Aflac Inc. (AFL)

Updated May 4th, 2020 by Eli Inkrot

Key Metrics

Current Price:	$35	**5 Year CAGR Estimate:**	9.2%	**Market Cap:**	$26 B
Fair Value Price:	$40	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	05/19/20
% Fair Value:	88%	**5 Year Valuation Multiple Estimate:**	2.5%	**Dividend Payment Date:**	06/01/20
Dividend Yield:	3.2%	**5 Year Price Target**	$49	**Years Of Dividend Growth:**	37
Dividend Risk Score:	A	**Retirement Suitability Score:**	A	**Last Dividend Increase:**	3.7%

Overview & Current Events

Aflac Inc., founded in 1955, is the world's largest underwriter of supplemental cancer insurance. The diversified insurance corporation also provides accident, short-term disability, critical illness, dental, vision, and life insurance. Roughly 70% of the company's pretax earnings are from Japan, with 30% coming from the U.S. The $26 billion market cap company, which has increased its dividend for 38 consecutive years, generates$3.3 billion in 2019 profit.

On April 29th, 2020 Aflac released Q1 2020 results for the period ending March 31st, 2020. For the quarter the company reported $5.16 billion in revenue, an -8.8% decline compared to Q1 2019. Net earnings equaled $566 million or $0.78 per share compared to $928 million or $1.23 per share in the year ago quarter. However, this quarter included sizable investment losses whereas last year's quarter included investment gains. On an adjusted basis, earnings-per-share equaled $1.21 compared to $1.12 previously.

Previously, Aflac provided a 2020 outlook expecting to generate $4.32 to $4.52 in earnings-per-share. However, this guidance has been withdrawn amid the evolving COVID-19 pandemic. The company is still repurchasing shares, albeit at reduced levels. In addition, Aflac declared a $0.28 quarterly dividend, representing a 3.7% year-over-year increase.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.57	$2.09	$2.93	$3.09	$3.08	$3.08	$3.40	$3.41	$4.17	$4.44	***$4.00***	***$4.87***
DPS	$0.57	$0.62	$0.67	$0.71	$0.75	$0.79	$0.83	$0.87	$1.04	$1.08	***$1.12***	***$1.36***
Shares[1]	939	933	936	919	885	849	812	781	755	727	***727***	***680***

From 2007 through 2019, Aflac was able to grow earnings-per-share by an average compound rate of 8.7% per annum, although part of that improvement is tax reform related. Also, keep in mind that from 2011 through 2017 the Yen was generally weakening against the dollar.

Aflac has two sources of revenue: income from premiums and income from investments. On the premium side, this is generally sticky with policy renewals making up the bulk of income. However, Aflac operates in two developed markets where we would not anticipate seeing outsized growth in the business. The other lever available is on the investment side, where the vast majority of the portfolio is in bonds. Here there is a possibility for income improvement should rates rise in the future. Finally, the share repurchase program has been an important driver as well.

However, all of these items – premium growth, higher rates and repurchases – are currently being challenged by the coronavirus pandemic. Aflac has indicated that it has seen an accelerated decline in sales at the end of March and in April. We have kept our modest growth rate intact, 4% annually, but reduced our 2020 earnings expectation.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	9.9	11.3	7.9	9.4	10.0	10.0	10.0	11.4	10.8	11.6	***8.8***	***10.0***
Avg. Yld.	2.3%	2.6%	2.9%	2.4%	2.4%	2.6%	2.5%	2.2%	2.3%	2.1%	***3.2%***	***2.8%***

[1] In millions.

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Over the last decade shares of Aflac have traded hands with an average P/E ratio of roughly 10 times earnings. We believe this is more or less fair for the security, considering that many insurers trade at a comparable multiple. This lower average valuation multiple allows for the robust share repurchase program to be more effective. Ongoing owners are much better served if the company is buying out past partners at 10 times earnings as compared to say 15- or 20-times earnings. With shares trading near 9 times our earnings estimate, this implies a small valuation tailwind.

Aflac is a Dividend Aristocrat with a long streak of rising dividends. Moreover, with the company paying out less than a third of its profits in the form of a dividend, there is ample runway for the dividend streak to continue.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	22%	30%	23%	23%	24%	26%	24%	26%	25%	24%	***28%***	***28%***

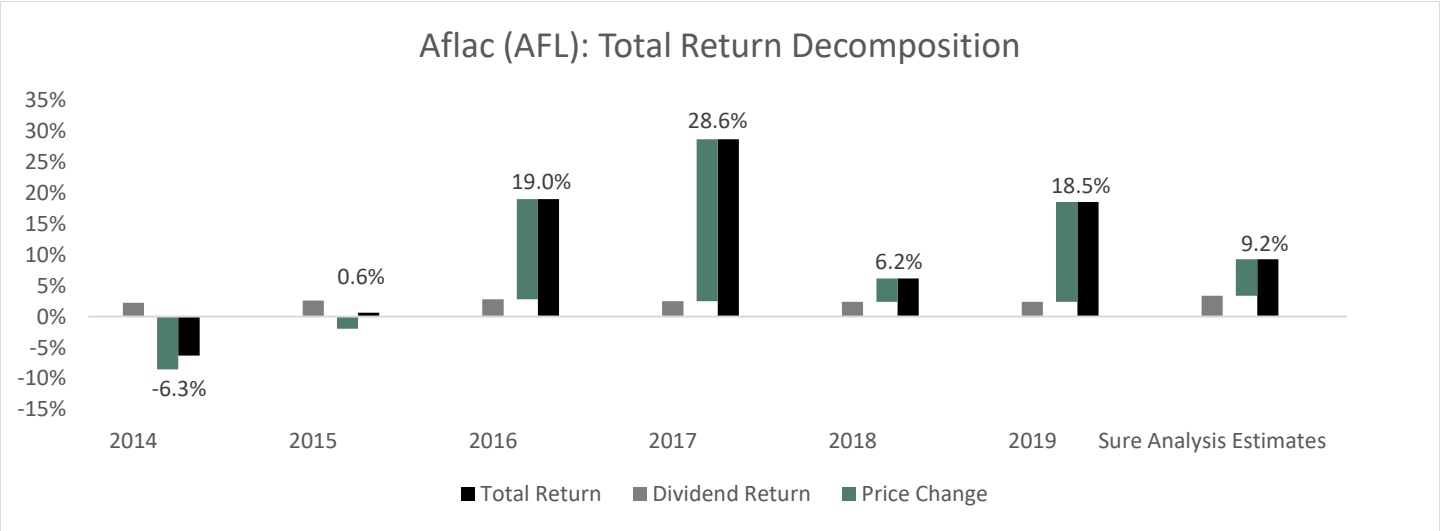
During the last recession Aflac generated earnings-per-share of $1.64, $1.31, $1.96 and $2.57 during the 2007 through 2010 period. Furthermore, the dividend was increasing this entire time. We are encouraged by the past performance and ongoing financial stability, as the company's strong brand and conservative approach serve as complementary competitive advantages. Although we do note that the company's international exposure, while strong in Japan, mitigates some of its reliability, especially as it relates to currency fluctuations.

Despite this reasonable recession performance, especially in comparison to other financial institutions, Aflac's share price dropped all the way from $34 in the middle of 2008 down to under $6 per share at the depths of the recession – even though the underlying earnings power was fine, and the dividend never faltered. We suppose this is a general cautionary note: in the long run business results will prevail, but in the short-term anything can happen, so it's important to be prepare accordingly.

Final Thoughts & Recommendation

Shares are down -34% since our last report. While earnings expectations have been reduced, the share price has fallen to a much greater degree. Aflac is the sort of security that looks quite interesting from first glance, given the solid business model, great dividend growth record and starting valuation near 9 times earnings. Total return potential comes in at 9.2% per annum, as the 4% growth rate and 3.2% starting dividend yield could be aided by a moderate valuation tailwind. With a significantly lower valuation, shares earn a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	20658	22090	25272	23827	22606	20811	22489	21600	21758	22307
Net Profit	2328	1937	2866	3158	2951	2533	2659	4604	2920	3304
Net Margin	11.3%	8.8%	11.3%	13.3%	13.1%	12.2%	11.8%	21.3%	13.4%	14.8%
Free Cash Flow	6989	10842	14952	10547	6550	6776	5987	6128	N/A	N/A
Income Tax	1233	1013	1436	1658	1540	1329	1408	-586	1063	1141

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets ($B)	101.0	116.24	131.09	121.31	119.77	118.26	129.82	137.22	140.41	152.77
Cash & Equivalents	2121	2249	2041	2543	4658	4350	4859	3491	N/A	N/A
Accounts Receivable	661	680	976	1165	842	705	669	827	N/A	N/A
Total Liab. ($B)	89.98	103.29	115.12	106.69	101.42	100.55	109.34	112.62	116.94	123.81
Accounts Payable	191	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Long-Term Debt	3038	3275	4343	4891	5268	4951	5339	5267	5778	6569
Shareholder's Equity	11056	12946	15978	14620	18347	17708	20482	24598	23462	28959
D/E Ratio	0.27	0.25	0.27	0.33	0.29	0.28	0.26	0.21	0.25	0.23

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	2.5%	1.8%	2.3%	2.5%	2.4%	2.1%	2.1%	3.4%	2.1%	2.3%
Return on Equity	23.9%	16.1%	19.8%	20.6%	17.9%	14.1%	13.9%	20.4%	12.2%	12.6%
ROIC	18.5%	12.8%	15.7%	15.9%	13.7%	10.9%	11.0%	16.5%	9.9%	10.2%
Shares Out.	939	933	936	919	885	849	812	781	775	746
Revenue/Share	21.83	23.53	26.93	25.49	24.90	24.02	27.17	27.07	28.09	29.88
FCF/Share	7.39	11.55	15.93	11.28	7.21	7.82	7.23	7.68	N/A	N/A

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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