

Pannonia

Rating: Neutral (prev. Sell)

Price target w/ Konzum (12-m): HUF 452 (unch.)

Price target w/o Konzum (12-m): HUF 352 (unch.)

Current share price: HUF 445

HUF million	2016	2017F	2018F	2019F
GWP	18 941	26 933	28 796	31 032
After-tax profits	724	2 598	1 580	1 760
Own equity	3 972	9 015	10 021	11 336
EPS [HUF]	11.7	40.8	22.6	25.2
DPS [HUF]	0.0	11.1	11.3	12.6
BVPS [HUF]	103.6	126.4	143.4	162.3
P/GWP (x)	1.5	1.1	1.1	1.0
P/E (x)	38.2	11.0	19.8	17.7
P/BV (x)	4.3	3.2	3.1	2.8
DVY (%)	0.0	2.5	2.5	2.8
ROE (%)	12.1	34.4	15.9	16.5



Performance	12M	YTD	3M	1M
Absolute	96.4%	-15.9%	48.7%	-16.2%
BUX relative	73.6%	-13.9%	49.4%	-13.8%

Share price closing as of 2/20/2018	HUF 445	Bloomberg	CIGP.BU
Number of shares [million]	71.3	Reuters	PANNONIA HB
Market capitalization [HUF bn/EUR mn]	31.87/ 102.3	Free float	70%
Enterprise value [HUF bn/EUR bn]	31.87 / 102.3	52 week range	201/544
Daily turnover 12M [EUR million]	?	EURHUF	311.5

FY2017 results were very much in line with expectations

Equity Analyst

Attila Vágó
+361 489 2265
a.vago@con.hu

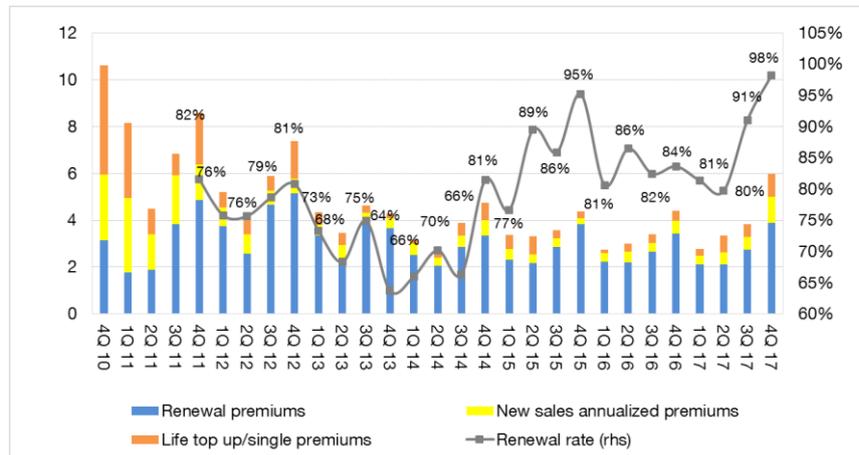
Alkotas Point
50 Alkotás utca,
H-1123 Budapest
www.con.hu

- Pannonia reported a full-year IFRS consolidated after-tax profit of HUF 2.6bn on GWP of 26.9bn in 2017, very much in line with our estimate of HUF 2.6bn for after-tax profit and HUF 27bn for GWP. After-tax profit rose 271% YoY mostly driven by the positive impact of badwill realized on the acquisition of the MKB insurance companies. Contribution to results were more or less evenly split between CIG Pannonia (ca. HUF 1.2bn) and realized badwill (ca. HUF 1.4bn) on the purchase of MKB insurance companies. (NTRL)
- The insurer reached HUF 2.1bn after-tax profit in its life segment for 2018 (+95% YoY) on GWP of HUF 15.9bn (+18% YoY) predominantly driven by a full reversal of impairment losses of ca. HUF 1bn previously booked for investments in its non-life subsidiary EMABIT. Adjusting for this one-off result, the profit after tax was HUF 1.1bn, ca. 3% higher compared to previous year, clearly beating our estimate of HUF 0.9bn for FY2017. The higher clean profit after tax was achieved as a combined result of the additional costs associated with organizational restructuring and the merge of the previous MKB life insurance company.
- We note that the change of technical reserves in the balance sheet and the change of technical reserves in the life segment's income statement

differed from each other as the impact of the acquisition of MKB insurance companies (the positive difference between the value of newly consolidated assets and liabilities) were directly recorded in own equity.

- With the reversal of impairment losses Pannonia should have generated enough free surplus to pay dividend after its 2017 fiscal year profit on our estimate. Pannonia earlier said that it would pay dividend of HUF 10 per share after the business year 2017, provided that the conditions of the payment of dividends apply. From 2018 and onwards Pannonia wishes to pay a maximum of 50% of the after-tax profit available for the payment of dividends of the current year to its shareholders.
- Pannonia’s non-life segment delivered HUF 439mn profit after tax (+116% YoY) on GWP of HUF 8.7bn (+47% YoY) for 2017, falling short of our estimate of HUF 543mn for after tax profit while GWP was in line with our estimate.
- As for life GWP from the first annual premiums of policies sold was HUF 2.57bn (+51% YoY). The renewal premiums of policies concluded in the previous years have increased by 3% YoY to HUF 10.85bn in 2017. Renewal rate rose to a record level of 98% in Q4/17 compared to 84% in Q4/2016.

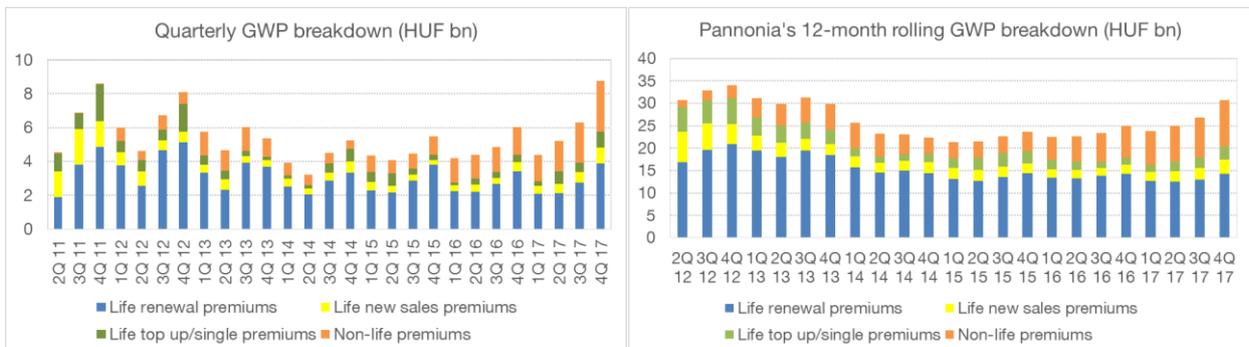
Figure 1 Pannonia’s life insurance renewal rate



Source: Pannonia, Concorde

- Top-up and single premiums were 188% higher than in the same period a year earlier, totaling to HUF 2.48bn, and accounted for 16% of total GWP (vs. 10% in 2016).

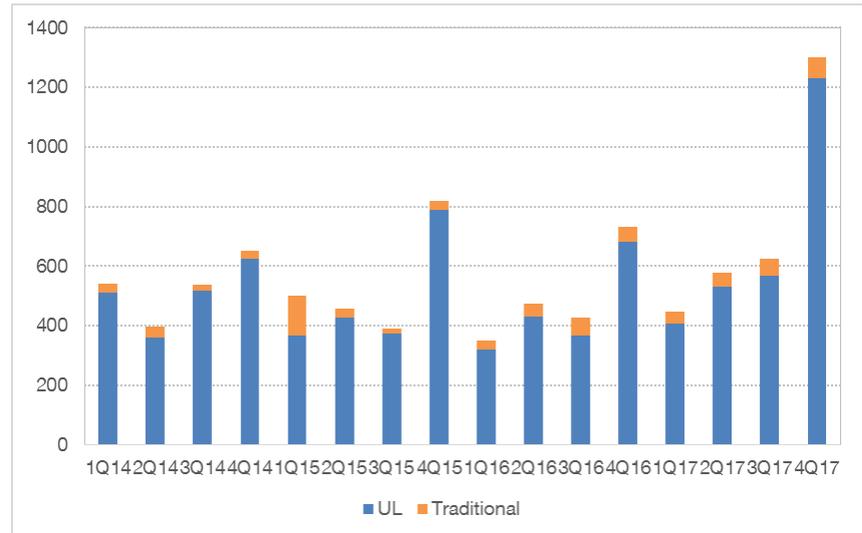
Figure 2 Pannonia’s premium income developments



Source: Pannonia, Concorde

- As for the breakdown of regular life insurance premium, UL-linked type products (incl. pension insurances) represented an increasing share.

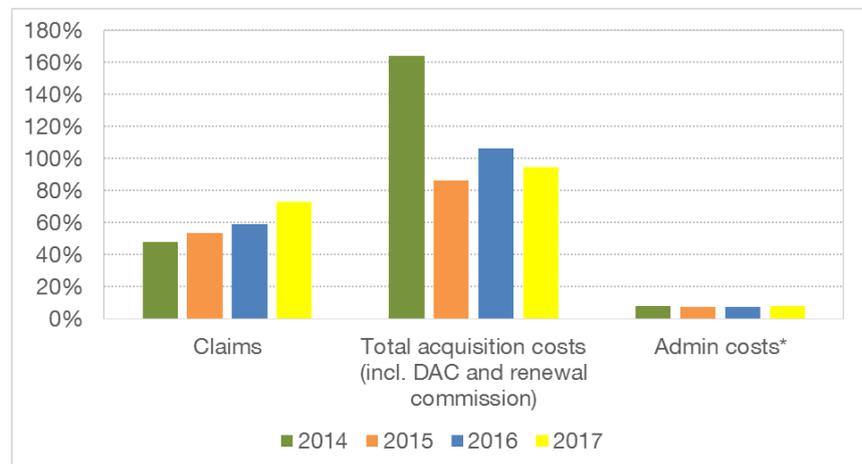
Figure 3 New sales breakdown of regular life insurances



Source: Pannonia, Concorde

- The share of the tied agent network in life insurance policies sold in 2017 was 48% , the performance of broker channel accounted for 40%, while the banking channel represented 12%.
- Over the course of 2017 Pannonia has constantly put considerable efforts into streamlining its business with a series of efficiency measures including cost cuts and thorough overhauling its distribution channels. We believe the full impact of cost efficiency measures implemented in recent years will remain in place to bolster profit growth, even with the increased costs associated with the acquired MKB insurance companies.

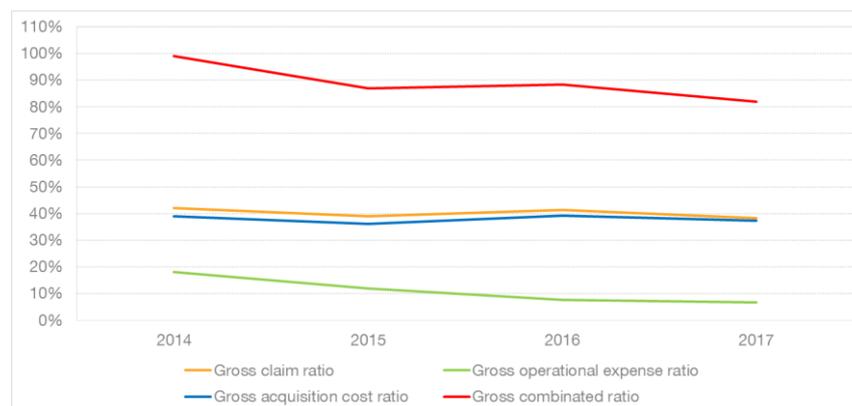
Figure 4 Life operating costs as a % of life insurance GWP



Source: Pannonia, Concorde

- The marketing of new pension insurance and long term care products sales via sales networks (which tends to be more captive and partnered with friendly domestically owned commercial banks), coupled with rigorous cost control also lent support to improve YoY.

Figure 5 Cost ratios of Pannonia's non-life segment



Source: Pannonia, Concorde

- The available solvency capital in the life segment stood at 260% at 31 December 2017, which significantly exceeded the 150% Solvency Capital Requirement of the Supervisor Authority (which in turn contains a 50% volatility puffer). In the non-life segment the solvency capital adequacy was 191% according to the Solvency II.
- Outlook: we maintain our earnings estimates for the forthcoming years until more clarity is available on the potential benefits from the recent strategic cooperation agreement with Konzum holding group. We expect an increase in OpEx due to wage pressures while new sales should accelerate on the back of new banking channels. New business margin is also expected to remain solid. In all, we anticipate that Pannonia's net income could come in at HUF 1.6bn in 2018 and HUF 1.8bn in 2019, implying an EPS of HUF 22.6 for 2018 and HUF 25.2, respectively). We also expect Pannonia to generate net profit of c. HUF 2.4bn by 2022, implying a 5-year EPS GAGR of c.10 percent by 2022 if not for additional earnings potential arising from partnering with Konzum.
- In our last comprehensive report on Pannonia (published last December) we established a 12-month TP of HUF 352 a share, implying a 21% downside from the current share price, while stressing that Pannonia shares may even be ca. 30 percent higher valued (at HUF 452) than our TP estimate should the insurer's partnership agreement and mutual capital increases with Konzum be implemented successfully. Of importance, Pannonia is still waiting for the approval of the Supervisory Authority on mutual capital increases. That said, **we re-rate the stock to Neutral from Sell as the probability that they will eventually form partnership has increased considerably after Pannonia's EGM approved the capital increase by Konzum.**
- We reiterate that our current level of knowledge about the potential deal with Konzum does not allow us to predict whether such a cooperation is sustainable and value creative at all, simply because neither of these companies had experience to carry out any such large transactions and form of collaboration beforehand. Only when we have a clue about where and at what costs Pannonia intends to invest the additional equity to be received from Konzum and how much synergy can really be achieved from collaboration with Konzum will we really be able to make a better estimate on how much profits can additionally be generated on a sustainable basis by partnering with Konzum. That said, we believe there is a significant upside in earnings therefrom given the countrywide branch network of friendly domestic banks that can potentially (and perhaps exclusively) be available for Pannonia in the future.
- Pannonia looks keen to seek further acquisition targets at an affordable price in order to realize economies of scale and extract cross-selling opportunities offered by its new banking partners. Pannonia may target

a 5 to 10 percent market share, and meanwhile constantly growing earnings. If the partnership with Konzum is realized, Pannonia's capital flexibility for sizeable acquisitions may be sufficient to reach its market share goal, in our view.

- Pannonia is currently trading at 19.8x on a 2018 P/E basis and 3.2x on a current P/BV basis. On the basis of 2018 P/E ratio and a forecasted ROE of 16.1% on average for the next five years Pannonia now is trading at a 47% premium over PZU and 56% premium over VIG, respectively. Pannonia’s relative lofty valuation clearly reflects investors’ firm belief in potentially beneficiaries partnership with Konzum. Evidently, in order for investors to ascribe this high multiple to Pannonia’s business, we think Pannonia has to provide greater disclosure about how to develop growth of its businesses on a sustainable basis.

Comparative valuation

		Market cap. (EUR th)	Embedded Value (EV) (EUR th)	Equity	BV	Market cap/EV	P/E FY1	P/BV	Div yield (%)	ROE (%)	Solvency ratio
Pannonia	HUN	101.02		29.00	0.42		19.80x	3.20x	2.2	34.40	>2.0
VIG	AUT	3527.68	8116.60	5881.90	42.30	0.43x	12.70x	1.43x	2.91	5.90	
PZU	POL	9177.32		8331.40	3.73		13.49x	4.40x	3.18	21.24	2.70
UNIQUA	AUT	2963.31	5068.00	3121.90	10.60	0.58x	18.10x	1.85x	5.13	3.51	0.86
Anadolu	TUR	671.22		203.50	0.47		10.45x	3.52x	4.4	25.14	3.67
Sigorta	TUR	421.13		360.00	0.72		9.92x	1.86x	1.5	12.87	1.39

Source: Bloomberg, Concorde

1.DISCLAIMER

This research/commentary was prepared by the assignment of Budapest Stock Exchange Ltd. (registered seat: 1054 Budapest, Szabadság tér 7. Platina torony I. ép. IV. emelet; company registration number: 01-10-044764, hereinafter: BSE) under the agreement which was concluded by and between BSE and Concorde Securities Ltd. (registered seat: H-1123 Budapest Alkotás utca 50., company registration number: 01-10-043521, hereinafter: Investment Service Provider)

BSE shall not be liable for the content of this research/commentary, especially for the accuracy and completeness of the information therein and for the forecasts and conclusions; the Service Provider shall be solely liable for these. The Service Provider is entitled to all copyrights regarding this research/commentary however BSE is entitled to use and advertise/spread it but BSE shall not modify its content.

This research/commentary shall not be qualified as investment advice specified in Point 9 Section 4 (2) of Act No. CXXXVIII of 2007 on Investment Firms and Commodity Dealers and on the Regulations Governing their Activities. Furthermore, this document shall not be qualified as an offer or call to tenders for the purchase, sale or hold of the financial instrument(s) concerned by the research/commentary

2. DISCLAIMER

This research report has been prepared by Concorde Securities Ltd., a full-service Hungarian investment banking, investment management and brokerage firm. Concorde Securities Ltd. is under the supervision of the National Bank of Hungary in its capacity as financial supervisory authority.

Concorde Securities Ltd. is registered in Hungary and does not have any subsidiaries, branches or offices outside of Hungary. Therefore we are not allowed to provide direct investment banking services to US investors and restrictions may apply to our potential investment banking services according to your country's jurisdiction. For important disclosures to U.S. investors, please refer of the "Notice to U.S. Investors" section at the end of this Disclaimer.

Our salespeople, traders and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are their own and may be contrary to the opinions expressed in our research products, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed by our analysts or traders.

Our research, sales and trading professionals are paid based on the profitability of the respective divisions of Concorde Securities Ltd., which from time-to-time may include revenues from the firm's capital market activity. Concorde Securities Ltd. does not prohibit analysts, salespeople and traders from maintaining a financial interest in the securities or futures of any companies that they cover or trade on their clients' behalf in strict compliance with the Hungarian Capital Markets Act.

ANALYSTS CERTIFICATION

The research analysts undersigned and responsible for the preparation of this report hereby certify that (i) the views expressed in this research report accurately reflect their personal views about any and all of the securities or issuers referred to in this research report; (ii) no part of the analysts' compensation was, is or will be directly or indirectly related to the specific recommendation or views expressed in this report and (iii) no part of their compensation is tied to any specific investment transactions performed by Concorde Securities Ltd.

Name and job title of individuals involved in the production of this report are disclosed at the end of this report.

Concorde Securities Ltd. is a leading manager and underwriter of Hungarian equity offerings. We have investment banking and other business relations with a substantial percentage of the companies traded on the Budapest Stock Exchange and covered by our research department. Concorde Securities Ltd, its directors and employees may have a position in these securities, which may change at any time.

Concorde Securities Ltd. acted as Lead Manager of the private and public share placement of the shares of FHB in 2003, Masterplast in 2012 and Duna House in 2016. Concorde Securities Ltd. acted as the Co-lead Manager of Gedeon Richter's exchangeable bond issue in September 2004. Concorde Securities Ltd. has provided financial advice to Magyar Telekom.

EXPLANATION OF RATINGS AND METHODOLOGY

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 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.

(https://www.con.hu/wpcontent/uploads/2016/04/Methodology_concorde_research.pdf?tstamp=201710021038)

Research disclosures:

Concorde Securities Ltd. may have published other investment recommendations in respect of the same securities/instruments recommended in this report during the preceding 12 months. Disclosure of previous investment recommendations produced by Concorde Securities Ltd. in the previous 12 months can be found at [Rating history](#).

(<https://www.con.hu/wp-content/uploads/2016/04/Rating-history.pdf?tstamp=201710021038>)

GENERAL

This report is provided for information purposes only and does not represent an offer for sale, or the solicitation of any offer to buy or sell any securities.

The information, and any opinions, estimates and forecast have been obtained from sources believed by us to be reliable, but no representation or warranty, express or implied is made by us as to their accuracy or completeness. The information, opinions, estimates and forecasts may well be affected by subsequent changes in market conditions. This document may not be reproduced in whole or in part, or published for any purpose.

REPRODUCTION OR REBROADCAST OF ANY PORTION OF THIS RESEARCH REPORT IS STRICTLY PROHIBITED WITHOUT THE WRITTEN PERMISSION OF CONCORDE SECURITIES LTD.

NOTICE TO US INVESTORS

This report was prepared, approved, published and distributed Concorde Securities Ltd. located outside of the United States (a "non-US Group Company"). This report is distributed in the U.S. by LXM LLP USA, a U.S. registered broker dealer, on behalf of Concorde Securities Ltd. only to major U.S. institutional investors (as defined in Rule 15a-6 under the U.S. Securities Exchange Act of 1934 (the "Exchange Act")) pursuant to the exemption in Rule 15a-6 and any transaction effected by a U.S. customer in the securities described in this report must be effected through LXM LLP USA.

Neither the report nor any analyst who prepared or approved the report is subject to U.S. legal requirements or the Financial Industry Regulatory Authority, Inc. ("FINRA") or other regulatory requirements pertaining to research reports or research analysts. No non-US Group Company is registered as a broker-dealer under the Exchange Act or is a member of the Financial Industry Regulatory Authority, Inc. or any other U.S. self-regulatory organization.

Analyst Certification

Each of the analysts identified in this report certifies, with respect to the companies or securities that the individual analyses, that (1) the views expressed in this report reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly dependent on the specific recommendations or views expressed in this report. Please bear in mind that (i) Concorde Securities Ltd. is the employer of the research analyst(s) responsible for the content of this report and (ii) research analysts preparing this report are resident outside the United States and are not associated persons of any US regulated broker-dealer and that therefore the analyst(s) is/are not subject to supervision by a US broker-dealer, and are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with US rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

Important US Regulatory Disclosures on Subject Companies. This material was produced by Concorde Securities Ltd. solely for information purposes and for the use of the recipient. It is not to be reproduced under any circumstances and is not to be copied or made available to any person other than the recipient. It is distributed in the United States of America by LXM LLP USA and elsewhere in the world by Concorde Securities Ltd. or an authorized affiliate Concorde Securities Ltd. This document does not constitute an offer

of, or an invitation by or on behalf of Concorde Securities Ltd. or its affiliates or any other company to any person, to buy or sell any security. The information contained herein has been obtained from published information and other sources, which Concorde Securities Ltd. or its Affiliates consider to be reliable. None of Concorde Securities Ltd. accepts any liability or responsibility whatsoever for the accuracy or completeness of any such information. All estimates, expressions of opinion and other subjective judgments contained herein are made as of the date of this document. Emerging securities markets may be subject to risks significantly higher than more established markets. In particular, the political and economic environment, company practices and market prices and volumes may be subject to significant variations. The ability to assess such risks may also be limited due to significantly lower information quantity and quality. By accepting this document, you agree to be bound by all the foregoing provisions.

LXM LLP USA assumes responsibility for the research reports content in regards to research distributed in the U.S. LXM LLP USA or its affiliates has not managed or co-managed a public offering of securities for the subject company in the past 12 months, has not received compensation for investment banking services from the subject company in the past 12 months, does not expect to receive and does not intend to seek compensation for investment banking services from the subject company in the next 3 months. LXM LLP USA has never owned any class of equity securities of the subject company. There are not any other actual, material conflicts of interest of LXM LLP USA at the time of the publication of this research report. As of the publication of this report LXM LLP USA, does not make a market in the subject securities.

Sales:

Eva Kormendi, CFA
 +36 1 489 2340
e.kormendi@con.hu

Tamas Hegedus
 + 36 1 489 2388
t.hegedus@con.hu

Trade:

Steve Simon
 +36 1 489 2335
i.simon@con.hu

Peter Rimar
 +36 1 489 2230
p.rimar@con.hu

Gyorgy Sugar
 +36 1 489 2231
gy.sugar@con.hu