CONCORDE RESEARCH

CEE Equity Research | Insurance | Hungary
17 August 2020

CIG Pannonia

Recommendation: Neutral (unch.)
Target price (e-o-y): HUF 315 (unch.)
Share price: HUF 344

Share price close as of 17/08/2020	HUF 344	Bloomberg	PANNONIA HB
Number of diluted shares [million]	94.4	Reuters	CIGP.BU
Market capitalization [HUF bn/EUR mn]	32 577/93.6	Free float	75%
Daily turnover 12M [HUF million]	0.08	52 week range	HUF 100 – 388

New broom may sweep clean

- CIG Pannonia Life Insurance (Pannonia) reported a profit after tax of HUF 520mn for Q2/20 compared to HUF -588mn in the same period a year earlier. The increase in after-tax profit was due to two one main reason: the profit after tax of the non-life segment, as a discontinued operation, was HUF 414mn profit, as against a HUF 559mn loss in previous year same period. The insurer's life segment increased its profit after tax from HUF 619mn to HUF 846mn YoY.
- The other comprehensive income was down to HUF 0.7bn as against HUF 1.1bn in Q2/19 mainly affected by (unrealized and realized) losses on OPUS shares.
- CIG Pannónia Life Insurance's Solvency II ratio stood at 336% at the end of March, 2020, while its consolidated Solvency II ratio was 321% compared to 329% and 254% at the end of March, 2020.
- GWP rose by 11% YoY from HUF 4.6bn to HUF 5.1bn in Q2/19. In the life segment, the new acquisition amounted to HUF 0.7bn which was 36% lower compared to the new acquisition in the same period a year earlier. In the traditional segment the decrease was attributed to a significant group insurance policy, which increased the acquisition in the base period of 2019. While in case of the unit-linked products, the decrease is mainly due to the COVID-19.
- GWP of unit-linked life insurance amounted to HUF 4bn (thereof HUF 1.8bn was pension insurance policies), HUF 1bn were traditional life products (thereof HUF 0.3bn came from pension insurance policies), and HUF 0.1bn were health insurance policies. In the life segment GWP from the first annual premiums of policies sold was HUF 1bn (+28% YoY). GWP from renewals came to HUF 2.9bn in Q2/20 (+15YoY), while top-up and single premiums amounted to HUF 1.2bn (-6% YoY), the latter was mainly due to a decrease in unit-linked life insurance policies. Within the total life insurance premium income top-up and single premiums represented 22% in Q2/20 compared to 27% in Q2/19. Non-life GWP dropped by 60% YoY from HUF 2.4bn to HUF 1bn mainly because of the divestment of some major activities.

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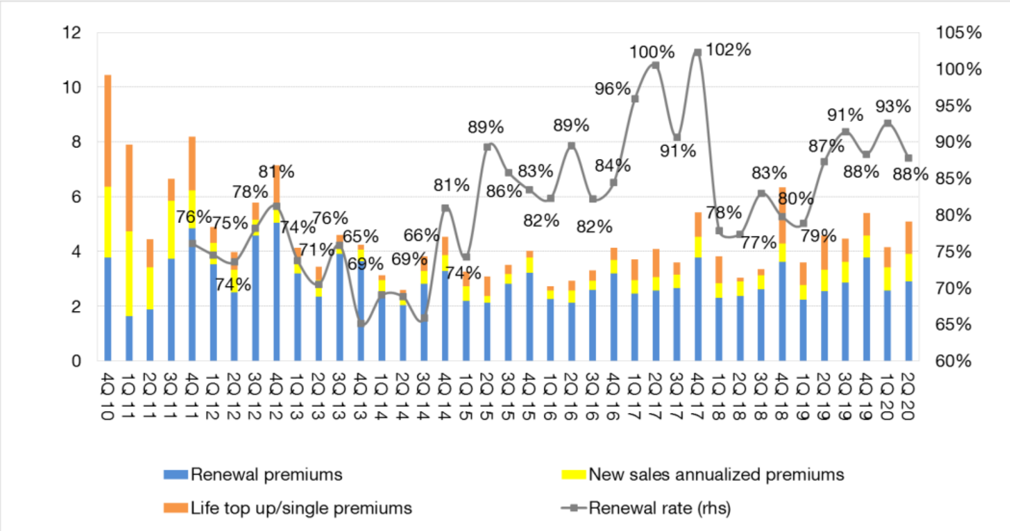
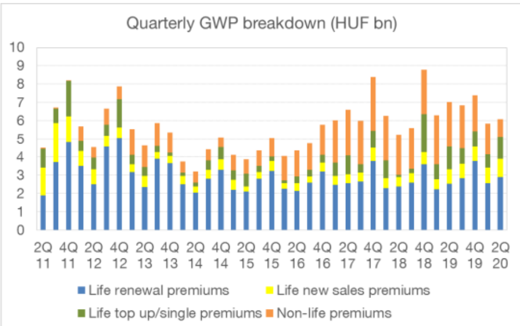
GWP breakdown in the life insurance segment (HUF bln)

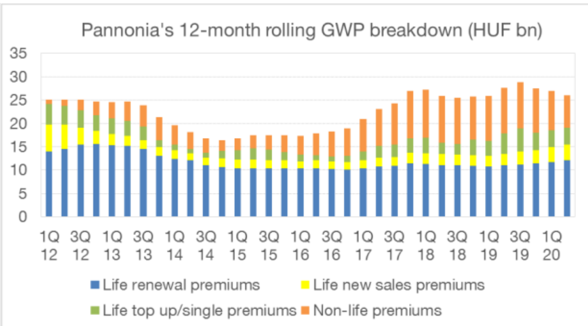


Source: Pannonia, Concorde estimate

- 12-month rolling GWP continued sliding for the third consecutive quarter due to deteriorating non-life premium income mainly as a consequence of divestments.

Quarterly consolidated GWP breakdown (HUF bn) | 12-m rolling GWP breakdown (HUF bn)





Source: Pannonia, Concorde estimate

- Pannonia earlier had decided to dispose of its Hungarian property, liability, goods in transit, cargo and vehicles insurance activities of its non-life company EMABIT (including more than 100 thousand pieces insurance with nearly HUF 6bn annualized premium), which is still subject to the approval of the Hungarian National Bank. Pannonia deems that the going concern is unsustainable in case of the EMABIT, therefore the whole activity of the non-life subsidiary has been defined as discontinued activity according to IFRS.
- The size of non-reinsured Italian surety insurance portfolio decreased to EUR 256mn by the end of 2019. For the most exposed and problematic product types (such as gaming which accounts for ca. 20% of total Italian exposure and 59% of non-reinsured portfolio) duration is less than six months. However, some of the contracts allow claims to be made even after the expiration date, for up to 1 year.
- CIG Pannonia Life Insurance Co., the parent company, has made a commitment to take over the operating costs of EMABIT from 1 Aug 2020 to ensure the solvency of its subsidiary. The maximum amount of the operating cost takeover is HUF 0.5bn for a period of three years, in line with the run-off of the portfolio. In addition, the parent company undertook an additional capital increase of HUF 0.5bn in the event that EMABIT's solvency capital would fall below the capital adequacy of 120% over the course of the next five years. As a result of recovery measures made earlier, EMABIT's solvency capital adequacy has been restored by increasing from 57% at

31 March, 2020 to 147% by 30 June 2020, including the additional capital requirement.

- Investment results were positive at HUF 3.2bn in Q2/20 as a result of an unprecedented recovery in the stock and bond market valuation after a collapse globally triggered by the outbreak of the coronavirus pandemic.
- Operating costs decreased by 2% YoY and accounted for 24% of GWP in Q2/20 (vs. 26% in Q2/19), of which fees, commissions and other acquisition costs represented 70% (vs. 73% in Q2/19), while admin costs and other expenses (mainly provisions) accounted for the rest.
- Acquisition costs also fell 2% YoY mainly due to traditional insurance products, and accounted for 87% of annualized premium of new sales compared to 113% in Q2/19. Other admin costs rose by 12% YoY. Net claims and related settlement expenses dropped by 29% YoY.
- The Group's CEO and Deputy CEO - dr. Gabriella Kádár and Miklós Barta - have resigned. After resignation of the previous management team the insurer's Board of Directors has elected a new management team and new members in to the supervisory board. The new Group CEO is dr. István Fedák (previously a member of the insurer's Board of Directors). We note that this is the third occasion since the insurer's establishment in 2008 when the board of directors and supervisory body have been completely reshuffled.
- Last Friday, shareholders at CIG Pannonia's General Meeting agreed with a vast majority to reduce the share capital of the insurer by a total of HUF 6,326,693,420 (amount of share capital reduction) to HUF 3,116,132,580. The primary reason for the reduction of the share capital to increase the insurer's profit reserve. The reduction of the share capital has been carried out by the reduction of the nominal value of dematerialized ordinary shares holding voting rights from HUF 100 to HUF 33 per share. The share capital consists of 94,428,260 dematerialized ordinary shares holding voting rights.
- Earlier we claimed that the potential partnership with Opus could lead to a significant, say a 30%, increase in the intrinsic value of Pannonia shares (our estimate is HUF 315 a share currently) should their partnership agreement and mutual capital increases be implemented successfully. We did stress, however, that our level of knowledge about the potential partnership with Opus did not allow us to predict whether such a cooperation would be sustainable and value creative, simply because neither of these companies had had experience to carry out any such form of collaboration before. We hold our view that only when it becomes clear that synergy can be achieved by realizing economies of scale and extracting cross-selling opportunities offered by new banking partners will we really be able to estimate how much profits can additionally be generated on a sustainable basis under the new leadership and through a close partnership with friendly domestic banks (Budapest Bank, MKB and Takarékbank, etc.). It is conceivable in our view, that CIG Pannonia could benefit from synergies from the partnership with these domestic banks in such scale that can be enough to explain a further improvement in stock valuation, and that our current estimate for CIG Pannonia's appraisal value proves to be too conservative.
- We still see an opportunity for CIG Pannonia to be more tactical with capital management (acquisitions, dividend payments) given its currently strong capital base, including a renewed shift in business mix towards the non-life segment and asset management while also focusing increasingly on selling healthcare insurance products. Evidently, in order for investors to ascribe higher multiples to CIG

Pannonia's business, the insurer has to provide greater disclosure about how to develop growth of its businesses on a sustainable basis.

- We believe that CIG Pannonia has plenty of room to grow (in terms of premium income) more rapidly in the medium than larger insurance carriers in Hungary and at a quicker clip than the overall domestic insurance market once partnership with the friendly banks starts working. We are also confident that CIG Pannonia remains on track to achieve efficiency gains through diversification of its distribution channels. That said, it has yet to be seen whether the insurer's cost control, risk management and capital allocation will remain as rigorous under new management as in the past, while a new strategy, if any elaborated at all, has yet to be announced in order to make a meaningful assessment of its future development trajectory and establish a new TP.

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Accumulate	Total return is expected to be in the range of 10-20%
Neutral	Total return is expected to be in the range of 10%-(-10%)
Reduce	Total return is expected to be in the range of -10-(-20%)
Sell	Total return is expected to be lower than -20%
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