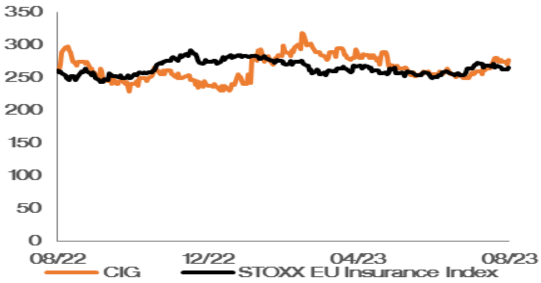
CONCORDE RESEARCH

CEE Equity Research | Insurance | Hungary
29 August 2023

CIG Pannonia

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

Share price as of 29/08/2023	HUF 284
Number of diluted shares [million]	94.4
Market capitalization [HUF mn/EUR mn]	26 818 / 70.0
Daily turnover 12M [HUF million]	0.01
Bloomberg	PANNONIA HB
Reuters	CIGP.BU
Free float	44.7%
52 week range	HUF 220 – 318



Net results under IFRS 17 grew impressively YoY in Q2/23

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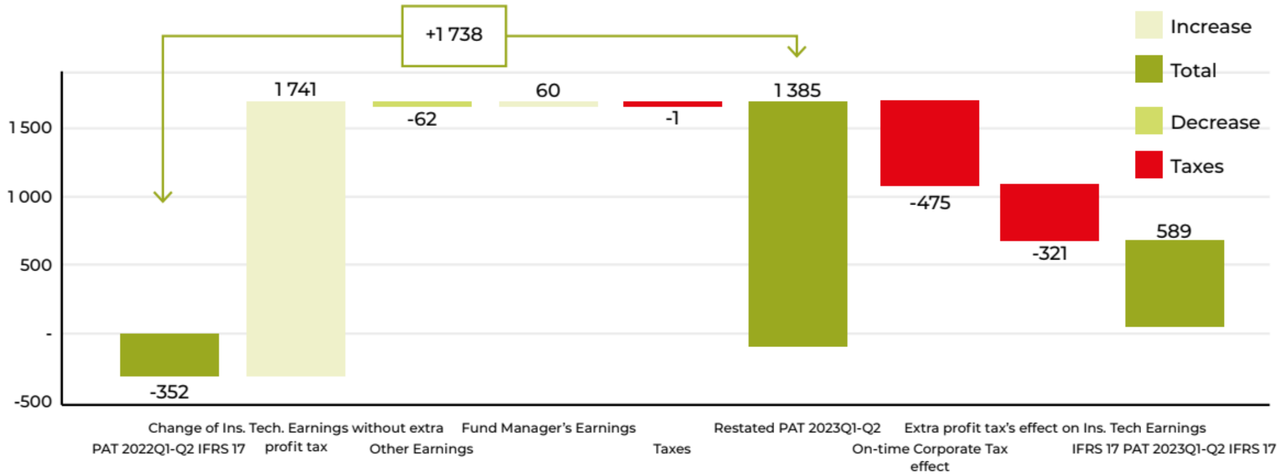
- CIG Pannonia (Pannonia or the insurer) reported HUF 971mn after tax profit for Q2/23 compared to HUF -325mn in Q2/22. Other comprehensive income including the changes in the fair value of other financial assets (ie. OPUS shares and government securities) valued at fair value was HUF 1.31bn compared to a loss of HUF 1.73bn in Q2/22. As a result, total comprehensive came in at HUF 645mn in Q2/23 as against a loss of HUF 790mn in Q2/22.
- It is worth stressing that Pannonia's reported its second 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 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).
- 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 tax impact of this transition a tax charge of HUF 475mn needed to be taken into account and charged to the profit in Q1/23. Also importantly, according to Pannonia's best estimate, the extra profit tax was HUF 321mn in H1/23, as a result of which, the insurer's consolidated after-tax profit came in at HUF 589mn in H1/23, up from HUF -353mn in H1/22. Adjusting for the aforementioned tax charges of HUF 796 mn in total, consolidated after tax profit was HUF 1.385bn in H1/23 compared to HUF HUF -353mn in H1/22.
- The primary reason for the outstanding earnings growth in Q2/2023 was (i) on the one hand, the growth of the insurance portfolio, (ii) on the other hand, a great improvement in profitability due to economies of scale and efficiency containment measures. The growth in the insurance stock and reinsurance contracts enabled Pannonia to offset the related costs and services, while the claim ratio and the combined ratio of casco products also improved, reducing Pannonia's capital requirements. The claim reserve for is formed in a foreign currency, thus the strengthening of the forint compared to last year's exchange rates resulted in reduction of reserves set aside for Pannonia's Italian suretyship products, whereby leading to the improvement of the technical result. However, the effect of the

strengthening of the forint is offset by the result of forward transactions recognized in the investment result (i.e. not in the technical result), as Pannonia seeks to match the currency exposure of assets and liabilities.

- *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.*

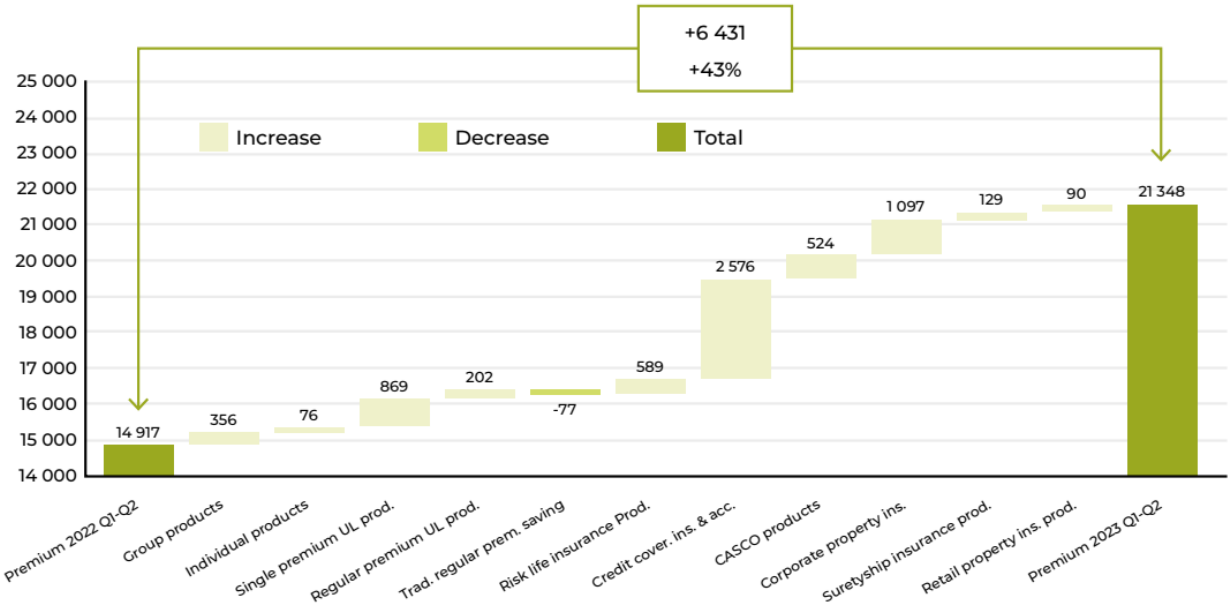
Breakdown of the y-oy increase of the IFRS 17 consolidated after tax result (HUF mn)



Source: Pannonia

- Pannonia has put focus on downsizing of its internal tied agent network and rechanneling it to its independent network; that is, it refocused its sales activities towards its banking and independent broker network in H1/23. Consequently, premium income increased in almost all portfolio groups, especially in credit coverage, corporate property and casco groups, meaning that premiums were 43% higher in Q2/23 than a year earlier (the life insurance premiums grew by 24%, while non-life premiums by 145% YoY, 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 186% and 1,858% respectively - are credit insurance policies taken over from BNP Paribas Cardif insurers; and (ii) the short-term contracts of non-life insurance segment – i.e. corporate property insurance and fleet casco. Life insurance policies linked to single premium investment units (UL), valuated 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.

Quarterly premium income development (HUF mn)



Source: Pannonia

Outlook

- We reiterate CIG Pannonia (Pannonia) as BUY, as well as our 12-m target price at HUF 410, which leaves a 44% upside potential from the current share price.
- We leave our net income forecasts (incl. special taxes) 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 (extra profit) 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, thus DPS can be HUF 14 for 2023 and HUF 18 for 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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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.

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