

Arch Capital Group(ACGL)

\$30.90 (As of 08/21/20)

Price Target (6-12 Months): **\$32.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 06/15/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: B

Growth: D

Momentum: A

Summary

Arch Capital boasts a strong product portfolio and has been maintaining an exemplary track record of premium growth. This apart, it has been diversifying its Mortgage Insurance business via strategic acquisitions that also complement the company's strength in the specialty insurance and reinsurance businesses. Robust capital position shields it from market volatility. It expects the pre-tax underwriting results of mortgage segment to remain positive for the remainder of 2020. Moreover, it effectively deploys capital to pursue growth initiatives and engage in share repurchases activity. Its shares have underperformed the industry in a year's time. However, exposure to cat loss induces earnings volatility. High cost tends to weigh on its margin. Its earnings of 4 cents beat the Zacks Consensus Estimate but plunged 95% year over year.

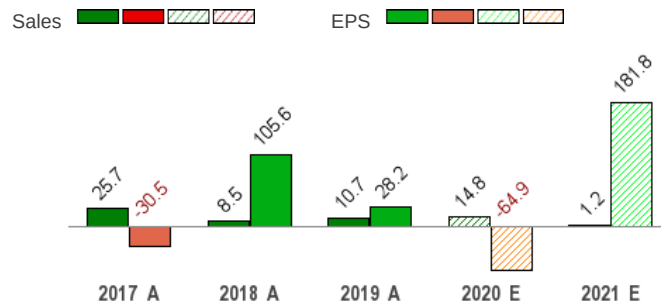
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$48.32 - \$20.93
20 Day Average Volume (sh)	1,373,672
Market Cap	\$12.5 B
YTD Price Change	-28.0%
Beta	0.76
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Insurance - Property and Casualty
Zacks Industry Rank	Top 48% (121 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	115.4%
Last Sales Surprise	NA
EPS F1 Est- 4 week change	84.5%
Expected Report Date	NA
Earnings ESP	0.0%
P/E TTM	16.5
P/E F1	31.2
PEG F1	3.1
P/S TTM	1.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					7,450 E
2020	1,898 A	1,794 A			7,364 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	\$0.63 E	\$0.72 E	\$0.64 E	\$0.72 E	\$2.79 E
2020	\$0.46 A	\$0.04 A	\$0.11 E	\$0.28 E	\$0.99 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 08/21/2020. The reports text is as of 08/24/2020.

Overview

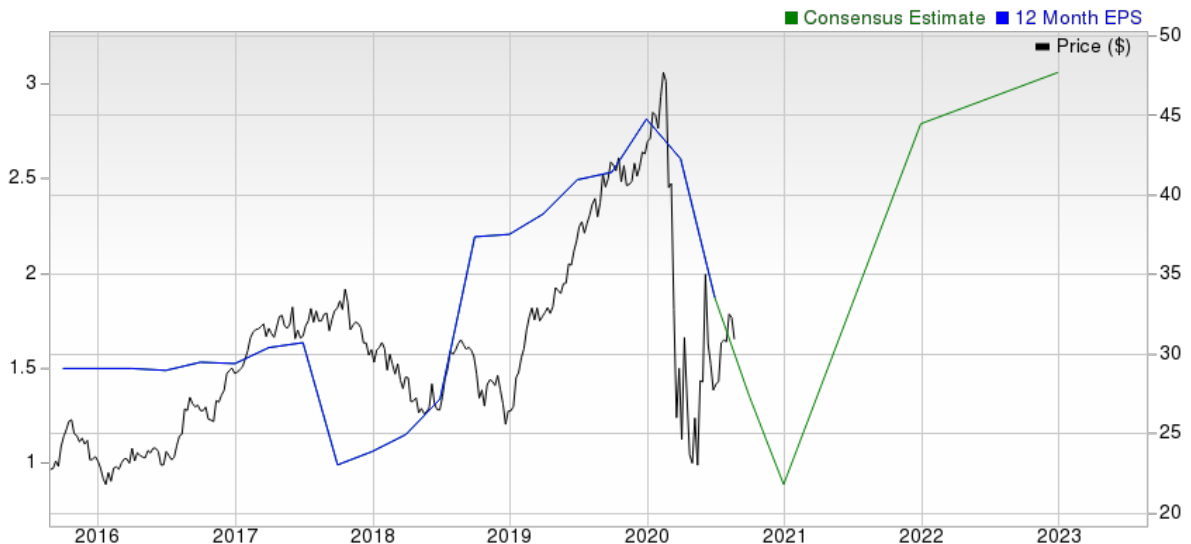
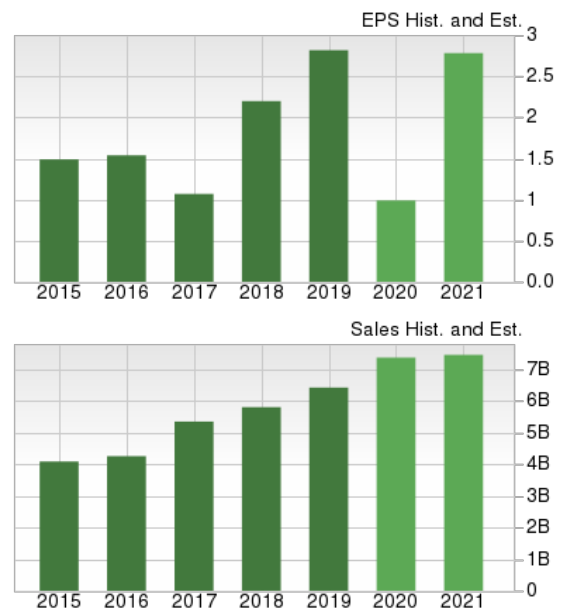
Established in 1995 and headquartered in Pembroke, Bermuda, Arch Capital Group Ltd. offers insurance, reinsurance and mortgage insurance across the world. Through its wholly owned subsidiaries, the property and casualty (P&C) insurer provides a wide range of products and services, which include primary 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 20.8% in the past year against the industry's decline of 2.5%. Nevertheless, solid fundamentals should help the shares bounce back.

▲ **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 29.9% year over year to \$3.5 billion in the first half of 2020 on the back of higher premiums across the Insurance, Reinsurance and Mortgage segments. We expect to the momentum to retain given new business opportunities, rate increases and growth in existing accounts.

▲ **Inorganic Growth:** Arch Capital 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. The company acquired Barbican Group Holdings in November 2019. In February of this year, Arch Capital has inked a deal with France-based corporate and investment bank Natixis to buy 29.5% stake in trade-credit insurance firm Coface. Valued at around \$520 million, the deal is in line with the company's efforts to develop uncorrelated sources of underwriting income.

▲ **Investment Results:** Net investment income increased at a CAGR of 15.7% in the last five years (2014-2019). However, in the first half of 2020, the same slumped 11.3% year over year to \$276.6 million due to lower yields available in the financial market. The current low interest rate environment is likely to keep investment yields under pressure, which would consequently weigh on its overall investment income. Nevertheless, growth in invested assets, higher level of income on fund investments, reinvestment of fixed income securities at higher available yields and the shift from municipal bonds to corporates are likely to drive the momentum in the near term.

▲ **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 12.1% year over year to \$27.62 in first-quarter 2020. It has a solid cash balance of \$854.3 million, which improved 17.6% from 2019-end level. However, long-term debt to capital of 23.7% compares unfavorably with the industry's measure of 21.3%. Times interest earned, a measure to identify the company ability to service debt, stands at 10.6%, which compares favorably with the industry's figure of 8.4%. 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.

The company engages in several shareholder-friendly moves courtesy of its sound capital position. Though the company had \$924.5 million remaining under its authorization it does not intend to buyback any in 2020.

Arch Capital is set to grow from premium growth, strategic buyouts, and robust capital and liquidity position shielding it from market volatility and enabling it to retain its financial flexibility.

Reasons To Sell:

- ▼ **Exposure to Catastrophe Loss:** Being a P&C insurer, Arch Capital remains exposed to catastrophe loss rendering substantial volatility to the insurer's underwriting results. In the first half of 2020, the company incurred catastrophe losses of \$259.7 million on account of the COVID-19 pandemic across the property casualty segments. Underwriting income plunged 74% year over year in the first half of 2020 to \$146.6 million while combined ratio deteriorated 1740 bps year over year to 95.8%.

However, for the U.S. mortgage insurance business, the company expects pretax underwriting income for the remainder of 2020 to remain positive with a combined ratio in the 70% to 80% range, slightly better than the result reported in second quarter.

- ▼ **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 first half of 2020, with the metric rising 39.6% year over year to \$3.4 billion. 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. In the second quarter, net margin contracted 380 bps sequentially and 450 bps year over year. Therefore, the company should strive for higher revenue growth rate than increase in expenses

- ▼ **Return on Assets:** The company's return on assets of 2.1% is lower than the industry's average of 3%. Return on assets is a profitability ratio denoting how effectively the company is deploying its assets to generate profit.
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Arch Capital's exposure to catastrophe loss inducing underwriting volatility and deteriorating combined ratio and escalating operating expenses weighing on margin expansion are headwinds.

Last Earnings Report

Arch Capital Q2 Earnings Top, Fall Y/Y on Segment Loss

Arch Capital Group Ltd. reported second-quarter 2020 operating income per share of 4 cents in contrast to the Zacks Consensus Estimate of a loss of 26 cents. However, the bottom line dropped about 95% year over year.

The quarter results reflect improved premiums. However, catastrophic losses including COVID-19 related losses were a drag on results.

Quarter Ending 06/2020

Report Date	Jul 29, 2020
Sales Surprise	NA
EPS Surprise	115.38%
Quarterly EPS	0.04
Annual EPS (TTM)	1.87

Behind the Headlines

Gross premiums written increased 19.6% year over year to \$2.3 billion, largely fueled by higher premiums written across its Insurance, Reinsurance and Mortgage segments.

Net investment income decreased 15.2% year over year to \$131.5 million.
Operating revenues of \$1.8 billion increased 10.7% year over year.

Total expense of \$1.8 billion increased 44.1% year over year on higher losses and loss adjustment expenses, acquisition expenses, other operating expenses, interest expense and forex.

Pre-tax current accident year catastrophic losses, net of reinsurance and reinstatement premiums were \$207.2 million, including \$173.1 million of COVID-19 related losses.

Arch Capital's underwriting loss was \$22.9 million against underwriting profit of \$293.1 million in the year-ago quarter. Combined ratio deteriorated 2140 basis points (bps) to 101.8%.

Segment Results

Insurance: Gross premiums written increased 12% year over year to \$1 billion driven by increases in property, energy, marine and aviation and professional lines, due in part to new business opportunities, rate increases and growth in existing accounts. Decrease in travel business, primarily due to the ongoing impact of the COVID-19 pandemic, was a partial offset.

Underwriting loss was \$56.7 million against \$2.6 million profit in the year-ago quarter. Combined ratio deteriorated 870 bps to 108.3%.

Reinsurance: Gross premiums written rose 47.9% year over year to \$807.1 million driven by increases in property lines, due in part to new business and rate increases.

Underwriting loss was \$33.1 million against \$36.7 million profit in the year-ago quarter. Combined ratio deteriorated 1650 bps year over year to 106.8%.

Mortgage: Gross premiums written increased 1.3% year over year to \$369.1 million. Underwriting income dropped 70.4% to \$76.4 million. Combined ratio deteriorated 5290 bps year over year to 80.9%. Arch MI U.S. generated \$24.6 billion of new insurance written.

Financial Update

Arch Capital exited the quarter with cash of \$854.3 million, up 41.1% year over year. Debt was \$2.9 billion, up 54.6% year over year.

As of Jun 30, 2020, book value per share was \$27.62, up 12.1% year over year.

Operating return on equity was 0.6% in the second quarter, down 1250 basis points.

Net cash provided by operating activities was \$711.1 million, up 49% year over year.

Recent News

Arch Capital Provides Q2 Catastrophe Loss Estimates - Jul 15, 2020

Arch Capital Group now estimates second quarter pre-tax net catastrophe losses in the range of \$205 million to \$225 million across its property casualty insurance and reinsurance segments, net of reinsurance recoveries and reinstatement premiums. The expected loss could be due to the company's exposure to the COVID-19 pandemic, civil unrest claims across the United States and other catastrophic events in the second quarter.

Valuation

Arch Capital shares are down 27.9% in the year-to-date period and 20.8% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 10.8% and 17.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 2.5% and 7.1%, respectively.

The S&P 500 index are up 5.4% in the year-to-date period and 18.3% in the past year.

The stock is currently trading at 1.05x trailing 12-month book value, which compares to 1.24x for the Zacks sub-industry, 2.45x 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 1.70x 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 \$32 price target reflects 1.08x 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	1.05	1.24	2.45	4.56
	5-Year High	1.70	1.67	2.91	4.56
	5-Year Low	0.82	0.93	1.72	2.83
	5-Year Median	1.35	1.45	2.53	3.75
P/S F12M	Current	1.69	1.7	6.22	3.71
	5-Year High	3.04	11.26	6.67	3.71
	5-Year Low	1.42	1.39	4.97	2.53
	5-Year Median	2.23	1.84	6.06	3.05
P/E F12M	Current	14.37	25.07	16.4	22.85
	5-Year High	28.77	31.55	16.4	22.85
	5-Year Low	7.67	21.01	11.6	15.25
	5-Year Median	15.87	25.42	14.26	17.58

As of 08/21/2020

Industry Analysis Zacks Industry Rank: Top 48% (121 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
American Financial Group, Inc. (AFG)	Outperform	3
Fidelity National Financial, Inc. (FNF)	Outperform	1
RLI Corp. (RLI)	Outperform	2
Axis Capital Holdings Limited (AXS)	Neutral	4
Chubb Limited (CB)	Neutral	3
Markel Corporation (MKL)	Neutral	3
Everest Re Group, Ltd. (RE)	Neutral	3
Alleghany Corporation (Y)	Neutral	2

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	Neutral
Zacks Rank (Short Term)	3	-	-	4	3	2
VGM Score	B	-	-	C	B	C
Market Cap	12.54 B	1.26 B	23.62 B	3.79 B	8.55 B	7.71 B
# of Analysts	4	2	14	3	3	1
Dividend Yield	0.00%	1.30%	1.65%	3.64%	2.90%	0.00%
Value Score	B	-	-	C	A	B
Cash/Price	0.24	0.27	0.07	0.43	0.20	0.35
EV/EBITDA	6.89	5.18	13.29	8.55	6.36	5.18
PEG Ratio	3.19	1.97	3.03	23.08	1.65	NA
Price/Book (P/B)	1.05	0.93	3.11	0.80	0.92	0.91
Price/Cash Flow (P/CF)	9.74	10.35	12.69	10.08	9.65	16.70
P/E (F1)	31.86	13.80	21.51	115.41	17.13	70.41
Price/Sales (P/S)	1.73	0.80	2.43	0.77	1.01	0.94
Earnings Yield	3.20%	5.87%	4.46%	0.87%	5.84%	1.42%
Debt/Equity	0.33	0.24	0.76	0.38	0.07	0.24
Cash Flow (\$/share)	3.17	3.12	6.93	4.47	22.15	32.24
Growth Score	D	-	-	B	C	D
Hist. EPS Growth (3-5 yrs)	14.06%	3.85%	10.44%	-22.66%	-15.88%	-17.29%
Proj. EPS Growth (F1/F0)	-64.89%	-3.84%	-5.53%	-84.52%	-41.52%	-67.82%
Curr. Cash Flow Growth	21.44%	3.77%	5.20%	-8.72%	310.65%	25.33%
Hist. Cash Flow Growth (3-5 yrs)	15.01%	4.81%	8.52%	-11.78%	-5.41%	-8.44%
Current Ratio	0.61	0.43	1.33	0.59	0.36	0.37
Debt/Capital	24.00%	20.03%	44.50%	25.37%	6.27%	20.99%
Net Margin	15.88%	5.15%	10.13%	-0.41%	6.24%	-0.76%
Return on Equity	6.97%	6.81%	14.67%	-1.85%	5.74%	1.32%
Sales/Assets	0.19	0.31	0.51	0.19	0.31	0.31
Proj. Sales Growth (F1/F0)	14.76%	0.00%	-1.54%	-6.60%	11.21%	0.00%
Momentum Score	A	-	-	D	C	C
Daily Price Chg	-1.59%	-0.36%	-0.15%	-1.12%	-1.18%	0.94%
1 Week Price Chg	-0.74%	0.07%	1.09%	4.33%	-2.98%	1.86%
4 Week Price Chg	-0.93%	1.34%	1.64%	8.75%	-4.15%	1.07%
12 Week Price Chg	6.40%	5.00%	6.72%	15.23%	4.55%	1.96%
52 Week Price Chg	-21.91%	-13.56%	1.00%	-31.16%	-14.08%	-28.56%
20 Day Average Volume	1,373,672	134,397	1,873,576	1,069,059	248,417	56,573
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	84.47%	2.35%	1.79%	-5.65%	-12.11%	31.90%
(F1) EPS Est 12 week change	15.56%	-0.52%	3.35%	-59.59%	-21.59%	-73.85%
(Q1) EPS Est Mthly Chg	135.71%	3.56%	0.42%	-18.52%	-53.50%	-53.37%

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	B
Growth Score	D
Momentum Score	A
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.

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