CONCORDE RESEARCH

CEE Equity Research | Insurance | Hungary
23 February 2021

CIG Pannonia

Recommendation: Neutral (unch.)
Target price (e-o-y): HUF 340 (prev. HUF 315)
Share price: HUF 324

Share price as of 23/02/2021	HUF 324	Bloomberg	PANNONIA HB
Number of diluted shares [million]	94.4	Reuters	CIGP.BU
Market capitalization [HUF bn/EUR mn]	30 595/85.3	Free float	49%
Daily turnover 12M [HUF million]	0.08	52 week range	HUF 100 – 388

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Breaking even in Q4/20

- CIG Pannonia Life Insurance (Pannonia) broke even in Q4/20 reporting HUF - 10 mn after-tax profit compared to HUF -0.29 bn in the same period a year earlier and HUF -0.43 bn in Q3/20. The increase of after-tax profit on both YoY and QoQ basis was due to lower OpEx (-12% QoQ and -39% YoY predominantly driven by a decline of commissions).
- In 2020, the insurer's consolidated profit after tax amounted to HUF 074 bn compared to HUF -0.64 bn in 2019, which was reduced by HUF 32 mn tax liability. EMABIT as non-life operation generated HUF 0.34 bn loss. We note that businesses up for sale generated profit before tax of HUF 0.79 bn in 2020. The overall comprehensive income came in at HUF 0.36 bn vs HUF 0.32 bn loss in 2019. Comprehensive income contains the decrease in the fair value of available-for-sale financial assets amounting to HUF 0.38 bn, of which HUF 0.35 bn is the unrealized loss on OPUS shares owned by the Group, while the remaining loss (HUF 31mn) arose from the unrealized loss on government bonds.
- Adjusted for one-off items, the life segment increased its profit after tax (without its subsidiaries) from HUF 0.74 bn profit in 2019 to HUF 1.68 bn in 2020. We note that the life segment's after tax result for 2019 was affected by HUF – 1.06 bn due to the exchange rate difference realized on the KonzumOpus share transformation. The profit after tax of the individual non-life segment, was HUF 0.79 bn loss in 2020, compared to the HUF 1.3 bn loss in previous year.

Breakdown of adjusted after tax profit (HUF mn)

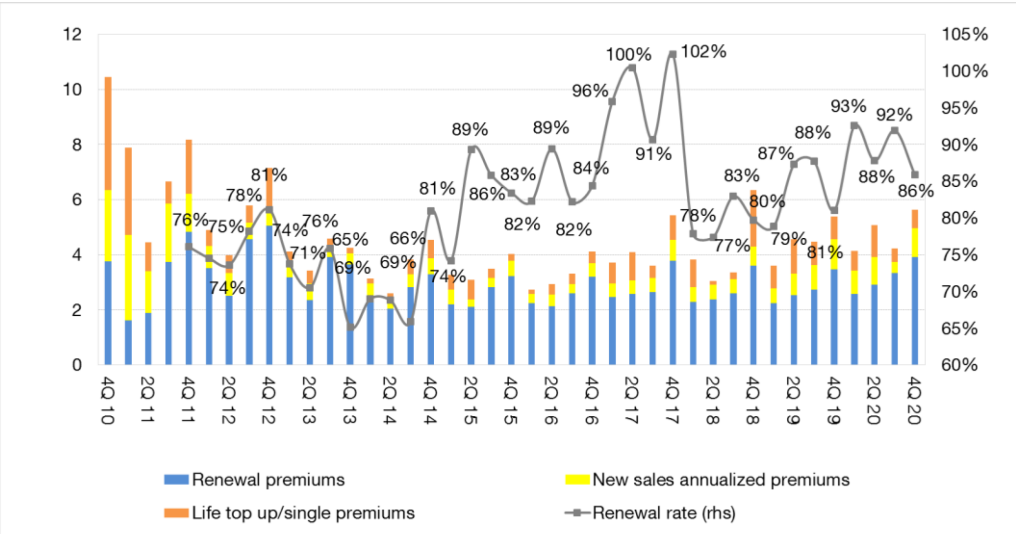
	Life	Non-life	Other	Total
Reported after tax profit	793	-370	380	803
One-off items*	882	-416	-534	-68
Adjusted after tax profit	1 675	-786	-154	735

Note: One-off items include loss absorption by the life segment, consolidation adjustments for business continuity, the consolidation impact of the employee share program, MKB Pannonia insurance carrier and other subsidiaries, impairment on CIG Pannónia Pénzügyi Közvetítő Zrt.
Source: CIG Pannonia, Concorde's estimate

ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 5.

- CIG Pannónia Life Insurer is financially stable and fundamentally solid. The insurer's life Solvency II capital adequacy ratio is reassuringly high at 337% (vs. 348% in Q3/20), and the consolidated capital adequacy ratio stays at 326% (vs. 336% in Q3/20).
- In the life segment, the total annualized amount of of new sales was HUF 0.87 bn, 20% lower than in the same period a year earlier. In the traditional segment alone the annualized amount of new sales rose by 25% YoY, which might be attributed to a significant group insurance policy (sold to employees of the Paks I-II. nuclear power plant). In case of the unit-linked products, the significant decrease is mainly due to the COVID-19 pandemic.
- As a whole, life insurance GWP rose slightly YoY from HUF 5.4 bn to HUF 5.64 bn in Q4/20. GWP of unit-linked life insurance reached HUF 4.35 bn (thereof 40%, ie. HUF 1.74 bn was pension insurance policies), HUF 1.15 bn were traditional life products (thereof HUF 0.31 bn came from pension insurance policies), and HUF 0.14 bn were health insurance policies. In the life segment GWP from the first annual premiums of policies sold came to HUF 1.0 bn (-6% YoY) in Q4/20. GWP from renewals was HUF 3.92 bn (+13YoY), while top-up and single premiums amounted to HUF 0.68 bn (-17% 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 Q4/20 compared to 15% in Q4/19. Renewal ratio declined QoQ from 92% to 86%, yet it increased YoY from 81%.

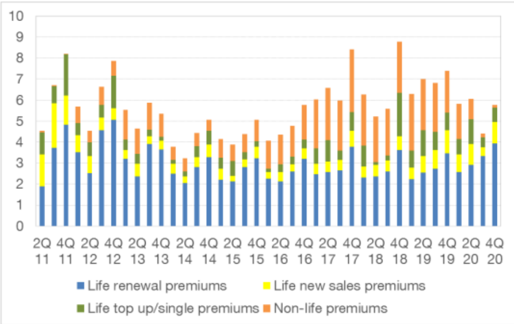
GWP breakdown in the life insurance segment (HUF bln)



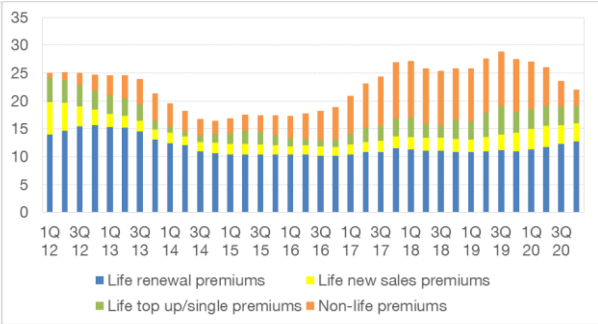
Source: Pannonia, Concorde estimate

- Non-life GWP dropped by 93% YoY from HUF 1.99 bn to HUF 0.13 bn mainly because of the divestment of some major activities.
- 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 6 bn annualized premium), which is still subject to the approval of the Hungarian National Bank. Pannonia deemed that the going concern was unsustainable in case of the EMABIT, therefore the whole activity of the non-life subsidiary had been defined as discontinued activity according to IFRS.

  At the end of 2020 the CIG Pannonia Group took steps at the operational level to restart EMABIT's insurance activities. As a result, the definition of discontinued activity according to IFRS 5 held for sale is no longer appropriate for the entire non-life segment. It can only be interpreted for the smaller Hungarian and Polish extended warranty and gap casco portfolio that are still actually on sale, and the currently active portfolios appear as continuing operations in financial statements of fourth quarter 2020. CIG Pannonia reported pre-tax results for non-life activities up for sale of HUF 0.79 bn for 2020, implying a 31% decline YoY.

- 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 123% by the end of 2020 due to non-reinsured Italian surety insurance portfolio (of which the size was EUR 256 mn 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.

  The review of existing claim reserves and regression reserves have been finished, and the insurer increased the outstanding claims reserve by HUF 566 million, compared to the end of 2019. In 2020, the total net claims expenditure on the Italian portfolio was HUF 1.28 bn, the earned premium of previously concluded contracts in 2020 was HUF 0.34 bn, and other technical results were HUF 0.02 bn million. The technical result of the Italian guarantee product in 2020 was a total loss of HUF 0.96 bn.

- Investment results were positive at HUF 5.85 bn in Q4/20 (vs. HUF 2.66 bn in Q4/19) 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 last year.

- Operating costs dropped by 29% YoY in Q4/20 and accounted for 28% of GWP (vs. 36% in Q4/19), of which fees, commissions and other acquisition costs represented 63% (vs. 76% in Q4/19), while admin costs and other expenses (mainly provisions) accounted for the rest. Earlier last year CIG Pannonia created provisions to the tune of HUF 0.19 bn for the expected loss on policies sold by its agency subsidiary CIG Pannónia Pénzügyi Közvetítő Zrt. Acquisition costs halved YoY mainly due to traditional insurance products, and accounted for ca. 115% of annualized premium of new sales.

- Net claims and related settlement expenses declined by 30% YoY in Q4/20 partly due to a decrease in non-life segment expenses (mainly on Italian products) and also due to life segment claims expenditures mainly due to the surrenders of unit-linked products.
- The amount of net change in reserves was HUF 6.3 bn, which is made up mainly a ca. 9% increase of unit-linked life insurance reserve QoQ.
- As for life insurance policies sold in 2020 the share of the tied agent network is 13%, independent brokers bring in 36% and the bank channel accounts for 18%. The financial intermediary subsidiary delivers 4% of new sales, while other business developments represents 29% of new sales.
- 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. Evidently, in order for investors to put trust in new strategy to turn CIG Pannonia into a niche national insurance carrier, new management has to provide greater disclosure about how to develop growth of businesses on a sustainable basis. **We roll over our 12-m TP from HUF 315 to HUF 340 a share and reiterate our Neutral rating on the insurer.**

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Rating	Trigger
Buy	Total return is expected to exceed 20% in the next 12 months
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%
Under Revision	The stock is put Under Revision if the covering analyst considers new information may change the valuation materially and if this may take more time.

Coverage in transition	Coverage in transition rating is assigned to a stock if there is a change in analyst.

Securities prices:

Prices are taken as of the previous day's close on the home market unless otherwise stated.

Valuations and risks:

Analysis of specific risks to set stock target prices highlighted in our investment case(s) are outlined throughout the report. For details of methodologies used to determine our price targets and risks related to the achievement of the targets referred to in the main body of the report or at Rating Methodology on our website, visit (https://www.con.hu/wp-content/uploads/2016/04/Methodology_concorde_research.pdf?tstamp=201710021038)

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