S&P Global
Market Intelligence

American Financial Group, Inc. NYSE:AFG

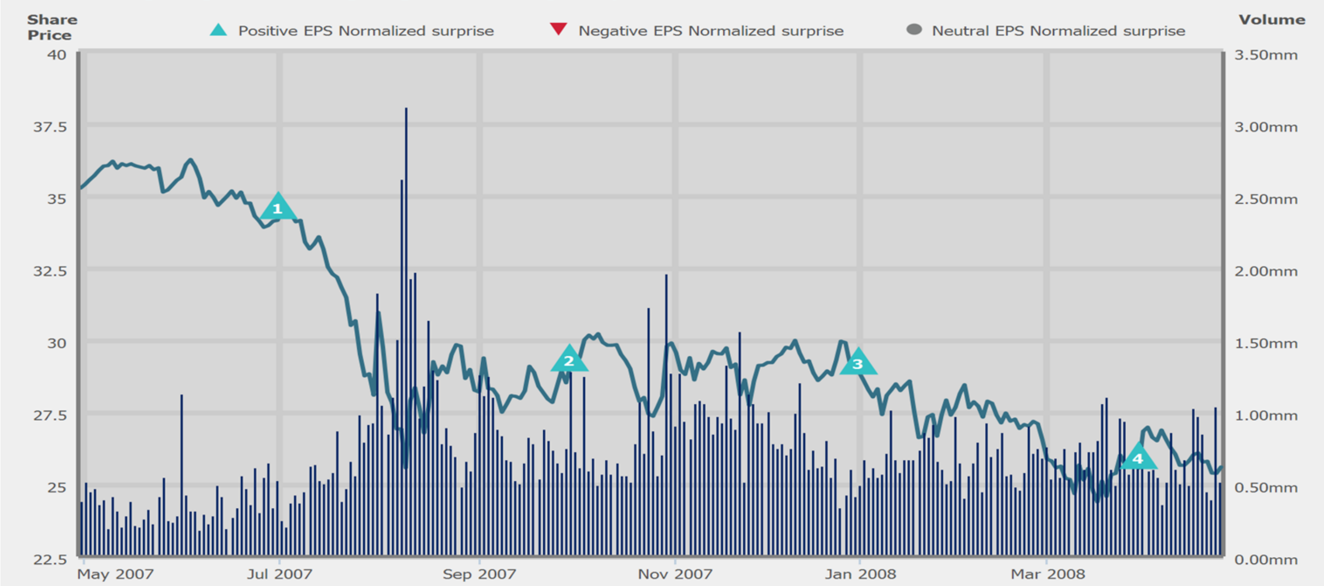
FQ2 2008 Earnings Call Transcripts

Friday, August 01, 2008 3:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2008-			-FQ3 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.90	0.96	▲6.67	0.92	3.91	3.55
Revenue	-	-	▲(6.40 %)	-	-	-
Revenue (mm)	661.10	618.80	-	-	2639.10	2654.70

Currency: USD
Consensus as of Aug-01-2008 4:05 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2007	0.82	0.93	▲13.41 %
FQ3 2007	0.85	0.97	▲14.12 %
FQ4 2007	0.94	1.21	▲27.37 %
FQ1 2008	0.89	1.09	▲22.47 %

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Call Participants

EXECUTIVES

Carl H. Lindner III

Keith Alan Jensen
Former Senior VP & CFO

S. Craig Lindner

ANALYSTS

Amit Kumar
Fox-Pitt Kelton

Jay Cohen
Merrill Lynch

John Gwynn
Morgan Keegan

Unidentified Analyst

Presentation

Operator

Good day, ladies and gentlemen. And welcome to the Second Quarter 2008 American Financial Group Earnings Conference call. My name is Shenou and I will be your coordinator for today. At this time all participants are in a listen-only mode. We will be facilitating a question-and-answer session towards the end of this conference. [Operator Instructions]. As reminder this conference is being recorded for replay purposes. I would now like to turn the presentation over to your host for today's conference, Mr. Keith Jensen, Senior Vice President of American Financial. Please proceed.

Keith Alan Jensen
Former Senior VP & CFO

Thank you. Good morning. I am here with Carl Lindner III, and Craig Lindner, the Co-CEOs of American Financial Group, and we are happy to welcome you to the second quarter conference call.

If you are viewing this 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 projections, which management believes are reasonable, but by their nature, subject to risk and uncertainties. The factors which could cause actual results 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 Securities and Exchange Commission, including the Annual Report on Form 10-K, 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 items that are not considered to be part of ongoing operations, such as net realized gains and losses on investments, effects from accounting changes, discontinued operations, significant asbestos and environmental charges, and certain other non-recurring items. AFG believes it to be a useful tool for analysts and investors in analyzing ongoing operating trends, and will be discussed for various queries during this call. A reconciliation of net earnings to core net operating earnings is included in our earnings release.

Now I am pleased to turn the call over Carl Lindner III, Co-Chief Executive Officer of American Financial Group.

Carl H. Lindner III

Good morning and thank you for joining us. We released our 2008 second quarter results yesterday afternoon. I'd like to start by covering some highlights on slide 3 of the webcast.

Core net operating earnings per share for the quarter were $0.96 compared to $0.93 in the 2007 second quarter, reflecting the beneficial effect of our 2007 and 2008 share repurchases. Improved results in our annuity and supplemental insurance operations and higher investment income were more than offset by lower underwriting results in our property and casualty operations, largely driven by catastrophe losses.

Record core net operating earnings for the first half of 2008 were $2.05 per share compared with $1.84 per share for the comparable period in '07.

Net earnings were $0.52 per share compared to $0.54 per share in the 2007 second quarter. 2008 second quarter earnings were impacted by net realized losses on investments of approximately $41 million or $0.35 per share. These charges were primarily related to declines in the market value of our equity positions and financial institutions, including National City.

We also completed our previously announced asbestos and environmental internal review. The 2008 net earnings included a $0.09 per share charge for strengthening A&E reserves, whereas the 2007 second quarter results were impacted by $0.46 per share of A&E charges. We are pleased that there were no new emerging trends or issues at surface in connection with their review.

Our insurance results for the quarter and through the first half of the year continued at an excellent pace. Each of our four property and casualty business segments produced solid underwriting profit, and we continue to make progress towards meeting the company's 2008 objectives.

Our annuity and supplemental insurance businesses benefited from increased spreads in the annuity lines during the quarter and, to a lesser extent, improved loss ratios in the supplemental insurance lines.

Through the first half of 2008, our record core earnings were 6% above the 2007 period, and our annualized core operating return on equity was 16%. Our financial condition and liquidity remained very strong.

A book value per share of $27.59, excluding unrealized gains and losses on fixed maturities, was up 6% compared to $26.03 per share at the end of the 2007 second quarter. The increase at our unrealized losses on fixed maturities was primarily a result of the increase in market interest rates during the quarter.

If you turn to slide 4, I would like to review the results of our specialty property and casualty operations. Overall underwriting profit in the 2008 second quarter of $75.5 million was 34% lower than the same period a year ago. The combined ratio increased 6 points to 87.8, excluding the impact of the A&E reserves strengthening on the insurance run-off operations in both periods.

The 2008 second quarter results were impacted higher catastrophe losses of $25 million, principally from tornados in the Midwestern part of the United States and lower underwriting profits in several of our specialty insurance operations. We recognized nearly $70 million in favorable reserve development, compared to approximately $46 million in the comparable period in 2007.

Our underwriting profit and combined ratio through the first half of 2008, reflect the effects of a more competitive market conditions, but our results and returns are in line with our expectations.

I am encouraged by the stability of our overall rate levels. Excluding the effect of California workers' comp, average rates in the other specialty operations, through the 2008 second quarter, were down about 3%, from the same prior year period.

Gross and net written premiums were down slightly for the quarter. Decreases in net written premium resulted from competitive pressures in the commercial general liability and excess and surplus lines markets. The acquisition of Marketform in January of this year has helped us to offset some of those declines.

And now I'd like to go to slides 5 and 6. I'd like to review the second quarter and six months results for each of our specialty business groups.

The Property and Transportation group continued to generate solid underwriting profit, in the first half of the year. Second quarter results were primarily impacted by catastrophe losses, primarily within Great American's property and inland marine division. These losses were partly offset by higher favorable development in our crop business.

2008 gross written premiums for the quarter and year-to-date were reflected by delays in reporting farmers' acreage in our crop operations, due to the flood conditions in the Midwest.

Net written premiums were also reduced by a required statutory premium adjustment in the second quarter, related to our crop business. Additionally, Great American's property and inland marine and trucking operations, experienced volume reductions, caused by softer market conditions. These decreases were somewhat offset by higher premiums in our National Interstate subsidiary.

We expect to see stronger growth in this group in the second half of the year when the majority of our crop premiums are recorded, aided by the impact of higher crop prices. We continue to monitor the impact of our crop business, of the flooding that occurred in the Midwest during the second quarter. While it's premature to conclude as to the effects of the flooding, we are encouraged by initial reports regarding growing conditions and anticipated yields of corn and soybeans.

As we reported earlier, ultimate losses will be affected by specific locations, yields, commodity pricing and a reinsurance sessions. This group's average renewal rate levels for the first half of the year were about 3% below the same period a year earlier.

The Specialty Casualty group produce strong underwriting profits this year. The increase in its combined ratio for the second quarter and first half of 2008 was largely driven by lower levels of favorable reserve development in the general liability operations. The declines in gross written premiums were driven primarily by volume reductions in our excess and surplus lines, reflecting continuing competitive pressure in those commercial causality markets and lower general liability premiums, resulting from the softening in the homebuilders market. These declines were partly offset by additional premium from the Marketform group which was acquired in 2008 first quarter.

Net written premiums for the 2008 second quarter and year-to-date were comparable to the 2007 periods, as additional premium from Marketform and higher premium retention helped to offset the declines in the general liability and excess and surplus lines. This group's overall average renewal rate through the first half of 2008 was about 4% lower than in the 2007 period.

Specialty Financial group's second quarter underwriting profits were $5.6 million lower than those recorded in the prior year. Underwriting profit for the first half of 2008 was up 52% over the comparable 2007 period. The group's combined ratio for the second quarter was up 5.5 points due primarily to recent unanticipated underwriting losses in our run-off RVI business, partly offset by higher underwriting profits in our fidelity and crime and surety operations.

The combined ratio for the first half of 2008 improved 2.6 points, primarily driven by improved surety and fidelity and crime results.

Rising fuel prices have led to recent declines in used car prices for larger vehicles, even those that have historically held strong residual values. Until the recent weeks, the remaining contracts are running off profitably, but recent developments required adjustments to our reserves.

The Specialty Financial group's 2008 results benefited from favorable reserve development, largely within the fidelity and crime and surety operations. The increases in net written premiums for the 2008 three and six month periods were primarily driven by the financial institutions operations, which more than offset higher premium cessions in our lease and loan operations.

This group's renewal rates through the first half of this year were about 2% lower than in the year earlier.

Moving on to our California workers' comp business, that business has continued to generate excellent profitability through the first six months of '08. The group's combined ratio for the second quarter and first half of 2008 was down from the comparable 2007 periods, primarily as a result of increased favorable prior year reserve development. The improved claims environment resulting from the California workers' comp reform legislations continued to benefit our results as well as those at the industry.

Due to long-tail nature of this business, we continue... we'll continue to be conservative in our reserving until a higher percentage of claims has been paid and the full impact of California reform can be determined.

The decline in net written premiums reflects the effect of lower rates, partially offset by this group's expansion of its excess workers' comp products. Renewal rate decreases in California averaged about 16% through the first half of this year.

Now I would like to move on to a review of our Annuity and Supplemental Insurance group, on slide 7. The Annuity and Supplemental Insurance group generated core operating earnings, before income taxes, for the 2008 second quarter that were 30% higher than the same period a year earlier. The increase is primarily due to higher earnings in the fixed annuity and supplemental insurance businesses, partially offset by lower earnings in our variable annuity operations.

Core operating earnings, before income taxes, for the first half of 2008 were relatively unchanged from the same 2007 period, as higher earnings attributable to the fixed annuity and supplemental insurance operations were offset by earnings declines in our variable annuity and run-off life operations, as well as costs associated with new initiatives.

We continue to work toward improving the annuity and supplemental insurance group's return on equity, and are pleased to see the favorable impact of wider spreads in a fixed maturity market.

Statutory premiums for the second quarter of 2008 were 18% higher than the second quarter of 2007, primarily resulting from annuity sales through our new bank annuity distribution channel launched in the second quarter of this year as well as increased sales of traditional fixed annuities. These increases were partly offset by lower sales of indexed annuities in the single premium market.

Premiums through the first six months of this year were relatively unchanged over the prior period. Higher annuity sales through the bank, new bank annuity channel were offset lower indexed annuity sales.

We're enthusiastic about our new initiative of selling fixed annuities through banks that began this year and believe it will help to expand our penetration in the fixed annuity market.

Moving to slide 8, we recently completed the previously announced comprehensive internal review of AFG's asbestos and environmental exposures relating to the run-off operations of our property and casualty group and exposures related to former railroad and manufacturing operations and sites. The review was done by our internal A&E, claims specialists in consultation with in-house statuaries and outside specialty counsel.

The most recent external study was completed about the same time last year. As you can see on slide 8, property and casualty group's asbestos reserves were increased by $6.5 million and its environmental reserves were increased by $5.5 million. At June 30, the P&C group's A&E reserves were $413 million, net of reinsurance recoverables.

During the course of this study there were no new identified the emerging trends or issues that management believes significantly impact the overall adequacy of AFG's A&E reserves. The modest increases were primarily due to reassessments of the potential loss on certainly outstanding cases. Survival ratio for asbestos reserves is 9.5 times paid losses and for A&E reserves, it's 9 times paid losses.

As you can see, these ratios compare favorably with A.M. Best's most recent report on A&E survival ratios of 8.6 times for asbestos reserves and about 8 times for A&E reserves at the end of 2006.

In addition, A&E study encompassed reserves for asbestos and environmental exposures of our former railroad and manufacturing operations.

Turning to slide 9, you'll see that asbestos and environmental reserves were increased modestly by $3 million, as a result of this review. We plan to perform an external comprehensive study next year and another internal review in 2010.

The market's continuing pressure on the price of common equities and financial institutions has depressed the pricing levels of many of our equities and some of our fixed maturity securities.

As a result, we recorded per-tax impairment charges of $61 million in the 2008 second quarter. Equities accounted for approximately 80% of the charges, primarily financial institutions, including National City.

At the end of the second quarter, AFG's carrying value in the remaining common equivalent shares of National City, were approximately $18 million. Approximately 98% of our portfolio of fixed maturity and equity securities is valued using prices from exchanges, prices provided by independent pricing services or quotes from brokers.

Our investment philosophy with respect to the securities that make up our mortgage backed securities portfolio has been consistent over a lot of years. And it's been focused on a senior tranches of these securities, which has cushioned us against significant market value declines. Our mortgage-backed securities represent approximately 31% of our investment portfolio. 97% of these securities have AAA ratings and substantially all are senior classes of securitizations.

We recognize the market's interest in issues related to mortgage-backed securities with sub-prime and Alt-A collateral. Accordingly, we've provided detailed information about our position in these securities in our supplemental financial package on our website. Suffice it to say, we haven't experienced significant losses in this market, and given current circumstances, we don't believe that our risk of loss will have a material adverse impact on our financial position.

We continue to monitor our insurance operating exposures related to sub-prime issues. Based on our review of claims notices and the facts and circumstances of which we are aware, we have no significant individual losses, and don't believe, our aggregate operating exposures related to sub-prime issues would be material to our financial condition.

Now I'd like to summarize some key aspects of our strategic focus outlined on slide 11.

We are focused on specialty niche markets within the property and casualty insurance and annuity and supplemental insurance industries where we have significant expertise. We will pursue appropriate uses of our excess capital, including internal growth opportunities within our existing portfolio of businesses, acquisition and startup opportunities that meet our specialty strategy and financial objectives and opportunistic share repurchase and change in dividend levels.

We believe we're well positioned to take advantage of the capital market disruptions. As a plan... as a result, we do want to keep some capital in reserve for opportunities that may arise.

And we remain committed to our strong underwriting culture, pricing discipline, risk management philosophy and continually monitor the adequacy of our rates in all markets. We have and will continue to reduce business volume and lines as needed, to achieve appropriate underwriting results.

Our investment group will focus on achieving returns over the long term that outperform various market indices, while effectively managing our portfolio risk, and we'll evaluate opportunities within our real estate portfolio.

The long-term objective is to achieve operating returns on equity between 12% and 15% along with consistent growth in book value.

We remain very enthusiastic about this year. And our expectations for 2008 are outlined on slide 12. We now expect net written premiums to be slightly above the prior year in our specialty property and casualty operations with a combined ratio range of 85% to 87%.

Because of our strong underwriting culture we expect to maintain adequate rates. That said, we do anticipate a modest decline in our overall average renewal rates in 2008 due to competitive conditions in certain markets. We expect net written premiums in our Property and Transportation group to increase 5% to 8%, primarily fueled by higher crop premiums as well as some new initiatives in our transportation businesses. This group should also maintain its excellent underwriting track record with a combined ratio in the range of 86% to 90%.

Our 208 guidance is based on assumptions that our accident year underwriting results in a crop operations will be about 50% or $60 million lower than our record 2008 results. Though it is very early to really conjecture.

We remain optimistic about growth opportunities in the Specialty Casualty group, resulting from our recent investment in Marketform and international expansion opportunities. We also expect the Strategic Comp acquisition to further expand our penetration and increase our geography coverage in the workers' comp market. Therefore we project flat to 3% growth in net written premiums, for specialty casualty.

We also expect this group to generate strong underwriting profit with a combined ratio in the range of 78% to 81%.

We are pleased with the performance of our Specialty Financial group through the first half of this year but are disappointed with the recent results in our run-off RVI business.

Overall we expect underwriting margins for the year to improve over 2007.

We look for this group's combined ratio to be in the range of 91% to 94% this year. And we project net written premiums to be flat to down percent... or down 2% for 2008.

This modest decrease is a result of the impact of recently announced reductions or eliminations of automobile leasing programs by automobile manufacturers.

We expect to see rate decreases in the California workers' comp market, moderate somewhat in the second half of this year. With that, and the expansion of our excess workers' comp program, we anticipate that net premium... net written premiums would be down about 6% to 9% this year. The combined ratio should be between 77% and 80% providing excellent returns on this business.

Based on recent market conditions and trends we expect full year core pre-tax operating earnings of our annuity and supplemental insurance group to be 8% to 12% higher than in 2007. Anticipated earnings growth in the fixed annuity and supplemental insurance lines is expected to be partially offset by lower earnings in the variable annuity and run-off life operations, as well as costs associated with new initiatives, primarily our new variable initiative.

Fixed annuity earnings in 2008 are expected to be 15% to 20% higher than in 2007 due primarily to higher spreads. New annuity initiatives were launched in the first half of 2008 in our variable operations and in the bank market. Overall annuity sales are expected to be up this year.

Growth from new initiatives is expected to more than offset anticipated declines in the sales of indexed annuities. Increased competition from the government subsidized Medicare Advantage product will likely continue to impact our supplemental insurance operations, and we expect these premiums to be flat to slightly down in 2008. Earnings from our supplemental insurance operations in 2008 are expected to be 10% to 15% higher than last year.

Our 2008 core net operating earnings guidance remains at between $3.90 and $4.10 per share. These expected earnings do exclude the potential for significant catastrophe and crop losses, unforeseen adjustments asbestos and environmental reserves and large gains or losses from asset sales.

And now we'd like to open the lines for any questions. Thank you.
Question And Answer

Question and Answer

Operator

[Operator Instructions] And your first question comes from the line of Jay Cohen of Merrill Lynch.

Jay Cohen
Merrill Lynch

Thank you. And still, I don't know, kind of good morning, good afternoon is right [indiscernible]. I've got a bunch of questions. Let me start with just several. The first is, in the property and transportation segment, in the second quarter did you record any losses in the crop business? I think you really don't get those of the second half or did you book some reserves for that?

Keith Alan Jensen
Former Senior VP & CFO

We did not. Jay, as we have indicated, it's really pre-mature to look forward and know what the answer is. This is something that we will analysis it in the third quarter and then the finalize it in the fourth quarter.

Carl H. Lindner III

Jay,as I mentioned, in our guidance we are figuring an accident year that's $60 million less or about 50% less than last year's record accident year in that. So we are. So we know what the reserves, where we are... we're trying to be conservative.

Jay Cohen
Merrill Lynch

Yes, the other way can be that, actually put some stuff in the second quarter, and you guys have done that. But it's obviously incorporated in your view for the year. And the share count seemed to go up in the quarter, kind of quarter end share count, I am just wondering what was happening there and were there any repurchases in the quarter?

Keith Alan Jensen
Former Senior VP & CFO

There were about $800,000 of repurchases in the month of April. The reason you saw the share count go up in the quarter is because when we retired the convertible issue, we issued shares for the premium. And my recollection is that, that was 2.2 million shares or something in that range.

Jay Cohen
Merrill Lynch

Right, right, that's helpful. Okay, and then on annuity life business, can you give us the core earnings for that business from the third and fourth quarter of last year, excluding the minority interest?

Keith Alan Jensen
Former Senior VP & CFO

I think we'll need to get back to you on that. I don't know that we have that specifically in front of us, we're working off [indiscernible].

Jay Cohen
Merrill Lynch

That's great, thanks a lot.

Operator

And your next question comes from the line of John Gwynn of Morgan Keegan.

John Gwynn
Morgan Keegan

Thanks. Carl, a company that most analysts and investors uses a peer comparison for AFG, those with consolidated, recently cut a deal with a Japanese company, what seemed to be a pretty favorable price. Do you have any comment on that transaction?

Carl H. Lindner III

It'sbeen a very good company. Tokyo had a very specific strategic objective in mind. Photojia [ph] shareholders got a great price for the company. I suppose if somebody have approached us with the three times book type of proposal and those kind of multiples, we, along with anybody else will have to think seriously about something like that.

John Gwynn
Morgan Keegan

Jim Maguire probably learned part of this property casualty lessons at Great American earlier in his career, I guess you also learned how to cut a deal too.

Carl H. Lindner III

I'd say so, yes, I think he used to work in our D&O operations when he was first entering the industry in that. But now clearly, Jim is very bright. I guess, he obviously got a good education from us too.

John Gwynn
Morgan Keegan

Right. Keith, would you care to comment on the change in your credit arrangements during the quarter?

Keith Alan Jensen
Former Senior VP & CFO

Sure during this quarter, we have entered into an additional credit agreement. We have an outstanding $500 million line of credit. As of the end of the quarter, we have drawn about $395 million of that. We have decided that, it was prudent for us to add into credit facility. So we have entered into $120 million supplemental line of credit which just gives us additional liquidity and cushion against any unforeseen outcomes.

John Gwynn
Morgan Keegan

Okay. And Keith, in the first half of the year, is there any crop... in the second quarter is there crop premium actually booked?

Keith Alan Jensen
Former Senior VP & CFO

Very, very modest.

John Gwynn
Morgan Keegan

Okay and most of this occurs in the third quarter and some falls into the fourth quarter, right?

Keith Alan Jensen
Former Senior VP & CFO

Yes, that's correct.

John Gwynn
Morgan Keegan

Okay. Craig, of the $49 million of equity impairment in the quarter, what portion of that pre-tax... what portion of that was net savings.

S. Craig Lindner

Let me get you that number here, John.

Carl H. Lindner III

Craig I've got, that was about $19 million.

S. Craig Lindner

19 million from net savings.

Carl H. Lindner III

Yes.

John Gwynn
Morgan Keegan

That's pre-tax.

Carl H. Lindner III

Pre-tax.

John Gwynn
Morgan Keegan

Okay. And Craig, at the cap rate level you mentioned improvement in spread, is that both action on creditive rights end market yields or is it one way or the other?

S. Craig Lindner

It is both, John I would say that it's more driven by the opportunity to buy investments that are much wider spread.

John Gwynn
Morgan Keegan

Okay. And Craig at cap rate I assume you reviewed that quarterly, other any concerns we should have about that say during the third quarter?

S. Craig Lindner

We take a look at that on a quarterly basis, the really thorough analysis and actually is a fourth quarter analysis, John. But spreads that we're enjoying right now are actually wider than what we have assumed in our back amortization.

John Gwynn
Morgan Keegan

Okay. And also Craig, on the 403b market, there have been a number of changes here recently. Is there anything that's materially affected your operations?

S. Craig Lindner

We'll find that here in a couple of months. The whole industry is going through a process right now where... with the implementation of the 403b regs which will be effective January 1 2009, each of the school systems is being given different responsibilities. And they have had... historically they're being given responsibility to basically administer the 403b plans for all the teachers. And what that means is most of the school systems are putting a TPA in place to handle that and are going through a process right now to identify the companies that they're going to allow to sell in the school district.

And hard to predict with a lot of accuracy where everybody is going to end up. I think at the end of the day, we will be in a fewer school districts but the number of companies selling in each of the individual school systems will go from 13, 14, 15 of five or so. We do a lot more business in fewer school systems. And I'd say we're about a third of the way through the process right now. And pretty early, we are doing in the RFP, RFI process that we are going through.

John Gwynn
Morgan Keegan

And the recent SEC moves on variable products, is that something that you think you are at a relative advantage or disadvantage on if it is indeed finalized that way?

S. Craig Lindner

Do you mean that equity indexed annuity product?

John Gwynn
Morgan Keegan

Right, right I am sorry.

S. Craig Lindner

Yes, first of all, the feedback that we get from the industry is that the industry is pretty much unanimous in their opposition to the proposal as outlined. So we would expect to see some changes but I certainly think that we are going to be in a descent position to continue to get our share of the market, kind of no matter what changes are put in place.

John Gwynn
Morgan Keegan

Okay, great. That's all I have. Thank you.

Operator

And your next question comes from the line of Gary Lenov [ph] of Ironwork.

Unidentified Analyst

Thank you. I was hoping you could repeat your outlook for the property and transportation business for the full year. I missed, when you said, you expect the net written premium fee --

Carl H. Lindner III

Behappy to. Our net written premiums in the property and transportation group will increase 5% to 8%, really fueled by higher crop premiums as well as some new initiatives in our transportation businesses. Also, the group will also have a combined ratio guidance of 86% to 90%, combined ratios. And again what I mentioned to Jay is our '08 guidance for our combined ratio is based on the assumption that our accident year underwriting results in our crop operations will be about 50% or $60 million lower than the record 2007 results that we had.

Unidentified Analyst

: Okay, that's helpful. In the release you have mentioned that your net written premiums in the quarter, in property and transportation business were affected by... you mentioned, required statutory premium adjustments as well as I guess the delay in premium reporting due to the flooding. Can you just elaborate on what are those premiums that required adjustments, and can you help us just a magnitude of the impact because of the flooding?

S. Craig Lindner

Sure, the premium adjustments are actually a strange accounting rule, SSAP-78 where the premium has to be reduced by the amount of Federal Crop Insurance Corporation's underwriting gain, after non-proportional insurance. It's a long way of saying that the premium is actually reduced for accounting purposes by the underwriting gain, that goes off to the Federal government. So that's what we are referring to, and you will see that there was a similar adjustment in the previous year. And that's in part reflective of the fact that in 2007 period the profits that we had were actually in excess, as Carl said earlier, they were record profits. And so that affected that adjustment. I think you had a second question, what was that?

Unidentified Analyst

The second question was I recognized that most of the premium is reported, crop premium is reported in the third quarter. But you made a mention of the fact that your written premiums for the second quarter were impacted by the delays related to the floods?

S. Craig Lindner

That's correct. What happened is the Federal government actually gave farmers, a one month reprieve on their acres planted reporting. And so we will be on a one month lag. So we'll be receiving what we normally would have had in June, in July and then likewise July and August.

Unidentified Analyst

Can you share the magnitude of what that might be?

S. Craig Lindner

I don't really have a sense of that. I'd like to say to you is that in... if you look at prior years, the amount of premium that's recorded in the first part of the year, first half of the year is very modest. The vast majority of the premium is recorded in the third and fourth quarters.

Unidentified Analyst

Okay.

Carl H. Lindner III

Okay, between crop prices, I mean for the whole year between what's happened with crop prices and now the continued expansion of plan net, our crop business is going to be up double-digit for us this year is what we think.

Unidentified Analyst

Okay, great. Gentlemen thank you very much.

Operator

And your next question comes from the line of Amit Kumar of Fox-Pitt Kelton.

Amit Kumar
Fox-Pitt Kelton

Yes, thanks so much. Just going back to the discussion on the crop book. Can you just refresh us as to what are the terms of Munich Re cover?

Carl H. Lindner III

Sure in the Munich Re cover, what we do is, if you take $100 of crop premium about 25% of that ceded to the federal government under their various accruals and the remainder is 50/50 quota share with Munich Re. And in that quota share they pick up half of their residuals. So retained roughly 35% to 40% of the gross written premium.

Amit Kumar
Fox-Pitt Kelton

Okay that's very helpful. And has there been an any change in terms of... I know you have talked about your crop book being up double digits. But going forward, is there any change in terms of the by state distribution based on what has happened recently?

Carl H. Lindner III

I don't think there have been any meaningful changes here over the past year.

Amit Kumar
Fox-Pitt Kelton

Okay and finally, I think you have touched upon this previously. But you've added to Alt-A now I think it's at $930 million, in Q1 it was close to $700 million. Do you think this is the appropriate level where you wanted to be or could there be like, what's that thought process going forward?

S. Craig Lindner

I think we are probably close to the maximum amount that we are comfortable within Alt-A securities. And we have just viewed some of the opportunities as being very, very attractive here in the last 3 to 4 months. But I think we are up about at the limit of our comfort level. Even though we feel very good about what we have purchased and, the market values reflected, we've been in the right spot, buying those securities,

Amit Kumar
Fox-Pitt Kelton

Okay, that's helpful. And one, finally one quick numbers question, do you have unrealized real estate gains number?

S. Craig Lindner

With caveat that we don't go through and do a full appraisal, when we look at the cash flow and reasonable multiples on that cash flow, we are looking at roughly $100 million to $150 million of unrealized pre-tax.

Amit Kumar
Fox-Pitt Kelton

So that's nearly double right, previously I thought it was 65 in Q1.

S. Craig Lindner

No it's similar to what we've had for last... for a while.

Amit Kumar
Fox-Pitt Kelton

Okay, that's very helpful. Thanks so much.

Operator

And your next question comes from the line of David Kukupa [ph] of Amber Capital.

Unidentified Analyst

Hi, and good afternoon. I was wondering if you can show us that you are worried about some potential taxes change, as far as the Presidential election. For example, estate taxes or capital gain taxes that could incline a company like yours which is family controlled to contemplate consolidation?

Carl H. Lindner III

I think we are like other business executives or business families, sure a change in tax rates or in personal income, sure. That's something that we are concerned about. And we are in involvement of political process and that we hope have some impact on that.

Unidentified Analyst

Okay. Also maybe if you can discuss about the consolidation, say again but more on your strategic view, if there were any new business line you would like to enter, where it would make more sense for you to enter through acquisition versus growing organically, on trying to develop the business?

Carl H. Lindner III

Well, we have grown our business both internally as well as making acquisitions. We are pretty active in the first half of this year, through the purchase of around two-thirds of Marketform, which helped us enter the new niche of non-US made now. We also are excited about that acquisition in that we have had pent-up demand by our US executives to write business in Europe, businesses like fidelity and crime, D&O, ocean, marine, large property. And we think Marketform will give us an excellent opportunity, to do that. We've made or are in the process of making a number of hires in those key specialty areas. And we expect there to be some positive impact from those hires in 2009. So, we are always looking for ways to increase our market position in the some 25 or 26 specialty property and casualty businesses that we already have or looking for new opportunities. And we're always out there.

Unidentified Analyst

: Thank you very much.

Operator

: [Operator Instructions]. And your next question comes the line of Jay Cohen of Merrill Lynch,

Jay Cohen
Merrill Lynch

Just a couple of other questions. First is, the California comp business, once again great results there. We did see at least one of your I think better competitors in California begin to have some issues on the margins. And I am wondering if you can sort of describe what you do differently than others and as why your margins have held out better?

Carl H. Lindner III

Well, I mean, we and Zenith and a few others have been special hatching in that market for, forever. And we have Republic or Work Comp subsidiary there has outstanding claims operation and our underwriting folks really have probably looked at every risk or a lot of the most efficient California of any size over long period of time. So I think that, that makes a difference.

As we've mentioned, we've been probably more conservative with our loss reserves than maybe quite a few of our competitors wanting to see how California reform plays out in that. So, I think maybe that's one reason why we've been able to, maybe report stronger, calendar year results. Maybe longer than, some others in that. I think the small to medium sized right now, side and I think that maybe has also helped us maybe versus, some others in that. Those should be the things that would probably come to mind.

Jay Cohen
Merrill Lynch

All right thanks Carl. And the other question, in the RVI business I know that has been run-off, for some reason I have thought your exposure was at this point quite minimal. So I think it's little surprise to see the losses flowing through. If used car prices continued to decline, what kind of exposure do you have in the second half of this year and into next year for further underwriting losses? Or did you try and take that into account when you did reserves in 2Q?

Keith Alan Jensen

Former Senior VP & CFO

Let me take the first part of your question first Jay. I think that we have said is that in the past reporting periods that the programs that we had been in for RVI were essentially gone except for one with the one measure manufacturer that where we never had any losses. All of these businesses have been put into run-off and that manufacturer has about another year of leases. And the manufacturer is Honda, and I think we have said that in a variety of forums.

What we are seeing is with the gas prices Honda, some of their larger vehicles are having unusual drops in their used car values as well. And so we've put up the additional amount this quarter to try and be conservative and take that into account. Clearly if there was a dramatic additional drop, there would be some additional losses on our part but we think we're in pretty good shape on it at this point in time. And the amount that we put up in this quarter was about $10 million.

Jay Cohen
Merrill Lynch

That's helpful. So if used car prices kind of stay where they are, depressed, but don't decline more, you are saying it should be okay in the second half of the year?

Keith Alan Jensen
Former Senior VP & CFO

Yes, that's right and remember that we're talking about Honda.

Jay Cohen
Merrill Lynch

Right, right. Yes, I guess it could have been...

Keith Alan Jensen
Former Senior VP & CFO

It's not across a broad market. Broad market we're out of.

Carl H. Lindner III

Jayin the past... I have got to probably make some comments feeling that we might even have some favorable run-off there in Honda. And I think, with fuel prices where there were, that perspective has changed. Just as Keith mentioned because of the drop in the SUV part of their stuff. So, there won't be any favorable development with... if the used car values stay the same, we'll fine probably with the charge we took in the same quarter, some launch.

Jay Cohen
Merrill Lynch

I guess you made good two decisions, one to exit the business and two, not do any huge deals with GM otherwise it might be in more difficult position at this point.

Carl H. Lindner III

That might be true.

Jay Cohen
Merrill Lynch

Thanks.

S. Craig Lindner

Jay, let me.. you had asked a question earlier that I've got an answer for you now. You had asked about third and fourth quarter of '07.

Jay Cohen
Merrill Lynch

Yes.

S. Craig Lindner

GA-PR operating earnings, that was $57 million for that 6 months period. And that's before consideration of debt expense and before consideration of minority interest.

Carl H. Lindner III

Yes Jay, another part of our business are premier, lease and loan business. The three auto manufacturers in decisions on leasing programs, probably will hurt us from... but it's doing [ph] revenue by about $30 million through some other products in that, but more on the revenue side I think than the profitability side, probably not much on that side.

Jay Cohen
Merrill Lynch

Okay that's helpful. Thanks guys.

Operator

There are no further questions. I will now like to turn the call back over to Mr. Keith Jensen.

Keith Alan Jensen
Former Senior VP & CFO

All right thank you. We appreciate your taking the time to join us and we look forward reporting to you at the end of the third quarter. Thank you and have a good day.

Operator
Ladies and gentlemen that concludes the presentation. Thank you for participation. You may now disconnect. Have an excellent weekend.