

Arch Capital Group(ACGL)

\$46.14 (As of 02/06/20)

Price Target (6-12 Months): **\$48.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 10/01/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: C

Growth: C

Momentum: D

Summary

Arch Capital's shares have outperformed the industry in the year's time. The company 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 money to pursue its growth initiatives as well as engage in share repurchases activity. 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.

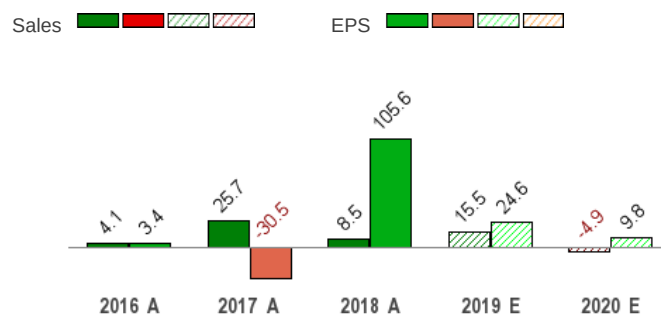
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$46.66 - \$29.95
20 Day Average Volume (sh)	1,415,027
Market Cap	\$18.7 B
YTD Price Change	7.6%
Beta	0.62
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Insurance - Property and Casualty
Zacks Industry Rank	Top 34% (87 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-3.1%
Last Sales Surprise	NA
EPS F1 Est- 4 week change	0.2%
Expected Report Date	02/11/2020
Earnings ESP	-1.1%
P/E TTM	18.2
P/E F1	15.3
PEG F1	1.5
P/S TTM	2.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020					6,370 E
2019	1,527 A	1,620 A	1,601 A		6,698 E
2018	1,362 A	1,476 A	1,434 A	1,527 A	5,798 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.73 E	\$0.76 E	\$0.70 E	\$0.78 E	\$3.01 E
2019	\$0.67 A	\$0.77 A	\$0.63 A	\$0.67 E	\$2.74 E
2018	\$0.56 A	\$0.59 A	\$0.59 A	\$0.46 A	\$2.20 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/06/2020. The reports text is as of 02/07/2020.

Overview

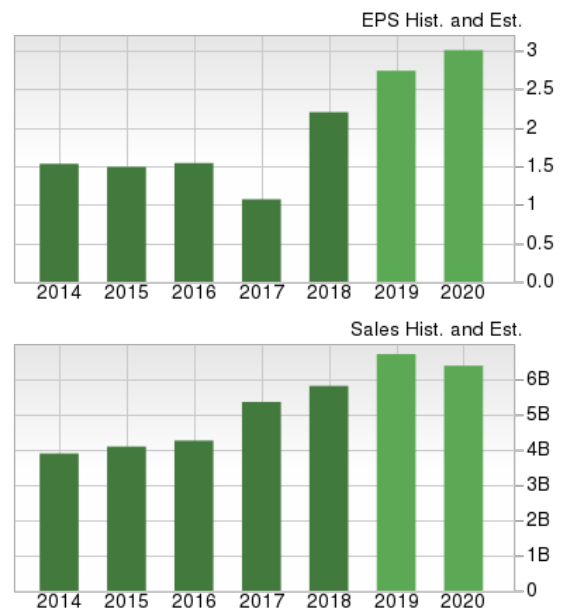
Established in 1995 and headquartered in Pembroke, Bermuda, Arch Capital Group Ltd. offers insurance, reinsurance and mortgage insurance across the world. Through its wholly owned subsidiaries, the property and casualty (P&C) insurer provides a wide range of products and services, which include primary 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% of 2018 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 (29%) 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 (21%) 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 outperformed the industry in the past year. 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 13.3% year over year in the first nine months of 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 the company 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. AIG United Guaranty Insurance (Asia) Limited buyout in 2017 has enhanced Arch's private mortgage insurance businesses, operating in the United States, Europe and Australia. We believe that the company will continue to boost its inorganic portfolio through such acquisitions, in turn accelerating its overall growth. Additionally, the United Guaranty Corporation buyout has helped the company to expand its mortgage insurance space and has also positively impacted the insurer's operational performance. In 2018, the company bought McNeil & Co. to enhance its underwriting skill. The company recently 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 the first nine months of 2019, with net investment income increasing nearly 16.5% from the corresponding period of 2018, primarily driven by growth in fixed maturities, term loans, 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.
 - ▲ **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. Also, debt to total capital ratio was 13.5% on Sep 30, 2019, improving 200 bps from 2018-end.
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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 11% year over year, while combined ratio remained flat. 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, as well as corporate expenses. The company's operating expenses witnessed an increase of 10.9% in the last five years. The trend continued through the first nine months of 2019, with the metric rising 9.8% 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 Q3 Earnings Miss Estimates, Rise Y/Y

Arch Capital Group Ltd. reported third-quarter 2019 operating income per share of 63 cents, which missed the Zacks Consensus Estimate by 3.1%. However, the bottom line improved 6.8%.

The year-over-year increase in earnings was due to higher premiums and net investment income as well as decrease in interest expense.

Behind the Headlines

Gross premiums written increased 26% year over year to \$2.2 billion, largely fueled by higher premiums written across its Insurance, Reinsurance and Mortgage segments.

Net investment income was up 12.1% year over year to \$161.5 million, driven by an increase in average investable assets.

Operating revenues of \$1.7 billion increased 20% year over year on the back of higher premiums earned, net investment income and other income.

Interest expense was \$31.3 million, up nearly 5.4% year over year.

Total expense of \$1.2 billion increased 11% year over year on higher losses and loss adjustment expenses, acquisition expenses, other operating expenses, interest expense and corporate expenses.

Arch Capital's underwriting income came in at \$235.7 million, up 0.4% year over year. Combined ratio deteriorated 210 basis points (bps) to 82.2%.

Segment Results

Insurance: Gross premiums written increased 20.2% year over year to \$1 billion. Net premiums written rose 22% year over year to \$703.8 million driven by the acquisition of U.K. commercial lines book of business, growth in existing accounts and rate increase in most lines of business.

Underwriting loss was \$24.1 million in the third quarter, compared with underwriting loss of \$26.7 million in the year-ago quarter. Combined ratio deteriorated 80 bps to 104%.

Reinsurance: Gross premiums written rose 52.2% year over year to \$662.6 million, reflecting new business opportunities in casualty and property lines. It is partially offset by a decline in other specialty business due to reductions in motor and agriculture business.

The segment sustained underwriting loss of \$2.7 million in contrast to underwriting gain of \$30.9 million in the year-ago quarter. Combined ratio improved 1040 bps year over year to 100.3%.

Mortgage: Gross premiums written increased 7% year over year to \$375.1 million. Underwriting income increased 13.8% to \$262.5 million. Combined ratio remained unchanged year over year at 24.6%. Arch MI U.S. generated \$25.3 billion of new insurance written, which increased 18.2% year over year.

Financial Update

Arch Capital exited the quarter with cash of \$880 million, up 35% year over year. Debt was \$1.7 billion, down 7% year over year.

As of Sep 30, 2019, book value per share was \$25.61, up 3.9% year over year.

Operating return on equity was 10.3% in the third quarter, down 110 basis points.

Net cash provided by operating activities was \$830.6 million, up 33.1% year over year.

Quarter Ending 09/2019

Report Date	Oct 29, 2019
Sales Surprise	NA
EPS Surprise	-3.08%
Quarterly EPS	0.63
Annual EPS (TTM)	2.53

Recent News

Arch Capital Acquires Barbican Group – Nov 29, 2019

Arch Capital has acquired Barbican group holdings limited, which includes Barbican's associated entities. The acquisition enhances Arch's commitment to both Lloyd's and the London market and provides its brokers and clients with more access to its Insurance and Reinsurance platforms.

Arch Capital's Rating Reiterated by AM Best – Oct 17, 2019

AM Best has affirmed the Long-Term Issuer Credit Rating (Long-Term ICR) of "a-" and the Long-Term Issue Credit Ratings (Long-Term IRs) of Arch Capital Group. Concurrently, affirmed the Financial Strength Rating (FSR) of A+ (Superior) and the Long-Term ICR of "aa-" of Arch Reinsurance Ltd. and its strategic affiliates. The outlook of these Credit Ratings (ratings) is stable.

Valuation

Arch Capital shares are up 52.2% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry and the Zacks Finance sector are up 14.9% and 10.9%, respectively.

The S&P 500 index are up 22.6% in the past year.

The stock is currently trading at 1.67X trailing 12-month book value, which compares to 1.46X for the Zacks sub-industry, 2.84X for the Zacks sector and 4.56X for the S&P 500 index.

Over the past five years, the stock has traded as high as 1.67X and as low as 1.06X, with a 5-year median of 1.34X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$48 price target reflects 1.73X 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	1.67	1.46	2.84	4.56
	5-Year High	1.67	1.67	2.89	4.56
	5-Year Low	1.06	1.26	1.83	2.85
	5-Year Median	1.34	1.47	2.51	3.62
P/S F12M	Current	2.92	1.67	6.53	3.55
	5-Year High	2.92	11.26	6.61	3.55
	5-Year Low	1.68	1.55	5.39	2.54
	5-Year Median	2.22	1.91	6.04	3
P/E F12M	Current	15.27	27.05	14.94	19.17
	5-Year High	28.77	31.55	16.21	19.34
	5-Year Low	10.18	22.77	12.01	15.18
	5-Year Median	15.88	25.79	14.07	17.46

As of 02/06/2020

Industry Analysis Zacks Industry Rank: Top 34% (87 out of 255)



Top Peers

Markel Corporation (MKL)	Outperform
RLI Corp. (RLI)	Outperform
American Financial Group, Inc. (AFG)	Neutral
Axis Capital Holdings Limited (AXS)	Neutral
Chubb Limited (CB)	Neutral
Fidelity National Financial, Inc. (FNF)	Neutral
Everest Re Group, Ltd. (RE)	Neutral
Alleghany Corporation (Y)	Neutral

Industry Comparison Industry: Insurance - Property And Casualty				Industry Peers		
	ACGL Neutral	X Industry	S&P 500	AXS Neutral	RE Neutral	Y Neutral
VGM Score	C	-	-	B	B	D
Market Cap	18.70 B	1.74 B	24.40 B	5.48 B	11.44 B	11.82 B
# of Analysts	4	2	13	3	3	2
Dividend Yield	0.00%	0.99%	1.75%	2.51%	2.21%	0.00%
Value Score	C	-	-	C	C	D
Cash/Price	0.26	0.18	0.04	0.22	0.10	0.16
EV/EBITDA	16.60	9.66	14.17	23.17	-65.57	45.21
PEG Ratio	1.53	1.73	2.05	2.55	1.17	NA
Price/Book (P/B)	1.66	1.23	3.31	1.14	1.27	1.34
Price/Cash Flow (P/CF)	17.63	14.48	13.63	13.29	51.82	32.90
P/E (F1)	15.32	14.23	19.08	12.73	11.70	17.99
Price/Sales (P/S)	2.86	1.06	2.67	1.06	1.46	1.48
Earnings Yield	6.52%	6.88%	5.24%	7.85%	8.55%	5.56%
Debt/Equity	0.26	0.21	0.71	0.33	0.07	0.19
Cash Flow (\$/share)	2.62	3.05	6.89	4.91	5.41	24.96
Growth Score	C	-	-	B	B	B
Hist. EPS Growth (3-5 yrs)	8.71%	-0.55%	10.80%	-22.01%	-26.70%	-22.88%
Proj. EPS Growth (F1/F0)	9.77%	12.38%	7.23%	103.57%	18.49%	18.40%
Curr. Cash Flow Growth	84.88%	9.94%	9.51%	-541.78%	-47.78%	122.47%
Hist. Cash Flow Growth (3-5 yrs)	11.39%	7.23%	8.55%	-13.32%	-27.90%	-13.07%
Current Ratio	0.69	0.44	1.20	0.55	0.35	0.32
Debt/Capital	20.08%	18.09%	42.90%	22.20%	6.59%	17.53%
Net Margin	21.97%	5.43%	11.76%	6.25%	5.30%	1.43%
Return on Equity	10.31%	6.81%	16.98%	5.40%	5.90%	4.36%
Sales/Assets	0.19	0.31	0.54	0.20	0.30	0.31
Proj. Sales Growth (F1/F0)	-4.89%	4.13%	4.15%	1.70%	8.92%	NA
Momentum Score	D	-	-	B	B	F
Daily Price Chg	0.92%	0.00%	-0.11%	-0.74%	-1.01%	0.19%
1 Week Price Chg	-1.84%	-1.09%	-2.60%	3.51%	-0.28%	-0.89%
4 Week Price Chg	5.83%	1.42%	1.51%	8.31%	1.52%	2.39%
12 Week Price Chg	13.49%	3.00%	5.63%	11.24%	4.45%	4.75%
52 Week Price Chg	51.93%	7.68%	17.01%	18.02%	26.05%	27.85%
20 Day Average Volume	1,415,027	93,795	1,961,054	508,246	265,405	48,533
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	2.81%	-0.22%	0.00%
(F1) EPS Est 4 week change	0.17%	0.00%	-0.00%	2.12%	-0.43%	-0.16%
(F1) EPS Est 12 week change	-0.23%	0.00%	-0.16%	-0.73%	0.93%	0.94%
(Q1) EPS Est Mthly Chg	7.35%	0.00%	0.00%	1.37%	-0.10%	5.44%

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	C
Growth Score	C
Momentum Score	D
VGM Score	C

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.

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