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AFG - Q4 2017 American Financial Group Inc Earnings Call

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CORPORATE PARTICIPANTS

Carl H. Lindner *American Financial Group, Inc. - Co-CEO, Co-President and Director*

Diane P. Weidner *American Financial Group, Inc. - Assistant VP of Investors Relations*

Joseph E. Consolino *American Financial Group, Inc. - CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd*

S. Craig Lindner *American Financial Group, Inc. - Co-CEO, Co-President and Director*

CONFERENCE CALL PARTICIPANTS

Amit Kumar *The Buckingham Research Group Incorporated - Analyst*

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

Jon Paul Newsome *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research and Senior Insurance Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the American Financial Group 2017 Fourth Quarter and Full Year Results Conference Call. (Operator Instructions)

As a reminder, this call is being recorded.

I would now like to turn the call over to Diane Weidner, Assistant Vice President, Investor Relations. Please go ahead, ma'am.

Diane P. Weidner - *American Financial Group, Inc. - Assistant VP of Investors Relations*

Thank you. Good morning, and welcome to American Financial Group's Fourth Quarter 2017 Earnings Results Conference Call.

I'm joined this morning by: Carl Lindner III; and Craig Lindner, Co-CEOs of American Financial Group; and Jeff Consolino, AFG's CFO.

Our press release, investor supplement and webcast presentation are posted on AFG's website. These materials will be referenced during portions of today's call.

Before I turn the discussion over to Carl, I would like to draw your attention to the notes on Slide 2 of our webcast. Certain statements made during this call may be considered forward-looking statements as defined under the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance. Investors should consider the 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 our 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. Thus, 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 H. Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

Well, good morning. We released our 2017 fourth quarter and full year results yesterday afternoon. If you'd please turn to Slide 3 of the webcast slides for an overview. AFG's fourth quarter and full year results established new all-time highs for core operating earnings. Our results were enabled by strong operating profitability in both the Property and Casualty and Annuity segments of our business, strong investment performance and effective capital management. 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.

We paid $421 million in dividends during the year, representing $113 million in regular common stock dividends and $308 million in special dividends paid in May and November of last year. Our quarterly dividend was increased by 12% to an annual rate of $1.40 per share beginning in October of '17.

AFG's 5-year total annualized shareholder return, representing growth in share price plus dividends was approximately 27%, exceeding the total return performance of the S&P 500, the S&P Property and Casualty index and the S&P Life and Health index over that same period.

Turning to Slide 4. We're pleased to report fourth quarter core earnings per share of $2.20, another all-time quarterly high for AFG. Our diversified portfolio of Specialty Property and Casualty and Annuity businesses has enabled us to outperform many of our peers during a very challenging quarter and year for the industry overall. These results include very strong profitability in our Property and Casualty operations and record earnings before the impact of fair value accounting in our Annuity segment. Our core P&C results included income of $0.28 per share related to the Neon reinsurance-to-close transaction.

Fourth quarter annualized core operating return on equity was 17.2% for 2017 compared to 15.7% in '16.

Net earnings per diluted share were $1.84, and included $0.36 per share of net non-core charges, the most significant of which was a $0.92 per share one-time write down of our deferred tax asset due to the impact of a lower U.S. corporate tax rate. We are very pleased that Congress has passed comprehensive tax reform for the first time since 1986. Foreign competitors have had an embedded tax advantage that's been part of the tax code since 1986. By closing the affiliate reinsurance tax loophole and lowering the corporate tax rate, Congress has largely leveled the playing field. Over time, it wouldn't surprise us to see a reversal of a long-term inversion trend and to see insurance companies moving back on shore. We welcome fair competition.

Tax reform is also good news for the economy, and when the economy does well, our insureds need more insurance. Jeff will discuss other non-core items later in the call as he recaps the components of our GAAP earnings.

Craig and I thank God, our talented management team and our great employees for helping to achieve these results, particularly as we and others responded to a heightened level of natural disasters in the U.S., and navigated a continued low interest rate environment.

We have established our 2018 core operating earnings guidance for AFG in the range of $7.90 to $8.40 per share. Craig and I will each discuss our guidance for each segment of our business later in the call. Our core earnings per share guidance assumes an effective tax rate of approximately 20%.

Now I'd like to turn our focus to our Property and Casualty operations. Please turn to Slide 5 and 6 of the webcast, which include an overview of the fourth quarter results. As you will see on the Slide, our Specialty Property and Casualty insurance operations produced very strong core operating earnings and healthy growth during the fourth quarter. On Slide 5, you'll see that gross and net written premiums increased 9% and 7%, respectively, in the 2017 fourth quarter compared to the same quarter a year earlier.

Property and Casualty operating earnings were 29% higher year-over-year. Significantly higher Property and Casualty underwriting profit and lower other expenses were the drivers of the improved results. The fourth quarter 2017 Specialty Property and Casualty combined ratio of 87.3% was 3.1 points lower than in the 2016 fourth quarter, and included six-tenths of a point in catastrophe losses, primarily due to wildfires in California.

The fourth quarter pretax loss from wildfires, net of reinsurance and inclusive of reinstatement premiums was $33 million. Losses related to third quarter catastrophes, specifically hurricanes Harvey, Irma and Maria and 2 earthquakes in Mexico developed favorably by $25 million during the quarter. So total pretax catastrophe losses net of reinsurance and inclusive of reinstatement premiums were approximately $12 million during the fourth quarter. Results also included 4.1 points of favorable prior year reserve development due largely in part to the successful reinsurance-to-close transaction agreement for Neon's 2008 to 2015 years of account and the continued strong results in our workers' compensation businesses.

Overall renewal pricing in our Specialty Property and Casualty group was up 1% during the fourth quarter and was up approximately 1% on average overall for the full year.

Now I'd like to turn to Slide 6 to review a few highlights from each of our Specialty Property and Casualty business groups. Our Property and Transportation Group reported fourth quarter underwriting profitability of $84 million compared to $75 million in the prior year period. Higher underwriting profit in our transportation businesses was partially offset by lower year-over-year underwriting profit in our agricultural operations. Strong yields and relatively stable commodity pricing contributed to very strong profitability in our crop insurance operations during the 2017 fourth quarter, albeit at lower levels of profitability that in the prior year fourth quarter.

Catastrophe losses for this group had a favorable impact of $3 million in the fourth quarter of '17 compared to a $6 million loss in the 2016 fourth quarter.

Fourth quarter 2017 gross and net written premiums in this group were both 8% higher respectively than the comparable prior year period. The increase was primarily attributed to higher crop insurance premiums as well as higher premiums in our Property & Inland Marine and Singapore operations. This growth was partially offset by lower premiums resulting from exit from the customs bond business, which was part of our Ocean Marine operations.

Overall, renewal rates in this group increased 3% on average for the fourth quarter of 2017, with most of our price increase coming from commercial auto and non-crop agribusiness operations. Overall, renewal rates in this group also increased approximately 3% for the full year.

Now the Specialty Casualty Group reported fourth quarter underwriting profitability of $58 million compared to $13 million in the prior year period. The higher underwriting profit was primarily attributed to favorable reserve development within Neon, most significantly in connection with the 2015 and prior year's reinsurance-to-close transaction, attributed to Neon's ongoing lines of business. We also reported higher underwriting profits in our workers' compensation and excess and surplus lines businesses. These improved results were partially offset by lower underwriting profits in our targeted markets operations.

I'm especially pleased with the strong profitability reported by our workers' compensation and excess and surplus lines businesses throughout 2017. Catastrophe losses for this group were $18 million in the fourth quarter of '17 and $4 million in the comparable '16 period, primarily the result of wildfires in California. Gross and net written premiums increased 8% and 9%, respectively, for the fourth quarter of 2017 when compared to the same prior year period. Growth within Neon, resulting from the growth of its portfolio and targeted classes of business, growth in our excess and surplus lines businesses and higher premiums in our workers' compensation businesses all contributed to these results. Rate increases in Florida and the growth in our high deductible workers' compensation business offset premium declines in our California workers' comp book that occurred in response a more challenging rate environment. Renewal pricing in this group increased by 1% in the fourth quarter and was flat overall for the year.

Our Specialty Financial Group reported an underwriting profit of $19 million in the fourth quarter of 2017 compared to an underwriting profit of $20 million in the fourth quarter of '16. All of the businesses in this group achieved excellent underwriting margins. Catastrophe losses for this group had a favorable $5 million impact in the fourth quarter of 2017 compared to a $2 million loss in the 2016 fourth quarter as losses from third quarter catastrophes developed favorably. Gross and net written premiums increased by 16% and 1%, respectively, in the 2017 fourth quarter when compared to the same '16 period. Higher premiums in our lending and leasing businesses, which were largely ceded, were the primary driver of the increase.

Renewal pricing in this group was flat during the fourth quarter, and for the year, it was down about 2%.

Now please turn to Slide 7 for a summary view of our 2018 outlook for the Specialty Property and Casualty operations. We expect a combined ratio between 92% and 94%, and growth in net written premiums in the range of 3% to 7% for the Property and Casualty specialty group overall. And then taking a look at each of the subsegments. We estimate a combined ratio in the range of 92% to 96% in our Property and Transportation Group, and expect net written premiums to be up 2% to 6%. Our Specialty Casualty Group is expected to produce a combined ratio in the range of 92% to 96%, and growth in net written premiums in this group is estimated to be in the range of 3% to 7%. And we estimate a combined ratio in our Specialty Financial Group in the range of 85% to 89%. Net written premiums are expected to be up 2% to 6%.

We do expect 2018 Property and Casualty investment income to grow between 4% and 6% year-over-year. And finally, we expect overall Property and Casualty renewal pricing in 2018 to be up 1% to 3%. Our goal is to secure increases in excess of what we achieved this past year. We, along with our domestic and foreign competitors, will be operating in a new tax environment, so it's difficult to determine in the long run what extent tax reform will impact price.

Tax costs are one of the many components of price, and we believe loss costs continue to be the primary driver of our pricing in our Specialty P&C businesses. Details for each of the Specialty Property and Casualty groups can be found on the slide.

And I'll now turn the discussion over to Craig to review the results in our Annuity segment and AFG's investment performance.

S. Craig Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

Thank you, Carl. AFG's Annuity segment had another record year, achieving pretax earnings of [$380 million] (corrected by company after the call). This record result demonstrates our commitment to achieving appropriate returns on new business and our ability to deliver consumer-friendly products that the market finds attractive.

I'll start with a review of our Annuity results for the fourth quarter beginning on Slide 8. Annuity earnings before income taxes were $97 million in the fourth quarter of 2017 compared to $132 million in the fourth quarter of 2016.

Under GAAP rules, a portion of the reserves for fixed-indexed annuities is considered to be an embedded derivative and is recorded at fair value based on the estimated present value of certain expected future cash flows. The impact of fair value accounting for fixed-indexed annuities includes Annuity interest accreted on this embedded derivative -- derivative reserve, totaling $3 million in the fourth quarter of 2017 and $1 million in the fourth quarter of 2016.

In addition to this interest, Annuity segment earnings are also impacted by other changes in the fair value of the embedded derivative. Assumptions used in calculating this fair value include: projected interest rates, option costs, surrenders, withdrawals and mortality. Variances from these assumptions as well as changes in the stock market would generally result in a change in fair value. Many of these adjustments are not economic in nature for the current reporting period, but rather impact the timing of reported results.

In the fourth quarter of 2017, the benefit of the higher stock market was more than offset by lower than expected interest rates, resulting in a net $11 million unfavorable impact to Annuity earnings. By comparison, in the fourth quarter of 2016, a significant increase in interest rates as well as an increase in the stock market resulted in large favorable impacts on Annuity earnings.

Annuity earnings before the impact of fair value accounting on fixed-indexed annuities were $108 million in the fourth quarter of 2017, up 5% from the prior year period, establishing a new all-time high for AFG.

As you'll see on Slide 9, quarterly average and Annuity investments and reserves grew approximately 10% and 12%, respectively, year-over-year. However, the benefit of this growth was partially offset by the runoff of higher-yielding investments.

Both quarterly periods included the positive impact from a strong stock market and higher-than-expected income from certain investments required to be marked to market through earnings as well as unplanned investment income resulting from early redemptions and other unusual events. In the fourth quarters of 2017 and 2016, AFG conducted detailed unlocking reviews of the major actuarial assumptions underlying its Annuity

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operations. The review resulted in an unlocking charge of $3 million in the fourth quarter of 2017 compared to a positive unlocking of $1 million in the fourth quarter of 2016. Unlocking amounts were included in the Annuity earnings before fair value accounting for fixed-indexed annuities.

AFG's Annuity segment reported statutory premiums of $909 million in the fourth quarter of 2017 compared to $1.1 billion in the fourth quarter of 2016. This decrease resulted from AFG's adherence to pricing discipline and a relatively low interest rate environment.

Although our Annuity sales were down 2% for the full year of 2017, I'm very satisfied with this result, given that industry sales of fixed and indexed annuities are estimated to have been down nearly 9% in 2017.

We believe we continue to be well positioned for the future. Additional information can also be found in AFG's Quarterly Investor Supplement posted on our website.

Please turn to Slide 10 for a summary of the 2018 outlook for the Annuity segment. For 2018, we expect earnings before the impact of fair value accounting on fixed-indexed annuities to be in the range of $400 million to $430 million. We expect our 2018 Annuity earnings to be in the range of $385 million to $425 million compared to $380 million reported in 2017. Our 2018 guidance assumes interest rates and the stock market rise moderately for the remainder of 2018. We also expect more normalized income from certain investments required to be marked to market through earnings and a lower impact in 2018 from unusual investment income items such as prepayment of fixed income securities. Fluctuations in returns on these investments or changes in interest rates and/or the stock market as compared to our expectations could lead to significant positive or negative impacts on the Annuity segment's results.

We expect 2018 Annuity premiums to be up 2% to 6% from the $4.3 billion reported in 2017.

Please turn to Slide 11 for a few highlights regarding our $46 billion investment portfolio.

AFG reported fourth quarter 2017 net realized gains on securities of $4 million after-tax and after deferred acquisition costs compared to net realized gains on securities of $32 million in the comparable prior year period. As of December 31, 2017, unrealized gains on fixed maturities were $619 million after-tax, after DAC, and unrealized gains on equities were $221 million after-tax.

As you'll see on Slide 12, our portfolio continues to be high quality, with 90% of our fixed maturity portfolio rated investment grade, and 98% with an NAIC designation of 1 or 2, its highest 2 categories. We've provided additional detailed information on the various segments of our investment portfolio in the Quarterly Investor Supplement on our website.

I will now turn the discussion over to Jeff, who will wrap up our comments with an overview of our consolidated fourth quarter 2017 results and share a few comments about capital and liquidity.

Joseph E. Consolino - *American Financial Group, Inc. - CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd*

Thank you, Craig. For the 2017 fourth quarter, we're pleased to report core EPS of $2.20. This establishes a new all-time quarterly high for AFG's core EPS.

Slide 13 summarizes AFG's operating earnings results that Carl and Craig have covered. The $2.20 is based on core net operating earnings in the quarter of $197 million. You can see a more detailed view of the components on Page 4 of our Quarterly Investor Supplement.

Property and Casualty pretax operating earnings were up 29% when compared to the 2016 fourth quarter. This is most significantly due to the 42% year-on-year increase in underwriting profit. Underwriting profit improved in our Specialty Property and Transportation subsegment and was essentially flat in Specialty Financial. Our Specialty Casualty subsegment showed the greatest increase in underwriting profit.

Neon, due to the reinsurance-to-close transaction, made a significant contribution, along with several other of our Specialty Casualty businesses, including our workers' compensation businesses and our Excess and Surplus Lines operations.

Catastrophe losses in the quarter were level with last year's quarter, thanks to favorable development on third quarter cat losses. We also had another very strong crop year.

Pretax Annuity operating earnings were $97 million, a decrease of $35 million due to fair value accounting adjustments. Parent company interest expense decreased by $1 million. We look for this to decline further in 2018 after our November 2017 debt retirement and refinancing.

Slide 14 provides a reconciliation of core net operating earnings to net earnings. Net [realized gains] (corrected by company after the call) on securities were $4 million or $0.04 per share in the fourth quarter of 2017. We'd previously announced a loss on the early retirement of AFG's 9-7/8% senior notes, which was $26 million or 29% per share during the quarter.

As Carl noted earlier, due to the impact of tax reform, AFG recorded a one-time write-down of our net deferred tax asset equal to $83 million or $0.92 per share during the fourth quarter. We also recorded a $56 million or $0.62 per share tax benefit from a restructuring of Neon during the fourth quarter. You may recall that AFG had reported a loss in connection with the liquidation for U.S. tax purposes of Neon's parent in the 2016 fourth quarter. Part of that restructuring loss was required to be deferred.

The fourth quarter 2017 sale of an indirect minority interest to certain Neon executives resulted in the recognition of the deferred component of the loss in the fourth quarter of 2017.

Additionally, Neon successfully negotiated a reinsurance-to-close transaction covering its 2008 through 2015 years of account. This generated $24 million of favorable development from Neon in our Specialty Casualty subsegment plus $18 million or $0.19 per share, recognized as noncore as it pertains to Neon's exited lines of business.

Neon reinsured to close it's 2007 and prior years of account in the previous year and now has eliminated all of its legacy loss reserves from the years preceding the arrival of its new management team.

As indicated on Slide 15, AFG's adjusted book value per share was $53.51 as of December 31, 2017. We have paid dividends of $4.79 per share during the year, resulting in growth in book value per share plus dividends of 9.8% during 2017. Adjusted tangible book value per share was $50.95 at December 31, 2017. Parent cash was $300 million at year end 2017. We maintained sufficient capital in our insurance businesses to meet our commitments to the rating agencies. Our excess capital stood at approximately $885 million at year-end 2017. We returned $207 million to our shareholders through dividends during the quarter. Approximately 4.1 million shares remain under our repurchase authorization as of February 1.

Please remember, we plan to hold approximately $200 million to $300 million as dry powder to maintain flexibility for opportunities that may arise. We review all opportunities for the deployment of capital on a regular basis.

In closing, Page 16 presents a single page summary of our 2018 core earnings guidance. Our full year earnings guidance for 2018 now assumes an effective tax rate of approximately 20% on core pretax operating earnings. AFG's expected 2018 core operating results exclude non-core items such as realized gains and losses and other significant items that may not be indicative of ongoing operations.

Now we'd like to open the lines for any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Greg Peters of Raymond James.

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

Good morning, everyone. Thank you for the call. Just a couple of questions for you. I noted your comments about the crop results, and I was hoping you might provide additional detail around not only the full year number for '17 but what you're thinking the outlook for the crop component is for 2018?

Carl H. Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

Hi, Greg. This is Carl. Again, we don't separately report crop. Last -- 2016 was an extraordinary year for crop. Last year, in '17, turned out to be a very good year also. Both of those years are probably above what we would consider to be a normal crop run rate. So in 2018, our guidance assumes a more normal crop operating income run rate, if that's helpful.

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

I guess. Maybe on -- maybe I just can come at this from a different perspective, then. If just look at your consolidated current accident year loss ratio results, and I'm just looking at the full year 2017 versus 2016. I guess this is from Page 6 of your supplement. It looks like there's -- the current year accident loss pick deteriorated 110 basis points. And I guess, when I think about 2018, I'm wondering if you're anticipating another 100-plus basis point erosion in your accident and your loss pick? Or is the pricing environment changing enough where it will stabilize?

Joseph E. Consolino - *American Financial Group, Inc. - CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd*

I guess, Greg, this is Jeff Consolino. I would first kind of give an overarching statement that we've considered not only crop as we've been discussing, but pricing objectives and trends in all of our specialty lines of business within the combined ratio guidance that Carl gave you. So that's our best current estimate of where we're going to wind up. Now in terms of deterioration, I don't like to kind of focus overall. I think, looking at the subsegments is more appropriate. And, for example, we had, in the Property and Transportation subsegment, a movement up in the accident year combined ratio X cats, 2017 versus 2016, of 1.8 points. While crop is fully 2/3 of that move up, we had a very satisfying crop year in 2017, and that move you see is just the fact that 2016 was a superior year to 2017 as we look at the year currently. So even to use the word deterioration on the heels of 2 pretty good years is kind of a contrary thing to say or hard to get your mind around. But that's what the driver is, and rather than trying to parcel this out, I would just focus on our overall combined ratio guidance as the totality of our best current estimate.

Carl H. Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

I think the other thing is, commercial auto, National Interstate and our Great American trucking business is a significant part of the Property and Transportation segment also. That is one place where we did achieve 3% in price increase this past year, where the market, particularly in commercial auto liability and the problems the industry continues to have, I think that will continue to have an opportunity to get some decent price increase in the commercial auto part of our business in that, so.

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

Thanks for the color. I don't mean to over emphasize the current accident year result. I mean, you had a great year end full year result. So maybe just one other question on Property Casualty, and then I have one question for Craig. On Property Casualty, just -- I noticed that a couple of states insurance department commissioners have called for a pass through of tax benefits from the lower federal tax reform and looking to benefit their consumers of the states. So I'm wondering if that's even going to have any impact on any of your businesses. And then I'll just put in the other question for Craig, just -- and then I'll just listen to your answers. Craig, I was just wondering in your sales outlook for indexed annuities, I'm wondering if there's any change in the competitive posture in the marketplace as a result of tax reform? I know some of your competitors are offshore, and I'm just curious if there's any, if you've seen -- noted any change there?

Carl H. Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

So Greg, on the first question. In a very difficult year for the industry, where a lot of lines need some rate, it's kind of hard to talk about competing away benefits when you're in that kind of environment. Plus there's -- not all of our competitors in our specialty markets were taxpaying entities prior to tax reform, so there's also that moving piece. Just to maintain the same returns, there may be some different price needed in that. Tax rate is really only one of the many factors that impacts on pricing. Frankly, the more important factors are loss history, loss trends, expenses, investment yield, reinsurance cost, risk selection and those factors. So that's our take on things.

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

Okay. And Craig, could you comment on sales -- annuity sales?

S. Craig Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

Sure. Greg, what I would say is it's probably too early for us to give an opinion as of whether the tax reform is going to have a big impact on the competitive environment. I have to -- first of all, we were extremely pleased with the outcome, the leveling of the playing field, what I think that was a significant positive for U.S.-based companies that weren't taking advantage of the loophole. I have to believe given companies that were paying very little tax are now going to be paying the same tax as other U.S.-based companies, I have to believe that long-term, that is going to have an impact on their pricing. I don't think they are going to accept -- I wouldn't think that they would now accept the return that is several points below what they were targeting before. So I would hope that longer term, it would have some impact on the competitive environment.

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

Great, thank you for your answers.

Operator

Our next question is from Amit Kumar of Buckingham Research.

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

Thanks & good afternoon and congrats on the quarter. A few questions. The first question sort of goes back to the previous discussion on the agriculture book and the numbers. You used a statement "in a more normal run rate." What exactly is that number when you say it's a normal run rate?

Carl H. Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

Well, looking at what your results are over more of a 5- to 10-year period of time, adjusted for any changes in the program itself, trying to adjust for changes in the program. As you know, there were years where the industry didn't make any money, years of big drought, where the industry didn't make a lot of money or where we made a smaller amount of money. And in this business, you're going to have -- each year is going to be a little bit different. So I think that's the best way that we think that we can project forward, is looking at the business and the changes and then looking at a, what we consider to be a normalized run rate. And in years of drought, where there is heavy drought, that could be lower than that. In years where there's great conditions and prices don't change a lot, you can have more. Some of those things you don't know, and until you -- the whole year's out. In this business, we usually don't know exactly what we have until the time you hit December and January, where you've got all the answers, so.

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

Sorry. I should probably rephrase the question. What I was trying to remember, and I don't have the numbers in front of me, was that below 90% combined ratio? Or is that like an 88% to 90% number? I can always go back and check. But I was wondering if you had those numbers handy on a historical basis.

Joseph E. Consolino - *American Financial Group, Inc. - CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd*

Hi, Amit. This is Jeff. I don't have those numbers handy. And to my knowledge, we don't really present them in any of our investor information.

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

Okay. One can always, I guess, compute them using the stat statements. Moving on to the discussion on commercial auto. Jeff, maybe, can you just give us a quick download on how the loss cost trends are? And if -- is it now in the right direction, et cetera? Just give us a quick update versus the historical perspective.

Carl H. Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

I can give you -- I'll let Jeff think about that, but I can give you a progress report on our commercial auto business, if that would be helpful. Yes, our 2017 calendar year combined ratio for National Interstate improved 3.8 points to 94.6 combined ratio. So we're very pleased with that. Workers' compensation was very profitable. Commercial auto is making an underwriting profit but frankly still needs more rate to get it to the combined ratio, to a level that meets our return objectives long term. Overall, rates for National Interstate, for the year, went up about 4%. Jeff, do you have any thoughts there on loss costs for National Interstate?

Joseph E. Consolino - *American Financial Group, Inc. - CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd*

Sure, and maybe be more broadly for our trucking business as well. So we're clearly watching loss trends carefully, and we have been since 2012 when unexpected severity started to creep into the business. We would measure the long-term loss trend for National Interstate's business somewhere in the neighborhood of 3.5 points plus or minus, maybe a little bit more. On the physical damage side, that was commercial auto liability, it's more muted down around kind of 1.5 points.

Carl H. Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

Yes. Jeff is speaking to our Great American trucking piece, that, which is mainly our owner operator business. We've had great results there in '17, and we got a little bit of price increase there, 2% last year.

Joseph E. Consolino - *American Financial Group, Inc. - CFO, Executive VP, Director and Chairman of the Board of Neon Capital Ltd*

We've been hearing this earnings season from -- same companies you have, and many of whom are great competitors and very respected and we understand there's still a lot of work to do in commercial auto. We've been raising rates since 2012 and try to stay ahead of trend, and we're going to keep at it.

Carl H. Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

Particularly in commercial auto liability, we got some work to do and -- as well as what the industry does. I think, maybe we're improving a little quicker than our peers, and I hope that maybe as other companies retrench that we get some opportunities about that. I know, I think I spoke about Westfield's exit from the truck business, which was right in National Interstate's backyard. And I know we took it -- that provided some fourth quarter opportunities, so. Hoping we get some more opportunities like that.

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

Got it. That's really helpful. And one cleanup and I'll re-queue. This is like a separate question. I know after the sale of the LTC business, there was a small piece of reserves. I think it was $37 million or so as of 2016 10-K. Has that piece generally been silent, or what's the reserve number? Maybe just like a quick 1-minute update on that would be great.

S. Craig Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

Let me get the stats on it. It's a tiny, tiny piece, but let me get my hands on the stats here. Just a second.

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

OK, I'll hop off and you can maybe take other questions and answer it later. Thank you so much and congrats on the quarter again.

Operator

(Operator Instructions) Our next question is from Paul Newsome of Sandler O'Neill.

Jon Paul Newsome - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research and Senior Insurance Analyst*

Hello and thanks for the call. I wanted to ask a sort of philosophical question about M&A, and whether or not this change in tax form changes the kinds of things you're looking for, looking at, perspectively.

Carl H. Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

I don't think it really changes the kinds of things that we're looking at. I think -- I would say that the change in the BEAT provisions probably helped to narrow. They helped to narrow, but not eliminate an embedded tax advantage that foreign competitors have had in potential M&A bidding situations, so. I think probably the beat provisions narrow that advantage a little bit. And so from that standpoint, we think we're fairly careful, thoughtful acquirers of business that demand double-digit returns and that, versus just going for a quick fix that's buying something that's immediately accretive and -- or just accretive, but isn't getting you the right return. So I think that the change, the beat provisions, could probably help us a little bit where maybe we hadn't been as competitive because of our -- the high bar that we have for ourselves.

Jon Paul Newsome - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research and Senior Insurance Analyst*

And seperately, do you think the regulatory environment has changed at all? I mean obviously, you're not necessarily directly affected by this, but we're hearing lot of states talk about trying to roll back rates because of taxes. But is this -- does this signal a change in how regulators are looking at insurance companies, in your opinion?

Carl H. Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

I'd say it's really too early to really kind of have much of an assessment on that, as the tax law is so new, so. I think I made some comments earlier that, where you have a lot of blood on the floor, results that weren't that great this past year. I think that influences things. I think, again, the tax rate's only one piece, when you're trying to price properly in that, loss histories and trends and expenses and your bets and your use of predictive analytics and all that are important factors, probably more important factors than the tax, as far as how you set your rates.

Jon Paul Newsome - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research and Senior Insurance Analyst*

OK, thank you.

Operator

And it looks like we have a follow-up from Amit Kumar with Buckingham Research.

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

I want to go back to the discussion on consolidation. And then when you -- I think it was Paul's question. This might even be closer to Jeff. If you look at the recent market activity with AIG acquiring Validus, apart from the acquisition, they also talked about using third-party capital, et cetera. I was curious, in terms of a thematic thought process, do you think AFG could make something work or look at something or does it make sense, just based on -- you do have the currency, based on the current stock multiple. I mean, has your thought process changed on that front? Or is it just too difficult to make it work?

Carl H. Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

I'm a little unclear of the question. Is it -- is what too difficult to make work?

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

Is, thematically, if AFG were to look at some of the smaller, I guess, Bermuda entities as partners, do you think that makes sense? Or are you so far removed from looking at any reinsurance segment per se? This is like a nonstarter from Day 1.

Carl H. Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

Yes, you know something Amit, one of the reasons we did so well is because of our careful underwriting and appetite and selection around catastrophe business. So I think you're correct. I think it would be hard for us to -- we wouldn't have a big appetite to integrate or acquire or integrate a business that has large property cat exposures or who's overexposed on the property, primary property D&F on that. I think that we have -- with our Neon team today, the other aspect is, is we've really put a quality team in place to give us a play in the property cat part of the market -- that business, on the reinsurance side, and we have a quality team that we've put in place to help us take advantage of opportunities in the D&F marketplace. So we have good quality talent in and, frankly, with that talent, we'd probably have the ability to write as much or little as what we have an appetite for. So really, it doesn't really add much to us to acquire a Bermuda entity or any other entity that is heavily exposed that way, so.

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

Got it, that's what I was looking for. Thanks for the answer and good luck for the future.

S. Craig Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

And Amit, I do have the stats on the long-term care, if you'd like to hear those. At the end of the year, AFG had $38 million of policy reserves in total. Because of the immaterial size of the remaining LTC business, the company certainly doesn't expect to have any material charges in the future. I'd also mentioned that the remaining business is all located in Florida, and the company recently received approval for a 10-year rate plan, which included rate increases in the first 5 years.

Amit Kumar - *The Buckingham Research Group Incorporated - Analyst*

Got it, that's actually very helpful. Thanks so much.

Operator

Our next question is from Greg Peters of Raymond James.

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

Thanks for taking my follow up question, and it's for Craig. I just wanted more color on the Annuity sales guidance in last year's results. I'm wondering if you could provide additional color on top of everything you've already provided on sales results by the bank channel versus independent agent channel. And what your view is for each of those channels for 2018? And maybe update us on DOL? And where, if any, that's going to have an effect in 2018?

S. Craig Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

Okay. Greg, I think, clearly, that we're -- I think distribution had some distractions in 2017, is that looming DOL rule, it was moving all over the place and certainly concerned about where that would end up, had an impact on industry premiums, in my opinion. As you know, what ended up being implemented was DOL light, and has been delayed until July of 2019. FIAs can still be sold by insurance-only agents. I think without a doubt it had -- that distraction had an impact on our sales in the second half of 2017 and clearly, on the industry sales. As I mentioned, the sales of fixed and indexed annuities in the -- in 2017 are estimated to be down 9%. Our hope is that some of the noise around that will be gone this year, and will result in stronger industry premiums. Time will tell, but that certainly is our hope. As it relates to any kind of oversight, I will tell you that we support any rule that requires agents to act in the client's best interest. It's hard to argue against that. We think that our consumer-centric model makes us quite a bit less vulnerable to any Department of Labor rule. There's a -- probably pretty likely that the SEC will propose some kind of a fiduciary rule in the near future. It will likely apply to all brokerage accounts, both qualified and nonqualified, and there's going need to be some conformity between the SEC and DOL provisions. So that's kind of where I come out on that subject. In terms of more color or -- certainly the environment of -- we believe that we're in the beginning of a rising interest rate environment. That should be positive for fixed and indexed annuity sales, so. Is that answering your question? Or would you like...

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

That's great color. It's a great -- I'm glad I asked the follow-up of you, and I -- maybe you could comment on -- I assume the down 9% number was more, rippled more through the independent channel than the bank channel. So maybe -- go ahead.

S. Craig Lindner - *American Financial Group, Inc. - Co-CEO, Co-President and Director*

Yes. Let me see if I could put my hands on that breakdown. Hang on one second, Greg.

Greg, I'm just looking -- the information that I'm looking at is LIMRA information that came out and at least in the schedule that I have in front of me, it doesn't break down financial institutions versus retail. Clearly, retail was impacted in a more major way last year.

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

OK, thank you very much for the answer. I appreciate it.

Operator

Thank you. And that does conclude our question-and-answer for today. I would now like to turn the call back over to Diane Weidner for any further remarks.

Diane P. Weidner - *American Financial Group, Inc. - Assistant VP of Investors Relations*

Thank you all for joining us this morning. We look forward to speaking with you again at the end of our next quarter. Have a good day, everyone.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone, have a great day.
