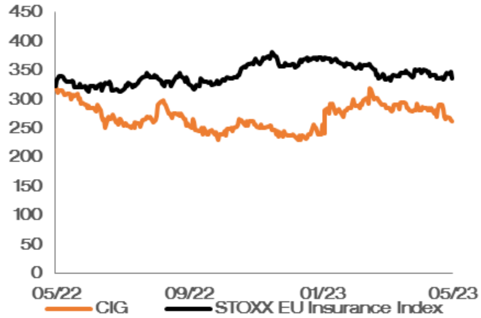
CONCORDE RESEARCH

CEE Equity Research | Insurance | Hungary
31 May 2023

CIG Pannonia

Recommendation: BUY (unch.)
Target price (e-o-y): HUF 410 (unch.)
Share price: HUF 260

Share price as of 31/05/2023	HUF 260
Number of diluted shares [million]	94.4
Market capitalization [HUF mn/EUR mn]	25 023 / 67.5
Daily turnover 12M [HUF million]	0.01
Bloomberg	PANNONIA HB
Reuters	CIGP.BU
Free float	44.7%
52 week range	HUF 220 – 318



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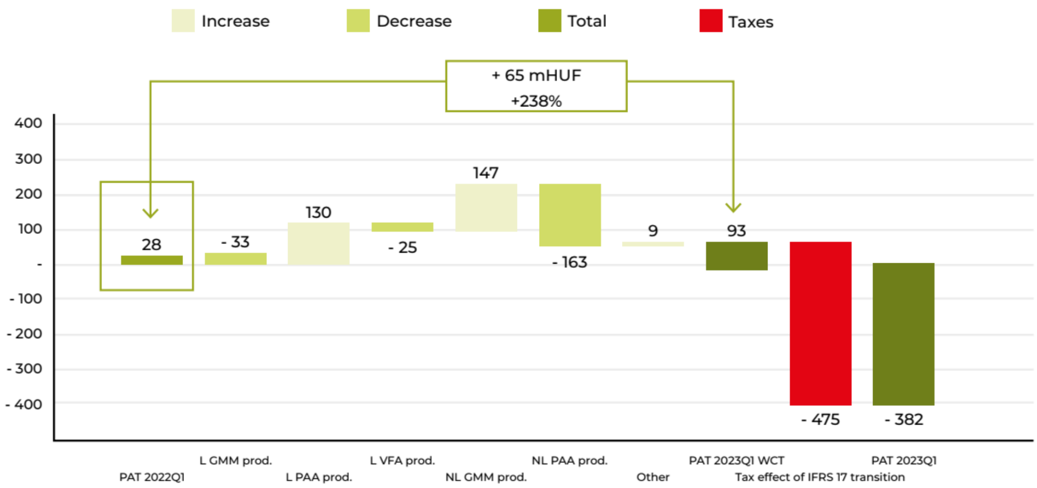
Adjusted net results under IFRS 17 grew threefold YoY in Q1/23

- CIG Pannonia (Pannonia) reported its first quarter results for the first time in accordance with IFRS 17 standards, which significantly differ from the results reported according to IFRS 4 standards used in the market until now. The introduction of the IFRS 17 accounting transition methodology for 31 December 2021 resulted in an a significant increase of HUF 7.3bn (+56%) from HUF 13.2bn to HUF 18.7bn in Pannonia's consolidated equity at that date, implying a BVPS of HUF 198 and 1.3x P/BV. However, the application of the IFRS 17 standard also meant a tax burden of HUF 475mn, which is charged to the result of the first quarter of 2023. Also importantly, according to the IFRS 17 methodology, Pannonia's consolidated after-tax profit for the entire year of 2022 was finally ca. HUF 199mn higher (HUF 1.41bn) than under the IFRS 4 standards.

- Consolidated after tax for Q1/23 was a loss of HUF 382mn compared to HUF 28mn in Q1/22. The primary reason for the loss is the aforementioned one-off tax charge of HUF 475mn due to the capital gain from the transition to IFRS 17 accounting standards. Adjusting for this tax effect, the profit after tax was HUF 93 million, which is actually three times the net profit in the first quarter of last year. From now on, the best approach to understand what HUF 93mn was made of is not the gross accounting of income and expenses, but the change in the result of the product groups presented according to the new IFRS 17 financial standards applied for insurance carriers compared to the same period of the previous year. 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).

- It is important to emphasize that from now on, the recorded written amount of premium income is determined not by premium income and their time-proportional part (this was a kind of "gross approach" until now), but by the insurance services provided (from now on according to a kind of "net approach"), ie. the insurance profit achieved on insurance products according to IFRS 17 is continuously released during the life of the given product (the scope of the contract), according to the level of services undertaken and not as time goes by. The role of future expectations and their changes has become very important: the insurer must have a forecast for service levels and expected cash flows for each group of contracts (GIC: Group of Insurance Contracts). The newly reported result is actually the difference between the calculated and expected performance at the time of the creation of the GIC, and the actual performance calculated later, with the inclusion of a previously unused risk measure (risk adjustment), the financial effect of which is that the insurance company creates a reserve (which it subsequently releases gradually). Separate evaluation methodologies apply to product groups, including UL-insurance products, the investment premium part of which will no longer appear in income and expenses, only that part of them which belong to the insurer.

- As for the breakdown of the increase of the consolidated results before taxes according to IFRS 17:



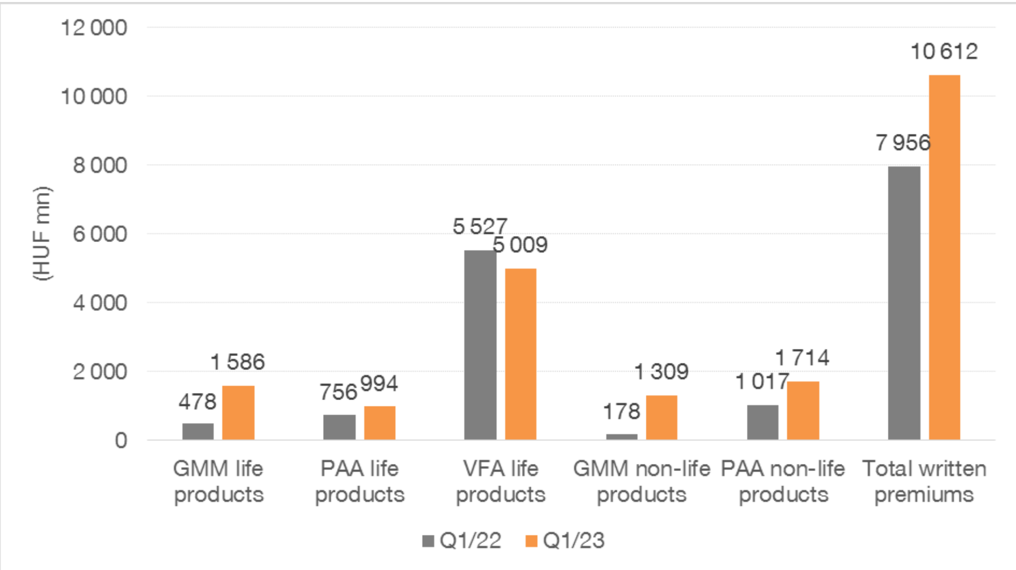
Source: Pannonia

- **GMM life products**: HUF 33mn loss YoY due mainly to traditional and term life insurances. The loss on the credit insurance policies taken over from the insurance company BNP Paribas Cardif was significantly mitigated by the volume and profit growth of group life and accident insurances, as well as the volume growth of risk life insurances.
- **GMM non-life:** HUF 147mn increase in profit explained by the fact that the loss reserve for Italian surety products (LIC, i.e. Liability for Incurred Claims) expressed in HUF decreased due to the strengthening of the HUF. The further improvement was caused by the increase in the effectiveness of engineering insurance.
- **PAA life products:** HUF 130mn increase in profit YoY achieved in short-term life, accident and health insurance as a result of the lower loss ratio assumptions for group life and accident insurance, while the insurance company's portfolio through MVM has expanded, and the results of group service financing insurance packages have also improved primarily thanks to the updated Elixir product.
- **PAA non-life:** HUF 163mn decrease in profit which was attributable to two products, fleet Casco and industrial property insurance in case of which Pannonia has not yet reached economics of scale, premiums are not yet enough to offset the related costs. However, Pannonia's mid-term strategy has already taken into account this effect in the initial phase of business expansion.

- **VFA life:** HUF 25mn decrease in profit caused by the greater than previously predicted losses on regular fee UL contracts that occurred in the first quarter of 2023.

- Pannonia's first quarter report also includes the effect of the additional insurance tax on certain insurance policies, introduced by the government last year, and the "traditional" insurance tax (which has existed for more than a decade in the case of non-life insurance).
- Written premiums grew by 33% YoY, reaching HUF 10.6bn in Q1/23, driven by an increase in the portfolio of long-term insurance contracts in both life and non-life insurance segments, and supported by the independent network and the banking channel, based on the strategic agreement with MBH Bank.
- In the **life insurance** segment, the GMM-valuated portfolio shows outstanding growth, with premiums up 232%, driven by the premium income from the credit coverage insurances taken over from BNP Paribas Cardif insurer. The PAA-valuated portfolio rose by 31% YoY thanks to the group insurance products sold through Hungarian Electricity Company (MVM), while a decrease of 9% was witnessed in the premium income valued according to VFA, due mainly to the weaker performance of UL insurance products. We note that the significant rise in yields in 2022 has created significant competition for this product group from other money market products, such as Hungarian government bonds, while profitability of the these insurance products group was also affected by the extra-profit tax introduced last year. Written premiums in the **non-life** segment grew more than sevenfold YoY, with the premiums for multiannual contracts valued under the GMM valuation method.

Change of Written Premium



Source: Pannonia, Concorde

- Other comprehensive income including the changes in the fair value of other financial assets (ie. OPUS shares and government securities) valued at fair value was HUF 449mn compared to a loss of HUF 424mn in the base period. As a result, total comprehensive came in at HUF 67mn in Q1/23 as against a loss of HUF 396 in Q1/22.
- Pannonia's capital adequacy ratio remained stable at 215% in the first quarter of 2023.

Outlook

- We reiterate CIG Pannonia (Pannonia) as BUY, as well as our 12-m target price at HUF 410, which leaves a 58% upside potential from the current share price.
- We leave our net income forecasts for 2023 and 2024 unchanged at HUF 1.56bn and HUF 2.04bn, respectively, which reflect the harmful impact of 1) a substantial increase in insurance (“windfall”) tax imposed on Hungarian insurers for the period between 1 July 2022 and 31 December, 2024, and 2) slowdown in economic growth as an consequence of high inflation eroding household real incomes and a great deal of uncertainty amid tightening financial conditions. Consequently, EPS may come in at HUF 17 in 2023 and then to grow again by 31% to HUF 22 in 2024.
- 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 and product innovation.

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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%)
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.

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