

American Financial(AFG)

\$64.28 (As of 06/15/20)

Price Target (6-12 Months): **\$67.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/30/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

Growth: B

Momentum: A

Summary

American Financial is well-poised to benefit from impressive inorganic growth and is thus prudently investing in businesses. The company is actively involved in startups, small-to-medium sized acquisitions, product launches. Consistent price increase in property and casualty business should favor results. It reported higher investment income on the back of solid performance of limited partnerships. It is believed that better industry fundamentals, with strong pricing and a high renewal ratio, should drive growth. Solid capital position enables it to deploy capital effectively. Shares of American Financial have underperformed its industry in the past year. However, soft performance of Annuity business continues to weigh on earnings of the company. Also, exposure to weather-related calamities induces earnings volatility and high cost weigh on margin.

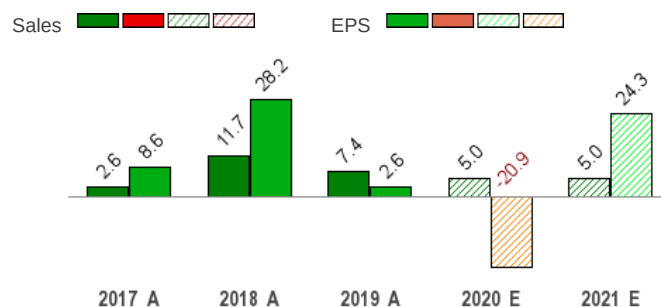
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$115.03 - \$44.01
20 Day Average Volume (sh)	1,010,526
Market Cap	\$5.8 B
YTD Price Change	-41.4%
Beta	0.85
Dividend / Div Yld	\$1.80 / 2.8%
Industry	Insurance - Property and Casualty
Zacks Industry Rank	Bottom 18% (208 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.6%
Last Sales Surprise	NA
EPS F1 Est- 4 week change	2.5%
Expected Report Date	08/04/2020
Earnings ESP	91.2%
P/E TTM	7.6
P/E F1	9.4
PEG F1	1.5
P/S TTM	0.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					8,501 E
2020	1,810 A				8,097 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	\$2.22 E	\$2.09 E	\$2.01 E	\$2.55 E	\$8.48 E
2020	\$1.88 A	\$0.68 E	\$1.86 E	\$2.41 E	\$6.82 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.

The data in the charts and tables, except sales and EPS estimates, is as of 06/15/2020. The reports text and the analyst-provided sales and EPS estimates are as of 06/16/2020.

Overview

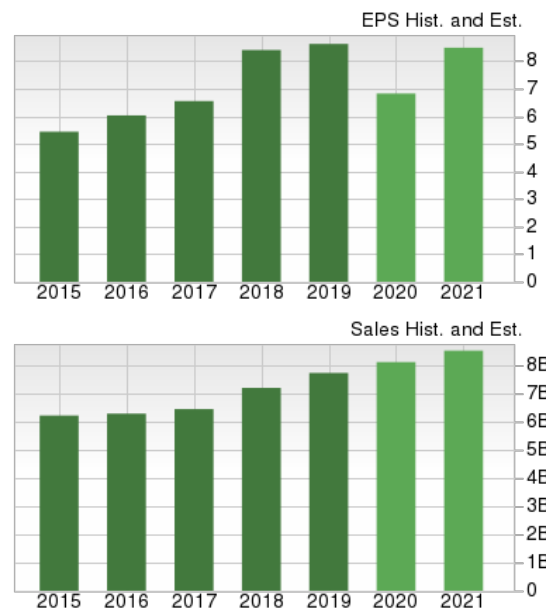
Founded in 1872 and headquartered in Cincinnati, OH, American Financial Group, Inc. is a holding company which, through its subsidiaries, engages primarily in property and casualty insurance, with focus on specialized commercial products for businesses. The company also engages in the sale of traditional 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:

- ▲ **Sturdy Growth Profile:** American Financial is actively involved in startups, small-to-medium sized acquisitions, and product launches. It is prudently investing in businesses. Net premiums written grew 2% year over year to \$1.2 billion in the first quarter of 2020 in the Specialty Property and Casualty Insurance segment.

Given continued solid operational performance, management now expects in 2020, Specialty Property and Casualty Group's net written premiums to be in a range that is 7% to 1% lower than results reported in 2019 (excluding the impact of Neon runoff). Net written premium is expected to be down 5% to up 1% year over year for Property and Transportation Group, and down 17%-23% in 2020 for Specialty Casualty Group (excluding the impact of Neon runoff).

Net written premium is expected to be 6% to 12% lower than 2019 premiums for Specialty Financial Group. The company expects 2020 core net operating earnings per share excluding marked to market (MTM) investments to be in the range of \$6.45 to \$7.25.

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.

- ▲ **Consistent Price Increase in Property and Casualty (P&C) Business:** American Financial witnessed renewal pricing increase of around 7% in the first quarter of 2020 in the Property and Casualty group. The same metric had increased 11% in the fourth quarter, excluding workers' compensation. The company intends to maintain satisfactory rates in P&C renewal pricing going forward. Management estimates Property and Casualty renewal pricing in 2020 to be up 5-8%, an improvement from 3% to 5% estimated previously. Excluding workers' compensation, the company estimates renewal rate increase of 8-11%, an increase from the range of 5% to 7% 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 are strong positive trends that should favor the company in the long run.

- ▲ **Improving Investment Income:** The company's net investment income has been improving over the past few quarters and this momentum continued in the first quarter of 2020. Net investment income increased 0.4% year over year to \$544 million in the first quarter of 2020. Despite a low rate of interest, income from partnerships and similar investments should continue to drive the momentum going forward.

- ▲ **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 92% to 96% for Property and Transportation Group and between 90% and 94% for Specialty Casualty Group in 2020. For Specialty Financial Group combined ratio is expected to be in the range of 87% to 91%.

- ▲ **Strong Capital Management:** American Financial has traditionally maintained moderate adjusted financial leverage around 20%, with good cash flow and interest coverage ratio. As of Mar 31, 2020, the company's long-term debt was \$1.5 billion, which remained flat with 2019-end level. Its cash and equivalents of \$1.8 billion as of Mar 31, 2020 are sufficient to meet debt obligations. On March 31, 2020, excess capital was approximately \$610 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.

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.

- ▲ **Share Price Movement:** Shares of American Financial have lost 37.9% in a year, compared with the industry's decline of 12.9%. We believe that acquisitions, better pricing and improving industry fundamentals will drive the company's shares going forward.
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Reasons To Sell:

▼ **Annuity Business:** The company has been witnessing weak performance at this segment over the past quarters. Premiums in the segment declined 13% to \$1.2 billion in first-quarter of 2020. The company implemented several rate decreases to maintain proper returns on annuity sales that have started to affect new sales.

In response to the continued drop-in market interest rates in 2019, the company has implemented numerous crediting rate decreases on its products in order to maintain appropriate returns on Annuity sales. It expects its pretax Annuity core operating earnings, excluding the impact of MTM investments in the range of \$280 million to \$310 million.

▼ **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. In the first quarter of 2020, the company incurred a catastrophe loss of \$9 million, which decreased 25% from the year-ago quarter. 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 quarter of 2020, total costs and expenses increased 3.2% to \$1.7 billion due to higher P&C insurance loss and expenses, annuity, life, accident and health benefits and expenses. The expenses are likely to weigh on the operating margin expansion.

Underperforming Annuity business weighing on earnings and exposure to cat losses (specifically its exposure to the crop business) inducing volatility to underwriting results pose near-term headwinds.

Last Earnings Report

American Financial Q1 Earnings Beat Estimates, Fall Y/Y

American Financial Group, Inc. reported first-quarter 2020 net operating earnings per share of \$1.88, which beat the Zacks Consensus Estimate by 1.6%. However, the bottom line declined 6.9% year over year.

The company witnessed improved net investment income and higher premiums in Specialty Property and Casualty Insurance segment, which were offset by soft performance in Annuity segment and higher expenses.

Quarter Ending **03/2020**

Report Date	May 11, 2020
Sales Surprise	NA
EPS Surprise	1.62%
Quarterly EPS	1.88
Annual EPS (TTM)	8.47

Behind the Headlines

Total operating revenues of \$1.8 billion rose 2.2% year over year. This top-line improvement can be attributed to higher net investment income and P&C insurance net earned premiums plus other income.

Net investment income of \$544 million increased 0.4% year over year.

The company recorded first-quarter net realized losses on securities of \$4.81 per share after tax and after deferred acquisition costs (DAC) that consist of \$4.69 in after tax post DAC against the prior-year quarterly net realized gains of \$1.61 per share.

American Financial's total cost and expenses were \$1.7 billion, up 3.2% year over year due to higher P&C insurance loss and expenses, annuity, life, accident and health benefits and expenses.

Segment Results

Specialty Property and Casualty Insurance generated \$1.2 billion in net premiums written, up 2% year over year. Increase in net premiums written in the Property & Transportation (12%), Specialty Financial Group (3%) and Other (38%) on a year-over-year basis led to the upside. Core operating earnings from the segment were \$181 million in the first quarter, down 2% year over year.

Underwriting profit of \$89 million increased 1%, attributable to higher underwriting profitability in Specialty Casualty and Specialty Financial Groups. It was partially offset by lower underwriting profit in Property and Transportation Group.

The segment's combined ratio improved 30 basis points (bps) year over year to 92.2%.

Annuity segment's premiums of \$1.2 billion decreased 13% year over year.

Pre-tax income totaled \$67 million, down 26% year over year.

Financial Update

As of Mar 31, 2020, American Financial had cash and investments of \$53.2 billion, which decreased 3.7% from the level at 2019 end.

As of Mar 31, 2020, long-term debt of \$1.5 billion remained flat from the 2019-end level.

As of Mar 31, 2020, the company's book value per share (excluding unrealized gains/losses on fixed maturities) was \$55.52, down 7% from the figure at 2019 end.

Annualized return on equity was (23.1%) against 25.9% in the year-ago quarter.

2020 Guidance

American Financial expects its pretax Annuity core operating earnings, excluding the impact of MTM investments in the range of \$280 million to \$310 million.

It continues to expect its 2020 core net operating earnings per share excluding MTM investments to be in the range of \$6.45 to \$7.25.

Based on current expectations of the impact of COVID-19, the company now projects P&C pretax core operating earnings, excluding the impact of MTM investments, in the range of \$630 million to \$690 million.

American Financial estimates 2020 combined ratio in the range of 92% to 94%.

Recent News

American Financial Trims 2020 View on Coronavirus Concern — Apr 15, 2020

American Financial has slashed its 2020 earnings guidance, which is likely to get dented by the coronavirus pandemic. For the current year, the insurer expects core net operating earnings per share of \$6.45-\$7.25, which is lower than the previously stated \$8.75-\$9.25. Pretax core operating earnings from the company's Annuity segment is estimated to be \$275-\$305 million compared with the earlier mentioned \$395-\$425 million. For pretax core operating earnings at its property and casualty (P&C) business, American Financial has also provided guidance of \$640-\$700 million.

American Financial Announces Quarterly Dividend — Apr 1, 2020

American Financial recently declared a regular dividend of 45 cents per share, paid on Apr 27, 2020 to shareholders as of Apr 25, 2020.

Valuation

American Financial's shares are down 41.4% and 37.9% 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 19.4% and 19.7% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 12.9% and 12.4%, respectively.

The S&P 500 index are down 4.8% in the year-to-date period and up 6.1% in the past year.

The stock is currently trading at 1.14x trailing 12-month book value, which compares to 1.21x for the Zacks sub-industry, 2.34x for the Zacks sector and 4.19x 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 Neutral recommendation indicates that the stock will perform in-line with the market. Our \$67 price target reflects 1.18x 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	1.14	1.21	2.34	4.19
	5-Year High	2	1.67	2.91	4.56
	5-Year Low	0.68	0.93	1.71	2.83
	5-Year Median	1.57	1.46	2.53	3.66
P/S F12M	Current	1.06	1.67	6	3.44
	5-Year High	2.05	11.26	6.65	3.44
	5-Year Low	1.06	1.39	4.95	2.53
	5-Year Median	1.63	1.87	6.06	3.02
P/E F12M	Current	8.48	23.5	16.5	22.11
	5-Year High	17.94	31.55	16.5	22.11
	5-Year Low	5.2	21.01	11.57	15.23
	5-Year Median	12.61	25.4	13.98	17.49

As of 06/15/2020

Industry Analysis Zacks Industry Rank: Bottom 18% (208 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
American International Group, Inc. (AIG)	Neutral	3
Cincinnati Financial Corporation (CINF)	Neutral	5
CNA Financial Corporation (CNA)	Neutral	3
The Hartford Financial Services Group, Inc. (HIG)	Neutral	4
Everest Re Group, Ltd. (RE)	Neutral	3
Alleghany Corporation (Y)	Neutral	3
Arch Capital Group Ltd. (ACGL)	Underperform	3
Markel Corporation (MKL)	Underperform	4

Industry Comparison Industry: Insurance - Property And Casualty				Industry Peers		
	AFG	X Industry	S&P 500	MKL	RE	Y
Zacks Recommendation (Long Term)	Neutral	-	-	Underperform	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	4	3	3
VGM Score	A	-	-	C	B	C
Market Cap	5.78 B	1.17 B	21.70 B	13.02 B	10.91 B	7.26 B
# of Analysts	3	2	14	2	2	1
Dividend Yield	2.80%	1.42%	1.95%	0.00%	2.86%	0.00%
Value Score	A	-	-	C	A	C
Cash/Price	0.32	0.23	0.06	0.36	0.12	0.29
EV/EBITDA	3.82	4.96	12.55	4.37	8.90	4.97
PEG Ratio	1.58	2.11	2.96	NA	NA	NA
Price/Book (P/B)	1.14	1.06	2.99	1.34	1.27	0.92
Price/Cash Flow (P/CF)	5.56	9.66	11.61	16.13	9.79	15.72
P/E (F1)	9.69	13.70	21.21	53.49	12.66	17.33
Price/Sales (P/S)	0.77	0.76	2.26	1.76	1.32	0.88
Earnings Yield	10.61%	7.01%	4.43%	1.87%	7.90%	5.77%
Debt/Equity	0.29	0.26	0.76	0.37	0.08	0.19
Cash Flow (\$/share)	11.57	3.12	7.01	58.60	22.15	32.24
Growth Score	B	-	-	C	C	F
Hist. EPS Growth (3-5 yrs)	12.92%	6.81%	10.87%	6.49%	-18.46%	-15.93%
Proj. EPS Growth (F1/F0)	-20.84%	-1.72%	-10.58%	-54.57%	-19.75%	23.05%
Curr. Cash Flow Growth	7.42%	5.61%	5.46%	13.53%	310.65%	25.33%
Hist. Cash Flow Growth (3-5 yrs)	12.34%	7.31%	8.55%	9.05%	-5.41%	-8.44%
Current Ratio	0.14	0.45	1.29	0.60	0.32	0.33
Debt/Capital	22.59%	20.55%	45.06%	27.81%	7.36%	17.98%
Net Margin	3.57%	3.92%	10.54%	-2.61%	8.25%	0.69%
Return on Equity	12.99%	7.52%	16.08%	6.33%	8.48%	3.26%
Sales/Assets	0.11	0.31	0.55	0.20	0.31	0.31
Proj. Sales Growth (F1/F0)	0.00%	0.00%	-2.59%	5.56%	10.09%	0.00%
Momentum Score	A	-	-	C	C	A
Daily Price Chg	3.13%	0.42%	0.98%	-0.48%	0.90%	0.54%
1 Week Price Chg	-12.86%	-6.32%	-7.25%	-7.00%	-4.95%	-12.94%
4 Week Price Chg	10.81%	5.95%	5.45%	12.01%	20.25%	4.09%
12 Week Price Chg	31.86%	19.64%	39.81%	27.38%	26.12%	11.96%
52 Week Price Chg	-37.88%	-20.36%	-4.47%	-12.28%	-13.30%	-26.20%
20 Day Average Volume	1,010,526	144,747	2,587,370	63,191	477,930	68,948
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	2.45%	0.00%	0.00%	-4.07%	0.10%	0.00%
(F1) EPS Est 12 week change	-23.95%	-18.82%	-15.39%	-56.22%	-32.81%	-28.13%
(Q1) EPS Est Mthly Chg	-12.82%	0.00%	0.00%	-0.58%	0.36%	0.00%

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	A
Growth Score	B
Momentum Score	A
VGM Score	A

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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