

| Insurance | Initiation of coverage | Austria |

# VIENNA INSURANCE GROUP

We recommend buying shares with our target price at EUR26.0 per piece

## Buy

Price 03/03/17	<b>EUR 23.1</b> CZK 628.9
12m target	<b>EUR 26.0</b> CZK 691
Upside to TP	<b>12.6%</b>
Dividend	<b>EUR 0.7</b> CZK 18.9
Total return	<b>15.6%</b>

### Sector stance

Overweight

### Investment type

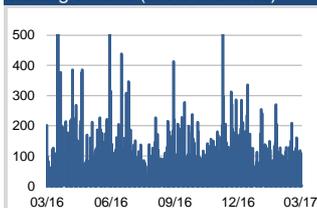
 EMG markets exposure 

### 1 year performance



Source: Bloomberg

### Trading volume (in ths of shares)



Source: Bloomberg

**Investment case 12M:** We initiate coverage of the Vienna Insurance Group stock with a Buy rating and a target price of EUR26.0 per share. The target price is at 11.5x 2016 EPS estimate and 11.6x 2017 EPS forecast. We expect a dividend payment distributed from 2016 net income in the amount of EUR0.7 per share, indicating a dividend yield of 3.0%. VIG is a well-capitalised insurance company with a solvency ratio of around 200% and an equity-to-assets ratio (11.2%) well above the peer group median (8.5%). The stock is undervalued in comparison with the peer group. In our opinion, this valuation is currently justified by lower profitability and a dividend yield. For the future, however, we believe the stock combines growth potential and stable profitability.

**Business strategy:** The VIG business model is built on the Austrian insurance market and subsequent expansion to CEE countries, where it expects stronger premium growth rates. CEE has generated a majority of premiums since 2008. The company is well established on the Czech and Slovak markets, which together with Poland and Romania constitute the core CEE markets. We expect the company to meet its 2016 pre-tax profit guidance.

**2016 company results:** We expect a mild increase of 1.2% in gross premium written to slightly more than EUR9.1bn. The low interest rate environment should still push down the financial results, which are expected to decline 10%. We see the management target of at least double 2015 PBT up to EUR400m as attainable as we expect it to exceed this level. Net income should reach less than EUR300m.

**Mid-term prognosis:** We expect an increase of the market share to 10% in Croatia, Hungary, Poland and Serbia, which is in line with VIG's mid-term strategy. We also assume a stagnating market share in the VIG's biggest markets (i.e. Austria, the Czech Republic and Slovakia).

**12M target price:** EUR26.0 based on a fair value of EUR24.7 and adjusted for positive sector appeal. The target price is 12.6% above the current market price.

**Valuation methodology:** The fair value estimate is based on an average of a discounted dividend model and excess return method. The target value was set by adjusting FV for sector, company and speculative appeal.

**Next events:** VIG will announce its 2016 full-year results on 19 April 2017.

### Share data

RIC VIGR.VI	Bloom VIG AV
52-week range	15.8-23.8
Market cap. (CZKbn)	79.9
Market cap. (EURm)	2956
Free float (%)	30
<b>Performance (%)</b>	<b>1m 3m 12m</b>
Share	0.5 19.5 2.2
Rel. to ATX Index	-1.8 6.9 -19.2

Source: Bloomberg

### Financial data (EURm)

	2015	2016e	2017f	2018f
Gross written premium	9020	9130	9293	9693
Net earned premium	8181	8344	8632	9004
Financial result	1059	954	1074	1144
Profit before taxes	157	403	414	425
EPS (adj., EUR)	0.6	2.3	2.2	2.3
Dividend (EUR)	1.4	0.6	0.7	0.8
Payout (%)	92.7	30.0	33.8	37.1
Embedded value	6844	7188	7400	7568

### Ratios

	2015	2016e	2017f	2018f
P/E act. (x)	35.7	10.2	10.3	10.0
P/E target (x)	40.1	11.5	11.6	11.3
Price/NEP (%)	40.6	39.8	38.5	36.9
Dividend yield (%)	5.5	2.3	2.7	3.1
Price/EmbV (x)	0.4	0.5	0.4	0.4
ROE (%)	1.7	6.5	6.1	6.0
ROA (%)	0.2	0.7	0.6	0.6
ROEV (%)	8.1	6.2	4.3	3.7

**The latest analysis:**  
No reports.

SOCIETE  
GENERALE  
GROUP



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## Summary

We initiate our coverage of the Vienna Insurance Group stock with a Buy rating and target price of EUR26.0 per share.

VIG began expanding beyond Austria in 1990 and now operates in 25 countries. The main markets in the CEE region are the Czech Republic, Slovakia, Poland and Romania. The domestic market's contribution to the top line has dropped below 50% since 2008.

The company is majority-owned by Wiener-Städtische WV (the original mutual insurance company), which holds a 70% stake. The stock is traded on the Vienna and Prague stock exchanges.

The reason for CEE expansion is higher expected insurance market dynamics relative to developed markets. Statistics show a strong correlation between insurance penetration and GDP per capita. Therefore, the growth of insurance markets in CEE countries should be in line with growth of the European economy, CEE convergence and insurance penetration growth. Increasing household wealth typically shifts the focus from obligatory motor policies through property insurance to the life insurance business.

VIG pursues a multibrand strategy. In its core markets, it operates more than one insurance company but aims to unite their non-operating activities to cut costs. The reasons for such a strategy include employee and customer loyalty, the ability to communicate with different market segments and comparability or intra-group competition.

VIG expansion has included both green-field entrances and acquisitions. The group remains active in acquisition markets. In 2016, it bought insurers in Serbia, Romania, Bulgaria and the Baltics.

We expect a mild increase of 1.2% in gross premium written to slightly more than EUR9.1bn in 2016. The low interest rate environment should still push down the financial results, which are expected to decline 10%. We see the management target of at least double 2015 PBT up to EUR400m as attainable as we expect it to exceed this level. Net income should reach less than EUR300m. On the mid-term horizon, we predict VIG's GWP to grow 4.0% on average in 2017-2021. After 2015's significant drop in profit margin, we expect a recovery for 2016. We estimate the profit margin to reach 4.8%; however, we do not expect a return to the levels seen in the previous years (about 6%). For the 5Y horizon, we predict an average profit margin at 4.5%.

VIG has had a stable dividend policy, paying out at least 30% of net attributable profit. We expect the management to propose a dividend in the amount of EUR0.7 per share distributed from last year's net attributable profit. In our model, we assume a gradual increase in dividend payments annually by EUR0.1 per share.

VIG stock is slightly undervalued in comparison with the group of its closest peers and even more undervalued compared with companies with no exposure to the CEE region. Currently, we think a lower valuation is justified by lower profitability and a dividend yield.

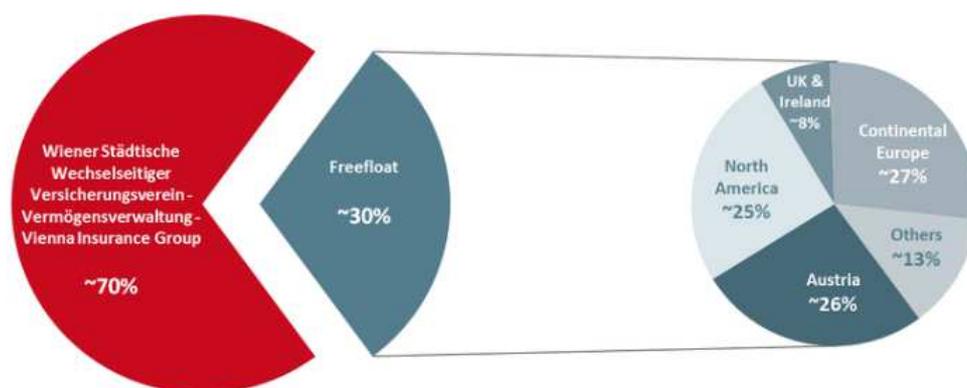
## The company

VIG is one of the largest insurers in the CEE region.

**Vienna Insurance Group offers both life and non-life insurance in the CEE region** including Austria. It has a history of more than 190 years, and its stock has been listed on the Vienna Stock Exchange since 1994. A double-listing on the Prague Stock Exchange took place in 2008.

VIG is majority-owned by Wiener Städtische Wechselseitiger Versicherungsverein-Vermögensverwaltung, which holds a 70% share. **The remainder of the company's equity is free float.**

### Shareholder structure



Source: Vienna Insurance Group

## Expansion in the CEE region

VIG has established itself in 25 countries since its expansion began in 1990.

Until 1990, VIG's activities were limited solely to the Austrian market (under the name of Wiener Städtische). VIG was one of the first foreign insurers to enter post-communist markets. Currently, **it is present in 25 countries, covering the entire CEE region.** The group includes about 50 insurance companies and employs approximately 23,000 people.

The expansion beyond Austria wasn't just symbolic. The domestic market has generated less than half of net earned premiums since 2008 (about 47% in 2016). However, the core countries responsible for about 85% of premiums combined are just a few: Austria, the Czech Republic, Poland, Slovakia and Romania.

A holding structure was established in 2010 after Austrian operations were removed from the parent company.

**The eastward shift of activities was the main driver in the establishment of a typical holding structure in 2010.** Since August 2010, VIG has operated in Austria through its subsidiary Wiener Städtische, and the parent company thus no longer participates in the direct insurance business (save for international corporate deals).

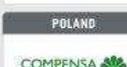
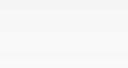
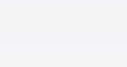
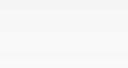
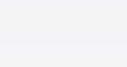
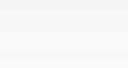
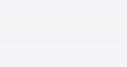
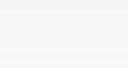
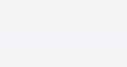
Contrary to most of its competitors, **VIG pursues a multi-brand strategy both nationally and internationally** (see the picture on the following page). Often, the multi-brand portfolio at the national level is a result of green-field expansion and subsequent acquisitions. VIG has stated that it prefers a multi-brand portfolio for utilising traditional brands and the

corresponding loyalty of both customers and employees. On the other hand, the multi-brand strategy doesn't preclude the mergers of subsidiaries. The group has already merged some of its activities in Poland, Bulgaria, Romania and other countries.

**VIG countries and brands**

**THE LEADING INSURANCE SPECIALIST IN AUSTRIA AND CEE.**




AUSTRIA	SLOVAKIA	BULGARIA	ESTONIA	TURKEY
  	  	 	   	  
ITALY BRANCH	POLAND	CROATIA	LATVIA	ALBANIA
 	  	 	 	 
SLOVENIA BRANCH	ROMANIA	HUNGARY	LITHUANIA	MACEDONIA
	   	  	 	  
CZECH REPUBLIC	ROMANIA	SERBIA	MOLDOVA	MONTENEGRO
   	  			
CZECH REPUBLIC	ROMANIA	UKRAINE	BELARUS	BOSNIA HERZEGOVINA
   	  	   		
CZECH REPUBLIC	ROMANIA	UKRAINE	GEORGIA	GERMANY
   	  	   	 	
CZECH REPUBLIC	ROMANIA	UKRAINE	GEORGIA	LIECHTENSTEIN
   	  	   	 	

January 2017  
www.vig.com

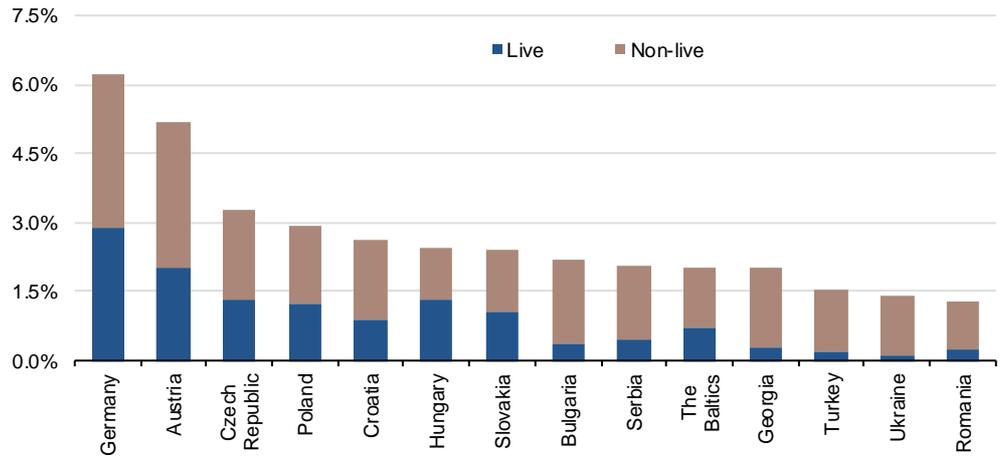
Source: Vienna Insurance Group

## Markets

CEE markets have very low insurance density, which gives them high growth potential.

The business idea behind VIG's expansion outside Austria is clear. The company established itself on markets with very low insurance density and strong growth potential. If the economic convergence of CEE markets toward the EU27 average continues, **we may expect above-average growth of their insurance markets.** The growth potential in CEE insurance premiums could thus be split into three sources: (1) growth of the European economy, (2) convergence of CEE economies and (3) increase in penetration.

2015 insurance market penetration in countries where VIG operates

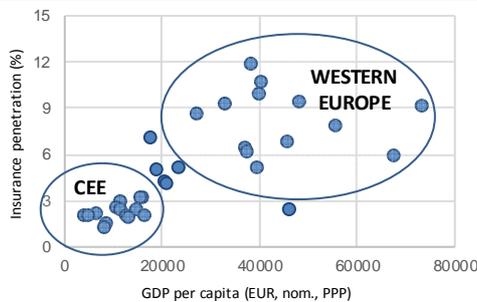


Source: Swiss Re (World Insurance in 2015); Economic & Strategy Research, Komerční banka

The higher the living standards, the stronger the demand for insurance products.

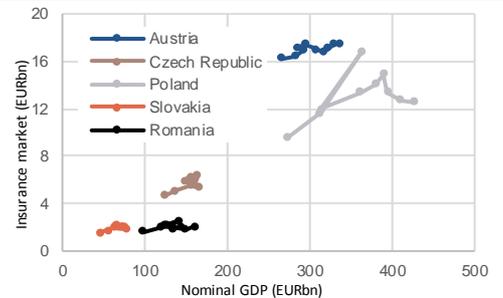
The following two charts underpin the fact that **the growing economy positively influences the development of the insurance market in the country.** Increasing living standards also led to a diversification of the overall market. Most importantly, the breakdown of the total premium has shifted toward life insurance in developed countries. Such a shift is also connected with the convergence process. As the population becomes richer, people are more inclined to seek to protect their future well-being. Also, several countries in the region have undergone pension reforms, and governments and the private sector alike highlighted the need for protecting future life standards.

Insurance penetration vs. GDP per capita



Source: Swiss Re (World Insurance in 2015); Eurostat; Economic & Strategy Research, Komerční banka

Trends in insurance market (2006-2015)

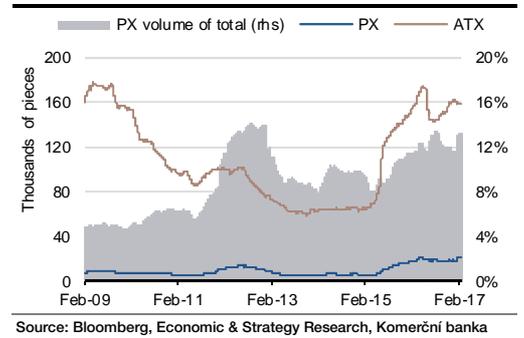


## VIG stock on the Prague market

VIG is one of the least traded stocks on the PSE.

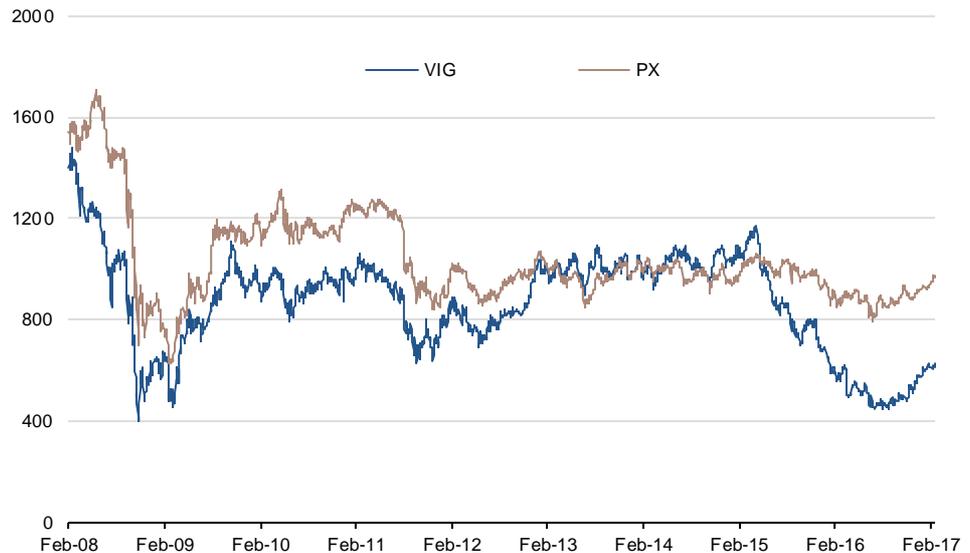
The Prague market has played a minor role in overall VIG stock liquidity since its introduction in February 2008 as the Vienna market retained its dominant position. Despite this, we have witnessed a rising trend of volume traded on the Prague Stock Exchange, which is now approximately 13% (below 5% at the beginning). VIG stocks are interesting mainly for local institutional clients, considerably less so for the Czech retail segment.

Average annual volume in PX and ATX



VIG's average daily turnover on the PSE represents almost CZK11m with a share of 1.6% to total amount of stocks traded. At the beginning of Prague trading, it was only 0.2%, but this improvement is also affected by the decreasing number of stocks listed on the PSE. The performance of VIG stocks since the beginning of its dual listing is shown in the following chart.

VIG stock price (CZK) and PX Index since dual listing on 5 February 2008



## Recent development

### Results for nine months of 2016

#### Income statement

	9M 2015	9M 2016	+/-%
1. Gross premiums written	6,912.4	6,961.8	0.7
2. Net earned premiums	6,147.3	6,158.9	0.2
3. Financial results	781.7	703.2	-10.0
4. Other income	78.3	122.8	56.8
<b>Total income</b>	<b>7,007.3</b>	<b>6,984.9</b>	<b>-0.3</b>
6. Expenses for claims and insurance benefits	-5,021.2	-5,091.5	1.4
7. Acquisition and administrative expenses	-1,395.5	-1,422.4	1.9
8. Other expenses	-430.6	-169.7	-60.6
<b>Total expenses</b>	<b>-6,847.3</b>	<b>-6,683.6</b>	<b>-2.4</b>
<b>Profit before taxes</b>	<b>160.0</b>	<b>301.3</b>	<b>88.4</b>
Taxes	-23.9	-70.3	194.4
Net profit before non-controlling interests (Profit for the period)	136.1	231.0	69.7
Non-controlling interests	-5.1	-11.2	120.7
<b>Net profit after minorities</b>	<b>131.0</b>	<b>219.8</b>	<b>67.8</b>

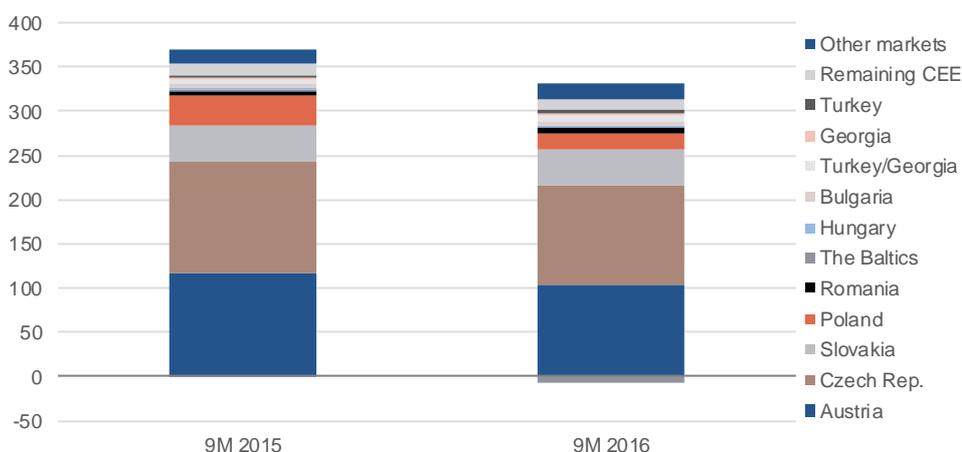
Source: Vienna Insurance Group; Economic & Strategy Research, Komerční banka

VIG's performance is negatively affected by a drop in the single-premium life insurance business.

The insurance company has raised its gross premium written by a mere 0.7%; in the case of net earned premium, the increase was even weaker, i.e. +0.2%. This development is negatively affected by a huge drop of 18.6% yoy in the single-premium life insurance business that corresponds with VIG's strategy to reduce this activity due to the low interest rate environment. This is also a reason for the 10% yoy drop in financial results.

According to CEO Elisabeth Stadler, the **company's management is satisfied with profit development, which is in line with the target VIG announced for 2016**. She also added in a statement about the released figures that the decision to exercise restraint in the traditional single-premium life insurance business was correct.

#### Geographical breakdown of profit before taxes (EURm)



Notes: Profit before taxes excluding central functions and consolidation (total PBT was EUR160m in 9M 2015 and EUR301.3m in 9M 2016; loss of EUR205.8m in central functions in 2015 was connected with impairments and IT write-down)  
Source: Vienna Insurance Group; Economic & Strategy Research, Komerční banka

**An increase of almost 90% in profit before taxes was the result of one-off effects in 2015**, such as the write-down of IT systems and impairments of goodwill (especially Romania, but also Hungary, Albania, Bosnia-Herzegovina and Moldova) and of the insurance portfolio in Poland in a total amount of EUR285m. Excluding central functions and consolidation, we have witnessed a drop in VIG's profit before taxes (see the previous chart), caused mainly by lower financial results in Austria, the Czech Republic and Poland. The Polish business has also suffered from a challenging motor environment. Startup costs and non-life portfolio transfers negatively impacted results of the Baltics (EUR-7.8m).

### 2016 results

The management target for 2016 profit before taxes seems achievable.

The insurance company will release its results for the year of 2016 on 19 April 2017. The following table shows our expectations for main income statement items. We expect a mild increase of 1.2% in gross premium written to slightly more than EUR9.1bn. The low interest rate environment should still push down the financial results, which are expected to decline 10%. An enormous increase in profit before taxes (PBT) and net income is affected by the one-off factors mentioned above. **We see the management target of at least double 2015 PBT up to EUR400m as attainable as we expect it to exceed this level.** Net income should reach less than EUR300m.

Estimates of 2016 results

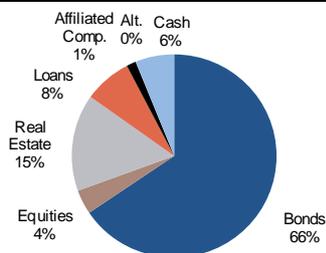
EURm	2015	2016	yoy
Gross premium written	9,020	9,130	1.2%
Net earned premium	8,181	8,344	2.0%
Financial result	1,059	954	-9.9%
EBT	157	403	156.9%
Net attributable profit	83	290	249.7%

Source: Vienna Insurance Group; Economic & Strategy Research, Komerční banka

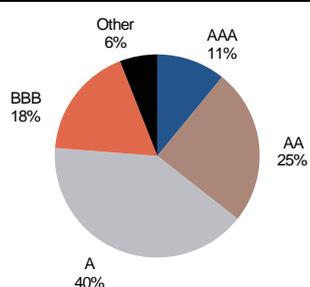
### Investment portfolio

The investment portfolio amounted to EUR36.5bn (cca 73% of total assets) as of 30 September 2016. Almost two-thirds of this is invested into bonds. A portfolio breakdown according to asset classes, ratings and issuers is shown in the following charts.

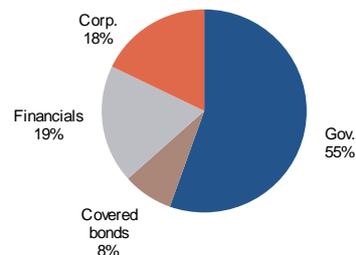
Asset classes



Bond portfolio by rating



Bond portfolio by issuer



Source: Vienna Insurance Group

## Real estate portfolio

The real estate portfolio provides VIG with some certainty; however, it also represents a source of risk.

**VIG's real estate portfolio accounts for 15.4% of the total and is its second-largest part.**

Housing societies represent 9.6%, while the remaining 5.8% is attributable to other real estate investments. Non-profit housing societies build or renovate housing and their financing largely comes from housing construction subsidies provided by subsidy laws and directives at the provincial level. Housing financed by housing construction subsidies is subject to special restrictions that govern annual distributions and access to the assets of the housing society. VIG has owned such companies for more than 30 years.

**The special treatment of housing societies provides VIG investment with some certainty** (furthermore, residents are VIG insurance clients). On the other hand, the portfolio value is thus linked to national budget expenditures with all the implicit risks. We thus cannot rule out a deterioration of the portfolio value should the government change its policy (rent subsidies may become the target of austerity measures, for example).

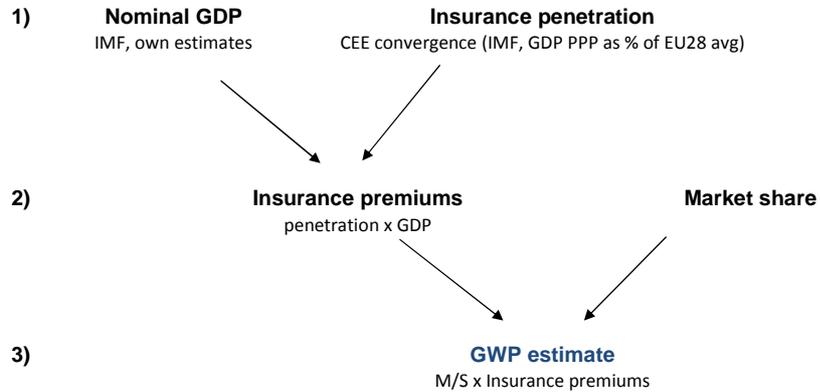
We made no value adjustments for the real estate portfolio in either direction in our model.

## Changes on the management board

At the beginning of 2016, Elisabeth Stadler became the new chief executive officer of the insurance company, replacing Peter Hagen, who started in this position in June 2012. The former CEO left more than two years before the end of his term due to differences in opinion regarding future strategic orientation and direction. The change was caused by the announced IT impairments in 2015, and Vienna Insurance Group also suffered losses in Romania and Italy as well as on bonds owed by bad bank Heta Asset Resolution during Hagen's tenure.

## Mid-term projections

Our projection of gross written premium starts at the macro level



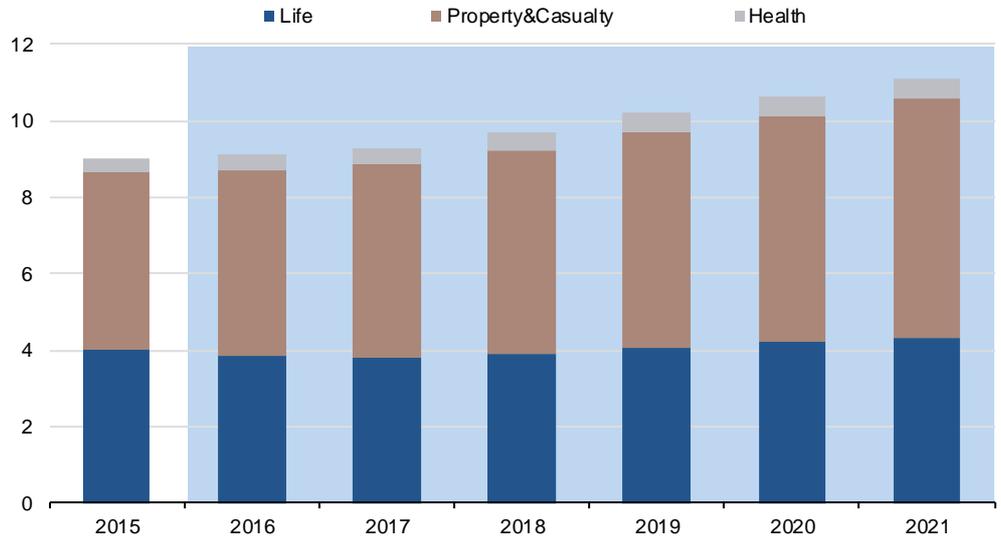
Source: Economic & Strategy Research, Komerční banka

### Gross written premium forecasts

We expect growth of gross written premium slightly above the total market where VIG operates.

On the mid-term horizon, we expect an increase of market share to 10% in Croatia, Hungary, Poland and Serbia, which is in line with VIG’s mid-term strategy. We also assume a stagnating market share in VIG’s biggest markets (i.e. Austria, the Czech Republic and Slovakia). Based on these assumptions, we predict VIG’s GWP to grow 4.0% on average in 2017-2021.

### Gross written premium projections



Source: Vienna Insurance Group; Economic & Strategy Research, Komerční banka

We suppose that VIG’s current strategy to reduce single-premium life insurance business is attributable to slower growth of its gross written premium than the whole insurance market where VIG operates. **We may see slightly worse growth this year as well, but for the following years we expect a better performance.**

Referring to VIG’s mid-term strategy, we also assume higher growth dynamics for non-life insurance. There are several reasons behind this: (1) penetration of life insurance in CEE countries is substantially lower than in the case of non-life insurance, and we do not expect significant changes in current trends, (2) expansion to new markets is easier through non-life insurance products, (3) the current low interest rate environment (despite anticipated future rate growth) is not supportive for life insurance.

### Profitability

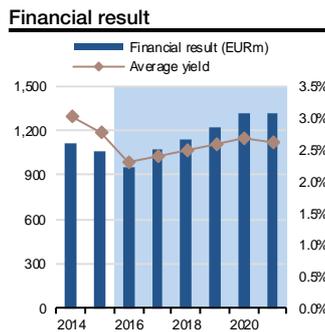
Total profit margin is expected to decrease slightly in the following years.

After 2015’s significant drop in profit margin (calculated as profit before taxes divided by net earned premium), we expect a recovery for 2016. **We estimate that the profit margin will reach 4.8%**; however, we do not expect a return to the levels seen in previous years (about 6%). This year, we project the same level as last year; in the following years, it should slightly decrease. For the 5Y horizon, we predict an average profit margin of 4.5%.

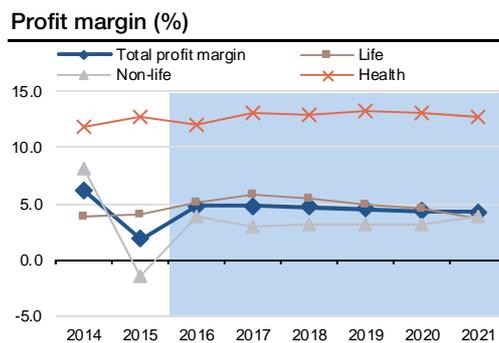
**We expect the deterioration to be affected mainly by developments in life insurance** and its decreasing profitability. We believe the life insurance segment will not only face competition from other insurers but will also be under pressure from alternative forms of wealth management such as pension and investment funds. Such competition will, in our opinion, lead to thinner margins.

**The financial results have been negatively affected by declining interest rates and yields for the past several years.** Although the ECB is not expected to hike interest rates within the next five years, we anticipate the rising inflation rate and increasing U.S. yields to influence the CEE region. Moreover, in the case of the Czech Republic, we expect monetary policy tightening (four hikes in 2018) to be a supportive factor. We also assume higher interest rates in Poland and Hungary next year, although these moves should not be as significant as in the Czech Republic.

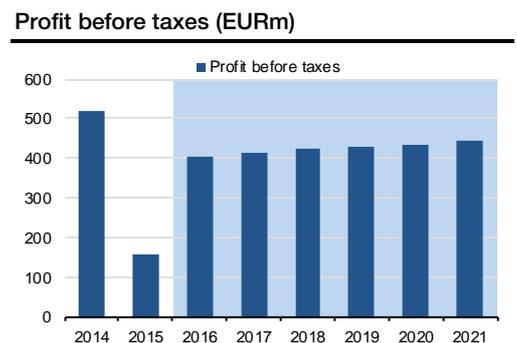
**Profit before taxes should exceed EUR400m for 2016**, and we expect a gradual increase in the following years. Net attributable income is expected to reach EUR290m in 2016, and in the future it should move close to the level of EUR300m.



Note: Average yield is a proxy for return on invested capital  
Source: VIG; Economic & Strategy Research, Komerční banka



Notes: profit margin is calculated as earnings before taxes divided by net earned premium  
Source: VIG, Economic & Strategy Research, Komerční banka

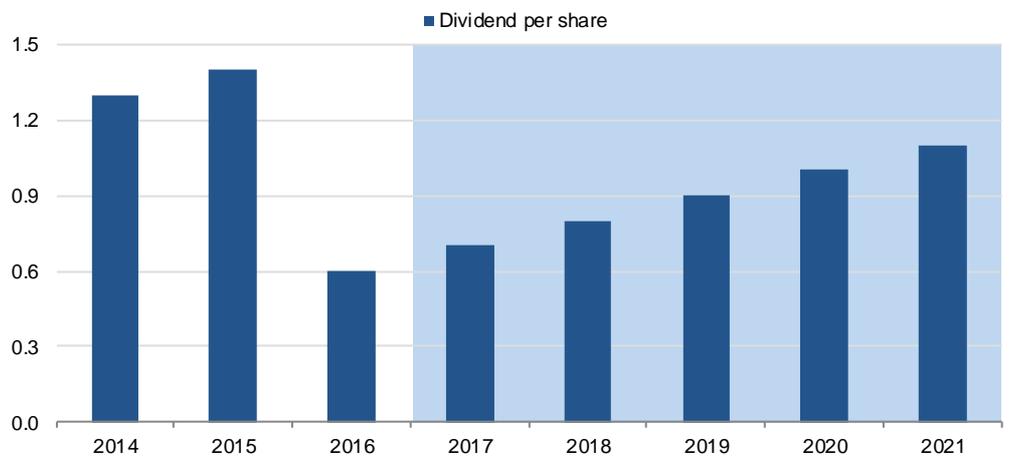


VIG is expected to maintain a stable dividend policy for the future.

### Dividend policy

VIG has had a stable dividend policy, paying out at least 30% of net attributable profit. Due to impairments in 2015 resulting in a significant drop in net profit, the insurance company cut its dividend to EUR0.6 per share from EUR1.4. Before, we had seen a gradual increase in a dividend payment by EUR0.1. We believe VIG will return to this policy and will raise it in the following years. Therefore, we expect the management to propose a dividend in the amount of EUR0.7 per share distributed from last year's net attributable profit, meaning a dividend payout ratio at 30%. In our model, we assume a gradually growing dividend payout ratio to 50%.

#### Projection of dividend per share in the future



Source: Vienna Insurance Group; Economic & Strategy Research, Komerční banka

**According to our estimates, the policy would not endanger the company's solvency.** The ratio of equity to total assets would remain well above the peer group median (estimated at 11.2% on average for the period of 2017-2021 versus the peer group median of 8.5%). We expect no share dilution in the years to come.

## Peer comparison

We divided European insurers into two peer groups. The first shares CEE exposure with VIG, while the other does not. In terms of P/E multiples, VIG stock is slightly undervalued in comparison with the group of its closest peers and more compared to companies with no exposure to the CEE region. Currently, we think a lower valuation is justified by lower profitability and a dividend yield.

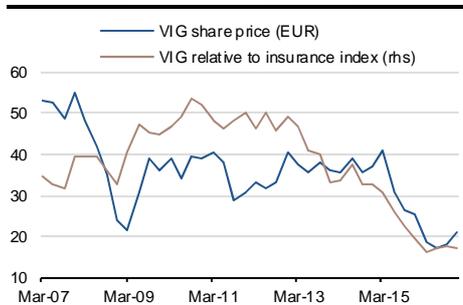
### Vienna Insurance Group vs. regional and West European peers

	P/E akt.	P/E 2017	P/E 2018	P/B akt.	EV/S akt.	EV/S 2017	EV/S 2018	DV akt.	DV 2017	ROE 2017	ROE 2018	ROA 2017	ROA 2018	E/A akt.
<b>VIENNA INSURANCE GROUP</b>	<b>10.2</b>	<b>10.3</b>	<b>10.0</b>	<b>0.6</b>	<b>0.6</b>	<b>0.7</b>	<b>0.7</b>	<b>2.6</b>	<b>3.0</b>	<b>6.1</b>	<b>6.0</b>	<b>0.6</b>	<b>0.6</b>	<b>11.2</b>
<b>peer group median</b>	<b>11.0</b>	<b>10.7</b>	<b>10.2</b>	<b>0.9</b>	<b>0.4</b>	<b>0.4</b>	<b>0.5</b>	<b>5.2</b>	<b>5.2</b>	<b>9.3</b>	<b>9.1</b>	<b>0.6</b>	<b>0.8</b>	<b>8.5</b>
AXA SA	9.4	9.6	9.2	0.8	0.4	0.4	0.4	5.0	5.2	8.1	8.2	0.6	0.6	8.5
Allianz SE	11.0	10.7	10.2	1.1	0.9	0.8	0.9	4.6	4.7	10.4	10.4	0.9	0.8	8.0
Assicurazioni Generali SpA	11.1	9.8	9.2	0.9	0.3	0.4	0.4	5.2	5.6	8.9	9.1	0.4	0.4	4.9
ING Groep NV	12.6	11.2	10.7	1.1	n.a.	n.a.	n.a.	4.9	5.1	9.3	9.5	0.5	0.6	6.0
Powszechny Zakład Ubezpieczeń	17.4	16.4	13.2	2.5	1.3	2.1	2.0	5.7	4.9	14.5	17.3	35.2	28.1	14.4
Zavarovalnica Triglav DD	6.7	9.2	11.0	0.9	0.5	n.a.	n.a.	9.5	9.9	9.6	8.1	1.9	1.5	20.2
UNIQA Insurance Group AG	9.8	15.0	9.5	0.7	0.4	0.4	0.5	6.5	6.7	4.2	6.4	0.3	0.9	9.6
<b>industry index remainder median</b>	<b>14.1</b>	<b>12.5</b>	<b>11.5</b>	<b>1.2</b>	<b>0.7</b>	<b>0.8</b>	<b>0.8</b>	<b>4.5</b>	<b>4.9</b>	<b>8.9</b>	<b>9.9</b>	<b>1.0</b>	<b>1.0</b>	<b>9.9</b>
Ageas	57.0	10.6	9.7	0.8	0.8	0.9	0.9	4.7	4.9	7.5	7.8	0.6	0.6	9.9
Aviva PLC	40.2	10.2	9.4	1.2	n.a.	n.a.	n.a.	4.3	4.6	10.1	10.0	0.3	0.4	4.7
Baloise Holding AG	12.7	12.5	11.9	1.1	0.4	0.6	0.6	3.7	3.9	8.8	8.9	0.9	0.9	6.9
Gjensidige Forsikring ASA	14.1	16.0	15.4	3.0	3.2	3.1	3.0	5.2	6.2	19.1	19.4	3.1	3.2	16.4
Helvetia Holding AG	17.4	13.7	11.5	1.2	0.6	0.7	0.6	3.4	3.6	8.6	9.9	1.0	1.0	9.9
Mapfre SA	11.7	11.2	10.4	1.0	0.6	0.5	0.5	4.9	4.9	8.9	9.5	1.3	1.4	16.9
Topdanmark A/S	10.5	13.5	13.2	3.3	0.9	1.1	1.1	n.a.	5.6	23.6	20.6	1.5	1.6	6.4

Notes: DV – dividend yield; figures for Vienna Insurance Group are based on our forecasts  
 Source: Bloomberg, Economic & Strategy Research, Komerční banka

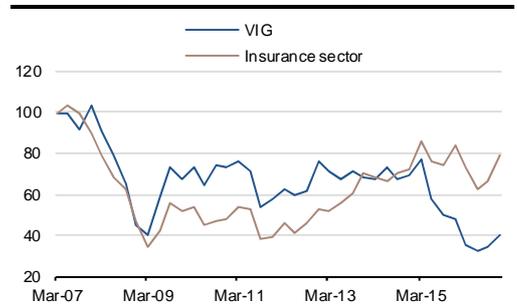
The insurance sector dropped significantly during the financial crisis of 2008-2009. Thereafter, VIG stocks outperformed the development of the Stoxx insurance sector index, but the reversal came in 2015 connected with unfavourable company results, impairments and management changes. We hope **the discount of VIG shares against the insurance sector will not expand further**; on the other hand, we do not expect it to narrow significantly, either, owing to lower profitability and the dividend yield.

VIG share price over the past 10 years



Source: Bloomberg

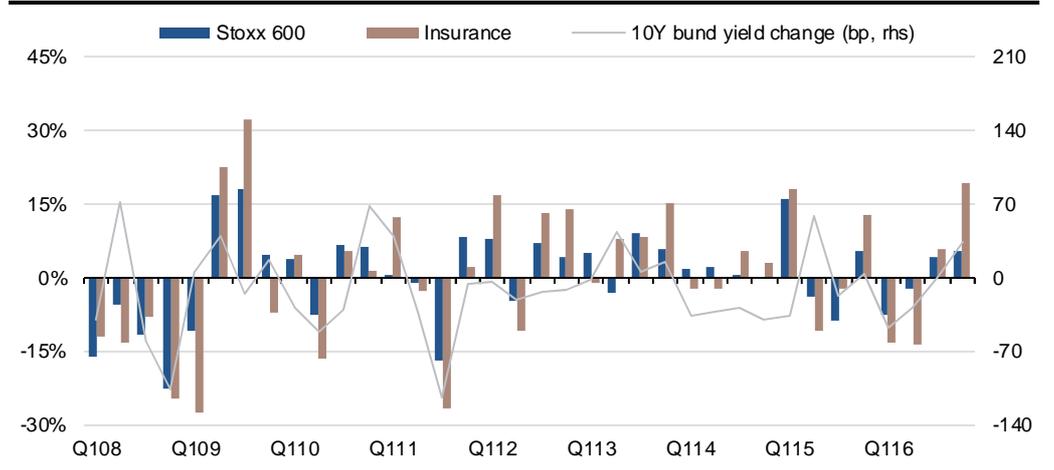
VIG share price over the past 10 years



In addition to the underperformance of VIG relative to the insurance sector, we need to mention that the sector itself underperformed broad market indices during the 2008-2009

financial crisis, for instance. The relation is somewhat correlated with the change in risk aversion (see the change in German bund yields, which are traditionally considered safe haven investments). In the time of rising bund yields (i.e. rising risk appetite), the insurance sector has outperformed the whole stock market. We reflect this factor in a sector appeal assessment.

**Quarterly performance of insurance sector index and Stoxx 600**



Source: Bloomberg

## Valuation

We use two methods to assess the fair value of the company:

**(1) Discounted dividend model (DDM)** – We consider a huge drop in dividend payments distributed from 2015 net income as a one-off factor resulting from extraordinary write-downs. Owing to the fact that VIG dividend policy has been quite stable in the previous years and the company also expressed its intentions to keep it stable, we assume a gradual increase of dividend. We discounted the projected dividends of 2017-2021 back to the beginning of March 2017.

**(2) Excess return method (ERM)** – The method calculates excess return over costs of equity. Return on equity is based on the market value of equity. The computed excess returns for the period of 2017-2021 are then discounted back to the present.

For both methods, we use a cost of equity of 7.3%. This is based on a risk-free rate of 0.9% (a weighted average of 10Y government bond yields), equity premium of 6.9% and beta of 0.92 (five years of weekly data versus the Austrian ATX index). The terminal value was calculated using a growth rate of 2.7% (ROE x profit retention ratio in 2022).

**Based on an average of our two models, we estimate the fair value of VIG shares at EUR24.7 per piece.** The following table discloses our calculation:

### Calculation of VIG's fair value based on our two models

	2017	2018	2019	2020	2021
<b>Key assumptions:</b>					
Cost of equity	7.3%				
Risk-free interest rate	0.9%				
Beta	0.92				
Equity premium	6.9%				
Long-term growth rate	2.7%				
<b>Discounted dividend model</b>					
<i>Dividend per share</i>	85	89	93	97	100
Explicit value	464				
Terminal value	2,438				
<b>Fair value per share</b>	<b>22.7</b>				
Fair value of equity (EURm)	2,902				
<b>Excess return method</b>					
ROE (market value)	10.2%	9.8%	9.3%	8.9%	8.7%
Cost of equity	7.3%	7.3%	7.3%	7.3%	7.3%
Return spread	2.9%	2.5%	2.1%	1.7%	1.4%
Equity (beginning of period)	2,726	2,920	3,107	3,285	3,454
<i>Economic profit (excess return)</i>	79	73	64	54	49
Opening equity	2,726				
Explicit value	265				
Terminal value	439				
<b>Fair value per share</b>	<b>26.8</b>				
Fair value of equity (EURm)	3,430				

Source: Economic & Strategy Research, Komerční banka

## Target price

We set the target price at EUR26.0 per share.

To achieve the target price, we reflect three parameters that may be assigned values ranging from -10% to +10% each, which means the target price may range from 70% to 130% of the fair value.

- **Sector appeal (+5%):** SG's recommendation for the European insurance sector remains at *Overweight*, and we assess this factor at +5%.
- **Company appeal (0%):** VIG offers a stable growth business model and positive performance on the main as well as new markets. The insurance company also implements measures to reduce the combined ratio. On the other hand, profitability and dividend yield are lower in comparison with its peers. These factors offset each other and, therefore, we assign 0% to this factor.
- **Speculative appeal (0%):** We do not currently see much room for valuation within the European insurance sector. VIG's share discount against the market is justified by lower profitability and dividend yield, in our opinion.

Using the above-mentioned parameters, **we set our target price at EUR26.0** (fair value plus 5%).

The following table provides a snapshot of the sensitivity of VIG's fair values to changes in the cost of equity and the long-term growth rate.

### Sensitivity analysis

<b>Discounted dividend model</b>					
Cost of equity / growth rate	1.7%	2.2%	2.7%	3.2%	3.7%
6.3%	23.5	26.0	29.1	33.2	38.9
6.8%	21.2	23.1	25.5	28.5	32.5
7.3%	19.3	20.8	<b>22.7</b>	25.0	28.0
7.8%	17.7	18.9	20.4	22.3	24.5
8.3%	16.3	17.3	18.6	20.1	21.9
<b>Excess return method</b>					
Cost of equity / growth rate	1.7%	2.2%	2.7%	3.2%	3.7%
6.3%	32.6	33.6	34.8	36.5	38.9
6.8%	29.1	29.6	30.3	31.2	32.4
7.3%	26.2	26.5	<b>26.8</b>	27.2	27.7
7.8%	23.8	23.9	24.0	24.1	24.2
8.3%	21.8	21.7	21.7	21.6	21.5

Source: Economic & Strategy Research, Komerční banka

## Major risks

- **Natural disasters are the main non-financial risk.** Floods and storms significantly affected profits in the past years, and a reoccurrence can never be ruled out.
- **Economic recession may have several effects on insurance companies.** It may lead to an increase in insurance frauds. It may also negatively impact premium growth and lead to adverse legislative changes.
- **VIG holds a large real estate portfolio.** Most of the investment is in Austrian housing cooperatives, which enjoy rental subsidies from the government. The withdrawal of these subsidies may lead to higher vacancy rates and subsequently lower property valuations.
- **Insurance companies analyse historical data and utilise results in product pricing.** Changes in risk incidence or scope may lead to losses.
- **Asset-liability management:** Insurers manage their investments so that they are able to fulfil their liabilities. Failure to properly manage their investments through incorrect decisions or a lack of adequate market instruments may lead to losses.
- **Several life insurance products guarantee a minimum yield to clients.** Deterioration of financial market conditions may lead to losses from such policies over the course of many years.
- **Government debt crisis:** Although VIG has only limited exposure to PIIGS countries, the crisis may endanger more countries including those in which the company operates.
- **Political risk:** Several insurance products enjoy tax-deductibility status in many countries. Political development, austerity measures and other changes may lead to a withdrawal of such support and negatively affect insurance companies' profitability. Also, other legislative changes such as the withdrawal of obligatory motor liability insurance could negatively impact the sector.
- **Pension reforms may have a negative impact on life insurers.** Pension funds offer a wealth management alternative to life insurance. A different tax treatment or inadequate support for pension funds may put the life insurance sector at a disadvantage.

**Vienna Insurance Group in figures**

	2014	2015	2016e	2017f	2018f	2019f	2020f	2021f
No. of shares at year end (m)	128	128	128	128	128	128	128	128
P/E	12.9	33.0	11.5	11.6	11.3	11.2	11.1	10.8
Price / embedded value	0.8	0.4	0.5	0.4	0.4	0.4	0.4	0.4
Price / book value	0.9	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Dividend yield (%)	3.5	5.5	2.3	2.7	3.1	3.5	3.9	4.2
<b>Per share data (EUR)</b>								
EPS	2.9	0.6	2.3	2.2	2.3	2.3	2.3	2.4
Dividend	1.3	1.4	0.6	0.7	0.8	0.9	1.0	1.1
Embedded value (EV)	47.7	53.5	56.2	57.8	59.1	60.4	61.6	62.6
<b>Income statement (EUR millions)</b>								
Gross premium written	9,141	9,020	9,130	9,293	9,693	10,204	10,628	11,115
Net earned premium	8,354	8,181	8,344	8,632	9,004	9,472	9,875	10,333
Financial income	1,117	1,059	954	1,074	1,144	1,225	1,314	1,315
Claims and insurance benefits	-6,920	-6,749	-6,897	-7,103	-7,422	-7,795	-8,140	-8,516
Operating expenses	-1,875	-1,848	-1,907	-1,930	-2,047	-2,153	-2,257	-2,368
Operating income	676	643	495	673	679	749	791	764
Other income	-158	-487	-92	-259	-254	-320	-358	-321
Pre-tax income	518	157	403	414	425	430	434	443
Income tax	-127	-62	-92	-94	-97	-98	-99	-101
Minority interests	-25	-12	-21	-33	-34	-34	-35	-35
Net income	367	83	290	287	294	298	300	307
<b>Balance sheet (EUR millions)</b>								
Total assets	44,425	44,580	51,084	52,350	53,756	55,751	57,535	59,534
Intangible assets	2,370	2,080	2,080	2,080	2,080	2,080	2,080	2,080
Investments excl. unit-linked	30,360	30,142	35,410	36,209	37,029	38,271	39,363	40,579
Unit-linked investments	7,742	8,144	8,844	9,115	9,414	9,825	10,205	10,637
Shareholders equity	5,283	4,490	5,716	5,910	6,097	6,276	6,444	6,606
Subordinated debt and other borrowings	920	1,280	1,280	1,280	1,280	1,280	1,280	1,280
Reserves	27,890	28,145	29,978	31,412	32,920	34,505	36,005	37,527
Unit and index linked reserves	7,392	7,777	8,548	8,252	8,810	9,368	9,926	10,484
Embedded value	6,112	6,844	7,188	7,400	7,568	7,732	7,886	8,019
<b>Accounting ratios (%)</b>								
ROE	7.4	1.7	6.5	6.1	6.0	5.9	5.7	5.7
ROA	0.9	0.2	0.7	0.6	0.6	0.6	0.6	0.6
ROEV	2.0	8.1	6.2	4.3	3.7	3.7	3.7	3.5
Profit margin	6.2	1.9	4.8	4.8	4.7	4.5	4.4	4.3
Life	3.9	4.1	5.1	5.9	5.4	5.0	4.7	3.7
Non-life	8.2	-1.5	3.8	2.9	3.2	3.2	3.2	3.9
Health	11.9	12.8	12.0	13.2	13.0	13.2	13.2	12.7
Non-life combined ratio	96.7	97.3	97.4	96.0	96.0	95.3	95.0	94.9
Tax rate	24.5	39.4	22.7	22.7	22.7	22.7	22.7	22.7
GWP growth yoy	-0.8	-1.3	1.2	1.8	4.3	5.3	4.2	4.6
Net income growth yoy	56.5	-77.4	249.7	-1.1	2.6	1.2	0.9	2.2
Dividend growth yoy	8.3	7.7	-57.1	16.7	14.3	12.5	11.1	10.0
Equity/assets	11.9	10.1	11.2	11.3	11.3	11.3	11.2	11.1
Total investments/total reserves	108.0	106.6	114.9	114.3	111.3	109.6	107.9	106.7
Payout ratio	53.7	92.7	30.0	33.8	37.1	40.9	44.8	49.1

Source: Vienna Insurance Group; Economic &amp; Strategy Research, Komerční banka

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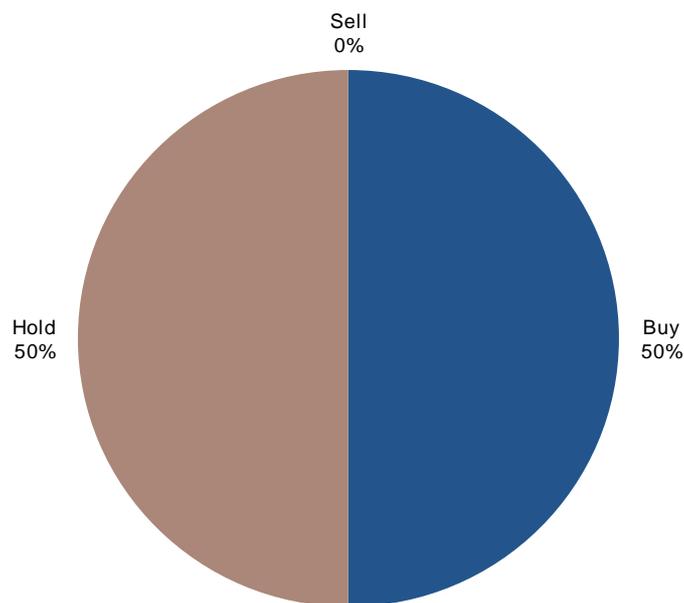
The recommendation in this document and/or the document itself was not disclosed to the issuer before its dissemination.

This recommendation is not updated at regular intervals. The date of the next update has not yet been determined and finally will be influenced by relevant changes of the facts used as the ground for this recommendation to reflect proper development in the industry and/or the analyzed company.

The main methods Komerční Banka is using for setting target price for stocks are discounted free cash flow analysis and sector comparison. Other methods may also be used if deemed appropriate by the analyst (e.g. sum of parts valuation, discounted dividend valuation, discount / premium to NAV). Target price is set for the time period of 12 months. Komerční Banka is using three grades of investment recommendation: buy, hold and sell. The recommendation is set for the time period of the next three to six months. The most important factor for setting the recommendation is the difference between actual market price and target price calculated by KB equity research. The recommendation should reflect also other factors the analyst expects to influence the stock and market in the time period of the next 3-6 months, i.e. target price substantially above current price does not automatically mean a buy recommendation for the next 3-6 months. Valuation methods and factors key for setting the recommendation are explained in the text of each analysis.

The chart below shows the structure of grades of valid investment recommendations of equity research of KB Economic & Strategy Research (8 recommendations).

**Investment recommendations of KB equity research (as of 3 March, 2017)**



Source: Economic & Strategy Research, Komerční banka

	CEZ	O2 CR	CME	Philip Morris CR	NWR	Pegas Nonwovens	Vienna Insurance	Fortuna	MONETA Money Bank
<b>Overview of last investment research and recommendations related to stocks of particular issuers</b>									
Recommendation	Hold	Buy	Hold	Buy	konec pokrývání	Buy	Buy	Hold	Buy
Target Price	CZK 448	CZK 267	USD 2.5	CZK 13500	n/a	CZK 863	EUR 26	CZK 96	CZK 90
Date	14/9/16	9/12/16	12/8/15	13/6/16	20/6/16	20/5/16	3/3/2017	20/5/16	6/9/16
<b>Overview of investment researches and recommendations for last 12M (quarterly)</b>									
Recommendation	Buy	Hold		Buy	Sell	Buy		In revision	
Target Price	CZK 420	CZK 260		CZK 11890	-	CZK 800		In revision	
Date	12/2/16	22/3/16		2/9/15	11/12/15	3/12/15		10/3/16	
Recommendation	Buy	Buy				Sell		Buy	
Target Price	CZK 608	CZK 251				CZK 819		CZK 79	
Date	18/9/15	12/11/15				11/9/15		28/8/15	
Recommendation						In revision		In revision	
Target Price						In revision		In revision	
Date						27/8/15		27/8/15	
Recommendation									
Target Price									
Date									
Direct or indirect share (5% or more) of the issuer of the registered capital of KB	no	no	no	no	no	no	no	no	no
Other significant financial interest of KB and/or its linked persons in the issuer	no	no	no	no	no	no	no	no	no
KB direct or indirect share (5% or more) of the registered capital of the issuer.	no	no	no	no	no	no	no	no	no
Significant financial interest in the issuer of the persons participating in elaboration of investment researches and recommendations.	no	no	no	no	no	no	no	no	no
<b>Relationships of Komerční banka with particular issuers</b>									
KB Management or co- management of public offerings in the past 12 month	no	no	no	no	no	no	no	no	no
Agreements or contractual relations for providing investment services with the issuer.	KB can have concluded agreements with the issuer for providing investment services. This information is protected by bank secret and could not be disclosed.								
Agreement with the issuer on production and dissemination of the research	no	no	no	no	no	no	no	no	no
KB market making** for common stocks of the issuer?	no	no	no	no	no	no	no	no	no

Source: Economic & Strategy Research, Komerční banka

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