AEGON (AGN NA)
Paper buyback writer

HOLD
Price target €6.10
(from €6.00)
Price €5.73^

Key Takeaway

AEGON looks set to move into firm excess territory through 2019 or earlier dependent on the timing of further non-core exits, where a benign regulatory outcome on RBC would also help. We believe add-on acquisitions and digital investments will be the more likely use of excess funds as AEGON seeks to pursue its global edict.

Paper back: Based on our SII earnings forecasts, while also taking into account Dutch UFR and re-risking charges, and possible regulatory charges in the US, SII capital will struggle to enter formal excess territory over our forecast period. Non-core exits in the US/UK, further rises in interest rates and an ameliorating US regulatory stance could change that, however, with a combination of all 3 on our calculations leading to as much as EUR 1.5bn of excess through 2019. Holding cash on our forecasts will in any case be sitting above the upper EUR 1.5bn threshold by this stage, with no requirement for external and corporate events to achieve this, at which point debt leverage ratios should also have fallen below the lower range level of 25%.

Capital day tripper: Given AEGON's unfortunate timing of its previous two buybacks, and the need for capital repair on both occasions in the year that followed, we believe AEGON will not think twice but three times before considering any buyback. Add-on acquisitions will in our view be a more likely use of excess funds as AEGON possibly seeks to rebalance its business further away from the US to pursue its global edict. In this context we note management commentary (2016FY results press release), *'AEGON intends for its Asia business to be a financially significant contributor in the future and growth engine for the group'*. Asian profits for 2017 were just 2% of group.

Digital writer: We note the increasing capital spend on digitalization (US$250m/£80m at TCS/Cofunds). With further costs cuts likely to be announced as part of the new business plan from 2019 (a necessity in our view given the sub 10% ROCs still being achieved in the core US and Dutch divisions) we believe a portion of excess generated will be devoted to efficiency and digitalization drives.

Valuation/Risks

AEGON trades on 2018F PER (economic earnings) 9.7X and div yield 4.9%. Our 12-month PT of EUR 6.1 is driven by a multi-stage residual income model cross checked by a DDM. Upside risks are a further rise in interest rates in Europe/US, and more non-core sales; downside risks include lower interest rates, and an unfavourable RBC outcome post tax cuts.

EUR	Prev.	2017A	Prev.	2018E	Prev.	2019E	Prev.	2020E
Dividend	--	0.27	--	0.28	--	0.29	--	0.31
Div. Yield		4.71%		4.89%		5.06%		5.41%
EPS								
FY Dec	*0.93*	1.08	*0.67*	0.69	*0.76*	0.79	--	0.80
FY P/E		5.3x		8.3x		7.3x		7.2x

Financial Summary

Net Debt (MM):	€6,981.0

Market Data

52 Week Range:	€5.77 - €4.26
Total Entprs. Value (MM):	€18,653.0
Market Cap. (MM):	€11,672.0
Shares Out. (MM):	2,037.0
Float (MM):	1,802.9
Avg. Daily Vol.:	8,523,252

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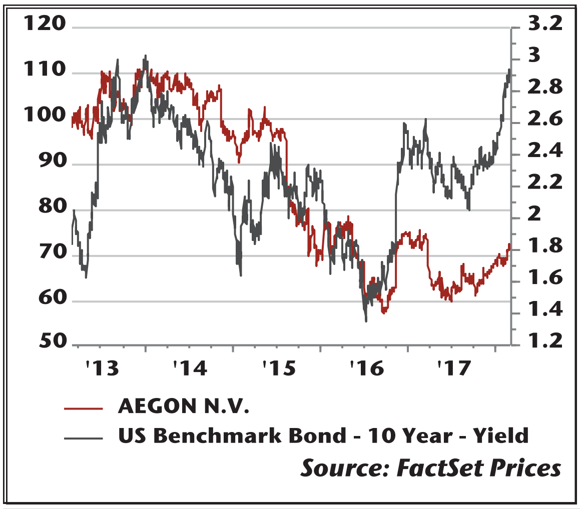
Price Performance

^Prior trading day's closing price unless otherwise noted.

Paper buyback writer

AEGON finally appears to be moving on from prolonged operational and capital misfortune and shareholder disappointment. The issue for the shareholder now becomes how management will redeploy capital on any excess build, with AEGON' SII ratio potentially reaching firm excess territory through 2019 (albeit helped along by more non-core exits, higher interest rates, and a benign regulatory outcome on RBC). Given AEGON's unfortunate timing of previous buybacks, pre-facing a need for capital repair, we believe add-on acquisitions will be a more likely use of excess funds as AEGON seeks to rebalance its business further away from the US possibly towards Asia to pursue its global edict.

Chart 1: AEGON vs Euro insurers : US 10 Year Yield



Source: Factset

Chart 2: Chart 3: AEGON vs EuroSTOXX

Source: Factset

The paper trail to excess

Based on our SII earnings forecasts and taking into account Dutch UFR and re-risking charges, and possible regulatory charges in the US, SII capital fails to enter excess territory. Non-core exits in the US/UK, further rises in interest rates and an ameliorating US regulatory stance could on our calculations change that with a scenario combination of all 3 leading to c EUR 1.5bn excess through 2019. Holding cash on our forecasts should in any case break though the upper EUR 1.5bn threshold through 2019, with no requirement for external and corporate events, at which point debt leverage ratios should have fallen below the lower range level of 25%.

Capital day tripper

The CFO's caution against premature buyback expectations on the full year analyst call, '*Let's not get ahead of ourselves in terms of pay-out ratio now that we're in a good position,*' is understandable in our view given the CEO's first-hand experience of AEGON's previous buybacks (2007, 2016) followed on both occasions (2008, 2017) by the need for capital repair. We in any case consider add-on acquisitions a more likely use of excess funds as AEGON possibly seeks to rebalance its business away from the US towards Asia as part of of its global edict (*'AEGON intends for its Asia business to be a financially significant contributor in the future and growth engine for the group'* management commentary 2016 full year results press release).

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Chart 3: AEGON Summary

EUR mn	2016		2017		2018F		2019F		2020F	
Americas	1,249	4%	1,381	11%	1,329	-4%	1,377	4%	1,420	3%
Netherlands	534	-1%	520	-3%	519	0%	544	5%	570	5%
UK	58	-54%	116	100%	130	12%	146	12%	164	12%
CEE	55	49%	67	21%	70	5%	74	5%	77	5%
Spain & Portugal	8	-33%	4	-50%	12		13	7%	14	7%
Asia	21	5%	49	133%	81	66%	99	23%	114	14%
AEGON Asset Management	149	-12%	136	-9%	153	13%	167	9%	180	8%
Holding	-162	0%	-170	5%	-162	-5%	-162	0%	-162	0%
Underlying earnings before tax	**1,913**	**-1%**	**2,103**	**10%**	**2,133**	**1%**	**2,258**	**6%**	**2,376**	**5%**
Other non operating items	-1077		334		-179		-54		-117	
Income before tax	**836**		**2,437**		**1,954**	**-20%**	**2,203**	**13%**	**2,259**	**3%**
Corporation tax	-250		-76		-409		-467		-483	
Net income	**586**	**-5%**	**2,361**	**303%**	**1,545**	**-35%**	**1,736**	**12%**	**1,776**	**2%**
EPS underlying (Euro)	**0.65**	**-2%**	**0.69**	**5%**	**0.77**	**13%**	**0.82**	**6%**	**0.87**	**5%**
EPS net income (Euro)	**0.22**	**-3%**	**1.08**	**393%**	**0.69**	**-36%**	**0.79**	**14%**	**0.80**	**2%**
Payout	40%		39%		36%		35%		36%	
Dividend (Euro)	**0.26**	**4%**	**0.27**	**4%**	**0.28**	**4%**	**0.29**	**4%**	**0.31**	**7%**
Number of shares (average)	2,062		2,057		2,044		2,044		2,044	
ROE underlying	**8.0%**		**8.2%**		**8.8%**		**8.8%**		**8.8%**	
USA US$ m	**2016**		**2017**		**2018F**		**2019F**		**2020F**	
Life and protection	392	11%	535	36%	578	8%	624	8%	649	4%
Retirement plans	280	7%	315	13%	337	7%	361	7%	379	5%
Mutual funds	50	0%	54	7%	60	12%	64	7%	68	5%
Variable annuities	393	-22%	410	4%	410	0%	430	5%	452	5%
Fixed annuities	172	161%	145	-16%	124	-15%	105	-15%	89	-15%
Stable Solutions	96	-5%	99	3%	99	0%	99	0%	99	0%
Underlying earnings before tax	**1,384**	**4%**	**1,560**	**13%**	**1,616**	**4%**	**1,694**	**5%**	**1,746**	**3%**
Account balance										
Life and protection	33,679	6%	33,760	0%	33,954	1%	34,973	3%	36,022	3%
Retirement plans	225,271	10%	227,289	1%	245,472	8%	265,110	8%	286,318	8%
Variable annuities	66,422	7%	64,004	-4%	65,622	3%	68,903	5%	72,348	5%
Fixed annuities	10,549	-4%	8,710	-17%	7,654	-12%	6,889	-10%	6,200	-10%
Margins										
Life and protection	0.95%		1.19%		1.19%		1.25%		1.26%	
Retirement plans	0.13%		0.14%		0.14%		0.14%		0.14%	
Variable annuities	0.57%		0.56%		0.52%		0.52%		0.52%	
Fixed annuities	1.49%		1.35%		1.24%		1.17%		1.11%	
Debt leverage IFRS	30%		29%		26%		25%		24%	
Group SII ratio (range 150-200%)	**157%**		**201%**		**195%**		**192%**		**195%**	
Group SII own funds	18,112		15,640		16,209		16,636		17,171	
Group SCR	11,524		7,800		8,310		8,660		8,810	
Group SII earnings	900		993		1438		1,214		1,297	
Dutch SII ratio (range 140-190%)			**195%**		**186%**		**177%**		**168%**	
Dutch SII own funds			6,600		6,550		6,500		6,450	
Dutch SCR			3,380		3,530		3,680		3,830	
Dutch SII earnings					300		325		350	
Cash remittance	**1,100**	**0%**	**1,184**	**0%**	**1,204**	**0%**	**1,293**	**0%**	**1,335**	**0%**
Remittance ratio	110%		57%		84%		85%		84%	
Holding cash post debt and gp costs	800		884		904		993		1,035	
Cost of dividend	-529		-530		-552		-572		-593	
Free cash post dividend	271		354		352		421		442	
Divdend cash cover	**151%**		**167%**		**164%**		**174%**		**175%**	

Source: Jefferies estimates, company data

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The paper trail to excess

We forecast SII earnings for AEGON climbing to EUR 1.3bn for 2020 vs EUR 1bn for 2017, benefiting from US tax cuts, and cost cutting initiatives. A sequence of regulatory and other exceptional charges will likely keep AEGON's SII ratio below the threshold for formal excess recognition until beyond 2020. That said we can create excess scenarios for AEGON, whether via non-core disposals (US VA back book, US fixed annuity business, UK traditional pensions), a lightning regulatory stance on RBC requirements or further rises in interest rates, where a combination of all three could lead to a position of > EUR 1.5bn of excess capital by as early as mid-2019. Holding cash on our forecasts should in any case break though the upper EUR 1.5bn threshold through 2019, with no dependency on external and corporate events, at which point debt leverage ratios should have fallen below the lower range level of 25%.

1) SII capital

Based on our SII earnings forecasts and taking into account Dutch UFR and re-risking charges, and possible regulatory charges in the US, SII capital fails to enter excess territory. Non-core exits in the US/UK, further rises in interest rates and an ameliorating US regulatory stance could on our calculations change that with a scenario combination of all 3 leading to c EUR 1.5bn excess through 2019.

SII capital generation

We forecast SII earnings for AEGON climbing to EUR 1.3bn for 2020 vs EUR 1bn for 2017.

We project SII earnings for AEGON at EUR 1.3bn for 2019

Our starting point to assess AEGON's future capital management potential is an assessment of the group's capital generation capacity (SII cap gen), the fuel for future cash remittance to the Holding and capital repatriation to the shareholder. Our forecasts are summarised in the table below with EUR 1.1bn of free capital generation for 2018 rising to EUR 1.3bn by 2020.

Chart 4: AEGON SII cap gen

EUR m	**2017**		**2018F**		**2019F**		**2020F**	
US	813	*-10%*	894	*10%*	935	*5%*	976	*4%*
Netherlands	260	*30%*	280	*8%*	300	*7%*	325	*8%*
UK	80	*60%*	114	*42%*	119	*5%*	125	*5%*
AM, CEE, Spain, Asia	140	*180%*	150	*7%*	160	*7%*	171	*7%*
Total	1,293	*8%*	1,438	*11%*	1,514	*5%*	1,597	*5%*
Holding costs	-300		-300		-300		-300	
Total post holding	**993**	***10%***	**1,138**	***15%***	**1,214**	***7%***	**1,297**	***7%***
Underlying earnings	1,543		1,714		1,809		1,900	
Stated earnings	2,230		1,414		1,605		1,645	
Cap gen vs underlying earnings	*64%*		*66%*		*67%*		***68%***	
Cag gen vs stated earnings	*45%*		*81%*		*76%*		***79%***	

Source: Jefferies estimates, company data

Our 2018 forecast for the operating divisions at EUR 1.4bn is in line with management guidance, rising by 5% in each of 2019 and 2020.

US tax benefits from 2018, TCS uplift from 2019, underpinned by recent US 10yr yield rise

For the **US** we factor in a US$ 100m increase vs 2017 reflecting the drop in US tax, with additional rises in 2019/20 capturing the benefit of cost efficiencies yet to feed through from TCS. Operational momentum from here should in any case be supported by the

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latest 50bps rise in US 10yr yields, negating the earlier drag from low reinvestment rates vs running yields. US tax cuts are almost certain in our view to lead to US life pricing competition but where a large proportion of AEGON's profits are secured by back book pricing immune from future pricing pressures.

Dutch momentum from asset re-risking; scope for further cost cuts to offset margin pressures

For the **Netherlands** our mid to high single digit in cap gen is aligned to mid-term company guidance of 5-10% growth in earnings, reflecting the benefit to earnings from the planned move over the next 3 years into riskier assets (EUR 50m cap gen benefit by 2020 due to EUR 4bn illiquid assets). We also expect additional expense programs to be launched for the next plan period beyond 2018, to combat the drag to earnings from the run-off of the wider margin back book.

UK platform momentum; periphery market trends overall supportive

The £40m of cost cuts still to come through 2018/19 in the **UK** should on our assessment more than compensate for margin compression from customer upgrades to the platform from back book, and any wider fee pressures from platform competition. In terms of the other periphery markets, **Asia** has recently turned cash neutral, able to fund its own growth, with the ongoing move in the **CEE** to protection (c 50% of new sales) continuing to fuel cash momentum. In **Spain** management expect the extension of Santander distribution to health to reinvigorate performance. Momentum outlook at the AM division also looks encouraging given last year's 5% inflow trend for 3rd party assets.

SII capital generation: exceptional impacts

Based on operating earnings alone AEGON would on our calculations be moving into comfortable excess territory over the coming year. However, a sequence of regulatory charges both in the US and Dutch markets, alongside portfolio re-risking costs will likely keep AEGON below the SII threshold for excess through 2020.

Chart 5: Group SII capital evolution

EUR m	2018F	2019F	2020F
Group SII own funds opening	15,640	16,209	16,636
Normalised capgen	1,438	1,514	1,597
Group costs	-300	-300	-300
Dutch UFR	-150	-150	-150
NAIC impacts	-240	0	0
Other impacts	55	-55	0
Market impacts	328	0	0
Dividend	-562	-583	-612
SII surplus closing	**16,209**	**16,636**	**17,171**
Group SCR opening	7,800	8,310	8,660
Illiquid investments	150	150	150
NAIC impact	360	200	0
Group SCR closing	**8,310**	**8,660**	**8,810**
Group SCR 150-200% range	***195%***	***192%***	***195%***
Excess capital SII >200%	**-411**	**-684**	**-449**
Normalised cap gen less dividend	576	632	686
SII normalised growth	***7%***	***8%***	***8%***

Source: Jefferies estimates, company data

Border line excess capital under SII 2017, backed by capital momentum

The 2017FY SII ratio of 201% compares with a target range of 150-200%. Factoring in op cap gen of EUR 1.1bn for 2017 climbing to EUR 1.3bn by 2020 (the shaded components in the table below) and deducting the dividends (as per our forecasts) suggests c 7pts of SII accretion for 2018 rising to 8pts annually thereafter. AEGON on operating earnings alone would firmly move into excess capital territory over our forecast period.

Sizable offsets, however, likely to keep SII <200%

There are a number of sizable offsets to take into account, however, which on our calculations will keep the SII ratio below the critical 200% threshold for excess capital recognition through 2020:

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- **UFR impact:** The EUR 450m charge to SII capital will be spread over the 3 year period until 2020

Lack of clarity on RBC impacts from the tax drop possible until 2019

We factor in a 15pts drop

Further 5pts impact possible from RBC capital charges

- **NAIC charges:** There is significant uncertainty as to how the increase in capital requirement under RBC (where this is calculated on a post-tax basis, and therefore rises as the tax rates drops) will be treated by the NAIC, and interpreted thereafter by the Dutch regulator DNB. Management have guided for a 15pts deterioration in the group SII ratio for the anticipated 60pts fall in RBC (from 470 to 410), captured here by the EUR 240m reduction in SII capital, and the EUR 360m increased in SCR. It is uncertain what the timetable will be for final resolution, with any capital impact possibly delayed until 2019. We have at this stage factored in the full impact of tax change but where the NAIC might allow some form of transitional offset, and where DNB might lower the conversion ratio to mitigate the consequence under the SII framework. There is also the possible negative impact of NAIC's move to economic based asset charges, where we have increased the 2019 SCR by EUR 200m to reflect these. Given the additional impact on RBC from tax change the NAIC might ameliorate its stance on these charges, or incorporate them in a new RBC landscape when a decision on tax is made. Given the uncertainty surrounding both these issues we believe the market will more likely factor in the strict outcome we have imputed here, until shown otherwise.

- **Dutch illiquid investments:** These have been clearly signposted by management at EUR 450m over the next 3 years.

- **Other impacts:** For 2018 these include EUR 170m for the sale of Ireland, US$ 30m capital release from the affinity/direct sales exits in US, US$ 120m TCS integration costs, £40m Cofunds integrations costs. For 2019 we have included a further US$ 100m integration cost for TCS.

Offsetting benefit of rising 10yr yields

- **Market moves:** YTD we have factored in an aggregate 35bps upward move in 10 year yields across the US, Dutch and UK markets.

SII capital: flex potential

We consider a range of factors that could lead to unexpected SII moves over our forecast period whereby AEGON would be comfortably entering the excess zone. Non-core disposals and a lightning regulatory stance on RBC requirements could for example lead to exceptional capital release though where we also note the increasing trend to SII charges for expense and digitalisation investments. There are also the financial markets influences to consider both positive (rising yields) and negative (falling equity markets, widening spreads).

Chart 6: Group SII potential impacts

SII financial market flex	**EUR m**	**SII pts**
Interest rates +50bps	468	6%
Interest rates -50bps	-624	-8%
Equity markets +10%	390	5%
Equity markets -10%	-195	-3%
Credit spreads +50bps	-78	-2%
Coporate moves	**Capital release**	**SII benefit**
Exit US VA GMIB, FA	800	9%
Sale of UK pensions	350	4%
Regulatory	**Capital release**	**SII benefit**
NAIC capital charge impact -50%	100	1%
NAIC tax reduction impact -50%		7%

Source: Jefferies estimates, company data

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Financial market influence; focus on benefit from rising yields

- **(+ve/-ve)** We show in the table above the **SII financial market sensitivities** as published by management. So far this year AEGON's SII capital base will have been positively influenced by the rise in bond yields particularly in the US, but also impacted (temporarily) by equity market volatility since the beginning of the year. Corporate bond spreads have remained benign however.

SII boost from potential from non-core exits

- **(+ve)** There is also the potential for **SII capital release from non-core disposals**, AEGON's pension administration business in the UK for example, also the variable annuity GMIB back book and fixed annuity portfolio in the US. The recent exit of Voya from its VA back book and fixed annuity business bodes well in this regard releasing c US$ 1bn of capital on US$ 30bn if assets vs AEGON's > US$ 20bn portfolio. We guesstimate up to 9pts of SII release for the US exits, and c 4pts for the UK pension business.

RBC resolution could release capital

- **(+ve)** There are also the forthcoming **regulatory decisions** in the US to consider, where NAIC or DNB amelioration on the aforementioned RBC capital issues could lead to capital release vs the strict read we have incorporated in our base SII projections.

Vs the perennial drag from digital investments

- **(-ve) Cost initiatives** have been becoming more sizable and frequent in recent years (US TCS integration costing US$ 280m over the next 3 years, with an £80m charge in the UK 2017/18 for Cofunds: combined SII charge = 4pts). We suspect cost and digitalisation initiatives will become part and parcel of AEGON's capital cost structure albeit below the line and not part of AEGIN's operational SII earnings.

SII capital: scenario test

We factor in the SII impacts from the various corporate actions and financial market events outlined above to create bull and bear scenarios.

Chart 7: SII scenario test

Capital event	SII ratio 2019	Capital release EUR m	Excess post events EUR m
Jeff forecast	***192%***		-684
Bull case			
NAIC release	*199%*	606	-78
UK pension sale	*196%*	346	-338
US VA/FA exit	*202%*	779	182
Interest rates +50bps	*198%*	520	-165
Cumulative	***218%***	**2252**	**1567**
Bear case			
Equity markets -10%	*189%*	-260	-944
Spreads +50bps	*190%*	-173	-858
Digitalisation EUR 250m	*190%*	-173	-858
Total	***185%***	**-606**	**-1291**

Source: Jefferies estimates, company data

Given a positive combination of NAIC resolution, non-core exits in the US/UK, and a further 50bps rise in 10yr yields AEGON could release EUR 2.25bn of capital and move to an excess position of EUR 1.6bn by the end of 2019.

Conversely, an NAIC resolution in line with our base case, a further EUR 250m charge for digitalisation and expense cuts, and less favourable financial markets (equities -10%, spread widening 50bps) wold see the SII ratio still sitting 15pts below the excess capital zone.

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SII capital generation: avoiding the calamity zone

AEGON finally appears to be moving on from prolonged operational and capital misfortune and shareholder disappointment. The more recent operational presentations on the Dutch and UK divisions suggest a management team more in control of its corporate destiny.

The last decade at AEGON has proved frustrating for the shareholder on a number of counts

The last decade of AEGON has been cluttered with operational and capital disappointments, driven by a combination of modelling flaws (poor internal controls), unkind regulatory shifts (AEGON's focus on retirement and pensions magnetising it to regulatory risk), and unfavourable financial market developments (margin compression on the back of falling interest rates). Management guidance has unsurprisingly in our view proved wide of the mark on several occasions (the second wave of sizable modelling charges in 2015 was particularly damaging for management credibility). The decision to cut the Dutch the interest rate hedge in early 2016 just ahead of the collapse in 10 year yields into negative territory, and the year-long crisis in Dutch SII that ensued, marked for us the nadir of such unfortunate episodes.

Capital repair appears to have been achieved with recent operational presentations boding well for AEGON's corporate outlook

We note the new appointments for Group CFO, Group CRO, and Dutch CEO over the past two years, with recent management presentations at the operational level (the UK and Dutch presentations 2H 2017) suggesting to us a corporate AEGON in considerably better control of its capital destiny than at any other time since 2000. Barring a further Black Swan financial event (a 200bps spike in US interest rates leading to a costly acceleration in fixed annuity redemptions for example), we see considerably less scope for further operational/capital disappointments from here.

2) Cash at Holding

In determining levels of excess capital at the group level aside from SII capital levels there are also the levels of cash at the holding and debt gearing to consider. Holding cash should on our forecasts break though the upper EUR 1.5bn threshold through 2019 and have reached a comfortable position of excess by 2020, at which point debt leverage ratios should have fallen below lower levels of 25%.

Holding free cash generation

Post Holding and dividend costs we project EUR 350m of free cash drop in 2018 rising to EUR 440m by 2020. We assume that the Dutch unit pays dividend throughout the period, where this view seems supported by our Dutch SII projections.

Holding cash to increase c EUR 400m annually

We set out our forecasts for cash generation at the Holding in the table below. We factor in cash remittance of EUR 1.2bn in 2018 climbing to EUR 1.34bn in 2020, in line with SII capital generation momentum, with the remittance ratio constant at c 85%. On this basis cash at the Holding post dividend payments, should increase by c EUR 400m annually.

- For the **US** we factor in cash remittance of US$ 900m for 2018 stable vs 2017 despite the US$ 100m increase in capital generation in the US from lower US taxes, with management cautioning on the potential drags to US RBC capital as discussed above. The increase we factor in for 2019 accommodates for the anticipated expense benefits from TCS.
- For the **UK** at £100m and rising, and other at EUR 150m (**AM** EUR 100m, **CEE & Spain** EUR 50m, and **Asia** zero) we are in line with management guidance.

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Chart 8: AEGON Holding cash generation

EUR m	2017		2018F		2019F		2020F	
Cash remittance								
US	797	*-9%*	741	*-7%*	789	*7%*	789	*0%*
Netherlands	0		200		225		250	
UK	167		114		119		125	
AM, CEE, Spain, Asia	220		150		160		171	
Total	**1,184**	**8%**	**1,204**	**2%**	**1,293**	**7%**	**1,335**	**3%**
Remittance ratio % SII capgen	***57%***		***84%***		***85%***		***84%***	
Holding	-300		-300		-300		-300	
Holding cash flow	**884**	***11%***	**904**	***2%***	**993**	***10%***	**1,035**	***4%***
Cash dividend (year-1)	-530		-552		-572		-593	
Net holding cash flow	**354**	***31%***	**352**	***0%***	**421**		**442**	
Dividend payout cash cover	***167%***		***164%***		***174%***		***175%***	

Source: Jefferies estimates, company data

- For the **Dutch** business management guidance is currently limited to an initial EUR 100m to be paid in the 1H this year, but with a return to semi-annual dividends expected thereafter. We factor in EUR 200m for 2018 rising to EUR 250m in 2020, on which basis we project a Dutch SII ratio of 168%, in line with management's middle range SII guidance for 2020 factoring in the annual drags from UFR and illiquid investments as set out in the table below. Financial market moves in the mean-time could of course sway the final outcome (equities +/-20% = +5/-5pts, interest rates +/-100bps = +8/-11pts).

Chart 9: Dutch SII capital evolution

EUR m	2018F	2019F	2020F
Dutch SII own funds opening	6,600	6,550	6,500
Normalised capgen	300	325	350
UFR	-150	-150	-150
Dividend	-200	-225	-250
Dutch SII own funds closing	***6,550***	***6,500***	***6,450***
Dutch SCR opening	3,380	3,530	3,680
Illiquid investments	150	150	150
Dutch SCR	3,530	3,680	3,830
Dutch SII 150 -190% range	***186%***	***177%***	***168%***

Source: Jefferies estimates, company data

Excess cash creation at Holding

We predict AEGON moving to a position of excess cash through 2019, with excess cash building to EUR 800m by the end of 2020. Any non-core exits could of course potentially drive this higher.

Excess cash of EUR 800m by 2020

Aside from the operational and dividend influences, there are also management actions to consider when projecting future cash levels at the Holding. For 2018 specifically the sale of Ireland is expected to release EUR 170m, but with the repayment of EUR 500m debt to more than offset. Factoring in our cash remittance forecasts from the units, and the impacts on cash from management actions that are already known, we project a move to excess cash through 2019, with EUR 800m of excess cash sitting at the Holding by end 2020.

Possibly driven higher by non-core exits

Further non-core exits beyond the sale of Ireland, for example the US VA back book and fixed annuity portfolio, or the UK traditional pensions business, would augment Holding cash further, by as much as EUR 1bn-plus according to our calculations in the earlier SII capital section. Adding this to our EUR 800m forecast for 2020 Holding cash would point

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to a potential EUR 2bn capital reallocation program at AEGON over the more medium term.

Chart 10: AEGON Holding cash

EUR m	2017	2018F	2019F	2020F
Cash beginning	1,500	1,404	1,426	1,847
Dividends received from units	1,184	1,204	1,293	1,335
Funding and operating expenses	-350	-300	-300	-300
Dividends paid	-530	-552	-572	-593
Acquisitions and divestments	600	170	0	0
Deleveraging	0	-500	0	0
Buy back	0	0	0	0
Other	-1,000	0	0	0
Cash end	**1,404**	**1,426**	**1,847**	**2,289**
Excess cash > £1.5bn		**-74**	**347**	**789**

Source: Jefferies estimates, company data

US$ wildcard

A further 10% decline in the US$ would reduce annual cash build by c EUR 80m and limit 2020 excess cash to EUR 550m.

In the table below we calculate the impact of a further 10% decline in the US$ vs Euro, leading to an annual drag on cash remittance to the Holding from the US of c EUR 80m. Holding cash for 2020 in this scenario would fall on our forecasts to EUR 2bn vs EUR 2.3bn previously, with excess cash for 2020 declining to EUR 550m vs EUR 800m previously.

Chart 11: US$ -10% cash generation impact

EUR m	2018F	2019F	2020F
Impact on cash remittance	-74	-79	-79
Holding cash end	1,352	1,694	2,057
Net holding cash flow	278	342	364

Source: Jefferies estimates, company data

Leverage

Our IFRS capital forecasts indicate a drop in leverage to below 25% through 2020, giving leeway for any leverage impacts from non-core exits to be absorbed.

Chart 12: AEGON leverage

EUR m	2017	2018F	2019F	2020F
Hybrid debt	4669	4669	4669	4669
Senior debt	2312	1812	1812	1812
Total leverage	6981	6481	6481	6481
Shareholders' equity	20573	21425	22448	23479
Defined benefit plans	1669	1669	1669	1669
Non contolling interests and options	81	81	81	81
Total capital	29304	29656	30679	31710
Including unrealised gains	4920	4920	4920	4920
Total capital excluding unrealised gains	24384	24736	25759	26791
Debt ratio (26-30% range)	***28.6%***	***26.2%***	***25.2%***	***24.2%***

Source: Jefferies estimates, company data

Leverage ratio <25% by 2020

Assuming no further debt redemptions beyond the EUR 500m loan being repaid mid-year, we project leverage ratios to fall to below range by 2020.

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US non-core sales potentially to add 1.8pts to the leverage ratio

Non-core sales over this timeframe would likely impact the ratio however. According to management the statutory capital for the US VA back book and fixed annuity business at US$ 1.6bn, compares with IFRS capital at US$ 3.8bn. A sale at book (statutory capital) would lead on our calculations to a US$ 2.2bn loss under IFRS thereby requiring US$ 550m of deleveraging to offset, otherwise adding 1.8pts to the leverage ratio 2018F. Pro forma for US sales the 2018/19/20 ratios would on this scenario rise to 28.0%, 26.8%, and 26%.

Capital day tripper

Management's caution against premature buyback expectations is unsurprising in our view given the track record of AEGON's buybacks in the past followed on both occasions by the need for capital repair. We consider add-on acquisitions a more likely use of excess funds as AEGON possibly seeks to rebalance its business away from the US towards Asia.

Management caution on buybacks

AEGON's CFO appeared to caution on too much optimism for future dividend increases and possible buyback potential on the recent 2017 full year results call. 'A year ago people were wondering whether we had to raise equity given the Dutch capital position. Let's not get ahead of ourselves in terms of pay-out ratio now that we're in a good position.' Such sanguine expectations for AEGON's future buyback potential are to be expected in our view given the CEO's first-hand experience of the emergency Government funding required just a year after AEGON's first buyback in 2007, with capital 'déjà vu' and the need for a EUR 500m bridge loan to replenish Holding capital just a year after AEGON's second buyback in 2016. AEGON will not think twice but three times before considering any further buyback plans.

Merited by past buybacks preceding forced equity and debt raises

On the basis that AEGON's capital, cash and leverage projections do pan out in line with our base scenario, through 2019 AEGON will have developed an excess cash position at the Holding, and with leverage hovering close to floor guidance levels. With further non-core exits possible (UK traditional pensions, US VA back book, US fixed annuities) SII could also venture into excess territory through 2019.

We believe management would err on the side of capital caution even with all three indicators suggesting excess capital capacity, given the potential financial market drags to SII (equity markets -20% = -6pts), and the gearing of cash generation to the US$ (-10% = -EUR 80m cash annually).

Chart 13: Excess capital considerations

	2018F	2019F	2020F
SII capital > 200%	195%	192%	195%
Leverage 25-30%	26.2%	25.2%	24.2%
Cash at Holding > EUR 1.5bn	1,426	1,847	2,289

Source: Jefferies estimates, company data

Add-on acquisitions more likely

Management caution acknowledged, we set out in the table below the potential value uplift from EUR 500m of capital redeployment. With AEGON's share price at current levels, buybacks would appear to be the more value accretive option unless AEGON can beat the upper end ROI range we have set here at 12%. We believe management will be more inclined to reinvest in AEGON's global proposition remembering the CEO's initial plan set out in 2009 to reweight the group away from the US to a more balanced 50/50 proposition. This compares to the current bias to US capital generation (pre Holding costs) at 62% (2018F) falling to 58% pro forma for US variable annuity back book and fixed annuity exits. We specifically note in this context AEGON's decision to create a separate earnings division for Asia with the stated intention for the region to become a significant contributor to group earnings in the future (vs negligible net profits in 2017). *'AEGON intends for its Asia business to be a financially significant contributor in the future*

To rebalance the group away from the US

Increased Asian emphasis

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and growth engine for the group' (management commentary 2016 full year results press release).

Chart 14: AEGON capital redeployment potential

Shareholder value of EUR 500m free capital

Management action	**Stated eps uplfit 2019**
Buyback at EUR 5.5	4.4%
Buyback at EUR 6.0	4.1%
Buyback at EUR 6.5	3.8%
ROI initial 7%	2.2%
ROI eventual 10%	3.1%
ROI eventual 12%	3.7%

Source: Jefferies estimates, company data

Add-ons for scale and expertise

Recent deals have been relatively small add-ons, Banque Postale (EUR 112m), Cofunds (£ 140m), and Mercer in the US, with the rationale of the latter two focused on bringing scale and additional expertise to existing businesses of the group.

We would prefer AEGON's corporate program from here to be rather more focused on periphery divestments (Asia, CEE, Spain, Latam) in line with the back to core strategies currently in play at Aviva, AXA and Generali. AEGON's track record of value destruction following acquisitions outside of the Dutch market (Transamerica US, Scottish Equitable UK) has led to considerable underperformance of AEGON shares vs both the market and sector over the past 20 years (see Jefferies AEGON The Illusionist August 2017), with moves into wider Europe and Asia continuing to frustrate on returns in our view.

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Valuation

Our price target of EUR 6.1 is driven from our multi residual return sum-of-the-parts with a DDM cross check. For our DDM we assume a long term growth rate of 4% (fading down from the 7% we project for 2020) with the bulk of the growth supplied by the reinvestment potential from the annual excess cash drop, where we assume any organic growth trend is eroded in part by margin pressures, reflecting in turn AEGON's focus on the highly regulated pension markets. AEGON appears cheap on IFRS earnings but where the value gap appears to close on the more meaningful SII earnings.

Chart 15: AEGON DDM

	2018	2019	2020	2021	2022	2023	2038	2039	TV	TV growth
	0	1	2	3	4	5	20	21	22	
DPS EUR	0.28	0.29	0.31	0.33	0.35	0.36	0.65	1.26	16.10	
Growth		*4%*	*7%*	*6%*	*5%*	*4%*	*4%*	*95%*		*2%*
Discount factor	1.00	0.91	0.83	0.75	0.68	0.62	0.15	0.14	0.14	
	0.28	0.26	0.26	0.25	0.24	0.22	0.10	0.17	2.18	
CoC	10.0%									
DDM valuation	**6.0**									
12-month adjustment	0.1									
Target price	**6.1**									

Source: Jefferies estimates, company data

Chart 16: AEGON multi residual return

EUR mn	**Capital '17**	**Earnings '18**	**ROC**	**CoC**	**Growth**	**Value**	**Price to book**	**PER**	**Capital**	**Value**
US	11,601	1,129	9.7%	10.0%	1.0%	11,455	0.99	10.1	49%	54%
Netherlands	6,366	417	6.6%	10.0%	0.0%	5,065	0.80	12.1	27%	24%
UK	2,244	118	5.3%			1,193	0.53	10.1	9%	6%
International	1,727	125	7.2%		4.0%	1,619	0.94	13.0	7%	8%
Asset management	445	116				1,505		13.0	2%	7%
US run off	293	0				293	1.00		1%	1%
Holding	1,000	-240				-2,404			4%	0%
Operational value	23,676	1,665				18,725			100%	100%
Buffer capital	-233					0				
Debt	-6,481	-220				-6,481				
Total value		1,445				12,244		8.5		
Per share						**6.0**				
12-month adjustment						0.1				
Target price						**6.1**		8.9		

Source: Jefferies estimates, company data

The discount rating on IFRS earnings all but erodes on an SII basis

AEGON certainly appears undervalued on an IFRS basis, PER 8.3X (2018F), but where the discount rating closes sharply on an SII earnings basis PER 9.7X (2019F). Economic (SII) earnings come in considerably lower than AEGON's IFRS version (by some EUR 400m) with the latter failing to recognise debt charges, including bond gains that generate no economic value, and recording negligible credit losses vs SII's over the cycle assumption.

- The annual perpetual debt charge of EUR 130m is excluded from IFRS net income but does form part of SII cap gen.

Where IFRS omits some critical cost elements

- SII earnings excludes bond gains (vs the EUR 150m we are forecasting for our 2019 IFRS earnings) on the economic basis that bonds are held to maturity for matching purposes.
- Credit losses are normalised under SII earnings at 25bps, and = EUR 180m, vs IFRS where the actual credit loss is recorded, at EUR 60m on our 2019 forecasts, giving a net of tax differential at EUR 120m for 2019F on our numbers.

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Risks

AEGON faces a range of operational, regulatory and financial market risks. Operationally, US life margins could come under pressure following the US tax drop, UK platform margins remain at the sharp end of competition, and with the run-off the wider margin Dutch back book an additional hurdle to operating momentum. A range of regulatory risks could also continue to affect AEGON, the latest one potential changes to how the RBC ratio is calculated in the US. US$ weakness, equity market falls, declining interest rates and corporate bond defaults in the US would all impact operating momentum and erode capital generation. Capital redeployment into add-on businesses could also bear down on the stock's rating given the history of AEGON's international ventures.

Appendix: Earnings forecast changes

Chart 17: AEGON forecast changes

Forecasts (EURm)	FY18E New	FY18E Old	% Chg	FY19E New	FY19E Old	% Chg	FY20E New	FY20E Old	% Chg
Gp cash remittance	1,204	1,195	0.8%	1,293	1,299	-0.5%	1,335		
Underlying earnings	1,714	1,631	5.1%	1,809	1,714	5.5%	1,900		
EPS stated	0.69	0.67	3.2%	0.79	0.76	3.3%	0.80		
Return on Capital	8.8%	7.9%	0.9%	8.8%	7.9%	0.9%	8.8%		

Drivers of Change

- rising interest rates US, UK, NL lifting underling earnings and eps
- supportive 2017FY results

Source: Jefferies estimates, company data

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Company Description

Global pensions, long term savings, life and health insurance provider predominantly in the US, Netherlands, the UK and CEE, with non-life operations in the Netherlands, Spain and Hungary.

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Investment Recommendation Record

(Article 3(1)e and Article 7 of MAR)

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Mark Cathcart holds a long equity position in AXA SA.
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- Aviva Plc (AV/ LN: p505.60, BUY)
- AXA SA (CS FP: €25.86, BUY)
- Generali (G IM: €15.44, BUY)

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Rating and Price Target History for: Aviva Plc (AV/ LN) as of 02-27-2018

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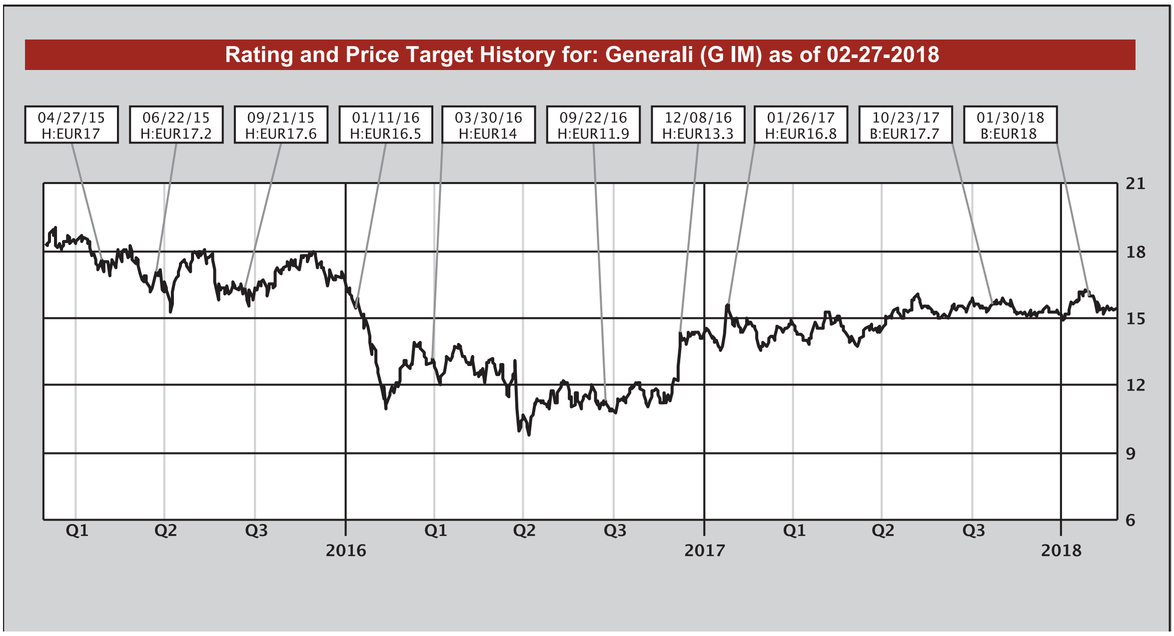

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