Nürnberger Beteiligungs

Insurance

3 April 2019

New business growth and changes to ZZR

Nürnberger Beteiligungs' (NBG's) FY18 results reflect an overall stable business at the top line, as gross premiums booked were up by 2.2% versus FY17 and new business was ahead of management expectations. However, the bottom line continues to be affected by the low interest rates translating into weaker net investment income (although a high base from one-off effects in FY17 played a role as well). This should also reduce earnings in FY19, with the current guidance implying a 10% y-o-y decline. On the other hand, the recent introduction of the 'corridor method' in case of the Zinszusatzreserve (ZZR) provided some tailwinds in FY18.

FY18 results ahead of management guidance

NBG has reported a net profit of €60.8m, down from €99.5m in FY17 but ahead of company guidance of €50m. The earnings beat was driven by several factors, including a more limited increase in reserves on the back of recent regulatory changes related to the ZZR and a solid level of new premiums in the life insurance business (up 7.0% y-o-y), translating into broadly stable gross premiums at €2.5bn. Moreover, the Property and Casualty (P&C) business was able to improve its combined ratio to 91.4% from 95.3% in FY17. NBG's high exposure to unit-linked and disability products reduces the impact of low interest rates on its business.

Cautious outlook underpinned by market factors

As the insurance industry in Germany continues to be shaped by low interest rates and strict regulations (in particular in the life insurance segment), NBG has issued relatively conservative guidance, with net profit forecasted at €55m, implying a c 10% y-o-y decline. The key reason behind this should be lower investment income (in particular realised gains). Gross premiums booked are expected to remain stable in life insurance but increase in the P&C and health insurance segments. Given the high proportion of life insurance business, this should translate into broadly stable premiums at group level, coupled with a slight increase in new business. NBG's actuarial result should be in line with FY18.

Valuation: Trading at a premium to peers

Based on the company's net income guidance for FY19, NBG's shares are traded at a c 40% premium to peer group on P/E ratio. Based on the declared dividend of €3.0 per share (which has remained stable since 2013), the shares offer a dividend yield of c 4.3%, with further space to grow in the future.

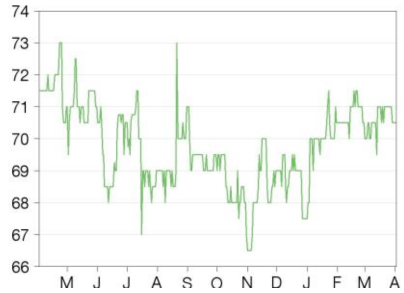
Historical performance

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/15	4,658	85.4	4.1	3.0	17.2	4.3
12/16	4,189	88.1	5.0	3.0	14.1	4.3
12/17	4,387	147.3	8.1	3.0	8.7	4.3
12/18	4,404	97.3	5.1	3.0	13.8	4.3

Source: Nürnberger Beteiligungs accounts

Price	**€70.5**
Market cap	**€812m**

Share price graph



Share details

Code	NBG6
Listing	Deutsche Börse Scale
Shares in issue	11.52m
Liquid resources at 31 December 2018	€375.8m

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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FY18 results: Earnings down due to investment income

NBG reported a 2.2% y-o-y increase in gross premiums booked to €3.5bn, which is broadly in line with management's guidance of a slight increase across its segments. This is in line with the increase in gross premiums booked by 2.1% y-o-y to €202.2bn in 2018 in the German insurance industry reported by the Gesamtverband der Deutschen Versicherungswirtschaft (GDV). At the same time, NBG's new premiums went up by a solid 7.8% y-o-y to €555.9m, ahead of the earlier management expectations of a slight decline in new business. This €40m y-o-y increase was mostly attributable to life insurance (€28.1m), but also property and casualty business (P&C, €11.7m). In the latter case, the main driver was the full consolidation of Neue Rechtsschutz-Versicherung (NRV, acquired in Q317).

Together with the somewhat lower gross investment income at €877.9m (vs €931.2m in FY17) and commission income at €47.6m (€53.4m in FY17), total group revenues improved marginally by 0.4% y-o-y to €4.4bn. Net investment income related to the standard insurance business reached €730.3m (down 6.5% y-o-y), with higher disposals gains of €212.8m (vs €154.0m in FY17) offset by the lower current income at €617.9m (FY17: €708.0m). The latter is the result of high base from one-time effects in FY17 (distributions from two special funds) and lower income from other investments (primarily private equity) in FY18, presumably due to the more challenging market environment towards the end of the year.

NBG's life insurance business (representing c 70% of gross premiums in FY18) was further supported by recent changes implemented by the German regulator (BaFin) in the calculation of Zinszusatzreserve (ZZR, see detailed discussion below). Consequently, the ZZR increase in the case of NBG stood at €61.3m in FY18, in comparison to €241.3m in FY17. Overall, other technical provisions stood at a positive €448.5m compared with a negative €1,571.1m, predominantly as a result of the negative capital market developments translating into lower provisions associated with unit-linked products (as distributions are not a fixed pre-set level here, but are dependent on the performance of the underlying investment portfolio within the insurance product). However, the latter is by definition accompanied by an opposite move in unrealised profits/losses from unit-linked insurance investments booked by NBG (a negative €1.1bn in FY18 compared with positive €723.5m in FY17). Hence, these two items have a relatively limited impact on the bottom line.

Claims expenses went up only slightly by 1.2% y-o-y to €2.3bn in FY18 despite the 9.8% y-o-y increase posted in H118. Operating expenses went up by 10.8% y-o-y to €558.9m on the back of higher acquisition costs (€425.2m vs €382.5m in FY17, largely associated with new business) as well as G&A expenses (€212.7m vs €187.8m) due to NRV consolidation and investments in process optimisation (including the implementation of new IT solutions). As a result of the above, NBG has reported net income at €60.8m, well above management guidance of €50m. This represents a c 39% y-o-y decline, which is partially the effect of higher comparative base due to a one-off effect from asset disposal in H117. After adjusting for minorities, net income stood at €58.8m, representing an ROE of around 7.4%.

Exhibit 1: Results highlights

€m	FY18	FY17	y-o-y
Gross premiums booked	**3,478.1**	**3,402.6**	**2.2%**
Premiums earned	**3,216.9**	**3,165.1**	**1.6%**
Net result on premium refunds	(354.9)	(187.7)	89.1%
Investment income	736.4	833.1	-11.6%
Unrealized profits/losses from unit-linked insurance investments	(1,050.4)	723.5	N/M
Other net technical income/(expense)	(24.4)	(48.7)	-49.8%
Claims expenses	(2,290.9)	(2,264.5)	1.2%
Change in other technical provisions	448.5	(1,571.1)	N/M
Operating expenses	(558.9)	(504.3)	10.8%
Change in equalisation and other reserves	(15.7)	12.5	N/M
Other net (non-technical) income/(expense)	(11.3)	(14.4)	-21.2%
Goodwill amortisation	(0.6)	(0.5)	19.4%
Extraordinary result	2.6	4.3	-38.5%
Pre-tax profit	**97.3**	**147.3**	**-34.0%**
Income and other taxes	(36.4)	(47.8)	-23.7%
Net income (incl. minorities)	**60.8**	**99.5**	**-38.9%**
Minorities	(2.0)	(6.5)	-68.4%
Net income (ex-minorities)	**58.8**	**93.1**	**-36.8%**

Source: NBG accounts, Edison Investment Research

Segment analysis

The **life insurance** segment result declined by 31.6% y-o-y to €44.0m, which was due to lower net investment income (down 10% to €662.3m) and a slight increase in claims expenses by 1.5% y-o-y to €1.8bn. Still, this was ahead of company guidance of €38m and was assisted by a healthy increase in new premiums of 7.0% y-o-y to €430.1m in FY18, with single-premium business growing 7.6% y-o-y (ahead of the market at 3.7% in 2018, according to GDV). As a result, gross premiums stabilised at around €2.5bn; earlier company expectations had been for a slight decline. This compares with gross premiums growth in the German market at 1.4% in 2018. In this segment, NBG's focus is on income protection (due to growing market penetration) and unit-linked products.

Moreover, the life insurance result was assisted by the introduction of the 'corridor method' to establish the reference rate for the purpose of calculating the ZZR. The previous formula was based purely on the 10-year average historical zero-coupon euro swap rate and required further creation of considerable reserves despite the fact that interest rates are no longer in decline. In our previous update note, we had highlighted that the German regulator (BaFin) was considering a formula adjustment that would be effective from 2018 and this has now materialised. This limits movements in the reference rate to a certain range, which is dependent on the current interest rates observed in the market and as a result, the rate went down from 2.21% to 2.09%, lowering the creation of new reserves in the German insurance industry for 2018 to €5.0bn from c €20.0bn based on the previous regulations (according to BaFin). This has assisted NBG's results as well, with a lower increase in ZZR at €61.3m (vs €241.3m in FY17). The regulatory change (although anticipated by management) was not factored into management guidance. Assuming a constant level of interest rates, the ZZR will further grow in 2019 (albeit to a lesser extent in comparison to the prior formula) and after a few years should start declining (although a bit later and more gradually). It is worth noting that NBG's future obligations from life insurance products are relatively limited due to a high proportion of unit-linked and disability business.

The **P&C** segment (23% of gross premiums in FY18) reported an increase in new premiums at 11.2% y-o-y to €115.3m, assisted by the consolidation of NRV. As a result, gross premiums booked went up 10.1% y-o-y to €785.4m. Insurance claims declined marginally to €344.7m from €349.0m in FY17 (excluding NRV, these numbers stand at €407.7m and €425.3m, respectively), which was particularly driven by the liability and vehicle insurance products. This translated into an improved combined ratio, which stood at 91.4%, down from 95.3% in FY17. Having said that, the lack of certain one-off effects (distribution from a special fund), which supported FY17 results, and the increase in equalisation reserves by €15.3m (vs a decline of €12.5m in FY17) had a negative impact on segment results. Together with the 6.5% y-o-y increase in operating expenses to €192.0m (although mostly due to NRV consolidation), this translated into a lower segment result of €23.9m vs €31.8m in FY17. Still, this was moderately ahead of management guidance of €22.0m.

The segment profit in **Health Insurance** stood at €4.5m in 2018 vs €4.0m in FY17, in line with management expectations. New premiums went up slightly to €10.5m from €10.2m in FY17 (vs expectations of a small decline), driven mainly by full insurance products. Gross premiums booked stood at €219.5m vs €217.7m in FY17. Here, NBG is putting strong emphasis on its student offering and supplementary long-term care insurance. The decline in the **Banking Services** segment result to €4.1m from €5.3m in FY17 was less pronounced than management had expected.

Outlook: Gross premium growth assisted by P&C

The German insurance industry (in particular life insurance business) continues to be affected by the low interest rate environment (weighing on investment income and demand for long-term pension products) as well as regulatory burdens. The potential changes to the life insurance regulations referred to as Lebensversicherungsreformgesetz II (LVRG II) may involve the introduction of a cap on fees earned on life insurance contracts and constrain the new business. According to GDV, gross premiums booked in the life insurance business should increase by c 1% in 2019. In line with the above, NBG expects a stable level of premiums booked in FY19 and guides to a segment profit of €38m (which implies a 14% decline from FY18). Premiums in the German P&C business should rise by c 3% (according to GDV), with NBG also expecting solid new business, especially in the commercial segment (following the efficiency measures introduced in FY18), as well as vehicle and casualty insurance. At the same time however, the NBG guides to a decrease in segment profit to €15m (vs €23.9m in FY18) due to higher equalisation reserves and reduced investment income. Together with the Health Insurance (profit guidance at €5.0m vs €4.5m in FY19) and Banking Services segment (profit to remain stable), this should result in group net profit at €55m in FY19, according to company guidance.

Valuation

As there are no Refinitiv consensus estimates for NBG, our P/E calculations for 2018 are based on management's FY19 net profit guidance of €55m. We feel it is an appropriate measure as management expectations appear relatively conservative, as exhibited by the FY18 earnings beat. Based on these figures, the company is trading at c 40% premium to the peer group. NBG pays out an annual dividend of €3 per share, implying a 4.3% yield, which is a c 18% premium to peers.

Exhibit 2: Peer group comparison

	Market cap (lcy m)	Share price (lcy)	P/E		Dividend yield	
			2019e	2020e	2019e	2020e
UNIQA Insurance Group	2,753.8	8.88	12.2	11.3	6.2%	6.5%
Helvetia Holding	6,066.5	610.00	12.1	11.7	4.1%	4.3%
Baloise Holding	7,930.0	162.50	12.5	11.4	3.9%	4.2%
Ageas	8,676.6	42.56	9.9	9.3	5.3%	5.7%
Swiss Life Holding	14,793.6	431.40	12.5	11.5	4.3%	4.8%
NN Group	12,380.6	36.15	9.1	8.4	5.7%	5.9%
CNP Assurances	13,465.5	19.53	9.9	9.6	4.6%	4.8%
AXA	54,472.9	22.37	8.1	7.7	6.5%	6.8%
Allianz	84,213.8	197.58	10.5	9.8	4.8%	5.1%
Talanx	8,615.3	34.08	9.3	8.6	4.5%	4.9%
Peer group average			**10.6**	**9.9**	**5.0%**	**5.3%**
Nürnberger Beteiligungs	817.9	71.00	14.9*	N/A	4.2%**	N/A
Premium/(discount)			**40.2%**	**N/A**	**18.2%**	**N/A**

Source: Refinitiv consensus at 27 March 2019. Note: *Ratio has been calculated based on management guidance. **Yield calculated based on dividend proposal from 2018 earnings.

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