

AEGON (AGN NA)

The Flying Dutchman

Key Takeaway

A better than expected SII ratio at 201% and EUR 100m increase in capgen guidance post US tax reform bode well for longer term dividend paying potential, with management confirming the possibility of more back book deals in the US. Uncertainty on the US regulatory capital requirement will likely prevent any dividend or buyback surprises through 2018/19, however.

Excess capital temporary only: AEGON appears to be on the threshold of excess capital: group SII 201%, Dutch SII 199%, both above upper end targets of 200%/190%, respectively. Pro forma for possible NAIC adjustments post tax reform in the US, however, and UFR lowering and planned portfolio re-risking in the Netherlands, our SII forecasts 2018/19 appear less compelling - group 186%/190%, Dutch 189%/183% - suggesting within range but not in excess territory.

Potential for further corporate redeployment: Management have confirmed their openness to exiting the fixed annuity book in the US. Voya's recently announced US\$ 30bn back book exit (variable and fixed annuity) enabling >US\$ 1bn capital release, compares with AEGON's cUS\$20bn VA and FA back book suggesting > US\$ 0.5bn of capital release potential (= c 6pts on group SII). Our group SII forecasts on this basis would rise to 192%/196%, still below the 200% excess threshold for buybacks however. There is also the possibility that AEGON embark on a wider scale paring down of periphery exposures (the CEE for example) along the lines of periphery withdrawal at AXA and Generali. We believe this is less likely, however, where management appear committed to their global reach.

Capgen momentum: Q4 capgen at EUR 384m comfortably beat market expectations with management now lifting capgen guidance for 2018 to EUR 1.4bn (+ EUR 100m for lower US taxes where AEGON's long duration portfolio should help protect it from likely pricing declines post tax cuts). We detect a number of factors suggesting a modicum of capgen momentum beyond 2018:

- Management have confirmed the current run rate of cost cuts at EUR 280m vs EUR 350m targeted for 2018, suggesting to us a beat at plan completion, with an additional US\$30m of costs saved beyond 2018 from TATA outsource. We expect the December NY Investor Day to be considerably more forthcoming on additional digitalisation and efficiency benefits yet to feed through.
- Franchise strengthening in both the UK and Dutch markets (we note supportive management presentations on both in recent months). Earnings momentum of 5-10% is now targeted for the Netherlands, where UK capgen targets were lifted last year from £70m to £100m on the back of platform momentum
- The 50bps rise in US 10 yr yields since the beginning of the year adds on our calculation an annual 1-2% to US earnings momentum for the next 5 years.

Dividend guidance unchanged: Management are guiding to full delivery of the EUR 2.1bn capital return to shareholders as targeted in the original 2018 plan in line with our dividend forecast of EUR 0.28 for 2018 (as per consensus). Scope for buybacks or dividend acceleration over our forecast period will therefore be dependent either on a more favourable US regulatory outcome (clarification to be given as late as 2019), or wider scale non-core exits.

Valuation: AEGON trades (vs peers) on a 2019 PER of 8.1X (10.2X), and 2018 dividend yield 5.2% (5.3%).

HOLD

Bloomberg AEX: AGN NA

Price target €6.00

Price €5.42^

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

Mark Cathcart *

Equity Analyst

+44 (0) 20 7029 8784 mcathcart@jefferies.com

Philip Kett *

Equity Analyst

+44 (0) 20 7548 4126 pkett@jefferies.com

Alexandra Zou *

Equity Associate

+44 (0)20 7029 8972 azou@jefferies.com

* Jefferies International Limited

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