COMPANY ANALYSIS - Sava Re Group

InterCapital Research

InterCapital

Insurance

February 14th, 2018

Finding Future Growth Outside Slovenia

EUR '000	2017E	2018E	2019E	2020E	2021E	2022E
Gross written premium	508,747	522,719	537,070	551,123	565,511	579,649
Gross claims settled	-299,014	-291,416	-301,548	-309,032	-316,543	-323,955
Net investment income	16,054	19,536	22,979	24,943	28,594	30,210
EBT	36,280	40,155	44,045	49,046	52,959	57,751
Net profit / loss	29,386	32,525	35,677	39,728	42,897	46,778
Total assets	1,700,321	1,754,042	1,810,870	1,871,267	1,934,289	2,000,436
Equity	315,577	336,170	358,721	384,010	411,025	440,332
Technical provisions	1,167,238	1,195,553	1,224,847	1,254,870	1,285,623	1,317,097
ROA	1.7%	1.9%	2.0%	2.2%	2.3%	2.4%
ROE	9.6%	10.0%	10.3%	10.7%	10.8%	11.0%
P/GWP	0.52	0.50	0.49	0.48	0.47	0.45
P/E	8.97	8.10	7.38	6.63	6.14	5.63
P/B	0.83	0.78	0.73	0.69	0.64	0.60

* Multiples were calculated based on the market price on February 14th, 2018

Following the release of the new strategy for the 2017-2019 period and 9M 2017 results, which were both slightly above our expectations, we update our model for Sava Re Group. We recognize the Group's efforts to step up the number initiatives, among them focusing on higher organic growth outside Slovenia, digitalization initiatives (development of innovation platform, increased web presence, tool for managing customer relation), seeking growth through acquisitions, development of pension and health insurance.

Growth will be driven by markets outside Slovenia while we see upside from new businesses, such as pension funds and health insurance. For 2017 we expect GWPs of EUR 508.7m (+3.8% YoY), way above EUR 494m initially targeted by the Group. In the projected period we believe Slovenian market will lag behind, especially in the life segment due to a large number of upcoming maturities. However, we projected a double-digit premium growth in insurance subsidiaries outside Slovenia coupled with reinsurance rate increases. Taking into account differing views on the extent of rate increases among industry participants, we were slightly conservative in our estimates. Also, we recognise some downside risk over time arriving from significant focus on „new" markets as segments.

We believe the dividend yield is attractive and sustainable at around 5-7% in the projected period (compared to current price). Although we didn't show a separate dividend discount model, our target price implies: 1) historical dividend of EUR 0.7 per share paid out in 2017, 2) annual growth of 10% until 2022 (in line with the recently published Group strategy), 3) reducing dividend growth to 5.5% annually in perpetuity, 4) cost of equity equal to 10%.

Sava Re trades well below the peers: 8.1x 2018e PE and 0.8x 2018e PB vs. sector PE 10.5x and PB 0.9x. Furthermore, the projections indicate that the Group should continuously achieve ROE above its CoE. We roll forward our valuation to 2022 and align our excess return valuation methodology combined with peer group analysis by valuing Sava's price on median multiples. As a starting point in the ERM we have used CoE of 10.0%, while the ROE spans from 9.6% to 11.0%. Adris' possible takeover of Sava Re was a big topic during our previous analysis. Considering recent developments, we are still waiting the final verdict on the story and thus did not include it in our model.

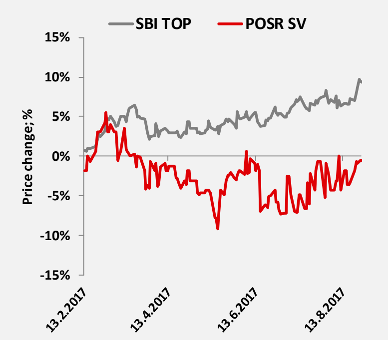
We increase our target to EUR 20.32 per share, thus giving BUY recommendation. This would put it at 9.77x 2018E earnings and 0.95x 2018E book value which looks fairly valued to us, especially taking into account dividend expectations.

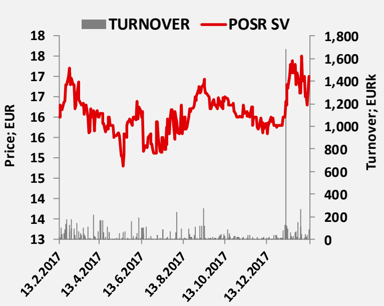
BUY

1 Y target price:	EUR 20.32
Price Feb 14, 2018:	EUR 17.00
Potential growth:	+19.5%

GENERAL SHARE INFORMATION

Bloomberg ticker	POSR SV
Number of shares	17,219,662
Market capitalization (EURm)	292.7
1Y high/low (EUR)	17.50 / 14.81
1Y average daily turnover (EURk)	42.52
Free Float	44.44%
Index member	YES
Website	www.sava-re.si/en/

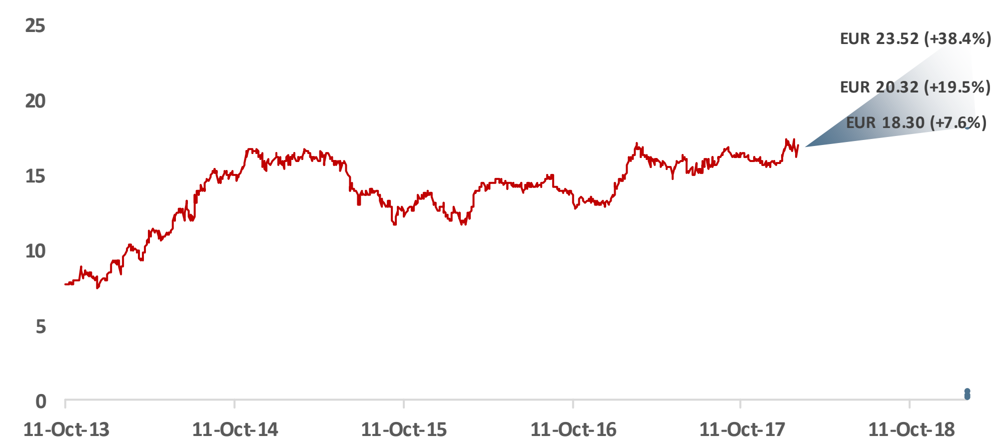




Margareta Maresic
Analyst
Tel. +385 1 4825 857
margareta.maresic@intercapital.hr

Valuation Snapshot: Sava Re Group, BUY, EUR 20.32

Exhibit 2 Share price development



Source: Bloomberg, InterCapital Research

Why recommendation BUY?
Current Sava Re's price at 8.1x 2018e PE and 0.8x 2018e PB looks attractive comparing the peer group trading multiples

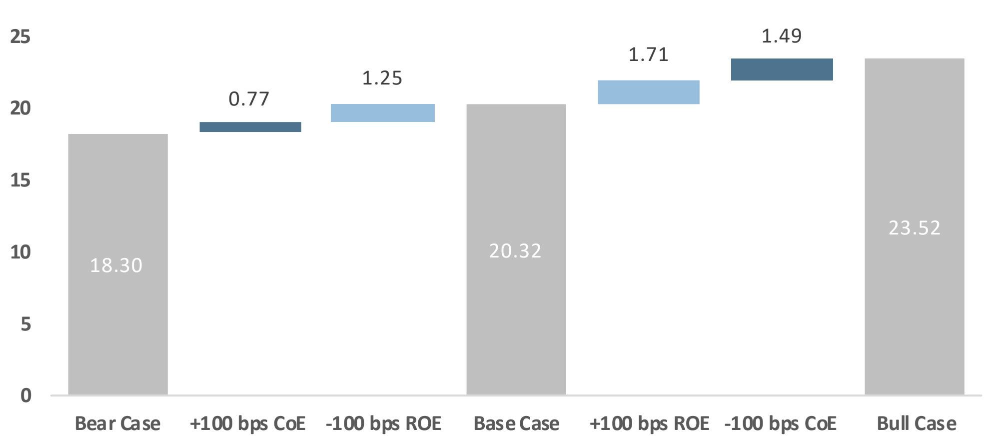
Exhibit 2 Scenario analysis

Target price HRK 20.32		Calcualted based on ERM and comparables (10.0 CoE, 2.0% terminal growth rate from 2022)
Bull Case EUR 23.52	ERM/ PEER	**Better market conditions:** - ROE increase by 100bps; - CoE decrease by 100 bps.
Base Case EUR 20.32	ERM/ PEER	**In base case we used the ERM and comparables method to determine the fundamental value of the Company.**
Bear Case EUR 18.30	ERM/ PEER	**Pressure on profitability:** - ROE decrease by 100bps; - CoE increase by 100 bps.

Source: Bloomberg, InterCapital Research

If we change base case assumptions regarding to ROE and CoE Sava RE Group still has higher projected price than current market price

Exhibit 2 Bear 2 Bull scenario



Source: Bloomberg, InterCapital Research

Risks to our model are adverse market conditions, catastrophic events, lower profitability on new markets and segments and changes in legislation.

Key themes related to Sava Re's business activities

Today's insurers face a wide range of complex challenges, from navigating financial market uncertainty and evolving consumer demands to outpacing digitally savvy new competitors. While these factors may add new risk, they also present opportunities for insurers, reinsurers and brokers. They are motivated to rethink strategy, redesign financial and capital models, revamp sales, service and support processes with technology, or explore new growth in emerging markets or through product innovation.

Intensified regulatory scrutiny and enhanced compliance and capital requirements through ORSA, IFRS and Solvency II regimes are at the forefront. In addition, modernizing technology and processes to derive value from the vast volume of data and driving efficiencies in front and back office operations will continue to challenge business models for several years to come. As insurers seek to secure profitable growth, mergers and acquisitions (M&A) are an increasingly important element of the overall strategy.

Global insurance market review 2017 and outlook 2018/19

According to Swiss Re, global growth prospects continued to improve during 2017 and a recession next year is unlikely. Even so, only moderate growth is expected this year. Emerging markets are performing better, especially in Asia (6% growth), but growth in commodity exporting regions is also accelerating as energy and metal prices rise. Inflation is currently fairly subdued globally, but with low unemployment rates in some countries (US, UK, Germany), the risk to casualty lines from inflation needs to be monitored. The multitude of large natural cat events – Harvey, Irma, Maria, earthquakes in Mexico, wildfires in California – in the second half of the year have drained capital out of the re/insurance P&C sector. Price increases in loss-affected segments are already happening and could be substantial.

Global non-life insurance premiums have grown by about 3% in 2017, and growth is forecast to remain steady at around 3% in 2018 and 2019 but could be stronger depending on the afore-mentioned price increases. Assuming 2018 is an average cat loss year, profits will improve. Global life insurance premiums are estimated to have grown by about 3% in 2017 (up from 2% in 2016), supported by robust performance of savings products in emerging markets, particularly in Asia. Premiums are forecast to increase by close to 4% annually over the next two years.

Non-life premium growth in CEE has eased slightly to below 5% in 2017 from 5.7% in 2016. Strong growth in most of the countries from the region has been more than offset by the drag from weakness in Russia (premiums down 5%). In the next two years, stable demand for non-life insurance is expected in CEE, with growth around 4-5% on an annual basis. Life premium growth in CEE has rebounded formidably in 2017 after contracting for four years in a row, but lower growth of around 5-6% is expected in the coming two years, reflecting the large share of Russia. However, elsewhere in the region, life business should rebound assuming steady economic growth.

Reinsurance

As we already stated before, the multitude of large nat cat events in the second half of the year have drained capital out of the reinsurance. Apart from the unusually high burden from nat cat, the reinsurance industry has also continued to suffer from headwinds arising from the ongoing low interest rate environment and the recent overall softening of underwriting conditions. As a consequence, ROE in non-life reinsurance declined from around 15% between 2012 and 2014 to 11% in 2016. For the first six months of 2017, the industry ROE further dropped to 9%, based on a combined ratio of 93% and an investment yield of 2.5%. Assuming no further large nat cat events for the rest of the year, the combined ratio for 2017 is estimated to be around 115%. Accordingly, overall global industry profitability (ROE) for the full-year is forecast to come in at around -4%. The ultimate volume of losses is not yet known, but it will likely be large enough to cause price rises even beyond the affected sectors/regions. Swiss Re believes that non-life reinsurers´ premiums will grow slightly less than, and profits slightly more than those of primary non-life insurers, but follow the same pattern.

Continued recovery in primary life insurance should support growth in life reinsurance revenues, including a recovery in traditional renewable business. Premium growth will nonetheless likely remain modest, especially in the large advanced markets. In real terms, global life reinsurance premiums are forecast to increase by just over 1% in 2018. Premiums in the advanced markets are projected to decline after adjusting for inflation, driven by developments in the US where cession rates continue their long-term down trend and growth in the primary market remains weak. In Western Europe, where cession rates are usually lower, reinsurance premiums are forecast to grow by about 1%. The strongest contribution to real growth in the advanced markets will likely come from developed Asia.

Low interest rate environment

Profitability remains challenging given the global low interest rate environment, which is putting pressure on investment returns and existing long-duration books of business. As interest rates gradually rise, investment income will grow only slowly, and with a lag to the rising rates. In the downside scenario, yields on government bonds would stay very depressed for another few years at least. They have now reached zero. The longer interest rates languish at these low levels, however, the greater the fallout and the stronger the redistributive effects.

In this benign inflation environment, interest rates are expected to remain very low. ECB is expected to increase the repo rate in 2019 at the earliest, and the Bank of Japan (BoJ) will likely keep rates close to zero over the forecast horizon. The US Fed is expected to continue to raise rates gradually, several times in both 2018 and 2019. In November, the Bank of England (BoE) raised interest rates for the first time in over a decade, reversing the post-Brexit emergency cut. The BoE indicated that another two hikes over the next three years would be appropriate to return inflation to target but highlighted that any decision would evaluate the progress of the ongoing Brexit negotiations carefully.

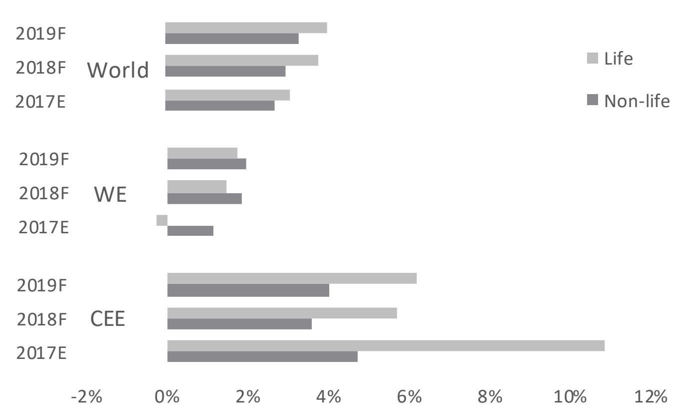
M&A

Over recent years the insurance world has changed materially and made economies of scale more important, especially in the areas of:

1. Regulation – in relative terms, smaller insurers face higher costs to implement Solvency II models than larger insurers;
2. Capital requirements / diversification – larger insurers face higher diversification benefits than smaller insurers;
3. Asset management – larger insurers have better access to illiquid assets which offer a higher yield than smaller insurers who lack the expertise; and
4. IT/digitalization – smaller insurers are likely to have more problems to move into the digital world than larger insurers (data platforms, product solutions).

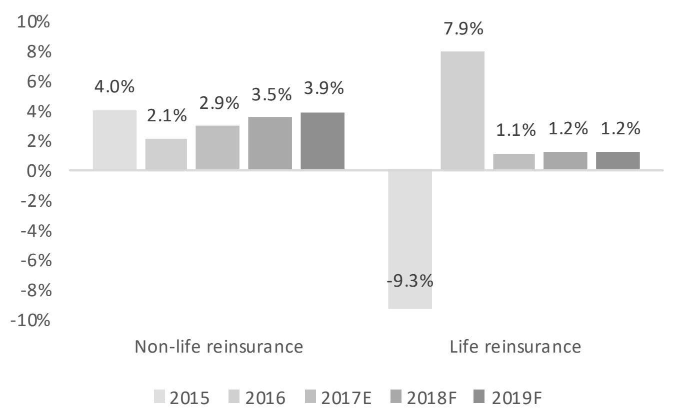
We believe that weaker insurers, especially smaller players, might eventually run into trouble, having a cost problem and probably losing market share. Add to that the low yield environment which allows cheap debt financing (both senior and subordinated) in addition to financing from internal funds and through raising equity capital, and it would be a surprise if we did not see increased M&A activity in years to come, not least because we now have more clarity on solvency positions. To sum up, with the low yield environment ongoing, and the recent hike in interest rates not having changed the situation dramatically, we believe consolidation will eventually accelerate.

Exhibit 5 GWP growth forecast in insurance until 2019 (YoY)



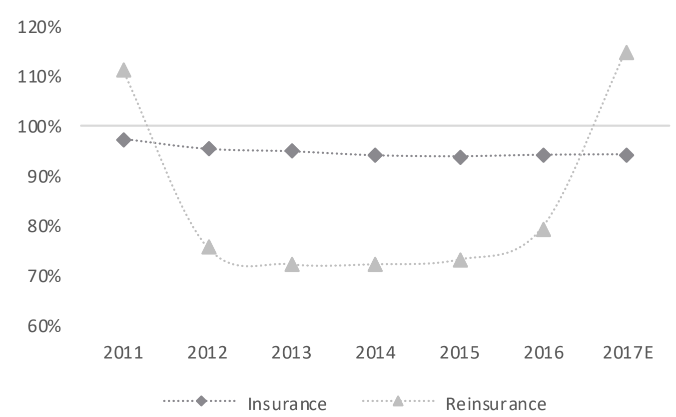
Source: Swiss Re, InterCapital Research

Exhibit 6 GWP growth forecast in reinsurance until 2019 (YoY)



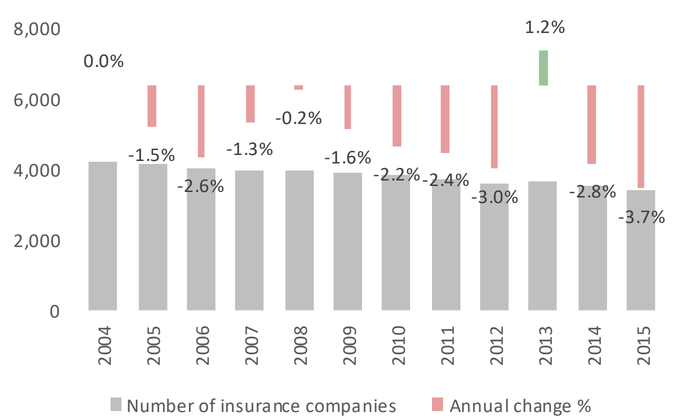
Source: Swiss Re, InterCapital Research

Exhibit 7 Combined ratio developement



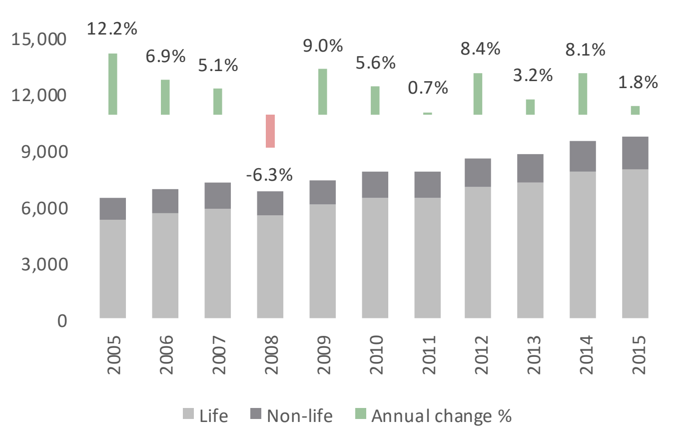
Source: Swiss Re, InterCapital Research

Exhibit 8 Insurance companies in Europe



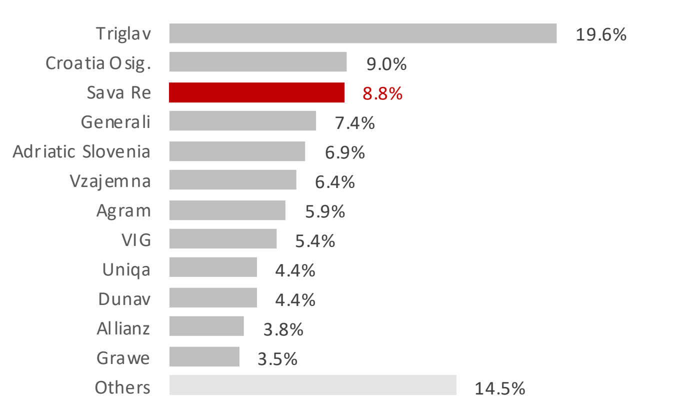
Source: Insurance Europe, InterCapital Research

Exhibit 9 European insurers investment portfolio (EURbn)



Source: Insurance Europe, InterCapital Research

Exhibit 10 Market shares in Adria region in 2016



Source: InterCapital Research, Triglav Group

Digitalization

Digitalization is currently probably one of the most important themes for insurers. It affects insurers on all parts of the insurance value chain, from communication with the client to data processing and offering new insurance solutions. It also heavily touches all other players in the market. This results in its high potential to challenge established companies.

Digitalization will change the way insurers communicate with their clients and impact the customer's journey with insurers – ranging from first contact with the web to financial advice through web-based conferences, followed by helping the client in the case of an insurance loss. The new trends also lead to different platforms to connect to customers and to additional product solutions and services which have not been possible before. Potential impacts of digitalization are almost impossible to assess, and we believe capital markets have difficulties to assess implications from it as well.

One thing is clear: digitalization will come. In banking services we have already seen important applications which make life easier and more efficient (in many cases even without having to write one single word anymore, just scanning and confirming). Firms which position themselves at the forefront of this development and enjoy advantages of scale are likely to be the winners of the development ahead, ultimately gaining market share. As such, we believe digitalization is highly scalable. Smaller insurers will clearly be at a disadvantage to larger players in developing digital solutions.

However, to lessen dependence on traditional agents and brokers, mainstream carriers may also have to simplify their products for direct or group distribution. Over the years, particularly on the life insurance, agents have frequently encouraged insurers to add additional features to differentiate their products, which have become increasingly complex as a result. While this development may benefit agents, who can help consumers by explaining the various bells and whistles of a given product, it has also added a layer of difficulty to the transaction. This sets the stage for a dual distribution strategy, with more customized, complex products being sold through agents, while a streamlined product set is marketed online or through group sellers.

IFRS 17

The new standard IFRS 17 replaces IFRS 4, and will become effective from 1 January 2021. IFRS 17 is a major departure from current accounting practice. While it is principles-based and allows discretion in how to calibrate and allocate valuation changes, the reform will likely increase volatility in reported equity capital and profits. The framework involves measuring insurance liabilities based on the risk-adjusted cash flows plus a margin for as-yet unearned profit. Liabilities are re-measured in each reporting period and valuation changes are reflected in published financial statements. Premiums written will no longer drive the top line as recognised revenues will no longer include investment components of insurance contracts.

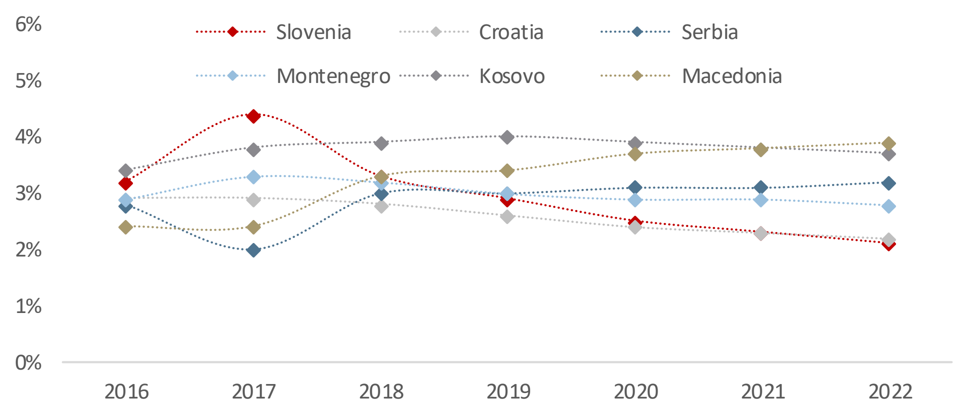
Implementing IFRS 17 will create challenges for many insurers. From an operational perspective, it will likely require significant investment in new data capture, systems and processes. The increased volatility in financial results will put increased emphasis on insurers to better communicate their underlying business performance including the sources of income and balance sheet volatility. This will help ensure that insurers´ costs of capital are not unduly driven higher by investors who misinterpret period-to-period swings in reported financial results.

Insurance market in Slovenia and Western Balkans

Economic growth in Slovenia is projected to remain solid and broad-based. Investment will accelerate as more EU structural funds are disbursed and capacity constraints bite. A strong labour market will lead to faster wage gains, supporting private consumption. Euro area growth should help exports remain buoyant despite cost increases. Accommodative euro area monetary policy is having an expansionary effect, and bank balance sheets have improved substantially. On the other hand, Slovenia has not taken full advantage of globalisation, with a low FDI stock and comparatively weak integration into global value chains. The growth of the Slovene insurance market has been almost unstoppable since the beginning of 2015, except for a few months in mid-2016 when a very slight decline was recorded. The new growing cycle began after the crisis which ruled over the market from 2011 to 2015, driven by the financial crisis in Slovenia (mostly related to banks). After that point in time, both life and non-life insurance segment saw a strong recovery.

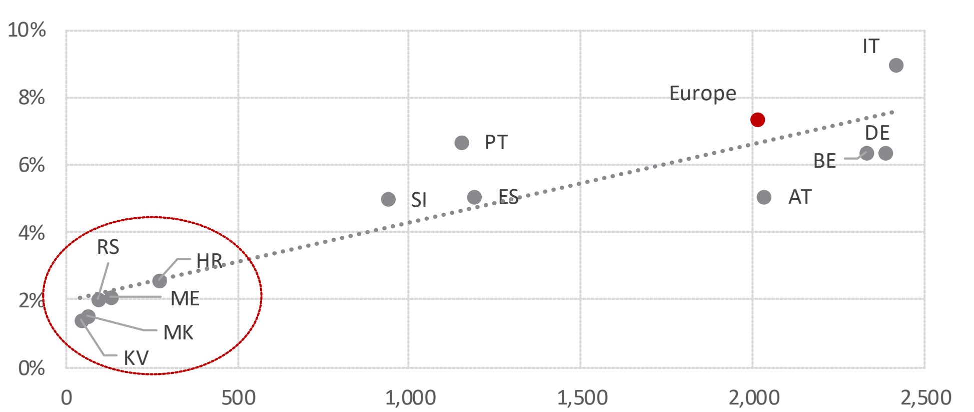
The economic environment continues to be a key driver for the insurance markets, according to a recent Munich Re white paper. Having said that, under the baseline and upside scenarios, insurance premium growth in the market will be close to GDP growth in Slovenia and generally higher than GDP growth in Western Balkans markets, which stand to benefit from increased insurance penetration. Following graphs show an overview of the markets/countries in which Sava Re Group operates.

Exhibit 11 GDP growth forecast for market in which Sava Re operates (in %)



Source: Focus Economics, InterCapital

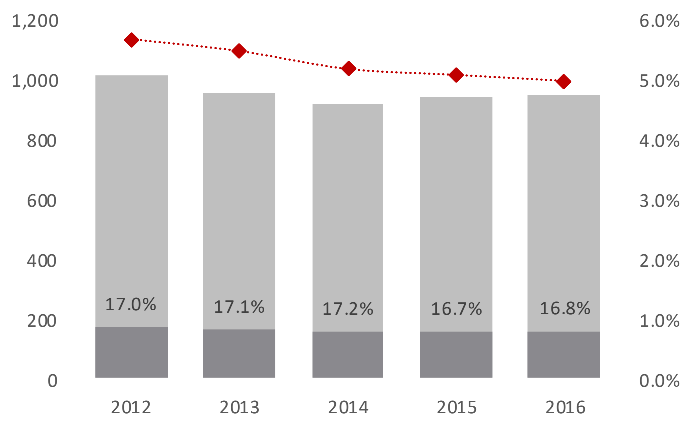
Exhibit 12 Insurance density (EUR) and penetration (in %) in selected European contries in 2015



Source: Insurance Europe, InterCapital Research

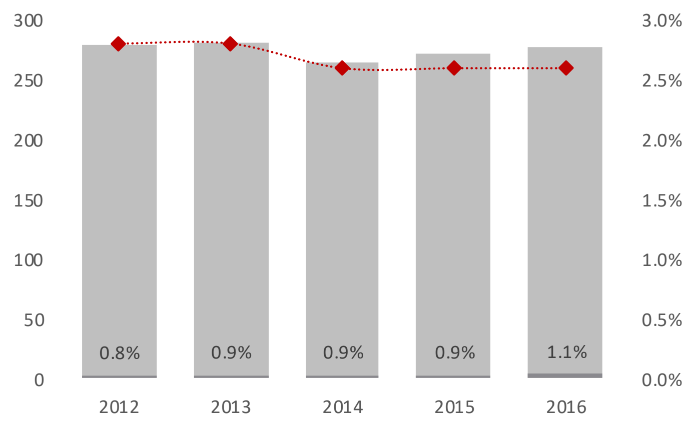
Insurance density (EUR per capita) | Sava Re's market share | Insurance penetration (% of GDP)

Exhibit 13 Slovenia



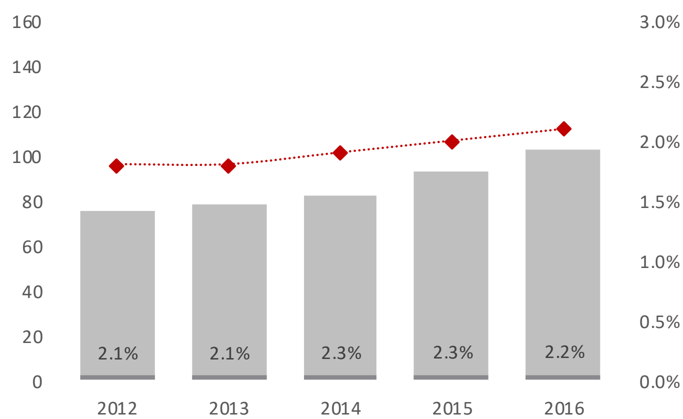
Source: Sava Re, InterCapital Research

Exhibit 14 Croatia



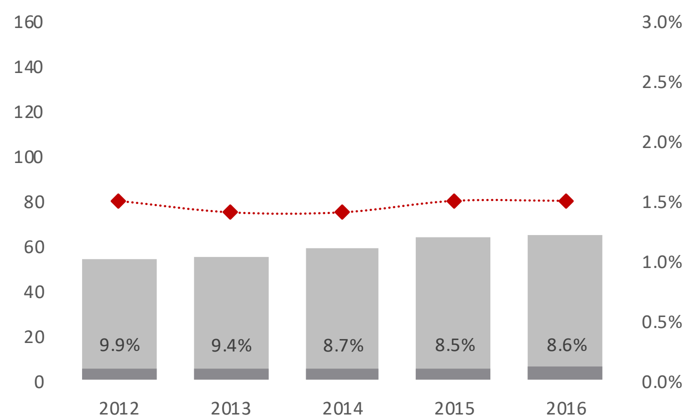
Source: Sava Re, InterCapital Research

Exhibit 15 Serbia



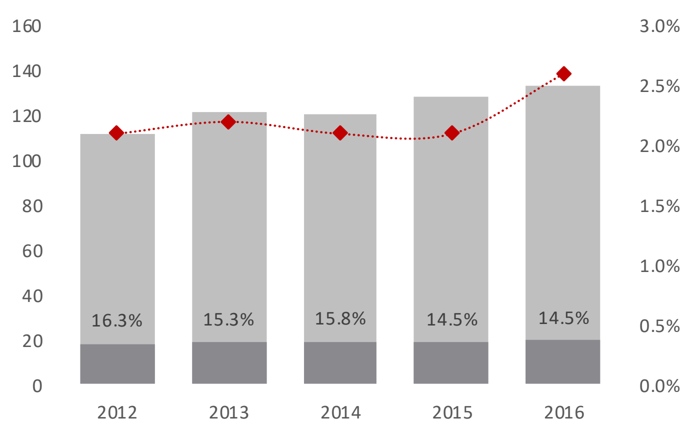
Source: Sava Re, InterCapital Research

Exhibit 16 Macedonia



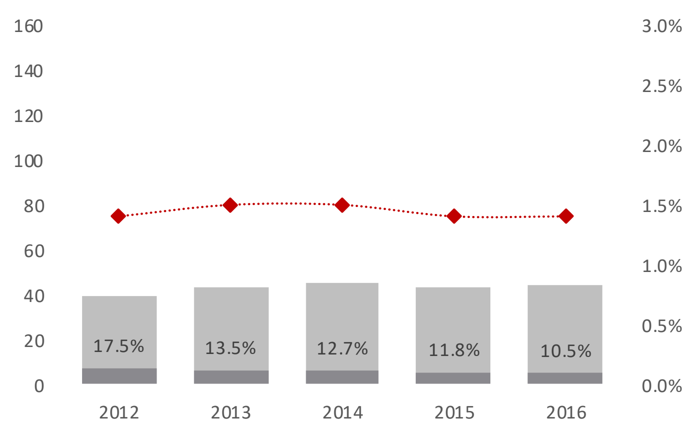
Source: Sava Re, InterCapital Research

Exhibit 17 Montenegro



Source: Sava Re, InterCapital Research

Exhibit 18 Kosovo



Source: Sava Re, InterCapital Research

Sava Re Group Results for 9M 2017

Sava Re Group continues to show strong improvement on the top line in most of its operating segments. However, Q3 brought a couple of large losses which impacted the Group's profitability.

EUR mil	FY 2015	FY 2016	%	9M 2016	9M 2017	%
Gross written premiums	486.3	490.2	*0.8%*	390.5	409.2	*4.8%*
Net premiums earned	447.6	458.1	*2.4%*	343.8	350.6	*2.0%*
Gross claims paid	271.5	269.4	*-0.8%*	195.3	218.6	*12.0%*
Net claims incurred	273.1	268.4	*-1.7%*	204.1	219.7	*7.7%*
Operating expenses	145.3	155.8	*7.3%*	111.3	112.0	*0.7%*
Net profit	33.4	32.9	*-1.3%*	22.6	20.9	*-7.5%*
Combined ratio	95.8%	95.0%	*-80 bp*	96.3%	94.5%	*-180 bp*
Combined ratio excl. FX differences	94.9%	94.6%	*-30 bp*	96.2%	95.6%	*-60 bp*
EUR mil	**Dec 2015**	**Dec 2016**	**%**	**Sep 2016**	**Sep 2017**	**%**
Total Assets	1,607.3	1,671.2	*4.0%*	1,689.5	1,718.1	*1.7%*
Equity	286.4	297.0	*3.7%*	296.2	307.4	*3.8%*
Return on equity	12.0%	11.3%	*-70 bp*	10.2%	9.1%	*-110 bp*
Net technical provisions	1,070.8	1,109.8	*3.6%*	1,135.3	1,153.5	*1.6%*

Overall, in the first nine months of the year, the Group recorded a 4.8% YoY increase in GWP (EUR 18.7m in absolute terms), ultimately reaching EUR 409.2m. The largest premium growth in absolute terms came from the Slovenian non-life insurance segment (+5.3%; EUR 10.9m), mostly on the back of motor insurance. Note that the growth comes mostly from the beginning of the year (increase of EUR 9.5m in H1) and it is still lower than the 5.6% growth in the Slovenian non-life insurance market. Going further, we see that a significant boost also comes from international non-life (+10.2%), whereby the largest growth was generated in Croatia and Montenegro. Slovenian life insurance business went up by 4.8%, while the largest relative premium growth of 11.6% was posted in international life insurance (exceeding the average market growth rates). As a result of soft market conditions, GWP in reinsurance segment ended flat.

Going further, gross claims paid jumped by 12.0%, due to an above-average number of claims both in the reinsurance segment (American storm and a large property loss in Russia, but note that the loss ratio seems flat due to positive impact from FX differences) and in the Slovenian non-life insurance operations (a number of hail storms). Gross claims paid in Slovenian life business grew by 66.7%, as a result of a large number of unit-linked policies that matured in January 2017. The movement needs to be viewed in conjunction with the change in technical provisions – net claims incurred, including the change in the mathematical and UL provisions went up by 4.7%. Combined ratio is 94.5%, which is a 180 bp improvement compared to 9M 2016. Nevertheless, combined ratio excl. FX differences stands at 95.9%, higher than FY 2017 plan. The Group's net investment income went down by EUR 6.4m to EUR 11.4m, which translates into return on investment of 1.4% (from 2.3% in 9M 2016). The investment result was lower largely because of net negative FX differences (EUR 5.7m). Excl. FX, net investment income comes in EUR 1.1m lower.

As a result of higher claims incurred and poorer investment income, further eroded by higher corporate tax rate, net profit ended 7.5% lower at EUR 20.9m (just 64% of 2017 goal). The annualised return on equity dropped to 9.1% (from 10.2%), also lower than planned.

Last but not least, Sava Re expects that the American storm losses will push up reinsurance prices in international reinsurance markets in the January 2018 renewals, as the leading catastrophe reinsurers incurred huge storm-related losses.

Strategic Plan of the Sava Re Group for the Period 2017–2019

In end-November, Sava Re Group published a strategic plan for the period 2017–2019, stating that its main goals will be: (1) digitalization and technological modernisation of operations to place clients in the centre; (2) continuous growth of the Group, both organic and acquisitions-based; (3) seeking opportunities in property and infrastructural projects to diversify the investment portfolio; and (4) closing the gap between book value and market value of shares.

However, more interesting guidance is the one concerning key figures. The Group has communicated a profit estimate for 2017 of approximately EUR 31m, at the lower end of the planned profit range for the year, while gross premiums written will be better than planned, exceeding EUR 505m. Annual plan for 2018 envisages a 2.8% YoY growth in gross premiums written, while the profit range is set 20% above the estimated 2017 profit and ROE is planned to breach 11%. The Group’s 2018 investment return, still restrained by the low interest rate environment, is planned at approximately 1.7%.

When we look at the longer time horizon, total GWP should reach EUR 514m in 2019, whereby special contribution comes from the organic growth outside Slovenia. By the end of 2019, Sava Re expects the share of GWP by non-Slovenian subsidiaries to increase from 12% to 20% of total GWP, while insurance operations in Slovenia should fall from 69% to 55% of total GWP. Note that almost all countries from Western Balkans are expected to see a strong double-digit growth, with Serbia and Croatia remaining the largest non-domestic markets (with GWP up by 20% and 34% in the next 3 years, respectively). On the flip side, life insurance segment in Slovenia is expected to decrease in the following years. Although this will be mostly off-set by non-life policies, Sava expects total Slovenian business slightly lower for the period (down by 1% in the next 3 years).

According to the 2017-2019 strategy, new business segments (such as pension and health business) are planned to account for 5% of the Group's GWP as demographic changes and the government's moves align in favour to these segments. Reinsurance operations will continue to account for roughly 1/5 of the total figure, with focus on some new markets like Latin America and Africa. The group also believes that, due to major cat events, the next year will finally bring lower price pressures for reinsurers and that the „soft market environment” might finally turn into other direction.

Profitability-wise, Sava Re targets ROE of 10.4% (+/− 0.5 p.p.) and solvency ratio between 170% and 230% in the period. Combined ratio for non-life insurance and reinsurance is planned at below 95% and below 93%, respectively. In life insurance business, Sava Re's target is a return on new insurance business of over 5% for Slovenia and over 2.5% for non-Slovenian companies.

The Group set the objective of achieving a return on investment of 2% for the strategy period. Regarding the portfolio structure, the management communicated that they aim to increase the proportion of investment properties and infrastructure products. Finally, dividends will reach up to 40% of the Group's net profit, but the management stated that they target a 10% growth of dividend per share on an annual basis.

The Group stated that it is planning growth through acquisitions as well. Sava Re will seek opportunities for growing its regional presence, and for expanding to new business segments, such as pension and health business and ancillary insurance services.

Assumptions for Model Development

9M 2017 results are slightly above expectations, with GWP up by 4.8% YoY. For FY 2017 we expect GWP in the amount of EUR 508.7m, an increase of 3.8% YoY, way above EUR 494m initially targeted by the Group and slightly above revised target of EUR 505m. As 9M 2017 figure (EUR 409.2m in GWPs) represents 80% of estimated consolidated GWP for 2017, we have no reason to doubt the figure will be met.

We recognize Sava Re's efforts to step up the number of initiatives both in 2016 and within its 2017-2019 Strategy. Among them we highlight the merger of their EU-based subsidiaries, strengthening brand recognition, some digitalization initiatives and multi-channel approach. The latter includes online policy sales and claims reporting, developing innovative services and IT supported products and much more, but still lags behind the "big players".

We also encourage Sava Re's focus on the non-Slovenian markets. In terms of insurance penetration and GWP per capita we believe there is still a fairly large catch-up potential compared to other developed markets from Europe. We expect Croatia and Serbia to contribute the most and Montenegro to become more difficult due to the expected liberalization of motor insurance segment. Generally, it seems that the reinsurance segment might finally experiences some hardening on the market, so we expect a stable contribution to the top line. All this appears to shift our previously cautious investment case coming from limited possibilities on the domestic market as well as quite fierce competition. This said, we project GWP growth of 2.6% CAGR 2017-2022.

The Group stated it will seek opportunities for growing its regional presence, and for expanding to business segments such as pension and health business and ancillary insurance services. Just a few weeks after the strategic plan was released, Sava Re published an official notice stating that it has signed a purchase contract for all the shares of NLB Nov penziski fond Skopje. The sellers were NLB Ljubljana and NLB Banka Skopje. NLB Nov penziski fond Skopje is a Macedonia-based pension fund management company, managing two pension funds (mandatory second pillar and voluntary third pillar pension funds) with approximately EUR 370.3m of AUM. Companies from NLB Group and Sava Re Group have been successfully cooperating on the Macedonian market for many years. The cooperation will continue in the future, and the products of the fund will be available in all branches of NLB Bank Skopje. We keep our fingers crossed that Sava Re finds even more lucrative targets, but we haven't put this case into our financial model.

Underwriting result

We expect net claims incurred to increase by 6.1% in 2017, due to a multitude loss events during the year. Keeping the loss ratio slightly below 60% in the further period, we estimated 5Y CAGR of roughly 1.6% between 2017 and 2022. Considering synergies from the merger of EU-based subsidiaries of EUR 2.2m in 2017, EUR 4.4m in 2018 and EUR 6.0m in 2019 and every future year, we estimate operating expenses growing with business development, but to a somewhat lower extent. Having said that, we projected operating expenses to increase by a CAGR of 0.8%. Note that positive effects also come from higher economies of scale in the period.

Investment income

Insurers' net investment income has been weak for a while due to the low interest rate environment, and we believe it will not recover in the near to medium term. We do not expect that Sava Re's net financial income and return on investments will significantly improve over the projected period either. With a conservative approach, we are keeping the rates mostly unchanged in the next couple of years. As effects of interest rate changes are somewhat delayed, especially for fixed rate securities with low turnover, we projected that potential interest rate hike will reflect on the investment portfolio with a time lag. In an attempt to meet higher returns, Sava Re announced a "search for yield" via investments in real-estate (up to 10% of the portfolio), so we have projected a mild shift in the portfolio structure. Nevertheless, we are keeping debt and FX securities accounting for almost 90% of total value of financial assets. Overall, we believe return on investment portfolio will end at 2.6% in 2022.

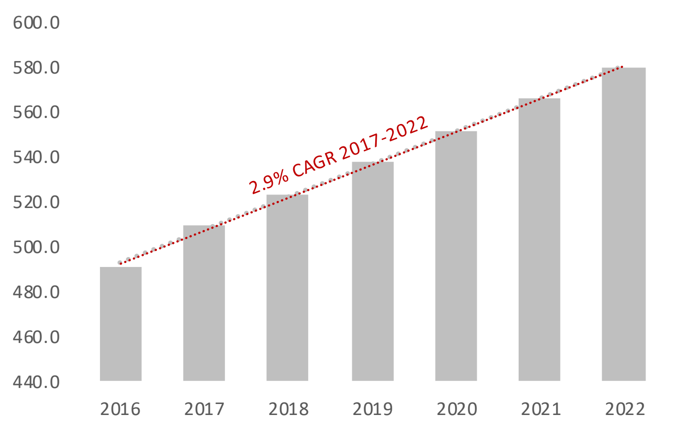
Bottom line

In line with the afore-mentioned, we expect a decrease of net income in 2017, while in the remaining period we expect stable growth. Namely, we believe Sava Re will post net income in the amount of EUR 29.4m in 2017 and further growth of roughly 9.7% CAGR in the projected period. According to our model, Sava Re will meet ROE of 10.4% (+/– 0.5 p.p.) communicated in the strategy but we believe it will be more inclined to the lower limit. However, in the end of the projected period we envisage ROE to reach 11%.

Balance sheet

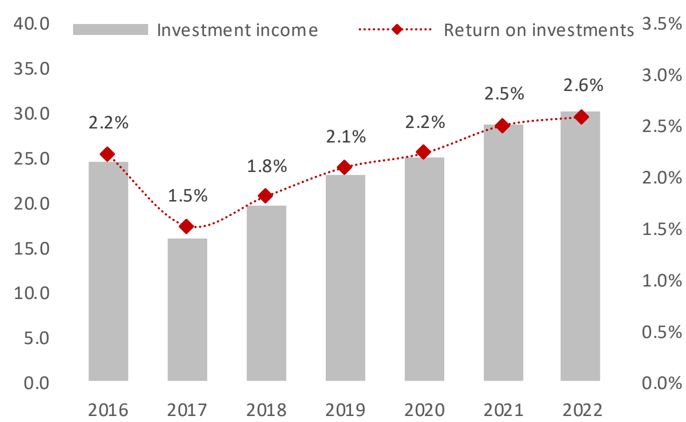
In the structure of total assets, financial assets represent the largest share. We started with the position value of EUR 1.030m recorded at the end of 2016. We added the afore-mentioned acquisition of the Macedonian pension fund and our targeted investment return. This way we got EUR 1,056m at the end of 2017, estimating future growth at 1.2% CAGR up to 2022. When it comes to technical provisions, we expect them to increase by 2.4% CAGR up to 2022. Although unearned premiums, mathematical provisions, claims provisions and other technical provisions are difficult to forecast, we rely on the premise that past experience, adjusted for the effects of current developments and likely trends, is an appropriate basis for predicting future outcomes.

Exhibit 20 GWP growth projections until 2022 (EURm)



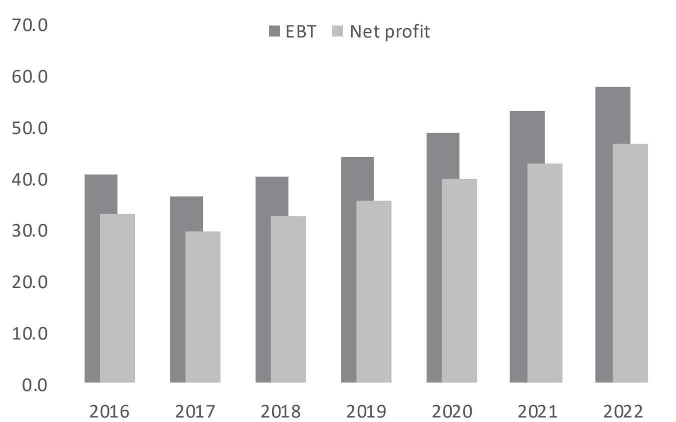
Source: InterCapital Research

Exhibit 21 Net inv. income (EURm) and return on inv. (in%)



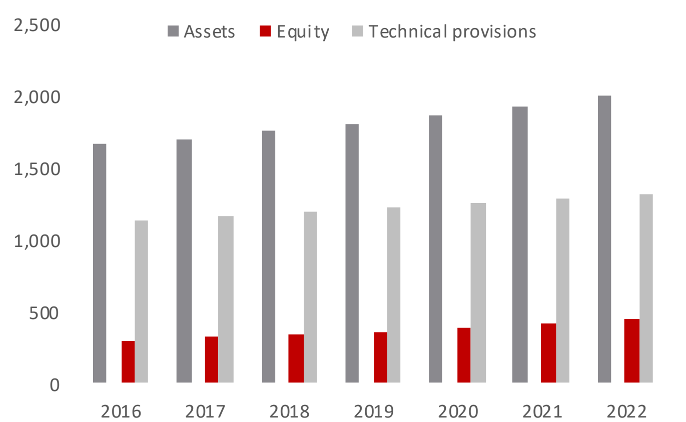
Source: InterCapital Research

Exhibit 22 EBT and net profit projections until 2022



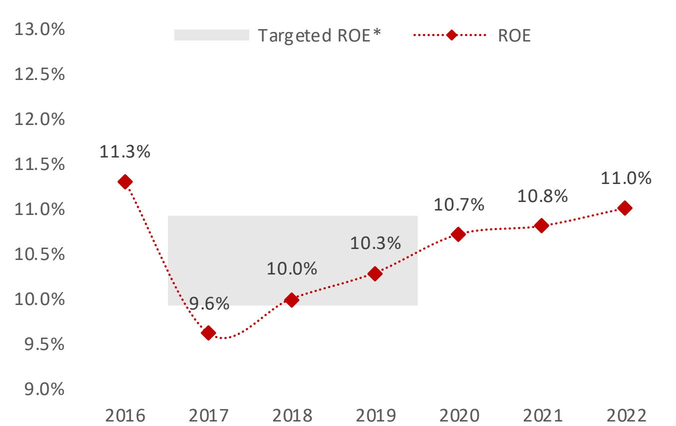
Source: InterCapital Research

Exhibit 23 Balance sheet positions (EURm)



Source: InterCapital Research

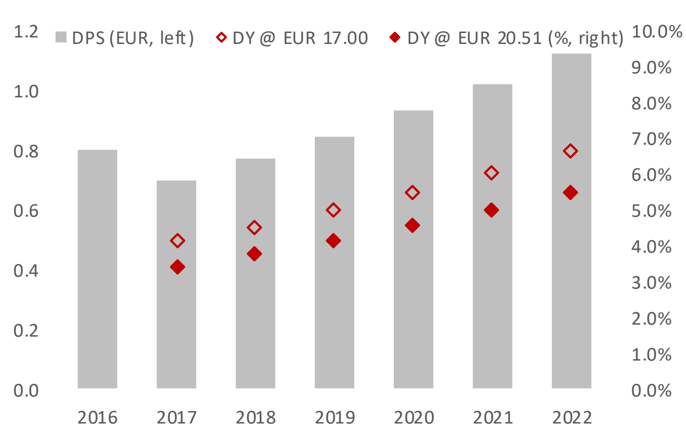
Exhibit 24 ROE projections until 2022



*according to Sava Re Group's strategy for 2017-2019

Source: InterCapital Research

Exhibit 25 Total dividend (EURm) and dividend per share (EUR)



Source: InterCapital Research

Valuation

Excess Return Model

The excess return model calculates the value of the company as the sum of current invested capital plus the present value of excess returns which the company is expected to generate in the future.

The two inputs needed to determine the value of the equity under the excess return model are the capital currently invested in the company and the excess of value in future periods.

The capital currently invested in the company is usually measured as the equity book value. Although it represents an accounting measures and is therefore influenced by accounting decisions, it should be much more reliable in valuing financial rather than manufacturing companies, as assets of financial companies are often marked to market.

In the valuation we have used cost of equity of 10.0%. Although the traditional CAPM model would give a somewhat lower value, we are more comfortable putting CoE closer to the long-term average. The explanation for such decision also lies in our belief that the low-interest environment and the entire QE regime are not going to be extended throughout the entire period.

By using the excess return model, we calculated the Company's equity value in the amount of EUR 327.8m.

Exhibit 26 Summary of Excess Return Valuation

EUR	2018E	2019E	2020E	2021E	2022E	TV
Net Income	32,525,242	35,676,756	39,727,638	42,896,979	46,777,943	44,077,228
- Equity Cost	31,557,711	33,616,988	35,872,085	38,401,005	41,102,467	44,033,194
Excess Equity Return	967,531	2,059,768	3,855,553	4,495,974	5,675,476	44,033
Beginning BV of Equity	315,577,106	336,169,884	358,720,854	384,010,052	411,024,671	440,331,943
Cost of Equity	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Return on Equity	10.0%	10.3%	10.7%	10.8%	11.0%	10.0%

Growth Rate (perpetual)	2.0%
Cost of Equity	10.0%
Return on Equity (perpetual)	10.0%
Equity Invested	315,577,106
PV of Equity Excess Return	12,266,346
Equity Value	327,843,453
Shares outstanding	15,497,696
PRICE PER SHARE	**21.15**

Source: InterCapital Research

Comparables Method

In selecting comparable companies, we have given importance to the business model as well as countries and markets in which they operate. The fundamental characteristic of the peer group is that they are largely present in the region and that they are among leaders in their respective domestic markets.

Relative valuation involves estimating the value of a firm by reference to the observed prices and fundamentals of peer companies. The most common approach for implementing relative valuation is based on price multiples. Given the choice of fundamental and a set of comparable companies, intrinsic value is estimated by multiplying the fundamental for the company by the corresponding multiple, which is based on the ratio of stock price to that fundamental for the group of comparable companies.

Unlike non-financial firms, for insurers the book value of equity is a reasonable predictor of future earnings. First, the book values of major assets and liabilities of insurance companies are relatively close to fair values. Second, unrecognized intangibles are on average relatively small. Third, due to regulation, insurers' ability to write premiums and generate income is directly related to their policyholders' surplus, which is a regulatory proxy for equity capital. Fourth, related to the previous point, insurers are required by regulators to maintain minimum equity capital, making book equity a useful measure of the scale of insurers' operations.

The above attributes of insurers' book value motivate us to put more weight on book value multiples compared to earnings multiples. Our price target is derived using blended peer multiples of 10.5x P/E median (25% weight) and 0.9x P/B median (75% weight). The company currently trades at 0.8x our projected book value as at end-2018, roughly in line with the group level. On a P/E basis, Sava Re trades at 8.1x our 2018 earnings estimate, significantly lower to the group median. Using comparables method and applying the market multiples on expected results for the company in 2018, we have generated a value of Sava Re Group of EUR 301.9m or EUR 19.48 per share.

Exhibit 27 Comparables – key data and multiples

Company	**Country**	**Ticker**	**Current P/E**	**Current P/B**	**2018 P/E**	**2018 P/B**
Uniqa	Austria	UQA AV Equity	14.0	0.9	13.2	0.9
VIG	Austria	VIG AV Equity	12.8	0.8	12.0	0.7
Croatia Osiguranje*	Croatia	CROSRA CZ Equity CROSPA CZ Equity	11.5	0.9	10.5	0.8
Triglav Group	Slovenia	ZVTG SV Equity	8.4	0.9	10.1	0.9
Generali	Italy	G IM Equity	11.2	1.0	9.7	0.9
Average			***11.6***	***0.9***	***11.1***	***0.8***
Median			***11.5***	***0.9***	***10.5***	***0.9***
Sava Re Group			**8.4**	**0.9**	**8.1**	**0.8**

Sava Re Group @ 2018			
Earnings			32,525,242
Equity			336,169,884
P/E median	10.5x	25%	340,397,354
P/B median	0.9x	75%	289,106,100
Implied value (weighted average)			**301,928,914**
Shares outstanding			15,497,696
PRICE PER SHARE			**19.48**

Source: Bloomberg, InterCapital Research

Valuation conclusion

We could not determine value using the cash flow to equity discount model due to the difficult defining of cash flow, CAPEX and working capital. Having said that, we are confident that financial service firms are best valued using equity valuation models, rather than enterprise valuation models, and with actual or potential dividends, rather than free cash flow to equity.

Regarding the peers, their size and markets in which they operate are slightly different than Sava Re Group's, but we believe that their business models and the investors they attract are similar enough to make them a good basis for valuation.

As the two valuation methods used in this analysis reflect the company's future operating results, in our opinion they are optimal for valuation. We have confidence in both peer analysis the value through excess return model, giving 50% weight to each method.

By summing up the two standalone values we have estimated the fundamental equity value of Sava Re at EUR 314.9m or EUR 20.32 per share, offering upside in relation to the market price as of 14 February 2017 of 19.5%.

Exhibit 28 Summarized calculation

EUR	ERM	Comparables
Equity Value	327,843,453	301,928,914
Weight	50%	50%
Total Value	**314,886,183**	
PRICE PER SHARE	**20.32**	

Source: InterCapital Research

Exhibit 29 Results for FY 2016 and projections until 2022

INCOME STATEMENT (EUR '000)	2016	2017	2018	2019	2020	2021	2022	5Y CAGR
Net premium income	**458,102**	**468,111**	**484,004**	**496,518**	**508,854**	**521,240**	**533,461**	**2.6%**
- gross written premium	**490,205**	**508,747**	**522,719**	**537,070**	**551,123**	**565,511**	**579,649**	**2.6%**
- ceded written premium	-31,243	-32,805	-34,445	-36,167	-37,975	-39,874	-41,868	5.0%
- change in unearned premium reserve	-861	-7,831	-4,269	-4,386	-4,294	-4,397	-4,320	-11.2%
Net investment income	**22,886**	**16,054**	**19,536**	**22,979**	**24,943**	**28,594**	**30,210**	**13.5%**
Net unrealised gains on investments of life insu	17,959	17,959	17,959	17,959	17,959	17,959	17,959	0.0%
Other income from insurance operations	18,237	18,927	19,447	19,981	20,504	21,039	21,565	2.6%
Other income	6,490	6,490	6,490	6,490	6,490	6,490	6,490	0.0%
Net claims incurred	**-268,394**	**-284,775**	**-277,539**	**-287,188**	**-294,316**	**-301,470**	**-308,528**	**1.6%**
- gross claims settled	**-269,446**	**-299,014**	**-291,416**	**-301,548**	**-309,032**	**-316,543**	**-323,955**	**1.6%**
- reinsurers' share	1,052	14,239	13,877	14,359	14,716	15,073	15,426	1.6%
Change in insurance technical provisions	-22,697	-5,454	-5,603	-5,757	-5,908	-6,062	-6,214	2.6%
Expenses for bonuses and discounts	-1,264	-1,311	-1,347	-1,384	-1,421	-1,458	-1,494	2.6%
Operating expenses	**-159,563**	**-161,782**	**-159,429**	**-161,121**	**-162,581**	**-166,826**	**-168,098**	**0.8%**
Net unrealised losses on investments of life ins	-11,256	-11,256	-11,256	-11,256	-11,256	-11,256	-11,256	0.0%
Other insurance expenses	-17,311	-17,966	-18,459	-18,966	-19,462	-19,970	-20,470	2.6%
Other expenses	-2,518	-2,015	-1,007	-1,035	-1,062	-1,090	-1,117	-11.1%
Profit before tax	**40,670**	**36,280**	**40,155**	**44,045**	**49,046**	**52,959**	**57,751**	**9.7%**
Income tax expense	-7,752	-6,893	-7,629	-8,369	-9,319	-10,062	-10,973	9.7%
Net profit	**32,918**	**29,386**	**32,525**	**35,677**	**39,728**	**42,897**	**46,778**	**9.7%**

BALANCE SHEET (EUR '000)	2016	2017	2018	2019	2020	2021	2022	5Y CAGR
Assets	**1,671,189**	**1,700,321**	**1,754,042**	**1,810,870**	**1,871,267**	**1,934,289**	**2,000,436**	**3.3%**
Intagible assets	25,509	25,764	26,021	26,282	26,544	26,810	27,078	1.0%
Property, plant and equipment	51,887	53,963	56,121	58,366	60,701	63,129	65,654	4.0%
Deferred tax receivables	51,887	53,963	56,121	58,366	60,701	63,129	65,654	4.0%
Investment property	7,934	10,829	10,990	44,740	57,074	58,321	59,751	40.7%
Financial investments	**1,030,235**	**1,055,842**	**1,076,989**	**1,062,579**	**1,072,995**	**1,096,441**	**1,123,319**	**1.2%**
Funds for the benefit of policyholders who bea	224,175	235,384	247,153	259,511	272,486	286,111	300,416	5.0%
Reinsurers' share of technical provisions	28,445	29,181	29,889	30,621	31,372	32,141	32,927	2.4%
Investment contract assets	121,366	125,007	128,757	132,620	136,599	140,697	144,917	3.0%
Receivables	127,409	126,919	145,000	161,844	177,919	193,722	208,023	10.4%
Other assets	17,965	18,863	19,806	20,797	21,836	22,928	24,075	5.0%
Cash and cash equivalents	**33,939**	**16,244**	**10,990**	**11,185**	**11,415**	**11,664**	**11,950**	**-6.0%**
Equity and liabilities	**1,671,189**	**1,700,321**	**1,754,042**	**1,810,870**	**1,871,267**	**1,934,289**	**2,000,436**	**3.3%**
Equity	**297,038**	**315,577**	**336,170**	**358,721**	**384,010**	**411,025**	**440,332**	**6.9%**
Controlling interests	296,277	314,815	335,407	357,958	383,246	410,260	439,566	6.9%
- Share capital	71,856	71,856	71,856	71,856	71,856	71,856	71,856	0.0%
- Reserves and retained net profit	215,372	213,573	231,026	250,424	271,662	295,506	320,932	8.5%
Non-controlling interests	761	762	763	763	764	765	766	0.1%
Subordinated liabilities	23,571	0	0	0	0	0	0	
Insurance technical provisions	**1,138,216**	**1,167,238**	**1,195,553**	**1,224,847**	**1,254,870**	**1,285,623**	**1,317,097**	**2.4%**
Other provisions	8,081	8,081	8,081	8,081	8,081	8,081	8,081	0.0%
Deferred tax liabilities	6,039	5,737	5,450	5,177	4,919	4,673	4,439	-5.0%
Investment contract liabilities	121,230	124,867	128,613	132,471	136,445	140,538	144,755	3.0%
Other financial liabilities	394	355	319	287	259	233	209	-10.0%
Operating liabilities	48,791	50,636	52,027	53,455	54,854	56,286	57,693	2.6%
Other liabilities	27,831	27,831	27,831	27,831	27,831	27,831	27,831	0.0%

Source: Sava Re Group, InterCapital Research

Disclaimer

Information in this report is intended for informative purposes only and does not represent the solicitation to buy or sell any financial instruments or participate in any particular trading strategy. The information contained in this report has been obtained from public sources as well as directly from Companies' Management. Although we believe our information and price quotes to be reasonably reliable, we do no guarantee their accuracy or completeness. In addition, the price or value of financial instruments described in this report may fluctuate and realize gains or losses. InterCapital Securities Ltd, headquartered in Zagreb, Masarykova 1, does not assume any responsibility for the damage caused by the use of information and projections contained in this report. Opinions expressed in this report constitute current judgment of the author(s) as of the date of this report and are subject to change without notice.

InterCapital Securities Ltd uses various methods in Company valuations. Among the rest are comparative analyses of peer companies, discounted cash flow methods and other.

Fundamental analysis is a financial analysis of industries and companies based on factors such as sales, assets, profit, products or services, markets and management. In conducting fundamental analysis, InterCapital Securities Ltd uses various methods to determine a value of the Issuer. Among the rest, analysis of comparable companies, discounted cash flow and other methods are being used. Although InterCapital Securities Ltd uses models commonly accepted in the financial industry and theory, the results of these models depend on plans and information obtained from the Issuer as well as subjective opinions of analysts.

InterCapital Securities Ltd owns the following issues:

The author of fundamental analyses in this report is Margareta Maresic. Margareta Maresic is employed in InterCapital Securities Ltd registered in Zagreb, Masarykova 1 as Analyst. InterCapital Securities Ltd is supervised by Croatian Financial Services Supervisory Agency (HANFA). All our analysts are certified Investment Advisory by HANFA.

Margareta Maresic has no ownership interest in Sava Re Group. He doesn't own any shares of Sava Re Group, and neither do his immediate family members.

The company InterCapital Securities Ltd. acts as a market maker for ADPLRA ZA, ATGRRA ZA, HTRA ZA, KOEIRA ZA, PODRRA ZA, RIVPRA ZA, ADRSRA ZA and ADRSPA ZA.

Fundamental rating values of an Issuer are given according to the following scale:

Strong buy - equities with expected absolute revenue of more than 20% in the monitored time period

Buy - equities with expected absolute return of 10%-20% in the monitored time period

Hold - equities with expected absolute return of -10% to 10% in the monitored time period

Sell - equities with expected absolute return below -10% in the monitored time period

Under review - an issuer might be placed Under Review due to new information which is not included in the analysis.

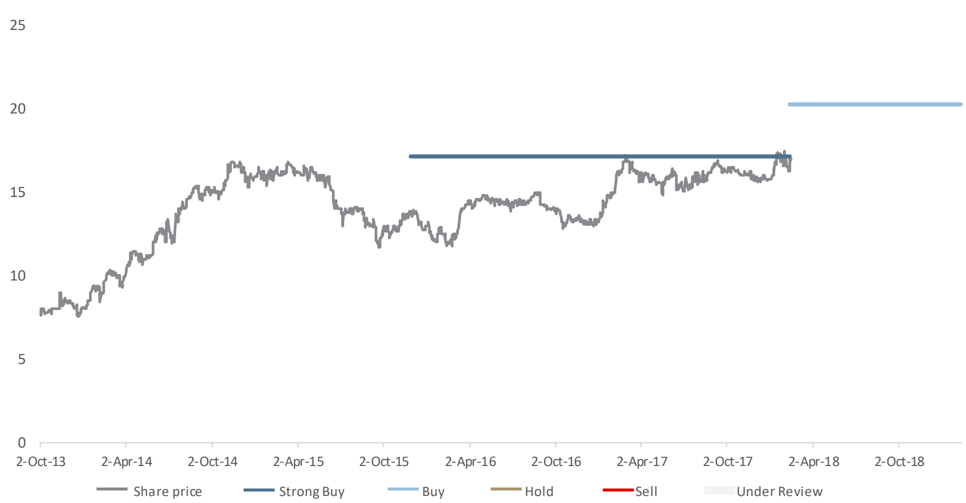
Up to August 14, 2014 the Hold recommendation was used for equities with an expected return of 0% to 10%, while the Sell recommendation was used for equities with an expected negative absolute return. Criteria for other recommendation remained unchanged.

4Q 2017 (1 October - 31 December 2017)

	Number	Share	Companies which InterCapital Securities Ltd. provided investment banking service within last 12 months
Strong Buy	4	21.1%	-
Buy	8	42.1%	ATGR-R-A
Hold	2	10.5%	-
Sell	1	5.3%	-
Under Review	4	21.1%	ADPL-R-A

Any investments indicated in the report constitute risk, are not readily available in all jurisdictions, can be illiquid and may not be suitable for all investors. Value or income realized on any one investment mentioned in the report may vary. If a financial instrument is denominated in a currency other than an investor's currency, a change in exchange rates may adversely affect the investment. Past performance is not necessarily indicative of future results. Investors must make their own informed investment decisions without depending on this Recommendation. Only investors with sufficient knowledge and expertise in financial dealings who are able to evaluate risk and return may consider investing in any form of securities or markets indicated herein.

Chronology of share recommendations



InterCapital Securities Research contacts

Divo Pulitika, Head of Research, +385 (0)1 4825 867, divo.pulitika@intercapital.hr

Margareta Maresic, Analyst, +385 (0)1 4825 857, margareta.maresic@intercapital.hr

Marcel Dimac, Analyst, +385 (0)1 4825 858, marcel.dimac@intercapital.hr

Important Disclosures for U.S. Persons

This research report was prepared by InterCapital Securities Limited ("ICS"), a company authorized to engage in securities activities in Croatia. ICS is not a registered broker-dealer in the United States and, therefore, is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. This research report is provided for distribution to "major U.S. institutional investors" in reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act"). Any U.S. recipient of this research report wishing to effect any transaction to buy or sell securities or related financial instruments based on the information provided in this research report should do so only through Rosenblatt Securities Inc, 40 Wall Street 59th Floor, New York NY 10005, a registered broker dealer in the United States. Under no circumstances should any recipient of this research report effect any transaction to buy or sell securities or related financial instruments through ICS. Rosenblatt Securities Inc. accepts responsibility for the contents of this research report, subject to the terms set out below, to the extent that it is delivered to a U.S. person other than a major U.S. institutional investor. The analyst whose name appears in this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA") and may not be an associated person of Rosenblatt Securities Inc. and, therefore, may not be subject to applicable restrictions under FINRA Rules on communications with a subject company, public appearances and trading securities held by a research analyst account.

Ownership and Material Conflicts of Interest

Rosenblatt Securities Inc. or its affiliates does not 'beneficially own,' as determined in accordance with Section 13(d) of the Exchange Act, 1% or more of any of the equity securities mentioned in the report. Rosenblatt Securities Inc, its affiliates and/or their respective officers, directors or employees may have interests, or long or short positions, and may at any time make purchases or sales as a principal or agent of the securities referred to herein. Rosenblatt Securities Inc. is not aware of any material conflict of interest as of the date of this publication.

Compensation and Investment Banking Activities

Rosenblatt Securities Inc. or any affiliate has not managed or co-managed a public offering of securities for the subject company in the past 12 months, nor received compensation for investment banking services from the subject company in the past 12 months, neither does it or any affiliate expect to receive, or intends to seek compensation for investment banking services from the subject company in the next 3 months.

Additional Disclosures

This research report is for distribution only under such circumstances as may be permitted by applicable law. This research report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient, even if sent only to a single recipient. This research report is not guaranteed to be a complete statement or summary of any securities, markets, reports or developments referred to in this research report. Neither ICS nor any of its directors, officers, employees or agents shall have any liability, however arising, for any error, inaccuracy or incompleteness of fact or opinion in this research report or lack of care in this research report's preparation or publication, or any losses or damages which may arise from the use of this research report. ICS may rely on information barriers, such as "Chinese Walls" to control the flow of information within the areas, units, divisions, groups, or affiliates of ICS.

Investing in any non-U.S. securities or related financial instruments (including ADRs) discussed in this research report may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the U.S. Securities and Exchange Commission. Information on such non-U.S. securities or related financial instruments may be limited. Foreign companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect within the United States.

The value of any investment or income from any securities or related financial instruments discussed in this research report denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related financial instruments. Past performance is not necessarily a guide to future performance and no representation or warranty, express or implied, is made by ICS with respect to future performance. Income from investments may fluctuate. The price or value of the investments to which this research report relates, either directly or indirectly, may fall or rise against the interest of investors. Any recommendation or opinion contained in this research report may become outdated as a consequence of changes in the environment in which the issuer of the securities under analysis operates, in addition to changes in the estimates and forecasts, assumptions and valuation methodology used herein.

No part of the content of this research report may be copied, forwarded or duplicated in any form or by any means without the prior consent of ICS and ICS accepts no liability whatsoever for the actions of third parties in this respect.