

# PEÑA VERDE

## Quarterly Report 4Q16

Current Price MXN 10.08

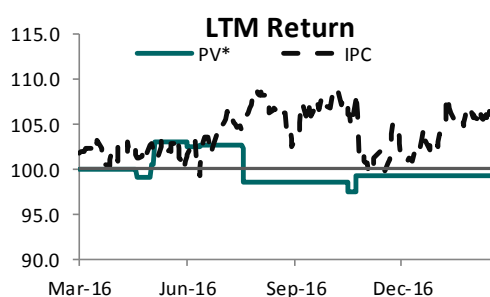
2017 Target Price MXN 10.64 (no discount for illiquidity applied)

Friday, March 03, 2017

### PV's long-term vision advances, with satisfactory results after a difficult year

#### Key Data

Local Ticker	PV*
2017 Target Price	MXN 10.64
Last Price	MXN 10.08
Expected Return	5.6%
LTM Return PV*	-1%
Outstanding Shares (million)	476.7
Free Float	3.0%
Marketability	Low
Market Capitalization (MXN million)	MXN 4,805
LTM Price Range	(9.90 - 10.45)



	2013	2014	2015	2016
<b>Valuation</b>				
P/E	65.7x	95.0x	7.9x	18.7x
P/BV	1.18x	1.32x	1.23x	1.13x
<b>Estimates (MXN)</b>				
Gross Written Premiums	3,321	4,190	5,143	6,866
YoY%	-4.1%	26.2%	22.7%	33.5%
Net Premiums Retained	2,675	3,204	3,923	4,876
YoY%	-3.8%	19.8%	22.5%	24.3%
Underwriting income	461	287	270	126
YoY%	-8.9%	-37.7%	-6.0%	-53.4%
Net income	59	46	613	257
EPS	0.12	0.10	1.29	0.54
YoY%	-97%	-22%	1228%	-58%
<b>Profitability</b>				
Combined Ratio	89.5%	97.0%	103.7%	107.4%
Acquisition Ratio	29.5%	28.3%	25.6%	27.0%
Claims Ratio	50.8%	58.7%	66.6%	68.0%
Operation Ratio	9.1%	10.0%	11.5%	12.4%

- **2016 results are not comparable with 2015.** Due to regulatory changes deployed in 2016, the results of Mexican insurers are not comparable with 2015's figures. An important effect of these changes was the increase of 2016's cost structure of PV. Effect that we do not expect in 2017.
- **2016 Results.** Written premiums were 6,865.5 million pesos, a technical profit of 125.7 million pesos and an operating loss of 569.2 million pesos. The integral financing result was 920.8 million pesos and EPS of 0.54 pesos.
- **Balance between growth and risk quality.** PV main challenge continues to be 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)., reported a year of operation in line with what was budgeted by the issuer. We believe that in the medium term this project will contribute to position General de Seguros as a reliable insurer in the Mexican entrepreneurial sector.
- **Low capitalization and trading volume.** The market capitalization of the company is approximately MXN 4,805 million, its trading volume is minimal and its free float is about 3%. These features limit the universe of potential investors in PV\*. However, following the acquisition in 4Q16 of a 12.2% stake of total outstanding shares, the company's goal of incorporating a strategic partner becomes effective, potentially increasing the share's float, and improving their visibility.
- **Target Price.** We introduce our 2017 y-e T.P. of 10.64 pesos, equivalent to 1.06X our 2016-majority-book-value forecast and 12.0X our projected EPS for the same year. This T.P. assumes that written premiums will grow 22%, the combined ratio would improve to 94.0% and the investment portfolio would achieve a peso return of 9.75% (CETES +300bp). However, this TP does not include a discount for the shares very low marketability
- **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.
- **Significant Events 2017.** We anticipate that during this year: (1) the ambitious telephone medical orientation call center project will begin its commercial phase, although it may be small now, it could be a major revenue generator in the future, and (2) The delisting of the General de Seguros subsidiary in the BMV.

#### 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. 2016 Report: Current data cannot be compared to those of 2015 due to the change in regulation.

Peña Verde's written premiums totaled **6,866 million pesos (mp)** in 2016, an increase of +33.5% y/y against the 5,142 mp in 2015. This variation is mainly explained by the dynamism of "General de Seguros", whose sales grew +26.4% y/y, reaching 3,797 mp. The branches with the highest growth were: fires (+454%), miscellaneous (+167%) and agricultural (+13.3%).

On the other hand, the subsidiary "**Reaseguradora Patria**" reached sales of 2,749 mp, which represented an increase of +29.3%, due to the company's success in gaining market share through the expansion of various new business lines, as well as the strengthening in the property casualty operation. The most significant increases occurred in the following sectors: fires, miscellaneous, earthquakes, maritime and transport and life operations.

The subsidiary **Patria Corporate Member Ltd**, which operates since January 2016 in the Lloyd's market in London, reported sales equivalent to 304.4 mp.

It is important to notice that the **growth in premiums was over represented**, because it includes a significant exchange rate effect that improved the data in pesos. In the future, the growth rate in sales will be around 20%, according to management forecasts.

**The consolidated net acquisition cost of PV \* was 1,317.2 mp** in 2016, which compared to 1,004.2 mp in 2015, an increase of +31.2%, resulting from a substantial jump in premiums. The net cost of acquisition represented 27.0% of the retained premiums.

**The net claims cost of PV rose 20.56%**, to 3,065.5 mp. Peña Verde's claims ratio was 68%, reporting an increase of 1.4 percentage points, mainly due to the increase in the IBNR claims, although it was also affected by an 142 mp hit due to events, such as the Earthquakes that took place in Ecuador and Taiwan, floods in India and the effects of the hurricanes Matthew and Earl. Those events represented the statistical loss estimated by Patria Re, however these are not expected to be recurrent.

Mainly due to the higher claims ratio, **technical profit decreased 53% y/y** to 125.7 mp. In addition, net operating expenses summed up to 604.86 mp and considering the net increase in technical reserves - affected by the regulatory change - PV recorded an Operating Loss of -569.23 mp, 57 mp higher than in 2015.

**The Comprehensive financing result** recorded a profit of \$920.8 mp, a drop of -32.8% generated mainly by a portfolio loss. However, the company had a positive foreign exchange result.

Given all of the above, **PV\* reported a net profit of 256.6 mp**, which compares unfavorably against the 613.1 mp of the previous year, mainly due to the substantial increase in the cost indexes and by a lower performance of the stock market investments.

**Total assets** were 18,397 mp, an increase of 20.8% versus 2015. Among the major changes in the year, we highlight the increase in investments in securities and reinsurers, permanent investments, and other assets.

**Stockholders' Equity**. In December 2016, the stockholders' equity reached 4,263 mp (Book value of 8.9 pesos per share), which compared to 3,940 mp in 2015 represents an increase of 8.2%. The total stockholders' equity reported was 4.305 mp.

**Purchase of a 12.2% stake of shares**. In the last quarter of 2016, PV acquired a package of 12.17% of the shares that were in circulation. Right now, these shares will remain in the treasury, although the issuer continues

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with its strategic plan of finding a partner that adds value to the company. When this operation is carried out, the floating capital of Peña Verde will increase considerably, improving the visibility of the shares.

### 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 8.2%, a sustainable ROE of 8.5% and a perpetuity growth of 4%, resulting in a "fair" multiple of 1.0714X. The product of this multiple with the BV estimated for 2017 (10.0 ps.), is 10.71 pesos; "fair" value according to this method.

Using 12X (in line with comparable local and international companies) estimated profits for the next year (0.88 pesos per share), we get a price of 10.56 ps. per share.

By averaging both values at 50%, we reach a y-e 2017 TP of 10.64 pesos for PV \* shares. This price does not assume a discount for the stock low visibility in the market. However, PV \* qualifies as a stock with high risk and low profit predictability.

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

	2014	2015	2016	2017f
Gross Written Premiums	4,190.0	5,142.6	6,865.5	8,375.9
Premiums Ceded	986.1	1,219.2	1,989.8	2,429.0
Net Premiums Retained	3,203.9	3,923.3	4,875.7	5,946.9
<i>Net Premiums Retained rate</i>	<i>76%</i>	<i>76%</i>	<i>71%</i>	<i>71%</i>
Net Increase in Provision for Unaccrued Premiums	314.7	107.0	367.3	448.1
Retention Premiums Accrued	2,889.2	3,816.3	4,508.3	5,498.8
Acquisition Costs	907.5	1,004.2	1,317.1	1,575.9
<i>Aquisition ratio</i>	<i>28%</i>	<i>26%</i>	<i>27%</i>	<i>27%</i>
Insurance claims incurred	1,694.9	2,542.5	3,065.5	3,271.8
<i>Claims ratio</i>	<i>59%</i>	<i>67%</i>	<i>68%</i>	<i>60%</i>
Underwriting (technical) income (loss)	286.9	269.6	125.7	651.1
Net Increase in Other Technical Reserves	282.9	330.8	90.1	475.7
Gross Income	4.3	-61.0	35.6	269.0
Net Operating Expenses	320.1	451.3	604.9	594.7
<i>Operating ratio</i>	<i>10%</i>	<i>12%</i>	<i>12%</i>	<i>10%</i>
Operating income (loss)	-315.8	-512.3	-569.2	-325.7
Comprehensive Financing Result	363.6	1,369.7	920.8	921.9
Earnings before income tax	47.8	857.4	351.6	596.2
Income tax payment provision	-9.9	204.2	89.7	178.9
Income tax rate	-20.8%	23.8%	25.5%	30.0%
Net profit (loss)	46.2	613.1	256.6	417.3
Minority interest	11.6	40.1	5.3	8.6
Majority Net Profit	46.2	613.1	256.6	408.8
EPS	0.10	1.29	0.54	0.88
Number of shares (million)	476.7	476.7	476.7	476.7
Gross Written Premiums growth	26.2%	22.7%	33.5%	22.0%
Net profit growth	-22.4%	1228.1%	-58.1%	59.3%
EPS growth	-22.4%	1228.1%	-58.1%	62.6%
<b>Cost index</b>				
Aquisition Ratio	28.3%	25.6%	27.0%	26.5%
Claims Ratio	58.7%	66.6%	68.0%	59.5%
Operation Ratio	10.0%	11.5%	12.4%	10.0%
Combined Ratio	<b>97.0%</b>	<b>103.7%</b>	<b>107.4%</b>	<b>96.0%</b>
<b>Other Indicators</b>				
P/E	95.00x	7.92x	18.72x	11.51x
P/BV	1.32x	1.23x	1.13x	1.01x
BV per share	7.0	8.3	8.9	10.0
PV's share price	9.2	10.2	10.1	10.1
<b>Balance Sheet Summary (million MXN)</b>				
Assets	12,569	15,224	18,397	20,760
Investments	9,741	11,735	13,407	15,239
Liabilities	8,949	10,939	14,092	15,937
Total Equity	3,619	4,285	4,305	4,823
Shareholder's Equity (majority)	3,327	3,940	4,263	4,775

Source: Prognosis and BMV

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