

Arch Capital Group(ACGL)

\$23.11 (As of 05/01/20)

Price Target (6-12 Months): **\$24.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 10/01/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:B

Value: D

Growth: B

Momentum: B

Summary

Arch Capital Group boasts a strong product portfolio and has been maintaining an exemplary track record of premium growth. This apart, the insurer has been diversifying its Mortgage Insurance business via strategic acquisitions that also complement the company's strength in the specialty insurance and reinsurance businesses. Moreover, banking on a solid capital position that supports financial flexibility, it effectively deploys capital to pursue growth initiatives as well as engage in share repurchases activity. Shares of the company have lost lower than the industry year to date. However, exposure to catastrophe loss due to natural and man-made catastrophe events induces volatility in underwriting results. Also, elevated expenses due to acquisition costs, corporate expenses and operating costs tend to weigh on margin expansion.

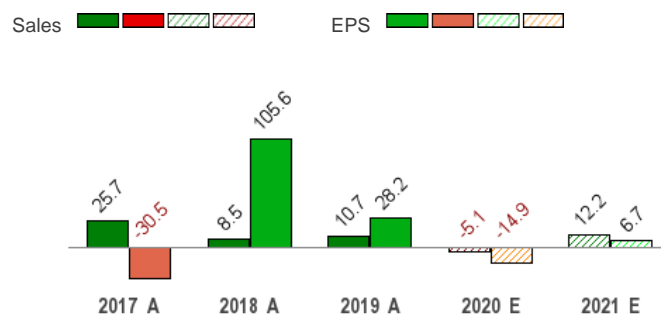
Price, Consensus & Surprise



Data Overview

| | |
|----------------------------|---|
| 52 Week High-Low | \$48.32 - \$22.41 |
| 20 Day Average Volume (sh) | 2,150,758 |
| Market Cap | \$9.4 B |
| YTD Price Change | -46.1% |
| Beta | 0.69 |
| Dividend / Div Yld | \$0.00 / 0.0% |
| Industry | Insurance - Property and Casualty |
| Zacks Industry Rank | Top 49% (123 out of 253) |

Sales and EPS Growth Rates (Y/Y %)



| | |
|---------------------------|------------|
| Last EPS Surprise | 10.5% |
| Last Sales Surprise | NA |
| EPS F1 Est- 4 week change | -19.7% |
| Expected Report Date | 05/04/2020 |
| Earnings ESP | -27.3% |

Sales Estimates (millions of \$)

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|------|---------|---------|---------|---------|---------|
| 2021 | | | | | 6,834 E |
| 2020 | | | | | 6,089 E |
| 2019 | 1,527 A | 1,620 A | 1,601 A | 1,669 A | 6,416 A |

EPS Estimates

| | Q1 | Q2 | Q3 | Q4 | Annual* |
|------|----------|----------|----------|----------|----------|
| 2021 | \$0.62 E | \$0.67 E | \$0.59 E | \$0.63 E | \$2.56 E |
| 2020 | \$0.54 E | \$0.67 E | \$0.59 E | \$0.61 E | \$2.40 E |
| 2019 | \$0.67 A | \$0.77 A | \$0.63 A | \$0.74 A | \$2.82 A |

*Quarterly figures may not add up to annual.

| | |
|---------|-----|
| P/E TTM | 8.2 |
| P/E F1 | 9.6 |
| PEG F1 | 1.0 |
| P/S TTM | 1.4 |

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/01/2020. The reports text is as of 05/04/2020.

Overview

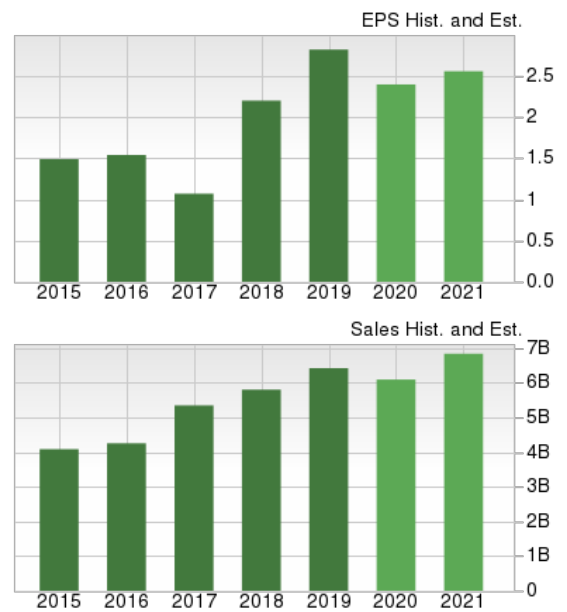
Established in 1995 and headquartered in Pembroke, Bermuda, Arch Capital Group Ltd. offers insurance, reinsurance and mortgage insurance across the world. Through its wholly owned subsidiaries, the property and casualty (P&C) insurer provides a wide range of products and services, which include primary and excess casualty coverages, professional indemnity, workers compensation and umbrella liability and employers liability insurance coverages to name a few. The company offers a full range of property, casualty and mortgage insurance and reinsurance lines, while maintaining focus on writing specialty lines of insurance and reinsurance.

Arch Capital classifies its operations into three underwriting segments and two other operating segments (non-underwriting). The underwriting segments are Insurance, Reinsurance and Mortgage. The other two operating (non-underwriting) segments are 'Other' and Corporate.

The **Insurance** (50.8% of 2019 gross premiums written) segment provides primary and excess casualty coverages, loss sensitive primary casualty insurance programs, professional indemnity, and other financial coverages as well as commercial automobile and inland marine products to name a few. This apart the segment deals in property, energy, marine, and aviation insurance, captive insurance programs, employers liability insurance coverages. This segment markets its products through a group of licensed independent retail and wholesale brokers.

Reinsurance (30.2%) segment primarily offers reinsurance for third-party liability and workers compensation exposures, reinsurance protection for catastrophic losses and commercial property risks; life reinsurance, risk management solutions accident and health, workers compensation catastrophe to name a few. This segment markets its reinsurance products through brokers, and directly to ceding companies.

Mortgage (19%) segment provides private mortgage insurance covering one-to-four family residential mortgages; mortgage insurance to cover previously originated residential loans; quota share reinsurance; and risk-sharing products. This segment sells its products directly as well as through brokers to its bank and credit union customers.



Reasons To Buy:

- ▲ **Price Impact:** Shares of Arch Capital have lost 46.1% year to date, compared to the industry's decline of 21.3%. Expanding U.S. mortgage insurance business, improving investment income, robust capital position and effective capital deployment should continue to push up the shares.
- ▲ **Strong Premium Growth:** Arch Capital has been displaying a brilliant track record of net premiums written. Consistent premium growth has been boosting better results, enabling the company to maintain sustained revenue growth over the past few years. Net premiums written improved 16.1% year over year in 2019. We expect the company to experience better results on the back of its diverse product and service portfolio.

Robust premium growth owing to a compelling product portfolio and solid inorganic portfolio, expansion of U.S. Mortgage Insurance business and strong capital continue to drive long-term growth.

Arch Capital has been effectively and efficiently catering to the evolving needs of its clients, which is a key to the company's success. The company believes that its customized products and services will help to serve its clients more efficiently, compared to its peers, and drive long-term growth of the company.

- ▲ **Inorganic Growth:** Arch Capital Group has made significant efforts to boost its inorganic growth through prudent acquisitions. These in turn helped the company expand internationally, added capabilities, enhanced operations and diversify business.. In November, 2019 the company acquired Barbican Group Holdings, which will expand its commitment to both Lloyd's and the London market and offer its brokers and clients an enhanced access to its Insurance and Reinsurance platforms.
- ▲ **Investment Results:** The company has been witnessing improvement in net investment income for the last several quarters. The momentum continued in 2019, with net investment income increasing nearly 12.1% from the corresponding period of 2018, primarily driven by growth in fixed maturities, equity securities and other income distributions from investment funds and other items. Though the interest rate was lowered by the Fed by 25 basis points (bps), it is much better than the near zero level during the financial crisis. The company estimates net investment income in the range of \$110 million to \$115 million in the first quarter
- ▲ **Robust Capital Position:** The P&C insurer has maintained a robust capital position over the years, reflecting its financial flexibility. The company's robust capital and liquidity position shield it from market volatility, enabling it to retain its financial strength and flexibility required to pursue new opportunities in keeping with its long-term strategy. Book value per share rose 21.1% year over year.

Additionally, debt to total capital ratio was 13.1% as of Dec 31, 2019, improving 240 bps from 2018-end. Also, times interest earned, a measure to identify the company ability to service debt stood at 23.6% in 2019, up from the 13.9% in 2018. The company's times interest earned ratio has been improving over the years. The improvement in this ratio indicates that the firm will be able to meet current obligations in the near future without any difficulties. At a time when every entity is looking forward to preserve liquidity amid uncertainty as a result of the COVID-19 outbreak, an improving ratio is reassuring for investors.

Reasons To Sell:

- ▼ **Exposure to Catastrophe Loss:** Being a P&C insurer, Arch Capital remains exposed to catastrophe loss caused by natural and man-made catastrophic events. Such a massive loss could render substantial volatility to the company's operational performance, which in turn, could affect the financial position and more importantly, the insurer's underwriting results. Given a not-so-active catastrophe environment, underwriting income increased 21.2% year over year, while combined ratio improved 130 bps. However, exposure to cat loss remains a concern as natural disasters are unpredictable and induce volatility in earnings.
- ▼ **Rising Expenses:** Arch Capital has been experiencing escalating operating expenses, primarily due to higher losses and loss adjustment costs, acquisition expenses, other operating costs, interest expense as well as corporate expenses. The company's operating expenses witnessed an increase of 10.9% in the last five years. The trend continued in 2019, with the metric rising 10.2% year over year. Hence, a rise in expenses tends to weigh on the operating margin expansion, which in turn, will negatively impact the company's overall results. In the last five years, the company saw a margin contraction by 680 bps. Therefore, the company should strive for higher revenue growth rate than increase in expenses.

Exposure to catastrophe loss rendering substantial volatility to the company's operational performance and escalating expenses weighing on the operating margin expansion remain headwinds.

Last Earnings Report

Arch Capital Earnings Beat Estimates in Q4, Soar Y/Y

Arch Capital Group Ltd. reported fourth-quarter 2019 operating income per share of 74 cents, which beat the Zacks Consensus Estimate by 10.5%. Also, the bottom line improved 60.9% year over year.

The upside can be attributed to improved net premiums written as well as a decrease in expenses related to the amortization of intangible assets.

Quarter Ending **12/2019**

| Report Date | Feb 11, 2020 |
|------------------|--------------|
| Sales Surprise | NA |
| EPS Surprise | 10.45% |
| Quarterly EPS | 0.74 |
| Annual EPS (TTM) | 2.81 |

Behind the Headlines

Gross premiums written increased 14.6% year over year to \$1.9 billion, largely fueled by higher premiums written across its Insurance, Reinsurance and Mortgage segments.

Net investment income was down 1.9% year over year to \$154.3 million due to a reduction in interest rates.

Operating revenues of \$1.7 billion increased 23.4% year over year on higher premiums earned.

Interest expenses were \$31.2 million, up 4.8% year over year.

Total expenses of \$1.3 billion increased 5.8% year over year on higher losses and loss adjustment expenses, acquisition expenses, other operating expenses, interest expenses, and corporate expenses.

Arch Capital's underwriting income was \$251.4 million, up 50.6% year over year. Combined ratio improved 400 basis points (bps) to 83.8%.

Segment Results

Insurance: Gross premiums written increased 24.9% year over year to \$1 billion. Net premiums written rose 28.7% year over year to \$688.7 million, driven by the acquisition of new businesses, growth in existing accounts and rate increase in most lines of business.

Underwriting loss was \$13.8 million in the fourth quarter compared with underwriting loss of \$15.6 million in the year-ago quarter. Combined ratio improved 70 bps to 102.1%.

Reinsurance: Gross premiums written rose 5.6% year over year to \$432.2 million. Net premiums written improved 4.3% year over year to \$338.9 million, reflecting new business opportunities in property lines and growth in existing accounts.

The segment reported underwriting income of \$26.4 million against underwriting loss of \$41.2 million in the year-ago quarter. Combined ratio improved 1710 bps year over year to 93.8%.

Mortgage: Gross premiums written increased 3.5% year over year to \$370.7 million. Net premiums written rose 2% year over year to \$315.5 million, driven by strong growth in monthly premium business on rise in demand for insurance in force. Underwriting income increased 12.5% to \$276.5 million.

Combined ratio improved 100 bps year over year to 21.6%. Arch MI U.S. generated \$24.1 billion of new insurance written, which increased 44.3% year over year.

Financial Update

Arch Capital exited the quarter with cash of \$726.2 million, up 12.3% year over year. Debt was \$1.7 billion, which inched up marginally from the year-ago quarter.

As of Dec 31, 2019, book value per share was \$26.42, up 22.8% year over year.

Operating return on equity was 11.7% in the fourth quarter, up 290 basis points.

Net cash provided by operating activities was \$505.3 million, up 15.3% year over year.

Full Year Update

Net income for the year ended Dec 31, 2019, surged nearly 150% year over year to \$316 million.

Recent News

Arch Capital Estimates Losses Due to Coronavirus - Apr 15, 2020

Arch Capital provided estimates related to losses incurred and premium volumes due to the impact of COVID-19 on its business.

The pandemic has resulted in increased market volatility and uncertainty, reduced liquidity of capital markets, and led to social disruption as well as intervention by various governments across the world.

The global financial markets experienced extreme volatility in interest rates, credit spreads and equity markets during the first quarter of 2020, thanks to the pandemic.

The property and casualty insurer estimates first quarter pre-tax net losses of \$85 million to \$95 million across its P&C insurance and reinsurance segments.

The company also expects to incur pre-tax net losses of \$40 million to \$50 million across its mortgage segment, given the company's loss reserve selections, set at the higher end of their range of indications across the mortgage segment as of Mar 31, 2020.

These estimated losses across insurance, reinsurance, and mortgage segments take into account claims made as of Mar 31, 2020 and are based on information from modeling techniques. However, the losses actually incurred may differ from estimates as result of uncertainties and the evolving nature of the global pandemic.

The company estimates net investment income in the range of \$110 million to \$115 million in the first quarter. Further, it estimates total return in the range of -0.65% to -0.95% on its core investment portfolio (excluding Watford). The estimated range will be changed after finalizing the analysis of the investment returns.

Valuation

Arch Capital shares are down nearly 46.1% in the year-to-date period and 32.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 21.3% and 26.4% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 17% and 22%, respectively.

The S&P 500 index is down 12.1% in the year-to-date period and 3.7% in the past year.

The stock is currently trading at 0.82x trailing 12-month book value, which compares to 1.04x for the Zacks sub-industry, 2.07x for the Zacks sector and 3.75x for the S&P 500 index.

Over the past five years, the stock has traded as high as 1.70x and as low as 0.82x, with a 5-year median of 1.35x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$24 price target reflects 0.82x trailing 12-month book value.

The table below shows summary valuation data for ACGL

| Valuation Multiples -ACGL | | | | | |
|---------------------------|---------------|-------|--------------|--------|---------|
| | | Stock | Sub-Industry | Sector | S&P 500 |
| P/B TTM | Current | 0.82 | 1.04 | 2.07 | 3.75 |
| | 5-Year High | 1.7 | 1.67 | 2.9 | 4.55 |
| | 5-Year Low | 0.82 | 0.93 | 1.71 | 2.84 |
| | 5-Year Median | 1.35 | 1.46 | 2.52 | 3.64 |
| P/S F12M | Current | 1.49 | 1.62 | 4.98 | 3.19 |
| | 5-Year High | 3.04 | 11.26 | 6.7 | 3.44 |
| | 5-Year Low | 1.42 | 1.6 | 4.98 | 2.54 |
| | 5-Year Median | 2.23 | 1.88 | 6.06 | 3.01 |
| P/E F12M | Current | 9.43 | 21.84 | 14.86 | 20.18 |
| | 5-Year High | 28.77 | 31.55 | 16.18 | 20.18 |
| | 5-Year Low | 7.67 | 21.07 | 11.24 | 15.19 |
| | 5-Year Median | 15.82 | 25.6 | 13.94 | 17.44 |

As of 05/01/2020

Industry Analysis Zacks Industry Rank: Top 49% (123 out of 253)



Top Peers

| Company (Ticker) | Rec | Rank |
|---|--------------|------|
| American Financial Group, Inc. (AFG) | Neutral | 3 |
| Axis Capital Holdings Limited (AXS) | Neutral | 3 |
| Chubb Limited (CB) | Neutral | 4 |
| Fidelity National Financial, Inc. (FNF) | Neutral | 3 |
| Market Corporation (MKL) | Neutral | 4 |
| Everest Re Group, Ltd. (RE) | Neutral | 3 |
| RLI Corp. (RLI) | Neutral | 3 |
| Alleghany Corporation (Y) | Underperform | 4 |

| Industry Comparison Industry: Insurance - Property And Casualty | | | | Industry Peers | | |
|---|-----------|------------|-----------|----------------|---------|--------------|
| | ACGL | X Industry | S&P 500 | AXS | RE | Y |
| Zacks Recommendation (Long Term) | Neutral | - | - | Neutral | Neutral | Underperform |
| Zacks Rank (Short Term) | 4 | - | - | 3 | 3 | 4 |
| VGM Score | B | - | - | F | C | B |
| Market Cap | 9.43 B | 1.22 B | 20.61 B | 2.93 B | 8.30 B | 7.27 B |
| # of Analysts | 3 | 2 | 14 | 2 | 3 | 2 |
| Dividend Yield | 0.00% | 1.26% | 2.11% | 4.70% | 3.76% | 0.00% |
| Value Score | D | - | - | C | C | C |
| Cash/Price | 0.17 | 0.26 | 0.06 | 0.55 | 0.14 | 0.28 |
| EV/EBITDA | 5.72 | 5.16 | 11.87 | 8.04 | 6.99 | 5.45 |
| PEG Ratio | 0.97 | 1.67 | 2.47 | NA | NA | NA |
| Price/Book (P/B) | 0.82 | 0.96 | 2.67 | 0.61 | 0.74 | 0.83 |
| Price/Cash Flow (P/CF) | 7.57 | 8.95 | 10.66 | 8.19 | 7.82 | 16.55 |
| P/E (F1) | 9.67 | 11.40 | 19.01 | 37.76 | 8.12 | 13.54 |
| Price/Sales (P/S) | 1.36 | 0.72 | 2.10 | 0.57 | 1.01 | 0.80 |
| Earnings Yield | 10.39% | 8.60% | 5.05% | 2.66% | 12.32% | 7.38% |
| Debt/Equity | 0.25 | 0.22 | 0.72 | 0.41 | 0.07 | 0.20 |
| Cash Flow (\$/share) | 3.17 | 3.12 | 7.01 | 4.47 | 22.15 | 32.24 |
| Growth Score | B | - | - | D | C | B |
| Hist. EPS Growth (3-5 yrs) | 11.92% | 3.05% | 10.88% | -22.01% | -22.54% | -18.81% |
| Proj. EPS Growth (F1/F0) | -15.01% | 5.40% | -7.32% | -63.29% | -4.75% | 57.45% |
| Curr. Cash Flow Growth | 21.44% | 5.61% | 5.92% | -8.72% | 310.65% | 25.33% |
| Hist. Cash Flow Growth (3-5 yrs) | 15.01% | 7.31% | 8.55% | -11.78% | -5.41% | -8.44% |
| Current Ratio | 0.56 | 0.44 | 1.23 | 0.57 | 0.33 | 0.33 |
| Debt/Capital | 19.06% | 18.73% | 43.84% | 26.09% | 6.49% | 18.22% |
| Net Margin | 23.47% | 7.57% | 11.08% | 6.25% | 12.31% | 9.49% |
| Return on Equity | 10.92% | 8.18% | 16.44% | 5.39% | 9.85% | 3.99% |
| Sales/Assets | 0.19 | 0.32 | 0.54 | 0.20 | 0.31 | 0.34 |
| Proj. Sales Growth (F1/F0) | -5.11% | 0.00% | -1.42% | -6.67% | 7.22% | 0.00% |
| Momentum Score | B | - | - | F | D | B |
| Daily Price Chg | -6.06% | -3.81% | -2.39% | -3.23% | -6.14% | -6.00% |
| 1 Week Price Chg | -12.93% | -3.88% | -1.74% | -12.20% | -13.01% | -6.01% |
| 4 Week Price Chg | -8.70% | 3.56% | 17.07% | 0.33% | -7.75% | 0.71% |
| 12 Week Price Chg | -47.92% | -22.23% | -18.53% | -43.96% | -38.27% | -35.01% |
| 52 Week Price Chg | -29.03% | -22.55% | -9.82% | -35.78% | -26.89% | -18.56% |
| 20 Day Average Volume | 2,150,758 | 137,204 | 2,641,413 | 952,771 | 345,492 | 51,370 |
| (F1) EPS Est 1 week change | 0.00% | 0.00% | 0.00% | -78.59% | -9.83% | 0.00% |
| (F1) EPS Est 4 week change | -19.71% | -6.22% | -6.62% | -81.97% | -14.20% | -8.05% |
| (F1) EPS Est 12 week change | -20.24% | -9.02% | -13.28% | -81.97% | -15.20% | -18.02% |
| (Q1) EPS Est Mthly Chg | -12.66% | -3.92% | -11.97% | -43.37% | -22.38% | -0.23% |

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

| | |
|----------------|---|
| Value Score | D |
| Growth Score | B |
| Momentum Score | B |
| VGM Score | B |

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

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