

Peña Verde

Current price: MXN 10.18
 12-month target price: MXN 9.80
 (No liquidity risk discount applied).



4Q18 quarterly report and medium-term outlook

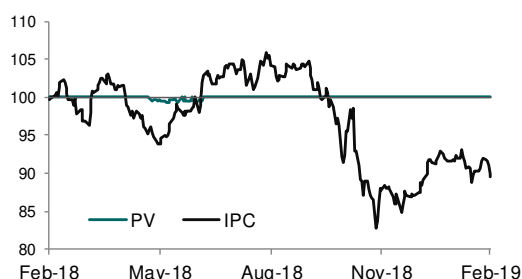
jueves, 07 de marzo de 2019

Solid 2018 at a technical and operating levels, but a loss in the investment portfolio produced a net loss. After a purge in the insurance business, we see a strong rebound in consolidated premiums in 2019

Key Data

Ticker	PV* MM
Exchange	BMV
12 Month T.P. (Estimated Fair Value)	MXN 9.80
Last Price	MXN 10.18
Expected Return	-3.7%
12 M Dividend Yield	0.1%
Expected Dividend Yield	0.0%
Total Expected Return	-3.7%
LTM Return PV*	0.1%
LTM Price Range (MXN)	(10.18 - 10.09)
Outstanding Shares (Million)	476.7
Free Float	1.22%
Trading Volume	Low
Market Cap (USD Million)	USD 251.71
P/E (TTM)	-8.7X
Price/Book Value	1.1X
Official Website	www.corporativopv.mx

12M Return vs IPC



	2016	2017	2018	2019f
Valuation				
P/E	18.7x	8.3x	-8.7x	12.2x
P/BV	1.1x	1.0x	1.1x	1.0x
ROE	6.0%	12.2%	-13.3%	8.6%
Estimates (MXN million)				
Gross Written Premiums	6,865	6,965	7,259	8,348
YoY%		1.5%	4.2%	15.0%
Net Retained Premiums	4,876	5,521	5,908	6,814
YoY%		13.2%	7.0%	15.3%
Underwriting Income	126	357	680	743
YoY%		184.2%	90.3%	9.3%
Net income	257	583	-561	399
YoY%		127.2%	n.m.	n.m.
EPS	0.5	1.2	-1.2	0.8
YoY%		127.2%	n.m.	n.m.
Profitability				
Combined Ratio	107.4%	103.2%	95.4%	95.5%
Aquisition Ratio	27.0%	28.1%	30.3%	29.0%
Claims Ratio	68.0%	62.0%	56.5%	58.0%
Operation Ratio	12.4%	13.0%	8.5%	8.5%

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

- 2018/2017 results.** Written premiums totaled 7,259 mp, an increase of +4.2%. However, the technical profit totaled 680 mp, +90.0%, as the company recorded a low net increase in the provision for unaccrued premiums. The operating loss fell -28.0%. The comprehensive financing result recorded a loss of -304 mp. Thus, the net loss reached -561 mp, an EPS of -1.2 pesos per share. This result contrasts significantly against the combined ratio of 95.4% in 2018.
- Capitalization.** The company maintains more than adequate levels of capitalization and solvency, as it has been the historical trend.
- 2019 Estimates.** After discussing with the management, we believe that written premiums can grow approximately +15.0%. This rate would result from a growth rate in the reinsurance business of +16.0% and +13.0% in the insurance business. The Lloyd's syndicate would maintain a solid dynamism. We assume that the comprehensive financial result would behave more normally, reaching 1,110 mp and a net profit of 399 mp at the end of 2019, equivalent to an EPS of 0.84 pesos.
- The reorganization of General de Seguros (GENSEG) is completed.** After the strengthening of the management team and purging the portfolio in GE, the company will retake its focus in the traditional business of SMEs located in the northwest and northeast of Mexico and Bajío. All available distribution channels will be used, a more open strategy.
- 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 accelerated growth, given the current and relatively small base of comparison.
- 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 MXN 4,853 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 open to possibilities to increase its stock's float. In our view, a private transaction would make sense if a strategic partner adds value to the PV business.
- Target price.** We introduce our 12-month T.P at 9.80 pesos, equivalent to 1.0X the estimated 2019 book value. This multiple is lower than the implicit or fair multiple that results from the Damodaran model, which is 1.05X. However, we do not incorporate a 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, liquidity, ceded reinsurances (counterparty, strategic partners) and credit risk in their investments.

2018 report

Income Statement

	Accumulated data		
	4Q18	4Q17	YoY Change
Gross Written Premiums	7,259	6,965	+4.2%
Net Retained Premiums	5,908	5,521	+7.0%
Retention Premiums Accrued	5,683	5,025	+13.1%
Acquisition Costs	1,792	1,550	+15.6%
Insurance Claims Incurred	3,211	3,117	+3.0%
Underwriting (Technical) Income (Loss)	680	357	+90.3%
Net Operating Expenses	503	720	-30.2%
Operating Income (Loss)	-512	-712	-28.0%
Comprehensive Financing Result	-304	1,368	n.m.
Net Profit (Loss)	-561	583	n.m.
<i>Acquisition Ratio</i>	30.3%	28.1%	+226 bp
<i>Claims Ratio</i>	56.5%	62.0%	-553 bp
<i>Operating Ratio</i>	8.5%	13.0%	-453 bp
Combined Ratio	95.4%	103.2%	-780 bp

Source: Prognosis and PV

n.m. = not meaningful

Peña Verde's written premiums totaled 7,259 million pesos (mp) in 2018, an increase of +4.2% y/y against the 6,965 mp in 2017. This variation is mainly explained by the dynamism in **Reaseguradora Patria**, that recorded sales of 4,060 mp, +17.0% y/y, resulting from the implementation of the expansion strategy in each business line. "The most important increase in 2018 was recorded in the reinsurance premiums taken from the fire and automobile segments".

On the other hand, the subsidiary **General de Seguros**, which as of December 2018, recorded sales of 2,733 mp, a drop of -11.0% y/y, "mainly due to the non-renewal of two businesses: (1) one concerning the life business line, for a net amount of approximately 183 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".

The subsidiary **Patria Corporate Member Ltd**, which operates since January 2016 in the Lloyd's market in London, reported sales equivalent to 452 mp, +12.0% y/y.

The net consolidated acquisition cost of PV * amounted 1,790 mp in 2018, which compared to the 1,550 mp in 2017, showed an increase of +15.6%. This resulted from an increase in reinsurance commissions paid to ceding companies and the costs associated with "excess losses" from hedges that protect retention.

The net cost of consolidated claims increased +3.0%, standing at 3,211 mp. Peña Verde's claims ratio was 56.5%, showing a decrease of 5.5 percentage points.

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In line with the acquisition costs and claims, the technical profit increased +90.3% y/y to 680 mp. In addition, net operating expenses totaled 503 mp and considering the net increase in technical reserves, PV recorded an operating loss of -512 mp, -28.0% y/y.

The **comprehensive financial result** recorded a loss of -304 mp, that compares negatively against the the gain of 1,368 mp in 2017. This would be the result of a "loss in the portfolio of shares of the subsidiaries, although this was offset in part by the yields on the fixed-income instruments and the profit in the foreign exchange result".

PV reported a net loss of 561 mp. This result is supported by the loss in the valuation of bond and stock portfolios.

Financial situation

Summary of the Balance Sheet (MXN millions)

	4Q18	%	4Q17	%	YoY Change
Investments	14,586	72.6%	14,756	71.4%	-1.2%
Receivables	2,249	11.2%	1,755	8.5%	+28.2%
Reinsurers	2,342	11.7%	3,064	14.8%	-23.6%
Other Assets	384	1.9%	334	1.6%	+14.8%
Total Assets	20,086	100.0%	20,681	100.0%	-2.9%
Technical Reserves	12,458	62.0%	12,610	79.6%	-1.2%
Reinsurers	1,457	7.3%	997	6.3%	+46.1%
Other Liabilities	1,070	5.3%	1,426	9.0%	-24.9%
Total Liabilities	15,819	78.8%	15,841	76.6%	-0.1%
Stockholder's Equity	4,267	21.2%	4,840	23.4%	-11.8%
Total Liabilities + Equity	20,086	100.0%	20,681	100.0%	-2.9%

Source: Prognosis based on GNP

n.m. = not meaningful

Assets amounted to 20,086 mp, -2.9% y/y. Among the most significant changes changes in the year, there is a decrease of -1.2% in investments, a drop of -23.6% in reinsurers and a jump of +28.2% in receivables.

Stockholder's equity. As of December 2018, the majority stockholders' equity reached an amount of 4,267 mp (BV of 9.0 pesos per share), a drop of -11.8%.

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.

2019 Forecasts

After discussing with the management, we believe that written premiums can grow approximately +15%. This rate would result from a growth rate in the reinsurance business of +16.0% and +13.0% in the insurance business. The latter would be recovering after an organizational restructuring and a better selection of clients. On the other hand, the subsidiary, Patria Corporate Member LTD, would grow at a sustainable rate of +15.0%.

We have relatively conservative assumptions for the cost structure. We assume a small increase in the operative loss from the level reached in 2018. Our assumption for the combined ratio is 95.5%, similar to that of 2018.

We assume that the comprehensive financial result reports a normalized gain of close to CETES 28d, reaching 1,110 mp and a net profit of 399 mp at the end of 2019, equivalent to an EPS of 0.84 pesos. It should be noted, that this last forecast is very volatile, particularly given the investment profile of the PV portfolios that assigns an average of 40.0% of the resources to the stock markets, and the remainder to the debt markets.

Summary of Medium-Term Strategy

In the reinsurance business, the management is optimistic about taking advantage of its current relationships with existing clients. However, they have adopted a more open position to use reinsurance intermediaries as a distribution channel and their portfolio has changed to a structure of 50% direct distribution and 50% with reinsurance intermediaries.

After the restructuring in the insurance business —the strengthening of the management team and the purging of the portfolio— the PV administration expects a significant increase in the productivity of a GENSEG, repositioned in the market. In a first stage, they anticipate resuming the traditional business focused on SMEs in the northwest, northeast and Bajío, mainly. On the other hand, they will use all viable distribution channels, with an omni-channel vision.

Summary of Long-Term Strategy: 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. In fact, they refer the following historical returns on their investment portfolio:

- +465 bp above the IPyC of the BMV in the last three years to 2018, which includes the fall of this last year.
- +600 bp above the IPyC in the last 5 and 8 years.

These results imply that, in the future, they could even contemplate the idea of managing investment funds for third parties.

Peña Verde's Annual Income Statement (MXN millions)

	2015	2016	2017	2018	2019f
Gross Written Premiums	5,143	6,865	6,965	7,259	8,348
(-) Ceded Premiums	1,219	1,990	1,444	1,351	1,534
Net Premiums Retained	3,923	4,876	5,521	5,908	6,814
<i>Net Premiums Retained rate</i>	<i>76.3%</i>	<i>71.0%</i>	<i>79.3%</i>	<i>81.4%</i>	<i>81.6%</i>
(-) Net Increase in Provision for Unaccrued Premiums	107	367	497	224	341
Retention Premiums Accrued	3,816	4,508	5,025	5,683	6,473
(-) Acquisition Costs	1,004	1,317	1,550	1,792	1,976
<i>Acquisition ratio</i>	<i>25.6%</i>	<i>27.0%</i>	<i>28.1%</i>	<i>30.3%</i>	<i>29.0%</i>
(-) Insurance claims incurred	2,543	3,065	3,117	3,211	3,755
<i>Claims ratio</i>	<i>66.6%</i>	<i>68.0%</i>	<i>62.0%</i>	<i>56.5%</i>	<i>58.0%</i>
Underwriting (technical) income (loss)	270	126	357	680	743
(-) Net Increase in Other Technical Reserves	331	90	349	689	697
Gross Income	-61	36	9	-9	45
(-) Net Operating Expenses	451	605	720	503	579
<i>Operating ratio</i>	<i>11.5%</i>	<i>12.4%</i>	<i>13.0%</i>	<i>8.5%</i>	<i>8.5%</i>
Operating income (loss)	-512	-569	-712	-512	-534
Comprehensive Financing Result	1,370	921	1,368	-304	1,110
Earnings before income tax	857	352	657	-816	576
(-) Income tax payment provision	204	90	63	-250	173
<i>Income tax rate</i>	<i>23.8%</i>	<i>25.5%</i>	<i>9.7%</i>	<i>30.6%</i>	<i>30.0%</i>
Net profit (loss)	613	256.6	583	-561	399
Minority interest	40	5.3	10	-6	4
Majority Net Profit	613	256.6	583	-561	399
EPS (TTM)	1.3	0.5	1.2	-1.2	0.8
Number of shares (million)	476.7	476.7	476.7	476.7	476.7
<i>Gross Written Premiums growth</i>		<i>33.5%</i>	<i>1.5%</i>	<i>4.2%</i>	<i>15.0%</i>
<i>Net Profit growth</i>		<i>-58.1%</i>	<i>127.2%</i>	<i>N.A.</i>	<i>N.A.</i>
<i>EPS growth</i>		<i>-58.1%</i>	<i>127%</i>	<i>N.A.</i>	<i>N.A.</i>

Other Indicators

	2015	2016	2017	2018	2019f
ROE	15.5%	6.0%	12.2%	-13.3%	8.6%
P/E	7.9	18.7	8.3	-8.7	12.2
P/BV	1.2	1.1	1.0	1.1	1.0
Book Value Per Share	8.3	9.0	10.2	9.0	9.8

Balance Sheet Summary (MXN millions)

	2015	2016	2017	2018	2019f
Assets	15,224	18,397	20,681	20,086	22,699
Investments	11,733	13,407	14,756	14,586	16,371
Liabilities	10,939	14,092	15,841	15,819	18,032
Technical Reserves	8,897	11,043	12,610	12,458	14,606
Total Equity	4,285	4,305	4,840	4,267	4,667
Shareholder's Equity (majority)	3,954	4,263	4,792	4,228	4,623

Source: Prognosis and BMV

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Prognosis


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