

Arch Capital Group(ACGL)

\$48.18 (As of 02/19/20)

Price Target (6-12 Months): **\$51.00**

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: B

Momentum: D

Summary

Arch Capital Group's operating income of 74 cents per share beat the Zacks Consensus Estimate by 10.5% and improved 60.9% year over year. Its shares have outperformed the industry in a 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 capital to pursue growth initiatives as well as engage in share repurchases activity. However, exposure to catastrophe loss induces volatility in underwriting results. Also, high costs tend to weigh on margin expansion.

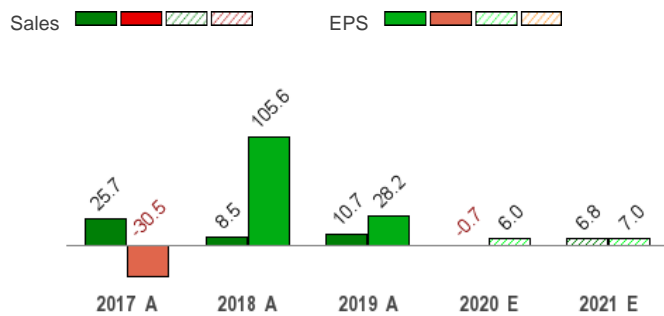
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$48.32 - \$31.53
20 Day Average Volume (sh)	1,464,561
Market Cap	\$19.5 B
YTD Price Change	12.3%
Beta	0.62
Dividend / Div Yld	\$0.00 / 0.0%
Industry	<u>Insurance - Property and Casualty</u>
Zacks Industry Rank	Top 44% (111 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	10.5%
Last Sales Surprise	NA
EPS F1 Est- 4 week change	-0.5%
Expected Report Date	05/05/2020
Earnings ESP	3.2%
P/E TTM	17.2
P/E F1	16.1
PEG F1	1.6
P/S TTM	2.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					6,804 E
2020					6,370 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	\$0.79 E	\$0.83 E	\$0.71 E	\$0.83 E	\$3.20 E
2020	\$0.75 E	\$0.77 E	\$0.68 E	\$0.74 E	\$2.99 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.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/19/2020. The reports text is as of 02/20/2020.

Overview

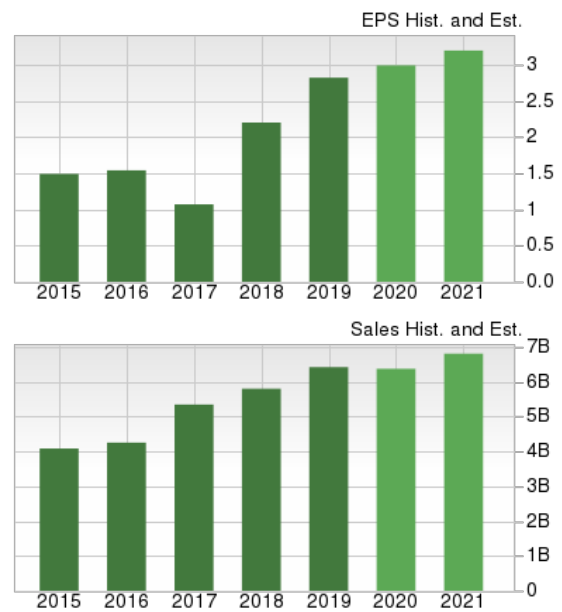
Established in 1995 and headquartered in Pembroke, Bermuda, Arch Capital Group Ltd. offers insurance, reinsurance and mortgage insurance across the world. Through its wholly owned subsidiaries, the property and casualty (P&C) insurer provides a wide range of products and services, which include primary 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 gained 49.2% in a year's time, outperforming the industry's increase of 10.8%. 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.

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.
- ▲ **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 13.1% as of Dec 31, 2019, improving 240 bps from 2018-end.

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.

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 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 49.2% over the trailing 12-month period. Over the past year, stocks in the Zacks sub-industry and the Zacks Finance sector are up 12.2% and 8.8%, respectively.

The S&P 500 index are up 21.3% in the past year.

The stock is currently trading at 1.74X trailing 12-month book value, which compares to 1.45X for the Zacks sub-industry, 2.85X for the Zacks sector and 4.68X for the S&P 500 index.

Over the past five years, the stock has traded as high as 1.74X and as low as 1.06X, with a 5-year median of 1.35X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$51 price target reflects 1.84X 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	1.74	1.45	2.85	4.68
	5-Year High	1.74	1.67	2.89	4.68
	5-Year Low	1.06	1.26	1.83	2.85
	5-Year Median	1.35	1.47	2.51	3.62
P/S F12M	Current	3.04	1.71	6.55	3.59
	5-Year High	3.04	11.26	6.65	3.59
	5-Year Low	1.68	1.55	5.39	2.54
	5-Year Median	2.22	1.89	6.04	3
P/E F12M	Current	15.96	27	14.98	19.39
	5-Year High	28.77	31.55	16.21	19.39
	5-Year Low	10.18	22.77	12.01	15.18
	5-Year Median	15.88	25.9	14.15	17.47

As of 02/19/2020

Industry Analysis Zacks Industry Rank: Top 44% (111 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	19.53 B	1.76 B	24.59 B	5.31 B	11.85 B	12.08 B
# of Analysts	4	2	13	3	2	1
Dividend Yield	0.00%	0.97%	1.78%	2.59%	2.13%	0.00%
Value Score	C	-	-	B	C	F
Cash/Price	0.24	0.18	0.04	0.23	0.10	0.16
EV/EBITDA	17.38	9.32	14.21	22.57	9.69	46.23
PEG Ratio	1.61	1.77	2.09	2.47	1.19	NA
Price/Book (P/B)	1.74	1.26	3.28	1.10	1.30	1.37
Price/Cash Flow (P/CF)	18.41	13.42	13.59	12.87	13.12	33.63
P/E (F1)	16.08	14.08	19.17	12.33	11.86	18.23
Price/Sales (P/S)	2.82	1.06	2.68	1.03	1.44	1.34
Earnings Yield	6.21%	6.98%	5.18%	8.11%	8.43%	5.49%
Debt/Equity	0.26	0.21	0.70	0.33	0.07	0.19
Cash Flow (\$/share)	2.62	3.27	6.93	4.91	22.15	24.96
Growth Score	B	-	-	C	C	D
Hist. EPS Growth (3-5 yrs)	11.92%	2.32%	10.84%	-22.01%	-22.54%	-22.88%
Proj. EPS Growth (F1/F0)	6.03%	12.84%	7.00%	103.57%	14.85%	93.73%
Curr. Cash Flow Growth	84.88%	19.96%	7.81%	-541.78%	310.65%	122.47%
Hist. Cash Flow Growth (3-5 yrs)	11.39%	7.23%	8.25%	-13.32%	-5.41%	-13.07%
Current Ratio	0.69	0.44	1.24	0.55	0.31	0.32
Debt/Capital	20.08%	17.99%	42.37%	22.20%	6.49%	17.53%
Net Margin	23.47%	8.34%	11.69%	6.25%	12.31%	9.49%
Return on Equity	11.11%	7.74%	16.86%	5.40%	9.85%	4.01%
Sales/Assets	0.20	0.32	0.55	0.20	0.31	0.34
Proj. Sales Growth (F1/F0)	-0.72%	3.86%	4.05%	1.70%	10.22%	0.00%
Momentum Score	D	-	-	A	A	A
Daily Price Chg	0.61%	0.00%	0.38%	-0.25%	0.27%	0.40%
1 Week Price Chg	3.32%	0.21%	1.65%	-1.50%	3.11%	0.69%
4 Week Price Chg	5.94%	-0.22%	0.86%	1.22%	3.41%	4.02%
12 Week Price Chg	14.09%	1.72%	4.56%	6.48%	6.53%	5.82%
52 Week Price Chg	49.16%	3.34%	14.15%	10.19%	31.10%	28.99%
20 Day Average Volume	1,464,561	78,233	1,989,235	479,308	254,064	43,998
(F1) EPS Est 1 week change	-1.24%	0.00%	0.00%	0.00%	0.12%	0.88%
(F1) EPS Est 4 week change	-0.50%	0.00%	-0.03%	2.53%	2.03%	0.88%
(F1) EPS Est 12 week change	-0.33%	0.00%	-0.21%	1.79%	1.81%	1.82%
(Q1) EPS Est Mthly Chg	3.08%	0.00%	-0.40%	1.37%	4.87%	0.00%

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	B
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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