

American Financial Group, Inc. NYSE:AFG

FQ2 2019 Earnings Call Transcripts

Wednesday, August 07, 2019 3:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2019-			-FQ3 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	2.04	2.12	▲ 3.92	1.99	8.62	9.05
Revenue (mm)	-	1200.00	-	-	-	-

Currency: USD

Consensus as of Aug-07-2019 1:29 AM GMT

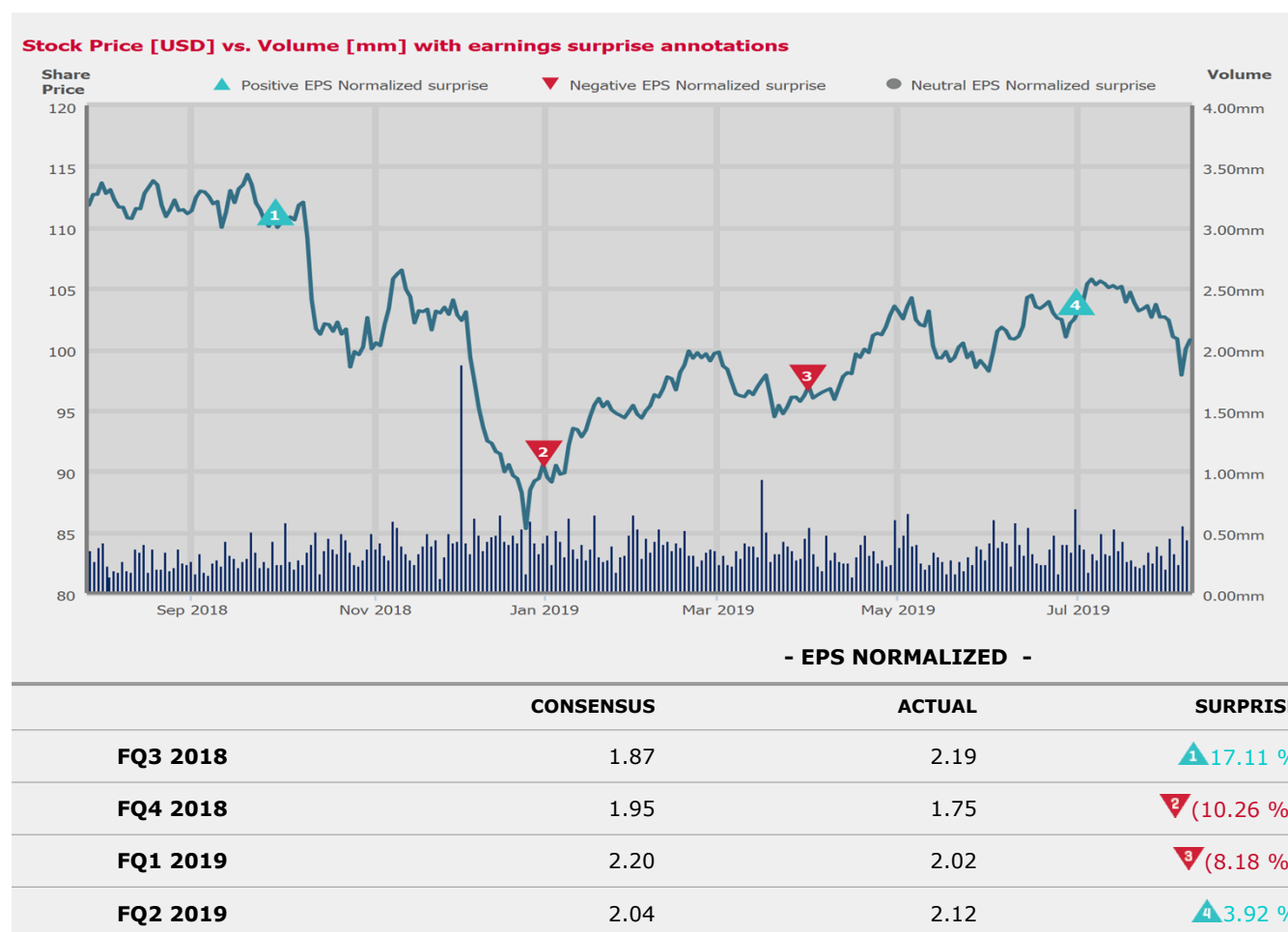


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Call Participants

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Presentation

Operator

Good day ladies and gentlemen, and welcome to the American Financial Group Second Quarter 2019 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, you may begin.

Diane P. Weidner

Assistant Vice President of Investor Relations

Good morning and welcome to American Financial Group's Second Quarter 2019 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 conditions 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. 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 2019 second quarter results yesterday afternoon. If you please turn to Slide 3 of the webcast slides for an overview. AFG reported core operating earnings of \$2.12 per share, reflecting strong operating profitability and investment results in both our Specialty Property & Casualty and Annuity segments. Second quarter 2019 annualized core operating return on equity was 15%. Net earnings per share were \$2.31 and included \$0.48 per share in after-tax net realized gains on securities and a negative impact of \$0.29 per share for Annuity non-core items including the impact of fair value accounting for fixed-indexed annuities and other items related to changes in the stock market and interest rates.

Craig and I thank God, our talented management team and our great employees for helping to achieve these results.

Based on results through the first 6 months of the year, we narrowed AFG's core net operating earnings guidance for 2019 to a range of \$8.40 to \$8.88 (sic) [\$8.80] per share from our previous range of \$8.35 to \$8.85 per share. We are maintaining a midpoint of \$8.60 per share, however.

Craig and I will 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 & Casualty operations. Please turn to Slides 4 and 5 of the webcast, which include an overview of second quarter results. As you'll see on Slide 4, gross written premiums were flat, net written premiums were up 1% when compared to the second quarter of 2018, primarily the result of lower crop insurance premiums. Delayed planting of spring crops resulted in late

acreage reporting and reduced overall second quarter Specialty Property & Casualty premiums. It is expected though that these delayed premiums will be included in our third quarter 2019 results.

Excluding crop, second quarter 2019 gross and net written premiums grew by 6% and 4%, respectively, when compared to the 2018 second quarter. Core operating earnings and AFG's P&C insurance operations were \$175 million in the second quarter of 2019, slightly below the \$180 million recorded in the prior year period.

The Specialty Property & Casualty insurance operations generated an underwriting profit of \$60 million in the 2019 second quarter compared to \$73 million in the second quarter of 2018. Higher underwriting profit in our Specialty and Casualty group was more than offset by lower underwriting profit in our Property and Transportation and Specialty Financial groups. The second quarter 2019 combined ratio of 95% increased 1.3 points from the prior year period and included 3.4 points of favorable prior year reserve development and 0.9 of a point in catastrophe losses.

Average renewal pricing across our entire Property & Casualty group was up about 3% for the quarter. Excluding our workers comp business, renewal pricing was up approximately 5%. Both of these measures reflect a continued improvement from renewal rate increases achieved in the first quarter of this year. And overall, Specialty Property & Casualty renewal rates are the highest we've achieved in over 5 years, meeting or exceeding expectations in each of our Specialty Property & Casualty subsegments. I'll discuss in more detail as we review the results of each.

Loss cost trends remain stable, and we're keeping our eye on inflation and interest rates though.

Now I'd like to turn to Slide 5 to review a few highlights from each of our Specialty Property & Casualty groups. Property and Transportation group reported an underwriting profit of \$4 million in the second quarter of 2019 compared to \$23 million in the comparable prior year period. These results include lower favorable prior year -- prior period reserve development in our agricultural and our transportation businesses and a larger year-over-year underwriting loss in our Singapore branch. Catastrophe losses in this group were \$8 million in the second quarter and \$10 million in the comparable 2018 period.

Second quarter 2019 gross written premiums in this group were down 6% and net written premiums were flat when compared to the prior year period, due primarily to delayed acreage reporting from insureds as a result of excess moisture and late planting of corn and soybean crops. It's expected again that these delayed premiums will be included in the third quarter 2019 results. Excluding crop insurance, 2019 gross and net written premium growth in this group was strong and was up 12% and 10%, respectively, when compared to the 2018 second quarter. The growth is primarily attributable to new business opportunities in our transportation businesses.

Overall, renewal rates in this group increased 5% on average in the 2019 second quarter, an improvement over renewal rates increases achieved in the first quarter of 2019. I continue to be pleased with the broad-based rate strengthening in this group, which includes our commercial auto liability business as well as corrective rate actions in our Singapore branch and aviation businesses.

AFG's updated earnings guidance reflects our current expectations of a below-average crop year, which I'll discuss in more detail. The 2019 growing season will go on record as one of the most challenging planting seasons on record due to spring flooding and excess moisture across the Midwest. As a result, we are processing a record number of preventative planning claims. It's still too early to know how the crop year will play out. In addition to the ultimate impact of preventative planning, other key considerations that will influence our crop insurance results include conditions throughout the remainder of the growing season and commodity prices. This week's USDA reports indicate that the percentage of corn and soybean crops in good or excellent condition is estimated to be 13 to 14 points lower than last year at this time. Though, keep in mind, 2018 yields were exceptionally strong. Corn futures are currently trading up about 3% from the spring discovery price and soybeans are down 9%. Trade concerns with China are probably already being factored into the commodity pricing, and the commodity prices today seem to be performing just fine.

On a more positive note, our winter wheat and our rainfall index business should perform better than average this year due to higher levels of precipitation countrywide. We will have a more complete picture with regard to our crop insurance business when we report our third quarter results.

The Atlas Financial Holdings transaction is progressing nicely. National Interstate will begin to issue policies in the third quarter, and we expect this business to add \$20 million in gross written premium in the second half of 2019. We expect gross written premiums produced by our wheels-based businesses consisting of National Interstate, Vanliner and Great American trucking, and with the addition of the Atlas paratransit business, this business will reach \$1 billion this year.

Now the Specialty Casualty group reported an underwriting profit of \$47 million in the 2019 second quarter compared to \$29 million in the comparable '18 period. Higher profitability in our workers compensation and public sector businesses was partially offset by lower year-over-year profitability in our excess and surplus lines businesses. Underwriting profitability in our workers comp business continues to be very strong. Catastrophe losses for this group were \$1 million in both the second quarters of 2019 and '18.

Gross and net written premiums for the second quarter of 2019, both increased 4% when compared to the second quarter of 2018. The addition of premiums from ABA Insurance Services, which we acquired in the fourth quarter of 2018 as well as growth in our excess and surplus lines, executive liability and social services businesses were the primary drivers of the higher premiums. Lower premiums in our workers comp businesses and within Neon, primarily due to foreign currency translation, partially offset this growth. Renewal pricing for this group was up 3% during the second quarter. Excluding rate decreases in our workers comp businesses, renewal rates in this group were up approximately 7%. Both measures again are improvement from renewal rate increases achieved in the first quarter of this year and the highest we've seen in 5 years. I'm pleased to see double-digit rate increases for Neon, and strong pricing momentum in our excess liability, umbrella, surplus lines, public D&O and social services business.

I would like to take the opportunity today to welcome Jim Slade to Great American Insurance group. Jim will lead our newly-formed Accident & Health division, which becomes our 35th Specialty Property & Casualty business and a new addition to the Specialty Casualty group.

Jim and his team will build upon Great American's existing array of accident and health insurance coverages, focusing on customized coverages for organizations and educational institutions.

The Specialty Financial Group reported an underwriting profit of \$21 million in the second quarter of 2019 compared to \$22 million in the second quarter of '18. Higher underwriting profitability in our equipment leasing and surety businesses was more than offset by lower underwriting profitability in our financial institutions business. Catastrophe losses for this group were \$3 million in both the second quarters of 2019 and '18. Second quarter 2019 gross written premiums were down 2% and 6%, respectively, when compared to the same 2018 period, primarily as a result of lower premiums in our financial institutions business. Renewal pricing in this group was up approximately 1% for the quarter.

Now if you turn to Slide 6 for a summary view of our 2019 outlook for the Specialty Property & Casualty operations. Although we continue to expect an overall combined ratio between 92% and 94%, we've adjusted our estimates for the combined ratios within each of our Specialty Property & Casualty groups. We've also adjusted our estimate for overall growth in net written premiums to be in the range of 2% to 5% now, an increase from the range of flat to up 3% estimated previously.

Looking at each segment, we now estimate a combined ratio in the range of 93% to 97% in our Property and Transportation Group, a point higher than the range of 92% to 96% previously estimated. As I noted earlier, while it's too early to project our crop results for this year, this adjustment takes into account a record number of preventing planning claims and our expectations for a below-average crop year. We now expect growth in the net written premiums in this group to be between 4% and 8%, an increase from the previous range of 3% to 7%. Our Specialty Casualty Group is now expected to produce a combined ratio in the range of 90% to 94%, a slight improvement from our previous estimate of 91% to 95%. And we now expect growth in net written premiums for this group to be between 2% and 6%, an improvement from the previous range of down 2% to up 2%, reflecting growth opportunities and strong pricing momentum

in the majority of businesses in this group. And we now expect the Specialty Financial Group combined ratio to be in the range of 87% to 91%, a slight improvement from our initial estimate of 88% to 92%. And based on the results of the first half of 2019, net written premiums are now expected to be down 4% to flat year-over-year, a decrease from the previous expectations of growth in the range of 3% to 7%. Our guidance with regard to net investment income has changed with results in 2019 expected to be up 2% to 6%, an improvement from our previous estimate of flat to up 4% year-over-year. Given the broad-based improvements noted in renewal pricing across many of our Specialty Property & Casualty businesses, we now expect overall renewal pricing -- P&C renewal pricing to be up 2% to 4% this year, an improvement from the previous range of 1% to 3%. And excluding workers comp, we expect renewal rate increases to be in the range of 5% to 6%.

And I'll now turn the discussion over to Craig to review the results in 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 \$1.35 billion in the second quarter of 2019 compared to \$1.4 billion in the second quarter of 2018, a decrease of 4%. Higher traditional fixed annuity premiums in the financial institutions channel were more than offset by lower FIA premiums in the retail and broker-dealer channels. In response to the continued drop in market interest rates in 2019, we've implemented several rate decreases in order to maintain appropriate returns on annuity sales, which has begun to temper new sales. As previously announced in the second quarter of 2019, we changed the way we define annuity core operating earnings. Beginning with the second quarter, annuity core operating earnings exclude the impact of items that are not necessarily indicative of operating trends, such as the impact of fair value accounting for fixed-indexed annuities, unlockings and other items related to changes in the stock market and interest rates. Core operating earnings will now include an expense for the amortization of FIA option cost, which is a better measure of the cost of funds for FIAs. We believe these changes will provide investors with a better view of the fundamental performance of the business and a more comparable measure of the Annuity segment's business compared to its peers.

Turning to Slide 8, you will see the components of pretax annuity core operating earnings under this new definition. Results for the prior -- for the periods prior to the second quarter of 2019 are shown in a comparable format to the new definition of our annuity core operating earnings and are reconciled to previously reported annuity core operating earnings. Growth in average invested assets contributed to higher year-over-year annuity earnings, which were more than offset by lower earnings from investments marked to market through operating earnings and higher option costs. Earnings from investments marked to market vary quarter-to-quarter based upon the reported results of the underlying partnerships and investments. Higher amortization of option costs reflects growth in AFG's annuity business as well as higher renewal option costs related to inforce business.

Turning to Slide 9, you will see that our quarterly average annuity investments and reserves both grew by approximately 12% year-over-year. AFG's spreads in the second quarter of 2019 were lower than in the second quarter of 2018, as spreads in 2018 reflect exceptionally high returns on certain investments that are marked to market through operating earnings as well as the impact of higher option costs in 2019.

Please turn to Slide 10 for a summary of the 2019 outlook for the Annuity segment. Taking into account the new definition of annuity core operating earnings beginning in the second quarter and based on \$194 million of core operating earnings reported by the Annuity segment in the first 6 months of 2019, we have narrowed the range of our 2019 guidance for pretax annuity core operating earnings to \$375 million to \$405 million from the range of \$365 million to \$425 million estimated previously.

Our revised guidance reflects renewal option costs in line with recent purchases and a return of 8% to 10% on investments required to be marked to market through operating earnings. For reference, these investments earned 11% in the first half of 2019. In addition, guidance assumes that lower long-term reinvestment rates will have a negative impact on the runoff of the Annuity segment's investment portfolio as well lower short-term rates were expected to have a negative impact on the Annuity segment's net

investments in cash, short-term investments and floating rate securities, which were approximately \$4 billion at June 30, 2019. Fluctuations in these items could lead to positive or negative impacts on the Annuity segment's results.

Finally, we're modifying our previously annuity premium guidance based on sales through the first 6 months of the year. We believe that recently implemented rate decreases on our annuity products and a contingent focus on pricing discipline will temper new sales as we remain committed to achieving appropriate returns on new business. As a result, we now expect that our 2019 annuity sales will be down 5% to 10% from a record \$5.4 billion of premiums in 2018. 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 11 for a few highlights regarding our \$53 billion investment portfolio. AFG reported second quarter 2019 net realized gains on securities of \$45 million after-tax and after deferred acquisition costs. This compares the net realized gains on securities of \$25 million in the second quarter of 2018. Approximately \$29 million of the realized gains recorded in the second quarter of 2019 pertained the securities that AFG continued to hold at June 30, 2019. As of June 30, 2019, net unrealized gains on fixed maturities were \$812 million after-tax and after DAC.

As you'll see on Slide 12, our portfolio continues to be high quality with 91% of our fixed maturity portfolio rated investment grade and 98% within NAIC designation of 1 or 2, its highest 2 categories. We've provided additional detailed information under various segments of our investment portfolio in the quarterly investor supplement on our website.

I will now turn the discussion over to Jeff, who will wrap up our comments with an overview of our consolidated second quarter 2019 results and share a few comments about capital and liquidity.

Joseph E. Consolino

Executive VP, CFO & Director

Thank you, Craig. Slide 13 summarizes AFG's second quarter consolidated core operating earnings results. AFG reported core EPS of \$2.12 in Q2 2019. Core net operating earnings in the quarter were \$192 million, \$7 million higher than a year ago quarter. Higher year-over-year core operating earnings in the Annuity segment under our new definition were offset by a lower operating earnings in our Specialty P&C insurance operations.

As Craig discussed earlier in the call, AFG's Annuity core operating earnings for the second quarter of 2019 exclude the impact of items that are not necessarily indicative of operating trends, and include an expense for the amortization of FIA option costs. We believe this better reflects the cost of funds for fixed-indexed annuities and AFG's evaluation of the financial performance of our annuity business. Items previously reported as a component of annuity core operating earnings are noted on the slide for the comparable prior year period.

Interest and other corporate expenses were \$6 million lower year-over-year. Parent company interest expense increased by \$1 million as compared to Q2 2018 as a result of the March 2019 issuance of \$125 million principal amount hybrid 40-year, 5 7/8% subordinated debentures due in 2059. Other expenses were \$7 million lower year-over-year, reflecting a normal run-rate in the 2019 second quarter.

Slide 14 provides a reconciliation of core net operating earnings to net earnings. In the second quarter of 2019, AFG recognized \$45 million or \$0.48 per share in net after-tax realized gains on securities. Annuity non-core items reduced net earnings attributable to shareholders by \$27 million or \$0.29 per share.

Turning to Slide 15, AFG's adjusted book value per share was \$58.49 as of June 30, 2019. Our annualized growth in adjusted book value per share plus dividends was a very strong 16.3% in the second quarter of 2019. We returned \$170 million to our shareholders in the second quarter with the payment of our regular quarterly dividend and \$1.50 per share special dividend during the quarter. Parent cash was approximately \$135 million at the end of the second quarter. We maintained solid levels of capital in our insurance businesses to meet our commitments to the rating agencies. Our excess capital stood at approximately \$1 billion at June 30, 2019. We plan to hold approximately \$200 million to \$300 million as dry powder to

maintain flexibility for opportunities as they arise. Our management team reviews all opportunities for the deployment of capital on a regular basis.

Wrapping up, Page 16 shows a single-page presentation of our updated 2019 core earnings guidance. Our guidance assumes an effective tax rate of approximately 20% on core pretax operating earnings. AFG's expected 2019 core operating results exclude non-core items, such as realized gains and losses, annuity non-core earnings and other significant items that may not be indicative of ongoing operations.

Now, we'd like to open the lines 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, maybe starting with the annuity piece first. Did you talk about how quickly you plan to change the crediting rates based on the interest rate outlook in the opening remarks?

Stephen Craig Lindner

Co-President, Co-CEO & Director

Amit, this is Craig. First of all, as it relates to new sales, we are constantly adjusting credited rates to earn our target rate of return. I think we've had some 5 or 6 adjustments so far year-to-date, and obviously with the move we've seen here in the last couple of days, we're preparing to make another change as it relates to new business. As it relates to the inforce, we are fortunate that we have approximately 120 basis points of difference between the current credited rates and the guaranteed minimums on approximately \$30 billion of reserves. So if we remain in this environment for an extended period of time, we have a lot of room to adjust the credited rates on inforce.

Amit Kumar

The Buckingham Research Group Incorporated

Got it. That's helpful. The second part to, I guess, the same discussion is, I know in the past, I think, in Q4, although, you've had interim periods, you look at the actuarial assumptions and there is some times noise from unlocking. Is there any way to think about that right now?

Stephen Craig Lindner

Co-President, Co-CEO & Director

Yes, Amit. Typically, we have done a very, very thorough review in the fourth quarter. Given the recent move in interest rates, we're looking to do that in the third quarter of this year. I guess, I can't give you a prediction of the outcome, but let me tell you how I would think about it. On the negative side, clearly, rates are lower than what we projected when we did the last unlocking. So we're going to put new assumptions in place related to future reinvestment rates and the period that it takes to get to the ultimate. So obviously given the current level of rates that is a negative. Now mitigating that impact, we have the ability to reduce credit rates and currently, we will reduce credited rates beyond what was assumed in the last unlocking. And the other mitigating factor is lower interest rates drive lower option costs. So those 2 items are positives. Obviously, the current level of reinvestment rates is a negative.

Amit Kumar

The Buckingham Research Group Incorporated

Got it. That's helpful. And switching to P&C, and then I will stop. Maybe, let's start with the crop insurance book. Historically, if you were to look at the previous sort of crop years. Which -- what would you quantify as an average year? Would that be 2014, 2015? Is there any way to sort of think about your historical crop results and how 2019 is shaping up to be?

Carl Henry Lindner

Co-President, Co-CEO & Director

As you know, we don't separately disclose that as a segment, Amit. But the last couple of years have been above average. This year, we're saying, it's going to be below average in the whole scheme of things. Jeff, you have any other perspective on that?

Joseph E. Consolino

Executive VP, CFO & Director

Yes. I do. Go ahead, Amit.

Amit Kumar

The Buckingham Research Group Incorporated

Apologies for the siren. I was trying to ask is, obviously in your initial guidance, you had an average crop here. And I was just wondering if there was a close enough proxy where you could say, yes, average would be 2013 or 2014 and obviously '18 and '17 and '16 were materially above expectations. I was just trying to come up with some sort of a thought process in terms of what is the closest proxy for how you define what is an average crop year without breaking the numbers?

Joseph E. Consolino

Executive VP, CFO & Director

I'm sorry, we really can't be more specific than that, but anything else we gave you Amit would we going into information we just haven't disclosed in the past. So, apologies.

Amit Kumar

The Buckingham Research Group Incorporated

Okay. But the only other question is and I'll stop here is, on the discussion on -- you're talking about the trends, I guess, 2 parts. One, any thoughts on the Child Victims Act and its impact on you? And separate from that, are you seeing any sort of noise or any change in trend line from the emerging discussion on the tort climate?

Carl Henry Lindner

Co-President, Co-CEO & Director

I think the -- that's something that we're watching. Obviously, in our nonprofit book that would be the part of our business where those types of claims or things that we would watch closely. I'm not sure we're a real heavy insurer in the state of New York itself. But of course, we kind of watch those trends in that. So that's something that we're keeping our eye on.

Amit Kumar

The Buckingham Research Group Incorporated

And on the -- separately on the tort climate, any thoughts on that overall in terms of jury awards or more attorney involvement?

Carl Henry Lindner

Co-President, Co-CEO & Director

I think, nothing new. There is -- in the commercial auto side of things, we continue to take pretty good rate. I think, we took 9% in our commercial auto liability side, that reflects an increase in the tort environment for -- in the commercial auto side. And I think, we're also, as far as some above average loss cost trend, the other place would be in the D&O side of things. As we don't write a lot of public, so I don't think our -- we're not seeing the same trend lines as those that would write a lot of public D&O in that. I think those are -- that's nothing new in our case. But those would be a few places that we would see things in. Excess liability, actually, the loss costs increase there would be a little higher than other lines. Commercial auto, when I asked our guys, what's driving that, it's commercial auto claims that are pushing up into the umbrella in excess levels.

Operator

The next question comes from Jay Cohen with Bank of America securities.

Jay Adam Cohen

BofA Merrill Lynch, Research Division

One, just follow-up on the crop side. I guess my assumption is that, the reduced premiums there, because of the planting issue, would it had some impact on your second quarter expense ratio? Is that fair?

Joseph E. Consolino

Executive VP, CFO & Director

Jay, this is Jeff. Yes, that would be correct.

Jay Adam Cohen

BofA Merrill Lynch, Research Division

And obviously your comments, which suggests that might reverse in the third quarter given the flow of premiums that -- we should see then?

Joseph E. Consolino

Executive VP, CFO & Director

Absolutely. To the extent we're recognizing a greater level of premium in Q3, our expense ratio would tends to decline as you have a greater denominator you're dividing it into. I would gratuitously throw in that when you look at the seasonalization of our expense ratio, Jay, we've tended to have a low expense ratio in the fourth quarter as crop profitability and contingent commissions related to that tend to come in. Clearly, putting down the marker that Carl has on a below-average year. You probably won't see the same reduction in expense ratio in the fourth quarter for Property and Transportation or across our whole business if indeed that comes to pass and our crop profitability is "below average."

Jay Adam Cohen

BofA Merrill Lynch, Research Division

That is helpful. And I guess the second topic on kind of overall transportation businesses, you seem to suggest that you had less favorable development in this segment, partly because of less favorable development or even adverse development in your transportation businesses. If you could kind of talk about the claims trends you are seeing? And then zero in, maybe, on the pricing that you're seeing in different parts of that business? Because it's a big business for you now.

Carl Henry Lindner

Co-President, Co-CEO & Director

Jeff, you want to address the reserves and I can talk a little bit about the pricing there?

Joseph E. Consolino

Executive VP, CFO & Director

Absolutely. Jay, as you mentioned, transportation is a business we like. It's gotten bigger. And Carl just had mentioned in the call that we see Atlas paratransit transaction what we call our wheels business, which is the transportation business, could crest \$1 billion gross this year.

In terms of development, let's go back to our previous struggles with National Interstate, which emerged in 2012. At that point, we felt like, we didn't see other companies reporting the same trends. So when we had the uptick in severity, we were concern and we've been working on rate for 7 consecutive years. Since then, part of the prescription there was to increase reserves in National Interstate, which happened and then ultimately, the rate has turned our combined ratio around to where we feel like the transaction where we bought in the minority is giving us an appropriate return on capital. Given all the rates and given the other actions we've taken, we feel like National Interstate is in a strong reserve position at this point. And it is true that in our transportation businesses, we're showing year-over-year lower level of favorable development when you compare Q2 of '18 to Q2 of '19. But we're still showing favorable development in that segment, which is a comment that I don't think many other companies in our industry can say. So I know it's a problem spot and a hot topic with others. We certainly feel like commercial auto needs the rate that Carl cited, and we're about 9% year-to-date. But we do have, what we believe, our prudently strong reserves for that business. And even though, the quarterly comparison is lower, '19 versus '18, we still are showing favorable development.

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

Yes. Well said, Jeff. I'm not sure I have a whole lot to add. You -- overall rate increase in National Interstate that -- in the quarter was 7% with commercial auto liability being 9%. I think Vanliner, we got 3%. In Great American trucking, 2% overall. In National Interstate that includes some decline in workers comp pricing. So I think we're pleased with our performance of our commercial auto or transportation business. We're achieving our overall combined ratio targets. Though, as I mentioned before, with those severity trends in commercial auto liability, we're continuing to take rate there. And I think our house is in order there. And I think we're going our business double -- we are growing this transportation business double-digit through 6 months. I think we're taking advantage of being -- having our house in order and being in a market in a correction mode and are very excited about the Atlas transaction and expect it to, as I mentioned before, to begin adding to our premiums in the second half.

Jay Adam Cohen*BofA Merrill Lynch, Research Division*

I guess it just helps when you see trends a bit earlier than others and you move quicker.

Operator

Our next question comes from Greg Peters with Raymond James.

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

Carl, in your opening comments, you specifically called out the operations in Singapore, called out your aviation operations and then in financial institutions in your Specialty Financial segment. I was wondering if you could spend an additional minute providing some additional context on those 3 businesses, whether it's the type of business being written in each of those subsegments and the order of magnitude of their effect on your second quarter results?

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

Greg, FIS is still making a solid underwriting profit, just not quite as profitable, at least in the first 6 months is what they have -- were in the prior period. FIS, that business we've achieved some rate increase, not a lot of much rate in the first 6 months. I think our guys are expecting for that to move up through the rest of the year in that. But that's been a very good business for us over a long period of time. I think that they've been tougher on some of the collateral protection accounts and they've been doing a little bit of re-underwriting to try to get back to the profitability -- the great profitability that we've been used to over time.

On the Aviation business, that's a business we started a number of years ago. We like others in the industry have had profitability problems in that. We've been working hard over the past 6 to 12 months to adjust our underwriting appetite and also rates. Rates in the second quarter in Aviation went up 23%, they're up about 21% for the year. Right or wrong or otherwise, we've chosen to adjust our underwriting appetite, increased rates and try to work our way through in a market that's correcting pretty well in that. So we'll see where that goes.

A little bit the same in Singapore. Singapore is a business we started, a branch we started a number of years ago. We've got a pretty good start on the premium side. I think they might have been up to \$50 million, \$60 million. We wrote an Uber like account called Grab, that really bit us hard and that we got off of, I think, a while ago. And that market seems to be correcting. We're getting pricing in Singapore of about 7% right now. So very similar. We've been taking underwriting actions as well as increasing price in Singapore in order to correct the results.

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

As a followup...

Joseph E. Consolino

Executive VP, CFO & Director

Greg, this is Jeff. You had said in your question you are hoping for some quantification. Just a couple of notes I would make would to put some numbers around Carl's commentary. With respect to the financial institutions business or FIS, that's in our Specialty Financial segment. It is a major component there. It's the biggest premium. And just to echo Carl's comment, it's a good business. It's operating at a combined ratio below 90. So very appropriate and good margins.

With respect to Aviation, we've talked for several quarters in a row, including last year, about the severity and the loss trends that's brought about. I would not single out aviation in the second quarter of 2019 as contributing any variance to our combined ratio in the quarter as compared to last year. Their margins in terms of dollars are roughly comparable, actually materially better.

And then Singapore, which is in Property and Transportation, you'll note that our Property and Transportation subsegments combined ratio rose by about, call it, 1.7, 1.8 points in the quarter. Singapore is a major contributor to that. So that would be driving the uptick in that subsegment.

Charles Gregory Peters

Raymond James & Associates, Inc., Research Division

As a followup, on the aviation account, where you are reporting substantial rate, is that a general aviation type business? Or is there some commercial and other aspects included?

Carl Henry Lindner

Co-President, Co-CEO & Director

That's what we would you call kind of more of a nonstandard general aviation type of a book. That's our niche. It's not the commercial -- large commercial airline company.

Charles Gregory Peters

Raymond James & Associates, Inc., Research Division

Craig, I'd like to ask you a question or 2 about your segments and your results. I was looking through Page 15 of your supplement and listening about your comments on pressure on sales. And it looks like, you've seen the most pressure on new sales in the broker-dealer single digit -- single premium-indexed annuity business, not as much in the financial institutions piece. Do you think your market actions aren't going to bleed over and lead to a decline in that larger piece of your new sales?

Stephen Craig Lindner

Co-President, Co-CEO & Director

Greg, time will tell. It really depends upon what our competitors do in terms of adjusting credited rates. We've been surprised that some of the competition has been as slow as they have been to adjust credited rates. But it really is going to be a function of whether our competitors are interested in earning the appropriate rate of return or whether they're going to accept returns that we would not.

Charles Gregory Peters

Raymond James & Associates, Inc., Research Division

Right. As a followup, you commented about the opportunity to reduce crediting rates. It seems in some respects there is some headwind in your annuity business as we look beyond this year, look to 2020. And I guess my question and I know you're not going to provide guidance on 2020 numbers yet, but is the annuity business in this current environment, especially what's transpired in say, the last month or 2, should we still think about the annuity business as a growth business for AFG? Or is it possible that it may stagnate for the year?

Stephen Craig Lindner

Co-President, Co-CEO & Director

I don't know quite what you mean by stagnate. First of all, we're going to price our product to earn the right rate of return. That's one of the beauties of being involved in a highly diversified company where if the environment in one line of business really isn't conducive to earning a right returns or investing more capital, we have the ability to kind of wait things out in that given line of business until conditions change and they always do. So you saw our guidance on premiums being down 5% to 10%, but it still drives growth, and the guidance on growth in reserves and investments is 9% to 11%. So it's still a very healthy growth in reserves and investments. So I wouldn't call that stagnate or maybe periods when premiums decline. We're okay with that. We're going to be disciplined with our pricing. But the guided level of premiums still generates a very healthy growth in investments and reserves.

Charles Gregory Peters

Raymond James & Associates, Inc., Research Division

I don't want to give you the wrong impression. I guess when I was -- what I'm looking at would be on Slide 10 in your annuity outlook, where you talk about the core earnings, the guidance that you provide for the year. And what I -- I am just trying to get a sense is that the opportunity with the crediting rates that will help lead to -- and the growth in your investments lead to growth in the pretax earnings as reported for 2020? Or are the market condition is such that it's possible that it might not grow next year?

Stephen Craig Lindner

Co-President, Co-CEO & Director

Yes. We have not given guidance, Greg, on next year yet. But -- and we feel pretty confident, we're going to continue to earn attractive returns in the annuity business. I'll just say that.

Operator

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

Jon Paul Newsome

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

First, I have a, what I think a bit of an accounting question. So Chubb said that the premium recognition in their crop business wouldn't change due to the slow planting. I was wondering if there's something about your business and your accounting that might be different in geographic trends or whatever that would create a difference in accounting from a premium perspective?

Joseph E. Consolino

Executive VP, CFO & Director

It's an interesting question, Paul. Unfortunately, we're not in a position to comment on Chubb's accounting policies. So I think that you can take Carl's guidance about the recording of premium and the timing as reflective of our business and how it's accounted for. And I can't really stray off of that territory.

Jon Paul Newsome

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

Fair enough. And then, could we hone a little bit in on the workers comp business. I think you said the profits were actually up, pricing has been widely talked about as being down for just about everybody. So I guess that either means you are expanding your worker's comp business quite a bit from a premium perspective or you're remarkably having negative [clean] cost inflation. Maybe you can just talk about sort of how that is holding up as well if it is?

Carl Henry Lindner

Co-President, Co-CEO & Director

Yes. Workers comp will probably under 19% of our overall direct written premium projected for this year. Our 6 months results overall for this year are very good. We have a healthy accident year combined ratio and a very healthy calendar year combined. The outlook, I think, is the same for the whole year. Overall, gross and net written premiums will be down a little for 6 months. And I think, they'll probably be down

low single-digit for the '19 year. As I think, we've said before, when we look at parts of our -- I mean from a loss cost trends standpoint, very pleased with what we're seeing on the loss cost trend side. Our overall loss or loss cost trends at Summit is about up 1%, Republic is pretty flat. Strategic Comp is not much going on there. So loss cost inflation, we're very pleased with it. So very pleased with overall results.

Republic as to be expected after the adjustments in rates, including current pricing being down 11%. I think for 6 months and for the whole year, we'll probably have a small underwriting -- accident year underwriting loss at Republic. Though, we're continuing because of the strong reserve position to have a small underwriting gain to probably breakeven results on a combined ratio for Republic. Again, keep in mind that we're earning 20% returns on equity even at 100% combined ratio in California.

Summit continues to do very well. I'd expect Summit to make a small -- accident year underwriting profit, healthy calendar year underwriting profit even with price being down 11%. Premiums will be down 2% to 4%. Feel good about the reserve position in that part of our business. And as I mentioned before, Strategic Comp has very healthy accident year and calendar year profit for 6 months and that's projected this year. They're actually growing in that part of our large deductible kind of part of our business and actually getting a little bit of rate increase through the first 6 months. So I'm -- we're pleased with our workers comp business right now.

Operator

Our next question comes from Christopher Campbell with KBW.

Christopher Campbell

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

The expense ratios were up in all 3 segments. And it sounds like Property and Transportation might be a little bit of crop related. But what's driving the higher expenses in the other 2 segments?

Joseph E. Consolino

Executive VP, CFO & Director

Chris, it's Jeff Consolino. So overall, I would say, our expense ratio is up, but only modestly. If I can throw some numbers at you, I'll try to dissect that by subsegment. I just want to lay my hands on the right analysis here.

We talked about Property and Transportation subsegment and the impact crop was having in the current quarter.

In our Specialty Casualty segment, our expense ratios moved up by about 0.8 of a point. The major contributor there, we have a number of longer tail casualty operations there, and there in some cases retaining more of their premium and buying less reinsurance. Since they are so profitable when they do buy reinsurance, they get a very healthy ceding commission. And so the act of buying less reinsurance versus keep more underwriting profit that kind of counterintuitively would tend to tick up the expense ratio if the ceding commission is in excess of our original acquisition cost. That's what's contributing to what's going on within Specialty Casualty segment.

We talked earlier in response to a different question about our financial institutions business inside the specialty financial subsegment, that financial institutions business is the biggest piece of that. We've talked about the nature of that business in past calls where there is a, what I would characterize as a variable commission for our production sources there, profit commission that if we have very little loss ratios, the originating agents can receive higher commissions. In 2018, with an active cat year, profit commissions were lower for our financial institutions business. This year, in a more normal cat environment, and we're back to paying a more normal level of profit commission. So that's why you see the expense ratio moving up in that segment by about 1.6 points, but you really wouldn't see a concomitant increase in the action -- your combined ratio because it's somewhat offset by overall loss ratio in the subsegment.

Christopher Campbell

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

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Okay. Great. Specialty Casualty reserve releases were up year-over-year. I guess what products and accident years are contributing to those?

Joseph E. Consolino

Executive VP, CFO & Director

Workers compensation is the biggest piece, Chris. And accident years, generally it's going back 3, 4, even more years, when you look at the accident years these are emanating from.

Christopher Campbell

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

So like '16 and prior?

Joseph E. Consolino

Executive VP, CFO & Director

If you go back to '16 and prior, that's more than 100% of the reserve release.

Christopher Campbell

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

Okay. Got it. Big picture question, I guess, what would be AFG's potential liability exposure to opioid distributors and manufacturers? Do you guys have any exposure there?

Carl Henry Lindner

Co-President, Co-CEO & Director

Give me a second there. Let's see if I have any notes on that. I don't think that's a big area of concern for us. We just don't -- we're not a large insurer of chemical -- pharmaceutical manufacturing companies and those types of risks. So obviously, something that we're keeping our eye on on that, but I wouldn't say that...

Christopher Campbell

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

Okay, got it. And then no repurchases this quarter, I guess, how do we think about the modeling this going forward given the recent pullback in this year?

Joseph E. Consolino

Executive VP, CFO & Director

We did just pay \$1.50 special dividend, which was a substantial commitment of our capital. Our CEOs and our Board are very focused on returning capital to shareholders in the most appropriate way if we can't deploy it growing organically or making sensible acquisitions. I think our actions have demonstrated a recent bias towards special dividends rather than repurchases. But it's all subject to financial analysis at a point in time.

Christopher Campbell

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

Got it. And then I guess how fast is the excess capital growing because I mean if you're pulling back in life, right? If there's going to be less life premium growth, that's obviously -- there is -- that's good guide in terms of the excess capital. But then you're growing P&C, which you'll need capital there to grow. I guess just combining those 2, how should we think about excess capital generation over time in modeling that?

Joseph E. Consolino

Executive VP, CFO & Director

Chris, we did report \$1 billion of excess capital with this earnings release. So even after paying that substantial dividend, we've built ourselves back up because we started the quarter when we ended

previous quarter in \$1.1 billion before that special dividend. We've said over time, I think Craig is pleased with the annuity business being a generator of excess capital rather than consumer of excess capital. With the P&C business, our after-tax returns are north of 15%, if you look back at say, the most recent years. And we're not going growing organically at 15%. So unless we find a way to reinvest that in things like the paratransit transaction or the ABAIS transaction, P&C will continue to generate excess capital for us. Now we've got good flexibility, and ideally, we'll have the opportunity to deploy it in a sensible way. And if not, we'll be returning it to shareholders.

Operator

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

Diane P. Weidner

Assistant Vice President of Investor Relations

Thank you all for joining us this morning, and we look forward to talking with you again when we release next quarter's 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.

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