S&P Global
Market Intelligence

American Financial Group, Inc. NYSE:AFG

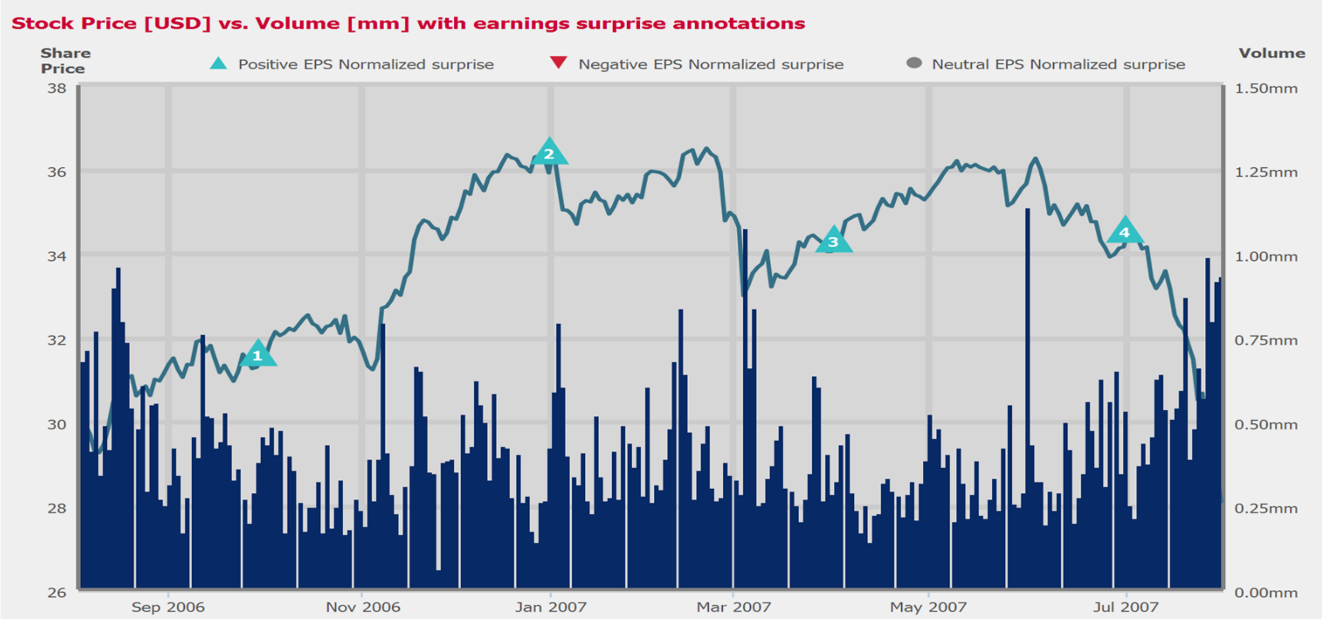
FQ3 2007 Earnings Call Transcripts

Tuesday, October 30, 2007 3:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2007-			-FQ4 2007-	-FY 2007-	-FY 2008-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.85	0.97	14.12	0.91	3.62	3.40
Revenue	-	-	12.32	-	-	-
Revenue (mm)	674.43	757.50	-	683.45	2626.43	2745.37

Currency: USD
Consensus as of Oct-29-2007 2:30 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2006	0.74	0.77	4.05 %
FQ4 2006	0.82	0.85	3.66 %
FQ1 2007	0.84	0.91	8.33 %
FQ2 2007	0.82	0.93	13.41 %

Table of Contents

Call Participants

EXECUTIVES

Carl Henry Lindner
Former Chairman of the Board

Keith Alan Jensen
Former Senior VP & CFO

Presentation

Operator

Welcome to the third quarter 2007 American Financial Group earnings conference call. (Operator Instructions) I would now like to turn the call over to Mr. Keith Jensen, Senior Vice President. Please proceed, sir.

Keith Alan Jensen
Former Senior VP & CFO

Good morning. I'm joined here today by Carl Lindner, III, and Craig Lindner, Co-CEOs of American Financial Group. It's our pleasure to welcome you to the American Financial Group third quarter results conference call. If you're viewing the webcast from our website, you can follow along with the slide presentation if you would like.

Certain statements made during the call are not historical facts and may be considered forward-looking statements. They 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 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. These include 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 items that are not considered to be part of ongoing operations, such as net realized gains or losses on investments, affects of accounting changes, discontinued operations, special 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, which will be discussed for various periods during this call. A reconciliation of net earnings to core net operating earnings is included in our earnings release.

It's now my pleasure to turn the time to Carl Lindner, III, Co-CEO of American Financial Group.

Carl Henry Lindner
Former Chairman of the Board

Good morning. We released American Financial Group's 2007

third quarter results yesterday afternoon and are pleased that you could join

us. Please turn to Slide 3 of the webcast materials. Our overall results for

the quarter continued at an excellent pace. Net earnings for the 2007 third

quarter were $0.93 per share versus $0.77 per share in the 2006 third quarter.

We again achieved record core net operating earnings in the third quarter, 22%

higher in the same period a year earlier. Through the first nine months of

2007, these core earnings were 24% above the 2006 period.

The significant increase was driven by improved underwriting

profits in the specialty property and casualty operations and higher investment

income. Greg and I want to thank our talented management team and employees for

their efforts and we want to thank God for blessing AFG's business.

Our financial condition and liquidity remain very strong.

Our book value per share of $26.75 was up 14% compared to the end of the 2006

third quarter. This is consistent with our long-term objective of attaining

compound growth in book value in excess of 10% per year.

We used $345 million of our excess capital during the

quarter to complete the purchase of the minority shares of our subsidiary,

Great American Financial Resources, and to buy back 3.8 million AFG shares.

Through the first nine months of this year, we've repurchased 4.7 million AFG

shares at an average price of about $28.44. We expect these transactions to add

to earnings between $0.15 and $0.17 per share on an annualized basis. We continue to make opportunistic buybacks of

our shares.

Prior to year end, we plan to transfer the shares of our

Great American Financial Resources that are owned by our Great American

Insurance subsidiary to AFG. This will provide additional flexibility in the

movement of capital and is expected to be viewed positively by rating agencies.

We had about $190 million of excess capital at the end of

the quarter. AFG's $18 billion investment portfolio stands at the highest

quality in our history. At September

30, 2007 investments and non-investment grade securities represented 5% of our investment portfolio. Mortgage-backed and related securities represented about 27% of the portfolio, and 99% of those securities are rated AAA. Investments in securities with sub-prime asset-backed collateral total $498 million. All of these investments are in short maturity tranches and are rated AAA. In addition, all these investments are in securities with fixed rate collateral.

We are pleased to note that as a result of our conservative investment approach, we have experienced no downgrades and have realized no impairment losses on the sub-prime securities held in our portfolio.

Before I turn to more detail in our operations, we would like to express our sympathies to those affected by the devastating fires in California. Since our book of business is focused on specialty commercial products, to date we have not experienced any significant losses related to this disaster. We are continuing to monitor our exposures, but don't expect this event to have a material adverse effect on our fourth quarter results.

Turning to Slide 4, the underwriting profit of specialty property and casualty operations in the 2007 third quarter of $105 million was 27% higher than in the same period a year ago. The combined ratio improved 2.5 points to 86.2%. The 2007 third quarter results included about $26 million or 3.4 points of favorable development compared to $28 million or 3.8 points in the 2006 period. The favorable development for the current and prior year periods came primarily from our property and transportation, specialty casualty and California workers' comp groups.

Through the first nine months of 2007, underwriting profit of the specialty operations was up 41% compared to the same period last year. These results reflect the impact of earned premium growth, continuing rate adequacy in most of our businesses, continued favorable reserve development and lower catastrophe losses.

During the first nine months of 2007, we've experienced favorable development of $81 million, or 4 points, including an A&E charge recorded in the second quarter, compared to $51 million, or 2.7 points in the same period a year earlier.

Catastrophe losses have been negligible compared to $22 million or 1.2 points last year. While at varying levels, all of our major groups are producing profitable underwriting margins. I continue to be encouraged by the stability of our overall rate levels.

Excluding the effect of California workers' comp, average premium rates and other specialty operations were down about 2% from last year in a relatively competitive environment. Net written premiums in the third quarter were 4% higher than the same quarter last year, and gross written premiums were up 8%.

Growth in net written premiums is somewhat depressed due to the 2006 restructuring of program business reinsurance that resulted in the return of approximately $26 million in premium to us last year. Strong growth in the property and transportation and specialty and financial groups more than offset declines in specialty casualty and the California workers' comp groups.

Year-to-date, gross and net written premiums were about 3% above 2006 levels due to the strong growth in the property and transportation group, particularly in the crop business. We also had strong growth in several businesses in our specialty financial group. This group was partially offset by significant rate reductions in the California comp business, as well as our decisions to exit the residual value insurance and earthquake-exposed excess property businesses in the early part of '06. Excluding the impact of these three businesses, gross and net written premiums were up 7% in the 2007 period compared to the 2006 period.

Turning to slides 5 and 6, I would like to cover the results of each of our specialty business groups. The property and transportation group continued its strong growth in profitability through the first nine months of this year. The group's third quarter underwriting profit was $18 million higher than last year's third quarter and its combined ratio improved 4 points. These improvements were due primarily to higher underwriting profits in the agricultural operations. Our crop insurance earnings are up due to favorable crop yields and acceptable crop pricing levels to date. Our largest crop exposures are in corn and soybeans. We will have a better view of their results during the fourth quarter, as prices and yields are finalized.

These strong results were partially offset by underwriting losses in a run-off homebuilders operation although year-to-date combined ratios for the last two years are about the same, underwriting profits up 8% resulting from strong premium growth. Gross written premiums for the three and nine months were 22% and 12% higher than the comparable 2006 periods, driven by excellent growth in our property, marine and agricultural operations. Over these same periods, net written premiums grew 18% and 10% respectively.

We did see some rate pressure in several business groups in this group during the third quarter. Average rate levels through the first nine months of the year are down slightly from the year earlier.

Now, our specialty and casualty group has maintained outstanding underwriting profitability through the third quarter this year. The group's combined ratio for the third quarter was 2.4 points higher than in the prior year. The 2007 results include $16 million, or 7.7 points of favorable reserve development compared to $10 million, or 4.8 points in the 2006 third quarter.

Through the first nine months of this year, this group's combined ratio improved 11.6 points. These results included $96 million, or 15.3 points of favorable development, principally from the excess and surplus lines in our mid-continent subsidiaries general liability operations. These operations have continued to generate excellent accident year underwriting results also.

Gross written premiums for the 2007 three and nine-month periods were 14% and 8% below the same periods in 2006, due primarily to stronger competition in our E&S business and a softening in the homebuilders market that affects our general liability coverages. We are firmly committed to keeping rates at a level that supports our profit objectives and we're prepared to walk away from businesses that don't meet those objectives. Through the first nine months of 2007, this group's overall average premium rate was about 3% lower than in 2006 period.

Specialty financial group continued its trend of strong premium growth and produced another solid underwriting profit. The group's combined ratio of 93.4% for the 2007 third quarter improved 28.4 points compared to the 2006 third quarter. Through the first nine months of this year, it was 13.9 points better than the same prior-year period.

The improvements are primarily due to lower losses in the residual value insurance business in runoff and higher underwriting profits in this group's other insurance operations. In fact, excluding the effect of RBI, the group's combined ratio would have been 88.6 for the first nine months of 2007 compared to 93.7 for the same 2006 period.

Gross and net written premiums for the third quarter were up 14% over the prior year. Through the first nine months of this year, gross and net premiums were up 11% and 17%. Growth in the property coverages offered under collateral and mortgage protection insurance for financial institution insured and in our surety operations were the primary drivers of the increased volume. Higher year-to-date net written premium growth rate is attributable to greater premium retention within the lease and loan operations. The premium rates in this group were down about 1% through the first nine months of the year.

Now, our California workers' comp business continued to generate excellent profitability, though on lower premium levels. Third quarter combined ratio of 77.5% was nearly 14 points higher than last year. 2007 results include 10.2 points of favorable reserve development, whereas 2006 results included 22.3 points. For the first nine months of 2007, combined ratio is up only 3 points compared to the same prior year period. 2007 results included 8.8 points of favorable development compared to 7.5 points in the 2006 period.

Continuing favorable prior year reserve development reflects the improved frequency and severity of claims resulting from the California reform legislation. While gross and net written premiums continue to be impacted by a lower rate environment, the reform legislation has significantly reduced workers' compensation costs for employers. Rate decreases in California averaged about 23% during the first nine months. We expect to see a slowdown in rate decreases in this business. In fact, the WCIRB has actually recommended a modest increase in rates beginning in 2008. We're achieving strong returns on this business and are optimistic that we can continue to do so at these rate levels.

Now let's turn to our annuity and supplemental insurance group on slide 7. Statutory premiums of $491 million in the third quarter of 2007 were essentially unchanged in the third quarter of 2006. Premiums of $1.5 billion in the first nine months were 31% higher than the comparable 2006 period. Year-to-date increases reflect substantially higher fixed indexed annuity premiums, partially offset by lower sales of traditional fixed annuities.

In addition, supplemental insurance premiums increased substantially over the 2006 period due to the acquisition of the Ceres Group in August of 2006.

In the 2007 third quarter improvement in the operating earnings of the fixed annuity lines were more than offset by declines in the supplemental insurance segment and higher mortality in the runoff life insurance operations. Third quarter 2006 supplemental insurance results included $3.4 million of pre-tax earnings related to favorable claims development in the Medicare supplement business.

Through the first nine months of 2007, core operating earnings are slightly below the 2006 period. Year-to-date 2006 results included $4.9 million of pretax earnings related to a payment received from a Florida county in exchange for certain limitations on future development of a marina owned by the company.

Now I would like to summarize some key aspects of our strategic focus on Slide 8. Our operations will remain focused on specialty niche markets within the property and casualty, annuity and supplemental insurance industries, where we have significant expertise and can continue to build franchise value.

The significant objective is the appropriate use of our excess capital. We're pursuing several potential courses of action. We're going to continue to seek acquisition and startup opportunities that follow our strategy of being a specialty insurance player. We'll also pursue internal growth opportunities for our existing specialty insurance businesses, with emphasis on our transportation and inland marine operations, as well as the annuity operations.

We're also going to continue opportunistic share repurchases. We remain committed to our strong underwriting culture and pricing discipline and continually monitor the adequacy of our rates in all markets. We'll reduce business volume in lines as needed to achieve appropriate returns. We'll focus on maintaining investment returns that outperform the market. Return on equity is targeted between 12% and 15%.

I would like to reiterate our expectations for 2007 and provide an outlook for 2008 on Slide 9. For 2007, we continue to expect growth in net written premiums of 3% to 5% in our specialty property and casualty operations with a combined ratio stable to slightly better than 2006.

Excluding the California workers' comp business, our expectation is that rates in our overall specialty operations will decline slightly, as some of our markets continue to be increasingly competitive. Our property and transportation businesses are expected to generate double-digit net written premium growth for the year, resulting from higher crop premiums, geographic penetration in our property and inland marine unit, and new programs in Great American's trucking operations, as well as in our subsidiary, National Interstate. This group should also maintain excellent underwriting margins.

Specialty casualty group’s underwriting profit for the year should be higher than 2006, with a mid-single-digit decrease in net written premiums resulting from competitive pressures in our E&S business and several other casualty lines.

We expect to significantly improve underwriting margins in the specialty financial group over 2006 to be sustained for the remainder of 2007 and its premium to grow in the mid-teens.

We are expecting rate decreases in our California workers' comp to subside somewhat during the 2007 fourth quarter. As a result, we now anticipate that this group's 2007 net written premiums will decline between 15% to 20%. Combined ratios are expected to increase somewhat, but should still be in the low 80s or below, still producing excellent returns.

In our annuity and supplemental insurance group, we expect premium growth and stable operating results. We continue to work on several product and distribution initiatives to help further this group's premium and earnings growth.

We plan to examine the AFG common stock dividend amount during the fourth quarter. Based on results so far this year and the trends in our business, we are increasing our forecast of AFG's 2007 core net operating earnings to be between $3.70 and $3.80 per share from the previous $3.45 to $3.65 per share.

Looking to 2008, Craig and I are optimistic about the upcoming year. We expect stable net written premiums and a continuation of the strong underwriting profits in the specialty operations. We look to improve the returns on our annuity and supplemental insurance group and expect that group to contribute between 15% to 20% of AFG's overall operating earnings.

Finally, we have announced that we are preliminarily targeting AFG 2008 core net operating earnings to be between $3.75 and $3.95 per share. The 2007 and 2008 expected results exclude the potential for extraordinary catastrophe and crop losses, adjustments to A&E reserves or large real estate gains.

Now, Craig and I would be pleased to answer any questions.

Thank you.

<TAG>Question-and-Answer Session</TAG>

Operator

(Operator Instructions) Sir, there are no questions at this time.

Keith Alan Jensen
Former Senior VP & CFO

Thank you for joining us for our third quarter conference call. We look forward to reporting our full year at the end of the fourth quarter. Thank you and have a nice day.