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AFG.N - Q4 2021 American Financial Group Inc Earnings Call

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OVERVIEW:

AFG reported full year 2021 net EPS of $23.30. Co. expects 2022 core net operating EPS to be $9.75-10.75.

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CORPORATE PARTICIPANTS

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

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

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

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

CONFERENCE CALL PARTICIPANTS

Charles William Lederer *Wolfe Research, LLC - Research Analyst*

Dong Yoon Han *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Michael David Zaremski *Wolfe Research, LLC - Research Analyst*

Sidney Schultz *Raymond James & Associates, Inc., Research Division - Equity Associate*

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the American Financial Group 2021 Fourth Quarter and Full Year Results Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions) I would now like to hand the conference over to your first speaker today, to Diane Weidner, Vice President, Investor Relations. Please go ahead.

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

Thank you. Good morning, and welcome to American Financial Group's Fourth Quarter 2021 Earnings Results Conference Call. We released our 2021 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.

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'm pleased to turn the call over to Carl Lindner III to discuss our results.

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

Good morning. We're pleased to share highlights of AFG's 2021 fourth quarter and full year results, after which Craig, Brian and I will be glad to respond to your questions.

AFG's financial performance during the fourth quarter was exceptional and a strong finish to an outstanding year. We're very pleased with the underwriting margins produced by our Specialty Property and Casualty businesses and returns in our portfolio of alternative investments that continued to exceed our expectations.

AFG's total shareholder return in 2021, representing the change in share price plus dividends, was a very impressive 89%. Our diversified portfolio of specialty insurance operations, and entrepreneurial culture and disciplined operating philosophy have positioned us well in a hard P&C market and an improving economy. Craig and I thank God, our talented management team and our employees for helping us to achieve these exceptionally strong results.

I'll now turn the discussion over to Craig to walk us through AFG's fourth quarter and full year results, investment performance and our overall financial position at December 31.

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

Thank you, Carl. As you'll see on Slide 3, AFG's core net operating earnings were a record $11.59 per share for the full year of 2021, generating a core operating return on equity of 18.6%.

Earnings from AFG's discontinued annuity operations, the significant gain on the sale of this business, and other non-core items contributed meaningfully to full year net earnings per share of $23.30.

AFG's net return on equity was a very strong 37.5% in 2021. We're very pleased to have achieved a valuation of approximately 140% of adjusted GAAP book value on the sale of AFG's annuity business. This calculation includes proceeds from the sale and dividends paid to AFG in conjunction with the sale. See Slide 4 for additional details.

Capital management is one of our highest priorities. 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.

The successful sale of our Annuity business provided a unique opportunity for us to return $2.7 billion to shareholders during the year. We paid $2.4 billion in dividends during the year, including $2.2 billion in special dividends and $176 million in regular common stock dividends and made share repurchases totaling $319 million.

Our quarterly dividend was increased by 12% to an annual rate of $2.24 per share, beginning in October of 2021. Growth in adjusted book value plus dividends was an impressive 34.4%.

Turning to Slides 5 and 6, you'll see that the fourth quarter 2021 core net operating earnings per share of $4.12 were more than double those in the prior period, producing an annualized fourth quarter core return on equity of 28.1%.

Net earnings per share of $4.18 included after-tax non-core realized gains on securities of $0.06 per share, which include fair value changes on securities that we continued to hold at the end of the quarter.

Now I'd like to turn to an overview of AFG's investment performance, financial position and share a few comments about AFG's capital and liquidity. The details surrounding our $15.7 billion investment portfolio are presented on Slides 7 and 8. Pretax unrealized gains on AFG's fixed maturity portfolio were $173 million at the end of the fourth quarter.

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For the 12 months ended December 31, 2021, P&C net investment income was approximately 64% higher than the comparable 2020 period and included significantly higher earnings from alternative investments.

We're especially pleased with the performance of our alternative investments during the quarter. Earnings from these investments may vary from quarter to quarter based on the reported results and valuation of the underlying investments, and generally are reported on a quarter lag.

The annualized return on alternative investments reported in core operating earnings in the fourth quarter of 2021 was a very strong 26.3% and was 24% for the full year. Incorporating the exceptional performance in 2021, the average annual return on these investments over the past five calendar years was 13%.

As we look forward to 2022, our guidance for the year reflects an assumed return of 10% on our portfolio of alternative investments. However, in the first quarter, we expect our alternative investment portfolio to exceed an annualized 10% return due to the sale of several multi-family real estate investments at favorable valuations.

Alternative investments with underlying real estate exposures have been a key contributor to the performance of this portfolio and help to differentiate our portfolio of alternative investments from our peers. We view our investments in real estate and real estate-related entities as a core competency.

As I've noted in previous calls, we've found great success in investing in multi-family properties in desirable communities where we continue to achieve high occupancy rates and very strong rent increases. These properties represent just over half of our alternative investment portfolio at December 31, 2021.

Excluding the impact of alternative investments, P&C net investment income for the 12 months ended December 31, 2021, decreased 6% year-over-year, reflecting lower market interest rates. As you can see on Slide 8, our investment portfolio continues to be high quality, with 88% of our fixed maturity portfolio rated investment grade and 98% of our P&C Group fixed maturities portfolio with an NAIC designation of 1 or 2, its highest two categories.

We've remained patient and disciplined in this prolonged low interest rate environment, and we're well positioned as interest rates begin to rise. As of December 31, 2021, our P&C company fixed maturity duration was approximately two years, the lowest in recent history.

More specifically, cash and floating rate securities of $3.8 billion account for 27% of our insurance company's investment portfolio. If indications of future interest rate increases come to fruition, these higher rates will produce investment income that contributes to profitability in a meaningful way. Assumptions embedded in our 2022 earnings guidance include four 25-basis point increases in the benchmark Federal Funds rate over the course of 2022.

Please turn to Slide 9, where you'll find a summary of AFG's financial position at December 31, 2021. Our excess capital was approximately $2.1 billion at 12/31/2021. This number included parent company cash and investments of approximately $1.9 billion. Our excess capital affords us the financial flexibility to make opportunistic repurchases, pay additional special dividends, grow our Specialty Property and Casualty business organically and through acquisitions and start-ups that meet our target return thresholds.

While all AFG's excess capital is available for internal growth and acquisitions, based on assumptions underlying AFG's current guidance, approximately $750 million of excess capital can be used for share repurchases and special dividends by year-end 2022, while staying within our most restrictive debt to capital guideline.

Last month, we announced AFG's acquisition of Verikai in December of 2021 for $120 million in cash. We believe that artificial intelligence and machine learning will continue to have a significant impact on the insurance industry and see Verikai as a thoughtful and effective leader in the use of these technologies.

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We've been very selective and intentional with our investments in the insurtech space and have enjoyed great success with several strategic relationships. Although we don't often invest directly in insurtech entities, we found Verikai to be an outstanding opportunity. Verikai will continue to operate as a stand-alone company to serve its insurance clients.

Book value per share, excluding unrealized gains related to fixed maturities, was $57.42 at December 31, 2021, compared to $63.61 per share at the end of 2020, and reflects $26.00 per share in special dividends paid in 2021.

I'll now turn the call back over to Carl to discuss the results of our P&C operations and discuss our expectations for 2022.

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

I'd like to begin by congratulating Gary Gruber on his upcoming retirement as Great American's President and Chief Operating Officer. Gary has played a significant role in the tremendous growth and success of our Property and Casualty business over the course of his nearly 45-year career with the company.

Gary is a treasured colleague and a longtime friend to me and many others. It's been an honor to work alongside him, and I wish him many years of health and happiness in retirement. Gary, thank you for your contributions and service to Great American and AFG.

With Gary's retirement, David Thompson has succeeded him as President and Chief Operating Officer of Great American's Property and Casualty Group, effective February 1. David is the 18th President in Great American's 150-year history. His executive leadership experience overseeing numerous Great American specialty property and casualty operations positions us well for growth and success.

Now turning to a review of the quarter, results in our Specialty Property and Casualty Group were outstanding, as you'll see on the overview on Slide 10. Fourth quarter pretax core operating earnings in AFG's P&C Insurance Segment established another record for the fourth time this year at $485 million.

Specialty Property and Casualty insurance operations generated an underwriting profit of $281 million in the 2021 fourth quarter, an impressive 57% increase year-over-year, driven primarily by higher year-over-year underwriting profitability in our Specialty Casualty and Property and Transportation Groups.

Despite the impact of devastating tornadoes in Kentucky and fire-related losses in Colorado, our catastrophe losses were a very manageable $25 million.

Underwriting margins across our portfolio of businesses were excellent, and our overall Specialty Property and Casualty combined ratio was an exceptionally strong 80.7%, improving 5.5 points from the prior year period. The fourth quarter 2021 combined ratio included 1.8 points in catastrophe losses and 5.0 points of favorable prior year reserve development.

Each of our Specialty Property and Casualty sub-segments produced combined ratios in the mid-80s or lower during the quarter, the strongest we've reported in 15 years.

Gross and net written premiums increased 14% and 12%, respectively, for the full year in 2021 and established new records for premium production. Premiums reported in the fourth quarter were significantly impacted by timing differences in the recording of premiums in our Property and Transportation Group.

When you adjust for those items, gross and net written premiums were up 12% and 9%, respectively, for the fourth quarter of 2021, when compared to the same period last year. With consideration to those adjustments, each of our Specialty Property and Casualty groups reported healthy growth as a result of an improving economy, new business opportunities and a continued strong renewal rate environment.

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Turning to pricing, renewal rate momentum continues. We achieved meaningful broad-based pricing increases across the vast majority of our businesses, with strong renewal pricing in our longer-tailed liability businesses outside of workers' comp. Average renewal pricing across the entire Property and Casualty Group was up approximately 7% for the quarter. And excluding workers' comp, average renewal rates were up approximately 8% in the quarter. We achieved a 9% overall rate increase for the year. And excluding workers' comp, renewal rates were up 12% overall in 2021.

These rates are on top of increases of 11% overall and 15% excluding workers' comp that were achieved in 2020. Renewal rate increases continue to be meaningfully in excess of estimated prospective loss ratio trends, which are approximately 3% for our Specialty Property and Casualty businesses overall and approximately 5% excluding workers' compensation.

Now the drivers of growth vary considerably across our portfolio of Specialty P&C businesses. In the aggregate, year-over-year growth in gross written premium for the full year in 2021, excluding crop, was about 60% attributed to growth and change in exposures and about 40% attributable to rate increase.

Now if you turn to Slide 11, I'd like to review a few highlights from each of our Specialty Property and Casualty business groups. Property and Transportation Group reported an underwriting profit of $116 million in the fourth quarter of 2021 compared to $74 million in the fourth quarter of 2020. Higher year-over-year underwriting profit in our crop operations more than offset lower underwriting profit in our transportation businesses. Catastrophe losses in this group, net of reinsurance and inclusive of reinstatement premiums, were $15 million in the fourth quarter of 2021, compared to $6 million in the comparable 2020 period.

The businesses in the Property and Transportation Group achieved an excellent 80.5% calendar year combined ratio overall in the fourth quarter, an improvement of 5.3 points from the comparable period in 2020.

Fourth quarter 2021 gross and net written premiums in this group were down 14% and 5%, respectively, when compared to last year's fourth quarter. Both gross and net written premiums were impacted by the timing of premium recognition in our crop business and the timing and renewal of a large account in our transportation businesses. Excluding the impact of these items, fourth quarter gross and net written premiums in this group grew 13% and 7% year-over-year, respectively. These premiums are expected to be recognized in the first quarter of 2022.

Overall renewal rates in this group increased 6% on average for the fourth quarter of 2021, accelerating slightly from the 5% rate increase reported in the third quarter. And for the full year, this group's pricing was up 6% overall.

Spring discovery pricing is underway in our crop insurance business. Current commodity futures pricing is significantly above last year's levels, with just looking the other day with average corn and soybean futures up 26% and 18%, respectively, in the first seven days in the month.

It's still obviously early in the discovery period and volatility factors aren't yet calculated until the last five days in the month. However, if the commodity prices and pricing continues at this rate for the remainder of the discovery period, we expect to have a double-digit growth in net written premiums in our crop business again this year.

The Specialty Casualty Group reported an underwriting profit of $140 million in the 2021 fourth quarter, compared to $91 million in the comparable 2020 period. Higher year-over-year underwriting profit in our workers' compensation, excess liability, excess and surplus lines, targeted markets and executive liability businesses were the driver of these results.

Underwriting profitability in our workers' compensation businesses overall continues to be excellent. The businesses in this Specialty Casualty Group achieved an exceptionally strong 78.0% calendar year combined ratio overall in the fourth quarter, an improvement of 6.0 points from the comparable period in 2020.

Fourth quarter 2021 gross and net written premiums increased 12% and 11%, respectively, when compared to the same prior year period. Nearly all the businesses in this group achieved strong renewal pricing and reported premium growth during the fourth quarter.

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Continued strong renewal rates and increased exposures contributed to higher premiums in our excess liability and excess and surplus lines businesses. And our mergers and acquisitions liability and executive liability businesses also contributed meaningfully to the year-over-year growth.

Renewal pricing for this group was up 7% in the fourth quarter. And excluding our workers' comp business, renewal rates in this group were up 11%. Looking at pricing for the full year for this group, pricing was up 11% overall and 17% excluding workers' comp.

Underwriting profitability in our workers' compensation businesses overall continues to be excellent. We have three stand-alone workers' compensation businesses with varying appetites and different niche focus areas. This strategy has served us very well in achieving strong results in our workers' comp book.

We are pleased that Great American Insurance Group will benefit from Verikai's predictive risk tool and unique marketplace solution as it enters the medical stop loss business, with a primary focus on small and underserved risks. We don't expect a very meaningful premium or earnings impact from this business in 2022, but we are pleased to add another compelling product offering to our portfolio of specialty insurance solutions.

Specialty Financial Group reported an underwriting profit of $24 million in the fourth quarter of 2021, compared to an underwriting profit of $20 million in the fourth quarter of 2020. Higher underwriting profit in our trade credit, surety and fidelity and crime businesses contributed to these results.

And the group -- this group continued to achieve excellent underwriting margins and reported an 85.5% combined ratio for the fourth quarter of 2021. Gross and net written premiums increased by 8% and 6%, respectively, in the 2021 fourth quarter when compared to the same 2020 period due primarily to the favorable impact of economic recovery on our surety business, and strong rate increases and new business opportunities in our fidelity and crime business. Renewal pricing in this group was up 7% in both the fourth quarter and full year 2021.

Now if you turn to Slide 12, you'll see a full-page summary of our initial guidance for 2022. Overall, we expect to see an ongoing hard property and casualty market, with opportunities for growth, arising from both continued rate increase and exposure growth, as well as margin expansion as compounded rates earn through.

We expect AFG's core net operating earnings in 2022 to be in the range of $9.75 to $10.75. This guidance reflects an assumed annualized return of approximately 10% on alternative investments and an average crop year, both of which were areas of strong outperformance for the company in 2021.

As we consider the outlook for our Specialty Property and Casualty operations, we expect a 2022 combined ratio for the Specialty Property and Casualty Group overall between 85% and 87%. Net written premiums for 2022 are expected to be 8% to 12% higher than the $5.6 billion reported in 2021.

Now looking at each sub-segment. We expect Property and Transportation's combined ratio to be in the range of 87% to 91%. Our guidance assumes, again, an average crop earnings for the year. We estimate growth in net written premiums for this group to be in the range of 8% to 12%.

Our Specialty Casualty Group is expected to produce a combined ratio in the range of 80% to 84%. Our guidance assumes continued strong renewal pricing in our E&S, excess liability and several of our other longer-tail liability businesses and continued calendar year profitability in our workers' compensation businesses overall.

We're estimating growth in net written premiums in the range of 6% to 10%. Premium growth will be tempered by rate decreases in our workers' compensation book, which are the result of favorable loss experience in this line of business. Excluding workers' comp, we expect 2022 premiums in this group to grow in the range of 7% to 11% in 2022.

We expect the Specialty Financial Group combined ratio to be in the range of 84% to 88%. And we expect growth in net written premiums for this group to be between 8% and 12%, based on projected growth in all the businesses across the group. And we expect renewal rates overall to increase between 5% and 7% in 2022. And excluding workers' comp, we expect renewal rate increases to be in the range of 6% to 8%.

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Craig and I are very pleased to report these exceptionally strong results for the fourth quarter and full year and we're proud of our proven track record of long-term value creation. We believe that our entrepreneurial, opportunistic culture, combined with our strong balance sheet and financial flexibility, position us very well as we begin 2022.

Now we'll open the lines for the Q&A portion of today's call. And Craig and Brian and I would be happy to respond to your questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) I show our first question comes from the line of Mike Zaremski from Wolfe Research.

Charles William Lederer - *Wolfe Research, LLC - Research Analyst*

Hi guys. This is Charlie on for Mike. Thanks for taking our question. On Craig's comment on the $750 million of returnable capital, what is driving the increase relative to your last update? Is that based on income that you expect to generate during the year? Or how should we think about that?

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

Yes. The $750 million is based on the assumptions in our model and that's what we expect to generate during the year. So if we -- if things go as planned, we would have $750 million of additional available just from the excess capital that we generate.

Charles William Lederer - *Wolfe Research, LLC - Research Analyst*

Got it. Okay. That makes sense. And then just on the net investment income upside that Craig spoke to, is that more from the floating rate debt that you guys hold? Or would you potentially extend the duration of your portfolio?

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

Yes. So, we actually have started to put some money to work with the significant increase in rates. But the -- I mean we would benefit meaningfully. What we put in our model was an assumption of four Fed rate increases kind of spread throughout the year.

And we did not assume that we were going to lengthen duration significantly. So I mean if rates continue to climb and we do lengthen duration, that certainly would be a positive to net investment income.

Charles William Lederer - *Wolfe Research, LLC - Research Analyst*

Got it. Okay, thank you.

Operator

I show our next question comes from the line of Derek Han from KBW.

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Dong Yoon Han - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Good morning. Thanks for taking my question. I just wanted to dive into the '22 outlook a little bit. What would kind of get you to the higher end of the combined ratio ranges for Property and Transportation and the Specialty Financial segments, given that you're still seeing very good pricing and growth? So, I just kind of wanted to understand what the risks are for -- to put you at the higher end of the combined ratio guidance.

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

Well, I think probably our crop business, for instance, probably is a line that has the most variability depending on what type of year you have. You can go from a drought year where you don't make anything to great years where you make a lot.

That's a business over time that we've earned very high returns on and have done well on average, I think, in a good part because of the broad mix of business that we have in the heartland for corn and soybeans and lower exposures in places like Texas and some of those types of states.

So, I mean that would -- when you're focused on the Property and Transportation. The other thing would be we factor in kind of an average year of catastrophes. If you had a more major catastrophe, naturally, that could impact you to the higher end of a range, as well as the industry. Now the good news in our case is, generally, we have a much lower relative exposure on the catastrophe side. So that's really helped us over time, have more predictable combined ratios in that.

On the Specialty Financial side, our lender-placed property business also has catastrophe exposure in that. So things like wildfires and -- or hurricanes or those types of events, it would probably be those kinds of things that could push the Specialty Financial combined ratio to the higher end.

Dong Yoon Han - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Got it. That's helpful. Sorry, go ahead.

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

Yes. I think -- no, those would be the main things that would come to mind.

Dong Yoon Han - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Okay. That's helpful. And then I just wanted to ask about the loss trend. You had said that maybe it was 2.7% last quarter. Is that still holding for '22? And then within the social exposed lines like D&O, are you seeing any acceleration in social inflation that makes the loss trends higher?

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

Yes. I think I kind of round it up a little bit. I consider our prospective loss ratio trend as we would be about 3% overall today. If you exclude workers' comp, which has had some really very favorable trends, our overall prospective loss trend as we've adjusted is more like 5%. So the 5% compares to the 12%, excluding comp rate that we got this year. I think we just -- I just talked about our guidance, excluding comp on pricing was 6% to 8%, if that gives you kind of a feel for things.

And then overall, compared to the 3%, we achieved about 9% in price in '21. And our guidance is for 5% to 7% in that. So I hope that gives you a little color.

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Dong Yoon Han - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Yes, that's really helpful. And then last question for me. Are you seeing any impact from wage inflation? Or are you kind of insulated from that, given that you have the unique profit-sharing plan in place?

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

You mean within our own employees or are you saying impact? We are seeing positive wage inflation impact in businesses like workers' compensation, which actually works to be a favorable. As we look at our loss ratio trend, our -- we've always been a little different than the industry in talking about loss cost trends. We talk loss ratio trend, which includes which offsets loss cost trend by favorable types of things like wage inflation. And particularly in works comp, we would have probably a couple of points of favorable wage inflation that is probably helping our results. Are you speaking to internally to AFG?

Dong Yoon Han - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Yes. I was more curious about your employee base, whether you kind of have to pay out for talent or maybe to pay more to retain talent.

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

I think certainly, everybody probably has had to -- from the last couple of years is probably, are increasing their wage, their overall average wage increase kind of in response to inflation. I think we're very blessed in that when we look at our turnover, really things haven't really moved. It's very stable.

So -- but I think in response to just our employees facing more inflation, we have made some adjustments to reflect that. But that's all built in guidance.

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

I think it's important to remember, too, we have a sticky long-term compensation plans, where our business units are based on accident years as they develop out. So there's a good long-term alignment there and then a great work culture here at Great American as well that helps keep our leaders happy and stable here at the company.

Dong Yoon Han - *Keefe, Bruyette, & Woods, Inc., Research Division - Analyst*

Okay. Thank you very much.

Operator

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

Sidney Schultz - *Raymond James & Associates, Inc., Research Division - Equity Associate*

This is actually Sidney Schultz calling on behalf of Greg. Just one question, it pertains to commercial transportation. When just looking at the industry, it seems that we're seeing higher litigated claims and larger settlements. And I'm hoping maybe you guys can just provide your perspective on these trends or expectations or what you guys are seeing moving forward.

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

Yes. I think we identified probably -- 8 or 9 years ago, we were probably one of the first companies to identify those, the severity trends in the commercial auto liability side. And they definitely are continuing. And I think that's one reason why even after 8, 9 years of taking rate, I think in the fourth quarter, we still took a 8% rate increase in the commercial auto liability portion of our business.

Yes, it's definitely real. And I think also what now as the economy is coming out of the pandemic, there's more miles being driven out there more vehicles, more miles. And I think that also has an impact on things. That's why we think as we look this year, we're continuing to take rate, and we want to be very careful.

Even though our commercial auto business is performing very well, achieving for the year and the last couple of years, achieving our combined ratio and return on equity objectives, we still feel that in the commercial auto liability side in particular, that we need to continue to take rate. And even on the physical damage side, with labor shortages and used vehicle parts, prices going up, that does impact commercial auto the same as it does impact private passenger auto. In some ways, maybe even more.

With respect to if you have specialized vehicles like moving vans or moving trucks, they may be harder to replace or to fix than the average passenger van or something. So, we're still going to take rate on the physical damage part of our business this year also.

Sidney Schultz - *Raymond James & Associates, Inc., Research Division - Equity Associate*

Got it. Thank you.

Operator

I show our next question comes from the line of Mike Zaremski from Wolfe Research.

Michael David Zaremski - *Wolfe Research, LLC - Research Analyst*

Great. I was on another call, so thanks for taking our follow-ups right now. I guess, back -- sticking to the question of on loss trend, a number of companies have been -- and we're seeing data points, too, pointing to kind of frequency trends on the casualty side being better than expected due to potentially a number of reasons, including the courts being still not fully reopened.

But some firms are also kind of -- and the data points are pointing to severity still being higher than expected and some firms have kind of taken up their prospective loss picks. And I know you haven't taken up your prospective view of inflation. But is the -- is this -- maybe if you can bifurcate, is frequency kind of the good guy still as severity is trending higher? Or still kind of severity is kind of in line with what you guys have been expecting?

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

Gosh, that's an impossible question to answer. Where we have 35 different specialty businesses, it would vary business by business. When we -- you take a look at our prospective loss ratio picks for businesses like D&O and public D&O, it would reflect our -- which is on our overall D&O business, it would be like a 7% prospective loss trend.

And it'll probably be a bit higher if we just took the public D&O part of that. So that reflects our quarterly actuarial work where we review where we think things are going and our own trends and that. So, the same thing applies, for instance, on specialty human services, which is our nonprofit part of our business.

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Our prospective loss ratio trend pick is around 8% on that business just with the trends that we see on that. Our business is doing fine, is earning targeted returns in that. But based off of what we see out there and with the severity on claims and that whole sector, we're just being -- we think we're being prudent in how we're looking at that.

So each business is a little bit different in that. You go to a business like workers' comp in that. And our workers' comp business, for instance, the frequency is actually down, and the severity is normalizing now in that -- but when you take a look at the positive impact, I think that I just mentioned from exposure change, wage inflation and that, the overall loss ratio, loss ratio trend there is pretty stable.

Michael David Zaremski - *Wolfe Research, LLC - Research Analyst*

And Carl, I appreciate that -- the color is helpful. You have also a unique commercial auto business, but maybe you can touch on commercial auto since there's some increasing chatter about some pressures there in terms of finding qualified drivers and then some changes in ages and the ability for drivers to -- a younger-aged drivers to move intrastate?

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

Yes. As I -- I think in the previous questions in that, elevated severity continues to be a factor, as I mentioned, and we're continuing to take rate. I mentioned also because of the -- on the physical damage side, too, because of the cost of labor and parts. We're continuing to take rate there.

Those are the trends we're seeing on the severity side. Claims frequency has returned some, but still is slightly less than pre-pandemic levels. If we go back to before the pandemic hit. Though about every month, starting in about the second quarter of last year, the frequency has kind of ticked up higher than the year prior, and it seems like it's been on an upward trend.

So even though we're making -- we're meeting or beating our targeted returns in commercial auto, we're very careful about continuing to take rate because on the frequency and severity side, we're seeing the trends that require additional rate. So that's our perspective on that.

Michael David Zaremski - *Wolfe Research, LLC - Research Analyst*

Okay. Great. And maybe one follow-up on capital since this is another area we get a lot of questions on. In terms of the overall excess capital position of, I believe, now still over $2 billion, so a sizable amount. Is a good portion of it effectively trapped due to leverage governors? And appreciative of your guidance and there still will be plenty of capital return, but thinking about the larger $2-plus billion number over the -- in the near term.

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

This is Craig. I wouldn't say that it's trapped permanently. There are levers we could pull to untrap it, I mean main one being redeeming the debt issue that matures in 2026. So, we said today that per our model that throughout 2022 -- by the end of 2022, we would have around $750 million to use to pay special dividends or repurchase shares.

If we would call the 2026 debt issue, and I'm not saying that we're looking to do that, but if we had a great use for excess capital to repurchase shares, pay special dividends or whatever, I mean, it is callable. But the [$750 million] (corrected by company after the call) would go to $1.7 billion at the end of the year. So the bulk of it would be unlocked if we would make a decision to...

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

Depending on what you think where rates are going. If rates move up as everybody thinks, there could be better and better opportunities to repurchase some debt.

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Michael David Zaremski - *Wolfe Research, LLC - Research Analyst*

Yes. Understood. And maybe lastly, and maybe if you discussed this already and I missed it, then you can let me know. But in terms of uses of excess capital, there was an M&A deal you entered into recently. I think there was more technology and more of a technology type of focus.

And I believe there's a good deal of goodwill associated with that acquisition. But maybe you can kind of touch on that acquisition, what excites you about it and whether there's others kind of maybe similar acquisitions that you're looking at that have more of a technology infrastructure lean to them?

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

Sure. I mean, I don't think it's a -- I wouldn't say that it's an important strategic position of the company to be out there trying to buy insurtechs and that's a significant component of our M&A. But when we see something that's -- when we believe in something like machine learning and artificial intelligence and the future of something like that, and also potentially through that lens, the potential impact and improvement in our own business and the use of that across maybe 35 businesses, that part excites us.

I think the other aspect of that is because of the Verikai acquisition, we have the opportunity to start a new business unit, which is focused on the medical stop loss insurance business, probably more of a focus on small and underserved risks. When you look at the marketplace as a whole, but we would be using Verikai's predictive risk tool.

We began quoting and learning the business some in the fourth quarter. The business is being done through a relationship with an MGU called Radion, which we have a minority investment, and we'll provide the paper for the business, and we'll share risk 50-50. So in this case, I think we have the ability using Verikai's technology and predictive risk tool to start a new business, which we think is in a potentially underserved market.

And I think we may have the ability to approach that market in a way that's a little bit different and would provide a competitive advantage long term. Again, we'll be in a learning phase, and there won't be much impact from the medical stop loss business in 2022. I think '23 probably would be more meaningful to us.

So I'm very excited about -- Verikai will run on -- they're run as an independent entity serving the industry. And we're excited about starting a medical stop loss business. So we thought that it was kind of a unique opportunity from that standpoint. As far as opportunities, we're always looking at things to acquire. We seem to be more successful over time in kind of the $20 million to $0.5 billion kind of category where there are not big auctions in that.

And we think we consider ourselves very disciplined. We want to invest in entities that can earn double-digit returns over time in that. So -- we have a high-quality portfolio of businesses already.

I want to be careful right now, distracting our management team too much when there's a bird in the hand with the market the way it is and the opportunity in a very broad-based way for our businesses to grow organically in that. And when -- also with respect to our own stock to the extent there's any weakness in the market and opportunities, I could argue that it's better to buy our equity at a 10% return, including -- not considering the cash and all that versus going out and taking the risk on buying some major entity that you don't know very well and where the return may not even be that initially.

So those are things that we think about and consider. And certainly, you can see last year, we've been very aggressive on returning capital to shareholders through special dividends where that makes sense.

Michael David Zaremski - *Wolfe Research, LLC - Research Analyst*

Very helpful. Thank you.

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Operator

I'm showing no further questions in the queue. At this time, I'd like to turn the call back over to Ms. Diane Weidner for any closing remarks.

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

Thank you, Dulem. Thanks to all of you on the call for your time today. We look forward to talking with you again next quarter when we share our first quarter 2022 results. Thank you so much, and have a great day, everyone.

Operator

Thank you. This concludes today's conference call. Thank you for participating. You may now disconnect.

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