

Sector View

Insurance

Top Picks Q1 2016: AXA and Allianz

	1 M	3 M	6 M	31/12/14
Insurance	-3.7%	7.7%	2.7%	12.2%
DJ Stoxx 600	-6.5%	-0.2%	-7.4%	4.3%

*Stoxx Sector Indices

Companies covered

AEGON	BUY	EUR6.2 vs. 8.3
ALLIANZ	BUY vs. NEUTRAL	EUR195 vs. 171
AXA	BUY	EUR32 vs. 29
CNP ASSURANCES	NEUTRAL	EUR15 vs. 17.5
COFACE	NEUTRAL	EUR10.5 vs. 11.1
EULER HERMES	BUY vs. NEUTRAL	EUR103
HANNOVER RE	SELL	EUR107 vs. 97
MUNICH RE	SELL	EUR200 vs. 189
SCOR	BUY	EUR38.5 vs. 36
SWISS RE	NEUTRAL	CHF110. vs. 100
ZURICH INSURANCE GROUP	NEUTRAL	CHF310 vs. 330

LOOKING BACK ON Q4 2015

Excluding Aegon and Zurich, Q3 2015 numbers (published in November) were in line or ahead of expectations. Strong operating performances have been driven by underwriting results, especially in P&C (primary insurers + reinsurers) thanks to lower-than-budgeted natcats. Most companies continue to suffer ongoing pressure on recurring Rols.

We have continued to see some volatility on the financial markets, driven by several geopolitical/economic issues. European rates have stabilised (10Y Euro rate at 1.07%). Corporate spreads have lowered in Q4 (down 13bps for the iTraxx Main and down 19bps for the iTraxx Senior Financials). Equity markets have risen (DJ Stoxx50 up 4.1%). These movements are positive for asset valuations, pushing insurers' NAVs up further.

As expected, most companies have passed the Solvency II test with flying colours. As expected, winners are companies with very diversified business models. We would especially mention AXA (212% at end-Sept.), Allianz (200%) and the reinsurers (Hannover Re, Munich Re 260% and Scor 208%).

Despite the challenging market environment, the insurance sector performed well again in Q4 2015 (+6.1% vs. Stoxx600 after +3.0% in Q3), as sustained convincing operating performances and strong capital and cash flow discipline have gradually improved the way investors see the sector, leading to a gradually lower cost of capital and as such some kind of gradual re-rating. The 2Y sector beta has come down to 1.0, its lowest level since 2002. AXA, our Q4 Top Pick, which was up 4.5% vs. the sector in Q4 (and up 15% for FY), is a good illustration of this.

NEW ESTIMATES, RECOMMENDATIONS AND FAIR VALUES

We take the opportunity to update our earnings forecasts for 2015-2017. On average, both our operating profit and net income sequences are revised upwards by 1%. Our sequence for NAV is revised downwards by 1% on average, mainly driven by higher returns to shareholders, helping companies to keep decent ROEs (c. 10% on average), above our cost of equity (9.3% on average).

We release our new fair values, which are based on our new 2016 estimates and adjustments we have made in our company specific betas. Please note that BG valuation criteria remain unchanged (risk-free rate 2.0%, equity risk premium 6.4%).

We take this opportunity to change two recommendations, with both Allianz (see below) and Euler Hermes (expected strong capital position within Solvency II, with a potential return to shareholders) turning to Buy vs. Neutral.



EUR	Fair value		Theoretical upside (%)	Recommendation	
	New	Old		New	Old
Aegon	6.2	8.3	23%	Buy	Buy
Allianz	195	171	25%	Buy	Neutral
AXA	32.0	29.0	31%	Buy	Buy
CNP	15.0	17.5	25%	Neutral	Neutral
Zurich (CHF)	310	330	24%	Neutral	Neutral
Hannover Re	107	97	5%	Sell	Sell
Munich Re	200	189	13%	Sell	Sell
Scor	38.5	36.0	18%	Buy	Buy
Swiss Re (CHF)	110	100	14%	Neutral	Neutral
Coface	10.5	11.1	13%	Neutral	Neutral
Euler Hermes	103	103	20%	Buy	Neutral

Source: Bryan Garnier & Co. ests.

WHAT WE SEE FOR Q1 2016

Geopolitical/economic uncertainties are high at the beginning of 2016, which could continue to generate some volatility on the financial markets. However:

Both the FED and the ECB have done their homework in December 2015, providing financial markets with some visibility on potential future actions.

Bonds usually represent 75% of total investments for insurance companies, with the bulk of it invested in OECD govies and investment grade corporate bonds. Going forward, the pressure on ROIs and investment income should remain. Should rates and spreads stay where they currently are, our

calculations show that a 5-year duration theoretical investment portfolio made of govies (40% Euro, 10% US) and corporate bonds (25% investment grade, 5% high yield, 20% financials) would generate a 3.3% return in 2016 vs. 3.8% in 2015 and 4.3% in 2014. Actually there is nothing new here, and active management of the investment portfolio and some kind of diversification should help mitigate this trend. Marked-to-market fluctuations may impact NAVs but this is pure IFRS accounting. From an economic standpoint only default rates matter. And the Eurozone continues to benefit from low oil prices, a low Euro and a very favourable refinancing environment (QE). Bottom line, impairment risks are fairly limited to us.

Insurance companies' Q4/FY 2015 numbers, which will be reported starting mid-February, should be strong again, driven by ongoing focus on underwriting results (primary P&C + reinsurance), persisting low natcats and insurers' ability to pass lower interest rates on to customers (traditional life). Munich Re reported that 2015 natcat insured losses have been USD27bn vs. USD31bn in 2014 and USD39bn in 2013 and vs. USD34bn on a long-term inflation-adjusted average over the 1985-2014 period. In most cases, shareholder returns should be very satisfactory.

As a consequence, we see no reason to suspect insurers will deviate from current strategies, i.e. focusing on underwriting profitability through better risk management and cost control, price discipline, a more favourable product-mix in Life/Protection, a prolonged focus on capital allocation and cash flow management. This strategy should help protect the overall profitability in the current low interest rates environment. It should also continue to ease investors' sentiment on the sector, which is good for valuation multiples. As a consequence, we will continue to use a 'risk-on' sector beta, i.e. 1.1 (vs. 1.35 for the 'risk-neutral' mode and 1.6 for the 'risk-off' mode) in our models.

CONCLUSIONS AND TOP PICKS

In the current unclear financial market environment, we believe the insurance sector will continue to benefit from its self-helped, transformational status. With current valuation multiples (1.0x P/NAV) undemanding considering the drop in the cost of capital, we have decided to increase the number of insurance stocks in our Top Pick list (2 vs. 1). We have also decided to focus on primary insurers, as the pricing environment in reinsurance remains challenging.

We continue to strongly support the AXA investment case (Buy, FV EUR32 vs. EUR29), considering: i/ the company's convincing transformational journey strategy over the last few years, ii/ the recurring quality of earnings over the last half years (pricing power, combined ratio, new business margin, solvency,...), iii/ managements' efforts to address shareholders' return (pay-out ratio revised upwards to 45-55%), and iv/ a prolonged 10% discount to peers like Allianz and Zurich. FY 2015 numbers will be reported on 25th February.

At Allianz (Buy vs. Neutral, FV EUR195 vs. EUR171), we highlight the operating trends in P&C (combined ratio) and at Pimco (outflows are broadly over), which should continue to improve following several difficult quarters. The company has also now clearly embarked on a transformation of its too traditional life book, which should continue to have favourable impacts on NBV margins, capital allocation and cash flows. Allianz's performance in 2014-2015 has been shy (broadly in line with the sector) and we believe it is time to be more aggressive on it. FY 2015 numbers are due to be published on 29th February.

[Click here to download document](#)



Analyst :
Olivier Pauchaut
33(0) 1 56 68 75 49
opauchaut@bryangarnier.com

Bryan Garnier stock rating system

For the purposes of this Report, the Bryan Garnier stock rating system is defined as follows:

Stock rating

BUY	Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements including a SWOT analysis, positive momentum, technical aspects and the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements including a SWOT analysis, positive momentum, technical aspects and the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 72%

NEUTRAL ratings 0%

SELL ratings 28%

Research Disclosure Legend

1	Bryan Garnier shareholding in Issuer	Bryan Garnier & Co Limited or another company in its group (together, the "Bryan Garnier Group") has a shareholding that, individually or combined, exceeds 5% of the paid up and issued share capital of a company that is the subject of this Report (the "Issuer").	No
2	Issuer shareholding in Bryan Garnier	The Issuer has a shareholding that exceeds 5% of the paid up and issued share capital of one or more members of the Bryan Garnier Group.	No
3	Financial interest	A member of the Bryan Garnier Group holds one or more financial interests in relation to the Issuer which are significant in relation to this report	No
4	Market maker or liquidity provider	A member of the Bryan Garnier Group is a market maker or liquidity provider in the securities of the Issuer or in any related derivatives.	No
5	Lead/co-lead manager	In the past twelve months, a member of the Bryan Garnier Group has been lead manager or co-lead manager of one or more publicly disclosed offers of securities of the Issuer or in any related derivatives.	No
6	Investment banking agreement	A member of the Bryan Garnier Group is or has in the past twelve months been party to an agreement with the Issuer relating to the provision of investment banking services, or has in that period received payment or been promised payment in respect of such services.	No
7	Research agreement	A member of the Bryan Garnier Group is party to an agreement with the Issuer relating to the production of this Report.	No
8	Analyst receipt or purchase of shares in Issuer	The investment analyst or another person involved in the preparation of this Report has received or purchased shares of the Issuer prior to a public offering of those shares.	No
9	Remuneration of analyst	The remuneration of the investment analyst or other persons involved in the preparation of this Report is tied to investment banking transactions performed by the Bryan Garnier Group.	No
10	Corporate finance client	In the past twelve months a member of the Bryan Garnier Group has been remunerated for providing corporate finance services to the issuer or may expect to receive or intend to seek remuneration for corporate finance services from the Issuer in the next six months.	No
11	Analyst has short position	The investment analyst or another person involved in the preparation of this Report has a short position in the securities or derivatives of the Issuer.	No
12	Analyst has long position	The investment analyst or another person involved in the preparation of this Report has a long position in the securities or derivatives of the Issuer.	No
13	Bryan Garnier executive is an officer	A partner, director, officer, employee or agent of the Bryan Garnier Group, or a member of such person's household, is a partner, director, officer or an employee of, or adviser to, the Issuer or one of its parents or subsidiaries. The name of such person or persons is disclosed above.	No
14	Analyst disclosure	The analyst hereby certifies that neither the views expressed in the research, nor the timing of the publication of the research has been influenced by any knowledge of clients positions and that the views expressed in the report accurately reflect his/her personal views about the investment and issuer to which the report relates and that no part of his/her remuneration was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in the report.	Yes
15	Other disclosures	Other specific disclosures: Report sent to Issuer to verify factual accuracy (with the recommendation/rating, price target/spread and summary of conclusions removed).	No

A copy of the Bryan Garnier & Co Limited conflicts policy in relation to the production of research is available at www.bryangarnier.com

London	Paris	New York	Geneva	New Delhi
Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	rue de Grenus 7	The Imperial Hotel
15 St. Botolph Street	75008 Paris	New York, NY 10022	CP 2113	Janpath
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Genève 1, CH 1211	New Delhi 110 001
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	Tel +4122 731 3263	Tel +91 11 4132 6062
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member	Fax+4122731 3243	+91 98 1111 5119
Authorised and regulated by the	Financial Conduct Authority (FCA) and		Regulated by the	Fax +91 11 2621 9062
Financial Conduct Authority	the Autorité de Contrôle prudentiel et de		FINMA	
(FCA)	resolution (ACPR)			

Important information

This document is classified under the FCA Handbook as being investment research (independent research). Bryan Garnier & Co Limited has in place the measures and arrangements required for investment research as set out in the FCA's Conduct of Business Sourcebook.

This report is prepared by Bryan Garnier & Co Limited, registered in England Number 03034095 and its MIFID branch registered in France Number 452 605 512. Bryan Garnier & Co Limited is authorised and regulated by the Financial Conduct Authority (Firm Reference Number 178733) and is a member of the London Stock Exchange. Registered address: Beaufort House 15 St. Botolph Street, London EC3A 7BB, United Kingdom

This Report is provided for information purposes only and does not constitute an offer, or a solicitation of an offer, to buy or sell relevant securities, including securities mentioned in this Report and options, warrants or rights to or interests in any such securities. This Report is for general circulation to clients of the Firm and as such is not, and should not be construed as, investment advice or a personal recommendation. No account is taken of the investment objectives, financial situation or particular needs of any person.

The information and opinions contained in this Report have been compiled from and are based upon generally available information which the Firm believes to be reliable but the accuracy of which cannot be guaranteed. All components and estimates given are statements of the Firm, or an associated company's, opinion only and no express representation or warranty is given or should be implied from such statements. All opinions expressed in this Report are subject to change without notice. To the fullest extent permitted by law neither the Firm nor any associated company accept any liability whatsoever for any direct or consequential loss arising from the use of this Report. Information may be available to the Firm and/or associated companies which are not reflected in this Report. The Firm or an associated company may have a consulting relationship with a company which is the subject of this Report.

This Report may not be reproduced, distributed or published by you for any purpose except with the Firm's prior written permission. The Firm reserves all rights in relation to this Report.

Past performance information contained in this Report is not an indication of future performance. The information in this report has not been audited or verified by an independent party and should not be seen as an indication of returns which might be received by investors. Similarly, where projections, forecasts, targeted or illustrative returns or related statements or expressions of opinion are given ("Forward Looking Information") they should not be regarded as a guarantee, prediction or definitive statement of fact or probability. Actual events and circumstances are difficult or impossible to predict and will differ from assumptions. A number of factors, in addition to the risk factors stated in this Report, could cause actual results to differ materially from those in any Forward Looking Information.

Disclosures specific to clients in the United Kingdom

This Report has not been approved by Bryan Garnier & Co Limited for the purposes of section 21 of the Financial Services and Markets Act 2000 because it is being distributed in the United Kingdom only to persons who have been classified by Bryan Garnier & Co Limited as professional clients or eligible counterparties. Any recipient who is not such a person should return the Report to Bryan Garnier & Co Limited immediately and should not rely on it for any purposes whatsoever.

Notice to US investors

This research report (the "Report") was prepared by Bryan Garnier & Co Limited for information purposes only. The Report is intended for distribution in the United States to "Major US Institutional Investors" as defined in SEC Rule 15a-6 and may not be furnished to any other person in the United States. Each Major US Institutional Investor which receives a copy of this Report by its acceptance hereof represents and agrees that it shall not distribute or provide this Report to any other person. Any US person that desires to effect transactions in any security discussed in this Report should call or write to our US affiliated broker, Bryan Garnier Securities, LLC, 750 Lexington Avenue, New York NY 10022. Telephone: 1-212-337-7000.

This Report is based on information obtained from sources that Bryan Garnier & Co Limited believes to be reliable and, to the best of its knowledge, contains no misleading, untrue or false statements but which it has not independently verified. Neither Bryan Garnier & Co Limited and/or Bryan Garnier Securities LLC make no guarantee, representation or warranty as to its accuracy or completeness. Expressions of opinion herein are subject to change without notice. This Report is not an offer to buy or sell any security.

Bryan Garnier Securities, LLC and/or its affiliate, Bryan Garnier & Co Limited may own more than 1% of the securities of the company(ies) which is (are) the subject matter of this Report, may act as a market maker in the securities of the company(ies) discussed herein, may manage or co-manage a public offering of securities for the subject company(ies), may sell such securities to or buy them from customers on a principal basis and may also perform or seek to perform investment banking services for the company(ies).

Bryan Garnier Securities, LLC and/or Bryan Garnier & Co Limited are unaware of any actual, material conflict of interest of the research analyst who prepared this Report and are also not aware that the research analyst knew or had reason to know of any actual, material conflict of interest at the time this Report is distributed or made available..