

## CEE insurance stocks to get a boost from rising profits, cheap valuation and stronger investor demand

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European insurance stock prices to swing from slump in 2010 (-8.7%) to strong momentum in 2011

Insurance stocks traded at attractive multiples - earning yields to stand strongly at 11.9% in 2011 and 12.8% in 2012

Vienna Insurance Group as top pick – high CEE exposure, good multiples and strong balance sheet

“We see the European insurance sector as highly attractive at the moment, given that balance sheets are constantly improving and valuation is cheap, despite companies’ huge growth potential. As the business environment is also improving, all these factors will help steer the sector to strong stock performance in 2011. CEE insurance companies in particular will ride this wave of positive developments, as they additionally rely on a very good location in markets that are still underpenetrated. Our top pick is therefore VIG, which has a high CEE exposure and can thus benefit from rebounding growth in the region and an improved investor sentiment,” explains Christoph Schultes, Insurance Sector Analyst at Erste Group.



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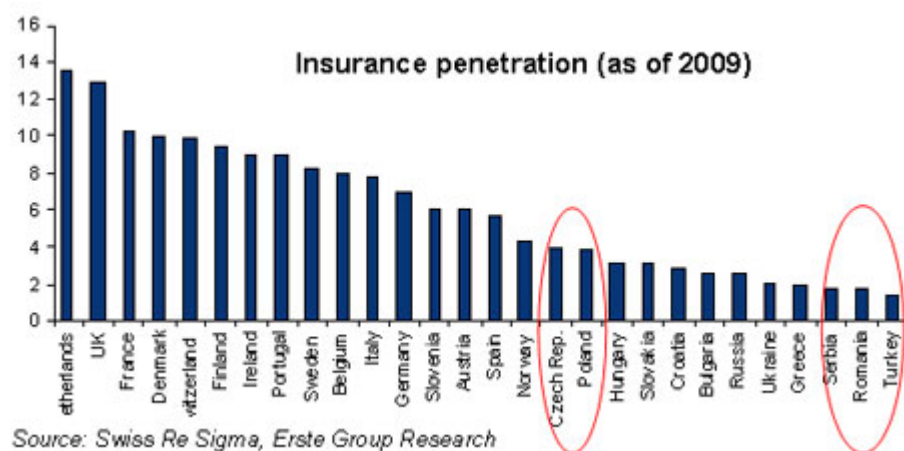
Source: FactSet

2010 was characterized by a remarkable catch-up of the overall economy, with Euroland expected to have achieved real GDP growth of 1.7%, after the slump of 4.1% in 2009. This favorable trend was reflected in DJ Euro Stoxx insurance companies' 6.8% top line growth in the first nine months of the previous year. The driving force behind the increasing premium income was the life insurance segment, which benefited from the rising confidence that insurance companies were able to fulfill their commitments even in a difficult business environment. The tendency for households to increase savings resulted in a soaring amount of single premium income.

On the other hand, 2010 was not a good year for insurance stocks. While most sectors in the Euro Stoxx Index recorded increasing share prices, the Insurance Index registered a price decline of 8.7% - this made it the fourth worst performing sector last year. However, it should also be mentioned that demand for insurance stocks significantly increased in the first weeks of the current fiscal year. The Euro Stoxx Insurance Index climbed by approximately 13% in January 2011, making the sector the second strongest (behind banks) in the current young year. Thus, the sector shows a clearly gaining momentum at present.

"If we take a look at the valuation we see the insurance sector is traded at very attractive multiples - the P/E ratios for 2010 (9.5x) and 2011 (8.4x) are the lowest among all Euro Stoxx sectors. Thus, the earnings yield we forecast for 2011 and 2012 is significant, amounting to 11.9% and 12.8%, respectively. We also notice investors are looking for a significant risk premium for investing in insurance companies," Schultes adds.

### Companies with CEE exposure to benefit from low insurance penetration and huge catch-up potential



The European insurance market cannot be seen as homogenous, nor can the different regions be viewed as uniform. In general, it can be stated that Western Europe is quite developed, while the CEE/SEE region has a huge catch-up potential. Most Western European countries are currently reporting insurance penetration rates of 6-10%, with the Netherlands and the UK being the absolute champions. On the other hand, the picture in CEE is more mixed: some markets like Turkey, Romania and Serbia record insurance penetration rates of below 2%, while in developed markets such as the Czech Republic, 4% or more of GDP is generated through insurance premium income. A look at insurance density confirms the clear correlation between the wealth of a country (measured in GDP per capita) and the expenditure on insurance contracts. The comparative analysis of insurance density therefore highlights the gap between Western European markets and the CEE/SEE ones, which clearly points to a huge catch-up potential for the CEE region.

### Valuation

The top pick remains Vienna Insurance Group. Erste Group analysts increase their target price to EUR 50 and therefore reiterate their Buy recommendation. VIG has high CEE exposure, ranking no. 1 in Czech Republic, Slovakia, Romania and Bulgaria (in addition to its no.1 rank in Austria). Analysts appreciate the company's attractive multiples and the strong balance sheet, including a solvency ratio of >200 and a war chest of more than EUR 1.2bn for further acquisitions and therefore stronger growth in the CEE region.

Erste Group analysts upgrade their recommendation for PZU to Accumulate and reiterate their target price of PLN 400. PZU has the strongest balance sheet of their peer group and, thanks to its high financial asset position, outstanding profitability. The only flaw is the fact that PZU is still losing market share and thus does currently not participate in the fantastic CEE growth story.

Erste Group Research reiterates its Reduce recommendation for UNIQA, but slightly raises the target price to EUR 13.8 since a liquidity discount is no longer included. The company's main problem is its low profitability, which is actually due to a very poorly performing property and casualty segment. Thus, the P/E multiples (based on Erste Group estimates) are the highest among its peer group.

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[Presentation \[pdf; 330.1 KB\]](#)

