

American Financial(AFG)

\$65.92 (As of 08/07/20)

Price Target (6-12 Months): **\$76.00**

Long Term: 6-12 Months

Zacks Recommendation:

Outperform

(Since: 08/07/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

1-Strong Buy

Zacks Style Scores:

VGM:C

Value: B

Growth: D

Momentum: C

Summary

American Financial's consistent price increase in property and casualty business should favor results. It boasts impressive inorganic growth and is prudently investing in businesses. American Financial is actively involved in startups, small-to-medium sized acquisitions, and product launches. Better industry fundamentals, a high renewal ratio, and favorable combined ratio should drive growth. Solid capital position enables it to deploy capital effectively. The company expects earnings per share in the range of \$6.60-\$7.40 in 2020. Shares of American Financial have underperformed its industry in the past year. However, soft performance of Annuity business continues to weigh on earnings. Also, exposure to weather-related calamities induces earnings volatility and high cost weighs on margin. The second-quarter bottom line missed estimates.

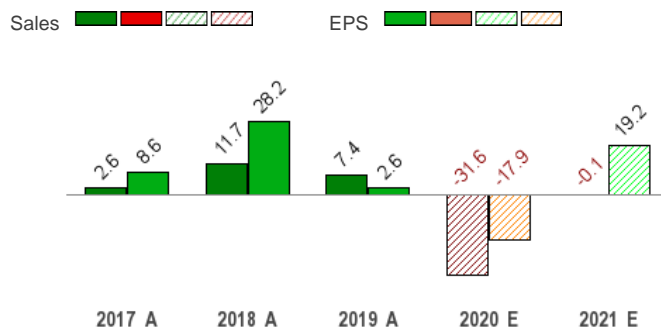
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$115.03 - \$44.01
20 Day Average Volume (sh)	448,726
Market Cap	\$5.9 B
YTD Price Change	-39.9%
Beta	0.82
Dividend / Div Yld	\$1.80 / 2.7%
Industry	Insurance - Property and Casualty
Zacks Industry Rank	Top 41% (103 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-36.8%
Last Sales Surprise	26.0%
EPS F1 Est- 4 week change	2.0%
Expected Report Date	NA
Earnings ESP	-4.5%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,299 E	1,308 E	1,327 E	1,339 E	5,273 E
2020	1,810 A	1,703 A	1,374 E	1,313 E	5,276 E
2019	1,771 A	1,836 A	2,088 A	2,016 A	7,711 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.35 E	\$2.20 E	\$2.02 E	\$2.60 E	\$8.44 E
2020	\$1.88 A	\$1.05 A	\$1.55 E	\$2.19 E	\$7.08 E
2019	\$2.02 A	\$2.12 A	\$2.25 A	\$2.22 A	\$8.62 A

*Quarterly figures may not add up to annual.

P/E TTM	8.9
P/E F1	9.3
PEG F1	1.5
P/S TTM	0.8

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/07/2020. The reports text is as of 08/10/2020.

Overview

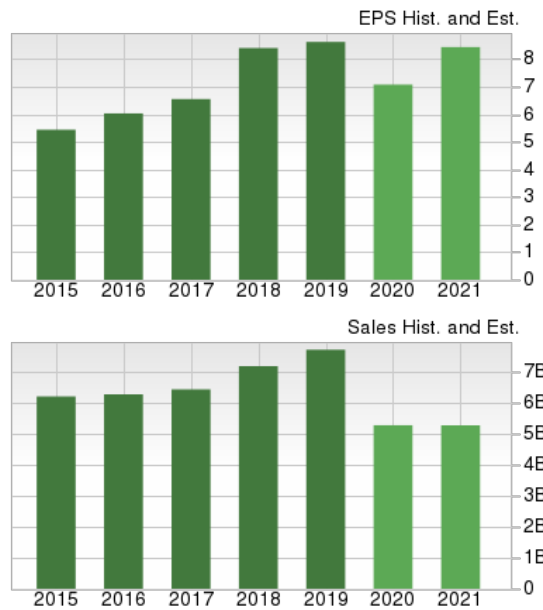
Founded in 1872 and headquartered in Cincinnati, OH, American Financial Group, Inc. is a holding company which, through its subsidiaries, engages primarily in property and casualty insurance, with focus on specialized commercial products for businesses. The company also engages in the sale of traditional fixed, fixed-indexed and variable-indexed annuities in the retail, financial institutions, registered investment advisor and education markets.

American Financial Group reports its earnings in three segments:

Property and Casualty Insurance Operations – These operations consist of approximately 30 niche insurance businesses offering a wide range of commercial coverage. The business is conducted through Property and Transportation (consisting Inland and Ocean Marine, Agricultural-related and Commercial Automobile), Specialty Casualty (consisting Executive and Professional Liability, Umbrella and Excess Liability, Excess and Surplus, General Liability, Targeted Programs and Workers' Compensation) and Specialty Financial (consisting Fidelity and Surety and Lease and Loan Services). These operations are conducted through subsidiaries namely Great American Insurance, National Interstate, Summit (Bridgefield Casualty and Bridgefield Employers), Republic Indemnity, Neon Lloyd's Syndicate and Mid-Continent Casualty. These subsidiaries carry strong ratings from AM Best and S&P.

Annuity Operations – Annuity operations primarily involve the sale of traditional fixed, fixed-indexed and variable-indexed annuities in the retail, financial institutions, broker-dealer and registered investment advisor markets through independent producers and through direct relationships with certain financial institutions. These operations are conducted primarily through the subsidiaries, Great American Life Insurance Company and Annuity Investors Life Insurance Company.

Other Operations – Through subsidiaries, it is engaged in a variety of other operations, including commercial real estate operations in Cincinnati (office buildings), Whitefield, New Hampshire (Mountain View Grand Resort), Chesapeake Bay (Skipjack Cove Yachting Resort and Bay Bridge Marina), Charleston (Charleston Harbor Resort and Marina) and Palm Beach (Sailfish Marina and Resort).



Reasons To Buy:

- ▲ **Share Price Movement:** Shares of American Financial have lost 35.2% in a year, compared with the industry's increase of 0.6%. We believe that acquisitions, better pricing and improving industry fundamentals will help the shares bounce back.
- ▲ **Sturdy Growth Profile:** American Financial is actively involved in startups, small-to-medium sized acquisitions, and product launches. It is prudently investing in businesses. Though net premiums written declined 5.1% year over year in the first half of 2020 in the Specialty Property and Casualty Insurance segment, the company expects decline in 2020 net premiums written to improve. It now estimates Specialty Property and Casualty Insurance net premiums written to decline in the range of 5-11%, an improvement from 8-14% decline estimated earlier.

American Financial, a niche player in the P&C and annuity markets, will benefit from the strategic acquisitions and improved pricing. Improving industry fundamentals will drive overall growth.

American Financial estimates property and casualty pretax core operating earnings, excluding the impact of alternative investments, between \$615 million and \$675 million. The company expects 2020 core net operating earnings per share excluding marked to market (MTM) investments to be in the range of \$6.60-\$7.40 per share, up from the earlier expectation of \$6.45-\$7.25 per share.

- ▲ **Consistent Price Increase in Property and Casualty (P&C) Business:** American Financial witnessed renewal pricing increase of around 9% in the second quarter of 2020 in the Property and Casualty group. The company noted that average renewal rate increases in the first half of 2020 have been the highest that it achieved in over 15 years. It intends to maintain satisfactory rates in P&C renewal pricing going forward. Management estimates property and casualty renewal pricing in 2020 to be up 7% to 10%, an increase from the range of 5% to 8% expected earlier. Excluding workers' compensation, the company estimates renewal rate increase of 10-13%, an increase from the range of 8% to 11% estimated previously. Along with price increase, projects loss cost trends are expected to remain stable and appear relatively benign across all the P&C lines. These trends should favor the company in the long run.
- ▲ **Favorable Combined Ratio:** American Financial's combined ratio has been better than the industry average for more than two decades. For 2020, the company expects combined ratio for the Specialty Property & Casualty Group in the range of 92% to 94%. Combined ratio is projected in the range of 90% to 94% (an improvement from 92% to 96% guided earlier) for Property and Transportation Group and between 91% and 95% (deterioration from 90% to 94% guided earlier) for Specialty Casualty Group in 2020. For Specialty Financial Group, combined ratio is expected to be in the range of 91% to 95% (a deterioration from 97% to 91% guided earlier).
- ▲ **Strong Capital Management:** American Financial has traditionally maintained moderate adjusted financial leverage around 20%, with good cash flow and interest coverage ratio. On Jun 30, 2020, excess capital was approximately \$850 million which will enable the company to meet the debt obligations. The company expects to have significant excess capital and liquidity throughout 2020 and beyond. It scores strongly with credit rating agencies.

Also, in each of the last 14 years, the company has successfully increased its dividends and paid out special dividend. The robust operating profitability at the P&C segment, a stellar investment performance and an effective capital management look. Its dividend strategy reflects its solid financial position. The company intends to hold back about \$200-\$300 million of the excess capital to maintain flexibility for any opportunity that may arise in the future.

Risks

- **Annuity Business:** The company has been witnessing weak performance at this segment over the past quarters. Gross statutory premiums declined 31% in the first half of 2020. The company implemented several rate decreases to maintain proper returns on annuity sales that have started to affect new sales. In fact annuity sales were lower in all channels during the second quarter of 2020 due to stay-at-home orders and other factors related to the COVID-19 pandemic. The company estimates the softness to continue through the third quarter. Operating earnings too dropped 44% in the first half of 2020.

Nonetheless, American Financial expects an attractive return on its alternative investments over the long term. It estimates pretax core operating earnings, excluding earnings from alternative investments, between \$300 million and \$320 million, an increase from \$280 million and \$310 million guided earlier. The company also anticipates 2020 gross annuity sales in the range of \$3.4 billion to \$3.9 billion and result in growth in average investments and reserves of 5% to 7% in 2020.

- **Exposure to Catastrophes:** The company's earnings have traditionally been affected by catastrophes. Even drought, which does not otherwise qualify as a catastrophe, had impacted its earnings, given its exposure to the crop business. Irrespective of catastrophe mitigation techniques deployed by it, exposure to weather-related calamities makes its earnings volatile.
- **Rising Expenses:** The company has been experiencing an increase in expenses due to higher P&C insurance losses & expenses, annuity, life, accident & health benefits & expenses, interest charges on borrowed money, expenses of managed investment entities and other expenses. In the first half of 2020, total costs and expenses increased 2.6% year over year. The expenses are likely to weigh on operating margin expansion. Net margin contracted 620 bps in the second quarter of 2020.
- **Increasing Debt with lower Times Earned Interest** - American Financial's debt level has been increasing over the last several years. As of Jun 30, 2020, the company's long-term debt was \$1.9 billion, up 30% from 2019-end level. Debt to total adjusted capital was 27.8% at June end, down 610 basis points from 2019 end level and compared unfavorable with the industry average of 21.8%. Also, times interest earned, which indicates how efficiently a company can service debt, has been declining. It was 4.5x in the second quarter of 2020, down 1020 year over year. The company must service debt uninterruptedly else creditworthiness could be dented.

Last Earnings Report

American Financial Misses on Q2 Earnings, Ups View

American Financial reported second-quarter 2020 core net operating earnings per share of \$1.05, which missed the Zacks Consensus Estimate by 36.8%. Also, the bottom line decreased 50.5% year over year.

Core net operating earnings take into account 48 cents per share loss from alternative investments and 75 cents per share of COVID-19 related losses.

Quarter Ending 06/2020

Report Date	Aug 04, 2020
Sales Surprise	25.96%
EPS Surprise	-36.75%
Quarterly EPS	1.05
Annual EPS (TTM)	7.40

Behind the Headlines

Total operating revenues of \$1.7 billion decreased 7.2% year over year. This top-line decline can be attributed to lower net investment income and decrease in net earned premiums at its P&C insurance as well as lower other revenues. The top line however beat the Zacks Consensus Estimate of \$1.4 billion.

Net earned premiums at its P&C insurance declined 1.3% to \$1.2 billion. Net investment income of \$468 million decreased 0.2% year over year.

American Financial's total cost and expenses were \$1.7 billion, up 1.9% year over year due to higher P&C insurance loss and expenses, annuity and supplemental insurance benefits & expenses and interest charges on borrowed money.

Segment Results

Specialty Property and Casualty Insurance generated \$1.1 billion in net premiums written, down 11% year over year, primarily as a result of the run-off of Neon.

Core operating earnings were \$116 million in the second quarter, down 34% year over year. Lower P&C net investment income was responsible for the decline.

Underwriting profit of \$54 million declined 10%, attributable to lower profits at Specialty Casualty and Specialty Financial Groups, partly offset by higher profits at Property and Transportation Group.

The segment's combined ratio deteriorated 20 basis points (bps) year over year to 95.2%.

Annuity segment's gross statutory premiums of \$687 million declined 49% year over year. Annuity sales were lower in all channels as a result of stay-at-home orders and other factors related to the COVID-19 pandemic

Operating earnings totaled \$42 million, down nearly 60% year over year.

Financial Update

As of Jun 30, 2020, American Financial had cash and investments of \$56.7 billion, which grew 2.7% from the level at 2019 end.

As of Jun 30, 2020, long-term debt of \$1.9 billion was up 29.8% from 2019-end level.

As of Jun 30, 2020, the company's book value per share (excluding unrealized gains/losses on fixed maturities) was \$56.95, down 4.6% from the figure at 2019 end.

Annualized return on equity was 7.5%, down 720 bps year over year. The company had about \$850 million of excess capital at Jun 30, 2020.

The company bought back \$76 million worth shares in the reported quarter.

2020 Guidance Upped

American Financial estimates net operating earnings in the bracket of \$6.60-\$7.40 per share, compared with the earlier expectation of \$6.45-\$7.25 per share.

Pretax annuity core operating earnings are expected to increase in the range of \$300 million to \$320 million, up from \$280 million to \$310 million guided earlier.

Gross annuity premiums are expected to be between \$3.4 billion and \$3.9 billion, and result in growth in average investments and reserves of 5% to 7% in 2020. This reflects higher persistency so far in 2020.

Recent News

American Financial Announces Quarterly Dividend — Jul 1, 2020

American Financial recently declared a regular dividend of 45 cents per share, paid on Jul 27, 2020 to shareholders as of Jul 15, 2020.

Valuation

American Financial's shares are down 39.9% and 35.2% in the year-to-date period and over the trailing 12-month period, respectively. Stocks in the Zacks sub-industry and the Zacks Finance sector are down 8.8% and 16.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 0.6% and 6.8%, respectively.

The S&P 500 index are up 3.8% in the year-to-date period and 16.4% in the past year.

The stock is currently trading at 1.17x trailing 12-month book value, which compares to 1.38x for the Zacks sub-industry, 2.45x for the Zacks sector and 4.67x for the S&P 500 index.

Over the past five years, the stock has traded as high as 2x and as low as 0.68x, with a 5-year median of 1.57x. Our Outperform recommendation indicates that the stock will perform in-line with the market. Our \$76 price target reflects 1.33x trailing 12-month book value.

The table below shows summary valuation data for AFG

Valuation Multiples - AFG					
		Stock	Sub-Industry	Sector	S&P 500
P/B TTM	Current	1.17	1.38	2.45	4.67
	5-Year High	2	1.67	2.91	4.67
	5-Year Low	0.68	0.93	1.72	2.83
	5-Year Median	1.57	1.46	2.53	3.73
P/S F12M	Current	1.1	1.8	6.22	3.66
	5-Year High	2.05	11.26	6.66	3.66
	5-Year Low	1.01	1.39	4.96	2.53
	5-Year Median	1.63	1.84	6.06	3.05
P/E F12M	Current	8.34	25.88	16.66	22.18
	5-Year High	17.94	31.55	16.66	22.18
	5-Year Low	5.2	21.01	11.59	15.25
	5-Year Median	12.6	25.67	14.26	17.52

As of 08/07/2020

Industry Analysis Zacks Industry Rank: Top 41% (103 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Arch Capital Group Ltd. (ACGL)	Neutral	3
Cincinnati Financial Corporation (CINF)	Neutral	3
The Hartford Financial Services Group, Inc. (HIG)	Neutral	3
Markel Corporation (MKL)	Neutral	3
Everest Re Group, Ltd. (RE)	Neutral	3
Alleghany Corporation (Y)	Neutral	2
American International Group, Inc. (AIG)	Underperform	4
CNA Financial Corporation (CNA)	Underperform	3

Industry Comparison Industry: Insurance - Property And Casualty				Industry Peers		
	AFG	X Industry	S&P 500	MKL	RE	Y
Zacks Recommendation (Long Term)	Outperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	1	-	-	3	3	2
VGM Score	C	-	-	B	C	C
Market Cap	5.92 B	1.18 B	23.30 B	15.02 B	11.68 B	7.72 B
# of Analysts	2	2	14	2	3	1
Dividend Yield	2.73%	1.25%	1.76%	0.00%	2.67%	0.00%
Value Score	B	-	-	B	A	B
Cash/Price	0.32	0.25	0.07	0.46	0.11	0.28
EV/EBITDA	3.92	5.73	13.32	4.64	9.51	5.70
PEG Ratio	1.52	2.06	2.94	NA	1.73	NA
Price/Book (P/B)	1.17	1.02	3.19	1.39	1.26	0.91
Price/Cash Flow (P/CF)	5.70	10.48	12.51	18.60	10.48	16.74
P/E (F1)	9.32	14.79	22.02	61.67	17.63	70.54
Price/Sales (P/S)	0.79	0.84	2.53	1.86	1.38	0.95
Earnings Yield	10.73%	5.83%	4.37%	1.62%	5.67%	1.42%
Debt/Equity	0.29	0.24	0.77	0.33	0.07	0.24
Cash Flow (\$/share)	11.57	3.12	6.94	58.60	22.15	32.24
Growth Score	D	-	-	B	C	D
Hist. EPS Growth (3-5 yrs)	12.92%	4.32%	10.46%	4.32%	-18.46%	-15.93%
Proj. EPS Growth (F1/F0)	-17.92%	-6.42%	-6.80%	1,219.03%	6,486.50%	-67.82%
Curr. Cash Flow Growth	7.42%	3.77%	5.39%	13.53%	310.65%	25.33%
Hist. Cash Flow Growth (3-5 yrs)	12.34%	4.81%	8.55%	9.05%	-5.41%	-8.44%
Current Ratio	0.14	0.45	1.33	0.68	0.34	0.37
Debt/Capital	22.59%	20.08%	44.50%	25.08%	6.27%	20.99%
Net Margin	3.13%	4.65%	10.13%	2.66%	6.24%	-0.76%
Return on Equity	11.45%	6.80%	14.39%	3.31%	5.74%	1.32%
Sales/Assets	0.11	0.31	0.51	0.22	0.31	0.31
Proj. Sales Growth (F1/F0)	-31.58%	0.00%	-1.51%	5.67%	11.10%	0.00%
Momentum Score	C	-	-	C	F	D
Daily Price Chg	4.83%	2.57%	0.90%	1.12%	3.81%	3.87%
1 Week Price Chg	-1.83%	-1.30%	0.14%	2.87%	-2.33%	-2.73%
4 Week Price Chg	16.00%	13.41%	8.95%	22.08%	17.23%	14.53%
12 Week Price Chg	19.20%	22.78%	18.90%	34.05%	43.58%	17.12%
52 Week Price Chg	-36.17%	-15.63%	1.18%	-4.49%	-7.71%	-26.88%
20 Day Average Volume	448,726	128,410	2,057,775	48,368	260,245	53,680
(F1) EPS Est 1 week change	2.02%	0.00%	0.00%	0.00%	0.00%	31.90%
(F1) EPS Est 4 week change	2.02%	0.00%	1.36%	0.00%	-15.93%	NA
(F1) EPS Est 12 week change	-6.08%	-5.11%	1.57%	-4.07%	-22.88%	-79.32%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.54%	-13.20%	-36.26%	-183.15%

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	C
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.

Disclosures

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