

American Financial(AFG)

\$106.40 (As of 02/24/20)

Price Target (6-12 Months): **\$112.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 01/30/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:A

Value: A

Growth: B

Momentum: C

Summary

American Financial's fourth-quarter 2019 earnings per share of \$2.22 outpaced the Zacks Consensus Estimate by 0.45%. Also, the bottom line increased 26.9% year over year. The company is well-poised to benefit from impressive inorganic growth and is thus prudently investing in businesses. It is actively involved in startups, small-to-medium sized acquisitions, and product launches. Consistent price increase in property and casualty business should favor results. The company's shares have underperformed its industry in a year. We believe that better industry fundamentals, with strong pricing and a higher renewal ratio, should drive growth. However, the soft Annuity business continues to weigh on earnings. Also, exposure to weather-related calamities and drought affected earnings of the company.

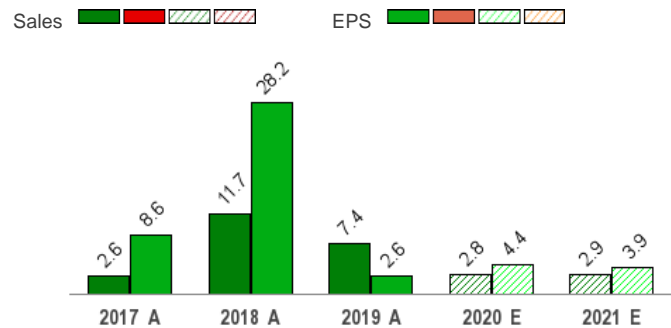
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$115.03 - \$93.75
20 Day Average Volume (sh)	369,957
Market Cap	\$9.6 B
YTD Price Change	-3.0%
Beta	0.83
Dividend / Div Yld	\$1.80 / 1.7%
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	0.5%
Last Sales Surprise	NA
EPS F1 Est- 4 week change	0.8%
Expected Report Date	05/06/2020
Earnings ESP	0.0%
P/E TTM	12.4
P/E F1	11.8
PEG F1	1.9
P/S TTM	1.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					8,152 E
2020					7,925 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	\$2.33 E	\$2.27 E	\$2.16 E	\$2.65 E	\$9.35 E
2020	\$2.18 E	\$2.14 E	\$2.08 E	\$2.56 E	\$9.00 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, including the Zacks Consensus EPS and Sales estimates, is as of 02/24/2020. The reports text is as of 02/25/2020.

Overview

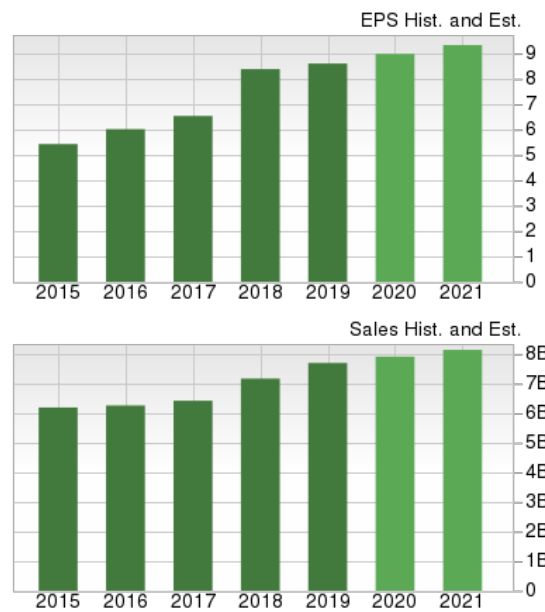
Founded in 1872 and headquartered in Cincinnati, OH, American Financial Group, Inc. is a holding company which, through its subsidiaries, engages primarily in property and casualty insurance, with focus on specialized commercial products for businesses. The company also engages in the sale of traditional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

Given continued solid operational performance, management now expects Specialty Property and Casualty Group's net written premiums to be up 3-7% (excluding the impact of Neon runoff) in 2020. Of this, net written premium is expected to increase 6-10% for Property and Transportation Group, and 1-5% for Specialty Casualty Group (excluding the impact of Neon runoff). Net written premium is expected to be 4-8% for Specialty Financial Group. The company expects 2020 net operating earnings to be \$8.75-\$9.25 per share.

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 5% in the fourth quarter of 2019 in the Property and Casualty group. The same metric increased 7% 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 2022 to be up 3-5%. Excluding workers' compensation, the company estimates renewal rate increase of 5-7%. 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 has continued through 2019. Investment income increased 9.4%, driven by strong performance of limited partnerships and similar investments. The company expects 2020 investment income to be up 0-4%.
 - ▲ **Favorable Combined Ratio:** American Financial's combined ratio has been better than the industry average over more than two decades. For 2020, the company expects Specialty Property and Casualty Group combined ratio between 92% and 94%. Of this, combined ratio is projected between 92% and 96% for Property and Transportation Group, and between 90% and 94% for Specialty Casualty Group. For Specialty Financial Group, combined ratio is estimated to be 86-90%.
 - ▲ **Strong Capital Management:** American Financial has traditionally maintained moderate adjusted financial leverage around 20%, with good cash flow and interest coverage ratio. In each of the last 14 years, the company has successfully increased its dividends and paid out special dividend. To this end, in May 2019, the company paid out a special dividend of \$1.50 per share. 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 gained 6.8% in a year, underperforming the industry's growth of 13.4%. 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 8% in 2019. 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. The company expects 2020 Annuity premiums to be \$4.5-\$5.2 billion. It reported \$5 billion in 2019. However, pre-tax annuity core operating earnings are expected to increase \$395-\$425 million. It reported \$398 million in 2019.

▼ **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 2019, the company incurred a catastrophe loss of \$61 million. Irrespective of catastrophe mitigation techniques deployed by it, exposure to weather-related calamities makes its earnings volatile.

▼ **Stretched Valuation:** Valuation remains stretched at current level. Price to book value, the multiple for valuing insurers, of 1.52X is higher than the industry average of 1.41X.

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 Q4 Earnings Top Estimates, Rise Y/Y

American Financial Group fourth-quarter 2019 net operating earnings per share of \$2.22 beat the Zacks Consensus Estimate by 0.45%. Also, the bottom line increased 26.9% year over year.

Higher net premiums written in Specialty Property & Casualty insurance operations were partially offset by lower premiums in Annuity Segment.

Behind the Headlines

Total operating revenues of \$2.1 billion rose more than 26% year over year. This top-line improvement can be attributed to higher net investment income and increase in net earned premiums at its Property & Casualty insurance. Net investment income of \$593 million increased 9.4% year over year.

American Financial's total cost and expenses were \$1.9 billion, up 8.2% year over year. This was due to higher P&C insurance loss and expenses, interest charges on borrowed money and other expenses.

Segment Results

Specialty Property and Casualty Insurance generated \$1.3 billion in net premiums written, up 9% year over year, driven by increase of 15% and 10%, respectively, in the Specialty Casualty and Specialty Financial. Core operating earnings were \$199 million in the fourth quarter, down 7% year over year, due to lower underwriting profits at Specialty P&C insurance operations. Underwriting profit of \$89 million declined 12.7% due to lower year-over-year profits in crop operations at the Property and Transportation Group.

The segment's combined ratio deteriorated 150 basis points (bps) year over year to 93.5%.

Annuity segment's premiums of \$1.1 billion declined 23% year over year, as higher traditional fixed annuity premiums in the financial institutions channel were offset by lower FIA premiums in the retail and broker dealer channels, Pension Risk Transfer, Education Market and Variable Annuities. Pre-tax income of \$100 million remained unchanged year over year.

Financial Update

As of Dec 31, 2019, American Financial had cash and investments of \$55.3 billion, which grew 13.9% from year-end 2018 level. As of Dec 31, 2019, long-term debt of \$1.5 billion was up 13.1% from 2018 end level. As of Dec 31, 2019, the company's book value per share (excluding unrealized gains/losses on fixed maturities) was \$59.70, up 8.8% from the figure at 2018 end.

Core operating return on equity was 14.9%, down 70 bps year over year.

2020 Guidance

American Financial expects full-year 2020 pretax Annuity core operating earnings to be in the range of \$395 million to \$425 million. It reported \$398 million in 2019.

American Financial expects core net operating earnings for 2020 to be in the range of \$8.75 to \$9.25 per share. Specialty Property & Casualty net written premiums are expected to grow in the range of 3% to 7% (excluding the impact of Neon runoff). Combined ratio for 2020 is expected in the range of 92% to 94%.

Quarter Ending **12/2019**

Report Date	Feb 03, 2020
Sales Surprise	NA
EPS Surprise	0.45%
Quarterly EPS	2.22
Annual EPS (TTM)	8.61

Recent News

American Financial's Unit to Quit Lloyd's Insurance Market — Jan 6, 2020

American Financial announced that it will no longer be part of the Lloyd's of London insurance market in 2020. To this end, the company commenced the process of putting its Lloyd's subsidiaries including its Lloyd's Managing Agency Neon Underwriting Ltd into a run-off.

American Financial Announces Quarterly Dividend — Jan 2, 2020

The board of directors of American Financial declared a quarterly dividend of 45 cents per share. The dividend will be paid out on Jan 27 to shareholders of record as of Jan 15.

Valuation

American Financial's shares are down 3% and up 6.8% 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 0.6% and 2.6% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are up 10.2% and 4.9%, respectively.

The S&P 500 index is flat in the year-to-date period and up 14.6% in the past year.

The stock is currently trading at 1.5x trailing 12-month book value, which compares to 1.4x for the Zacks sub-industry, 2.8x for the Zacks sector and 4.7x for the S&P 500 index.

Over the past five years, the stock has traded as high as 2x and as low as 1.1x, with a 5-year median of 1.6x. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$112 price target reflects 1.6x 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	1.52	1.41	2.75	4.66
	5-Year High	2	1.67	2.89	4.9
	5-Year Low	1.08	1.26	1.83	2.85
	5-Year Median	1.57	1.47	2.52	3.62
P/S F12M	Current	1.77	1.71	6.55	3.39
	5-Year High	2.05	11.26	6.65	3.43
	5-Year Low	1.2	1.55	5.39	2.54
	5-Year Median	1.58	1.89	6.04	3
P/E F12M	Current	11.75	26.2	14.45	18.44
	5-Year High	17.94	31.55	16.21	19.34
	5-Year Low	9.9	22.77	12.01	15.18
	5-Year Median	12.61	25.9	14.15	17.47

As of 02/24/2020

Industry Analysis Zacks Industry Rank: Top 44% (111 out of 255)



Top Peers

Cincinnati Financial Corporation (CINF)	Outperform
CNA Financial Corporation (CNA)	Outperform
Markel Corporation (MKL)	Outperform
Arch Capital Group Ltd. (ACGL)	Neutral
American International Group, Inc. (AIG)	Neutral
The Hartford Financial Services Group, Inc. (HIG)	Neutral
Everest Re Group, Ltd. (RE)	Neutral
Alleghany Corporation (Y)	Underperform

Industry Comparison Industry: Insurance - Property And Casualty				Industry Peers		
	AFG Neutral	X Industry	S&P 500	MKL Outperform	RE Neutral	Y Underperform
VGM Score	A	-	-	D	B	D
Market Cap	9.59 B	1.71 B	23.50 B	18.19 B	11.54 B	11.14 B
# of Analysts	4	2	13	4	2	2
Dividend Yield	1.69%	1.03%	1.83%	0.00%	2.19%	0.00%
Value Score	A	-	-	D	C	D
Cash/Price	0.28	0.18	0.04	0.26	0.10	0.19
EV/EBITDA	9.02	8.25	13.56	30.25	9.43	8.04
PEG Ratio	1.93	1.82	2.02	NA	1.15	NA
Price/Book (P/B)	1.51	1.26	3.20	1.71	1.26	1.27
Price/Cash Flow (P/CF)	9.78	12.91	13.05	25.71	12.78	24.07
P/E (F1)	11.82	14.08	18.56	33.20	11.55	18.15
Price/Sales (P/S)	1.16	1.04	2.60	1.91	1.40	1.23
Earnings Yield	8.46%	7.02%	5.38%	3.01%	8.66%	5.51%
Debt/Equity	0.23	0.21	0.70	0.37	0.07	0.20
Cash Flow (\$/share)	10.88	3.53	7.03	51.34	22.15	32.24
Growth Score	B	-	-	C	C	C
Hist. EPS Growth (3-5 yrs)	13.23%	2.32%	10.85%	1.59%	-22.54%	-18.81%
Proj. EPS Growth (F1/F0)	4.41%	11.63%	6.90%	2.17%	14.85%	79.85%
Curr. Cash Flow Growth	39.71%	19.96%	6.78%	174.99%	310.65%	25.33%
Hist. Cash Flow Growth (3-5 yrs)	13.00%	7.43%	8.38%	10.64%	-5.41%	-8.44%
Current Ratio	0.16	0.44	1.22	0.60	0.31	0.33
Debt/Capital	18.38%	18.05%	42.37%	27.64%	6.49%	18.22%
Net Margin	10.89%	8.51%	11.57%	18.81%	12.31%	9.49%
Return on Equity	13.00%	7.74%	16.80%	5.61%	9.85%	3.99%
Sales/Assets	0.12	0.32	0.55	0.26	0.31	0.34
Proj. Sales Growth (F1/F0)	0.00%	3.83%	4.03%	10.68%	10.22%	0.00%
Momentum Score	C	-	-	D	A	D
Daily Price Chg	-3.57%	-1.76%	-2.98%	-1.55%	-2.35%	-1.54%
1 Week Price Chg	-2.19%	-0.71%	-0.94%	1.30%	-0.52%	-4.49%
4 Week Price Chg	-1.96%	-0.53%	-0.94%	12.60%	3.80%	-2.48%
12 Week Price Chg	-2.56%	-0.29%	1.75%	17.66%	5.29%	-0.39%
52 Week Price Chg	7.15%	1.49%	10.97%	31.68%	26.81%	22.42%
20 Day Average Volume	369,957	78,502	2,001,782	36,072	265,039	48,441
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-7.17%
(F1) EPS Est 4 week change	0.84%	0.00%	-0.05%	0.96%	2.03%	-6.35%
(F1) EPS Est 12 week change	0.56%	0.00%	-0.21%	0.99%	1.81%	-5.47%
(Q1) EPS Est Mthly Chg	5.19%	0.00%	-0.49%	2.78%	4.87%	-3.79%

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	C
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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