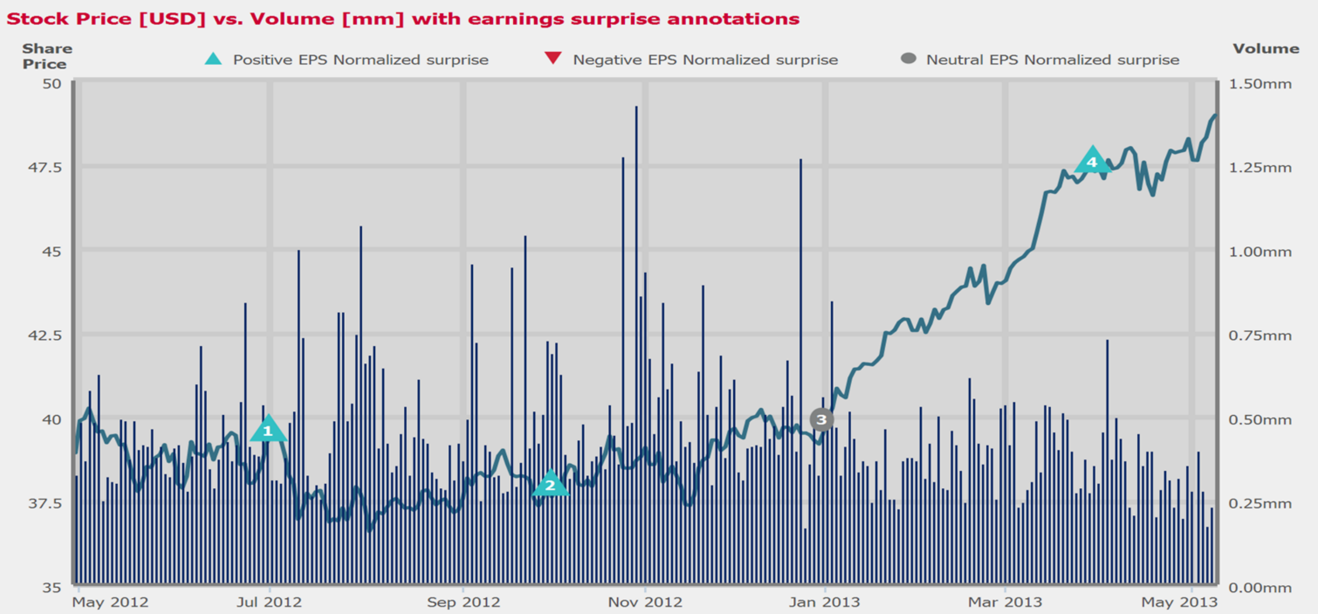
S&P Global
Market Intelligence

American Financial Group, Inc. NYSE:AFG
FQ2 2013 Earnings Call Transcripts
Tuesday, July 30, 2013 3:30 PM GMT
S&P Global Market Intelligence Estimates

	-FQ2 2013-			-FQ3 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.86	0.96	11.63	0.99	3.99	4.40
Revenue (mm)	771.40	709.00	(8.09 %)	787.45	3049.15	3482.10

Currency: USD
Consensus as of Jul-30-2013 1:29 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2012	0.79	0.91	15.19 %
FQ3 2012	0.60	0.82	36.67 %
FQ4 2012	0.67	0.67	0.00 %
FQ1 2013	0.81	0.92	13.58 %

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Call Participants

EXECUTIVES

Carl Henry Lindner
Co-President, Co-CEO & Director

Craig Lindner
Former Co-President and Director

Diane P. Weidner
Assistant Vice President of Investors Relations

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

ANALYSTS

Amit Kumar
Macquarie Research

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Good morning. My name is Salima and I will be your conference operator today. At this time, I would like to welcome everyone to the American Financial Group 2013 Second Quarter Results Conference Call. [Operator Instructions] Thank you.

I will now turn today's conference call over to Diane Weidner. Please go ahead.

Diane P. Weidner
Assistant Vice President of Investors Relations

Thank you, Salima. Good morning and welcome to American Financial Group's second quarter 2013 earnings results conference call. I'm joined this morning by Carl Lindner III; and Craig Lindner Co-CEOs of American Financial Group; and Jeff Consolino AFG's Chief Financial Officer. If you're viewing the webcast from our website, you can follow along with the slide presentation if you would like.

Certain statements made during this call are not historical facts and may be considered forward-looking statements and are based on estimates, assumptions, and projection, which management believes are reasonable, but by their nature subject to risks and uncertainties. The factors which could cause actual results and/or financial conditions to differ materially from those suggested by such forward-looking statements include, but are not limited to those discussed or identified from time to time in AFG's filings with the Securities and Exchange Commission, including the Annual Report on Form 10-K and quarterly reports on Form 10-Q. We do not promise to update such forward-looking statements to reflect actual results or changes in assumptions or other factors that could affect these statements.

Core net operating earnings is a non-GAAP financial measure, which sets aside significant items that are generally not considered to be part of ongoing operations, such as net realized gains or losses, effects of certain accounting changes, discontinued operations, and certain non-recurring items. AFG believes this non-GAAP measure to be a useful tool for analysts and investors in analyzing ongoing operating trends and will be discussed for various periods during this call. A reconciliation of net earnings attributable to shareholders to core net operating earnings is included in our earnings release.

Now, I'm pleased to turn the call over to Carl Lindner III to discuss our results.

Carl Henry Lindner
Co-President, Co-CEO & Director

Good morning. We released our 2013 second quarter results yesterday afternoon. I'm assuming everyone is reviewed our earnings release and the investor supplement that's posted on our website.

We are pleased to report an adjusted book value per share of $44.78 as of June 30th, 2013. This represents growth of 2% during the quarter. Net earnings were $1.20 per diluted share and include $0.28 per share of realized gains and a charge of $0.04 per share for guaranty fund assessments related to Executive Life Insurance Company of New York, an unaffiliated life insurance company.

Annualized return on equity was 11.1% for the 2013 second quarter; compared to 10.2% for the second quarter of last year.

Our core net operating earnings of $0.96 per share were 5.5% higher than the comparable prior year period and include a 39% increase in pretax core operating earnings in our annuity segment with lower underwriting profitability within our Property and Casualty segment. Annualized core return on equity was 8.9% for the 2013 second quarter.

Based on AFG's results in the first 6 months of the year we have modified guidance in each of our Specialty Property and Casualty groups, but we have not changed our overall guidance for Property and

Casualty net written premiums or combined ratios. We have increased our core pretax operating earnings in our Annuity and Run-off segments, the details of which Craig and I will share later in the call.

Our core operating earnings guidance for AFG has been increased to $3.70 to $4.10 per share, from our previous estimated range of $3.60 to $4.00 per share.

Now, let me begin with a review of our Specialty Property and Casualty results, which are summarized on Slides 4 and 5 of the webcast.

On Slide 4, you will see the summary results for our Specialty Property and Casualty group. The Property and Casualty, Specialty insurance operations recorded an underwriting profit of $21 million for the second quarter of 2013 and generated a combined operating ratio of 97%, a 5.2 point increase from the second quarter of last year. Lower profitability in our Property & Transportation and Specialty Casualty Groups were partially offset by higher profitability in our Specialty Financial Group.

Catastrophe losses were $19 million or 2.6 points in the second quarter of 2013, compared to $6 million or 0.8 points in last year's second quarter.

Gross and net written premiums grew 2% overall when compared to the 2012 second quarter, with double-digit premium growth in our Specialty Casualty and Specialty Financial Groups, partially offset by lower premiums in our Property & Transportation Group.

We did have spring planting delays that resulted in late acreage reporting in our crop insurance business, which impacted overall Specialty Property and Casualty premiums for the quarter. Excluding our crop business, gross and net written premiums for the second quarter was 15% and 10% respectively, when compared to the 2012 period.

Over 2/3 of our Property and Casualty businesses reported pricing increases during the second quarter, helping us to achieve about a 5% overall renewal rate increase. This follows a similar increase in the first quarter of 2013 and is the 7th consecutive quarter that we have reported overall price strengthening.

Loss cost trends, continue to be stable, appear to be benign across almost all of our Property and Casualty businesses. Frequency is generally flat and severity is tracking reasonably well with the core consumer price index.

One Slide 5, you will see a few highlights from each our of Specialty Property and Causality business groups. Property & Transportation group our largest sub-segment by premiums reported lower profitability in the quarter, primarily the result of lower earnings in our transportation business and higher catastrophe losses.

I'm disappointed in the poor underwriting results reported by this group during the quarter, particularly of 52% owned National Interstate sub, where increased claims severity heavily impacted transportation results. We remained committed to obtaining appropriate rate increases in this business, and we'll reduce premium volume as needed until we know that we can get the pricing right.

Losses from spring storms in the southeastern U.S. were the primary hurdle for the non-transportation businesses and the source of catastrophe losses in our property and inland marine operations. Catastrophe losses for this group totaled $18 million for the quarter, compared to $4 million in the prior year period.

Gross and net written premiums were down 16% and 11% during the second quarter of 2013. Although, if you exclude crop insurance gross and net written premiums grew by 6% and 3% respectively, when compared to the 2012 second quarter.

As discussed earlier, crop premiums were lower in the second quarter because excess moisture resulted in delays in planting spring crops, which subsequently delayed acreage reporting.

Crop premiums always impacted by annual planning decisions by each farmer. It's not until acreage reporting time that we know what corps have been planted allowing us to determine and record the premium. Each year the timing of premium recognition is a bit different due to planting progress. This year's lower second quarter crop premium is the result of this variability. We expect a catch-up of these premiums in our third quarter results.

Net written premiums in this group were also impacted by the increased cost of reinsurance programs during the second quarter. Our property and inland marine treaty increased in response to recent loss experience. And as we reported last quarter, our crop insurance excessive loss treaty was renewed at an incremental cost of about $2 million.

Yesterday's USDA reports indicate that corn and soybean crop conditions are very favorable, with both crops developing one to 2 weeks behind historical trends. Also, in addition to yield, we track moderate futures prices closely, may serve a key role in determining profitability in our crop insurance business. Our crop futures are currently trading at around $4.73, down about 16% from the spring discovery price. Our insured share portion of the commodity price risk through deductibles that they choose of up to 35%.

And we recently renewed our crop quota share reinsurance agreement; it's a 5 year agreement that commences with the 2013 reinsurance year. I'm pleased that terms and conditions are similar to our prior agreement.

Overall, renewal rates in the Property & Transportation group increased 6% on average for the quarter, following a 5% increase achieved in the first quarter of 2013.

Our transportation and property and inland marine businesses reported sequential price increases for the quarter, consistent with our goal to get rates where they need to be to improve profitability at these operations. Our National Interstate Sub and our Transportation businesses achieved quarterly price increases of 7% and 8% respectively and our property and inland marine business achieved a 7% increase.

Specialty Casualty group second quarter underwriting profit was slightly lower than the 2012 second quarter. An improvement in accident year results was offset by lower favorable prior year reserve development. Most of our businesses in this group produced strong underwriting profit margins during the quarter.

Gross and net written premiums were up 23% and 16% respectively for the second quarter of 2013 when compared to the same prior year periods. While nearly all businesses in this group reported growth, our workers' compensation and excess and surplus lines were the primary sources of the higher premiums. New business opportunities, increased exposures from higher payroll on existing accounts, strong retentions, and higher renewal pricing have contributed to the growth in our workers' comp businesses. In addition, new business opportunities and general market hardening have generated increased premiums in several of our excess and surplus lines businesses. Renewal pricing in this group was up approximately 5% for the second quarter following a 6% increase achieved in the first quarter of 2013.

Our executive liability, California workers comp and excess and surplus lines business has achieved the highest increases. Our executive liability operations obtained 10% rate increases in consecutive quarters in 2013, and we achieved a 9% increase in our California workers comp business during the second quarter, following a 13% increase in the first quarter.

The Specialty Financial group reported higher underwriting profit in the second quarter 2013 when compared to the prior year period, due primarily to higher underwriting profit in our financial institutions business, primarily from lender-placed mortgage property insurance. Businesses in this group continue to perform well achieving an overall combined ratio of 86.6%.

Gross and net written premiums were up 16% and 15% for the 2013 second quarter, respectively from the comparable 2012 periods. Gross written premiums increased primarily as a result of growth in lender-placed mortgage property insurance. Despite experiencing some pricing pressure we benefitted from changes in the competitive marketplace and we've added several new accounts in this book of business.

Renewal pricing in this group was down 1% for the second quarter, following a 1% increase achieved in the first quarter.

Now, let's turn to Slide 6 for an overview of the 2013 outlook for the Specialty Property and Casualty operations. Our objective is to achieve an increase of 4% to 6% in the Specialty groups overall renewal rates in 2013. We continue to expect to achieve a combined ratio between 91% and 95%, and net written premiums in our Specialty Property and Casualty operations expect to be 8% to 12% higher than the last year levels.

We have adjusted our 2013 expectations for the Property & Transportation group. We now expect this group to produce a combined ratio in the 95% to 99% range, 3 points higher than our previous estimate. Our guidance assumes normalized crop earnings for the year, and we estimate this group's net written premiums to be up 2% to 6% slightly lower than the range of 3% to 7% estimated previously. Embedded in the guidance is our expectation that full year 2013 crop net written premiums will be slightly lower than 2012.

We expect Specialty Casualty group to produce a combined ratio in the 89% to 93% range, an improvement from a range of 91% to 95% estimated previously. And we now anticipate net written premiums will be up 15% to 19% based on strong growth in the first half of the year and indications of market hardening and continued growth in our workers' comp and E&S businesses. This is an increase from the 13% to 17% increase in our previous guidance.

And we expect the Specialty Financial groups combined ratio to be between 87% and 91%, a slight improvement from the 88% to 92% estimated previously. We continue to project net written premiums to be up 11% to 15% in this group primarily the result of the growth in our financial institutions business.

Finally, we continue to expect 2013 Property and Casualty investment income to be about 5% lower than last year.

Now, I'd like to turn the discussion over to Craig to review our results in our annuity segment investment performance.

Craig Lindner
Former Co-President and Director

Thank you, Carl. The Annuity segment reported record quarter pretax operating earnings in the 2013 second quarter that were 39% higher than the comparable 2012 period as you'll see on Slide 7. The increase in core pretax earnings was primarily a result of growth in annuity assets and the favorable impact that rising interest rates had on AGF's fixed indexed annuity reserves.

Annuity premiums of $861 million in the 2013 second quarter increased sequentially by $237 million or 38% from the first quarter of 2013. This strong growth reflects successful distribution channel expansion, as well as new product development. In fact, we announced last week that several of our Great American Life fixed indexed annuity products are now offered by Wells Fargo Advisors.

Year-to-date 2013 annuity premiums were down 13% from the comparable 2012 period. This decrease was anticipated and reflects rate and commission actions taken by AFG in response to the exceptionally low interest rate environment.

The focus of our annuity business is to maintain appropriate spreads on our base of invested assets. On Slide 8, you'll find a comparison of average fixed annuity investments, average fixed annuity reserves, the net interest spread earned, and the net spread earned. Over the last year fixed annuity investments at amortized cost have grown by 14%, and average fixed annuity reserves are up 12% compared to the last year.

Our net interest spread earned, which represents the difference between net investment income earned and interest credited was 302 basis points during the second quarter of 2013. This decrease of 14 basis points from the comparable prior year period was due primarily to the run-off of higher yield investments.

Compared to last quarter, net interest spread earned was 3 basis points higher. The net spread earned represents our net interest spread plus expenses, plus or minus any impact that fluctuations in the stock market or interest rate have on the accounting for a fixed indexed annuity assets and liabilities.

For the second quarter of 2013, the net spread earned was 165 basis points, an improvement of 23 basis points from the second quarter of 2012, reflecting the impact that higher interest rates had on AFG's fixed indexed annuity business, partially offset by the run-off of higher yielding investments. Compared to the first quarter, net spread earned widened by 7 basis points. Additional information about the components of these spreads for AFG's fixed annuity operations can be found at AFG's Quarterly Investor Supplement posted on our website.

Please turn to Slide 9 for an overview of the 2013 outlook for the annuity segment as well as the run-off long-term care and life segment. Our average annuity investments and reserves grew between 3% and 4% during the second quarter, a trend we expect to continue through the third and 4th quarters of 2013.

Although net interest spread was up about 3 basis points in the second quarter, we expect these spreads to narrow as higher yielding investments in our portfolio continued to run off. Furthermore, we expect net spreads, which were impacted by stock market performance and interest rates, to be closer to 130 to 140 basis points in the second half of the year as compared to approximately 160 basis points earned in the first half of the year.

With consideration given to these factors, we expect 2013 full year core pretax operating earnings in our annuity and run-off long-term care and life segments to be 13% to 18% higher than the $252 million reported for the full year of 2012. Based on strong sales during the second quarter, we now believe the annuity premiums will be flat to up slightly for the full year as compared to last year.

Now, please turn to Slides 10 and 11 for a few highlights regarding our investment portfolio. AFG recorded second quarter 2013 net realized gains of $26 million after-tax and after deferred acquisition costs compared to $9 million in the comparable prior year period. Unrealized gains on fixed maturities were $462 million after-tax, after-DAC at June 30, 2013, a decrease of $257 million during the quarter reflecting the impact of rising interest rates.

As you will see on Slide 11, our portfolio continues to be high quality with 86% of our fixed maturity portfolio rated investment grade and 96% with an NAIC designation of 1 or 2 its highest 2 categories. We have provided additional detailed information on the various segments of our investment portfolio in the quarterly investor supplement on our website.

I will now turn the discussion over to Jeff who will wrap up our comments with an overview of 2013 consolidated second quarter results.

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Thank you, Craig. Slide 12 shows highlights of our consolidated income statement for the 3 months period ended June 30, 2013, and 2012 by sources of earnings. This table summarizes the segment results Carl and Craig just reviewed with you and highlights other key items impacting AFG's consolidated results.

Starting with core net operating earnings per share, AFG generated a 5.5% increase in core net operating earnings per diluted share to $0.96 per diluted share in the second quarter of 2013, as compared to $0.91 in the second quarter of 2012. We accomplished this despite a slight decrease in our core net operating earnings year-over-year, thanks to the effective share repurchasing activity.

Core net operating earnings for the 2013 second quarter were $87 million as compared to $90 million in the prior year's quarter. Weighted average diluted common shares are 7% lower, though, at $91.5 million in the second quarter of 2013, down from $98.0 million in the year ago second quarter.

Looking at segment results, our P&C segment operating earnings were $82 million in the second quarter of 2013, compared to $103 million in the comparable 2012 period. This is a decrease of $21 million. Carl has discussed the factors impacting underwriting income in the Specialty P&C group, which consisted of elevated levels of cat losses year-over-year, lower levels of reserve release, and disappointing results for our National Interstate Subsidiary. P&C net investment income declined by $4 million year-over-year in line with our expectations.

As Craig described, annuity segment earnings were up $23 million or 39% during the second quarter to a record $82 million, matching the P&C insurance group result. The 3 basis point increase in interest spread earned from the first quarter to the second was the result of higher levels of cash invested in the second quarter.

Earnings contributed by other operating segments declined year-over-year by $19 million. It's important to remember that the second quarter of 2012 included $12 million in earnings from our Medicare supplement and critical illness business, which were sold effective August of 2012.

Interest expense in the quarter was $17 million, $1 million less than the prior year period. Other expense decreased by $2 million during the 2013 second quarter.

Finally, annualized core operating return on equity was 8.9% for the 2013 second quarter, compared to 9.2% in the second quarter of 2012.

Turning to Slide 13. AFG's adjusted book value per share increased 5% during the first 6 months of 2013 to $44.78. Tangible book value on an adjusted basis at June 30th, 2013, was $42.38. Our, capital adequacy, financial condition, and liquidity remained strong. We maintained sufficient capital in our insurance businesses to meet our commitments with the rating agencies. Our excess capital was approximately $650 million at June 30th, 2013. This includes cash at the parent company of approximately $265 million.

During the second quarter of 2013, AFG repurchased 1.4 million common shares for an aggregate price of $67 million or an average price of $48.37.

On Slide 14, you will find a recap of the 2013 guidance for AFG's core net operating earnings, as well as guidance discussed earlier in this call for key financial measures in the Specialty Property and Casualty operations at the Annuity segment. These 2013 expected results exclude non-core items such as realized gains and losses, as well as other significant items that may not be indicative of ongoing operations. With that said, we would now like to open the lines for any questions.

Question and Answer

Operator

[Operator Instructions] The first question comes from the line of Amit Kumar with Macquarie.

Amit Kumar
Macquarie Research

May be 2 or 3 quick questions. First of all, just going back to the discussion on NFGL[ph] and I'm not sure you can speak with them. The way I understand is that there were 2 components, one was unusually large claims, and secondly, there was some development on business, which is already in run-off. Can you just sort of briefly expand on was there anything beyond that, should we worry about this going forward or do you think that this has been put to bed this quarter?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Amit, this is Jeff Consolino. We can speak for National Interstate; they're consolidated in our financial results. But I would encourage you to get a whole of their conference call transcript from their call, which occurred this morning at 10 o'clock, if you want to drill into what National Interstate discussed.

In summary, the result was driven by the competitive conditions in the commercial auto market that have emerged over the last several years. And National Interstate discovered that they were not as conservatively reserved as they wanted to be specifically for accident year 2011, and specifically, because of emergence of severity, which trends did not abate, the solution for this was to erase the rates across the business segments and on the call National Interstate discussed that they have walked away from approximately $35 million in premium year-to-date.

Management further discussed their willingness to walk away from as much business as required in order to restore their margins. So we think it’s the appropriate move for them to get the reserves to the level that they are at, they are not operating at an accident year level of profitability that we like to see them at. But we have every confidence that the management's corrective plan will result in restoring those margins overtime and we support management in those endeavors to make that happen.

Amit Kumar
Macquarie Research

And in the reserve review was that internal, external, or was that generated by something else?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

National Interstate's management, including financial management, undertook to study the results in conjunction with actuarial resources from American Financial Group.

Amit Kumar
Macquarie Research

The other question I had was just going back to the crop discussion and the timing; can you sort of probably talk about what level of premiums will now shift into Q3 from Q2?

Carl Henry Lindner
Co-President, Co-CEO & Director

I think probably the important thing to focus on Amit is I think I mentioned based on our guidance that our crop premiums when all said and done will be down little bit, low single-digit decreases in that. So whatever the shortfall because of late -- kind of the rate planning in that will be caught up in effect in the third quarter. So, the miss in premiums from where we had projected this quarter will fall into the normal third quarter premiums that get reported will be there but then the catch-up from the reported this quarter will fall into the third quarter. And I think, I would point you towards where we're going to end up and that's we think that our overall crop premiums will probably be down to 2% to 3% or something like that.

Amit Kumar
Macquarie Research

I guess I was trying to figure out the variability and the street estimates versus the possible variability because of the timing in Q3, but I can come back to that offline. I guess the only other question I had was firstly on the discussion on excess capital and talking about the utilization of capital. And I'm curious as you look forward and obviously you've bought back a meaningful amount of stock in the past, what is the sort of the next level, I mean you've talked about looking at M&A candidates, but I'm curious is there some sort of urgency saying that we have to get to probably a low double-digit sooner than later or is it more so let's keep on evaluating opportunities as they present themselves?

Carl Henry Lindner
Co-President, Co-CEO & Director

I think we're kind of business as usual. We don't ever try to let cash burn a hole in our pocket. We have great growth opportunities both on the Annuity and Property and Casualty side. We're doing opportunistic share repurchase when it makes sense and we're going to continue to look at consecutive increases in our dividend and we're always active in the M&A side. And as mentioned before, generally you find us is in a starting things up or doing things in the $50 million to $500 million type of size and that's our bread and butter. So those are the kind of things we continue to look at.

Amit Kumar
Macquarie Research

I guess what I was also trying to ask is the buyback and especially where the stock is trading at now. I mean does that thought process change going forward as you look towards 2014 or how do you think of capital return versus the net income being generated in the quarter exclusive of any consolidation?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Amit, this is Jeff. In the quarter just behind us the second quarter when you aggregate our earnings minus dividends and repurchases, we still fully repurchased the aggregate amount of net income in the quarter. There were no explicit goal to buyback or otherwise dispose of profits over and above our ordinary dividend.

As Carl said, the mantra is to be thoughtful about return on capital not to let the excess capital "burn a hole in our pocket" and deploy it when we can meet our return thresholds. The change in the stock price obviously changes the dynamics in terms of the return opportunity in repurchasing stock. So we will keep our powder dry and use that capital when we see outstanding opportunities.

Amit Kumar
Macquarie Research

But is there is a longer term or medium term return -- I'm sorry, longer or medium term return like return on equity goal or not?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Again, this is Jeff. This company understands very well the returns they're getting in the core businesses whether it's the Annuity business or the Specialty Property and Casualty businesses that's measured on an ongoing basis and that's the foundation for the targets that the employees have in those segments for achieving their personal goals. So we can maintain a return on capital discipline at the unit level without having to worry about the total consolidated level.

And as Carl said in previous discussions, you could deploy that capital to do something that would be "accretive" given today's low interest rate environment but we're not of a mind to sacrifice any return on capital goals just to do something.

Carl Henry Lindner
Co-President, Co-CEO & Director

Yes. Amit, we want to grow book value double-digit at a double-digit compounded annual rate, which remains we're looking for total returns of double-digit plus, so.

Operator

The next question comes from Ryan Byrnes from Janney Capital.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Quickly just want to drill down a little bit in the Annuity segment, I guess the earnings guidance. I guess, if I look at the first half of the year, I've got it up about 33% but then obviously guidance is up kind of 13% to 18% for the year. In order for me to get there I kind of need to have it flat in the back half of the year. And obviously, you guys talked about higher yielding assets kind of I guess coming off on the back half of the year. Just wanted to -- I guess, is any more granularity there and also, I guess what that could mean for 2014, is that going to be a I guess a constant pressure going forward?

Carl Henry Lindner
Co-President, Co-CEO & Director

At today’s interest rate level, yes. The -- today's reinvestment rate is lower than the existing portfolio rate. We do have some ability to manage the credited rates and we've done that over the last several years. But although, we do expect to see continued growth in earnings that's certainly, that's our goal over the next several years. But it really is a function of where reinvestment rates are. But in today's interest rate levels, the reinvestment rates today are lower than the portfolio rate, so that will continue to put some pressure on spreads.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

And I guess, could you quantify like, what -- I'm just trying to figure out the spread there, the difference between the assets that were coming off versus I guess the new money opportunities for you guys?

Craig Lindner
Former Co-President and Director

I mean the existing portfolio where I can get the exact number but it's something at excess of 5%, I want to say it's in the neighborhood of 5.25%. And today's reinvestment rate would be a little over 4%.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

And then, quickly just trying to -- sorry, going back over to Jeff here, with I guess kind of the National Interstate. I think they kind of quantified that it is basically $11.50 million kinds of those large losses that they kind of flowed through their accident year loss ratio. Now, you guys completely all flow through to you guys as well, I'm just trying to figure out what a peer accident year loss ratio would be in that segment without that National Interstate, so?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Sure. If you strip out National Interstate, which earned about $128 million of premium in the quarter from Property & Transportation and you strip out cat losses, the conclusion you should reach is the overall segment was about breakeven on an underwriting basis excluding National Interstate and excluding cat.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

And then, just quickly my last question. Just in the Specialty Casualty segment, the last couple of quarters you guys noted kind of rate increases in the 5% to 6% range. And then, I noted that the underlying or I guess kind of the underlying loss ratio was kind of flat year-over-year. I just wanted to see, obviously it sounds like earned premium should be counted coming through at a higher rate, just want to see if there are any kind of -- anything if I'm missing there?

Carl Henry Lindner
Co-President, Co-CEO & Director

No, I think you're seeing a conservative approach to book in those years. We've seen favorable development emanating from that book of business. So we're just trying to make sure we maintain reserve adequacy and reserve strength at the same time we're growing that business.

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

We're pleased with both the rate on rate and the growth and premium that we're seeing across almost all of our Specialty Casualty businesses. So that's -- and I'm obviously, disappointed on the Property & Transportation with National Interstate or property inland marine business with the catastrophes, but we're taking steps. And there was a sequential improvement in pricing from the first to second quarter in our property [indiscernible].

I think I'm excited about it. So we had a good quarter despite the hiccup from cats and National Interstate really kind of validates our model, the diversification that we have across our portfolio in that. Not all of our businesses are going to do well at one time in that and we love our business model.

Operator

The next question comes from Vincent DeAugustino.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

I guess for Craig on the Annuity side, there is a little bit of a jump in the acquisition impact on the net spend or earned at about a 100 basis points. And so, just curious if there's anything notable there or any change in your condition strategy or appetite for flows that might be impacting that?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

This is Jeff Consolino. And if you don't mind I'm going to field that question. I don't know if you have the supplement close at hand. But that data would be on page 13 of the Investor Financial Supplement. What you have in that particular line item is affected by the FAS 133 fair value adjustments related to the embedded derivatives and equity indexed annuities.

As that adjustment run through it's effectively in acceleration or deceleration of pretax earnings, and would be subject to the same acceleration or deceleration of deferred acquisition costs and any other move would be like unrealized gains or losses. The so called K factor is approximately 50% on that. And so if you have a move of say 40 basis points of changed in fair value derivatives you would expect about a 20 point increase in the DAC, which would elevate it from kind of an 80 basis points run rate to a 100 basis points. So, you're going to see in effect running through the acquisition expense because of DAC in those movements on an ongoing basis. No change in the aggregate on commission or anything like that in this quarter.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Guess it was a modeling issue on my end. And then, just coming off the National Interstate call not too long ago, I'm sorry to keep hitting on this. But one of the things that I think is most interesting about AFG is your discipline and ability to just not walk away from when premiums and margins don't make sense, but also divest business units when that also makes sense. And so when I hear National Interstate stated, there has been underwriting margin of at least 4% on any given product and I understand that 4% might be the floor, but a 4% cutoff rate however it doesn't seem to jive with kind of your thresholds because maybe we can find out is that, even though you thought the product was priced at 96 really it comes in at 104. So, my question comes down to your strategy with National Interstate not just because of this quarter, but Nationals' results has also have lagged AFGs for some time now and with what may kind of seem like a difference in underwriting targets. I'm just curious what's in your intention to just stick this out or if there is any chance that we may see something similar to some of your past divestitures, where, kind of just maybe what you're thinking about internal time horizon where even despite your confidence in management do they get it right. Do you walk away I'm just kind of curious how you are thinking about this longer-term?

Carl Henry Lindner
Co-President, Co-CEO & Director

Hi, this is Carl. I wouldn't -- I don't think we're looking at anything different long-term. We like National Interstate's business model particularly the uniqueness and their alternative risk business and their market position in passenger transportation. And we at AFG we work through things more often and dispose of things and take a different strategic direction.

We still view National Interstate as a core specialty part of our business and we're going to work through things. As I mentioned before, we're getting rates up. Jeff mentioned the business that's been let go. We will have the-- over time there will be the same return expectations and underwriting targets National Interstate as they are consistent with the rest of the company.

Craig Lindner
Former Co-President and Director

So -- and I listened to the National Interstate call as well. I frankly don't remember any 4% targets being put out there. As you know overtime National Interstate has achieved far better results just a 4 percentage point underwriting margin, management is aiming to get back into the low 90s on an accident. Admittedly, that will take time and that will take the application of rate and the discipline of walk away from the accounts and business that can't meet those aspirations. But we're committed to seeing them, get through that and we at AFG, we'll be patient and supply whatever resources we can to help them achieve their goals.

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Commercial autos kind of dragged the market a little bit overall. It's probably been competitive a little bit longer and so. I think the commercial auto part of business a little bit behind the rest of the business overall in our industry on rate increase in that. So, that's where we are looking at it.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

And then just to clear the comment about the 4% was coming from conference back in February so completely agree that, that didn't pop up on the transcript today just going back a little bit earlier this year. But thanks for the answers and looking forward to talking to you guys soon. Thanks.

Operator

The next question comes from Jay Cohen of Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Couple of questions. First is your own transportation business I assume the results in that business were quite a bit better than what National Interstate announced?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Yes, they were. And in our own transportation business we like the trend on the accident year combined ratio in particular. So, we're not too worried on that. It's pretty much physical damage only with guys that owned their own rigs and that. We like the trends actually on that part of the business.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Secondly, there's one line item in our model is different than what you guys announced? And that was the underlying loss ratio in the specialty financial business seemed really quite strong in the quarter. And I was wondering if there was anything unusual in that number?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Hi, Jay this is Jeff. So the underlying loss ratio going to the supplement here for specialty financial, which is Page 10, we have an underlying loss ratio for the current accident year, excluding cat of 32.9% and that is a sequential improvement from 40% in the last quarter. I think it represents -- let me just pull out one more piece of data here, a continued strong performance by our lenders in mortgage property protection business and that's a large component of that overall.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Should we look at that number as may be a little better than a normalized run rate or is that -- or could just be the new run rate for that business?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

We've our guidance for the year and so, I think where we came out on guidance for the year in that some segments reflects our expectations going forward for that subclass and every class and specialty financial.

Carl Henry Lindner
Co-President, Co-CEO & Director

Jay, in Property you can have a little variability quarter-to-quarter. So I'm not sure I read something strong in that.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Last question was the tax rate on core earrings, it jumps around a bit, and I'm wondering if you can give us any guidance on the kind of ongoing tax rate we should be assuming for core earnings?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Jay, this is Jeff. If you look at operating earnings, the effective tax rate is around 29% in the quarter. You would expect on $123 million of pretax core operating earnings roughly $43 million of tax expense. It's a straight up rate of 35% federal tax rate. We are, of course, an investor in tax exempt instruments and other things that have permanent differences for tax. And so, with our booked tax versus the expected there's about $6 million of difference for tax and with interest and other permanent differences. That's fairly stable.

With National Interstate, we usually have double taxation on their earnings once at the National Interstate corporate level and once to build up on top of that our deferred tax liability. Because National Interstate earnings went into a reverse this quarter rather than getting an offset against to set a permanent differences I think that's exacerbated it. So I think the normal tax rate you would have seen in past quarters will reassert itself, so that National Interstate continues to be profitable and so, I'd view that as a blip.

Operator

And the final question is a follow-up from Amit Kumar from Macquarie.

Amit Kumar
Macquarie Research

Thanks. I just have 2 quick follow-ups. You mentioned on the question regarding disposition of any NATL, you said you like NATL, it is a core holding. The stock is down 17%. If it is a core holding why would not you be heading to that here and probably ramping up your ownership of the company if you believe in the long-term prospects?

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Amit, we do believe in the long-term prospects of the company and we are currently the majority stockholder in the company and consolidate its results on our financial statements. Whether or not we acquire any shares in National Interstate would be wholly dependent on what our other capital allocation decisions are. And speaking as the chief financial officer of the company, we think we have better opportunities to invest our capital or will have better opportunities to invest our capital. That is something that might be subject to change over time, in contrast to Carl's earlier statement where our view of National Interstate with its specialty focus, niche orientation and ART expertise. This is a specialty business that we like and we would like to own effectively forever. So, we are happy with the ownership level as it is. We could evaluate it in the future depending on stock price but we have a great many other possible uses for our capital and that would be just thrown into the mix of where we are putting our capital to work.

Amit Kumar
Macquarie Research

So if I understand this correctly, what you are saying is that other avenues of future capital deployment would probably earn a better return versus a stock which is down 17% today.

Joseph E. Consolino
Executive VP, CFO, Principal Accounting Officer & Director

Sounds like you have got a particular idea in mind. I'm not quite picking it up, though, or you are not being subtle enough. Again, speaking as the CFO rather than a co-CEO, I look at the price level for AFG common stock and I would be the price level for National Interstate common stock. I personally have a hard time recommending that we would be an acquirer of additional shares of National Interstate compared to AFG and not just share repurchase.

Amit Kumar
Macquarie Research

Now, I totally understand that based on where it is trading at on a practical basis. That is helpful. The only other question I guess I had was, in the opening remarks you mentioned something about lender placed business expanding and I could not quite catch that entire comment. I think you are alluding to the growth in specialty financial. Can you just expand on that comment, you said the lender-placed grew well others pulled back something like that?

Carl Henry Lindner
Co-President, Co-CEO & Director

I think because of some competitive marketplace changes in that, we've had some opportunities and we picked up a number of accounts that is allowing that particular part of our specialty financial business to grow, so.

Operator

And there are no further questions.

Diane P. Weidner
Assistant Vice President of Investors Relations

Okay. Thank you Salima. Thank you all for joining us this morning. We look forward to talking to you again when we report our third quarter results. Thank you and have a great day.

Operator
Thank you. This will conclude today's conference call. You may now disconnect your lines.