

CIG Pannonia

Recommendation: Under revision (prev. Neutral)

Target price (e-o-y): Under revision (prev. HUF 315)

Share price: HUF 303

Share price close as of 09/26/2019	HUF 303	Bloomberg	PANNONIA HB
Number of diluted shares [million]	94.4	Reuters	CIGP.BU
Market capitalization [HUF bn/EUR mn]	28.7.0/85.4	Free float	50%
Daily turnover 12M [HUF million]	0.07	52 week range	HUF 297 – 456.5

The adventure in Italy is getting uglier

- CIG Pannónia announced succinctly that its wholly owned subsidiary, CIG Pannónia First Hungarian General Insurance Company Ltd. (EMABIT), due to its cross-border activity in Italy, is expected to report a further loss of HUF 670 million on top of losses (HUF 692 million) incurred in Q2/19.
- Background to the case is that EMABIT guaranteed the concession fee and tax liability of some gaming companies in Italy. The business generated revenues in the early years (about HUF 500 million), but this year the insurance company suffered heavy losses due to this insurance activity.
- In our opinion, what might happened is a crime which eventually led to the ugly losses. The Italian gambling companies may have deliberately committed tax evasion.
- What is known at this point: CIG Pannonia guaranteed a total of EUR 12.8 million for a group of Italian gambling companies on which it reported preliminary losses of HUF HUF 692 million in Q2/19. Apart from these exposure there might be more, the size of which is not yet disclosed, but the reported additional loss on them has been HUF 670 million so far.
- These numbers reflect CIG Pannonia's best estimates at the moment, which may, of course, change (the actual loss may be more or less). Reinsurance, regression (lower than the estimated final loss rate), brokerage commission reclaims can have a positive impact on the loss rate, while further unknown claims and claim settlement costs may have a negative impact on it.
- The case will not likely be closed for months or even years.
- The current management is likely to remain in the helm of the life insurance company. Bluntly, it would be very difficult to find a new executive to take the CEO position of EMABIT in this awkward situation. What happened is that the CEO of CIG Pannónia Group, who has no direct experience in non-life insurance, has also taken over the chief executive position of the non-life business.
- Due to the additional claims that has triggered further provisioning needs and thus led to further losses, the non-life insurance capital adequacy ratio will likely fall below 151 percent published at the end of the first half of the year. This is the threshold below which the National Bank of Hungary (NHB) as the supervisory authority may even call for the non-life insurer to replenish its capital. The parent life insurance

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company will be able to do this, in our view, which however will weaken its own liquidity position and capital adequacy (the same risk exposure requires higher capital needs). The capital increase will be easily made from the amounts of capital increase previously placed in the capital reserve, which in principle will not affect the life insurer's ability to pay dividends.

- Currently, EMABIT is recorded on the life insurance company's B/S at a cost of ca. HUF 5.3 billion. This may be reviewed (in part) if the auditor considers the incident as a cause for the deterioration in EMABIT's profit outlook, and therefore there may be need to lower the fair value estimate for EMABIT. In this case, the loss of EMABIT would already have a profound impact on the consolidated profit as well as on the life insurance company's stand-alone results. If that were the case, it would affect the life insurance company's capital adequacy as well as dividend payment ability.
- This situation is expected to provoke OPUS as the largest single shareholder. It should be noted that management rights over CIG Pannonia is exercised by other investment companies ("principal investors"), which together with friendly hands may hold more than 30 percent of the parent life insurance's company on our estimate.
- The position of OPUS as a shareholder is rather weak in CIG Pannonia. Notwithstanding being represented on the board of directors of the life insurer, the principal investors have apparently the upper hand. They are clearly clinging to the current management, and are unlikely to allow other shareholders to have a say in the insurer's strategic direction or dividend policy. Of course, OPUS could opt to increase further their current ownership (24.9%) in the life insurance company to try and acquire control over it. However, this would require buying a large number of shares (more than 5 million shares at least), either on the market or from the principal investors, which could probably only be made at significantly higher prices than the current market price. Even so, they would not go beyond the 33 per cent ownership threshold level above which they would be required to make a mandatory public offer to all shareholders.
- We do not happen to believe that this would be the purpose of OPUS. They have always treated CIG Pannonia as a financial investment. It worth keeping in mind that last year a capital increase of HUF 8 billion was made in life insurance by KONZUM/OPUS at a price of HUF 350 per share, while the life insurance company bought KONZUM / OPUS shares at a price of HUF 300 per share. However, while OPUS injected directly fresh capital into the life insurance company, the life insurance company bought KONZUM / OPUS shares from a private equity fund! Another issue is that the price of KONZUM/OPUS shares have since fallen considerably since the transaction (which was partly realized upon the delisting of KONZUM from the BSE), as well as the unduly high expectations that the OPUS Group will effectively lend support to CIG Pannónia's expansion in the domestic insurance market that we are afraid may not turn out to be the case at any time soon. Instead, it could easily happen that the relationship between the two major shareholder groups is so blurred that it may also drag on the insurer's market performance.
- CIG Pannonia's after-tax profit may amount to HUF 250 million in H2/19 (as opposed to HUF 950 million anticipated previously), which would result in a full-year after-tax loss of HUF 370 million this year, while net of extraordinary items consolidated profit could reach HUF 1.5 billion on our estimate.
- It is too early to quantify the exact amount of losses that may arise from guarantees provided for Italian gambling operators. We warn that our profit and TP estimates for the coming years may also need to be revised, but we will only be able to provide the new estimates once more public information is available on the approximate amount of losses of EMABIT arising from its insurance activities in Italy.

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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%)
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