Research Update:

Vienna Insurance Group Affirmed At 'A+' On Solid Earnings And Robust Capital After AEGON CEE Integration; Outlook Stable

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Overview

- In May 2023, Vienna Insurance Group (VIG) received all regulatory approvals and consequently finalized the acquisition of the remaining part of AEGON Central and Eastern Europe (CEE) entities in Poland and Romania it did not own.
- The group's capital remained comfortably above the 'AAA' level at year-end 2022 after strong business growth, consolidation of AEGON entities in Hungary and Turkey, and the effects of the aggressive normalization of interest rates in Europe.
- Consequently, we affirmed our ratings on VIG entities at 'A+'.
- The stable outlook reflects VIG's leading market positions in Austria and CEE, as well as our expectation that earnings will continue supporting at least very strong capital adequacy, despite weaker economic conditions anticipated in 2023, needs arising from organic or external growth, and dividend payments over the next two-to-three years.

Rating Action

On July 27, 2023, S&P Global Ratings affirmed its 'A+' long-term insurer financial strength and issuer credit ratings on operating holding company, Vienna Insurance Group AG Wiener Versicherung Gruppe (VIG). At the same time, we affirmed our 'A+' long-term issuer credit rating on VIG RE zajist'ovna a.s., a core subsidiary of Austria-based multiline insurer VIG. The outlooks on both entities are stable.

We also affirmed the 'A' issue rating on VIG's senior unsecured debt and the 'A-' issue rating on the group's subordinated debt.

Rationale

In May 2023 VIG received all necessary regulatory approvals to complete the acquisition of the remaining part of Aegon's Central and Eastern European (CEE) operations in Poland and Romania. This came after VIG received approvals to acquire AEGON's Hungary and Turkey operations in first-half 2022. As a result, VIG has fully finalized the acquisition of AEGON's CEE operations, which it initially announced on Nov. 29, 2020.

Following the acquisition of AEGON CEE, VIG has become the largest insurer in Hungary and further consolidated its leading position in Romania. In addition, it solidified its positions in Poland and Turkey. Overall, VIG observed very strong business growth in 2022, when gross written premiums (GWP) expanded 14.1% to €12.56 billion. The effect of the consolidation on VIG's Hungarian and Turkish operations amounted to €444.5 million, and accounted for 3.7% of the total premium volume, meaning a robust organic growth rate of 10.1% excluding it. In our view, strong organic growth due to continued price increases to reflect inflation, some new organic risk additions, and further consolidation of operations in Poland and Romania will support group growth in 2023 and 2024. Notably we expect GWP growth will remain very strong this year, at 7%-10%, despite anticipated headwinds due to the weakening economic environment in Europe.

Following strong organic growth in 2022, the consolidation of AEGON's Hungarian and Turkish operations, impairment of Russian assets and some other intangibles, and the rapid increase in interest rates last year, VIG retained a very solid balance sheet. The group's capital adequacy remained robust and stood comfortably above the 'AAA' level at year-end 2022, according to our risk-based capital model. VIG's initial capital buffers and prudent financing structure--with the 2021 issuance of a €300 million restricted Tier 1 bond, which we classify as having intermediate equity content--counterbalanced the costs and additional capital requirements from the AEGON CEE acquisition. We note that under International Financial Reporting Standard (IFRS) 4 the group reported net income of €464 million last year, supported by strong underwriting and investment results. It also had solid earnings retention, which solidified the group's capital buffers above 'AAA' levels in our model.

We believe that VIG's solid year-end 2022 capital position provides sufficient room to consolidate AEGON's remaining comparably smaller operations in Poland and Romania. This position also enabled the group to partially buy back a capital-qualifying hybrid in April 2023 (see "Insurer VIG's Jr. Sub. Notes Affirmed At 'A-' On Tender Offer; Equity Content To Be Maintained For Notes Not Bought Back," published April 13, 2023, on RatingsDirect). We think that continued strong underwriting and operating performance will provide capacity to tap good organic premium growth, continue paying regular dividends, and still build some buffers for currently weaker economic conditions in VIG's region of operations. In our view, a diversified investment portfolio will also help safeguard VIG's balance sheet from investment losses outside the current risk tolerance within the next two years. Overall, we expect the group's capital adequacy to remain at least in the 'AA' range in our capital model from 2023-2025.

In 2022, VIG reported a net combined (loss and expense) ratio of 94.9% (under IFRS4), which under the new accounting standard of IFRS17 translated to 92.3%. We expect VIG to continue to report a solid consolidated net combined ratio in 2023-2025, supported by management's continuous focus on underwriting, tariff increases in line with inflation, and strict cost controls. We note the group's generally conservative reserving policy and the comparably shorter-tail nature of its business in the CEE region limit risks from high inflation. We believe that interest rate increases in 2022 and first-half 2023 will reduce pressure on life earnings, which we expect to stay at least flat over the next two years. Furthermore, the group's investment portfolio remains of solid quality, gradually benefiting from higher interest rates in the respective CEE countries. Overall, we expect

VIG to deliver resilient return on equity (ROE) in 2023-2025.

We believe that it will still take time for VIG to fully realize the benefits from the AEGON CEE acquisition in its bottom line. It will now need to consolidate the Polish and Romanian operations and further integrate the Hungarian and Turkish operations to benefit from new economies of scale. Notably, we believe that the performance of VIG's new combined Hungarian operations remains limited due to challenging economic conditions, as well as an extraordinary tax on insurance premiums from July 1, 2022, until at least year-end 2024. Similarly, the Turkish market is experiencing a challenging economic environment, with very high levels of inflation. As such, we believe that further integration of AEGON CEE entities is unlikely to immediately lead to a material and sustainable increase in earnings diversity outside of the group's flagship Austrian, Czech, and Slovak operations.

After the spike in interest rates last year, VIG's unrealized gains dropped, triggering a decline in shareholders' equity. Financial leverage also increased to slightly higher than 40% at year-end 2022. We do not see this as a concern, since the group:

- Prefinanced its hybrid with a first call date in 2023 and executed a liability management action to reduce the outstanding amount of legacy hybrid. Therefore, we expect the legacy hybrid of €284 million to be called at the first call date in 2023.
- Performed a liability management operation in April 2023 with which it bought back hybrid debt of about €186 million.
- The first disclosure of VIG's IFRS 17 balance sheet shows a material increase in shareholders' equity of about 23% compared to IFRS 4 disclosed values, while the group's strong earnings also allow solid retention.

Therefore, we now estimate VIG's leverage should materially reduce to firmly below 40% over 2023-2025.

Outlook

The stable outlook reflects VIG's leading market positions in Austria and CEE, as well as our expectation that earnings will continue supporting at least very strong capital adequacy, despite weaker economic conditions expected in 2023, needs arising from organic or external growth, and dividend payments during the next two-to-three years.

Downside scenario

We could lower the ratings if VIG's:

- Operating performance does not meet our earnings expectations for a prolonged period.
- Capital adequacy falls below our risk-based capital model's 'AA' level for an extended period.
- Funding structure deteriorates with financial leverage sustainably above 40% or fixed-charge coverage below 4x.

Upside scenario

We could raise the ratings in the mid term if VIG's:

- Full integration of AEGON CEE entities significantly and sustainably increases its earnings diversity outside Austria, Czechia, and Slovakia and earnings materially and consistently exceed our base-case assumptions; and
- Capital adequacy sustainably exceeds our 'AA' confidence level.

Environmental, Social, And Governance

ESG credit indicators: E-2, S-2, G-2

ESG credit factors have no material influence on our VIG rating analysis.

Ratings Score Snapshot

Financial strength rating	A+
Anchor	a+
Business risk	Strong
IICRA	Intermediate
Competitive position	Strong
Financial risk	Very Strong
Capital and earnings	Very Strong
Risk exposure	Moderately Low
Funding structure	Neutral
Modifiers	0
Governance	Neutral
Liquidity	Exceptional
Comparable ratings analysis	0
Support	0
Group support	0
Government support	0

IICRA--Insurance Industry And Country Risk Assessment.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions , March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- Criteria | Insurance | General: Insurers Rating Methodology , July 1, 2019
- General Criteria: Group Rating Methodology , July 1, 2019
- Criteria | Insurance | Property/Casualty: Assessing Property/Casualty Insurers' Loss Reserves , Nov. 26, 2013

- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model , June 7, 2010

Related Research

- Insurer VIG's Jr. Sub. Notes Affirmed At 'A-' On Tender Offer; Equity Content To Be Maintained For Notes Not Bought Back, April 13, 2023
- Vienna Insurance Group AG Wiener Versicherung Gruppe, Dec. 1, 2022
- Delayed Aegon CEE Acquisition Unlikely To Deter VIG From Strengthening Its Position In Central And Eastern Europe, April 8, 2021
- VIG Insurance Entities Ratings Affirmed On Announced Acquisition Of Aegon's Central And Eastern European Operations, Dec. 3, 2020

Ratings List

Ratings Affirmed	
Vienna Insurance Group AG Wiener Versicherung Gruppe	
Issuer Credit Rating	A+/Stable/--
Financial Strength Rating	A+/Stable/--
Senior Unsecured	A
Junior Subordinated	A-
VIG RE zajist'ovna a.s.	
Issuer Credit Rating	A+/Stable/--
Financial Strength Rating	A+/Stable/--