EDISON

Scale research report - Update

Nürnberger Beteiligungs

Insurance

26 September 2018

Low interest rates and ZZR remain a burden

Nürnberger Beteiligungs' (NBG's) top-line growth in H118 was largely assisted by the full consolidation of the legal protection insurance business. Low interest rates coupled with regulatory requirements (most notably Zinszusatzreserve, ZZR) continue to hinder the insurance industry. As a result of this and higher claims in property and casualty (P&C) business, as well as a one-off effect in H117, NBG recorded a 43.5% y-o-y drop in net profit in H118 to €23.6m, Still, FY18 net income guidance (€50m) was reiterated as H118 earnings represent c 47% of the guided number.

Modest organic growth in new premiums

NBG recorded a 3% y-o-y increase in gross premiums booked, along with a 3.7% y-o-y rise in new premiums, although mostly due to consolidation of Neue Rechtsschutz-Versicherung (NRV, majority stake acquired in Q317) within the P&C insurance segment. Organic growth in new premiums stood at only c 1.2% y-o-y, whereas gross premiums excluding the consolidation effect declined by 0.4% y-o-y. Amid continued creation of significant technical reserves related to standard life insurance contracts and the increase in group insurance claims by 9.8% vs H117, net profit decreased by 43.5% y-o-y to €23.6m.

Regulations affecting the life insurance market

NBG's business continues to be constrained by the low interest rate environment. Moreover, the ZZR reserve regulations introduced back in 2011 require the creation of additional reserves in the life insurance business to cover future obligations, even though interest rates are no longer declining. However, recent comments from the German regulator (Bafin) suggest the burden might be eased soon (even as soon as 2018). In contrast, Bafin also considers the introduction of a cap on fees earned on life insurance contracts, which might limit the growth in new business.

Valuation: Trading at a premium to peers

Based on management guidance for FY18, the company is trading at a 48.6% premium to the peer group based on the P/E ratio. NBG pays out annual dividend of €3 per share, which constitutes the 4.3% yield and implies a 10.5% premium to peers.

Historical performance

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/15	4,658	85.4	4.1	3.0	16.8	4.3
12/16	4,189	88.1	5.0	3.0	13.8	4.3
12/17	4,387	147.3	8.1	3.0	8.5	4.3
06/18 (LTM)	4,465	127.6	7.1	3.0	9.7	4.3

Source: Nürnberger Beteiligungs

Price	**€69.0**
Market cap	**€795m**

Share price graph

Share details

Code	NBG6
Listing	Deutsche Börse Scale
Shares in issue	11.52m
Liquid resources at 30 June 2018	€542.5m

Business description

Nürnberger Beteiligungs is the parent company of a group of insurers and financial service companies. It is one of Germany's oldest insurers operating since 1884. Nürnberger Beteiligungs offers life, health and property and casualty insurance, with strongest demand for unit-linked life, disability and pension insurance and standard pension insurance.

Bull

- Very strong finances and conservative reporting.
- Well-established brand name and solid historical performance.
- Stable annual dividend payments.

Bear

- Low-interest rate environment.
- Regulatory uncertainty.
- Highly competitive industry.

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Edison profile page

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Financials: Earnings down due to claims and reserves

In H118 the company reported an increase of 3.0% y-o-y in total premiums booked to €1.75bn, along with a 3.7% rise in new premiums compared with H117. Both figures have been influenced by the full consolidation of RV from Q317. Adjusting for its impact on NBG's results (€57.1m in gross premium booked and €5.9m in new premiums), the business saw a decline of 0.4% y-o-y and a 1.2% y-o-y growth, respectively. Similarly, NBG reported a 6.2% improvement in the total number of contracts at the end of H118 vs H117, but this is entirely attributable to the H217 performance, as the total number as at end-June 2018 was 20k lower than the end of FY17. Due to persisting unfavourable market conditions, dominated by low interest rates coupled with the ZZR reserve requirements introduced back in 2011 in Germany, higher insurance claims in comparison to H117, as well as a one-off effect from asset disposal in H117, net profit declined by 43.5% y-o-y to €23.6m. Nevertheless, these results are in line with management's FY18 net profit guidance, reiterated as €50m.

Exhibit 1: Results highlights

in € '000	H118	H117	y-o-y
Gross premiums booked	**1,751.9**	**1,701.4**	**3.0%**
Premiums earned	**1,573.9**	**1,547.2**	**1.7%**
Net result on premium refunds	(84.8)	(87.6)	-3.1%
Investment income	373.1	343.8	8.5%
Unrealized profits / (losses) from unit-linked insurance investments	(181.3)	390.2	n.m.
Other net technical income / (expense)	(22.5)	(27.8)	-18.8%
Claims expenses	(1,165.6)	(1,061.5)	9.8%
Change in other technical provisions	(172.9)	(793.3)	-78.2%
Operating expenses	(272.6)	(255.8)	6.6%
Change in equalisation and other reserves	(3.9)	0.5	n.m.
Other net (non-technical) income / (expense)	(4.0)	3.1	n.m.
Goodwill amortization	(0.3)	(0.2)	n.m.
Pre-tax profit	**39.0**	**58.7**	**-33.5%**
Income and other taxes	(15.5)	(17.0)	-9.0%
Net income (incl. minorities)	**23.6**	**41.7**	**-43.5%**
Minorities	(2.1)	(4.4)	n.m.
Net income (ex-minorities)	**21.5**	**37.3**	**-42.5%**

Source: NBG accounts, Edison Investment Research

Segment analysis

The **life insurance sector** (representing c 68% of total premiums booked in H118) continued its struggles as in H118 it has suffered from a 2.2% decrease in number of contracts, which is now amounting to 2,802k. As a result, both gross and new premiums decreased by 1.1% and 1.3% respectively despite the improving premium per contract ratio. Moreover, insurance claims increased by 9.0% y-o-y to €941.7m in H118. Still, the net profit of €17.7m suggests the company remains on track to meet the management guidance for the FY18 set at €38m, which is significantly below the net profit recorded in the FY17 (€64.3m). This is a result of high-volume one-off events in H217, when the company recorded robust investment income; this will be difficult to replicate under the current market conditions. In addition, the company's business is still affected by the ZZR reserve requirements, which are calculated based on 10-year average historical zero-coupon euro swap rate. Such a long timeframe results in lower interest rate assumptions for calculating the reserve requirements (currently 2.21%), despite interest rates remaining stable recently. The problem has already been identified by the German regulator and there is an ongoing discussion to adjust the formula to better suit the market circumstances.

P&C insurance (representing 26% of total premiums booked in H118) has seen a 16.4% jump in total number of contracts vs H117, which stood at 2.84m at the end of H118. It was accompanied by a 16.1% y-o-y improvement in gross premiums along with 20.7% y-o-y increase in new premiums.

These positive changes, however, are not coming solely from organic growth but result from the full consolidation of Neue Rechtsschutz-Versicherung, which was acquired in Q317. Removing the consolidation impact from the results would put the gross premium and new premiums increase at 1.5% and 9.4% y-o-y, respectively. Contrary to the improving premiums, the company reported just €7.6m of net profit in H118 compared with €15.2m in H117. The decrease is a result of the inflated base, as H117 had been boosted by abnormally low levels of natural hazard and large claims (H118 profit was broadly in line with H116 levels). This is well documented by the company's combined ratio, which moved from 92.1% in H117 to 95.8% in the analysed period. Claims related to storm Friederike only amounted to €10.1m in H118, translating into total claims related to natural disasters for the period at €19.0m compared with €7.9m in H117. In H118 NBG realised 34.5% of management expectations for 2018, with net profit amounting to €22m.

In contrast to life insurance, the **health insurance** segment (c 6.3% of total premiums in H118) was able to retain the positive momentum. Slight improvements were recorded across all performance measures, including number of contracts (+4.3% y-o-y), gross premiums (+0.8%) and net profit (15.0%). The NGB also managed to secure €5.4m in new premiums equalling the H117 total. The company benefited from 12% decrease in claims as well as a less pronounced negative impact of changes in technical provisions. If NBG can retain the pace, it should slightly exceed management guidance of €4.5m annual net profit (which was already revised upwards from €4.0m during the FY17 results publication). These expectations emerge from progressing digitalisation, which provides clients with an easy access to the simplest insurance products driving the segment's income.

Exhibit 2: Segment analysis

Financial data (€m)	H118	H117	y-o-y
Gross premiums			
Life	1,187	1,200	-1.1%
Health	110	109	0.8%
P&C	456	393	16.1%
Total	1,752	1,701	3.0%
New premiums			
Life	174	176	-1.3%
Health	5	5	0.0%
P&C	63	52	20.7%
Total	242	234	3.7%
Investment income			
Life	337	302	11.4%
Health	18	18	-2.2%
P&C	16	13	28.8%
Total	424	392	8.2%
Segmental Profit			
Life	18	18	-3.8%
Health	2	2	15.0%
P&C	8	15	-50.0%
Consolidated net profit	24	42	-43.4%
Number of insurance contracts (in '000)			
Life	2,802	2,866	-2.2%
Health	389	373	4.3%
P&C	2,840	2,439	16.4%
Total	6,031	5,678	6.2%

Source: NBG accounts

As per the GDV (German Insurance Association) forecasts for 2018, the German insurance industry is expected to record a 2.0% increase in gross premiums, including 1.3% within the life insurance segment, 2.0% within health insurance and 2.9% within the P&C segment. Applying NBG's business structure based on H118 figures, this implies an annual growth rate of 1.76%, which is broadly in line with management expectations of a slight increase in premiums across segments in FY18. Even though the company enjoys high demand for unit-linked life and pension insurance, standard pension insurance and disability insurance, the management expects a y-o-y decrease in new business in the life insurance segment in FY18 due to demanding conditions in standard life insurance along with a reduction in single-premium business. The life insurance business should continue to be affected by the low interest rate environment. According to Moody's, even if interest rates start to rise, the duration mismatch between the assets and liabilities of life insurers would force them to reinvest maturing assets at lower yields for a certain period of time.

Last years' results in the health insurance segment were assisted by large contracts with corporate clients; this will be hard to replicate in the current period. They should, however, enable reporting of an increase in total gross premium within the segment. Based on full consolidation of NRV and organic business growth, P&C segment is expected to expand in the FY18, which is confirmed by Moody's stable outlook for this business in Germany.

Valuation

As there is no Bloomberg consensus for NBG, our P/E calculations for 2018 are based on management's net profit guidance for the year. We feel it is an appropriate measure as management expectations are relatively conservative as they appear to go further than simply factoring in non-recurrence of the one-off investment gains. Based on these figures, the company is trading at 48.6% premium to the peer group. NBG pays out annual dividend of €3 per share, which constitute the 4.3% yield, implying a 10.5% premium to peers.

Exhibit 3: Peer group comparison

	Market cap (LCYm)	Share price (LCYm)	P/E (x)		Dividend yield	
Company's name			**2018e**	**2019e**	**2018e**	**2019e**
UNIQA Insurance Group	2,589.42	8.38	11.72	10.91	6.3%	6.7%
Helvetia Holding	5,812.93	584.50	11.95	11.34	4.2%	4.3%
Baloise Holding	7,251.68	148.60	12.54	11.38	4.0%	4.2%
Ageas	8,943.13	44.05	10.90	10.50	4.9%	5.1%
Swiss Life Holding	12,245.03	357.80	11.39	10.65	4.2%	4.7%
NN Group	12,813.59	37.57	10.15	9.36	5.0%	5.3%
CNP Assurances	13,210.54	19.24	9.90	9.60	4.5%	4.7%
AXA	54,320.29	22.42	9.06	8.33	5.9%	6.3%
Allianz	80,360.98	186.94	10.58	9.93	4.7%	5.0%
Talanx	8,135.03	32.18	9.34	8.43	4.6%	4.9%
Peer group average			**10.75**	**10.04**	**4.8%**	**5.1%**
Nürnberger Beteiligungs	800.64	69.50	15.98*		4.3%**	
Premium/(discount)			**48.6%**		**10.5%**	

Source: Bloomberg consensus at 18 September 2018. Note: *Ratio has been calculated based on management guidance. **Yield calculated based on dividend paid out in 2018 from 2017 earnings.

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