S&P Global
Market Intelligence

American Financial Group, Inc. NYSE:AFG

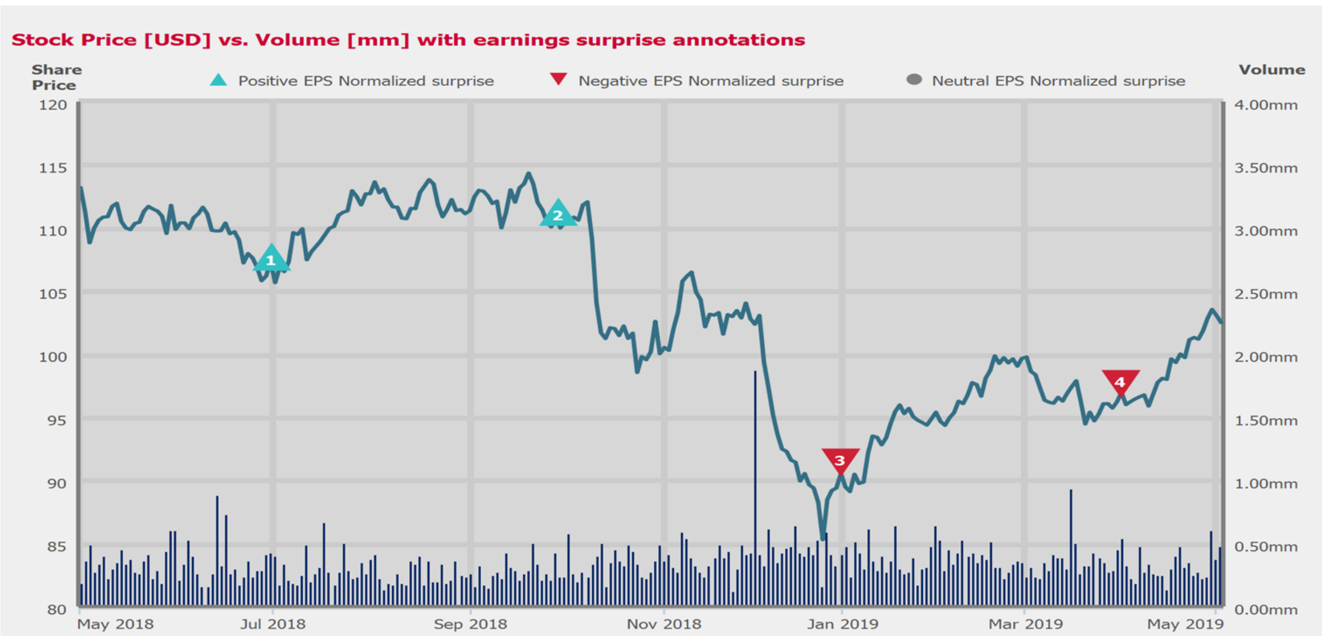
FQ1 2019 Earnings Call Transcripts

Thursday, May 02, 2019 3:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2019-			-FQ2 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	2.20	2.02	(8.18 %)	2.03	8.69	8.92
Revenue (mm)	1228.00	1173.00	(4.48 %)	1266.00	5076.00	5226.50

Currency: USD
Consensus as of May-02-2019 11:26 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2018	1.91	2.04	6.81 %
FQ3 2018	1.87	2.19	17.11 %
FQ4 2018	1.95	1.75	(10.26 %)
FQ1 2019	2.20	2.02	(8.18 %)

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Call Participants

EXECUTIVES

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

Diane P. Weidner
Assistant Vice President of Investor Relations

Joseph E. Consolino
Executive VP, CFO & Director

Stephen Craig Lindner
Co-President, Co-CEO & Director

ANALYSTS

Amit Kumar
The Buckingham Research Group Incorporated

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Ronald Paul McIntosh
Lomas Capital Management, LLC

Presentation

Operator

Good day, Ladies and gentlemen, and thank you for standing by. Welcome to the American Financial Group 2019 First Quarter Results. [Operator Instructions] Now it's my pleasure to turn the call to Diane Weidner, Assistant Vice President of Investor Relations.

Diane P. Weidner
Assistant Vice President of Investor Relations

Good morning and welcome to American Financial Group's First Quarter 2019 Earnings Results Conference Call. I'm joined this morning by Carl Lindner III and Craig Linder, co-CEOs of American Financial Group; and Jeff Consolino, AFG's CFO.

Our press release, investor supplement and webcast presentation are posted on AFG's website. These materials will be referenced during portions of today's call. Before I turn the discussion over to Carl, I would like to draw your attention to the notes on Slide 2 of our webcast. Certain statements made during this call may be considered forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance.

Investors should consider the risks and uncertainties that could cause actual results and/or financial condition to differ materially from these statements. A detailed description of these risks and uncertainties can be found in AFG's filings with the Securities and Exchange Commission, which are also available on our website. We may include references to core net operating earnings, a non-GAAP financial measure, in our remarks or in responses to questions. A reconciliation of net earnings attributable to shareholders to core net operating earnings is included in our earnings release.

And finally, if you're reading a transcript of this call, please note that it may not be authorized or reviewed for accuracy, thus it may contain factual or transcription errors that could materially alter the intent or meaning of our statements.

Now I am pleased to turn the call over to the Carl Lindner III to discuss our results.

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

Good morning. We released our 2019 first quarter results yesterday afternoon. If you'd please turn to Slide 3 of the webcast slides for an overview.

AFG reported core operating earnings of $2.02 per share compared to $2.42 per share in the first quarter of 2018. Fair value accounting for fixed-indexed annuities in our Annuity segment significantly impacted the quarterly comparison. Annualized first quarter return on equity was a strong 14.5%. And our core insurance businesses continue to perform very well.

We reported strong operating earnings in our Specialty Property and Casualty operations, and pretax earnings before fair value accounting had established a new all-time quarterly high for our Annuity segment. Net earnings per share were $3.63 and included $1.61 per share in after-tax net realized gains on securities.

Craig and I thank God, our talented management team, and our great employees for helping to achieve these results. Returning capital to our shareholders is an important component of our capital management strategy and reflects our strong financial position and our confidence in AFG's financial future.

So in conjunction with our first quarter earnings release, we announced the special cash dividend of $1.50 per share payable on May 28 of this year to shareholders of record on May 15, 2019. Payment of the special dividend will not preclude AFG's consideration of a special dividend later in the year. And is in addition to the company's regular quarterly cash dividend of $0.40 per share most recently paid on

April 25, 2019. We are maintaining our 2019 core operating's -- earnings guidance for AFG in the range of $8.35 $8.85 per share. Craig and I will discuss our guidance for each segment of our business in more detail later in this call.

Now I'd like to turn our focus to our Property and Casualty operations. If you would, please turn to Slide 4 and 5 of the webcast, which include an overview of first quarter results.

Our Specialty Property and Casualty Group performed very well during the quarter with strong underwriting margins and healthy year-over-year growth in net written premiums. As you'll see on Slide 4, gross and net written premiums in our Specialty Property and Casualty Insurance Operations grew by 5% and 4%, respectively, year-over-year primarily due to the growth within our Property and Transportation and Specialty Casualty Groups.

Core operating earnings on AFG's Property and Casualty Insurance Operations were $185 million in the first quarter of '19, slightly below the $188 million reported in the prior year period. Specialty Property and Casualty Insurance Operations generated an underwriting profit of $88 million in the 2019 first quarter compared to $92 million in the first quarter of last year, a decrease of 4%. Higher underwriting profitability in our Property and Transportation Group was more than offset by lower underwriting profit in our Specialty Casualty and Specialty Financial Groups.

The first quarter combined -- first quarter 2019 combined ratio of 92.5% increased 0.8 points from the prior year period. And first quarter of '19 results included 4 points of favorable prior year reserve development compared to 5.1 points of favorable development in the comparable prior year. Cat losses were 1.1 points of the combined ratio in the first quarter of '19. By comparison, cat losses added 1.2 points in the prior year period.

Overall, our accident year combined ratio, excluding cats, improved slightly against last year's first quarter. Average renewal pricing across our entire Property and Casualty group was up 1% for the quarter. Now excluding our Workers' Comp businesses, renewal pricing was up slightly more than 4% and improvement over the renewal rate increases that we achieved for the whole year 2018. Renewal pricing is exceeding our expectations in each of our Specialty Property and Casualty subsegments, which I'll discuss in more detail as we review the results of each. Loss cost trends remain stable, though we're keeping our eye on inflation and interest rates.

Now I'd like to turn to Slide 5 to review a few highlights from each of our Specialty Property and Casualty business groups. The Property and Transportation Group reported an underwriting profit of $39 million in the first quarter of 2019 compared to $33 million in the comparable prior year period. Higher underwriting profit in our Transportation businesses was partially offset by lower underwriting profit in our agricultural property and inland marine, ocean marine businesses as well as our Singapore branch. Catastrophe losses in this group were $9 million in the first quarter of '19 and $5 million in the comparable 2018 period.

First quarter 2019 gross and net written premiums in this group were 3% and 6% higher, respectively, than the comparable period. The gross and gross written premiums was primarily attributable to new business opportunities in our Transportation businesses. Overall, renewal rates in this group increased 4% on average in the first quarter of '19, an improvement over renewal rate increases achieved last year.

And I am especially pleased with rate strengthening in our commercial auto liability in Aviation businesses. Now we are closely monitoring the flooding in the Midwest and its potential impact on the agricultural community and specifically spring planting. Though, through the use of mapping technology, we determined that approximately only .333% of our insurance acreage is located in the flood-impacted region. And we did have an opportunity to use this information in establishing our funding strategy in April.

Generally speaking, also, the corn planting window throughout much of the current flood-impacted region runs from early to mid-April through the end of May. The soybean planting window within this region runs from late April to the end of June. And with the current technology and equipment, the majority of our insureds can complete planting within a 7- to 10-day window. So it's really early in the growing season, and we are hopeful that our growers will be successful in getting their crops in the ground within these time frames. We'll definitely have more details to share when we report our second quarter results.

Specialty Casualty Group reported an underwriting profit of $36 million in the 2019 first quarter compared to $41 million in the comparable '18 period. Higher profitability in our alternative market, Specialty Human Services and Public Sector businesses were more than offset by lower underwriting profit in our Excess and Surplus Lines and Workers' Compensation businesses. Despite lower year-over-year profit in our Workers' Compensation operations, these businesses continue to achieve excellent underwriting margins. Catastrophe losses for this group were $1 million in the first quarter of this year and $5 million in the comparable 2018 period.

Gross and net written premiums for the first quarter of '19 were up 7% and 5% respectively compared to the same period in 2018. Higher year-over-year gross written premiums within Neon, the addition of premiums from ABA Insurance Services as well as improved pricing and higher retentions in our Excess and Surplus Lines businesses, were the primary drivers of the higher premiums. Lower premiums in our Workers' Compensation businesses partially offset the growth.

The integration of ABA Insurance Services is proceeding as planned, and we continue to anticipate an incremental $40 million to $50 million in net written premium from this business in 2019. Renewal pricing for Specialty Casualty Group was down 1% during the first quarter. Now when you exclude rate decreases in the Workers' Comp businesses, renewal rates in this group were actually up by 1%, an improvement from the renewal rate increases that we achieved in 2018.

We are seeing strong pricing momentum in our umbrella excess liability, surplus lines and public D&O businesses. Specialty Financial Group reported an underwriting profit of $13 million in the first quarter of 2019 compared to $15 million in the first quarter of '18. The decrease was primarily driven by lower underwriting profitability in our Financial Institutions business as 2018's first quarter benefited from commission reductions after the active 2017 catastrophe year.

Catastrophe losses for this group were $2 million in the first quarter of '19 compared to $3 million in the prior year quarter. First quarter gross written premiums were up 3%. Net written premiums were down 2%, respectively, when compared to the prior year period primarily as a result of higher premiums in our Fidelity and Crime businesses, which were offset by lower premiums in our surety and lending and leasing businesses. Renewal pricing in this group was up 3% for the quarter.

Now please turn to Slide 6 for a summary view of our 2019 outlook for the Specialty Property and Casualty operations. We continue to expect a 2019 combined ratio for the Specialty Property and Casualty Group overall between 92% and 94%. Our guidance for growth in net written premiums is also unchanged in the range of flat to up 3% for the year.

And looking at each segment, we continue to estimate a combined ratio in the range of 92% to 96% in our Property and Transportation Group and growth in net written premiums between 3% and 7% for the year. Our guidance assumes a normal level of crop earnings. We continue to expect our Specialty Casualty Group to produce a combined ratio in the range of 91% to 95%. Net written premiums are expected to be down 2% to up 2%, consistent with our initial guidance.

Net written premium guidance assumes lower premiums, resulting from Neon's increased reinsurance ceded in 2019 and lower premiums in our Workers' Compensation businesses. These items will be offset by full year premiums, as I mentioned before, from ABA Insurance Services.

We now expected the Specialty Financial Group combined ratio to be in the range of 88% to 92%, revised upward from our initial estimate from 86% to 90%. Our projection for growth in net written premiums continues to be in the range of 3% to 7%. We expect modest growth across all of our businesses in this group. And we also expect double-digit rate increases in our financial institutions business by the end of this year.

Our guidance with regard to net investment income is unchanged with results in 2019 expected to be flat to up 4% year-over-year. Keep in mind, results in 2018 were exceptionally strong primarily due to the strong performance of limited partnerships and similar investments, which we don't expect to continue.

Given the broad-based improvements noted already in the renewal pricing across many of our Specialty Property and Casualty businesses, we now expect overall Property and Casualty renewal pricing to be up 1% to 3% in 2019. And excluding Workers' Comp, we expect renewal rate increases to be in the range of 4% to 6%, up from the previous levels.

I'll now turn the discussion over to Craig to review the results in our Annuity segment and AFG's investment performance. Thank you.

Stephen Craig Lindner
Co-President, Co-CEO & Director

Thank you, Carl. I'll start with a review of our Annuity results for the first quarter beginning on Slide 7.

Statutory Annuity premiums were nearly $1.4 billion in the first quarter of 2019, an increase of 22% from the prior year period. The year-over-year increase was driven by higher sales of traditional fixed annuities in the financial institutions channel. While we're very pleased with premiums through the first quarter, we've implemented several rate decreases in response to decreases in market interest rates over the last several months, and these actions are expected to slow sales.

Turning to earnings results are, pretax Annuity earnings were $90 million in the first quarter of 2019 compared to $125 million in the first quarter of 2018. Fair value accounting for fixed-indexed annuities had an unfavorable impact of $44 million in the first quarter of 2019 compared to a favorable impact of $13 million in the 2018 first quarter.

Turning to Slide 8. You will see that pretax Annuity earnings before fair value accounting for fixed-indexed annuities were a quarterly record $134 million in the first quarter of 2019, an increase of 20% over the prior year period. These results were driven primarily by growth in the business and the favorable impact of a very strong stock market, partially offset by the unfavorable impact of higher crediting rates and option costs.

The S&P 500 Index increased by 13% in the first quarter of 2019. The strong stock market performance favorably impacted pretax Annuity earnings before fair value accounting for FIAs, particularly FIAs with guaranteed benefits, by $14 million or $0.12 per share.

The components of fair value accounting for FIAs are shown on Slide 9. Under GAAP, a portion of the reserves for fixed-indexed annuities is considered to be an embedded derivative and is recorded at fair value based on the estimated present value of certain expected future cash flows. Assumptions used in calculating this fair value include projected interest rate, option costs, surrenders, withdrawals and mortality.

Variances from these assumptions as well as changes in the stock market will generally result in a change in fair value. Items such as changes in interest rates and the performance of the stock market are not economic in nature for the current reporting period but rather impact the timing of reported results. The impact of fair value accounting for fixed-indexed annuities includes an ongoing expense for Annuity interest accreted on the FIA-embedded derivative reserve.

The amount of interest accreted in any period is generally based on the size of the embedded derivative and current interest rates. We expect both the size of the embedded derivative and interest rates to rise, resulting in continued increases in interest on the embedded derivative liability. In the first quarter of 2019, corporate A2 rates decreased by approximately 49 basis points compared to the year-end market expectation that they would increase. This difference contributed to a significant unfavorable fair value accounting impact of $45 million or $0.39 per share. By comparison, a 13% increase in the S&P 500 Index contributed to a favorable fair value accounting impact of $15 million or $0.13 per share for the first quarter of 2019.

The majority of the impact of these 2 items is noneconomic and is expected to reverse over time. By comparison, in the first quarter of 2018, the benefit of significantly higher-than-expected interest rates was minimally offset by the impact of a decrease in the stock market. For additional analysis of fair value accounting, see our quarterly investor supplement, which is posted on AFG's website.

Turning to Slide 10. You will see that AFG's quarterly average Annuity investments and reserves grew by approximately 12% and 11%, respectively, year-over-year. AFG's net interest spread in the first quarter of 2019 was lower than in the first quarter of 2018. The net interest spread in 2018 reflects exceptionally high returns on certain investments that are mark-to-market through operating earnings.

The net interest spread in 2019 reflects higher crediting rates and option costs. AFG's net spread earned before fair value accounting for FIA's was higher in 2019 than in 2018, reflecting the favorable impact of a very strong stock market. AFG's net spread earned reflects the impact of changes in interest rates in both periods.

Please turn to Slide 11 for a summary of the 2019 outlook for the Annuity segment. Based on the strong stock market performance to date in 2019, we now expect Annuity earnings before the impact of fair value accounting for FIAs and unlocking to be in the range of $445 million to $475 million, an increase from the range of $435 million to $465 million previously provided.

Included here are estimated Annuity earnings sensitivities to incremental changes in the S&P 500 Index, changes in Corporate A2 rates and changes in the yields achieved on certain investments. These details of also been added as a new page in our Quarterly Investor Supplement.

Finally, we are modifying our previously announced Annuity premium guidance based on sales through the first 4 months of the year. We believe, however, that recently implemented rate decreases on our Annuity products and continued focus on pricing discipline will temper new sales as we remain committed to achieving appropriate returns on new business.

As a result, we now expect that our 2019 Annuity sales will be flat to down slightly from the record $5.4 billion of premiums reported in 2018. Additional information on the Annuity segment's earnings, premiums, investments and reserves can be found at AFG's Quarterly Investor Supplement posted on our website.

Please turn to Slide 13 for a few highlights regarding our $51 billion investment portfolio. AFG reported first quarter 2019 net realized gains on securities of $145 million after-tax and after deferred acquisition costs. This compares to net realized losses on securities of $74 million in the first quarter of 2018.

Approximately, $127 million of the realized gains recorded in the first quarter of 2019 pertained to securities that AFG continued to hold at March 31, 2019. As of March 31, 2019, net unrealized gains on fixed maturities were $464 million after-tax, after DAC, an increase of $381 million since year-end. As you'll see on Slide 14, our portfolio continues to be high-quality with 91% of our fixed maturity portfolio rated investment grade and 98% within NAIC designation of 1 or 2, its highest 2 categories.

We've provided additional detailed information on the various segments of our investment portfolio in the Quarterly Investor Supplement on our website. I'll now turn the discussion over to Jeff who will wrap up our comments with an overview of our consolidated first quarter 2019 results and share a few comments about capital and liquidity.

Joseph E. Consolino
Executive VP, CFO & Director

Thank you, Craig. Slide 15 summarizes AFG's first quarter consolidated core operating earnings results. AFG reported core EPS of $2.02 in Q1 2019. Core net operating earnings in the quarter were $184 million.

The year-over-year decrease in core earnings in the 2019 first quarter was primarily the result of the impact of fair value accounting on our Annuity segment's results, which Craig detailed for you earlier in this call.

Interest and other corporate expenses were relatively unchanged year-over-year. Parent company interest expense increased by $1 million from Q1 2018 as a result of the March 2019 issuance of $125 million principal amount to hybrid 40-year, 5 7/8% subordinated debentures due in 2059. Other expenses were flat year-over-year.

Slide 16 provides a reconciliation of core net operating earnings to net earnings. Accounting guidance adopted on January 1, 2018, requires holding gains and losses in equity securities to be recognized in net earnings, which will contribute significantly to volatility in reported GAAP earnings. In the first quarter of 2019, AFG recognized $145 million or $1.61 per share in net after-tax realized gains on securities, reversing nearly 80% of the Q4 2018 negative mark-to-market.

As indicated on Slide 17, AFG's adjusted book value per share was $58.02 as of March 31, 2019. Annualized growth in book value per share plus dividends was an impressive 26% in the first quarter of 2019 powered by the rebound in the equity markets.

We returned $36 million to our shareholders in the first quarter with the payment of our regular quarterly dividend. The aggregate amount of the special dividend announced yesterday will be approximately $135 million and will be paid at the end of this month. Parent cash was $215 million at the end of the first quarter. We maintained solid levels of capital in our insurance businesses to meet our commitments to the rating agencies.

Our excess capital stood at approximately $1.1 billion at March 31, 2019, due to strong GAAP earnings and the issuance of our $125 million 5 7/8% hybrid in the 2019 first quarter. We plan to hold approximately $200 million to $300 million of dry powder to maintain our flexibility for opportunities as they may arise. Our management team reviews all opportunities for the deployment of capital on a regular basis.

Wrapping up, Page 18 shows a single page presentation of our updated 2019 core earnings guidance. Our guidance assumes an effective tax rate of approximately 20% on core pretax operating earnings. AFG's expected 2019 core operating results exclude noncore items, such as realized gains and losses and other significant items that may not be indicative of ongoing operations.
With that, now we'd like to open the lines for any questions.

Question and Answer

Operator

[Operator Instructions] And our first question is from Greg Peters with Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

I just have a couple of small questions. In the Property Transportation business, I was wondering if you could comment on how your commercial auto book is performing? Maybe also add in some color on National Interstate?

And then Craig, also, on the Property Casualty business, in the financial institutions, I think in your comments you said that you expect the financial institutions business rate environment to go up, I think you said like 10% later in the year. And I was just trying to square that with the combined ratio expectations of 88% to 92%. So -- and then I have a question on your Annuity business.

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

Greg, this is Carl. Happy to give a little color on our commercial auto business. Overall, very pleased with the performance of our commercial auto business. National Interstate and our Great American trucking part of our business are achieving the combined ratio targets that we've set. Actually, with our house in order, I feel we're in a good position to take advantage of a market that's still in a correction mode and so feel very good. That said, on the severity trends for the industry in our -- even our severity trends in commercial auto liability are causing us to continue to take pretty solid rate on that part of the business.

We got about 8% price increase on that part of National Interstate's business, and we'll continue to take rate in that.

So I feel good about our business. And again, I think with our house in order, I think we're in a position to take advantage of a market that's in a correction mode.

On the Specialty Financial -- I think it was -- you were referring to a comment about expecting double-digit increases in our Financial Institutions business. Yes. I think throughout this year, I think we're going to see the pricing levels escalate on that book. And I think we do expect to be able to, by the time year-end comes, to achieve double-digit rate on that book.

So I think that's a positive. Our combined ratio and our overall Specialty Financial business is so good that to get -- we try to be as exacting as we can. Naturally rate increases of that magnitude on that part of our business have to help going into next year. So...

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Right, Carl. Switching to the Annuity business, Craig, I was looking at Page 16, and I noted your comments about changing your rates and how it might affect sales going forward.

I was looking on Page 16, sequentially noting the lower results in broker-dealer single-premium Annuity business. I assume that's just a reflection of a competitive market where some of your peers might be more aggressive but maybe you can add some additional color there?

Stephen Craig Lindner
Co-President, Co-CEO & Director

Sure, Greg. Part of it is a reflection of just a pretty competitive marketplace right now. What I would say is we really focused on that segment as having potential, and we were one of the really early players to be successful in growing that segment of our business in a pretty major way.

Since then, some of our competitors who weren't focusing on that segment have made it a priority to penetrate that segment of distribution. And I think that's the -- I think that's the answer, Greg.

Operator

And our next question is from Christopher Campbell with KBW.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

My first question is on capital management. So the special dividend only uses up about $150 million, which still leaves close to $1 billion in excess capital based on the $1.1 billion you disclosed at quarter end. So I guess, just given you're retaining this, should we expect something inorganic to happen sometime soon?

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

I think we've said in the past that we're -- we feel -- we're sensitive when our capital gets to be $1 billion or over to be more aggressive in using it, that -- with the special dividend that's paid, it will push it under $1 billion. As in every year -- every year's a little different mixture. No. But I wouldn't assume that there is some big deal on the table right now or anything.

I think if you look over, historically, this is very normal. We have plenty of flexibility to continue to look at opportunities on the acquisition side. And as I mentioned earlier, this special dividend we declared doesn't preclude us from declaring another one towards the end of the year, as we've done in prior years also.

So I think we're pretty good capital managers over time. Some of the acquisitions like Summit, and bringing in National Interstate, the rest of that, all those transactions earned very significant double-digit returns on equity.

So those are the kinds of things that we're looking to do. We don't do things just to do them, and in that we're fairly picky. Tougher buyers, and that's just the way we look at things. I hope that gives you a little color.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Yes, it does, definitely. And I think you had mentioned in response to one of the prior questions about being interested in commercial auto, given the problems a lot of competitors are having. Would that be something that you would be interested in pursuing if it came up? You know, something in commercial auto?

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

Well, sure. If we have our house in order, and that could mean more organic growth than what we're assuming today or it could -- if there's an opportunity on the acquisition side that made sense for us, sure. Right now, we feel there's great opportunities in the market, probably organically. So hope that helps.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

That make sense. And then just -- I've seen some articles about -- there's a rumor that you guys might be considering disposing of like Neon. Does hardening pricing at Lloyd's, does that change any of the calculus? And if that were to occur, what is Neon sitting on AFG's books at? And then how much existing capital could that free up?

Joseph E. Consolino
Executive VP, CFO & Director

Chris, this is Jeff Consolino. Just to start with, we don't comment on market speculation one way or the other, whether it pertains to buying or selling businesses.

Overall, Neon is on our books effectively at 0. And so most of our capital at Lloyd's is provided in the form of letters of credit rather than tangible capital.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, got it. And then just one last one is on annuities, I'm not -- certainly not an expert on it. But my understanding is that most of the life peers report the earnings, net of the fair value adjustments to kind of make it cleaner.

I guess, could you just give us color on why AFG doesn't follow this approach?

Stephen Craig Lindner
Co-President, Co-CEO & Director

This is Craig. It's something that we've studied from time to time and we'll continue to study. I think some of our peers do define core operating earnings in a different way than we do. We were actually very pleased with the first quarter. If you look at the underlying fundamentals, they were really very strong. We had a very strong premium quarter. We were able to hit targeted returns or exceed targeted returns on new business.

The earnings were impacted at a major way by the decline in interest rates which resulted in an increase in the embedded derivative, which we flow through earnings, that hit the earnings by some $45 million. It is purely a timing issue. It has nothing to do with the underlying economics.

So when you kind of normalize things, we were actually very pleased with the quarter. We are continuing to study whether or not it makes sense to change our definition of core operating earnings, just say that.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Great. That's very helpful. And then just one last one, on the guidance update, on the P&C pricing. Looks like you increased that about 100 bps on the lower and the upper end. So I'm just kind of wondering, the underwriting guidance didn't change at all. So is your view of rates are getting better but loss cost inflation is also creeping up, would that be a fair assessment of why guidance isn't changing?

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

Well, things you do today, you really impact future periods. In a -- most policies earn over 12-month period of time, we're almost halfway through the year at this point. So no, we're not -- it doesn't reflect any change in our perspective about the stability on the loss cost side or claims side. I think it reflects more of an optimistic, enthusiastic outlook as to the direction of pricing that we see.

We're seeing in businesses like D&O right now -- some snippets, we don't have our final April pricing and stats in and all that but I'm getting excerpts from our folks in businesses like public company D&O and other parts of our business that make us more optimistic as to where our pricing is going to go for the rest of the year. So I think it reflects more of that optimism.

Operator

Our next question comes from Paul Newsome with Sandler O'Neill.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

I just got 1 left. You've been great about returning shareholder money on a timely basis. But I'm curious about whether or not the map has changed enough that we might see a switch from special dividends to stock repurchase? And just talk about that process if you would, please?

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

I think that's something that we're always -- quarter-by-quarter, month-by-month, we're always trying to find the best uses for our excess capital, whether that's organic growth, acquiring something, share repurchases, returning capital in the form of special dividends.

I think the first quarter's an indication that we continue to feel, right or wrong or otherwise, that returning capital to our shareholders in the form of special dividends is a very effective, positive strategy.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

I'm not arguing it's positive, but the valuation of the stock is down. Is there some point where there's an inflection point where you decide that it's just better to repurchase stock than give dividends? Or is the dividend just sort of kind of how you think things should be done on a regular basis?

Joseph E. Consolino
Executive VP, CFO & Director

Paul, this is Jeff Consolino. The way you're phrasing the question, it kind of invites us to say, never, which of course we should never say.

This company has been a very aggressive purchaser of it stock in the past, retiring about 1/3 of the shares outstanding at various points. And so that's always very much a part of the thought process.

Clearly, we've got a picture of our earnings power and confidence in our future that would be really a neutral across repurchase or dividends.

As Carl said, with the first quarter special dividend, and that will go out and that will be a significant return on capital that goes to all shareholders. But the CEOs are always evaluating the merit of share repurchase and looking things like years to pay back and return on investment and the like.

So I don't think we can tell you with a bright line what would trigger that. It's just our evaluation of the circumstances as we're preparing to return capital. We do have significant excess capital. So if the opportunity arose to retire a significant component of our shares outstanding at a good return on investment, past actions show that we'd be ready to do it.

Operator

And our next question is from Amit Kumar with Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Maybe I'll take this in reverse order, following up Paul's question on capital management. Does the special dividend -- the cash dividend in Q1, does -- should we not expect a special dividend in Q2? I was trying to remember what was the timing if the excess capital remains strong at that point? Should we not be surprised to see another special dividend? Or how should I think about that timing?

Joseph E. Consolino
Executive VP, CFO & Director

Amit, last year, we announced the $1.50 special dividend this time of year, and then a second $1.50 special dividend in the fourth quarter, which was payable before year-end.

We're always evaluating things. But I think when you get to the fourth quarter, not only do you have the benefit of having gone through the year and evaluated other options and either pursued them or not, whether you're in the business planning process and you can have a clear picture of how much capital you want to support organic growth initiatives or other things. So again, there's no cookie-cutter approach. When you look at the last couple of years, it's been a second quarter-fourth quarter kind of split between the significant special dividends we've paid.

Amit Kumar
The Buckingham Research Group Incorporated

Got it, so that's helpful. The other question I had, I think Chris was talking about this, or someone else, regarding the commercial auto environment. And I think it was -- everyone's trying to ask about Protective Insurance, which I'm sure, you won't answer. Is there a way to talk about -- has commercial auto environment improved enough over the past 6 months or 12 months for you to think differently? Or just because maybe you've had better successes than others, maybe you can do a better job in that space? Maybe just talk about the relative attractiveness of commercial auto today versus maybe 6 months or a year ago?

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

Amit, I think we really kind of got our house in order last year also once the whole year was complete in that. We're meeting the combined ratio targets that we've set. We're still taking rate, as I mentioned before, on the commercial auto liability side at National Interstate because the severity trends are still pretty high within the industry in that.

So because we're meeting our targets and I think our house is in order, we feel like we're in a position to take advantage of a market that I mentioned is definitely still in a correction mode when you see what's going -- when you understand what's happening in the marketplace in that.

So lots of corrective actions being taken by others. Lots of price reunderwriting and all that. So that should provide opportunities for us for organic growth, potentially acquisitions, but we're very disciplined. We -- that's just our approach to things. We've been out -- we're different than others probably in that we're in our seventh -- probably we've taken 7 years of rate increase.

So this wasn't -- it wasn't a quick turnaround at National Interstate. It took a while because of the severity trends. And my guess is as the rest of the market, they're definitely not in their seventh year of rate increase, would be my guess. Some may be in their first or second year or fourth year or whatever. So I think the -- it's going to take a while for things to -- from industry results to get better.

Amit Kumar
The Buckingham Research Group Incorporated

I agree. And I know that, that National Interstate change was phenomenal, and I heard that Jeff maxed out his [seamless] budget for you. The other question I had was going back to the agricultural discussion. And I think I heard it correctly, you said, 33 basis points of 1%, so it's -- clearly de minimis.

On another call, there was a comment made that most of the flooding was already, I guess, in flood zones, floodplains, et cetera, so that's why there wasn't much of an ag impact, and yet we have seen completely different commentary coming out of some of those agricultural bureaus. And I was trying to -- maybe you can help us better understand what exactly is going on, on the ground? And also refresh us as to the timeline when planting happens, when delayed planting happens, if things do worsen, when do we start seeing the impact in the numbers?

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

Okay. I think I kind of addressed the things. But I think the statistics -- we use mapping technology pretty thoroughly and with that, over the past couple of months, we determined that about 0.333% Of our insured acreage is located in flood impacted -- in the flood-impacted regions. So we had an -- because of that use of that technology, we had an opportunity to use that information that we got in establishing our funding strategy. You -- every year companies in this business, you can choose how much risk you want to take within the funding -- your funding strategy. So we were able to use that information.

So I think the bigger picture is not maybe so much the flood impact, it's really preventative planning at some point.

But again, when you understand the corn planning windows really extend until the end of May, and soybean planting extends to the end of June. And then also, sometimes if corn planting windows are missed, farmers will choose to plant soybeans versus corn, and that kind of thing. It would seem like there is still plenty of flexibility when you understand that it only takes with technology farmers to -- it only takes them a 7- to 10-day window to plant. So it's really early to really try to prognosticate what the impact is.

Amit Kumar
The Buckingham Research Group Incorporated

And it's booked mostly RP?

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

I think we'll know more in the second -- as we report second quarter earnings, we'll know more over -- by the end of June, exactly kind of where we stand.

Amit Kumar
The Buckingham Research Group Incorporated

And it's booked mostly revenue protection or yield?

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

Most of the business is revenue coverage and that. Actually I think Crop-Hail business doesn't include flood, just for your information. Most of the business is really revenue coverage.

It's early and we're -- like I say, we're keeping our eye on it. Commodity prices, doesn't seem to be too much going on there that's concerning. Soybean prices, I think that was -- I glanced at it today, they may be down, I think, it was 8% to 10%, 8% to 9%, something like that. So we don't really get -- on the commodity price side, we don't get too concerned if the yields are decent, until you start getting up into 16% to 20% changes in commodity prices.

Operator

[Operator Instructions] Our next question is from Ronald McIntosh with Lomas capital.

Ronald Paul McIntosh
Lomas Capital Management, LLC

Two quick questions. One numbers' question. Your Annuity business, I think your guiding to spreads for the balance of the year in that range of 117 to 127 bps before fair value. I think that's about 15 bps lower than what you earned in this quarter and a year ago quarter. Is that yield curve, new money rate unlocking, can you get underneath that a little bit and see why spreads would be under pressure?

And then a second question on ROE. At the outset you mentioned your very fine 14.5% ROE. I think quick back on the envelope, that implies roughly a 21% ROE for P&C and 11% for life. Number 1, is that range roughly correct? Number 2, are you earning a cost -- above cost of capital in both businesses? And number 3, as long term stewards of capital, is that kind of gap or range acceptable long term, especially as noted earlier, with the accounting the 11% is a lumpy 11%?

Stephen Craig Lindner
Co-President, Co-CEO & Director

So that's a lot of questions. Let me start out with -- I can tell you, the return on the Annuity business in the first quarter was around 11% but that is after incurring a $45 million hit related to something that really is not economic in nature, it's just the result of a decline in interest rates and discounting the embedded derivative at a lower rate. So if you make some adjustment, if you kind of normalize things, I think it gets you back to a very acceptable return on the Annuity business. And as it relates to P&C returns, Jeff, you want to...

Joseph E. Consolino
Executive VP, CFO & Director

Sure. Ron, I guess just to close off on Craig's comment, if you go ahead and strip out the effect of fair value accounting in total, which is of course a complicated item made up of many elements, the return on capital for the annuity business after-tax exceeds 15% in the quarter. So any inference that the business is not earning its cost of capital I think is not correct.

Stephen Craig Lindner
Co-President, Co-CEO & Director

And again, if you look at the midpoint of guidance for the year, that would result in something in the neighborhood of a 13% after-tax return unleveraged.

Joseph E. Consolino
Executive VP, CFO & Director

And for P&C we feel like we're earning about a 15% or 16% after-tax return on a GAAP basis in that business. And so that would be consistent with what Craig said when you roll it up for the whole company.

Ronald Paul McIntosh
Lomas Capital Management, LLC

And in terms of decreasing spreads?

Stephen Craig Lindner
Co-President, Co-CEO & Director

A couple of things are impacting that. One thing you have to take into consideration though, is with the lower tax rate, we don't have to earn the same interest spread to earn the targeted rate of return, a lower tax rate obviously impacts that. There are a couple of things that are impacting the cost of funds going up a little bit, we do have some Federal Home Loan Bank borrowings, those rates have gone up a bit. The option costs were slightly higher today than they have been historically. So there were a few things that were affecting the cost of funds but you do have to take into consideration that we don't need the same spread to earn our targeted rate of return because tax rates are lower today.

Operator

And I'm not showing any other further questions in the queue. I would like to turn the call back to Diane Weidner for her final remarks.

Diane P. Weidner
Assistant Vice President of Investor Relations

Thank you, Carmen, thank you all for joining us this morning. We look forward to talking with you again when we share our second quarter results.

Operator
And with that, ladies and gentlemen, we thank you for participating in today's conference. This concludes the program and you may all disconnect. Have a wonderful day.