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29 September 2019

CIG Pannonia

Recommendation: Under revision (prev. Neutral)
Target price (e-o-y): Under revision (prev. HUF 315)
Share price: HUF 303

Share price close as of 09/26/2019	HUF 303	Bloomberg	PANNONIA HB
Number of diluted shares [million]	94.4	Reuters	CIGP.BU
Market capitalization [HUF bn/EUR mn]	28.7.0/85.4	Free float	50%
Daily turnover 12M [HUF million]	0.07	52 week range	HUF 297 – 456.5

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The adventure in Italy is getting uglier

- CIG Pannónia ("the insurer") announced succinctly that its wholly owned subsidiary, CIG Pannónia First Hungarian General Insurance Company Ltd. (EMABIT), due to its cross-border surety insurance activity in Italy, is expected to report a further loss of HUF 670 mn on top of losses (HUF 692 mn) incurred in Q2/19.
- Background to the case is that EMABIT guaranteed the concession fee and tax liability of some gaming companies in Italy. Initially, this new business (once considered as "niche") generated plenty of revenues, but this year it heavily burdensome to EMABIT as the principals (gaming companies) failed to meet their obligation according to the terms of the agreement with the obligee.
- EMABIT cross-border guaranteed a total of EUR 12.8 mn for a group of Italian gaming companies on which it reported preliminary losses of HUF 692 mn in Q2/19. Apart from these exposures there might be more, the size of which are not yet disclosed, but the reported additional losses on them have been HUF 670 mn so far. These numbers reflect EMABIT's best estimates at the moment, which may, of course, change (the actual loss may be more or less). Reinsurance, regression (resulting in lower than the estimated final loss rate), reclaims of brokerage commission can have a positive impact on the loss rate, while further unknown claims and claim settlement costs may have a negative impact on it. EMABIT's former CEO resigned his office shortly after the first losses on the Italian gaming surety insurance were disclosed, and the CEO of the CIG Pannonia Group, who has had proven track record of running the life insurance business but has no the same long direct experience in the field of non-life insurance, has been elected to helm the non-life segment as well.
- Due to the additional losses on surety insurances, EMABIT's capital adequacy ratio will likely fall below 151 percent published at the end of the first half of the year. This is the threshold below which the National Bank of Hungary as the supervisory authority may even call for the non-life insurer to replenish its capital. The parent CIG Pannonia will certainly be able to put in more capital to buttress its non-life insurance daughter, which however will weaken its own liquidity position and capital adequacy (the same risk exposure requires higher capital needs), in our view. The capital increase can easily be made from the amounts of capital increase previously placed in the capital reserve of the life insurer. Losses should in principle not affect the life insurer's ability to pay dividends.

- Currently, EMABIT is recorded on the parent life insurer's B/S at a cost of ca. HUF 5.3 billion. This may be reviewed (in part) if the auditor considers the incident as a cause for the deterioration in EMABIT's profit outlook, and therefore there may be need to lower the fair value estimate for EMABIT. In this case, the loss of EMABIT would already have a profound impact on the consolidated profit as well as on the life insurance company's stand-alone results. If that were the case, the life insurance company's capital adequacy as well as dividend payment ability would be affected.
- Losses on the Italian gaming surety insurances were completely unexpected. EMABIT was about to deliver another year of strong revenue and profit growth, underpinned by excellent new business sales, and then out of the blue, it announced huge losses, and caught all investors off guard (including OPUS, which is the largest single shareholder and being represented in the board of directors of the insurer).
- Despite the fact that Opus is the insurer's largest single investor, management rights over CIG Pannonia is controlled by other investment companies ("principal investors"). These investors together with friendly hands are assumed to hold more than 30 percent of the parent life insurance company's outstanding shares. They are clinging to the current management, and have the upper hand when it comes to the insurer's strategic direction or dividend policy. Of course, OPUS could opt to increase its ownership (24.9%) in the insurer to try and acquire control over it. That would require buying a large number of CIG Pannonia shares (more than 5 million at least), either on the market or from the principal investors, which could probably only be made at significantly higher prices than the current share price. Even doing so, they should not go beyond the 33 per cent ownership threshold level above which they would be required to make a mandatory public offer to all shareholders.
- We do not happen to believe that this would be the real purpose of OPUS. They have always treated CIG Pannonia as a financial investment. They wanted always to cooperate with the insurer's management and principal investors so as to create value. Just as a reminder, CIG Pannonia raised its capital by HUF 8 billion by issuing new shares brought by KONZUM / OPUS at a price of HUF 350 per share, and at the same time the life insurance company purchased KONZUM / OPUS shares at a price of HUF 600 per share (after adjusting it for the impact of the share spit and swap). Interestingly enough, while OPUS injected directly fresh capital into the insurer, the insurer brought KONZUM / OPUS shares directly from a private equity fund. It is also worth noting that the price of KONZUM/OPUS shares have slid considerably since these transactions (the negative impact of which was partly realized in the life insurer's books upon the delisting of KONZUM from the BSE), as well as the high expectations that the OPUS Group may tend to lend effective support to CIG Pannónia's expansion in the domestic insurance market that we are afraid may not turn out to be the case at any time soon. Instead, it could happen that the relationship between the two major shareholder groups becomes so blurred that it may also be a drag on the insurer's market performance.
- **Given additional losses announced lately on gaming surety insurances, CIG Pannonia's after-tax profit may amount to HUF 250 million in H2/19 (as opposed to HUF 950 million anticipated previously), which would lead to a full-year after-tax loss of HUF 370 million, while net of extraordinary items consolidated profit could reach HUF 1.5 billion this year on our estimate.**
- **The case will likely drag on for months or even years. It is too early to quantify the exact amount of losses that may arise from the Italian cross-border gaming surety insurances. We warn that our profit estimates for the coming years as well as out TP may also need to be revised, but we will only be able to provide the new estimates once more public information is available on the approximate amount of losses on gaming surety insurance activities in Italy.**

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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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