S&P Global
Market Intelligence

American Financial Group, Inc. NYSE:AFG

FQ2 2018 Earnings Call Transcripts

Thursday, August 02, 2018 3:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2018-			-FQ3 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.91	2.04	6.81	1.86	8.55	8.62
Revenue (mm)	1184.00	1161.00	(1.94 %)	1297.00	4891.00	5156.67

Currency: USD
Consensus as of Aug-02-2018 1:58 AM GMT

- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2017	1.30	1.61	23.85 %
FQ3 2017	0.84	1.06	24.71 %
FQ4 2017	1.64	2.20	34.15 %
FQ1 2018	1.92	2.42	26.04 %

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Call Participants

EXECUTIVES

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

Diane P. Weidner
Assistant Vice President of Investors Relations

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

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

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the American Financial Group 2018 Second Quarter Results Conference Call. [Operator Instructions] As a reminder, this call is being recorded. I would now like to introduce your host for today's conference, Ms. Diane Weidner. Ma'am, you may begin.

Diane P. Weidner
Assistant Vice President of Investors Relations

Thank you. Good morning, and welcome to American Financial Group Second Quarter 2018 Earnings Results Conference Call. I am joined this morning by Carl Lindner III and Craig Lindner, 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 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 Carl Lindner III to discuss our results.

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

Good morning. We released our 2018 second quarter results yesterday afternoon. If you'd please turn to Slide 3 of the webcast slides for an overview. Craig and I were pleased to report a new second quarter record for AFG's core operating earnings of $2.04 per share, up 27% from last year's second quarter. These results include excellent profitability in our Property and Casualty operations and outstanding results in our Annuity segment. Second quarter annualized core operating return on equity was a strong 15.1%. Net earnings per diluted share were $2.31 and included $0.27 per share in realized gains on securities. Craig and I thank God, our talented management team and our great employees for helping to achieve these results. Based on the results to the first 6 months of the year, we're increasing our 2018 core operating earnings guidance for AFG to be in the range of $8.10 to $8.60 per share, which is a $0.20 increase from our previous estimate of $7.90 to $8.40 per share. As with our initial guidance, we continued to assume an average crop year and a normalized level of catastrophe losses. We expect to have more clarity on these items when we report our third quarter results. Craig and I will each discuss our guidance for each segment of our business in more detail later in the call.

Now I'd like to turn our focus to our Property and Casualty operations. So please turn with me to Slides 4 and 5 of the webcast, which include an overview of second quarter results. As you'll see on Slide 4, our Specialty Property and Casualty Insurance operations produced a very strong core operating earnings and healthy growth during the second quarter. Gross and net written premiums both increased 11% in the second quarter of 2018 when compared to the same quarter a year earlier. Property and Casualty operating earnings were 10% higher year-over-year. Higher net investment income was the driver of the improved results, which Jeff will discuss later in the call.

Specialty Property and Casualty underwriting [Technical Difficulty] was in line with the strong results reported in the 2017 second quarter. The Specialty Property and Casualty combined ratio of 93.7% was 0.5 point higher than the year ago second quarter and included 3.9 points in favorable prior year reserve development. Catastrophe losses added 1.4 points. Overall, renewal pricing in our Specialty Property and Casualty Group was up 0.4% during the second quarter. That's the highest that we've seen in 13 quarters and is in line with our overall loss ratio trend, which is just below 1.5%. Loss cost trends remain stable, and we're keeping our eye on inflation and interest rates. Excluding our Workers' Comp business, overall renewal pricing was up 3.4% during the quarter, the highest it's been in 16 quarters. I'm pleased that we're seeing also broader price movement and achieving renewal rate increases in the majority of our Specialty Property and Casualty businesses. In our Workers' Compensation businesses, we continue to see pricing pressure associated with strong industry profitability. Despite the rate decreases, we believe we're making appropriate return [Technical Difficulty] businesses in the current policy year.

Now I'd like to turn to Slide 5 to review a few highlights in each of our Specialty Property and Casualty business groups. Our Property and Transportation Group reported a second quarter underwriting profit of $23 million compared to $21 million in the prior year period. These results include higher year-over-year underwriting profits in our transportation businesses and improved results in our ocean marine operations as well as lower underwriting profitability in our property & inland marine and equine mortality businesses. While the calendar year combined ratio improved to just under 94%, the underlying action at year combined ratio ex cats increased 2.5 points year-over-year, primarily as a result of losses in our aviation and equine mortality books. Catastrophe losses were $10 million for this group during the second quarter of '18 compared to $11 million in the comparable prior year period. Gross and net written premiums for the second quarter were both 7% higher than the comparable 2017 period. The growth is primarily attributable to new business opportunities in our property and inland marine business and continued rate increases in our transportation businesses. Overall, renewal rates in this group increased 4% on average for the second quarter of 2018. Renewal rate increases within National Interstate's book continue to be strong at 5% overall. We are achieving rate increases of approximately 8% in commercial auto liability, which were tempered a bit by increases of approximately 3% in auto physical damage.

Our crop year is shaping up nicely. Commodity futures prices for corn and soybean approximately 4% and 11% lower respectively than spring discovery prices. Growing conditions are favorable at this point in the season, with industry reports of 72% of corn crops and 70% of soybean crops in good to excellent condition with current yield projections for both to be slightly above their respective yield trends. Moisture levels in the soil and continued favorable weather through September are important to good results.

We continue to be encouraged by progress on the farm bill, which expires on September 30. Both the Senate and House have passed bills and the legislation is moving to conference. At this point, there is no measurable impact to crop insurance.

Turning to the Specialty Casualty Group. Specialty Casualty Group reported second quarter underwriting profitability of $29 million, which is unchanged from last year's second quarter. Higher profitability in our target marketed -- markets businesses were offset by lower year-over-year profitability in our excess and surplus lines. Catastrophe losses for this group were $1 million and $2 million in the second quarters of 2018 and '17, respectively.

Underwriting profitability in our Workers' Compensation businesses was very strong, and we continue to experience favorable prior year reserve development in this line of business. We're pleased with the geographic diversity and mix of business that we have within this line. Gross and net written premiums for the second quarter of 2018 increased 13% and 14%, respectively, when compared to the second quarter of 2017. Growth within Neon was the main driver of the higher premiums. Our general liability, executive liability in excess and surplus lines businesses also reported higher year-over-year premiums. This growth was partially offset by lower premiums in our Workers' Compensation businesses as noted earlier. Although renewal pricing within Specialty Casualty was flat in the second quarter, I'm very pleased with the pricing momentum I'm seeing in several of the businesses in this group, including excess liability and D&O. And excluding rate decreases in our Workers' Compensation businesses, renewal rates in this group were up approximately 3%, the highest they've been in 16 quarters.

Now our Specialty Financial Group reported an underwriting profit of $22 million in the second quarter compared to an underwriting profit of $23 million in the second quarter of last year. Higher underwriting profitability in our financial institutions business was partially offset by lower underwriting profitability in our surety business. Catastrophe losses for this group were $3 million and $5 million in the second quarters of 2018 and '17, respectively. All of the businesses in this group continued to achieve excellent underwriting margins with an overall combined ratio of 85.6% reported for the 2018 second quarter. Gross and net written premiums for the second quarter of 2018 were up 10% and 7%, respectively, when compared to the same 2017 period, primarily as a result of higher premiums in our financial institutions business. Renewal pricing in this group was up approximately 5% for the quarter. Higher renewal rates in our lender services businesses, primarily in response to catastrophe-exposed property accounts or accounts with prior year cat losses contributed to these results.

Please turn to Slide 6 for some review of our 2018 outlook in Specialty Property and Casualty Operations. We do expect a combined ratio for the Property and Casualty Specialty Group overall between 92% and 94%. We have increased our guidance for growth in net written premiums to be in the range of 4% to 8%, which is up from our previous estimate of between 3% and 7%.

Now looking at each segment, we now estimate a combined ratio in the range of 91% to 95% in our Property and Transportation Group. That's a slight improvement from a range of 92% to 96%, estimated previously. We continue to expect net written premiums to be flat to up 4% during 2018 for this group. We continue to expect our Specialty Casualty Group to produce a combined ratio in the range of 92% to 96%. We have increased our estimate for growth in net written premiums to between 6% and 10%, up from our previous estimate of growth of 3% to 7%, primarily as a result of the growth within Neon during the first half of the year. We don't expect the growth rate at Neon in the second half of the year to match the growth rate reported during the first half. We have revised our expectations for the combined ratio for the Specialty Financial Group to be in the range of 86% to 90%, up slightly from the range of 85% to 89% estimated previously. And we have raised our projection for growth in net written premiums to be in the range of 3% to 7%, which is up from our previous estimated growth between 2% and 6%. We continue to expect overall Property and Casualty renewal pricing this year to be up 1% to 2% overall. And given the strong performance of certain investments, including limited partnerships and similar investments during the first 6 months of the year, net investment income is now expected to grow between 10% and 13% year-over-year from the 4% to 6% growth, previously estimated. I'll now turn the discussion over to Craig to review the [Technical Difficulty] our Annuity segment and AFG's investment performance.

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

Thank you, Carl. I'll start with a review of our Annuity results for the second quarter beginning on Slide 7. Statutory Annuity premiums were $1.4 billion in the second quarter of 2018 compared to $1.3 billion in the second quarter of 2017, a new quarterly record for the Annuity. Significant -- significantly higher premiums in the retail and broker-dealer channels potentially offset by lower premiums in the financial institutions channel. Reduction in the retail and broker-dealers markets was particularly strong due to the launch of several new products in addition to an improving interest rate environment in the first half of 2018. Our indirect back channel premiums have softened due to certain competitors offering significantly higher credited rates. Pretax Annuity earnings were $99 million in the second quarter of 2018 compared to $85 million in the second quarter of 2017, an increase of 16%. As you can see on the slide, included in these results is a $27 million unlocking charge. We monitor the major actuarial assumptions underlying our Annuity operations throughout the year and conduct detailed reviews or unlocking of assumptions in the fourth quarter of each year. If changes in the economic environment or actual experience would cause material revisions to future estimates, AFG will unlock assumptions in an interim quarter.

Due to continued higher FIA option costs, resulting primarily from higher-than-expected risk-free interest rates, we unlocked assumptions for option costs and interest rates in the second quarter of 2018, resulting in a net charge to earnings of $27 million. The unlocking charge takes into account the negative impact of higher option costs, partially offset by higher reinvestment rates. In addition, we've started adjusting FIA renewal caps to help mitigate the higher option costs. These actual and expected cap decreases were used in calculating the unlocking charge. We will continue our practice of conducting detailed reviews of assumptions, including option costs and interest rates in the fourth quarter of each year, including the fourth quarter of 2018.

Turning to fair value accounting, under GAAP rules, 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 rates, option costs, surrenders, withdrawals and mortality. Variances from these assumptions as well as changes in the stock market would generally result at a change in fair value. Some of these adjustments 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 FIA embedded derivative reserve. The amount of the 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 second quarter of 2018, interest rates rose 20 to 25 basis points compared to our estimate of a 5 basis point increase, and the stock market increased nearly 3% compared to our expectation of a 1% increase. The significant favorable impact from these 2 items relative to our expectations more than offset continued higher FIA option costs. By comparison, during the second quarter of 2017, the benefit of a higher stock market was more than offset by lower interest rates, resulting in an unfavorable impact to annuity operating earnings. For an analysis of fair value accounting, see our Quarterly Investor Supplement, which is posted on AFG's website. Annuity earnings before the impact of unlocking and fair value accounting on fixed-indexed annuities were $123 million in the second quarter of 2018, up 22% from the prior year period, establishing a new all-time quarterly high for the Annuity segment.

Turning to Slide 8, you'll see that quarterly average annuity investments and reserves grew by 10% and 9%, respectively, year-over-year. As shown on our Quarterly Investor Supplement, these results also include exceptionally high returns on certain investments, including very strong earnings from limited partnerships and similar investments, which is not necessarily expected to be recurring. The benefit of these items was partially offset by the runoff of higher-yielding investments.

Now please turn to Slide 9 for a summary of the 2018 outlook for the Annuity segment. Based on stronger-than-expected earnings in the first half of 2018, we now expect full year 2018 earnings before the impact of fair value accounting on fixed indexed annuities to be in the range of $430 million to $450 million, up from our previous guidance of $410 million to $435 million. Similarly, we now expect pretax annuity earnings for the full year, which include the impact of fair value accounting for FIAs and the second quarter unlocking charge to be higher, and in the range of $395 million to $430 million. And this is up from our original guidance of $385 million to $425 million. Included in this guidance are several assumptions, including the expectation that corporate A2 interest rates will rise by 5 to 10 basis points, depending on duration, between now and the end of the year; and that increases in the S&P 500 of 1% each quarter; normalized investment income; and FIA option costs that are in line with experience. Fluctuation in any of these items, as compared to our expectations, could lead to significant positive or negative results on the Annuity segment's earnings.

Finally, we continue to emphasize earning the appropriate return on our new sales, regardless of the competitive environment. Based on our strong sales year-to-date, we continue to expect that our 2018 full year annuity premiums will be up 10% to 15% over the $4.3 billion reported in 2017. There are a few factors that influence our guidance; the resolution of the Department of Labor Fiduciary Rule has provided lift for the retail market, and the current demand shorter surrender charge period products fits well with our product strategy.

Furthermore, this reflects the introduction of new products in 2018 and opportunities to grow our business and the registered investment adviser and broker-dealer markets. Please note that the fluctuations in returns on investments, large changes in the interest rates and/or the stock market and higher or lower FIA option costs as compared to our expectations could lead to a significant positive or negative impact on the Annuity segment's results. Additional information on the Annuity segment's earnings, premiums, investments and reserves can be found in AFG's Quarterly Investor Supplement posted on our website.

Please turn to Slide 10 for a few highlights regarding our $47 billion investment portfolio. AFG reported second quarter 2018 net realized gains on securities of $25 million aftertax and after deferred acquisition costs. This compares to net realized gains on securities of $5 million in the second quarter of 2017. At June 30, 2018, unrealized gains on fixed maturities were $191 million aftertax, after DAC. As you will see on Slide 11, our portfolio continues to be high quality with 90% of our fixed maturity portfolio rated investment grade and 98% with an NAIC designation of 1 or 2, its highest 2 categories.

We 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'll wrap up our comments with an overview of our consolidated second quarter 2018 results and share a few comments about capital and liquidity.

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

Thank you, Craig. Slide 12 summarizes AFG's core operating earnings on a consolidated basis. The $2.04 core EPS is based on core net operating earnings in the quarter of $185 million. The increase in earnings in the second quarter was primarily the result of strong operating earnings in our insurance businesses, bolstered by a lower effective tax rate of 20% in the quarter as compared to 29% in the year-ago quarter. Property and Casualty pretax operating earnings were 10% higher year-over-year. P&C underwriting profit was virtually unchanged from the very strong results in the year-ago second quarter. P&C net investment income grew $19 million or 20% year-over-year. This is primarily the result of unusually high returns on certain investments, including limited partnerships and similar investments.

The sale of real estate in the 2017 second quarter partially offset other expenses in that period, making the second quarter 2018 P&C other expenses higher by comparison. Pretax earnings for our Annuities segment increased 16% year-over-year. Parent company interest expense decreased by $7 million year-over-year as a result of our 2017 debt refinancings. Other corporate expenses increased by $11 million starting with Q1 this year. This includes income and expenses related to AFG's previously reported run-off lines of business.

Slide 13 provides a reconciliation of core net operating earnings to net earnings. As noted last quarter, AFG adopted ASU 2016-01 [Technical Difficulty] refers to 2018, which requires holding gains or losses on equity securities to be recognized through earnings. The impact to our income statement will vary each quarter, depending on the level of volatility and the performance of the securities held in our equity portfolio and the overall market. In the second quarter of 2018, AFG recognized $25 million or $0.27 per share in net aftertax as gains.

As indicated on Slide 14, AFG's adjusted book value per share was $55.24 as of June 30, 2018. Our annualized growth in book value per share plus dividends was a very strong 17.2% this quarter. We returned $165 million to our shareholders with a payment of our regular quarterly dividend and $1.50 per share special dividend during the quarter.

Parent cash was $260 million at the end of the second quarter. We maintain sufficient capital in our insurance businesses to meet our commitments to the ratings agencies. Our excess capital stood at approximately $720 million at June 30, 2018. This already reflects the upcoming negative impact of tax reform on the NAIC capital model and RBC ratio, even though this change doesn't get formally implemented until the end of 2018. Remember, we plan to hold approximately $200 million to $300 million as dry powder to maintain our flexibility for opportunities as they arise. Our management team reviews all opportunities for deployment of capital on a regular basis.
Wrapping up, Page 15 shows a single representation of our updated 2018 core earnings, which has moved up by $0.20 per share. Our guidance assumes an effective tax rate of approximately 20% on core pretax operating earnings. AFG's expected 2018 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 line for any questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Amit Kumar with Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Just a few questions. And I want to make a quick comment. The audio of the call was cutting in and out a bit. So maybe when the transcript comes out, someone can take a quick look at it because I checked with other people and they're also facing the same issue for all the presenters. The first question is on the guidance, and if I look at the Specialty Casualty segment and then I look at the underlying numbers for the Specialty Casualty segment, if I look at the loss PICs and even the guidance for the forward, is it assuming a higher inflation? Or is that conservatism? Why is the number unchanged going forward?

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

We try to take into account what we see in current trends and where -- what our reported results are year-to-date and our reserve position in that segment, as we set our guidance. So we try to do the best we can every quarter. I mean, we're one of the few companies that gives pretty detailed guidance overall and by segment and that. I'd just say, generally, outside of some big event like some big property cat or those kinds of things, we've been pretty accurate.

Amit Kumar
The Buckingham Research Group Incorporated

I guess what I was trying to ask is, the Specialty Casualty guidance is unchanged. And that's what I was trying to figure out. Why -- are you noticing something in the trends at the end of H1? Or is it just inflation? Or is there any new sort of thought process?

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

Amit, I hope that the audio is coming through for you. So I, for one, am struggling a little bit with your question. Through 6 months, our Specialty Casualty combined ratio is 94.0%. Our guidance brackets that plus or minus 2 percentage points and with the caveat that Carl offered about the potential for catastrophe events in the balance of the year being a wildcard, basically that guidance is straight down in the middle of our results year-to-date. We haven't changed that guidance for the segment combined ratio over the course of the quarter because we haven't seen anything that would cause us to modify or back-off of it. So are you looking at something...

Amit Kumar
The Buckingham Research Group Incorporated

Yes, you answered my question. I didn't -- probably I didn't phrase it properly, but you just answered it. The second question was on the discussion of the agriculture book. Can you, sort of, talk about are RPP and FCIC this -- and this $12 billion package, and how should we all as outsiders think about where this thing will end up? I know I think the numbers are squared up in Q3, Q4, maybe just help us understand because this is a bit of a one-off thing for us?

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

Are you talking about my comments about the crop year?

Amit Kumar
The Buckingham Research Group Incorporated

Yes, and the tariffs especially. With the tariffs coming in and then you have a $12 billion aid package and then the Midwest farmers will have an RPP policy. So I'm just trying to sort of add all of this and figure out how will the ultimate numbers look? And will they end up looking different with all of these moving parts? Or should I -- am I too worried about it too soon?

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

Yes. I think we're still trying to get our arms around exactly what it means. But our bottom line is, is we don't think it really impacts the program itself much. Best we can figure out is that farmers aren't going to -- we don't think farmers are going to benefit doubly in that. Anything -- any payments made to them would be figured in payments that we would make. That's the best that we can figure at this point. We think it's a neutral impact to our crop business. And again, we think our crop [Technical Difficulty] shaping up very nicely. Commodity prices on corn and soybeans are 4% and 11% lower, I think, as of yesterday. Probably the bigger impact on the tariff have been kind of a little bit more volatility around soybean prices. The point they were down, I think, 15% and they backed off to 11%. So we're keeping our eye on that. That seems to be more of the impact that we've noted. The growing conditions are very favorable at this point. You always look out for early frost or any kind of late, lack of rainfall. That doesn't seem to be too much of the case right now in that. But we're very optimistic right now about our crop year and the way it's shaping up. And I don't -- we don't really see the government having any negative impact on that.

Amit Kumar
The Buckingham Research Group Incorporated

Got it. The final question and I will requeue. Just going back to the discussion on capital management and the discussion on excess capital and thinking of your guidance and the thought process for the second half of 2018, how should we be thinking about another special dividend here for the remainder of the year?

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

Good question. We generally, as we go into the third quarter of the year and that, we kind of get an idea of what we have on our plate with regards to any acquisitions that we think that we have a good [Technical Difficulty] on. And then, we look at excess capital as it's projected to [Technical Difficulty] we make up our minds. We've already paid one special dividend. I think in our commentary that we've said that depending on what we have on our plate and what needs we have through year-end, keeping some excess, that we definitely would be considering another special dividend towards the end of the year.

Operator

Our next question comes from Greg Peters with Raymond James.

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

I'll echo Amit's comments regarding the interruptions on your presentation. I don't know if it's faulty conference call equipment or what, but there were some interruptions. I wanted to just focus on some big-picture issues. First of all, I was wondering if you could comment on how, by segment, there's been any change in the renewal ratios or if your retention ratios continue to be consistent with where they were a year or 2 ago? I'm particularly interested in that in the context of the Workers' Comp business where you talked about pricing challenges.

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

Greg, thanks for your question. We generally don't issue detailed renewal retention type of data. We have so many -- we have some 33 different businesses, segments that -- and the businesses are so different. Generally, overall though, gosh I mean, we were growing 11% in the quarter, and we're seeing good growth in each of the segments. I'm very pleased, in general, business by business. That has to mean that we're taking advantage opportunistically for new business opportunities as well as having renewal

-- our renewals have to be in good shape also. So very pleased with the premium growth that we have, particularly, in this kind of a market. And I do think probably our use of predictive analytics helps us become -- and getting -- excluding comp, we're getting the strongest price increase we've gotten in quite [Technical Difficulty] years. I think that makes us comfortable with that growth even within this market. So...

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

That's a good answer, Craig. I was struck by your comment about analytics. Could you spend 30 seconds and give us a peek into what you're doing on that side of the equation?

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

We really have a -- we have a [Technical Difficulty] group here at [Technical Difficulty] that's focused on really using predictive analytics throughout our organization, particularly in the businesses where we think it can have the biggest impact. We use it extensively within compensation, in businesses -- our other businesses and with a goal of really expanding the use of it across our businesses. So -- and that not only includes underwriting pricing, but we're trying to expand the use of that on the claims side also. For instance, our California Workers' Comp business, Republic, they're initiate -- they've been initiating predictive analytics in a claim side, which we think will bear a lot long term. So those would be [Technical Difficulty] maybe a little bit of color around that.

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

I wanted to take my next question to Craig around the Annuity business. Now, I noted your comments at the beginning about new products really helping boost the retail result. One of the other players in the marketplace has -- there's some speculation on whether it's going to remain independent or merge. I'm wondering if you'd seen any fallouts? I know you don't like to comment on competitors, but I'm just wondering if you'd seen any fallout in the marketplace that has helped your retail sales on -- as a result. And the second question on the Annuity business, given the strong growth, and I know you -- from an overall corporate standpoint, you talked about being more than adequately capitalized. But I'm curious about the capital demands that you're having in your Annuity business considering the really strong growth results you're posting.

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

Greg, on the first question, it's really hard to know what impact having a major competitor kind of be in plays is having. I don't think that, that is -- was a major driver of our premium growth, to be honest. I think that's -- I think our premium growth is driven by a couple of things. Certainly, the resolution of the certainty that the Department of Labor Fiduciary Rule as proposed was not going to be implemented. That certainly has had a very positive impact on sales, particularly retail sales. The volatility of the stock market, higher interest rates and, frankly, the kind of consumer-centric nature of our model and products. We're selling shorter products, more value to the customer. That's all just played really well in this environment. So we are very pleased with the growth, and yes, expect it to continue. What was your second question, Greg?

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

Second question -- the second question was just around -- and it was the capital question. And I recognize your comments about adequate capital at the company overall. I'm curious about within the Annuity business, considering the growth, what kind of demands you're seeing for capital as a result of the success, if any? Or maybe you could provide us a snapshot on what your RBC ratio is within that business? Just some -- whatever you're willing to provide some additional color.

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

Sure. First of all, the tax reform, change in the tax rate cost us, I believe, it was about 30 points, 30% in the RBC. So that did have an impact on us. Because of the consumer-centric nature of the -- number one, very low cost of putting business on the books from an operating standpoint and the fact that we are a lower-commissioned company. I think our commissions average 1.5 points or 2 points less than the industry. The capital strain for us when we put new business on the books is lower than most of our competitors. Obviously, when you're growing at a very [Technical Difficulty] rate, it's going to consume more capital. Given the excess capital position at AFG and given the ability to do business significantly at attractive rates of return, we're happy to put some of the capital to work growing the business.

Operator

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

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

I was hoping you could hone in a little bit more on the Workers' Comp market and give us some sense of kind of where pricing is versus your view of claim cost trend? Just a sense, what the offset is to the other parts of the business, which seemed to be doing well from a sort of pricing versus claim cost perspective?

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

Sure, Paul. I would be happy to kind of give some color around that. Maybe the way to address that is just by a couple of the larger pieces of the business. And our Summit operations, which is our Southeastern operation and that. Obviously, we're very pleased with Summit's results with -- they've had strong underwriting profitability every year since we acquired it. If you take a look at their business today, with the Florida January and June rate increases, I think we still feel we should make an overall small accident year underwriting profit and have a healthy return this year. Florida could end up being closer to breakeven on a -- or a little higher combined ratio sign. Little early to [Technical Difficulty]. So that would be our kind of things happening on the accident year. On the loss cost side, loss cost trend frequency is down 2%, severity is up 3%. When you -- so an overall loss cost trend of about 1%. Then, when you look at the positive impact of inflation, payroll, that's actually a positive 2%. So really we consider our loss ratio trend for Summit to be down 0.7%, what we call our loss ratio and that. We feel they have [Technical Difficulty] overall reserve position is strong, profitability is very solid. So we feel good that even though accident year margins may be a little bit less, but really strong returns in that, particularly on Workers' Comp. In California, we've had healthy underwriting [Technical Difficulty] and double-digit returns the last 5 years or so. I think we probably project about an 11% price decline this year. We still expect to make a small accident year underwriting profit for 2018 in a double-digit return and that. Just to kind of give you an idea again, at even 101% accident year combined ratio, that's a 15% return on equity. So we -- I think we expect to make a small accident year underwriting profit for this year and continuing -- we look at the business as continuing to have a strong reserve position, a stable claims environment. Our loss ratio trend for California is down 2%. That's for the loss cost trend of 0 with severity being up 1%, frequency being down 1% and then there is [Technical Difficulty] inflation exposure change that's a positive of a couple of points of 2%. So really, our loss ratio trend there is really kind of negative 2%. So very good trends there in California. Our Strategic Comp business is performing very well. It's a high deductible business, we look at it a little bit different. So when -- the other part of our Workers' Comp business is in National Interstate, and that's been very profitable. So I'm very pleased with our profitability on Workers' Comp, kind of where the trends are. Rates are moving down, but this year, again, I think we're in position to make a very nice [Technical Difficulty] year underwriting profit and very strong returns and that. I hope that gives you a little more color.

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

That was awesome. And then, my other question was, I'd just like to hear a little bit about your views on the M&A pipeline. Whether things are still pretty expensive out there? Or what -- just your general thoughts on M&A. And what you're seeing out there at the moment from your -- obviously, from your perspective only?

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

Yes, I think we always see a pretty good pipeline. This year is no exception. I think we're getting some good opportunities to look at. So hopefully, we will be able to bring something over the finish line. Again, our sweet spots in kind of $50 million to $500 million range and that. Those are the kinds of things that we like to look at. We're not great in big auctions on big -- bigger entities and that type of thing, we don't like to play that game. So we're seeing, I think, our share of opportunity. I'm hopeful we'll be able to accomplish a few things this year. So...

Operator

[Operator Instructions] We have a follow-up question from Amit Kumar with Buckingham Research.

Amit Kumar
The Buckingham Research Group Incorporated

Few quick follow-ups. The first question is, now that I have the numbers in front of me, going back to the Specialty Casualty segment, I guess, what I was trying to ask is, if I look at the current accident year ex cat loss, Page 9 of the supplement for Q2 shows 65.8%. For Q2 of 2017, the number was 63.6%. What I was trying to figure out is, what caused that delta? Or was there something unusual in Q2 2017?

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

So you're -- and I apologize that you had flagged for us the quality of the audio. You broke up a little bit in your question to me. But I think what you're asking is looking at the supplement Specialty Casualty segment, on Page 9, when you look at the underlying combined ratio, it has gone up during the quarter versus the year-ago quarter?

Amit Kumar
The Buckingham Research Group Incorporated

Yes, yes, that's correct.

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

Okay, perfect. Thank you very much. So it's up about 2.5 points. And what we attribute that to, you break it into a couple of things. It's mainly just a higher accident year in some of our specialty Workers' Comp. So we have a increase across that of about 2 points. That constitutes the majority of the uptick in the Specialty Casualty subsegment.

Amit Kumar
The Buckingham Research Group Incorporated

Got it. That was the answer I was looking for. I apologize of the way I phrased it, I think it wasn't clear previously. The second question. Can you remind us, and I know it's been a while, for Republic's, for your Workers' Compensation book, what's the hazard classes you operate in? Was it more clerical, sort of in the retail, construction? Can you just quickly remind us, what was the biggest component of that book?

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

Manufacturing would be 45%, I think, looking historically, and the rest would be retail, wholesale, not a lot of large account business.

Amit Kumar
The Buckingham Research Group Incorporated

Got it, that's helpful. And the final question is on the guidance for the Annuity segment. If you sort of look at the ex unlocking earnings for Q2 and then you look at the guidance, unless I missed this comment in the opening remarks, is the second half earnings, it seemed to me lower than the first half earnings ex unlocking? Is that a fair assumption? Or did I misinterpret it? And if so, what would be the reason for the second half earnings lower in the Annuity segment?

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

Yes, what we're doing for the guidance for the second half of the year is we are normalizing the investment income related to mark-to-market assets. We had a very strong period in the quarter and the first 6 months. Our returns on our BA assets and some limited partnerships interest that we mark-to-market and flow through investment income were actually 19% for the quarter, and they were around 18% for the first 6 months of the year. So what we're doing, Amit, is assuming for the last 2 quarters, there is an 8% type return on those investments. So I think that's what is driving the numbers that we put in the guidance. I mean, hopefully, we'll do better. We just didn't think it was prudent to project that and put it into the guidance.

Operator

At this time, I'm showing no further questions. I'd like to turn the call back over for closing remarks.

Diane P. Weidner
Assistant Vice President of Investors Relations

Thank you, and thank you all for joining us this morning. We look forward to speaking with you again when you share our third quarter results.

Operator
Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program. You may now disconnect. Everyone, have a great day.