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Stephen Craig Lindner *American Financial Group, Inc. - Co-President, Co-CEO & Director*

CONFERENCE CALL PARTICIPANTS

Christopher Campbell *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

PRESENTATION

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Good afternoon, everyone. My name is Chris Campbell. I'm on the P&C Insurance team. And joining me for this session are the senior management team for American Financial Group in Cincinnati. To my right is Co-CEO, Carl Lindner. To his right is his brother, Co-CEO and in-charge of the Annuity operation, Craig Lindner; and then CFO, Jeff Consolino. So thank you, gentlemen, for joining us. We really appreciate, and we're happy to have you.

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Nice to be here.

QUESTIONS AND ANSWERS

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Okay. Great. So I'll just start off with some questions. So just as we begin, can we get some overall thoughts on AFG's overall business model? And then it's very unique that AFG still has a P&C and Annuity book, where a lot of U.S. companies have kind of moved away from that model. How does that work for AFG? And what are the advantages?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

We love our business model. We have some 34 different Specialty Property and Casualty niches. Craig has carved out a couple of niches in the Annuity business. And I think it means more consistent results over time. It works for us. Our stock has really performed well. Our results have been great. We have good returns. And the Annuity business, along with businesses like crop business, lender-placed property, equine mortality. Between the Annuity business and a lot of P&C businesses, like those, some 60% of our capital is allocated to businesses that don't correlate to the general property and casualty cycle, which I love. And I think it makes us an even stronger company. I think the Annuity business also, if you're -- in the insurance business, in general, if you can underwrite better than your peers, invest money better than your peers, and then allocate excess capital and invest that excess capital appropriately at double-digit returns long term means great things to returns in that. We stack up well. But we have a particularly talented management -- money management group, and we've been able to invest money at greater returns than peers over time. The Annuity business gives our overall business a higher investment leverage to our capital than those Property and Casualty companies. So in our case, if it allows us to take advantage of our core talent or skill and that's investing money over time, which can make a meaningful difference on growth and book value and healthy earnings and that.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Okay. And then you noticed -- Carl and Craig, you noticed that one of your most important jobs as CEO's is capital management. So can you just discuss your overall capital management philosophy, the use of special dividend? And then just what opportunities are you seeing right now to put capital to work?

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Sure, Chris, capital management is a top priority of ours. Frankly, the opportunities are a little different each year. Certainly, when we have the ability to grow our businesses at appropriate rates of return, we certainly want to have the capital to support that. We have had pretty healthy growth here the last couple of years in addition to -- we certainly have more capital than required to support the growth of the business. We're always looking at a steady flow of acquisitions. Frankly, we're pretty disciplined with buyers. If we make an acquisition, we want to get to a double-digit after-tax rate of return in a short period of time. But we're always looking at acquisition opportunities. Certainly, looking at full time startup-type opportunities. In the recent past, dividends have -- we felt have made a lot of sense too given levels of excess capital. We felt the special dividends were an appropriate thing. I think last year, we paid $3.50 in special dividends, and we've got a $1.50 special dividend so far this year. We'll take a look at as we get closer to year-end and what opportunities we have on the acquisition side or other opportunities for the capital, but there is the potential for another special dividend as we get closer to year-end. Carl and I also have a goal of raising our regular dividend at a double-digit rate, just announced -- a 14% increase in the regular dividend.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Great. Any questions from the audience? Okay. All right. So during the second quarter earnings call, you announced an increase in your 2018 EPS along with your better segment guidance. What are the underlying drivers behind this change and what opportunities are you capitalizing on?

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Chris, we did raise the guidance. The midpoint went up by $0.20 a share. It's driven mainly by stronger-than-expected investment performance in the first half of the year. Stronger investment income on both sides of the business.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

And anything on the underwriting side that you're seeing right there?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Well, I think, our guidance, still we're projecting good underwriting result this year. So...

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Okay. Great. And then so Craig, just building on that. On the increased guidance for the higher investment income. Can you give us a little bit more, like, beneath the hood underlying color on where you're seeing those opportunities in the investment portfolio?

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Sure. So the main driver of the very strong investment performance, somewhat above what we have projected, came from investments in assets that are mark-to-market on a quarterly basis, principally limited partnership interests, some private equity, some real estate limited partnership interest. On a consolidated basis, we have about $1,200,000,000 invested in those types of assets, and we generated returns in the first 6 months of 16%, 17% overall. So very, very strong performance on that $1.2 billion of investment.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Any questions from the audience? Okay. Hold on. Can we get 2 mics, just to make it easier for us?

Unidentified Analyst

Given your investment management style, I just was wondering what's the health view on the credit cycle right now. And are there industry asset classes or areas in the BBB space that you're trying -- are you spending more time to try to avoid pitfalls that may come due to the volatility that's currently occurring?

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Yes. So we're still fairly constructive on credit. We don't see a recession around the corner. You never know what some unexpected geopolitical event could cause. But certainly, we don't have a not expected event. But we're still pretty constructive on credit. Having said that, frankly, we don't think you get paid to take risk. We are finding certain areas that we find attractive, and we'll step out and take a bit more risk. But when we look at the absolute level of interest rates, and we take a look at the very, very tight spreads, frankly, this is a time we're being pretty conservative, even though we're not negative on credit. We just -- over a long period of time, we had pretty significant outperformance on the investment side relative to our peers. We attribute that to being very opportunistic in times like this, when most asset classes are pretty highly priced and rates are low, spreads are tight. This is the time when we're going to be pretty conservative. We had tremendous opportunities in 2009, 2010 to buy residential mortgage-backed securities, commercial mortgage-backed securities, senior tranches that we were buying at $0.70, $0.75 on the dollar. Those are the tight periods when you'll see us step out and take a bit more risk. When Meredith Whitney was predicting massive defaults in municipal bonds. We took very large positions in the muni market. Those are the types of times when you'll see us, really reach a bit in terms of assets that we're purchasing. Today is not one of those times. It's kind of the opposite extreme, and we're being very cautious.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Any other questions. This one. Yes, we have one from Josh?

Unidentified Analyst

Sticking with munis. What is your current thought process there with tax reform, making that less attractive as an alternative to investing in straight corporates?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Could you repeat that -- the question?

Unidentified Analyst

Tax reform reduced the muni tax advantage. What is your thought process in terms of munis as investment?

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

First of all, tax reform was hugely important to our businesses. On the Annuity side, we were seeing almost every deal that was done, was done with a structure that allowed the buyer to strip income out of the U.S. company and take it to Bermuda or some tax-advantaged haven. We were paying 35% taxes. And the companies that put this -- that were taking advantage of a loophole in the tax law were paying 5% or 6% taxes. So it was hugely important to us, really leveled the playing field on both sides of the business. As it relates to the investment side, buying municipal bonds is now a bit more attractive on the life side than it was previously. Really doesn't change much on the investment side as it relates to the P&C investment portfolio.

Unidentified Analyst

And then more generally, on your businesses. What is your outlook for the commercial lines, pricing or what areas are you seeing that are attractive and -- or how does that compare to your position?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Well, I think the good news is, in the Property and Casualty side, we're earning 15%, 16% after-tax returns. I'd love to grow almost all of our businesses as the market allows an opportunity. That -- we seem to be finding our opportunities. I think we're growing out ahead of the average company out there today. I was very pleased in the second quarter that pricing overall was rough and dirty, even with loss costs and excluding workers comp, which is a unique situation. It's probably the highest pricing levels that we've seen in probably, I think I said 15, 16 quarters or so. So I'd like to trend that way. But again, if we can just -- if we can continue to find organic opportunities to grow a 15%, 16% return on equity business and find opportunities to expand geographically to buy things right, our sweet spot for acquisitions is kind of in the $50 million to $500 million range. And the tax law change seems to be giving certainty to a lot -- quite a few entities in that price range, particularly privately owned companies and that. So I think if anything we're probably seeing maybe a few more opportunities to what we've seen in the past. So I'm very enthusiastic about the environment and the ability to continue to grow our business.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

And we have one up here.

Unidentified Analyst

Did you see more pressure on M&A following the Hartford's recent announcement and Markel's (inaudible)

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Can you define pressure for me?

Unidentified Analyst

Pressure based on your investors as well as your -- in terms of trying to compete with the similar commercial P&C peers that are out there.

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Not really. Those were probably businesses that you mentioned that weren't on our -- that weren't targets for us or weren't things that we were considering in our approach to business in that. We're looking at -- our focus again is in the price range I talked about and more on adding geographically on to our businesses, adding new niches. That's more, I think, of our focus. Our family and our employees control some 24% of the company. We're a lot more longer-term focused than probably a lot of companies, some of which probably had targets on their back and could be, I don't know some of the motivation for doing transactions. Now we don't have short-term pressure to make acquisitions in that. Our focus is long term, trying to invest or either give back too much excess capital or investing excess capital in a way that's not only accretive, which is a piece of cake with interest rates where they've been. As Craig mentioned, we want to focus on things that putting our money to work at double-digit-plus returns over the long term. I think you'll find our culture is more entrepreneurial, is more opportunistic and more patient than those companies.

Unidentified Analyst

Just one follow-up. Does the M&A strategy or the targets that you're looking for expand to the Annuity space as well or is it just on the commercial P&C?

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

We'll look at annuity deals from time to time. What I would tell you is we're pretty pleased with the organic growth. We just raised our guidance to -- now expecting premium growth of, when we put our guidance out, we raised the expectation to up 10% to 15% this year. My guess at this moment in time is we're going to be at the upper end of that range. So for 5, 6 years, we have been able to grow the business at a very strong rate. I kind of like designing our own products and having the features in the products that really fit our consumer-centric model. So I'm not saying that we would never make an acquisition on the Annuity side, but we're very pleased with our ability to grow the business with products that we design, and we're comfortable with, and be able to grow on an organic basis. We've been growing reserves and assets at a 10% to 12% or 13% rate for some number of years. So we don't feel -- we don't need to go buy something to achieve growth.

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

No worker's comp questions?

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

I'm trying to get you. I mean, you guys have got so much -- you got so many good audience questions. Let's see.

Unidentified Analyst

A quick one on the tax reform comment you made the private companies you guys are targeting are now a little more comfortable and even more likely to sell. Can you flush that comment out a little bit, why would that be the case?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Well, I think before sellers and buyers had hard time putting accurate values until they knew what certainty -- what the tax law result was going to be. On the buy side, you certainly didn't want to pay a seller had expectations that you should be factoring in tax -- the tax -- the new tax law and that which is -- when you put a multiple on that could be a significant amount of money. And the buyer doesn't want to do that unless he has a certainty that those tax savings are going to be a sure thing. I think that's the primary thing that I mentioned. But I think for people that own their own businesses also having certainty of what the tax law is going to be, certainly might have given them more clarity and comfort in doing things so.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Okay. We've got one from Eric in the back.

Unidentified Analyst

Just looking forward to your earnings and your ROE. What are some, I guess, headwinds presented from improving and growing further?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Well, I don't think there are too many companies out there in our space that are earning 15% to 16% return. So I'm very happy with that. If we can grow the business at those returns, I think that's the -- where our bigger focus is, either growing organically on the Annuity and the Property and Casualty side, which we are, and then making the -- investing in new businesses, starting up new businesses, which we've been successful at over a long period of time. We're buying businesses that are good fits. I think that's the bigger focus and challenge. Was there a different aspect of that, that you -- did I answer your question?

Unidentified Analyst

I guess, just looking at consensus estimates, it's kind of a flat outlook. I'm just kind of curious to your thoughts, the ability to grow that?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Consensus outlook for next year, you mean?

Unidentified Analyst

EPS.

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

We're not -- we're just on the beginning of our planning process, and we usually don't give guidance until later in the year or early next year in that. But being an entrepreneurial and opportunistic culture works, we seem to always, in 34 different specialty niches find the ability to where a given business is being disrupted to take advantage of things in that. A couple of our large competitors have had problems in the commercial auto space and some of the larger buffer comp, larger comp type of area. And we've -- both last year and this year, we were able to take advantage of that. So there's always markets that are melting down or markets that are being disruptive in some way. And we love being a disruptor when it comes to that. And again, I think we've been very successful with the acquisitions that we've done. The buying of National Interstate. We spent $307 million. I think I promised everybody we were going to work on getting the combined ratio under 95, which would allow us to earn a double-digit return on the incremental investment. We reported a 92.4 combined ratio through 6 months, a number of years later. So we feel pretty good about that. We acquired Summit for $400 million. That's been off the charts. Huge success with big returns in that. So I think we're confident in our ability to find opportunities going forward and acquire things in an intelligent fashion. And if we don't, there should be some share repurchase or special dividends along the way, which most investors that I talk to really like.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Okay. Any questions, right now? Okay. Excellent. So Carl, here's your worker's comp question, right. So just discuss what you're seeing in terms of loss costs. You've seen one big -- we've seen like one big worker's comp writer in the U.S. talk about elevated frequencies, first half of the year. Just what are you seeing in terms of frequency and severity, and -- after you spoke and then what's your outlook for loss costs trends in that line.

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Well, first of all, we're very happy with our worker's comp business. We take a very specialized approach, and that's been a very good business for us. The amazing thing right now is when you look at the loss ratio trend on our overall worker's comp book, it's actually flat to negative a little bit. And what I mean by loss ratio trend, we take a look at loss costs. We take a look at frequency, severity and then what's going on in the economy on payrolls. Severity is going up, but the change the improvement in frequency is offsetting the upward change in the severity on our worker's comp book. And then when you add the growth in wages, the effect of the economy, we come up with -- on our book right now a loss ratio trend of flat to down a little bit. So we think that's a good thing. As far as outlook, a little early for guidance and all that. But if you were to ask me today on our whole worker's comp business, I think that 2019, we're going to continue to make healthy calendar year and healthy accident year underwriting profits there overall. And I think our main -- our 3 main businesses there are Republic, which is mainly California comp, Summit or Southeastern comp and Strategic Comp, probably the one that -- California probably ends up being closer to a very small accident year underwriting profit next year or breakeven. Florida, if we took the State of Florida on its own, could be breakeven to a little bit over. But when you put all of our comp business together as an entity, I think we're still going to have healthy accident year and calendar year underwriting results with good returns. I think on the growth side, right now because of some rate decreases in various states, I think our premiums will probably be flat to down mid-single-digit next year. Again, it's early, but that would be the way how I'd look at it.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Got it. Very helpful. One for you, Craig. I'm just thinking about the recent, like dock unlocking charge due to the higher option costs. What drove that charge? And what are the other factors that you're keeping an eye on to make sure that you don't have to record another premium deficiency?

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Sure. So it is unusual for us to do an unlocking in an interim period. Normally we do a very complete review in the fourth quarter of the year and take a look at all the assumptions that the actuaries have used related to profitability of the business. We were seeing a trend for several quarters of higher hedging costs, higher option costs, driven principally by higher short-term interest rates. And this is a phenomenon that wasn't unique to us. It's affecting everybody in the indexed annuity business. So we just -- we took a look at it. We made the determination that it wasn't a temporary thing. We made the determination that it was kind of a permanent change and thought it was the appropriate thing to go ahead and recognize that in the second quarter, even though typically, the fourth quarter is when we look at unlocking stuff.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Right. Got it. And kind of just shifting a little bit, crop. So are there any negative potential implications for agricultural subsidies in the crop book?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

I don't think so. I don't think the payments on -- the tariff payments really are separate from the MPCI program. I think probably the biggest impact around the tariffs in that, and it's more on commodity prices themselves in that. Just the administration's approach on tariffs overall has had a downward -- some downward pressure. Most of the commodity prices are dictated by normal supply and demand. But I do think the administration's policies have impacted prices. Obviously, there wouldn't be any tariff necessary -- it wouldn't be necessary for there to be the tariff payment type of program, to begin with. Crop year is shaping up nicely. I think when you look at the corn and soybeans, which are in our book of business are 65% or so or more of the total multi-peril crop premium. 2/3 are good to -- are rated good to excellent right now. Corn and soybean yields are being projected by the USDA and others to be at record levels. That's usually a good thing. The discovery prices themselves, again, it's a 30-day average in October of -- November, December contract. So until we get most of the way through October, it's harder to prognosticate. Corn is down about 8%. Soybean, discovery prices on those futures are down roughly 17%, 18%. Generally, when yields are strong, you can work your way through even 16% to 18% declines in prices in that. But a lot of people don't know about the government multi-peril crop program, is the farmers generally choose up deductibles of 15% and higher. So before there's yield changes or prices that are down on average more than -- much more than 15%, you don't really -- you're not exposed to losses.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Okay. Any questions from the audience? Okay. So another Annuity question for Craig. So you referenced your consumer-centric Annuity business. Given AFG typically pays lower commission, how are you able to successfully grow it given that's your cost base?

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

We do estimate that our average commissions are 1.5 or 2 points lower than the average of the industry. That obviously allows us to give more value to the customer. Our consumer-centric model plays really well in this environment for a number of reasons. Our products generally are much easier to understand. We typically have shorter surrender charge periods. Most people think that we're kind of in the beginning of an upward trend in rates today. So the fact that we're selling shorter products, shorter surrender charge periods is a real selling factor. And there are other reasons that distribution or customers want to do business with a given company. We have an excellent reputation on giving great service, having consistent ratings. You go back to the 2009, 2010 period, most annuity companies were being downgraded. In some cases, they were capital-constrained because of our philosophy of carrying excess capital. And because of the great diversification we have in lines of business, we did not receive a downgrade during that period of time. We were not capital-constrained. We were able to grow our -- basically, take on all business that we could get so long as we were earning a right rate of return. So I think just the predictability of our company. We've been in the business for a long, long time. We view that we're a high-quality company, that we'll always be there, always have the capacity to write business. And our consumer-centric model is playing very well in this environment.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Okay. And then, probably, I have time for one more, really briefly. Commercial auto. You'd mentioned -- I think, Carl, you had mentioned National Interstate outperforming your expectations when you bought the rest of it. So what are you just seeing in terms of rates and loss cost trends across that broader book?

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Well, the commercial auto overall, industry wide and in our case, yes, loss costs -- if there's an area where loss costs were increasing, the higher rate, it's in the commercial auto area. And commercial auto liability, even though National Interstate's accident year combined is under 95, we're still taking rate particularly in the commercial auto liability part of that. We're making a small underwriting profit there, but we want to improve that further. So we are -- I think kind of like our 6-year rate, Jeff?, but it's focused on the commercial auto liability part of that. So when you take a look at an industry that's still way above 100 and our business is generating real solid underwriting profit returns. We got at it much earlier. We've been at it for trying to improve things for 5 years and happy to report that I think we've achieved that. Now I'd love to see us take advantage of some of the disruption and continue where the industry is continuing to have to take rate in that. I'd love to see us be able to take advantage of growing the business more.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Yes. Excellent. All right. So I think we're out of time. So thank you, gentlemen for joining us. We appreciate it.

Stephen Craig Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Thank you.

Carl Henry Lindner - *American Financial Group, Inc. - Co-President, Co-CEO & Director*

Thanks.

Christopher Campbell - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Thank you.
