CEE insurance:

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outstanding premium growth of the last years gone, but double-digit growth rates still on the table

- Financial turmoil determines negative quarterly results and decreasing shareholder equity across European insurance companies
- Western Europe: declining property and casualty business expected, life insurance to face more volatile business
- CEE: GDP growth and rising insurance penetration to support higher premium income
- Despite difficult environment, investors to find undervalued companies trading at historically low multiples. Buy recommendation on Vienna Insurance Group

Against the background of a very unfavorable business environment, with significant falls in credit and equity markets, as well as an overall slowdown in premium volumes, European insurance companies are facing challenging times. Although the European insurance sector is less affected by the financial crisis than other industries (particularly less than the banking sector), the financial turmoil has had a significant impact on the companies' financials so far, leading to negative results in the third quarter and sharply decreasing shareholder equity. As a result, the first insurance companies were forced to ask for capital injections.

"However, it is incorrect to say that the whole sector is in danger, as we find the general concerns unfounded. It is rather more appropriate to take a detailed look at the business, balance sheet and valuation of each single company. We think that, in this difficult environment, investors may find companies that are significantly undervalued (1) compared to their peer group/sector and (2) traded at historically low multiples", says Christoph Schultes, insurance sector analyst at Erste Group.

Impact of deteriorating economic environment in different markets

The recent GDP estimates in the Euro area have confirmed the downward trend for economies there, with some markets already in a technical recession. According to Erste Group estimates, the countries in the Euro area will show GDP growth of 1.1% in 2008, while next year will bring negative growth of -0.4%. For the Western European insurance business, this will have a negative effect, say analysts of Erste Group:

- Lower GDP and rising unemployment will lead to a slightly declining property and casualty business. While most of the insurance areas can be expected to show stable premium income (fire, household, casualty, liability, etc.), motor vehicle insurance will probably come under pressure, since this area has been facing tough competition in the recent past, with steady car sales having a mitigating effect. Further softening markets with declining margins cannot be ruled out.
- Life insurance will face a more volatile business, with slightly declining new life business and higher life policy lapses in general. A closer look at the countries' key insurance figures (insurance penetration and insurance density) is necessary to estimate the total impact on the life insurance side. Countries with a rather low (compared to the EU 15 average) life insurance density are expected to show positive growth rates, even in the expected difficult business environment in the coming years.

In CEE, the estimates for 3Q GDP brought – despite the deceleration of growth worldwide – some positive surprises: Czech and Slovak growth remained strong in 3Q (4.7% y/y and 7.1% y/y, respectively). Despite further deceleration in the coming quarters (given the worsening industrial production figures and declining new orders) overall growth should (according to Erste Group Research estimates) remain relatively solid next year (2.5% and 4.8%, respectively for Czech Republic and Slovakia), compared to the gloomy outlook for Western European economies. Same analyst expect Romania and Poland to present sound GDP growth next year as well (4.4% and 3.0%, respectively), while Hungary is predicted to deliver negative GDP growth of -0.8%.

Positive effect from two sides

Christoph Schultes says the general expected GDP growth will lead to sound growth rates in all CEE insurance business segments. According to him, rising GDP automatically induces higher premium income;

GDP growth (%)	2007	2008f			2009f			2010f
		IMF	EU	Erste Group	IMF	EU	Erste Group	Erste Group
Czech Republic	6.6	4.0	4.4	4.4	3.4	3.6	2.5	3.5
Croatia	5.6	3.8	3.5	3.4	3.7	3.0	1.7	3.0
Hungary	1.1	1.9	1.7	1.1	2.3	0.7	-0.8	2.5
Poland	6.7	5.2	5.4	5.2	3.8	3.8	3.0	4.4
Romania	6.0	8.6	8.5	8.3	4.8	4.7	4.4	5.3
Serbia	7.5	6.0	n/a	6.5	6.0	n/a	3.5	4.0
Slovakia	10.4	7.4	7.0	7.4	5.6	4.9	4.8	6.2
Ukraine	7.6	6.4	n/a	4.8	2.5	n/a	-2.5	5.5
CEE8 weighted average	**6.3**	**5.4**	**n/a**	**5.1**	**3.7**	**n/a**	**2.0**	**4.4**
Eurozone	**2.6**	**1.3/1.2***	**1.2**	**1.1**	**0.2/-0.5***	**0.1**	**-0.4**	**1.2**

**) October forecast (left number), November forecast (right number)*
Source: IMF, EU, Erste Group Research

insurance penetration should be supported by the massive catch-up potential in these countries. "Studying the premium development during downward trends in different countries in the past also clearly shows that we should not assume declining premium income in these countries. We do not expect to see the outstanding premium growth of the last few years in the coming years. However, double-digit growth rates should not be exceptions", he estimates.

"The macroeconomic fears regarding the CEE region (in particular) are not appropriate for insurance companies, in our view. In the CEE region, the much more important sector is the property and casualty sector, which is less affected by the financial crisis. Moreover, unlike banks, which see their biggest risk in non-performing loans in a slumping economy, insurance companies do not have a comparable risk", further points Schultes.

Historical low valuation, P/B multiple at 0.8x

Until 2002, DJES Insurance companies were traded at extremely high P/E ratios, whereas 2001 and 2002 were somewhat distorted by the falling earnings in those years. Between 2004 and 2006, P/E ratios were quite stable between 10.8x and 11.4x. However, this ratio fell below 10x for the first time in 2007 and currently stands at 8.3x, despite sharply dropping earnings, burdened by extraordinary items (due to the financial crisis).

While one might argue that P/E ratios are currently not the most useful multiple, since earnings are hardly predictable, the P/B ratio tells a similar story. From 2003 to 2005, the price/book multiple was very constant at approximately 1.5x. In 2008, the P/B ratio fell below the 1.0x mark for the first time and now stands at 0.8x.

The ROE clearly shows that earnings are coming off a cyclical high. In 2007, the DJES Insurance companies posted the highest profits in their history. Although the ROE has significantly come down in 2008, analysts' estimates forecast a recovery in 2009.

Peer group comparison

The chart clearly shows that the composite insurer peer group trades at higher multiples than those of the EuroStoxx Insurance index, especially as far as the price/book multiples are concerned. Generali and UNIQA have the highest price/book values (in the case of Generali, a high ROE seems to justify it). On the other side, Allianz and Vienna Insurance Group show the lowest price/book multiples. While Allianz suffered from a negative result, due to the result of discontinued operations (Dresdner Bank), the extremely low price/book multiple for Vienna Insurance Group is not justified, in our eyes.

	PE 08e	PE 09e	PE 10e	P/B 08e	P/B 09e	P/B 10e	ROE 08e	ROE 09e	ROE 10e
Allianz SE	6.9 x	5.6 x	4.7 x	0.79 x	0.69 x	0.62 x	8.8%	12.3%	13.1%
Assicurazioni Generali SpA	11.2 x	9.5 x	8.4 x	1.84 x	1.77 x	1.51 x	16.4%	18.7%	18.0%
AXA SA	7.5 x	6.4 x	5.4 x	0.73 x	0.67 x	0.63 x	9.7%	10.4%	11.8%
Mapfre SA	6.7 x	6.3 x	6.0 x	1.18 x	1.08 x	0.98 x	17.6%	17.2%	16.2%
Sampo Oyj	11.1 x	9.3 x	8.4 x	1.15 x	1.13 x	0.97 x	10.4%	12.2%	11.6%
UNIQA	19.0 x	11.9 x	7.9 x	1.56 x	1.36 x	1.17 x	7.8%	12.2%	15.9%
Vienna Insurance Group	6.6 x	6.5 x	6.2 x	0.73 x	0.69 x	0.64 x	12.8%	10.8%	10.7%
Median	**7.5 x**	**6.5 x**	**6.2 x**	**1.15 x**	**1.08 x**	**0.97 x**	**10.4%**	**12.2%**	**13.1%**

Source: Factsheet, Erste Group estimates

We strongly recommend that investors look at the companies' shareholders' equity, since this balance sheet item provides a clear picture of the financial strength of a company and the impact of the financial crisis. In addition, we would also look at the ratio of investments to a company's technical reserves, as this ratio could be a kind of indication of the strength of a company's portfolio.

Source: Company data, Erste Group calculations

Recommendations of Erste Group analysts:

We reiterate our **Buy recommendation on Vienna Insurance Group,** which is the only company in its peer group that was able to increase its shareholders' equity on an organic basis. The company is traded at

		Allianz	AXA*	Generali	MAPFRE	Sampo	UNIQA	VIG
1-3Q 08 results	Gross premiums written	66,839	45,942	51,661	10,668	3,478	4,429	6,018
	Ch. y/y	-3.3%	-2.4%	6.6%	13.9%	-0.2%	12.6%	19.6%
	Net profit	667	2,162	1,670	716	521	91	301
	Ch. y/y	-90.9%	-32.0%	-29.4%	41.6%	-84.9%	46.9%	20.0%
	Shareholders' equity	37,548	40,547	12,510	5,073	6,256	1,257	3,844
	Ch. 3m	-7.2%	-	2.7%	5.3%	-3.5%	6.4%	0.1%
	Ch. 6m	-16.5%	-11.2%	-9.1%	26.7%	-16.2%	-0.3%	60.2%
	Ch. 9m	-21.4%	-	-15.4%	17.1%	-19.1%	-5.9%	64.4%
	Combined ratio	94.9%	96.4%	95.1%	93.0%	91.8%	96.5%	96.0%
	Cost ratio	26.6%	28.0%	26.8%	23.9%	23.5%	32.4%	31.8%
	Loss ratio	68.3%	68.4%	68.3%	69.1%	68.3%	64.1%	64.2%
	Goodwill in % of shareholders' equity	30.6%	38.7%	44.2%	32.6%	8.5%	25.4%	25.6%
	Investments in % of technical reserves	107.0%	101.9%	111.2%	118.4%	141.6%	104.4%	117.9%

* 1-2Q 08 results

discounts compared to other composite insurers that are not justified, in our view. The price/book multiple for 08e stands at 0.7x, the PE 08e amounts to 6.6x, while the price/premium multiple for 08e is 0.34x. **Our target price remains at EUR 44. Our new target price for UNIQA is EUR 14.9,** which reflects the recent developments and the dilution due to the capital increase. We therefore **cut our recommendation to Reduce**. Our view is supported by the high multiples at which UNIQA is currently traded. UNIQA's price book multiple 08e is 1.6x, while the PE ratio for 2008e stands at 19.0x.