Erste Bank Analysts: Outlook for insurance markets in CEE better than stock prices indicate

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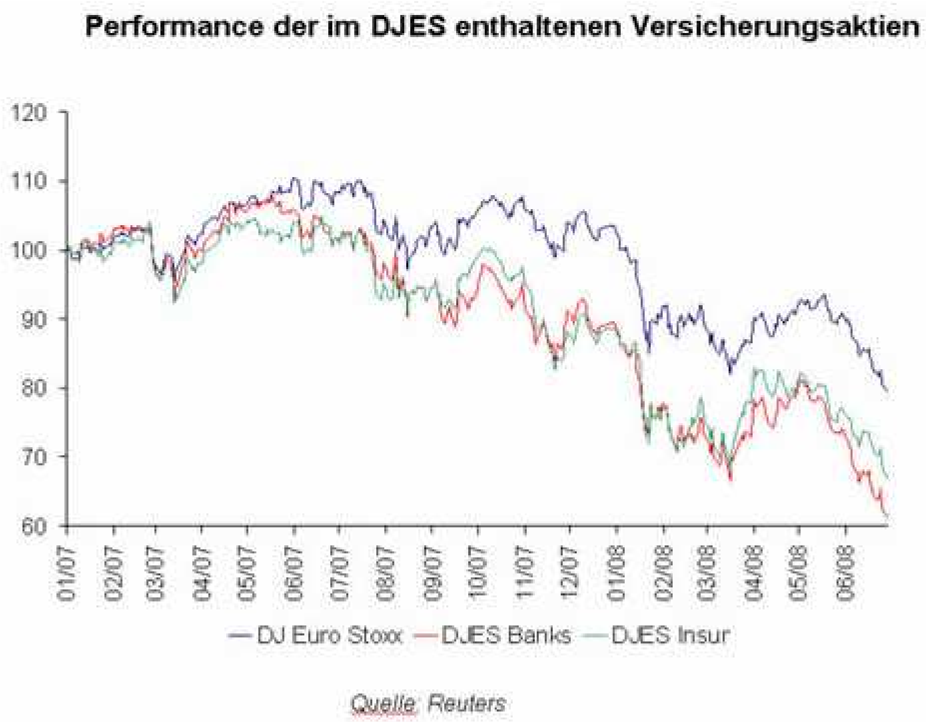
- European insurance companies: not seriously affected by financial crisis, but generally declining pre-tax profits due to weak financial markets
- Business environment: Eastern European markets still growing, while Western European markets already stagnating
- Vienna Insurance Group: purest CEE player among Western European insurance compa-nies, top pick with Buy recommendation and target price of EUR 66
- UNIQA: Accumulate with new target price of EUR 21.3, cheapest stock among its peer group in terms of price/embedded value and price/premium multiples

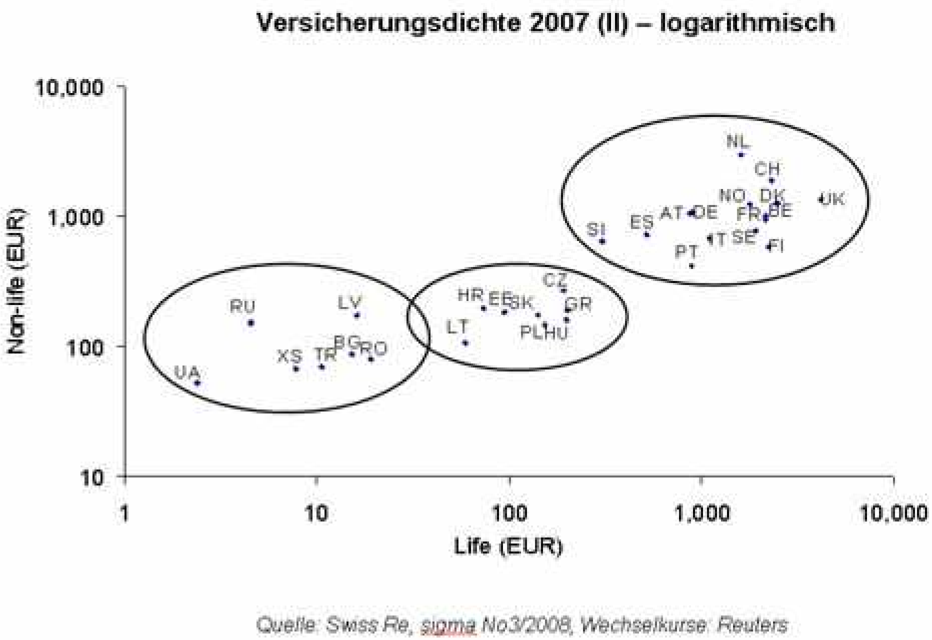
The European insurance industry has – according to the first studies available – not been seriously affected by the financial crisis. The total share of the worldwide insurance industry in the cost of the financial crisis should be around 12%, while the majority of the total costs are burdening banks, pension funds, hedge funds and other investors. In addition, this cost will vary from region to region and European insurers should not be significantly hit, other than in the banking sector, where European banks are carrying some 52% of the total losses, amounting to USD 387. The main reason for this can be seen in the need for insurers to cover euro liabilities with euro investments. In addition, it can be assumed that most of the companies have learned their lessons from the financial crisis of 2001/02, which resulted in a more conservative asset allocation.

The weak financial markets, however, have led to dropping financial results in the first quarter of this year, resulting in generally declining pre-tax profits, which dropped on average by 22.3%. Only three companies (Hannover Re, Mapfre and Vienna Insurance Group) were able to present increasing pre-tax results. However, it has to be pointed out that all 14 companies presenting detailed 1Q08 results reported operating profits. The average shareholders' equity also declined by 8.4%. Only Vienna Insurance Group reported slightly increasing shareholders' equity (+2.6%).

“All in all, we can say that there was indeed a negative impact of the sub-prime crisis and the following financial turmoil. In particular, the weak financial markets in the first quarter of 2008 burdened the industry's capital. However, in contrast to the banking sector, the negative impacts on the insurance industry due directly to the sub-prime crisis are rather limited as of today. The impacts due to the weak financial markets are significant, but not alarming”, states Christoph Schultes, insurance sector analyst at Erste Bank and the author of the report.

Share price of insurance companies considered equally as the banking titles by the investors
Nevertheless, most investors do not seem to share this opinion. The insurance stocks (DJES Insurance) lost 11.0% in 2007 and another 24.6% in the first six months of this year. Looking at the share price developments of the banking and insurance sectors clearly shows that both sectors are considered equal. The result is that insurance stocks are currently traded at the level seen in July 2005. The median of the forward P/E 2008 multiple of the DJES Insurance has dropped to 7.6x at the moment.





Eastern Europe still offers enormous growth potential

While most of the Western European markets are more or less saturated, Eastern Europe still offers enormous growth potential, mainly based on two facts. Firstly, the economies in Eastern European countries are growing much faster than in Western Europe, resulting in significantly higher GDP growth rates. Secondly, Eastern Europe is benefiting from increasing wealth, which results in strong savings growth, leading in turn to increasing demand for insurance products. The insurance density and insurance penetration ratios in the Eastern European countries clearly show the huge catch-up potential in these countries.

"Most of the developed Western European markets generate premium income of around/more than EUR 1,000 per capita for each segment. Another group of countries that can be classified as quite developed, the CEE/SEE countries (like CZ, HU, PL, SK, HR), have non-life insurance density of (well) above EUR 100 and life insurance income of around EUR 100 per capita. The last group of countries (RO, BG, RU, UKR) can be called less developed, with premium income of some EUR 100 per capita in the non-life segment and a life insurance density of around EUR 10. However, these markets are currently showing the highest growth rates, especially in the life segment," analyzes Schultes.

The analysts of Erste Bank see the following insurance companies as TOP picks:

Vienna Insurance Group: After the "restricted period" following the capital increase, we resume our coverage with a Buy recommendation and a target price of EUR 66 (previously EUR 72), which is based on a sum-of-the-parts valuation. Our valuation is strongly supported by a price/embedded value multiple of below 1x and a PEG ratio of 0.7x. We assume that the CEE stake will exceed the 50% mark in 2009 (currently 44%), which could be a trigger for the company's share price development. In addition, VIG's financial strength should attract investor interest. VIG was the only company among the DJES Insurance companies to present increased equity in 1Q08.
UNIQA: Our new target price for is EUR 21.3 (previously EUR 25.0) and includes a liquidity discount of 10% to reflect the current investor aversion to rather illiquid stocks. We therefore reiterate our Accumulate recommendation. We think that the recently declining share price is not justified. The company's price/embedded value ratio and the price/premium multiple amount to 0.9 and 0.4, respectively, the lowest among the peer group companies.

INSURANCE Sector Report [pdf; 243,7 KB]

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