S&P Capital IQ

CONTENTS

American Financial Group, Inc. NYSE:AFG

FQ4 2016 Earnings Call Transcripts

Thursday, February 02, 2017 4:30 PM GMT

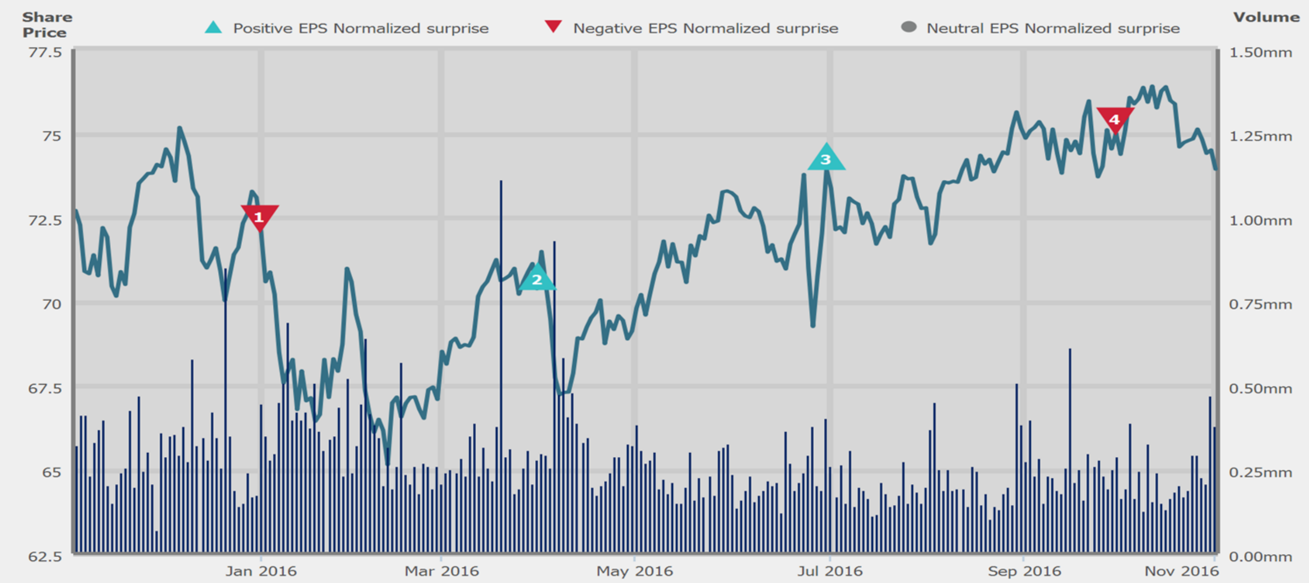
S&P Capital IQ Estimates

	-FQ4 2016-			-FQ1 2017-	-FY 2016-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.60	1.98	▲23.75	1.32	5.65	6.03
Revenue (mm)	1093.19	1144.00	▲4.65	1129.84	4779.18	4328.00

Currency: USD

Consensus as of Feb-02-2017 12:04 PM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2015	1.60	1.52	▼1 (5.00 %)
FQ1 2016	1.18	1.25	▲2 5.93 %
FQ2 2016	1.26	1.28	▲3 1.59 %
FQ3 2016	1.52	1.51	▼4 (0.66 %)

Call Participants

EXECUTIVES

Carl H. Lindner
Co-Chief Executive Officer, Co-President and Director

Diane P. Weidner
Assistant Vice President of Investors Relations

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

S. Craig Lindner
Co-Chief Executive Officer, Co-President and Director

ANALYSTS

Amit Kumar
Macquarie Research

Jay Adam Cohen
BofA Merrill Lynch, Research Division

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

SHAREHOLDERS

Unknown Shareholder

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the American Financial Group Q4 2016 Earnings Conference Call. [Operator Instructions]

I would now introduce your host for this conference call, Ms. Diane Weidner, Assistant Vice President, Investor Relations. You may begin.

Diane P. Weidner
Assistant Vice President of Investors Relations

Good morning, and welcome to American Financial Group Fourth Quarter 2016 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 EVP and Chief Financial Officer. Our press release, investor supplement and webcast presentation are posted on AFG's website. These materials will be referenced during portions of the call.

Before I turn the discussion over to Carl, I'd like to draw your attention to the notes on Slide 2 of our webcast. Certain statements made during this call may be considered forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance. Investors should consider the risks and uncertainties that could cause actual results and/or financial condition to differ materially from these statements. A detailed description of these risks and uncertainties can be found in AFG's filings with the Securities and Exchange Commission, which are also available on our website.

We may include references to core net operating earnings, a non-GAAP financial measure, in our remarks or responses to questions. A reconciliation of our 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, thus it may contain factual or transcription errors that could materially alter the intent or meaning of our statements.

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

Carl H. Lindner
Co-Chief Executive Officer, Co-President and Director

Good morning. We released our 2016 fourth quarter and full year results yesterday afternoon.

Please turn to Slide 3 of the webcast slides for an overview. AFG's fourth quarter and full year results established new records for earnings. Strong operating profitability in both the Property and Casualty and Annuity Segments of our business, superior investment performance and effective capital management have enabled us to achieve 5-year compounded growth and adjusted book value plus dividends of 10%.

Returning capital to our shareholders is an important component of our capital management strategy and reflects our strong financial position and our confidence in AFG's financial future. We paid $187 million in dividends during the year, representing $100 million in regular common stock dividends and an $87 million special dividend paid in December of 2016. Our quarterly dividend was increased by 12% to an annual rate of $1.25 per share beginning in October of last year. We repurchased $133 million of AFG's common shares during 2016 at an average price per share of $69.47.

As we previously announced, we completed our merger with National Interstate in November, which put approximately $320 million in excess capital to work.

AFG's 5-year total annualized shareholder return, representing growth in share price plus dividends, was approximately 23%, exceeding the total return performance of the S&P 500, S&P Property and Casualty Index and the S&P Life & Health Index over the same time period.

Turning to Slide 4. We're pleased to report fourth quarter core earnings per share of $1.98 a share, a new quarterly record for AFG. These results include strong profitability in our Property and Casualty operations and record earnings in our Annuity segment. Fourth quarter annualized core operating return on equity was 15.7% for 2016 compared to 12.7% in '15. Net earnings per diluted share were $4.33 and include $2.35 per share of non-core tax benefits and realized gains on securities.

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

We have established our 2017 core operating earnings guidance for AFG in the range of $6.20 to $6.70 per share. Craig and I, we each discuss our guidance for each segment of our business later in the call.

Our earnings guidance for 2017 assumes no change in the corporate tax rate of 35%. Granted there's a lot of uncertainty around corporate tax reform, however, we agree that the current 35% corporate rate impedes the competitiveness of U.S. companies and has created disincentives for insurers to locate their operations in the United States. While we're certainly in favor of a lower corporate tax rate, we also support the general concept of border adjustments to help level the playing field. Who knows? Perhaps, some of the changes under consideration by the GOP and the Trump administration will lead to a rebirth of the reinsurance industry in this country.

Before we take a closer look at AFG's results this quarter, I'd like to take a moment to recognize our friend and colleague, Don Larson, who will retire in March after 43 years with the company. Don held the position of President and Chief Operating Officer of Great American's Property and Casualty Group for the past 7 years. Though for the last 20 years as my partner, he's played an important role in our Property and Casualty Group's success and has helped us shape our culture. We also extend our congratulations to Gary Gruber, a 40-year AFG vet, who succeeds Don in the role of President and COO.

Now please turn with me to Slides 5 and 6 of the webcast, which include an overview of results in our Specialty Property and Casualty operations. Beginning on Slide 5, you'll see that gross and net written premiums increased 6% and 3%, respectively, in the 2016 fourth quarter compared to the same quarter a year earlier. Fourth quarter underwriting profit was up 10% year-over-year. Higher underwriting profitability in our Property and Transportation and Specialty Financial Groups was partially offset by lower underwriting profitability in our Specialty Casualty Group. The fourth quarter 2016 combined ratio of 90.4% improved 0.60 point from the 2015 fourth quarter and included 0.90 point of adverse prior year reserve development and 1.1 points in catastrophe losses.

Overall renewal pricing in our Specialty Property and Casualty Group was up approximately 1% during the fourth quarter, consistent with the previous quarter. Pricing was flat overall for the whole year of '16.

Now I'd like to turn to Slide 6 to review a few highlights from each of our Specialty Property and Casualty Groups. Our Property and Transportation Group reported fourth quarter underwriting profitability of $75 million compared to $34 million in the prior year period. Favorable growing conditions and relatively stable commodity pricing contributed to higher underwriting profitability in our crop insurance business, which was the driver of the improved results in this group. Catastrophe losses were $6 million in the fourth quarter of '16 and $3 million in the comparable 2015 period. Fourth quarter gross and net written premiums in this group were 12% and 4% higher, respectively, than the comparable prior year period. The increase was primarily due to higher crop insurance premiums in rainfall products, the large majority of which was ceded to the Federal Crop Insurance Program. If you exclude crop, fourth quarter 2016 gross and net written premiums in this group were virtually unchanged from the prior year period. I'm really -- I'm especially pleased that our Property and Transportation Group ended the year with strong underwriting results and returns on equity, driven by excellent results in our crop and inland marine operations as well as higher profitability in our transportation businesses.

Overall renewal rates increased 2% in the fourth quarter of '16, including a 4% increase in National Interstate's renewal rates. The average renewal rate increase for this group during the whole year of '16 was approximately 3%.

Now the combined ratio in our Specialty Casualty Group was 97.4% for the fourth quarter of last year compared to 90.2% in the prior year period. Underwriting losses in one of our excess and surplus lines businesses, primarily related to coverage written for New York contractors, and lower profitability in our targeted markets operations were the primary reasons for the lower underwriting profit year-over-year. In addition, catastrophe losses for this group were $4 million in the fourth quarter and $1 million in the comparable '15 period.

And I'm especially pleased with the strong profitability reported by our workers' compensation businesses for the fourth quarter and the full year. Gross and net written premiums increased 3% and 1%, respectively, for the fourth quarter of '16 when compared to the same prior year period. Higher premiums in our targeted markets and executive liability businesses were partially offset by lower premiums in our excess and surplus lines operations, primarily the result of tougher underwriting standards related to the New York contractors business, as well as lower premiums within our workers' compensation businesses. Net written premiums were also impacted by higher ceded premiums within Neon.

Renewal pricing for this group was flat during the fourth quarter and included a decrease of approximately 2% in our workers' compensation businesses. Excluding comp, renewal pricing in this group was approximately up 1% for the quarter and also for the full year.

Underwriting profit in our Specialty Financial Group was $20 million in the fourth quarter of '16 compared to $15 million in the fourth quarter of 2015. All businesses in this group reported higher year-over-year underwriting profit in the fourth quarter and continued to achieve excellent underwriting margins during '16. Catastrophe losses for this group were $2 million in the fourth quarter of 2016 and $5 million in the comparable prior year period. Gross and net written premiums both increased by 1% in the fourth quarter when compared to the same period in 2015. Renewal pricing in this group decreased about 1% on average for the fourth quarter and all of the year of 2016.

Now please turn to Slide 7 for a summary view of our 2017 outlook for the Specialty Property and Casualty operations. Despite competitive conditions, we're optimistic as we start this year. We expect a combined ratio between 92% and 94% and growth in net written premiums in the range of 2% to 6% for the Property and Casualty Specialty Group overall.

Taking a look at each subsegment. We estimate a combined ratio in the range of 91% to 95% in our Property and Transportation Group and expect net written premiums to be flat to up 3%. Our Specialty Casualty Group is expected to produce a combined ratio in the range of 94% to 96%. Growth in net written premiums in this group is estimated to be in the range of 5% to 9%. We estimate a combined ratio in our Specialty Financial Group in the range of 84% to 88%, with net written premiums are expected to be flat to up 4%. We expect overall Property and Casualty renewal pricing to be flat to up 1%. Additionally, we expect our Property and Casualty investment income to grow by 4%. Details for each of our Specialty Property and Casualty Groups can be found on the slide.

I'll now turn the discussion over to Craig to review the results in our Annuity segment and AFG's investment performance.

S. Craig Lindner
Co-Chief Executive Officer, Co-President and Director

Thank you, Carl. AFG's Annuity segment had another record year, achieving pretax operating earnings of $368 million and annuity premiums of $4.4 billion. In addition, as a result of its strong statutory results, the Annuity segment continues to generate significant amounts of excess capital. I'm very pleased with these results, which illustrate our investment skills, disciplined product pricing and our focus on consumer-friendly products.

I'll start with a review of our Annuity results for the fourth quarter, beginning on Slide 8. The Annuity segment reported a record $132 million in pretax operating earnings in the 2016 fourth quarter compared to $101 million in the fourth quarter of 2015, an increase of 31% year-over-year. Under fair value accounting, variances from expectations of certain items, such as projected interest rates, hedge costs and surrenders as well as changes in the stock market, have an impact on the accounting for fixed-indexed annuities. Although these accounting adjustments have been recognized through AFG's reported core earnings, many of these adjustments are not economic in nature but rather impact the timing of reported results.

In the fourth quarter of 2016, a significant increase in interest rates as well as an increase in the stock market resulted in a large favorable impact on Annuity earnings. This compares to a relatively small favorable impact on Annuity earnings in the fourth quarter of 2015, primarily the result of the increase in the stock market. Annuity earnings before the impact of fair value accounting were $103 million in the fourth quarter of 2016 compared to $96 million in the fourth quarter of 2015, an increase of 7%. We continue to achieve appropriate returns on new business, and the interest spread on our in-force business continues to exceed our plan by several basis points.

As you'll see on Slide 9, AFG's fourth quarter 2016 earnings continued to benefit from favorable investment results, including the continued significant positive impact of certain investments required to be mark-to-market through earnings. In addition, AFG's quarterly average Annuity investments and reserves grew by approximately 11% and 12%, respectively, year-over-year. The benefit of this growth was partially offset by the runoff of higher-yielding investments.

In the fourth quarters of 2016 and 2015, AFG conducted detailed reviews or an unlocking of the major actuarial assumptions underlying its Annuity operations. The review resulted in a positive unlocking of $1 million in the fourth quarter of 2016. In the fourth quarter of 2015, the positive unlocking amount was $10 million. These unlocking amounts were included in earnings before fair value accounting for fixed-indexed annuities.

AFG's Annuity segment reported statutory premiums of $1.1 billion in the fourth quarter of 2016, virtually unchanged from the fourth quarter of 2015. Additional information can also be found at AFG's Quarterly Investor Supplement posted on our website.

Please turn to Slide 10 for a summary of the 2017 outlook on the Annuity segment. We expect 2017 earnings before fair value accounting for fixed-indexed annuities to be in the range of $375 million to $395 million. Our assumptions include modest increases in interest rates and the stock market and a more normalized run rate of investment income going forward as compared to the unusually high amount achieved in the second, third and fourth quarters of 2016. We're assuming no impact from fair value accounting for FIAs, and therefore, we believe that the full year 2017 pretax Annuity operating earnings will be in the range of $375 million to $395 million, an increase from the $368 million reported in 2016. Large changes in interest rates and/or the stock market as compared to our expectations could lead to additional positive or negative impacts on the Annuity segment's results. We expect that premiums for the full year of 2017 will be flat to down 10% from the $4.4 billion sold in 2016.

The company continues to implement product and process changes needed to comply with the Department of Labor fiduciary rule and is proceeding under the premise that the DOL rule becomes effective in April of 2017 in its current form. The 2017 premium projection I just mentioned reflects this premise as well.

There is considerable discussion surrounding the possibility of a delay or other action impacting the rule. In addition, there remains pending litigation seeking to invalidate the rule. However, until there's some definitive action impacting the rule, the company intends to continue to pursue necessary changes. Assuming the rule is effective in April of 2017, AFG believes the biggest impact will be on insurance-only licensed agents whose sales represent less than -- represented less than 10% of our fourth quarter premiums. While AFG management continues to believe the adjustments required of the company and its distribution partners to comply with the rule will impact 2017 premiums, we do not believe the new rule will have a material impact on AFG's results of operations. We believe that our business model, which we adopted many years ago, positions us well in a changing regulatory environment.

Please turn to Slide 12 for a few highlights regarding our $41 billion investment portfolio. AFG recorded fourth quarter 2016 net realized gains on securities of $32 million after tax and after deferred acquisition costs compared to a net realized loss of $14 million in the comparable prior year period. As of December of 2016, unrealized gains on fixed maturities were $306 million after tax and after DAC, and unrealized gains on equities were $98 million after tax.

As you'll see on Slide 13, our portfolio continues to be high quality, with 89% of our fixed maturity portfolio rated investment grade and 97% with a NAIC designation of 1 or 2, its highest 2 categories. We have 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 consolidated fourth quarter 2016 results and share a few comments about capital and liquidity.

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

Thank you, Craig. Slide 14 recaps AFG's fourth quarter consolidated results by segment. Core net operating earnings per share in the quarter were $1.98. $1.98 is based on core net operating earnings in the quarter of $176 million. You'll be able to see a more detailed view of the components on Page 4 of our Quarterly Investor Supplement.

The reconciliation of AFG's core net operating earnings to net earnings is detailed on Slide 15. Net earnings attributable to shareholders were $385 million or $4.33 per share in the quarter. Net earnings for the quarter include several noncore items, including $32 million or $0.36 per share for after-tax realized gains on securities and $66 million or $0.74 per share for the previously disclosed tax benefit related to the National Interstate merger. We also recorded $111 million or $1.25 per share related to a tax benefit associated with the restructuring of our investment in Neon, our Lloyd's syndicate. The restructuring allows us to recapture a portion of our investment covering previous losses reported by the business.

As indicated on Slide 16, AFG's adjusted book value per share was $53.11 as of December 31, 2016. Adjusted tangible book value per share was $50.43. Our capital adequacy, financial condition and liquidity remains strong. We maintain sufficient capital in our insurance businesses to meet our commitments to the rating agencies. Our excess capital stood at approximately $950 million at December 31, 2016. We returned $123 million to our shareholders through dividends and share repurchases during the quarter. Approximately 4.1 million shares remain under our repurchase authorization as of February 1, 2017. As a reminder, we plan to hold approximately $200 million to $300 million as dry powder to maintain flexibility for opportunities that may arise. We plan to continue returning excess capital to our shareholders through the course of 2017 and review all opportunities for deployment of capital on a regular basis.

Turning to Slide 17. You'll find the single-page summary of our 2017 core earnings guidance. As a reminder, AFG's expected 2017 core operating results exclude noncore items such as realized investment gains and losses and other significant items. It may not be indicative of ongoing operations.
Now we'd like to open the line for any questions.

Question and Answer

Operator

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

Amit Kumar
Macquarie Research

Just a few questions to start off, right, and then I'll re-queue. Maybe I'll start with the Great American piece, the Annuity piece. Can you remind us what percent of your equity-indexed annuities is under surrender protection?

S. Craig Lindner
Co-Chief Executive Officer, Co-President and Director

Yes. Let me get that information here, Amit. So here's how we look at basically the surrender protection we have. I think you really do need to look at more than just the numbers that -- of the percentage of the business that has surrender charges on it. Here's how we look at that. First of all, we think that our business model with lower upfront conditions and lower bonuses has allowed us to maintain credited rates for a much longer period of time. And the fact that our existing credited rates are higher than many of our peers, we think that, that bodes well in a rising interest rate environment and will help the persistency. We have about 22% of the total annuities that have a GMIR of 3% or higher, which we think gives really good surrender protection in a rising interest rate environment given that the current GMIRs on new products is 1% on most products. We have 6% of the annuities that have MVAs. We have 18% that were sold with riders. So in the event that they would surrender early, we would keep all the rider fees, and they would get no benefits. We have 51% that is inside of a surrender charge period, and so that leaves about 3% of the business that is outside of the surrender charge period and without any other protections, so we actually feel pretty good. We think that we are very well positioned for -- our preference would be a modest rise in rates, kind of a gradual increase in rates, but we think we're actually very well positioned. And to give you an exact answer to your question, your original question, it's about 86% of the business today that has surrender charge protection. But in addition to that, we have protections with the other things that I just mentioned.

Amit Kumar
Macquarie Research

That's fair. The other question, I guess, just staying on this topic. What's the average commission that you pay per channel? And how should we think about the commission levels going forward?

S. Craig Lindner
Co-Chief Executive Officer, Co-President and Director

Really, I mean, commission levels going forward really are going to be a function of whether the Department of Labor rule is implemented. If it is implemented, clearly, they are coming down, and you're going to see more fee-based products. Let me see if I can get my hands on our exact commissions in different segments. We are clearly on the low side. Our model, many years ago, was changed to a consumer-centric model, consumer-friendly model with smaller commissions, lower upfront bonuses, and which allows us to give more value to the customer. Hang on 1 second. Let me give you -- okay. In bank FIAs, the average commission is 4% to 6%; bank fixed, 3.5% to 5%; retail fixed-indexed annuities, 4.5% to 7.5%; retail fixed, 3% to 7%; overall indexed annuities, 4% to 7.5%; and then overall fixed and fixed-indexed annuities, 3% to 7.5%. But as I said, we are on the low side compared to the industry.

Amit Kumar
Macquarie Research

Got it. The final question, I'll re-queue after this, is how should we think about the returns on this business in terms of whether the changes happen or not going forward?

Carl H. Lindner
Co-Chief Executive Officer, Co-President and Director

We are not going to change our return expectations. We price our product to earn between 12% and 13%. It's different on the different products. The products that we deem to be riskier should be priced at a higher rate of return. The products we deem to be the least risky, we can be on the low side of that. On average, we price to get a 12% to 13% after-tax return. I will tell you over the last 3 or 4 years, with the outperformance on the investment side, we've done better than that.

Operator

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

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

I was wondering if you could give us a little bit more detail about the Neon transaction. It just seemed like it was quite a large gain this quarter, and I'm just a little bit surprised by -- could you kind of walk us through exactly why that would have happened, just to give us a little bit better understanding if -- I mean, obviously, it's a good thing, but any comments would be helpful, I think.

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

Paul, this is Jeff Consolino. I touched on it in my comments, but what we've done is a restructuring of the entities which own Neon. And so the restructuring relates to the liquidation for U.S. tax purposes of the parent of our Neon operations. And in a liquidation, you calculate your gain or loss in a liquidation by comparing the value of the assets and liabilities received upon liquidation to our investment. In our case, the liquidation reflects the significant investment we've made in Neon and in Neon's operations to fund previous losses in the business. And so upon liquidation, we're entitled to recognize a portion of those losses and recognize the benefit that's included within our financial results.

Operator

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

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions. First, in the Specialty Casualty business, the New York contractor book, this is an issue that we've been hearing about for years, I think, and it's been under some pressure. I was a little surprised to see it come up and bite you a little bit this quarter. What changed there that caused the losses?

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

Jay, this is Jeff again. The New York contractors business has been a very tough market for a number of years. There's no question about that. As a result, it's known as a tough class to write and has migrated from standard carriers in the excess and surplus lines market, where our excess and surplus lines business has chosen to enter the business and write it at much improved rates and more restrictive terms when available. The result that we're recognizing in the quarter includes some reserve additions to that. I would say that it's our belief that the New York contractor business is not performing as well as we had hoped when our excess and surplus lines business entered that market. So this reflects us backing off of the loss picks that we had previously had to a more conservative level, and that's reflecting the experience we see coming through.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. And then secondly, again, in that segment, your guidance for premium growth, I guess, is a little surprising on the high side given what we saw in 2016 and noting the market conditions. So what's driving that 5% to 9% premium growth that you're expecting?

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

As you know, Jay, there are a lot of diverse operations within our Specialty Casualty subsegment. I would point towards a couple specific factors. The first is that Neon is in that subsegment, and we've talked about it in past quarters with the new management team. They have gone ahead and taken a hard look at all aspects of their business. They've exited certain lines and chosen to get into different lines to rebalance the portfolio. So in 2016, Neon's results were typified by a significant decrease in premium. As we look forward to 2017, Neon will grow back to the level they were at largely in 2015, which will be, therefore, some amount of growth '17 versus '16 but effectively flat to '15. The second is that our workers' compensation business, which has had rate pressure in many jurisdictions, there has been a rate increase approved in Florida for our Summit operation, where half of their business is in Florida. And so with that 14% rate increase, we would expect to see growth in the workers' compensation business broadly. Finally, our targeted markets business within Specialty Casualty is seeing some good opportunities on kind of one-off or a case-by-case basis to grow, and so that's incorporated in our plan for 2017. So those are really the areas I would point to that cause us to have the premium guidance where we have it for Specialty Casualty.

Operator

[Operator Instructions] Our next question comes from Abe Schultz [ph] with Maxim Group.

Unknown Shareholder

Carl, Craig, having been a shareholder for over 50 years, the story only gets better. Congratulations on the record earnings. Your dad must be smiling ear to ear. He couldn't be more proud. Congratulations.

Carl H. Lindner
Co-Chief Executive Officer, Co-President and Director

Thank you, Abe.

S. Craig Lindner
Co-Chief Executive Officer, Co-President and Director

Thanks, Abe. We appreciate it.

Operator

Our next question is a follow-up from Jay Cohen with Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

There's no one else in the queue. I might as well get back in. Let's see. Excess capital. You obviously used some with the National Interstate acquisition, but it seemed to come right back to the levels where it was. Was this simply a case of just the earnings in the quarter? Or was there another change that drove that kind of recapture, if you will, or increase in the excess capital?

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

Sure, Jay. This is Jeff again. We started the quarter with nearly $1.1 billion of excess capital, which we disclosed on our third quarter earnings conference call, and we ended the year at $950 million. That's moved by about $130 million. Now we do have $385 million of earnings, less $122 million of capital management in the quarter. And so when you take that and you net the $320 million from the National Interstate investment in the merger, all else equal, you would have expected us to have our capital reduced by, call it, $60 million. Then with the growth of the business, the difference between that and the reduction of $128 million is really related to retention of capital as our businesses grow. So that's, perhaps, a more detailed answer than you cared for. I think you had it exactly right, which is with the strong level of earnings in the quarter, that excess capital came right back, notwithstanding the significant investment we made in National Interstate during the quarter.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes. I guess what I was missing was the difference between net income and operating income as well, which obviously added to the capital.

Joseph E. Consolino
CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

That's right.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Also, just last point, I wish my best to Don. I've known this company a very, very long time, and I associate him with the company. It's been a phenomenal run. I'm sure he will enjoy his retirement.

Carl H. Lindner
Co-Chief Executive Officer, Co-President and Director

Thanks, Jay.

Operator

Our next question is a follow-up question from Amit Kumar with Macquarie.

Amit Kumar
Macquarie Research

Just, I guess, one follow-up. Just going back to the discussion on agriculture, on the crop insurance book, did I miss this? Did you talk about what the year ended in terms of what was the combined ratio? And how are we thinking about conditions for 2017?

Carl H. Lindner
Co-Chief Executive Officer, Co-President and Director

No, we really don't report our crop business as a separate type of a number. I can tell you that 2016 was an outstanding crop year, significantly better than the last 5-year average for us. I don't -- it's pretty early to really make too much commentary on '17. Right now, we expect premiums to be flat to down maybe 2%. That's all driven by where commodity price is as we -- as they're spring setting prices that are determined now. But where commodity rates are or commodity prices are today, that would then -- when we look at the base rates, what's happening there, and we won't know what the volatility factor is until March 1, we're guessing premiums to be kind of flat to down for this year, but too -- obviously, too early to comment about the prospects for '17. I think in our guidance, we'd be looking at a normal run rate for our crop business from a profit standpoint.

Amit Kumar
Macquarie Research

Got it. And I guess the only other question I had, and apologies if this has been asked before, I know you made some comments initially about the taxation situation, and I think that you said that the guidance does not obviously include any impact. But let's say if the tax rate was going to go down, do you get the sense that any benefit would net down to earnings? Or do you get the sense, based on where we are and the market conditions, competition will pick up, and hence, any benefit would be competed away?

Carl H. Lindner

Co-Chief Executive Officer, Co-President and Director

I like the position we're in, Amit. Most of the time, we're a full taxpayer. I think we're in a position to keep the biggest part of any change in tax rates. From a practical standpoint, we're already competing against a lot of competitors that are already tax-advantaged. So they're already pricing their products. I'm assuming they're lower tax rates. So I like our position. If anything, it should -- we should be able to keep a big part of any corporate tax change, and maybe -- I would think if it benefits anybody, it's going to benefit folks like us that would have more flexibility on pricing. Let's also see where these proposals on the border adjustments go and the impacts potentially on our competitors that are, right now, more tax-advantaged than us. I think also from a political standpoint, my brother Craig pointed out, even if tax -- corporate tax rates come down, there's no political certainty long term that they would stay down at the same levels, so I'm not sure it'd be very smart for the industry to give that away. I mean, that can always go the other way.

Operator

And I'm not showing any further questions at this time. I'd like to turn the call back over to our host.

Diane P. Weidner
Assistant Vice President of Investors Relations

Great. Thank you. Thank you, Kevin, and thank you all for joining us this morning as we've discussed our year-end results. We look forward to sharing more results with you when we share our first quarter results in 2017. This concludes our call for today.

Operator
Ladies and gentlemen, this does conclude today's presentation. You may now disconnect, and have a wonderful day.