| Equity Research |

Equity Outlook

High valuation suggests profit taking and reducing equity positions


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- **The main global stock markets were marked by reaching new highs in the fourth quarter.** Positive global macroeconomic development continued, and the earnings season exceeded expectations.
- **At the end of the year, the Prague Stock Exchange stagnated after its previous growth in the third quarter.** Despite only 2% growth, it managed to outperform most of its Western and CEE peers.
- **After a short break, CME and Fortuna once again became the frontrunners on the Prague Stock Exchange.** ČEZ, which gained 11% in the fourth quarter and ranked third, was also very successful.
- **The post-summer holidays period led to an increase in trading volumes on the Prague Stock Exchange.** ČEZ kept its lead with a 35% share on 4Q traded volumes. Smaller issuances have moderated their increased activity in the past quarter as the share on traded volume of the five largest stocks increased from 85% to 88%.
- SG continues to reduce the risk profile of its allocation. Asset price valuations are indeed high or very high, but for EM assets, risk-taking and momentum-investment are at their peak. **Société Générale reduced the exposure for equities in its asset allocation and advises keeping an underweight position.** High growth expectations are an incentive to continue switching out of equities in favour of sovereign bonds. With an impressive run since June and net positioning at an all-time high, SG suggests slightly reducing oil and other commodities.
- **The U.S. S&P 500 has entered expensive territory.** Indeed, on all metrics, U.S. equities are trading at levels only seen during the late-90s bubble. Since Trump's election, the U.S. equity market has risen more than 25%, but only half of this comes from earnings growth. The other half has been driven by P/E expansion, as the U.S. market is already pricing in potential tax reform.
- **Positive economic momentum should continue to support the EuroSTOXX 50** and core markets such as France and Germany. However, the stronger EUR and higher bond yields will likely limit performance. Both the Italian and Spanish equity markets will probably be more affected by changes in ECB policy as their overall credit ratings are relatively weak.
- **The Prague Stock Exchange could deliver a growth of around 9% next year with an estimated dividend yield at 5.4%.** We believe financial stocks are among the most attractive on the PSE, especially Moneta Money Bank and Erste Group. We also recommend buying shares of CME, Philip Morris CR and Fortuna. Pegas Nonwovens and Fortuna will be likely delisted from the PSE.

Prague Stock Exchange statistics

	2012	2013	2014	2015	2016	11/2017
PX Index (eoy)	1,039	989	947	956	922	1,059
Change (CZK)	14.0	-4.8	-4.3	1.0	-3.6	14.9
Change (USD)	18.4	-8.9	-16.7	-7.0	-6.9	37.3
Traded volumes (CZK m)	250,608	184,571	158,222	169,202	163,580	132,240
Traded volumes (USD m)	12,810	9,461	7,648	6,941	6,687	5,611
Market capitalization (CZK m)	1,093,799	1,074,426	1,018,162	1,011,989	1,020,891	1,195,964
Market capitalization (USD m)	57,540	54,189	44,434	40,696	39,844	55,772

Source: PSE, Bloomberg, Economic & Strategy Research, Komerční banka

KB/SG recommendations for the PSE titles

Company	Price	Target price	Recomm.	From date	Year high	Year low
CEZ	490.7	542.0	Buy	20.IX.17	498.0	392.8
CME	103.2	108.4	Buy	27.VII.17	110.0	63.1
Erste Bank	920.7	1,048.2	Buy	3.VIII.17	986.2	722.4
Fortuna	178.0	198.0	Buy	9.XI.17	179.6	85.0
Kofola	419.5	-	-	-	445.9	353.0
Komercni banka	901.5	-	-	-	1,013.0	855.0
Moneta Money Bank	78.2	90.0	Buy	17.VIII.17	90.8	74.5
O2 CR	276.5	270.0	Hold	18.IX.17	292.6	230.9
Pegas Nonwovens	820.0	in review	Sell	13.IX.17	1,027.0	759.1
Philip Morris CR	16,299.0	17,546.0	Buy	22.VIII.17	17,211.0	12,425.0
Stock Spirits	77.8	-	-	-	79.9	46.5
Unipetrol	371.6	-	-	-	389.0	176.5
VIG	648.9	673.0	Buy	3.III.17	686.8	549.0

Source: PSE, Bloomberg, Economic & Strategy Research, Komerční banka

Companies overview

	Price	Monthly	year-to-date change		Avg. daily volumes	
	CZK	change	CZK	USD	1-11/2017	1-11/2017
Company	11-Dec-17	(%)	(%)	(%)	(CZK m)	(USD m)
CEZ	490.7	1.5	14.1	35.2	166.8	7.7
CME	103.2	3.2	54.9	83.5	5.9	0.3
Erste Bank	920.7	-1.8	25.1	48.2	63.9	2.9
Fortuna	178.0	16.3	107.5	145.8	4.6	0.2
Kofola	419.5	1.2	14.3	35.5	0.7	0.0
Komercni banka	901.5	-2.2	1.9	20.7	115.2	5.3
Moneta Money Bank	78.2	-0.8	-5.6	11.8	124.8	5.8
O2 CR	276.5	3.7	8.0	28.0	38.2	1.8
Pegas Nonwovens	820.0	-1.5	6.6	26.3	13.8	0.6
Philip Morris CR	16,299.0	0.6	24.5	47.5	12.0	0.6
Stock Spirits	77.8	1.9	37.8	63.3	1.9	0.1
Unipetrol	371.6	-3.5	102.2	139.5	14.1	0.7
VIG	648.9	-0.1	12.8	33.6	10.6	0.5

Source: PSE, Bloomberg, Economic & Strategy Research, Komerční banka

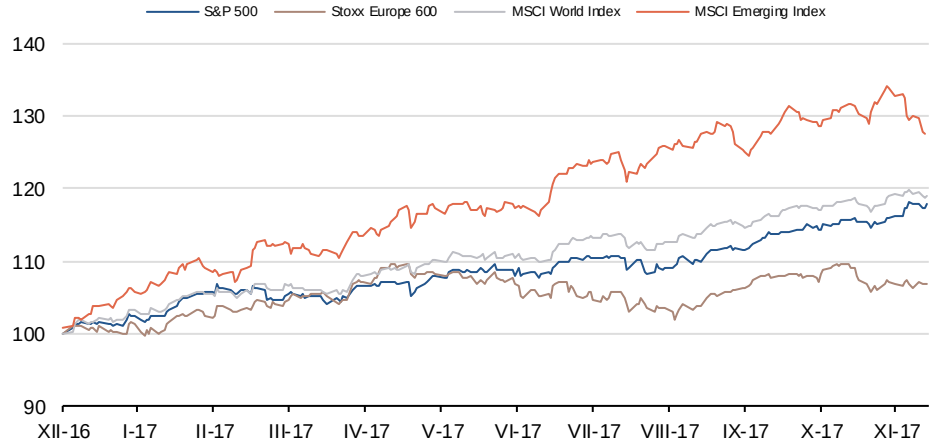
U.S. markets reached new highs in 4Q

Global equity market

Source: Bloomberg, MSCI World index

The fourth quarter was marked by reaching new historical and long-term highs on global stock markets. The most successful were companies in the U.S. and Asia. The growth trend in the fourth quarter was reinforced by positive macroeconomic news and rising oil prices. The earnings season has been very successful globally. On average, companies achieved higher sales and profits than estimated. Markets in the last quarter responded to speculation about the approval or disapproval of U.S. tax reform. All three major U.S. stock indices reached new historical highs by the end of November. The S&P 500 index has gained 18% since the beginning of the year (a 5% gain in the fourth quarter). The Dow Jones Industrial Average index increased 23% and Nasdaq rose 27% over the year. European stocks grew at the end of October, but with a fall in oil prices. Earnings results were not as positive as in the United States, and markets made a correction at the beginning of November. Overall, the Euro Stoxx 600 added only 7% since the beginning of the year (in 4Q, the market moved sideways and gained only positive zero). Asian stock markets had similar dynamics as U.S. markets in 4Q and the period since the beginning of the year. Most of the Asian stock indices in the last quarter gained about 6% on average and 19–24% since the beginning of the year. The MSCI Emerging index strengthened 3% in the fourth quarter, bringing the year-to-date gain close to 32%.

Development of main equity indices since the beginning of the year

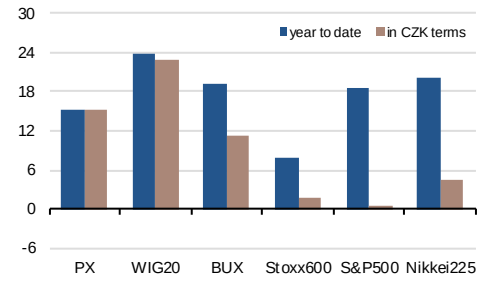


Source: Economic & Strategy Research, Komerční banka, Bloomberg; *data as of 7 December 2017

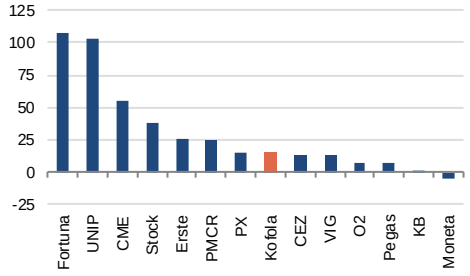
The Prague Stock Exchange is still ahead of its Western peers but lags behind regional peers.

After more than 6% growth in the third quarter, the Prague Stock Exchange significantly slowed down at the end of the year. It moved sideways with slight fluctuations in both directions. For the fourth quarter, it gained only 2%. In spite of this result, which is far worse than how equity markets in the U.S. and Asia performed, 2% growth is a quite decent result considering European conditions. Even with this growth, the Prague Stock Exchange outperformed most of its Western peers (Germany +1.5%, France +0.8%, England -0.3%) and CEE peers (Poland -1.8%, Hungary +1.5%). However, in a year-to-date comparison, the PX index lags behind regional peers with its 16% gain. The Polish WIG20 with its gain of 24% holds the front position followed by the Hungarian BUX index, which grew 18%. The Romanian BET index gained only 10% due to a weak third quarter and ranked fourth behind the Prague Stock Exchange.

PX vs. other stock indices in 2017 (%)



Prague stocks in 2017 (%)



Source: Economic & Strategy Research, Komerční banka, Bloomberg

Unipetrol, Fortuna and CME are the winners in this year's race for the highest appreciation.

The fourth quarter changed the ranking of profitability of individual titles on the Prague Stock Exchange. Betting company Fortuna reached the biggest gains in 4Q growth (a gain of 20%), as well as in year-to-date growth (108% appreciation). The impetus for growth in the fourth quarter was 3Q17 earnings, which exceeded expectations in almost all published items. There was a significant positive impact of the acquistion of the Hattrick Sports Group, and the success of the new online gaming segment was confirmed. Second rank has reached CME media group with a gain of more than 16% after a less successful third quarter. Overall, since the beginning of the year, it has ranked third with a yield of 57%. Growth in the last quarter was supported by speculations about the new bidders in the acquisition of CME's majority stake, which should be Chinese investment group CEFC together with Czech investment group Penta. Stock prices of energy giant ČEZ and Unipetrol both appreciated approximately 10%. Unipetrol with its year-to-date gain of 104% ranks second among the most profitable companies on the Prague Stock Exchange. The company continues to benefit from the persisting favourable trend in the sector and renewed production at its plants. ČEZ has reached the eighth position in a comparable period with a gain of 14%. The last company belonging to the group of successful companies is liquor producer Stock Spirits, which gained over 9% (ranked fourth with a year-to-date gain of 38%).

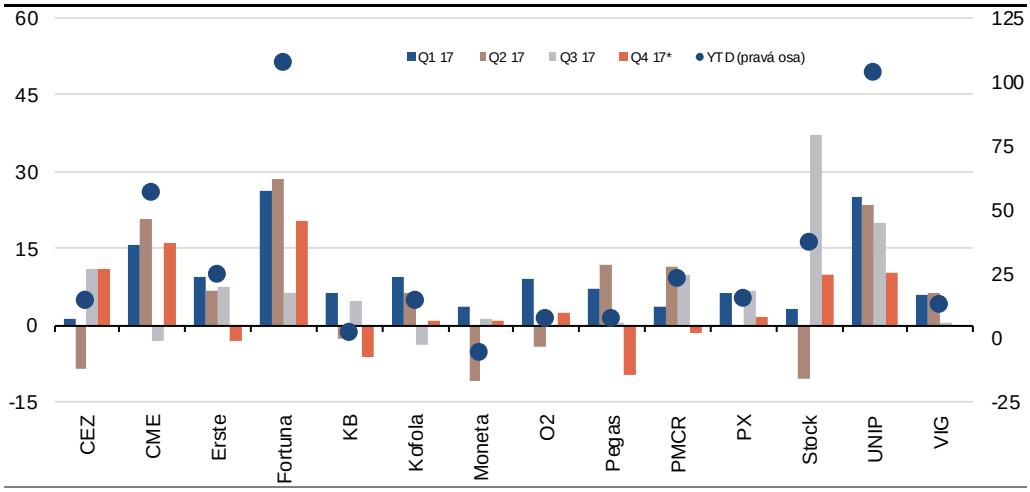
Volatility has avoided O2 Czech Republic, Moneta, VIG and Kofola in 4Q.

O2 Czech Republic, Moneta Money Bank, Kofola and VIG belong to the second notional group of companies that gained up to 2% in the fourth quarter. The earnings for 3Q17 were not surprising, which corresponded with the volatility of these stock titles. None of the companies made any significant upward or downward movement. The exception may be Moneta stocks, where earnings were more positive than the market expected, even though the volatility didn't increase. At the same time, Moneta's performance (a loss of 6%) since the beginning of the year reached the last position in the rankings.

Pegas became the loser of the last quarter.

The last group, which lost its struggle for profits at the end of the year and suffered losses, includes some big players. Pegas stocks suffered the biggest loss of 11%. Since the beginning of the year, Pegas gained only 7%. The loss in the fourth quarter is mainly due to concerns about the possibility of withdrawal of shares from the stock exchange, which would lead to significantly lower liquidity, a change in the dividend policy and, last but not least, unfavorable 3Q earnings. Despite the growth of sales, the company's net profit fell almost 90% yoy. Banking houses, Komerční banka (-5%) and Erste Group (-2%) also lost in the fourth quarter. The cigarette producer Philip Morris suffered a mild loss of 2%.

Development of Czech stocks (performance in %)

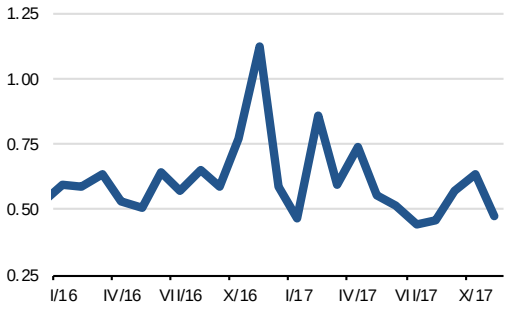


Source: Economic & Strategy Research, Komerční banka, Bloomberg; *data as of 7 December 2017

ČEZ, Moneta Money Bank and Komerční banka are the three most traded titles on the Prague Stock Exchange.

The beginning of autumn gave signs of recovery in trading activity on the Prague Stock Exchange after the summer-holiday downturn. Dspite no new IPOs or SPOs, average daily trading volumes in September and October were on the level of annual daily average of CZK600m. In November, trading volumes again fell to holiday levels. ČEZ kept its winning position, representing around 35% of traded volume. Smaller issuances moderated their increased activity in the past quarter as the share on traded volume of the five largest stocks increased from 85% to 88%. Moneta Money Bank, with its 20% share on traded volume, ranked second in the ranking of the most traded titles on the Prague Stock Exchange followed by Komerční banka with 17% and Erste Group with 12%. Five of the most traded titles were traditionally topped by O2 Czech Republic with 4%. In the last quarter, Unipetrol's trading volume rose close to 4%.

Average daily trading volume (CZKbn)



Source: PSE, Bloomberg, Economic & Strategy Research, Komerční banka

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Global economic outlook

United States: Another rate hike in December

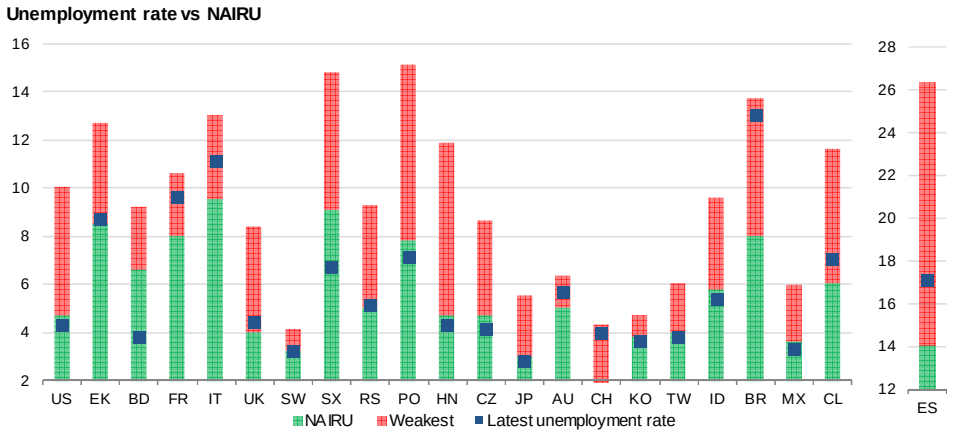
Domestic demand remains the key driver of US GDP growth.

In 3Q17, the US economy added 3.0% qoq, annualised, after 3.1% qoq in 2Q17. Household consumption remains the main driver of GDP growth and looks set to remain in the driving seat for the time being. This view is also supported by the tight situation in the labour market, the falling savings rate and the relatively high demand for consumer loans. The unemployment rate declined to 4.1% in October, its lowest rate since 2010, and should decline further, in our view. The number of jobless claims is falling and has even hit its lowest level in several decades. In addition, household balance sheets should be boosted by planned tax cuts. Corporate investment is likely to contribute more to GDP growth, thanks primarily to revitalised investment activity in the energy sector. According to SG economists, US GDP will grow by 2.1% this year, after last year's 1.5% and GDP momentum should be similar in 2018.

BOX 1: US economic cycle is in the late phase

The current phase of expansion in the US began in June 2009 and is already the third-longest in US history. By February 2018, it is set to become the second-longest and by May 2019 it would match the longest phase of expansion ever recorded in the country. According to SG economists, the next recession will begin in 2H19. Unemployment rates are a good indicator of the current stage of the global economic cycle. The unemployment rate is already below NAIRU, as shown in the chart below.

Unemployment rate vs NAIRU

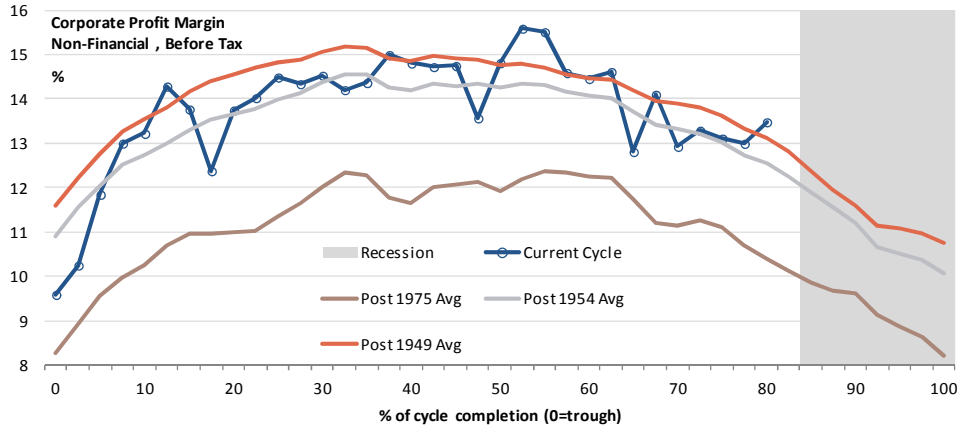


Source: Datastream, SG Cross Asset Research/Economics

This chart shows that many countries are already in the late stage of expansion, which is true also for the US. The unemployment rate falling below NAIRU is usually associated with marked wage growth, accelerating inflation and an increase in interest rates. This in turn puts pressure on company margins, which leads to a decline in investment and finally the deceleration of economic growth.

Consequently, profit margins are another good indicator of the stage of the economic cycle. In 2Q17, profit margins in the US surprised with an upturn, but this was caused by a temporary increase in productivity. Over the coming quarters, unit labour costs will rise in our view, which will probably mean a further decline in profit margins.

United States: profit margins and economic cycle



Source: Datastream, Haver analytics, SG Cross Asset Research/Economics

The maturity of the US cycle can also be seen in the household saving rate, which has already declined substantially.

The US cycle is showing clear signs of maturity and, in our view, the economy is set to move into recession in 2H19. Recession in the US will gradually spill over into the euro area and Slovakia will not be immune to the effects. The biggest risk to our projections is that Donald Trump will not be able to enforce any tax cuts. We assign a 30% probability to this scenario. This would mean that the recession would probably begin earlier in the US, and even as early as 2H18. Accordingly, there would be with an earlier slowdown in the euro area and Slovak economies.

the Fed will hike rates at its December's meeting.

The US central bank (the Fed) embarked on its balance sheet normalisation process in October. The amount of maturing bonds, which will not be reinvested, was set at USD6bn a month for government bonds and USD4bn for mortgage-backed securities. This amount will be raised each quarter until the targeted amount is not achieved (USD30bn for government bonds and USD20bn for mortgage-backed securities). How long the targeted amount will be effective, or in other words, how much the Fed plans to reduce its balance sheet, has not yet been announced. The Fed's balance sheet currently stands at USD4,500bn, vs "only" USD900bn before the QE programme was launched. In any case, the lower amount of reinvestment should push yields at the longer end of the curve gradually higher and thus help the US central bank to tighten monetary conditions. The Fed will, however, also tighten monetary policy through rate hikes. According to SG economists, the Fed will hike rates at its December's meeting (12-13 December) and implement another three rate hikes next year.

Next year we expect EUR/USD to strengthen to 1.27.

The Fed's hawkish rhetoric, together with the hope that Donald Trump will be able to enforce tax cuts to some extent, has stopped the euro from the strengthening to EUR/USD1.20. According to SG economists, the EUR/USD should be trading at 1.18 at the end of this year. Next year, however, we expect the euro to strengthen again given the reduction in the quantitative easing programme in the euro area. We see the euro trading at 1.27 against the dollar by the end of 2018.

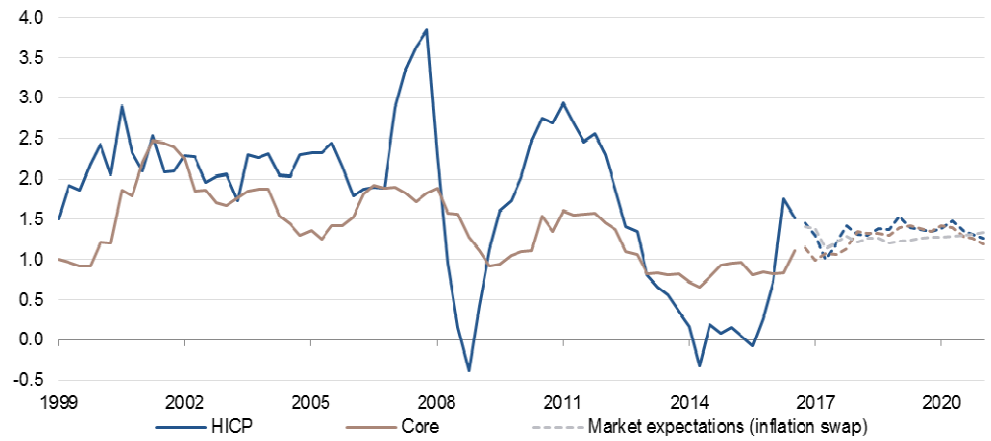
Euro area: rate hike still not in sight

Economic activity is likely to decelerate in 2018-19.

GDP growth in the euro area achieved solid 0.6% qoq in 3Q17 On a yoy comparison, the economy added 2.5%, its highest pace since 2011. Households are benefiting from a good situation on the labour market. The unemployment rate declined to 8.8% in October, its lowest

level since 2009, and the decrease is set to continue. Additionally, in Germany, important wage negotiations are set to be concluded at the end of this year and in March 2018, which should put upward pressure on wages. This is then reflected in growing consumer confidence, which in October moved back into positive territory for the first time since 2001. Consequently, retail sales are gathering the pace as well. The euro area economy is also benefiting from the global trade recovery. This should be seen in the development of net exports, which were a drag in the second quarter. Investment also remains an important contributor to GDP growth (+0.5 pp in 2017 and 2018). This year, we expect euro area GDP growth to come in at 2.2% yoy, but the risks are concentrated on the upside. However, economic activity is likely to decelerate in 2018-19, as the ECB starts to taper its QE programme, the negative impacts of Brexit become more visible, and the US moves into recession from 2H19 (box 1).

Inflation in the euro area remains muted



Source: Eurostat, Macrobond, SG Cross Asset Research/Economic & Strategy Research, Komerční banka

The first rate hike will take place in June 2019.

The ECB announced in October that it would prolong its quantitative easing programme by nine months, i.e. until September 2018. At the same time it will reduce its volume of purchases from the current €60bn per month to €30bn from January 2018. Whether the programme comes to an end or not will depend mainly on wages, investment and inflation trends. Inflation in the euro area already found a peak in April (1.9% yoy). Due to diminishing base effects it has decelerated since then and is even set to fall below 1% at the beginning of next year. Next year, we expect consumer prices to reach 1.2% on average after this year's 1.5% yoy. Among other things, the lack of inflationary pressure can be attributed to low unit labour costs. In Germany, new agreements with labour unions in both the industry and the public domain (the old ones end in December 2017 and March 2018) could bring higher wage growth. Meanwhile, core inflation should not exceed 1.3% yoy on average. According to SG, the inflation trend is likely to lead the ECB to prolong its QE programme once more, until the end of the next year. However, the volume of asset purchases should not be more than €15bn. The first rate hike and at the same time the last one will take place in June 2019. The deposit rate is set to rise by 20bp to -0.2% and the repo rate by 5bp to 0.05%.

China: Next year, the Chinese economy will slow down

China will continue its structural reforms.

The Communist Party Congress in October confirmed current General Secretary and the President Xi Jinping at its function. He even strengthened its position as he was placed on an equal footing with Party founder Mao Zedong. It is important that no growth target was mentioned at the Congress. From the conclusions of the congress, China will not prioritize balancing the economy and strengthening China's role abroad over GDP growth. This

suggests China intends to continue structural reforms. This year, the midterm growth target will be achieved (our forecast is GDP growth of 6.8%). Next year, however, the Chinese economy will decelerate, and the economy will add just 6.2%, according to SG economists. The financial deleveraging campaign, together with restrictive measures on the housing market and higher interest rates, will decelerate GDP growth. In addition, the Chinese government intends to substantially cut industrial production in the northern region to reduce air pollution. If the plan is realised strictly, it could cut 0.6-0.8pp of industrial production growth and 0.2-0.25pp of GDP growth in the next six months. Chinese RMB this year relatively stable thanks to effective capital controls and a weaker U.S. dollar. However, it might slightly weaken in 2018 given the prospect of slower economic growth. Nevertheless the capital control should limit the downside risk.

Japan: Surpassing potential growth for four years

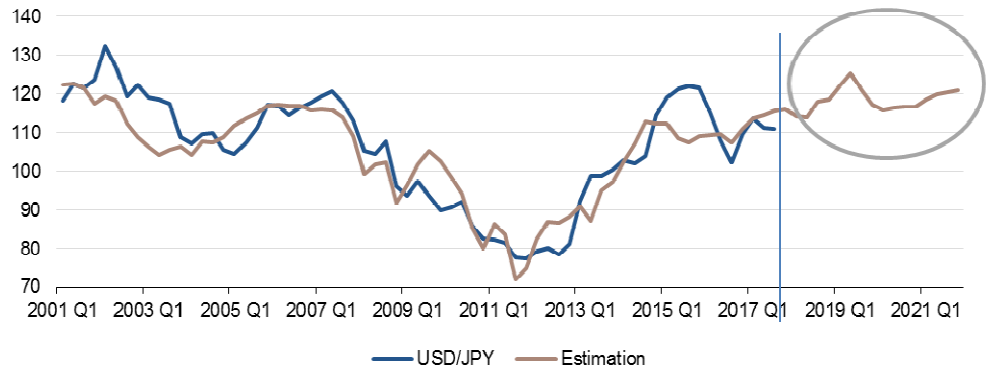
The economy is driven by domestic demand.

The Japanese economy is likely to add 1.3% yoy after this year's strong 1.5%. It will therefore surpass the potential growth rate (1%) for the fourth consecutive year. The main sources of GDP growth are moving from external to internal. The situation on the labour market is tight, which results in wage growth and should be increasingly reflected in rising household consumption. A global economic revival, along with a weaker yen, should stimulate corporate activity. In addition, corporations must react to the labour shortage with higher investments and the development of new products and services if they want to increase sales further. Investment will grow also thanks to preparations for the Tokyo Olympic Games in 2020. The planned increase in consumer tax in October 2019 remains a risk.

The BoJ is likely to raise its long-term yield target in 2H18.

The Bank of Japan still continues to control yields of 10-year government bonds, which keep JPY at a weaker levels. Thus it tries to reach its 2% inflationary target. In 2H18, the BoJ will raise the long-term target, according to SG economists. The necessary conditions for the BoJ to raise its long-term yield are core CPI growing above 1% yoy, USD/JPY rising to around 120 and the BoJ's risk assessment in its outlook report becoming more neutral. Even though the yield control is likely to push JPY to weaker levels, negative interest rates so far have not weakened the position of financial institutions. Apparently there is some excessive real estate investment, which is, however, monitored by regulators. If the impact of negative interest rates should start to be evident, the BoJ would, in our opinion, increase them.

JPY is likely to weaken



Source: Bloomberg, SG Cross Asset Research/Economics

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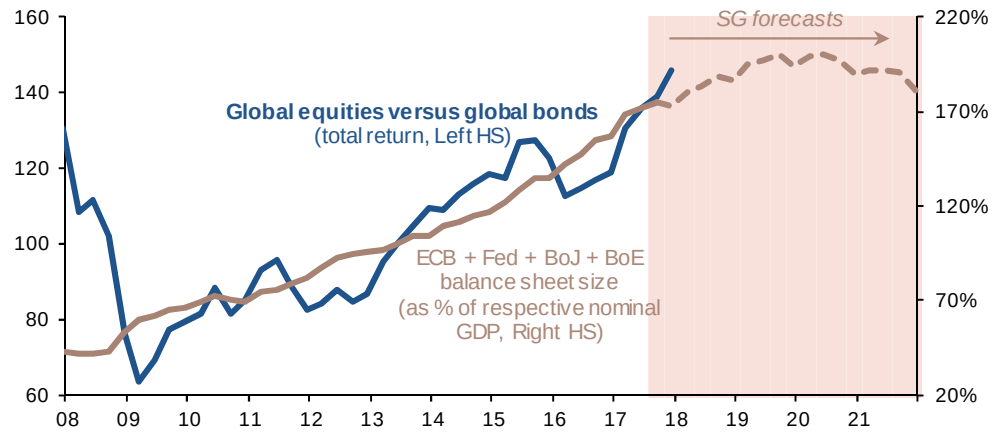
Outlook for equity markets

SG cut the weight of equities in its global portfolio from 50% to 40% and newly keeps an underweight recommendation.

Our outlook for equity markets is based on the forecasts and recommendations of Société Générale's reports *Multi-Asset Portfolio – Be ready for the end of Goldilock* (published on 28 November, 6:59 CET) and *The Big Picture – To bear or not to bear* (published on 23 November, 7:43 CET). SG continues to reduce the risk profile of its allocation. Asset price valuations are indeed high or very high, but for EM assets, risk-taking and momentum-investment are at their peak. The highly visible resynchronisation of global growth leaves the door open for a number of central banks to implement faster exit strategies than currently expected, especially the ECB and later the BoJ. The U.S. economy is late-cycle and impacted by perceived poor political leadership. As a result, **Société Générale reduced the exposure for equities in its asset allocation and advises keeping an underweight position.** High growth expectations are an incentive to continue switching out of equities (-10pp to 40%) in favour of sovereign bonds (+10pp to 28%). The reduction of weight of equities in its global portfolio was caused by lowering the weight of U.S. equities (-8pp) to a minimum of 10% and reducing the position in Europe stocks by 2pp to 10%. With an impressive run since June and net positioning at an all-time high, SG suggests slightly reducing oil and other commodities (-2pp to 5%).

Switch from equities to bonds in a context of balance sheet normalisation, especially in the US



Source: SG Cross Asset Research/Global Asset Allocation ; Multi Asset Portfolio – Be ready for the end of Goldilock on 28 November, 6:59 CET

There is no room for further gains on the U.S. equity market.

The U.S. S&P 500 has entered expensive territory. Indeed, on all metrics, U.S. equities are trading at levels only seen during the late-90s bubble. Since Trump's election, the U.S. equity market has risen more than 25%, but only half of this comes from earnings growth. The other half has been driven by P/E expansion, as the U.S. market is already pricing in potential tax reform. The U.S. economy is in the last phase of the cycle, also characterised by declining profit margins. The rise in bond yields and Fed repricing should be headwinds against further U.S. equity rerating.

The expected strengthening EUR should limit the performance of EU equities and justifies a mild weight reduction.

Positive economic momentum should continue to support the EuroSTOXX 50 and core markets such as France and Germany. However, the stronger EUR and higher bond yields will likely limit performance. Both the Italian and Spanish equity markets will probably be more affected by changes in ECB policy as their overall credit ratings are relatively weak. Political gridlock should remain a source of uncertainty for the Italian and Spanish equity markets in 2018 (elections in Italy, Catalonia and Spain). In the United Kingdom, we expect the FTSE 100 to be under pressure from Brexit negotiations.

Asian markets offer potential growth of indices, but there are fears of a negative spill-over effect of U.S. assets on Asia.

Asian equities remain a bright spot in equity markets. However, we are concerned by the high valuation of U.S. assets and the spill-over effect on Asia of a correction in U.S. equities, U.S. Treasuries or both. We are less concerned about regional risks. The Communist Party Congress has consolidated President Xi Jinping's power and further defined his policy agenda. We believe this is a stabilising factor for Asian assets. An equally influential factor is the likelihood of Shinzo Abe being Japan's prime minister for another four years, which would mean a continuation of the current loose policy mix.

For Asian equities earnings on the whole, valuation and liquidity send positive signals. Our thesis is that Chinese equities are unlikely to repeat the very strong returns of the past 12 months, but we do not expect the Chinese economy's trajectory to be a destabilising factor for Asian equity markets. **We are neutral on Chinese equities; overweight on the Japanese, Korean and ASEAN markets; and tactically underweight for India and Taiwan.**

SG/KB outlook for equity indices

Index	Last price *11-Dec*	III.18 *est.*	VI.18 *est.*	IX.18 *est.*	XII.18 *est.*	XII.19 *est.*	change *1 year (%)*
S&P 500 (USA)	**2,652**	**2,500**	**2,450**	**2,550**	**2,500**	**2,000**	**-5.7**
DJ Stoxx 600 (Europe)	**390**	**380**	**385**	**390**	**385**	**310**	**-1.2**
FTSE 100 (UK)	7,434	7,300	7,200	7,200	7,000	5,500	-5.8
CAC 40 (France)	5,405	5,400	5,500	5,600	5,500	4,500	1.8
DAX 30 (Germany)	13,173	13,000	13,200	13,500	13,500	11,000	2.5
FTSE MIB (Italy)	22,778	21,500	21,000	22,000	21,500	17,000	-5.6
IBEX 35 (Spain)	10,330	9,800	9,600	10,000	9,800	8,000	-5.1
Nikkei 225 (Japan)	**22,939**	**21,500**	**22,000**	**23,500**	**24,500**	**25,500**	**6.8**
HSCEI (China)	11,432	11,200	11,700	12,000	12,800	14,000	12.0
KOSPI 200 (South Korea)	325	325	335	350	365	385	12.3
Sensex (India)	33,385	32,000	33,000	33,670	34,650	38,800	3.8
MSCI AC Asia ex-Japan	691	680	700	720	750	780	8.6
PX (KB/SG, market prices)	**1,062**	**1,100**	**1,080**	**1,120**	**1,140**	**1,231**	**7.3**
PX (KB/SG, consensus)	**1,062**	**1,100**	**1,090**	**1,130**	**1,170**	**1,264**	**10.1**

Source: SG Cross Asset Research (Multi Asset Portfolio from 28 November 2017); Economic & Strategy Research, Komerční banka

Financials remain the most recommended sector by SG.

From a sectoral perspective in Europe, the recovery of the EMU economy, decreasing unemployment and rising wages should support consumption and growth in cyclical sectors. From the consumer sector, we prefer **automobiles & parts.** The current environment should also still be positive for **financials,** including the insurance sector. In light of the expected higher demand for oil, we recommend buying **oil & gas.** We also newly recommend overweight **tobacco.**

Rising interest rates do not bode well for highly leveraged consumer staples and telecoms.

Among the losers in the current environment are consumer staples, telecoms and industry, for which the expected increase in bond yields will be a big headwind. Negative earnings momentum is also behind our negative recommendation for **consumer staples.**

Our outlook for the Czech equity market is positive.

The Prague Stock Exchange could deliver a solid return next year. We adopt a bottom-up approach because the PX index consists of only 13 issues, with the five largest usually having a combined weight of almost 80%. Of the most traded blue chips, we actively cover nine companies (including SG's coverage of Erste Group shares). For valuing other stocks, we use two approaches, i.e. the actual market price and market consensus. An average of these two estimates shows potential growth of around 9% over the one-year horizon (see the table above) with an estimated dividend yield of 5.4%.

We see financial stocks as the most attractive on the PSE.

We believe financial stocks are among the most attractive on the Prague Stock Exchange. For financial institutions, we keep a *Buy* recommendation for Moneta Money Bank and Erste Group, which offer a total return of 27% and 18%, respectively. In general, the European banking sector should benefit from favourable economic conditions, strong household consumption and investment activity. Additionally, Czech banks are well-

capitalised. We are also positive on shares of Vienna Insurance Group, for which we also keep a *Buy* recommendation with an expected total return of 6%

Among other stocks, we have a ***Buy* recommendation for CME,** profiting from an improving financial performance supported by the growing media markets of CEE and a significant reduction of debt service. **We also recommend buying shares of tobacco producer Philip Morris Czech Republic,** supported by favourable results and higher capacity utilisation. Our latest fundamental analysis recommends buying shares of Fortuna betting company, which should mainly profit from recent acquisitions. We keep a *Hold* recommendation for O2 Czech Republic and a *Sell* recommendation for Pegas Nonwovens. The latter will likely be delisted from the PSE in the near future; Fortuna may later face the same fate.

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Expected domestic corporate events in the following months

Date	Company	Event
18 December	Kofola ČeskoSlovensko	General meeting
18 December	Pegas Nonwovens	Extraordinary general meeting
25 January	Unipetrol	4Q17 earnings announcement
30 January	O2 Czech Republic	Preliminary results for 4Q17
8 February	Komerční banka	Preliminary results for 4Q17
8 February	CME	4Q17 earnings announcement
12 February	MSCI	Announcement of MSCI rebalancing
28 February	Erste Group	Preliminary results for 4Q17
1 March	MSCI	MSCI rebalancing effective date
7 March	Stock Spirits Group	4Q17 earnings announcement
9 March	Fortuna Entertainment Group	4Q17 earnings announcement
15 March	Unipetrol	Annual report for 2017
20 March	Kofola ČeskoSlovensko	4Q17 earnings announcement
21 March	ČEZ	4Q17 earnings announcement
22 March	Vienna Insurance Group	4Q17 earnings announcement
23 March	Pegas Nonwovens	4Q17 earnings announcement
28 March	Philip Morris ČR	4Q17 earnings announcement

Source: Bloomberg, companies

Foreign markets

S&P 500 (USA)

Zdroj: Bloomberg

Stoxx600 (Europe)

Zdroj: Bloomberg

Nikkei 225 (Japan)

Zdroj: Bloomberg

HSCEI (China)

Zdroj: Bloomberg

WIG 20 (Poland)

Zdroj: Bloomberg

BUX (Hungary)

Zdroj: Bloomberg

Utility

ČEZ

3Q17 results were unconvincing; investment in decentralised energy is growing

Buy

Price 11.12.17	**CZK 491**
12m target	**CZK 542**
Upside to TP	**10.4%**
Dividend	**CZK 35**
Total return	**17.5%**

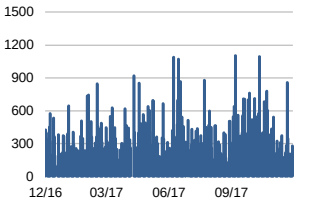
Sector stance
Underweight

Investment type
Commodity price exposure ✓
High dividend yield ✓

1 year performance (CZK)

Source: Bloomberg

Trading volume (in ths of shares)



Source: Bloomberg

Share data

RIC CEZsp.PR	**Bloom** CEZ CP		
52-week range			392.8-498
Market cap. (CZKbn)			264.2
Market cap. (EURbn)			10.3
Free float (%)			30
Performance (%)	**1m**	**3m**	**12m**
Share	1.6	17.8	17.7
Rel. PX Index	1.8	13.6	-0.1

Source: Bloomberg

The latest reports:
http://bit.ly/CEZana17e
http://bit.ly/CEZ_Q317res_eng

CEZ results for 3Q17

CZKbn	3Q16	3Q17	change	KB estimate	consensus*
Revenues	46.2	45.8	-1%	45.99	45.99
EBITDA	10.7	9.7	-9%	10.36	10.24
EBIT	3.6	2.1	-42%	2.86	2.47
Net profit	0.9	-0.1	n/m	1.03	0.87
Adjusted net profit	1.9	0.3	-84%	1.12	0.87

Source: CEZ, Economic & Strategy Research, Komerční banka. *CEZ poll of 12 analysts including KB

The 3Q17 company results lagged behind expectations, particularly at the operating and net profitability levels. EBITDA, which dropped 9% yoy to CZK9.7bn, was negatively affected by lower realisation prices and higher emissions allowance costs; on the other hand, the generation breakdown benefited positively from higher utilisation of nuclear power plants. CEZ reported a net loss of less than CZK100m. This was affected by higher D&A, primarily due to the inclusion of the Prunerov power plant in the company's assets. At the same time, CEZ wrote off a part of goodwill in Turkey in the amount of CZK0.4bn. Adjusted profit was CZK0.3bn.

Management's guidance: Management slightly reduced its full-year EBITDA outlook by CZK1bn to CZK52bn. This was primarily due to the decision of the Supreme Court to postpone the decision concerning the payment of SZDC's debt from 2011 beyond 2017 (including the ancillary, with an impact on EBITDA of roughly -CZK1.3bn). However, the guidance for net profit remained unchanged at CZK19bn.

Bulgarian assets: CEZ reiterated this morning that it has agreed on the conditions of sale for its Bulgarian coal-fired power station Varna, which has been closed due to unsatisfactory environmental limits since 2015, with Bulgarian company SIGDA OOD. The transaction price has not yet been announced as the two sides are awaiting approval by the Bulgarian Competition Authority. We assume, in an optimistic scenario, that CEZ could gain EUR50m (roughly CZK1.3bn). Today, there are also headlines that CEZ has a serious buyer for its other Bulgarian assets, namely the distribution network, the Orešec solar power plant and the Bara biomass processing plant. In this case, the price could exceed the last known bid of EUR300m (about CZK7.7bn).

New acquisitions: CEZ ESCO has acquired four companies operating in the field of decentralised energy. Specifically, Hormen CE producer of lights, AirPlus air-conditioner supplier, OEM Energy Polish power plant installer and Easy Power local distribution network operator. In the coming days, CEZ ESCO will complete another acquisition, a prominent provider of services in the area of thermal energy modernisation. The transaction value was not revealed. The management only mentioned that the acquisition costs are such that the return on investment is more than 10% a year. Acquisitions fit into the company strategy to become a major player in this field. CEZ invests in energy services with a view to their future development on the basis of the EU's 2030 targets, which include an increase of 35% in renewable energies and 30% energy savings, for instance.

Main risks: The significant weakening of wholesale power prices, any sizeable unplanned outages at nuclear reactors above the outages already scheduled for this year, a significant decrease in dividend payout.

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Media

CME

A new significant bidder is in the game of buying a majority stake in CME

Buy

Price 11.12.17	**USD**	**4.9**
	CZK	104.2
12m target	**USD**	**5.0**
	CZK	108.5
Upside to TP	**3.1%**	
Dividend	**USD**	**0.0**
	CZK	0
Total return	**3.1%**	

Sector stance

Overweight

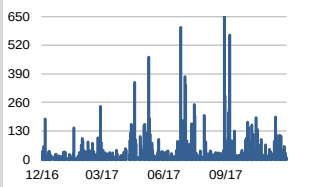
Investment type

Cyclical sector ✓

1 year performance (CZK)

Source: Bloomberg

Trading volume (in ths of shares)



Source: Bloomberg

Share data

RIC CETVsp.PR	**Bloom** CETV CP		
52-week range			63.1-110
Market cap. (CZKbn)			15.1
Market cap. (EURm)			703
Free float (%)			44
Performance (%)	**1m**	**3m**	**12m**
Share	4.2	14.6	50.1
Rel. PX Index	4.4	10.5	27.4

Source: Bloomberg

The latest reports:

http://bit.ly/CME_TP5e

http://bit.ly/CME3Q17res

CME results for 3Q17

$m	3Q16	3Q17	change	KB estimate	consensus*
Revenues	107.5	119.4	11.1%	110.4	120.5
OIBDA	19.3	25.1	30.1%	22.8	25.7
Operating income	11.5	16.0	39.9%	14.4	n/a
Net profit	-19.8	-7.9	nm	-8.5	-3.2

Source: CME, Economic & Strategy Research, Komerční banka, *Bloomberg poll

Results: Revenues rose 11.1% to $119.4m, and the sales breakdown showed a positive contribution by all markets. Profitability continued its growth trend in the third quarter, mainly due to TV ad market expansion and the continuing growth of carriage fees and subscription revenues. OIBDA grew a strong 30% in 3Q17, reaching $25.1m. Decreasing but still high interest expenses and losses from discontinued operations generated a total net loss of $7.9m (-$19.8m in 3Q16).

Speculation on sales of majority stake in CME: In November, a new bidder appeared who is about to buy a majority stake in CME from Time Warner. This is a joint effort by the Chinese investment group CEFC and Czech investment group Penta. Time Warner has a 46.5% voting share in CME, but on a fully diluted basis the U.S. group has a 75% interest in CME, based on warrants exercisable until May 2018. In addition, CME agreed on sales of its Slovenian and Croatian activities for $262.5m to Slovenian company United Group in July. This should allow the company to quickly redeem its debt. The completion of the transaction was scheduled for the beginning of 2018. In November, CME was also hit by Croatian regulators who blocked the sale of its Croatian business. CME is now considering its next steps. The question is whether new bidders, i.e. CEFC with Penta, would be interested in the Croatian activities if CME can't reach an agreement with the Croatian regulators.

Outlook: Although the company does not expect strong growth from 2016, fuelled by the European football championship, to be repeated this year, it forecasts OIBDA growth of 13–17%. Romania and the Czech Republic remain the main growth regions. The strengthening of overall profitability should bring increased unlevered free cash flow generation that could rise up to $110m, based on the company's forecasts. The company plans to use the free cash flow to further reduce its leverage as capex is planned at last year's level of $30m.

Risks: The main risks against our recommendation are the unsuccessful completion of sales of the Slovenian and Croatian activities, the possibility of selling a majority stake in CME and subsequent withdrawal of shares from the stock exchange, deterioration of the macroeconomic environment in CEE, USD strengthening, rising interest rates and capital dilution.

Upcoming events: 4Q17 results could be reported at the end of February 2018.

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Sports betting

Fortuna

New acquisitions and sales channels improve results

Buy

Price 11.12.17	**CZK 178.0**
12m target	**CZK 198.0**
Upside to TP	**11.2%**
Dividend	**EUR 0** CZK 0.0
Total return	**11.2%**

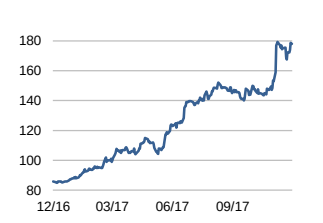
Sector stance

No rating

Investment type

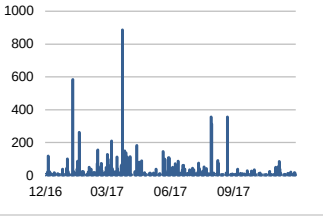
Defensive ✓

1 year performance



Source: Bloomberg

Trading volume (in ths of shares)



Source: Bloomberg

Share data

RIC FOREsp.PR	**Bloom** FOREG CP		
52-week range			85-179.6
Market cap. (CZKbn)			9.3
Market cap. (EURm)			362
Free float (%)			33
Performance (%)	**1m**	**3m**	**12m**
Share	16.3	21.1	107.0
Rel. PX Index	16.6	16.7	75.6

Source: Bloomberg

The latest reports (in Czech only):

http://bit.ly/FOREG_1117_upd

http://bit.ly/FORTUNA_Q317res

Fortuna results for 3Q17

€m	3Q16	3Q17	change	KB estimate
Amounts staked	244.4	558.1	128.4%	508.2
Gross wins	39.7	85.1	114.2%	67.6
Revenues	26.5	60.7	129.2%	43.0
EBITDA	6.2	20.7	234.6%	11.6

Source: Economic & Strategy Research, Komerční banka, Fortuna

Results: 3Q17 exceeded our and market expectations in all areas. This year's trend of a significant increase in amounts staked continued also in 3Q reaching €558m with 128% growth. The newly acquired Hattrick Sports Group and Fortuna Romania, as well as the growing interest in the online gaming segment, highly contributed to great financial results. Gross wins reached €85m with 114% growth. The growth rate of gross wins is lower than the growth rate of amounts staked mainly due to lower gross win margins on online gaming. The huge 235% yoy growth in EBITDA to €21m was caused by positive development in Hattrick and also lower acquisition costs with Fortuna Romania (for detailed information, please check our 3Q comment http://bit.ly/FORTUNA_Q317res).

Outlook for 2017: The company has confirmed its outlook to achieve in 2017 amounts staked of EUR1.3bn and an EBITDA increase of 20–25%, net of the impact of the Hattrick Sports Group and Fortuna Romania acquisitions. After their consolidation, amounts staked should increase to €1.9bn and EBITDA should grow 80–95%. Fortuna's outlook corresponds with our expectation that new acquisitions should increase amounts staked by €600m this year and total amounts staked should reach €1.9bn. We expect EBITDA to increase 85% to €41m. CAPEX should be between €11m and €14m by the end of the year.

Our recommendation: The target price and recommendation were revised based on very positive 3Q17 results. We have updated mainly our assumptions regarding future growth of newly acquired companies. We increased our *Hold* recommendation to *Buy* and also increased our target price for Fortuna shares from CZK128 to CZK198. For more information, please check our analysis http://bit.ly/FOREG_1117_upd.

Risks: The main risks against our recommendation are the failure to meet the expected positive impacts of recent acquisitions, the attitude of the major shareholder toward minority shareholders, further growth in betting taxation on the company's main markets and the continuation of high capital expenditures.

Upcoming events: Results for 4Q17 will be presented on 9 March 2018.

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Banking

MONETA Money Bank

A dividend below CZK9 paid from this year's profit would be a disappointment

Buy

Price 11.12.17	**CZK 78.1**
12m target	**CZK 90.0**
Upside to TP	**15.2%**
Dividend	**CZK 9.3**
Total return	**27.1%**

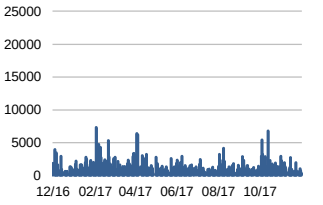
Sector stance
Overweight

Investment type
High dividend yield ✓
Sensitivity to economic cycle ✓

1 year performance

Source: Bloomberg

Trading volume (in ths of shares)



Source: Bloomberg

Share data

RIC MONET.PR	**Bloom** MONET CP		
52-week range			74.45-90.8
Market cap. (CZKbn)			39.9
Market cap. (EURm)			1559
Free float (%)			57.49
Performance (%)	**1m**	**3m**	**12m**
Share	-0.8	2.4	n/a
Rel. PX Index	-0.6	-1.3	n/a

Source: Bloomberg

The latest reports:
http://bit.ly/MONETupd_1708eng
http://bit.ly/MONET_17Q3eng

Company results for 3Q17

CZKm	3Q16	3Q17	yoy	KB estimate	Consensus
Net interest income	2,047	1,804	-11.9%	1,798	1,800
Net fee and commission income	473	474	0.2%	437	464
Total operating income	2,659	2,452	-7.8%	2,439	2,435
Net profit	909	924	1.7%	819	818
Earnings per share	1.78	1.81	1.8%	1.60	1.60

Source: Economic & Strategy Research, Komerční banka, MONETA Money Bank

The 3Q17 announced results were surprising, especially at the level of net profit, which was about 13% higher than the market consensus. This result was associated with lower operating costs and, in particular, lower impairments of loans. Moneta recorded high yoy growth in retail and corporate loans. The net interest margin continued to decline to 4.3% from 5.8% in 3Q16. Apart from refinancing loans provided in the past with lower interest rates and strong pressure on a slump in consumer interest rates, the drop is also caused by a change in the loan breakdown, with a significantly increasing share of provided mortgages, and is also a result of NPL monetisation as these loans bore higher interest rates.

Consumption of excess capital: Capital adequacy reached 18.1% (excluding net profit for the first three quarters of this year). Management reaffirmed its medium-term target CET1 ratio of 15.5% over the next 15 months. Excess capital amounted to CZK2.949bn at the end of 3Q17, of which CZK0.9-1.0bn would be used to meet the requirements of the new IFRS 9 regulation, CZK0.3-0.5bn to investments in the digital and IT system, and an unspecified amount to support credit activity. The rest (we estimate CZK1.2-1.4bn) could be distributed to shareholders in 2018 and 2019.

Management guidance: Management upgraded its guidance for the full-year net profit to CZK3.9bn, mainly due to lower risk costs, which is about CZK200m more than the market consensus. The board leaves operating profit unchanged at a minimum of CZK10.3bn. Operating costs should be kept below CZK4.8bn. At the same time, management reiterated that it will continue NPL monetisation. In October 2017, there was another sale with an estimated positive impact on results of CZK120m.

Dividend policy: The CEO stated that management would propose a distribution of dividends significantly above the payout dividend ratio of 70% of consolidated net profit to shareholders. Taking into account that MMB will stick to a similar dividend policy as last time, when it paid 100% of last year's net profit plus less than CZK1bn excess capital, a dividend of less than CZK9 per share would be disappointing.

Risks: We still consider the low interest rate environment with an impact on falling interest margins as the main risk. The volume of loans provided is growing, which is one of the pillars of the company's current strategy, helping to offset partially lower margins. If the growth did not accelerate further, it would have a negative impact on the company's performance. A faster increase in the CNB's interest rates would have a potentially positive effect on the bank's performance.

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Telecommunications Services

O2 Czech Republic

Full-year results may exceed our initial estimates

Hold

Price 11.12.17	CZK 275
12m target	CZK 270
Upside to TP	-1.8%
Dividend	CZK 21
Total return	5.8%

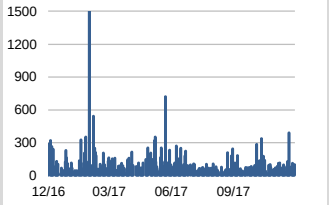
Sector stance
Underweight

Investment type
Defensive ✓
High dividend yield ✓

1 year performance (CZK)

Source: Bloomberg

Trading volume (in ths of shares)



Source: Bloomberg

Share data

RIC SPTTsp.PR	**Bloom** TELEC CP		
52-week range			230.9-292.6
Market cap. (CZKbn)			85.3
Market cap. (EURm)			3333
Free float (%)			28
Performance (%)	**1m**	**3m**	**12m**
Share	3.2	1.5	19.3
Rel. PX Index	3.4	-2.2	1.2

Source: Bloomberg

The latest reports (in Czech only):
http://bit.ly/TELECupd_1709
http://bit.ly/O2CR_Q317

O2 Czech Republic results for the third quarter of the year

CZK bn	3Q16	3Q17	Change	KB estimate	Consensus
Sales	9.51	9.43	-0.9%	9.30	9.32
EBITDA	2.80	2.71	-3.2%	2.58	2.50
Operating profit	1.88	1.91	1.2%	1.66	1.65
Net profit	1.46	1.48	1.4%	1.27	1.27

Source: O2 Czech Republic, Economic & Strategy Research, Komerční banka, consensus of O2 Czech Republic

3Q17 results O2 Czech Republic surpassed both our and market expectations, in total. The company reported a mild yoy decline of 1% in revenues. The termination of roaming charges in the EU in the middle of June had the biggest impact on O2's profitability. This also led to a drop in EBITDA to CZK2.7bn. Within the segments, Czech mobile networks saw the fastest-rising dynamics, with O2 CR making 3.4% more than last year and revenues exceeding CZK5bn. The negative impact of lower roaming revenue has been offset by rising customer base quality, higher data service spending and a positive impact of revenue from financial services. Sales in Slovakia increased 2.2% to CZK1.8bn. The growing share of contract customers with an increasing total client base, with the improvement of transmissions networks and the growing interest in the smartphone portfolio, is the biggest contributor to this development. On the contrary, they were negatively affected by the strengthening CZK against EUR. Revenues in the fixed-line segment amounted to almost CZK2.7bn, which means a yoy decline of almost 10%. There is a positive development of revenues from O2TV, but they are insufficient to compensate for lower revenues from traditional voice services and the continued decline in data service revenues.

Estimates of full-year results: The company did not comment on its guidance for this year. The termination of roaming charges will continue to have an adverse effect on the company profitability, but on the other hand, we expect continued positive customer base development, higher data service spending and rising financial services revenues. The results favourably surprised us at the levels of operating and net profit. In our last analysis, we expected a 1% drop for the whole year. The third-quarter results gave hope that O2 could eventually slightly increase profit compared with last year.

Risks: We consider tighter regulations as the biggest risk. The exchange rate of EUR/CZK represents another risk. The significant strengthening of CZK would show up in lower revenues from the Slovak mobile segment expressed in CZK. The entrance of a new operator could push margins down.

Expected events: The company will publish its 4Q17 results by the end of January 2018.

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Textiles

Pegas Nonwovens

Textile shares are likely to be withdrawn from the stock market

Sell

Price 11.12.17	**CZK 825**
12m target	**In review**
Upside to TP	**n/a**
Dividend	**In review** In review
Total return	**n/a**

Sector stance

Neutral

Investment type

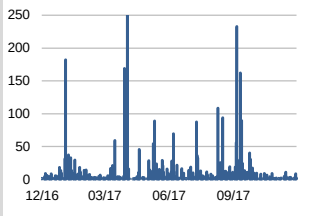
High dividend yield ✓

Low market capitalisation ✓

1 year performance

Source: Bloomberg

Trading volume (in ths of shares)



Source: Bloomberg

Share data

RIC PGSN.PR	**Bloom** PEGAS CP		
52-week range			759.1-1027
Market cap. (CZKbn)			7.6
Market cap. (EURm)			298
Free float (%)			99
Performance (%)	**1m**	**3m**	**12m**
Share	-0.9	-18.1	5.3
Rel. PX Index	-0.7	-21.0	-10.7

Source: Bloomberg

The latest reports (in Czech only):

http://bit.ly/PEGASupd_1709

http://bit.ly/PEGAS_17Q3res

3Q17 results

EUR millions	3Q16	3Q17	yoy	KB estimate	Consensus
Sales	51.11	55.69	9%	59.40	57.84
EBITDA	11.28	10.26	-9%	11.46	10.78
Operating profit	7.33	5.82	-21%	7.17	6.42
Net profit	5.48	0.72	-87%	2.59	2.14

Source: Pegas, Economic & Strategy Research, Komerční banka, consensus Pegas Nonwovens

The company's results for the third quarter were disappointing. All major indicators lagged behind our and market expectations. The increase in total production and the development of polymer prices have been positive. Despite this, the transmission mechanism of prices was not as favourable as we expected, which was reflected at all levels of the profit and loss account. Production volume, thanks to the new line in Znojmo, reached a record 27,893 tonnes, up 11.4% yoy.

Full-year estimates: The third quarter was the second in a row when results came as a disappointment. Polymer prices in the final quarter have begun to grow again. Our estimate of full-year EBITDA at EUR47.9m seems too optimistic, and its fulfillment would mean an increase in the EBITDA margin to 30%, which we consider unrealistic. In our opinion, meeting the management's guidance within the range of EUR43-50m is also in danger, and the risk of its non-fulfillment due to the current development of polymer prices is quite high.

New majority owner: R2G Rohan Czech became the majority shareholder after its voluntary redemption bid was settled in the third quarter when its share was 88.49%. The company would be obliged to buy back the remaining shares if its stake would be 90%; the minority shareholder's squeeze-out would be at a 95% stake. However, the obtained majority is sufficient for the general meeting of the company to decide to withdraw shares from the stock exchange. The remaining shares would become practically illiquid, and their transfer will only be possible on the over-the-counter market. The majority owner will not be obliged to buy these shares, let alone for a previously set redemption price of CZK1,010 per piece.

Revision of the target price and recommendations: The company results currently have no impact on the stock price, which is now affected by other factors. We perceive a great risk that the new majority owner will decide to withdraw shares from the stock exchange, thereby making minority shareholders' shares illiquid, which will reduce their value. In our latest commentary on the results (http://bit.ly/PEGAS_17Q3res, in Czech only), we reiterated our recommendation to sell the company's shares, but we put the target price into the review (before it was CZK876). We consider it to be too high in the context of the intended owner's actions, worse economic results and the increasing risk of not meeting the management's guidance.

Risks: Continuing growth in polymer prices and a failure of the management's guidance are seen as the main risks of worse business performance and stock prices. On the contrary, keeping shares on the stock exchange and maintaining the existing dividend policy would be positive for our current recommendation.

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| Tobacco |

Philip Morris CR

The Anti-Smoke Act still has no confirmed negative effects on cigarette consumption

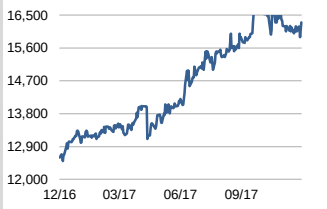
Buy

Price 11.12.17	**CZK 16123**
12m target	**CZK 17546**
Upside to TP	**8.8%**
Dividend	**CZK 1070**
Total return	**15.5%**

Sector stance
Overweight

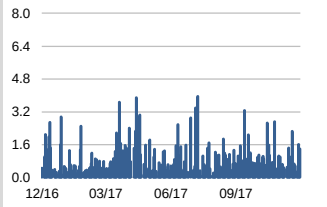
Investment type
High dividend yield ✓

1 year performance



Source: Bloomberg

Trading volume (in ths of shares)



Source: Bloomberg

Share data

RIC TABKsp.PR	**Bloom** TABAK CP		
52-week range			12425-17211
Market cap. (CZKbn)			44.3
Market cap. (EURm)			1730
Free float (%)			22
Performance (%)	**1m**	**3m**	**12m**
Share	-0.5	2.3	27.9
Rel. PX Index	-0.3	-1.4	8.5

Source: Bloomberg

The latest reports (in Czech only):
http://bit.ly/PMCR_82017
http://bit.ly/PM_IQOS

Since the last equity outlook published on 27 September, Philip Morris has not published any new figures or news. In mid-November, the media reported that cigarette consumption in the first nine months of the year totaled 15.4m pieces, which is the same as in the comparable period of 2016. The act about cigarette box printing, valid from 7 December 2016, and the introduction of the Anti-Smoke Act from 31 May 2017 for the time being had only a minimal impact on cigarette consumption. This may be considered slightly positive news if taken into account that in our valuation models we assume a decent drop in sales. The impact of the Anti-Smoke Act could show up more in the fourth quarter, when restaurant and pub gardens, where smoking is allowed, are currently closed. New platforms could be a counterweight to this decline.

New platforms: Philip Morris International has invested heavily more than $3bn into the development of new platforms worldwide. One of them is the IQOS, which heats tobacco without burning it (more about the IQOS here http://bit.ly/PMCR_IQOS). The company sold 7.4bn packs of special cigarettes for IQOS worldwide last year and for this year expects to sell 32bn. As of the second half of the year, the device is also available in the Czech Republic. Philip Morris sees great potential in IQOS cigarettes, which are being sold on more than 20 markets worldwide, in some places at brand stores called iQOS Store. Sales of new smokeless technology are expected to grow very fast and by 2025 to make up to a third of the cigarette market.

Possible change in the Anti-Smoke Act: Given the outcome of the parliamentary elections, as the ČSSD, who approved the Anti-Smoke Act, has a much weaker position now, its opponents are now trying to come up with a new milder law. This should allow the establishment of smoking rooms in pubs and at the same time grant exemption from the ban to small bars up to 50 square meters. First the senators will discuss recommendations for the government, which could subsequently deal with the new law.

Outlook for 2017: For the time being, the negative impact of the Anti-Smoke Act has not been confirmed, as demonstrated by cigarette consumption in the first nine months of this year. The last quarter will show whether there will be any negative impact, as the restaurant gardens are closed. Though the possible negative impact of the new act, we assume growth of profit due to relocation of production from other European countries where capacity is released to produce new technology. Net profit growth, which we expect at more than 6%, will allow the company to maintain high dividends.

Risks: Lower cigarette consumption, lower-than-expected production, the failure of the new IQOS technology, stricter regulations for smoking and stronger increases in excise duties would be reflected negatively in the results and the company valuation.

Upcoming events: Results for 4Q17 will be presented at the end of March 2018.

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Insurance

Vienna Insurance Group

Continuing positive trends will support the company's future performance

Buy

Price 11.12.17	**EUR**	**25.4**
	CZK	649.9
12m target	**EUR**	**26.0**
	CZK	673
Upside to TP	**2.2%**	
Dividend	**EUR**	**0.9**
	CZK	18.1
Total return	**5.8%**	

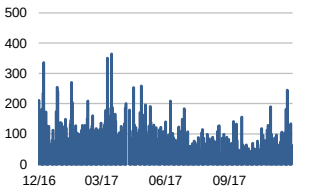
Sector stance
Overweight

Investment type
EMG markets exposure ✓

1 year performance

Source: Bloomberg

Trading volume (in ths of shares)



Source: Bloomberg

Share data

RIC VIGR.VI	**Bloom** VIG AV		
52-week range			20.4-26.4
Market cap. (CZKbn)			83.3
Market cap. (EURm)			3255
Free float (%)			30
Performance (%)	**1m**	**3m**	**12m**
Share	-0.3	3.2	24.0
Rel. to ATX Index	1.7	-0.3	-3.8

Source: Bloomberg

The latest reports:
http://bit.ly/VIG_201703
http://bit.ly/VIGres_Q217
http://bit.ly/VIG_Q317res

VIG results for 3Q17

EURm	3Q16	3Q17	change	KB estimate	consensus
Gross premium written	2,034	2,180	7.2%	2,071	2,064
Net earned premium	1,967	2,107	7.1%	2,000	1,995
Financial result	254	244	-4.0%	241	244
EBT	100	111	10.7%	114	108
Net attributable profit	67	68	2.0%	77	72

Source: Vienna Insurance Group, Economic & Strategy Research, Komerční banka

Overall, **3Q17 results** came as a mild surprise in comparison with the market's and our expectations. CEO Elisabeth Stadler expects a continued positive performance in the final quarter, similar to the performance so far in 2017.

Facts and figures: (1) Gross premiums written rose strongly 7.2% yoy. Life insurance was the biggest surprise, recording a yoy increase of 4.8% despite an anticipated decline. VIG also registered a huge increase in the life single premium business in Q317 (+11.6%) in contrast with previous quarters, when this segment showed a deep drop. Property and casualty insurance developed more or less in line with our expectations (+9.2%), supported by motor and other property and casualty lines of business. On the contrary, health insurance was a disappointment as dynamics (+6.4%) lagged behind expectations. (2) VIG's main markets reported solid results. Except for Romania, where the negative impact of lower insurance premiums in the motor segment led to lower total gross premiums (-8.1%), the insurance company registered a yoy increase of total GWP. Poland added 14% yoy in 3Q17. (3) It is also worth mentioning the huge increase in the Baltics (+124.4%), affected positively by BTA consolidation. Overall, we consider developments on other markets positively. (4) EBT went up 10.7% to EUR110.7m in 3Q17. All segments contributed positively, including the Baltics, where we have seen negative results for many quarters previously. (5) VIG reported a stable combined ratio of 98%. This will be negatively affected in 4Q17 by Storm Herwart at the end of October, which mainly affected companies in the Czech Republic, Austria and Poland. Expected costs are estimated within a range of EUR40-45m. (6) The Solvency II ratio was virtually stable at 225% in 3Q17 compared with 2Q17, demonstrating the the insurance company's strong capital position. Management targets a range of 170% to 230%.

Potential impact on share price/recommendation: The released figures confirm positive trends. The CEO expects to significantly increase the good results previously achieved in 2016. Despite the low interest rate environment, economic growth remains strong in the CEE region and should continue to support the company's performance this and next year. We keep our Buy recommendation with a target price at EUR26 per share.

Main risks: Natural disasters and insurance fraud are the main risks. Weaker economic trends and a longer period of a low interest rate environment would negatively influence VIG's performance.

Upcoming events: The insurance company will announce its full-year results on 22 March 2018.

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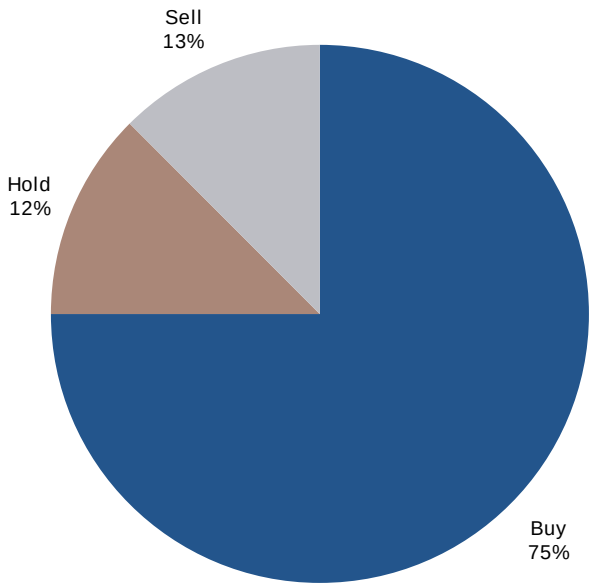
The chart below shows the structure of grades of valid investment recommendations of equity research of KB Economic & Strategy Research (8 recommendations).

Investment recommendations of KB equity research (as of 11 December 2017)



Source: Economic & Strategy Research, Komerční banka

KB Equity Research ratings on a 12 month period

BUY: absolute total shareholder return forecast of 15% or more over a 12 month period.
HOLD: absolute total shareholder return forecast between 0% and +15% over a 12 month period.
SELL: absolute total shareholder return forecast below 0% over a 12 month period.
Total shareholder return means forecast share price appreciation plus all forecast cash dividend income, including income from special dividends, paid during the 12 month period. Ratings are determined by the ranges described above at the time of the initiation of coverage or a change in rating (subject to limited management discretion). At other times, ratings may fall outside of these ranges because of market price movements and/or other short term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by research management.

	CEZ	O2 CR	CME	Philip Morris CR	Pegas Nonwovens	Vienna Insurance	Fortuna	MONETA Money Bank
Overview of last investment research and recommendations related to stocks of particular issuers								
Recommendation	Buy	Hold	Buy	Buy	Sell	Buy	Buy	Buy
Target Price	CZK 542	CZK 270	USD 5	CZK 17546	In revision	EUR 26	CZK 198	CZK 90
Date	20/9/17	18/9/17	27/7/17	22/8/17	16/11/17	3/3/2017	30/11/2017	17/8/17
Overview of investment researches and recommendations for last 12M (quarterly)								
Recommendation	Hold	Hold	Buy	Hold	Sell		In revision	Buy
Target Price	CZK 44	CZK 267	USD 4.2	CZK 13500	CZK 876		In revision	CZK 95
Date	14/9/16	31/1/17	27/4/17	25/5/17	13/9/17		9/11/17	9/6/17
Recommendation	Buy	Buy	Buy	Buy	Hold		Hold	Buy
Target Price	CZK 420	CZK 267	USD 3.7	CZK 13500	CZK 876		CZK 128	CZK 90
Date	12/2/16	9/12/16	10/3/17	13/6/16	19/4/17		12/6/17	6/9/16
Recommendation		Hold			Buy		Hold	
Target Price		CZK 260			CZK 863		CZK 96	
Date		22/3/16			20/5/16		20/5/16	
Recommendation								
Target Price								
Date								
Valuation methods	DFCF	DFCF DDM	DFCF	DDM	DFCF DDM	DDM ERM	DFCF	DFCF DDM ERM
Frequency of rec. (per year)	twice	twice	twice	twice	twice	twice	twice	twice
Direct or indirect share (5% or more) of the issuer of the registered capital of KB	no	no	no	no	no	no	no	no
Other significant financial interest of KB and/or its linked persons in the issuer	no	no	no	no	no	no	no	no
KB direct or indirect share (0.5% or more) of the registered capital of the issuer.	no	no	no	no	no	no	no	no
Author's direct or indirect share (0.5% or more) of the registered capital of the issuer.	no	no	no	no	no	no	no	no
Significant financial interest in the issuer of the persons participating in elaboration of investment researches and recommendations	no	no	no	no	no	no	no	no
Relationships of Komerční banka with particular issuers								
KB Management or co-management of public offerings in the past 12 month	no	no	no	no	no	no	no	no
Agreements or contractual relations for providing investment services with the issuer	KB can have concluded agreements with the issuer for providing investment services. This information is protected by bank secret and could not be disclosed.							
Agreement with the issuer on production and dissemination of the research	no	no	no	no	no	no	no	no
KB market making for common stocks of the issuer	no	no	no	no	no	no	no	no

Note: DFCF – Discounted free cash flow model, DDM – Discounted dividend model, ERM – Excess return model

Source: Economic & Strategy Research, Komerční banka

We do not include our one-off short-term recommendations based on Société Générale's analyses to this overview.

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