

Peña Verde

Current price: MXN 10.18
12-month target price: MXN 11.90
(No liquidity risk discount applied).



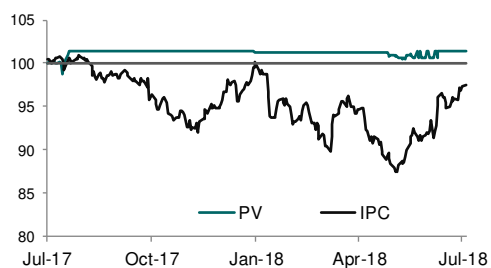
2Q18 quarterly report
viernes, 03 de agosto de 2018

While underwriting operations improved in 2Q18/2Q17, we decided to cut our net profit forecast for 2018, using a more conservative financial-gains assumption

Key Data

Ticker	PV* MM
Exchange	BMV
12 Month T.P. (Estimated Fair Value)	MXN 11.90
Last Price	MXN 10.18
Expected Return	16.9%
12 M Dividend Yield	0.1%
Total Expected Return	18.9%
LTM Return PV*	1.4%
LTM Price Range	(10.18 - 9.91)
Outstanding Shares (Million)	476.68
Free Float	2.77%
Trading Volume	Low
Market Cap (USD Million)	USD 260.30
P/E (TTM)	57.50X
Price/Book Value	0.96X
Official Website	www.corporativopv.mx

12M Return vs IPC



	2015	2016	2017	2018f
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Valuation

P/E	7.9x	18.7x	8.3x	10.0x
P/BV	1.2x	1.1x	1.0x	0.9x
ROE	15.5%	6.0%	12.2%	9.2%

Estimates (MXN million)

Gross Written Premiums	5,143	6,865	6,945	7,176
YoY%		33.5%	1.2%	3.3%
Net Retained Premiums	3,923	4,876	5,521	5,742
YoY%		24.3%	13.2%	4.0%
Underwriting Income	270	126	362	744
YoY%		-53.4%	187.7%	105.7%
Net income	613	257	583	485
YoY%		-58.1%	127.4%	-16.8%
EPS	1.3	0.5	1.2	1.0
YoY%		-58.1%	127.4%	-16.8%

Profitability

Combined Ratio	103.7%	107.4%	103.6%	97.4%
Acquisition Ratio	25.6%	27.0%	28.1%	29.4%
Claims Ratio	66.6%	68.0%	62.5%	58.1%
Operation Ratio	11.5%	12.4%	13.0%	9.8%

Source: Peña Verde, Bloomberg and Prognosis estimates

n.m.: not meaningful

- 1H18/1H17 results.** Written premiums totaled 3,206 million pesos (mp), a slight increase of +0.4% y/y. The technical profit reached 311 mp and the operating loss was -241 mp. The comprehensive financing result reached +411 mp. Thus, the net profit amounted 179 mp.
- After improving its governance, the company will focus on strengthening its digital platform.** After the creation of the Peña Verde SAB holding company in 2013, the implementation of better corporate governance practices and a strengthening of the management team, the company plans to focus on improving its digital platform in 2018, which could imply significant investments.
- Profitable growth.** The company's challenge continues to be to increase its market share and scale, while controlling its cost structure, particularly the claims ratio. We anticipate an accelerated growth in *Patria Re* and a stability in *General de Seguros* in the coming years.
- Low market cap. and trading volume.** The capitalization value of the issuer is approximately MXN 4,853 million, its trading volume is minimal, and its free float is only 3%, which limits the universe of potential PV* investors.
- Commitment to the stock market.** The company is open to possibilities to increase its stock's float. In Prognosis view, a private transaction would make sense if a strategic partner adds value to the PV business.
- We reduced our 2018 forecasts.** We anticipate that premiums of PV* will grow ~3.3% (vs our previous forecast of +8%), driven by dynamic growth in *Patria Re* and a fall in *General de Seguros*. We also anticipate an improvement in the combined ratio to 97.4% from 103.8% in 2017. We assume lower gains in the portfolio versus 217. Thus, we reached an estimated net profit of 485 mp (vs our previous forecast of 583 mp), an EPS of 1.0 peso.
- Target price.** Despite a lower EPS estimate, we reiterate our 12-month T.P at 11.90 pesos, equivalent to 1.0X the estimated June-2019-book value of PV. However, we do not incorporate a liquidity discount, due to the low trading volume of the shares.
- Risks.** The main risks are: slow economic growth, competition, the execution of new strategies and the behavior of financial markets. Others may include the cost of reinsurance, a higher claims ratio, shares liquidity, ceded reinsurances (counterparty, strategic partners) and credit risk in their investments.

1. 2Q18 report

Income Statement			
	Accumulated data		
	2Q18	2Q17	YoY Change
Gross Written Premiums	3,206	3,191	+0.4%
Net Retained Premiums	2,581	2,598	-0.7%
Retention Premiums Accrued	2,745	2,408	+14.0%
Acquisition Costs	805	711	+13.2%
Insurance Claims Incurred	1,630	1,250	+30.4%
Underwriting (Technical) Income (Loss)	311	447	-30.4%
Net Operating Expenses	218	324	-32.9%
Operating Income (Loss)	-241	-143	+68.7%
Comprehensive Financing Result	411	930	-55.8%
Net Profit (Loss)	179	678	-73.6%
<i>Acquisition Ratio</i>	31.2%	27.4%	+382 bp
<i>Claims Ratio</i>	59.4%	51.9%	+744 bp
<i>Operating Ratio</i>	8.4%	12.5%	-405 bp
Combined Ratio	99.0%	91.8%	+722 bp

Source: Prognosis and PV

n.m. = not meaningful

Note: The acquisition and operating ratios consider the net retained premiums, while the claims ratio considers the retention premiums accrued.

Peña Verde's written premiums totaled 3,206 million pesos (mp) as of 2Q18, an annual increase of +0.4% y/y, against 3,191 mp in 2Q17. This variation is mainly explained by the expected good dynamism in "Reaseguradora Patria", which "reached sales of 1,689 mp, an increase of +8.8% y/y, supported by the growth in reinsurance premiums from the fire, agricultural and automobile segments, but also from other operations".

On the other hand, the subsidiary "**General de Seguros**", which as of June 2018, "reached sales of 1,335 mp, a fall of -9.8% y/y, mainly due to non-renewal of a life operation business, for a net amount of approximately 188 mp. This drop was partially offset by increases in the fire, maritime and other segments. The premiums taken in General de Seguros amounted to 3.3 mp".

"Net increase in provision for unaccrued premiums. As of June 2018, this provision recorded a decrease of 165 mp, due to the cancellation of two important operations, the first one concerning health and property casualty segments from "Reaseguradora Patria" and the second concerning the life segment from "General de Seguros".

The net consolidated acquisition cost of PV* amounted 805 mp in 2Q18, an increase of +13.2% vs the 711 mp in 2Q17.

The net cost of consolidated claims increased +30.4%, standing at 1,630 mp. Peña Verde's claims ratio was 59.4%, an annual increase of 7.4 percentage points.

The **technical profit** fell -30.4% YoY to 311 mp. On top of that, net operating expenses totaled 218 mp and the **operating loss** amounted -241 mp.

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The **comprehensive financing result** reached 411 mp, which compares unfavorably against the profit of 930 mp a year ago. That is the result of a loss in investments, mainly in the stock market.

PV reported a **net profit** of 179 mp, which also compares unfavorably against the 678 mp profit in the previous year. The 2Q18 result is explained by the following: "a) decrease in the in provision for unaccrued premiums, and b) a FOREX gain".

Financial situation

According to the company's information, **total assets** amounted 20,670 mp in 2Q18, growing +13.5% y/y. "The most significant changes are the following: a) a 763 mp increase in investments, b) a 1,274 mp increase in reinsurers and c) an increase of 382 mp in debtors. The other asset accounts recorded no relevant changes".

Stockholder's equity. As of June 2018, the majority stockholders' equity reached 5,039 mp, an annual increase of +1.6%.

2. Target Price

We recalculated the implicit or fair value multiple using the Damodaran formula, $P/BV * = (ROE-g)/(Ke-g)$. We used cost of capital of 10.2%, a sustainable ROE of 10.5% and a nominal perpetuity growth of 4%, resulting in a "fair" multiple of 1.0488X. However, the market values the issuer at 1.0X its known book value, which we conservatively prefer to use. We have forecasted a book value of 11.90 pesos for June 2019, which is also our 12-month target price.

This price does not assume a discount for the low trading volume of the shares. However, shares qualify as high risk and profits have low predictability.

Company's description:

PV* is a holding company. Its main business consists in managing its subsidiary companies General de Seguros and Reaseguradora Patria through a third subsidiary, "Servicios Administrativos Peña Verde", with the purpose of improving management, regulatory compliance and generating economies of scale. General de Seguros operates all insurance segments except for pensions in all states of the Mexican Republic. The company's health segment is managed by its subsidiary "General de Salud". Reaseguradora Patria provides reinsurance services in all its forms in Mexico, Latin America and the rest of the world.

Peña Verde's Annual Income Statement (MXN millions)

	2015	2016	2017	2018f
Gross Written Premiums	5,143	6,865	6,945	7,176
(-) Ceded Premiums	1,219	1,990	1,424	1,434
Net Premiums Retained	3,923	4,876	5,521	5,742
<i>Net Premiums Retained rate</i>	<i>76%</i>	<i>71%</i>	<i>79%</i>	<i>80%</i>
(-) Net Increase in Provision for Unaccrued Premiums	107	367	425	-70
Retention Premiums Accrued	3,816	4,508	5,096	5,811
(-) Acquisition Costs	1,004	1,317	1,550	1,690
<i>Acquisition ratio</i>	<i>26%</i>	<i>27%</i>	<i>28%</i>	<i>29%</i>
(-) Insurance claims incurred	2,543	3,065	3,184	3,377
<i>Claims ratio</i>	<i>67%</i>	<i>68%</i>	<i>62%</i>	<i>58%</i>
Underwriting (technical) income (loss)	270	126	362	744
(-) Net Increase in Other Technical Reserves	331	90	349	536
Gross Income	-61	36	13	208
(-) Net Operating Expenses	451	605	720	566
<i>Operating ratio</i>	<i>12%</i>	<i>12%</i>	<i>13%</i>	<i>10%</i>
Operating income (loss)	-512	-569	-707	-357
Comprehensive Financing Result	1,370	921	1,368	944
Earnings before income tax	857	352	661	587
(-) Income tax payment provision	204	90	67	94
<i>Income tax rate</i>	<i>24%</i>	<i>26%</i>	<i>10%</i>	<i>16%</i>
Net profit (loss)	613	256.6	583	485
Minority interest	40	5.3	10	8
Majority Net Profit	613	256.6	583	485
EPS (TTM)	1.3	0.5	1.2	1.0
Number of shares (million)	476.7	476.7	476.7	476.7
<i>Gross Written Premiums growth</i>	<i>N/A</i>	<i>34%</i>	<i>1%</i>	<i>3%</i>
<i>Net Profit Growth</i>	<i>N/A</i>	<i>-58%</i>	<i>127%</i>	<i>-17%</i>
<i>EPS growth</i>	<i>N/A</i>	<i>-58%</i>	<i>127%</i>	<i>-17%</i>

Other Indicators

	2015	2016	2017	2018f
ROE	16%	6%	12%	9%
P/E	7.9	18.7	8.3	10.0
P/BV	1.2	1.1	1.0	0.9
Book Value Per Share	8.3	9.0	10.2	11.2

Balance Sheet Summary (MXN millions)

	2015	2016	2017	2018f
Assets	15,224	18,397	20,677	21,938
Investments	11,733	13,407	14,756	15,784
Liabilities	10,939	14,092	15,835	16,592
Technical Reserves	8,897	11,043	12,610	13,274
Total Equity	4,285	4,305	4,842	5,346
Shareholder's Equity (majority)	3,954	4,263	4,794	5,297

Source: Prognosis and BMV



Prognosis

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