

Peña Verde

Current price: MXN 10.18
12-month target price: MXN 10.40
(No liquidity risk discount applied).



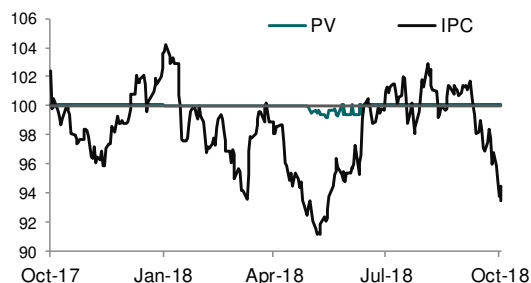
3Q18 quarterly report
jueves, 01 de noviembre de 2018

Premiums increased in Patria Re, but fell in General de Seguros, producing flat consolidated income. High claims trigger a fall in underwriting earnings and an operating loss. For y/e 2018, we forecast weak financial products and a marginal profit

Key Data

Ticker	PV* MM
Exchange	BMV
12 Month T.P. (Estimated Fair Value)	MXN 10.40
Last Price	MXN 10.18
Expected Return	2.2%
12 M Dividend Yield	0.14%
LTM Return PV*	0.0%
LTM Price Range	(10.18 - 10.09)
Outstanding Shares (Million)	476.68
Free Float	2.77%
Trading Volume	Low
Market Cap (USD Million)	USD 242.63
P/E (TTM)	53.7X
Price/Book Value	1.0X
Official Website	www.corporativopv.mx

12M Return vs IPC



	2015	2016	2017	2018f
Valuation				
P/E	7.9x	18.7x	8.3x	145.2x
P/BV	1.2x	1.1x	1.0x	1.0x
ROE	15.5%	6.0%	12.2%	0.7%

Estimates (MXN million)

Gross Written Premiums	5,143	6,865	6,945	6,962
YoY%		33.5%	1.2%	0.2%
Net Retained Premiums	3,923	4,876	5,521	5,628
YoY%		24.3%	13.2%	1.9%
Underwriting Income	270	126	362	449
YoY%		-53.4%	187.7%	24.2%
Net income	613	257	583	33
YoY%		-58.1%	127.4%	-94.3%
EPS	1.3	0.5	1.2	0.1
YoY%		-58.1%	127.4%	-94.3%

Profitability

Combined Ratio	103.7%	107.4%	103.6%	102.0%
Aquisition Ratio	25.6%	27.0%	28.1%	29.7%
Claims Ratio	66.6%	68.0%	62.5%	62.1%
Operation Ratio	11.5%	12.4%	13.0%	10.2%

Source: Peña Verde, Bloomberg and Prognosis estimates
n.m.: not meaningful

- Accumulated results in 3Q18.** Written premiums totaled 5,053 million pesos (mp), an increase of +1.1% y/y. The technical profit reached 328.6 mp, -36% y/y. The operating loss was -567.1 mp. The comprehensive financing result reached +599.4 mp. Thus, the net profit amounted 16.6 mp.
- After improving its governance, the company focuses 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 is improving its digital platform in 2018, which implies 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. As has been the case in 2018, we anticipate an accelerated growth in *Patria Re* and stability in *General de Seguros* in the coming years.
- Low market cap. and trading volume.** The trading volume of the shares 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 adjusted our 2018 forecasts.** We anticipate that premiums of PV* will remain flat in 2018 vs 2017, since the good dynamism in *Patria Re* will be offset by the weakness in *General de Seguros*. We also anticipate a combined ratio of 102%, from 103.8% in 2017. We assume lower gains in the portfolio versus 2017. Thus, we reached an estimated net profit of 33 an EPS of 0.1 pesos. The very high volatility in the financial markets could affect the valuation of the portfolios of PV, more than previously anticipated.
- Target price.** We reduced our 12-month T.P to 10.40 pesos, equivalent to 1.0X the estimated September-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.

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1. 3Q18 report

Income Statement			
Accumulated data			
	3Q18	3Q17	YoY Change
Gross Written Premiums	5,053	4,997	+1.1%
Net Retained Premiums	4,086	3,950	+3.5%
Retention Premiums Accrued	4,099	3,704	+10.7%
Acquisition Costs	1,207	1,141	+5.8%
Insurance Claims Incurred	2,564	2,050	+25.1%
Underwriting (Technical) Income (Loss)	329	513	-35.9%
Net Operating Expenses	387	503	-23.0%
Operating Income (Loss)	-567	-387	+46.5%
Comprehensive Financing Result	599	836	-28.3%
Net Profit (Loss)	-17	477	n.m.
<i>Acquisition Ratio</i>	29.5%	28.9%	+65 bp
<i>Claims Ratio</i>	62.5%	55.3%	+720 bp
<i>Operating Ratio</i>	9.5%	12.7%	-326 bp
Combined Ratio	101.6%	97.0%	+459 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 5,053 million pesos (mp) as of 3Q18, an annual increase of +1.1% y/y, against 4,997 mp in 3Q17. This variation is mainly explained by the expected good dynamism in **Reaseguradora Patria**, which "recorded sales of 2,759 mp, an increase of +15% y/y, caused by the increases in reinsurance premiums in the fire, automobile and agricultural business lines, but also in the refinancing operations".

On the other hand, the subsidiary "**General de Seguros**", which as of September 2018, "recorded sales of 1,986 mp, a drop of -15.6% y/y, mainly due to the non-renewal of two businesses: (1) one concerning the the life business line, for a net amount of approximately 188 mp and (2) the other concerning the agricultural sector and the non-renewal of some businesses related to the CADENA program (Component of Attention to Natural Disasters) for an amount of 178 mp. The previous decreases were partially offset by the increases in the maritime and transport branches and accidents and diseases. On the other hand, the premiums from General de Seguros amounted 8.5 mp".

"Net increase in provision for unaccrued premiums. As of September 2018, this provision recorded a decrease of 13 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 1,207 mp in 3Q18, an increase of +5.8% vs the 1,141 mp in 3Q17.

The net cost of consolidated claims increased +25.1%, standing at 329 mp. Peña Verde's claims ratio was 62.5%, an annual increase of 7.2 percentage points.

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The **technical profit** fell -35.9% YoY to 329 mp. On top of that, **net operating expenses** totaled 387 mp (-23.0%) and the **operating loss** amounted -567 mp (+46.5%).

The **comprehensive financing result** reached 599 mp, which compares unfavorably against the profit of 836 mp a year ago. That is the result of a loss in investments.

PV reported a **net loss** of -17 mp, which also compares unfavorably against the profit of 477 mp profit in the previous year. The 3Q18 result is explained by the following: "a) an increase in the claims ratio, and b) an increase in the net increase in provision for unaccrued premiums".

Financial situation

According to the company's information, **total assets** amounted 20,171 mp in 3Q18, growing +6.3% y/y. "The most significant changes are the following: a) a 642 mp increase in investments, b) an increase of 446 mp in debtors. The other asset accounts recorded no relevant changes".

Stockholder's equity. As of September 2018, the majority stockholders' equity reached 4,714 mp, an annual increase of +0.4%.

2. Target Price

We recalculated the implicit or fair value multiple using the Damodaran formula, $P/BV^* = (ROE-g)/(K_e-g)$. 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 10.4 pesos for September 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	6,962
(-) Ceded Premiums	1,219	1,990	1,424	1,335
Net Premiums Retained	3,923	4,876	5,521	5,628
<i>Net Premiums Retained rate</i>	76%	71%	79%	81%
(-) Net Increase in Provision for Unaccrued Premiums	107	367	425	33
Retention Premiums Accrued	3,816	4,508	5,096	5,594
(-) Acquisition Costs	1,004	1,317	1,550	1,669
<i>Acquisition ratio</i>	26%	27%	28%	30%
(-) Insurance claims incurred	2,543	3,065	3,184	3,476
<i>Claims ratio</i>	67%	68%	62%	62%
Underwriting (technical) income (loss)	270	126	362	449
(-) Net Increase in Other Technical Reserves	331	90	349	623
Gross Income	-61	36	13	-174
(-) Net Operating Expenses	451	605	720	572
<i>Operating ratio</i>	12%	12%	13%	10%
Operating income (loss)	-512	-569	-707	-746
Comprehensive Financing Result	1,370	921	1,368	802
Earnings before income tax	857	352	661	56
(-) Income tax payment provision	204	90	67	21
<i>Income tax rate</i>	24%	26%	10%	38%
Net profit (loss)	613	256.6	583	33
Minority interest	40	5.3	10	1
Majority Net Profit	613	256.6	583	33
EPS (TTM)	1.3	0.5	1.2	0.1
Number of shares (million)	476.7	476.7	476.7	476.7
<i>Gross Written Premiums growth</i>	N/A	34%	1%	0%
<i>Net Profit Growth</i>	N/A	-58%	127%	-94%
<i>EPS growth</i>	N/A	-58%	127%	-94%

Other Indicators

	2015	2016	2017	2018f
ROE	16%	6%	12%	1%
P/E	7.9	18.7	8.3	145.2
P/BV	1.2	1.1	1.0	1.0
Book Value Per Share	8.3	9.0	10.2	10.0

Balance Sheet Summary (MXN millions)

	2015	2016	2017	2018f
Assets	15,224	18,397	20,677	20,319
Investments	11,733	13,407	14,756	14,511
Liabilities	10,939	14,092	15,835	15,537
Technical Reserves	8,897	11,043	12,610	12,429
Total Equity	4,285	4,305	4,842	4,783
Shareholder's Equity (majority)	3,954	4,263	4,794	4,737

Source: Prognosis and BMV



Prognosis

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