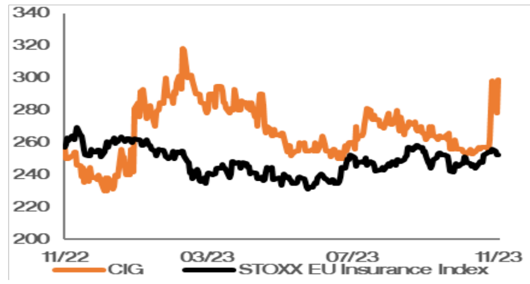
CONCORDE RESEARCH

CEE Equity Research | Insurance | Hungary
30 November 2023

CIG Pannonia

Recommendation: Coverage in transition (prev. BUY)
Target price (e-o-y): Under revision (prev.: HUF 410)

Share price as of 29/11/2023	HUF 299
Number of diluted shares [million]	94.4
Market capitalization [HUF bn/EUR mn]	28.1 / 74.3
Daily turnover 12M [HUF million]	5.1
Bloomberg	PANNONIA HB
Reuters	CIGP.BU
Free float	41.3%
52-week range	HUF 220–340



CIG Pannonia shows resilience in Q3/23 despite one-offs

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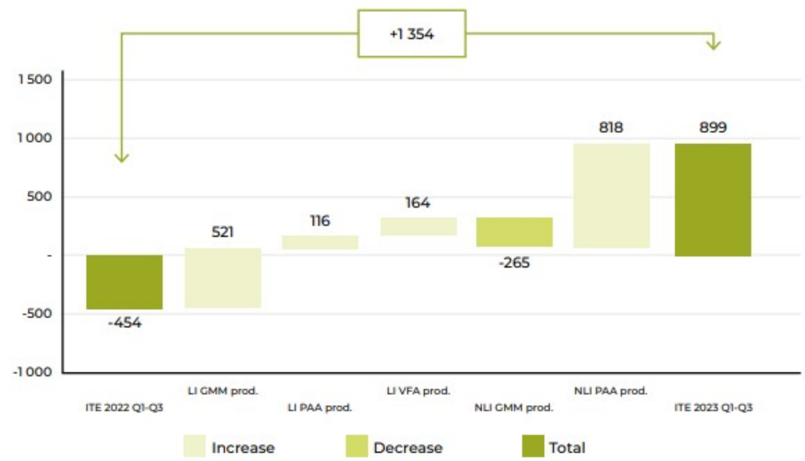
- CIG Pannonia (Pannonia or the insurer) reported HUF 772mn after tax profit for Q3/23 compared to HUF 938mn in Q3/22. Other comprehensive income including the changes in the fair value of other financial assets (OPUS shares and government securities) valued at fair value was HUF -191mn compared to a loss of HUF 1.33bn in Q3/22. Total comprehensive income came in at HUF 2.34bn in Q3/23 as against a slight loss of HUF 44mn in Q3/22. Pannonia's capital position has constantly been stable, with a capital adequacy ratio of 215% at the end of 30 September, 2023.
- It is worth stressing that Pannonia reports its results in accordance with IFRS 17 standards, which significantly differ from the results reported according to IFRS 4 standards used previously. Accordingly, the insurance portfolios are evaluated using the so-called General Measurement Model (GMM), the Premium Allocation Approach (PAA) and the Variable Fee Approach (VFA).
- As mentioned earlier, the use of the IFRS 17 accounting transition methodology for 31 December 2021 increased Pannonia's consolidated equity by HUF 7.3bn (+56%), however, due to the transition, a one-time tax effect of HUF 475 million had to be considered and to be charged to profit. Also importantly, according to Pannonia's best estimate, the extra profit tax was HUF 502mn in Q1-3/23 (HUF 181mn in Q3/23), as a result of which, the insurer's consolidated after-tax profit came in at HUF 1.36bn in Q1-3/23, up from HUF 585mn in Q1-3/22. Adjusting for the mentioned tax charges of HUF 977mn in total, consolidated after tax profit was HUF 2.34bn in Q1-3/23.
- The primary reasons for the outstanding earnings growth in Q1-3/2023 were (i) the growth of the insurance portfolio, (ii) a great improvement in profitability due to economies of scale and efficiency containment measures, and (iii) and a higher yield environment. Generally speaking, long-term life insurance products and typically short-term non-life contracts (according to the PAA valuation method), e.g. the corporate property contracts were driving the result, partly due to the growth of these portfolios, as well as the efficiency improvement. The decrease in the annual result of the non-life segment's contract portfolio valued using the GMM methodology was due to the significant positive run-off result on suretyship insurances in 2022, as a result of the closure of cases still pending at that time, which did not recur in 2023.

- Technical results improved by more than HUF 1.3bn YoY as a combined result of dynamic growth in sales, which exceeded the average growth rate of the insurance sector.

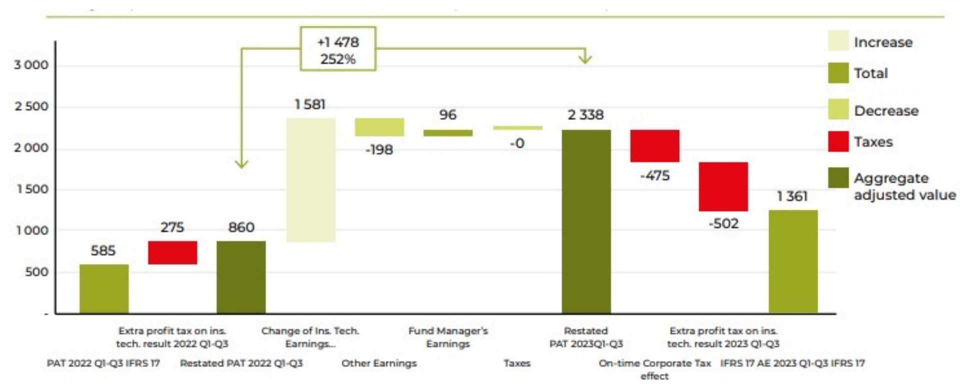
Breakdown of the YoY change of consolidated technical results (HUF mn)



Source: Pannonia

- At the beginning of 2023, Pannonia reviewed its sales organization and processes, and carried out transformations in accordance with its sales strategy including the downsizing of its internal tied agent network and rechanneling it to its independent network, refocusing its sales activities towards the banking and independent broker network and paving the way for its expansion. As a result, premium income increased in almost all portfolio groups, especially in the credit coverage, corporate property, single premium UL and risk life insurances. The smaller decline of regular premium savings products can largely be attributable to the crowding out effect of the high yields having a negative short-term impact on the sales of this product group.

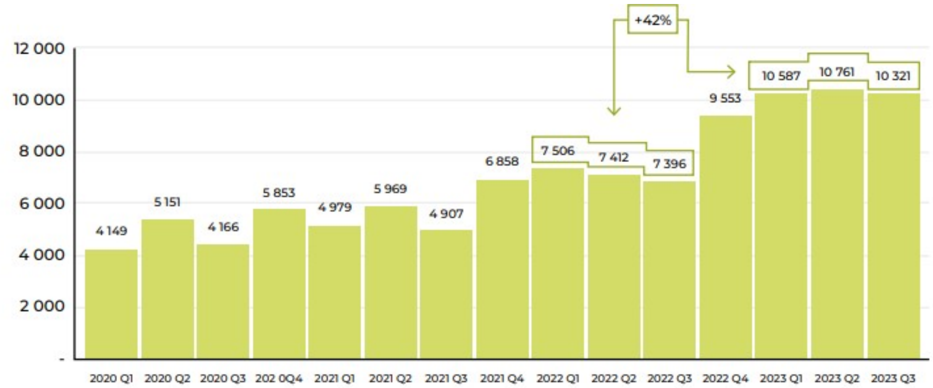
Breakdown of the YoY increase of the IFRS 17 consolidated after tax result (HUF mn)



Source: Pannonia

- Consequently, premium income increased in almost all portfolio groups (especially in credit coverage, corporate property and casco groups), meaning that life insurance premiums grew by 21% YoY, while non-life premiums by 153% YoY, reaching HUF 31.7bn (+42% YoY). In fact, in each quarter of 2023 premiums HUF 10bn compared to HUF 7.5bn on average in the corresponding periods of last year.

Quarterly development of GWP (HUF mn)

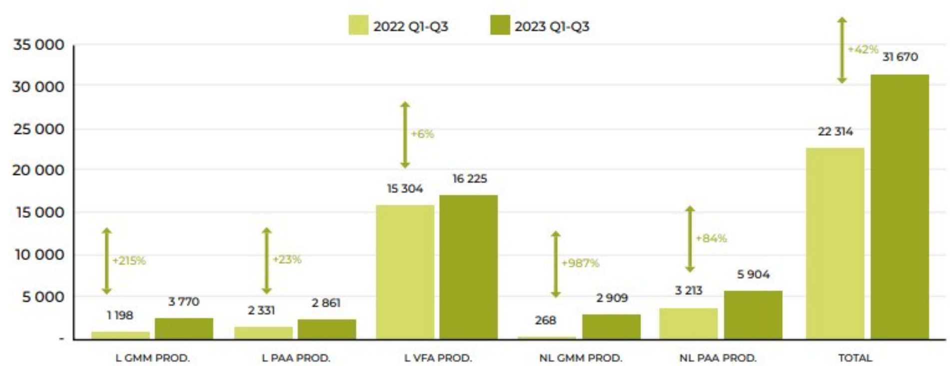


Source: Pannonia

- Premium growth was driven by: (i) the portfolios of both the life insurance segment and the non-life insurance segment assessed with the GMM method - with an increase of 215% and 987% respectively - are credit insurance policies taken over from BNP Paribas Cardif Insurer; and (ii) the short-term contracts of non-life insurance segment – i.e. corporate property insurance and fleet casco. The growth of premium income, evaluated with the VFA valuation method, was only 6% YoY primarily generated by life insurance policies linked to single premium investment units (UL). In contrast, premium income from regular premium UL products, amidst a high yield environment decreased YoY.

- Life insurance policies linked to single premium investment units (UL), evaluated with the VFA valuation method, show more modest results with a 10% increase YoY given the crowding out effect of the high yields having a negative short-term impact on the sales of this product group.

Premium income development (HUF mn)



Source: Pannonia

Outlook

- Based on the strong increase in premium income achieved in the first nine months of the year, we need to revisit our net income forecasts for 2023 and 2024 (including special taxes), currently estimated at HUF 1.56bn and HUF 2.04bn, respectively. Our stance on Pannonia's income generation in the coming years reflects 1) the significant increase in the insurance (extra profit) tax charged to Hungarian insurers for the period between July 1, 2022 and December 31, 2024, 2) the slowdown of domestic economic growth and 3) the increased uncertainty prevailing among market participants amid tightened regulatory conditions. Despite this unfavorable regulatory and economic environment, Pannonia has an outstanding growth potential and stable capital situation. As a result, EPS may reach at least HUF 17 in 2023 and further increase significantly in 2024. Assuming a payout ratio of 100%, that would mean a dividend yield of about 7-10% after 2023 and 2024 earnings based on yesterday's closing price.

- Due to the transfer of coverage, we withdraw our earnings forecasts and we put our e-o-y TP under revision until further earnings revision.
- Our previous TP was set at HUF 410 a share and the recommendation was BUY on CIG Pannonia. We remain confident that Pannonia's resilient and flexible organization can weather the impending economic slowdown, rather than being overwhelmed by it, while remaining committed to market expansion in both organic and inorganic ways and to product innovation.

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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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