

# Sava RE (POSR SV)

ALTA

NEW  
INVESTMENT  
CULTURE

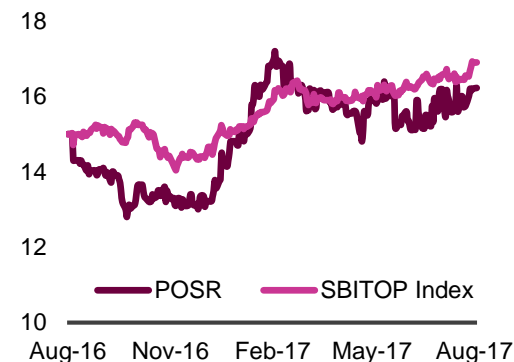
**12M Target price: 20 EUR Recommendation: BUY**

Previous target price: 17.6 EUR, HOLD (11.4.2017)

## KEY MARKET DATA:

Stock data as of 28.08.2017 :		Price performance:		3M	12M
Market price (EUR)	16.2	Price change in %	1.6%	8.2%	
52 week range (EUR)	12.8 - 17.2	SBI 20 index change in %	4.9%	12.7%	
Market Cap (EUR)	279.4	Relative to SBI 20 index in %	-3.1%	-4.0%	
		Valuation multiples:		TTM	Forward
Avg. daily trade vol., EUR(k)	37	P/GWP	0.5	0.5	
Average daily % of stock traded	0.014%	P/E	7.1	8.6	
No. of Shares in millions	17.2	P/B	0.8	0.8	
Dividend yield	4.9%				

## SHARE PRICE DYNAMIC:



## KEY COMPANY DATA & ESTIMATES:

million €	FY2015	FY2016	TTM	2017F	2018F
GPW	486.3	490.2	507.2	506.2	523.8
NPE	447.6	458.1	462.4	469.3	486.0
Claims paid	273.1	268.4	278.5	298.4	302.0
Net income	33.4	32.8	35.6	29.1	30.1
ROE	11.7%	11.1%	11.9%	9.3%	9.1%
EPS	2.00	2.10	2.30	1.88	1.95
DPS	0.80	0.80		0.84	0.97
Equity Inv	18.9	17.0	17.0		
Fin. Assets	1,023.1	1,038.2	1,027.8		
Tech. Prov.	1,094.7	1,138.2	1,187.7		
Equity	285.4	296.3	299.3	313.0	330.0
Assets	1,607.3	1,671.2	1,709.2	1,694.1	1,757.9
Equity/Assets	18%	18%	18%	18%	19%
P/E	7.8	7.2	7.1	8.6	8.3
P/B	0.8	0.8	0.8	0.8	0.8

## KEY CURRENT DEVELOPMENT:

- In the past year Croatian company Adris Group has already gathered around 21% of voting shares and consequently requested regulators for clearance to increase its ownership above 33%. The latest rumour ran by SiOL website (not confirmed) is that Adris request was denied for the second time by Slovenian Insurance Supervision Agency. This story is and will be influencing investor sentiment regarding POSR shares.
- On a positive note Sava Re did not pursue for a majority stake in Gorenjska Banka, as some Spring rumours implied.
- In general we believe that **results for the first and second quarter were in line with our expectations**. Sava Re Group however surprised on the top line and reported growth on almost all markets.
- **Due to stability of capital adequacy ratio, we have adjusted our future dividend policy projections**. More optimal capital use positively affected ROE and hence our valuations.
- Therefore we increased our price target and upgraded the recommendation from hold to buy.

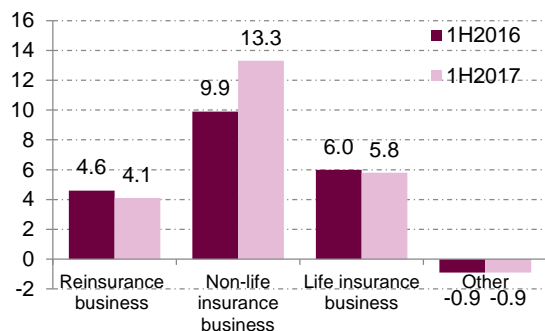
# 1H17 Results

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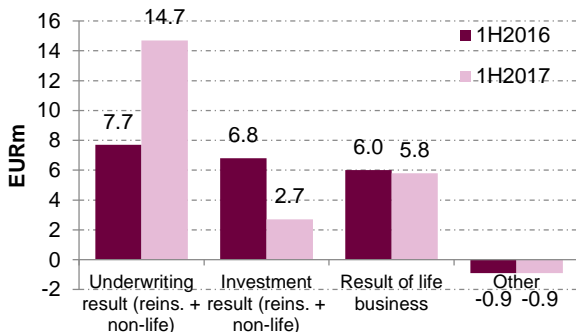
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- Net claims higher due to life segment dynamic - large number of unit-linked policies that matured in January 2017. Note that this was somewhat offset by Change in technical provisions. According to the report, many policyholders opted for taking out new policies.
- Excluding FX, net investment result was almost at the same level as in 1H2017.

Gross income statement by operating segment



Composition of consolidated gross profit



Income statement	1H2016	1H2017	YoY
Gross written premiums	280.8	297.8	6.0%
Reinsured premiums	-19.5	-23.3	19.2%
Net earned premiums	226.0	230.3	1.9%
Net claims	-131.8	-142.0	7.7%
Net operating expenses	-75.3	-75.8	0.7%
Net inv. Income	11.6	7.8	-32.8%
EBT	19.6	22.4	14.4%
<b>Net profit</b>	<b>14.4</b>	<b>17.1</b>	<b>19.1%</b>
Total Assets	1,563.7	1,584.3	1.3%
<b>Shareholders' equity</b>	<b>294.2</b>	<b>299.3</b>	<b>1.7%</b>

Unconsolidated GWP	1H2016	1H2017	YoY
Reinsurance	91.4	95.4	4.3%
Zavarovalnica Sava (SLO NL)	155.0	164.5	6.1%
Sava Montenegro	5.7	6.5	13.2%
Sava osiguranje, Belgrade	7.3	7.9	7.6%
Sava osiguruvanje, Skopje	6.3	6.4	1.8%
Zavarovalnica Sava (CRO NL)	4.6	5.9	28.0%
Illyria	3.6	3.8	6.3%
Zavarovalnica Sava (SLO life)	39.6	41.4	4.7%
Zavarovalnica Sava (CRO life)	1.6	1.9	13.4%
Illyria Life	0.8	0.9	3.9%
Sava životno osiguranje	0.6	0.7	13.6%
Sava pokojninska	0.7	1.2	68.4%

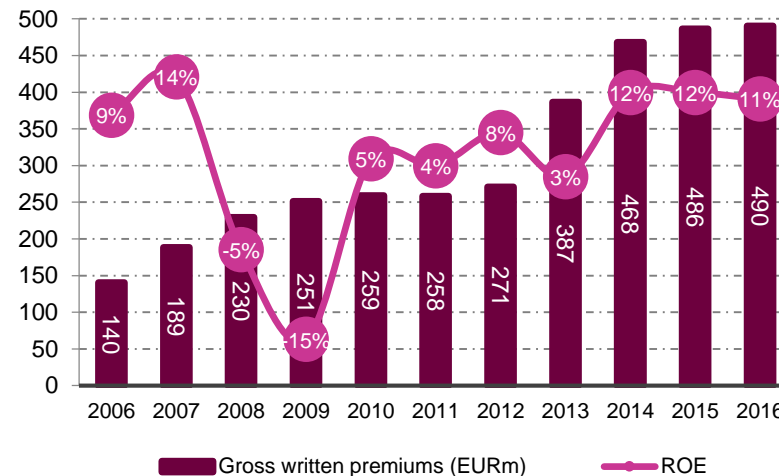
- GWP growth on all markets and in all segments.
- The highest growth was reported for health insurance premium (+120%), while the highest nominal contribution came from land vehicles casco (EUR 3.4m).
- While GWP grew by 6.0%, net earned premiums increased only by 1.9%. Retention rate decreased due to higher Change in net unearned premiums (mainly due to larger share of non-proportional reinsurance business) and higher amount of ceded premium (+19%).
- Net operating expenses increased only slightly, however, that was due to Change in deferred acquisition costs (same effect from GWP growth as in case of the movement of unearned premiums).
- Extreme growth in Croatia was due to good positioning in internet sales, improved premium collection and increased efficiency of sales network. Strong growth was achieved already in 1q2017 (+34%) and continued in 2q2017 (+26%).
- Special offer to policyholders linked to DWS FlexPension funds to sign new policies linked to a new internal fund.
- Book value per share now stands at EUR 19.3 with TTM 12m ROE at 11.9%.

# Investment Thesis

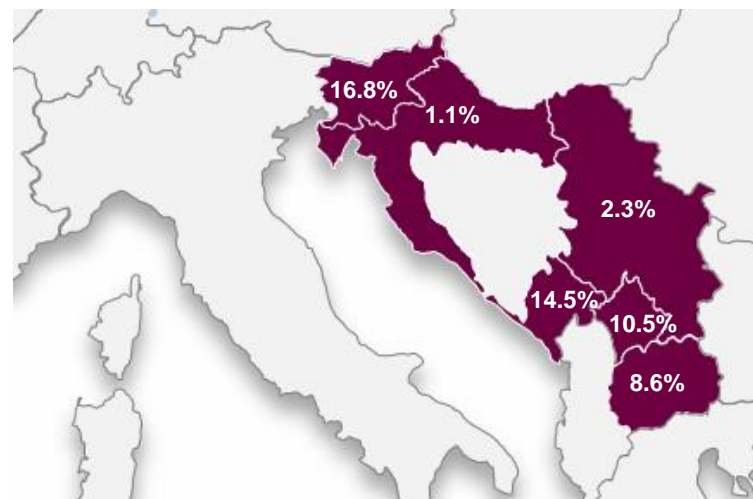
## POSITIVE:

- In recent years it transformed itself from reinsurance player to **2nd largest insurance group in Adria region** with insurance presence in 6 countries. Sava Re Group is also second largest insurer in Slovenia where it generates majority of its premiums and **held 17% market share in 2016**.
- With acquisition of **Zavarovalnica Maribor** the Group took an opportunity to consolidate Slovenian insurance industry and to benefit from synergies. While takeover was concluded already in 2013, in 2016 Sava Re started with further centralization of insurance segment. The management expects that after transition period of 3 years, **annual synergies will amount between EUR 5m to EUR 6m**.
- Sava Re group stable profitability and positive effects following the acquisition activities led to high capital adequacy ratio which enabled group to pay out **above normal dividend payout** and also initiate share buybacks which ended in 2016.
- Majority of Sava Re premiums are generated on the domestic market, however the Group has also an **exposure to other SEE markets** where future GDP growth will be faster and Sava Re could benefit from development of insurance market.
- Sava Re Group generates a part of premiums also on global **reinsurance** market. Although pricing trends are negative, this segment provide positive diversification effects.
- While Triglav Group will be very likely the preferred **takeover target** for large insurance groups, the acquisition of Sava Re is likely to be much easier since it would be more politically and publicly acceptable. While there are no signs of privatization process which would be necessary for the takeover, in 2016 Croatian company Adris Group have already stated acquiring shares and currently holds around 21% of voting shares and requested regulators for clearance to increase its ownership above 33%.

## Acquisition of ZM led to improved profitability and higher stability



## Market share in 2016



# Investment Thesis

## NEGATIVE:

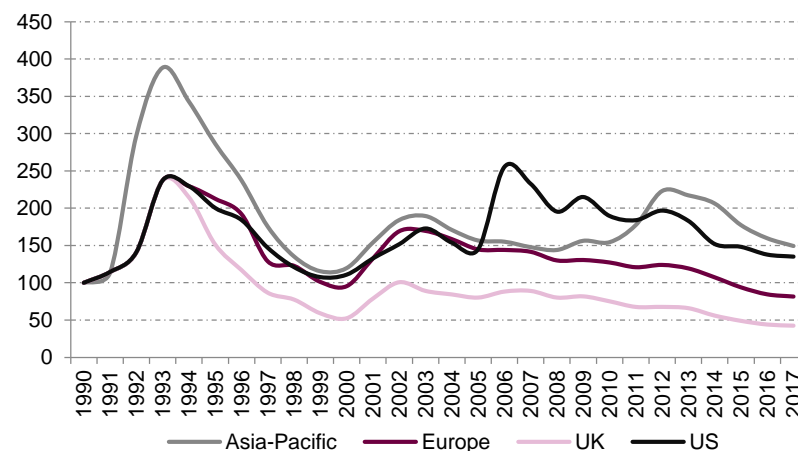
- Although Sava Re Group is the second largest insurance group in Adria region, that is mainly due to domestic Slovenian premiums which is also the most developed country in the region. The **importance of GWP outside Slovenia still very low**.
- Although the region presents an opportunity for above average growth of Sava Re Group, the **SEE region is also a highly macroeconomically and politically unstable** region with the legal systems and controlling mechanisms still in earlier stages of development (the lag in development varies from country to country).
- During the Slovenian banking crisis insurers had an opportunity to benefit from higher interest rates on domestic market. However, currently also Slovenian insurance companies can feel the effects of zero interest rate central bank policy. **Low interest environment (reinvestment and interest rate risk) will weigh on investment returns** and consequently on profit level versus past few (excellent) years.
- In 2016 Sava Re ended the share buyback program with reaching maximum of 10% minus 1 of all issued shares. Since there is **no plan of retiring own shares** and could even be used for M&A, this could eventually negatively weigh in on EPS and the valuations.
- We believe reinsurance business is positive for diversification of operational risk, however, current environment is relatively unfavourable. Due to low interest rates capital inflows on **global reinsurance market** pressured prices, which were already **in a negative trend** due to low level of mass loss events.
- Although we consider Sava Re Group as most likely takeover target, we cannot get pass the fact that around 40% of shares are directly or indirectly **owned by the government influenced entities**. Since privatization is not supported by the public it is unlikely that politicians will support any takeover attempts, at least not before Parliament elections in 2018. Additionally, there is also a risk of politically motivated influence on strategic focus and management stability, which could be seen also in the latest management shake-up.

## Interest rate sensitivity analysis for life and non-life (AR 2016)

	+100bp		-100bp	
	Value	Change in value	Value	Change in value
Government bonds	421.2	-17.1	421.2	18.7
Corporate bonds	390.7	-13.8	390.7	14.9
Bond mutual funds	6.6	-0.3	6.6	0.3
<b>Total</b>	<b>818.5</b>	<b>-31.1</b>	<b>818.5</b>	<b>33.8</b>







	+100bp		-100bp	
	Value	Change in value	Value	Change in value
Value of mathematical provision	252.7	-25.2	252.7	-6.7

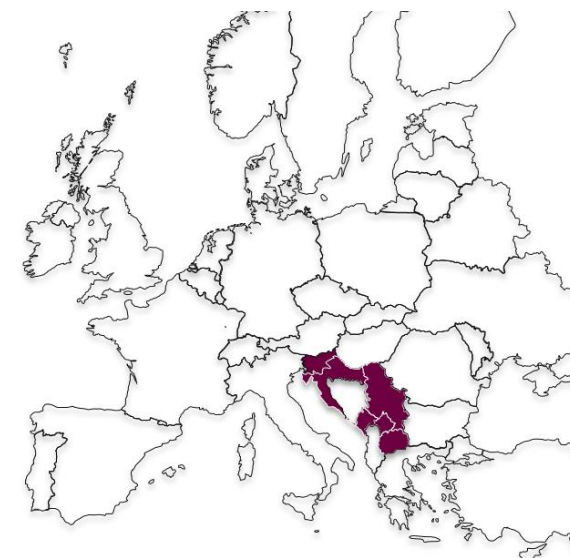
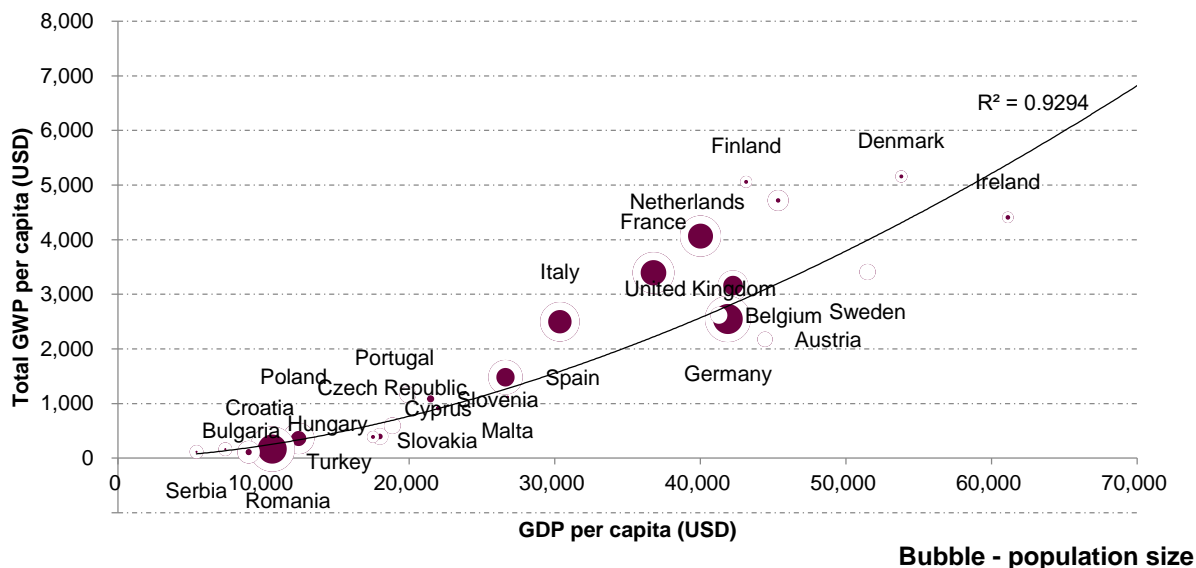
## Regional property catastrophe ROL index - 1990 to 2017



Source: Guy Carpenter

# Market overview

		Insurance penetration 2016	GWP 1H2016 in EURm	Insurance density in EUR per capita 2016	Market Share In 2016
Slovenia		5.0%	207.1	980	16.8%
Croatia		2.6%	7.8	278	1.1%
Serbia		2.1%	8.6	103	2.3%
Montenegro		2.1%	6.5	129	14.5%
Macedonia		1.4%	6.4	68	8.6%
Kosovo		1.4%	4.7	44	10.5%



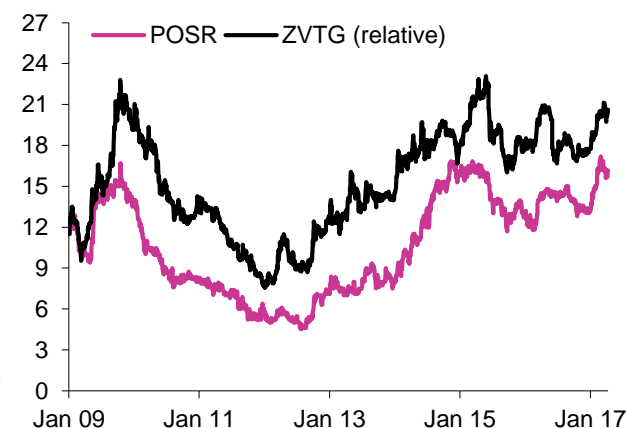
# Relative valuation

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Company name	P/E			P/B			ROE TTM		
	TTM	2017F	2018F	TTM	2017F	2018F	TTM	2017F	2018F
Zavarovalnica Triglav	7.4	8.5	8.7	0.87	0.83	0.79	11.9%	10.0%	9.3%
PZU SA	17.1	13.2	12.5	2.95	2.55	2.45	17.2%	20.7%	20.0%
Aksigorta	8.0	9.1	8.3	2.08	1.85	n.a.	25.9%	21.6%	n.a.
Generali	11.2	9.8	9.4	1.00	0.91	0.88	9.0%	9.7%	9.5%
VIG	11.9	11.4	10.7	0.73	0.64	0.62	6.1%	6.0%	5.9%
Uniqua	26.8	11.7	11.0	0.88	0.80	0.79	3.3%	7.2%	7.3%
Allianz	11.1	10.8	10.5	1.28	1.13	1.09	11.5%	11.1%	10.6%
Hannover Re	10.3	11.8	11.3	1.47	1.32	1.27	14.3%	11.8%	11.5%
MunichRe	11.3	11.5	10.4	0.91	0.84	0.81	8.1%	7.6%	7.9%
Sava Re	7.1	8.6	8.3	0.84	0.80	0.76	11.9%	9.5%	9.4%
Median	11.2	11.4	10.5	1.00	0.91	0.84	11.5%	10.0%	9.4%

Company name	Div. yield (%)			Assets/ Equity (%)	Price to GWP	Price to Net Prem. Earned
	TTM	2017F	2018F			
Zavarovalnica Triglav	9.2	9.2	5.9	5.2	0.63	0.71
PZU SA	4.4	4.9	5.3	9.1	1.94	2.12
Aksigorta	0.0	6.0	5.4	4.9	0.61	0.81
Generali	5.3	5.9	6.2	22.4	0.36	0.37
VIG	3.2	3.4	3.7	11.6	0.36	0.39
Uniqua	5.8	6.2	6.6	9.6	0.58	0.56
Allianz	4.2	4.6	4.8	13.8	1.07	1.15
Hannover Re	4.8	5.0	5.2	7.2	0.74	0.85
MunichRe	4.9	5.1	5.3	8.9	0.58	0.57
Sava Re	4.9	4.9	5.2	5.7	0.50	0.54
Median	4.8	5.1	5.3	9.1	0.61	0.71



- Our relative analysis implies an upside as target price based on P/E, P/B, P/GWP and P/NPE stands at EUR 20.5. In comparison to our previous analysis target price improved by EUR 1.0. The lift is mostly a result of a average peer multiple expansion. Namely higher yields in the last few months contributed to a recovery of European insurance sector valuations, albeit remained under pressure in the reinsurance segment. Here the negative trends in the underwriting business are still offsetting benefits from higher yields.
- Valuation based only on P/B multiple implies target price of EUR 18.6, however, we believe Sava Re Group has a higher growth potential from the perspective of GWP and also net profit if realization of synergies will be higher than expected.
- Sava RE multiples are slightly lower versus Zavarovalnica Triglav (closest peer, quoted on LJSE), however the later has a more dominant position on the domestic market.

# FCF valuation - forecasts

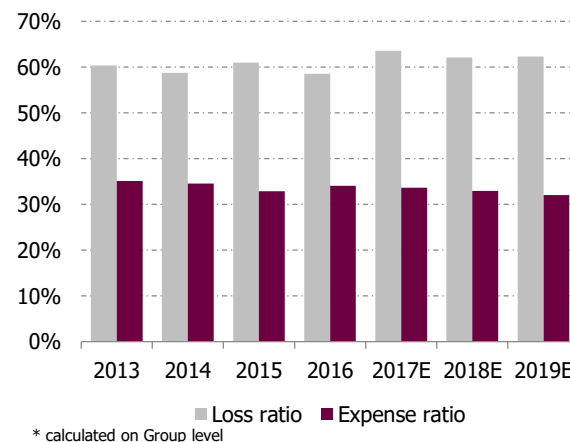
## ESTIMATES:

EURm	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F
Assets	1,694.1	1,757.9	1,826.2	1,896.6	1,972.2	2,050.3	2,126.4	2,200.5	2,272.2
Total investment assets	1,066.3	1,110.4	1,157.2	1,205.3	1,257.0	1,310.5	1,362.7	1,413.4	1,462.4
AFS	877.5	911.4	947.2	986.4	1,028.5	1,070.3	1,110.9	1,150.0	1,187.5
Receivables	135.2	139.9	136.3	132.3	137.4	141.2	144.9	148.4	151.7
Cash	21.3	22.2	23.1	24.1	25.1	24.0	22.7	21.2	19.5
Equity	313.8	330.9	346.5	363.3	380.9	400.3	418.3	435.1	450.5
Technical reserves	1,167.2	1,211.3	1,260.7	1,310.7	1,364.9	1,419.9	1,474.3	1,528.0	1,580.6
Other insurance liabilities	48.1	49.8	51.6	53.5	55.5	57.6	59.5	61.5	63.4
<b>EURm</b>									
Gross written premiums	506.2	523.8	543.1	563.2	584.6	605.9	626.8	647.3	667.2
Net earned premiums	469.3	486.0	504.3	522.3	542.3	562.7	582.8	602.5	621.8
Net claims	298.4	302.0	314.3	326.5	340.0	357.2	374.6	392.2	409.9
Net operating expenses	157.8	159.7	161.8	165.4	170.4	173.7	176.5	179.0	181.2
Expense ratio*	34%	33%	32%	32%	31%	31%	30%	30%	29%
Combined ratio*	97%	95%	94%	94%	94%	94%	95%	95%	95%
Net investment result	23.5	27.2	28.4	29.6	32.0	34.1	36.2	38.4	40.6
EBT	36.0	37.3	37.8	39.5	41.5	44.6	46.6	48.6	50.6
Net profit	29.1	30.1	30.5	31.9	33.5	36.0	37.7	39.3	40.8

\* calculated on Group level

## MAIN ASSUMPTIONS:

- We made only slight adjustments regarding future projections and increased income tax rate to 19% (nominal rate).
- We also somewhat lowered projections for 2017. Given numerous events of hail storms in Slovenia during the summer months, claims in the second half of the year could increase. Sava Re already commented that large loss events after the reporting period could amount to EUR 3.5m.
- For now we do not have any information regarding the exposure toward hurricane Harvey, however, given management comments in case of other catastrophic events on global reinsurance market, Sava Re maximum loss should be limited to EUR 5m.
- All in all we see profit gradually improving while ROE should move around 9% over the long haul.



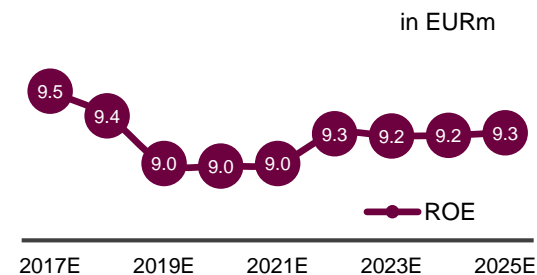
# Excess return - commentary

## VALUATION TABLE:

Year	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Net profit	29.1	30.1	30.5	31.9	33.5	36.0	37.7	39.3	40.8	43.2
Cost of Equity	-27.3	-30.4	-32.0	-33.5	-35.1	-36.1	-37.2	-38.1	-38.8	-38.4
Excess return	1.7	-0.2	-1.5	-1.6	-1.6	-0.1	0.5	1.2	2.1	4.7

Long-term cost of capital	
Equity Invested	269.4
Period PV of Equity Excess Return	2.2
Terminal PV of Equity Excess Return	34.4
<b>Value of Equity</b>	<b>305.9</b>
<b>Equity value per share</b>	<b>19.7</b>

Cost of equity	2016	TV
Leveraged beta	1.0	1.0
Risk free rate	1.17%	1.17%
Premiums	8.53%	7.39%
<b>Cost of equity</b>	<b>9.7%</b>	<b>8.6%</b>
<b>Perpetuity growth rate</b>	<b>2.0%</b>	

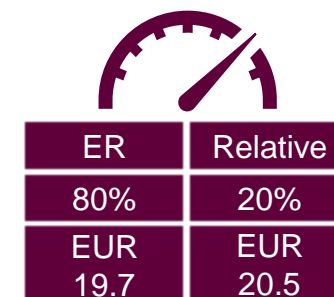


- Given the stability of capital adequacy ratio we adjusted dividend payout policy which is now more linked to estimated future capital needs and return of the excess capital. Dividend payout ratio could be around 40% to 50% in the next few years.
- Note that dividend payout is in line with announced dividend policy, however, Sava Re does not reveal exact percentages regarding payout. Given the relatively stable GWP growth, the continuation of higher payout would positively affect ROE and hence the valuation.
- Sava Re ended 2016 with the Solvency ratio of 204%. Since Sava Re's calculations do not include „Loss-absorbing capacity of deferred taxes“, adequacy ratio is in line with Triglav Group which ended 2016 with ratio of 246%.

Solvency 2 ratio	Capital
> 230%	Overcapitalization Additional engagement
200% – 230%	Appropriate capitalization Potential reallocation
170% - 200%	Optimal capitalization Optimization of operations
140% – 170%	Still appropriate capitalization Potential reallocation
< 140%	Undercapitalization Safeguarding the solvency

## WEIGHTING SCHEME & END COMMENTARY:

- Our baseline target price consists of peer (20% weight) and excess return valuation (80% weight) method. Combination of both valuation methods derives to a target price of EUR 20 and hence higher from our previous research report where we set our price target at EUR 17.6 (including dividend).
- Target implied P/B ratio is at 1.04x.
- Valuation indicates that there is roughly 22% upside potential, therefore we are upgrading our recommendation from hold to buy.
- Note however that investor sentiment could be under the influence of possible shareholder structure change news and/or rumours (that is Adris M&A story).





# Historic Financial Data

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in EURm	2010	2011	2012	2013	2014	2015	2016
<b>Assets</b>	<b>578.4</b>	<b>582.0</b>	<b>640.6</b>	<b>1,378.3</b>	<b>1,454.4</b>	<b>1,607.3</b>	<b>1,671.2</b>
Intangibles	23.3	18.3	17.8	40.2	34.9	30.5	25.5
Property, plant and equipment	26.7	24.5	24.6	46.0	44.5	47.2	51.9
Investment property	4.9	6.1	5.1	5.6	5.1	8.0	7.9
Investments in associates	42.3	49.1	55.3	2.9	3.1	0.0	
Financial investments	324.2	325.2	350.2	931.1	974.7	1,015.1	1,030.2
Unit-linked insurance assets	23.7	24.1	27.6	175.8	202.9	214.2	224.2
Cash and cash equivalents	4.0	4.7	4.1	3.4	5.6	4.7	33.9
<b>Equity</b>	<b>154.7</b>	<b>148.1</b>	<b>171.4</b>	<b>240.1</b>	<b>271.5</b>	<b>286.4</b>	<b>297.0</b>
Equity of non-controlling interests	4.4	2.5	2.0	2.0	1.9	1.0	0.8
Subordinated liabilities	31.2	31.2	31.2	30.5	28.7	23.5	23.6
Insurance technical provisions	303.3	320.9	360.1	846.2	870.0	887.1	911.2
Insurance technical provisions for unit-linked insurance contracts	23.6	23.7	27.0	170.8	195.7	207.6	227.0
<b>Book Value per share</b>	<b>8.7</b>	<b>8.5</b>	<b>9.8</b>	<b>13.8</b>	<b>15.7</b>	<b>16.6</b>	<b>17.2</b>
<b>in EURm</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
<b>GWP</b>	<b>259.1</b>	<b>258.4</b>	<b>270.8</b>	<b>386.7</b>	<b>468.2</b>	<b>486.3</b>	<b>490.2</b>
ceded written premium	-25.3	-24.4	-20.6	-22.6	-27.4	-30.3	-31.2
change in unearned premiums	-1.9	1.1	-3.9	15.6	-4.2	-8.0	-1.8
change in unearned premiums for the reinsurance and co-insurance part				-0.5	0.9	-0.4	1.0
<b>NPE</b>	<b>231.9</b>	<b>235.1</b>	<b>246.2</b>	<b>379.1</b>	<b>437.6</b>	<b>447.6</b>	<b>458.1</b>
Net claims incurred	-140.0	-136.2	-149.9	-229.0	-257.1	-273.1	-268.4
gross claims settled	-131.3	-128.4	-136.3	-221.2	-255.3	-271.5	-269.4
reinsurers' and co-insurers' share	13.3	8.6	5.4	9.1	10.6	17.7	14.8
changes in claims provisions	-22.0	-16.4	-19.0	-11.6	-16.9	-5.4	-15.8
change in the provision for outstanding claims for the reinsurance and co-insurance part				-5.3	4.6	-14.0	2.1
Operating expenses	-85.3	-87.9	-87.7	-129.4	-146.6	-148.9	-159.6
Acquisition cost	-44.3	-53.5	-54.8	-46.9	-47.5	-49.9	-51.9
Investment Income	19.9	17.8	21.7	36.4	36.1	39.6	33.1
Net unrealised gains on investments of life insurance policyholders who bear the investment risk		2.5	3.5	9.2	19.1	26.6	18.0
Expenses for financial assets and liabilities	-10.2	-14.2	-10.7	-42.0	-6.9	-13.0	-8.6
Net unrealised losses on investments of life insurance policyholders who bear the investment risk		-5.5	-2.3	-9.5	-7.9	-25.9	-11.3
<b>EBT</b>	<b>8.8</b>	<b>7.7</b>	<b>14.3</b>	<b>15.8</b>	<b>39.0</b>	<b>40.1</b>	<b>40.7</b>
Total taxes	-3.3	-3.7	-2.5	-0.2	-8.4	-6.7	-7.8
Net profit / loss	5.5	4.1	11.8	15.6	30.5	33.4	32.9
Attributable to equity holders of the parent	7.5	6.0	12.1	15.7	30.6	33.4	32.8
<b>in EURm</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
Loss ratio	60.4%	57.9%	60.9%	60.4%	58.8%	61.0%	58.6%
Expense ratio	36.8%	37.4%	35.6%	34.1%	33.5%	33.3%	34.8%
Combined ratio	97.2%	95.3%	96.5%	94.5%	92.3%	94.3%	93.4%
Net margin	2.9%	2.3%	4.5%	4.0%	6.5%	6.9%	6.7%
Assets Turnover	0.45	0.44	0.42	0.28	0.32	0.30	0.29
ROA	1.3%	1.0%	1.9%	1.1%	2.1%	2.1%	2.0%
Assets to Equity	3.85	4.00	3.78	5.79	5.39	5.63	5.64
ROE	5.0%	4.1%	7.2%	6.6%	11.3%	11.7%	11.1%

# Company & ALTA Description

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## COMPANY DESCRIPTION:

- A leading Slovenian reinsurer with a 31% domestic market share while it is also the largest locally-based non-captive reinsurer in the CEE region.
- Through consolidation of Zavarovalnica Maribor and Tilia which ended with forming Zavarovalnica Sava the Group became second largest insurance company in Slovenia.
- It also operates on foreign markets in the Western Balkans (Croatia, Kosovo, Macedonia, Montenegro, and Serbia).
- 63% of total GWP tied to non-life, 19% to life, 18% to reinsurance.

## OWNERSHIP STRUCTURE:

SDH d.d.	25.0%
Zagrebačka Banka (Fiduciary)	14.2%
Sava RE d.d.	10.0%
EBRD	6.2%
Raiffaisen Bank (Fiduciary)	4.5%

Source: KDD

## RESEARCH REPORT:

**Prepared by:**  
Matej Šimnic  
Analyst

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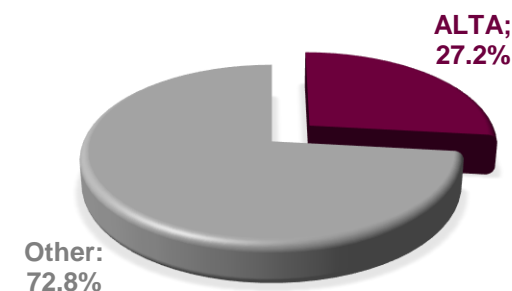
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- ✓ Our trading advantage is our execution of large trading blocks with low impact on the market.
- ✓ 38,300 brokerage clients with EUR 3.3 bn of assets.
- ✓ European Banking award: Best Broker & Best Asset Manager in 2015 and 2016.

TTM market share:



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