S&P Capital IQ

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American Financial Group, Inc. NYSE:AFG

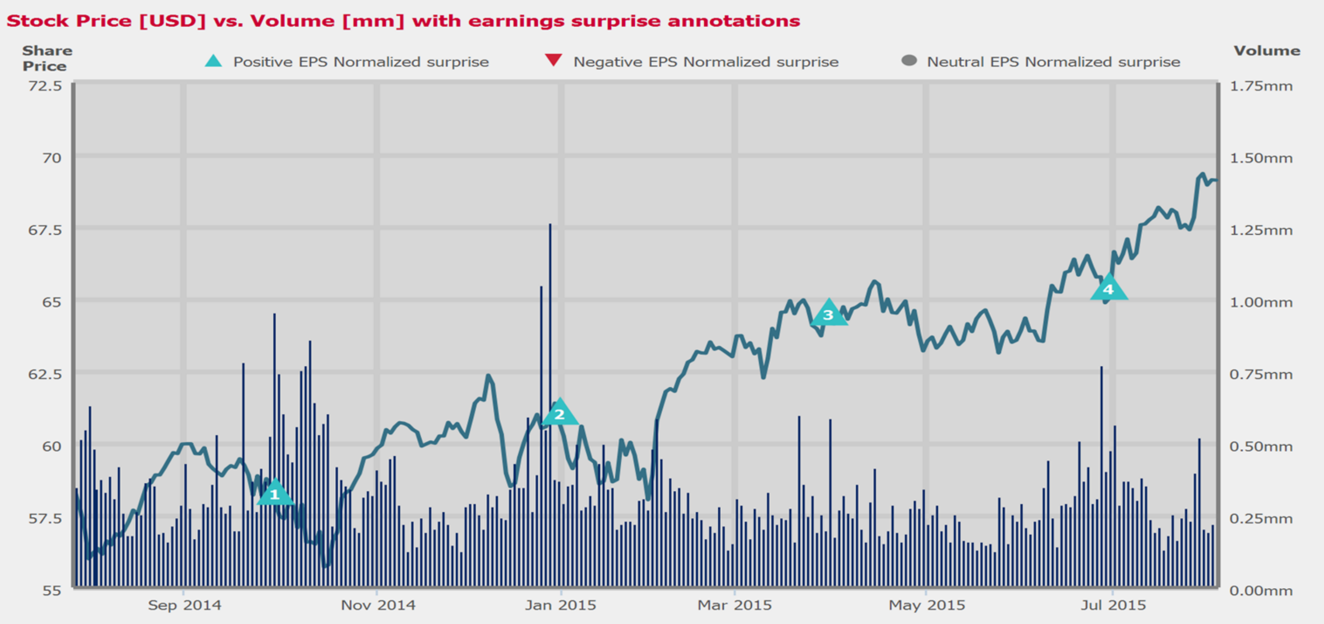
FQ3 2015 Earnings Call Transcripts

Wednesday, November 04, 2015 4:30 PM GMT

S&P Capital IQ Estimates

	-FQ3 2015-			-FQ4 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.50	1.38	▼(8.00 %)	1.55	5.48	5.61
Revenue (mm)	1300.00	1173.00	▼(9.77 %)	1069.60	4279.00	4429.94

Currency: USD
Consensus as of Nov-04-2015 4:43 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2014	1.16	1.40	▲1 20.69 %
FQ4 2014	1.29	1.35	▲2 4.65 %
FQ1 2015	1.12	1.25	▲3 11.61 %
FQ2 2015	1.19	1.28	▲4 7.56 %

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

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

Christopher William Martin
Macquarie Research

Jay Adam Cohen
BofA Merrill Lynch, Research Division

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

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the American Financial Group 2015 Third Quarter Results Conference Call. [Operator Instructions] As a reminder, this call is being recorded.

I'd now like to turn the conference over to your host for today, Miss Diane Weidner, Assistant Vice President, Investor Relations. Ma'am, you may begin.

Diane P. Weidner
Assistant Vice President of Investors Relations

Thank you. Good morning, and welcome to American Financial Group's Third Quarter 2015 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 risk and uncertainty. 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 quarterly reports on Form 10-Q. We do not promise to update such forward-looking statements to reflect actual results or changes in assumptions or other factors that could affect these statements.

Core net operating earnings is a non-GAAP financial measure which sets aside significant items that are generally not considered to be part of ongoing operations, such as net realized gains and losses, discontinued operations and certain nonrecurring 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. 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 2015 third quarter results yesterday afternoon. I am assuming that our participants have reviewed our earnings release and the investor supplement posted on our website.

We are pleased with AFG's strong core net operating earnings, record third quarter premiums achieved in our Annuity segment and healthy growth in our property and casualty operations. Core net operating earnings were $1.38 per share, a decrease of $0.02 per share from the comparable prior year period. These were -- these results reflect higher underwriting profit and higher net investment income at our Specialty Property and Casualty insurance operations, which was more than offset by the impact that fair value accounting had on the results of our Annuity segment.

Annualized core operating return on equity was 11.6% for the 2015 third quarter compared to 12.3% for the third quarter of 2014. Net earnings per diluted share were $0.71 a share and included a $0.58 per share for A&E reserve strengthening and $0.09 per share related to realized losses in a loss on the early retirement of debt.

During the quarter, we repurchased $35 million of AFG common shares at an average price per share of $68.56. We also announced a special dividend of $1 per share payable in December. 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 increased AFG's 2015 core operating earnings guidance to $5.30 to $5.60 per share, which is up from the range of $5.25 to $5.55 per share estimated previously. Craig and I will each discuss our guidance for each segment of our business later in the call.

Last week, we formally celebrated the opening of Great American's newest property and casualty branch office in Singapore. Particular focus areas include marine, general liability and professional and executive liability. Entry into the Singapore market has enabled us to expand our international footprint into Southeast Asia. We have a respected, experienced team in place and look forward to the profitable growth of our newest international business.

Now let's take a closer look at AFG's results this quarter. If you would turn to Slides 4 and 5 of the webcast, which include an overview of results in our Specialty Property and Casualty operations. Beginning on Slide 4. You'll see that gross and net written premiums were both up 6% in the 2015 third quarter compared to the same quarter a year earlier. Although the marketplace has become more competitive, we're still finding opportunities to grow our Specialty Property and Casualty businesses.

Underwriting profit was up 20% year-over-year, reflecting strong performance by the vast majority of our 31 businesses that comprise our Specialty Property and Casualty Group. Third quarter 2015 combined ratio of 92.9% improved by nearly 1 point from the comparable prior year quarter and included 1.2 points of favorable prior year reserve development and 0.9 points in catastrophe losses.

Overall Specialty Property and Casualty Group pricing was flat and was impacted by price softening in our workers' comp businesses. We continue to focus on price adequacy, however, and achieved increases in over 40% of our Property and Casualty businesses during the third quarter, most notably, in our Property and Transportation Group.

With that, I'd like to turn to Slide 5 to review a few highlights from each of our Specialty Property and Casualty business groups. Our Property and Transportation Group reported a year-over-year improvement in underwriting results for -- in the third quarter, as well as the sequential improvement from the second quarter of 2015. Higher profits in our agricultural and transportation businesses were partially offset by lower underwriting profitability in our Property & Inland Marine and ocean marine businesses.

Catastrophe losses for this group were $7 million in the third quarter of '15, increasing from $1 million in the third quarter of 2014.

The increases in gross and net written premiums in this group were due primarily to the growth in our transportation businesses as a result of new accounts and organic growth in several product lines, as well as higher premiums in our ag businesses.

It's shaping up to be a good crop year, with solid profitability expected in our crop insurance business. Corn and soybean crops finished strong as August and September growing conditions were ideal. Crops were able to reach maturity ahead of a major frost event. Early harvest yields are coming in better than expected, with many states, particularly those in the Western corn belt, projecting yields well above trend. Concern areas are portions of Illinois, Indiana and Ohio due to variable yields resulting from early-season excessive rainfall. We're pleased that the corn and soybean October harvest price discovery period closed with corn and soybean harvest prices about 8% below spring discovery prices.

In Property and Transportation, we continue to focus on adequate pricing. Overall renewal rates for this group increased 4% on average for the quarter, with our National Interstate subsidiary achieving a 5% rate increase.

I am pleased with the underwriting profitability reported by our Specialty Casualty Group during the quarter. Nearly all the businesses in this group achieved strong underwriting margins. I'm pleased, especially pleased with the profitability within our workers' compensation businesses, which helped to offset underwriting losses in our international operations.

Next week, Martin Reith will be joining us as the CEO designate of Marketform, which operates Syndicate 2468 at Lloyd's of London. His success in building and leading insurance operations in the Lloyd's market is consistent with the core Great American Insurance Group tradition of specialty focus and consistent profitability. Our leadership team will be working closely with Martin to get this business back on track.

The majority of businesses in the Specialty Casualty Group reported growth, particularly our excess and surplus businesses. This growth was partially offset by lower premiums in our general liability business, primarily the result of competitive market conditions, re-underwriting efforts within our Florida homebuilders business and the slowdown within the energy sector. Pricing in this group was down about 2%. Our workers' compensation businesses reported a pricing decline of about 6% on average for the quarter, due primarily to lower renewal pricing in Florida. Excluding workers' compensation, pricing in this group was up about 1% on average for the quarter.

Our Specialty Financial Group reported excellent profitability this quarter, with especially strong results in our financial institutions business. Every business in this group achieved excellent underwriting margins during the quarter, producing an overall calendar year combine of 81%. Growth and higher retentions in our financial institutions business were the primary factors driving a double-digit increase in net written premiums in this group during the quarter. Renewal pricing in this group was flat for the third quarter.

Now please turn to Slide 6 for a summary view of our 2015 outlook for the Specialty Property and Casualty operations. We now estimate that growth in net written premiums will be in the range of 6% to 8%, which has narrowed a bit from the range of 4% to 8% previously estimated. Our combined ratio guidance is unchanged and is expected to be between 92% and 94%.

We've increased our guidance for net written premiums in our Property and Transportation Group. We now expect growth of 3% to 6%, an increase from our previous expectations that premiums would be down 1% to up 2%. This change in guidance is primarily the result of-higher-than-expected premiums in our transportation businesses. Our guidance for combined ratio remains 96% to 99% in this group.

The premium guidance for Specialty Casualty Group was narrowed a bit. We now expect growth in a range of 9% to 12%, changed from our previous range of 8% to 12%. Our combined ratio guidance for this group continues to be in a range of 91% to 94%.

We've increased our estimates for growth in net written premiums in our Specialty Financial Group, to be in the range of 7% to 10%, which is an increase from the growth of 3% to 7% estimated previously. And the outlook for the combined ratio for this group has improved to a range of 80% to 83%, a 1 point improvement over our previous estimate of 81% to 84%. These changes are based on the group's strong results through the first 9 months of the year.

Additionally, we now expect our property and casualty investment income to grow by 10%, an increase from growth of 8% estimated previously. On the pricing front, we now expect overall property and casualty renewal pricing to be flat to up 1%.

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. I'll start with a view of our annuity outlook for the remainder of 2015. As you'll see on Slide 7, we're increasing our guidance for annuity earnings before the impact of fair value accounting by $5 million to a range of $345 million to $355 million. Higher than previously expected net interest spreads is the primary factor driving the increase in our estimates.

Based on where interest rates and the stock market are today, we now expect the full year 2015 core pretax annuity operating earnings as reported will be $325 million to $335 million, a decrease of $5 million from our previous estimate. As we saw in the third quarter, significant changes in the stock market and/or interest rates as compared to our expectations can lead to a significant positive or negative impact on the Annuity segment's results due to the impact of fair value accounting.

You'll also see on Slide 7 that based on our recent sales trend, we've increased our premium guidance and now estimate the full year 2015 annuity premiums will be in the range of $3.8 billion to $3.95 billion, an increase from the $3.7 billion achieved in 2014.

Significant changes in interest rates and/or the stock market from our expectations could lead to additional positive or negative impacts on the Annuity segment's results. These earnings expectations do not reflect any potential earnings impact from our annual unlocking fourth quarter review of the major actuarial assumptions at our fixed annuity business. Since our net interest spreads are higher than previously projected, we currently believe that the unlocking will likely have a positive impact on earnings.

The fundamentals of our Annuity business remain very strong despite the lower-than-expected recorded earnings after fair value accounting. Taking a look at results in the third quarter, you'll see on Slide 8 that core pretax annuity operating earnings before fair value accounting were $89 million or 2% higher than the prior year period. AFG's 2015 earnings continued to benefit from growth in annuity assets as well as the ability to maintain net interest spreads year-over-year.

AFG's quarterly average annuity investments and reserves grew by approximately 13% year-over-year. The benefit of this growth was partially offset by the impact that the significant decrease in the stock market in the third quarter had on certain AFG annuity reserves. Variances from expectations of certain items, such as projected interest rates, option costs and surrenders, as well as changes in the stock market, have an impact on accounting for indexed annuities. These accounting adjustments are 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 third quarter of 2015, the significant stock market decrease resulted in a large unfavorable impact on annuity earnings because of the impact of fair value accounting on fixed-indexed annuities. In addition, interest rates decreased during the quarter compared to the expectation that they would rise. This also had a negative impact on the Annuity segment's core pretax operating earnings. In the third quarter of 2014, changes in the stock market and interest rates were much more moderate, resulting in a minor impact on annuity earnings.

I was very pleased with the Annuity segment's record third quarter annuity premiums of $1.32 billion, a 63% increase from the comparable prior year period. During the second quarter of 2015, interest rates rose significantly from the first quarter 2015 lows, allowing AFG to raise the credit rates on its annuities and have become much more competitive in the markets. This is in contrast to 2014, when interest rates generally decreased throughout the year, resulting in AFG lowering its credited rates in order to maintain appropriate returns on sales.

A summary of the components of spreads for AFG's fixed annuity operations can be found on Slide 9. Additional information can also be found in AFG's Quarterly Investor Supplement posted on our website.

In April, we announced a definitive agreement to sell our runoff long-term care insurance business to HC2 Holdings. Included in the sale are United Teachers Associates Insurance Company and Continental General Insurance Company, the legal entities that contained AFG's long-term care insurance business. This transaction will result in the disposition of substantially all of AFG long-term care business. The transaction is expected to close prior to year-end, subject to customary conditions, including receipt of required regulatory approvals.

Now please turn to Slide 10 for a few highlights regarding our $38 billion investment portfolio. AFG recorded third quarter 2015 net realized losses of $6 million after-tax and after deferred acquisition costs compared to net realized gains of $8 million in the comparable prior year period. As of September 30, 2015, unrealized gains on fixed maturities were $445 million after-tax, after DAC, and unrealized gains on equities were $44 million after-tax.

As you'll see on slide 11, our portfolio continues to be very high quality, with 88% of our fixed maturity portfolio rated investment-grade and 98% with an NAIC designation of 1 or 2, its 2 highest categories. We provided additional detailed information of 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 third quarter 2015 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 12 recaps AFG's third quarter consolidated results by segment. Core net operating earnings per share in the quarter were $1.38, down $0.02 from Q3 2014's record $1.40. The impact of fair value accounting that Craig described reduced AFG's core net operating EPS by $0.16 in 2015 third quarter.

As we've stated before, we do not believe that fair value accounting presents an accurate depiction of the results of operations for our Annuity segment. Some in our industry choose to exclude it from core operating EPS. We have not.

That $1.38 is based on core net operating earnings in the quarter of $123 million. You'll be able to see a more detailed view of these components on page 4 of our Quarterly Investor Supplement.

P&C core pretax operating earnings improved by $23 million year-over-year, due to P&C underwriting profit improving by $12 million and increase in P&C net investment income of $7 million and P&C other expenses decreasing by $4 million.

As for the other components of AFG's core net operating earnings, Craig previously covered our Annuity segment earnings, which were $19 million lower year-over-year, result of the impact of fair value accounting for fixed-indexed annuities. Results in our runoff long-term care and life segment improved by $5 million.

Interest expense at parent holding company increased $1 million due primarily to our 6 1/4% hybrid debt offering in September 2014. Other expense was $6 million higher than what was reported in the 2014 third quarter. Last year's quarter was not indicative of a run rate for this line item.

Turning to Slide 13, you'll see a reconciliation of core net operating earnings to net earnings and diluted earnings per share. In addition to realized investment losses and the loss on the redemption of AFG's 7% senior notes, net earnings in the quarter were reduced by an A&E reserve strengthening of $52 million after-tax or $0.58 per share. The components of our special A&E charge are further outlined in the bottom in Slide 13.

A.M. Best released its annual asbestos and environmental special report on October 27. That report shows an industry 3-year adjusted survival ratio of 8.2x paid losses as of year-end 2014. The adjusted 3-year survival ratio for AFG's P&C insurance subsidiaries now stands at 11.5x paid losses.

As indicated on Slide 14, AFG's adjusted book value per share was $49.01 as of September 30, 2015. This is a decrease of $0.62 during the third quarter. The biggest piece of this decrease was a decrease of $86 million in unrealized gains in equity securities during the third quarter of 2015, which resulted in a decrease of $0.98 per share in adjusted book value per share. Tangible book value per share was $46.12 at September 30, 2015.

Our excess capital stood at approximately $700 million at September 30. In the quarter, we chose to increase our capital allocated to common stock, where we increased our common stock's fair value by approximately 25%. While the S&P decreased by approximately 7% in Q3 2015, I would note that through the beginning of November, the S&P has risen order-to-date by over 9%. So I would expect that much of the stock market impact on capital will have reversed subsequent to quarter end.

The pending sale of our runoff long-term care insurance business is expected to generate approximately $110 million in excess capital.

We returned $57 million to our shareholders through dividends and share repurchases during the quarter. Approximately 3.2 million shares remain under our repurchase authorization. We plan to continue returning excess capital to our shareholders through the course and remainder of 2015, notably through the December special dividend of $1 per share announced in the press release, plus, subject to market conditions, continued share repurchase.

Closing with Slide 15. You can see a single-page summary of our 2015 core earnings guidance. We have upped AFG's 2015 core operating earnings guidance at each end of the range by $0.05 to $5.30 to $5.60 per share. As a reminder, AFG's expected 2015 core operating results exclude noncore items such as realized investment gains and losses 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 the line of Christopher Martin of Macquarie.

Christopher William Martin
Macquarie Research

Congrats on the underwriting results this quarter and the annuity premium growth. So I have 2 questions related to crop insurance. The first is regarding the proposed $3 billion in budget cuts for the program. How do you think this might impact the industry? And do you think that this could drive more consolidation amongst the smaller players?

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

Yes, I don't think -- if the bill was drafted, isn't good news for the crop industry, and definitely would probably have an impact on greater consolidation, on my mind. I think right now, though, there's a supposed deal for it to be revised in the upcoming omnibus spending bill in that. And that seems to be a positive. But we'll continue to monitor that closely and see what happens to NAV, right? I think that's a positive right now.

Christopher William Martin
Macquarie Research

All right, great. And then sort of staying on the crop, with the strong El Niño we've seen, typically, that leads to the favorable growing conditions. Do you guys have sort of an early outlook on what you expect 2016 to look like in both premiums and commodity pricing?

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

We generally do guidance a little bit later once we kind of have a little bit better feel on things. I think one question I've been getting is about El Niño. Generally, the current predictions are for a strong El Niño event to influence weather patterns this winter. Generally, for the crop industry, that's a positive event to the extent that there's wetter-than-average conditions, particularly in California or in some of the Southern tier states, which actually could bring drought relief to those regions. So El Niño, our initial take is that, that could be positive. That's something that is talked a lot about right now. On the -- I think you can get a little bit of a flavor. If crop prices, the discovery prices are down 8%, usually, in the spring discovery, prices that establish premium levels for next year. Generally, when you look at the futures that tie to more of the spring time period in that, generally, they're not down quite as much. So I think that there should be a fairly stable -- my initial thought will be kind of a stable outlook on premiums for next year. But it all depends on what the spring discovery prices are, and that's -- until that -- you're able to measure that in the spring, it's kind of tough to prognosticate.

Operator

Our next question comes from the line of Paul Newsome of Sandler O'Neill.

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

I wanted to -- I apologize, I had to jump off the call briefly, so tell me if I'm being redundant [ph]. But perhaps, a little bit more on the asbestos charge. It seemed a little bit larger than I think that we've seen in the past. Why that might be? And are we getting -- at what point do you think we get to the point where we -- those asbestos charges get pretty small?

Joseph E. Consolino

CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd

Paul, it's Jeff Consolino. Thanks for your questions. I guess, in terms of your statement that the asbestos and environmental special charge is bigger than before or what you've seen just in terms of history, we typically work with a internationally-recognized independent actuarial firm on a 2-year rotating basis. So the last time we had that outside firm in was 2013. The charge we took this quarter of $79 million pretax is comparable to the $76 million of 2013, so I guess I would challenge the assumption that says without precedence or unusual. As it relates to the overall asbestos and environmental environment, I do think that A.M. Best report issued at the end of October is fairly illustrative of what the industry is seeing. And we would say, for our P&C business, the analysis was driven by slightly higher-than-expected indemnity and defense costs. And as the industry exposures to asbestos have matured, the focus of litigation has radiated out to smaller companies and companies with ancillary asbestos exposures. Our insurance for these kinds of exposures have been the driver of our reserve increases in prior periods. As for environmental, we've looked at the environmental piece primarily attributable to increased defense cost and a small number of claims where the cost for remediation have increased. So I hope that gives you a good sense as to what's sitting inside that number. But I guess I'll leave it to you to follow up if you have any further questions.

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

Yes, that's great. And I have a separate life insurance, entirely separate life insurance question. And it is hopefully a fairly straightforward question. So I think of the fixed annuity business as being pretty straightforward. You basically make -- the vast majority of what you make is in interest rate spread on the assets under management. And I'm looking at Slide 8 and one of the things I noticed is that the average fixed annuity assets are up 13% and the interest rate spread is also improved, which are both fantastic. But the core operating earnings was up only 2%. What would be the other factors that make that core not go up, say, at least in line with the average fixed annuity investments?

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

This is Craig. The answer to that is the impact of the stock broker decline on non-fair value items, specifically rider reserves. The decline in the stock market resulted in us needing to put up more reserves against the riders, and that is what accounts for that difference.

Operator

Our next question comes from the line of Ryan Byrnes of Janney Montgomery.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Just had a question. Obviously, the big hire out in London, are there any initial changes, I guess, strategy changes for Marketform that we should know about? And maybe try to figure out how much of a use of excess capital that could be going forward.

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

Ryan, it's Jeff Consolino. We're excited, as Carl said, about the hire of Martin Reith on our London Marketform operation. Martin's track record speaks for itself, and we think he's the kind of leader that's consistent with the kind of leadership we have in our domestic U.S. business. And Martin has not yet started at Marketform, and so I think it's premature and we'd be getting out ahead of him to talk about any changes that may transpire. So why don't we park that and keep track of it as his tenure starts to get underway. And likewise, I think I wouldn't want to talk about capital commitment, or use of capital till we're further down the road in that change.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Got you. So you won't put any pressure on him quite yet, I understand that. And then moving on to the workers' comp market. I saw that Florida, the state of Florida is looking to put through a 5% rate reductions heading into next year. Just wanted to get your thoughts on that. And where the underlying margin of that business are going. I know that you guys are have gotten a lot deeper with data analytics, which are kind of softening that pressure. But just want to get your thoughts there.

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

Naturally, we were disappointed that the Commissioner chose a number higher than what the NCCI was choosing in that. Our results continue -- to date, we have good results at Summit, meets our expectations. I think what the -- it's going to -- the rate decline probably will help us -- we'll need to be more selective in our underwriting and tighten up our analytics model such that we can maintain margins there, particularly in Florida. So I think the -- when we look through the lens of our own predictive analytics model, and that 5% rate reduction may work out to be more like 1% or 2% based off of our mix of business, our specific mix of business, would be our initial take on that. But if we have to tighten things, we'll do that in order to meet the margins.

Operator

[Operator Instructions] Our next question comes from the line of Jay Cohen of Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions. First, in the property transportation business, you highlighted some, I guess, lost pressure or lost activity in property and then the marine lines. I'm wondering, were there unusual events? Unusual there or large events that led to that?

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

No. I wouldn't say any large events. Certainly, nothing that would be cat-like.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Okay. Just underlying pressure from a pricing/claims standpoint?

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

Again, I think you have to look at the diversity of those businesses, Jay. Again, I'll point you to a couple of things since I'm not satisfied with the short answer. You can see in the supplement, you can see the press release that cat losses year-over-year were higher so, but set that aside because we carve that out separately. In terms of the underlying loss ratio I would say a couple of things. I'm just going to try to refer to a schedule here quickly if you don't mind. So I show our loss and loss adjustment ratio for the quarter for Property and Transportation, excluding cat and excluding prior-year development, at 74.6%. A year ago, that was 81.4%. We had a more favorable crop order, given the comments that Carl made, and so we had a greater level of profitability and the lower loss ratio in crop. Likewise, a year ago, we talked about the pressures in transportation, both in National Interstate and in our own individual owner-operator business for Great American, and we have seen improvement in both of those. Agri business and equine also have improved, and so when you take those all out, you can see that the improvement is really attributable to all of those levels. So higher level of cats offset by improving results in crop, trucking, National Interstate, equine and agri business, that's really what's moving the loss activity [ph] ratio on an accident year x cat basis for that subsegment.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes. I was looking at that same ratio, but I was looking at a relative to the first half of the year, where that ratio was in the 60s, seemed to pop up. I don't know if there's seasonality here, but -- and if there was just any loss activity. But that's fine. Secondly, Marketform. What's the underlying issue that needs to be resolved? Obviously, you're not happy with the performance. What's the problem in that business?

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

I think we've had a -- we've not had a leadership group that's properly selected and priced the business in a decent number of the businesses. We have some great teams that have produced very profitable results, but we continue to be disappointed per our standards, that we've had the right leadership and the right team to get the job done. That's why we made the leadership change and why we went out of our way to get somebody that had the best track record there. We're not messing around. We want to -- we want Marketform to be a very profitable venture for us. One of the few disappointments, when you look across our 31 different specialty businesses.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Great. So basic underwriting blocking and tackling, you need someone right for that job, then?

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

Exactly.

Operator

Our next question comes from the line of Greg Peters of Raymond James.

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

A couple areas to touch on. In the Annuity segment, can you provide some additional color behind the fair value accounting adjustment? And considering the market movement since the end of the third quarter, is it possible that there could be a positive adjustment going into the fourth quarter?

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

Greg, this is Craig. I'm going to give you a little more color on the -- what impacted us in the third quarter. The 2 largest drivers of the $22 million fair value accounting hit that we took were the decline in the stock market and interest rates that ended the quarter a bit lower than we had expected. Obviously, we've had a very significant recovery in the stock market so far in the fourth quarter. Interest rates have moved up. If you look at the guidance that we put into the news release that we issued last night, you'll see that we're steering to -- if you look at the midpoint of the guidance on operating earnings, we're steering to a $100 million operating number. That compares to $67 million that we just reported in the third quarter, and that does include a nice recovery in the stock market. Our assumptions related to interest rates and the stock market that go into that guidance are that in the fourth quarter, the stock market would increase by 8%. And I think as of this moment, it's up a little bit more than 8%. And it assumes that rates would trend up in the quarter. It assumes, as an example, that the 10-year corporate A2 rate would be at a 3.69%, which is about where it is today. So it assumes an 8% increase in the stock market, it assumes interest rates stay around where they are today. And if that happens, we recover -- in the guidance, we assume that we were going to recover, that we're going to have a positive impact from fair value accounting of approximately $8 million. And that's what is included in our guidance for an operating earnings number in the fourth quarter of $100 million.

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

If you could add -- or if I look at what you're -- it looks like you're going to be able to achieve, in terms of operating earnings, within the Annuity segment for 2015. How do you think about the returns on allocated capital that you expect to get this year relative to your long-term objectives?

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

The return that we're projecting after the negative impact of fair value accounting, which frankly, we're not a big fan of, but including fair value accounting, the return this year is projected to be between 11% and 12%, not including realized gains on stocks.

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

Right. And is that consistent with your long-term objective?

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

What we've seen certainly over the last 4 or 5 years is an uptrend in the returns in the Annuity business. We have been bogged down by a block of higher-GMIR business. The new business that we're putting on the books has a return that we find to be very attractive. It's still impacted by some of the older business that has 3% and 4% GMIRs. So new business targeted returns are in that neighborhood of 12%. And over the last 3, 4 years, we've exceeded that by a fairly significant margin.

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

If I could continue further, switch gears over to the workers' compensation business. I believe, Carl, in your comments, you implied that there are rate decreases in the environment in other states other than Florida. And I was wondering if you could provide us some perspective on how we should think about the impact of these rate decreases as we look to 2016 projections.

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

Yes, there are -- I think it probably impacts our growth, obviously. I think -- as there -- as you have rate decrease that [indiscernible] in Florida and California -- in the third quarter in California, we had about a 6% price decline, I think about 3% year-to-date 2015. I think one of the -- the immediate effect is for, instance in California, we're probably going to grow low single-digit this year versus the double-digit growth that we've had in the past. In Summit, 5% price decline will probably mean that we'll write less premium than what we projected for Summit this year and probably some next year. I kind of mentioned in Summit, we're highly focused on predictive analytics. And as the rates have moved down there, we tightened up our underwriting grid and are using our modeling more extensively. And I will try to do the same thing in the other workers' comp business that we write also. The good news is we have excellent margins when you look at our workers' compensation business today. And if maybe versus some others, we can give up a few points of margin and still be earning really good returns. So I think that's the -- that's probably my perspective on it.

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

If I could just close out with the discussion on capital management. I'm sure many of your shareholders, yourselves included, appreciate the special dividend. But there is an ongoing discussion and argument in the institutional shareholder market of about whether you get any credit for special dividends among institutional investors. I was hoping maybe you could weigh in with your opinion on that. And also, just provide some commentary around how you balance the formula between share repurchase and dividends in terms of capital management.

Carl H. Lindner

Co-Chief Executive Officer, Co-President and Director

There's probably not any ideal answer to that question. I think most shareholders, we usually get out a couple of times after each quarter and talk to our investors. And generally the feedback around special dividends is generally very positive, definitely more positive than negative comments we get. Now you have to put that special dividends in the context of just intelligent overall management of excess capital. We think that we've done an excellent job of that over time. We've had -- we've combined acquisition opportunities and organic growth opportunities, along with a consistent double-digit increase, compounded increase in dividends, along with special dividends. And now the mix of how we look at things every year is a little bit different based off of our opportunities to grow organically, what potential acquisitions we have on the plate. And generally, come the fourth quarter, we kind of know where we're going to end up by year-end. And generally, if we think a special dividend is appropriate and we still have the capital to take advantage of the other opportunities we have, that's when we kind of focus in and make that decision around special dividends. And naturally, sure, I'd love to have -- be in a tight market where we can grow the business 20% and take advantage of that. But the reality right now is it's a very competitive market where I think we've been effective at picking places to grow organically where rates are adequate and provide attractive returns. And I think we've been good at picking out appropriate acquisition opportunities, like Summit and a number of the other startup businesses that we've been engaged in. So I hope that answers your question.

Operator

And that does conclude our question-and-answer period for today. I'd like to hand the conference back over to Miss Weidner for any closing remarks.

Diane P. Weidner
Assistant Vice President of Investors Relations

Thank you. And thank you all for joining us this morning as we reviewed our third quarter results. We look forward to talking to you all again as we look at next quarter. Have a good day.

Operator
Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program, and you may all disconnect. Have a great rest of your day.