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AFG.N - Q4 2020 American Financial Group Inc Earnings Call

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OVERVIEW:

Co. reported 4Q20 net EPS of $7.93. Expects 2021 initial non-GAAP core net operating EPS to be $6.25-7.25.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the American Financial Group 2020 Fourth Quarter Results Conference Call. (Operator Instructions) As a reminder, today's program is being recorded.

I would now like to introduce your host for today's program, Diane Weidner, Vice President of Investor Relations. Please go ahead.

Diane P. Weidner - *American Financial Group, Inc. - VP of Investor & Media Relations*

Good morning, and welcome to American Financial Group's Fourth Quarter 2020 Earnings Results Conference Call. We released our 2020 fourth quarter and full year results yesterday afternoon. Our press release, investor supplement and webcast presentation are posted on AFG's website under the Investor Relations section. These materials will be referenced during portions of today's call. I'm joined this morning by Carl Lindner III; and Craig Lindner, Co-CEOs of American Financial Group; and Brian Hertzman, AFG's CFO.

Before I turn the discussion over to Carl, I would like to draw your attention to the notes on Slide 2 of our webcast. Some of the matters to be discussed today are forward-looking. These forward-looking statements involve certain risks and uncertainties that could cause actual results and/or financial condition to differ materially from these statements. A detailed description of these risks and uncertainties can be found in AFG's filings with the Securities and Exchange Commission, which are also available on our website.

We may include references to core net operating earnings, a non-GAAP financial measure, in our remarks or in responses to questions. A reconciliation of net earnings attributable to shareholders to core net operating earnings is included in our earnings release.

And finally, if you are reading a transcript of this call, please note that it may not be authorized or reviewed for accuracy, and as a result, it may contain factual or transcription errors that could materially alter the intent or meaning of our statements.

Now I am pleased to turn the call over to Carl Lindner III to discuss our results.

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

Good morning. We released our 2020 fourth quarter and full year results yesterday afternoon; and Craig and I are delighted to report a very strong finish to the year.

AFG's core net operating earnings were $8.44 per share for the full year of 2020, compared to $8.62 per share in '19. Fourth quarter 2020 core operating return on equity was in excess of 14%, as indicated on Slide 3. Capital management is one of our highest priorities. And returning capital to our shareholders is an important component of our capital management strategy, and reflects our strong financial position and our confidence in AFG's financial future. Craig and I are pleased that we returned $649 million to shareholders during the year. In addition to $313 million in share repurchases, we paid $336 million in dividends during the year, representing $163 million in regular common stock dividends and a $173 million special dividend. And our quarterly dividend was increased by 11.1% to an annual rate of $2.00 per share beginning in October of 2020.

We're also proud of our track record of value creation for shareholders. Growth in adjusted book value per share plus dividends was 13% in 2020. AFG's 10-year total shareholder return, representing growth in share price plus dividends, was approximately 287%, exceeding the total return performance of the S&P 500, the S&P Property and Casualty Index and the S&P Life & Health Index over the same time period.

Now turning to Slide 4 for a view of the 2020 fourth quarter. AFG reported record core net operating earnings of $3.09 per share, compared to $2.22 per share in the fourth quarter of 2019. Fourth quarter results included $0.84 per share in earnings from alternative investments that are marked-to-market through core earnings, compared to $0.32 per share in the fourth quarter of 2019. We're very pleased with the rebound in the performance of these assets, which were adversely impacted by the downturn in financial markets in the first half of 2020 as a result of the pandemic. Annualized core operating return on equity in the fourth quarter was an exceptionally strong 20.3%.

Now turning to Slide 5, you'll see that the fourth quarter net earnings per share of $7.93 included after-tax non-core items aggregating to $4.84 per share. A significant component of these non-core items included realized gains on securities of $5.36 per share, the majority of which pertain to the transfer of investments in AFG's annuity block reinsurance transaction that was entered into in October, and the mark-to-market of equity securities that AFG continued to own at December 31, 2020.

We're extremely proud of AFG's fourth quarter and full year 2020 results, especially in a year fraught with challenges, including a global pandemic, the related economic disruption and a heightened level of natural disasters. None of us would have imagined the challenges 2020 would bring but we are extremely proud of these results and the resiliency, dedication and the creativity of our employees over the many months. Craig and I thank God, our talented management team and our employees for helping us to achieve these results and position our business for continued success.

Last week's announcement about the sale of our annuity business brings significant changes to the way AFG will report its results in 2021. Looking forward, we have established initial 2021 core net operating earnings guidance per share to be in the range of $6.25 to $7.25. There are several important assumptions underlying this guidance, including the expectation that earnings from our annuity business will be classified as discontinued and reported as non-core effective January 1, 2021. In addition, our guidance assumes no earnings on the cash proceeds from the sale, and an expectation that the AFG Parent will have $43 per share in cash and real estate-related investments following the close of the sale. Craig will talk more about the details, including pro forma financial results and expectations during his remarks, and I'll review detailed guidance for each of our property and casualty businesses later in the call.

Now I'd like to turn our focus to our Property and Casualty operations. If you'd please turn to Slide 7 and 8 of the webcast, which include an overview of our fourth quarter results. As you'll see on Slide 7, core operating earnings in AFG's Property and Casualty insurance operations were $274 million in the fourth quarter of 2020, a new quarterly record for AFG, and a 38% increase from the prior year period. Significantly higher year-over-year Property and Casualty underwriting profit and higher earnings from alternative investments were partially offset by lower other Property and Casualty net investment income, primarily the result of lower interest rates.

The Specialty Property and Casualty insurance operations generated an underwriting profit of $179 million in the 2020 fourth quarter, compared to $89 million in last year's fourth quarter. Higher underwriting profitability in our Property and Transportation and Specialty Casualty Groups were partially offset by lower year-over-year underwriting profit in our Specialty Financial Group.

Fourth quarter 2020 combined ratio of 86.2% improved 7.3 points from the 93.5% reported in the comparable prior year period. Results for the 2020 fourth quarter included 1.5 points in catastrophe losses and 2.4 points of favorable prior year reserve development. We continue to carefully monitor claims and loss trends related to the COVID-19 pandemic. Numerous legislative and regulatory actions, as well as the specifics of each claim contribute to a highly fluid evolving situation. AFG didn't record any additional reserve charges for COVID-19 in the fourth quarter.

Given the uncertainties surrounding the ultimate number or scope of claims relating to the pandemic, approximately 72% of AFG's COVID-19 related reserves from the $95 million in charges recorded in the first half of 2020 are held as incurred but not reported at year-end December 31, 2020. These reserves represent the Company's current best estimate of losses from the pandemic and related economic disruption. Our claims professionals and those who support them are working tirelessly to review claims with the care and attention each deserves.

Now turning to pricing, we continue to see strong renewal rate momentum, and achieved broad-based pricing increases in the quarter, with exceptionally strong renewal pricing in our longer-tailed liability businesses outside of workers' comp. Our average renewal rate increases are the highest we've achieved in over 15 years. Average renewal pricing across our entire Property and Casualty Group was up approximately 13% for the quarter. And if you exclude our workers' comp business, renewal pricing was up approximately 17% in the quarter.

We believe the current market conditions reflect a continuation of meaningful renewal pricing increases, which have been in response to the low interest rate environment, trends in social inflation, elevated loss, industry loss experience following heavy industry cat experience, higher reinsurance pricing, among other factors. We expect the market to remain firm throughout 2021, allowing us to achieve attractive renewal rate increases in excess of loss costs.

Now gross and net written premiums for the fourth quarter were down 2% and 7%, respectively, when compared to the fourth quarter of 2019, primarily the result of the run-off of Neon. If you exclude the impact of the Neon run-off, gross and net written premiums increased 6% and 2%, respectively, year-over-year.

Now I'd like to turn to Slide 8 to review a few highlights from each of our Specialty Property and Casualty Groups. The Property and Transportation Group reported an underwriting gain of $74 million in the fourth quarter, compared to an underwriting loss of $2 million in the comparable prior year period. Improved year-over-year results in our crop operations following 2019 losses from prevented planting, along with significantly improved accident year results in our aviation business and higher profitability in our transportation businesses, were the primary drivers of the improved results.

Fourth quarter 2020 gross written premiums in this group were up 3%. Net written premiums were down 2% when compared to the 2019 fourth quarter. Growth and new business opportunities in our property and inland marine and ocean marine businesses and higher gross written premiums in our crop operations were partially offset by lower premiums in our transportation business, primarily from reduced exposures as a result of COVID-19 and premium reductions in two large national accounts. Higher cessions of certain crop insurance products contributed to the year-over-year decrease in net written premiums in the 2020 fourth quarter. Overall renewal rates in this group increased 5% on average for the fourth quarter of 2020 with continued strong renewal rate momentum.

Now the Specialty Casualty Group reported an underwriting profit of $91 million in the fourth quarter compared to $69 million in the comparable '19 period. Higher year-over-year underwriting profit in our excess and surplus and excess liability businesses and improved year-over-year results in our general liability business were partially offset by lower favorable prior year reserve development in our workers' comp businesses. Though underwriting profitability in our workers' comp business overall continues to be excellent. This group reported an impressive 84% combined ratio for the fourth quarter and 90% for the full year. Improved market conditions in our excess and surplus lines and excess liability businesses have enabled us to achieve significant rate increases and act on new business opportunities as the market has hardened.

Gross and net written premiums in this group decreased 7% and 16%, respectively, for the fourth quarter of 2020 when compared to the prior year period, primarily due to the run-off of Neon. When you exclude the impact of Neon, gross and net written premiums increased 9% and 3%, respectively, in the fourth quarter of 2020 when compared to the same period in '19. Significant renewal rate increases and new business opportunities in our excess and surplus, excess liability and D&O businesses contributed to the growth.

The COVID-19 pandemic has resulted in reduced exposures in our workers' comp businesses, which when coupled with renewal rate decreases in our workers' compensation businesses, contributed to lower year-over-year premiums, partially offsetting the growth in the other businesses within this group. Renewal pricing for this group was up 19% in the fourth quarter. Excluding workers' comp, renewal rates in this group were up approximately 29%, much higher than the renewal rate increases achieved in the first three quarters of 2020.

The Specialty Financial Group reported an underwriting profit of $20 million in the fourth quarter of 2020, compared to $32 million in the fourth quarter of last year or of '19. Lower underwriting profit in our surety and trade credit businesses, along with higher year-over-year catastrophe losses in our financial institutions business were the primary drivers of the decrease. Nearly all businesses in this group continue to achieve excellent underwriting margins.

Gross and net written premiums increased by 2% and 4%, respectively, in the 2020 fourth quarter when compared to the same 2019 period due primarily to the growth in our lender services business, which was partially offset by COVID-related economic impacts in our surety business and tighter underwriting that reduced new business in our trade credit business. Renewal pricing in this group increased each quarter in 2020, and was up approximately 9% during the fourth quarter and 8% on average for the full year. This is the highest overall annual renewal rate increase we have achieved in this group since 2002. These results were driven primarily by improved pricing in our lender-placed mortgage property business and market tightening in our trade credit insurance operations.

Now if you'd please turn to Slide 9 for a summary view of our 2021 outlook for the Specialty Property and Casualty operations. We expect a 2021 combined ratio for the Specialty Property and Casualty Group overall between 89% and 91%. Net written premiums are expected to be 5% to 9% higher than the $5 billion reported in 2020.

Now looking at each segment, we estimate a combined ratio in the range of 88% to 92% in our Property and Transportation Group. Our guidance assumes a normal level of crop earnings for the year. Net written premiums for this group are estimated to be 9% to 13% higher in 2021. We expect our Specialty Casualty Group to produce a combined ratio in the range of 87% to 91% in 2021. Our guidance assumes strong renewal pricing in our E&S, excess liability and several of our other longer-tail liability businesses. We expect net written premiums for this group to be 3% to 7% higher than 2020 results and 5% to 9% higher excluding workers' compensation. The Specialty Financial Group combined ratio is expected to be in the range of 88% to 92%. We expect net written premiums in 2021 to be 4% to 8% higher than 2020 results.

With regard to pricing, we expect overall property and casualty renewal rates in this year, in '21, to be up 6% to 8%. Excluding workers' comp, we expect renewal rate increases to be in the range of 8% to 10% as indicated by the continued pricing momentum we saw through the end of 2020. We expect Property and Casualty investment income to be down 1% to up 3% when compared to results reported in 2020, primarily as a result of continued low interest rate environment.

Now I'll turn the discussion over to Craig to review the fourth quarter and full year results in our Annuity Segment, the impending sale of the annuity business and AFG's investment performance. Thank you.

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

Thank you, Carl. I'll start with a review of our annuity results for the fourth quarter beginning on Slide 10, where you will see the components of pretax annuity core operating earnings.

Fourth quarter 2020 pretax annuity core operating earnings increased 24% year-over-year, reflecting significantly higher earnings from the Annuity Segment's alternative investments. Pretax core operating earnings before alternative investments in the fourth quarter decreased by $7 million, or 8% year-over-year, reflecting an unusually high amount of one-time investment income earned in the fourth quarter of 2019 and the impact of lower interest rates on the Annuity Segment's investment portfolio, including the impact of significantly lower short-term rates on the Annuity Segment's $5 billion of cash and floating rate investments. In total, the Annuity Segment achieved a core operating return on equity of nearly 15% in the fourth quarter of 2020 and approximately 11% for the full year.

The Annuity Segment's GAAP return on equity, which includes all operating and non-operating earnings and the block reinsurance transaction, was an impressive 27% in the 2020 fourth quarter and 16% for the full year. The results produced by our Annuity business in the fourth quarter and full year demonstrate the strong fundamentals of our business, our pricing discipline and the success of our operating model. The Annuity Segment continued to have a very strong balance sheet at December 31, 2020, with unrealized gains in the annuity bond portfolio of $2.6 billion, risk-based capital in excess of 400% and capital well in excess of the amounts indicated by ratings agencies to maintain our ratings.

Turning to Slide 11, you'll see that AFG's quarterly average annuity investments and net reserves decreased approximately 10% and 11%, respectively, year-over-year as a result of the annuity block reinsurance transaction, which was effective October 1, 2020. In the absence of the reinsurance transaction, average annuity investments and reserves would have each grown by approximately 5% on a pro forma basis.

On the bottom half of the slide, you'll see information about our annuity spreads, starting with our core net interest spread, which takes into account our net investment yield and our cost of funds. Our core net interest spread was 228 basis points in the fourth quarter of 2020, an increase of 34 basis points over the comparable 2019 quarter. This increase reflects significantly higher returns on the Annuity Segment's alternative investments as well as lower cost of funds resulting from the company's renewal rate strategy. These positive impacts on spreads were partially offset by the negative impact of lower interest rates.

Our core operating net spread earned in the fourth quarter of 2020 was 142 basis points compared to 107 basis points in the comparable 2019 quarter. This 35 basis point increase reflects the same impacts mentioned previously.

We were pleased that returns on alternative investments in the third and fourth quarters of 2020 increased sharply from previous quarters, achieving annualized yields in those quarters of approximately 14% and 17%, respectively. As indicated on Slide 12, gross statutory annuity premiums were $1.32 billion in the fourth quarter of 2020, compared to $1.14 billion in the fourth quarter of 2019, an increase of 16%. This increase was driven by higher sales in the financial institutions channel, as well as higher pension risk transfer premiums. I'm extremely pleased that the sales in the fourth quarter of 2020 were nearly $200 million higher than the fourth quarter of 2019.

Please turn to Slide 13 for a few highlights regarding our $52.5 billion investment portfolio. AFG recorded fourth quarter 2020 net realized gains on securities of $468 million after tax and after deferred acquisition costs. This compares to net realized gains on securities of $51 million in the fourth quarter of 2019. Approximately $292 million of the realized gains recorded in the fourth quarter of 2020 related to the transfer of investments in connection with the annuity block reinsurance transaction. An additional $123 million of after-tax, after-DAC realized gains pertain to equity securities that AFG continued to own at December 31, 2020. As of December 31, 2020, pretax, pre-DAC unrealized gains on AFG's fixed maturity portfolio were $2.8 billion.

We believe our investment portfolio is appropriately positioned for this uncertain economic environment. As you can see on Slide 14, our portfolio continues to be high quality, with 88% of our fixed maturity portfolio rated investment grade. In addition, the percentage of fixed maturity investments rated non-investment-grade by the NAIC remains at less than 3% of total fixed maturity investments at December 31, 2020.

I will now turn the discussion over to Brian, who will discuss AFG's financial position and share a few comments about capital and liquidity.

Brian S. Hertzman - *American Financial Group, Inc. - Senior VP & CFO*

Thank you, Craig.

Please turn to Slide 15, where you will find a summary of AFG's financial position at December 31, 2020. We repurchased $80 million of AFG common stock during the quarter at an average price of $74.98 per share. Share repurchases, especially when executed at attractive valuations, are an important and effective component of our capital management strategy. During the quarter, in addition to share repurchases, we returned $216 million to our shareholders with the payment of our regular $0.50 per share quarterly dividend and a $2.00 per share special dividend. In November, AFG redeemed its $150 million in 6% Subordinated Debentures due 2055 at par value. The redemption resulted in an after-tax non-core loss on retirement of debt in the fourth quarter of approximately $4 million or $0.04 per share.

Our excess capital was approximately $1.2 billion at December 31, 2020. This number includes parent company cash of approximately $215 million. We expect to continue to have significant excess capital and liquidity throughout 2021 and beyond. Specifically, our insurance subsidiaries are projected to have capital in excess of the levels expected by rating agencies in order to maintain their high current ratings, and we have no debt maturities before 2026.

Before I turn the discussion back over to Craig to share a bit more color on the sale of the annuity business, I wanted to make a couple of comments about corporate overhead expenses going forward. Historically, we have allocated overhead expenses to our P&C and Annuity segments to the extent that those expenses directly benefit those operations. Consequently, there will be about $15 million in expenses currently allocated to the Annuity Segment, like the expenses of our in-house investment management, that will not go away as part of the sale. For other currently shared services like IT, there's an 18-month transition services agreement under which MassMutual will be reimbursing us for those costs that benefit the Annuity Segment.

I mentioned the in-house investment management as an example of an expense that won't go away with the sale, but I would be remiss if I didn't share with you the fact that, even post sale of the Annuity Segment, our investment management expenses at the current level are lower than what we would be required to pay an outside investment manager.

Another important note, the impact of the $15 million in retained expenses following the sale are fully loaded in the guidance that we have provided. We feel like we run an efficient organization and are excited about growth opportunities in our Property and Casualty operations. Supporting prudent growth in Property and Casualty is the first place we will look to deploy any resource capacity created by the sale.

I will now turn the discussion back over to Craig for some additional thoughts on the sale of the annuity business, including the significant liquidity and excess capital generated by the transaction and other financial impacts.

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

Thank you, Brian.

Before I turn to a discussion about the sale, I'd like to start with a word of thanks. Our people, culture, products and business model have propelled AFG's annuity business and enabled us to emerge as a market leader. Carl and I are thankful for the many contributions of our Annuity associates and AFG employees who've been an important part of the growth and profitability of our annuity business, and we're pleased that our Annuity Group associates will have the opportunity to become part of a new beginning with a great company, MassMutual.

One of the true joys of my business career has been working with our associates to build this company together, and I'm thankful for their contributions to our success. Now, I'd like to turn to Slide 16, which outlines a few highlights from last week's announcement about the sale of AFG's annuity business to MassMutual.

Under the terms of the agreement, AFG's annuity businesses will be sold to MassMutual for $3.5 billion in cash, subject to final closing adjustments to the extent that GAAP shareholders' equity excluding AOCI of the entities sold varies from $2.8 billion. GAAP shareholders' equity excluding AOCI of the entities to be sold was $2.9 billion at December 31, 2020. AFG expects to recognize an after-tax gain on the sale of $620 million to $690 million or $7.10 to $7.90 per share when the sale closes, which is expected to occur in the second quarter of 2021. In addition, prior to the completion of the transaction, AFG Parent will acquire approximately $500 million in real estate-related partnerships and directly owned real estate from GALIC.

AFG's 2021 earnings guidance and the December 31, 2020 pro forma financial information provided assumes that the $500 million in real-estate related investments acquired from GALIC will reside within the AFG Parent. We're continuing to evaluate the merits of including these assets within the P&C investment portfolio, and we'll provide additional details when we make a final decision. This transaction will result in AFG's exit from the fixed and indexed annuity market.

We have long believed there was a compelling value in AFG's business model, with both a Specialty P&C business and a market-leading fixed and indexed annuity business. In today's environment, we believe AFG's common shares have been undervalued because the market has not fully recognized the value of our annuity business. AFG's stock has been trading at a significant discount to the value we believe is appropriate, given the high quality of our insurance businesses. We are always looking for ways to create long-term value for our shareholders, and in the fall of last year, we began internal discussions regarding the future of the annuity marketplace, and whether we should consider a sale of AFG's Annuity business.

Key considerations beyond an appropriate valuation were the continued employment of our employees, ensuring that our policyholders would be treated fairly, ensuring that our distribution partners would have an impeccable business partner and finding a buyer that would support the local community. In achieving a sale price that represented the full value of AFG's market-leading annuity business, we sought a buyer that would give appropriate consideration to the following: AFG's high-caliber annuity product portfolio, high-quality investment portfolio, and a business model which collectively enabled the Company to effectively navigate multiple economic cycles; the Annuity Segment's strong brand recognition as a member of the Great American Insurance Group; an annuity business with industry leadership in several important product lines and distribution channels, including indexed and the financial institutions channel; and an infrastructure comprised of high-quality annuity professionals and systems.

MassMutual's commitment to establish a subsidiary in Cincinnati ensures that the agreement will have no impact on GALIC's relationships with and commitments to its annuity policyholders and distribution partners. Importantly, we are very pleased that the transaction will provide compelling career opportunities for our annuity associates, and allow this annuity business to remain part of the Greater Cincinnati community.

This transaction simplifies AFG's business model by creating a stand-alone specialty Property and Casualty company that highlights AFG's long-standing top performance as a specialty P&C franchise in a more transparent manner. Pro forma financial information is provided on Slide 17, and illustrates how the transaction will significantly enhance AFG's excess capital and liquidity.

On a pro forma basis, AFG's parent cash as of December 31, 2020 was $3.2 billion, and excess capital increased from the $1.2 billion reported at December 31, 2020 to an estimated $4.4 billion. As for use of proceeds, the ultimate deployment of this capital has not been determined. We are continuing to review options that provide the best opportunity to create long-term value for our shareholders, and we'll continue to evaluate opportunities for deploying AFG's excess capital. Alternatives include the potential for healthy, profitable organic growth, expansion of our specialty property and casualty niche businesses through acquisitions and start-ups that meet our target return thresholds, as well as share repurchases and special dividends.

We will now open the lines for any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Mike Zaremski from Crédit Suisse.

Michael David Zaremski - *Crédit Suisse AG, Research Division - Research Analyst*

Hey, good afternoon. Thanks. Okay. A number of questions. I guess thanks for some of the color about the rationale for the sale. I guess the biggest, the number one question we're getting from investors is how to think about the use of proceeds. So I know it's a broad question, but maybe you can touch on whether -- how you think about M&A versus you did cite earlier, you feel the stock valuation, I believe, is inexpensive. So if you can touch on that first? And then I have a follow-up.

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

Sure. We just signed a deal up just in a short period of time ago. So I think now we're going to move towards closing the deal. And I think as we have always, over the years, our use of capital, excess capital is going to be what we consider to be the highest and best use and the highest returning types of uses.

And if you look at us historically, that mix is a mix of organic growth. We've done some acquisitions. We've repurchased our shares, our stock when we thought it was undervalued. Clearly, we continue to think our stock is undervalued today. And we've also done a combination, along with stock purchases, of extraordinary dividends. We're proud of our track record of increasing our annual dividend. So I think we're working with a larger pool of excess capital than usual. So I think as we have in the past, Craig and I and our team will thoughtfully and strategically, moving forward from today, consider all those things and what makes sense.

Again, we're very much aligned with shareholders. Our family and our management team own a big chunk of the stock. And we think like shareholders. We want to continue to build significant shareholder value going forward. So we'll be thoughtfully and strategically thinking about that now that we have that deal, the MassMutual deal signed up. And that, Craig, do you have any other thoughts?

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

Carl, I think you stated it very well.

Michael David Zaremski - *Crédit Suisse AG, Research Division - Research Analyst*

I guess, Carl, as a follow-up to that. You didn't mention anything about deleveraging. Should I be reading into that you're not saying that or that's in the cards, too?

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

Brian, do you have any color on that?

Brian S. Hertzman - *American Financial Group, Inc. - Senior VP & CFO*

Sure. So depending on how we want to use the proceeds, we could use up to $2 billion of the proceeds, for example, to buyback stock or pay special dividends without violating any of our debt covenants or commitments to ratings agencies. So we have flexibility there without having to retire debt. We feel like we've positioned our debt at a very attractive interest rate. So to the extent we can deploy that capital in our operations that's, at the moment, probably a better use than buying back debt. So not that we wouldn't consider it, but it's not one of the major considerations.

Michael David Zaremski - *Crédit Suisse AG, Research Division - Research Analyst*

Okay. That's helpful. I'm going to switch gears to the P&C operations and maybe re-queue. In terms of the top line growth expectations of, I believe it was 4% to 9% for 2021. That compares to, I think, 2% on an apples-to-apples basis, correct me if I'm wrong, in 4Q. I know there's a lot going on, but maybe you can kind of talk to kind of where you see some of the pluses and minuses or where that momentum is coming from in terms of the top line growth expectation?

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

Yes. I think the guidance we put out there is 5% to 9%. Excluding comp is 6% to 10% in that. Our best guess, I think, obviously, COVID will have some impact early on. We're betting that the economy continues to gain strength and improve in that. I think the good news, in our case, is we think we have some good, broad-based opportunities to grow our business this year in each of the different segments in that.

So we're very excited about the opportunity for National Interstate, for instance, in our commercial auto-oriented subs. Now that we're meeting our return targets or combined ratio targets. Commercial auto, even on commercial auto liability, we're meeting our targets. So we think there are good opportunities in that part of our Property and Transportation businesses.

If you've been watching crop prices, for instance, corn and soybean futures prices, if that holds up through the month of February, which kind of the base prices are figured on, we could see that business grow 15%, 20%, at a double-digit rate. We've had some nice growth in our property and inland marine business. We think that will continue. Specialty Casualty, gosh, I think we're still going to see good opportunities to grow our excess and surplus lines business, our D&O business, our excess liability business, our human services business, our public sector business, pretty broad-based opportunities there.

And in the fourth quarter, I was pleased to see even in our Specialty Financial segment, where the pandemic and the bank's approach in the lender-placed property part of the business, we grew some in the fourth quarter. So I think this year, I think we'll begin to see some growth there and in businesses, maybe even trade credit as things have stabilized, in surety as the economy improves. Fidelity and crime, we're one of the top in market share, one of the top players in that business. And I think we'll continue to have good momentum and good opportunities in that. As our aviation business has improved dramatically in profitability going back to P&T. I guess, aviation, even in the Property and Transportation, we see some opportunities to grow. So I think the good news that we see is, I think we have some pretty broad-based opportunity for organic growth. I hope that gives you some color.

Michael David Zaremski - *Crédit Suisse AG, Research Division - Research Analyst*

Yep, that's helpful. Thank you.

Operator

Our next question comes from the line of Paul Newsome from Piper Sandler.

Paul Newsome - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Good morning. Thanks for answering the questions. I wanted to ask you about M&A focus. Historically, the firm has been very focused on sort of that $200 million-ish acquisition price. I was wondering, given the fact that you have a lot more cash than that, does that change the sort of acquisition strategy that you historically had. Does it open up for more opportunities or different opportunities than you've had in the past?

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

Good morning Paul. I think generally, what I've said historically is, is our sweet spot is kind of $50 million to $500 million actually. When you look at the Summit transaction, that was $400 million-ish. And the buy-in of National Interstate, that was in the same territory and all that. That seems to be our sweet spot. As we have more excess capital, if there was a really great opportunity for us to add to our existing great franchise, sure, we would look at something like that. The difficulty is, is when you look around and you look at our returns on equity in our property and casualty business, there really aren't -- I mean, repurchasing your own shares and owning more of an entity and a franchise that is already earning great returns, acquisitions have to compete with that. So again, it gets back to, we think that we're pretty intelligent managers and users of excess capital, if you look at the blend over the years. And for us to do something larger would really have to be very attractive, and we'd have to be very confident that it would be a great add to our franchise.

Paul Newsome - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Fantastic. Appreciate it. Congratulations on the quarter.

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

Thank you.

Operator

Our next question comes from the line of Greg Peters from Raymond James.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

Good afternoon, everyone. Congratulations on just a monumental decision on behalf of the organization. Listen, I realize the ink is still drying from the transaction and you're not willing to talk about what you're going to do with the capital yet. One of the considerations that has crossed my mind is that with the reduced earnings power of the company because of the sale, that at some point down the road the payout ratio for your dividend might come under review. And I was just wondering, obviously, there's a lot of ground to cover between now and then, but I'm just curious how you view the payout ratio in the context of the earnings power of the company going forward.

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

Yes. Greg, this is Craig. I mean, the reality is, we're not going to be earning zero on the cash in the parent forever. So I wouldn't jump at a conclusion that the earnings power of the company is greatly diminished. We have to decide what we're going to do with the excess capital and cash in the parent. But certainly, the ability to pay the dividend in place today or continue, our goal has always been to raise the dividend each year at a double-digit pace. I think, if anything, this transaction enhances that ability.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

Okay. I know on Slide 16 of your presentation, you provided us a GAAP...

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

No. I mean, another, I mean, I don't really understand the question too much, to be honest, it's not very intuitive. If we're saying we have a business that's going -- our core business is going to earn the range of earnings that we are, and we pay a $2 annual dividend. That would say that there's no problem with that and we're generating excess capital. So really don't understand your question much. Sorry about that.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

That's all right, [Carl]. It's a fair response. I just was looking at, listen, your record on capital returns is among the best. But you're, at some point, you're missing the annuity earnings and that was part of the blended consideration that went into your payout ratio. But listen, I don't want to -- it's not worth arguing about or discussing.

The other question I had for you considering the strong results you've posted in your Property and Transportation, Casualty and Financial businesses, and you talk about the rate increases. The Casualty business, I think you said your rates are up 19% and I'm just curious what your perspective is about the balance between getting all that rate and actually growing your business more because when you're guiding to combined ratios in the high 80s and low 90s, it seems like you're near targeted return levels, at least from a combined ratio perspective.

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

I think that's a good question. I think it really differs tremendously line by line when you look at things. We're doing very well. We've always done very well in the excess liability arena, even when rates were lower than what they should have been in the industry in that. And as rates have increased the way they have, that business has grown tremendously. So we've really used it as an opportunity to grow a lot.

In the D&O arena, as the technical rate for public D&O has looked more attractive for certain companies risk by risk, we've been writing more. Our appetite went from zero, for instance, for public D&O over the past years to having more of an appetite because the technical rate for certain risk looks pretty good.

So strategically, it really, Greg, kind of it's business by business in that. I think we're in a enviable position of having solid underwriting profits. And going into this year, continuing to be able to make those decisions line by line, getting rate increase that exceeds loss cost and being able to choose line by line whether we go more with growth or what, have more margins. So I hope that gives you a little bit of color.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

It does. Thank you. The final question on Page 16 of your slide deck, you said the GAAP shareholders' equity excluding AOCI of the entities to be sold was $2.9 billion at year-end. What was the GAAP shareholders' equity, including AOCI, of the entities to be sold at the end of December 31, 2020? Did I miss it somewhere in the press release?

Brian S. Hertzman - *American Financial Group, Inc. - Senior VP & CFO*

It's another $1 billion or so of equity in the business. Ultimately, that will go away with the sale. We'll be much less leveraged from an investment perspective and our AOCI balances will be smaller post transaction.

Charles Gregory Peters - *Raymond James & Associates, Inc., Research Division - Equity Analyst*

Got it. Thank you for the answers.

Operator

(Operator Instructions) Our next question comes from the line of Meyer Shields from KBW.

Meyer Shields - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Great. Two questions. One, on the deal, can we get a sense of how much of the net corporate expenses are going to be reimbursed by MassMutual on an annual basis?

Brian S. Hertzman - *American Financial Group, Inc. - Senior VP & CFO*

I'm sorry. Can you repeat the question? I'm sorry.

Meyer Shields - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Right. So just expense model, sort of what corporate expenses look like after the deal. And I understand that $15 million that had been allocated to annuities stayed with P&C. But there are some expenses apparently where the MassMutual will be bearing those expenses. I'm just wondering if that number is available.

Brian S. Hertzman - *American Financial Group, Inc. - Senior VP & CFO*

So just to, I guess, to clarify that a little bit. So the annuity, the expenses that MassMutual will be reimbursing are expenses that are inside the annuity earnings. So we're excluding everything annuity in our guidance. So that won't really affect AFG's ongoing results because they're just going to be sort of reimbursing us at cost for those services. So the real change in expenses is pretty much as simple as add $15 million to what we currently have, as that would be our expectation going forward. There won't be anything really going away. That $15 million is sort of the net number.

Meyer Shields - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Okay. No. That's perfect. And then looking at potential M&A, I guess, one of the assumptions I would make is that since pricing for a lot of specialty lines is getting better right now, the only properties that are available might need some significant turnaround efforts. I don't know if that sentiment is something that you would share. I was hoping you could talk about, if it is your comfort in terms of buying something that you'd have to fix?

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

Gosh. That would be so acquisition specific. And if we have in-house street-smart knowledge about a given business and understand it well and think we can turn things around, we might do something. I mean, the Atlas transaction was a little bit like that. A company that was in trouble in that. And we managed to take a piece of the paratransit part of that business and some other risks and define what we know and what we're good at and what we think we could fix and do well. And so we did that transaction. It wasn't a big transaction, but we're writing -- I think we ended up writing maybe $40 million of premium at our prices and at great underwriting, great returns. So if there's something larger that we feel that we have the expertise in, I might give that a try in that. So I really, it's really entity-specific and whether we have the in-house knowledge to tackle things in that.

I mean, frankly, right now, we have such good opportunities, I think, organically and in some of the new businesses we've -- new lines we started in that. I want to be careful about getting our management's team distracted by taking on too much of a fixer upper, if you understand what I'm saying.

Meyer Shields - *Keefe, Bruyette, & Woods, Inc., Research Division - MD*

Thank you. That was very helpful. Thank you so much.

Operator

Our next question is a follow-up from the line of Mike Zaremski from Crédit Suisse.

Michael David Zaremski - *Crédit Suisse AG, Research Division - Research Analyst*

Yes. Just one clarification. The $500 million of real estate that you're retaining that was associated with the annuity deal. Can you explain, are you paying outright $500 million for that and we should deduct that from the sale price? I'm sure we can back into it looking at the math. I just wanted to have some clarification on what's going on there.

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

Sure. This is Craig. The answer is yes. We are going to be purchasing around $500 million or a little over $500 million of real estate as part of the deal. So if we end up deciding to hold the real estate in the parent, then I think that you reduce the cash in the parent by $500 million, and that is the way we presented things in our pro forma, is when you look at the pro forma cash in the parent, it is as if we're going to hold that $500 million plus of real estate in the parent. As I said in my comments, we are studying whether or not it makes sense to hold some or all of those real estate assets in the Property and Casualty company. And if we do that, if we decide to do that, then potentially there's an extra $500 million plus of cash in the parent versus the pro forma numbers that we presented to you today.

And let me take just a minute also and give you the logic behind that. That was a requirement of mine as part of the deal was to allow us to buy those real estate assets at book value. And the reason that I wanted to do that is the vast majority of the real estate assets are multifamily investments and they're investments where we hold an 80% position. It's a limited partnership. But what I would say is, we're very active in selection of the properties, very active in the decision to monetize those properties from time to time. And with an 80% position, you have a lot of influence even as a limited partner. Those properties, those investments were jointly held between Property and Casualty and Annuity, and to split the investment position and take our position from 80% to 40% would greatly diminish our influence. They've been very, very strong performing investments in excellent markets, and we expect that they will continue to perform well.

With a smaller amount of directly owned real estate, kind of the same rationale was used. If we owned 100% of a property, to split it up and have MassMutual own 50% and us own 50% didn't make a whole lot of sense. That was the rationale for AFG requiring as part of the deal that we could purchase those real estate assets.

Michael David Zaremski - *Crédit Suisse AG, Research Division - Research Analyst*

Okay. That's helpful. And I can take this offline, too. So you said you're studying, I think, shifting them from the parent to the statutory entity or entities. Is that something we should be thinking about that could impact your financials or maybe any color there?

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

I mean, if we would do that, obviously, earnings would move from the parent into the Property and Casualty company and we would have more cash up in the parent.

Michael David Zaremski - *Crédit Suisse AG, Research Division - Research Analyst*

Thank you very much.

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

Yes, the deal, the signing of the deals, so new. It's something that we want to stay. We want to make sure that we're comfortable with all the different rating agencies, the requirements, they're different and what the capital charges are. We just haven't had time to study it. And so it's something strategically that we're looking at.

Brian S. Hertzman - *American Financial Group, Inc. - Senior VP & CFO*

When you look at the detail we provided on the earnings guidance in the press release itself, you'll see that we identified $0.35 per share in 2021 expected earnings coming from those assets. So if we put them in the P&C Group, that earnings will be in the P&C Group. If not, it will be at the holding company, but that's sort of the contribution we're expecting from those assets in our current models.

Michael David Zaremski - *Crédit Suisse AG, Research Division - Research Analyst*

Thank you.

Operator

Our next question comes from the line of Rudy Miller from The Miller Group.

Rudy R. Miller - *The Miller Group - Chairman, CEO, and President*

Yes. This is Rudy Miller with Miller Group, Scottsdale, Arizona, 72 degrees, everybody, blue sky. I'd like to make a couple of comments first, please. Have been a shareholder through our firm, Miller Group, Miller Capital Corp., Miller Investments, Miller Management, in business a little over 50 years. And we've been following American Financial for a long time.

And one of the things we're most impressed about, and we have been an investor way back starting at $26 a share. And we've added to our position each year, small institution, 100% controlled by myself and just think you guys have done one of the best jobs in insurance management. You're very artful, very thoughtful, bright guys, love our return, think sometimes the analyst -- a lot of questions I heard, I'm on my dollar, my stock. I don't work for those guys. As Chairman of the Board of my firm that I think sometimes the analysts, I don't know why you guys sometimes get discounted by so many analysts out there. That's my opinion to you analysts who are listening.

The job you guys have done on managing is, the multiple that you paid from my calculation regarding what you bought this for compared to other insurance transactions, and I have been in the industry on a public Board and a major shareholder of a pretty large insurance company along the way in my career and I think you guys do one of the best job in your space and how you utilize your investment money is tremendous. And I just really think you do one of the best jobs instead of. And quite frankly, 80% of the questions that were asked you, I got the same information they did. I already had those analyzed out. I thought they were weak questions by some of those analysts that asked you questions, couldn't figure it out since it's already presented. Some color? Yes, correctly. So anyway, I don't have any questions, just keep doing what you're doing, gentlemen. Merci beaucoup.

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

This is Craig. I really appreciate your comments. And I guess the way we look at it is, we try to be as transparent as we can with giving information about our businesses. And if analysts or the market kind of gets it wrong in terms of the valuation or prospects, that creates opportunities for us. Over the years, there have been periods where we've repurchased a very large number of our shares. So I mean, we'd rather have the stock trade at an appropriate valuation. But if it doesn't, that creates opportunities for us also.

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

Yes. Thank you, Rudy. This is Carl. Thank you. Appreciate your feedback. And I have to tell you, we have such a great, deep bench of executive talent and management talent in our insurance businesses. We're just very blessed to be able to work with such a talented group of people, and that's a big part of the secret.

Rudy R. Miller - *The Miller Group - Chairman, CEO, and President*

Well, we really think you guys are doing a great job. I apologize for my voice, had a vocal cord surgery recently, and I don't say a lot. I don't normally go into conference calls, have my lieutenants do it, but I wanted to be on this one myself. And I'll tell you what, in March, I was one of those buyers at $44.75. So every time I see it go down, we just add to our position. In fact, we just bought some when your release came out and we bought on the open. Our last trade was at $87.41.

So we monitor it pretty closely. We don't have the position some people have, but we do real well with American Financial. We like your business and we like your management team. You guys are smart and hard working. And you earned it. I love what you said, your ownership. You are out there for the stockholder. We all participate in the gains and with the way you managed through the pandemic. I don't hear enough positive sometimes. It's always the negative. Hey, once again, I'm going to let you guys go. Thanks for the time and God bless America and let's go give them hell.

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

Thank you.

Operator

Thank you. This does conclude the question-and-answer session of today's program. I'd like to hand the program back to Diane Weidner for any further remarks.

Diane P. Weidner - *American Financial Group, Inc. - VP of Investor & Media Relations*

Thank you all for joining us this morning. We look forward to talking with you again as we share our first quarter 2021 results. I hope you have a great day.

Operator

Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.
