S&P Global
Market Intelligence

American Financial Group, Inc. NYSE:AFG

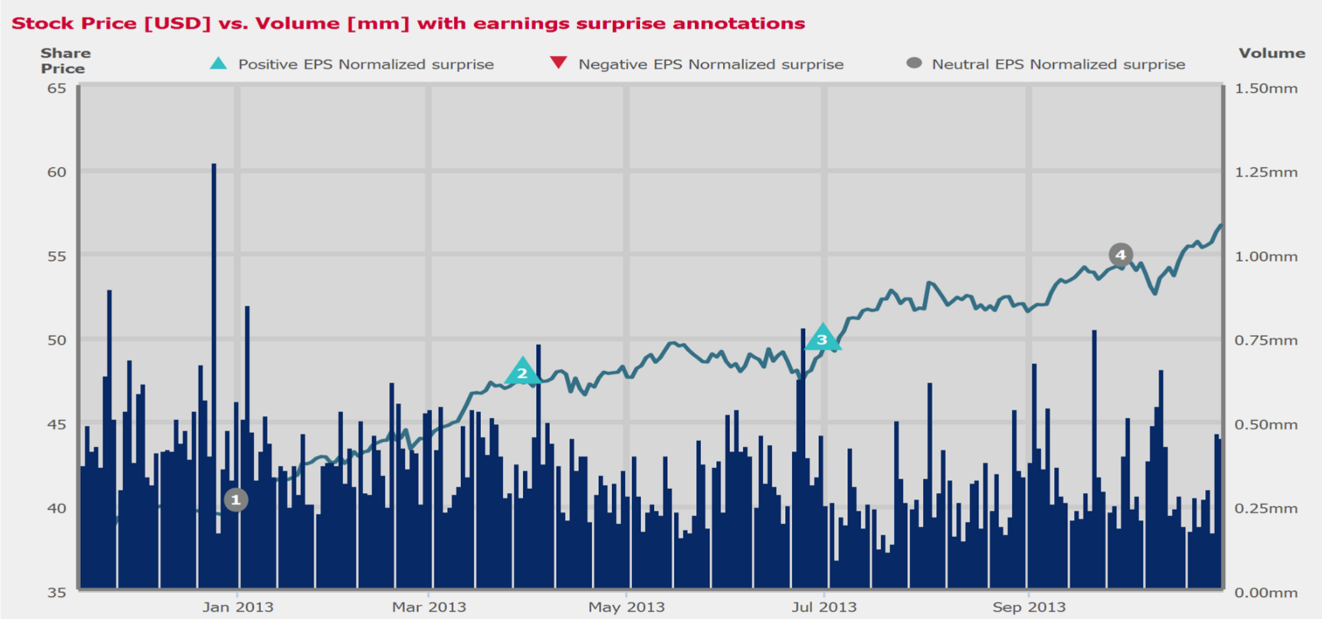
FQ4 2013 Earnings Call Transcripts

Friday, January 31, 2014 4:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2013-			-FQ1 2014-	-FY 2013-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.21	1.28	▲5.79	0.98	4.15	4.22
Revenue (mm)	847.10	859.00	▲1.40	838.70	3250.55	3204.00

Currency: USD
Consensus as of Jan-31-2014 4:31 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2012	0.67	0.67	1 0.00 %
FQ1 2013	0.81	0.92	▲2 13.58 %
FQ2 2013	0.86	0.96	▲3 11.63 %
FQ3 2013	1.06	1.06	4 0.00 %

Table of Contents

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
Macquarie Research

Daniel O'Brien

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to American Financial Group 2013 Fourth Quarter and Year-End Results Conference Call. [Operator Instructions] I would now like to introduce your host for today's conference, Diane Weidner, Assistant Vice President of Investor Relations. Ma'am, you may begin.

Diane P. Weidner
Assistant Vice President of Investors Relations

Thank you, Sam. Good morning and welcome to American Financial Group's Fourth Quarter 2013 Earnings Results Conference Call. I'm joined this morning by Carl Lindner III and Craig Lindner Co-CEOs of American Financial Group; and Jeff Consolino, AFG's Chief Financial Officer. If you are viewing the webcast from our website, you can follow along with the slide presentation if you'd like.

Certain statements made during this call are not historical facts and may be considered forward-looking statements and are based on estimates, assumptions, and projections, which management believes are reasonable, but by their nature subject to risks and uncertainties. The factors which could cause actual results and/or financial conditions to differ materially from those suggested by such forward-looking statements include, but are not limited to, those discussed or identified from time-to-time in AFG's filings with the Securities and Exchange Commission, including the Annual Report on Form 10-K and the quarterly reports on Form 10-Q. We do not promise to update such forward-looking statements to reflect actual results or changes and assumptions or other factors that could affect these statements.

Core net operating earnings is a non-GAAP financial measure, which sets aside significant items that are generally not considered to be part of ongoing operations, such as net realized gains and losses, discontinued operations and certain non-recurring items. AFG believes this non-GAAP measure is a useful tool for analysts and investors in analyzing ongoing operating trends and will be discussed for various periods during this call.

A reconciliation of net earnings attributable to shareholders to core net operating earnings is included in our earnings release. If you are reading a transcript of this call, please note that it may not be authorized or reviewed for accuracy, plus it may contain factual or transcription errors that could materially alter the intent or meaning of our statement.

Now, I'm pleased to turn the call over to Carl Lindner III to discuss our results.

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

Good morning. We released our 2013 fourth quarter results yesterday afternoon. I'm assuming that our participants have reviewed our earnings release and the investor supplement posted on the website.

We're pleased to report record core net operating earnings per share of $1.28, reflecting a 90% increase in the core pre-tax operating earnings in our Property and Casualty Insurance segment and a 35% increase in core pre-tax operating earnings in our Annuity segment.

Annualized core operating return on equity was 11.5% for the 2013 fourth quarter compared to 6.4% for the fourth quarter of 2012. Net earnings were $1.73 per diluted share and include $0.45 per share of realized gains. Annualized return on equity was 15.5%. Adjusted book value was $45.90 at December 31, 2013.

We ended 2013 with a strong fourth quarter and reported record net earnings per share for the year. Craig and I thank God and our management team and our employees for helping to achieve these results. We also focused on returning capital to shareholders over the course of the year.

If you turn to Slide 4, you'll see a few highlights. We paid $161 million in dividends during the year, representing $72 million in regular common stock dividends and an $89 million special dividend paid in December of 2013. Our quarterly dividend was increased by 13% to an annual rate of $0.88 per share beginning in October of last year. We repurchased $70 million of AFG's common shares at an average price per share of $48.17.

Growth in adjusted book value per share was 8% for the year. Total value creation measured by growth in book value plus dividends was $5.19 per share or 12% during 2013. AFG's annualized total 5-year shareholder return, representing growth in share price plus dividends was just over 23%. This substantially exceeds the equal measures of performance of the S&P 500 and the S&P Property and Casualty Index.

As we'll discuss later in the call, we also achieved healthy growth in businesses, where we're achieving desired returns. We continue to identify opportunities to grow our specialty insurance businesses.

As you know, earlier this month, we announced that we had reached an agreement with Liberty Mutual Insurance to acquire Summit Holdings Southeast, Inc., which will be our 29th Specialty Property and Casualty Insurance business. We expect this transaction to close early in the second quarter.

We have established our 2014 core operating earnings guidance for AFG in the range of $4.50 to $4.90 per share. Later in the call, we'll discuss expectations for our Specialty Property and Casualty Group and our Annuity segment.

Now, I'd like to review fourth quarter Specialty Property and Casualty results summarized on Slides 5 and 6 of the webcast. On Slide 5, you'll see summary results for our Specialty Property and Casualty Group.

The Specialty Property and Casualty Insurance operations generated underwriting profit of $75 million for the fourth quarter of '13 compared with $15 million in the fourth quarter of '12, with each of our Specialty Property and Casualty sub-segments achieving higher underwriting profits.

The fourth quarter 2013 combined ratio of 91.3% improved nearly 7 points from the 2012 fourth quarter, and reflects overall improved accident year underwriting profitability. Results last year or in 2012 were impacted by the Midwest drought, which lowered crop profitability and higher catastrophe losses, primarily from Superstorm Sandy.

Fourth quarter results in 2013 include less than $1 million in catastrophe losses compared to $33 million in the comparable 2012 period. Results for the 2013 fourth quarter also include $5 million in favorable reserve development. By comparison, favorable reserve development in the fourth quarter of 2012 was $12 million.

Gross and net written premiums were up 11% and 17%, respectively, in the 2013 fourth quarter, compared to the same quarter a year earlier, due primarily to higher premiums in our Specialty Casualty Group. Full year 2013 net written premiums were up 13%.

And almost 2/3 of our Property and Casualty businesses reported pricing increases during the fourth quarter, resulting in an overall renewal rate increase of about 3%. This is the ninth consecutive quarter that we've reported overall price strengthening.

The average renewal rate increase for the year was about 4%. Rates remain in excess of loss cost trends, which appear to be relatively benign across almost all of our Property and Casualty businesses.

On Slide 6, you'll see a few highlights from each of our Specialty Property and Casualty business groups. Property and Transportation Group, our largest sub-segment by premiums reported an underwriting profit of $17 million in the 2013 fourth quarter compared to an underwriting loss of $14 million in the prior year period. Higher profitability in our crop insurance and property and inland marine operations contributed to these results.

Commodity pricing for corn at harvest time was down approximately 22% from 2013 spring discovery prices, which impacted our crop insurance profitability, while soybean pricing was unchanged from spring pricing. Despite the price volatility, profitability in our crop insurance business improved over last year's results, which were adversely impacted by the effects of the Midwest drought.

In addition, losses from Superstorm Sandy were the primary drivers of lower underwriting profitability in our property and inland operations in the 2012 fourth quarter. Catastrophe losses for this group were negligible in the 2013 fourth quarter compared to $28 million in the comparable 2012 period. This group reported $3 million of unfavorable development in the fourth quarter of 2013, which was driven by 3 points of unfavorable reserve development in our transportation businesses.

Property and Transportation Group's gross and net written premiums were up 4% and 11% during the fourth quarter of 2013, respectively, and reflect growth in nearly every business unit, which was offset by lower premiums in our crop operations. Lower crop premiums were the result of delayed reporting of winter wheat plantings, the effect of which will be recorded in the first quarter of 2014. Excluding crop premiums, fourth quarter gross and net premiums grew by 10% and 13%, respectively.

Net written premiums for the full year of 2013 were up about 5%. Overall renewal rates in the Property and Transportation Group increased 5% on average for the quarter. The average rate increase for this group during 2013 was also about 5%. Our Transportation and Property and Inland Marine businesses reported sequential price increases for the quarter consistent with our goal to improve the profitability of these operations. Our National Interstate sub achieved a 7% rate increase.

Now, the Specialty Group -- Specialty Casualty Group reported a fourth quarter underwriting profit of $32 million, significantly higher than in the 2012 fourth quarter. The improvement was due primarily to higher accident year profitability particularly in our workers comp businesses as well as a $5 million improvement in prior year reserve development.

Gross and net written premiums were up 20% and 24%, respectively, in the fourth quarter of 2013, when compared to the same prior year period. While nearly all businesses in the Specialty Casualty Group reported growth, our workers compensation, excess and surplus lines and agency captive insurance businesses were the primary sources of the higher premiums.

New business opportunities increased exposures from higher payrolls on existing accounts, strong retentions and higher renewal pricing contributed to the strong growth in our workers comp businesses. In addition, new business opportunities and general market hardening have generated increased premiums in several of our excess and surplus lines businesses. Net written premiums were up 23% for the full year.

Renewal pricing in this group was up about 3% for the fourth quarter and up about 5% for the full year. Our California workers comp business achieved an 8% in the fourth quarter and an average renewal increase of 9%. California only, probably about 10%.

Specialty Financial Group recorded an underwriting profit of $17 million in the fourth quarter of 2013 compared to $16 million for the same period a year ago. Higher underwriting profits in our financial institutions business were partially offset by lower underwriting profitability in our surety and fidelity businesses. Almost all the businesses in this group continue to perform well and achieved an overall combined operating ratio of 85.2% for the quarter.

Gross and net written premiums were up 9% and 22%, respectively, when compared to the 2012 fourth quarter. Growth in our financial institutions and Surety business contributed to these results. Growth in gross written premiums were tempered by the October 2013 sale of a service contract business, which ceded all of its premiums under reinsurance contracts. Renewal pricing in this group was flat for the third quarter and for the full year of '13.

Now, if you turn to Slide 7, for an overview of the 2014 outlook for the Specialty Property and Casualty operations, we expect to achieve a combined ratio between 91% and 95%, and growth in net written premiums between 17% and 21%. Excluding Summit, we expect growth in net written premiums to be in the range of 5% to 9%. We're targeting overall average renewal rates for Specialty Group to be in the range of 3% to 4% this year.

We expect Property and Transportation Group to produce a combined ratio in the 94% to 98% range. We estimate this group's net written premiums will be flat-to-up 5% from amounts reported in 2013, primarily as a result of lower commodity price futures for corn and soybeans. We expect the Specialty Casualty Group to produce a combined ratio between 90% and 94%, and have growth in net written premiums between 45% and 49%.

Now, these estimates include approximately 9 months of earnings in premiums from our planned acquisition of Summit and continued growth in our workers comp and excess and surplus lines businesses. If you exclude Summit, we'd expect net written premium growth in the 12% to 16% range. We expect the Specialty Financial Group's combined ratio to be between 87% and 91%, and net written premium growth in the range of 3% to 7%.

And finally, our current expectation is that 2014 Property and Casualty pre-tax net investment income will be about 10% higher than in 2013. This increase reflects an incremental $1 billion in cash that we'll invest following the closing of the Summit acquisition and the additional $400 million in capital that we're putting to work in connection with this transaction.

Now, I'd like to 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. The Annuity segment reported recorded core pre-tax operating earnings of $92 million in the 2013 fourth quarter compared to $68 million in the comparable 2012 period, a 35% increase as shown on Slide 8.

Annuity premiums were $1.4 billion in the 2013 fourth quarter, were a 147% higher than the fourth quarter of 2012. This record premium reflects successful distribution channel expansion as well as new product offerings.

We believe that AFG has benefited from its strong ratings and that the annuity industry has benefited from the rise in interest rates in 2013. Full year 2013 annuity premiums were up 35% from the prior year.

For the first time in its history, AFG has exceeded $4 billion of annuity sales in a year, while achieving record annuity group profitability. Our team was well-positioned to act on opportunities to grow our business at favorable returns, while remaining committed to consumer centric product design and disciplined pricing.

Turning to Slide 9, you'll see that the higher pre-tax core earnings reflect a higher net spread earned on a growing asset base. AFG's fourth quarter average balance of fixed annuity investments and amortized cost grew by 17% year-over-year.

Our net interest spread was 286 basis points during the fourth quarter of 2013, a decrease of 32 basis points from the comparable prior year period. The decrease was due primarily to the runoff of higher yielding investments.

Net spread earned during the fourth quarter of 2013 increased by 18 basis points from the comparable prior year period. The negative impact of the runoff of higher yielding investments was more than offset by the favorable impact of certain items, including changes in interest rates.

For example, since certain indexed annuity reserves are discounted using current market rates, the significant increase in interest rates in the fourth quarter and full year of 2013, had a very favorable impact on 2013 earnings. Conversely, the drop in interest rates for the full year of 2012 had a negative impact on 2012 earnings.

In addition, 2012 annuity results, including a $14 million unlocking charge compared to a $2 million unlocking charge in 2013. Furthermore, both periods also included exceptionally strong investment results. Additional information about the components of these spreads for AFG's fixed annuity operations can be found in AFG's quarterly investor supplement posted on our website.

Please turn to Slide 10, for an overview of the 2014 outlook for the Annuity segment. Due to the large favorable items impacting earnings in 2013, we expect core pre-tax operating earnings in 2014 to be flat compared to the $328 million reported in 2013. While we expect average fixed annuity investments and average fixed annuity reserves to grow by 15% to 18% in 2014, we expect our net spread earned to be 20 basis points to 25 basis points lower than the 1.6 points achieved for the full year of 2013.

Although we achieved record annuity premiums in 2013, many factors will impact our ability to surpass the same level of sales in 2014. Based on information currently available, we expect that AFG's annuity premiums will be flat in 2014 compared to the $4 billion achieved in 2013. Significant changes in market interest rates and/or the stock market could lead to significant positive or negative impacts on the Annuity segment's results.

Please turn to Slide 11, for a few highlights regarding our investment portfolio. AFG recorded fourth quarter 2013 net realized gains on securities of $41 million after tax and after deferred acquisition costs compared to $36 million in the comparable prior year period. Unrealized gains on fixed maturities were $405 million after tax, after DAC, at December 31, 2013, a decrease of $44 million from September 30.

As you'll see on Slide 12, our portfolio continues to be high quality, with 86% of our fixed maturity portfolio rated investment grade and 97% 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 will now turn the discussion over to Jeff, who will wrap up our comments with an overview of our 2013 consolidated fourth quarter results.

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

Thank you, Craig. Good morning, everyone. Slide 13 shows highlights of our consolidated income statement for the 3 months period ended December 31, 2013 and 2012, by sources of earnings. This table summarizes the segment results that Carl and Craig just reviewed for you, and highlights other key items impacting AFG's consolidated operating results.

Core net operating earnings per share were $1.28 for the quarter, representing a 91% increase from the fourth quarter of 2012. Core net operating earnings for the 2013 fourth quarter were $117 million compared to $61 million in the prior year's quarter, increasing by 92%.

Looking at segment results. Our P&C segment operating earnings were $131 million in the fourth quarter of 2013 compared to $69 million in the 2012 fourth quarter. This is an increase of $62 million or nearly double. Carl has discussed the factors impacting underwriting income in the Specialty P&C Group, where underwriting profit rose from $15 million in the 2012 fourth quarter to $75 million in the 2013 fourth quarter.

These consist of higher accident year underwriting profitability in each of our Specialty P&C sub-segments and the lower level of cat losses, year-over-year. P&C pre-tax net investment income declined by $2 million, year-over-year, from $69 million in Q4 2012 to $67 million in Q4 2013.

As Craig described, our Annuity segment core pre-tax operating earnings were up $24 million or 35% during the fourth quarter, to a record $92 million. Results in our run-off long-term care and life operations improved by $9 million in the 2013 fourth quarter, but still came in at a negative $3 million.

Interest expense was $17 million in both periods. Other expense increased by $4 million in the 2013 fourth quarter. And finally, annualized core operating return on equity was 11.5% for the 2013 fourth quarter compared to 6.4% in the fourth quarter of 2012.

Having gone through the components of core earnings, you'll see on Slide 14 that our net earnings for the quarter were $158 million or $1.73 per share. Net earnings include $41 million or $0.45 per share in after-tax realized gains.

Turning to Slide 15, AFG's adjusted book value per share increased 8% during 2013 to $45.90. Adjusted book value per share rose by $3.38 in 2013, and when you add in the $1 special dividend and $0.805 of quarter common stock dividend, the total increase in shareholder net worth in 2013 exceeds 12%. Tangible book value per share on an adjusted basis at December 31, 2013, was $43.59.

Our capital adequacy, financial condition and liquidity all remained strong. We maintained sufficient capital in our insurance businesses to meet our commitments to the rating agencies. Our excess capital was approximately $1 billion at December 31, 2013. This included cash at the parent company of approximately $525 million.

As a reminder, we'll be investing approximately $400 million of our excess capital in Summit, during the early part of 2014. Still, we maintained more than enough capital flexibility to grow our business or take advantage of market opportunities as they arise. We continue to expect to grow our excess capital throughout the course of 2014.

We declared a special dividend of $1 per share in the fourth quarter of 2013 and there were no share repurchases during the fourth quarter of 2013. As of January 31, 2014, there are approximately 6.1 million shares remaining under our repurchase authorization. We review all opportunities for deployment of capital on a regular basis.

On Slide 16, you'll find a recap of 2014 guidance for AFG's core net operating earnings as well as guidance reviewed earlier in the call, our key financial measures in the Specialty Property and Casualty Group and the Annuity segments. In this guidance, we are assuming that Summit will be consolidated in our 2014 results or 9 months. These 2014 expected results exclude non-core items, such as realized gains and losses as well as other significant items that may not be indicative of ongoing operations.
Now, we would like to open the line for any questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Vincent DeAugustino of Keefe, Bruyette & Woods.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

First question I guess I have is, just looking at the planned renewal rate increases for 2014. If I'm looking at that the right way, they're probably about in line with loss cost inflation. So I'm just curious, if you'd expect maybe on some of your non-rate driven margin improvement initiatives for those to be able to overcome some of the favorable impact of weather in 2013. And if we kind of normalize that, can we kind of still shake out what is your net margin improvement with kind of all those moving parts?

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

I might address that a couple of different ways. First of all, and in our Specialty Casualty and Financial businesses, they have outstanding profitability and returns, high returns today in that. So we don't need as much rate increase there. Property and Transportation, some of our Transportation businesses are the ones that are in the need in property and inland marine, probably have been in the need of most of the increase, and we would continue to be pushing for rate.

You made a comment about our overall loss cost. As a company, our overall loss costs are a little under 3%. So I think that our goal is to definitely cover our loss cost, and maybe as, again, with heavier rate in the Property and Transportation side, definitely we'd be trying to exceed loss cost on that.

We always have initiatives in each of our businesses aside from rate to improve our profitability. We've been focusing on predictive analytics to continue to be more sophisticated on the rate segmentation of our business and our underwriting approaches and appetites for business. So that's an ongoing effort that impacts our business in that also.

So Specialty Financial, generally it's not had a lot of rate, hasn't really needed it. The perspective for this year is probably for, again, not much rate in Specialty Financial. So keep in mind the 3% or 4% is overall, which means that other than Specialty Financial businesses, maybe a little higher than that.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

And just to, I guess, continue on the same with the transportation book. I'm just curious, if in your opinion, if some of the pressure is perhaps economic related as we bounced off the bottom of the recession. And if that actually implies the second derivative economic growth slows, if that might imply emerging -- would you see more benign loss cost trends in 2014?

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

Maybe Jeff and I will take a crack at this. On the great American side or great American physical -- our truck physical damage business is performing fairly well. I think definitely the economy as it improves would definitely help that business as well as revenue and I think profitability on the national interstate side. And maybe let Jeff comment.

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

I think taking a step back and looking at the commercial auto segment in totality for the industry, we had 4 or 5 years running of decreasing rate. We had therefore several calendar years most recently, where the line as a whole failed to make an underwriting profit. So I would tend to believe that the problems for the class in general, broader than just AFG or any one company, is excessive competition, too much rate competition.

Ideally, we're seeing an abatement of that as certain competitors are forced to exit the market or behave more rationally, and that may well help turn the business. Certainly, the rate increases that we feel like we need are rate increases that the market is accepting. And so I think as that line of business for the industry gets healthier, we will benefit from that. But I would lay this mainly at the feet of excessive competition.

Operator

Our next question comes from Dan O'Brien of Janney Capital.

Daniel O'Brien

Just quickly wanted to talk about the capital management philosophy going forward. Obviously, you guys hadn't repurchased in the past 2 quarters, so I'm guessing that above kind of adjusted, I guess or excess the book, we should be looking at special dividends. Is that the right way to think about it?

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

This is Carl. We're continually evaluating what are the highest and best uses for our capital and that every year is a little bit different, based off of the opportunities that we have. Here recently we're focused on a pretty sizable acquisition, Summit. We have paid extraordinary dividends in the last 2 years. So that's always in the handbag. So every year is a little bit different.

Again, we're really looking for how to use our excess capital in the most effective way to generate -- not only be accretive, but to get the right returns on equity as we make the investments. And then return an appropriate amount to the shareholders through dividends and/or share repurchase, if that makes sense.

Daniel O'Brien

Okay, great. And then just shifting over to, I guess, the republic workers comp book. I just wanted to figure -- obviously, you guys have started growing that now and as you guys mentioned, kind of 8% to 9% rate increases. Where are you guys booking that book right now from a combined ratio standpoint? And what are the expected, I guess, ROEs for the business right now?

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

We don't really separately pull that out in that, but I can give you a little bit of an outlook in that for it. In the California -- Republic writes business in a number of states other than California, not that significant. But we did, in California only, achieve about a 10% renewal price increase in last year, on top of achieving some decent rate in the previous year.

So I can tell you that 2013's estimated accident year at this point, we believe has moved to underwriting profitability. If you look over a long period of time, Republic has generally outperformed the industry by a pretty significant margin, probably in the 6 point to 10 point range in that.

So keep in mind, that the industry combined ratio in 2012 was about 120, and Republic probably was, we estimate, somewhere in 105 to 108 in 2012. So the rate increases that we've been taking have moved our estimates of Republic's profit to what we consider to move to underwriting profitability last year.

We're going to continue to -- we filed 6.5% in price increase, I think effective in January of this year. So we'll get probably mid-single digit type of increase is kind of what our objective is. We think our loss cost trends in Republic are probably in the 2% to 3% range, somewhere in there. We feel good about our reserves. We achieved double-digit growth last year. We'd expect to achieve double-digit growth this year.

Daniel O'Brien

And then, just my last one quickly with crop. I guess a 2-parter, the first part, obviously, is kind of the delayed planting of the winter wheat, and I'm just trying to figure out what kind of revenue adjustments I need to think about for first quarter? And then secondly, just wanted to get, I guess, how your crop book results were for 2013 overall, if you guys are able to share that information?

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

The winter wheat's not a real big percent of our business. So we're not talking about big dollars as far as the impact in the first quarter of this year, and that's not really -- corn and soybeans are the vast majority of what we do. So I don't think that there's not much of an impact.

As far as AFG's crop results this past year in 2013, our crop results did meet our expectations, due to the significant decrease in corn prices and the late season freeze that damaged the California citrus crop. That said, we did report a solid underwriting profit for our Crop business last year. So probably lower than historical mainly due to the change in commodity prices in that.

Operator

Our next question comes from Jay Cohen of Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Couple of questions, I guess really on the kind of the growthy areas within Specialty Casualty. On the E&S side, can you talk about your submission activity? Obviously, some of your competitors have had some challenges. Have you seen an uptick in your submission activity in the lines of business that you operate in?

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

I think we probably have seen some change in our casualty binding flow and in some of our E&S companies in that. And our primary opportunity has kind of been the New York contractors opportunity over the past year or so. But I think we are seeing an improvement in opportunities, submissions and opportunities within our overall E&S business.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

The other business you mentioned, which I don't think you talked too much about was the Agency Captive business. Can you talk about what you're doing there? And how big a business that is for you?

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

I don't know if I have that handy. I can probably have Diane get back to you around the size there.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

What's -- in general, what's that business like? What exactly are you doing there?

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

We're partnering with agents to share and -- the agency cap is, larger agents have the ability to have a way to retain and share in the underwriting result and investment income over time of a particular book of business in that.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

What lines of business are we talking there?

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

A pretty broad array of package liability, commercial auto, kind of the normal commercial lines type of business.

Operator

Our next question is a follow-up from Vincent DeAugustino of Keefe, Bruyette & Woods.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

It's just a couple quick ones. You guys had mentioned that winter wheat is not a big crop, but you had also mentioned some of the temperature issues with the citrus crop. So I'm just curious, if the delayed winter wheat planting has any potential impacts from the recent harsh weather as far as temperatures were. Any of the other, maybe, southern crops might be impacted? Clearly not the farmer, but just curious with the temperatures that we're seeing, if there is anything we should be on a look out for?

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

I think winter wheat went into dormancy this winter in pretty good shape. Wheat under cover of snow is a good thing generally, in that. So I think the damage that there will be to the wheat crop would be from the extremely cold temperatures in areas that lack snow cover in that. And I know that's a generalization, but I think overall -- so it could get very region specific or acreage specific in that. But all-in-all, I think we remain optimistic with regard to the wheat crop.

Vincent M. DeAugustino
Keefe, Bruyette, & Woods, Inc., Research Division

And just one last one for Craig, just looking at the Annuity business in terms of your expectations for 20 basis points to 25 basis points of spread compression. I'm just curious, maybe off the baseline, your 10 year expectation, what you'd be kind of thinking about next year, just so we can kind of gauge as that moves around, how that might be relative to your expectations?

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

I mean, Derek, earnings are very sensitive to market interest rates. I mentioned in my conference call script that under FAS 133 GAAP accounting, we'll require to discount certain index, the annuity reserves. And so obviously, when rates are lower that hits our earnings. When rates move up, we benefit from that, because we use a higher discount rate. We use a discount rate that's tied to the A2 corporate rate.

We benefited greatly last year from the much larger increase and people were expecting at the beginning of the year. Basically, what we do when we put a budget together, is we look at the forward curve, we look at the futures market and assume that the market is correct in their assumption on an increase in rates.

For 2014, when we put our budget together, the forward curve basically assumed that the 10 year would move up by 60 basis points or so during the calendar year. Now, the reality is the beginning of the year has gone -- so far this year, it's gone the other direction. I think we're down 35 basis points or some number close to that, so far year-to-date.

Our expectation would be that you see rates trend back up, but not to the levels that we would have guessed at the beginning of the year. I certainly would expect to end the year with higher treasury rates and corporate rates than what we're looking at today. But I think we have reduced our expectations for the increase in rates versus what we were looking at a month ago.

Vincent M. DeAugustino

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

On the alternatives?

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

On the alternative markets, agency captive related business, that's about $116 million of gross premium and about $56 million of net premium. And the larger competitors, the top competitors in that market would be Hartford, Sparta, would be couple of examples there.

Operator

Our next question comes from Amit Kumar of Macquarie.

Amit Kumar
Macquarie Research

Just a few, I guess, follow-ups to the earlier question. So just going back to the discussion on crop, I think you mentioned that you had a profit in that book. What are the sort of ending combined ratio on that book versus what you had previously?

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

Below a 100.

Amit Kumar
Macquarie Research

Come on. I mean, can you share like more details on that?

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

We don't separately break out the Crop business in our disclosures. So that's the most I can really give you at this point.

Amit Kumar
Macquarie Research

Can you share like what the points delta might be versus 2012?

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

There was an improvement in profitability in 2013 versus 2012. 2012, obviously, had the drought to contend with.

Amit Kumar
Macquarie Research

Okay. I guess moving on, the only other question I had was on the discussion regarding the farm bill. I don't know if I missed this, but do you view the discussion on SCO and STAX -- I mean, is that a bigger deal for 2014 or does that add to demand on the fringes? How do you think about those changes being discussed at a farm bill?

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

It's obviously pretty early to conjecture on something like that. I think, generally, it's a positive. I'm not sure that we're expecting some huge amount, a huge impact from it, but generally probably a positive.

The thing we don't know is, one question is, is how much the new programs might displace the current coverage written at the 80% to 85% level in that. That's probably the unknown.

On the farm bill itself, I think it's very much a positive for crop insurers in that. The big cuts I think are really on direct farm aid and food stamp program, and it basically reinforces the crop program as being a lifeblood to the agricultural industry in that. So I think it was a very much a positive in that.

Operator

Thank you. And at this time, I'm not showing any further questions. I would like to turn the call back to management for any further comment.

Diane P. Weidner
Assistant Vice President of Investors Relations

Thank you, Sam, and thank you for joining us this morning. We look forward to speaking with you again, when we release our first quarter 2014 results.

Operator
Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program. You may all disconnect. Everyone have a wonderful day.