S&P Global
Market Intelligence

American Financial Group, Inc. NYSE:AFG

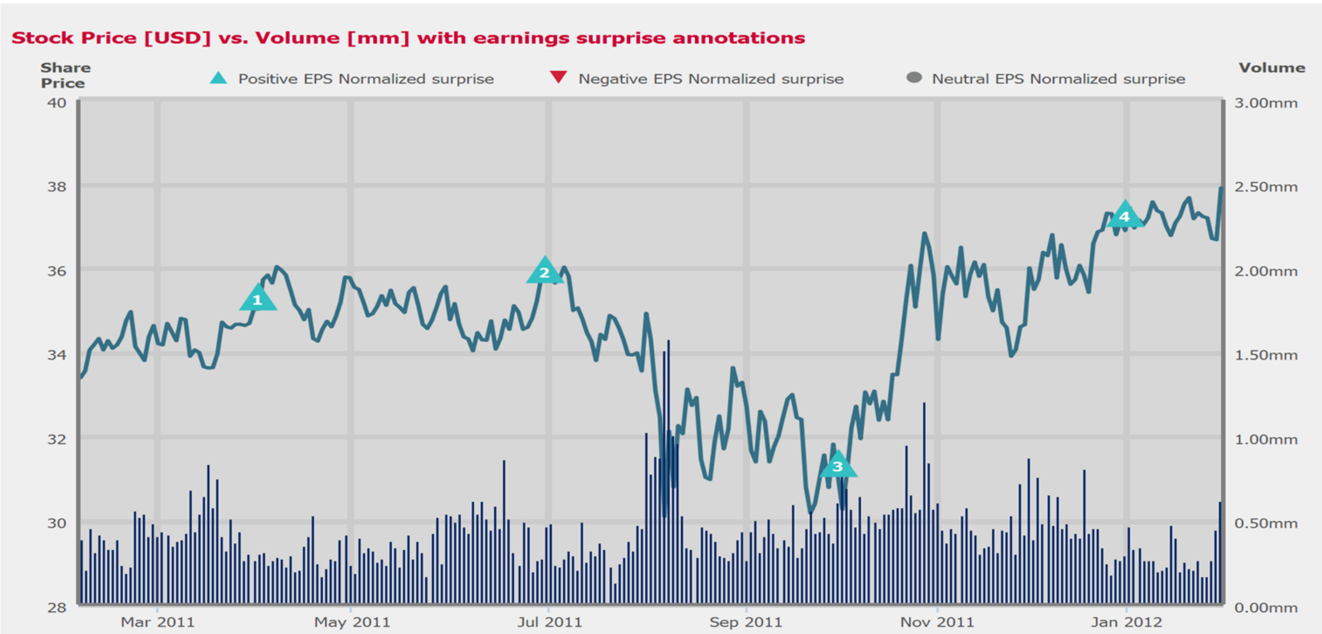
FQ1 2012 Earnings Call Transcripts

Tuesday, May 01, 2012 3:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2012-			-FQ2 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.78	0.86	10.26	0.76	3.65	3.75
Revenue (mm)	723.68	607.00	(16.12 %)	-	2827.00	2905.00

Currency: USD
Consensus as of May-01-2012 1:28 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2011	0.79	0.81	2.53 %
FQ2 2011	0.56	0.78	39.29 %
FQ3 2011	0.82	0.90	9.76 %
FQ4 2011	0.94	1.06	12.77 %

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Call Participants

EXECUTIVES

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

Diane P. Weidner
Assistant Vice President of Investors Relations

ANALYSTS

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Matthew Jay Rohrmann
Keefe, Bruyette, & Woods, Inc., Research Division

Ryan J. Byrnes
Macquarie Research

Presentation

Operator

Good morning. My name is Tina and I will be your conference operator today. At this time, I would like to welcome everyone to the American Financial Group 2012 First Quarter Earnings Conference Call. [Operator Instructions] Thank you. Ms. Weidner, you may begin your conference.

Diane P. Weidner
Assistant Vice President of Investors Relations

Good morning and welcome to American Financial Group's First Quarter 2012 Earnings Results Conference Call. I'm joined this morning by Carl Lindner III, and Craig Lindner, Co-CEOs of American Financial Group. If you're viewing a webcast from our website, you can follow along with the slide presentation if you 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 are 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 on investments; effects of certain accounting changes; discontinued operations; significant asbestos and environmental charges; 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, and thank you for joining us. We released our 2012 first quarter results yesterday afternoon and are pleased with another quarter of strong operating earnings in our Specialty Property and Casualty and Annuity and Supplemental businesses. I am assuming that the participants on today's call reviewed our earnings release and supplemental materials posted on our website.

I am going to review a few highlights and focus today's discussion on key issues. I will also briefly discuss our outlook for 2012. Now let's start by looking at our first quarter results summarized on slides 3 and 4 of the webcast.

Prior year financials result have been adjusted to reflect the impact of the adoption of a new FASB standard regarding the accounting for costs associated with acquiring insurance contracts. This resulted in a reduction in AFG's December 31, 2011 shareholders equity of approximately a $134 million which is about 3%.

Net earnings were a $1.14 per share for the quarter including realized gains of $0.28 per share primarily from the sale of a portion of our remaining interest in Verisk Analytics. Core net operating earnings for the quarter were $85 million or $0.86 per share compared to the prior year's result of $91 million or $0.85 per share.

Our profit in our Annuity and Supplemental Group was more than offset by lower underwriting profit in our Specialty Property and Casualty operations and lower Property and Casualty investment income. Both periods reflect the affect of share repurchases. Our annualized core operating return on equity was approximately 9%.

We have continued to deploy our excess capital in ways that enhance shareholder value. We repurchased a 1.5 million shares of our common stock during the first quarter at an average price of $37.91 per share or approximately 95% of March 31, 2012 book value per share. As of April 30, 2012, there are approximately 6.5 million shares remaining under our repurchase authorization.

In addition to share repurchases and dividends we continue to seek other alternatives for deployment of excess capital. We've invested excess capital when we see potential for healthy profitable organic growth and by introducing new products and services. And we are always looking for opportunities to expand our Specialty niche businesses through start ups or acquisitions, where it makes sense.

As you will see on slide 4, AFG's book value per share excluding appropriated retained earnings and unrealized gains and losses on fixed maturities increased 4% during the quarter to $40.07. Tangible book value on a comparable basis was $37.69 at March 31, 2012.

Our capital adequacy, financial condition and liquidity remained strong and are key areas of focus for us. We've maintained sufficient capital on our insurance businesses to support our operations at a level such that capital adequacy is not a matter of concern to the rating agencies. We are pleased that during the first quarter A.M. Best changed the outlook on several grade American Property and Casualty companies from stable to positive.

Our excess capital was approximately $770 million at March 31, 2012 which included cash at the parent company of approximately $380 million. On slide 5, you'll see summary results for our Specialty Property and Casualty operations. The Property and Casualty Specialty Insurance operations churned in another strong period, reporting an underwriting profit of $48 million for the first quarter of 2012 and generating a combined ratio of 92%, one point higher than the comparable period in 2011.

Gross and net written premiums were up 9% and 4% respectively in the 2012 first quarter compared to the same quarter a year earlier due primarily to increased premiums in our Specialty Casualty segment. We are seeing solid evidence of price increases in selected Property and Casualty markets with overall Property and Casualty pricing increases in back to back quarters for the first time in a few years. About two-thirds of our Property and Casualty business units achieved increases in the first quarter of 2012.

I'm really encouraged by the momentum in price increases that we are achieving and feel good about the opportunity for sequential increases in pricing in subsequent quarters. We expect to achieve a 3% to 5% increase in our overall average renewal rates in 2012.

Now I would like to discuss a few highlights from each of our Specialty Business Groups on slide 6. Property & Transportation Group, our largest segment reported an underwriting profit of $27 million during the first quarter of 2012, 25% lower than the 2011 first quarter. Improved results in our Crop Insurance operations were more than offset by lower underwriting profits in our Property and Inland Marine and Transportation businesses, primarily the result of lower favorable prior-year reserve development.

We are pleased that catastrophe losses in this group were nominal. Gross written premiums were up 3% during the first quarter of 2012 primarily due to higher winter wheat commodity prices and market firming in our Property and Inland Marine businesses. These favorable upward trends were offset somewhat by lower gross written premiums in our transportation business. Net written premiums were down 2% resulting from increased sessions of our Winter Wheat business.

Average renewal rates in Property & Transportation Group were up 2% in the first quarter of 2012, our biggest quarterly increase in this group in six years. The Specialty Casualty group reported an underwriting profit of $4 million and in 2012 first quarter, up from $1 million reported on a comparable 2011 period.

Higher profitability in our International, General Liability and Workers' Comp businesses were largely offset by lower favorable reserve development in our excess and surplus lines and executive liability businesses.

We experienced growth across the board in this segment and are seeing more business opportunities here arising from increased exposures and general market hardening. We are particularly pleased that nearly all businesses in this group achieved pricing increases during the first quarter with the overall group achieving a blended 4% increase for the quarter. This is the highest increase for this group since mid-2005.

Gross and net written premiums for the first quarter of 2012 were both up 15%. While nearly all businesses in this group reported growth, our high deductible workers' compensation and excess and surplus lines businesses were primary drivers of the higher premiums. Specialty Financial Group reported underwriting profit of $16 million for the first quarter of 2012, unchanged from the comparable 2011 period.

Nearly all the businesses in this group achieved excellent underwriting margins during the quarter. Higher gross-written premiums resulted primarily from a service contracts business initiated in the second quarter of 2011, where all the premiums were ceded under a reinsurance agreement.

Additionally, planned reductions in coastal and near-coastal property exposures in our Financial Institutions business contributed decreases in both gross and net written premiums for the quarter. Pricing in this group was flat for the first quarter of 2012.

Now let me move on to a review of our Annuity and Supplemental Insurance Group on slide 7. The Annuity and Supplemental Insurance Group reported a record first quarter pre-tax operating earnings of $67 million in 2012, a 24% increase over the comparable 2011 period. The 2012 results reflect higher earnings in our fixed annuity operations as well as improved results in our supplemental insurance lines.

Higher profitability in our fixed annuity operations were primarily result of a larger base of invested assets. In our supplemental insurance lines, Medicare supplemental results were significantly higher than last year due primarily to improved loss experience and lower policy lapses. In addition, the significant stock market increase in the first quarter of 2012 had positive impact on results and our variable and fixed index annuity blocks.

Statutory premiums of $906 million in the first quarter of 2011 were 60% higher than the first quarter of 2011, primarily due to the increased sales of fixed index annuities. Sales of traditional single premium annuities and annuities sold in the 403(b) market were lower when compared to the first quarter of 2011.

AFG sales of annuities through banks have grown substantially since entering this market in 2007 and comprised about 30% of the annuity and supplemental group's premiums in the first quarter of 2012.

While we have achieved rankings as the top-three annuity provider in several large regional banks, we also continue to expand distribution in super regional banks, which have assets in excess of $25 billion.

Now, please turn to slide 8 for a few highlights regarding our investment portfolio. During the first quarter of 2012, AFG reported net realized gains of $28 million, primarily on the sale of a portion of our remaining interest in Verisk Analytics.

As of March 31, 2012, we still held 2.5 million shares with an unrealized gain of approximately $113 million. Net unrealized gains on fixed maturities were $541 million, an increase of $82 million since December 31, 2011. A vast majority of our investment portfolio is held in the fixed maturities with approximately 88% rated investment grade, and 96% with a designation of NAIC 1 or 2. We have provided additional detailed information on the various segments of our investment portfolio and the investment supplement on our website.

Now, I would like to cover our outlook for 2012 on slide 9. Based on the first quarter of 2012 results, we now expect the 2012 full-year pre-tax core operating earnings in our Annuity and Supplemental Insurance Group to be 15% to 20% higher than in 2011. Accordingly, we have raised AFG's full-year 2012 core net operating earnings guidance to $3.40 to $3.80 per share.

Expectations for growth in net written premiums and guidance for combined operating ratios for each of our specialty property and casualty operations is outlined in slide 9.
These 2012 expected results exclude the potential for significant catastrophe and crop losses, significant adjustments to asbestos and environmental reserves, large gains or losses from asset sales or impairments and significant unlocking adjustments in the annuity and supplemental group. Thank you and now I would like to open the lines for any questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from Matthew Rohrmann, KBW

Matthew Jay Rohrmann
Keefe, Bruyette, & Woods, Inc., Research Division

First question, Carl, is it fair to say that with winter wheat and obviously soy has done well year-to-date that crop results perhaps are a little bit better than you expected so far into 2012?

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

I think the winter wheat crop seems to turn out pretty well. That said, our company takes a little bit more defensive position than most and quite a bit of our business seeded in the government bucket. Overall, I would say it’s real early on for a crop business, but crop planting conditions seem to be in pretty good shape right now. Doesn’t seem like there is any particularly troublesome issues right now.

Matthew Jay Rohrmann
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, great. And then, just any color that you can provide on the maybe slightly slower growth or margins on the transportation business?

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

I think that in the great American transportation business, we're focusing on improving profitability there versus growth. So we’re emphasizing rate over premium growth.

And the National Interstate management team can probably address that question better than me, but I think also they want to continue to show their stellar combined ratio that they've had there overtime and they are focused also on profitability along with some makes-sense growth this year.

Matthew Jay Rohrmann
Keefe, Bruyette, & Woods, Inc., Research Division

And then, just last quick numbers question, the catastrophe losses were small in the quarter. Was that $4 million in Property & Transportation or is it elsewhere?

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

I think the biggest part of that is in Property & Transportation, regarding losses…

Diane P. Weidner
Assistant Vice President of Investors Relations

There were also some losses in our Specialty Financial segment related to our financial institutions book, but again, obviously very small overall.

Operator

Your next question comes from Ryan Byrnes, Macquarie.

Ryan J. Byrnes
Macquarie Research

Just a quick question on the large deductible workers' comp book. What kind of rate increases are you guys seeing in that book and, I guess, obviously, how is that compared to loss cost trends? And maybe just to focus on which states you guys are seeing these increases already in the new business? Thanks.

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

Yes, on the strategic comp business, that's again our large deductible business just kind of business -- a pod of business outside of California. We are getting a double digit rate increases there and that is -- and, yes, both on new business and renewal business there. That may be one of places where it seems like we are getting greater pricing on new business versus renewals.

Ryan J. Byrnes
Macquarie Research

And just -- for loss cost trends, how is that, I guess [ph], book. Sorry, I am trying to get a view into how margins are looking.

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

I think on the strategic comp side, probably a lower frequency and some higher severity in 2010 and '11. And that would play along with what we are seeing on the ability to get price increase. It is an area of opportunity for us. We are getting price increase and we are able to grow our business and make sense there [ph].

Ryan J. Byrnes
Macquarie Research

And then just quickly, obviously you guys also mentioned that your E&S book is growing right now, what kind of -- are there any kind of lines in particularly you are seeing or you're seeing attractive submissions right now?

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

Yes, probably a couple of different things. We are seeing a lot of New York and other contracting liability type of business. We're also -- because it seems like the market on some -- where there were accounts that required fairly large primary liability layers which seems to be a little bit less capacity than there was and the ability to write some buffer types of layers that maybe weren't there before.

Ryan J. Byrnes
Macquarie Research

And then quickly, and just last one from me is that, I guess obviously your capital management obviously continued in the first quarter and just trying to figure out what type of market conditions would, I guess, cause you to slow your capital management program, say rates continue to be up 5% to 7%, what causes you guys to slow it down?

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

Slow repurchase activity?

Ryan J. Byrnes
Macquarie Research

Yes, exactly. For repurchase activity, yes.

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

Well, with an excess of $750 million of excess capital, we got plenty of flexibility to do plenty of share repurchase, to do small, medium size acquisitions and flexibility to keep [indiscernible] right now.

So I think the bigger factor is where is our stock trading at. As long as our stock is trading below book value and we're getting price increases in our Property and Casualty book and saying growing earnings in our annuity business, we think it's a smart thing to continue to repurchase a fairly significant chunk of our stock, particularly if it sells below book.

Operator

[Operator Instructions] Your next question comes from Jay Cohen, Bank of America-Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Most of my questions were actually already asked, but one other question and that is, in the Specialty and Casualty business can you talk about claims trend outside of workers comp. What are you seeing in some of those lines of business?

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

Surprisingly, overall in our business loss cost trends appear to be pretty benign. In the Specialty and Casualty group in particular, I think I mentioned strategic comp. I think in our P&L probably got some lower frequency, higher severity but it may be tied to our Canadian book. California workers comp, pretty stable, pretty benign on the frequency and indemnity side. Mid-Continent, where we specialized in home builders liability, the frequency and severity there are probably lower, just because of the soft economy, particularly as it impacts home builders now. But overall in our business, pretty benign. No common increase in frequency or severity across our business.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

It doesn't seem like on the surety side either with all the economic pressure, especially in the construction business, that you've seen any pressure there. Is that fair assessment?

Diane P. Weidner
Assistant Vice President of Investors Relations

Yes, Jay, it's Diane. I would say that, that is a fair assessment. We don't -- we really haven't seen any [indiscernible] trends in that line.

Operator

And there are no further questions at this time. Are there any closing remarks?

Diane P. Weidner
Assistant Vice President of Investors Relations

I would like to thank you all for joining us this morning, and we look forward to talking with you again when we report our second quarter results. Thanks and have a great day.

Operator
This concludes today's American Financial Group 2012 First Quarter Earnings Conference Call. You may now disconnect.