

# Peña Verde

## Quarterly Report

Last Price 9.10 MXN

Target Price 9.00 MXN

# 4Q14

February 26th, 2015

## Good growth strategy implementation particularly in “General de Seguros”, but increased IBNR reserves eats into 2014 profit

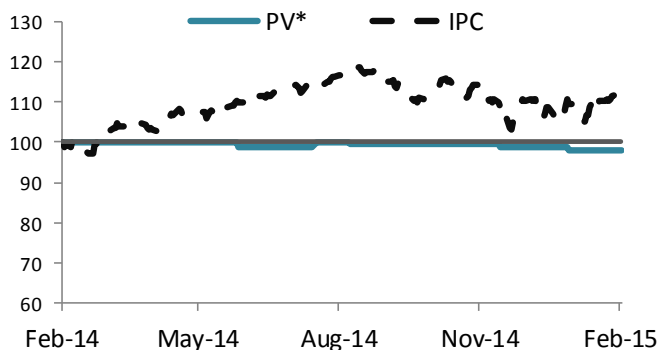
### Key Data

Local Ticker	PV*
12 M Target Price	MXN 9.00
Last Price	MXN 9.10
Expected Return	-1.1%
2014 Div. Yield	N.A.
Total Expected Return	-1.1%
MEXBOL Expected Return	4.7%
LTM Return PV*	-2%
Outstanding Shares (million)	476.7
Free Float	2.3%
Beta	N.A.
Marketability	Low
Average Daily Trade 6M (thousand)	USD 484.3
Market Cap (USD Million)	USD 289
Book Value per Share	MXN 7.0
Enterprise Value (Million)	USD 299
Net Debt	-MXN 147
LTM Price Range	(9.10 - 9.30)

- **Growth strategy towards 2018.** We are pleasantly surprised with the implementation of the company's growth strategy in 2014, despite a difficult macroeconomic environment. The management of PV\* seems to have left aside its conservative approach to privilege profitability and decided to gain market share with a new and more friendly products' offering. In our view this is the right strategy for the company's sustainability in the long term.

- **2014 results.** Written premiums reached \$ 4,190.0 mp, an increase of 26.2%, slightly above our estimates. *General de Seguros* jumped 54.5% over 2013 and represented 60% of total written premiums. The consolidated claims index was 58.7%, an unanticipated increase of 7.9 percentage points, mainly due to increased reserves for claims incurred but not reported, IBNR: 147 mp in *Reaseguradora Patria*, due to a change in methodology, and 106.4 mp in *General de Seguros*, due to higher premiums. Underwriting income was 287 mp a 38% fall. Financial income rose sharply compared to 2013 to reach 364.2 mp. Thus, the net result in 2014 was 46.2 mp, an annual decline of 22% primarily due to higher IBNR reserves.

- **Target Price.** We have trimmed our Target Price for y-e 2015 to MXN 9.0 per share from 9.32 due to a lower net income and book value base. Our TP is comprised by: (1) the “fair” book value multiple by our new 2015 BV forecast and (2) an average peer P/E multiple of 12X our 2015 EPS estimate. Our TP is in line with the current price of the PV\* shares, which does not include any potential new business diversification of the holding company.



	2012	2013	2014
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### Valuation

P/E	1.3x	81.0x	13.6x
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P/BV	0.31x	1.34x	1.32x
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### Estimates (MXN)

Gross Written Premiums	3,462	3,321	4,190
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YoY%	7.3%	-4.1%	26.2%
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Net Premiums Retained	2,779	2,675	3,204
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YoY%	9.8%	-3.8%	19.8%
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Underwriting (technical) inc	505	461	287
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YoY%	148.8%	-8.9%	-37.7%
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Net income	760	55	321
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EPS	3.80	0.11	0.67
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YoY%	-74%	-97%	487%
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### Profitability

Combined Ratio	91.9%	89.5%	97.0%
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Aquisition Ratio	28.0%	29.5%	28.3%
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Claims Ratio	51.6%	50.8%	58.7%
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Operation Ratio	12.2%	9.1%	10.0%
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ROE	23.5%	1.7%	9.7%
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## 1 Ongoing Medium term strategy

**Better than expected.** We are pleasantly surprised with the implementation of the company's growth strategy. Our model assumes that management guidance is accomplished at a slower pace than this guidance indicates. Nevertheless, in 2014 results have exceeded our expectations, particularly for *General de Seguros*. In *Patria Re*, the competitive environment has increased substantially affecting profitability.

**A more aggressive strategy.** It looks like the experienced management of PV\* has left aside the conservative approach that privileges profitability and has decided to gain market share with a new and more friendly products' offering, for a market that has good growth prospects, although it is fiercely competed. In our view this is the right strategy for the company's sustainability in the long term.

**General de Seguros** management plans to duplicate its portfolio by y-e 2018, which is their five year goal since the end of 2013. This would require reaching around 3.1 billion pesos in gross written premiums. Our original forecast for 2018 is in line with this goal, although after the explosive growth in 2014 we will look over our forecasts for the following years. With a more dynamic overall market the management goal would be accomplished with annual increases of ~ 11.0% in written premiums beginning in 2015. In the view of **Prognosis** if Mexican economic growth in fact speeds up steadily towards 2018, *General de Seguros* goal might be conservative.

**Patria-Re's** management goal is to reach USD 210 million in written premiums at y-e 2018 –a goal more aggressive than our forecasts. They also pose a USD 400 million objective for y-e 2023. In spite of the global concentration of the business and of narrow margins, *Patria-Re* has managed to obtain a solvency grade of A, coming from A-. This is a high rating that might help them to underwrite business. On the other hand, the management keeps looking to grow up to 25% of their topline outside Mexico, from the current 12%. They plan to focus on Latin America, giving preference to the entrance to the complex Brazilian Market and to maintain their subscription efforts in the European market.

**New projects.** Judging from our conversations with the company, they have the intention to continue using the PV platform for potential new businesses. Although they do not reveal its nature; it is clear, in our view, that the company seeks greater visibility in the future.

### 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 with the exception of the USA.

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## 2. 4Q14 report.

**PV's written premiums grew 30% in the 4Q14, but registered a net loss of -215.8 mp, mainly due to the increase in IBNR reserves.**

Peña Verde's written premiums reached 1.146 billion pesos (bp) in the fourth quarter of 2014, a strong 30% annual increase, achieving a 26.2% growth for all 2014 exceeding our 22.2% growth estimates.

Most of the growth in written premiums is due to *General de Seguros* which in 2014 had sales of \$2.526 bp, an increase of 54.5%.

The divisions that showed higher sales growth was "Life Insurance" with 123.8%, derived from allocations of new tenders as the Ministry of Public Security and the Mexico City Banking Police and the Agricultural division showing an increase of 94.1%, mainly due to obtaining business in the states of Tabasco, Michoacán, Nayarit and Coahuila. The "Car" division grew by 31.4% thanks to the uptake of a truck fleet and individual cars of cars grew by 31.4%.

Meanwhile subsidiary "*Reaseguradora Patria*", reported sales of \$1.63 bp, a marginal increase of 0.2%, driven by increases in the catastrophic, agricultural, fire hazards and life divisions.

The net acquisition cost amounted 907.5 million pesos, an increase of 15% compared to 2013, this increase is related to the sales growth.

The claims ratio was 58.7%, 7.9 percentage points higher than 2013. In *General de Seguros* life and agriculture divisions showed an increase in the IBNR for \$97.0 and \$9.4 million pesos respectively due to the growth in written premiums while the subsidiary "*Reaseguradora Patria*" had an IBNR increase of 147 million pesos derived from a change in the method of how this reserve is established.

Peña Verde posted a technical loss in the 4Q14 of 140.2 million pesos, which in 2014 amounted 427.0 mp, a decrease of 37.7% over the previous year. The company believes that the fall was largely due to increased acquisition costs (directly related to the sales growth) and a high claim ratio in 2014.

Consolidated operating expenses were \$ 320.1 million pesos, accounting for 7.6% of written premiums.

Although the 4Q14 was unfavorable for equity markets affecting negatively the comprehensive financing result, with a loss of -132.6 million pesos. For 2014 it reached 364.2 million pesos, an increase of 232.1% compared to 2013.

Due to the above, Peña Verde recorded in the 4Q14 a net loss of -215.8 million pesos, which ends up in an accumulated profit of 46 million pesos in 2014, an annual decrease of 22.4%. We estimated a 22.2% growth, but the unexpected increase in IBNR, and the negative market performance in the last quarter of the year, made our expectations fall short, which otherwise were very much in line with the growth agenda of the company.

At the end of 2014, the net worth of PV reached an amount of 3.619 bp, an increase of 0.9% compared to the end of 2013. The book value per share as of December 2014 is 7.60 pesos.

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### 3. Target price

Using the fair or implicit multiple of 1.073X, introduced in our IC report, by 8.5 ps., our new BV forecast for 2015, we arrive at a value of 9.12 ps. per share. On the other hand, using 12X our 2015-EPS, we arrive at a price of 8.88 ps. per share. The average of these two values is our TP of 9.0 pesos for the shares of PV\* at y-e-2015.

<b>Income Statement</b>	<b>4Q13</b>	<b>4Q14</b>	<b>4Q14 vs 4Q13</b>
<i>(in current million pesos)</i>			
Gross Written Premiums	882.4	1,146.7	30%
Net Premiums Retained	635.9	848.3	33%
Retention Premiums Accrued	193.6	765.3	295%
(-) Acquisition Costs	426.5	253.9	-40%
(-) Insurance claims incurred	25.7	651.5	2435%
Underwriting (technical) income (loss)	91.7	(140.2)	-253%
Gross Income	(66.0)	(194.0)	-194%
(-) Net Operating Expenses	20.7	66.2	221%
Operating income (loss)	(86.6)	(260.2)	-200%
Comprehensive Financing Result	68.8	(132.6)	-293%

Source: PV and Prognosis

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

	2011	2012	2013	2014
Gross Written Premiums	3,226.2	3,461.5	3,320.6	4,190.0
Premiums Ceded	695.2	682.0	646.0	986.1
Net Premiums Retained	2,531.0	2,779.5	2,674.6	3,203.9
<i>Net Premiums Retained rate</i>	78%	80%	81%	76%
Net Increase in Provision for Unaccrued Premiums	137.4	125.3	132.7	314.7
Retention Premiums Accrued	2,393.6	2,654.2	2,541.9	2,889.2
Acquisition Costs	679.4	779.4	789.2	907.5
<i>Aquisition ratio</i>	27%	28%	30%	28%
Insurance claims incurred	1,511.0	1,369.3	1,292.2	1,694.9
<i>Claims ratio</i>	63%	52%	51%	59%
Underwriting (technical) income (loss)	203.1	505.5	460.5	286.9
Net Increase in Other Technical Reserves	277.1	315.2	315.6	282.9
Gross Income	-74.0	190.5	145.0	4.3
Net Operating Expenses	231.6	339.9	243.9	320.1
<i>Operating ratio</i>	9%	12%	9%	10%
Operating income (loss)	-305.5	-149.3	-98.9	-315.8
Comprehensive Financing Result	445.7	1,238.1	109.6	363.6
Earnings before income tax	140.6	1,088.8	10.8	47.8
Income tax payment provision	-41.5	268.0	-59.6	-9.9
Income tax rate	-29.5%	24.6%	-553.5%	-20.8%
Net profit (loss)	182.1	820.8	59.5	349.3
Minority interest	110.0	61.3	10.9	27.9
Majority Net Profit	71.7	759.5	54.7	321.3
EPS	14.64	3.80	0.11	0.67
Number of shares (million)	4.9	200.0	476.7	476.7
Gross Written Premiums growth		7.3%	-4.1%	26.2%
Net profit growth		958.7%	-92.8%	487.1%
EPS growth		-74.1%	-97.0%	487.1%
Cost index				
Aquisition Ratio	26.8%	28.0%	29.5%	28.3%
Claims Ratio	63.1%	51.6%	50.8%	58.7%
Operation Ratio	9.1%	12.2%	9.1%	10.0%
Combined Ratio	<b>99.1%</b>	<b>91.9%</b>	<b>89.5%</b>	<b>97.0%</b>
<b>Other Indicators</b>				
Dividends	16.9	0.0	0.0	0.0
ROE	6.9%	23.5%	1.7%	9.7%
P/E	0.34x	1.32x	81.00x	13.65x
P/BV	0.02x	0.31x	1.34x	1.32x
<b>Balance Sheet Summary (million MXN)</b>				
Assets	9,624.9	10,715.8	10,952.6	12,568.9
Investments	7,441.6	8,615.6	8,855.8	9,741.0
Cash and Deposits	89.7	162.0	147.3	147.3
Liabilities	6,591.1	7,214.7	7,366.2	8,949.5
Technical Reserves	5,450.1	5,558.9	5,856.3	7,354.5
Total Equity	3,033.8	3,501.1	3,586.4	3,619.4
Shareholder's Equity (majority)	1,044.9	3,231.1	3,304.4	3,326.6

Source: Prognosis and BMV



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Carlos Fritsch

[cfritsch@prognosismex.com](mailto:cfritsch@prognosismex.com)

Fernando Lamoyi

[flamoyi@prognosismex.com](mailto:flamoyi@prognosismex.com)

Rubí Grajales

[rigrajales@prognosismex.com](mailto:rigrajales@prognosismex.com)

+52 (55) 5202 9964

+52 (55) 5202 95 71

 Paseo de las Palmas 755 - 901  
Col. Lomas de Chapultepec 11000  
México D.F.

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