Introduction

Patrick: [00:01:41] **Today we're breaking down Markel. Markel is an insurance and investing business. It shares the same operating structure as Berkshire Hathaway in that it uses insurance underwriting profits to fund an investing portfolio that includes both minority and controlling interest in public and private businesses.**

It was founded in 1930 by Sam Markel to insure jitney buses, and today is a Fortune 500 company with a market value of $17 billion. To break down Markel, I'm joined by Peter Keefe and Saurabh Madaan. Peter is an investor at Avenir and long-time Markel shareholder. While Saurabh was the Deputy CIO at Markel and is now the Founder and Managing Member of Manveen Asset Management.

We discuss why the Berkshire comparison is unfair, how a specific set of values is so deeply embedded in the business, and we use Markel as a lens to talk about capital allocation and the psychology of investing more broadly. Please enjoy this breakdown of Markel.

What Markel Does and Why It's Unique

Patrick: [00:02:33] **So Saurabh and Peter, thank you so much for taking the time to break down Markel with me. I think because we have both of you with very interesting paths to the business and interesting histories with it, it would be really fun to get you actually both to answer the same question at the beginning which is just how you would explain this business to a friend of yours that's approaching it for the first time because its structure and its history is quite unique.**

There are some analogs obviously that we'll draw on that people will understand. But Peter, maybe starting with you, how would you explain this to a friend that had never heard of the business before?

Peter: [00:03:06] I would say that it's an insurance business that uses the profits from the insurance company to fuel an investment portfolio. And between the two of them, you should achieve a high rate of compounding per share over a long period of time. That's Markel on a breath.

Patrick: [00:03:24] **Saurabh, how about you?**

Saurabh: [00:03:25] I would just add that you could also describe Markel as a collection of systems and values. If you heard the Daily Journal meeting this year, Mr. Munger said that the business world is quite like the physical world, where all businesses eventually die. Maybe that is true and maybe that isn't such a bad thing overall for human progress. Businesses might die, but perhaps values can endure like they have across centuries and millennia and human civilization.

And I would argue that Markel is a business that chooses to identify itself as a collection of values and systems underlying which is the Markel Style. And the businesses that Markel has been and started with insurance, as Peter was saying. There are also other privately-owned businesses, and these will evolve and change with time, but I think the values and systems, some of which have positive virtuous feedback loops within them will help endure.

Patrick: [00:04:24] **As is always the case, I have somewhat of a rough plan for navigating the conversation around the business that goes off the rails right away. And I have to go straight to the Markel Style and those values and those systems because if that's going to ultimately drive where this thing goes from here and how it's gotten to here, I think it's incredibly important to explore.**

So I'll ask you both again to summarize what you think those values and those systems are that are most interesting. Saurabh, I'll start with you this time. When you came to the business, you came from Google, and you've had an interesting path to get there. What most attracted you? What do you think are the powerful and enduring systems and values that exists that are unique to Markel?

Saurabh: [00:05:02] Yes. I think I would start with about Tom Gayner, the CEO, he has written about in the last few annual letters. He refers to the win-win-win architecture of Markel, where you do your business in such a way that your customers win first and foremost. Two, the associates who work at Markel, they win and thrive.

And finally, the shareholders that provide capital win. And then Markel Style, which we referred to, it was a document that was written at the time Markel went public in 1986 by Alan Kirshner at the time. And it basically has a set of certain values and the pursuit of excellence being one. A sense of humor being another one. A disdain for bureaucracy being another one.

These are values that have -- which stood the test of time. And equally importantly, what is interesting is the Markel Style does not have the one word that a lot of analysts use to describe Markel. It does not have the word insurance in it.
Patrick: [00:06:07] Peter, what about you? What's been your experience watching the impact of these values and these systems on how the business has evolved?

Peter: [00:06:15] I think that Markel by virtue of its commitment to honesty and transparency with its owners has created a culture and a mindset within its ownership that's forgiving, that has resulted in a shareholder base that's incredibly stable over time. And as I tell people, if you're a highly promotional business, you're not going to be forgiven in your first misstep.

But if you're a Markel, and your commitment to these fundamental values of transparency and honesty and accountability, your shareholders will forgive you. Saurabh said it best. I mean businesses are like people.

They are ideas organized around people and capital. That's all businesses are. And so businesses have values. Every business has a set of values. And I think Markel has been truer to its value set than almost any business, of which I'm aware apart from Berkshire.

Patrick: [00:07:19] **How has that happened? What are the means by which that's possible over decades?**

Peter: [00:07:23] Again, it's the people suffusing their own personal values through the business. Markel has a dinner at its annual meeting every year. Tom and Markel executives speak at it. But if you're fortunate, you'll find yourself seated with, say, someone who has been an underwriter in their Red Bank operation for 13 years.

And you get a chance to ask them about the company, you'll say, "What do you think of Tony Markel?" And they will say, "You know what, I had never met Tony, but Tony gave me a call when my child was sick eight years ago." And he said, "I'll never forget that."

And the fact that they've been there 5, 10, 13, 15, 20 years, of course, it's a hand-selected group of people. But if you talk to enough of them, you acquire an understanding that these personal values that are held by the Markels, as expressed through the Markel Style are suffused throughout the individuals and the systems and the processes in the firm.

All goes back to the people whose name on the door and Alan Kirshner and Tom and the fact that the people throughout the organization, in fact, all constituencies, whether it's employees or shareholders, understand that these values are real. They're just not words on a piece of paper, call the Markel Style. There's real what -- from what I can tell, complete and total buy-in up and down the line.

Patrick: [00:08:53] **I think the cheap analogy would be to compare Markel, call it, a mini Berkshire. If you Google it and read little write-ups about it, you'll hear something like that. Can you explain how and where that falls short of explaining what Markel is and does in its history?**

Peter: [00:09:08] I don't describe Markel as a mini Berkshire because I think it's unfair. It'd be like comparing Peter Keefe to Warren Buffett, it doesn't work. And so I think Berkshire is Berkshire and Markel is Markel. They have the same fundamental operating structure, and I don't think it's any secret that Markel is modeled on Berkshire.

But I just think it's an unfair comparison. But the fact of the matter is, Markel has done an outstanding job over time of allocating capital using that model. But I think the comparison is fundamentally unfair and not apt although you see it all the time.

Patrick: [00:09:47] **Saurabh, what would you say? I know you've studied both businesses in great detail. And once you get down beneath the layer of have an insurance business that's really well run and profitable and create an asset pool basically to invest in equities and elsewhere. Once you get past that comparison, where do you think there's important differences?**

Saurabh: [00:10:05] Tom has often referred to his mentor, Ned Reynolds, who says the secret to success in investing is lasting the first 30 years. And with a lot of love and gratitude towards both Tom and Markel, what I've observed is that sometimes by satisficing in the short term, you can optimize in the long term. Sometimes by just pursuing the right set of values, but over a longer period of time, even ordinary people can achieve extraordinary results.

And I think for Berkshire to become Berkshire, it was very unlikely that it would have occurred without the singular genius of somebody like Warren Buffett at the helm. I think Tom is trying to -- and this is my opinion, Markel has been designed in such a way that the set of values and principles that power Markel, just being repeated over a very long period of time should be able to deliver extraordinary results, even if it weren't a singular genius running the place.

What Good and Bad Insurance Businesses Look Like

Patrick: [00:11:18] **Peter, I'd love to zoom in now on brass tacks and what actually happens in the business and really spend some time talking about insurance. I think everyone conceptually understands insurance businesses, but the specific lines that the business has gone into.**

I'd love to hear your perspective on like good versus bad versus okay versus great insurance businesses, what the dimensions are that matter and really get a masterclass on, given that there's lots of different lines of business that Markel is in, how you think about the insurance business and how that's evolved at Markel over time.

Peter: [00:11:48] What attracts us broadly to the insurance business, the property and casualty insurance business is the well-known fact that if you underwrite at a profit, you have not only cost-free capital, but you're getting paid money to hold other people's capital. I try to use the comparison to a bank. A bank gets your $100, they credit you with $1 or $2 or $3 or $4 per year, depending on interest rates.

So the bank pays you. You give $100 to an insurance company, people don't realize it's still your money, but the insurance company may earn a huge underwriting profit on that. Last year, Markel retained $0.08 on every dollar. So you take the bank model and you put the numerator in the place of the denominator and you've got an insurance company, at least one that's underwriting profitably.

So then you look more closely at the specific lines that Markel writes, and it's got two big underwriting units. It's got the primary insurance unit. And then it's got the reinsurance unit. And within the insurance unit, which was 87% of last year's gross written premiums, 25% of that is professional liability, which is errors and omissions, directors and the officers, employment practices, intellectual properties, cyber and stuff like that.

Now these are unusual difficult-to-underwrite lines of business. You can't walk down the street to your Nationwide or your Allstate guy or your Farmers guy and get these coverages. So think everything but personal lines that happens to be complex, one of their lines of business, one of their specialty lines, summer camps. Just think for a moment how hard that business must be to underwrite.

You've got counselors. You don't know who the counselors are. You don't know how they're going to behave. You don't know if the counselors may have a drug or an alcohol problem. You don't know exactly how safe the physical equipment is there. You don't know everything about systems and processes. And then you might have a camp in Georgia, which is going to have different risks than a camp in Maine.

So I likened the insurance underwriting business to being similar to the investment business. The first thing you have to do is be able to understand risks, where can I lose? In fact, it might even be more apt to compare an insurance underwriting to someone looking at a fixed income instrument. The first thing they're focused on is not losing money and trying to figure out where there might be vulnerabilities in the risk.

So these specialty admitted lines that Markel involves itself with are enormously difficult to understand, enormously difficult to underwrite. And I've used some terms here that probably ought to be defined. So you've got specialty risks, which are basically risks that aren't heavily regulated at a state level, let's call them non-admitted risks. Admitted business is generally more prosaic business. Think personal lines. These are heavily regulated at the state level.

And then you'll have specialty admitted, which is business that is regulated but has some novel twist to it that requires an additional level of underwriting. So it's not an accident that people like Buffett happen to be terrific underwriters and terrific investors because I think the skill set, quite frankly, is analogous. I think the overlay is almost, if not 100%, close to 100%."

Patrick: [00:15:27] **Saurabh, how does that feel to you inside the business and how quality or how high performance is architected? What does it mean to run a -- especially because it's happening across different kinds of insurance, it's not just car insurance, it's not just equine mortality or whatever other specialty lines they might be, what's above that, that allows them to be good and high quality in all these areas?**

Saurabh: [00:15:51] Just to give people examples and flavors of some of these lines, you mentioned equine mortality. There is hole in one insurance related to golf. There's insurance for paintings and museums. Peter mentioned errors and omissions. So all of these are specialty niche lines where if you've had the relationships for a long time, you develop your sense of data and underwriting discipline.

And you're at scale, and you're writing a huge amount of aggregate premium. In Markel's case, that's about $8 billion of underwriting or net earned premiums. But each line itself is a niche. So you're specialized and you're diversified. So that's the one layer above philosophy that we're going to be specialized in these niches, but we are going to be diversified across niches.

And then there is an incentive structure that aligns with long-term values underwriters are paid based on the underwriting profits they bring over multiple years. And Peter gave this perfect analogy, it's a little bit like a bank. But in any year, you could pretty much show whatever earnings you want to show. But over time, you'll know whether your loans work well. Similarly, whether the risks you're writing will show up over time.

And people are compensated over multiple years. So let's say, if you're an underwriter and you're paid on five-year profits, then you will do the right things for the long term. The second dimension of that, Patrick, would be that if this process is repeated over and over again, human beings are creatures of habits and businesses are collections of human beings. These become systemic. I think that's been helpful for Markel.

Finally, I would just make this finer point. If you're writing a $100 of insurance and you're making $8 of profit in your underwriting. Right away, you've made $8 in profit, but these dollars work on both sides. The insurance premiums you collect stay with you for a while. Markel's duration of insurance liabilities is three to four years. So if you look at Markel's investment portfolio, that's 3 to 4x the size of premiums. So let's do a simple math here.

You have $100 of premium, you're making $8 in underwriting. And if you have $300 in investments, which you hold at negative cost of capital, even if you're making 4% or 5% on that, that's adding $12 to $15 additional. So your overall pretax returns on equity become exceptional because there's a virtuous feedback loop. But it only works if these entities can stand on their own independently. Obviously, leverage works doubly badly if you're not underwriting profitably.

Patrick: [00:18:52] **Why aren't there 50 of these? That seems like the obvious question. If this is such a virtuous feedback loop between a collection of insurance businesses and lines of business on the one side, a well-run investment portfolio, not that either of those is easy to execute or do.**

But why did there seem to only be two examples of this in Markel and Berkshire, maybe there's a few others. It just seems like something that would be replicated or at least people would try to replicate the model all over the place. So why aren't there more set up like this?

Peter: [00:19:24] Because the insurance business is really hard. At its core, Patrick, it's a commodity. Although once you get into the specialty lines, it becomes less commoditized. But a lot of people have tried. In fact, I can't tell you how many money managers I've known who said, "Well, we want to get some permanent capital. We'll start an insurance company or buy an insurance company. We use that financial engine to fuel our investments, and we won't have to worry about capital coming and going."

It doesn't work that way. The insurance business is a hard, hard business, which is one of the reasons why Markel is exceptional. They've managed through their underwriting discipline and then to generate underwriting profits. So you have to get the insurance piece of it right before you can do the other stuff right, and it's hard to do. It's really hard to do.

Patrick: [00:20:14] **I remember asking Todd Combs one time. He made the point in an interview I was doing with him, I think, for Carr, that none of the four largest insurers had been founded after 1950, the ones that operated today were**

all extremely old businesses

So maybe even just zooming in on that hard part of insurance, why does that seem to be the case that the insurance businesses that lead the market today are all exceptionally old and really haven't been successfully attacked by new entrants or new technology or disruptive innovation or what have you.

Peter: [00:20:46] Saurabh said it, values live on. Rest of the stuff doesn't. And you can speak in the case of Markel, the value has been transmitted down through the generations. But again, insurance is a hard business. In many cases, the marginal price is set by the dumbest person in the business. That's why it's so hard. And so that's why these values have to be reinforced day after day, hour after hour, year after year. That's the only way you survive in the insurance business.

Patrick: [00:21:16] **Does this surprise you, Saurabh, given the -- studying the history of the insurance industry that there isn't really a great modern story of a new stand-alone insurance business, forget the tack-on investing portion that's come to dominate. Is that surprising to you for any reason?**

Saurabh: [00:21:32] So if I think about it from the ground up, just using common sense, lines where there is no pricing power that are highly regulated, over there, people with the highest scale and the longest streak of operations are probably likely to provide the cheapest cost. So that's where you would expect there to be just few winners and few big ones.

And they may not have the best economics, but that's what the industry lends to. When it comes to specialty insurance, Peter just said it, investors who are just seeking for permanent capital may not necessarily have the insurance acumen, which is not easy, which doesn't just come for free. And I think if I look at the flip side of that, somebody who gets promoted within an insurance company is not necessarily the world's best at capital allocation or investment.

Those are not the skill sets that the system filters for. So it almost requires a very deliberate and conscious focus against what happens in most places where you want to marry the circle of great capital allocation investing with the circle of skill set that comes in writing great insurance. And as simple as it sounds, it's not that easy.

How Markel Invests

Patrick: [00:22:54] **If we transition a little bit to talking about the investment portfolio, which was worth $7.5 billion at the end of last year, and it's really concentrated in its top holdings. I think it's really interesting that it took, whatever, five-plus decades, six decades of insurance operations before this investing portion, the investment portfolio started to dominate the headlines, if you will, about the business, I think Markel Ventures was after 2000.**

So just to make your point, it was a 70-year period before the founding of the business and Markel Ventures came to be. But can you talk a bit about the evolution of -- the start and evolution of the investment portfolio and what drives it? We haven't talked about Tom Gayner yet as an investor and as a leader of the business, maybe now it would be the appropriate time to do so, talk about Ned Reynolds. But talk about the evolution of the investment portfolio.

Saurabh: [00:23:43] So I think we've got to start in 1930 when Sam Markel first founded Markel in Norfolk, Virginia. And this was a family-owned insurance operation for the next two generations. The third generation actually had to collect money from their own selves and other sources to buy the business from the second generation.

And this is when Steve Markel, Tony Markel, Alan Kirshner; three key people with family ties who made a huge impact on Markel came to the scene. In 1980s, Steve Markel, who's one of the wisest people you might come across, he began investing in equities for Markel. 1986, Markel went public at $8 a share. And Tom Gayner at the time was an analyst at a local firm called Davenport, who began following Markel.

Steve and Tom developed a friendship and in 1990, Tom joined Markel. And it was Steve – I think, Tom would agree that Steve convinced Tom to buy Berkshire. The first Berkshire shares for Markel were purchased in 1990 for about $5,700 a share or thereabouts. And Tom thought they were expensive. How can anything above $1,000 be cheap?

But it worked beautifully for both Tom, Steve as well as the rest of Markel shareholders that this nascent equity portfolio began to evolve. There were two major developments that happened over the next few years. One was in 1990, Markel acquired Shand Morahan, which was another insurance-related operation, which doubles the size of Markel.

And in the late 1990s, Terra Nova was acquired. So these acquisitions sizably increased the size of the equity portfolio , which Tom was increasingly beginning to allocate just like it exists at Berkshire.

Patrick: [00:25:47] **If you think about the investing style, how would you characterize it? In the same way that you start to think about this as similar to underwriting an investment manager that you would give money to a mutual fund or something you'd start to dig into who's the principle?**

How do they think about business? How do they think about earning returns in excess of just putting this underwriting profit into the S&P 500 or something? What has become the Markel equity investing style? Is it the same story of values and systems there? Or is it something distinct?

Saurabh: [00:26:17] I think it's appropriate to begin with values. Markel's investing style is not to optimize for the next month or the next year or even the next three or four years. It is to try and optimize for the next 100 years. And what that means is that with that mindset, you end up doing things differently. You buy good businesses, good returns on capital, low debt.

Make sure that these businesses have a good reinvestment runway, run by people with equal measures, talent and integrity, those three. And the fourth criteria is a reasonable price. But Markel has been increasingly in a very disciplined and measured way, adding to its equities through all seasons. And what that allows is the simple dollar cost averaging into above-average businesses delivers above-average comp run rate results.

Patrick: [00:27:15] **Peter, I'm curious whether or not you think about it like I described, which is, it's like you're hiring an investment manager to manage money on your behalf with a really nice kicker of efficiency from the insurance side.**

Peter: [00:27:27] Well, it's got an element of that. But capital allocation is capital allocation. And as I alluded to earlier, I think there are great similarities between the investment process and the underwriting process. So I don't think it's an accident that these great property and casualty insurers also have terrific investors leading the charge.

Tom tells the story earlier in his career, maybe this is during the dot-com days of his monthly meetings with Steve Markel. And of course, like everybody else who was saying they were behind the markets during that period of time. And so Tom would go report to Steve and behind the market, market's doing this and our portfolio is doing that. And Steve would simply say, "I understand what you're doing, it makes sense. Talk to you next month."

Now, there is a structural advantage that property and casualty insurance industry has over traditional asset management in that, as Saurabh alluded. You walk out to the mailbox every month, and there's more money there, whereas the traditional money management business, as Charlie Munger has noted, is notoriously procyclical. You get money in the door when things are going and blowing, and it goes out the door when things are not. That's been the history of the investment management business and the mutual fund business.

There are some money managers who've been able to buck that trend. So that's one difference that a Markel and a Berkshire are going to have. You're hiring them to allocate capital. Then in the case of Markel, they've got three choices. They've got the insurance business, which they feed first. They've got the investment portfolio , the equity portfolio , and you mentioned it's about $7.5 billion, $8 billion, and then they've got Markel Ventures.

Patrick: [00:29:18] **Can you describe the Markel Ventures story and the key differences between Markel Ventures? How it's thought of? How it's operated versus the public equity investment portfolio?**

Saurabh: [00:29:28] So Markel Ventures began in 2005 with the acquisition of a company called AMF Bakery, which I think would have been a very small...

Patrick: [00:29:38] **It's like $14 million or something yes.**

Saurabh: [00:29:40] And since then, Markel has been buying businesses with somewhat more regularity. And now this collection of businesses spans the broad swath of the U.S. industrial economy, produces in the ballpark of $5 billion in revenues. So it's a sizable enough part for Markel. And I think the quality of businesses that Markel has acquired has improved over time.

Patrick: [00:30:11] **Can you define quality, what that means?**

Saurabh: [00:30:13] Yes. Quality in terms of returns on capital and so on. And that might even involve paying up a little bit more than maybe in the earliest of times when you were just nibbling and experimenting whether this would work. And one key advantage of Markel Ventures is that money can be moved within ventures or in and out of Markel Ventures in a very tax-efficient way.

So unlike public equities, there is total control of capital allocation when you own these companies in entirety. And on the flip side, while the public equities work and count as capital against writing insurance, so they work on both sides of the field. Markel Ventures, the regulators don't necessarily give you as much credit as they give you for publicly listed cash.

Patrick: [00:31:06] **And what are the implications of that from the capital allocator seats? So knowing that you get less credit, what does that mean in terms of capital allocation decisions when you're thinking about the three buckets of insurance, public, equities and Markel Ventures?**

Saurabh: [00:31:20] In terms of capital allocation, the first priority would be whenever you can grow your insurance business profitably, grow it. Whenever there are organic opportunities of growth or tuck-in acquisitions within the cash that is already being produced with Markel Ventures, keep doing that.

And then all the remaining cash goes into equities and fixed income almost programmatically. And these three operations have multiplicative effects on each other. So insurance capital, you're making money on insurance. You're also making money on equities that lets you write more insurance and vice versa. So there's multiplicative geometric effects.

Similarly, the fact that you have businesses in which you directly control capital allocation and you're getting the direct sense from the ground of what's happening in the real business world allows you to be a better investor. And the lenses you use as an investor also help you allocate capital in the businesses you directly control.

How Leadership & Strategy Built A Formidable Moat

Patrick: [00:32:21] **How would you compare the investment team and decision-making process to the more traditional long-only, let's say, mutual fund or institutional capital allocator with Tom at the top? So you'll see all different kinds of structures. Sometimes it will be one key investor decision maker. Sometimes it will be huge teams of portfolio managers and analysts. Where would Markel and Tom slot into the lineup, if you will, of how investment decisions are made and managed?**

Saurabh: [00:32:48] This is a good question. And I would say it's helpful to have some context and history of Markel. Back in the days when Steve Markel and Tony Markel were involved, and Alan Kirshner were involved, there are just stories and legends that Steve and Tony would have heated arguments and Alan would be a referee.

In the past decade or so, Tom and Richie were the co-CEOs And this year, Tom has taken charge as the sole CEO In terms of the team structure that you mentioned, Mike Heaton has taken over as day-to-day operations of the Markel Corporation level. Andrew Crowley is the President of Markel Ventures. And Jeremy Noble is the President of Insurance.

And at the highest level, these teams are very small. So as opposed to like a Wall Street fund or an institution where you would have large teams analyzing small pockets of the portfolio. At Markel, it's been smaller teams that scale.

Peter: [00:33:53] I would point out that if you look at Markel's shareholder roster, there's a lot of people who think like Tom and the Markels, who all take a simple, concentrated, fundamental, bottom-up approach to acquiring great businesses and great managers at a discount to the assessment of intrinsic value. If you walk into Markel's investment operation, I'm sure it's like ours.

There's no screens hanging from the ceiling. No people slamming phones. I think it was Chris Davis, who once said that he was proud of the fact that you could walk into his investment operation, you might be there for half an hour before figuring out that it was an investment operation because it had none of the trappings.

And I'm sure that that's the case at Markel. It's a commonsensical approach that doesn't require a fleet of analysts who are trying to figure out what the health care legislation is going to look like. And by the way, before we get too far afield, I think it's so important to talk about on the insurance side, Markel's conservative reserving posture.

This is an expression of the corporate values of discipline, integrity, honesty and humility, I might add. I think you'll find most insurance companies want to report as much income as they can on a quarterly basis to please the bank dogs on the sell side, not Markel. If you look at how their insurance reserves have worked over time, they historically have done what's known as release reserves. That's where they look back at prior years, say 2015.

So well, we over-reserved for that errors and omissions class of business that we wrote then, and we're going to now take those reserves into earnings. It takes discipline, honesty and integrity to do that. So the mantra inside the insurance operation there is they want reserves to be more likely redundant than deficient. And redundant in the insurance world means there's more than what you need.

So this is key to understanding how the investment engine operates and how this virtual cycle that Saurabh has talked about profits from the insurance engine, flowing into the investment portfolio, flowing into the Markel Ventures. You can look at plenty of insurance companies, and you can almost tell the quality of their underwriting from their investment portfolios.

100% bonds, they may not trust the reserves. Because they know that they need that money. So I just want to point this out because I think it's a critical piece of equipment in this engine that generates these -- what we hope will continue to be these magnificent returns.

Patrick: [00:36:38] **And I'm sure some part of that prudence or conservatism probably factors into my question around the investment strategy. And I'll ask the question that I've been on the receiving end a lot in the career in investing which is how could it be that with markets so seemingly efficient, a small team without crazy, fancy quantitative systems or something could still select securities that can outperform. I'm asking the efficient markets question, how could it be? Is it duration? What would you attribute that ability to, if you had to?**

Peter: [00:37:14] Buffett said that the stock markets and mechanisms for transferring wealth from the impatient to the patient. And to be patient, you don't need a fleet of analysts or you don't need to be close to a data center, so you get a 1 millionth of a second jump on your competition. And as Munger says, any IQ over 120 is wasted in this business. So you just need to be smart and have the right temperament. I jumped the question here, Saurabh, because I just couldn't restrain myself, but I would defer to you on this one.

Saurabh: [00:37:44] Yes, I think it's a fascinating question that I think about, too. And I don't think investing is the kind of game where adding a 21st member to your 20-member team is going to increase the quality of your results by 5%. It's not a committee decision-making sport. It's a sport where all you're trying to do is be rational and make independent decisions. And I'd argue that maybe having a smaller team helps in being independent.

The second thing I would add is just focusing on long-term values rather than day-to-day mark-to-market fluctuations creates a different mindset. So if you walked into the offices at Markel, it would be very hard for you to tell whether the market is up or down. Those are simple things, which you can't necessarily measure on a spreadsheet, but I think they make a difference over time.

Patrick: [00:38:38] **Is there anything in the investment portfolio either in ventures or in the public equity portfolio that you would draw people's attention to as like an exemplar position of some of these ideas of just a high return on capital, long duration, high-quality business? You mentioned Berkshire already, obviously that's one. But beyond Berkshire?**

Saurabh: [00:38:55] If you think about it, Markel's portfolio has maybe 100-or-so securities. But Berkshire alone, I would think, would probably be like a 10% position. So I would draw attention to the fact that Tom has allowed it to run. So it's not only long duration, but it's sizable enough. There's companies like Brookfield Asset Management in there, which also Markel has held for a long time.

And pretty much with any investment, including Berkshire, there would be like a five-year stretch where they might underperform the market. And if you were like a money manager having to report to your clients every few months, it would make it hard to hold those. But I think within the flywheel and the value system of Markel, that becomes possible.

Patrick: [00:39:46] **It's just an interesting thing to think about the willingness to let positions run like that and just have that alone is something that doesn't often happen. I've talked to Peter to Chuck about his position in American Tower, which I think over the course of them owning that position was like 100x return for them.**

It sounds easy in hindsight, but how ridiculously hard it is to let things work over time. Peter, does that resonate? Any insight you would have from a career thinking about investing in and holding businesses and the psychological or the external pressures that make that kind of story very rare?

Peter: [00:40:22] Yes. I gave a talk to some investors at a conference this weekend, and I told them that my biggest mistakes have not been the businesses in which I lost the most. I said it was the great compounders that I let get away because I sold them too soon because I had allowed some thinking about the market or the economy to possibly creep into my thinking. But in all cases, I outsmarted myself.

And so two, it goes with trimming positions, which I hear people talk about. It's like chewing on an aluminum foil when I hear that because your best businesses are likely to be the ones that have appreciated the most over time. And it's like Warren said, it's like cutting the flowers and watering the weeds.

So it's a lesson that I think many of us, myself in particular, have had to learn the hard way. But Warren said in his letter this year, "I get a good idea every five years." When I read that, I said, "Oh my gosh. That means I'm going to get one about every 50 years." So maybe I better hang up my spikes. In any event, you get the idea.

You have a small team, as Saurabh said. Saurabh said it so beautifully. You don't get 5% more by adding #21. In fact you probably subtract 10%. I try to seek out people like Saurabh. We have a small investment team here, and we augmented by talking to people like Saurabh and others. And we own American Tower too.

We were backyard in those days, and I'm guilty of having trimmed some of it. I hate to think about it. But fortunately, we hold onto most of it. But it's a matter of temperament, Patrick. And this goes back to what makes Markel a success, what makes Berkshire a success is you've got to have the right temperament.

You've got to be able to -- instead of panicking when things get tough, it's useful to have some predatory instinct that gets excited when things are coming unglued. And that's not brains, that's not ability, that's temperament. And you either have it or you don't. And I think it's a hard thing to learn.

Saurabh: [00:42:33] I think this American Tower investment is a legendary story for investors. And I think Peter is being modest. I think he was right in the center of activity when things reached a moment of crisis at American Tower. And it's also a story related to value. So I would urge Peter to share some color because I know this would be interesting to a lot of the audience.

Peter: [00:42:55] Sure. This is directly relevant to Markel because we've talked about values and culture being so important to what is otherwise a business that has some commodity characteristics. So I'll tell you the story of how values and integrity and honesty made the difference because you don't know until a company or a person or an institution is under fire.

So we were investors in American Tower, which is now the world's largest publicly traded REIT, I think. But it wasn't always the case where this huge company was regarded as a defensive, safety bid type business. In 2002, the company had a near-death experience. A landrush mentality had taken over the tower industry as an emerging wireless technology fueled an explosion in mobile bandwidth consumption requiring tens of thousands of new cell towers.

Gripped by FOMO, American Tower became levered to the hilt and all this work until the dot-com bubble burst and the banks suddenly wanted their money back. It didn't make a difference how beautiful your business model was and AMT couldn't do it. So American Tower's Founder and CEO, Steve Dodge, who'd had a terrific prior record as a capital allocator and per share value creator, at our request, agreed to see us.

In Boston, we had written the stock from the high teens to the mid-40s and back down to under $1. So off to Boston, we went. I think you mentioned Chuck Acre earlier, he was part of this meeting as well. So Steve agreed to see us. And when we went to see him, he was ashen and grim-faced.

And he said to us and I'm paraphrasing, "I have a company to fix and I can't waste any time, but you all were early investors who relied on my judgment, which has been revealed to be flawed. And I can give you an hour and I'll answer any questions to the extent it's legal for me to do so. What I can tell you is that this is the worst thing that has ever happened in my business career. I can't guarantee it, but I think we can fix it."

Steve was honest, transparent and humble. He didn't blame the Fed, the banks, the credit markets or the dog. He accepted full accountability for the company's condition and that meant as much or more to us than the extremely limited information he was able to give us.

We got back to D.C. and tripled the position and hold most of those shares to this day. But the moral of that story is not how smart we were because we weren't. The decision to invest or not invest was a function of our ability to trust the people who are throwing the switches at the company. We believe we could trust the guy who is throwing the switches, so we invested. The same is true at Markel.

As I said earlier, Markel, because of its reputation, is going to be forgiven by its investors. I wish more public companies understood this. Treat your investors as partner, treat them openly, honestly and transparently and they will forgive you when you misstep. If you're one of these highly promotional companies that continually focuses on 90-day increments, you will not be forgiven if 90 days is what's important to you. Compare that to Markel's 100 years.

How to Value a Business Like Markel

Patrick: [00:46:06] **This is going to be a hard question because it's just so not the case. But imagine you had to separate yourself from your understanding and history with Markel, and we're approaching it as a security for the first time today.**

It's got about a $17 billion market cap. How do you think about valuing something like this? Markel itself has done well by paying, say, a fair or below intrinsic value price for the securities that it's buying the businesses that it's buying. How do you think about intrinsic value for something like this that's really unique in its structure?

Saurabh: [00:46:37] If I were approaching this business for the first time, I would just go read Tom Gayner's annual letter first. And he describes the business as three engines working together, the insurance business, the public investments portfolio and the Markel Ventures side. So I would just look at what is each of them basically worth.

And at a very, very high level, the insurance business has somewhere in the ballpark of $8 billion in net earned premiums. And Markel has made profits on these premiums for 16 out of the last 20 years. Tom's aspiration is the 10-5-1 plan for this to grow to $10 billion in 2025 and for Markel to be making a $1 billion profit out of it. That would be in the insurance language 90% combined ratio.

That means a 10% margin. So even if you penciled 95% combined or 5% margins on today's premiums, that comes to around $24 a share of Markel. Markel shares are around $1,300 today per share. Markel Ventures has similar earnings power, in my opinion. So if you pencil a 6% or 7% net margin on their $5 billion of revenues, you combine it with insurance, rough, rough math, both of these businesses produce about $50 per share in earnings power.

The interesting part is let's look at the investment portfolio now. So per share of Markel, as shareowners, we own roughly $2,000 per share of investments, around $7.7 billion of that is equity.

So that's around $5.67 per share or roughly 1/4 of that. Even if you make 5% return on this investment portfolio, that's roughly $100 pretax in earnings power. So combine that with the earnings power of Markel Ventures and underwriting, adjust for taxes and interest, you can argue, but it's not unreasonable to say the earnings power is somewhere in the neighborhood of $130 to $150 a share. So at $1,300, Markel is trading at 10 or 11, maybe 12x depending on your number.

The fascinating part is Markel, this $2,000, out of which around $1,500 is in cash or fixed income in a 0% interest rate environment doesn't earn much. But in a 5% interest rate environment, it starts adding dollars, which are almost 100% profit margins. So the earnings power and ROE for every 100 basis point change in interest rate, you could come up with your own estimates, which you could argue within reason that increases by 200 basis points.

Peter: [00:49:36] I think that we arrived at the same earnings power. The 10-5-1 is an aspiration. 10 underwriting points in the insurance business is a hard thing to do in any year. It's even harder to do for five years. So just to be on the conservative side, we did 5-5-1, five underwriting points. And with some nonheroic assumptions with respect to returns on equities, let's call it, 6% on equities. Let's call it, 4.5% on the taxable fixed income portion of the portfolio, and subtract out most of the cash and cash you might get, what, 2%.

And we arrive at roughly the same figures that Saurabh mentioned. We think that by the time the measurement period for the 10-5-1, which we have recast is 5-5-1 rolls around. We're looking at earnings per share of $140. And I think you need to draw the circle wide enough. Now, I'm sure we'll get to the risks in the business. They're in the insurance business, and they're in the business of insuring the unimaginable.

So it won't be five points every year. It won't be 10 points every year. But the fact of the matter is they have to be given credit for the underwriting discipline that argues in favor of underwriting profits. And I think it might be worth pointing out that they acquired a reinsurance business in 2013. And our experience in reinsurance since then has not been good. They had a profit in the reinsurance business and underwriting profit in 2022, but it's been a long road to get there.

And so I think we're making an assumption that actions have been taken to strengthen the results in the reinsurance side of the business. Markel clearly has the willingness and the ability and the discipline and the values to walk away from poorly-rated business. They have done so in the reinsurance business. They are no longer writing a property catastrophe business in that world.

Underwriting results are likely to benefit from the roll-off of some of these problematic reinsurance funds that have plagued the company for 10 years. The fact that they've had these terrific combined ratios over the past 10 years has masked the fact that they've been having some difficulties in the reinsurance world. So the way Avenir looks at it, reinsurance is under control.

Just getting it under control liberates a lot of underwriting profit. The recent increase in interest rates, we have never have an opinion on interest rates, but let's just say they stick roughly at these levels. It's going to have a magnificent impact on investment income in the years to come. So you take the combination of those things and the results from Markel Ventures, which we think Markel Ventures ought to do actually better than the public equity portfolio.

We think a higher return hurdle should be applied to those assets. Because as Saurabh pointed out, the public equities and the bonds are two-way players. They satisfy regulatory capital environments and contribute investment income. Markel Ventures does not satisfy regulatory requirements, although you can move capital around from ventures into the insurance company or tax efficiently than you can with an investment portfolio.

But all that said, I would still argue that ventures ought to generate a higher return, ought to have a higher hurdle rate than the rest of the portfolio. So no heroic assumptions with $140 a share in earnings. And of course, as is Markel's historic practice, those earnings are probably economically higher because the tenant seats are reserved conservatively.

Lessons and Takeaways From Studying Markel

Patrick: [00:53:39] **I love the discussion on pricing. I think it's so interesting. And it makes me think about the role of key people in the business. I had a friend who -- we were talking about investment management organizations and it's more of a thing, but he calls it the bullet test, which is like how many partners, let's say, can somebody lose and still have the business survive?**

So let's say Goldman Sachs, for example. A lot of Goldman partners could go away and leave it, go to a different job and Goldman would be okay. A lot of investment management firms, the lead partner leaves, the thing is gone. The business walks out the door each afternoon.

How do you think about that vis-a-vis Tom and others who lead investment-making decisions? And obviously we've talked a lot about the counterbalance to this, which is enduring culture, value, systems.

But I do think reading the letters and everything Tom, for instance, is an incredibly -- we've sung his praises to some extent already. He is an incredibly important part of the business. How do you think about something like key man risk and even thinking decades ahead when Tom is no longer running the business about that aspect of what drives returns

for Markel?

Saurabh: [00:54:41] And I might sound like a beaten record here, but I'll go back to the idea of values. As long as those values are systemic, they can endure. But I would argue that Tom and maybe the topmost layer of Markel leadership are just exceptional people who have done an amazing job in institutionalizing these values and making them systemic. Tom's not even 60 yet.

So he certainly has a long runway ahead of him, and I hope he continues to take great care of himself. But I do think that Markel increasingly becoming a company more strongly tied to its values, does some work to mitigate the risk as well as the fact that the leadership player below Tom is much younger than him.

Patrick: [00:55:29] **Maybe you guys can also just talk a bit more about some of the other risks and/or challenges that you most think about as it relates to Markel.**

Peter: [00:55:37] Markel is in the insurance business. As I said earlier, there's a commodity aspect to it and prices are set by the dumbest guy around. People do the unimaginable. They fly planes into buildings, pandemics occur. So we don't know what the unimaginable is, but that's what we're concerned about. So they're in the insurance business, that's the risk.

Saurabh: [00:55:58] And if I could add to that, I think the insurance business at Markel is not a monolith. There is a specialty business that we've talked about at fair length, but there's also a part of the business that is reinsurance, for example. And that tends to be a more challenging business, also more episodic. And it's also more capital intensive.

I think it's fair to also discuss that Markel's shares in the last five-or-so years in the recent past have not delivered the same kind of performance that they did in their first couple of decades.

Part of that is a function of things that are outside one's control, things like interest rates and so on. But I think there's a part that is example of unforced errors, as you would call them, in tennis.

Peter: [00:57:02] Well, of course, it's the unforced errors that you can't guard against. You don't know them when they're being committed. But Saurabh, you've talked about this being a 100-year business. And if you have talented people, above-average people, over time, that above-average capability is going to express itself in above-average returns. It's real simple.

Patrick: [00:57:21] **Peter, what is your experience with Markel changed about how you invest or approach other businesses?**

Peter: [00:57:28] I don't know that it has changed how we invest or approach other businesses. I think that we've learned a lot about how hard the property and casualty insurance business is by talking to the people at Markel for decades now. To add on to what Saurabh said, businesses are collections of values, and they're the values of the people who run the business.

Your personal values and your business values should be one in the same so far as I'm concerned. And businesses will attract magnetically people who share similar values. We see this all the time. Talented people with good values find each other. Whether it's a church, whether it's on the baseball team, whether it's in the corporation, they find each other. And the people who have less attractive values find themselves and they organize themselves in the businesses some time.

So I think that there's people one layer down in Markel who have a deep sense of buy-in to these values were talented people. And we've spoken to them. Tom is unique. If you've ever heard him speak, you know that. So it's not like we're going to replace Tom, if God forbid, something happens to him. But there'll be someone else who do an excellent job because there's just, in my judgment, a significant level of buy-in of these values throughout the corporation.

Patrick: [00:58:54] **Saurabh, what has the most surprised you switching from an outsider to an insider? I always find this transition fascinating when someone that's interested in the business, an investor or some other role has a model of what a thing is and then goes to be inside that thing and something changes, some things more or less than you thought. What jumps to mind when you think about that transition and what you've most learned that surprised you the most?**

Saurabh: [00:59:19] I've begun to appreciate simplicity even more. So you read all these things about Markel, but you don't really know they're actually true until you've been on the inside and seen, yes, that's how it is actually run. It's a small investment team. There are no Bloomberg terminals flashing all the time and so on.

Similarly, it's a set of values that are talked about often across businesses. What I've also grown to appreciate on the flip side is that these things sound simple, but they're not easy. They are unusual and people question this way of doing things all the time. If you bring consultants, they would ask you to optimize.

And at Markel, one interesting factoid is you have all these Markel Ventures companies. If you consolidated the HR and so on, you could save money. And on a spreadsheet, you could totally argue that why not do it. But Tom has always referred to them like LEGO blocks. Even if one of these breaks, it can be replaced and it doesn't bring the whole building down.

So designing that with simplicity so that they endure for the long term will require you to forego optimization. And it's counterintuitive. It doesn't take more IQ points, but it does take more empathy points and more caring points. Charlie Munger, when he was recently asked, "What is the one quality that makes Warren Buffett very successful at DJCO?"

He talked about his ability as a thinker and a learner. But what he emphasized most on, he said, "Both Warren and I have had the fiduciary team. We care about what happens to our people." And that's how I think about the leadership at Markel. They really care. It's just my belief that over time that, that will pay off.

Patrick: [01:01:06] **We like to close these conversations by asking for you to abstract from all of your experience with the company Markel in this case. One lesson for investors and one lesson for operators, entrepreneurs that you think this business can teach, and I'll let you take whichever those and whatever order you'd like. Saurabh, maybe we'll start with you.**

Saurabh: [01:01:26] I would say character and culture are the only things that last. And related corollaries, think about the game you're playing. Are you playing a finite game? Are you playing an infinite game?

And somebody who's in the game of abiding by the right values is playing an infinite game, in my opinion, because values endure. You may not always win the next 100-meter lap, but values can endure and do very well over the long marathon of life.

Patrick: **[01:01:57] How about you, Peter?**

Peter: [01:01:59] I can't say it better than Saurabh said, but the lesson for both is exactly the same in my line, find people of good character.

Patrick: [01:02:07] **Simple as that. Let it run. Thank you, guys, so much for a really interesting conversation on a unique business. Again, I think the common question I asked that, kind of lazily, is why aren't there more of these? I think we've done a good job answering that question today. Thank you, both, so much for your time.**

Peter: [01:02:24] You're welcome, Patrick. It's been nice to be with you.

Saurabh: [01:02:26] Likewise. Thank you so much.