

# PEÑA VERDE

## Quarterly Report 4Q15

Current Price MXN 10.15

Target Price 2016 MXN 9.90

Tuesday, March 29, 2016

**Good growth in revenues, but below costs and expenses, in 2015. Net profit surged due to a solid Comprehensive Financial Result. The key challenges faced by management in the future are: (1) to grow while underwriting good risks and (2) capitalize on its recent foray into the Lloyd's market**

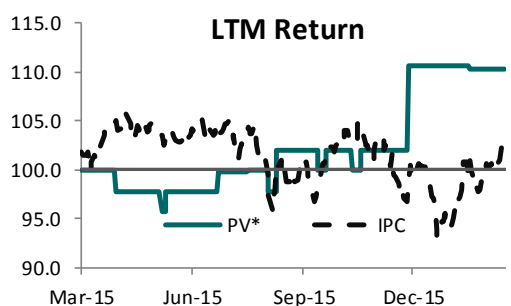
- In 2015, written premiums increased 23% to 5.143 billion pesos (bp), the operating loss grew due to higher claims and higher expenses to -512 million pesos (mp). A solid Comprehensive Financial Result, led by gains in the investment portfolio, caused net profit to reach 613 mp, from 46 mp in 2014.
- The important foray into the prestigious Lloyd's market provides an opportunity to develop product lines in specialized segments and may expand the reinsurance capacity of the company.

### Key Data

Local Ticker	PV*
12 M Target Price	MXN 9.90
Last Price	MXN 10.15
Expected Return	-2.5%
LTM Return PV*	10%
Outstanding Shares (million)	476.7
Free Float	3.0%
Marketability	Low
Market Capitalization (MXN million)	MXN 4,838
Book Value per Share	MXN 8.2
LTM Price Range	(8.80 - 10.18)

- **Target Price.** We introduce our 2016 y-e T.P. of 9.90 pesos, equivalent to 1.1X our 2016-majority-book-value forecast and 12.0X our EPS for the same year. This T.P. is based on the assumption that written premiums will grow 15%, the combined ratio would improve to 96.9% and a 7% expected return of the investment portfolio (CETES + 300bp).

- **Balance between growth and risk quality.** In our opinion, the main challenge for the company is to increase its market share and scale, while controlling the claims ratio and operating expenses.



- **PV\* is the only Mexican company to achieve registration at the prestigious Lloyd's market to subscribe risks.** Last December, PV\* announced the creation of a company named "Patria Corporate Member, Ltd.", with an investment of 8.78 million pounds (~220 mp). We believe that this strategy/alliance is the result of a good corporate governance by the management and the company's financial strength. It represents an opportunity to develop product lines in specialized fields (energy, aircrafts, maritime, satellites, art and jewelry, international trade credit, among others), while the company expands and diversifies its reinsurance capacity. The operation tries to position *General de Seguros* as the insurer of the Mexican entrepreneur sector.

	2013	2014	2015	2016F
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### Valuation

P/E	65.7x	95.0x	7.9x	12.1x
P/BV	1.18x	1.32x	1.23x	1.13x

### Estimates (MXN)

Gross Written Premiums	3,321	4,190	5,143	5,914
YoY%	-4.1%	26.2%	22.7%	15.0%
Net Premiums Retained	2,675	3,204	3,923	4,485
YoY%	-3.8%	19.8%	22.5%	14.3%
Underwriting income	461	287	270	558
YoY%	-8.9%	-37.7%	-6.0%	106.8%
Net income	59	46	613	365
EPS	0.12	0.10	1.29	0.84
YoY%	-97%	-22%	1228%	-34%

### Profitability

Combined Ratio	89.5%	97.0%	103.7%	96.9%
Acquisition Ratio	29.5%	28.3%	25.6%	25.9%
Claims Ratio	50.8%	58.7%	66.6%	61.0%
Operation Ratio	9.1%	10.0%	11.5%	10.0%

- **Low capitalization and trading volume.** The market capitalization of the company is approximately MXN 4,838 million, its trading volume is minimal and its free float is about 3%, these features limit the universe of potential investors in PV\*.

- **Risks.** The main risks faced by PV\* are economic, competition, the implementation of new strategies and the behavior of financial markets. Others risks include the cost of reinsurance, claims rate, liquidity, loans (counterpart, strategic partners) and credit investments.

### 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.

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### 1.- 2015 Report

**Better than expected.** Even if the results in 4Q15 remained in line with our revised premiums forecast and our costs and expenses expectations, we had to revise them upwards throughout the year as a result of the implementation of the company's growth strategy to gain a larger market share. As it happens frequently among insurance companies, growth comes by taking more aggressive risks and therefore more claims and higher expenses.

**Growing taking good risks.** PV\* management set aside the conservative approach to boost profitability and decided to gain a larger market share with new products in a market with good growth prospects, but fiercely competitive. In 2015, particularly in the car segment, there was a price war in the industry that eventually ended up affecting profitability. This is, in our opinion, the great challenge for the sustainability of the company in the long term, taking good risks to grow.

**Written premiums** by Peña Verde amounted 5.142 billion pesos (bp) in 2015, an increase of 22.7% YoY, led by the subsidiary "General de Seguros" which continues to implement its strategy, growing in all business divisions, being the automobile sector the one with the larger increase (+21.6%) due to a new truck and car fleet businesses and Agriculture (+35.0%), mainly in the CHAIN business and traditional insurance.

**Meanwhile, the subsidiary "Reaseguradora Patria",** had sales of 2.126 bp, representing an increase of 28.5%, driven by increments in premiums for reinsurance within the fields of other catastrophic risks, automobiles, fire, sea accidents and various.

**Acquisitions costs** of PV\* totaled 1.0 bp in 2015, higher than the 907.5 mp in 2014, recording a 10.7% increase due to strong revenue growth in premiums.

**The consolidated net cost of claims** rose 50%, reaching 2.542 bp. The claims ratio of Peña Verde was 66.6%, increasing 7.9 percentage points, mainly due to claims in the automobile sector, fire, other catastrophes and agricultural risk where significant growth was recorded in premiums.

The **underwriting technical income** fell 6.0% to 269.6 mp, mainly due to higher claims: Moreover, **operating expenses** jumped 41% and considering the net increase in technical reserves, PV recorded an **operating loss** of 512 mp, which compares unfavorably with the 2014 loss of 315.8 mp.

**The comprehensive financing result** recorded a solid gain of 1,369 bp, an increase of 277% mainly due to the revaluation of the company's stock portfolio, and secondly because a positive foreign exchange result.

Given all of the above, PV\* reported a net income of 613.1 mp, 13 times the profit of \$ 46.2 mp in 2014.

According to the accounting information, assets amounted 15.224 bp, jumping 21.1% vs 2014. Among the most significant changes in the year, we highlight the increase in security investments, reinsurers, permanent investments, availability and other assets.

In December 2015, majority shareholder's equity amounted 3.94 bp (BV of 8.3), rising 18.4% vs the 3.326 bp in 2014. Total shareholder's equity amounted to 4,285.3 mp.

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<b>Income Statement</b>	4Q14	4Q15	4Q15 vs 4Q14 %
<small>(in current million pesos)</small>			
<b>Gross Written Premiums</b>	1,146.7	1,221.2	6%
Premiums Ceded	298.4	305.1	2%
Net Premiums Retained	848.3	916.1	8%
Retention Premiums Accrued	765.3	986.6	29%
(-) Acquisition Costs	253.9	241.0	-5%
(-) Insurance claims incurred	651.5	770.1	18%
<b>Underwriting (technical) income (loss)</b>	(140.2)	(24.4)	-83%
Gross Income	(194.0)	(91.2)	-53%
(-) Net Operating Expenses	66.2	96.4	46%
<b>Operating income (loss)</b>	(260.2)	(187.6)	-28%
Comprehensive Financing Result	(132.6)	190.2	-243%
<b>Net Profit/Loss</b>	(215.8)	41.8	-119%
Majority Net Profit	(5.0)	7.4	-248%
Minority Interest	(215.8)	41.8	-119%

Source: PV y Prognosis

## 2.- Target Price

Using the fair or implicit multiple of 1.073X, introduced in our IC report, multiplied by our majority BV per share forecast for 2016 of 9.0 ps, we arrive at a value of 9.65 ps per share. On the other hand, using 12X our 2016-EPS, we arrive at a price of 10.1 ps per share. The average of these two values is our TP of 9.90 pesos for the shares of PV\* at y-e-2016.

## 3.- Relevant Event: Starting operations in the world's largest specialized insurance and reinsurance market, Lloyd's, based in England.

On December 8, PV\* announced, alongside with Patria Reinsurance Company, that they created a company in London, England: *Patria Corporate Member Ltd.* The investment in *Patria Corporate Member Ltd.* totaled 8.78 million pounds (approximately 220 million pesos); Patria joined with 53% and Genseg\* with 46% of such amount. This investment was authorized by the corresponding Mexican authority. Lloyd's has authorized the creation of a special purpose syndicate, 6125, to be managed by Pembroke Managing Agency Limited".

Thus the parties began a collaboration in the insurance and specialized reinsurance business around the world. Specialized lines are diverse and include some of the following: energy, satellite, maritime, art and jewelry, aerospace and international trade credit, among others.

It must be mentioned that PV\* is the only Mexican company that has been granted with membership to join - creating a union to ensure risks - in Lloyd's exclusive global market. The risks are underwritten by several unions and each part takes a portion of the risk. "Lloyd's Corp." supervises and supports the efficient operation of the Lloyd's market. Today this market is the most important in the world for specialized insurance and reinsurance risk.

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### Peña Verde's Annual Income Statement (million MXN)

	2011	2012	2013	2014	2015	2016f
Gross Written Premiums	3,226.2	3,461.5	3,320.6	4,190.0	5,142.6	5,913.9
Premiums Ceded	695.2	682.0	646.0	986.1	1,219.2	1,428.6
Net Premiums Retained	2,531.0	2,779.5	2,674.6	3,203.9	3,923.3	4,485.3
<i>Net Premiums Retained rate</i>	78%	80%	81%	76%	76%	76%
Net Increase in Provision for Unaccrued Premiums	137.4	125.3	132.7	314.7	107.0	80.2
Retention Premiums Accrued	2,393.6	2,654.2	2,541.9	2,889.2	3,816.3	4,405.1
Acquisition Costs	679.4	779.4	789.2	907.5	1,004.2	1,160.5
<i>Aquisition ratio</i>	27%	28%	30%	28%	26%	26%
Insurance claims incurred	1,511.0	1,369.3	1,292.2	1,694.9	2,542.5	2,687.1
<i>Claims ratio</i>	63%	52%	51%	59%	67%	61%
Underwriting (technical) income (loss)	203.1	505.5	460.5	286.9	269.6	557.5
Net Increase in Other Technical Reserves	277.1	315.2	315.6	282.9	330.8	375.4
Gross Income	-74.0	190.5	145.0	4.3	-61.0	182.3
Net Operating Expenses	231.6	339.9	243.9	320.1	451.3	448.5
<i>Operating ratio</i>	9%	12%	9%	10%	12%	10%
Operating income (loss)	-305.5	-149.3	-98.9	-315.8	-512.3	-266.3
Comprehensive Financing Result	445.7	1,238.1	109.6	363.6	1,369.7	840.0
Earnings before income tax	140.6	1,088.8	10.8	47.8	857.4	573.7
Income tax payment provision	-41.5	268.0	-59.6	-9.9	204.2	172.1
Income tax rate	-29.5%	24.6%	-553.5%	-20.8%	23.8%	30.0%
Net profit (loss)	182.1	820.8	59.5	46.2	613.1	401.6
Minority interest	110.0	61.3	10.9	11.6	40.1	36.1
Majority Net Profit	71.7	759.5	59.5	46.2	613.1	365.5
EPS	37.16	4.10	0.12	0.10	1.29	0.84
Number of shares (million)	4.9	200.0	476.7	476.7	476.7	476.7
Gross Written Premiums growth		7.3%	-4.1%	26.2%	22.7%	15.0%
Net profit growth		958.7%	-92.2%	-22.4%	1228.1%	-40.4%
EPS growth		-89.0%	-97.0%	-22.4%	1228.1%	-34.5%

### Cost index

Aquisition Ratio	26.8%	28.0%	29.5%	28.3%	25.6%	25.9%
Claims Ratio	63.1%	51.6%	50.8%	58.7%	66.6%	61.0%
Operation Ratio	9.1%	12.2%	9.1%	10.0%	11.5%	10.0%
Combined Ratio	<b>99.1%</b>	<b>91.9%</b>	<b>89.5%</b>	<b>97.0%</b>	<b>103.7%</b>	<b>96.9%</b>

### Other Indicators

Dividends	16.9	0.0	0.0	0.0	0.0	0.0
ROE	6.9%	23.5%	1.8%	1.4%	16.9%	8.9%
P/E	0.13x	1.21x	65.70x	95.00x	7.92x	12.08x
P/BV	0.02x	0.31x	1.18x	1.32x	1.23x	1.13x
BV per share	213.3	16.2	6.9	7.0	8.3	9.0
PV's share price	5.0	5.0	8.2	9.2	10.2	10.2

### Balance Sheet Summary (million MXN)

Assets	9,624.9	10,715.8	10,952.6	12,568.9	15,224.2	16,966.6
Investments	7,441.6	8,615.6	8,855.8	9,741.0	11,735.4	13,031.0
Cash and Deposits	89.7	162.0	147.3	147.3	289.0	254.5
Liabilities	6,591.1	7,214.7	7,366.2	8,949.5	10,938.8	12,279.6
Technical Reserves	5,450.1	5,558.9	5,856.3	7,354.5	8,896.5	10,192.1
Total Equity	3,033.8	3,501.1	3,586.4	3,619.4	4,285.4	4,687.0
Shareholder's Equity (majority)	1,044.9	3,231.1	3,304.4	3,326.6	3,939.7	4,312.0

Source: Prognosis and BMV



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