

Peña Verde

Current price: MXN 10.18
12-month target price: MXN 9.0
(No liquidity risk discount applied)

 Prognosis

3Q quarterly report

November 9, 2020

- **Stellar performance of Patria Re in the 3Q20 and accumulated to September 2020. General de Seguros remains lagging**
- **Insurance claims and acquisition cost above our estimates, but operating expenses below them. We improve our forecast to a net loss of around -417 million pesos (previously -519 mp) in 2020, with financial gains impacted by the Covid-19 crisis in 1H20. Target price rises in line with our estimated book value**
- **PV introduces the concept of “Patrimony”, adding 60% of the catastrophic reserve to equity. Thus, the book value per share is 9.4 pesos, while “patrimonial value” is 18.1 pesos, both as of 3Q20**

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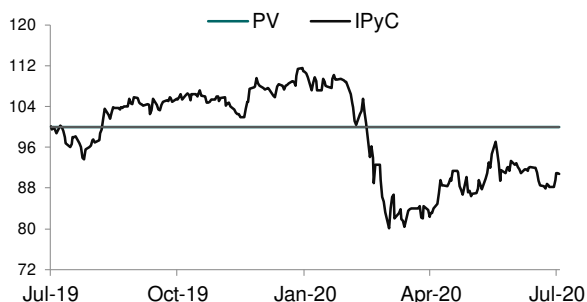
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Key Data

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	0.0%
Expected Dividend Yield	0.0%
Total Expected Return	2.2%
LTM Return PV*	0.0%
LTM Price Range (MXN)	(10.18 - 10.18)
Outstanding Shares (Million)	476.7
Free Float	1.22%
Trading Volume	Low
Market Cap (USD Million)	USD 217.77
P/E (TTM)	-21.2X
Price/Book Value	1.1X
Official Website	www.corporativopv.mx

12M Return vs IPyC



	2017	2018	2019	2020f
Valuation				
P/E	8.3x	-8.7x	14.9x	34.7x
P/BV	1.0x	1.1x	1.0x	1.0x
ROE	12.2%	-13.3%	7.0%	-8.9%
Estimates (MXN million)				
Gross Written Premiums	6,965	7,259	8,214	9,365
YoY%	1.5%	4.2%	13.2%	14.0%
Net Retained Premiums	5,521	5,908	6,635	7,495
YoY%	13.2%	7.0%	12.3%	13.0%
Underwriting Income	357	680	743	601
YoY%	184.2%	90.3%	9.4%	-19.1%
Net income	583	-561	326	-417
YoY%	127.2%	n.m.	n.m.	n.m.
EPS	1.2	-1.2	0.7	0.3
YoY%	127.2%	n.m.	n.m.	-57.1%
Cost Structure				
Adjusted Combined Ratio	100.5%	93.8%	102.6%	101.2%
Acquisition Ratio	28.1%	30.3%	28.7%	30.4%
Claims Ratio	62.0%	56.5%	59.6%	61.2%
Operation Ratio	10.3%	6.9%	14.4%	9.6%

Source: Peña Verde, Bloomberg and Prognosis estimates

Note: Adjusted combined ratio is calculate over net retained premiums

n.m.: not meaningful

• **3Q20/3Q19 results².** Written premiums totaled 2,632.2 million pesos (mp), a +17.2% y/y increase, driven once again by the good dynamism of *Reaseguradora Patria*. Technical profit added 283 mp, an increase of more than +100% y/y. Operating loss was of 169 mp and financial gains recorded a profit of 281 mp. Thus, net profit totaled 21 mp. However, in the accumulated of the year the net loss stood at 409 mp, an EPS (12-months) of -0.29 pesos per share.

• **2020 Estimates.** We expect written premiums to grow approximately +14%, driven by: (1) The dynamism of Patria Re, this year influenced by a probable positive FX rate effect and (2) a gradual return to growth path in *General de Seguros*. We also expect the cost structure to remain well-behaved. We estimate an adjusted combined ratio of 101.2% in 2020, with acquisition, claims and operation ratios of 30.4%, 61.2% and 9.6%. Financial gains of 386 mp would be insufficient to offset the operating loss for the year, which would result in a net loss of 417 mp.

• **New 2020-2025 Plan.** The company has launched a new digital, cultural and organizational transformation plan that could be a catalyst for solid growth in the medium-term. This plan encompasses all Peña Verde's divisions with a horizon of 5 years, in which the company proposes; among other things, to generate value, consolidate solid and sustainable growth and seek greater visibility in the stock market in order to access additional sources of financing that leverage future growth. The health emergency will make planning more difficult, but its results will likely be stronger.

• **Risk management.** The company visualizes itself as a specialist in risk management and plans to capitalize on this expertise, including a successful historical management of its investment portfolios.

• **Low market cap. and trading volume.** The capitalization value of the issuer is approximately USD 255.2 million, its trading volume is minimal, and its free float is only 1.2%, which limits the universe of potential PV* investors.

• **Commitment to the stock market.** The company is substantially improving its visibility, as evidenced by the hiring of Andrés Millán to spearhead the financial strategy and that of Miguel A. Murcio as head of investors relations. In Prognosis's opinion, PV would be open to possibilities to increase its floating capital and leverage its future growth. Over time, in our opinion, this will gradually result in an increase in the market value of the PV* securities.

• **Target price.** Our 12-month T.P is of 10.40 pesos, equivalent to 1.05X the estimated 2020 book value. We use the implicit or fair multiple that results from the Damodaran model, which is 1.05X. However, we do not incorporate the customary liquidity discount due to the low trading volume of the shares. As of 3Q20, the book value per share is 9.4 pesos while its "patrimonial value" is 18.1 pesos.

• **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.

² Note: The figures presented in the report are preliminary. They do not include the third quarter of 2019 and 2020 of Patria Corporate Member LTD given the difference in reporting times of the operation in the United Kingdom.

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1. 3Q20 report

Income Statement

	Accumulated data			Non-accumulated data		
	3Q20	3Q19	YoY Change	3Q20	3Q19	YoY Change
Gross Written Premiums	7,005	5,669	+23.6%	2,632	2,246	+17.2%
Net Retained Premiums	5,654	4,648	+21.6%	2,121	1,788	+18.7%
Retention Premiums Accrued	5,593	4,498	+24.3%	2,065	1,592	+29.8%
Acquisition Costs	1,716	1,349	+27.2%	719	518	+38.8%
Insurance Claims Incurred	3,389	2,808	+20.7%	1,063	962	+10.5%
Underwriting (Technical) Income (Loss)	488	342	+42.8%	283	111	+154.7%
Net Operating Expenses	523	587	-10.9%	187	160	+16.7%
Operating Income (Loss)	-790	-793	-0.3%	-169	-233	-27.4%
Comprehensive Financing Result	199	915	-78.3%	281	139	+102.6%
Net Profit (Loss)	-409	54	n.m.	34	-58	n.m.
<i>Acquisition Ratio</i>	30.3%	29.0%	+134 bp	33.9%	29.0%	+490 bp
<i>Claims Ratio</i>	60.6%	62.4%	-183 bp	51.5%	60.5%	-898 bp
<i>Operating Ratio</i>	7.5%	10.4%	-289 bp	7.1%	7.1%	-03 bp
Consolidated Combined Ratio	98.4%	101.8%	-338 bp	7.1%	7.1%	-03 bp
Adjusted Combined Ratio	100.6%	105.5%	-483 bp	92.5%	96.6%	-411 bp
<i>Investments (1)</i>	17,947.0	15,882.2	13.0%			
<i>Catastrophic reserve (1)</i>	6,921.2	5,563.0	24.4%			
Patrimony (1)(2)	8,630.5	7,740.5	11.5%			

Source: Prognosis and PV

(1) Investments, Catastrophic Reserve and Patrimony 2019 with figures as of December 2019

(2) Patrimony = Equity + (Catastrophic Reserve x 60%)

Note: The Adjusted Combined Ratio is calculated over Retention Premiums Accrued

n.m.: not meaningful

Peña Verde's written premiums totaled 2,632 million pesos (mp) in 3Q20, an increase of +17.2% y/y, against the 2,246 mp in 3Q19. This variation is mainly explained by the dynamism in **Patria Re**, that recorded sales of 2,004.2 mp, +28.7% y/y compared to 1Q19, as a result of the pursuit of increasing participation in the places in which the company operates by expanding its business lines. For its part, the subsidiary **General de Seguros**, issued premiums for 584.6 mp, a decrease of -4.5% y/y. The relative weakness of premiums is due to the portfolio clearance that PV has implemented to care for profitability. The administration estimates that it is reaching the end of this process, so the recovery of dynamism would be close.

In the accumulated to the third quarter of the year, Peña Verde's written premiums reached 7,005 mp, an annual increase of +23.6%, derived from the increase in written premiums of Patria Re of +42.1% that offset the -4-4% drop of General de Seguros.

The net consolidated acquisition cost of PV * amounted 719 mp in 3Q20, +38.8% vs the 518 mp in 1S19. This came from an increase in reinsurance commissions paid to ceding companies and the costs associated with "excess losses" that protect retention. In the accumulated of the year, the net acquisition cost of PV* stood at 1,716 mp, recording an acquisition ratio of 30.3%, superior to the prior 29%.

The **net cost of consolidated claims** rose +10.5%, to 1,063 mp. Such cost grew due to several incidents that affected the results from Re Patria. In the accumulated of the year, the net cost of consolidated claims of PV* stood at 3,389 mp, recording a claims ratio over retain premiums accrued of 60.2%, showing a decrease of -1.8 percentage points.

The **technical profit** grew 42.8% y/y to 488 mp. This is explained by the increase in the cost of claims and the net acquisition cost, although being partially offset by the rise in written premiums.

In addition to the above, **net operation expenses** totaled 187 mp, +16.7% y/y in 3Q20. While, in the accumulated of the year net operating expenses totaled 523 mp, an annual drop of -10.9%. Thus, operating expenses on written premiums represented 7.5% during the first three quarters of the year.

The **comprehensive financial result** accumulates a profit of 199 mp, that compares negatively against the bigger gain of 915 mp in 3Q19. In 3Q20 this result recorded a gain of 280.9 mp on a portfolio of 17,947.3 mp. This gain was mainly due to a rise in the FX rate, a better valuation of the debt instruments due to lower rates, and the rebound of equities during the 3Q20.

PV reported a cumulative net loss of 409 mp as of 3Q20. However, with non-accumulated figures, in the 3Q20 the company totaled a net profit of 34 mp, thanks to the good performance of the investment portfolio and a larger technical income.

Financial situation

Summary of the Balance Sheet (MXN millions)

	3Q20	%	3Q19	%	YoY Change
Investments	17,947	68.9%	15,716	69.6%	+14.2%
Receivables	3,299	12.7%	2,546	11.3%	+29.6%
Reinsurers	3,774	14.5%	3,343	14.8%	+12.9%
Other Assets	513	2.0%	410	1.8%	+25.0%
Total Assets	26,051	100.0%	22,574	100.0%	+15.4%
Technical Reserves	16,827	64.6%	14,320	78.7%	+17.5%
Reinsurers	2,744	10.5%	1,919	10.5%	+43.0%
Other Liabilities	927	3.6%	1,069	5.9%	-13.3%
Total Liabilities	21,573	82.8%	18,202	80.6%	+18.5%
Stockholder's Equity	4,478	17.2%	4,372	19.4%	+2.4%
Total Liabilities + Equity	26,051	100.0%	22,574	100.0%	+15.4%

Source: Prognosis based on GNP

According to the company's information, **total assets** amounted 26,051 mp as of 3Q20, growing +15.4% y/y. Investments grew +4.2% y/y, reinsurers rose +12.9% y/y and receivables advanced +29.6% y/y.

Regarding **liabilities**, technical reserves increased +17.5% to 16,827 mp in 3Q20 vs. 3Q19. Meanwhile, **stockholder's equity** totaled 4,478 mp (a book value per share of 9.4 pesos), a slight increase of +2.4%, compared to 3Q19.

2. Relevant events

January 15, 2020. "The company announced that, with effect from November 1, 2019, Andrés Millán Drews joined Grupo Peña Verde as Vice President of Asset Management and Financial Strategy".

January 15, 2020. "The company announced that, with effect from February 3, 2020, María Cristina Rohde Faraudo, decided to leave the Company after more than 4 years as General Director of Administrative Services for Peña Verde".

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April 15, 2020. “The company announced measures implemented in the face of the COVID-19 health emergency”.

October 2, 2020. “The company announced that Capital Finance International (CFI) magazine awarded its subsidiary Patria Re the recognition of the Most Responsible Reinsurer Mexico 2020”.

3. 2020 Estimates

Although the numbers reported by the company are generally better than our estimates, we believe there is a slowing trend in the Mexican insurance industry, and we are more comfortable with our current estimates.

We expect written premiums to grow approximately +14%, driven by: (1) The dynamism of Patria Re, this year influenced by a probable positive FX rate effect and (2) a gradual return to growth path in General de Seguros.

We also expect the cost structure to remain well-behaved. We estimate an adjusted combined ratio of 101.2% in 2020, with acquisition, claims and operation ratios of 30.4%, 61.2% and 9.6%. We believe that there will be increases in operating expenses related to the transformation of the company, but that they will be offset by a decrease in expenses related to the Employee Participation in Profits.

Thus, assuming a gradual recovery of the stock portfolio that results in a slightly positive financial income that is close to 386 mp, we estimate a net loss of -417 mp, or -0.87 pesos por share.

For 2021, we are considering, **on a preliminary basis**, a growth of +10% in premiums, a combined ratio of 102.0 and an advance in the financial gains of +6.0%.

4. 5-year Peña Verde Group business plan

Since the publication of the 4Q19 PV report in the BMV stock market, it has become clear that attention to the potential investor has increased, given the richer and clearer information reported. After the conference with the management – strengthened with new members with experience- it became clear that a transformation, not only organizational, but cultural and modernizer through investment commitments in digital technology, is underway.

Organizational. To begin with, the company announced the hiring of Andres Millan to Peña Verde Group, an executive with experience – among other places, in the World Bank – as Vice President of Asset Management and Financial Strategy, with the departure of María Cristina Rohde, who until November had served as General Director of Administrative Services of PV. In addition to that, the function of investor relations is formalized with the hiring of Miguel Angel Murcio (Corporate Finance Manager).

On the other hand, the role of the SAPV holding is transformed with two important functions to support the companies: 1) Business support and transformation and 2) asset management and financial strategy. It is worth mentioning that the Group is divided into two divisions, that of Insurance, which brings of Health and the Call Center and the Reinsurance division formed by Patria and Patria Corporate Member LTD in London.

Cultural. A greater professionalization of the subscription of risks and operation processes is sought, with measurements parameters that did not exist before.

Digital. The administration decided to promote a digital transformation of all its processes. To do this, it will invest 4% of its total revenues in cutting-edge technology to compete more strongly in the Mexican financial market. Of this total, between 15 and 25% of the resources will be classified as investment (CAPEX) and the remaining as operating expense.

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The main objective of the transformation embodied in the 5-year Business Plan is to generate value for PV shareholders, customers, and employees. Realistically, the plan sees that around 2023 the company could be growing at high and sustained rates, maintaining good profitability. A particularly important additional objective is to improve the visibility of the Group and its relationship with the stock market, in order to help leverage future growth. Over time, in our view, this will result in actions that gradually increase the stock market value of PV*.

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Peña Verde's Annual Income Statement (MXN millions)

	2015	2016	2017	2018	2019	2020f
Gross Written Premiums	5,143	6,865	6,965	7,259	8,214	9,365
(-) Ceded Premiums	1,219	1,990	1,444	1,351	1,579	1,870
Net Retained Premiums	3,923	4,876	5,521	5,908	6,635	7,495
<i>Retention rate</i>	76.3%	71.0%	79.3%	81.4%	80.8%	80.0%
(-) Net Increase in Provision for Unaccrued Premiums	107	367	497	224	326	302
Retention Premiums Accrued	3,816	4,508	5,025	5,683	6,309	7,193
(-) Acquisition Costs	1,004	1,317	1,550	1,792	1,808	2,189
<i>Acquisition ratio</i>	26.3%	29.2%	30.9%	31.5%	28.7%	30.4%
(-) Insurance claims incurred	2,543	3,065	3,117	3,211	3,757	4,404
<i>Claims ratio</i>	66.6%	68.0%	62.0%	56.5%	59.6%	61.2%
Underwriting (technical) income (loss)	270	126	357	680	743	601
(-) Net Increase in Other Technical Reserves	331	90	349	689	668	776
Gross Income	-61	36	9	-9	75	-175
(-) Net Operating Expenses	451	605	720	503	907	690
<i>Operating ratio</i>	11.8%	13.4%	14.3%	8.9%	14.4%	9.6%
Operating income (loss)	-512	-569	-712	-512	-832	-865
Comprehensive Financing Result	1,370	921	1,368	-304	1,301	386
Earnings before income tax	857	352	657	-816	469	-479
(-) Income tax payment provision	204	90	63	-250	139	-64
<i>Income tax rate</i>	23.8%	25.5%	9.7%	30.6%	29.8%	13.4%
Net profit (loss)	613	256.6	583	-561	326	-417
Minority interest	40	5.3	10	-6	4	2
Majority Net Profit	613	256.6	583	-561	326	-417
EPS (LTM)	1.3	0.5	1.2	-1.2	0.7	0.3
Number of shares (million)	476.7	476.7	476.7	476.7	476.7	476.7
<i>Gross written premiums growth</i>		+33.5%	+1.5%	+4.2%	+13.2%	+14.0%
<i>Net retained premiums growth</i>		+24.3%	+13.2%	+7.0%	+12.3%	+13.0%
<i>Retention premiums accrued growth</i>		+18.1%	+11.5%	+13.1%	+11.0%	+14.0%
<i>Net profit growth</i>		-58.1%	+127.2%	n.m.	n.m.	n.m.
<i>EPS growth</i>		-58.1%	+127.2%	n.m.	n.m.	-57.1%

Other Indicators

	2015	2016	2017	2018	2019	2020f
ROE	15.5%	6.0%	12.2%	-13.3%	7.0%	-8.9%
P/E	7.9	18.7	8.3	-8.7	14.9	34.7
P/BV	1.2	1.1	1.0	1.1	1.0	1.0
Book Value Per Share	8.3	9.0	10.2	9.0	9.9	9.9

Balance Sheet Summary (MXN millions)

	2015	2016	2017	2018	2019	2020f
Assets	15,224	18,397	20,681	20,086	22,917	27,336
Investments	11,733	13,407	14,756	14,586	15,882	19,199
Liabilities	10,939	14,092	15,841	15,819	18,217	22,632
Technical Reserves	8,897	11,043	12,610	12,458	13,957	18,106
Total Equity	4,285	4,305	4,840	4,267	4,700	4,704
Shareholder's Equity (majority)	3,954	4,263	4,792	4,228	4,657	4,662

Source: Prognosis and BMV

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Economía, Finanzas e Inversiones S.C.

- Over 30 years of direct experience analyzing debt and equity securities
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