

# CIG Pannonia

Recommendation: Neutral (unch.)

Target price (e-o-y): HUF 315 (unch.)

Share price: HUF 335

Share price as of 18/11/2020	HUF 335	Bloomberg	PANNONIA HB
Number of diluted shares [million]	94.4	Reuters	CIGP.BU
Market capitalization [HUF bn/EUR mn]	31 633/87.7	Free float	75%
Daily turnover 12M [HUF million]	0.08	52 week range	HUF 100 – 388

## Surprisingly weak Q3 results

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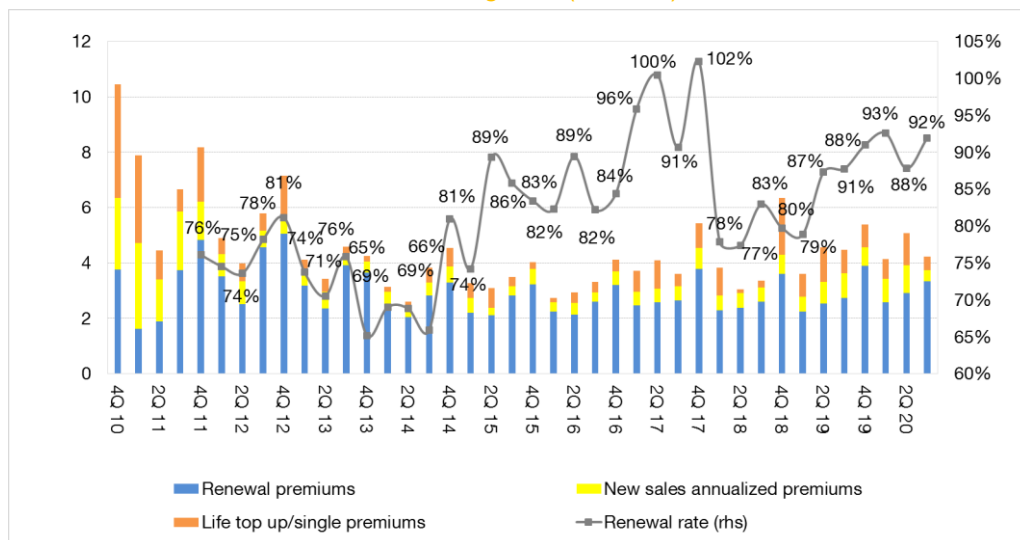
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- CIG Pannonia Life Insurance (Pannonia) reported an unexpectedly low profit after tax of HUF 9mn for Q3/20 compared to HUF 489mn in the same period a year earlier and HUF 520mn in Q2/20. The precipitous fall in after-tax profit on a QoQ basis was primarily due to significantly lower GWP and higher OpEx. The increase in OpEx was driven by the expected loss on policies sold by CIG Pannónia Pénzügyi Közvetítő Zrt, a wholly-owned agent subsidiary.
- In Q1-3/20, the insurer's consolidated profit before tax amounted to HUF 1bn (in 2019 the profit before taxation was HUF 282mn), that was reduced by HUF 162mn tax liability. EMABIT as discontinued non-life operation generated HUF 100mn loss. The overall profit after tax was HUF 746mn, which is HUF 1.06bn higher than the profit after tax of first three quarter in 2019. The other comprehensive income contains the decrease in the fair value of available-for-sale financial assets amounting to HUF 958mn, of which HUF 667mn is the unrealized loss on OPUS shares owned by the Group, while the remaining loss (HUF 291mn) arose from the unrealized loss on government bonds. The total comprehensive income represents a gain of HUF 212mn in 2020.
- CIG Pannónia Life Insurer is financially stable, its fundamentals are certain, the Solvency II capital adequacy is outstandingly high 348%. The consolidated capital adequacy is 326%.
- Life insurance 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 dropped by 5% to HUF 4.2bn YoY (thereof 29%, ie. HUF 1.22bn was pension insurance policies), HUF 0.9bn 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 came to HUF 0.4bn (-55% YoY). GWP from renewals was HUF 3.34bn in Q3/20 (+22YoY), while top-up and single premiums amounted to HUF 0.5bn (-41% 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 12% in Q3/20 compared to 19% in Q3/19. Non-life GWP dropped by 93% YoY from HUF 2.35bn to HUF 1bn mainly because of the divestment of some major activities.

GWP breakdown in the life insurance segment (HUF bln)

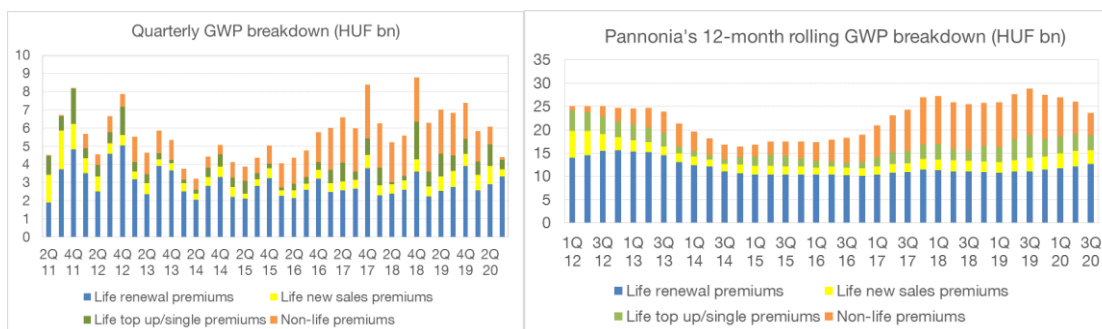


Source: Pannonia, Concorde estimate

- 12-month rolling GWP continued sliding for the fourth consecutive quarter due to deteriorating non-life premium income 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.
- 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, but it fell again to 135% by the end of September, 2020 due to non-reinsured Italian surety insurance portfolio (of which the size was EUR 256mn at 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.

- Investment results were positive at HUF 2.7bn in Q3/20 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 early this year.
- Operating costs rose by 23% YoY in Q3/20 and accounted for 38% of GWP in Q2/20 (vs. 30% in Q3/19), of which fees, commissions and other acquisition costs represented 54% (vs. 69% in Q3/19), while admin costs and other expenses (mainly provisions) accounted for the rest.
- Other expenses (HUF 333mn) is higher with HUF 275mn compared to the 2019 same period (HUF 51mn), the most significant part of the rise (HUF 185mn) is the expected loss on policies sold by CIG Pannónia Pénzügyi Közvetítő Zrt. Acquisition costs fell 4% YoY mainly due to traditional insurance products, and accounted for 128% of annualized premium of new sales compared to 98% in Q3/19. Net claims and related settlement expenses dropped by 26% YoY.
- As for life insurance policies sold so far in 2020 the share of the tied agent network is 12%, independent brokers bring in 36% and the bank channel accounts for 18%. The financial intermediary subsidiary delivers 6% of new sales, while other business developments represents 28 percent of new sales.
- 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. We reiterate both our TP at HUF 315 a share and our Neutral rating on the insurer.

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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%)
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