

Tuesday, April 28, 2020 | update

PZU: buy (reiterated)

PZU PW; PZU.WA | Insurance, Poland

More Life In a Crisis

The coronavirus crisis is probably easier to navigate for the insurance industry than for banks, by which we do not mean it is easy. For example, quarantine lockdown will most likely slow down growth in non-life premiums amid lower sales of passenger cars and tighter management of disposable income by households. That being said, the momentum in non-life insurance business was about to decelerate anyway even before the epidemic due to a high market penetration rate. On the other hand, as the pandemic spreads across the globe, the life market is probably poised for a revival. This is confirmed by studies which revealed that the coronavirus's high death toll has boosted coverage inquiries even among young people - a demographic where the penetration rate to date has been the lowest. For PZU, one major risk factor moving forward is its banking division, expected to contribute 38% less to consolidated earnings this year, as well as necessitating a goodwill write-down. On top of that, PZU's investments are bound to perform far worse in 2020 in terms of income generation, in particular when it comes to the stock market and real estate. Looking at current bond yields, to achieve decent investment returns in the years ahead will be a challenge, which, however, can be tackled with more acquisitions. After taking into consideration the change economic landscape, we revise our 2020 and 2021 net income forecasts for PZU downward by 23% and 16%, respectively. We want to emphasize that the expected goodwill impairment has no effect on valuation. In spite of lower profits, we expect ROE to hold at a high 15% going forward, and we anticipate uninterrupted dividend yields of 8%-9% in the coming years. All in all, we see PZU as one of the safest bets for pandemic times in the financial sector, and so we reiterate our buy call on the stock.

Not quite immune to COVID-19

Looking at data from past recessions, we can make an informed guess that PZU's gross written premiums are about to stop rising, with the life business compensating for declines in the nonlife business. We also anticipate a decrease in investment income to PLN 1.6bn this year, which, however, might be partly offset by fewer accident claims from drivers amid drastically reduced road traffic. Finally, we expect PZU to write down PLN 720m on goodwill originating from the assets of Alior Bank, on the one hand, and on the other hand reverse disability pension provisions worth about a half of this amount. Using these assumptions, we are prompted to cut our FY2020 net income estimate by 23%. At the same time, we reduce the FY2021 forecast by 16% after factoring in a lack of one-offs and a likely normalization of claims.

The worst-case scenario

In our worst-case crisis scenario, PZU would suffer a 5% fall in premiums in 2020, followed by flat growth in 2021. Moreover, interest income from debt securities would be cut in half, and cost of risk in the Life business would jump to 8% in 2020. In this scenario, our per-share valuation of PZU decreases by 11% to a level which would imply an accumulate recommendation.

(PLN m)	2018	2019	2020E	2021E	2022E
Gross written premiums	23,470	24,191	24,145	24,643	25,309
Net premiums earned	22,350	23,090	23,529	23,464	24,004
Claims	-14,563	-15,695	-15,391	-15,808	-16,225
Pre-tax income	7,086	7,080	5,137	5,935	6,980
Net Income	3,213	3,295	2,555	2,853	3,090
ROE (%)	21.8	21.2	14.6	14.9	15.4
P/E (x)	8.0	7.8	10.1	9.1	8.4
P/B (x)	1.7	1.6	1.4	1.3	1.3
DPS (PLN)	2.50	2.80	0.00	2.37	2.64
Dividend Yield (%)	8.4	9.4	0.0	7.9	8.8

Current Price	PLN 29.92
Target Price	PLN 35.93
MCap	PLN 25.84bn
Free Float	PLN 17.00bn
ADTV (3M)	PLN 162.5m

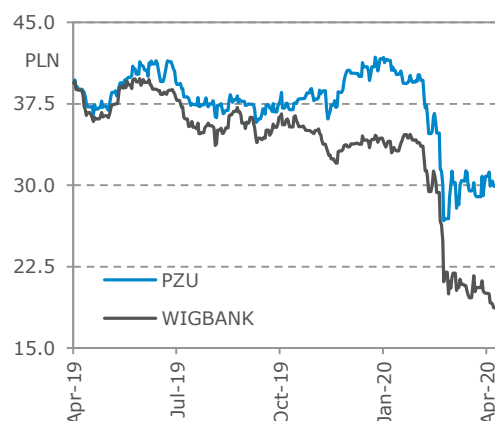
Ownership

State Treasury	34.19%
Others	65.81%

Business Profile

PZU is the number-one provider of insurance in Poland with the largest market shares in both life and non-life policies. Aside from insurance, the Company also operates the third-largest pension fund in the country. Outside of its core home market PZU has a presence in Lithuania, Latvia, Estonia, and Ukraine. In recent years PZU branched out into banking through the acquisition of controlling stakes in two Polish banks, Pekao and Alior.

PZU vs. WIG-Banks



Company	Target Price		Rating	
	new	old	new	old
PZU	35.93	41.91	buy	buy

Company	Current Price	Target Price	Upside
PZU	29.92	35.93	+20.1%

Forecast Update		2020E	2021E
GWP		-1.39%	-1.56%
Claims		-0.27%	+0.24%
Net income		-23.02%	-15.44%

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List of abbreviations and ratios contained in the report:

EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from -5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
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NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

mBank issued the following investment recommendations for PZU in the 12 months prior to this publication:
PZU

recommendation	buy	hold	accumulate	buy	hold	accumulate
date issued	2020-03-04	2020-02-05	2019-12-05	2019-09-05	2019-07-03	2019-04-02
target price (PLN)	41.91	41.91	41.91	43.38	43.38	43.38
price on rating day	36.31	40.54	36.47	36.59	44.35	40.79

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