18th February 2016

Insurance

Euler Hermes

Price EUR74.19

Sometimes things go the wrong way…

Fair Value EUR100 vs. EUR103 (+35%) **BUY**

Bloomberg	ELE FP
Reuters	ELER.PA
12-month High / Low (EUR)	105.2 / 70.7
Market Cap (EUR)	3,364
Emb. Value (BG Est.) (EUR)	2,482
Avg. 6m daily volume ('000)	12.80
3y EPS CAGR	4.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-10.0%	-11.8%	-20.0%	-16.3%
Insurance	-7.1%	-17.1%	-15.7%	-16.0%
DJ Stoxx 600	-0.3%	-13.5%	-15.1%	-10.1%

(EURm)	2015	2016e	2017e
Total gross prem.	2,372	2,449	2,528
% change		*3.2%*	*3.2%*
Insurance op. profit	386	391	425
Total operating profit	378	383	417
Underlying PTP	427.7	422.3	456.9
% change		*-1.3%*	*8.2%*
Net attributable profit	*302.5*	*297.8*	*322.0*
% Change		*-1.5%*	*8.1%*

(EURm)	2015	2016e	2017e
Shareholders' equity	2,715	2,822	2,965
Technical reserves :			
-Life net (excl. UL)	NM	NM	NM
-UL contracts	NM	NM	NM
-P&C net	2,388	2,507	2,632
NAV net of intangibles	2,482	2,588	2,731
Embedded value	2,482	2,588	2,731

(EUR)	2015	2016e	2017e
EPS (€)	6.86	6.95	7.76
% change	-	*1.3%*	*11.6%*
P/E	10.8x	10.7x	9.6x
P/NAV (%)	1.2x	1.2x	1.1x
ROE	NM	NM	NM
Dividends	4.4	4.4	4.5
Div yield (%)	5.9%	5.9%	6.1%

Q4 underwriting performance (down 32% yoy) has been penalized by a major claim in Spain. Excluding this item, the profitability remains very satisfactory despite the more challenging macro environment. Yet we have slightly adjusted downwards (2%) our 2016-2017 numbers and our new fair value is EUR100. The solvency 2 margin stands at 173% (vs. 190-200% expected) as the regulator has asked for some buffer. This is bad news in the short term, as it leaves no room for a special shareholder return. Longer term, this buffer might vanish, and the company might use some leverage to get more excess capital. We stick to our Buy rating, considering the quality of the fundamentals compared to Coface (including the quality of the solvency margin).

ANALYSIS

- FY 2015 net income was EUR302m, stable vs. 2014. The underwriting result was down 14% to EUR301m (combined ratio at 80.1% vs. 75.4%, driven by a more challenging macro environment).
- Q4 2015 net income was EUR76m, up 9% yoy, driven by investment income (capital gains) and a lower tax rate. The underwriting result was down 32% yoy to EUR54m, with the combined ratio deteriorating from 77.5% to 85.6%, mainly driven by one major claim in Spain. Excluding this item, the Q4 combined ratio would have been in the 77-78% area, i.e. in line with 9M figures.
- We have marginally adjusted downwards our 2016-2017 numbers (-2% on average) to take into consideration the further deterioration of the macro environment (combined ratio expected at 81% in 2016 and 79% in 2017). Our FV is also revised downwards to EUR100 (vs. EUR103).
- The regulator has approved company's solvency internal model. Yet it has asked for a specific buffer, which translates into a Solvency II margin 30 points below previous economic solvency: the end-2015 solvency 2 margin is 173% vs. 203% for the end-2014 economic solvency. The satisfactory points are the following: i/ the 'capital requirement' / 'net turnover' ratio is 74%, which compares very favourably to the 109% ratio at Coface (using the standard formula), meaning the Euler Hermes' solvency model is much less capital intensive than that of Coface; ii/ this 173% solvency margin is based on pure shareholder equity (99.7% pure in fact), i.e. without the help of any eligible debt, whereas 21% of Coface's available capital relies on hybrid debt.
- But there is a dark side to this 173% solvency margin: it leaves no room in the short term for a special shareholder return, considering the company does not want to go below the 160% mark. So bottom line, the company intends to pay a EUR4.4 regular dividend, which offers a 64% pay-out ratio and a nice 5.9% yield. But we were expecting more… Could this buffer be removed at some point in time? Yes (at least partially). Could the company issue some debt (remember: leverage is currently close to 0) and leverage the business a little to improve the ROE (11.4% without any leverage!) and get more excess capital? Yes. But we doubt any of this potential good news for shareholders will materialize in the near future. Once again, a 5.9% yield is not bad, but we were expecting more!

VALUATION

- Based on our new 2016 numbers, our valuation for the company is EUR100.

NEXT CATALYSTS

- Q1 2016 numbers on 29th April 2016. AGM to follow on 25th May 2016.

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Stock rating

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BUY ratings 63.4% NEUTRAL ratings 28.4% SELL ratings 8.2%

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