players in Indian financial services. It offers advisory and broking services (both retail and institutional), financial products distribution, institutional research and investment banking services. It operates in over 2,500 locations across India, comprised of a wide branch and sub-broker network providing unparalleled research coverage on over 200 companies. It serves over 800,000 customers and has a strong online presence. Mobile trading has significantly aided in increasing the number of customers: mobile trading clients in 2019 accounted for 54% of trading.

IIFL SEC was founded in 1996 and became a member of the Indian stock exchanges in 2000. Since its founding it has housed all the businesses of IIFL Holdings, the company that Fairfax India originally invested in, except for the NBFC and wealth management. However, in September 2019 with the demerger of IIFL Holdings into three separate companies, IIFL SEC became a separate company listed on the Indian stock exchanges and Fairfax India became a direct shareholder with a 26.5% ownership interest. It is serendipitous that one of IIFL SEC's most senior executives is H. Nemkumar, as it is through him that we first got to know of the IIFL group; he is a very trusted advisor to us and has been a key resource for us in all of Fairfax Financial and Fairfax India's capital markets dealings in India.

IIFL SEC operates in three broad areas within the capital markets and financial services sector in India:

- Retail broking and financial products distribution (70% of revenue) – in retail broking it has established itself as a leading institution through a combination of leading-edge technology, diverse product offerings, management expertise, and a wide network of branches across India. IIFL Securities' mobile trading app, IIFL Markets, targeting retail clients continues to be the highest rated amongst peers with over 3.3 million downloads. Mobile brokerage constituted about 43% of total broking revenue. IIFL Securities' mutual fund app had over 890,000 downloads in 2019 and is steadily building on its customer base. In financial products distribution, it offers retail clients a wide range of products including mutual funds, insurance, IPOs and debt instruments.
- Institutional broking (21% of revenue) – it is a leading independent (not associated with any international bank) broker, with a highly acclaimed, pedigreed 80-member strong sales and research team that covers over 200 Indian companies accounting for about 80% of India's market capitalization. It is a market leader in block sales placements, placing over \$15 billion in blocks over the past five years. It has more than 600 domestic and foreign clients and has developed trusted long-term relationships with them through sustained high-quality performance.
- Investment banking (5% of revenue) – it is a highly regarded category 1 merchant banker in India and despite volatile markets, completed 21 transactions in 2019, including 6 IPOs. It continues to have a substantial pipeline of transactions which are at various stages of execution.

IIFL SEC also owns a portfolio of commercial properties, rented mostly to group companies, with a current market value of about \$100 million (amounting to about 50% of its market capitalization), that generates rental income of approximately \$7.5 million. These assets may be monetized in the future.

In 2019, due to weak sentiment among investors as a result of a slowing economy, IIFL SEC's revenues declined 14% to \$113 million and profit before tax (before exceptional items) declined 30% to \$30 million. The stock started trading at listing at about 42 rupees per share, subsequently declined to about 22 rupees per share, and has since recovered to about 60 rupees per share, implying a price to earnings ratio of 8.1 times 2019 earnings and a price to BVPS ratio of 2.1 times. Over the last four years IIFL SEC has generated an average ROE of 29%.

Based on its strong business franchise, growth potential and attractive ROE, we expect that IIFL SEC will be a good investment for Fairfax India.

Saurashtra Freight (Saurashtra)

In February 2017 Fairfax India invested \$30 million to acquire a 51% interest in Saurashtra. \$18 million of the \$30 million was used to purchase part of the founder's stake; the remaining \$12 million was invested directly into Saurashtra. After the completion of the transaction, Saurashtra was left with about \$22 million of cash, which it intended to use to pursue its acquisition plans.

Saurashtra's principal business is owning and operating container freight stations (CFS), which are an important link between transport operators and shipping lines and effectively work as an extension of a port. It is in the port's best interest to focus on maximizing container traffic and not get bogged down handling containers that are waiting to be dispatched. Also, ports lack adequate storage facilities to hold containers for extended periods of time. CFSs provide a facility outside of congested ports for temporary storage of goods pending customs clearance and further distribution. Activities like stuffing and destuffing of containers, which might otherwise have to be done in the port, are done at the CFS.

Launched in 2005, Saurashtra is located five kilometers from Mundra port. With 24/7 operations, Saurashtra has the capacity to handle 180,000 TEUs (twenty-foot equivalent unit shipping containers) per annum and handled about 100,000 TEUs in 2019, implying capacity utilization of about 54%. It has achieved a market share of about 14% at Mundra port, the highest among all CFSs there.

Despite the significant headwinds and challenges described below, Saurashtra, under the able leadership of Raghav Agarwalla and Ashutosh Maheshwari, produced reasonable financial results in 2019. Volume of containers handled dropped 4% to about 100,000 TEUs and while revenues declined by 1.7% to \$21 million, net profit from a depressed level the previous year grew by 323% to \$3.9 million. Saurashtra generated \$5 million of free cash in 2019, and at year end had a cash balance of \$18 million and no debt. In the five years prior to our acquisition of Saurashtra in 2017, revenue and EBITDA had grown at 17% and 18% per annum respectively, generating a 17% average ROE. However, as of 2019, performance has eroded significantly from the time of our investment. Based on three-year compounded numbers to 2019, revenue grew by 13% and EBITDA declined by 5%, generating an average ROE of 3%. Raghav's efforts to grow the business inorganically through acquisitions have not been successful because he has been unable to find good businesses at reasonable valuations. We are working with Raghav on alternatives to remedy this situation.

The headwinds faced by the industry are due to reduced export volumes in Mundra port as a result of the temporarily depressed economic conditions and larger volumes of import cargo being routed through captive CFSs of shipping lines. This situation is exacerbated by additional CFS capacity that has been created at Mundra port resulting in significant pricing and margin pressure for all CFS operators.

Further, India, in its zeal to improve its "ease-of-doing-business" scores, has implemented changes in its customs clearance processes that simplify the steps and improve the speed at which goods clear customs both for exporters and importers. This reduces the "dwell" time of goods in CFSs, reducing their revenues. Also, some exporters have adopted the "self-sealing exports" methodology which enables them to send their goods directly from their factory to the port, completely bypassing CFSs.

Fairfreight Lines, the non-vessel operating common carrier (NVOCC) business that Saurashtra launched in 2017, has made good progress, though it also faced headwinds as the result of reduced trade volume between India and the Arab Gulf region. It now accounts for about 19% of Saurashtra's sales and 7% of net income.

5paisa Capital (5paisa)

5paisa, which literally means “5 cents”, is one of India’s fastest growing technology-led financial services companies. It offers an array of financial products and services through a digital platform and mobile application. Its services are targeted at retail investors and high-volume traders who actively invest and trade in securities markets and seek DIY (do-it-yourself) services at a low cost. With its diverse services and products encompassing online discounted stock broking, depository services, research and distribution of mutual funds and other financial products, 5paisa successfully fulfils its customers’ diverse needs. Recently, it added gold investments and commodities trading to its product suite. 5paisa remains focused on innovation based on understanding customer behaviour, and constantly strives to achieve technological superiority, as it has done through the development of its robust trading platform, its advanced mobile app, its artificial-intelligence powered robo-advisory platform, and its paperless account opening process.

5paisa has sustained a strong pace of client acquisition since inception in 2016, taking its total client base to 424,000 in 2019. The 5paisa mobile app has been hugely popular, in 2019 recording over 3,600,000 downloads and sustaining a rating of 4.2 on Playstore.

IIFL Holdings spun off 5paisa in 2017 and Fairfax India owns a 26.6% equity interest in it. While it is a small startup, it is growing at about 100% a year and will continue to make losses until it reaches a critical mass of users. However, it has the potential to be a major player in digital discount broking and financial products distribution.

Financial Position

Fairfax India came into being about five years ago on January 30, 2015, when it issued 106.7 million shares at \$10.00 per share, raising gross proceeds of \$1.03 billion by completing a public offering, a placement to cornerstone investors and an issue to Fairfax Financial. In September 2016, the company arranged a \$225 million two-year secured loan from a syndicate of Canadian banks. In January 2017 Fairfax India issued 42.6 million shares at \$11.75 per share in a public offering and a concurrent private placement to OMERS and Fairfax Financial, raising gross proceeds of \$500 million. In March 2017, the company repaid its \$225 million term loan to the syndicate of Canadian banks, and then in July 2017 it arranged a \$400 million one-year secured loan from a Canadian bank. In June 2018 Fairfax India replaced its expiring secured loan with a \$550 million, one-year secured loan, with an option to extend for an additional year, with a syndicate of Canadian banks. Including the approximately \$227 million of the proceeds of the Sanmar loan repayment less current investment commitments, Fairfax India currently has about \$286 million plus an unused credit line of \$50 million for new investments and ongoing expenses.

At December 31, 2019, the financial position of Fairfax India was as follows:

	(\$ millions)
Undeployed cash and investments ⁽¹⁾	286
Unused line of credit	50
Secured term loan (from a syndicate of Canadian banks, maturing in June 2021)	550
Common shareholders’ equity	2,571.8
Total debt to equity	21.3%

(1) Includes passive investments in publicly traded Indian companies

Developments in India

In the three years since the end of 2016, India has moved up by 67 places to number 63 in the World Bank Business Report’s “ease of doing business” measure. According to a World Bank director, this is the third year in a row that India has made it to the top 10 “improvers” in doing business, a success that very few countries have achieved over the 20 years since the project was started. At this rate India could in the not too distant future be among the top 50 countries in which to do business. This is a testament to the unrelenting economic reforms that Prime Minister Modi has been implementing since he took office almost five years ago.

However, 2019 has been a year of opposites in India.

In the national elections held in May 2019, Prime Minister Modi won a massive and decisive mandate to lead the country for another five-year term. Beating all predictions, his BJP party again won an absolute majority in the parliament, taking 303 out of the 542 seats. In the previous election the party had won 282 seats, also an absolute majority. This will give him the needed majority to implement reforms that will drive the economy with his business-friendly policies. On the other hand, his party lost elections in many states, among them Rajasthan, Madhya Pradesh, Maharashtra, Jharkhand and Delhi, both before and after the national elections.

The Indian stock markets performed well in 2019 with a return of 11.9% for the large cap US\$ S&P BSE Sensex. On the other hand, economic growth decelerated sharply, with the July to September 2019 quarter growth declining to a 26 quarter low of 4.5%, and with the economy now forecast to grow by only 5.0% for the year ending March 31, 2020. The economy in the previous year had returned to a growth level of 6.8% after it had overcome the twin shocks of demonetization and implementation of the GST. The economic slowdown appears to have started with the withdrawal of easy credit for consumers, SMEs and real estate developers when, after the September 2018 default of IL&FS, funding became difficult for NBFCs that were providing the easy credit. This appeared to fuel a downward spiral: consumer spending growth slowed and sales in many consumer sectors like automobiles cratered, resulting in production cuts and plant shutdowns that led to job losses which then led to further depressed consumer spending.

The Monetary Policy Committee (MPC) cut policy rates by 135 basis points (bps) over five consecutive meetings, starting from February 2019. However, bank lending rates moderated by only about 45bps during this period due to bank deposit rates that did not fall in tandem with the policy rates, tight liquidity conditions and poor lender and business confidence. The RBI through its Open Market Operations is trying to flatten the yield curve (defined as the spread between the 10-year government bond yield and the 3-month Treasury Bill yield) in order to pressure bank lending rates lower. These transactions have so far had only a modest impact on long term bond yields.

India received above normal rainfall in the recent monsoon season and several regions were flooded due to excessive rains. Successive weather disruptions – drought in the October to March 2018/19 crop season (called Rabi) and floods in the July to October 2019 crop season (called Kharif) – resulted in poor crops and drove a sharp acceleration in food price inflation, especially for vegetables. Food price inflation climbed to a six-year high of 12.2% in December 2019 as a result of higher inflation in categories like vegetables (about 60%) and pulses (about 15%). This pushed the headline CPI inflation rate to 7.4% in December 2019, a level of inflation which is outside MPC's mandated inflation target range of 2% to 6% and caused it to suspend the monetary easing cycle. The MPC is now balancing policy to try and address high inflation and weak economic growth.

However, good news seems to be on the horizon. High reservoir levels and soil moisture levels point to a good Rabi harvest that could cool inflation and revive consumer demand. A fall in the CPI could enable and encourage the MPC to initiate one more policy rate cut. Therefore, while 2019 was a tough year for the Indian economy, recent early data indicates that the downward trend in some key economic indicators have bottomed and there are some early signs of a turnaround. The worst may be behind us, and we may see a gradual consumption driven recovery.

During 2019 the government announced several measures to reverse slowing growth momentum:

- Corporate tax rate cut – In September 2019 the government announced corporate tax cuts, reducing tax rates from about 35% to about 25%. Companies could either claim exemptions and tax benefits and continue with existing tax rates or switch to new lower tax rates but forego exemptions and other tax benefits.
- Roll back of surcharge on capital gains tax of alternate investment funds (AIF) and foreign portfolio investors (FPI) – In August 2019 the government rolled back the unintended increase in surcharges on capital gains tax of AIFs and FPIs.
- AIF to assist completion of stalled real estate projects – The government announced that it would set up an AIF, with initial funding of about \$1.4 billion, for providing last mile funding for the completion of construction of stalled residential apartment projects. Government-owned financial institutions, like the Life Insurance Corporation of India (LIC) and the State Bank of India (SBI), and other financial institutions were expected to provide additional funding of about \$2.1 billion by participating in the AIF.
- Merger of public sector unit (PSU) banks – The government merged ten relatively small PSU banks into four large PSU banks. It also announced the release of about \$10 billion for the recapitalization of PSU banks.

As we end our first five years of operations, we would like to acknowledge the strong support and leadership provided by Jennifer Allen, former Chief Financial Officer, Keir Hunt, General Counsel and Corporate Secretary, S. Gopalakrishnan (Gopal), Hamblin Watsa Managing Director for Indian Investments, and John Varnell, Vice President of Corporate Affairs. We would like to welcome Amy Sherk, our new Chief Financial Officer, who has taken over seamlessly from Jennifer as Jennifer became the CFO of Fairfax Financial. We would also like to thank our independent directors – Tony Griffiths, Chris Hodgson, Alan Horn, Deepak Parekh and Lauren Templeton – for their wise advice, support and encouragement.

We are looking forward to seeing you at our annual meeting at 2:00 p.m. (Eastern time) on April 16, 2020 at Roy Thomson Hall, 60 Simcoe Street, Toronto, Canada. Once again you will have the opportunity to meet the excellent leaders of many of our companies: Raghav Agarwalla (Saurashtra Freight), Mahesh Babani (Privi), Sumit Bali (IIFL Finance), Karan Bhagat (IIFL Wealth), Siraj Chaudhry (NCML), Nirmal Jain (IIFL Group), Nahoosh Jariwala (Fairchem Speciality), Hari Marar (Bangalore International Airport), Captain Pinto (Seven Islands Shipping), C.V.R. Rajendran (CSB Bank), Vijay Sankar (Sanmar Chemicals Group), and R. Venkataraman (IIFL Group).

March 6, 2020



Chandran Ratnaswami
Chief Executive Officer



V. Prem Watsa
Chairman